

STRENGTHENING TURKISH SMALL AND MEDIUM SIZE ENTERPRISES  
AND PROMOTING ENTREPRENEURSHIP IN THE  
LIGHT OF EUROPEAN UNION POLICIES

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## ABSTRACT

### STRENGTHENING TURKISH SMALL AND MEDIUM SIZE ENTERPRISES AND PROMOTING ENTREPRENEURSHIP IN THE LIGHT OF EUROPEAN UNION POLICIES

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This thesis analyses the ways of strengthening Small and Medium Sized Enterprises (SMEs) in Turkey and promoting entrepreneurship in the light of the current EU policies from a holistic approach. Analyses of theoretical framework and exploring the structure of SMEs, existing support policies and the future strategies of both European Union and Turkey are the major stages of this study. This thesis makes critical evaluation of SME policies in Turkey by pointing out their weaknesses, which are supported by the results obtained from the case study conducted on SMEs in Adana. This study also attempts to develop some recommendations in order to eliminate shortcomings of SME policy in Turkey. The main idea of this thesis is that a long term strategy, which should be developed in order to promote entrepreneurship and support Turkish SMEs requires reassessment of the policies and developing effective measures in wide range of policy domains such as, R&D, technology, labor markets, financial markets, education and social policies.

Keywords: Enterprise, Entrepreneur, Entrepreneurship, Small and Medium Sized Enterprises, European Union.

## ÖZ

### AVRUPA BİRLİĞİ POLİTİKALARI IŞIĞINDA TÜRKİYE'DEKİ KÜÇÜK VE ORTA BOY İŞLETMELERİN GÜÇLENDİRİLMESİ VE GİRİŞİMCİLİĞİN TEŞVİK EDİLMESİ

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Bu tez, Türkiye'deki Küçük ve Orta Boy İşletmelerin (KOBİ) güçlendirilmesinin ve girişimciliğin teşvik edilmesinin yollarını mevcut AB politikaları ışığında bütüncül bir yaklaşımla analiz etmiştir. Teorik çerçevenin analizi ile Türkiye ve Avrupa Birliğindeki KOBİ'lerin yapısının, mevcut KOBİ politikalarının ve geleceğe yönelik stratejilerin araştırılması, bu çalışmanın temel aşamalarıdır. Bu tez, Adana'daki KOBİ'ler üzerinde yapılan örnek çalışmanın sonuçları ile de desteklenen, Türkiye'deki KOBİ politikalarının zayıflıklarına işaret ederek eleştirel bir değerlendirme yapmıştır. Bu çalışma Türkiye'deki KOBİ politikalarının eksikliklerini ortadan kaldırmaya yönelik bazı öneriler getirmeye de çalışmıştır. Bu tezin ana fikri girişimciliği teşvik etmek ve Türk KOBİ'lerine destek sağlamak için geliştirilmesi gereken uzun vadeli bir stratejinin, mevcut politikaların gözden geçirilmesini ve AR-GE, teknoloji, işçi piyasası, mali piyasalar, eğitim ve sosyal politikalar gibi geniş politika alanlarında etkin tedbirleri gerektirdiğidir.

Anahtar Kelimeler: İşletme, Müteşebbis, Girişimcilik, Küçük ve Orta Boy İşletmeler, Avrupa Birliği.

To my son Batuhan

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## LIST OF ABBREVIATIONS

<b>ABİGEM</b>	EU Enterprise Development Center
<b>ASO</b>	Ankara Chamber of Industry
<b>BC-NET</b>	Business Cooperation Network
<b>BEST</b>	Business Environment Simplification Task
<b>CEECs</b>	Central and Eastern European Countries
<b>CIP</b>	Competitiveness and Innovation Framework Programme
<b>CIS</b>	Community Innovation Survey
<b>CORDIS</b>	Community Research and Development Information Service
<b>CRAFT</b>	Co-operative Research
<b>EAGGF</b>	European Agricultural and Guidance and Guarantee Fund
<b>EEA</b>	European Economic Area
<b>EFT</b>	European Fund for Turkey
<b>EIB</b>	European Investment Bank
<b>EIC</b>	Euro Info Center
<b>EIF</b>	European Investment Fund
<b>ENSR</b>	European Network for SME Research
<b>EPMC</b>	Enterprise Programme Management Committee
<b>ERCF</b>	Exchange Risk Cover Fund
<b>ERDF</b>	European Regional Development Fund
<b>ESF</b>	European Social Fund
<b>ESOB</b>	Union of Chambers of Tradesmen and Craftsmen
<b>ETF</b>	European Technology Facility
<b>FIFG</b>	Financial Instruments for Fisheries Guidance
<b>FP6</b>	The Sixth Framework Programme for Research and Technological Development
<b>GEM</b>	Global Entrepreneurship Monitor
<b>GIAD</b>	Young Businessman Associations
<b>ICT</b>	Information and Communication Technologies

<b>IDABC</b>	Interoperable Delivery of Pan-European E-government Services to Public Administrations, Businesses and Citizens
<b>İGEM</b>	Enterprise Development Centers
<b>İGEME</b>	Export Promotion Centre
<b>IMF</b>	International Monetary Fund
<b>IRC</b>	Innovation Relay Centers
<b>ISPA</b>	Instrument for Structural Policies for Pre-Accession
<b>İTKİB</b>	Istanbul Textile and Apparel Exporters Union
<b>KGF</b>	Credit Guarantee Fund Inc.
<b>KOSGEB</b>	Small and Medium Industry Development Organisation
<b>KSS</b>	Small Sized Industrial Estates
<b>KÜGEM</b>	Small Enterprise Development Centers
<b>MAP</b>	Multiannual Programme for Enterprise and Entrepreneurship
<b>MEKSA</b>	The Vocational Training and Small Industry Supporting Foundation
<b>NGO</b>	Non Governmental Organizations
<b>OECD</b>	Organisation for Economic Cooperation and Development
<b>OLBs</b>	On-Lending Banks
<b>PHARE</b>	Pologne Et Hongrie: Assistance Pour La Reconstruction Des Economies
<b>pNDP</b>	Preliminary National Development Plan
<b>SAPARD</b>	Support for Agriculture and Rural Development
<b>SIAD</b>	Industrialist and Businessman Associations
<b>SIS</b>	State Institute of Statistics
<b>SME</b>	Small and Medium Sized Enterprises
<b>SPO</b>	State Planning Organisation
<b>TEKMER</b>	Technology Development Centers
<b>TESK</b>	Confederation of Tradesman and Artisans of Turkey
<b>TESKOMB</b>	Union of Credit and Guarantee Cooperatives for Tradesman and Artisans of Turkey

<b>TOBB</b>	Turkish Union of Chambers and Commodity Exchange
<b>TOSYÖV</b>	Turkish Foundation For Small and Medium Businesses
<b>TPE</b>	Turkish Patent Institute
<b>TSE</b>	Turkish Standards Institute
<b>TTGV</b>	Technology Development Foundation of Turkey
<b>TÜBİTAK</b>	Scientific and Technical Research Council of Turkey
<b>TÜRKAK</b>	Turkish Accreditation Agency

## **CHAPTER 1**

### **INTRODUCTION**

Throughout the first three-quarters of the 20<sup>th</sup> century, large enterprise was clearly the dominant form of business organisation. During the 1940s-1960s, system of mass production and consumption was the characteristic of highly developed economies. However, during the 1970-1990 period, the system of production and consumption undergone a transformation with globalization. It has shifted from mass production of goods at centralized location to a flexible system of production. In many sectors, break-up of large business units into smaller ones has been considered essential for achieving flexibility (Audretsch and Feldman, 1996). As a consequence wide range of empirical findings (Nickell, 1996; Davis at al., 1996; Lundström and Stevenson, 2001a and OECD, 2002) show that from the 1970s onward in most European countries and North America the importance of small business increased and a new trend towards the small business has been started.

While trying to understand the reasons behind these developments, Audretsch and Thurik (2001:267) argue that due to globalisation there is an emergence of entrepreneurship in Europe and North America. They claim that globalisation shifted the comparative advantage towards knowledge based economic activity and this has changed the role of the Small and Medium Sized Enterprises (SMEs) in the globalised economy. According to Audretsch and Thurik, this has occurred for two reasons; first large enterprises in traditional manufacturing industries have lost their competitiveness in producing in the high cost domestic countries, second



small entrepreneurial enterprises take on a new importance and value in a knowledge-based economy.

According to the conventional theories of innovation this is a contradictory argument because SMEs cannot be important in a knowledge-based economy due to their limited investments in research and development. Indeed research and development is seen as an activity of large firms. However a series of studies (Audretsch and Feldman, 1996; Audretsch and Paula, 1996; OECD, 2002 and OECD, 2000) have clearly documented that SMEs account for an important share of new product innovations especially newly emerging industries such as biotechnology and computer software despite their low R&D expenditures. According to these studies SMEs get the knowledge inputs from other third party firms or research institutions such as universities. More interestingly it is claimed that knowledge spills over from a firm conducting the R&D or the research laboratory of a university. Thus as knowledge has become more important as a factor of production, knowledge spillover has also become more important as a factor of production. Consequently as a channelling mechanism of knowledge, SMEs provide knowledge created in one organisation to become commercialised in a new enterprise. Therefore, SMEs, achieved new importance in a knowledge-based economy of globalising world (Audretsch, 2002: 10).

Following the trend of downsizing of larger firms, especially from the early 1990s onwards, fostering small and medium sized enterprises and entrepreneurship has become one of the most important policy goals. All developing and developed countries started to address this topic regularly, which also lead to ever more scientists and politicians being attracted by the issue. The main reason for this is explained as SMEs are seen as a way to increase economic growth and competitiveness and to create jobs. Every developing or developed country is intervening in some way to promote

SMEs because of the perceived importance of them for economic development.

Parallel to these developments in the international economy, in the late twentieth century, SMEs emerged as a key agenda item of economic policy makers across Europe, both for individual member states and for the European Union. Fostering entrepreneurship and SMEs is a topic of increasing importance for the EU. Although Industrial and SME policies have been developed as independent policies in the EU, at the beginning of 2000 these two policies have been merged and renamed as “Enterprise and Industrial Policy”. Moreover, SMEs which is the title of the 15<sup>th</sup> chapter of the accession negotiations of previous enlargements including 2004 enlargement, has been changed as “Enterprise and Industrial Policy” in forthcoming enlargement.

Currently, policies concerning the SMEs are evaluated under the Enterprise Policy of the EU due to the complementary character of the two policies. However, in the EU literature, objectives of SME-oriented and entrepreneurship-oriented policies differ to some extent. SME policy focuses on predominantly already existing SMEs, while entrepreneurship policy focuses more on entrepreneurs who may be at different stages of the process of developing a new or early stage business. For instance, unlike enterprise policy, creating an entrepreneurial society is not an objective of the EU SME policy. Thus entrepreneurship policy is broader in context, it includes measures to stimulate an entrepreneurial culture, to create widespread promotion of entrepreneurship as an employment choice, as well as providing support to emerging and early stage entrepreneurs. In this context, European Commission recommends member states to follow a more comprehensive policy and develop an enterprise policy in line with the European Union policies. On the other side, enterprise policy does not exclude large enterprises but since more than 99 percent of all enterprises are

SMEs in the European Union, a debate about entrepreneurship and enterprise policy is mainly a debate on SMEs, therefore SME policy still remains at the core of Enterprise Policy in the EU and in all member states.

The EU underlined importance of the SMEs for the first time in the Maastricht Treaty but SMEs became a main policy goal with the Lisbon process where the new strategic goal of the Union by 2010 is declared as to “*become most competitive and dynamic knowledge based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion (European Council, 2000a: para.5).*” In order to reach this aim, special attention is given to create a friendly environment for starting up and developing innovative businesses, especially SMEs. Moreover, in the context of Lisbon process variety of instruments have been developed in order to foster the SMEs.

SMEs also play a particularly important role in the Turkish economy, because of their large share both in the gross domestic product and in the workforce. In Turkey, almost every government has carried out different policies to support these enterprises. However, the attention to these policies has increased with the establishment of a customs union between Turkey and the European Union on 31 December 1995. Moreover Turkey as a candidate country has started to participate in some programmes of the EU that are aiming to promote SMEs.

In this framework, this thesis seeks to identify the ways of strengthening Turkish SMEs and promoting entrepreneurship in the light of the current EU policies from a holistic point of view. It sets a useful base for the future studies in the related areas by exploring both theoretical framework and practical aspects of the issue and by trying to clarify complex policy tools of both Turkey and the EU. In order to understand the SME policy of the EU, the study tries to gather all scattered *acquis communautaire*

on various aspects of SMEs and analyse them in an order, therefore it is also good source of information for the future studies. The thesis is of importance for determining the main weaknesses of Turkish SMEs and bottlenecks of SME policies as well. At the same time, it tries to make contribution for the following studies by developing some recommendations concerning Turkish SME policies on the basis of benchmarking and best practices of the EU member states.

First pillar, which serves to the main aim of this thesis, is to clarify the basic concepts of SMEs and entrepreneurship and explore the link between entrepreneurship and economic growth. In the literature the word “enterprise” is used in a variety of contexts and with a wide range of meanings, the narrower meanings are closely linked to entrepreneurship. However, in general the words enterprise, entrepreneurship and SMEs are used interchangeably. Thus these concepts have to be clarified within a theoretical framework, in order to understand the main dynamics of EU Enterprise policy. Therefore, Chapter Two is devoted to clarifying the confusion of these concepts. It initially seeks to introduce concepts of enterprise and entrepreneurship and their interrelationship. Then the role of the entrepreneurship in economic growth both in terms of theoretical framework and empirical findings is explored in order to display why entrepreneurship is a subject of interest. In this respect, narrow definition of entrepreneurship, which refers to SMEs and act of starting them, (Bridge at all., 1998:99; Dejardin 2000: 4; Lundstrom and Stevenson 2002: 80) is taken into consideration.

SMEs are not smaller version of big businesses, they have a number of distinctive features and in many aspects they are heterogeneous. They differ for instance in their stage of development, in their business sector or in their type of ownership. Moreover there is no single, clear and widely accepted definition of SMEs. However in order to develop effective promoting policies

of SMEs, clear understanding of SMEs is necessary. Therefore, Second Chapter introduces specific aspects of SMEs that distinguish them from other enterprises, explores variations of them and indicates some official definitions used to describe them. Finally Second Chapter clarifies the differences between SME policy and Entrepreneurship policy.

Second pillar of the subject is to explore the SME and entrepreneurship policy of the EU. After giving brief historical perspective of the policies concerning the SME in the EU, legal and institutional framework of the SMEs are introduced in Chapter Three. In order to understand current policies and instruments, initially latest definition of SMEs, which was adopted by the Commission in 2003 and entered into force in 2005, is explained<sup>1</sup>. Secondly basic data concerning the SMEs is given in order to understand the contribution of the SMEs to the EU economy. Finally, currently active policy tools and programmes adopted by the EU with the main sources of funds available to European SMEs are introduced.

Third pillar, which contributes to the main aim of this study, is to explore main features of Turkish SMEs and SME Policies. Understanding main features of Turkish SMEs and analysing the policies developed for promoting the SMEs are of great importance for determining the bottlenecks of the policies. Therefore, Chapter Four is devoted to exploring SME policy in Turkey. After giving brief historical background about the SME policies in Turkey, the structure of the SMEs and their contribution to Turkish economy are tried to be explored by figures in order to understand why fostering the growth of innovative and internationally competitive SMEs is of importance for Turkey.

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<sup>1</sup> Commission of the European Communities, Commission Recommendation 2003/361/EC of 06/05/2003 Concerning the Definition of Micro, Small and Medium Sized Enterprises, Official Journal of the European Communities L124, 20.05.2003, p 36-41.

Since statistical information on Turkey's SME sector is relatively fragmentary and few time series are available, it is difficult to analyze trends over time. However, some data provide a snapshot of its relative place in the overall economy. According to statistics for the year 2000, the SMEs represent 99.8 percent of the total number of enterprises, 76.7 percent of total employment, 38 percent of capital investment, 26.5 percent of value added, roughly 10 percent of exports and 5 percent of bank credits (State Planning Organisation, 2004). Therefore, while SMEs dominate the economy in terms of employment, they evidently operate with comparatively little capital equipment, generate relatively low levels of value added, make only a small contribution to Turkish exports and receive only a marginal share of funds mobilized by the banking sector.

Fourth Chapter also explores legal and institutional framework in Turkey. In this respect, the Chapter focuses on the current supports, aids and programmes for Turkish SMEs developed by the government and emergence of "entrepreneurship concept" under the participation of Turkey to the EU programmes.

Fourth pillar of the subject is to determine main weaknesses of Turkish SMEs and problems encountered in promoting policies towards entrepreneurship and SMEs. As the policies and importance of SMEs in both Turkey and the EU are explored in the Chapters Three and Four, this enables us to make comparison and to explore main problems of Turkish SMEs and policy bottlenecks. Furthermore, a survey was conducted on SMEs in Adana and possibility to generalise the results of the survey to all Turkish SMEs is tried to be examined. This case study is considered to be significantly contributive to revealing the problems of Turkish SMEs and measuring the effectiveness of the policy tools implemented by various organisations under the SME Policy of Turkey.

Moreover, on the basis of the determined problems and bottlenecks, recommendations are developed in some policy areas in order to promote entrepreneurship and strengthening the Turkish SMEs in the light of EU experiences. Although European Commission develops wide range of policies in order to promote SMEs and entrepreneurship in the Union, participation to these policies or implementation of them are not compulsory for the member states. In order to strengthen their SMEs and to promote entrepreneurship, member states follow different paths and hence there are various implementations in the EU. However EU gives great importance to “learning each other’s processes” and European Commission encourages member states to share their best practices in different areas such as, education, training, legislation, regulations, taxation, financial matters and technological capacity. Based on the assumption that these best practices may play crucial role in solving main problems of the SMEs in Turkey, special attention is given to these practices and their applicability in Turkey.

Final Chapter of this thesis summarises major findings of each Chapter and tries to draw a conclusion.

## CHAPTER 2

### INTEGRATED APPROACH TO THE POLICIES FOR PROMOTING ENTREPRENEURSHIP AND ECONOMIC GROWTH

The aims of this Chapter are to clarify the basic concepts of SMEs and entrepreneurship, to explain the importance of developing an integrated approach and to explore the link between entrepreneurship and economic growth.

#### **2.1 Clarification of the Concepts: Enterprise, Entrepreneurship and Entrepreneur**

The term ***entrepreneurship*** is derived from the French verb “entreprendre” and the German word “unternehmen”, both of which translate to “undertake”. Entrepreneurship does not correspond fully with any established academic discipline such as economics, any particular sub-discipline within economics such as labour economics or industrial economics. The interdisciplinary nature of the topic reflects that entrepreneurship itself is a multifaceted, complex social and economic phenomenon.

***Entrepreneurs*** are those who engage in entrepreneurship. The entrepreneur is the individual (or team) that identifies the opportunity, gathers the necessary resources, creates and is ultimately responsible for the consequences of the organisation. Therefore, entrepreneurship is the means by which new organisations are formed and therefore the means with which



wealth and job creation mechanisms are initiated (Carton, Hofer and Meeks, 1998: 35).

The word “**enterprise**” is used in variety of contexts and with a wide range of meanings. The narrower meanings are closely linked to entrepreneurship and small business activity. Indeed, the words enterprise, entrepreneurship, and small business often appear to be used interchangeably but it is also argued that there are many small businesses that do not demonstrate enterprises (Bridge at al., 1998). In almost all the studies carried out by scholars, if the word enterprise used alone, it usually refers to small and medium firms or enterprise, although there is no clear explanation that they exclude large firms. If the large firms or enterprises are intended to be referred then generally words “large enterprises”, “large firms”, “large scale enterprises” are used.

By the middle of the nineteenth century the word “entrepreneur” was being used to indicate the owner of an industrial enterprise. By the start of the twentieth century, neo-classical school, in particular Leon Walras and Alfred Marshall, changed the theory of capitalist economy. In their theory where key component is market equilibrium, there is no place for the entrepreneurs as initiators of economic activity. Suppliers respond to market pressures, if prices rise they supply more and if prices fall, they supply less. According to neo-classical school, supplier should not interrupt this equilibrium by introducing innovative products or services. However, classical economists objected to the absence of entrepreneurs. Along these line, Schumpeter had the greatest impact on the contemporary entrepreneurship literature (Bridge at al., 1998: 23).

Schumpeter considers that innovation is the key force in creating new demand and economic growth. According to him, entrepreneurs are the owners or managers who started new business to exploit invention. If they

are successful then they create wealth for themselves and employment for others from their ability and ambition, rather than only from ownership of land or capital. So he distinguishes between two persons: the person who is an entrepreneur and introduces innovation in product or process and the person who is a manager and establishes or runs a business in traditional ways. He argues that innovations create new demand and entrepreneurs bring the innovations to the market, this destroys the existing markets and creates new ones, which are in turn destroyed by even new products or services. Schumpeter calls this process as “*creative destruction*” (Clemence, 1991: 21)

Since, in Schumpeter’s definition entrepreneurship involves innovative activity, the term “entrepreneur” is not a permanent one and the initiator of an enterprise is an entrepreneur only if he pursues innovative activity. Entrepreneurship is a process and not a static phenomenon. In other words entrepreneurship is a type of behaviour.

The importance of entrepreneurs and the relevance of Schumpeter’s theory are accepted by mainstream economists. However, this does not imply that there is a single accepted definition of entrepreneur. Taking into account Schumpeter’s approach, contribution of entrepreneurship to economic development is one of the meanings assigned to “enterprise”. In this context the words enterprise and entrepreneurship can be synonymous. The word enterprise is also used to refer to all stages of a unit of business, including the process of a business start-up. These are the “narrow” meanings of enterprise. In other words, it refers to small businesses and the act of starting them which contribute directly to economic development and job creation.

Gibb (1987) describes enterprise in terms of set of attributes and resources. The starting point for identifying these attributes is entrepreneurs. Initiative, strong persuasive powers, moderate rather than high risk taking,

flexibility, creativity, independence, problem solving ability, imagination, leadership and hard work are the main attributes of entrepreneurship. He describes enterprise as the exercise of this set of attributes and entrepreneur as someone who demonstrates use of these attributes in a particular task or context, usually in business or commerce (Gibb, 1987:6).

However, there is no clear agreement on precisely what these attributes, skills or attitudes are. Furthermore, the possession of such attributes, skills and attitudes is not necessarily sufficient for a person to act in an enterprising manner and to take the initiative in business formation and development. What is also needed is the resource to start with (Bridge at al., 1998:27).

## **2.2 An Integrated Approach to the Policies for Promoting Entrepreneurship**

Before distinguishing entrepreneurship policies from SME policies, giving certain definitions of SMEs and analysing specific features of SMEs are considered to be useful.

### **2.2.1 Main Characteristics of SMEs**

The specific aspect of SMEs that distinguishes them from other businesses is obviously their size. Therefore they have some features in common; however they are by no means identical. There are many varieties of SMEs which differ for instance in their stage of development, in their line of activities or in their type of ownership.

The definition of SMEs, where size of the business is used as the distinguishing feature, varies considerably across countries. In some of the most developed countries such as the United States and Canada, enterprises

with fewer than 500 employees are called SMEs, in the European Union, enterprises with fewer than 250 employees are called SMEs and in many developing countries, 50 employees is the limit for SMEs.

Although most of the time quantitative measures are used for defining SMEs, they also have qualitative common characteristics. They are not simply smaller version of big businesses and have some distinctive features. SMEs are independent businesses, not a part of or owned by larger companies. Usually the managers are also the owners of the firm. Capital and ownership are provided by one person or by a small group of people and their owners manage them. They generally serve only local customers and have only a small share of the available market. In other words, relative size of an SME within its industry is small when compared with the biggest firms in its field. This measure can be in terms of sales volume, number of employees or other significant comparisons. Moreover, owners or managers of SMEs acquire most of their business knowledge on the job and money invested in the business is often personal money (Bridge et al., 1998:137).

As Gibb points out “the business is the ego” for an owner of SME, therefore even objective criticism of the business is taken personally. Perceived social status or acceptability is linked to business success. Indications of business problems are hidden (Gibb, 1988:14).

Furthermore, the values embodied in the business are the values of owner or founder. These values are revealed in the products or services supplied, in growth orientation, in quality standards and in employee relations. Owners or managers of SMEs have lack of confidence to discuss problems with outsiders and they are closed to the advices coming from outside. For these reasons, an owner’s network is likely to be based on personal friends and contacts, rather than formal support network (Bridge et al., 1998:137).

### **2.2.2 SME Policy versus Entrepreneurship Policy**

All of the governments in the world are aware of the importance of SMEs and their contribution to economic growth, social cohesion, employment and local and regional development. In all modern economies a high percentage of all firms fall within the definition used for SMEs. SMEs constitute more than 95 percent of the enterprises and 60-70 percent of the employment in the OECD economies. In Europe-19<sup>2</sup> more than 99 percent of all enterprises are SMEs and SMEs provide jobs for almost 140 million people or over 2/3 of total private employment. This means there are a very small number of large firms in the EU and OECD countries (European Commission, 2004).

Entrepreneurship policy is a relatively new phenomenon. Most of the governments have developed SME policy for many years. However, recently EU and other developed countries extend their policies towards strengthening the SMEs and include entrepreneurship policy into their public policy. Although SME policy remains at the core of entrepreneurship policy, there are some differences between them.

Since, general goal of SME policy is to strengthen the existing SMEs, it takes the existing stock of firms and then develops instruments to promote their viability. It includes the measures taken after a business starts up. Unlike SME policy entrepreneurship policy includes potential entrepreneurs as well as the existing stock of SMEs. In this respect, entrepreneurship policy includes opportunities offered to the entrepreneurs at the start up stage that is the critical struggling stage for a business to set up and become operational. This suggests that entrepreneurship policy is more focused on

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<sup>2</sup> Although this study analyses SME policy of the EU, as regards to SME statistics, Europe-19 is given. Europe-19 refers to EU-15 plus EFTA countries. EFTA countries participate in almost all the policies of the EU towards SMEs and entrepreneurship.

EU-19 countries: Austria, Belgium, Denmark, Germany, Greece, Spain, France, Finland, Ireland, Italy, Luxembourg, Netherlands, Portugal, Sweden, UK, Iceland, Liechtenstein, Norway, Switzerland.

the process of change, regardless of the organizational unit. It also has a greater sensitivity to framework or environmental conditions that shape the decision making process of the entrepreneurs. Whereas, SME policy focuses on enterprise (Audretsch, 2002: 47).

Entrepreneurship policy is broader in context; it includes measures to stimulate an entrepreneurial culture, to create widespread promotion of entrepreneurship as an employment opportunity, as well as providing support to emerging and early stage entrepreneurs (Lundstrom and Stevenson, 2001a: 19).

Another distinguishing feature of entrepreneurship policy from traditional SME policy is that every country has a ministry or governmental agency charged with promoting the viability of the SME sector. However no such ministry or agency exists to promote entrepreneurship.

Lundstrom and Steveson (2002) argue that, traditional SME policy lacks a theoretical base. Arguments of neo-classical economics have been used to justify different measures. Most of the SME policy measures such as reducing imperfections or external effects in the market are taken from the neo-classical point of view. Measures or actions, taken under the SME policy in the EU and OECD, are improving access to finance, information and markets, developing skilled labor force, encouraging R&D and technological development and reducing the obstacles of regulatory, legislative and administrative burdens. However, Lundstrom and Steveson consider that this weak theoretical point of view gives little guidance on how to create effective measures for SMEs.

SME policy has also been criticized that, it is a long-term tradition and it has lack of focus and limited evaluation. In the study<sup>3</sup> carried out by Lundstrom and Steveson, between the years 2000-2001, for six member states of EU and four members of the Asia Pacific Economic Cooperation, it is concluded that although these countries has carried out SME policy for at least between 25- 30 years and measures have been taken in a number of areas, such as access to financing, reduction of administrative burdens and improving information and training services, effects and impacts of these types of measures on SMEs have not been evaluated properly. Most of the time policies have been carried out by trial and error. This is seen as one of the weaknesses of the traditional SME policies in most of the countries (Lundstrom and Steveson, 2002:5).

In order to develop a formal entrepreneurship policy in a government policy, it is accepted that existing SME policies should be considered in a broader perspective. With such an approach, incentive policies of a government focus not only on existing firms but also on emerging entrepreneurs and this new policy helps to develop necessary social-cultural, economic and legal environment to make entrepreneur more innovative and competitive. In turn these SMEs contribute more to economic growth and create jobs.

Developing an integrated policy is necessary which means developing a more systematic and broader SME policy by including measures to create entrepreneurship culture. This integrated approach provides all the policies towards SMEs to be implemented within coordination and effectively serves creating entrepreneurship culture, reducing the burdens and loosening the restrictions for start up and close, providing entrepreneurship education,

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<sup>3</sup> During the April 2000 and June 2001, Lundstrom and Steveson undertook a study of the states and nature of entrepreneurship oriented policies. Six members of the European Union (Finland, Ireland, the Netherlands, Spain, Sweden and United Kingdom) and four members of the Asia Pacific Economic Cooperation (Australia, Canada, Taiwan and the United States) were analysed in terms of SME and entrepreneurship policies implemented by these countries. Results of the study are presented in their book called *On The Road To Entrepreneurship Policy*.

supporting for venture capital, promoting access to finance, developing incentives according to needs of target groups, increasing the entrepreneurship activities in the country.

The first countries developing entrepreneurship policies are Canada, the Netherlands and the UK. The Canadian government was the first to adopt a National Policy on Entrepreneurship. The most advanced in entrepreneurship policy at present are the Netherlands, Finland and the UK (Lundstrom and Steveson, 2001b:34).

One of the results from the study carried out by Lundstrom and Steveson, for six member states of EU and four members of the Asia Pacific Economic Cooperation, the policy mix governments have at their disposal to develop the SME consists of: 1) ensuring an efficient functioning of markets and institutions through the adjustments of legislation and regulations, 2) the provision of information and advice, 3) the provision of debt and equity financing and 4) the provision of tax incentives. As a government moves towards entrepreneurship policy, the mix broadens to encompass: 5) the elimination of barriers to entry, 6) promotion of entrepreneurship, 7) entrepreneurship education and 8) the creation of new structures, products and services to meet the needs of new starters (Lundstrom and Steveson, 2001b:34).

In some countries, entrepreneurship or enterprise was specifically mentioned as an industrial policy priority as in the case of Finland, the Netherlands, Sweden and the UK. In some cases entrepreneurship was referenced either as part of SME policy or separate entrepreneurship policy statements. It is noted that it is often difficult to gather the scattered pieces of government's entrepreneurship policy instruments. Often the distinction between SME policy and entrepreneurship policy is blurred and formal



entrepreneurship policies are somewhat rare (Lundstrom and Steveson, 2001b: 36).

Although, Industrial and SME Policies have been developed as independent policies in the EU, these two policies have been merged and renamed as “Enterprise and Industrial Policy” at the beginning of 2000. Moreover, SMEs which is the title of the 15<sup>th</sup> chapter of the accession negotiations of previous enlargements including the 2004 enlargement has been changed as “Enterprise and Industrial Policy” in forthcoming enlargements.

Currently, policies concerning the SMEs and entrepreneurship are evaluated under the Enterprise Policy of the EU due to the complementary character of the two policies. SME policies in the EU focus on predominantly already existing SMEs, while entrepreneurship policy focuses more on entrepreneurs who may be at early stages of the process of developing a new business. For instance, unlike enterprise policy, creating an entrepreneurial society is not an objective of the EU SME policy. Thus entrepreneurship policy is broader in context, it includes measures to stimulate an entrepreneurial culture, to create widespread promotion of entrepreneurship as an employment choice, as well as providing support to emerging and early stage entrepreneurs. In this context, European Commission recommends member states to follow a more comprehensive policy and develop an enterprise policy in line with the European Union policies. Although enterprise policy does not exclude large enterprises, since more than 99 percent of all enterprises are SMEs in the European Union, a debate about enterprise policy is mainly a debate on SMEs, therefore SME policy still remains at the core of Enterprise Policy in the EU and in all member states.

## **2.3 Contribution of Entrepreneurship and SMEs to Economic Growth**

There is a wide range of theoretical formulations and empirical analyses that try to link entrepreneurship to economic growth.

### **2.3.1 Theoretical Framework**

According to Schumpeter, finding new combinations of factors of production is a process of entrepreneurial discovery that will become the engine that drives economic development. These new combinations provide better ways to meet existing demand or create new products, often making current technologies and products obsolete in a process of “*creative destruction*”. The firm of the innovative entrepreneur will consequently grow through the dual process of taking market share from existing suppliers and increasing overall demand for the products offered in the market. Thus the process of creative destruction is built on dynamic, deliberate entrepreneurial efforts to change market structures and can be an incentive for additional innovations and profit opportunities (Dejardin, 2000:2; Thurik and Wennnekers, 2001:2; Audretsch 2002:10).

Based on the concept of creative destruction, Schumpeter formulated his “*theory of long waves of business cycles*” and economic growth. In this theory, business cycles are seen as the result of innovation. The innovation he mentioned consists of the formulation of a new idea and its implementation in a new product, process or service. Finally this process leads to creation of pure profit for the innovative enterprise, the dynamic growth of the national economy and expansion of employment (Dejardin, 2000;7; Thurik and Wennnekers, 2004:145; Audretsch and Thurik 2004:150).

Audretsch argues that,

..While traditional theories suggest that entrepreneurship will retard economic growth, these new theories suggest exactly the opposite-that entrepreneurship will stimulate and generate growth. The reason for these theoretical discrepancies lies in the context of the underlying theory. In traditional theory, new knowledge plays no role, by contrast the new theories are dynamic in nature and emphasize the role that knowledge plays..... Entrepreneurship is the vehicle by which ideas are sometimes implemented... (Audretsch 2002: 10).

R&D is an important source for both innovation mentioned by Schumpeter and knowledge mentioned by Audretsch. Then most of the studies in this area try to find out an answer to the question that where innovative firms with little or no R&D get the knowledge inputs. Audretsch claims that knowledge inputs come from third-party firms or research institutions, such as universities (Audretsch, 1995). He explains that knowledge spills over from other firms conducting the R&D or from university research laboratories. In the spillover mechanism, which is put forward by Audretsch and used by various author, there are still some debating issues.

Audretsch and Thurik (2004) distinguish three ways in which entrepreneurial capital affects growth. The first way is by creating knowledge spillovers. Knowledge spillover is an important mechanism driving growth. Entrepreneurship serves as mechanism by which knowledge spills over to a new firm in which it is commercialized. However, the literature identifying the creation of knowledge spillover is underdeveloped. The second way in which entrepreneurship capital generates economic growth is through augmenting the number of enterprises and increasing competition. Not only does an increase in the number of firms enhance the competition for new ideas but greater competition across firms also facilitates the entry of new firms specializing in a particular new product. A third way in which entrepreneurship capital generates economic output is by providing diversity

among firms. Not only does entrepreneurship capital generate a greater number of enterprises, it also increases the variety of enterprises in a certain location. There has been a series of theoretical arguments suggesting that degree of diversity as opposed to homogeneity will influence the growth potential.

Schmitz presents another model in which entrepreneurial activity is a key determinant of productivity growth. In his model Schmitz focuses in particular on the role of imitative activities of entrepreneurs in economic growth. Imitating entrepreneurs are entrepreneurs which imitate existing activities and put them into practice, thereby often creating knowledge through a process that Schmitz characterizes as learning by implementing (Schmitz, 1997: 725).

### **2.3.2. Empirical Studies on SMEs and Entrepreneurship**

There are various approaches in the empirical literature on entrepreneurship and economic growth using different measures of entrepreneurial activity. For instance, while some of empirical studies measures entrepreneurship in terms of the relative share of economic activity accounted for by small firms, other studies use data on self-employment, the number of market participants or firm start-ups as an indicator of entrepreneurial activities (UNCTAD, 2004:5).

Recently, the analyses of the Global Entrepreneurship Monitor (GEM)<sup>4</sup> represent the most important sources for statistical analysis of the links between entrepreneurial activity and economic growth. GEM analyses

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<sup>4</sup> GEM was established in 1997 as a joint research initiative by Babson College and London Business School and strongly supported by Kauffman Center for Entrepreneurial Leadership at the Ewing Marion Kauffman Foundation. The central aim is to bring together the world's best scholars in entrepreneurship to study the complex relationship between entrepreneurship and economic growth. Although GEM started its studies with 10 countries in 1999, 37 countries were participated in the study of GEM in 2001. Currently it provides annual assessments of the national level of entrepreneurship. GEM annual reports are available at: [http://www.entreworld.org/Bookstore/Product.cfm?DID=6&Product\\_ID=64&CATID=22](http://www.entreworld.org/Bookstore/Product.cfm?DID=6&Product_ID=64&CATID=22) (12.08.2005)

are based on a harmonised assessment of the level of national entrepreneurial activity for all participating countries and represent one of the rare sources of data on entrepreneurship conducive to cross-country comparison.

In its 2002 report, the GEM shows that national level of entrepreneurial activity has statistically significant relationship with subsequent levels of economic growth. GEM data also suggest that there are no countries with high levels of entrepreneurship and low levels of economic growth (Reynolds at al, 2002:21).

This finding is supported by a variety of other empirical studies using different indicators of entrepreneurial activity. Nickell (Nickell, 1996 and Nickell at all., 1997) examine the relationship between the effect of market competition, measured as an increase in the number of competitors and development of companies productivity performance. Using data from around 600 UK manufacturing firms for the periods 1972-1986 and 1982-1994, the authors find evidence that competition, or increase in the number of competitors, have a positive impact on total factor productivity growth.

In his long term study of U.S. job generation, Birch found that large firms are no longer the major providers of new jobs for Americans. Instead, he discovered that most new jobs emanated from small firms (Birch, 1981:8).

More recently Konings links gross job flows in the UK to enterprise size. He finds that the gross job creation rate is the highest in small establishments and the lowest in large establishments. By contrast, the gross job destruction rate is the lowest in small establishments and the highest in large establishments (Konings, 1995: 15-24).

There is also debate concerning the contribution of SMEs to innovation, which is an important indicator for economic growth. Although SMEs have a very small percentage in the R&D expenditures of total business in the OECD, a large amount of evidence shows that SMEs contribute greatly to the innovation system by introducing new products and adapting existing products to the needs of customers (Acs and Audretsch, 1990 :17). A number of studies since 1980s have tried to measure innovative output of SMEs. Audretsch (1995) identifies SMEs as contributing 2,38 times more to innovations per employee than do large firms in US. He also mentions that studies on countries other than US which use different types of output measures have generally confirmed these findings for US.

On the other hand, innovator SMEs have relative advantages in some sectors compared to large corporations. Audretsch (1995) has demonstrated that SMEs contribute more to innovative activity in electronic computer equipment and process control instruments, while large corporations contribute more in pharmaceuticals and aircrafts. Moreover in many other industries, SMEs in the OECD countries contribute to the innovative process in a very different way. While some SMEs in high technology sectors make intense use of science based knowledge and are active technology developers, most SMEs operate in medium to low technology environments and they are innovative without using R&D inputs.

More systematic approach is developed by European Community Innovation Survey (CIS)<sup>5</sup>. The survey distinguishes between R&D and non-R&D innovations. The CIS has shown that patterns of innovation in SMEs are based mostly on non-R&D investment. Two types of non-R&D inputs are explained by the Survey. The first one is capital equipment or input-embodied innovation and the second one is design innovation. In capital equipment based innovation firms acquire new process technologies or

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<sup>5</sup> CIS: Community Innovation Survey (CIS) was jointly initiated and implemented by Eurostat and DG Enterprise in 1991. First edition was published in 1992 and second was published in 1997 by Eurostat.

intermediate products. In such an innovation SMEs benefit from innovations developed elsewhere. Design innovation which does not necessarily require access to scientific knowledge or advanced engineering technology refers to improvements in the products that do not radically change their function or technological base, but allows firms to meet customer requirements better (OECD:2000).

Then most of the studies in this area try to find out answer to the question of where innovative firms with little or no R&D get the knowledge inputs. Audretsch (Audretsch, 1995) claims that knowledge inputs come from third-party firms or research institutions, such as universities. He explains that knowledge spills over from other firms conducting the R&D or from university research laboratories.

## **CHAPTER 3**

### **ENTREPRENEURSHIP POLICY IN THE EUROPEAN UNION**

This Chapter analyses the development of the SMEs and enterprise policy from the days of European Community to the European Union of today. There are more than 19 million SMEs (for EU-15), providing jobs for almost 78 million people in the EU as of 2001. Since more than 99 percent of all the enterprises in the EU are SMEs, the debate over entrepreneurship policy is largely a debate over SMEs (European Commission, 2003a: 20).

In exploring the development of policies on promoting entrepreneurship in the European Union, this Chapter first describes evolution of the European Community's SME policy and it focuses on the introduction of the Lisbon Strategy. Then legal and institutional frameworks of the SMEs are introduced. In the third part of the Chapter, contribution of SMEs to the European economy is emphasized. This contribution is revealed by means of the basic data and statistics on SMEs in the European Union and their impact on the EU's economy. After giving the latest definition of the SMEs in the EU, fourth part of this Chapter analyses currently active strategies and programmes for SMEs adopted by EU after the Lisbon Strategy. This Chapter concludes with a short exploration of the main sources of funds available to European SMEs.

#### **3.1 Evolution of SME Policy in the EU (1957-2000)**

There are no provisions in the Treaty of Rome of 1957 about small and medium sized industry or entrepreneurship, but perhaps these were not the



hot topics either in the EC or anywhere else. However, the role of SMEs became increasingly apparent in the decades that followed the creation of the European Economic Community, largely as a result of changes in industrial structure as well as in economic theory and by the increasing consciousness, on the part of members of the EU, of the important role that the SMEs had played in economic development in the competitors states of Japan and the United States of America. By the early 1980s, importance of SMEs had become more obvious not only to the European Commission but also to different European member states.

1983 was declared as the European Year of SMEs and Craft Industries. This was followed in May 1984 by a Commission communication, which set out number of steps to improve the administrative, legal and economic climate for SMEs. The Commission set up a working party that submitted its conclusions to the Commission in November 1985. In line with the recommendations of this working party, an independent “SME Task Force”<sup>6</sup> was set up in 1986 in order to coordinate all relevant activities within the Commission. This Task Force was meant to promote the harmonization of national and Community policies and to help with setting up of an infrastructure, at the European level for solving SMEs practical problems and in particular developing a communication and training strategy for SMEs.

In 1986, the Commission also launched an “Action Programme for SMEs”<sup>7</sup> that laid out a coherent framework for a Community business support first time. The Action Programme was based on identified needs of SMEs. The Programme was an important step in the development of an enterprise policy and defined for the first time a coherent framework in which Community policies in relation to enterprises could be evaluated. The first part of the programme dealt with the means by which to provide a

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<sup>6</sup> Commission of the European Communities, Commission Staff Working Paper, SEC(85)1592, 04.11.1985.

<sup>7</sup> Council Resolution of 3.11.1986 Concerning the Action Programme for Small and Medium Sized Enterprises, Official Journal of the European Communities, C 287, 14.11.1986.

favourable environment for SMEs which included, promoting spirit of enterprise, improving administrative environment, adopting company law and improving the tax environment. The second part was designed to respond directly to the specific needs of SMEs such as training to support SMEs, establishing Euro Info Centers (EIC)<sup>8</sup>, creation of Business Cooperation Network (BC-NET)<sup>9</sup>.

Finally, EC, for the first time, established the concept of SMEs in the Treaty on European Union (Maastricht Treaty). The Maastricht Treaty, which created the European Union, states the industrial competitiveness as one of the main objectives of the EU:

The Community and the Member States shall ensure that the conditions necessary for the competitiveness of the Community's industry exist. For that purpose, in accordance with a system of open and competitive markets, their action shall be aimed at .....encouraging an environment favourable to initiative and to the development of undertakings throughout the Community, particularly small and medium-sized undertakings<sup>10</sup>.

The Treaty indicates that the Community shall contribute to the achievement of the objectives set out in Article 157. Thus it is possible to decide on specific measures by the Commission and Council in support of action taken in the Member States to achieve the objectives set out in the aforementioned article. After the Maastricht Treaty, various measures and programmes were initiated by the European Commission and the Member States.

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<sup>8</sup> Euro Info Centers represent an interface between European institutions and local actors. They are located throughout Europe and in constant contact with European Commission. Their task is to inform, advise and assist SMEs , about EU activities and initiatives. Currently there are 300 centers across 46 countries in Europe. More information is available at:  
<http://europa.eu.int/comm/enterprise/networks/eic/eic.html>, (10.08.2005).

<sup>9</sup> BC-NET (Business Cooperation Network) has been developed by the European Commission. It is a network, which EU appoints some business consultants and intermediaries to help SMEs to find partners at regional, national, Community and international level. BC-NET consists of 600 consultants, which help companies to expand worldwide. More information is available at:  
<http://europa.eu.int/comm/enterprise/networks/eic/eic.html>, (10.08.2005).

<sup>10</sup> Treaty on European Union (Maastricht Treaty), Official Journal of the European Communities, C191 of 29.07.1992, Article 157.

The Commission prepared an “Integrated Programme for SMEs and the Craft Sector”<sup>11</sup> in 1994. The aim of this programme was to achieve closer coordination between all parties involved in SME development. These parties include national, regional and local authorities, the social partners and Community institutions. The integrated programme also aimed at bringing together Community enterprise policy, those elements of other Community policies such as the structural funds, R&D and training and certain aspects of Member States’ enterprise policy.

In line with the suggestions of the Amsterdam Summit of 16-17 June 1997, the BEST (The Business Environment Simplification Task Force) Work Group was established to prepare a report on the improvement of the business environment for SMEs and the simplification of legislation in the Member States. The goal of BEST’s work is to ensure an exchange of best practices among member states and to create an environment where member states can benefit from each other’s experience. This is an important open method of co-ordination mechanism and Commission provides benchmarking exercises in the areas identified as vital to promoting entrepreneurship.

On the other hand financial framework to promote the SMEs is created by the “Multiannual Programmes”. First Multiannual Programme was adopted by the Council in 1989<sup>12</sup>. The Programme was to be implemented from 1991 to 1993. The initial amount for the First Multiannual Programme was estimated as ECU 110 million. After this initial Programme three more

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<sup>11</sup> Commission of the European Communities, Commission Staff Working Paper: Integrated Programme for SMEs and the Craft Sector COM (1994) 207, 03.06.1994 and revised by COM (1996) 329, 10.07.1996.

<sup>12</sup> Council Decision No. 89/490/EEC of 28.07.1989 on the Improvement of the Business Environment and the Promotion of the Development of Enterprise, and in Particular Small and Medium-Sized Enterprises, in the Community, Official Journal of the European Communities, L 239, 16.08.1989.

followed in 1993<sup>13</sup>, 1997<sup>14</sup> and 2000<sup>15</sup>. Under these programmes, SMEs are financed in the priority areas, which are not covered by other policies of the European Union.

Until the Lisbon European Council (23-24 March 2000), the Commission developed many measures under the programmes and action plans that were developed through a Communication<sup>16</sup> in order to strengthen the SMEs in Europe. After the introduction of the Lisbon Strategy a more co-ordinated approach has been followed and the measures have started to be implemented more effectively.

### **3.2. Institutional and Legal Framework for SMEs in the EU**

In the European Commission, a Directorate General (DG XXIII), which is responsible for Enterprise policy, Distributive Trades, Tourism and Co-operatives, was established in 1989. In 1999 a new Directorate General For Enterprise (DG Enterprise) was created by merging the former DG XXIII, DG Industry (DG III), and the Directorate for Information Society. The new organization started work on 1 January 2000.

The main tasks of the DG Enterprise are to complete and manage the single market for products; increase competitiveness, improve the business environment; prepare innovation and research framework programmes and

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<sup>13</sup> Council Decision No. 93/379/EEC of 14.06.1993 on a Multiannual Programme of Community Measures to Intensify the Priority Areas and to Ensure the Continuity and Consolidation of Policy for Enterprise, in particular Small and Medium-Sized Enterprises, in the Community, Official Journal of the European Communities, L 161, 02.07.1993.

<sup>14</sup> Council Decision No. 97/15/EC of 9.12.1997 on a Third Multiannual Programme for Small and Medium-Sized Enterprises in the EU, Official Journal of the European Communities, L 006, 10.01.1997.

<sup>15</sup> Council Decision No.2000/819/EC of 20.12.2000 on a Multiannual Programme for Enterprise and Entrepreneurship, and in Particular for Small and Medium-Sized Enterprises (2001-2005), Official Journal of the European Communities, L333, 29.12.2000 and amended by Council Decision No 593/2004/EC, Official Journal of the European Communities, L 268, 21.07.2004.

<sup>16</sup> Commission of the European Communities, Commission Communication on Promoting Entrepreneurship and Competitiveness, (1998) 550 final of 30.09.1998.

non-legislative sectoral activity; ensure coherence and co-operation with other policy areas such as industrial policy, tax policy etc.; support direct actions such as Euro Info Centres (EIC), Innovation Relay Centres (IRC)<sup>17</sup>, other key tasks like Interoperable Delivery of Pan-European E-government Services to Public Administrations, Businesses and Citizens (IDABC)<sup>18</sup>.

The list of the *acquis communautaire* given in Appendix A of this thesis sets out the references of existing community legislation and other measures, which are under the management of DG Enterprise. It includes both “hard *acquis*” creating legal obligations; and “soft *acquis*” measures, which do not create legal obligations themselves, but have a bearing on the application of hard *acquis*.

The legislation concerning the SMEs is divided into two groups; binding measures and recommendations. There is a limited number of legally binding measures in the area of SME policy. The majority of the *acquis* consists of a list of other measures that have a bearing on SME policy in broad terms<sup>19</sup>.

Concerning the SMEs, there are many institutions and organisations which support the various activities and programmes of the European Commission and provide different kinds of data. “*The European Observatory for SMEs*” which was established by the Commission in 1992 in

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<sup>17</sup> Innovation Relay Centers (IRCs) are the network of 52 advise organizations specifically to SMEs on technology and innovation. It also helps them to identify technology needs, recommends identifiable suitable technologies to match these needs, give assistance on exploitation and advice on the EU research and technology programmes. More information is available at: <http://europa.eu.int/comm/enterprise/networks/eic/eic.html> (10.07.2005)

<sup>18</sup> IDABC (Interoperable Delivery of Pan-European E-government Services to Public Administrations, Businesses and Citizens) is the follow-up to previous IDA (Electronic Interchange of Data Between Administrations). It uses the opportunities offered by information and communication technologies to encourage and support the delivery of cross-border public sector services to citizens and enterprises in Europe, to improve efficiency and collaboration between European public administrations. It also provides financing to projects that address European policy requirements and improve cooperation between administrations across Europe. More information is available at: <http://europa.eu.int/idabc/> (10.07.2005)

<sup>19</sup> The DG Enterprise prepares “Pink Book” which is a structured list of the legislation for which DG Enterprise is responsible. Most recent edition covers the period up to 30 June 2004.

order to improve the monitoring of the economic performance of SMEs in Europe, provides various reports based on SME statistics using Eurostat's SME database and European Network for SME Research (ENSR) surveys. Since 1992, the European Observatory for SMEs prepared reports on various topics such as business environment, enterprise policies, labour market and employment, education and training, management in SMEs, cooperation between SMEs, administrative burdens, women in SMEs, access to community programmes. These reports are prepared by independent bodies and serve to political decision makers, researchers, economists and SMEs. The observatory monitors 7.600 SMEs in Europe from the EU-15 as well as from Iceland, Liechtenstein, Norway and Switzerland, collectively known as Europe-19.

“SME Envoy” is another system established by the Commission in 2003. SME Envoy System tries to ensure that interest and specific needs of SMEs are taken into account in European Union programmes and policies<sup>20</sup>. The SME Envoy has regular meetings with the non-governmental organizations (NGO)<sup>21</sup>, members of the Economic and Social Committee and members of the European Parliament. This close cooperation provided by SME Envoy ensures that SMEs are better consulted during the preparation of new legislation. The Envoy System also allows the Commission to be better informed about the concerns of SMEs. Furthermore, SME envoy helps to improve the impact analysis system for SMEs.

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<sup>20</sup> Commission of the European Communities, Commission Staff Working Paper, The SME Envoy: An Active Interface Between the Commission and the SME Community, SEC (2003) 60 final, 21.01.2003. More information is available at:[http://europa.eu.int/comm/enterprise/entrepreneurship/sme\\_envoy/](http://europa.eu.int/comm/enterprise/entrepreneurship/sme_envoy/) (14.08.2005).

<sup>21</sup> SME envoy has regular meetings with the European Association of Craft and SMEs (UEAPMA), Union of Industrial and Employers Confederations of Europe (UNICE), Association of European Chambers of Commerce and Industry (Eurochambers), European Small Business Alliance (ESBA), representatives of national organizations.

Besides the Envoy System, European Commission also takes into account Global Entrepreneurship Monitor (GEM)<sup>22</sup> reports when developing SME policies.

One of the important organizations that European Commission has close co-operation is Organisation for Economic Cooperation and Development (OECD). As regards to promoting SMEs, European Commission participates in the studies of OECD and shares its experiences. One of the most important activities of OECD is “Bologna Charter on SME Policies<sup>23</sup>” It is the outcome of the first Conference of Ministers responsible for SMEs and Industry Ministers of OECD countries. In the Bologna Charter, vital contribution of innovation to SME competitiveness, importance of clusters to stimulate innovative and competitive SMEs, opportunities created by electronic commerce are recognised and some recommendations are defined in these areas. Moreover, with regard to enhancing the competitiveness of SMEs in transition economies and for their partnership with SMEs of OECD countries, some policy recommendations are determined in the Bologna Charter. At the end of the Conference it is envisaged that Bologna Conference is the start of a policy dialogue among OECD countries that would be followed up by continuous monitoring of the progress made with regard to the implementation of the Bologna Charter, which is called as Bologna Process<sup>24</sup>. The European Commission takes into account this Bologna Charter and Process when implementing its EU wide SME policy.

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<sup>22</sup> See section 2.2.2 of this thesis.

<sup>23</sup> OECD organized international ministerial conference on SMEs in Bologna, Italy, on 15 June 2000. Key outcome of the conference was the adoption of the Bologna Charter on SME policies by the governments of almost 50 countries, including all the OECD countries, plus several large developing countries like Brazil, China, South Africa. More information is available at: [http://www.oecd.org/document/17/0,2340,en\\_2649\\_34197\\_1809105\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/17/0,2340,en_2649_34197_1809105_1_1_1_1,00.html), (04.08.2005).

<sup>24</sup> Under the framework of the Bologna Process, The Second OECD Ministerial Conference was held in Turkey on 3-5 June 2004. “Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs” was adopted at the end of the Conference. In the declaration, the need to support the development of the best set of public policies that is considered to foster the creation and rapid growth of innovative SMEs is reaffirmed and a set of required actions in the areas such as institutional framework, SME assistance development programmes and human resources mobilization is recommended.

### 3.3 Contribution of SMEs to the European Economy

There are 19.3 million enterprises in the European Economic Area (EEA) and Switzerland which provide employment for 140 million people. 92 percent of these enterprises are micro (0-9 employees), 7 percent are small (10-49 employees), less than one percent are medium sized (50-249 employees). Only 0.2 percent of all enterprises in Europe are large size with more than 250 employees. Just over two-thirds of all jobs are concentrated in SMEs. Only one-third of all jobs are provided by large enterprises. Within SMEs, the major share of jobs (56 %) are situated in micro enterprises which employ less than 10 employees (European Commission, 2004).

It can be followed from Table 3.1 that, on the average, an enterprise in the Europe-19, including all large enterprises, provides employment for 7 people. In SMEs the average is 5. In the Europe-19, approximately 20 million SMEs provide jobs for close to 98 million people and 40 thousand large-scale enterprises employ about 42 million people. Table 3.1 shows that turnover per enterprise, value added per worker, share of exports in turnover are all lower in SMEs when compared with LSEs, but the share of labour costs in value added is higher.

Table 3.1 - Basic Data About SMEs and Large Scale Enterprises (LSE) in Europe-19<sup>(1)</sup>, (2003)

	SME	LSE	Total
Number of Enterprises (1.000)	19.270	40	19.310
Employment (1.000)	97.420	42.300	139.710
Average Number of Workers/Enterprise	5	1.052	7
Turnover Per Enterprise (1.000 EUR)	890	319.020	1.550
Value Added Per Worker (1.000 EUR)	55	120	75
Share of Exports in Turnover (%)	12	23	17
Share of Labour Costs in Value Added (%)	56	47	52
(1): Europe 19: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK, Iceland, Norway, Switzerland, Liechtenstein			

Source: European Commission, 2004: 26.



Table 3.2 indicates that EU-15 is dominated by micro enterprises which have 3 workers per enterprise on average. Countries differ significantly with respect to the scale of their enterprises. For example, the average number of workers per enterprise varies between 2 in Greece, and 12 in the Netherlands.

Table 3.2 - Average Number of Workers Per Enterprise in Europe-19 Countries, (2003)

	Micro	Small	Medium	SME	Large	Total	Size-Class Dominance <sup>(2)</sup>
Austria	5	19	101	8	871	11	Micro
Belgium	3	21	104	5	115	7	Micro
Denmark	4	20	97	7	814	10	SME
Finland	3	20	102	4	932	7	LSE
France	3	21	102	5	1123	8	Micro
Germany	4	18	90	7	1001	10	LSE
Greece	1	19	99	2	646	2	Micro
Ireland	3	19	94	7	691	10	SME
Italy	2	18	97	4	1013	4	Micro
Luxembourg	3	21	103	7	710	9	SME
Netherlands	4	29	118	8	955	12	LSE
Portugal	2	19	96	4	760	5	SME
Spain	3	20	97	5	931	6	Micro
Sweden	3	19	100	5	1062	7	Micro
UK	4	18	99	7	1328	11	LSE
EU-15	3	19	98	5	1059	7	Micro
Iceland	1	21	78	2	624	4	LSE
Norway	3	19	99	5	885	7	Micro
Switzerland <sup>(1)</sup>	2	19	101	5	890	8	SME
Europe-19	3	19	98	5	1052	7	Micro

(1): includes Liechtenstein (2): largest share in total employment is taken into account.

Source: European Commission, 2004: 27.

From Table 3.3 which includes data according to SME size, a strong correlation between enterprise size and labour productivity measured as value added per workers is seen. A worker in micro enterprise creates an average of 40 thousand Euros of value added, while in medium scale enterprises, this amount stands at 60 thousand Euros. In the large-scale enterprises, average value added per worker is 120 thousand Euros as can be

followed from Table 3.1. This number is 3 times higher than micro enterprises. This suggests that labour productivity increases along with enterprise size. Relatively low labour productivity in small enterprises has also been noted in the literature (Audretsch et al., 1999; Acs and Audretsch, 1990).

Table 3.3 - Basic Data According to SME-Size in Europe-19, (2003)

	Micro	Small	Medium	Total
Number of Enterprises (1.000)	17.820	1.260	180	19.270
Employment (1.000)	55.040	24.280	18.100	97.420
Average Number of Workers/Enterprise	3	19	98	5
Turnover per Enterprise (EUR 1.000)	440	3.610	25.680	890
Value Added per Enterprise (EUR 1.000 )	120	1.180	8.860	280
Share of Exports in Turnover (%)	9	13	17	12
Value Added per Worker (EUR 1.000)	40	60	90	55
Share of Labour Costs in Value Added (%)	57	57	55	56

Source: European Commission, 2004: 30.

Table 3.4 shows SMEs share across industrial sectors. As Table 3.4 indicates, with regard to enterprise size, transport and communication, and energy sectors are large-scale industries, and thus are characterized by a greater role for large enterprises. In the manufacturing sector SMEs are dominant on the basis of largest share in total employment in the sector. Producer services are on average a large-scale activity, but this is comprised of both large scale activities like banking and micro dominant industries such as real estate. The other industrial groups (construction, trade, hotels, and restaurants and personnel services) tend to be small-scale activities. The small-scale activities involved in these services are reflected by relatively low number of workers per enterprise.

In the analyses at the European level, SMEs have been characterized as having lower profitability and export level compared to large-scale enterprises. This is reflected in the data by the industries in Table 3.4. Only in

wholesale industry, is the share of exports in turnover significantly larger in SMEs than in large enterprises.

Table 3.4 - SMEs by Sector of Industry, Europe-19, (2003)

	Number of Enterprise (1.000)	Worker/Per Enterprise	Size-class Dominance <sup>(4)</sup>	Value Added Per Worker <sup>(5)</sup>	(%) Profitability SMEs – Total Industry <sup>(6)</sup>	(%) Propensity to Export SMEs – Total Industry <sup>(7)</sup>
Extraction <sup>(1)</sup>	50	38	LSE	112	-1	-2
Manufacturing	2.250	16	SME	81	-3	-12
Construction	2.280	6	Micro	96	0	-1
Wholesale Trade	1.510	6	Micro	96	-1	1
Retail Distribution <sup>(2)</sup>	3.740	5	Micro	96	-2	0
Transport, Communication	1.040	10	LSE	78	-10	-1
Producer Services	4.310	6	LSE	69	-10	-2
Personal Services	4.140	5	Micro	83	0	-1
Non - primary private enterprise (total) <sup>(3)</sup>	19.310	7	Micro	74	-9	-4

(1) : includes energy ,  
(2):includes car and repair,  
(3): The sector that provides products of nature like food, raw materials, fuels, minerals directly from natural resources is called primary sector  
(4): on the basis of largest share in total employment  
(5)Industry total=100  
(6) Gross operating surplus adjusted for imputed wage of self employed, as percentage of value added; SME minus industry total  
(7) : Share of export in turnover (%); SMEs minus industry total

Source: European Commission, 2004: 30.

Developments in the new member states, acceding and candidate countries have been identified as a priority concern for the EU. This has been the case for the last decade and it is now more important because of the new accessions. The new member states and Candidate countries are comprised of two groups of countries, ten Central and Eastern European Countries (CEECs)<sup>25</sup> and three Mediterranean countries (Cyprus, Malta, Turkey), which have a very different historical background.

<sup>25</sup> CEECs; Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.

The CEECs are in a process of profound structural change after the decisive break with communism that was made in the early 1990s. SME development became important for economic reform policies carried out by all governments in the region. Many new SMEs have been created from the break up of larger inefficient state enterprises, and from the mass privatization of smaller units such as retail outlets. However, these countries still need to adapt towards the structure of the EU economies.

The European Union welcomed to ten new member states on 1 May 2004<sup>26</sup>. Table 3.5 presents some structural information with respect to the SMEs in the new member states and candidate countries compared to Europe-19. In terms of number of workers, Europe-19 is almost five times as large as new member states and candidate countries put together.

However, the associated number of enterprises is three times larger in Europe-19. With regards to the average number of workers per enterprise, new member states and candidate countries and Europe-19 are quite similar.

Differences among member states exist with respect to average enterprise size. As was clearly shown in Table 3.2, in the Mediterranean countries the average firm size is relatively low. This suggests that the structure of the SMEs in new member states and candidate countries may be similar to those played in Mediterranean EU countries such as Greece and Italy (Reynolds at all, 2002:31). Average number of workers per enterprise is 4 in Italy, 2 in Greece as previously indicated in Table 3.2 and 3 in new member states and candidate countries as given in Table 3.5.

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<sup>26</sup> As of 1 May 2004 new member states are Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Malta, Slovak Republic, Slovenia and candidate countries are Romania, Bulgaria, Turkey.

Table 3.5 also compares the basic SME data in Europe-19 with two other major economies, the United States and Japan. In terms of number of enterprises, they are very similar. The number of enterprises making up each size class are close to each other between the US and Europe. However, data taken from United States reveals a lower share of employment in SMEs and higher share of employment in large enterprises than in Europe. Japan has fewer SMEs and LSEs than Europe 19, but enterprise size with respect to the number of workers per enterprise is quite similar.

Table 3.5 - SMEs Data in the Europe 19, New Member States and Candidate Countries, USA and Japan

	Micro	Small	Medium	Total	LSE	Total
Europe 19, 2003						
Enterprises (1.000)	17.820	1.260	180	19.270	40	19.310
Number of Workers (1.000)	55.040	24.280	18.100	97.420	42.300	139.710
Average Number of Workers per Enterprise	3	19	98	5	1052	7
New MS+CC , 2000						
Enterprises (1.000)	5.670	230	50	5.950	10	5.970
Number of Workers (1.000)	10.210	4.970	5.350	20.530	10.150	30.670
Average Number of Workers per Enterprise	2	22	107	3	919	5
USA, 2000						
Number of Enterprises (1.000)	19.88	1.009	167	21.164	59	21.223
Number of Workers (1.000)	27.872	20.061	15.560	63.593	66.042	129.635
Number of Workers per Enterprise	1	20	94	3	1.119	6
Enterprise Japan, 2001						
Number of Enterprises (1.000)	n/a	n/a	n/a	4.690	13	4.703
Number of Workers (1.000)	n/a	n/a	n/a	25.601	12.676	38.277
Number of Workers per Enterprise	n/a	n/a	n/a	5	975	8

Source: European Commission, 2004: 14, 33.

### 3.4 Current Entrepreneurship and SME Policy in the EU

Before explaining the policies towards SMEs in the EU, it is necessary to give a legal definition of SMEs as they exist in the EU. Next section focuses

on the efforts of the European Commission to develop a common SME definition and the criteria used in that definition.

### **3.4.1 Definition of SMEs in the EU**

It was very difficult for the European Commission to provide a single definition for SMEs for all its policy areas. In the first Action Programme in 1986<sup>27</sup>, the general definition for SMEs is stated as “any firm with a workforce not exceeding 500, with net fixed assets of less than ECU 75 million and with not more than one third of its capital held by a larger firm”. However, different definitions have been used for different programmes. By 1992 there were at least 10 different SME definitions, which created inconsistencies and also distorted competition between enterprises. In order to reduce this confusion, the Commission tried to find an acceptable definition of SMEs, to which all Member states could agree on. In 1996, European Commission adopted<sup>28</sup> first common SME definition as follows:

SMEs are defined as independent enterprises, which have fewer than 250 employees, and have either, an annual turnover not exceeding ECU 40 million, or an annual balance sheet total not exceeding ECU 27 million. Independent enterprises are those which are not owned as to 25 % or more of the capital or the voting rights by one enterprise, or jointly by several enterprises, falling outside the definition of an SME or a small enterprise, whichever may apply (Commission, 1996:4-9).

Commission, taking into account the economic developments since 1996, adopted a new definition in 2003<sup>29</sup>. This definition entered into force on 1 January 2005 and applies to all the policies, programmes and measures that the Commission operates for SMEs. For Member States, the use of the definition is voluntary, but the Commission is inviting them, together with

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<sup>27</sup> Council Resolution of 03.11.1986 Concerning the Action Programme for SME, Official Journal of the European Communities, C287, 14.11.1986.

<sup>28</sup> Commission of the European Communities, Commission Recommendation 96/280/EC of 03.04.1996 Concerning the Definition of Micro, Small and Medium Sized Enterprises, Official Journal of the European Communities L107, 30.04.1996, p.4-9.

<sup>29</sup> Commission of the European Communities, Commission Recommendation 2003/361/EC of 06.05.2003 Concerning the Definition of Micro, Small and Medium Sized Enterprises, Official Journal of the European Communities, L124, 20.05.2003, p 36-41.

the European Investment Bank (EIB) and the European Investment Fund (EIF) to apply it as widely as possible (Commission, 2003:36-41).

Table 3.6 indicates the new and old thresholds for definition of micro, small and medium sized enterprises. As shown in Table 3.6, medium sized enterprises have less than 250 workers and these enterprises have either less than 50 million Euros annual turnover or less than 43 million Euros annual balance sheet total. Small enterprises are defined as enterprises, which employ less than 50 workers and whose annual turnover or annual balance sheet total does not exceed 10 million Euros. Although thresholds in terms of number of workers employed are same for all enterprise categories with that of previous definition, ceilings of annual turnover and annual balance sheet total are higher in new definition when compared with the ceilings of previous definition. Since number of micro enterprises has increased throughout the EU in the last years, the new definition takes this development into account by setting financial thresholds for them. Micro enterprises are defined as enterprises, which employ less than 10 workers and whose annual turnover or annual balance sheet total does not exceed 2 million Euros. By updating the thresholds and the definition, the European Commission aims to promote micro enterprises and to improve access to capital to promote innovation.

Table 3.6 - Definition of SMEs in the EU – Thresholds as of 2005.

Enterprise Category	Number of Workers Employed	Annual Turnover	And/Or Annual Balance Sheet Total
Medium	<250	≤ € 50 million (in 1996 € 40 million)	≤ € 43 million (in 1996 € 27 million)
Small	<50	≤ € 10 million (in 1996 € 7 million)	≤ € 10 million (in 1996 € 5 million)
Micro	<10	≤ € 2 million (Previously not defined)	≤ € 2 million (Previously not defined)

Source: European Commission, 2005: 8.

The new definition also takes into account different relationships between enterprises<sup>30</sup>. According to the new definition, the first step to qualify as an SME is to be considered as an enterprise. “An enterprise is considered to be any entity engaged in an economic activity, irrespective of its legal form. This includes, in particular, self employed persons and family businesses engaged in craft or other activities, and partnership or associations regularly engaged in an economic activity (Commission, 2003:36-41)<sup>31</sup>.

An enterprise is not an SME under the new definition if 25 percent or more of its capital or voting rights are directly or indirectly controlled, jointly or individually, by one or more public bodies. The reason for this stipulation is that public ownership may give such enterprises certain advantages, notably financial, over others financed by wholly private equity capital. Universities or autonomous local authorities, which have the status of a public body under national law, are not covered by this rule<sup>32</sup>.

Another important issue, which the new definition takes into account, is whether an enterprise is autonomous or not. If an enterprise holds more than 25 percent of the capital or voting rights in another enterprise and/or vice versa, then this enterprise is not autonomous but a partner enterprise. Partner enterprises add a proportion of the other enterprise’s number of workers and financial details to their own data when determining their

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<sup>30</sup> For further information: Commission of the European Communities, “The New SME Definition User Guide and Model Declaration”, Enterprise and Industry Publications, Luxembourg, 2005.

<sup>31</sup> Commission of the European Communities, Commission Recommendation 2003/361/EC Of 06/05/2003 Concerning the Definition of Micro, Small And Medium Sized Enterprises, Official Journal Of The European Communities L124, 20.05.2003, Article 1 provisions.

<sup>32</sup> Commission of the European Communities, “The New SME Definition User Guide and Model Declaration”, Enterprise and Industry Publications, Luxembourg, 2005.



eligibility for SME status<sup>33</sup> on the basis of thresholds, which are previously indicated in Table 3.6.

### **3.4.2 Active Programmes and Actions (2000-2005) Under the Current Entrepreneurship and SME Policies of the EU**

In the presidency conclusions of the Lisbon European Council, the new strategic goal of the European Union by 2010 is declared as follows:

*to become most competitive and dynamic knowledge based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion (European Council, 2000a:paragraph 5).*

For Europe to increase its living standards, it needs to accelerate employment and productivity growth through a wide range of reform policies as well as a wider macroeconomic framework. It is now recognised that there is a need for radical transformation of the economy in order to create some 15 million new jobs by 2010. Single action is considered to be useless to deliver higher growth and jobs. Urgent actions across five policy objectives are seen necessary. In the Strategy which was declared at the end of the Lisbon European Council, main objectives of the EU by 2010 are determined to be: to create a knowledge society; to complete internal market for the free movement of goods, capital and services; to provide environmental sustainability; to build an inclusive labour market for stronger social cohesion and finally to create the right climate for entrepreneurs.

In terms of creating the right climate for entrepreneurs, special attention is given to create a friendly environment for starting up and developing innovative businesses, especially SMEs. The Commission has tried to develop a friendly environment in which enterprise can survive and grow. Moreover, the Commission takes into account the conditions for SMEs in the European economy as a whole and in the Single Market in particular.

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<sup>33</sup> As an illustrative example, if an enterprise have a 30 percent stake in other enterprise, this enterprise add 30 percent of its number of workers employed, turnover and balance sheet to own figures. If there are several partner enterprises, the same type of calculation must be done for each partner enterprise.

Reason or logic behind promoting entrepreneurship particularly the SMEs is to believe in the vital contribution of SMEs to the increased competitiveness, economic growth and employment in the EU.

In the presidency conclusion, it is stated that European institutions, national governments and regional and local authorities must continue to pay particular attention to the impact and compliance costs of proposed regulations. European Council considered that an open method of coordination should be applied in this area and specified for four actions concerning the entrepreneurship policy and in particular for SMEs. It asked:

- the Council and the Commission to launch, by June 2000, a *benchmarking exercise on issues* such as length of time and the costs involved in setting up a company, the amount of risk capital invested, the numbers of business and scientific graduates and training opportunities,

- the Commission to present shortly a communication on an entrepreneurial, innovative and open Europe together with the *Multiannual Programme in Favour of Enterprises and Entrepreneurship* for 2001-2005,

- the Council and the Commission to draw up a *European Charter for Small Companies* to be endorsed in June 2000 which commits Member States to focus in the above mentioned instruments on small companies as the main engines for job creation in Europe, and to respond specifically to their needs,

- the Council and the Commission to report by the end of 2000 on the ongoing review of *European Investment Bank and European Investment Fund financial instruments* in order to redirect funding towards support for business start-ups, high-tech firms and micro enterprises, as well as other risk capital initiatives proposed by the European Investment Bank (Lisbon European Council, 2000a: paragraph 15).

In line with the aforementioned instruments asked by Lisbon European Council, **The European Charter for Small Enterprises**<sup>34</sup> was endorsed at the Feira European Council on 19-20 June 2000<sup>35</sup>. Implementation process for EU-15 was launched in 2000. The acceding (new member states) and candidate countries (Bulgaria, Romania and Turkey) endorsed the Charter in Maribor (Slovenia) in 2002 and have been taking part

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<sup>34</sup> See Appendix C for "European Charter for Small Enterprises" document.

<sup>35</sup> European Council (2000), Santa Maria Da Feira European Council Presidency Conclusions, 19-20 June 2000, Annex III, [http://www.europarl.eu.int/summits/fei1\\_en.htm](http://www.europarl.eu.int/summits/fei1_en.htm), (14.08.2005).

in the implementation process since 2002. In 2003 the countries of the western Balkans endorsed the Charter followed by Moldova in 2004. Currently 35 countries participate in the Charter process.

The Charter for Small Enterprises urges the Member States and the Commission to take action to support and encourage small enterprises in ten key areas.

The first key area is *education and training for entrepreneurship*. In order to give entrepreneurial spirit and new skills to young people from an earlier age, entrepreneurship and business lessons are envisaged in secondary and university levels. In addition, training programmes for small enterprises are seen necessary.

The second key area is *cheaper and faster start-up*. Cost of companies' start-up is targeted to become most competitive in the world. Online registration is strongly encouraged in order to start up faster and refrain from the burdensome procedures during the registration of new companies.

Another key area is *better legislation and regulation*; Member States are urged to assess their bankruptcy laws in the light of good practices. New regulations at national and Community level are recommended to be screened in order to assess their impact on small enterprises and entrepreneurs. Wherever possible, national and EC rules are simplified.

The fourth key area is *availability of skills*. It is stated that member states endeavour to ensure lifetime training to the needs of small businesses. Training institutions and training schemes to deliver an adequate supply of skills are seen necessary.

The fifth one is *improving on line access*. Public authorities are urged to increase their electronic communication with the small business sector. This provides companies to receive advice, to make applications, to file tax returns or to obtain simple information online in a faster and cheaper way.

The sixth key area is *getting more out of the Single Market*. The Member States and European Commission are entitled to complete the single market. So that enterprises can provide maximum benefit from it. At the same time, European and national competition rules are vigorously applied to make sure that small businesses have every chance to enter new markets and compete on fair terms.

The seventh key area is *taxation and financial matters*. Tax systems, which are based on rewarding, encouraging start-ups, favouring small business expansion and job creation, are recommended by using the best practices. In order to improve the access of small enterprises to financial services, implementation of Financial Services Action Plan<sup>36</sup> and Risk Capital Action Plan<sup>37</sup>, improving the relationship between the banking system and small enterprises by creating appropriate access conditions to credit and to venture capital are foreseen. Moreover, European Investment Bank is considered to increase funding available to start-ups and high-technology enterprises, including equity instruments.

The eighth key area is *strengthening the technological capacity of small enterprises*. Technology cooperation and sharing among different company sizes and particularly between European small enterprises are fostered by the Commission. More effective research programmes focusing on the commercial application of knowledge and technology and quality and

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<sup>36</sup> Commission of the European Communities, Commission Communication on Implementing the Framework for Financial Markets: Action Plan, COM(1999)232 Final, 11.05.1999.

<sup>37</sup> European Parliament Resolution on Commission Communication to the Council and the European Parliament on Implementation of the Risk Capital Action Plan (RCAP), P5\_TA (2002)0181, Official Journal of the European Communities, C127 E/665, 29.05.2003.

certification system to small enterprises are aimed to be developed. Special attention is given to application of Community patent to be available and easily accessible to small enterprises. Cooperation between small enterprises and higher education and research institutions is emphasized.

Ninth key area is *making use of successful e-business models and developing top-class small business support*. EU institutions together with the Commission co-ordinate member states and EU activities to create information and business support systems, networks and services which are easy to access and understand and relevant to the needs of business. Commission also encourages enterprises to exploit reports of the European Observatory<sup>38</sup> for SMEs.

Moreover, the European Commission and Member States encourage small enterprises to apply best practices and adopt successful business models. The European Commission with member states' experts works on several best projects in the ten priority areas of the European Charter. Each year best projects of the participating countries to the European Charter are evaluated and new implementations included in these best projects are of importance for European Commission. Therefore, European Commission publishes them and makes recommendations in annual implementation reports of the European Charter. According to the European Commission, such an open method of coordination and taking actions on the basis of these best practices are useful.

The tenth and the final priority area is *developing stronger, more effective representation of small enterprises' interest at Union and national level*. Using effective indicators assessing progress over time and searching

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<sup>38</sup> The European Observatory for SMEs was established by the Commission in 1992 in order to improve the monitoring of the economic performance of SMEs in Europe. For further information see section 3.2 of this thesis.

for better practices in all fields that affect small businesses to continuously improve their performance are seen necessary<sup>39</sup>.

Member states and candidate countries that endorsed the charter prepare annual reports, which contain all details about new practices implemented in the ten areas of the Charter and submit these reports to the Commission<sup>40</sup>. The Commission's "Fifth Report on the Implementation of the European Charter for Small Enterprises" lists progress in the following fields; education for entrepreneurship, better regulation, bankruptcy law and skills shortages, especially measures to overcome the lack of skilled technicians and engineers. <sup>41</sup>

In order to strengthen the SMEs in the priority areas determined by the Charter for Small Enterprises, Member States draw inspiration from measures developed in other countries. Learning from each other's strengths improves the environment for business and helps small enterprises to reach their potential for competitiveness. For example, Luxembourg has taken inspiration from Belgium and the Netherlands in appointing a "Commissioner for administrative simplification" within its Ministry which is in charge of SMEs. Building on the experiences in Ireland and the Netherlands, the Czech Republic is developing a system to "monitor skill gaps" and to anticipate long term demand. Moreover, the joint member state – Commission project on "education for entrepreneurship" has served as an inspiration to Estonia, Lithuania, Sweden and Norway. France the Netherlands, Finland and Norway have established formal links between different sectors of the public administration, with the aim of setting up a

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<sup>39</sup> After the 2003, SME Envoy started to perform this function in the Commission.

<sup>40</sup> Reports are available at:  
[http://europa.eu.int/comm/enterprise/enterprise\\_policy/charter/reports.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/charter/reports.htm) ,(14.08.2005).

<sup>41</sup>Commission of the European Communities, Communication from the Commission to the Council and the European Parliament, Report on the Implementation of the European Charter for Small Enterprises COM (2005)30 Final, 08.02.2005. [http://europa.eu.int/comm/enterprise/enterprise\\_policy/charter/index.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/charter/index.htm) (14.08.2005).

global entrepreneurship education strategy. Yet a coherent framework is still missing in many other countries. With regard to comprehensive education, countries that already include entrepreneurship explicitly in the curriculum (The Czech Republic, Spain, Ireland, Poland, Finland and Norway) are so far in a minority (Commission, 2005a).

The European Charter for Small Enterprises has established a good foundation for enterprise policy on a European level for the 21<sup>st</sup> century. After the fourth **“Multiannual Programme for Enterprise and Entrepreneurship and in Particular Small and Medium Sized Enterprises [MAP (2001-2005) ]”**<sup>42</sup> which provides financial framework for the projects in the priority areas presented in the European Charter for Small Enterprises, focus has shifted from many, small and ad hoc activities to a more systematic approach, benchmarking and good practice exchange between the Member States. By launching these two instruments main aim of EU is to follow an effective monitoring of progress and to ensure a more coherent strategic direction.

The MAP (2001-2005)<sup>43</sup> is in force to be implemented during five year period 2001-2005. In 2004, it was extended to the end of 2006<sup>44</sup>. The MAP (2001-2005) is based on experiences from previous multiannual programmes<sup>45</sup> and it is the principal means for the Commission to undertake projects, which aim to realize the ten action lines of the European Charter for Small Enterprises. Moreover, it is also an instrument for the fulfilment of the

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<sup>42</sup> Council Decision No.2000/819/EC of 20.12.2000 on a Multiannual Programme for Enterprise and Entrepreneurship, and in Particular for Small and Medium-Sized Enterprises (2001-2005), Official Journal of the European Communities, L333, 29.12.2000.

<sup>43</sup> See Appendix D for the Multiannual Programme for Enterprise and Entrepreneurship (2001-2005).

<sup>44</sup> European Parliament and the Council Decision 593/2004/EC of 21.07.2004 Amending Council Decision 2000/819/EC on a Multiannual Programme for Enterprise and Entrepreneurship, and in Particular for Small and Medium Sized Enterprises (SMEs) (2001-2005), Official Journal of the European Communities, L268, 16.08.2004.

<sup>45</sup> See section 3.1 of this thesis for the previous Multiannual Programmes.

“OECD Bologna Charter on SME Policies”<sup>46</sup> which was signed by the EU Member States in 2000.

The areas of action are principally based on identifying and exchanging best practices in accordance with the new Best Procedure described in the Commission Communication of 26 April 2000<sup>47</sup>. The MAP (2001-2005) has 5 objectives; (1) enhancing growth and competitiveness of business in a knowledge-based, international economy; (2) promoting entrepreneurship; (3) simplifying and improving the administrative and regulatory environment for business, in particular to promote research, innovation and business creation; (4) improving the financial environment for business, especially SMEs; (5) giving business easier access to Community support services, programmes and networks and improving the coordination of these facilities. The first three objectives mentioned above are related to policy development, fourth one is related to financial instruments and the last one refers to “Euro Info Centres”. The actions of the MAP (2001-2005) are organized every year into an annual work programme. Each year an implementation report is presented to the Enterprise Programme Management Committee (EPMC) which composed of representatives of the authorities of participating countries and to the European Parliament. This report is also made publicly available.

Under the title of : *enhancing growth and competitiveness of business in a knowledge-based, international economy*; The MAP (2001-2005) aims to foster, in particular, measures to enhance competitiveness and innovation. It also aims to assist the free movement of goods and market access. Implementation of the programme provides an adequate range of skills to the needs of small business, by which they can take advantage of the use of new

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<sup>46</sup> It is the outcome of OECD international ministerial conference realized on 15 June 2000. This document was signed by 50 governments including Turkey. For further information, see section 3.2 of this thesis.

<sup>47</sup> Commission of the European Communities, Communication from the Commission on Challenges for Enterprise Policy in the Knowledge Driven Economy: Proposal for a Council Decision on a Multiannual Programme for Enterprise and Entrepreneurship (2001-2005), COM (2000) 256 final, 26.04.2000.



information and communication technologies and encourage innovative practices, thereby fostering the integration of sustainable development.

Under the *promoting entrepreneurship*; aims of the programme are in particular; assisting the creation and transfer of businesses, developing training in entrepreneurship, fostering the enterprise culture throughout society and identifying and promoting specific policies in favour of SMEs.

Under the *simplifying and improving the administrative and regulatory environment for business*, in particular to promote research, innovation and business creation; further development of the business impact assessment system for proposed Community legislation, better regulation and a simpler administrative environment are envisaged.

Regarding the *improving the financial environment for business, especially SMEs*; the start up scheme, SME guarantee facility, seed capital action and joint European venture measures are envisaged<sup>48</sup>.

As regards to *giving business easier access to Community support services, programmes and networks and improving the coordination of these facilities*, the programme develops actions to foster access of enterprises to Community programmes and ensures better coordination particularly with the framework programme for research, technological development and demonstration activities. It improves the operation, cooperation and coordination of Community networks, in particular Euro Info Correspondence Centres and promotes the organization of entrepreneurship business cooperation events, and makes use of the report entitled the “European Observatory for SMEs<sup>49</sup>”.

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<sup>48</sup> These measures, which are determined in order to foster financial environment for business is introduced in the section 3.4.3 of this thesis.

<sup>49</sup> European Observatory for SMEs was established by the Commission in 1992 in order to improve the monitoring of economic performance of SMEs in Europe, its task is to provide information on SMEs to policy makers researchers, economists and SMEs themselves.

The financial reference amount for the implementation of the Programme was set at 450 million ECUs of which 317 million ECUs is allocated to financial instruments and 133 million ECUs to other priorities including business support networks<sup>50</sup>.

The Commission evaluates the implementation of this Programme and submits reports to European Parliament, the Council, the Economic and Social Committee and the Committee of Regions every two years. The final external evaluation report was published in 15 November 2004<sup>51</sup>. The report is generally positive, nevertheless improvements were suggested, particularly in strategic programming and the links with the European Charter for Small Enterprises, the sixth Framework Programme for Research and Technological Development and the Structural Funds.

Even five years after introduction of the Lisbon Strategy, Europe has a long way to go to meet the Lisbon objective for 2010. It is believed by the European Union institutions that progress is strongly dependent on success to foster entrepreneurship and small business and EU needs an environment where small businesses do not struggle with red tape and where entrepreneurial people can transform their ideas into business (Commission, 2005a: 4).

To monitor the progress on the Lisbon Strategy, 14 indicators have been agreed by the European Council<sup>52</sup>. However the overall picture is very mixed and much needs to be done both in the entrepreneurship area and in

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<sup>50</sup> The budget of the previous Programme was 180 million ECUs.

<sup>51</sup> Commission of the European Communities, Commission Staff Working Paper: Report on a Multiannual Programme For Enterprise and Entrepreneurship and in Particular For Small and Medium Sized Enterprises, SEC(2004) 1460, 15.11.2004.

<sup>52</sup> Commission and the Council agreed on a list of 14 structural indicators on the basis of Communication from the Commission COM(2003)585, 8.9. 2003. These structural indicators were amended by the Presidency Conclusions of Brussels European Council of 8 December 2003.

other areas drawn in the Strategy. These indicators and performance of member states are given in Appendix B. For instance, target for research and development expenditure is 3 percent of GDP, however as of 2004, it is 2 percent in the EU-15 and 1.9 percent in the EU-25. Even when the new member states are excluded; there are still some earlier member states with very low percentages such as Spain (1 percent), Italy (1.1 percent) and Luxembourg (0.6 percent). It seems to be a weakness in terms of being a knowledge society, which is one of the objectives of the Strategy. Moreover, EU target is to increase employment rate to 70 percent by 2010 and to 67 percent by 2005. It is noted as 64.4 percent for EU-15 and 62.9 percent for EU-25 as of 2004. For those who are pessimistic, net job creation largely slowed down considerably in recent years and 2010 target of 70 percent employment rate is unattainable (Kok, 2004:10).

EU Member States and the Commission have failed to achieve the objectives of the Lisbon Strategy. Kok's midterm review<sup>53</sup> of the Lisbon Strategy states that reasons for this failure are an overloaded agenda, poor coordination, conflicting priorities, external challenges (the twin challenge from Asia of China and India and the United States) and the challenges of enlargement process. Finally there has been lack of determined political action because of the poor economic performance (Kok, 2004:6).

However it is also noted that the Lisbon strategy is even more urgent today as the growth gap with North America and Asia has widened. As Kok argues, Europe must meet the combined challenges of low population growth and ageing. One of the five urgent actions recommended in the report is relevant to business climate and it recommends reducing the total administrative burden; improving the quality of legislation; facilitating the

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<sup>53</sup> The European Council held in Brussels in March 2004 invited the Commission to establish a High Level Group headed by Wim Kok, former Prime Minister of the Netherlands, to carry out an independent review to contribute to the midterm review of Lisbon Strategy. Report of the High Level Group was made public and submitted to the Commission by 1 November 2004.  
[http://europa.eu.int/growthandjobs/pdf/kok\\_report\\_en.pdf](http://europa.eu.int/growthandjobs/pdf/kok_report_en.pdf), (14.08.2005).

rapid start-up of new enterprises; and creating an environment more supportive to business (Kok, 2004:6).

In order to define future policy, by taking into account the results of the midterm review of Lisbon strategy, the “**Competitiveness and Innovation Framework Programme (CIP) for 2007-2013**” was adopted by the Council on 6<sup>th</sup> April 2005<sup>54</sup>. This is a MAP successor programme. CIP was proposed by taking into account the objectives of Lisbon Strategy. It deals with weak entrepreneurial spirit and insufficient innovation in the EU so as to reach the objectives of the Lisbon Strategy. The Commission declares that Europe lags behind the US concerning the entrepreneurial spirit and the innovation. The new CIP programme has been proposed as one of the main Community measures contributing to generating economic growth and creating more jobs.

Three specific programmes under CIP have been proposed, Entrepreneurship and Innovation Programme, ICT (Information and Communication Technologies) Policy Support Programme and Intelligent Energy Programme. Entrepreneurship and Innovation Programme aims to bring together activities that were previously dispersed over the MAP and activities for industrial competitiveness.

Running from 2007-2013, Programme proposes a budget of more than 4 billion Euros over the 7-years period.

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<sup>54</sup> Commission of the European Communities, Proposal for a Decision of the European Parliament and of the Council Establishing a Competitiveness and Innovation Framework Programme (2007-2013). COM (2005) 121 final, 06.04.2005. It has not been published yet in the Official Journal of the European Communities.

### **3.5 Assistance Available to European SMEs Under the Current Entrepreneurship and SME Policies of the EU**

The European Union provides assistance to SMEs in member states and candidate countries. They are available in different forms such as grants, loans, and in some cases guarantees. SMEs can also benefit from a series of non-financial assistance measures in the form of programmes and business support services.

#### **3.5.1 Financial Assistance**

Currently most important financial assistance for the European SMEs is provided by the financial instruments of **Multiannual Programme - MAP (2001-2005)**. The European Commission and the European Investment Fund (EIF) signed the agreement on the implementation of the MAP (2001-2005) on 18 December 2001. It provides the new legal basis for the EU funded financial instruments. New and old member states (EU-25), EFTA countries and the candidate countries<sup>55</sup> are eligible under this programme and total EU budget amounts 317 million Euros which is managed by the European Investment Fund.

European Investment Fund is an institution whose main objective is to support the creation and growth of SMEs. It is a vehicle for venture capital and it is equally dedicated to providing portfolio guarantees for all types of institutions involved in the financing of SMEs. The EIF operates through financial intermediaries<sup>56</sup> using its own funds or those available within the framework of mandates entrusted to it by EIB or the European Union. Its

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<sup>55</sup> As of 2004 new member states are Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Malta, Slovak Republic, Slovenia and candidate countries are Romania, Bulgaria, Turkey. However when the MAP (2001-2005) was adopted by the Council in 2000, new member states participated the MAP as candidate countries.

<sup>56</sup> There are intermediaries for each beneficiary country. Credit Guarantee Fund Inc. (Kredi Garanti Fonu İşletmeleri A.Ş) is intermediary in Turkey.

shareholders are EIB (59.5 percent), European Union via European Commission (30 percent) and 34 financial institutions (10.85 percent). EIF operations are driven by two folded objectives: serving EU policies and generating financial returns (European Investment Fund, 2005:16)<sup>57</sup>.

The EIB has four financial instruments to manage. First one is “*the Start-up Scheme of the European Technology Facility (ETF)*”. ETF instrument of EIB provides allocation of EIB resources to the funds (intermediaries), which give venture capital to the small firms. With regard to venture capital activities, the intermediaries are selected in conformity with best business and market practice in a fair and transparent manner in order to avoid any distortion of competition<sup>58</sup>. Start-up scheme aims to invest in Venture Capital funds such as; seed capital funds, business incubators<sup>59</sup>, smaller or newly established funds, funds operating regionally, funds focused on specific industries or technologies and funds financing the exploitation of R&D results (i.e. funds linked to research centre and science park). The Start-up phase is normally defined as up to 5 years. However, for companies in specific high technology sectors, in particular life sciences, the start up phase can be up to 10 years, due to the extended pre-commercialization of product development and testing phases that are characteristic of these particular sectors. The investment target for ETF Start up Facility is between 10 percent and 25 percent of the total capital committed in a fund or business incubator. A maximum amount of 10 million Euros is invested in any single fund/incubator. Venture capital funds and incubators need to be able to support adequate professional management, make a sufficient number of investments and thus are in a position to provide follow-up finance. Total

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<sup>57</sup> European Investment Fund, “Annual Report 2004” declares that EIF has been rated AAA/Aaa/AAA, which is the highest credit rating possible, by the rating agencies Standart&Poor’s, MOODY’S, and Fitch since July 2003.

<sup>58</sup> For further information see, Council Decision 2000/819/EC on a Multiannual Programme for Enterprise and Entrepreneurship, and in Particular for Small and Medium-Sized Enterprises, Official Journal of the European Communities, L 333/84, 29.12.2000.

<sup>59</sup> Business incubators provide small start-up firms with premises, infrastructures and range of services that can improve their ability to initiate and run their operations during the early development period. They are non-profit and non-governmental units.

budget of this instrument is 100 million Euros (European Investment Fund, 2005:17).

The second financial instrument is “*SME Guarantee Facility*”. The objective of the SME Guarantee Facility is to increase the availability of loans to small or newly established companies through sharing risk with national guarantee schemes and mutual guarantee schemes. The SME Guarantee Facility covers (1) loan guarantees which provide guarantees for loans to enterprises with growth potential and with up to 100 employees, (2) micro-credit guarantees which provide guarantees for loans of up to 25 thousand Euros to micro enterprises with up to 10 employees, particularly entrepreneurs starting a business, (3) equity guarantees which provide guarantees to existing equity guarantee schemes in order to own funds investments in enterprises with up to 249 employees, (4) ICT (Information Communication Technologies) loan guarantees provide guarantees for loans for investments in information technology equipment, software and relevant training, to enterprises with up to 100 employees (European Investment Fund:2005).

The third financial instrument is “*Seed Capital Action*”. This action complements the ETF Start-up Scheme. It supports the costs of seed funds and incubators in which EIF already invests. The support provided by the Seed Capital Action is aimed at the long-term recruitment of additional investment managers to increase the number of qualified personnel and to reinforce the capacity of the venture capital and incubator industries to cater for investments in seed capital. The nature of the support provided by the Seed Capital Action is comprised of a grant to cover part of the management costs linked to eligible activities. For each additional eligible staff member recruited, the beneficiary signs a facility grant agreement. The maximum amount granted per beneficiary is either maximum 300 thousand Euros or 5 percent of capital allocated to Seed Capital Investments at the time of

signature of the facility grant agreement. Total budget allocated to this instrument is 17 million Euros. (EIF, 2005:18)

Fourth instrument is called as “*Joint European Venture*”. MAP (2001-2005) aims to stimulate the setting-up of joint ventures between European SMEs and thus enabling them to benefit from the opportunities offered by the single market. The EU contribution is intended to cover some of the expenses relating to the setting-up of a joint venture. Maximum contribution per project is 100 thousand Euros. (EIF, 2005:18). This instrument is not open to SMEs from the candidate countries and cannot support projects in these countries<sup>60</sup>.

Under the MAP (2001-2005), funds are indirectly available by using national financial intermediaries to be implemented. There are also funding opportunities directly available to SMEs. These funds have specific objectives designed such as environment, research, education etc..SMEs can directly apply for the programmes, generally on condition that they present sustainable and transnational projects which creates value-added. Support of the EU generally covers 50 percent of the costs of the project.

As regards to innovation and research, “**The Sixth Framework Programme for Research and Technological Development (FP6) 2002-2006**”<sup>61</sup> is the frame for the EU activities in the field of science, research and innovation. It has a budget of 17.5 million Euros for the years 2002-2006. There are two ways that SMEs can participate in FP6, they participate by joining the projects in “thematic priority areas” or through the

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<sup>60</sup> As of 2004 new member states, which were candidates when the MAP (2001-2005) initiated in 2000, are eligible to submit projects under the Joint European Venture instrument of MAP (2001-2005).

<sup>61</sup> European Parliament and Council Decision 1513/2002/EC of 27 .06.2002 Concerning the Sixth Framework Programme of the European Community for Research, Technological Development and Demonstration Activities, Contributing to the Creation of the European Research Area and Innovation, Official Journal of the European Communities, L232, 29.08.2002.



projects that fall into “specific measures” designed by the FP6<sup>62</sup>. At least 15 percent of the FP6 budget for the seven thematic priority areas is dedicated to SMEs. Seven thematic priority areas are (1) life sciences, genomics and biotechnology for health (2) information society technologies (3) nanotechnologies and nano sciences (4) aeronautics and space (5) food quality and safety (6) sustainable development, global exchange and ecosystems (7) citizens and governance in a knowledge based society (European Parliament and the Council:2002).

Specific measures for SMEs in FP6 are Co-operative Research Projects (CRAFT) and Collective Research Projects. CRAFT is a scheme specifically designed for SMEs to enable them to take part in research activities to directly improve their business competitiveness. A number of SMEs from different countries assign a significant part of the required research to external organisations, such as, universities or research centres. Project size is 0.5-2 million Euros (European Commission, 2002).

Collective Research is a type of research carried out by research performers on behalf of industrial associations or groupings like trade associations that represent a large group of SMEs. The aim is to expand the knowledge base and improve the overall competitiveness of large communities of SMEs via reinforcing the technological basis of particular sector(s), developing technological tools (such as, diagnosis, safety equipment, etc.). Each Collective Research project includes a core group of SMEs which are involved in all aspects of the project, from the definition of the research to the dissemination of the final results. Project size is 2-5 million Euros<sup>63</sup> (European Commission, 2002).

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<sup>62</sup> As regards to FP6, more information is available at:  
[http://europa.eu.int/comm/research/fp6/index\\_en.cfm](http://europa.eu.int/comm/research/fp6/index_en.cfm), (12.08.2005).

<sup>63</sup> Guides for each part of the FP6 are also available at:  
<http://fp6.cordis.lu/fp6/calls.cfm>, (09.08.2005).

Under the Sixth Framework Programme for Research and Technological Development (FP6) 2002-2006, SMEs benefit from Innovation Relay Centers. The mission of these *Innovation Relay Centers (IRCs)* is to facilitate innovation all around Europe through specialized business services which support the cross-border transfer of new technologies. These services are primarily targeted at technology-oriented small and medium-sized enterprises (SMEs), but they are also available to larger firms, research institutes, universities and technology centres.

The first IRCs were established in 1995 with the support of the European Commission, as members of an integrated pan-European platform to stimulate transnational technology transfer and promote innovation services. Within the context of FP6, IRC Network is foreseen as an important tool for the achievement of the goals of the programme. Currently, more than 70 IRCs cover a wider geographical area than any other technology transfer network in the world (Commission, 2004a).

As regards to “**Structural Funds**”, European regional development funds are a major funding source for SMEs. The beneficiaries of the structural funds receive a direct contribution to finance their project. In order to improve the effectiveness of structural measures, 3 objectives have been set for the period 2000-2006. Within these, there are specific measures aimed at SMEs.

First objective is development of the least favoured regions by developing and strengthening SME support structures, the second one is conversion of regions facing difficulties by promoting entrepreneurship and creating alternative job opportunities where large scale traditional industries declined. The last one is modernizing systems of training and increasing employment by promoting the development of human resources. The three objectives of structural funds are implemented through four instruments

European Regional Development Fund (ERDF), European Social Fund (ESF), Financial Instruments for Fisheries Guidance (FIFG) and European Agricultural and Guidance and Guarantee Fund (EAGGF) (Commission, 2004a).

### **3.5.2 Non-Financial Assistance**

As regards to education and training, SMEs may participate in certain actions particularly under the “Leonardo Da Vinci”<sup>64</sup> programmes. Companies need a skilled workforce to cope with rapid scientific and technological changes in an increasingly competitive world. To meet this challenge the European Commission's Leonardo da Vinci Programme serves as a laboratory of innovation in the field of lifelong learning. It envisages acquisition of changes in production systems and the dissemination of new technologies, in particular in the SMEs, training of managers and directors of SMEs on transfer of innovative technologies. Programme is open to member states, candidate countries and EFTA countries (Council of the European Union, 1999).

European Commission created Euro Info Centers in 1987 which represent an interface between European institutions and local actors. They are located throughout Europe and in constant contact with European Commission. Their task is to inform, advise and assist SMEs about EU activities and initiatives, as well as providing feedback to the European Commission about the EU issues affecting SMEs. Currently there are 300 centers across 46 countries in Europe.

Business Cooperation Network (BC-NET) has been developed by the European Commission. It is a network, which EU appoints some business

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<sup>64</sup> Council Decision of 26 April 1999, Official Journal of the European Communities, L146, 11.06.1999. More information is available at: [http://europa.eu.int/comm/education/programmes/leonardo/new/more\\_en.html](http://europa.eu.int/comm/education/programmes/leonardo/new/more_en.html), (09.08.2005).

consultants and intermediaries to help SMEs to find partners at regional, national, Community and international level. BC-NET consists of 600 consultants, which help companies to expand worldwide.

EUREKA is a Pan-European network for market oriented, industrial R&D organizations. EUREKA supports the competitiveness of European companies by creating links and networks of innovation throughout 34 countries<sup>65</sup>. Community Research and Development Information Service (CORDIS) proposes 30.000 web pages for SMEs. It has also own web site which provides various information to SMEs<sup>66</sup>. Other programmes available for SMEs to the development of the information society are e-Content and e-TEN (Commission, 2004a).

Commission co-finances sectoral meetings for European and Latin American companies seeking to establish trade links and strategic alliances. "AL Invest" is a network of operators from Europe and Latin America co-operating to organize meetings between companies that are active in the same sector.

"Asia Invest" programme offers Euros 35 million for 2003-2007 in order to provide assistance to intermediary organizations to facilitate mutually beneficial partnership and opportunities for cooperation agreements between SMEs. Moreover Executive Training Programme in Japan and Korea aims to help European company managers to approach the Japanese and Korean markets, the training programme covers language programmes, seminars on the business environment and first hand experience of working in local companies. Half of the participants of this programme are SMEs. Finally "Gate way to Japan" supports the introduction of European products on the Japanese market (Commission, 2004b).

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<sup>65</sup> More information is available at: <http://www.eureka.be/home.do>, (09.08.2005).

<sup>66</sup> More information is available at: <http://www.cordis.lu/en/home.html>, (09.08.2005).

## **CHAPTER 4**

### **POLICIES CONCERNING SMEs AND ENTREPRENEURSHIP IN TURKEY**

The aim of this Chapter is to explore the main features of SMEs and SME Policies in Turkey in order to compare with the SME policies in the EU. After giving a historical overview of Turkish SMEs and their institutional framework, this Chapter initially focuses on the structure of the Turkish SMEs and their contribution to the economy; then the supports and aids to strengthen Turkish SMEs are explored in the light of Turkey-EU relations.

#### **4.1 Historical Overview of Turkish SMEs in the Framework of the Macro Economic Policies of Turkey**

Until the 1980s, almost all the Turkish governments implemented the policy of expanding investment in the state sector, mainly through inflationary financing. The inflation rate exceeded hundred percent per annum in 1979, there were also increased public sector deficit, monetary expansion and unemployment. A stand by agreement was reached with the International Monetary Fund (IMF) in 1979 and a severe stabilization and economic reform programme was launched in 1980 to deal with the economic crisis. The development of Turkish industry during the years of import substitution encouraged domestic production. The urban population increased rapidly and many rural migrants were employed in small businesses and informal sector jobs. The number of small businesses continued to increase in parallel with local economic development and increasing transport facilities. In 1980s, almost half of the workers in the

manufacturing sector were employed in small firms. There was also a slight shift from very small firms towards those of a larger size (Özcan, 1995:54).

Under favourable international conditions, Turkish economy had a major transformation at the beginning of the 1980s. Development of a free market economy, liberalization of foreign trade, elimination of price controls and monetary policies have been pivotal elements of this transformation. Turkish exports increased remarkably after 1980s and enjoyed the opportunities created in the Middle East. However, with the sharp downturn in oil prices after 1985 this market had reached its limits. The deterioration of public health services and education occurred as liberalization policies cut the levels of social expenditures by the state. While the agriculture and manufacturing sectors were losing support, the commercial and banking sectors gained support through the government policies of the 1980s. Many argued that burden of state economic enterprises, found in many different sectors such as transport, mining, banking and manufacturing, and heavy bureaucracy blocked a rapid liberal transformation in the Turkish economy during the 1980s (Özcan, 1995:54).

While the 1970s showed a remarkable increase in the numbers of medium and large firms, liberal policies throughout the 1980s encouraged the development of entrepreneurs and more outward looking business environment. Notably university graduates and youngsters of urban and middle classes established new professional and service sector businesses which have been mainly small, but better integrated and often dependent upon large capital institutions. However, the free market and liberalization policies have affected some sectors of small firms negatively. These were mainly in traditional manufacturing and agriculture sectors. Commercial businesses and some service sectors like tourism benefited from liberal policies. The opening of the economy offered an export oriented production route to only a small group of these firms. Mainly textile, food processing,

agricultural machinery and transport industries offered some opportunities to SMEs during the 1970s and 1980s. However, SMEs remained weak in the development of skills, technological improvements and research and development (Müslümov, 2002:15; Özcan, 1995: 49).

The Turkish economy entered its down turn cycle in the early 1990s with increasing inflation rates, business closures and budget deficit. On 5 April 1994, government announced a new tight programme. According to some, the country was saved from bankruptcy but for many people it meant frozen salaries, tightening state expenditures and increasing prices. A massive privatisation act together with the constitutional change was lunched soon after. Meanwhile Turkey entered into the Customs Union with the EU on 31 December 1995. SMEs faced initial shock of the opening of the economy and competition following the Customs Union.

Some factors which stem from Customs Union created unfavourable conditions for Turkish SMEs. Particularly, harmonisation of technical legislation with the EU created high cost for Turkish SMEs. For instance, acquisition of the “CE” marking<sup>67</sup> which is required for the free circulation of the goods in the single market, was limited among Turkish SMEs. Moreover there were no notified bodies in Turkey in order to implement CE marking directives<sup>68</sup>.

Besides these technical legislation problems, Turkish SMEs did not have a chance to benefit from support measures similar to those of the EU member states’ SMEs. Economic and social funds of the EU are being used for the elimination of regional imbalances, improvement of infrastructure,

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<sup>67</sup> The CE marking is a mandatory European marking for certain products such as medical devices, electronic equipment, domestic appliances, pressure equipment, personal protective equipment, refrigerators, toys that fall “New Approach Directives” of EU. CE indicates conformity with mandatory European safety requirements. If the product meets the provisions of the applicable European Directives, and the CE marking is affixed to a product, countries may not prohibit, restrict or impede the placing in the market or putting into service of the product.

<sup>68</sup> Council Directive on CE marking 93/68/EEC of 22.07.1993, Official Journal of the European Communities, L 220, 30.08.1993.

solution of environmental problems, building up of research-development capacities, creation of employment or solution of some sectoral problems. These funds reduce the cost of environmental, R&D and employment expenditures of the EU originated products. However, Turkish products, which seek for demand in the same market, under the same conditions, do not benefit from these funds. Although for Turkish originated products to be sold in the EU market, quality is considered to be in line with that of the EU legislation, cost-increasing expenditures such as environmental expenditures are met mostly from the producers' own budgets which means that there are inevitable unfavorable conditions in competition against Turkish products (State Planning Organisation, 2004).

As regards to customs union it may be concluded that when the heavily SME dominated structure of Turkish industry is taken into consideration, the customs union has been an unfair challenge; since necessary adjustment support was not provided for Turkish SMEs.

In early 2001, the Turkish economy was on the financial default. A long period of political instability, persistently double digit rates of inflation, growing public sector debt and deteriorating bank portfolios triggered a massive loss of investor confidence. In spring 2001, government launched series of policy reforms, in the same year stand by agreement with IMF and for convergence with the EU's *acquis communautaire* National Programme For the Adoption of the *Acquis* was also put into effect. In 2002 Urgent Action Plan of the government was adopted which envisaged wide-ranging structural reforms targeting macroeconomic stabilisation and a higher rate of growth (Söğüt, 2005: 2).

In the following three years the main economic targets of the programme were exceeded by a significant margin. The economy recovered rapidly. As of 2005, Turkish economy is among the fastest growing



economies of OECD member countries. Significant progress has also been made in stabilising and modernising the Turkish banking sector. Market capitalisation is at a high level and the quality of assets is improving. Banks have achieved a healthier asset – liability structure and more free capital. On the other hand, major challenges are the relatively large share of government securities in total banks' assets and the sharp decline in the yield of these securities. The drop in the general level of interest rates cuts further into the earning potential of banks. Thus, profitability is seen as the main issue in the near future and in the medium term (OECD, 2004).

In December of 2004, European Council acknowledged that Turkey had met the Copenhagen political criteria for the EU membership with a view to opening accession negotiations on 3 October 2005. This positive outcome is considered to provide Turkey with important external anchor for domestic policy. It is also considered to contribute to further strengthening of investor confidence and to general improvements in expectations. Moreover, Turkey has embarked upon a variety of economic policies and medium and long term economic strategies that effect SMEs either directly or indirectly (OECD, 2004).

As a conclusion, while in most of the developed and developing countries of the world as well as in the EU, concept of entrepreneurship and SMEs have been put into the agenda after 1970s, debates surrounding SME policies have been started only after the mid 1990s in Turkey. After mid 1990s, besides negative effects of the customs union, Turkish SMEs have evolved in a generally unfavourable business environment marked by sharp fluctuations in GDP, recessions, high inflation, exchange rate instability and the introduction of adjustment policies. However, currently there are tendencies to accept innovative SMEs and entrepreneurship as backbone of the economy in Turkey.

## **4.2 Definition of SMEs and Institutional Framework in Turkey**

SMEs constitute a major part of the Turkish economy accounting for a large proportion of the country's business and total employment. However, there is no common and legal definition of SMEs in Turkey. It is observed that different organisations use different SME definitions within the framework of their job descriptions, target groups and resources allocated for their activities. It is claimed that there are more than 30 SME definitions, which are used by different organizations in Turkey (TOSYÖV, 2000:8). These definitions reflect differences both in terms of the criteria selected for the description and of the thresholds determined within the framework of these criteria.

As shown in Table 4.1, scope of Turkey's various national definitions is relatively narrow. They only cover the manufacturing sector and exclude services and tourism, which are expanding rapidly. The more restrictive definitions are those of Small and Medium Industry Development Organisation (KOSGEB), the Undersecretariat of Foreign Trade and Eximbank, which cover only manufacturing industry. KOSGEB does not represent micro enterprises which have 1-9 employees. Undersecretariat of Treasury has broadest definition which covers many sectors and all size classes of SMEs (State Planning Organisation, 2004:26).

A common SME definition is needed for developing policies for SMEs, planning the programmes to be implemented within the framework of these policies and conducting research in this field. Due to discrepancy of SME definitions, enterprises are exposed to different assessments by different institutions when demanding services. This situation reduces the effectiveness of implementations and constitutes an important obstacle in providing transparency of services (State Planning Organisation, 2004:25).

Table 4.1 - SME Definitions in Turkey and the EU

Organisation	Scope of Definition	Criteria	Micro	Small	Medium
KOSGEB	Manufacturing Ind.	Number of Workers	-	1-50	51-150
Halkbank	Manufac. Ind., Tourism, Software Development	Number of Workers	-	-	1-250
		FIA <sup>(1)</sup> (Euro)	< 230.000	< 230.000	< 230.000
Undersecretariat of Treasury	Manufacturing Industry, Tourism, Agro Industry, Mining, Education, Health, Software Development,	Number of Workers	1-9	10-49	50-250
		Investment Amount <sup>(2)</sup> (Euro)	< 350.000	< 350.000	< 350.000
Undersec. of Foreign Trade	Manufacturing Industry	Number of Workers	-	-	1-200
		FIA <sup>(1)</sup> (Euro)	-	-	< 1.830.000
Eximbank	Manufacturing Industry	Number of Workers	-	-	1-200
EU	Non Primary Private Sector <sup>(3)</sup>	Number of Workers	1-9	10-49	50-249
		Annual Turnover or Annual Balance Sheet	≤ € 2 million or ≤ € 2 million	≤ € 10 million or ≤ € 10 million	≤ € 50 million or ≤ € 43 million
<p>(1) FIA: Fix Investment Amount</p> <p>(2) IA: Amount of Investment Subject to SME Incentive Certificate.</p> <p>(3) Non Primary Private Sector: It excludes government sector and the sector that provides products of nature such as food, raw materials, fuels, minerals.</p>					

Source: State Planning Organisation, 2004:18 and European Commission, 2005:8.

There is a need to develop a common SME definition in order to align with the relevant Commission recommendation<sup>69</sup> as well. The issue of Turkey's compliance with the SME definition of the EU is emphasized in the Commission Regular Reports on Turkey's Progress Toward Accession<sup>70</sup> as

<sup>69</sup> Commission of the European Communities, Commission Recommendation 2003/361/EC of 06/05/2003 Concerning the Definition of Micro, Small and Medium Sized Enterprises, Official Journal of the European Communities L124, 20.05.2003, p 36-41.

<sup>70</sup> Commission of the European Communities, 2004 Regular Report on Turkey's Progress Toward Accession, SEC(2004) 1201, 2.10.2004.

well as among the short-term measures of the Accession Partnership prepared for Turkey in 2003<sup>71</sup>.

Apart from the definition problem, Turkish SMEs have also organisational problems. There is no legal or political organisation concerned with the SMEs in Turkey. Although there are many both public institutions and private organisations in economic area, it is difficult to measure their effective coordination among themselves in policy implementation.

There are several public organizations responsible in the formulation and implementation of SME policies. The Undersecretariat of State Planning Organisation (SPO) is responsible for preparing long-term development plans and annual programmes that also cover SME policies. SPO determines macro policies for SMEs and ensures coordination among public and private organizations with the aim of increasing the effectiveness of implementation of these policies (KOSGEB, 2003).

The Ministry of Industry and Trade is the primary authority for defining SME policies and it implements these policies through its affiliated organisation of Small and Medium Industry Development Organisation (KOSGEB). KOSGEB was established in 1990 (Law No. 3624)<sup>72</sup> and its main duty is to implement SME policies with the aim of supporting growth and development of SMEs in Turkey. It carries out the necessary development and support programmes for the following functions: to develop SMEs' technological skills, to improve their training and information levels, to provide appropriate financial mechanisms and to improve their managerial infrastructure (KOSGEB, 2001:17; Akgemci, 2002:20). KOSGEB has

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<sup>71</sup> Council Decision of 19 May 2003 on the Principles, Priorities, Intermediate Objectives and Conditions Contained in the Accession Partnership with the Republic of Turkey, Official Journal of the European Communities L 145, 12 .06. 2003.

<sup>72</sup> t Law No. 3624 on the Establishment of KOSGEB was published in the Official Gazette No.20498 of 20.04. 1990.

established 30 sub institutions in order to perform its duties (Ekinci, 2003:42).

Undersecretariat of Treasury is responsible for state aids to SMEs' investments and Undersecretariat of Foreign Trade develops programmes to foster the export of SMEs via its affiliated institutions such as Export Promotion Centre (İGEME – İhracatı Geliştirme Merkezi) and Unions of Exporter.

There is no financial institution established specifically for the purpose of financial support to SMEs, however T. Halk Bank usually bears this task. Apart from T. Halk Bank, SMEs are also supported in the areas of loans and guarantees through the Credit Guarantee Fund Operation and Research Co. Inc. (KGF A.Ş) and Union of Credit and Guarantee Cooperatives for Tradesman and Artisans of Turkey (TESKOMB – Türkiye Esnaf ve Sanatkarlar Kredi ve Kefalet Kooperatifleri Birlikleri Merkez Birliği) (State Planning Organisation, 2004:13).

Other public institutions that render services to SMEs within the scope of their operational domain are State Institute of Statistics (SIS), Ministry of National Education, Scientific and Technical Research Council of Turkey (TÜBİTAK), Turkish Standards Institute (TSE), Turkish Patent Institute (TPE) and Turkish Accreditation Agency (TÜRKAK).

Apart from the public institutions, there are organisations in economic area in the form of unions, confederations, foundations and associations.

Firms operating in the trade and industry sector are represented by Turkish Union of Chambers and Commodity Exchange (TOBB), the number of enterprises was estimated as 1.2 million at the end of 2003. Industrial enterprises under TOBB receive government support. However, SMEs in

wholesale and retail trade are not covered by many programmes provided by the government (OECD, 2004:28). Moreover, in order to be organised under TOBB, an enterprise is obliged to employ 10-49 workers (TOBB, 2002:17). This condition makes membership of TOBB impossible for micro enterprises. TOBB covers medium and large industrialists and small and medium sized enterprises and it has the Medium and Small Enterprise Board, which deal with the problems of SMEs and support them in different areas such as technology and education.

Confederation of Tradesman and Artisans of Turkey (TESK – Türkiye Esnaf ve Sanatkarları Konfederasyonu) is one of the most important organisations for micro enterprises. As of 31 January 2003, TESK had registered more than 2.76 million trade and craft enterprises. Turnover of these firms is substantial and is highly sensitive to swings in the economy. Enterprises, which have less than nine employees, can be a member of the TESK.

Regarding the foundation, there are Turkish Foundation For Small and Medium Businesses (TOSYÖV – Türkiye Küçük ve Orta Ölçekli İşletmeler Serbest Meslek Mensupları ve Yöneticileri Vakfı) and The Vocational Training and Small Industry Supporting Foundation (MEKSA – Mesleki Eğitim ve Küçük Sanayii Destekleme Vakfı). They provide training and consultancy for their members (TOSYÖV; 2003: 5).

Another non-governmental organisation is Technology Development Foundation of Turkey (TTGV – Türkiye Teknoloji Geliştirme Vakfı). It is an independent non-profit organization established jointly by the private and public sectors. It was established by the collaboration of private and public sectors in 1991 and with the financial support of World Bank. TTGV tries to encourage Turkish industry to increase its investments in R&D and to provide funds and expertise for industrial technology projects. TTGV acts as a

catalyst in establishment of technology parks in Turkey. It also identifies technological research areas and carries out research projects in these areas (Söğüt, 1997:12).

Another type of organisation is associations in Turkey, which represents SMEs in real meaning and provides them to be in an organised structure. In this context Industrialist and Businessman Associations (SIAD – Sanayici ve İşadamları Derneği) and Young Businessmen Associations (GIAD – Genç İşadamları Derneği) are most effective ones (Ekinici 2003:40).

#### **4.3 Structures of the SMEs and Their Contribution to Turkish Economy**

The State Institute of Statistic (SIS) produces no economy wide data on SMEs, partly because of the various definitions used by various organizations which are involved in SME policies, statistical information on Turkey's SME sector is relatively fragmentary and few time series are available. Therefore it is difficult to analyse trends over time and make comparisons among sectors. However, some data provide their relative share in the overall economy. According to the most recent estimates, the SMEs, including services, accounted in 2000 for: 99.8 percent of the total number of enterprises, 76.7 of total employment, 38 percent of capital investment, 26.5 percent of value added, roughly 10 percent of exports and 5 percent of bank credit. While SMEs dominate the economy in terms of employment, they evidently operate with comparatively little capital equipment, generate relatively low levels of value added, make only a small contribution to Turkish exports and receive only a marginal share of funds mobilized by the banking sector (State Planning Organisation, 2004).

There is no concrete data concerning the total number of SMEs in Turkey. However, SIS survey results on household labour force provide some

data concerning the total employment provided by the enterprises, which have less than 50 workers. Although, this threshold for SMEs is 249 in the EU and it is incompatible with the generally accepted thresholds (either 150 or 249) for SME definition in Turkey as well, data presented in Table 4.2 give some idea concerning the share of small and micro enterprises in total employment in Turkey.

As shown in Table 4.2, between the years 2000 and 2004, micro enterprises (1-9 workers) have largest share in total employment when compared with small (10-49 workers) and large sized enterprises (more than 50 workers). While enterprises having 1-9 workers provided 67 percent of total employment in 2004, only 18 percent of the total employment was provided by the enterprises having more than 50 workers

Table 4.2 - Employment By Size of Enterprises Including All Sectors in Turkey (2000-2004)

Years	Total Employment (1.000)	Share in Total Employment					
		1-9 worker (1.000)	%	10-49 worker (1.000)	%	50+ worker (1.000)	%
2000	21.581	14.719	68,2	3.296	15,3	3.565	16,5
2001	21.523	14.659	68,1	3.254	15,2	3.610	16,7
2002	21.354	14.379	67,4	2.893	13,5	4.082	19,1
2003	21.147	14.119	66,8	2.954	14,0	4.074	19,2
2004	21.790	14.587	67,0	3.276	15,0	3.927	18,0

Source: Obtained from SIS.

Since there is no statistical information covering SMEs (1-249 workers) in all sectors, statistical evaluations on SMEs are made mostly in manufacturing industry. Almost all the SME definitions developed by different institutions in Turkey cover manufacturing industry and SMEs in manufacturing industry are represented by almost all of the institutions related to SMEs such as KOSGEB, TOBB and TESK.

Since Turkish State Institute of Statistics classifies SMEs in the manufacturing sector as those enterprises with 1-150 workers, which again



creates confusion, calculations in Table 4.3 made on the basis of this threshold. Table 4.3 shows the main figures concerning the manufacturing sector. According to 2000 data, there are approximately 210 thousand enterprises in the manufacturing sector and 99 percent of them are SMEs (1-150 workers). SMEs in the manufacturing sector employ almost 918 thousand workers. The shares of SMEs in manufacturing sector in terms of employment and value added are 60 percent and 31 percent respectively for the year 2000 which indicate SMEs in the manufacturing sector have low productivity rate. It is also distinguished that approximately 199 thousand of 208 thousand enterprises, operating in the manufacturing sector, are micro enterprises.

Table 4.3- Enterprises in the Manufacturing Sector (2000)

Size Groups	Number of Enterprises	Average Number of Workers	Total Value Added (Euro)	Share in Total Number of Enterprises (%)	Share In Average Number Of Workers (%)	Share in Total Value Added (%)
1-9	198.700	527.624	3.138.145.989	94,82	34,40	8,52
10-49	6.938	178.298	3.274.146.909	3,31	11,62	8,89
50-99	1.726	120.409	2.491.383.113	0,82	7,85	6,76
100-150	748	91.462	2.517.919.947	0,36	5,96	6,83
SMEs Total <sup>(1)</sup>	208.112	917.793	11.421.595.958	99,31	60	31
151-250	645	123.442	4.229.188.200	0,31	8,05	11,48
251+	798	492.759	21.190.044.174	0,38	32,12	57,52
Total <sup>(2)</sup>	209.555	1.533.994	36.840.828.332	100	100	100
(1): Turkish State Institute of Statistics classifies SMEs in the manufacturing sector as those enterprises with 1-150 workers. Therefore calculations are made on the basis of this classification						
(2): Figures include only private sector.						

Source: State Planning Organisation, 2004:11.

Table 4.3 classifies SMEs in manufacturing sector as enterprises, which have less than 150 workers. In contrast Table 4.4, which makes comparison between sectors, classifies SMEs as enterprises, which have less than 250 workers.

As shown in Table 4.4, SMEs (1-249) provide employment for about half of the workers in the manufacturing sector, which has totally around one million workers. Highest number of jobs, which is provided by the SMEs, are in the wholesale and retail trade sector with 1.9 million workers. This is followed by hotels and restaurants and manufacturing. As regards to contribution of total employment and value added, excluding financial intermediation sector, SMEs (1-249 workers) have larger share in service sectors compared to the manufacturing sector. While SMEs (1-249 workers) in manufacturing sector provided 30 percent of total value added and 48 percent of total employment within the sector, 98 percent of the total employment and 96 percent of the total value added in real estate sector are provided by SMEs. SMEs which are in wholesale and retail trade and hotels and restaurants provided 95 percent of the total employment within the sectors and they provided respectively 84 and 87 percent of total value added in the same sectors.

Table 4.4 - Employment and Total Value Added Shares of SMEs by Sectors in Turkey (2001)

Size of Class (ISIC Rev.3) <sup>(1)</sup>	Employment by SMEs in the Sector (1-249)		Total Employment in the Sector	Share in Total Value Added in the Sector
	Number	%	Number	%
Manufacturing (D)	525.763	48	1.093.046	30
Wholesale and Retail Trade; Repair of Motor Vehicles, Personal Household Goods (G)	1.971.578	95	2.069.182	84
Hotels and Restaurants (H)	627.612	95	659.645	87
Financial Intermediation (J)	42.345	24	179.595	22
Real Estate, Renting and Business Activities (K)	220.116	98	225.180	96
Education (M)	66.917	91	73.667	83
Health and Social Work (N)	96.962	58	166.733	26
Other Community, Social and Personal Service Activities (O)	194.072	95	204.193	73

(1): ISIC Rev.3: International Standard Industrial Classification of All Economic Activities and capital letters indicate codes of ISIC Rev 3 classification

Source: Obtained from SIS.

Enterprises in selected services sector<sup>73</sup> are predominantly micro enterprises as it is indicated in Table 4.5. Micro enterprises are those firms, which have 1-9 workers and most of the definitions used in Turkey do not include micro enterprises. Generally, these micro firms do not receive any specific support assigned to them. According to Table 4.5, there are approximately 180 thousand micro enterprises in the services sector which has 185 thousand enterprises in total. While 74 large enterprises which have more than 500 workers provide jobs for almost 59 thousand workers in the sector, approximately 180 thousand micro enterprises employ more than half of 643 thousand of total workers in the service sector.

Table 4.5 - Number of Enterprises, Average Number of Workers Employed by Size of Enterprises in Service Sectors<sup>(1)</sup> (2001)

Size of Enterprise Groups	Number of Enterprises	Annual Average Number of Workers
1-9	179.494	411.256
10-49	4.893	89.189
50-199	498	46.259
200-499	140	37.834
500+	74	58.535
Total	185.099	643.073

(1) : The Table covers ISIC Rev.3 selected service sectors: K,M,N,O (see Table 4.4).

Source: Obtained from SIS.

The small size of Turkish SMEs and their relatively modest contribution to national output stand out in international comparisons. For example, the proportion of SMEs with fewer than 100 workers is higher in Turkey than in many other OECD countries (Italy is a notable exception), and most Turkish SMEs fall into the category of enterprises with fewer than ten employees. Furthermore, while micro-enterprises account for 34 percent of total employment in manufacturing sector, they account only 8,5 percent of total value added in the same sector as of 2000, whereas in Italy, France and Portugal, where such firms are proportionately fewer and employ fewer

<sup>73</sup> Selected sectors are; Real Estate, Renting and Business Activities (K), Education (M), Health and Social Work (N) Other Community, Social and Personal Service Activities (O).

people, their contribution to total output ranges from 11 percent to 15 percent (OECD, 2004:27).

In geographical terms, the distribution of SMEs reflects that of the population as a whole. They are concentrated in the coastal regions along the Marmara and Aegean Seas, with 38 percent and 17 percent of the enterprises, respectively, and in Central Anatolia, with 16 percent. The Mediterranean coastal region (11 percent), the Black Sea region (9 percent), south-eastern Anatolia (6 percent) and eastern Anatolia have far less registered economic activity (OECD, 2004:28).

Turkish industry is much more SME based than the EU industry when the European scales of enterprises are taken into account as a comparison base. When comparing the economy as a whole with that of the EU, it is seen that the agricultural sector and the rural population employed in the agricultural sector have considerably higher proportions in Turkey than corresponding average figures in the EU. However, this situation is in a process of rapid change towards the normal standards of developed countries in line with the movement of urbanization. On the other hand, capital accumulation of Turkey remains insufficient. Foreign capital inflow to Turkey stays at a very low level as well. In this situation considering the surplus labour force that exceeds the capacity of the large enterprise sector, it is an inevitable development option for Turkey to promote SMEs, which is the most economic employment creation area (OECD, 2004: 28).

#### **4.4 SMEs and Entrepreneurship in Turkey –EU Relations**

Although relations between Turkey and the EU (the European Economic Community as it was then called) commenced with the “Association Regime” and the framework of this regime was drawn by Ankara Agreement that took effect on 1 December 1964, relations gained momentum

with the Association Council Decision No:1/95 dated 6 March 1995. This Decision finalized the process of forming a customs union between Turkey and the EU in the area of industrial products. Improvement of cooperation in some sectors was anticipated while financial cooperation was initiated under a unilateral statement issued by the EU. Within the scope of this statement a total of 2, 2 billion ECUs in grants were envisaged for Turkey. However due to certain reasons, only a limited portion of this financial aid (around 33 percent) has been provided to Turkey (State Planning Organisation, 2004:29).

With the Customs Union, the SME Action Plan was prepared in order to support the Turkish SMEs, which was undergoing structural harmonisation. However, this plan which aimed to eliminate the negative effects of the Customs Union could not be realised, as sufficient national resources were not available.

In the Cardiff Summit of June 1998<sup>74</sup>, the EU's "European Strategy for Turkey" document was enacted. Within the framework of this document, an "Industrial Strategy" was formulated with the efforts from both parties to cover the issues related to Turkish industry and SMEs in the Customs Union and harmonisation with the EU. This was followed by the establishment of a Contact Group for Industrial Cooperation between Turkey and the EU, but the strategy was not put into practice by the EU.

After the declaration of Turkey as a candidate country destined to join the Union on the basis of the same criteria as applied to the other Candidate States in Helsinki Summit on 10-11 December 1999, Turkey, like other Candidate States, was foreseen to benefit from a pre-accession strategy to stimulate and support its reforms. While PHARE, ISPA and SAPARD were developed for supporting the harmonisation of Central and Eastern European

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<sup>74</sup> European Council (1998), Cardiff European Council Presidency Conclusions, 15-16 June 1998.

candidates, Turkey was not included in this scope. In this period, financial aid for Turkey came from the allocation of MEDA-II funds and from the funds of the “Pre-Accession Financial Assistance” where Turkey was provided with 177 million Euros of annual support. This support was anticipated to go up to 250 million Euros in 2004, 300 million in 2005 and 500 million Euros in 2006. Besides Turkey’s harmonisation efforts with the EU in a number of fields, harmonisation of SME policies with the EU is also supported by allocating these resources. Turkey had also the opportunity to participate in Community programmes and agencies and meetings between candidate countries and the Union in the context of the accession process

#### **4.4.1 SME Strategy and Action Plan**

After the declaration of Turkey as a candidate country, European Commission prepared first Accession Partnership Document of Turkey in 2001<sup>75</sup>. Concerning the SMEs, specific action is not envisaged in the document. However, revised 2003 Accession Partnership Document<sup>76</sup>, envisages that Turkey develops and implements a national SME strategy in line with the European Charter for Small Enterprises and the Multi-Annual Programme for Enterprise and Entrepreneurship. In the Accession Partnership Document, it is also mentioned that this strategy includes the improvement of the business environment for SMEs, particularly where access to finance is concerned.

Under the pre-accession strategy, financial assistance is possible for Turkish SMEs like other various areas but this is possible under the condition that Turkey prepares its national SME Strategy and Action Plan, which brings

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<sup>75</sup> Council Decision of 8 March 2001 on the Principles, Priorities, Intermediate Objectives and Conditions Contained in the Accession Partnership with the Republic of Turkey, Official Journal of the European Communities L 85/13, 24.03.2001.

<sup>76</sup> Council Decision of 19 May 2003 on the Principles, Priorities, Intermediate Objectives and Conditions Contained in the Accession Partnership with The Republic of Turkey, Official Journal of the European Communities, L 145, 12.06.2003.

Turkish SME and entrepreneurship policies parallel to that of the EU member states and makes the EU financial assistance available to Turkish SMEs. In this framework, studies have been started through the harmonisation of national policies with the EU policies.

Accordingly, Turkish government indicated its intention in the revised Turkish National Programme for the Adoption of the Acquis (NPAA) 2003<sup>77</sup> and outlined the necessity to promote SMEs as by taking the following steps in the short term:

- increasing the capacity in the field of SME financing, including the establishment of new types of financing institutions;
- establishing a Market Maker Institution, which will create a network of service centres for technology transfer at national level, and support SMEs in the fields of technology transfer and industrial problem-solving (GEBZE –Technology support project for SMEs);
- supporting SMEs in terms of harmonization with technical legislation

In the medium term the “Industrial Strategy” and other comprehensive measures are to be adopted<sup>78</sup>. The NPAA envisages around 50 million Euros for capacity building measures and around 3 billion Euros of credits.

An SME Study Group<sup>79</sup> was formed to prepare “Turkish SME Strategy and Action Plan” with the aim of applying the policies towards SMEs at the national level and enhancing competitive power of SMEs in the process of

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<sup>77</sup> Decision of Council of Ministers 2003/5930 on Turkish National Programme for the Adoption of the Acquis (NPAA), Turkish Official Gazette No.25178, 24.06 2003.

<sup>78</sup> Chapter 4.17. of Turkish National Programme for the Adoption of the Acquis.

<sup>79</sup> SME Study Group consisted of Ministry of Industry and Trade, SPO, Undersecretariat of Treasury, Undersecretariat For Foreign Trade, SIS, KOSGEB, TOBB, TESK and coordination with the EU ensured by Secretariat General for the EU Affairs (EUSG).

harmonization with the EU. The SME Strategy and Action Plan was prepared and adopted in 2003<sup>80</sup>.

Implementation of this document, which was prepared within the framework of the pre-accession strategy, is one of the priorities of the SME Chapter of the 2003 Turkish NPAA. The SME Strategy and Action Plan is considered to be the main document for determining related activities of SMEs to be funded under the Pre-accession Financial Assistance of the EU. The SME Strategy and Action Plan is prepared to determine the essential strategies for SMEs and to express clearly the responsibilities of public and private organisations on the way to the desired objectives; and to formulate the sum of required actions and projects.

Turkish SME Strategy and Action Plan indicates lack of know-how and low level of technology, lack of a favourable financial environment as the main weaknesses of Turkish SMEs (State Planning Organisation, 2004: 27).

Turkish SME Strategy and Action Plan determines the areas in which actions are to be taken by taking into account priorities of the European Charter for Small Enterprises and Turkey's national priorities. Actions that are considered to be implemented in the framework of the Strategy are in the areas of finance, technology and competitiveness, which are indicated as weak points of the Turkish SMES.

SME Strategy and Action Plan clearly indicates roles of public and private bodies and identifies development of projects that need to be implemented by utilizing national and international resources in the ten priority areas indicated in the European Charter for Small Enterprises. Strategy fields are determined as follows: education and training for entrepreneurship, development of cheaper and faster processes for business

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<sup>80</sup> High Planning Council Decision No.2003/57 of 10.11. 2003 on Turkish SME Strategy and Action Plan.



start-ups, enactment of better laws and legislation, training to provide qualified personnel, improving on line access and transactions via internet, opening up to new markets, improvements in taxation and financial matters, development of technological and innovation capacity of SMEs, informing SMEs on best practices via internet and developing high level SME support schemes, more effective representation of SMEs on national and international platforms (State Planning Organisation, 2004:51).

In line with the statements of revised Accession Partnership, Turkey has also prepared “Industrial Policy for Turkey<sup>81</sup>” in 2003. Main objective of Industrial Policy for Turkey is specified as increasing competitiveness and productivity of the industry and promoting and maintaining sustainable growth within an outward oriented structure, in the face of increased global competition. In that respect, industrial policy aims to improve the business environment favourable to industrial competitiveness, in which entrepreneurs and enterprises can take initiatives, create opportunities and use their potential. Industrial Policy lays out the principles and policies in order to reach this main objective and one of them is Improving SMEs and Entrepreneurship. Industrial Policy for Turkey document put the case clearly and states that:

..The main objective of SME policy is to improve the productivity of the SMEs, to increase their share within total value added and to enhance their international competitiveness. As Turkey has ratified the European Charter for Small Enterprises in April 2002, significant attention will be given to the principles stated in the Charter. It is of great importance to develop the SMEs, which have positive impacts on creating a competitive market, increasing employment, development of entrepreneurship and improvement of income distribution... (State Planning Organisation, 2003: 50).

Turkish SME Strategy and Action Plan and Industrial Policy which were adopted in 2003 have provided legal basis for the policies towards enhancing SMEs and promoting entrepreneurship in Turkey. In addition, for the first time, a road map for SMEs has been prepared with the aim of applying policies on SMEs and entrepreneurship at the national level and

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<sup>81</sup> High Planning Council Decision No: 2003/44 of 30.09.2003 on Industrial Policy for Turkey.

enhancing competitive power of SMEs in the process of harmonization with the EU.

Furthermore, Turkey's first Preliminary National development Plan (pNDP)<sup>82</sup> is prepared to form the basis for using the financial assistance being provided by the EU within the framework of Turkey-EU relations towards economic and social cohesion in 2003. It is aimed that during the pNDP period (2004-2006), pre-accession financial assistance is to be used in an effective way. Moreover, the necessary infrastructure is envisaged to be initiated for the utilization of structural funds after the accession period. In the pNDP, weaknesses of SMEs are defined in terms of finance.

Finally, the 8<sup>th</sup> Five Year Development Plan, which is running from 2001 to 2005<sup>83</sup>, also outlines necessity to;

- Improve the productivity of SMEs,
- Increase the share of SMEs within the overall credit volume (as of 2004, 5 percent of overall credit volume),
- Back up SMEs with modern financing instruments and institutions within an environment which is in harmony with the capital and financial markets,
- Provide utilisation of financing facilities such as credit guarantee funds, risk capital, financing investment partnerships, asset investment partnerships,
- Support the enhancement of current technology levels of SMEs (State Planning Organisation, 2000: 102-103).

8<sup>th</sup> Five Year Development Plan aims at increasing income and welfare to overcome regional disparities. This is envisaged to take place via supporting industrial activities and capacity building in the enterprise sector and via enhancing entrepreneurship (State Planning Organisation, 2000: 64).

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<sup>82</sup> High Planning Council Decision No: 2003/61 of 22.12.2003 on Preliminary National Development Plan.

<sup>83</sup> Decision of Turkish Grand National Assembly No.697 of 27.06.2000 on 8<sup>th</sup> Five Year Development Plan.

#### **4.4.2 Participation of Turkey to the EU Programmes**

As it is already mentioned in section 3.1, following the recommendations of the report by the Business Environment Simplification Task Force (BEST) set up at the Amsterdam European Council in June 1997, the European Union developed an Action Plan to foster SME entrepreneurship and competitiveness. The Action Plan, in which Turkey has taken part, is based on the sharing of best practices among participating countries. Action plan has been deployed in the areas of *education and training, access to capital, visibility of support services, public administration and employment and working conditions*.

Following the Business Environment Simplification Task Force, with the adoption of the ***European Charter for Small Enterprises***, European Commission started to implement its SME and entrepreneurship policies more effectively. The acceding and candidate countries (Bulgaria, Romania and Turkey) endorsed the Charter in Maribor (Slovenia) in 2002 and have been taking part in the implementation process since 2002.

By endorsing this Charter, Turkey has committed itself with all institutions and bodies to take concrete steps in ten areas<sup>84</sup> to develop programmes and projects, and to allocate the required resources. Therefore, the Charter in a way sets Turkey's long-term SME strategy. The policies implemented and results obtained in the areas covered by the Charter are reviewed in annual reports. Turkey's contribution to these reports<sup>85</sup> are prepared under the coordination of KOSGEB and by the participation of relevant institutions and are submitted to the European Commission.

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<sup>84</sup> Ten action areas of the European Charter for Small Enterprises are given in section 3.5.2

<sup>85</sup> 2002, 2003 and 2004 reports in relation to the EU SME Charter were prepared under the coordination of KOSGEB and by the participation of relevant institutions and these reports were submitted to the European Commission.

Turkey achieved some progress concerning the Charter's priority areas. As regards to *Education and Training (area 1 of the Charter)*, the Programme for Development of Young Entrepreneurs was implemented within 27 universities in 2003-2004 academic years, as regards to *Cheaper and Faster Start Up (area 2 of the Charter)* tradesman and artisans time have the opportunity to register online for the first upon implementation of the e-Tradesman project launched by the Ministry of Industry and Trade under the e-State project. Concerning the *Improving Online Access (area 5 of the Charter)*, under the Tax Department Automation Project II launched in April 2004, tax payers are able to have access to their account, payments and debts in the tax department through the internet. The project also provides the mean for tax payers to submit their declaration and additional statements on the internet.<sup>86</sup>.

*In the Area of Access to Finance (area 7 of the Charter)*, a co-operation has been established with banks to provide new credit mechanisms for SMEs. In the 2003-2004 period, KOSGEB provided a total of 1627 SMEs repayable loans with low interest rates and 30 million Euros which transferred to three public banks for export loans with no interest rate.

Under the *Straightening the Technological Capacity of Small Enterprises (area 8 of the Charter)*, Turkey has established two innovation relay centers with the two projects<sup>87</sup> Moreover KOSGEB, has provided computer software support to SMEs, particularly for software for Institutional resource planning and for manufacturing sector. As of July 2004, 1074 SMEs were provided support for 8 million Euros in this field.

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<sup>86</sup> For further information see, Report on the Implementation of the European Charter for Small Enterprises in the Candidate Countries, COM(2005) 30 final, 08.02.2005. Available at: [http://europa.eu.int/comm/enterprise/enterprise\\_policy/charter/index.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/charter/index.htm), (09.04.2005).

<sup>87</sup> "IRC-AEGEAN Project" and the "IRC Anatolia Project".

Furthermore, ***Multiannual Programme for Enterprise and Entrepreneurship and in Particular for Small and Medium Sized Enterprises (2001-2005)*** which is the main financial instrument of the European Charter for Small Enterprises calls for an array of measures in the areas specified in the European Charter for small enterprises. Turkey has also been participating the Programme under the coordination of KOSGEB since 2002<sup>88</sup>. Turkey's share of contribution to the Programme is approximately 4.5 million Euros which is provided from "Pre-Accession Financial Assistance" and KOSGEB budget. Within this Multiannual Programme, Turkey aims to share experiences, create synergy among bodies that promote SMEs, foster co-operation between institutions, activate dormant resources and steering them towards areas, where they are needed. SME support policies, projects, best practices and successful solutions within the European Union are of important for Turkey in order to provide accumulation of knowledge and experience in these fields.

Under the programme, Turkey specifically aims to learn about rapidly deploying the financial instruments and mechanisms-related to start-up capital, venture capital, credit guarantee and "business angels"<sup>89</sup> which is developed by the European Union to support knowledge and technology based and innovative businesses.

Financial and non-financial supports for Turkish SMEs which are provided from the EU funds and national resources are summarised in the following section.

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<sup>88</sup> Turkey-EU Momerandum of Understanding Regarding the Participation of Turkey to the Multiannual Programme for Enterprise and Entrepreneurship and in Particular for Small and Medium Sized Enterprises was signed on 23 October 2002.

<sup>89</sup> Business Angels are private financial enterprises that provide financing instruments to entrepreneurs other than banks. Further information is available at:  
[http://europa.eu.int/comm/enterprise/entrepreneurship/financing/business\\_angels.htm](http://europa.eu.int/comm/enterprise/entrepreneurship/financing/business_angels.htm) (14.08.2005)

## **4.5 Supports to Strengthen SMEs and Promote Entrepreneurship in Turkey**

Supports and aids provided for Turkish SMEs are classified under three headings in this section of the thesis. Firstly financial aids, which are granted by both Turkish governments and EU are analysed. Secondly supports given specifically for innovation, technology dissemination and R&D are introduced; finally activities on education, training, and consultancy and for access to information are presented.

### **4.5.1 Financial Supports for SMEs**

Turkish government issues a list of state aids to investment annually. In order to take advantage of such state aid, a special state aid certificate is obtained by firms from Undersecretariat of Treasury. Typical state aid programmes are tax allowances, deferrals and exemptions depending on the location and type of investment, VAT refunds for locally purchased machinery, customs exemptions on imported machinery and raw materials.

Investment and working capital credits are provided for investors to whom incentive certificates are given within the framework of Council of Minister Decision on State Aids for Investments by SMEs<sup>90</sup> which is implemented by Undersecretariat of Treasury. Within the scope of incentive certificates, SMEs are also entitled to make use of exceptions from customs duty and mass housing fund, VAT exclusion, and taxes, duties and fees exemption (Council of Ministers Decision No.2000/1822).

Table 4.6 summarises distribution of SME incentive certificates by Undersecretariat of Treasury from 1997 to 2003. 372 million Euros of total

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<sup>90</sup> Council of Ministers Decision No.2000/1822 on State Aids for Investment by SMEs, Official Gazette No.24291, 18.01.2001.

loans were allocated to more than 6 thousand SMEs in this period. Approximately one third of total loans were allocated as working capital loans and remaining loans were allocated as investment loans to SMEs. As it is clearly indicated in Table 4.6, there is a substantial decrease in total loans from 1997 to 2003.

Table 4.6 - SME Incentive Certificates (1997-2003)

Year	Number of SMEs	Number of Employment	Investment Loans (Million Euros)	Working Capital Loans (Million Euros)	Total Loans (Million Euros)
1997	1.550	14.974	92	18	110
1998	1.171	12.117	54	13	67
1999	1.695	10.222	58	38	96
2000	1.229	5.587	38	26	64
2001	246	674	4	3	7
2002	390	1.498	14	6	20
2003	147	517	6	2	8
Total	6.428	45.589	266	106	372

Source: State Planning Organisation, 2004:21.

There is no financial institution established for the purpose of financial support for SMEs, however the T. Halk Bank bears this function. The most important share within the financial aids provided for SMEs is constituted by loans offered by T. Halk Bank with the convenient terms. Breakdown of the Bank's loans between the years 1999-2002 is presented in Table 4.8.

As shown in Table 4.7, impact of the 2001 economic crises affected the amount of loans provided by the Bank. A considerable decline is observed in the amount of SME fund loans and the volume of loans for tradesman and artisans while the most serious decline occurred in the entrepreneurship loans which decreased from 17 million Euros in 1999 to 44 thousand Euros in 2002.

Table 4.7 - T. Halkbank Inc. Loans (Million Euros) (1999-2002)

Years	SME Loans				Loans for Tradesman and Artisans		Entrepreneurship Loans	
	Fund Loans		Industrial Loans		Number	Amount	Number	Amount
	Number	Amount	Number	Amount				
1999	-	686	26.074	172	707.546	676	29.614	17
2000	-	742	26.849	153	877.757	682	4.536	5
2001	37.492	560	14.191	27	891.222	159	2568	0,369
2002	33.567	428	18.873	72	145.059	102	520	0,044

Source: Source: State Planning Organisation: 2004, p19.

Undersecretariat of Foreign Trade provides state aid for exports of enterprises. In this context, data regarding the aids provided for SMEs in the period of 1996-2000 are given in Table 4.8. Largest share of the state aid for exports is allocated to participation in exhibitions abroad and R&D activities. Approximately 41 million Euros of total state aids for exports was allocated to more than 8 thousands SMEs which participated in various exhibitions in 1996-2000 period and approximately six hundred SMEs received more than 24 million Euros for their R&D activities in the same period. It is distinguished that only 5 SMEs received state aids for training in this period.

Table 4.8 - State Aid for Exports to SMEs (Euro) (1996-2000)

Type of Aid	Number of SMEs	Amount of Aid
R&D Aid	626	24.547.368
Support for Environmental Cost	217	211.121
Support for Market Research	240	235.454
Aid For Offices/Store Abroad	47	1.359.477
Support for Participation in Exhibitions Abroad	8.380	40.995.531
Aid for Training	5	519.127
Aid for Employment	9	316.882
Aid for Brands	18	1.490.592
Total	10.142	69.600.394

Source: State Planning Organisation, 2004:17.

Apart from the state aids, Turkey is intended to introduce non-traditional financial instruments in line with the European Charter, such as venture capital and KOBİ A.Ş. which was established as a new financial instrument. This company provides capital support to the firms in the form of



partnership. 49 percent shares of the firms whose application is found appropriate is bought by the KOBİ A.Ş., thereby it is targeted to provide financial sources for SMEs without interest.

Second non-traditional financial instrument is venture capital for SMEs. Venture capital is a term to describe the financing of start up and early stage businesses as well as business in turn around situation. Venture capital investments generally are higher risk investments but offer the potential for above average returns (Akkaya and İçerli, 2001:63). Arrangements concerning the venture capital investment companies were adopted in 1993<sup>91</sup>. The new Communication of Capital Market Board<sup>92</sup>, generally parallel to international practices, has simplified the public disclosure obligations of venture capital investment companies<sup>93</sup>. Currently “Vakıf Risk Venture Capital Investment Company” and “İş Risk Venture Capital Investment Company” are operating as venture capital investment companies. In 2004, SME Venture Capital Investment Partnership was established by TOBB and KOSGEB (KOSGEB, 2004).

As of 2000, value of the venture capital funds which are 43 billion US Dollars in the EU, was realised as 250 million US Dollars in Turkey (Çetindamar, 2002:84). However, an important progress made in the field of venture capital is the establishment of Venture Capital Association of Turkey in 2004. With the establishment of this Assosication, the inflow of funds is expected to increase (KOSGEB, 2004).

The Capital Market Board of Turkey makes arrangements towards meeting financial needs of SMEs. It is authorised to make arrangements concerning the establishment of markets from which SMEs obtain funds. In

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<sup>91</sup> Communication Concerning the Procedures and Principles of Venture Capital, Turkish Official Gazette No.21629 of 06.07.2003.

<sup>92</sup> Communication Serial VI No.16 of Capital Market Board, Official Gazette No.25339 of 07.01.2004.

<sup>93</sup> In Turkey Capital Markets Board is a sole independent regulatory and supervisory authority for the Turkish capital markets.

2003, as a result of the arrangements made by Capital Market Board, “Second National Market” has been established in the Stock Exchange for SMEs which are unable to meet the requirements of the National Market. Thereby it is tried to ensure that SMEs raise funds in the Capital Market (KOSGEB, 2004).

The Credit Guarantee Fund Operation and Research Co. Inc. (KGF A.Ş.) was established in 1991. Its shareholders are the Union of Chambers and Commodity Exchange (TOBB), The Vocational Training and Small Industry Supporting Foundation (MEKSA), Turkish Foundation For Small and Medium Businesses (TOSYÖV), Turkish Artisans and Craftmen Confederation (TESK), Halkbank and KOSGEB. It has been issuing guarantees for SMEs since 1994. Up to 2003, guarantees which are 43.6 million Euros in total have been issued in response to approximately one thousand applications from more than six hundred enterprises. The KGF A.Ş., which currently has agreements with 4 banks<sup>94</sup> issues guarantees in an amount of up to 400 thousand Euros and for up to 80 percent of loans to be used by SMEs which lack sufficient guarantee (KOSGEB, 2003:23).

As regards to the EU financial supports, all the instruments for financial assistance<sup>95</sup> were merged in a single programme in 2001 by a Framework Regulation<sup>96</sup> of the Council which ensures funds for the priority areas in the Accession Partnership and the National Programme of Turkey. As of 2002, all funds for Turkey are pre-accession oriented and evaluated under the “Turkey-EU Pre-Accession Financial Assistance” Since enhancing Turkish SMEs is one of the priorities of both Accession Partnership and National Programme of Turkey, some programmes and projects have also

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<sup>94</sup> Halkbank, Garanti Bank, Şeker Bank and Vakıfbank.

<sup>95</sup> In the Helsinki European Council, three instruments for financial assistance to Turkey was envisaged, these were MEDA II Funds, European Strategy Programme for Development of Customs Union, European Strategy Programme for Economic and Social Development.

<sup>96</sup> Council Regulation No 2500/2001 of 17.12.2001 Concerning Pre-Accession Financial Assistance for Turkey, Official Journal of the European Communities L342, 27.12.2001.

been launched under “Turkey-EU Pre-Accession Financial Assistance”. Some of the programmes and projects within this framework are introduced below.

In 2001 a project on *Small Enterprises Loan Programme (SELP I)* was launched in order to address the specific financial needs of Turkish SMEs and to create a system of incentives for the local commercial banks. The current endowment of the SELP I contributes to meet massive demand by SMEs only to a limited extent, as the project is restricted to three cities (Kocaeli, Izmir and Gaziantep) which are relatively well developed

The overall objective of the Programme is to contribute to the economic development and employment creation and to support the expansion and strengthening of the financial sector. The Programme has 20 million Euros budget and the maximum loan amount is 30,000 Euros for fixed capital investments. After some delays with the start of the programme, SELP I gained momentum in 2004. The European Commission enlisted German Bank KfW in July 2002 to establish and manage the SELP I..

The good results in these regions have initiated a similar project under 2005 programming of Pre-accession Financial Assistance of the EU<sup>97</sup>. An extension of the SELP approach under Small Enterprises Loan Programme II (SELP II) is in close cooperation with other EU-funded programmes and it allows the inclusion of less developed regions and/or cities, especially in the eastern part of the country<sup>98</sup>. Taking into account the weight of the agricultural sector in the less developed regions of Turkey, lending to the agricultural sector is also given priority within the framework of the SELP II project. This is foreseen to improve livelihood and economic development of that region, being a precondition for social and political stability. Duration of

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<sup>97</sup> 2005 Programming of Turkey-EU Financial Assistance was not finalised and financing memorandum has not been signed yet.

<sup>98</sup> Regions have not been determined yet.

the SELP II is foreseen as 7 years after signing the Funding Agreement and (4<sup>th</sup> Quarter 2005 - 4<sup>th</sup> Quarter 2012) and has 20 million Euros Budget.

Purpose of the SELP II is to make available to the target group permanent access to loans (particularly long-term loans) to be provided by private commercial banks at close to market conditions in the project locations. Target group of SELP II is bottom end SMEs which have less than 50 employees and assets of less than 1 million Euros. SELP II envisages 'small loans' up to a maximum of 50 thousand Euros for fixed capital.

Activities within the project cover three major components: First, KfW is foreseen to set up the *European Fund for Turkey (EFT)* to increase the Turkish capacity in the field of SME financing. This Fund is envisaged as an umbrella for the above mentioned activities and is available to refinance for small loans (particularly long term loans) provided by commercial banks. Secondly, *An Exchange Risk Cover Fund (ERCF)* is envisaged to be set up in order to mitigate the currency risks born by the participating banks through extending TRL-denominated loans to final borrowers. Third activity is technical assistance such as providing training for Banks staffs and capacity building for Turkish Development Bank (TKB) to manage European Fund for Turkey (EFT) which is foreseen to be established within the SELP II project.

Eastern Anatolia Development Programme is another project funded by the EU resources. Programme covers Bitlis, Hakkari, Muş, and Van (TR 90 NUTS 2 Region) and 8,5 million Euros is allocated for SME by the SME grant scheme component of the project. SME component of the Eastern Anatolia Development Programme aims at increasing employment and creating new jobs by supporting local SMEs. Under the programme successful projects are supported by means of grants.

Apart from the Eastern Anatolia Development Programme, three Regional Development Programmes which cover 27 provinces<sup>99</sup> are financed by the EU funds within the framework of the EU-Turkey Pre-Accession Financial Assistance. The wider objectives of these programmes are to reduce regional disparities and support sustainable development. All of these programmes envisage grant schemes for SMEs. The target groups are small and micro enterprises active in agriculture, manufacturing and services sectors. Granting a maximum of 100 thousand Euros per project encourages physical investments of the target group enterprises. However, not more than 50 percent of the project cost is covered. In order to increase the management capacity of the target group, entrepreneurship activities are promoted via technical assistance covering topics such as enterprise management, consultancy services and access to business database.

Under the 2004 programming of Turkey-EU Pre Accession Financial Assistance, a project on *Supporting Women Entrepreneurship* was launched. It has two components, first component aims to support women entrepreneurship, through the management, training and consultancy and second one aims to support women entrepreneurship through establishment of business incubators. Total budget of the project is 4.8 million Euros. As an institutional beneficiary, Confederation of Turkish Tradesmen and Craftsmen (TESK) was authorized and Chamber of Tradesmen and Craftsmen (ESOB – Esnaf ve Sanatkar Odaları Birliği) located in regions is responsible to implement the Project. The target group of the project is women who are ready to establish their own business and be part of the formal economy and also women who want to reinforce their current business. The other target groups are women associations supporting women development in the economy and in the society. Project funds are available to cover costs related with building renovation, equipment for common use, technical assistance

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<sup>99</sup> Bitlis, Hakkari, Muş, Van (TRB2 Region Development Programme); Amasya, Çorum, Samsun, Tokat, Çankırı, Kastamonu, Sinop, Erzurum, Erzincan, Bayburt (TR82, TR83 and TRA1 Regions Development Programme); Ağrı, Ardahan, Bingöl, Elazığ, Iğdır, Karamanmaraş, Kars, Kayseri, Konya, Malatya, Sivas, Tunceli and Yozgat (TRA2, TR72, TR52 and TRB1 Level II Regions Development Programme)

team, incubator's personnel and operating expenses for the duration of the project which is 24 months.

Other project under the 2005 programming of Turkey-EU Pre Accession Financial Assistance is *Fashion and Textile Cluster (FTC) Programme*. It aims to extend network among SMEs in the textile and clothing sector, at local, national and European levels, as well as with business support organisations. Total budget of the project is 10 million Euros and 2 million Euros grant scheme is envisaged for SMEs in the sector. This programme is designed as a multiannual programme and consists of 2 main programme phases. The first phase consists of institution building and technical assistance related with the establishment the fashion and textile cluster. According to the results of the first phase, the second phase is considered to have investment support (common use equipments for the cluster and/or grant scheme for SMEs). Fashion and Textile Cluster Programme envisages investment in five main components: Cluster Coordination Agency, Fashion Institute, R&D Centre, Consultancy Centre, five Joint projects. The beneficiary of the Programme is Istanbul Textile and Apparel Exporters Union (ITKIB – İstanbul Tekstil ve Konfeksiyon İhracatçılar Birliği).

#### **4.5.2 Innovation, Technology Dissemination and R&D Supports for SMEs**

*Law on Technology Development Zones*<sup>100</sup> encourages the establishment of Technology Development Zones in Turkey and includes ensuring the adaptation of SMEs to new and advanced technologies and commercialising technological information. This law ensures cooperation between universities, research institutions and organizations and production sectors and introduces the necessary incentives and support mechanism for

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<sup>100</sup> Law No.4691 on Technology Development Zones was published in the Official Gazette No. 24454 on 6 July 2001.

SMEs to form a technological infrastructure. These zones serve the aim of promoting technology dissemination towards SMEs. Under the provisions of the Law some technoparks have been accepted as Technology Development Zones<sup>101</sup> by the Board of Evaluation<sup>102</sup> (KOSGEB, 2003:24). All the firms in these zones are SMEs and they operate mostly on communication technologies, defense industry and electronic sectors. The earnings of management companies and the earnings derived from software and R&D activities exclusively in these zones by payers of income and corporation tax, which operate in these zones, are exempted from income and corporation tax until the end of 2013. The salaries paid to researches who are specialized in software and R&D personnel in connection with these tasks are exempted from all taxes until the end of 2013<sup>103</sup>

Technology Development Foundation of Turkey (TTGV), which has been established in line with the agreement between World Bank and Turkey in 1991, gives technological support services to firms. It also acts as a catalyst in establishment of technoparks in Turkey. For this reason, TTGV make contribution for the establishment of technoparks that lead to the formation and development of new businesses where results of R&D works of universities and research centers can be transferred; that increase the technological infrastructure and income level in the regions where they are located; that create employment opportunities for highly skilled employees and that attract foreign investors. TTGV provides both financial support and expert assistance to the sponsoring institutions to design their technopark proposals with international best practices. It gives credits to the technopark

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<sup>101</sup> Under the provisions of the Law on Technology Development Zones, following zones were established: Ankara (Middle East Technical University, Bilkent University and Hacettepe University), İzmir (Atatürk Organized Industrial Zone), Gebze OSB Technopark, Istanbul (Istanbul Technical University Arı Technopark, TUBITAK Marmara Center for Research and Yıldız Technical University), Eskişehir Organized Industrial Zone and Kocaeli Industrial Zone. Total number of firms functioning under these zones are 166 and they employ 1473 researchers.

<sup>102</sup> Board of Evaluation is comprised of State Planning Organisation (SPO), Ministry of Public Works and Settlement, High Education Council (YOK), TUBITAK; TOBB; TTGV.

<sup>103</sup> Implementing Regulation on Technology Development Zones, Turkish Official Gazette No.24790 on 19 06.2002, Article 37.

projects up to the 20 percent of the project budget. In addition it provides fund with low interest rates to the firms who make R&D. TTGV also provides assistance to beneficiary firms with their patent application.

*Decision of Council of Ministers on State Aids for Investments*<sup>104</sup> which was adopted in 2002, regulates allocation of loans on favourable terms for R&D investments undertaken by enterprises in the status of an SME as well as by large-sized enterprises and other investments undertaken in the priority technology areas determined by the High Board of Science and Technology or TUBİTAK. It also provides some state aids to Technology Development Zones.

Concerning State Aids for Investments to SMEs<sup>105</sup>, in order to provide the use of new and advanced technologies by SMEs, the government develops support instruments such as, allocation of loans on favourable terms out of the budget resources for SME investments; exemption from taxes, duties and charges; exemption from value added tax; exemption from customs duties and social housing fund levies for their renewal, modernisation and quality upgrading investments.

KOSGEB offers a range of different support measures aimed at enhancing the innovative capacities of small firms and supports R&D efforts through Technology Development Centres (TEKMER – Teknoloji Geliştirme Merkezleri). KOSGEB has set up 13 TEKMERs<sup>106</sup> within various universities to encourage and support entrepreneurship towards advanced technology, to strengthen university-industry cooperation and convert the results of technology transfer and R&D activities into economic value. KOSGEB signs a

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<sup>104</sup> Council of Ministers Decision No 2002/4367, Official Gazette No.24810 of 9.07.2002.

<sup>105</sup> Council of Ministers Decision No.2000/1822, Turkish Official Gazette No.24291 of 18.06. 2000.

<sup>106</sup> 13 TEKMER are in the following Universities; METU,Ankara, Boğaziçi, Dokuz Eylül, Ege, Erciyes,Hacettepe, Karadeniz Technique, Pamukkale, İstanbul Technique, İstanbul, Yıldız Technique and there is also TEKMER in the Gebze High Technology Institute.



contract with the universities for 10 years in order to establish TEKMER in the universities. These centers which are established within a university use all the facilities of the university and receive consultancy from the university. At the centres, entrepreneurs who have an idea to develop new products or technology are provided financial support for equipment purchase, information services, financial and managerial consulting assistance, information services, training programmes and acquisition of software for R&D activities of technology based companies. (KOSGEB, 2003:24). If the Technology Development Centres of KOSGEB are established in the Technology Development Zones, they can benefit from the tax exemptions provided by the Law on Technology Development Zones. In these Centres KOSGEB also tries to develop new incubators, provide training and offices for entrepreneurs and help them to develop business plan.

Concerning the research and development, latest development is the establishment of *Innovation Relay Centers* (IRC) under the Sixth Framework Programme of the EU. First innovation relay centre of Turkey, which is the IRC Anatolia Consortium<sup>107</sup>, was established in 2004. It is formed by METU Technopark (the coordinator), which is a private company managing Turkey's biggest science park, KOSGEB and the Ankara Chamber of Industry (ASO). IRC Anatolia Consortium undertakes to build and develop an organizational infrastructure for promoting the transfer of research results and technologies, in accordance with the needs expressed by the industrial structure of Southeast, Middle, and East Anatolia regions in Turkey. IRC Anatolia is the bridge between European research and technological development (RTD) programmes and the Anatolian region. The main purpose of IRC Anatolia is to develop mutually profitable business alliances, and to help SMEs to find suitable technology partners or suppliers.

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<sup>107</sup> More information is available at: <http://www.irc-anatolia.org.tr>, (01.08.2005).

### **4.5.3 Supports on Education, Training, Consultancy, Access to Information and Management for SMEs**

KOSGEB provides educational support for both start up firms and existing firms. The training programmes are intended to increase the supply of qualified personnel who are aware of and able to use modern technology in the production process. The training is delivered under the two types of training programmes. General education programmes are produced and delivered through KOSGEB facilities and deal with basic managerial and technical issues. More specialized training is provided by a variety of public and private professional organizations on topics not included in KOSGEB courses. KOSGEB provides funding for 80 percent of the costs of general education programmes and up to 4.000 Euros per firm for procurement of specialized training. The support ratio for such training varies by type of region; firms in developed regions are eligible for 70 percent coverage and firms in least developed regions receive up to 90 percent of expenses. Ministry of Education also provides vocational training for SMEs.

The *Entrepreneurship Development Institute* of KOSGEB, which was established in 1998, provides entrepreneurship courses to University students in cooperation with their universities. This institute provides business start-up training and business development training to current and future entrepreneurs.

KOSGEB has “*Small Enterprise Development Centers (KÜGEM – Küçük İşletmeleri Geliştirme Merkezleri)*” which provide training, consultancy and laboratory services to entrepreneurs. However in 2003, laboratories under KÜGEMs were separated from these Centers and KÜGEMs renamed as Business Development Centers (IGEM – İş Geliştirme Merkezleri). As of 2005, there are 26 IGEM and 16 laboratories in different provinces of Turkey.

Under the European Commission Multiannual Programme for Enterprise and Entrepreneurship and in Particular for Small and Medium Sized Enterprises, 9 “Euro Info Centers”<sup>108</sup> were established by KOSGEB. These centres provide information on technical, financial and trade issues as regards to the EU legislation and the EU funded projects. “KOBINET Information Network” project, which is created by Euro Info Centers and supported by the EU, is in practice since 1998. It has approximately one million Euros budget and KOSGEB contribution is 305 thousand Euros. KOBINET is a SME information-sharing network. SME database, one page free web site, notices of business proposals and useful information for SMEs are available online via KOBINET.

“EU Enterprise Development Centers - AB İş Geliştirme Merkezleri” are centres which are established by the financial contribution of the EU under the MEDA programme in 1998 and supported by Turkish Union of Chambers and Commodity Exchange (TOBB). ABİGEM provide managerial assistance, including counselling regarding the hiring of employees with special skills needed to increase capacity in the businesses operated in co-operation with canthers. Funds are provided to cover partial reimbursement of skilled personnel for periods ranging from 12 to 18months. The support covers approximately 70percent of salary costs in the developed regions of Turkey. Enterprises in less developed regions receive support for 90 percent of salary costs. Currently there are four centers in Kocaeli, İzmir, Denizli and Gaziantep.

Moreover, *Halkbank* provides consultancy services to entrepreneurs on project consultancy, financial and technical information via its “information centers for entrepreneurs”.

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<sup>108</sup> Euro Info Centers are located in İstanbul (2 centers), Bursa, Ankara, Samsun, Denizli, Konya, Gaziantep and Adana.

Furthermore, KOSGEB<sup>109</sup> develops *incubators* for the firms which are at their start up phase. Incubators provide cheap office, equipment and training for SMEs, support entrepreneurs on legal and management issues and help them to develop business plans.

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<sup>109</sup> Beside KOSGEB, there are a few private business incubators in Turkey such as Ericsson Mobility World and Siemens Business Accelerator.

## **CHAPTER 5**

### **BOTTLENECKS OF TURKISH SME POLICY AND RECOMMENDATIONS**

This Chapter initially intends to reveal the main weaknesses of Turkish SMEs and problems encountered in promoting policies towards entrepreneurship and SMEs. Therefore a survey was conducted on SMEs in Adana and possibility to generalise the results of the survey to all Turkish SMEs is tried to examine. This case study is considered to be a significant contribution to revealing the problems of Turkish SMEs and measuring the effectiveness of the policy tools implemented by various organisations under the SME Policy of Turkey. This Chapter also develops some recommendations in order to strengthen the Turkish SMEs and promote entrepreneurship in the light of EU policies.

#### **5.1 Main Weaknesses of Turkish SMEs and Problems in Promoting Policies Towards Entrepreneurship and SMEs**

Although, entrepreneurs are defined as those who engage in entrepreneurship and concept of entrepreneurship refers to a process, which includes taking risk, making innovation, implementing this innovation, it is difficult to measure effectiveness and size of this action. Therefore most of the studies in the world (GEM, 2001, OECD 1998, Lunstrom and Stevenson, 2002) accept number of new firms as number of entrepreneurs.

Researchers studying on entrepreneurship generally use two indicators to determine entrepreneurship level of a country. One of them is

the number of business owners as a percentage of the labour force excluding agriculture and the second one is the total dynamic. Total dynamic is the number of business entry minus number of business exits divided by the total number of firms at the beginning of the period (Lunstrom and Stevenson, 2002:55-237).

Table 5.1 indicates entry and exits of the firms in 1997-2001 periods. It is seen that number of new entries starts to decrease after 1999. Although number of entries is around 22,7 million in 1999, it decreases to 16 million in 2001. In the same period, number of exits increased from approximately 10,1 million to 13,7 million. It is concluded that net entries showed substantial decrease in 1999-2001 period. Most important factor for this decrease is explained in terms of financial bottlenecks of Turkey and 2001 financial crises.

Table 5.1 - Number of Business Entry and Exit in Turkey (1997-2001)

	1997	1998	1999	2000	2001
Number of Entries	11.598	18.023	22.691	21.404	16.171
Number of Exits	13.391	11.940	10.166	12.055	13.707
Net Entries	1.793	6.083	12.525	9.349	2.464

Source: Çetindamar, 2002: 61.

Table 5.2 indicates entry and exits of the firms in selected countries and Turkey. Net entry in Turkey seems to be higher than Finland, UK and Spain, however proportion of the businesses entry (3,5 percent) to total business is lowest in Turkey when compared to other countries. This may indicate that entrepreneurship level is lower than the selected other countries.

Table 5.2 - Business Entry and Exit in Selected Countries and Turkey

Year	Country	Proportion of Business Entries to Total Enterprises (%)	Proportion of Business Exits to Total Enterprises (%)	Net Entry (%)
1986-1991	Finland	11,2	9,8	1,4
1995-2000	Sweden	7,8	2,6	5,2
1996-1998	Spain	13,4	11,4	2
1984-1991	USA	13,6	9,2	4,4
1995-1999	UK	10,09	10,3	0,6
1995-1999	Turkey <sup>a</sup>	3,5	0,9	2,6

Sources: Çetindamar, 2002:61; Lundström, A. and Stevenson, L., 2001(b):37.

If the manufacturing sector in Turkey is analysed in terms of entrepreneurship level, situation is not much more different than the overall situation. Table 5.3 indicates that entry rates are inconsistent in the period of 1985-1995. Lowest entry rate is 8 percent in 1991 and highest entry rate is 21 percent in 1992. During the 1985-1995 period, while net entries are very low, exit rates are very high in the manufacturing sector. It indicates that business environment is not appropriate in order to entrepreneurial firms to survive and become widespread.

Table 5.3 - Entry and Exit in Manufacturing Sector in Turkey (1985-1995)

Year	Proportion of Business Entries to Total Enterprises (%)	Proportion of Business Exits to Total Enterprises (%)	Net Entry (%)
1985	16	9	8
1986	13	8	5
1987	11	9	2
1988	12	9	3
1989	11	10	1
1990	10	10	0
1991	8	10	-1
1992	21	19	12
1993	12	10	2
1994	9	7	1
1995	12	12	0

Source: Çetindamar, 2002:139.

Finally, number of business owners who are evaluated as entrepreneurs increased in the period of 1989-1999, however percentage of business owners to total employment decreased in the same period. (Çetindamar, 2002:140).

It may be concluded that SMEs in Turkey is not successful to survive and Turkey is not successful in entrepreneurship area and finally Turkish society is not an entrepreneurial society.

Reasons of this weak situation are summarised under three titles; first issue is the policies surrounding the SMEs, second one is insufficient know-how and low level of technology and the last one is accessing to finance.

### **5.1.1 Policies Surrounding the SME Sector**

For many years, Turkish firms had to operate in a particularly unstable and unfavourable macro economic environment characterised by high inflation and succession of deep recession. There is no sustainable macroeconomic environment in which the business sector and in particular SMEs operate.

Apart from the macro economic environment, there is no systematic long term SME Policy in Turkey, which entails a wide range of policy domains including education, R&D, competition policies, labour market and social policies and a strong banking sector. Turkish SME Policy is developed on trial and error. Therefore, SMEs in Turkey encounter many problems in their business environment and they are not able to compete with their European partners. Moreover, there have been no efforts concerning the promotion of entrepreneurship in Turkey. Nowadays such an approach is emerging but still there is not a separate entrepreneurship policy to create entrepreneurial society.



SME Strategy and Action Plan which was prepared by Turkish authorities for 2004-2006, is not a long term strategy. The Strategy has some weaknesses. One of them is that, although there are many actions throughout the document to be accomplished, no mechanism is foreseen to evaluate the accomplishments and success of the actions.

The set of SME policies and programmes is less effective than it might be. OECD criticise SME support structure of Turkish government by pointing out relatively high levels of support for relatively small numbers of SMEs. This kind of support structure may produce positive outcomes for some SMEs, but it is unlikely to do much to stimulate change throughout the economy. An alternative model, which awards smaller subsidies to many SMEs can provide greater returns to the economy (OECD, 2004:18). Moreover, governments have focused on increasing productivity and competitiveness of the SMEs in the industrial sector but have placed less emphasis in other sectors, such as wholesale and retail trade and service sectors.

Despite the wide range of its activities, KOSGEB supports the SME sector in a limited manner. Although with its information acquisition and experience, KOSGEB is capable to support large numbers of smaller enterprises, most of its programmes still narrowly focus on supporting medium-sized industrial enterprises, with little support to smaller business start-ups.

There are administrative, legislative and regulatory burdens which impact existing small firms and hamper new business entries. While significant progress has been made and business registration process is

legally reduced from 19 steps to three in 2003<sup>110</sup>, further easing of bureaucratic constraints is needed to support new business creation. Entrepreneurs claim that closure procedures of a business take 2 years in Turkey, it is a bottleneck for those entrepreneurs who want to change their area of business.

The complexity of some supports which are provided by KOSGEB and other institutions, and depth and breadth of the programmes make it difficult for SMEs to understand and apply them.

There is no common definition of SMEs that includes SMEs in all industries and is harmonised with the EU applications. Existing definitions usually take into account the average number of workers employed annually by enterprises. Using these criteria as sole criteria makes the definition distorted. Having large shares of equity in a small firm by the large companies hinders this small firm to behave like SMEs. This situation misleads both researches and policy makers. Since large shares of equities are owned by large firms, these kinds of SMEs do not have financial problems. These enterprises chose being small just to use advantage of being small. It causes unfairness in terms of policy implementations for other SMEs that have growth problems. So a common definition that includes autonomous criteria is urgently needed by Turkish SMEs.

State Institute of Statistics does not develop the collection and publication of SME statistics according to the standards developed by EUROSTAT and harmonised with the EU practice. Therefore it is very difficult to carry out academic studies for researchers and evaluate impacts of the policies for policy makers. Lack of publications and academic studies concerning the SMEs makes it difficult for SMEs to be better known within the Turkish economy.

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<sup>110</sup> Under the Reform Programme to Improve the Investment Environment in Turkey, Law No. 4884 was published in the Turkish Official Gazette No.25141 of 17 June 2003. This law reduced red tape for investments in Turkey.

There is no impact assessment unit that analyses effects of the applied policies, programmes and results of the implemented projects. In 2004, KOSGEB has established a similar unit called the Research and Analysis Unit, however this office is only in charge of the industrial sector. Moreover, without common definition and a set of comparable statistics, this unit does not seem to work efficiently.

SMEs are not under a framework law. This situation creates some disadvantages for SMEs. For example, micro enterprises are not subject to bankruptcy provisions and they do not have composition in bankruptcy rights. On the other hand, Turkish Trade Law does not accept work places belonging to tradesmen and artisans as commercial enterprises (Ekinçi, 2003:52).

There are also problems concerning human resources. There is no coherent education strategy concerning the SMEs. Generally, business owners have a low level of education in SMEs. Moreover, they do not have enough financial resources to allocate for education expenditures. Mostly business owners are technicians, engineers or foremen who are facile workers and well experienced in their production. However they do not have market oriented evaluation and management capacities. Furthermore, they do not have enough skill and capacity to follow new financial instruments and management models.

SMEs that require well-trained employees suffer particularly, as big companies usually more easily attract workers with better education through higher salaries and better working conditions. In order to solve these problems there is no adequate programme developed by the Ministry of Education. Vocational training provided by the Ministry of Education and KOSGEB is not widespread yet. Further efforts are needed in order to teach

necessary skills to the employers at all levels of an enterprise and to encourage the spirit of entrepreneurship.

Some employment support programmes are operated by KOSGEB through the Enterprise Development Centers (IGEM – İş Geliştirme Merkezleri) and Technology Development Centres (TEKMER). Both IGEM and TEKMER provide a combination of technical and managerial assistance, including counselling regarding the hiring of employees with the special skills needed to increase capacity in the business. However, this support is not a country wide support, therefore limited number of SMEs have opportunity to use it.

SMEs do not have any marketing strategy and they do not allocate financial resources to market development measures such as advertisement, promotion, market research or sales techniques. They are not competitive in export market because of lack of quality and standardisation and the high price of their products. They hesitate to allocate their financial resources to participate in exhibitions abroad or sometimes they are not interested at all. One of the goals of the Turkish government is to increase the international competitiveness of industrial SMEs in order to make them more outward oriented and increase their level of export. In most countries, there are SMEs whose activities are export oriented and achieve remarkable results, but on the whole SMEs do not contribute much to exports. Despite efforts of many governments, there is little evidence that industrial SMEs are increasing their share of exports in most countries. Therefore the amount of resources which are used to support export oriented activities in Turkey need to be carefully evaluated to determine if such activities are sufficiently productive (OECD, 2004:22).

Small Sized Industrial Estates (KSS – Küçük Sanayi Siteleri) are long lasting policy tools in Turkey. Establishment of KSS is being promoted by the

Ministry of Industry and Trade in order to ensure that small and medium sized industrialists produce in modern and healthy conditions and to take environmental pollution under control. The Ministry of Industry and Trade provides long term loans with low interest rates for cooperatives of small industrialists within the limits determined according to the degree of regional development of the province where KSS is considered to be established (State Planning Organisation, 2004:13). However many of the existing KSS appear to have excess capacity. While more than 500 thousand employees are available to be employed in the 372 KSS as of 2003, only 400 thousand positions were filled (OECD, 2004:57). Furthermore, these estates have many problems such as lack of laboratories, workshops, and centres for quality control and usually establishments of the estates lasts for more than ten years, because of the lack of finance (Ekinci, 2003:56).

### **5.1.2 Insufficient Know-How and Low Level of Technology**

SMEs have some advantages when compared to large enterprises. SMEs are more close to consumers and they have the chance to discover their problems and tastes. This provides them to make changes in their product and innovations to achieve consumer satisfaction. However, most of the SMEs do not use this advantage as a factor of production.

A substantial proportion of Turkish SMEs, especially the smallest ones outside urban centres, produce for either the national or local markets. The design of their products is outmoded and in many cases they are produced with inefficient methods and outdated tools. They do not emphasise R&D or even if more of them wish to improve their technological capacity and modernise their plant and equipment, they find it difficult to do so because of the difficulty of obtaining financing and of access to credit and equity. To cope with the competition, these firms need help in the areas of technology transfer, design, management and education.

After the customs union with the EU was put into effect, Turkish SMEs faced pressure to use high technology and acquire know-how in order to meet European competition and take advantage of opportunities in the domestic market. However, they did not fully take advantage of these opportunities for a number of reasons. First, even though rapid progress has been made in recent years, investment in information and communication technologies (ICT) remains low in Turkey. Second, the support policies that would have been necessary for their technological development were not available, owing to the lack of public funding. Moreover an unfavourable economic environment and the drop in domestic demand following economic crises in a climate of increased competition slowed SMEs' technological development (World Bank, 2004).

The low level of technology is linked to weakness in innovation. In the study carried out by the World Bank in 2004, several factors explain this situation; first Turkey's R&D effort suffers from too little participation by the private sector. The share of the business sector in total R&D expenditure is around 35 percent, against the OECD average of 65 percent in 2000, although the number of companies conducting R&D has increased between 1996 and 2000, most of the rest of the R&D infrastructure is in government laboratories. Second, University-based intellectual potential is high, however, university-industry interactions are weak because there is inadequate funding for cooperative projects at the universities, and research laboratories and equipment are limited in some faculties. Third, finance for innovation and R&D is in short supply. Tax incentives have also been modest and benefit only large firms (World Bank, 2004).

Raising awareness about research, technological development and innovations in SMEs is stated as a major goal of KOSGEB in the SME Strategy and Action Plan of Turkey. There is a need for cooperation among

KOSGEB, TUBITAK, TTGV, TOBB and the universities in order to reach this goal. However no specific projects aimed at accomplishing these objectives are identified in the Action Plan. Some of the existing programmes such as TEKMER Centers, Innovation Relay Centers (IRC) are operated by KOSGEB and some government supports like organised industrial zones, already target these objectives. The private sector, professional organisations and universities are started to work on strengthening the technological capacity of small firms particularly under the 6<sup>th</sup> Framework Programme of the EU, however outcomes of these efforts are not clear yet. An important progress made in this field in 2004 is the launching of the IRC-AEGEAN Project<sup>111</sup> and IRC Anatolia Project<sup>112</sup>. Under these projects innovation transfer centers have also been established under the 6<sup>th</sup> Framework Programme of the EU.

However, programmes and projects are scattered but not widespread and supports are limited in terms of the numbers of businesses covered.

### **5.1.3 Availability and Access to Finance**

While, some people who argue that most of the problems and weaknesses encountered by SMEs are stemming from financial problems believe that lack of finance and access to finance are the most important problems of SMEs, others see these issues as secondary problems. In terms of the EU implementations, it is observed that, instead of direct financial aids, EU develops support mechanisms in the weak areas of SMEs such as marketing, lack of knowledge, education and vocational training and technology. The EU particularly supports entrepreneurs in their start up phase in terms of seed capital.

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□ The Project is initiated by KOSGEB, Aegean University Chamber of Industry for the Aegean Region and Atatürk Organised Industrial Zone in İzmir.

<sup>112</sup> The project is initiated by KOSGEB, Chamber of Industry of Ankara, Middle East Technical University Technopark JSC.

Turkish SMEs find the necessary capital and financial services in very short supply. SMEs use only 5 percent of total bank credit in Turkey. Commercial banks tend to be primarily specialized in large business and they have reservations against financing the SME sector. Their development is hampered by several technical and financial factors: the classical credit analysis currently applied is based on balance-sheet interpretation. The SMEs, however, prepare balance sheets principally for the tax authorities, which make them difficult to analyse under banking criteria. Moreover, high fixed costs and relatively small loan sizes for SMEs result in high unit costs for a credit. This makes SME finance relatively unattractive for profit-driven banks.

Because of the lack of information about individual SMEs and the market (e.g. credit and payment history, average credit-failure in the market), loans to SMEs are considered very risky. Insufficient guarantees or their insufficient enforcement makes it difficult for them to properly secure their loan. Perceived as disproportionately costly and risky, the banks tend to concentrate on larger loans to larger companies, which are thought to generate a higher fee and interest income. Additionally, Turkish banks have traditionally been active in investing in government bonds. The state-owned banks, Halkbank, Ziraat Bankası, and TKB supply financial services to SMEs only to a very limited extent compared to the huge demand in Turkey.

In particular, the lower segment of the SMEs (having up to 50 employees with a maximum asset size of 1 Million Euros) has difficulties accessing long-term finance. Due to the national importance of these SMEs, insufficient access to long-term funds is a serious obstacle for growth and development.

Apart from the traditional financing instruments, financing instruments such as credit guarantees for SMEs, venture capital investment



partnership, real estate investment partnerships, SME finance companies, factoring and leasing companies for SMEs, and SME stock exchange enabling SMEs to make use of equity markets are not well developed in Turkey.

## **5.2 Case Study: A Survey on SMEs in Adana**

In order to measure awareness of SMEs concerning the support provided for them and to reveal major problems of SMEs, a case study was made in the Anatolian city of Adana in April 2005. Adana is one of the industrialized and mostly developed cities in Turkey. There are approximately one thousand registered SMEs in Adana. The number of the SMEs in the manufacturing sector to which the questionnaire was sent is about five hundred. 118 of them have responded to the questionnaire.

The questionnaire is given in Appendix E of this thesis. In the questionnaire, eleven questions are asked to the SMEs operating in the manufacturing sector in Adana. First five questions aim to analyse structure of the sample by asking years of activity, average number of employees and turnover of the firms. Following four questions try to determine awareness level of the sample and source of information concerning the SME support policies both in the EU and in Turkey. Remaining two questions ask most important problem of the SMEs in manufacturing sector and sources of the financial problems.

Initially the structure of the firms that participated to the survey is analysed. Major findings are summarised in the tables below:

As shown in Table 5.4, of the 118 SMEs, only 6,8 percent are new comers, 29,7 percent are in business for 2-5 years and 24,5 percent are in business for more than 10 years. 75 percent of the firms are active for less

than 10 years. It is concluded that most of the SMEs are young firms in the manufacturing sector in Adana.

Table 5.4 – Breakdown of SMEs in Adana by Years of Activity

Years of Activity of SMEs	Number of Firms	Share of Each Category in Total Firms (%)
1 Year	8	6,8
2-5 Years	35	29,7
6-10 Years	46	39
More Than 10 Years	29	24,5
Total	118	100

Table 5.5 shows distribution of the sample with respect to the number of workers employed annually. Only 9,3 percent of SMEs employ less than 10 workers. 51,7 percent of the firms included in the survey are classified as small (10 to 49 workers) which indicate that sample is dominated by small enterprises. Medium size (50-250 workers) firms follow the small size firms with 36 percent.

Table 5.5 - Breakdown of SMEs in Adana by Size

Number of workers employed annually	Distribution	
	Number of Firms	Share of Each Category in Total Firms (%)
1-9 Workers	11	9.3
10-49 Workers	61	51.7
50-99 Workers	24	20.3
100-249 Workers	19	16.1
250 and Above	3	2.6
Total	118	100

As shown in Table 5.6, 89 percent of the firms have annual turnover between 500 thousand-5 million YTL and only 6.8 percent of the firms have annual turnover above 5 million YTL.

Table 5.6 - Breakdown of SMEs in Adana by Annual Turnover

Annual Turnover	SMEs	
	Number of Firms	Share in Total Turnover (%)
500.000 YTL or Less	5	4.2
500.000-1 Million YTL	55	46.6
1 Million-5 Million YTL	50	42.4
5 Million and Above	8	6.8
Total	118	100

Table 5.7 gives information about the relation between year of activity and turnover. 68,5 percent of the firms (72 firms) having turnover between 500.000-5 million YTL are in the business for more than 5 years. 22,8 (24 firms) percent of these firms are in the business for more than 10 years. Only 29 firms in the sample are in the business for more than 10 years and 5 of them have more than 5 million YTL turnover.

Table 5.7 - Relation Between Year of Activity and Turnover of SMEs in Adana

Year of Activity	Annual Turnover			
	500.000 YTL or Less	500.000 - 5 Million YTL	5 Million YTL and Above	Total
1 Year	1	7		8
2-5 Years	2	26	2	30
6-10 Years	2	48	1	51
More than 10 years	-	24	5	29
Total	5	105	8	118

In the questionnaire, the firms were also asked questions about where they get the information concerning the supports provided for SMEs in Turkey. Since micro firms are only 9.3 percent of the total firms, which answered the questionnaire, and 63,5 percent of 118 firms are in business more than 5 years, our expectation was to get a high awareness rate.

There is European Information Centre in Adana which is established under the framework of “Multiannual Programme for Enterprise and Entrepreneurship (MAP-2001-2005)”. Another centre which is established

under the coordination of KOSGEB is Enterprise Development Center (IGEM). The European Information Centre informs SMEs concerning the EU programmes and supports. The Enterprise Development Center provides business information and training for SMEs and gives consultancy services to the SMEs in the region. Therefore, before analysing the survey results, it was expected that SMEs in Adana would have substantially higher rates of knowledge when compared with the average rates of knowledge of overall SMEs in Turkey concerning the SME policies of the EU and supports given by Turkish government. Main findings of the survey are as follows:

As can be followed from Table 5.8, with the 60,2 percent, 71 of the 118 firms receive the information from either press or their colleagues. Only 11 (9,3 percent) of the 118 firms indicate KOSGEB as their source of information. Additionally Adana Chamber of Commerce is a source of information for 27.1 percent of the sample firms.

Table 5.8 - Source of Information on Support Provided for SMEs in Adana

Source of Information	Number of Firms	Share in Total Firms (%)
Colleague	39	33.1
Chamber of Commerce	32	27.1
Press	32	27.1
KOSGEB	11	9.3
Halk Bank	4	3.4
Total	118	100

SMEs are asked whether they have any idea about supports provided by the EU for SMEs in their sector and the EU SME policy. The awareness rate of the sample by source of information is summarized in Table 5.9.

Table 5.9 - Awareness of SMEs in Adana According to Source of Information

Awareness	KOSGEB	Chamber of Commerce	Press	Colleague	Total
Yes	5	3	3	5	16
No			1		1
Partially	5	1	24	71	101
Total	10	4	28	76	118

117 firms are aware of the supports and policies of the EU and 101 of them are not satisfied with the level of information that they have. Only 10 firms of the 117 are informed by KOSGEB. In terms of source of information, the Chamber of Commerce has the lowest share and 4 of the sample firms get the information from the Chamber of Commerce. Press is the main source of information for 23 percent of SMEs (28 of 117 firms) and approximately 65 percent of the firms (76 of 117 firms) get the information from their colleagues. It is very surprising that colleagues are the major source of information together with press for those firms having knowledge concerning the supports and policies of the EU.

This high percentage may indicate ineffectiveness or insufficient services of the European Information Center and the Enterprise Development Center in Adana. On the other hand, this result may support the claim that the basic feature of an SME is its network, which is based on personal friends and contacts rather than formal support network (Bridge at al., 1998:138).

In the survey SMEs are asked that how membership of Turkey to the EU would effect the SMEs in their sector . Table 5.10 summarizes the answers received from 118 firms. 66,2 percent of the answers, which is a significant number, is gathered around positive effects. 48,4 percent of the sample firms claim that it will be easier for SMEs to enter the new markets and 17,8 percent of the sample thinks that financial supports to Turkish SMEs will increase after the membership of Turkey.

Only 11 firms, which is the 9,3 percent of the sample think that membership of Turkey to the EU will have negative effect on SMEs and it is surprising that only 2 of these 11 firms find competitiveness of Turkish SMEs very low to enter the EU market or to compete with the SMEs in the EU. Finally, 22 percent of the sample firms, which is considerably high rate

concerning the SMEs in Adana, have said that they have no idea about the effects of Turkey's membership to the EU.

Table 5.10 - Effects of EU Membership on Turkish SMEs in Adana

Effects of EU Membership	Number of Firms	Share in Total Firms (%)
Positive Effect- Increase in Financial Supports	21	17,8
Positive Effects - Easy to enter new markets	57	48,4
<b>Total Positive Effects</b>	<b>87</b>	<b>66,2</b>
Negative Effect - Lack of competitiveness of Turkish SMEs	2	1,7
Negative Effect - High cost of new legislation	9	7,6
<b>Total Negative Effects</b>	<b>11</b>	<b>9,3</b>
No effect	3	2,5
No idea	26	22
<b>Total</b>	<b>118</b>	<b>100</b>

The most important problems of SMEs in the manufacturing sector were asked to the sample firms. Table 5.11 presents data on the most important problems of the SMEs.

As shown in Table 5.11, answers are almost equally distributed between financial, marketing-sale and bureaucratic problems, 23 of the 118 firms with 19,5 percent believe that finance is the most important problem for them. Considerable numbers of firms think that marketing and bureaucracy (respectively 17,8 percent and 17 percent) are the main problems. Only 18 of the 118 firms ( 15,3 percent) consider that high tax rate is the substantial problem for them. Few firms think that qualified employee or high running costs are major problems of SMEs in manufacturing sector. Moreover, insufficient R&D is not considered as a major source of problems by a large number of firms and only 10 firms in the sample see R&D as a main problem. Finally, with 2,5 percent, it seems that firms do not think that not having a brand is the main problem of SMEs.

Table 5.11 - Most Important Problem of SMEs in Manufacturing Sector in Adana

Problems	Number of Firms	Share in Total Firms (%)
Financial Problems	23	19,5
Marketing-Sale	21	17,8
Bureaucracy-Red Tape	20	17
High tax rates	18	15,3
Qualified Employee	12	10,2
High Running Costs	11	9,3
Insufficient R&D	10	8,4
Not Having a Brand	3	2,5
Total	118	100

The last question of the survey aims to reveal sources of the financial problems encountered by the SMEs. As shown in Table 5.12, the major source of the financial problems is state aids.

47 firms (48,3 percent), which include almost half of the sample, indicate either insufficient state aids or narrow scope of the state aids as major sources of their financial problems. Of the 47 firms, 29 firms find state aid insufficient and 28 firms find scope of the state aids narrow and limited. 27,1 percent of the sample firms complain from insufficient bank credits as a source of financial problems. A limited number of firms indicate insufficient seed and venture capital as a main source of financial problems.

Table 5.12 - Source of Financial Problems for SMEs in Adana

Problems	Distribution	
	Number	%
Insufficient Seed and Venture capital	11	9.3
Insufficient Bank Loans	32	27.1
Insufficient Financial Organizations	18	15.3
Insufficient State Aids	29	24.6
Narrow and Limited Scope of State Aids (certain sector certain regions)	28	23.7
Total	118	100

As a conclusion, in terms of source of information and effects of Turkey's membership, survey results are interesting. SMEs do not think that

membership will affect their business in a negative way and they get the information on SME policies and supports of the EU from their colleagues. As regards to support for SMEs in Turkey, most important sources of information are colleagues, chamber of commerce and press respectively.

### **5.3 Recommendations to Strengthen the Turkish SMEs and Promote Entrepreneurship in the Light of EU Policies**

As it has been argued in the preceding sections, in the context of EU entrepreneurship and SMEs policies, Turkish SMEs have certain weaknesses and problems. This section of the thesis tries to give recommendations concerning the weaknesses of SMEs and bottlenecks of the implemented policies in Turkey by introducing some good practices and benchmarks identified under the framework of the European Charter for Small Enterprises as reference implementations.

The European Charter for Small Enterprises, which was approved by 35 countries including Turkey calls upon partner countries to take action to support SMEs in ten key areas, which are presented in Chapter 3.5.2. The European Commission with member states' experts works on several Best Procedure Projects. Each year best projects are evaluated and the European Commission reports good practices and recommendations in the selected areas. According to the European Commission it is important to take actions on the basis of these conclusions and recommendations as they are testified by a number of concrete examples. Annual implementation reports show that each year more states draw inspiration from measures developed in other countries. Learning from each other improves the environment for business and help SMEs to solve their problems (Commission, 2005a: 4).

Although the good practices of the member states identified by the Commission are useful as a source of ideas, it should be kept in mind that these good practices should be carefully evaluated before adoption because



each country has its own structure and peculiarities regarding the SMEs and best practices can rarely be adopted one to one. As a result, a best practice implemented in a member state may not work in Turkey or it may not serve to solve the problems of Turkish SMEs because effectiveness of a measure may vary from one country to another.

In Turkey, supports for SMEs, from national and international resources (especially the EU and World Bank) were increased particularly after the establishment of Customs Union between Turkey and the EU and fostered with the declaration of Turkey as a candidate country for the EU at the Helsinki Summit. In this period, Turkey not only provided financial supports for the SMEs but also due to its candidacy status it has launched many programmes and projects in various areas such as education for entrepreneurs, creating innovative entrepreneurs, and dissemination of technology among SMEs. Most of the mechanisms that are to be implemented in order to support SMEs are mechanisms that are offered by the EU and particularly in the context of the European Charter for Small Enterprises and the Multi-annual Programme for Enterprises. As a candidate country, Turkey has started to adopt some of the EU policies in the area of SMEs but it does not have a national impact assessment mechanism in order to assess the effectiveness of the policy mechanisms that have been used in the framework of harmonisation with the EU.

Therefore, in order to evaluate effectiveness of tools for policy implementation, an impact assessment unit should be established. Moreover, procedures and mechanisms, which will be followed by this unit, should be determined beforehand. KOSGEB has established Research and Analysis Unit in 2004, however this unit is only in charge of industrial sector. Therefore it cannot assess the effectiveness of the policies that are covering SMEs in other sectors. In this respect, we may argue that such a unit should cover all the SMEs in Turkey and make both ex ante and ex post analysis of

the impacts of all activities, projects and programmes that are launched to support all SMEs without discriminating according to their size or sector.

The impact assessment unit that should be created needs particular data in order to make analyses on the effectiveness of policy tools. Beside surveys that may be carried out by this unit, it requires enterprise statistics, which are comparable. Therefore, in line with the EU practices SIS should take action to develop a database on enterprise statistics according to the standards developed by EUROSTAT. Otherwise it is difficult to make comparison between Turkish SMEs and EU SMEs in many respects and evaluate the impacts of the policies implemented by the Turkish government.

At this point, the crux of the matter is to develop a common SME definition because SIS cannot carry out any statistical research without a common definition and this is the most urgent problem of Turkey that should be solved both in order to develop effective mechanisms to support SMEs and in order to assess effectiveness of existing mechanisms.

Various SME definitions used in Turkey are explained in 4.2. and as it is underlined these definitions, which are based on the number of the workers employed, seem to be the most important obstacle that prevent Turkish SMEs to benefit from various supports provided by public institutions and other organisations.

In developing a common definition, most important issue is the so-called “autonomous criteria”. According to the autonomous criteria of the EU, an enterprise is not an SME if one or more public bodies directly or indirectly control 25 percent or more of its capital or voting rights, jointly or individually. Moreover, if an enterprise holds more than 25 percent of the capital or voting rights in another enterprise and/or vice versa, then this enterprise is not autonomous but a partner enterprise. Partner enterprises

add a proportion of the other enterprise's number of workers and financial details to their own data when determining their eligibility for SME status. Therefore in order to develop a common definition taking into consideration the autonomous criteria and other criteria that is harmonised with the EU recommendation<sup>113</sup> should be adopted by strong cooperation between Ministry of Industry and other stakeholders such as KOSGEB, TOBB, TOSYÖV. As a result, it can be claimed that developing such a common definition and adopting it in practice helps to solve the problems concerning lack of statistics, insufficient academic studies, ineffectiveness of the supports provided for SMEs and it may provide optimum organisation among SMEs.

Organisational problems of Turkish SMEs are mentioned in 4.2 and 5.1.1 of the thesis and as it has been argued there is a lack of SME organisation in the political and legal area and most of the SME organisations are in the economic area. However even the SME organisations in the economic area have important problems. As a primary public organisation KOSGEB, which coordinates and provides assistance in the implementation of the policies, covers neither micro enterprises nor enterprises operating other than manufacturing sector. Therefore KOSGEB's mandate should be broadened to make it a support agency for SMEs in all sectors of the economy with the exception of agriculture. This requires a change in KOSGEB's establishment law in a way that all SMEs in Turkey including the micro ones will have a chance to use the programmes that are coordinated by KOSGEB. Moreover KOSGEB should also adjust its programming approach to reach all SMEs including the service sector and the wholesale sector, which need assistance with respect to technology, information and training. However, KOSGEB can provide this assistance in cooperation with professional associations, chambers of commerce and other stakeholders.

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<sup>113</sup> Commission of the European Communities, Commission Recommendation of 2003/361/EC Concerning the Definition of Micro, Small And Medium Sized Enterprises, Official Journal of the European Communities, L124, 20.05.2003, 36-41.

In order to provide optimum organisation, political representation and cooperation between university and industry is also an important issue. It is observed that political representation of SMEs is difficult however lobbying may be an effective instrument in order to raise their problems and solve them. Recently, with the techno parks established within the universities, cooperation between university and industry has been initiated partially; however effectiveness in country wide has not been accomplished yet.

Most of the time policies concerning SMEs have been carried out by trial and error. This is seen as one of the weaknesses of the traditional SME policies in most of the countries (Lundstrom and Steveson, 2002:5). Thus the EU and OECD started to adopt a new approach called *entrepreneurship policy*, which is considered to be more systematic than SME policy (Audretsch, 2002:46). Accordingly it is argued that in order to develop a formal entrepreneurship policy in the framework of general public policy, existing SME policies should be undertaken in a broader perspective. If such an approach is provided, incentive policies will not only focus on existing firms but also on emerging entrepreneurs. As a result it will contribute to create an entrepreneurial society. Until recently, policies in Turkey are concentrated on existing SMEs particularly on medium sized enterprises. A main policy bottleneck is that there has not been any strategy to create entrepreneurs and a society having *entrepreneurial spirit*. That is to say there was no entrepreneurship approach in Turkey. This trend, which stems mainly from the dominant role that governments traditionally played in the Turkish economy, has started to change with the liberalisation policies of the 1980s. Moreover especially after the Helsinki Summit, Turkey is affected by the EU practices as regards to creating entrepreneurial society and some projects have already been developed in the areas such as supporting women entrepreneurs and providing entrepreneurial education at university level.

However, general efforts should be deployed at all levels aiming to promote a more entrepreneurial culture and effective and continuous strategy in this area. These efforts should include improving the image of entrepreneurship, increasing vocational education, providing management training for enterprise owners, providing cooperation between schools and business world, increasing the training of teachers.

On the other hand, Turkish educational system should also be restructured to develop an entrepreneurial society. Member States are increasingly giving priority to the promotion of entrepreneurship in the education system. Several member states developed initiatives to give entrepreneurial spirit and skills in primary schools. Ireland has skill development and enterprise perspective programme in its curriculum for 10-12 year old students. Finland, Sweden, the UK and Norway have developed entrepreneurial skills programme in primary schools. Countries such as Belgium, Denmark, Greece, Ireland, and Luxembourg have programmes in secondary schools. Germany, Spain and Austria have university chairs on business start-ups and management of SMEs. Therefore, in Turkey, vocational high schools and universities can work with low-level schools to provide general entrepreneurial curriculum in order to build an entrepreneurial culture.

*Strengthening the overall business environment* has the highest priority both for providing a high number of entrepreneurs in a society and entrepreneurs to become more successful in their business. The instability of the macro economic environment has constituted an obstacle to the success of the implemented policies towards SMEs in Turkey. Successful macro economic policies are essential to SMEs long-term development strategies. In particular more needs to be done in areas such as strengthening the banking sector, development of a tax system that does not discourage enterprises, easing bureaucratic constraints in both start up and closure procedures of

SMEs, improving SME' access to financial markets, fostering the availability of venture capital and access to securities market.

A core aspect of SME development strategy should be development of SMEs capabilities in terms of *technology, innovation and communication*. Furthermore university and industry cooperation is also substantial for enhancement of SME' capacity to take advantage of technology. TTGV and TUBITAK should make more efforts to disseminate the support mechanisms to all SMEs in this policy area.

In line with the European Charter, member states make various initiatives in order to strengthen the technological capacity of SMEs, including innovation. Good practice in the area mentioned by the Commission in 2004 is the PRO INNO programme of Germany. Germany grants a special promotion bonus for international cooperation under the programme called the PRO INNO scheme (programme for competence in innovation among SMEs). This programme supports national and international research cooperation between SMEs or between SMEs and research institutions. Approximately 77 percent of the enterprises promoted have fewer than 50 employees. 40 percent of enterprises are under 5 years old and 35 percent are 6-10 years old enterprises. The widespread effect of the programme is marked. Since 1999, roughly 1.3 billion Euros have been spent on R&D in some 3.9 thousand enterprises (Commission, 2004b: 27).

Although TUBITAK, KOSGEB and TTGV tries to support SMEs in this area, there are not comprehensive projects like in the PRO INNO programme of Germany. TTGV has supported 246 projects since its establishment in 1991 and totally allocated 200 million Euros in R&D activities of SMEs. KOSGEB tries to develop instruments such as Technology Incubation Centers where 200 technology based SMEs are supported as of 2003. However these figures are very low considering the number of SMEs in Turkey. Therefore a

comprehensive programme should be developed in order to create innovative SMEs.

Finance is one of the most prominent barriers to business start-up. Most countries' SME policy introduces programmes that offer financial support to start-ups and young entrepreneurs. The European Commission's seed capital action focuses on smaller seed capital funds leaving the assessment of actual business projects to regional and local offices. Concerning the access to finance in Turkey, often the only chance for entrepreneurs to raise finance is to ask their own family. SME's share in the overall volume of bank lending is very low (currently 5 percent of total credits) and should be increased. Moreover alternative financial instruments such as venture capital, business angels and equity financing through the stock exchange should be developed.

The European Commission encourages member states and creates a variety of tools to reduce administrative, legislative and tax burden on SMEs. Although in the area of better legislation and regulation concerning the SMEs, considerable progress has been made in last 5 years in Turkey, there needs to be much effort. Efforts concerning simplification of tax procedures have been initiated by Ministry of Finance. These initiatives should be carried to the area of reducing tax burdens on SMEs. Some EU member states offer tax credits to encourage private investors and venture capitalist to invest in SMEs. Such kind of tools should also be evaluated by the Ministry of Finance.

In the area of legislation affecting entrepreneurship, both UK and the Netherlands reformulated their Bankruptcy Law to reduce the penalties associated with small business failure and to end the principle of unlimited liability. It is interesting to note that even the US, which is considered a best practice country, has amended its Bankruptcy Act in the year 2000 in order

to extend the time which small firms have to file reorganisation plans with the bankruptcy courts.

In Turkey, micro enterprises are not subject to bankruptcy provisions and they do not have a right composition of debt in case of bankruptcy. Therefore including Bankruptcy Law, regulations should be scrutinised.

As a conclusion, since entrepreneurship and SME issues are horizontal issues, it should be recognised that a long term strategy for SMEs and entrepreneurship call for actions across a wide range of policy domains, including education, R&D, technology, government regulations, competitive policies, labour market, financial market and social policies in Turkey.



## **CHAPTER 6**

### **CONCLUSION**

This thesis, which consists of an introduction, four main chapters and a conclusion, seeks to identify the necessary measures in order to improve Turkey's practices for promoting entrepreneurship by studying the similar practices in the EU.

The first main Chapter in the thesis develops a conceptual framework for understanding the policy of promoting entrepreneurship and SMEs from a holistic point of view. Entrepreneurship, which does not correspond fully with any established academic discipline, is a new social and economic phenomenon. Therefore, there is a weak theoretical base for entrepreneurship and SMEs. Within the context of the existing theoretical debates discussed in Chapter Two, it is concluded that SMEs are explicitly or implicitly defined as the main agents of economic growth. Furthermore, various empirical studies confirm that there is a strong link between entrepreneurship and economic growth.

Recently, there seems to be unanimous agreement among developed and developing countries, including the EU member states, that the dynamism of entrepreneurship and innovative SMEs are key drivers of economic growth, productivity increase and job creation, therefore all the governments intervene in some way to promote SMEs and entrepreneurship.

According to the findings of Chapter Three, which explores the development of the EU entrepreneurship policy, starting from 1990s one of

the agenda items of the European Community is to develop policy tools in order to promote entrepreneurship and innovative SMEs. For this purpose, various activities were held and a holistic approach that entails enterprise and society level measures in an effectively coordinated manner has come to be regarded as the core of these policies.

More recently, in the Lisbon European Council (23-24 March 2000), most urgent issue facing Europe was declared as growth and employment. Thus one of the strategic objectives of the EU has become a process by which to foster entrepreneurship and SMEs. In line with the instruments determined by the Lisbon European Council (23-24 March 2000) the European Charter for Small Enterprises and Multiannual Programme for Enterprise and Entrepreneurship and in Particular Small and Medium Sized Enterprises [MAP (2001-2005)] were adopted in 2000. These two policy tools established a good foundation for enterprise policy on the European level for the 21<sup>st</sup> century and MAP (2001-2005) provided financial framework to support SMEs in the priority areas that are presented in the European Charter for Small Enterprises.

Education and training for entrepreneurship, cheaper and faster start-up, better legislation and regulation and access to finance, strengthening the technological capacity of SMEs and developing more effective representation of SMEs's interest at union and national level are the main priority areas of the EU in order to promote entrepreneurship and SMEs. The European Commission has developed some instruments in order to monitor and evaluate progress of the member states in these priority areas and provided financial and non-financial assistance for promoting SMEs and entrepreneurship. Furthermore, European Commission attaching importance to learning from each other's experience tries to determine member states' best implementations in the priority areas identified as vital to promoting entrepreneurship and publish these best practices. Finally, it is concluded

that EU enterprise policy which has wider perspective than the traditional SME policy, focuses on increasing the number of entrepreneurs and developing an entrepreneurial culture besides strengthening the existing SMEs.

The Fourth Chapter of this thesis focuses on exploring main features of Turkish SMEs and SME Policies. The initial finding of this Chapter is that Turkish SMEs, which have evolved in a persistent unfavourable business environment marked by macroeconomic instability, play a particularly important role in the Turkish economy because of their number and large share in the total employment. Secondly, all the governments in Turkey have tried to support Turkish SMEs in several ways. Nevertheless, there has never been a concrete strategy towards promoting entrepreneurship. Thirdly, it was found that, although lack of economy wide data on Turkish SMEs hampers research and in particular the determination of their precise contribution to the Turkish economy, it is clear that their contribution to total output and employment are much smaller from that of SMEs in the European Union

Attention to the SME policies has increased by Turkish government after the establishment of Customs Union between Turkey and the EU and support policies towards SMEs was fostered with the declaration of Turkey as a candidate country for the EU in the Helsinki European Council in 1999. After the Helsinki Summit, Turkey not only provided financial supports for the SMEs but also, due to its candidacy status, it has launched many new programmes and projects that are currently well underway in the EU. Moreover, the role of public policy in promoting SMEs gained great importance due to the process of integration into the EU through the adoption and implementation of the *acquis communautaire*. Meanwhile, Turkish SME Strategy and Action Plan, which declares the essential strategies for SMEs in line with the European Charter for Small Enterprises and determines responsibilities of public and private organisations on the way to

the desired objectives, was adopted by the government in 2003. Since these are very recent developments, efforts made under the framework of this strategy have not yet yielded the desired results.

After exploring the policies and importance of the SMEs in the EU and Turkey in Chapters Three and Four, it is concluded that Turkish SMEs are weak compared to their European competitors. It is clear that in contrast to the support and services offered to small and medium sized enterprises in the EU, the quality, variety and size of the supports for SMEs in Turkey are relatively inadequate.

Furthermore, there are substantial problems encountered in promoting policies towards entrepreneurship and SMEs which are discussed in Chapter Five. Combining the findings of the proceeding Chapter and the case study conducted on SMEs in Adana, it is concluded that SME policies and programmes are less effective than they could be in Turkey. One of the reasons is that, Turkish governments implement an SME support structure with relatively high levels of support for relatively small numbers of SMEs which is unlikely to do much to stimulate change throughout the economy. Most of the programmes and supports of KOSGEB, which is the main government institution concerning the SMEs, narrowly focus on micro enterprises and business start-ups. Nature of the supports, which are scattered, complex and not widespread in their application, makes it difficult for SMEs to understand and exploit them as fully as possible.

Concerning the ineffectiveness of the SME policies, findings have shown that most urgent issue is definition problem of SMEs. The lack of a common definition of SMEs, which includes SMEs in all industries and is harmonised with the EU, hampers the development of SME statistics that are harmonised with the practices in the European Union. In turn, lack of statistics makes it impossible to evaluate the impacts of the policy tools

implemented by the Turkish government and to compare Turkish SMEs with that of the EU in many respects.

Besides the ineffectiveness of the policies, in some areas either there is a lack of policy tools or they are insufficient. Turkish SMEs need help in the key areas of education, access to finance and technology transfer to cope with competition. However, there is not any coherent education and training strategy towards SMEs in which entrepreneurship is taught as a skill in each level of education. Moreover, Turkish SMEs find the necessary capital and financial services in very short supply. Financing instruments such as credit guarantees for SMEs, venture capital investment partnership, real estate investment partnerships, SME finance companies, factoring and leasing companies for SMEs, and SME stock exchange enabling SMEs to make use of equity markets are not well developed in Turkey when compared to EU Member States. Furthermore, SMEs do not put much emphasis on R&D. Some of them are not aware of the importance of technological development and innovation and some find it difficult to allocate their resources on R&D activities because of the financial problems. There are not widespread programmes aimed at promoting technology dissemination towards SMEs. It is clear that underdeveloped R&D base of Turkey is the crux of the problem.

Proceeding with these arguments, in line with the SME policies of the EU, strong efforts are needed on three areas, which are access to finance, non financial support and technology. The actions to be undertaken in these areas essentially should focus on education and training, legislative and regulatory problems, creation of new enterprises, enhancement of SMEs' capacity to take advantage of technology by drawing inspiration from benchmarking and best implementations developed by the EU member states.

It is considered that the entry of large numbers of young people into the labour market, a huge shift of jobs from the farm sector to industry and

services and the swelling ranks of women in the labour market will require substantial new job creation in Turkey over the years ahead. From the experiences of the many developing countries, the bulk of this job creation is considered to be in SMEs. Furthermore, SMEs are also expected to be significant contributors to government policy and programme efforts to foster development in Turkey's least developed regions. Continuation of an economic policy that can sustain strong growth in a climate of stability is thus an initial and vital prerequisite for the development of SMEs.

As an overall conclusion, Turkish government recognizing that innovative and competitive SMEs and entrepreneurship make substantial contribution to economic growth, employment, regional and local development, social cohesion and in turn higher living standards and wealth, has to make more efforts to create entrepreneurial Turkish society which entails combining wide range of policy domains, including education, R&D, technology, government regulations, competitive policies, labour market, financial market and social policies in Turkey. Therefore, more systematic and broader SME policy, which require ex ante and ex post impact analyses of the policy tools supporting entrepreneurship and SMEs, is vital.

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## APPENDICES

### APPENDIX A: LIST OF THE ACQUIS COMMUNITAIRE CONCERNING SMES

#### BINDING MEASURES

Council Decision 86/664/EEC establishing a consultation and co-operation procedure in the field of tourism

Council Decision 93/379/EEC on a multiannual programme of Community measures to intensify the priorities areas and to ensure the continuity and consolidation of policy for enterprise, in particular small and medium-sized enterprises, in the Community

Commission Decision 97/761/EC approving a support mechanism for the creation of transnational joint ventures for SMEs in the Community

Council Decision 97/15/EC on a third multiannual programme for small and medium-sized enterprises (SMEs) in the European Union (1997-2000)

Council Decision 2000/819/EC on a multiannual programme for Enterprise and Entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005)

*Implementing measure:*

1) C/2001/3973: Commission Decision relating to the implementation of the financial instruments of the multiannual programme for Enterprise and Entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005)

2) Notice of implementation of the ETF start-up facility, the SME guarantee facility and the seed capital action under the multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005)

*(OJ C 54, 01.03.2002)*

3) Notice of implementation of the ETF start-up facility, the SME guarantee facility and the Seed Capital Action under the multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005)

*(OJ C 45, 25.02.2003)*

Council Regulation 1435/2003/EC on the Statute for a European Cooperative Society

Council Directive 2003/72/EC supplementing the Statute for a European Cooperative with regard to the involvement of employees

#### RECOMMENDATIONS

Council Recommendation 86/665/EEC of 22 December 1986 on standardised information in existing hotels  
*(OJ L 384, 31.12.86 p. 54)*

**Council Recommendation 86/666/EEC of 22 December 1986 on fire safety in existing hotels**  
*(OJ L 384, 31.12.86 p. 60)*

**Council Recommendation 90/246/EEC of 28 May 1990 relating to the implementation of a policy of administrative simplification in favour of small and medium-sized enterprises in the Member States**  
*(OJ L 141 02.06.90 p. 55)*

**Commission Recommendation 94/390/EC of 25 May 1994 concerning the taxation of small and medium sized enterprises**  
*(OJ L 177 09.07.94 p.1)*

**Commission Recommendation 94/1060/EC of 7 December 1994 on the transfer of small and medium-sized enterprises**  
*(OJ L 385 31.12.94 p.14)*

**Commission Recommendation 96/280/EC of 3 April 1996 concerning the definition of small and medium-sized enterprises**  
*(OJ L 107 30.04.96 p.4)*

**Commission Recommendation 97/344/EC of 22 April 1997 on improving and simplifying the business environment for business start-ups**  
*(OJ L 145 05.06.97 p.29)*

**Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises**  
*(OJ L 124 20.05.03 p.36)*



## RESOLUTIONS

- Council Resolution of 10 April 1984 on a Community policy on tourism  
*(OJ C 115, 30.04.1984 p.2)*
- Council Resolution of 3 November 1986 concerning the action programme for small and medium sized enterprises (SMEs)  
*(OJ C 287, 14.11.1986 p. 1)*
- Council Resolution of 22 December 1986 on a better seasonal and geographical distribution of tourism  
*(OJ C 340, 31.12.1986 p.1)*
- Council Resolution of 30 June 1988 on the improvement of the business environment and action to promote the development of enterprises, especially small and medium-sized enterprises in the Community  
*(OJ C 197, 27.07.1988 p. 6)*
- Council Resolution of 26 September 1989 on the development of subcontracting in the Community  
*(OJ C 254, 07.10.1989 p.1)*
- Council Resolution of 27 May 1991 on the action programme for small and medium-sized enterprises including craft industry enterprises  
*(OJ C 146, 05.06.1991 p.3)*
- Council Resolution of 17 June 1992 on Community action to support enterprises, in particular small and medium-sized enterprises, including craft industry enterprises  
*(OJ C 178, 15.07.1992 p.8)*
- Council Resolution of 3 December 1992 on administrative simplification for enterprises, especially small and medium-sized enterprises  
*(OJ C 331, 16.12.1992 p.3)*
- Council Resolution of 22 November 1993 on strengthening the competitiveness of enterprises in particular of small and medium-sized enterprises and craft enterprises, and developing employment

*(OJ C 326, 03.12.1993 p.1)*

- Council Resolution of 10 October 1994 on giving full scope to the dynamism and innovatory potential of small and medium-sized enterprises, including the craft sector and micro-enterprises, in a competitive economy

*(OJ C 294, 22.10.1994 p.6)*

- Council Resolution of 27 November 1995 on small and medium-sized industrial enterprises (SMEs) and technological innovation

*(OJ C 341, 19.12.1995 p.3)*

- Council Resolution of 22 April 1996 on the co-ordination of Community activities in favour of small and medium-sized enterprises and the craft sector

*(OJ C 130, 03.05.1996 p.1)*

- Council Resolution of 13 May 1996 on Euro-Mediterranean co-operation regarding tourism

*(OJ C 155, 30.05.1996 p.1)*

- Council Resolution of 9 December 1996 on realising the full potential of small and medium-sized enterprises (SMEs), including micro-enterprises and the craft sector, through an integrated approach to improving the business environment and stimulating business support measures

*(OJ C 18, 17.01.1997 p.1)*

- European Charter for Small Enterprises (adopted by the General Affairs Council, 13.06.2000, and welcomed by the Feira European Council, 19. – 20.06.2000)

- Council Resolution of 21 May 2002 on the future of European tourism

*(OJ C 135, 06.06.2002 p.1)*

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- Commission Communication on the Round Table of high level representatives from the Banking sector

*(COM (94) 435 final, 28.10.1994)*

- Communication on the Commission recommendation of 7 December 1994 on the transfer of SMEs

*(OJ C 400, 31.12.1994)*

- Commission Communication – Green Paper on the role of the Union in the field of tourism

*(COM (95) 97 final, 04.04.1995)*

- Communication on the Commission recommendations of 12 May 1995 on payment periods in commercial transactions

*(OJ C 144, 10.06.1995)*

- Commission Communication on the coordination of activities in favour of SMEs and the craft sector

*(COM (95) 362 final, 08.09.1995)*

- Commission Communication – Reporting on the feasibility of the creation of a European Capital Market for smaller entrepreneurially managed growing companies

*(COM (95) 498 final, 25.10.1995)*

- Commission Communication – Crafts and small enterprises, keys to growth and employment in Europe

*(COM (95) 502 final, 26.10.1995)*

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*(COM (96) 591 final, 14.11.1996)*

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*(COM (97) 187 final, 05.05.1997)*
- Commission Communication on promoting the role of voluntary organisations and foundations in Europe  
*(COM (97) 241 final, 06.06.1997)*
- Commission Communication on the impact of the introduction of the Euro on capital markets  
*(COM (97) 337 final, 02.07.1997)*
- Commission Communication – Report on late payments in commercial transactions  
*(OJ C 216, 17.07.1997)*
- Commission Communication – Participation of European Economic Interest Groupings (EEIGs) in public contracts and programmes financed by public funds  
*(COM (97) 434 final, 09.09.1997)*
- Report from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions on the co-ordination of activities to assist small and medium-sized enterprises (SMEs) and the craft sector  
*(COM (97) 610 final, 25.11.1997)*
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*(OJ C 93, 28.03.1998)*
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*(COM (98) 222 final, 07.04.1998)*
- Commission Communication to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions – Promoting entrepreneurship and competitiveness – the Commission’s response to the BEST Task Force Report and its Recommendations  
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*(COM(2002)68 final, 06.02.2002)*
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*(COM(2002) 610 final, 07.11.2002)*
- Commission Communication to the Council and the European Parliament – Thinking small in an enlarging Europe  
*(COM (2003) 26 final, 21.01.2003)*
- Report from the Commission to the Council and the European Parliament on the implementation of the European Charter for Small Enterprises  
*(COM (2003) 21 final, 13.02.2003)*

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*(OJ C 118, 20.05.2003) (Corrigendum OJ C 156, 04.07.2003)*
- Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of Regions – Basic orientations for the sustainability of European Tourism  
*(COM(2003) 716 final, 21.11.2003)*
- Communication from the Commission to the Council and the European Parliament – Access to finance of small and medium-sized enterprises.  
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- Commission staff working paper – Report on the implementation of the European Charter for Small Enterprises in the candidate countries for the accession to the European Union  
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- Commission staff working paper – The SME Envoy: an active interface between the Commission and the SME Community  
(SEC(2003) 60 – 21.01.2003)
- Commission staff working paper – Communication on basic orientations for the sustainability of European tourism – Extended impact assessment  
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## APPENDIX B: STRUCTURAL INDICATORS OF LISBON STRATEGY AND PERFORMANCE OF MEMBER STATES

**Relative performance of the old Member States according to the structural indicators on the shortlist**

		AT	BE	DE	DK	ES	FI	FR	EL	IE	IT	LU	NL	PT	SE	UK	EU-25	EU-15	US	Target 2005	Target 2010
Levels (1)																					
GDP per capita (PPS, EU-15 = 100)	2003	111.4	106.6	98.8	112.9	87.3	100.6	103.6	73.0	121.7	97.8	194.6	109.9	68.3	105.6	108.9	91.2	100.0	140.3		
Labour productivity per person employed (PPS, EU-15 = 100)	2003	98.4	118.4	94.3	97.8	94.8	96.8	113.7	90.3	119.7	103.6	132.2	95.2	63.5	96.5	101.9	93.1	100.0	121.6		
Employment rate (%) (2)	2003	69.2	69.6	65.0	75.1	59.7	67.7	63.2	57.8	65.4	56.1	62.7	73.5	67.2	72.9	71.8	62.9	64.4	71.2	67.0	70.0
Employment rate females (%) (2)	2003	62.8	51.8	59.0	70.5	46.0	65.7	57.2	43.8	55.8	42.7	52.0	65.8	60.6	71.5	65.3	55.1	56.0	65.7	57.0	60.0
Employment rate of older workers (%)	2003	30.4	28.1	39.5	60.2	40.8	49.6	36.8	42.1	49.0	30.3	30.0	44.8	51.1	66.6	55.5	40.2	41.7	59.9		50.0
Educational attainment (20-24) (%)	2003	83.8	81.3	72.5	74.4	63.4	65.2	80.9	81.7	85.7	69.9	69.8	73.3	47.7	85.6	78.2	76.7	73.8			
Research and development expenditure (% of GDP)	2003	2.2	2.2	2.5	2.5	1.0	3.4	2.2	0.6	1.2	1.1	1.7	1.9	0.9	4.3	1.9	1.9	2.0	2.8		3.0
Business investment (% GDP)	2003	20.3	17.9	16.3	18.2	22.1	15.3	15.9	21.8	19.7	16.5	15.0	16.5	19.1	12.6	14.6	16.8	16.7			
Comparative price levels (EU-15 = 100)	2002	102	98	104	131	82	123	100	80	118	95	100	102	74	117	108	96	100	113		
At-risk-of-poverty rate (%)	2003	12.0	13.0	11.0	10.0	19.0	11.0	15.0	20.0	21.0	19.0	12.0	11.0	20.0	9.0	17.0	15.0	15.0			
Long-term unemployment rate (%)	2003	1.1	3.7	4.6	1.1	3.9	2.3	3.5	5.1	1.5	4.9	0.9	1.0	2.2	1.0	1.1	4.0	3.3			
Dispersion of regional employment rates	2003	3.1	7.7	6.0	—	8.9	6.1	5.0	3.6	—	17.0	—	2.4	3.9	4.3	6.0	13.0	12.0			
Greenhouse gas emissions (index base year = 100)	2002	108.5	102.1	81.1	99.2	139.4	108.8	88.1	128.5	128.9	109	84.9	100.6	141	98.3	85.1	91.0	97.1	113.1		92.0
Energy intensity of the economy	2002	146	214	165	123	229	272	187	258	164	184	198	202	254	224	212	210	191	330		
Volume of transport	2002	120	100	102	85	137	95	96	127	133	103	110	97	126	90	86	101	102	91		

Source: Eurostat, if not stated otherwise. For a detailed definition of and explanatory notes on the indicators as well as on single values go to: <http://europa.eu.int/comm/eurostat/structuralindicators>  
 (1) Levels for the year indicated or for the last available year.  
 (2) Employment data US: source OECD.

## **APPENDIX C: EUROPEAN CHARTER FOR SMALL ENTERPRISES**

Small enterprises are the backbone of the European economy. They are a key source of jobs and a breeding ground for business ideas. Europe's efforts to usher in the new economy will succeed only if small business is brought to the top of the agenda.

Small enterprises are the most sensitive of all to changes in the business environment. They are the first to suffer if weighed down with excessive bureaucracy. And they are the first to flourish from initiatives to cut red tape and reward success.

At Lisbon we set the goal for the European Union to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, more and better jobs and greater social cohesion.

Small enterprises must be considered as a main driver for innovation, employment as well as social and local integration in Europe.

The best possible environment for small business and entrepreneurship needs therefore to be created.

### **Principles**

In urging for this, we:

Acknowledge the dynamic capacities of small enterprises in answering to new market needs and in providing jobs;

Stress the importance of small enterprises in fostering social and regional development, while behaving as examples of initiative and commitment;

Recognise entrepreneurship as a valuable and productive life skill, at all levels of responsibility;

Applaud successful enterprise, which deserves to be fairly rewarded;

*Consider that some failure is concomitant with responsible initiative and risk-taking and must be mainly envisaged as a learning opportunity;*

Recognise the values of knowledge, commitment and flexibility in the new economy.

The situation of small business in the European Union can be improved by action to stimulate entrepreneurship, to evaluate existing measures, and when necessary, to make them small-business-friendly, and to ensure that policy-makers take due consideration of small business needs. To this end, we pledge ourselves to:

Strengthen the spirit of innovation and entrepreneurship which enables European business to face the challenges ahead;

Achieve a regulatory, fiscal and administrative framework conducive to entrepreneurial activity and improve the status of entrepreneurs;

Ensure access to markets on the basis of the least burdensome requirements that are consistent with overriding public policy objectives;

Facilitate access to the best research and technology;

Improve access to finance throughout the entire life-cycle of an enterprise;

Improve our performance continuously, so that the EU will offer the best environment for small business in the world;

Listen to the voice of small business;

Promote top-class small business support.

### **Lines for action**

By endorsing this Charter, we commit ourselves to work along the following lines for action, taking due consideration of small business needs.

#### *1. Education and training for entrepreneurship*

Europe will nurture entrepreneurial spirit and new skills from an earlier age. General knowledge about business and entrepreneurship needs to be taught at all school levels.

Specific business-related modules should be made an essential ingredient of education schemes at secondary level and at colleges and universities.

We will encourage and promote youngsters' entrepreneurial endeavours, and develop appropriate training schemes for managers in small enterprises.

## 2. *Cheaper and faster start-up*

The costs of companies' start-up should evolve towards the most competitive in the world. Countries with the longest delays and most burdensome procedures for approving new companies should be encouraged to catch up with the fastest. Online access for registration should be increased.

## 3. *Better legislation and regulation*

National bankruptcy laws should be assessed in the light of good practice. The learning from benchmarking exercises should lead us to the improvement of current practices in the EU.

New regulations at national and Community level should be screened to assess their impact on small enterprises and entrepreneurs. Wherever possible, national and EC rules should be simplified. Governments should adopt user-friendly administrative documents.

Small enterprises could be exempted from certain regulatory obligations. In this context, the Commission could simplify competition legislation to reduce the burden of compliance for small business.

## 4. *Availability of skills*

We shall endeavour to ensure that training institutions, complemented by in-house training schemes, deliver an adequate supply of skills adapted to the needs of small business, and provide lifetime training and consultancy.

5. *Improving online access*

Public authorities should be urged to increase their electronic communication with the small business sector. Thus, companies will be able to receive advice, make applications, file tax returns or obtain simple information online, therefore faster and more cheaply. The Commission must lead by example in this area.

6. *More out of the Single Market*

Small businesses are feeling the benefits from the reforms underway of Europe's economy. The Commission and Member States must therefore pursue the reforms underway aiming at the completion in the Union of a true internal market, user-friendly for small business, in critical areas for development of small businesses including electronic commerce, telecommunications, utilities, public procurement and cross-border payment systems.

At the same time, European and national competition rules should be vigorously applied to make sure that small businesses have every chance to enter new markets and compete on fair terms.

7. *Taxation and financial matters*

Tax systems should be adapted to reward success, encourage start-ups, favour small business expansion and job creation, and facilitate the creation and the succession in small enterprises. Member States should apply best practice to taxation and to personal performance incentives.

Entrepreneurs need finance to translate ambitions into reality. In order to improve the access of small enterprises to financial services, we will:



Identify and remove barriers to the creation of a pan-European capital market and to the implementation of the Financial Services Action Plan and the Risk Capital Action Plan;

Improve the relationship between the banking system and small enterprises by creating appropriate access conditions to credit and to venture capital;

*Improve the access to the structural funds and welcome initiatives by the European Investment Bank to increase funding available to start-ups and high-technology enterprises, including equity instruments.*

#### *8. Strengthen the technological capacity of small enterprises*

We will strengthen existing programmes aimed at promoting technology dissemination towards small enterprises as well as the capacity of small business to identify, select and adapt technologies.

We will foster technology co-operation and sharing among different company sizes and particularly between European small enterprises, develop more effective research programmes focussed on the commercial application of knowledge and technology, and develop and adapt quality and certification systems to small enterprises. It is important to ensure that a Community patent is available and easily accessible to small enterprises.

We will foster the involvement of small enterprises in inter-firm co-operation, at local, national, European and international levels as well as the co-operation between small enterprises and higher education and research institutions.

Actions at national and regional levels aimed at developing inter-firm clusters and networks should therefore be supported, pan-European co-operation between small enterprises using information technologies enhanced, best practice in co-operative agreements spread, and small enterprises co-operation supported to improve their capabilities to enter pan-European markets and to extend their activities in third country markets.

9. *Successful e-business models and top-class small business support*

The Commission and Member States should encourage small enterprises to apply best practice and adopt successful business models that enable them to truly flourish in the new economy.

*We will co-ordinate Member States and EU activity to create information and business support systems, networks and services which are easy to access and understand, and relevant to the needs of business; ensure EU-wide access to guidance and support from mentors and business angels, including through websites, and exploit the European Observatory on SMEs.*

10. *Develop stronger, more effective representation of small enterprises' interests at Union and national level*

We will complete a review of how the interests of small businesses are represented at EU and national level, including through the social dialogue.

We commit ourselves to progress towards these goals using the open method of coordination of national enterprise policies. The Multiannual Programme for Enterprise and Entrepreneurship, the Cardiff process on

economic reforms, the Luxembourg process on employment policies and other Community programs and initiatives will be used to this end. We will monitor and evaluate progress annually on the basis of a Commission report on the relevant issues at the Spring Summits.

We will use effective indicators to assess progress over time and in relation to the best in the world to reinforce our learning, searching for better practice in all fields that affect small business to continuously improve our performance.

# APPENDIX D: MULTIANNUAL PROGRAMME FOR ENTERPRISE AND ENTREPRENEURSHIP (2001-2005)

L 333/84

EN

Official Journal of the European Communities

29.12.2000

## II

(Acts whose publication is not obligatory)

## COUNCIL

### COUNCIL DECISION of 20 December 2000

**on a multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005)**

(2000/819/EC)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 157(3) thereof,

Having regard to the proposal from the Commission <sup>(1)</sup>,

Having regard to the Opinion of the European Parliament <sup>(2)</sup>,

Having regard to the Opinion of the Economic and Social Committee <sup>(3)</sup>,

Having regard to the Opinion of the Committee of the Regions <sup>(4)</sup>,

Whereas:

- (1) The importance of enterprise and entrepreneurship for the achievement of Community objectives and the difficulties faced by enterprises and entrepreneurs have been the subject of a number of communications, Decisions and reports, and most recently of the Commission Communication of 26 April 2000 on 'enterprise policy in the knowledge-driven economy'. These have identified major areas for action at Community level.
- (2) Small and medium-sized enterprises (SMEs) make a significant contribution in terms of competitiveness, research, innovation, skills and employment and face particular problems.
- (3) Action is required to help overcome these difficulties. A series of Programmes, particularly the Third Multiannual Programme for Small and Medium-sized Enterprises (SMEs) in the European Union (1997-2000), adopted by

Council Decision 97/15/EC <sup>(5)</sup>, which expires on 31 December 2000, have provided a framework for such action.

- (4) On 29 June 1999, the Commission reported in its Communication to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions on the external evaluation of the said programme.

- (5) It is necessary to adopt a further programme for the period beginning 1 January 2001 and to ensure that enterprise policy is endowed with sufficient resources to attain its objectives.

- (6) On 9 November 1999, the Council approved a report on the integration of sustainable development in the enterprise policy of the European Union. Account should be taken of sustainable development when defining and implementing the measures to be adopted under this programme.

- (7) On 20 June 2000, the Santa Maria da Feira European Council approved the European Charter for Small Enterprises and requested its full implementation in particular as part of the proposals for the Multiannual Programme for Enterprise and Entrepreneurship. Measures by the Union to promote SMEs should take account of the objectives set out in the Charter.

- (8) Similar actions have been launched in the framework of the OECD, and in particular with the Charter on policies concerning SMEs adopted by the OECD Ministers for Industry in Bologna on 15 June 2000.

<sup>(1)</sup> OJ C 311, 31.10.2000, p. 180.

<sup>(2)</sup> Opinion delivered on 26 October 2000 (not yet published in the Official Journal).

<sup>(3)</sup> Opinion delivered on 29 November 2000 (not yet published in the Official Journal).

<sup>(4)</sup> Opinion delivered on 21 September 2000 (not yet published in the Official Journal).

<sup>(5)</sup> OJ L 6, 10.1.1997, p. 25.

- (9) On 7 November 2000, the Council emphasised the need to improve significantly the financing of innovative companies and to redirect financial instruments towards support for new business start-ups, high-tech firms and micro-enterprises.
- (10) The measures necessary for the implementation of this Decision should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission <sup>(1)</sup>.
- (11) This Decision constitutes the legal basis for specific complementary measures which are not part of other Community policies and which cannot be better carried out at Member State level.
- (12) The Agreement on the European Economic Area (EEA) concluded with the EFTA/EEA countries and the additional protocols to the Association Agreements concluded with the countries of Central and Eastern Europe provide for participation of those countries in Community programmes. Provision should also be made for participation by Cyprus, Malta and Turkey in the framework of the Association Agreements concluded with those countries. Participation by other countries could be considered when agreements and procedures so allow.
- (13) A financial reference, within the meaning of point 34 of the Interinstitutional Agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure <sup>(2)</sup>, is included in this Decision for the whole duration of the programme, although this will not affect the powers of the budget authority as defined by the Treaty,
- (d) to improve the financial environment for business, especially SMEs;
- (e) to give business easier access to Community support services, programmes and networks and to improve the coordination of these facilities.
2. These objectives shall be implemented mainly via the areas of action described in Annex I.
3. Furthermore, by its very nature, this programme shall be used as a means of progressing towards the objectives set by the European Charter for Small Enterprises.

#### Article 3

1. The Commission shall be assisted by the Enterprise Programme Management Committee, (hereinafter referred to as the 'Committee').
2. Where reference is made to this paragraph, Articles 4 and 7 of Decision 1999/468/EC shall apply.

The period laid down in Article 4(3) of Decision 1999/468/EC shall be set at three months.

3. The Committee shall adopt its Rules of Procedure.

#### Article 4

1. The measures and actions necessary for implementing this programme relating to the matters referred to below shall be adopted in accordance with the management procedure referred to in Article 3(2):
- the annual working programme and the corresponding budget allocations;
  - the criteria and content of invitations to tender exceeding EUR 100 000;
  - the performance indicators for evaluating the actions needed to achieve the objectives set out in Article 2.
2. The Committee shall, moreover, be kept regularly informed of any other question concerning this programme, in particular of the annual implementation report and the evaluation reports mentioned in Article 5(1).

#### Article 5

1. The Commission shall evaluate the implementation of this programme and shall submit to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions:
- every two years, an evaluation report on progress made in taking account, in a coordinated manner,
    - of enterprise policy in Community policies and programmes as a whole,
    - of the implementation of the European Charter for Small Enterprises,
  - an external evaluation report by the end of December 2004.

HAS ADOPTED THIS DECISION:

#### Article 1

A programme for Community policy for enterprise and entrepreneurship, in particular for small and medium-sized enterprises (SMEs), hereinafter referred to as 'this programme', is hereby adopted for a period of five years from 1 January 2001.

#### Article 2

1. This programme shall have the following objectives:
- (a) to enhance the growth and competitiveness of business in a knowledge-based internationalised economy;
  - (b) to promote entrepreneurship;
  - (c) to simplify and improve the administrative and regulatory framework for business so that research, innovation and business creation in particular can flourish;

<sup>(1)</sup> OJ L 184, 17.7.1999, p. 23.

<sup>(2)</sup> OJ L 172, 18.6.1999, p. 1.

2. These reports shall examine whether the objectives of this programme have been achieved. They shall undertake a cost-benefit analysis of the measures and actions implemented, particularly on the basis of the performance indicators referred to in the third indent of Article 4(1).

#### Article 6

This programme shall be open to the participation of:

- the EFTA/EEA countries in accordance with the conditions established in the EEA agreement;
- the associated central and eastern European countries (CEEC) in accordance with the conditions established in the Europe Agreements, in the additional protocols thereto and in the decisions of the respective Association Councils;
- Cyprus, funded by additional appropriations in accordance with procedures to be agreed with that country;
- Malta and Turkey, funded by additional appropriations, in accordance with the provisions of the Treaty;

— other countries, when agreements and procedures so allow.

#### Article 7

1. The financial reference amount for the implementation of this programme shall be EUR 450 million.
2. The annual appropriations shall be authorised by the budgetary authority within the limits of the financial perspective.

#### Article 8

This Decision shall take effect on 1 January 2001 and shall cover the period to 31 December 2005.

#### Article 9

This Decision is addressed to the Member States.

Done at Brussels, 20 December 2000.

*For the Council*  
*The President*  
J.-C. GAYSSOT

## ANNEX I

## DESCRIPTION OF THE AREAS OF ACTION

The areas of action will principally be based on identifying and exchanging best practice in accordance with the new Best Procedure described in the Commission communication of 26 April 2000, while taking account of the needs of SMEs, and will be aimed at:

**1. Enhancing growth and the competitiveness of business in a knowledge-based, internationalised economy:**

This programme will foster, in particular, measures to:

- enhance competitiveness and innovation;
- assist the free movement of goods and market access;
- prepare enterprises for facing globalisation and, in particular, promote the participation of SMEs in the process of standardisation and its implementation;
- provide an adequate range of skills geared to the needs of small businesses;
- develop the use of new information and communications technologies;
- encourage innovative practices;
- foster the integration of sustainable development.

**2. Promoting entrepreneurship:**

This programme will aim, in particular, at:

- assisting the creation and transfer of businesses;
- developing training in entrepreneurship;
- fostering the enterprise culture throughout society;
- identifying and promoting specific policies in favour of SMEs.

**3. Simplifying and improving the administrative and regulatory environment for business, in particular to promote research, innovation and business creation:**

The following will be sought in particular:

- further development of the business impact assessment system for proposed Community legislation;
- better regulation and a simpler administrative environment in general.

**4. Improving the financial environment for business, especially SMEs:**

In response to the conclusions of the Lisbon European Council of 23 and 24 March 2000, this programme will foster in particular:

- (a) measures to improve the financial environment for business, especially SMEs. These measures, arrangements for the operation of which are set out on an indicative basis in Annex II, are as follows:

(i) *the Start-up Scheme of the European Technology Facility (ETF), operated by the European Investment Fund (EIF).*

The ETF Start-up Scheme will support the establishment and financing of SMEs in their start-up phase:

- by investing in relevant specialised venture capital funds, particularly in seed funds, smaller funds, funds operating regionally or funds focused on specific sectors or technologies, or venture capital funds financing the exploitation of R&D results, e.g. funds linked to research centres and science parks which in turn provide risk capital for SMEs. This scheme will reinforce upstream the ETF established by the European Investment Bank (EIB) in cooperation with the EIF by adopting an investment policy involving a higher risk-profile, both as regards intermediary funds and their investment policies.

The EIF will select, make and manage the investments into the venture-capital funds, where appropriate working with national schemes. The detailed terms and conditions for implementing the ETF start-up facility, including its monitoring and control, will be laid down in a cooperation agreement between the Commission and the EIF which takes account of the indicative outline in Annex II.

- by supporting the establishment and development of business incubators and associated follow-up programmes (mentoring schemes).

(ii) *the SME Guarantee Facility, operated by the EIF*

The SME Guarantee Facility will provide cross-guarantees or, where appropriate, co-guarantees for guarantee schemes operating in Member States, and direct guarantees in the case of the EIF or any other appropriate financial intermediary, its losses from the relevant guarantees being covered by the general budget of the European Union.

This will enable market failures to be remedied in the following areas:

- loans for SMEs with growth potential, in order to reduce the particular difficulties they face because of the high risk which they represent (e.g. small or newly-established companies);
- microcredit, in order to encourage financial institutions to play a greater part in that area by offering loans of a smaller amount which involve proportionately higher unit handling costs for borrowers with insufficient guarantees;
- own-funds investments in SMEs with growth potential, including investments by local or regional funds which provide seed capital and/or capital in the start-up phase, in order to reduce the particular difficulties which SMEs face because of their weak financial structure;
- exploitation by small undertakings of the new possibilities presented by the Internet and e-commerce - guaranteed loans could cover IT equipment, software and training in order to help such undertakings modernise themselves in these areas and make them more competitive.

As well as guarantees or cross-guarantees, additional aid to financial intermediaries could be envisaged, particularly with regard to microcredit. Such aid is intended to partially offset the high administrative costs inherent in such activities.

The budgetary allocation will cover the full cost of the facility, including EIF's guarantee losses and any other eligible costs or expenses of the facility. The cost of the facility to the general budget of the European Union will be capped so that it does not under any circumstances exceed the budgetary allocations made available to the EIF under this facility; there will be no contingent liability on the budget.

The detailed terms and conditions for implementing the SME guarantee facility, including its monitoring and control, will be laid down in a cooperation agreement between the Commission and the EIF which takes account of the indicative outline in Annex II.

(iii) *Seed Capital Action, operated by the EIF*

The Seed Capital action aims to stimulate the supply of capital for the creation of innovative new businesses with growth and job creation potential, including those in the traditional economy, through support for seed funds, incubators or similar organisations in which the EIF participates - either from its own resources or on its mandate - from their early years onwards.

(iv) *Joint European Venture*

This programme aims to use the commitments effected up until 31 December 2000 for the benefit of undertakings planning to enter into a transnational partnership. The maximum contribution per project is EUR 100 000.

These financial measures might be adapted in the light of future Council decisions. These financing facilities will have to be implemented in close collaboration with the Member States.

- (b) use of the euro by business;
- (c) measures to encourage proximity financing, and in particular to develop networks of Business Angels;
- (d) promoting a Community-wide network for seed capital funds and their managers and stimulating an exchange of best practices and training;
- (e) the organisation of Round Tables of bankers and SMEs.

5. **Giving business easier access to Community support services, programmes and networks and improving the coordination of these facilities:**

This programme will, in particular, develop actions to:

- foster access for enterprises to Community programmes and ensure better coordination particularly with the fifth framework programme for research, technological development and demonstration activities (FP5),
- improve the operation, cooperation and coordination of Community networks, in particular the Euro Info Centres and the Euro Info Correspondence Centres. In carrying out these activities, the Commission may have recourse to technical assistance organisations or experts, the financing of which may be provided for within the overall financial framework of this programme,
- promote the organisation of Europartnership business cooperation events,
- make use of the report entitled 'European Observatory for SMEs'.



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The SME Guarantee Facility will provide cross-guarantees or, where appropriate, co-guarantees for guarantee schemes operating in Member States, and direct guarantees in the case of the EIF or any other appropriate financial intermediary, its losses from the relevant guarantees being covered by the general budget of the European Union.

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- own-funds investments in SMEs with growth potential, including investments by local or regional funds which provide seed capital and/or capital in the start-up phase, in order to reduce the particular difficulties which SMEs face because of their weak financial structure;
- exploitation by small undertakings of the new possibilities presented by the Internet and e-commerce - guaranteed loans could cover IT equipment, software and training in order to help such undertakings modernise themselves in these areas and make them more competitive.

As well as guarantees or cross-guarantees, additional aid to financial intermediaries could be envisaged, particularly with regard to microcredit. Such aid is intended to partially offset the high administrative costs inherent in such activities.

The budgetary allocation will cover the full cost of the facility, including EIF's guarantee losses and any other eligible costs or expenses of the facility. The cost of the facility to the general budget of the European Union will be capped so that it does not under any circumstances exceed the budgetary allocations made available to the EIF under this facility; there will be no contingent liability on the budget.

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- promote the organisation of Europartnership business cooperation events,
- make use of the report entitled 'European Observatory for SMEs'.

## ANNEX II

## COMMUNITY FINANCIAL INSTRUMENTS

## I. Indicative outline of the implementation of the ETF Start-up Scheme

## A. Introduction

The ETF Start-up will be operated by the EIF on a trust basis.

## B. Intermediaries

With regard to venture capital activities, the intermediaries will be selected in conformity with best business and market practice in a fair and transparent manner in order to avoid any distortion of competition, having regard to the aim of working through a wide range of specialised funds.

With regard to the implementation of additional action to promote business incubators, the EIF will rely on the experience acquired by Member States in that area.

## C. Maximum investment

The maximum aggregate investment in an intermediary venture capital fund will be 25 % of the total equity capital held by the relevant fund, or 50 % in exceptional cases such as new funds which are likely to have a particularly strong catalytic role in the development of venture capital markets for a specific technology or in a specific region. No commitment in a single venture capital fund will exceed EUR 10 million other than in exceptional, duly substantiated cases; commitments will not in any case exceed EUR 15 million. The intermediary venture capital funds will comply with established market practices with regard to portfolio diversification.

D. Investment *pari passu*

The investment made by the ETF start-up in the intermediary funds will rank *pari passu* with other equity investors. Any exception to this rule must be subject to the opinion of the Committee referred to in Article 3.

## E. Life of the facility

The ETF Start-up scheme is established as a long-term facility that will usually take 5 to 12 year positions in venture capital funds. In any case, investments will not exceed 16 years from the time of signature of the cooperation agreement between the Commission and the EIF referred to in Annex I.

## F. Realisation of investments

As most of the investments to be made under the ETF Start-up scheme will be in unquoted, illiquid entities, the realisation of those investments will be based on the distribution of the proceeds received by the intermediary funds from the sale of their investments in SMEs.

## G. Reinvestment of proceeds from realised investments

Proceeds from reimbursements effected by the EIF funds may be reinvested during the first four years following 20 December 2000. This period may be extended by up to three years, subject to a satisfactory evaluation of the facility having been made 48 months after 20 December 2000.

## H. Trust account

A separate trust account will be set up within the EIF to hold budgetary funds underpinning the scheme. This account will be interest-bearing; interest earned will be added to the resources of the facility. The investments made by the EIF under the ETF Start-up scheme and the EIF's management fees and other eligible expenses will be debited from, and the proceeds from realised investments will be credited to, the Trust Account. At the end of the fourth year following 20 December 2000 or, provided that the reinvestment period of the scheme is extended, after the end of the extended reinvestment period, any balances on the Trust Account, other than funds committed and not yet drawn down/invested and funds reasonably required to cover eligible costs and expenses, such as the EIF's management fee, will be returned to the general budget of the European Union.

## I. Court of Auditors

Appropriate arrangements will be made to allow the Court of Auditors to exercise its mission and to verify the regularity of the use of the funds.

## II. Indicative outline of the implementation of the SME Guarantee Facility

### A. Introduction

The SME Guarantee Facility will be operated by the EIF on a trust basis.

### B. Intermediaries

Intermediaries are chosen from among the guarantee schemes operating in the Member States within the public or private sector, including mutual guarantee schemes, the EIB or any other appropriate financial institution. Intermediaries will be selected in conformity with best business and market practice in a fair and transparent manner, having regard to:

- (a) the effect on the volume of financing (loans, investments) made available to SMEs, and/or
- (b) the effect on the access to finance by SMEs, and/or
- (c) the effect on risk-taking in SME financing by the intermediary concerned.

### C. Eligible SME lending

The financial criteria governing the eligibility of SME financing for guarantees under the SME Guarantee Facility will be determined individually for each intermediary on the basis of their activities, with the aim of reaching as many SMEs as possible. These rules will reflect market conditions and practices in the relevant territory.

The guarantees and cross-guarantees will mainly be available to cover financing for SMEs with up to 100 employees (with priority given to SMEs with up to 50 employees in respect of specific activities to promote the use of the Internet and e-commerce by small undertakings). Particular attention will be given to financing for the acquisition of intangible assets.

### D. EIF guarantees

The guarantees given by the EIF will relate to individual financing in a specific portfolio of transactions. The guarantees issued by the EIF will cover a part of the risk taken by the financial intermediary in the underlying financing portfolio.

### E. EIF's capped maximum cumulative losses

The EIF's obligation to pay its share of financing losses to the intermediary will continue until the cumulative amount of payments made to cover losses from a specific financing portfolio, reduced where appropriate by the cumulative amount of corresponding loss recoveries, together with other revenue, reaches a pre-agreed amount, after which the EIF's guarantee is automatically cancelled.

### F. EIF *pari passu* with intermediary

The guarantees given by the EIF will usually rank *pari passu* with the guarantees or where appropriate with the financing given by the intermediary.

### G. Trust Account

A trust account will be set up within the EIF to hold the budgetary funds underpinning the scheme. This account will be interest bearing; interest earned will be added to the resources of the facility.

### H. EIF's right to withdraw funds from the Trust Account

The EIF will have the right to debit the Trust Account for payments to meet its obligations for the maximum cumulative losses under the guarantee facility, and, subject to agreement by the Commission, any other eligible costs, for example its management fees, eligible legal fees and promotional expenses of the scheme.

### I. Loss recoveries and other revenue payable to the Trust Account

Any moneys recovered from loan losses for which payment has been made under guarantees called, together with any other revenue, will be credited to the Trust Account.

### J. Duration of the Scheme

It is envisaged that the individual SME guarantees will have a maturity of up to 10 years. Any amount outstanding on the Trust Account at the time of expiry of the outstanding guarantees will be repaid to the general budget of the European Union.

### K. Court of Auditors

Appropriate arrangements will be made to allow the Court of Auditors to exercise its mission and to verify the regularity of the use of the funds.

**III. Indicative outline of the implementation of the Seed Capital Action****A. Introduction**

The Seed Capital action will be operated by the EIF.

**B. Court of Auditors**

Appropriate arrangements will be made to allow the Court of Auditors to exercise its mission and to verify the regularity of use of the funds.

**IV. Joint European Venture**

Experience has shown that this scheme needs to be simplified in order to enable SMEs' requests for financial contributions to be dealt with quickly by the financial intermediaries and Commission departments and to ensure that Community resources are used correctly. Furthermore, the Commission is currently examining the possibility of adapting the eligibility criteria in order to respond more effectively to the needs of SMEs with regard to cross-border investments, including those in applicant States.

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## APPENDIX E: QUESTIONNAIRE FOR SURVEY

### SURVEY ABOUT THE SMALL AND MEDIUM SIZED ENTERPRISES

This survey is being done on the point of being used as the scope of the high degree thesis regarding on SMEs that is being carried out in the European studies of Middle East Technical University. Results of the research, if demanded, will be transmitted to those companies which answered the survey. If it is demanded, mark one of the boxes below and write your e-mail address...

I want the results of research to be sent to me.

I want the whole thesis that is prepared to be sent to me.

E-Mail address:

**Company Name:**

**City of Location:**

**Area of Activity:** *(please write in detail.)*

#### 1- Which groups does your area of activity belong to?

- Manufacturing
- Service
- Tourism
- Health
- Education
- Software Improvement
- Others

#### 2- For how long have you been active in this area?

- 1 year
- 2-5 years
- 6-10 years
- More than 10 years

#### 3- Under which group do you classify your company?

- A company that is newly started to operate.
- A company that doesn't show any important increases on its turn over and which does not have any increase in its number of employees since its activation.
- A company, which does not show any increase in its turn over but show increase in number of employees.
- A company whose turn over and number of employees increases substantially.

**4- What is the average number of employees worked in your company annually?**

- 1-9 employees
- 10-49 employees
- 50-99 employees
- 100-249 employees
- 250 employees and above

**5- What is the average turn over annually in your company?**

- 500.000 YTL and less
- 500.000-1.000.000 YTL
- 1.000.000-5.000.000 YTL
- 5.000.000 YTL and above

**6- Where do you get information about the supports that are provided to SMEs in Turkey? Number it in order of priority.**

- KOSGEB
- Halk Bank
- Chamber of Trade
- Press
- Colleagues
- Others (*if you put the others section in to ordering, please indicate what it is*)

**7- As regards to your sector, do you have any idea about the supports that are provided to SMEs or SMEs Policies of European Union?**

- Yes
- No
- Partially

**8- If your answer is YES or PARTIALLY for the above question, what are your sources of information?**

- KOSGEB
- Chamber of Trade
- Press
- Colleagues
- Others (*please indicate what it is*)

**9- How do you think SMEs in your sectors will be affected after Turkey becomes the member of European Union? (More than one option can be marked)**

- Financial aid to SMEs will increase
- It will be negatively affected because SMEs won't be able to compete with the SMEs of EU countries
- It will be easier to enter new markets with the membership
- With the membership, the cost of adoption of new regulations will be high
- There won't be any affect of it
- I don't have any idea

**10- In your opinion, what is the most important problem of the SMEs in your area of action? (Order it in degree of importance)**

- Financial problems
- High running costs
- High tax rates
- Not having a brand for its own
- Marketing-Sale
- Qualified employee
- Legal regulations and troubles stemming from bureaucracy
- Not having enough Research and Development (R&D)

**11-Where do you think the financial problems of SMEs arise from? Order it in degree of importance.**

- Insufficient seed and venture capital
- Insufficient long-term credits with low interest rate
- Insufficiency of financial organizations
- Insufficient state aids to SMEs
- Narrow and limited scope of state aids (being towards to certain sectors and certain region)
- Others (*please indicate what it is*)

**Thank you for your attention**

P.S. If it is possible you to send the survey, that you filled, with E-mail please write "SMEs Survey" in the subject part and send it to [seval@euturkey.org.tr](mailto:seval@euturkey.org.tr)