European Association of Public Banks
European Association of Public Banks and Funding Agencies AISBL

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EAPB response to EC consultation on possible revision of the EU SME Definition as provided in the Recommendation 2003/361/EC.

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Background

The European Association of Public Banks, EAPB, welcomes the possibility to provide feedback on the possible revision of the EU SME Definition as provided in the Recommendation 2003/361/EC. Generally EAPB believes that the small and medium-sized enterprises (SME) Definition has proven its worth in identifying those enterprises which are confronted with market failures particularly in the area of access to finance.

As National and Regional Promotional Banks and institutions (NPB) EAPB members perform a public mission of fostering economic development, especially by contributing to SMEs growth. Thus, it supports any initiative from the European Commission to create favorable framework conditions for SMEs. SMEs form the backbone of the European economy. They are indispensable for growth, employment and innovation in the EU. Economies with a stable medium-sized base are evidently developing better.
Compared to large companies, however, SMEs have to accept disadvantages that only because of their size. Complex regulations and administrative burden have increased in recent years. This is also reflected in the implementation of the requirements for European Structural and Investment Funds as well as European funding programs in the current funding period. In order to achieve the EU's economic development objectives, it is necessary to incentivize SMEs to make targeted investments. Therefore, the rules should be clear and unambiguous for them.
More than 99% of European businesses are SMEs. There is a constant lack of mid and large-caps with a strong growth potential in employment and the ability to compete with European and Asian competitors. Indeed, mid and large-caps only represent 0,2% of EU businesses but gather more than 30% of persons employed. While the recovery remains fragile and the growth leverages still need to be enhanced, a revision of the current SME definition could have a potentially positive impact.
As it stands, the definition appears to hinder the expansion of SMEs beyond the provided thresholds. In particular, unlisted small mid-caps from 250 to 500 employees remain excluded from the scope of the SME European definition. It reduces the level of support they can benefit from. Also, they have to comply with stronger requirements or face larger fees for EU administrative compliance. It penalizes their development and the overall European economy. In this field, it should be kept it mind that American and Japanese definitions provide higher thresholds in terms of staff headcount, turnover or balance sheet total. Furthermore, even the EIF considers enterprises up to 500 employees as SMEs for its investment operations.

In September 2016, in several judgments on the SME definition, the European Court of Justice found that it was neither clear nor precise enough. Against this background, a revision should also lead to a simplification. Not only should the inflation rate since the last adjustment of the 2003 thresholds be taken into account. The aim should be that companies can make a self-declaration with a high level of legal certainty.

Adjustment of thresholds:

Given that the inflation growth between 2003 and 2016 amounts to 26.75%, there is a strong case for a compensation at least for inflation and productivity growth. In addition to taking into account the inflation rate in annual sales and the balance sheet total, the criteria referring to the number of employees should be adjusted. The EC itself recognized in its 2014 Risk Capital Guidelines that certain companies with exceeding employee numbers and / or financial thresholds in the definition of SMEs may face similar financial bottlenecks. Likewise, in some EC support programs such as InnovFin small mid-cap companies can also be funded. These thresholds should be included in the future SME definition. Otherwise, it would be difficult to understand why purely European funded

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programs can support more companies and a higher support amounts than using European and / or national funds granted or managed by Member States.

Against this background, we propose raising the thresholds as follows

Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 500	≤ € 75 m		≤ € 75 m
Small	< 100	≤ € 20 m		≤ € 20 m
Micro	< 20	≤ € 4 m		≤ € 4 m

While keeping a targeted definition, EAPB members would welcome a more dynamic handling of the way the criteria are combined (e.g. an enterprise fulfilling the criteria of balance sheet and turnover, but having more than the maximum number of employees could be newly recognized as being an SME).

Adjustment of linked companies

The calculation of thresholds should take into account only single undertakings with their linked companies in the meaning of the de minimis Regulation (Regulation (EU) No 1407/2013).

Article 2 (2) of the de minimis Regulation:
2. 'Single undertaking' includes, for the purposes of this Regulation, all enterprises having at least one of the following relationships with each other:
(a) one enterprise has a majority of the shareholders' or members' voting rights in another enterprise;
(b) one enterprise has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another enterprise;
(c) one enterprise has the right to exercise a dominant influence over another enterprise pursuant to a contract entered into with that enterprise or to a provision in its memorandum or articles of association;
(d) one enterprise, which is a shareholder in or member of another enterprise, controls alone, pursuant to an agreement with other shareholders in or members of that enterprise, a majority of shareholders' or members' voting rights in that enterprise. "

This definition is used in the context of compliance with the so-called de minimis threshold. The definition can be traced back to a judgment of the European Court of Justice in which financial and corporate links between individual legal entities were assessed in order to assess an economic entity. In that sense, this definition has the same objective as the SME definition. Although the granting of de minimis aid is not linked to the SME definition, many SMEs also apply for de minimis aid. The alignment of the SME definition and de minimis aid thresholds would therefore not only simplify the rules but would also increase the legal certainty for businesses.

Elimination of connections via natural persons

When considering the "single undertaking" under the de minimis Regulation inter-firm relationships should be considered like in Recommendation 2003/361/EC. In contrast to the SME recommendation, however, this does not include corporate links that arise through natural persons or a group of natural persons who in the past have, in many cases, contributed to significant interpretation difficulties and thus to legal uncertainty. The generalization of the jurisdictional practice of the EC for very complicated individual cases may also have led to a more stringent interpretation than was originally intended by decision-makers. The interpretation of unclear legal concepts, such as "*relevant market or to adjacent markets*" or the difficult consideration of the degree of relatedness for the assessment of groups of natural persons could thus be dispensed with.

Elimination of the partner connections

Furthermore, this proposal would eliminate the need to consider partner companies, which would also reduce complexity and increase legal certainty. Questions to what extent the partner companies of partner companies have to be included in the calculation of the thresholds, or other very specific constellations could be removed. The

whole very hard-to-understand complex of partners enterprises referred to in the second subparagraph of Article 3 (2) in conjunction with paragraph 4 as exceptions to the rule would therefore become obsolete.
Moreover, for equity investments of institutional investors ("business angels", VC companies and other investment companies), there would be no effect on the classification as a SME below the control limit. This seems justified to us, since in the past - with the objective of maintaining the SME status of the target companies - difficulties have been experienced with the € 1.25 million limit set out in Article 3 (2) or the 25% threshold, as defined by the autonomous companies in Article 3 (1) of the SME definition with no justification. This has made in more difficult to ease the funding difficulties for certain SMEs.

Equal treatment of companies with municipality ownership

With the exception of small municipalities, a company cannot currently be considered as an SME if 25% or more of its capital or voting rights is controlled, directly or indirectly, by one or more public authorities or public law entities (Article 3 para. 4 of the SME Recommendation).
This rule should be deleted without replacement. Public-sector involvement in companies generally does not result in these companies having much better access to the capital market than 'normal' companies. A company of which a local authority has shares has similar difficulties to those of a "normal" company of the same size.

Elimination of connections to Temporary Consortia

Finally difficulties with Temporary Consortia (TC) have also been reported. In Spain for example, a Temporary Consortium is a unique company (without legal personality) created by a group of companies with the aim to deliver a specific service for a period of time. TC are important because they allow a SME to participate in bigger projects where its current size would otherwise not allow, or to share experiences and knowledge with other SMEs or larger enterprises. In these cases, it is not clear to what extent these Temporary Consortia have to be included in the calculation of thresholds. In the absence of clear rules about how to consolidate this kind of temporary companies, it could be considered to apply the same rules that apply for “normal” companies, but this could lead to a disproportionate result, especially when considering a company which owns more than 50% of a Temporary Consortium.

Example: a Temporary Consortium is owned by 3 companies A, B and C (A owns 51%, B owns 30% and C owns 19%). Company A contributes 5 employees, Company B contributes 3 and Company C contributes 2 (the TC has 10 employees in total). If we want to calculate data for Company A, with the current rules we should do: 100% A + 100% TC + 30% B. The main problems we want to point out are:

1) Company B might be a big company, for example, with 3.000 employees. This means that we have to include 900 employees in the calculation for company A.

2) The calculation for A depends on the period of time in which it is done. Company A could be considered a big company during the period of time in which it owns the Consortium, and an SME once the Consortium does not exist anymore. In our opinion, in both cases company A should be considered an SME.

3) It is difficult to obtain data from Temporary Consortiums because they are generally not obliged to publish their financial statements. And an SME participating in one of them would not be able to obtain data from other partners.

There are also problems when a SME holds a minority share of a TC (A: 26%, B: 51%, C: 23%) and a big company is providing the majority of the workforce, which is also a common situation.

We believe companies having participations in Temporary Consortiums should not be taken into account in the calculation of thresholds, except when there are employees and assets belonging exclusively to the TC. Only in this case the percentage attributable to the SME should be included in the calculation of the thresholds. And upstream enterprise data should not be included in neither case. Only when the TC is the one receiving the financing directly (and not the companies integrating it), the calculation should be done with the current rules.

** **The European Association of Public Banks (EAPB)** gathers over 30 member organisations which include promotional banks such as national or regional public development banks and local funding agencies, public financial institutions, associations of public banks and banks with similar interests from 17 European Member States and countries, representing directly and indirectly the interests of over 90 financial institutions towards the EU and other European stakeholders.*

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