

# Executive Summary

## **The business dimension as a factor of competitiveness**

The Spanish economy is overcoming one of the greatest economic recessions in our history; one that has destroyed nearly four million jobs and 345,000 businesses. The crisis highlighted the fragilities of the economic structure that raised our risk premium to over 600 base points and forced the adoption of difficult measures to turn the situation around. The series of economic reforms and the intervention of the European Central Bank have enabled us to recover confidence and today we have the highest growth in Europe. However, if we have learned anything in recent years, it is, first of all, that in a globalised world (despite growing protectionist reactions), reforms to improve competitiveness are a constant need if we do not want to lose the pace of progress and welfare; and secondly, that these reforms are more effective and stable when entrepreneurs, politicians and social agents work together.

For 25 years, the Instituto de la Empresa Familiar has sought to contribute to the debate on the situation, problems and needs of our economy from a practical point of view, based on the experience of our members. Consequently, the growth and dimension of our businesses have always been one of the main concerns as they determine progress and stability, as has been especially highlighted by the crisis.

Family businesses are a cornerstone of the growth of the Spanish economy, both from a quantitative point of view, as they represent 90% of businesses, 70% of private employment and 60% of the gross added value of the Spanish economy, and from a qualitative point of view, as they are businesses with greater longevity, a greater vocation of continuity and a greater commitment to job stability, even at the cost of lower profits.

Their vocation of continuity and long-term vision explain some of their characteristics, such as meticulousness, discipline, a culture of hard work, risk-taking and a commitment to the social and regional environment. In this approach, stability and confidence become essential elements in business decision-taking and in conveying business culture through family.

The success or failure of businesses in general, and of family businesses in particular, depends on their capacity to grow, because a company that grows has greater probabilities of lasting. Growth is a combination of a large number of factors: talent, enthusiasm, hard work, seriousness, commitment, instinct, innovation, experience, entrepreneurial spirit and organisational ability. These values or factors are part of the business culture, something that takes years and that is handed down from one generation to another as a way of understanding life and that must be safeguarded as part of the cultural heritage of society, since prosperity, economic progress and social welfare depend on it.

However, it is not just a case of taking care of this family business legacy, but of ensuring that we foster this culture of entrepreneurship and establish a framework of institutional relations that improves, or at least does not limit, the growth potential of businesses.

From this point of view, this report analyses the profile of Spanish businesses and their evolution in recent years, which will enable us to carry out a diagnosis of their situation.

Based on this, we study the main factors that determine their growth capacity, followed by the recommendations of the international institutions in these matters, ending with the proposals of the Instituto de la Empresa Familiar that we feel are appropriate with a view to improving the growth potential of businesses and job creation.

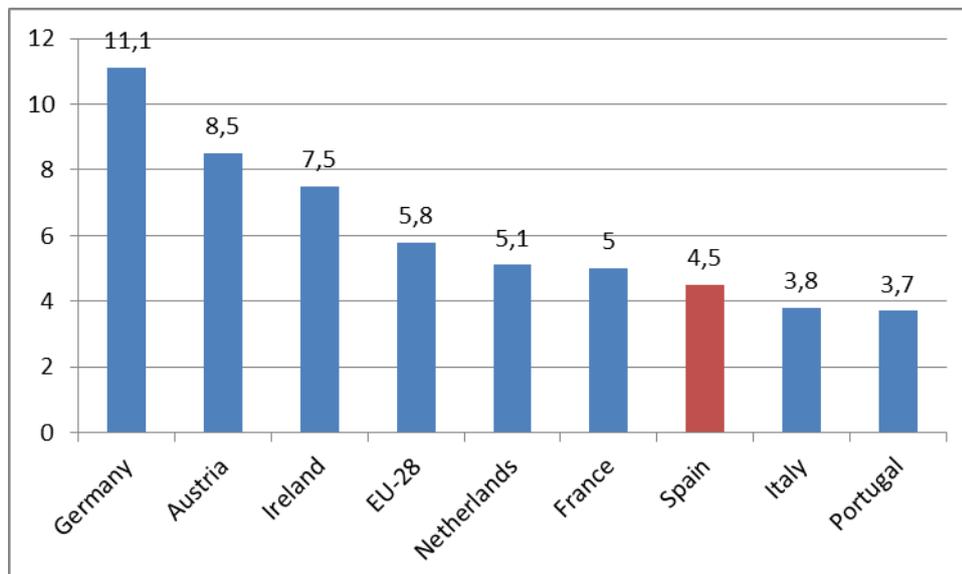
## Diagnosis of the business dimension in Spain

Chapter I, therefore, focuses on the analysis and evolution of Spanish businesses, enabling us to establish a diagnosis of their present situation.

According to the latest available data in the Central Business Directory (DIRCE), reporting to the Spanish National Office of Statistics (INE), on 1 January 2016 there were 3.24 million active businesses in Spain, of which over half did not have any salaried workers. It is, therefore, a highly atomised business sector, in which the self-employed worker and the small- and medium-sized company predominates, and only 0.7% of the total of companies have more than 50 workers, compared with 3 % in Germany and 1.2 % in the EU28.

The smaller size of the Spanish business sector can be seen in the number of workers, as whereas European Union businesses have an average work force of 5.8 employees, this figure in Spain is 4.5 workers, 22.4% less. The average size of French businesses stands at 5 workers, that of Austrian businesses at 8.5 and that of German businesses at over 11 employees per business. This gap has remained constant for some time, and was even more pronounced in the stage prior to the financial crisis. It is the smaller businesses (between 0 and 9 workers) that employ a greater number of employees (40.9% of the total), above the European average, which stands at around 29%.

Graph 1. Number of persons employed per enterprise



Source: Eurostat

The smaller size of Spanish businesses has a direct impact on the competitiveness of the business sector and on the Spanish economy as a whole, which can be analysed through three

of its principal elements: productivity, the capacity for internationalisation and the investment in Research, Development and innovation, all of them fundamental tools in driving growth and job creation.

In effect, larger businesses are in a better position to have an influence on elements that determine their productivity, for example, better conditions for accessing financial markets, greater ability to attract talent and train their workers, and more resources to tackle the complex tax and regulatory environment and to invest in innovation or internationalisation.

In this sense, it is in the productivity of Spanish micro-businesses (between 0 and 9 workers) where we see a greater distance with the rest of their European counterparts, whereas Spanish businesses with more than 50 workers display similar levels to those of the major economies in our environment, such as Germany, France the United Kingdom.

This, to a large extent, provides the answer to the lower productivity in Spain. The difference displayed with the other major EU economies is not so much a consequence of all Spanish businesses being less productive, but rather the result of a greater proportion of SMEs in the business sector, together with the lower relative productivity of this type of business.

The empirical evidence shows a close relationship between the degree of internationalisation of a company and its size, which normally goes in both ways, creating a virtuous circle. The larger the business, the greater its capacity to take on projects abroad, while the greater a company's presence abroad, the greater its growth potential usually is.

The higher export tendency of bigger businesses compared with SMEs in the case of Spain is nearly 10 percentage points, whereas in the average for EU countries, this percentage is higher than 15 percentage points. In both cases, businesses tend to export more, the bigger they are.

Another relevant indicator of good business performance is innovative behaviour. In the case of Spain, business investment in R+D+i is still very far from the rest of its European partners, with a private cost equivalent to 0.65% of the Gross Domestic Product, a percentage a long way below countries such as France (1.46%) or Germany, with nearly 2%.

In Spain, it is seen how, whereas the percentage of businesses with more than 250 workers that carry out some form of innovative activity is similar to that of other European economies, around 90%, the percentage of SMEs that innovate is 30%, very much less than that of other countries such as France or Italy and less than half of the figure for Germany. This huge difference in the case of smaller businesses limits their ability to compete and hampers their growth capacity.

The consequence of all of these elements is that the Spanish business sector displays greater weakness and an excessive dependence on the economic cycle. In periods of expansion, the Spanish economy is able to increase its business sector more than the rest of Europe, but in times of recession, this trend is strongly inverted, which meant the closure of 345,000 businesses during the financial crisis.

The stability of the business sector, its solidity and its ability to overcome periods such as the one experienced in recent years also has a direct effect on the stability and durability of employment. The more consistent the business sector, the less the destruction of jobs will be

in times of recession and the greater the ability of the economy to maintain employment and social welfare. Spain has been the second country in the EU with the greatest deterioration of the job market since the start of the financial crisis, second only to Greece. In 2007, the Spanish unemployment rate stood at around 8%, a similar percentage to that of other economies around us, such as Germany and France. From that moment on, as a consequence of the economic and financial crisis, every country underwent a process of job destruction that was, however, especially significant in Spain. Whereas other companies, little by little, were able to moderate and even stabilise the process, the unemployment rate in Spain continued to rise drastically, reaching a historic high of 25% of the population being jobless in 2013.

All of these elements have their impact on the longevity of businesses. In Spain, 45% of businesses with over 20 workers are at least 20 years old, whereas only 15% of businesses with up to 9 workers pass this threshold. We can, therefore, see a direct relationship between longevity and size.

By comparing the profile of Spanish businesses with that of other countries, we can confirm that size is one of the main differentiating elements. This dimension is, basically, the result of the evolution of business growth, so it can be said that the factors that have an influence on business growth, in the last instance, determine the average size of businesses.

### **Determining factors in business size**

Chapter II of this report therefore analyses the principal factors that determine the ability of businesses to grow and gain in size.

There are a great many factors that have an influence on growth capacity. From a business point of view, most notable are elements such as talent, an entrepreneurial spirit, specialisation, technology, training, internationalisation, the ability to innovate, image and the organisation itself. However, all of this is encompassed in an institutional framework that determines the rules of the game in which businesses trade.

At our most recent conference in La Coruña, the traditional survey of members highlighted the factors that, from their point of view, most influenced growth: human capital, job market, administrative efficiency and decrease of regulatory barriers, simplification of taxation and developed financial markets. This work focuses on the analysis of this institutional framework of relations between the Administration and businesses as external factors that directly affect stability and economic confidence, the final element that determines business decision-taking for investing and growing.

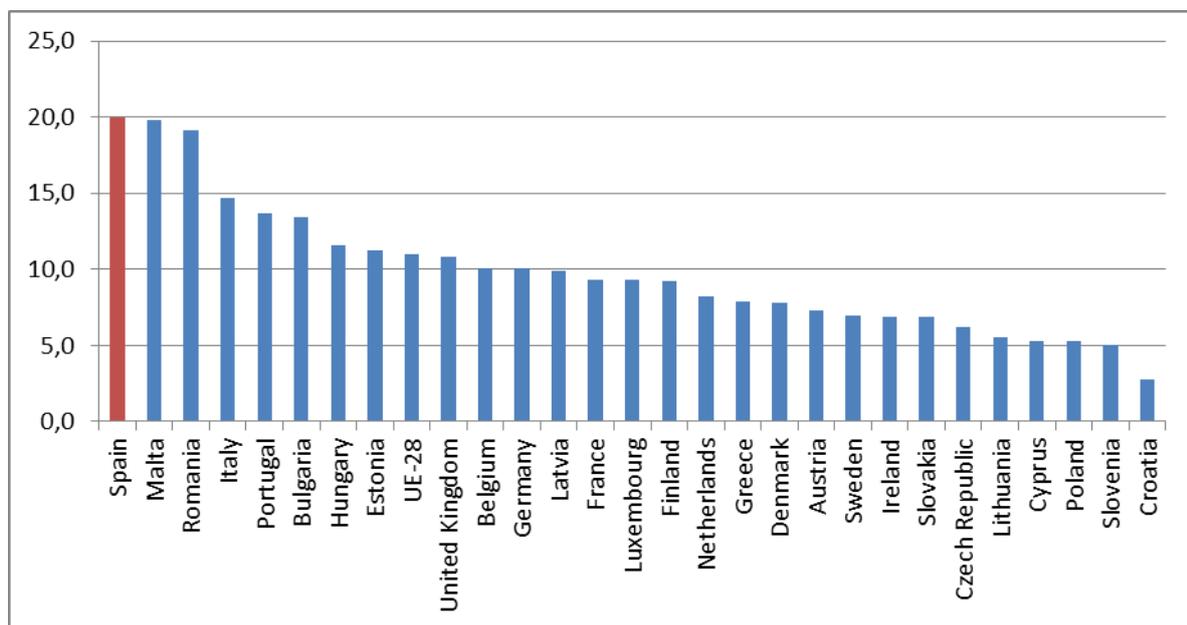
#### **I. Quality of human capital**

Human capital, understood as the talent, education and level of training of people, and which determines their productivity, is probably the principal element for the progress and advancement of a society. This fact is especially relevant in an increasingly more open environment in which competition is ever greater for jobs of little added value. For the company and for society, it is essential to have trained and skilled people who contribute knowledge and attitudes that foster and drive the good development of business projects, and

where they can become enthused and apply their ability and confidence in themselves. This section analyses indicators that show the level of education and training in Spain and compares them with those of other reference countries.

Consequently, firstly, Spain shows the highest school dropout rate in the EU, with a figure of 20% (population between the ages of 18 and 24 that has completed compulsory secondary education at most and has not continued to study any type of training), secondly, a percentage of young people that neither study nor work (between the ages of 15 and 29) of 23%, the fourth highest in the OECD, and thirdly, an educational level of young people between the ages of 15 and 16 that is increasingly better according to the PISA report, but below other countries in our environment.

Graph 2. School dropout rate (2015)



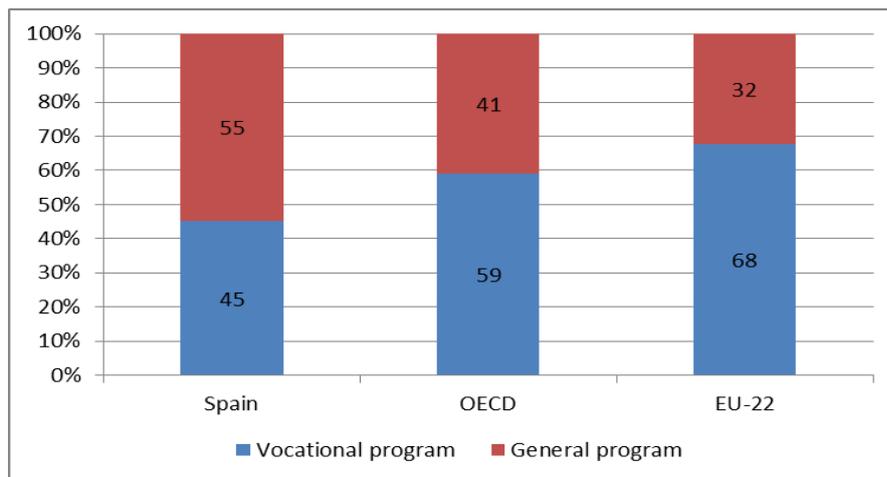
Source: Eurostat

In the field of higher education, if we analyse some of the principal world rankings, only one of our universities is among the top 200 places in the classification. The situation of business schools, however, is significantly better, as Spain has three of these institutions in the top ten in the world.

With regard to the number of master's degree students, in 2015 just 0.76% of the population was studying on a course of this type, whereas this percentage was practically double in countries like Austria and Sweden, while in France it stood at 1.29% and in Germany at 1.22%. The same is true for the number of doctoral students. In Spain, barely 0.07% of the total population decided in 2015 to start this type of degree course, whereas in Finland 0.36% did it, with 0.28% in Austria, 0.24% in Germany and 0.22% in Sweden.

For its part, Vocational Training continues to be a secondary option in Spain compared with other types of general programmes. Consequently, only 45% of the population between 25 and 34 years of age who have passed Secondary Education have studied on vocational education programmes, compared with 68% in the European Union.

Graph 3. Educational attainment of 25-34 year-olds, by programme orientation (2015)



Source: OECD

One of the consequences of these figures is the high youth unemployment rate, which in the case of under-25s is double the EU-27 average. Some of the causes of this serious situation are also associated with the shortcomings that characterise our employment relations model, and with a lesser entrepreneurial culture. According to the results of the 2015 Global Entrepreneurship Monitor (GEM), used by the United Nations, the World Bank and the OECD, Spanish society is below the average of the 54 countries studied in terms of self-confidence to start up a business opportunity, the number of entrepreneurial projects started up in recent years, risk-taking and self-employment as a desired professional option. Much further from the average is the perception of existing entrepreneurial opportunities and the percentage of the adult population (between 18 and 64 years of age) who state their intention of starting a business in the next three years.

Adult education, for its part, is another of the essential tools for improving human capital. According to the European Labour Force Survey drafted by Eurostat, Spain displays one of the highest percentages of adults with a low level of education, 43% of the population has a level of education equal to or less than compulsory secondary education, whereas the EU-28 average stands at 27% and is below 20% in the Scandinavian countries.

The participation of Spanish managers and experts in ongoing training activities is also low in relative terms. Specifically, 57% of Spanish managers and experts take part in training activities, whereas this percentage is over 70% in countries like Germany and France. According to Eurostat information, the bigger the size of the business, the higher the education of the workers, which partly explains some of these figures.

There is, therefore, plenty of room for improvement of education as a public service provision. It is essential to turn around a situation that, as we will see, has direct effects on progress, employment, social wellbeing and, finally, business size. It is everyone's obligation to place human capital as an absolute priority, to demand greater involvement of school students, enhance their skills, foster their confidence in themselves and channel this energy into personal projects that will end up having a positive impact on society. We need to recover a system that offers hope, with a greater connection between hard work, risk and recompense, that improves social recognition and that steadily eliminates fear of failure. And

all of this needs to be done with the stability of the model as backdrop and avoiding the constant changes to education systems that end up becoming a hindrance to our society.

## II. Job market

For the great majority of businesses, the workings of the job market is one of the principal challenges facing our economy. Our unemployment rate continues to be very high, and this reflects a bad design of the model, which is especially prejudicial to specific groups, such as the less-well educated and young people. As we saw in the previous section, human capital is the cornerstone of the progress of society as a whole, and in this sense work must be understood as an inverse learning system for some of these groups, where they learn as they carry out tasks.

If we analyse an expanded historical series of the job market, we can distinguish a number of different periods. Between 1975 and 1995, the number of people in work remained relatively constant, standing at around 12.5 million workers. From that moment on, Spain experienced a period of strong increase in the number of active people in work, which reached its peak in 2007 with a total of 20.7 million people employed. After the crisis, nearly four million jobs were lost again, with a minimum in the first quarter of 2014 of 16.9 million people in work, which has steadily recovered in recent years to the current 18.5 million.

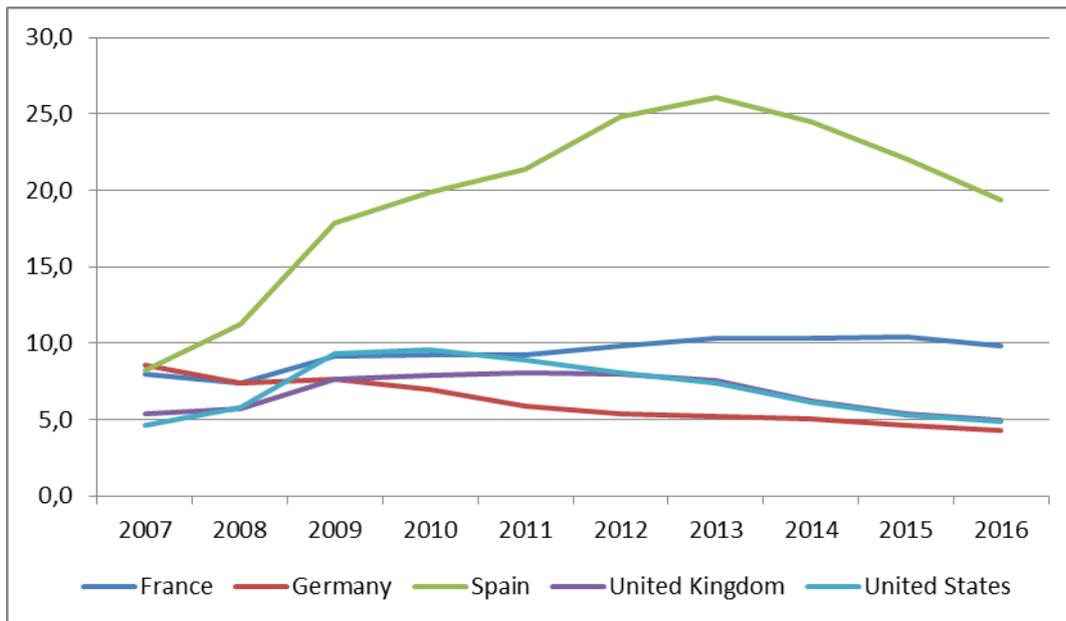
The incorporation of women in the job market has seen the number of women in work rise from 4.3 million in 1995 to 8.4 million today, practically doubling the starting figure. This has also meant that whereas in 1995 women represented 34% of the total number of people in work, today this percentage has risen to 45.4%. The lesser difference between the number of people of both genders in work is explained to a large extent by the greater resistance of female employment during the crisis.

If we compare a snapshot of the Spanish job market after the last 20 years, we see a significant increase in the number of salaried employees in relation to self-employed workers. This creation of new jobs has also been primarily on indefinite contracts, which have gone from representing 26% of the active population to 39%, whereas the proportion of temporary workers has fallen by 2.5 points.

It is self-employed workers who have experienced the greatest reduction, going from representing 19.4% in 2005 to 13.6% of the active population in 2016. This fall appears to be the consequence of both cultural elements and the conditions of the economic and business setting. Special attention is merited by the weak role of young people in self-employed business start-ups, having gone from half a million self-employed workers in 1995 to scarcely 200,000 in 2016.

The Spanish job market has been characterised in recent years, therefore, by a higher unemployment rate than the European average (although it reached similar levels in 2007), high instability, concentrated especially on temporary workers, and a progressive loss of importance of self-employed workers or entrepreneurs, especially notable in the case of young people.

Graph 4. Unemployment rate

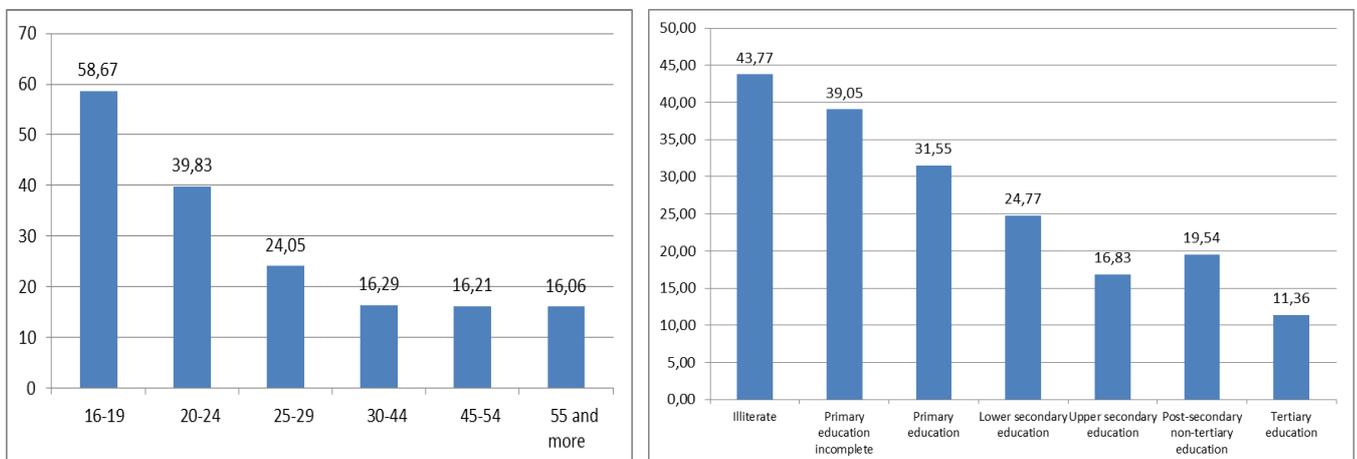


Source: International Monetary Found

This high unemployment rate is the consequence, among other factors, of the difference between salaries and productivity. Whereas salaries are set exogenously according to collective agreements (national, provincial or company), productivity depends on training, organisational ability, specialisation, talent, etc., many of which are also related, as has been analysed in previous sections, to business size, education and training.

Consequently, the social groups where there is a greater difference between their real productivity and their salaries, which are those set by agreement, are the ones that display the highest unemployment rates, as is the case of young people. The unemployment rate falls significantly as the average age, i.e. professional experience, rises. The same occurs with the groups that display a lower level of education. The unemployment rate of people without studies exceeds 43%, that of people with unfinished primary studies is 39%, and that of people with primary education is 31%, compared with 11.36% unemployment among people with higher education.

Graph 5. Relationship between unemployment, age and educational level



Source: Spanish national institute of statistics

Besides this, if we analyse salary level according to business size, we see how the average remuneration of employees is higher in the case of the bigger businesses, those with more than 200 workers, with a figure of 28,065 euros compared with 18,830 euros in the case of businesses of up to 49 workers.

If we analyse the ratio between productivity and salaries by Autonomous Community compared with the regional unemployment rate, we see how there is an inversely proportional relationship between the two variables. In Communities where productivity per employee is proportionally higher than their regional salary, the unemployment rate is lower, as is the case of the Basque Country, Madrid, La Rioja and Navarre. The opposite occurs in Communities like Andalusia, Castilla La Mancha, Extremadura and Murcia, which have some of the highest unemployment rates in Spain.

This relationship is maintained if we analyse individually the level of education of each of the Autonomous Communities. Consequently, the higher the level of education, the lower the level of unemployment. This way, regions such as Madrid, the Basque Country and Navarre, where the percentage of population with higher education is greater, display the lowest unemployment rates in the whole country. In the same vein, if we compare the level of education with the salary level, we see how there is also a direct positive relationship between a higher percentage of the population with higher education and a higher average salary level.

The simplification of employment administration must also be another element for reform, as it especially affects the smallest, which have fewer resources for finding out the numerous alternatives in hiring or procedures or the continuous changes to regulations.

The principal challenge, therefore, must be to improve productivity, the employability of workers and levels of education and training with the aim of aiding job creation, especially among the groups with the greatest difficulties.

### III. Efficiency of the Public Administrations

Two other factors that most influence the growth and size of businesses are related to the Administration. Firstly, efficiency in the provision of public services, and secondly, its role as regulator of relations between the public and businesses.

The Public Administration manages resources equivalent to more than 40% of GDP, which calls for strict control, not only financial but also in terms of efficiency. For the public finances to be sustainable, the economy must grow and create jobs, something that depends in turn on the efficiency of the Public Administrations. The current economic dynamism and the rise in prices is allowing an increase in tax collection and the reduction of the deficit, but it is urgent to continue with structural reforms in the Public Administration that enable us to face future situations in more complicated financial environments, with higher interest rates. The monetary policy of the European Central Bank is currently being used to finance at very low rates and, despite this, the cost in this section exceeds 30,000 million euros a year. Consequently, if in recent years one of the aims has been the deleveraging of the private sector, it is now a priority to return to controlled levels of public debt.

To some extent, it is a virtuous circle where the sustainability of the social model depends on growth, and growth depends on budgetary austerity, control of spending, a greater share-out

of the tax burden and greater tax collection stability. The lack of flexibility of important spending programmes and the instability of revenue make the budget a sensitive instrument that requires commitment, anticipation and political consensus, especially for specific items such as pensions.

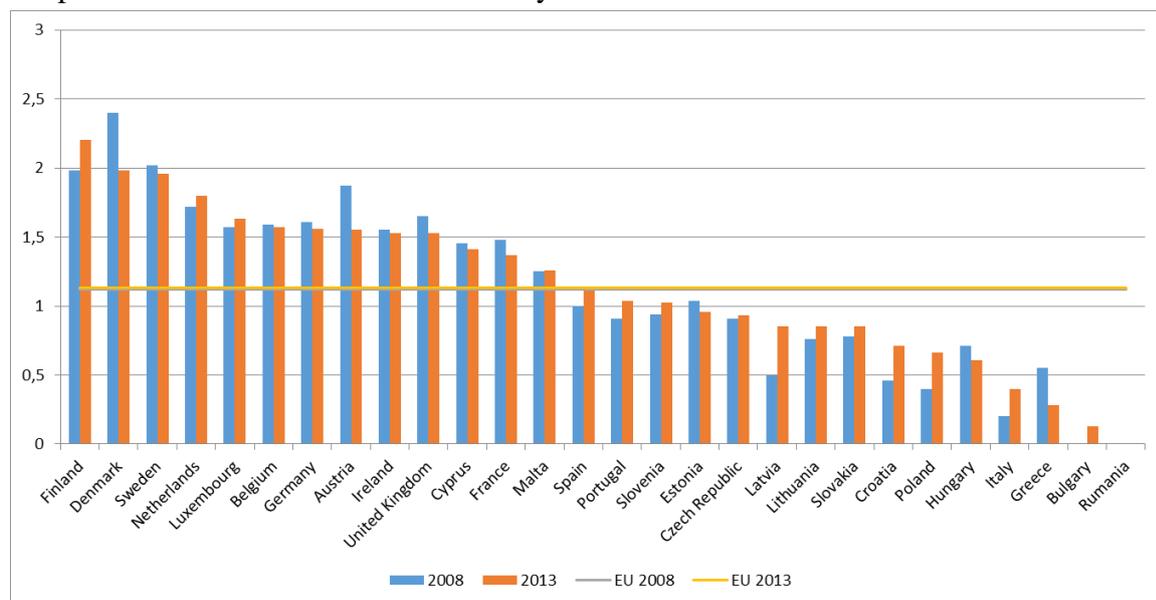
Budgetary consolidation is being achieved through growth, moderate inflation and an increase in spending below nominal GDP. However, it is important to ensure a good stable framework if we want to comply with the equation and create the conditions that allow not only the economy but the business sector as a whole to grow and gain size and competitiveness. To this effect, it is important to highlight the role of the Budgetary Stability Act, which introduced rules to increase commitment to fiscal discipline, aware of its relevance as a factor of confidence and economic growth.

The evolution of the Public Administrations in Spain has been marked by the transfer of powers to Autonomous Communities and Local Corporations and places us as one of the most decentralised economies in the world, which calls for greater coordination and conditionality of spending control measures, even aware of the funding problems that may exist in the Autonomous Communities, something that will have to be considered in the new funding model.

In the case of Spain, the decentralisation process has been done in a short space of time and, in many cases, has led to the creation of administrative structures in areas already covered by other administrations, which has generated redundant actions and greater administrative complexity. This calls for the need to improve coordination, simplification and the reduction of duplication between the various administrative levels.

According to the *Member States Competitiveness Report*, drafted by the European Commission, Spain is at the European average in terms of the efficiency of the Public Administration, although still behind other economies around us such as France, Germany and the United Kingdom and, in any event, very far from the Scandinavian countries, at the forefront in terms of administrative efficiency.

Graph 6. Public Administration efficiency



Source: European Commission

There is, therefore, plenty of room for improvement in the public sector, meaning that a review of the role of the Public Administrations in Spain is necessary that will allow an improvement to the efficiency of their running and greater use of more effective resources. To this effect, one of the elements that requires review is control of spending and the assessment of its effectiveness. There are different types of external audits of the public sector, but whereas financial audits are commonplace, there are practically no management audits, for example. This is why we need to increase collaboration with the public sector to conduct this type of audit, both due to the demand for greater transparency and to the lack of technical resources to carry out this work in the Administration itself.

The development of public-private collaborations is based on competence as the element that generates efficiency, on the experience of businesses, and on the economies of scale thanks to work procedures that enable similar systems to be applied in different administrations, with significant cost reductions. Public-private collaboration has been steadily rolled out due to force of circumstances in increasingly more administrations and in more sectors: infrastructures, maintenance of gardens, cleaning, security, health, education, social protection, tax collection, inspections, etc. Really, there are few issues that must be carried out exclusively by civil servants, yet there is still the perception in the Administration that what is public should be managed publicly, even though it is more inefficient.

Besides this, the role of the citizen must be increasingly greater in public management as they are the reference as recipient and assessor of these services. This way, replacing the model of administrative allocation of services with another in which the public's freedom of choice is the ordinary way of providing services allows for a better allocation of resources depending on the public's choices.

#### IV. Simplification and rationalisation of the regulatory sphere

The fourth of the factors that have a decisive impact on companies' ability to improve their competitiveness is administrative regulation.

Regulation is the set of rules that establish the relationship between the Administration and the taxpayer. Because of this, the relationship between the two parties is essential and must be simple, stable and transparent so that there is fluid communication and that dynamism and growth are not limited.

The aim of regulation may be of a social, environmental, safety, employment, etc. nature, but it must be in proportion to one of the priority objectives of economic policy: generating confidence. Today, the tangle of rules and regulations especially hinders growth in a country like Spain, with an average size of businesses that is smaller than other countries around us.

It is important that rules should be simple so that everyone understands them, so that they can be fulfilled and so that they are not an obstacle to the freedom of movement of people, goods, capital, services or information, nor that they hinder market unity. Therefore, one of the first considerations that should be made when speaking of regulation is the importance of the simplification of content, texts, procedures and access to information, in other words, transparency, which depends to a large extent on the digital development of the Public Administrations. In addition, they should not only be simple, they should also be long-lasting.

On the basis of simple rules, which are not synonymous with weakness, it is easier to establish organic Administration structures that are more efficient.

Today, in the majority of cases, you need to hire a professional to be able to comply with tax, administrative, employment, etc. obligations if you do not want to be penalised in any way. There are a great many public employees responsible for supervising compliance with regulations, but there are few public professionals who help understand these obligations. According to data from the Spanish Confederation of Business Organisations (CEOE), in 2015 the regional and national parliaments drafted nearly a million pages (961,291) of new laws, rules and regulations that were set out in the corresponding Official Gazettes. To these should be added the 2,057 legislative acts of the European Union and other thousands of town councils. A greater involvement by the Administration with the taxpayer to find out their problems, especially by experts, would help them understand the difficulties of starting up any business, for example. We need to be aware that we are all working in the same direction and that the Administration plays a decisive role in the ability of businesses to grow and create jobs.

The complex legal set-up (European, national, regional and local) is a hindrance to business competitiveness, investment and growth, which especially affects SMEs, and causes severe market distortions, primarily due to differences of interpretation.

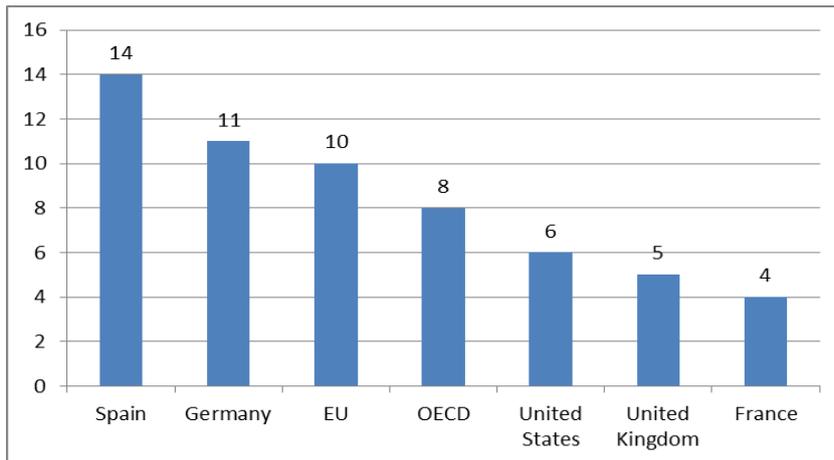
This is recognised by the Spanish Administration Reform Commission (CORA), which sets out in detail in its Executive Report the duplications, procedures, regulations, etc. that could be improved. It is an effort the success of which will depend on the Administration's ability to monitor and understand the principal interested parties, the taxpayers.

The citizen and the Administration need a clear and simple channel of communication, but today, the high volume of public agencies and the regulatory complexity hinder this understanding. There is room to improve the administration – citizen communication, especially if we make the most of the opportunities of the digital and technological world, which has already allowed us to automate many of the administrative processes that had been done manually. According to the CORA Report, for example, the in-person submission of an application to the Public Administrations costs businesses and citizens 80 euros as compared to the 5 euros it costs to do it digitally.

Regulatory and procedural complexity translates into organisational complexity. Consequently, in 2015 an administrative mass of 18,850 agencies was recorded, which means one administrative unit for every 2,500 citizens.

Spain is still a long way off the leading developed countries in relation to its administrative complexity. According to the indicators of the Global Competitiveness Index, drafted by the World Economic Forum, Spain is in 124th position out of 140 countries analysed with regard to governmental regulatory burden. The number of days needed to obtain licences continues to be one of the highest in Europe (88 days compared with 48 in France and 4 in Germany) and the same is true for its cost in euros and the time needed to start up a business.

Graph 7. Time required to start a business (days) (2015)



Source: OECD

In an open two-way communication model between the Administration and the taxpayer, transparency in its broadest sense is essential, in other words, the ability of the citizen to access and understand the information needed to comply with their obligations and exercise their rights. According to World Economic Forum figures, Spain is in 76th place out of a sample of 140 countries analysed in 2015 with regard to transparency in public decision-taking.

Simpler communication, that allows the public's opinion to be taken into account through their ability to choose, with fewer and more stable rules, improves trust between both sides. To achieve this aim, the digital world plays a highly relevant role and appears as a great opportunity to simplify the administrative processes, language and organic structure of the Administration and improve its internal flexibility, as well as to foster market unity.

## V. Taxation

The fifth of the factors analysed is taxation.

The tax system is one of the factors that determines business growth and size to a greater extent. The aim of any tax system is to raise revenue with a view to financing public services, and trying to do so fairly and efficiently, fostering saving and investment, as well as the competitiveness of the economy.

If we analyse the Spanish tax system, we get some interesting ideas as a result. Firstly, the instability of revenue in relation to other countries around us. Secondly, the high proportion of contributions in the total collection. And thirdly, the high complexity of the system, due to the high number of tax figures, regional or municipal differences, excessive regulation and constant regulatory changes. All of this results in greater insecurity, an increase in indirect costs, a rise in tax fraud and a high degree of disputes.

Instability of revenue according to the economic cycle became evident in the financial crisis, when public revenue lost 6 GDP points in collection in just two years, something that has only happened in Spain. With regard to the comparison of revenue in relation to GDP, it is important to take into account the differences between the GDP per capita of each of the

countries, as with an equal collection in terms of GDP, the tax effort is lower in countries with higher income. It is not the same thing to collect in public revenue 38% of GDP with a GDP per capita of 85% (PPA EU 15=100) like Spain, than collecting that same percentage, but with a GDP per capita of 100%, as in the United Kingdom. If we compare public revenue in relation to its GDP per capita, the conclusions are that Spain has a high tax effort.

If we analyse the tax structure in Spain, including financing of Social Security, we see a greater proportion of social contributions out of the total public revenue with regard to the European Union average, in other words, employment is taxed comparatively highly in Spain. Consequently, as a percentage of the total revenue, collection through contributions stands at 31.1% of the total average in the last 20 years in Spain whereas in the EU it comes to just 27.9%, i.e. 3.2 points more. This figure is especially interesting taking into account that the unemployment rate is double the European average.

The third of the elements that hinders a fairer and more efficient system is the high complexity of our tax system. It is a complexity derived from the high number of laws, the fiscal fragmentation both in Autonomous Communities and in Municipalities, tax procedures, communication between the Administration and the taxpayer, continuous rule changes, etc.

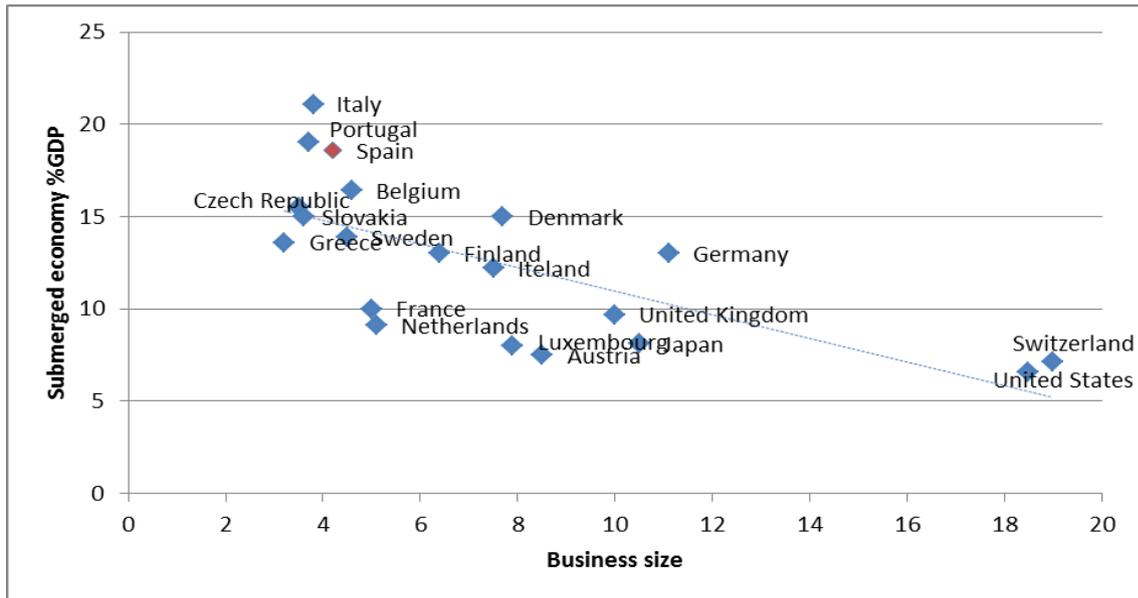
Some of the main consequences of this strong complexity are the lack of transparency and the insecurity suffered especially by new businesses and small- and medium-sized businesses, i.e. the initially most fragile ones. The high number of rules, their constant changes and the demands by the Tax Agency or the Social Security force the majority of businesses to hire a tax or employment advisor to be able to keep up to date with the continuous rule changes in each of the administrative levels, and this increases indirect costs.

All of these elements hinder understanding and disincentivise business growth. It is true to say that there are specific regulations for SMEs, but on occasion this favourable fiscal or employment treatment means, however, a threshold limiting growth in size.

Another consequence of complexity is fraud. There are various studies that coincide in the submerged economy in Spain possibly varying between 18% and 22%. A large part is the consequence of the tax culture, or the lack of it, but another important part arises from the tangle of taxes that citizens have to face. If we look at the data analysed by Dr Friedrich Schneider, we see that, in effect, the submerged economy in Spain in 2015 stood at 18.2% of GDP, a figure that coincides with the average of the EU28 countries. Probably the improvement in new technologies is one of the factors that help reduce the informal economy, but what appears to be evident is that we need to make the most of administrative digitisation to simplify communication between the Administration and the taxpayer.

Another of the interesting aspects that we see is that there is a direct relationship between business size and tax fraud. The bigger the average size of businesses in a country, the lower the percentage of fraud in the economy.

Graph 8. Submerged economy vs business size



Source: Friedrich Schneider, “Size and Development of Shadow Economy” and Eurostat. 2014.

Another consequence of the complexity of tax regulations is the high degree of disputes, with the uncertainty and the costs that it creates for the taxpayer. In the period between 2007 and 2014, the number of claims in Economic-Administrative Courts rose by 82.3% to reach 207,053 cases. This is a high number of claims that shows the difficulties of interpretation of some tax rules, even for the civil servants themselves, something that is reflected in the fact that 41.95% of the claims in 2014 were fully or partially admitted.

Besides this, the amount of the volume of debt pending collection by the Spanish Tax Authority (AEAT) has steadily increased in recent years according to the 2014 Report of the Tax Agency, exceeding 50,000 million euros alone in the country, a large part of them for tax debts challenged in the courts.

Therefore, simplification, digitisation, an efficient and stable design of tax systems and an effective and efficient relationship between the Administration and the taxpayer contribute to helping economic growth and business size and, therefore, to greater stability in tax collection.

## VI. Access to financing

The last of the factors analysed was access to financing.

Businesses' capacity for financing is another essential element that determines their growth and size, while at the same time acting as a driving force and catalyst to the economy as a whole.

The basis of all investment processes tends, firstly, to be savings, equity, as the main source of financing. The majority of businesses, especially during their early years, use their own self-financing to start their operations. It is, therefore, particularly important to promote and foster the ability to save in society as a whole.

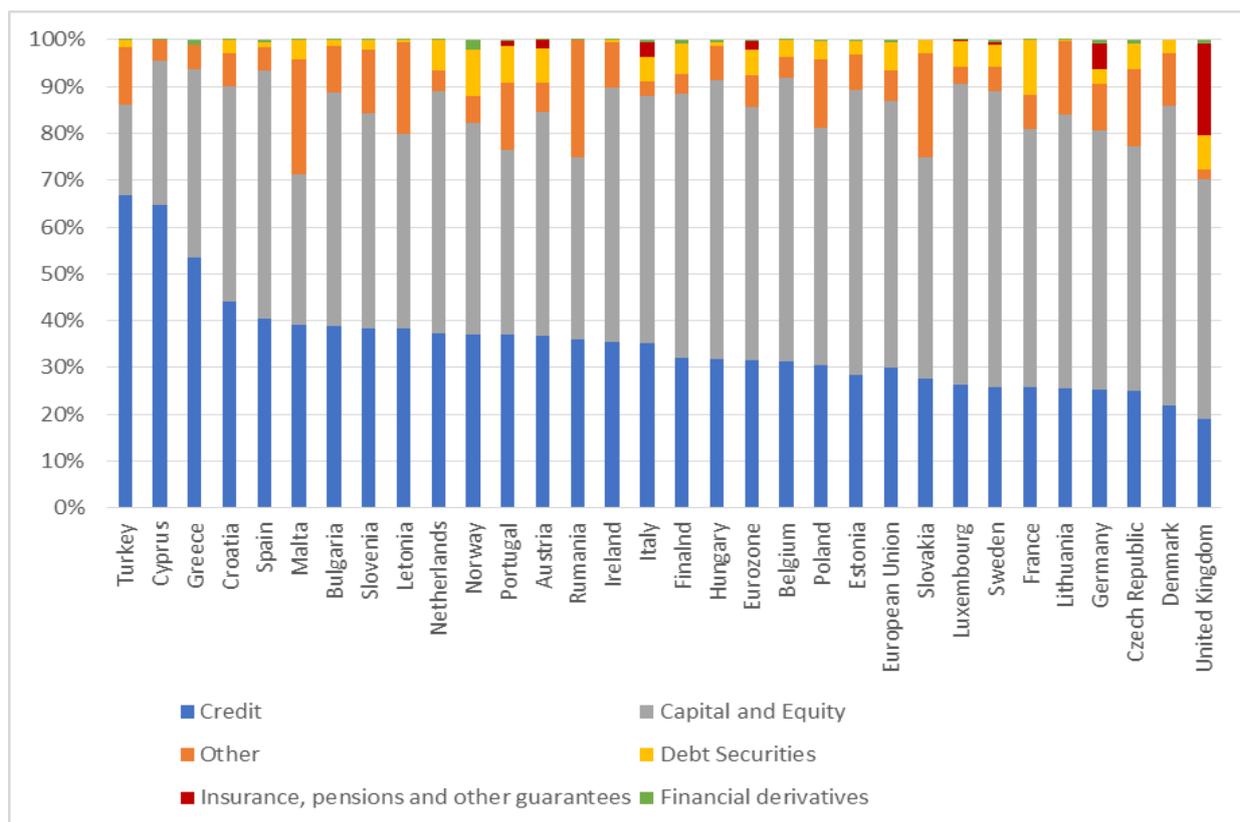
Together with own funds, external financing is also a decisive factor. Adequate procurement of external funds allows business to start investment, internationalisation and R+D+i projects, etc. and, in short, foster their growth, increase size and improve their competitiveness. In this sense, loans and bank credit are the most popular and widely-used tools by Spanish businesses.

In fact, credit played a leading role in the leverage process that positioned Spain as one of the most indebted countries of the developed economies. At the start of the financial crisis, our economy had accumulated a debt in the non-financial sectors of around 250% of GDP, which had been built up primarily by the private sector (non-financial businesses at 127.5% and domestic at 81.9%) and which, in the public sector, stood at just 40%. In 2011, non-financial and family businesses began a deleveraging process that helped reduce the debt in these resident sectors by 27% and 16% of GDP respectively, which accounts for an overall adjustment of 43% of GDP. This reduction was partly possible to private debt being transferred to public debt as part of the restructuring process of our economy. The public sector has therefore seen a substantial rise in its level of debt, standing now at around 100% of GDP, following an increase of 64 percentage points. In the coming years, the public sector will have to lead this debt reduction process so that our economy can undergo a gradual deleveraging and facilitate the recovery of private credit.

The restructuring of the Spanish banking sector played a decisive role in the normalisation of the financial system, which has fostered the integration, merger and reduction of the banking network, its recapitalisation, the strengthening of its solvency and the reform of certain assets, primarily property. All these elements were key to credit recovery. However, the exhaustive expansion of regulatory policy and the growing importance of the European Central Bank are creating a more rigorous regulatory framework that may lead to a loss of efficiency in the system.

Looking at the analysis of the liabilities structure, we see that Spanish businesses rely more heavily on bank credits, which reach around 40.4% of their total balance sheet, ahead of Italy (34.8%) and the Euro-zone average (31.4%) and a long way behind countries such as the United Kingdom (19.1%), Germany (25.3%) and France (25.8%).

Graph 9. Passive structure



Source: Eurostat

The smaller relative size of businesses partly explains this dependency and the reduced financial culture of entrepreneurs. Every year, the World Bank, in collaboration with the McDonough School of Business at Georgetown University, writes a report on financial culture around the world in which it assesses public knowledge of basic financial matters concerning interest rates, financing, risk diversification and inflation. The results of the latest document published in 2015 showed how Spain continues to lag behind its neighbours, such as the United Kingdom, Germany and France, and is a very long way behind the Scandinavian countries.

The ability to construct and analyse financial information is essential for procuring external resources. However, what tends to happen is that credit agencies, investors and other financial intermediaries do not have sufficient financial information about businesses to optimise the volume of financing that they are willing to lend and, on the other hand, businesses are unaware of the potential alternative sources of financing, and how they operate.

Being a larger business improves training and financial information and helps with access to alternative financing and not just credit. This correlation between the development of the financial markets and the average size of businesses can clearly be seen at the international level, where English-speaking countries have the most developed markets and, therefore, the most financing options.

## **Recommendations from leading international agencies**

For their part, various international agencies have made numerous recommendations in recent years with the aim of encouraging growth and increasing the size of Spanish businesses.

Chapter Four of this report focuses on the proposals by the European Commission (EC) and the International Monetary Fund (IMF), as they share two main characteristics. On the one hand, they have an effective influence on the economic policies of states through the conditioned granting of financial assistance, and, on the other, they monitor continuously and thoroughly the situation of the countries that they supervise. The most representative example of the influence that these two institutions have is probably their participation in the Memorandum of Understanding regarding the 2012 Financial Sector Policy conditions.

Certain specific areas also include OECD recommendations because, despite having a consultative rather than an executive role, it also carries out continuous and detailed monitoring of the Spanish economy. Also, given the relevance of education, it includes the recommendations made by the Committee of Experts for the Reform of the Spanish University System in accordance with the Spanish Ministry of Education.

In their reports, both the European Commission and the International Monetary Fund both agree about increasing the size of Spanish businesses. These agencies base their view on numerous works that find that the presence of small businesses tends to slow down productivity growth, limit exports and, therefore, make a negative contribution to a country's GDP.

Following the format of the report, these recommendations are grouped according to the factors analysed in Section Three: human capital, job market, efficiency of the Public Administrations, regulation, taxation and financing.

## **Proposals of the Instituto de la Empresa Familiar**

Lastly, Section Five focuses on the proposals of the Instituto de la Empresa Familiar. The aim of these conceptual proposals is not to go into the details of the problems in each area, but to tackle the design and how to approach these factors that limit businesses' potential for growth.

To raise the growth potential of businesses, we first have to trust them and the public, as anyone could be an entrepreneur-in-waiting. To ensure that increasing numbers of people are able to carry out their personal or professional plans, a favourable environment is needed, in other words, a good, straightforward regulatory framework that does not disincentivise businesses from starting up and that takes into account the heterogeneity and differences of taxpayers. The Administration should foster and facilitate the personal goals of each individual, from the initial stages in their education to their training and the moment when they take their first steps as an entrepreneur. It should therefore develop better communication with the taxpayer, as this is the only way to find out their needs, their concerns and their objectives. The best system to ensure that the Administration works for citizens, and not citizens for the Administration, is a two-way relationship of understanding where the citizen's freedom to choose is the way in which the State, Autonomous Communities and Local Corporations are informed about their preferences. We are all in the

same boat and we are all interested in raising growth and in job creation. In this game of relationships between the Administration and the taxpayer, companies and citizens, who are the protagonists, need to understand the rules of the game well to take on new investment projects.

However, at the same time, we need to understand that individual freedoms must be supported by a greater culture of what is public to strengthen equal opportunities, guarantee equal rights and call for the same obligations for all.

The quality of human capital, the efficiency of the job market and administrative and fiscal simplification are all factors that depend to a large extent on the relationships between the Administration and the taxpayer. Citizens and businesses are the end receivers of public services and, therefore, should be the protagonists and the ones to say how they would like them to be provided. The heterogeneity of individual preferences cannot be met by an administrative allocation system that also acts as a bottleneck and reacts slowly to social change, instead what is needed is greater participation by businesses to meet the demands and different priorities of citizens.

Citizens and businesses make their decisions based on the information available and the possible alternatives. However, when there are no options in public services provision, this relationship becomes one-way, as citizens have to meet a series of requirements or are allocated a specific services provider. This occurs in education, training, healthcare, social provisions, in very different areas of public administration.

Therefore, one of the main changes needs to happen in communication between the Administration and the taxpayer. To ensure two-way communication, the rules of the game need to be straightforward, clearly written, stable over time and therefore agreed on and accessible to all. Transparency and the ability to choose are the fundamental pillars needed to improve participation by citizens and businesses in the allocation of resources and, in this sense, the digital world is an unbeatable opportunity.

As well as greater protagonism for citizens, for which simplification, transparency and stable tax, employment and administrative rules are essential, the relationship between both parties improves as does confidence in investment. When the Administration, businesses and citizens work together, the results are always better, so greater empathy from both parties is necessary. We need to improve culture of the entrepreneur and strengthen the culture of what is public to give value to the work of public employees, improve the efficiency of the Public Administrations, increase incentives to undertake professional and business plans and fight against fraud. Everything is interwoven and we all depend on each other.

The proposals for improving the quality of human capital, based on an Education Agreement, include a more individualised system that ensures that each student's potential is developed as fully as possible while at the same time they can contribute their value to the group. Improvements to human capital lie in increased productivity, an essential factor for reducing unemployment. Talent is a value that comes from the individualisation of education, greater specialisation in universities and increased training through workplace internships, where dual training has to be one of the main commitments for the vocational professions.

A system needs to be established to help citizens choose public services, wherever this is possible, irrespective of the service in question, and a system to assess previous and

subsequent policies needs to be carried out, something that is particularly necessary in active employment policies, for example.

Administrative simplification includes less complex regulations, more straightforward processes, less market fragmentation, stability, smaller organic structures, wording that is easier to understand and improved corporate relations with the taxpayer, something that can also be applied to tax regulations and relationships. Corporate relations, replacing the self-assessment system, collaboration through tax advisers are elements that also help improve or prevent a submerged economy.

Businesses are the engine driving growth in the economy, and the viability of the social protection system, pensions, education and healthcare depends on them. An economy that grows and improves the productive structure of its businesses and allows them to expand is an economy that ensures progress, stability, employment and the sustainability of its public finances. Therefore, these proposals are aimed at understanding the need to find meeting points and common objectives between businesses and the Administration, giving citizens a leading role as the cornerstone of these changes, at a time when digital transformation offers a wealth of opportunities that would have been unthinkable just a few years ago.