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Opinion

RETHINKING THE SME DEFINITION

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Executive Summary

- The **current definition of small and medium-sized enterprises** (SME) under European law is based on the Commission Recommendation 2003/361/EC, which has subsequently been embedded in EU binding law by being included in the Commission Regulation (EU) No 651/2014.

- Under this legal framework, **SMEs that are mainly or entirely owned by public authorities —also known as the ownership criterion— do not fall under the European definition of an SME**. This non recognition has **negative consequences** on:
    - their access to financing opportunities, by limiting the scope of funding and financial programmes available to them; and
    - their right to benefit from administrative simplification measures, leading to distorted conditions of competition for public SMEs.

- SGI Europe therefore considers that **private and public SMEs are not accorded equal treatment**. In fact, this definition **contradicts the principles of the Treaty on the Functioning of the European Union by discriminating among Member States**, based on the ownership criteria.

- This situation **particularly affects Local Public Services Enterprises (LPSEs), by restricting their ability to fulfil their mission of general interest** as public services and services of general interest providers. Given their strategic role in the European territories, these public SMEs need to be supported, particularly in the context of economic recovery following the Covid-19 related crisis.

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The European SME definition: state of play for LPSEs

Local Public Services Enterprises (LPSEs)

Local public services enterprises (LPSEs) are often small-scale utilities and companies providing ser-vices of general interest (SGIs) and services of general economic interest (SGEIs). These companies, created by and/or operating for local or regional authorities, stand at the crossroads of private and public sectors: they are flexible and responsive businesses, while operating for the general interest, based on community values.

Although some LPSEs are organised under public law, the majority is established under private law (mostly as limited liability companies, as joint-stock companies or as not-for-profit associations). They are mainly or entirely owned by public shareholders (local and/or regional authorities). Their key common features lie in the fact that they deliver SGIs to the entire society, citizens and businesses alike.

LPSEs are present all across the European Union (EU), totalling more than 32 000 of these public undertakings. Their importance and attractiveness are mainly due to their ability to be involved in more than 15 areas of activity, such as:

- Urban development: public equipment, urban planning, housing and social housing...
- Energy networks: heating and water supply, waste and wastewater management...
- Environment and networks: digital and communication networks, telecommunications, energy-efficient building renovation, thermal renovation...
- Mobilities: public transport operation, transport infrastructures, marinas...
- Citizen services: public health, social care, early childhood, cemeteries...
- Recreational activities: tourism, culture and leisure equipment and infrastructure...

In 2020, the 1 332 French LPSEs are active in the following areas:

- Culture and tourism – 25.4% (339 LPSEs)
- Planning and urban planning – 22.7% (303 LPSEs)
- Sustainable development, energy, waste management, water, equipment – 17.8% (237 LPSEs)
- Dwelling and social housing – 13% (173 LPSEs)
- Economic development – 10,7% (143 LPSEs)
- Mobility – 6% (81 LPSEs)
- Health and social care – 4.4% (59 LPSEs)

Through its involvement in so many crucial spheres of activities and its steady growth, the LPSE model has undoubtedly proven successful in Europe. It is proof that providing public services and SGIs at local level is not only possible, but also fundamental to ensure a connection between citizens and their local authorities, as well as to guarantee the economic and social development corresponding to the needs of their given territories. In other words, LPSEs are fundamental structures that enrich the fabric of European local public services and services of general interest.

European SME definition: an issue for LPSEs

The current definition of an SME under European law is based on the Commission Recommendation 2003/361/EC (OJ L 124, 20.5.2003, p. 36). It has subsequently been embedded in EU binding law, by being included in the Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market, in Annex 1, Articles 2 and 3.

This definition, which is referenced to in various European legal instruments, requires three cumulative criteria to qualify an undertaking as an SME:

- Staff headcount: the enterprise must employ less than 250 employees in annual full-time equivalents.
- Financial performance: the undertaking must have an annual turnover of less than EUR 50 million.
- Ownership: the enterprise will not be considered an SME if "25% or more of the capital or voting rights are directly or indirectly controlled, jointly or individually, by one or more pub-lic bodies" [Art. 3(4) of the Recommendation]

Based on the staff headcount and financial performance criteria, around 97% of LPSEs are SMEs —with 45% of them considered microenterprises.

1 177 LPSEs out of 1 430 members (i.e. 82,3%) of the German Association of Local Utilities of municipally determined infrastructure undertakings and economic enterprises (VKU), have fewer than 250 employees. Likewise, 1 288 LPSEs of the 1 332 French LPSEs have fewer than 250 employees (i.e. 96,7%).

However, the third criterion creates a hurdle for LPSEs. Under the EU definition, these local public undertakings are not recognised as SMEs since they are, for the most part , owned over 25% by public entities[1]. This contrasts with the fact that they face the same challenges as "traditional" private sector SMEs, such as limited financial and human resources or administrative burden.

This criterion, also referred by the Court of Justice of the European Union in the NMI Technologietransfer GmbH case[2], enables the differentiation between an "autonomous enterprise" and a non-autonomous one. In the present case, the European approach to autonomy of an undertaking is necessarily linked to its ownership. As we shall see later, this definition contradicts Article 345 TFEU by retaining the ownership factor as an overriding criterion.

Impact of the SME definition on local public services providers

The application of the European SME definition results in tampering the very provision of public services at local level in Member States (MSs), as well as their choice of SGI management model.

Hindered provision of local public services

The legal concept of SGIs is explicitly recognized in Article 14 TFEU, which establishes MSs' responsibilities towards the provision of these services. Under that Article, MSs shall ensure the necessary financial, legal and political principles and conditions for the operation of these services in order to enable them to fulfil their missions.

In view of the above, the European SME definition restricts the possibility for LPSEs to fulfil their mission of general interest as public services and SGI providers. Faced with this situation, SGI Europe that represents employers and enterprises providing SGIs since 1961, cannot remain inactive. Based on its mandate to protect

[1] In fact, there are LPSEs that have a public share of less than 25%. This is the case for 1 166 out of the almost 1 250 members of the German Association for Energy and Water Management (BDEW) that are SMEs, which have a municipal share of less than 25%. This represents 93% of the SMEs in BDEW.
[2] Judgment of 24 September 2020, NMI Technologietransfer Gmb v. EuroNorm GmbH, C-516/19, EU:C:2020:754, paragraph 8.

and represent the interests of these essential actors, we are very concerned with this SME definition that risks undermining the special protection of SGIs guaranteed by the European treaties.

Unwanted discrimination towards Member States

The current SME definition contradicts Article 345 TFEU by differentiating between private SMEs and LPSEs. In other words, the exclusion of almost all LPSEs from this definition is based on the ownership criteria, whereas Article 345 TFEU states that "the treaties shall in no way prejudice the rules in Member States governing the system ownership".

The European Commission (EC) justifies this ownership-based differentiation in its "User guide to the SME Definition", by stating that public ownership may give certain advantages to enterprises —particularly from a financial perspective— over other undertakings financed by private capital. The same reasoning is also reiterated in the abovementioned CJEU case from September 2020. This is completely at odds with the reality of LPSEs, which are usually owned by smaller local authorities that often do not have sufficient financial resources even to cover the costs of directly managed activities. In these situations, thinking about interventions to support infrastructure investments, for example, appears unrealistic.

These European rules thereby result in discrimination towards MSs, particularly by influencing their operational choices on how to provide public services. Indeed, if providing SGIs at local level by means of an LPSE presents more disadvantages than benefits, MSs will rather adopt a cautious approach to public services provision (e.g. through more "traditional" public administrations or institutions).

SGI Europe requests

Whereas the European Commission does not seem to acknowledge yet the importance of the LPSE model, SGI Europe is convinced that the modification of the SME definition should be carried out urgently. Since 2003, the perception of public enterprises has considerably evolved, with an increased awareness that "public" is not equivalent to neither "advantaged", nor "favoured". Indeed, public SMEs are not big companies in disguise, and do not benefit from hidden subsidies or additional staff. Faced with this common misconception, SGI Europe wants to stress out that LPSEs meet the same challenges than private SMEs of the same size.

We also want to emphasise the fact that the request to change the SME definition is not a demand for positive discrimination: it is a simple request to get equal treatment and to be eligible to funds and legal facilitations reserved for SMEs. LPSEs shall not be excluded per se anymore. In fact, re-leasing public SMEs under public control from regulatory burden does not disadvantage private SMEs. And at all events, these 32 000 LPSEs will never constitute a danger to the 23 million SMEs operating in the EU.

SGI Europe request is a simple demand to be able to benefit from simplification measures adopted for SMEs at European and MSs level, in accordance with the "think small first" principle enshrined in the European SME development culture since the "Small Business Act" of 2008.

Given all the above, SGI Europe urges the European institutions, and particularly the European Commission to:

- **Amend Article 3(4) of the Annex to Commission Recommendation 2003/361/EC as the benchmark SME definition, to provide only for the number of employees and the annual turnover or total annual balance sheet criteria. Therefore, the public participation thresh-old should be removed, and public control should not affect the SME status of a company;**

- **Subsequently amend all EU legal instruments, both binding and non-binding, that refer, directly or indirectly, to this definition, by adjusting them accordingly.**

Annex: Concrete impact of the current SME definition on LPSEs

The non-recognition of LPSEs as SMEs has serious consequences on their access to financing opportunities and administrative simplification measures. By their size and their social capital, LPSEs meet the same challenges as private SMEs. Hence, opening the current definition to LPSEs would allow them to be eligible to many measures reserved to SMEs and designed to compensate for disadvantages precisely related to their size.

It should be reminded that LPSEs work for the general interest and at the disposal of other SMEs:

- They open public markets, favourable to private SMEs.
- They are deeply rooted in their local business environment, and lead to indirect and induced growth and employment in private SMEs.
- They provide the infrastructure basis on which other SMEs can develop.

General reference to the European SME definition in national regulations

Covid-19 crisis

Even though the original European definition of SMEs comes from a non-binding Recommendation, it has become the benchmark definition both in the European corpus of law and in the national regulations. Its subsequent inclusion in Annex I of the Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market confirmed its binding force.

As mentioned above, the definition has been incorporated as a direct reference in numerous regulations, both European and national. In addition, it has also been directly integrated within legal instruments, therefore becoming binding per se.

As such, the reference to the Recommendation's SME definition was to be found in various nation-al laws during the Covid-19 crisis (non-exhaustive list):

- Under Italian Law: within the Legislative decree of 17 March 2020 on measures to strengthen the national health service and economic support for families, workers and businesses connected to the epidemiological emergency from COVID-19 (Decreto legge sulle Misure di potenziamento del Servizio sanitario nazionale e di sostegno economico per famiglie, lavoratori e imprese connesse all'emergenza epidemiologica da COVID-19), in Article 56.5.

- Under Spanish law: within the Royal Decree-Law 25/2020 of 3 July 2020 on urgent measures to support economic reactivation and employment (Real Decreto-ley 25/2020, de 3 de julio, de medidas urgentes para apoyar la reactivación económica y el empleo), in the Fourth Final Provision.

Administrative and regulatory burden

The following is a list of concrete examples where European regulations affect LPSEs efficient functioning, leading to distorted conditions of competition.

Regulation (EU) 2016/679 of 27 April 2016 on the protection of natural persons regarding the processing of personal data and on the free movement of such data

Scope of the Regulation:

In order to acknowledge the specific situation of micro, small and medium-sized enterprises, Recital 13 of Regulation (EU) 2016/679 provides for a derogation regarding the keeping of a register for entities employing fewer than 250 persons. In addition, Union institutions and bodies as well as MSs and their supervisory authorities are encouraged to take account the specific needs of these undertakings in applying this Regulation.

Impact on LPSEs:

Due to the definition of SMEs used in Regulation (EU) 2016/679, which is directly taken from the Commission Recommendation of 2003, many SMEs do not benefit from the foreseen facilitations because of the "25% ownership rule". This is particularly regrettable since the Regulation explicitly aims at easing the burden on SMEs. In concrete terms, this Regulation allows the following benefits for SMEs:

- SMEs are exempted from appointing a data protection officer if data processing is not one of their core tasks;
- The notification requirement for SMEs are completely abolished;
- SMEs can charge a fee for data requests from citizens or customers to cover their own costs;
- SMEs do not have to undergo an impact assessment unless there is a concrete danger for data protection;
- The new rules are tailored to be flexible and consider the size of a company when consider-ing data protection requirements.

On the contrary, and since they are excluded from the European SME definition, LPSEs must sup-port the load of these measures and therefore invest additional time and resources, which results in clear disadvantage for them .

National implementation Act:

For example, the Portuguese implementation Act of the Regulation (EU) 2016/679, the Law No. 58/2019, of 8 August that ensures the implementation, in the national legal order of Regulation (EU) 2016/679 (Lei n.º 58/2019, de 8 de agosto - Assegura a execução, na ordem jurídica nacional, do Regulamento (UE) 2016/679)), refers to the European SME definition as the benchmark definition for the undertakings in Article 39.

Directive 2012/27/EU of 25 October 2012 on energy efficiency

Scope of the Directive:

Under this Directive, many companies must submit an energy audit every four years. However, this regulation provides exceptions to this rule for SMEs, whose definition must be sought in the Com-mission's Recommendation from 2003 [see Article 2(26)]. This means that if those SMEs have a public shareholding of more than 25 percent, as is the case for LPSEs, then they must conduct an energy audit, no matter their size or resources.

Impact on LPSEs

Energy audits are indeed a good instrument to identify efficiency potentials in a company. However, for smaller companies, the effort required for such an audit is often only matched by low efficiency or savings potentials. Therefore, this regulation is not economically feasible for these LPSEs.

National implementation Acts:

- Under German law, the revised Energy Services Act (Gesetz über Energiedienstleistungen und andere Energieeffizienzmaßnahmen) contains an obligation to conduct regular energy audits for all companies that are not SMEs as defined by the European Commission. Para-graph 8 (1) with a reference to paragraph 1 No. 4 of this law refers to SMEs within the meaning of Commission Recommendation 2003/361/EC of 6 May 2003.
- Same goes under French law, with one of the implementations acts of the Directive, relat-ed to the thresholds beyond which a legal person performs an energy audit (Décret n° 2013-1121 du 4 décembre 2013 relatif aux seuils au-delà desquels une personne morale ré-alise un audit énergétique).

Funding and financial programmes

The European definition of SMEs is also used and/or referred to in many financial support policies or programmes at both EU and national level, but also by some private stakeholders like banks. This means that while facing the same challenges as private SMEs, LPSEs cannot benefit from pro-grammes precisely designed to tackle the specific issues related to their limited financial and human resources. If this issue has long been a problem for LPSEs, the Covid-19 crisis increased the difficulties for various MSs, also with effects on the LPSE's ability to make the investments necessary to improve the quality of services and increase the resilience of the system. Despite the measures introduced by the EU to overcome the current crisis - i.e. Next Generation EU - it is easy to think that these resources will mainly be used for large projects. For smaller and more widespread infra-structures, however, it will be necessary to leverage other resources. In this context, allowing also publicly controlled SMEs access to the measures envisaged for other SMEs represents a solution that cannot be postponed anymore.

Access to funding (loans, guarantees)

<u>The Austrian case during the Covid-19 crisis</u>

Hardship fund

During the Covid-19 crisis, Austria implemented various financial support measures for SMEs, such as grants, deferrals of social security contributions or compensation from the State. It also established a hardship fund to help the applicants overcome the crisis, through a financial contribution.

This fund created to support the self-employed and micro-entrepreneurs affected by the crisis defines eligible applicants as self-employed persons, companies consisting of one-person, free-lancers, but also micro-businesses according to Recommendation 2003/361/EC of 6 May 2003. This means that small LPSEs are excluded from this funding because of the European SME definition.

Bridging loans and guarantees

Bridging loans and guarantees were granted in Austria in the context of the pandemic. The purpose of these guarantees is to facilitate the financing of working capital loans for companies whose sales and earnings development were affected by order cancellations, delivery defaults and other market changes caused by to the Covid-19 crisis.

The Austrian State granted these guarantees to numerous companies, including SMEs active in various economic sectors such as industrial or commercial production, research and development, services, transport and traffic, processing companies of agricultural products or trade. However, and once again, the benchmark criteria are the ones provided in Recommendation 2003/361/EC. Consequently, LPSEs are excluded from these supporting measures to face the crisis.

The French financial institutions

In France, several financial institutions regularly deny funding to LPSEs. The main reason for this situation lies in the fact that they strictly apply the European definition of SMEs when providing financing instruments (loans, guarantees).

- N'PY, a French LPSE that gathers eight ski resorts and develops its tourism and local economy, has been denied funding by such institutions in March 2018.
- SPL Pôle funéraire public - Métropole de Lyon, a French LPSE operating funeral and crematorium services in the city of Lyon, was also denied a financial loan in the midst of the Covid-19 crisis in April 2020 for this reason.

Access to State aid

As mentioned at the beginning of this paper, the reference to the SME definition of the European Commission also applies to the Commission Regulation (EU) No 651/2014 of 17 June 2014 ("General Block Exemption Regulation") declaring certain categories of aid compatible with the internal mar-ket. Article 3 IV Annex I states that except in the cases referred to in the second subparagraph of paragraph 2, an enterprise cannot be considered an SME if 25 % or more of its capital or voting rights are directly or indirectly controlled, jointly or individually, by one or more public bodies. As such, many LPSEs are excluded from the scope of State aid measures limited to private SMEs. LPSEs therefore face higher barriers than private SMEs to obtaining State aid because some LPSEs cannot benefit from the measures dedicated to SMEs in the General Block Exemption Regulation.

Access to financing programmes and funding for SMEs at EU level

If LPSEs are eligible to use European Structural and Investment Funds (ESIF) and especially European Regional Development Funds (ERDF) in order to develop their territorial and infrastructure projects, several European funding and programme are restricted to SMEs in the European sense of the term.

The European programme dedicated to research and innovation, Horizon 2020, provides finance support to innovative organisations throughout Europe. 20% of its global budget for the period 2014-2020 is dedicated exclusively for SMEs that fall under the European legal definition. LPSEs are negatively affected by the fact that they cannot benefit from the budget lines dedicated to SMEs.

The Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) aims to facilitate access to finance for SMEs in all phases of their lifecycle – creation, expansion, or business transfer. Eligible businesses benefit from easier access to guarantees, loans and equity capital. Part of the COSME budget is dedicated to investments in risk-capital funds that provide venture capital and mezzanine finance to expansion and growth-stage SMEs. Because of the European definition of SMEs, LPSEs are excluded from this programme. However, many of them would highly benefit from it, such as LPSEs operating in the culture and tourism sectors, which have increasing financing issues.

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