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## Audit preview

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# European Regional Development Fund – supporting SMEs in getting more competitive

October 2020

Small and medium-sized enterprises (SMEs) are the backbone of the EU's economy, providing a significant source of jobs and economic growth. The European Regional Development Fund (ERDF) provides support for SMEs worth a total of €54.6 billion for the current (2014-2020) period, including €25.6 billion dedicated to the specific objective of "enhancing the competitiveness of SMEs". Support for SMEs will remain a key pillar of EU cohesion policy under the EU's next long-term budget for the 2021-2027 period.

We are conducting an audit on whether ERDF support for SMEs has focused on results and helped to make SMEs more competitive and fit for future. In particular, we will examine whether this support is designed in a way that delivers lasting competitive gains for SMEs, whether it targets relevant beneficiaries and addresses the most relevant needs, and whether projects implemented using ERDF support have been effective.

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## SMEs – the backbone of the EU’s economy

Small and medium-sized enterprises (SMEs) are the backbone of the EU’s economy<sup>1</sup>, providing a significant source of jobs and economic growth. In 2018, EU SMEs:

- numbered over 25 million;
- represented 99.8 % of all non-finance businesses<sup>2</sup>;
- employed around 98 million people;
- generated around 56 % of total added value<sup>3</sup>.

SMEs comprise micro, small and medium-sized businesses. The Commission’s official definition of these sub-categories uses three different criteria: employment, turnover and balance sheet total (see [Table 1](#)).

**Table 1 – Definition of SMEs**

Company category	Staff headcount or	Turnover or	Balance sheet total
Medium-sized	< 250	≤ €50 m	≤ €43 m
Small	< 50	≤ €10 m	≤ €10 m
Micro	< 10	≤ €2 m	≤ €2 m

Source: Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC).

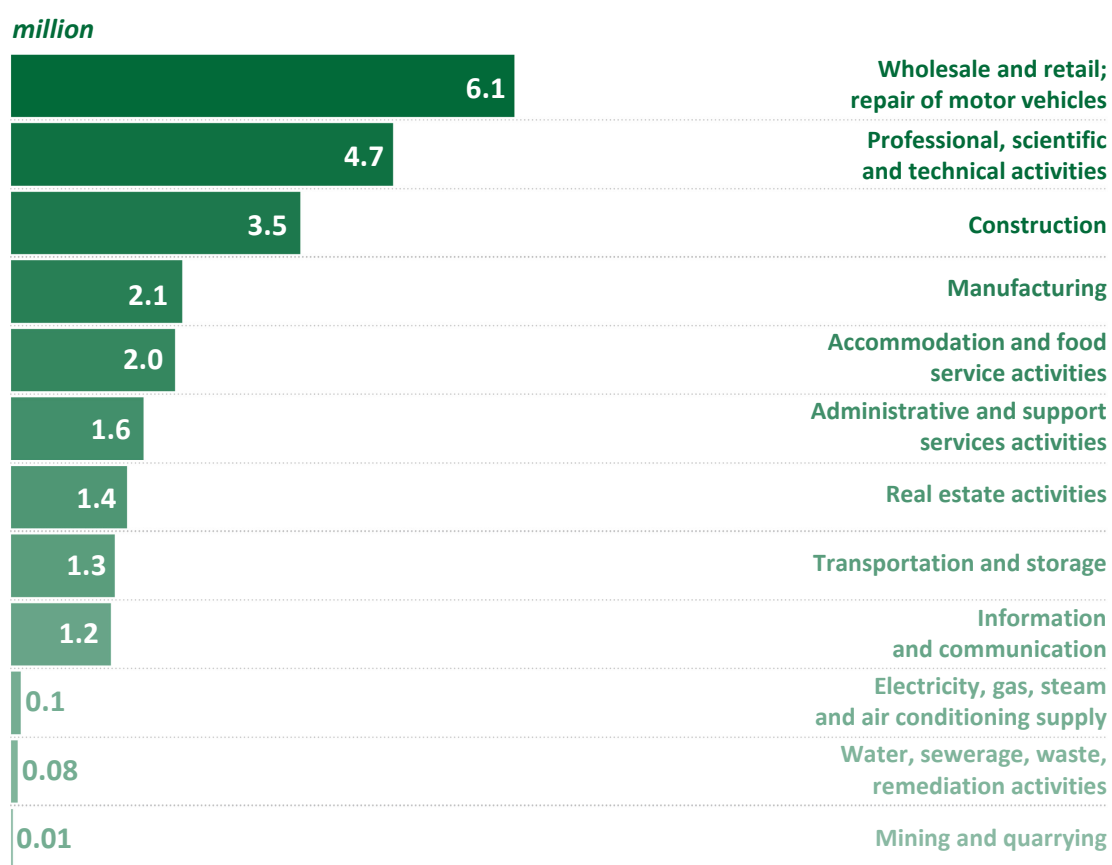
SMEs deliver innovative solutions to challenges such as climate change, resource efficiency and social cohesion, and help to spread this innovation throughout Europe’s regions. This makes them essential to the EU’s transition to a sustainable and digital economy and to its competitiveness and prosperity, economic and technological sovereignty, and its resilience to external shocks<sup>4</sup>.

The number of SMEs varies considerably between Member States: Italy has the highest number overall at 3.7 million, while Malta has the lowest at 28 500. The Czech Republic has the highest number of SMEs per 1000 inhabitants at around 96, while Romania has the lowest at 25.

The number of SMEs also varies by industry (see [Figure 1](#)). In 2017, the four industries with the largest number of SMEs were<sup>5</sup>:

- (1) wholesale and retail trade; motor vehicle and motorcycle repair – over 6 million SMEs,
- (2) professional, scientific and technical activities – over 4.5 million,
- (3) construction – over 3.5 million and,
- (4) manufacturing – over 2 million.

**Figure 1 – Number of SMEs by industry in 2017**

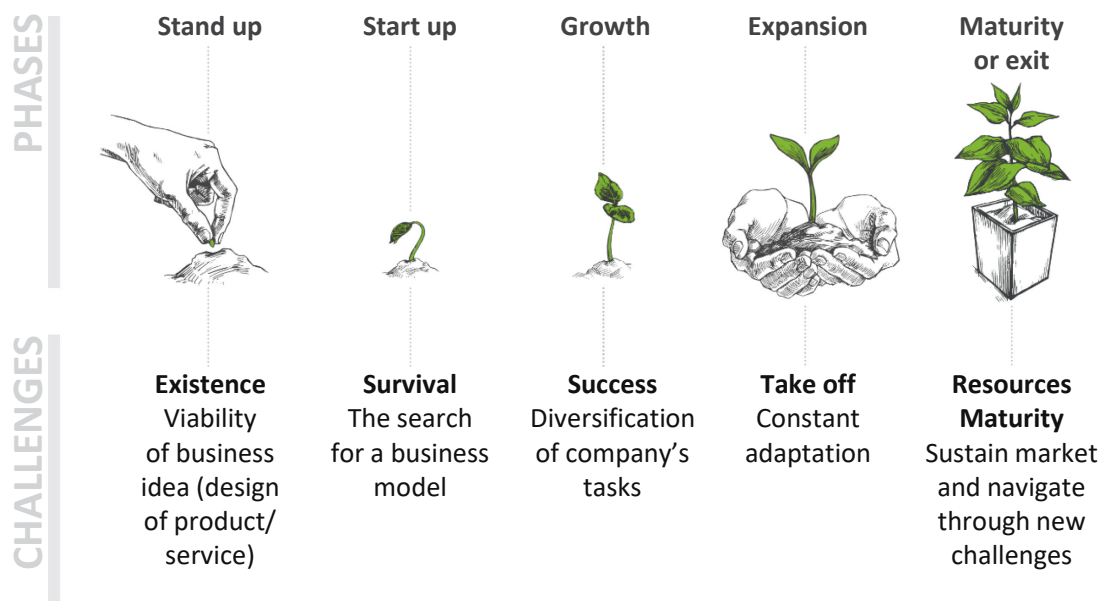


Source: ECA, based on Eurostat data.

### The business life cycle

Starting a business can be broken down into five stages<sup>6</sup>, as illustrated by [Figure 2](#). However, not all businesses experience every stage of this life cycle.

**Figure 2 – The phases of a business lifecycle and their challenges**



Source: ECA, adapted from <https://www.entrepreneur.com/article/271290>.

Bigger companies and scale-ups tend to be more productive than smaller SMEs. The size of SMEs is also reflected in their export patterns: 72 % of medium-sized SMEs export outside the EU, compared to less than 50 % of micro-SMEs.

### Competitiveness

Competitiveness is “the advantage that a firm gains by lowering costs, increasing productivity, improving the quality of and differentiating and innovating products and services offered, and by improving marketing and branding”<sup>7</sup>. In broad terms, competitiveness describes a firm’s ability to sell products in a competitive marketplace, make profit and survive on the market.

There are different ways of assessing a firm’s competitiveness: the main indicators are ones that measure **past or current competitiveness**, such as market share and profitability. A firm’s ability to survive and grow are also important indicators. However, as past and current performance do not necessarily predict future performance, indicators of a firm’s **competitive potential** are also necessary to assess likely future changes in its competitiveness. These mainly concern innovation (e.g. changes in its products and processes). Another indicator, productivity, reflects both a firm’s current competitiveness and its competitive potential<sup>8</sup>.

## EU support for SMEs

The EU aims to make Europe the world's most attractive place for starting and scaling up businesses<sup>9</sup>. Its overall policy agenda places a high priority on competitiveness, innovation and growth in SMEs across Member States. Key challenges facing EU SMEs include difficulties accessing finance, a limited supply of skilled labour, and excessive regulation and bureaucracy.

### Strategic initiatives

EU support for SMEs includes the following strategic initiatives.

#### **The 2008 “Small Business Act for Europe” (SBA)<sup>10</sup>**

- Aimed at promoting entrepreneurship in Europe, simplifying the regulatory and policy environment for SMEs and removing the remaining barriers to their development.
- Based on the premise “think small first”.

#### **The 2016 “start-up and scale-up initiative”<sup>11</sup>**

- Aimed at strengthening the growth and scaling-up of SMEs.
- Identifies barriers to start-ups scaling up: many regulatory and administrative barriers; few opportunities to find and engage with potential partners in finance, business and local authorities; limited access to finance.
- Presents actions to take to tackle the identified problems.

#### **The 2020 “SME strategy for a sustainable and digital Europe”<sup>12</sup>**

- Has two main goals:
  - increase the SMEs engaged in sustainable business practices and those employing digital technologies; and
  - make Europe more attractive for starting a small business and growing it in the digital market.
- Sets out the path towards sustainability and digitalisation, emphasising the need for smart, sustainable and inclusive growth.

- Is closely linked to the new Green Deal and the EU's industrial strategy.

## Funding

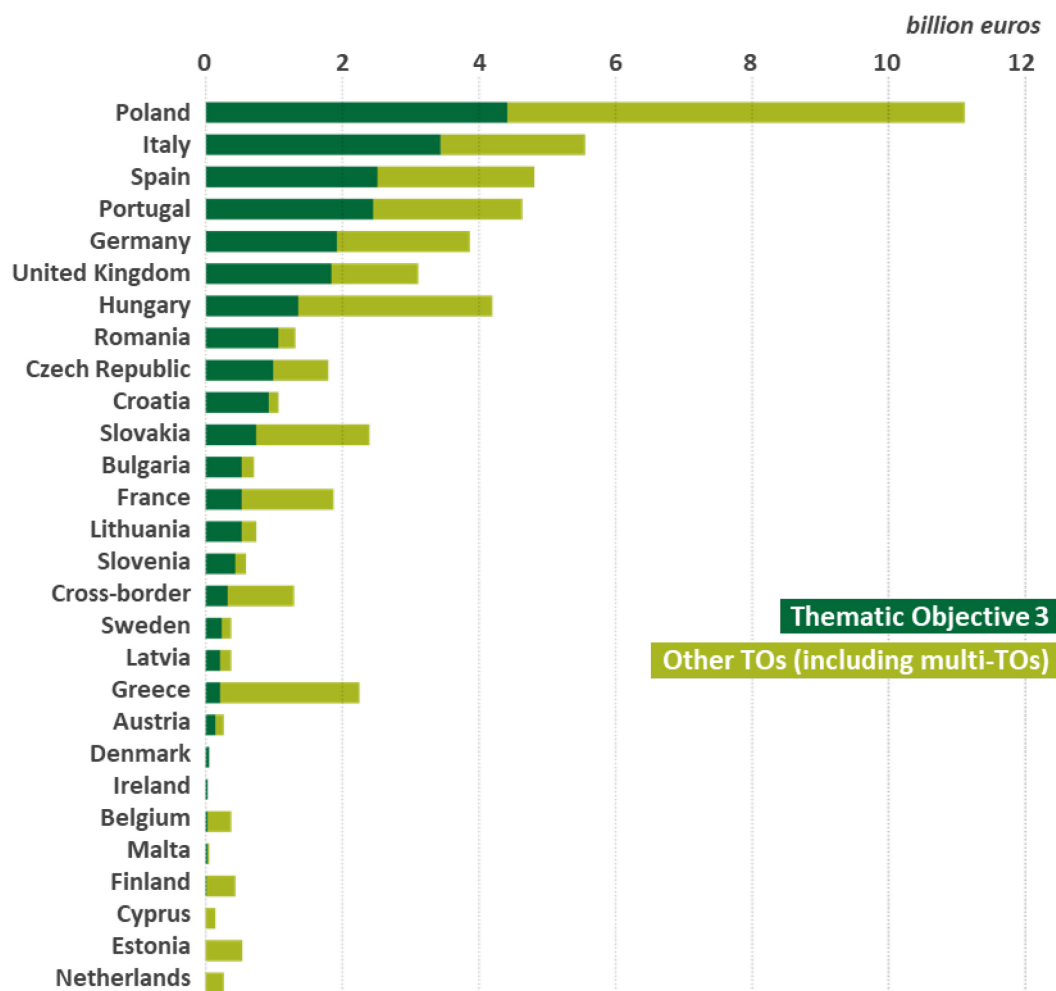
EU financial support for SMEs comes from a variety of sources. The only EU programme specifically dedicated to SMEs is “Competitiveness of Small and Medium-Sized Enterprises” (COSME), which aims to help them access finance. EU SMEs can also benefit from EU funds to promote competitiveness in specific areas (e.g. the SME Instrument under Horizon 2020 for research and innovation) or economic sectors (e.g. the Creative Europe fund for the culture sector). Since SMEs are instrumental in boosting regional economies, they can also benefit from the European Structural Investment (ESI) funds, which are mainly aimed at reducing economic, social and territorial disparities between EU regions. The EU's agricultural and fisheries funds mainly target SMEs in the rural development sector.

## ERDF support for SMEs

This audit focuses specifically on support for SMEs from the European Regional Development Fund (ERDF), one of the ESI Funds. The ERDF supports job creation, competitiveness, economic growth, improved quality of life and sustainable development through the creation and growth of businesses, including SMEs. ERDF support for SMEs focuses on boosting their competitiveness. It is worth a total of €54.6 billion, of which €25.6 billion is devoted to “Enhancing the competitiveness of SMEs”, one of 11 ERDF “thematic objectives” (TO 3). Other thematic objectives also target SMEs (see [Figure 3](#)), but less directly and with lower amounts. Such financial support can take the form of grants, loans, prizes or financial instruments, provided either directly to SMEs themselves or indirectly through intermediaries.



**Figure 3 – Planned ERDF support to boost SME competitiveness in 2014-2020 period, by Member State (in million euros)**



Source: ECA, based on the Open Data Cohesion Platform as of March 2020.

## Impact of and EU response to COVID-19 – State of play as of July 2020

The COVID-19 crisis and its ensuing global financial crisis have made it even harder for businesses, including SMEs, to remain competitive, requiring them to firstly survive on the market and then quickly adjust to immediate challenges. While their capacity to survive on the market mainly depends on their current competitiveness (and the extent to which their market has been affected by the crisis), their ability to adjust to challenges largely depends on their competitive potential.

Several initiatives, such as the coronavirus response investment initiatives (CRII<sup>13</sup> and the CRII+<sup>14</sup>) and REACT-EU<sup>15</sup>, will provide support for SMEs. In terms of ERDF support

for SMEs, the additional money will mainly take the form of working capital or investment support.

## Legal framework

The legal basis for ERDF support for SMEs is the ERDF Regulation for the 2014-2020 programming period<sup>16</sup>, including the changes introduced following the COVID-19 crisis. In particular, Article 5 lists “enhancing the competitiveness of SMEs” as one of the ERDF’s investment priorities.

## Roles and responsibilities

### European Commission

The Commission supports SMEs through various regulatory initiatives, raising awareness and promoting the exchange of good practices. It also helps SMEs access funding and works together with the European Investment Bank and financial intermediaries in the Member States in this regard.

Within the Commission, the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) is responsible for designing the EU’s SME policy. However, other Directorates-General are also of great importance for this audit area, as they manage funds that are relevant for SMEs, including DG REGIO that manages the ERDF.

### EIB Group

The EIB Group (comprising the European Investment Bank and European Investment Fund) supports SMEs by working together with a wide network of commercial banks, national banks and institutions, leasing companies, venture capital and private equity funds, angel investors and other providers.

The European Fund for Strategic Investments (EFSI), a joint initiative by the EIB Group and the Commission, has a specific scheme for SMEs offering almost €5.5 billion. This is implemented by the EIF and is aimed at helping high-potential, high-risk SME start-ups to access equity funding and loans.

## Member States

Implementing EU SME-related policies is mainly the responsibility of the relevant national and regional authorities in each Member State (or their delegated implementing bodies). These authorities prepare support programmes and select and monitor projects.

## Focus of the audit

The purpose of the audit is to assess whether ERDF support for SMEs has focused on results and helped to make SMEs more competitive and fit for future. In particular, we will examine whether:

- the Commission and Member States have designed ERDF support in a way that provides SMEs with lasting competitive gains;
- the Member States have reached relevant beneficiaries, addressed the most relevant needs and implemented effective projects using ERDF support.

The audit will focus on ERDF support for SMEs in the current 2014-2020 period. SME competitiveness is a key pillar of EU cohesion policy in the current period and will remain so in the 2021-2027 period. We will also provide an initial assessment of the design of support for the new period. Since the audit comes at the end of the current period and the start of a new one, its conclusions and recommendations may help the Commission and the Member States to make better use of the ERDF to make EU SMEs more competitive, resilient and fit for the future. This is particularly important given the challenges SMEs are facing in the COVID-19 crisis and the major role ERDF funding plays in some Member States.

The audit complements two other audits, one published in February this year – our special report ([SR 2/2020](#)) on EU support for SME innovation through the SME Instrument – and another audit on EU support to help SMEs access international markets that started recently ([Audit preview: EU support for the internationalisation of SMEs](#)).

### **ABOUT ECA SPECIAL REPORTS AND AUDIT PREVIEWS**

The ECA's special reports set out the results of its audits of EU policies and programmes or management topics related to specific budgetary areas.

Our audit previews provide information in relation to an ongoing audit task. They are based on preparatory work undertaken before the start of the audit and are intended as a source of information for those interested in the policy and/or programme being audited. Since we identified the issues underlying these areas of enquiry before the audit work commenced, they should not be regarded as audit observations, conclusions or recommendations.

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- <sup>1</sup> European Parliamentary Research Service, “Helping European SMEs to grow”, June 2017.
  - <sup>2</sup> Consisting of all economic sectors except: “agriculture, forestry, and fishing”; “financial and insurance activities”; “public administration and defence, compulsory social security”; “education”; “human health and social work activities”; “arts, entertainment and recreation”; “other service activities”; “activities of households as employers; undifferentiated goods and services-producing activities of households for own use” and “activities of extraterritorial organisations and bodies”.
  - <sup>3</sup> Commission, Annual Report on European SMEs 2018/2019, Table 2, November 2019.
  - <sup>4</sup> Commission, “An SME Strategy for a sustainable and digital Europe”, COM(2020) 103 final.
  - <sup>5</sup> These statistics cover the “business economy”, which includes industry, construction and distributive trades and services. It does not cover agriculture, forestry and fishing, nor public administration and (largely) non-market services such as education and health.
  - <sup>6</sup> See Noel Jones, “SME’s LIFE CYCLE – STEPS to FAILURE or SUCCESS?”, available at: <http://www.moyak.com/papers/small-medium-enterprises.pdf> and Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth”, Harvard Business Review, May 1983, at <https://hbr.org/1983/05/the-five-stages-of-small-business-growth>
  - <sup>7</sup> Draft thematic guidance for desk officers, competitiveness of SMEs, version 2, 13/03/2014.
  - <sup>8</sup> Background documents for the European Semester, “Measuring competitiveness”, Ref. Ares(2018)1159686 – 01/03/2018.
  - <sup>9</sup> Communication from Commission, “An SME Strategy for a sustainable and digital Europe”, COM(2020) 103 final.
  - <sup>10</sup> Communication from the Commission, “Think small first” – A “small business act” for Europe, COM(2008) 394 final, 25.6.2008.
  - <sup>11</sup> Communication from the Commission, “Europe’s next leaders: the Start-up and Scale-up Initiative”, COM(2016) 733 final.
  - <sup>12</sup> Communication from Commission, “An SME Strategy for a sustainable and digital Europe”, COM(2020) 103 final.
  - <sup>13</sup> Regulation 2020/460 amending regulations 1301/2013 (the CPR) and 1303/2013 (the ERDF), 31.3.2020.
  - <sup>14</sup> Regulation 2020/558 amending regulations 1301/2013 (the CPR) and 1303/2013 (the ERDF) as regards specific measures to provide exceptional flexibility for the use of the ESI funds in response to the Covid-19 outbreak, 24.04.2020.
  - <sup>15</sup> Proposal for a regulation amending regulation 1303/2013 as regards exceptional additional resources and implementing arrangements under the Investment for growth and jobs goal to provide assistance for fostering crisis repair in the context of the COVID-19 pandemic and preparing a green, digital and resilient recovery of the economy, COM(2020) 451 final, 28.5.2020.

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<sup>16</sup> Regulation (EU) No 1301/2013 of the European Parliament and of the Council of 17 December 2013 on the European Regional Development Fund and on specific provisions concerning the Investment for growth and jobs goal and repealing Regulation (EC) No 1080/2006.

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