

# SMALL AND MEDIUM-SIZED ENTERPRISES IN THE EU AND STATE AIDS PROVIDED FOR THEIR SUPPORT

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## Abstract

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Provisions on the restriction of State aids form an important part of the primary and secondary EU competition law. The basic premise of the regulation is the circumstance that aid provided by States from public resources to enterprises can distort the competition within the EU and therefore is declared for incompatible with the EU internal market. At the same time we must realise that there are several situations in which a suitably scheduled State aids can act as a positive input to the development of the internal market and therefore a complete prohibition of State aids would be rather counter-productive. In several areas of the competition regulation rules and criteria for the admissibility of suitable State aids are formulated by the EU law. The rules for the admissibility of State aids for the support of small and medium-sized enterprises (SMEs) are one of these areas. The aim of the present article is to analyze the requirements for the provision of State aids to the SMEs as laid down by the SME block exemption of 2001 and, consequently, by the new GBER in force since 29 August 2008. Consequently the article analyses the impact of the State aids both on the supported SME and on the relevant market and/or the potential distortion of the competition it may cause. The analysis of the methodology for the assessment of aid for SMEs will be provided in order to define the categories of specific SME exemptions given by the EU Council regulation. Finally, the procedure for the approval of State aids to SME that fall outside the block exemptions, will be outlined. Comparative method will be used in order to evaluate the possible procedures available to the Member States.

State aid, EU competition law, small and medium-sized enterprises, 2008 GBER

The Treaty on Functioning of the EU (thereinafter “TFEU”) contains an important principle according to that any aid provided by State or from public resources that distorts or potentially may distort the competition shall be incompatible with the EU internal market.

Main form in that these aids may cause injury to the competition consist in the fact that if an enterprise or its product receive – unlike other competitors on the relevant market – an aid from State or other public resources, this enterprise wins a comparative advantage on this market and the possibility of other enterprises to assert in a better way on the market is thereby reduced. Although the enterprise receiving the aid may be less efficient

as to its functioning on the relevant market, the other competitors that are not supported by any aid will not get the equal chance to take part in the relevant market. As the dynamics, productivity and competitiveness are weakened, in the final effect both the market and the consumers may suffer from it (BILAL, S., PHENDON, N., 2003).

When applying these strict rules to the competition on the EU internal market we must see at the same time that not every aid directed on the EU internal market can cause the above quoted negative impacts. There are several situations in which the market forces – without being streamlined or assisted – can create an insufficient offer of important activities or services and under

the circumstances given a suitable scheduled State aid scheme may significantly contribute to the protection of general interests. In the light of the fact that such aid can act as a positive input, whereas the complete prohibition of State aids would be as such counter-productive. Instead of this – as in case of other areas of the competition regulation – rules and criteria for the admissibility of suitable State aids must be formulated by the EU law.

One of the areas where such rules may reach positive results and influence the growth of the EU internal market represent aids provided for the support of small and medium-sized enterprises (thereinafter “SMEs”). SMEs play crucial role in the development strategy of the EU for economic growth and social welfare and – as stressed by the EU Commission – are crucial for the development of the internal market. SMEs are regarded as important element for the development of jobs and “entrepreneurial boom” in the EU. The promotion and support of SMEs allows new and smaller enterprises to be created, develop and grow. Thus again increases the pool of competitors and reinforces the relevant markets. Better competition drives down consumer prices, increases innovation and efficiency and adds to the long term stability of the market (FLOYD, D., Mc MANUS, J., 2005).

In line with the strategic importance of SMEs, we may observe a consistently favourable approach of the EU legal rules on State aids developed mainly by the EU Commission to State aid for the encouraging of development and sustainability of SMEs. In particular, aid may be approved where it corrects the market failures that are recognized as having significant limiting effect on the development of SMEs. SMEs usually have difficulties obtaining and securing capital for all types of expenditure. This is due to financial institutions being unwilling to accept the risk against the limited guarantees that SMEs are able to provide. In addition, due to their size SMEs will have limited access to certain types of information (such as new technology and new markets) (MULHERN, A., 1995). SMEs consequently enjoy a favoured status in relation to State aids. As set out below, many types of aid to SMEs are block exempted, and SMEs are also generally able to enjoy the benefit of higher levels of aid intensity than larger enterprises.

The aim of the present article is to analyze the requirements for the provision of State aids to the SMEs as laid down by the SME block exemption of 2001 and, consequently, by the new General Block Exemption Regulation in force since August 2008. Consequently the article analyses the impact of the State aids both on the supported SMEs and on the relevant market and/or the potential distortion of the competition it may cause

## METHODS AND RESOURCES

The analysis of the methodology for the assessment of aid for SMEs will be provided in order

to define the categories of specific SME exemptions given by the EU Council regulation. Finally, the procedure for the approval of State aids to SME that fall outside the block exemptions, will be outlined. Comparative method will be used in order to evaluate the possible procedures available to the Member States.

## RESULTS AND DISCUSSION

In 1992 the Commission published its first guidelines setting out criteria for the approval of aid to SMEs. (Community guidelines on State aid for small and medium-sized enterprises (1992) OJ C213/2). The guidelines identified the advantages offered to the economy by SMEs and recognized a number of market failures that significantly hampered their development and progress. Accordingly, they set out the conditions under which aid could be approved pursuant to Article 107 para. 3(c) TFEU. A revised version of these guidelines was published in 1996/ Community guidelines on State aid for small and medium-sized enterprises (1996) OJ C213/4/. Although the revised version of the guidelines stipulated that its operation would be reviewed after it had been in force for a period of three years, this was overtaken by the Commission's development of a block exemption for SMEs.

In 2001, pursuant to the Enabling Regulation / Council Regulation (EC) 994/98 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid (1998) OJ L42/1/ the Commission adopted a block exemption for certain types of State aid to small and medium-sized enterprises. /Commission Regulation (EC) 70/2001 on the application of Articles 107 and 108 of the EC Treaty to State aid to small and medium-sized enterprises (2001) OJ L10/33 / This formalized the policy that had been set out in the Commission's 1992 and 1996 guidelines. It set out clear ‘safe harbours’ where aid that fell within the scope of the block exemption would automatically be considered to be compatible with the internal market without the need for notification to and approval of the Commission. In 2003 the Commission published a number of proposals in its Recommendation concerning the definition of micro, small and medium-sized enterprises, (Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises (2003) O L124/36) which were directed at improving the wording and application of the block exemption. As a result, the block exemption was amended in 2004. (Commission Regulation (EC) 3641/2004 amending Regulation (EC) 70/2001 as regards the extension of its scope to include aid for research and development (2004) O L63/22) In particular, the amendments extended the scope of the block exemption to cover aid to SMEs for R&D activities. In 2006 the block exemption was amended further, to bring within its scope aid to

SMEs active in the processing and marketing of agricultural products. (See Commission Regulation (EC) 1857/2006 on the application of Articles 107 and 108 of the Treaty to State aid to small and medium-sized enterprises active in the production of agricultural products and amending Regulation (EC) 70/2001).

The SME block exemption has been replaced in 2008 by the provisions of the new General Block Exemption Regulation (thereinafter “GBER”). This Regulation, in force since 29 August 2008, is due to expire on 31 December 2013. (Commission Regulation (EC) 800/2008 on the application of Articles 107 and 108 of the Treaty declaring certain categories of State aid compatible with the internal market (General Block Exemption Regulation) (2008) OJ L214/3). GBER contains exemptions for categories of SME aid that are similar to the exemptions in the SME block exemption (“investment aid” or “aid for the participation at fairs”). In addition, GBER covers a number of new categories of aid to SMEs, such as aid for female entrepreneurship, and aid for the early adoption of future EU environmental standards. SMEs also generally benefit from more favourable treatment under other GBER exemptions for horizontal aid and regional aid. As with the SME block exemption, aid falling within the categories specified in the General Block Exemption Regulation may be granted without prior notification to the Commission and without its approval. According to the transitional provisions any aid granted before 31 December 2008, which does not satisfy the conditions of the GBER but fulfils the conditions of the previous SME block exemption, is still deemed compatible with the internal market and exempt from notification (Article 44 para 2 GBER).

GBER, together with the Commission’s general rules for the approval of aid measures, establish the following methodology for the assessment of aid for SMEs.

- a) A number of SME support measures do not constitute State aid.
- b) Where there is aid, the General Block Exemption Regulation enables aid to SMEs that complies with certain substantive and transparency requirements to be implemented without prior notification and approval.
- c) SME aid measures not eligible under the General Block Exemption Regulation may still be individually approved by the Commission under Article 107 para 2 and 3 TFEU (see below).

From the scope of the GBER are excluded the most forms of aid to the agriculture and fisheries sectors. Instead, such aid has been the subject of separate block exemptions and guidelines. (See for Commission regulation (EC) 1857/2006 on the application of Articles 107 and 108 of the Treaty to State aid to small and medium-sized enterprises active on the production of agricultural products (2006) OJ L358/3).

### Existence of aid

For State aid to arise, all of the criteria defined by Article 107 para 1 TFEU must be met. These involve the following:

- a) there must be aid in the sense of a gained benefit or advantage,
- b) the aid is granted by the State and through State resources,
- c) the aid favours certain enterprises or the production of certain goods (the principle of “selectivity”),
- d) the aid is capable to distort competition and affect trade between Member States.

In most cases of aids granted to SMEs, it will be straightforward to establish the existence of aid within Article 107 para 1 TFEU. The doubtful cases are likely to be those where the nature of the SME’s business makes it questionable whether the aid would affect trade between Member States, and cases of *de minimis* aids (see below).

Article 107 para 1 TFEU applies only if the aid strengthens the position of an enterprise compared with other enterprises competing in intra-EU trade. This condition has been interpreted broadly, so that it is not (for example) necessary to establish that the beneficiary itself exports its products, or even that there is any actual trade between Member States in the product or service at the time when the aid is granted. But it is acknowledged that the criterion may well not be satisfied where aid is granted to enterprises in relation to products or services which by their nature are not traded between States. This may well be the case for SMEs, particularly micro enterprises, providing local services for example. If this is the case, the aid is likely to fall outside the scope of Article 107 para. 1 TFEU (Community guidelines on State aid for small and medium-sized enterprises (1996) OJ C213/4, para 2.1/).

Aid to SMEs may also fall within the scope of the *de minimis* block exemptions as provided by the Regulation 1998/2008 /Commission regulation (EC) 1998/2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid (2006) OJ L379/5/. In such cases, the aid is deemed not to meet the criteria of Article 107 para. 1 TFEU. Beside this general *de minimis* Regulation, there are separate *de minimis* Regulations applicable in the agriculture and fisheries sectors /Commission Regulation (EC) 1535/2007 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid in the sector of agricultural production (2007) OJ L337/35/.

### General Block Exemption Regulation (GBER)

Chapter I of the GBER contains a set of common conditions and procedural provisions applicable to the various types of aid covered by the Regulation. We will first discuss in more details provisions of this chapter relevant to aids specifically targeted at SMEs and thereafter we will mention the specific SMEs aid exemptions in the GBER, as set out in Chapter II of this Regulation.

In addition to the exemptions specifically aimed at SMEs (see below), SMEs benefit from more favourable terms than those applicable to larger enterprises in almost all of the other exemptions specified by the GBER, namely

- in relation to regional investment and employment aid, SMEs are permitted to receive higher levels of aid intensity, and benefit from other favourable conditions (Article 13 GBER),
- in relation to environmental aid, SMEs are able to benefit from increased levels of aid intensity with regard to aid for investment enabling enterprises to go beyond EU standards for environmental protection (Article 18 GBER),
- aid for the acquisition of transport vehicles which go beyond EU standards (Article 19 GBER),
- aid for investment in energy saving measures (Article 21 GBER),
- environmental investment aid for high-efficiency cogeneration (Article 22 GBER),
- environmental investment aid for the promotion of energy from renewable energy sources (Article 23 GBER),
- aid for environmental studies (Article 24),
- aid intensities in the provisions on aid for risk capital (Article 29 GBER),
- increased levels of aid intensity for training aid (Article 39 GBER).

### Common and procedural provisions

In relation to the specific SMEs exemptions, GBER provisions exclude aid to enterprises in the coal, fisheries and aquaculture sectors, and the primary production of agricultural products. The only relevant exceptions to these exclusions are aids for research, development and innovation (i.e. in relation to SMEs, the provisions of Articles 35 to 37 GBER) and environmental aid which are applicable in relation to the primary production of agricultural products (insofar as the aid is not already covered by the Agriculture Block Exemption Regulation). In addition, the SMEs research, development and innovation provisions apply to the fishery and aquaculture sectors.

Certain other aids are also excluded under the GBER, namely where the value of the financial assistance exceeds limits as specified therein. This varies according to the type of aid in question. For the various categories of aid specific to SMEs, the thresholds for enterprise and project are (see GBER, Article 6):

- a) €7.5 million in the case of SME investment and employment aid,
- b) €2 million in the case of consultancy aid in favour of SMEs,
- c) €2 million in the case of aid granted to SMEs for participation in fairs, and
- d) €5 million in the case of aid granted to SMEs for industrial property rights costs.

In addition to the specific provisions mentioned above in relation to the SME exemptions, the GBER contains a number of general conditions common for all types of aid within its reach. In summary, these provisions concern:

- a) the exclusion of all forms of aid to certain enterprises and certain sectors,
- b) the general conditions for exemption of aid schemes and individual aid granted under such schemes, as well as for ad hoc individual aid,
- c) the basis of calculation of aid intensities,
- d) the requirement to provide documentary evidence of eligible costs,
- e) the requirement for exempted aid to be transparent,
- f) the conditions under which aid can be cumulated with other aid exempted under GBER,
- g) the requirement for aid to have an incentive effect, and
- h) the reporting and monitoring requirements applicable to all aids exempted under GBER.

### Specific SME exemptions

GBER defines an enterprise as “any entity engaged in an economic activity, irrespective of its legal form” (GBER, Annex I, Article 1). This includes self-employed persons and family businesses, as well as partnerships or associations regularly engaged in an economic activities. Thereafter GBER defines micro, small and medium-sized enterprises (GBER, Annex I, Article 2). These categorizations are important for determining the levels of aid that can be authorized under different areas of the GBER. In general, the various block exemptions generally allow greater levels of aid and aid intensity to smaller enterprises. The table below sets out the definitions for each category of enterprise.

In addition to the increased intensities of aids for SMEs under the general horizontal and regional aid provisions (see above), GBER exempts a number of specific categories of aid that apply exclusively to SMEs. These are:

- aid for newly created small enterprises (Article 14),
- SME investment and employment aid (Article 15),

I: Definition for categories of enterprise

Category of enterprise	Number of Employees <sup>26</sup>	Annual turnover (€)	Annual balance sheet total (€)
Micro	Less than 10	2 million	2 million
Small	Less than 50	10 million	10 million
Medium-sized	Less than 250	50 million	43 million

(Source: GBER, Annex I, Articles 1,2)



- aid for female entrepreneurship (Article 16),
- aid for early adaptation to EU environmental standards (Article 20),
- aid for consultancy (Article 26),
- aid for participation in fairs (Article 27),
- aid for industrial property rights costs (Article 33),
- aid for young innovative enterprises (Article 35),
- aid for innovation advisory services and innovation support services (Art. 36),
- aid for the loan of highly qualified personnel (Article 37).

We will now briefly analyse the conditions for exemption in each of the above cases.

Under the regional aid provisions of GBER, aid may be granted to newly created small enterprises. The eligible expenses are the costs directly incurred in creating the enterprise, namely the legal, advisory, consultancy and administrative costs. The aid can also be used to support certain types of running costs of the enterprise in the first five years following the enterprise's creation. The aid cannot, however, be awarded to enterprises that are controlled by shareholders that had owned a failed enterprise active in the same market, or adjacent markets, in the previous year. This prevents inefficiencies created by supporting unsuccessful enterprises /see GBER, Article 14 (e)/.

Investment and employment aid may be granted to SMEs. The maximum aid intensity is 20% in the case of small enterprises and 10% in the case of medium-sized enterprises /GBER Article 15 para 2/. The costs eligible for aid are (for investment aid) the eligible tangible and intangible costs or (for employment aid) the estimated wage costs of employment directly created by the investment project, over a period of two years. Where the aid concerns the processing and marketing of agricultural products, different levels of aid intensity apply which vary depending on the region: 75% of eligible investments in the outermost regions, 65% of eligible investments in the smaller Aegean Islands, 50% of eligible investments in regions eligible under Article 107 para 3(a) TFEU and 40% of eligible investments in all other regions. / Article 15 para 4/. This is to enable further assistance to be given for agricultural aid in regions of the EU where the standard of living is abnormally low or where there is serious under-employment.

GBER has introduced a new type of exempted aid in the form of "aid for small enterprises newly created by female entrepreneurs" /see GBER Article 16/. The origins of this exemption seem to have come from the Small Business Act (see COM (2008) 394) which identified a clear differential between the genders in relation to entrepreneurial activity. In order to deal with this difference, the new exemption under GBER has the clear aim of promoting female entrepreneurship in the EU, and reducing the inequalities existing *de facto* in the area of entrepreneurship (compare Recitals 44 of GBER). The aid must be granted to a "small enterprise newly created by female entrepreneurs". This means

that 51% or more of the capital of the enterprise must be owned by one or more women, or women are the registered owners of the enterprise, and women must be in charge of the management of the enterprise. The aid ceiling is € 1 million per enterprise, 33% of which may be paid in any single year. The maximum aid intensity is 15% of eligible expenses incurred in the first five years after the creation of the enterprise (GBER Article 16 paras 2–4). The eligible costs include the legal, advisory, consultancy and administrative expenses directly incurred in setting up the business. In addition, a number of other types of running costs are eligible for aid, including interest on external financing, utilities bills and child care and parental costs, including parental leave (GBER Article 16 para 5). As in the case of the general category of aid for newly created small enterprises, there is a provision aimed at preventing aid to 'phoenix' enterprises, by excluding aid to enterprises that are controlled by shareholders that had owned a failed enterprise active in the same market, or adjacent markets, in the previous year.

SMEs have disproportionate costs in adapting to new EU environmental standards. In larger organizations, such overheads will not be sufficient to have a detrimental effect on the business, but for SMEs this can have a significant impact on their profitability, and hence their continuing viability. The GBER therefore allows aid to assist SMEs to comply with new EU environmental standards, which are not yet in force. This type of aid to SMEs is new in the GBER. To benefit from exemption the investment must be implemented at least a year before the mandatory date for transposition of the standards in question. The aid intensity is set at 15% for small enterprises and 10% for medium-sized enterprises if the investment is implemented more than three years before the mandatory date of transposition. If the investment is implemented between one and three years before that date, only small enterprises are eligible for aid, and then only up to a maximum intensity of 10%. The eligible costs are the extra investment costs necessary to achieve the level of environmental protection required by the EU standard /see GBER Article 20/.

GBER exempts further on aids to SMEs for consultancy up to a maximum aid intensity of 50% of the eligible costs. Eligible costs are the consultancy costs of services provided by external consultants. These services must not be a continuous or periodic activity, nor relate to the enterprise's usual operating costs such as routine tax consultancy services, regular legal services or advertising (see GBER Article 26).

GBER exempts also certain types of aid assisting SMEs to participate in fairs. Fairs provide opportunities to access information that may be useful for SMEs, as well as show-casing the goods or services that SMEs can offer. Aid for SME participation in fairs is thus exempted up to a maximum aid intensity of 50% of the costs incurred

in renting, setting up and running the stand for the first participation of an enterprise in any particular fair or exhibition (see GBER Article 27). Consistent with the Commission's previous practice, aid for subsequent participation in any particular fair or exhibition will not be covered (compare e.g. Decision 2003/226/EC *Saxony SMEs* (2003) OJ L91/13, paras 66–68).

As to the research, development and innovation aids for SMEs, it is recognized that SMEs may experience difficulties in gaining access to new technological developments and technology transfers, as well as highly qualified personnel. For that reason, in addition to the higher aid intensities permitted for aid for R&D projects and technical feasibility studies (GBER Articles 31 and 32). SMEs may benefit from four specific types of R&D aid that are not available for large enterprises. These are aid for industrial property rights costs for SMEs, aid to young innovative enterprises, aid for innovation advisory and support services, and aid for the loan of highly qualified personnel (see GBER Article 33–37).

#### **Authorization of aids to SMEs under Article 107 paras. 2 and 3 TFEU**

Aid for SMEs that falls outside the GBER (and outside the special rules for agriculture and

fisheries) must still be notified to the Commission for approval under the provisions of Article 107 paras. 2 and 3 TFEU. Of these, the main provision under which State aid for SMEs is likely to be approved is Article 107 para. 3(c) TFEU. In addition, some forms of aid to SMEs may fall under the derogation in Article 107 para. 3(d) TFEU for aid to promote culture and heritage conservation, or the categories in Article 107 para. 2 TFEU of aids which are always exempted such as social aids and disaster aid.

The Commission has till today not set out any general guidelines for the approval of SME aid that falls outside the block exemptions. Many SME aids will, however, be covered by the specific horizontal aid and regional aid guidelines. In the remaining cases, it is necessary to refer simply to the general principles governing Article 107 paras. 2 and 3 TFEU. In addition – as in the case of other aids falling outside GBER – the Commission is still likely to assess the aid in accordance with the guiding principles of the GBER. Aids that do not meet all of the criteria of the GBER should therefore be constructed in a way that is, otherwise, as similar to the GBER as possible.

### **CONCLUSION**

The recent reforms in the legal regulation of State Aids in the EU creates a further milestone in the concept of European integration to a fully harmonised model based on the unification and levelling of the standard of living in the Member States in the framework of a supranational legal system where the primary method is represented by the regulatory mechanism of the EU institutions.

The creation of a supranational legal system logically disables the powers of national legislatures and strengthens the direct relations between of the private persons towards the EU. The intentional strengthening of the roles of regions compared to the States is connected with this consequences. Another aspect of this model are also the efforts to introduce – from the viewpoint of legislation and institutional framework – a non-competing and thus harmonized system in that the individual Member States can not compete because there would be in fact only one and only system determined by a detailed harmonization of national legal regulations.

It is a question whether this regulation and harmonization method in its final consequences does not reduce the ability of regions, Member States and/or the EU as a whole to compete within the global economics. Some Member States fighting with higher costs for ensuring their development within legal and political directives guidelines of the EU (and the lower ability to compete that is connected therewith) seek how to transpose these costs (as well as the lower ability to compete) to other EU Member States that for many reasons find themselves on another level of economic growth, have another priorities and/or ambitions in the process of development of the economic integration.

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