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From National Champions to Small and Medium Sized Enterprises: Changing Policy Emphasis in France, Germany and Sweden*

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ABSTRACT

This paper examines recent European policy changes designed to support small and medium size enterprises (SMEs). These changes have resulted in both the development of specific support programs for SMEs and more general deregulatory measures to improve the economic environment for business. The rationale often provided is that SMEs contribute to a dynamic and innovative environment and generate high quality employment. An analysis of OECD material and a review of the literature on SMEs reveals that their role in innovation, employment growth and the adoption of new forms of work organisation is often over-emphasised. The vast majority of SMEs do not carry out research and development and are associated with low quality and insecure employment. Policies in support of SMEs need to be formulated with an awareness of the diversity of SMEs. There are only a very limited number of SMEs which make an important contribution to employment and innovation. Efforts to facilitate the establishment and growth of these high quality SMEs need to be based on targeted programs rather than general measures such as tax reduction or labour market deregulation. Targeted policies include R&D support, the improvement of SMEs' intangible investments and regional access to capital and technology. General measures are more likely to create an environment in which low quality, low wage employment is generated in SMEs with little future.

In the post-war period, in many European countries, industry policy was directed to particular sectors of industry or it involved support for particular firms on the point of bankruptcy because of their importance to national employment or production. Industry policy was based on

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strategic interventions, designed to manage structural change in the broader national interest. In more recent times, the very concept of industry policy has become controversial because of its association with sectoral intervention and state-led economic adjustment. The dominant view is that the state should focus on enhancing business competitiveness by reducing business costs through tax reform or labour market deregulation rather than strategic policy interventions that interfere with market processes. This view suggests that policies in support of industry in Europe should focus on the inherent disadvantage of European firms relative to their US and UK counterparts in relation to wage costs, labour market regulation, high taxation and government spending and universal welfare provision.

Agitation for policy reform of this nature flows from the view that innovation and employment growth depend on the existence of a dynamic entrepreneurial culture which facilitates the establishment and development of small and medium sized enterprises (SMEs). As a consequence, support for SMEs is increasing in European countries and is often linked to transformations in post-war policy regimes that were thought to favour large enterprises. Audretsch and Thurik (1997) have argued that these policy changes amount to a 'shift from the managed economy to the entrepreneurial economy'.

This paper analyses these changes in the context of three European countries – France, Germany and Sweden. The first part of the paper explains that the post-war policy regimes of these three countries favoured the growth of large enterprises rather than the establishment of new firms. The second section of the paper relies on a range of OECD studies to identify the major policy changes in these countries that have resulted in a shift in emphasis towards SMEs and have been designed to improve the economic environment for small business.

The rest of the paper evaluates these policy changes by reference to OECD data and the literature on SMEs, which suggest that the role of SMEs in innovation, employment growth and the adoption of new forms of work organisation is often over-emphasised. SMEs are diverse in nature, with only a small number of SMEs contributing to high quality employment, net job creation and innovation. Public policy programs need to be formulated with an awareness of that diversity. The paper argues that general measures to support SMEs including tax cuts and labour market deregulation may have the consequence of promoting those SMEs which do not undertake research and development and which engage in insecure and low wage employment. The paper concludes with the argument that if the objective of policies in support of SMEs is to promote high quality SMEs, then targeted rather than general measures are appropriate. Targeted policies would need to enhance service delivery at a regional level, improve access to high risk loans, encourage investment in intangible assets such as management and employee training and promote both the utilisation of existing technology and research and development expenditure. Some of these programs are already in place in the three countries and they differ from general deregulatory measures in that they do not require significant changes to the political, institutional and social structures that have characterised post-war policy regimes in the three countries.

National Policy Frameworks and the Dominance of Large Firms

Throughout the post-war period, the national policy framework of most European countries involved extensive political co-ordination of business activity and labour markets. France, Germany and Sweden were renowned for their unique models of economic organisation that were clearly distinguishable from the Anglo-Saxon liberal tradition. The French model's distinctiveness was associated with its strong administrative capacities and directive influences over economic development (Cohen, 1995). Studies of the German model focused on the social market principles, the unique system of national training, close bank-industry relations, the system of private sector governance focused on industry associations and the industrial relations system which resulted in low wage differentials and wide collective bargaining coverage (Streeck, 1996; Vitols, 1997). Sweden was unique in terms of its active labour market policies, extended welfare state development and solidarity wages policy which, as with Germany, resulted in low wage differentials and wide collective bargaining coverage (Meidner, 1993).

It has often been argued that these policy regimes were more conducive to the development of large rather than small firms. France's system of indicative planning and the grand visions for industrial development associated with Charles DeGaulle and Georges Pompidou in the 1960s were the basis for a model of industrial co-ordination that heavily favoured large enterprises, whether privately or publicly owned. For a time, the promotion of national champions was linked to a desire to build military strength and focused on industries such as aerospace, computers and nuclear weapons. Horizontal and vertical mergers and acquisitions were encouraged in the private sector as part of the same vision for establishing a limited number of dominant French firms within an industry (Cohen, 1995). The nationalisations of the early 1980s reinforced the dominance of large firms. As a result of the nationalisations, the public share of productive activities increased from 11 to 22 percent and was dominated by large firms (de Bandt, 1998, 90).

The German model, although it also favoured large enterprises, was much less dependent on the role of the state. The social market principles were the framework of German public policy and they emphasised market led adjustment, although they encompassed recognition that markets would not always produce socially desirable outcomes. The social market principles did not incorporate a role for state co-ordination of production and the state sought to distance itself from the socialism of Eastern Europe by allowing a significant degree of market freedom. However, the German model has retained a commitment to social goals and one way in which it has achieved socially desirable outcomes is through its system of wage negotiation. Collective bargaining is well established throughout the German economy, with around ninety percent of employees covered by collective agreements (OECD, 1997b). Because of the influence of collective bargaining, wages in Germany have remained quite high. Streeck has argued that, partly as a consequence of the high wage workforce, German industry has been forced to develop a strategy of 'diversified quality production' rather than relying on price competitive strategies based on cost minimisation (Streeck, 1996). It has sometimes been argued that this model has favoured large firms because new firms have found it difficult to compete in the high cost German economy.

It has also been argued that small firms have been disadvantaged relative to large firms because the latter have been incorporated in close bank-industry relationships and institutionalised networks between industry and government (Vitols, 1997, 31). However, small and medium sized enterprises, the *Mittelstand*, have benefited from aspects of the German model, especially from the provision of long term finance by large banks at times when the *Mittelstand* have experienced adjustment and restructuring pressures (Deeg, 1997, 58–61). In addition, the large firms have assisted the *Mittelstand* through the provision of well trained labour. One perspective even suggests that the small firms have depended on the large firms for survival (Herrigel, 1996, 9–10). However, the high wage environment in Germany has served to discourage SMEs, particularly of the kind that depend on cost competitiveness for survival (Streeck, 1996).

As with the German model, Sweden has had a highly regulated labour market. The central strategy of the union movement in influencing wage outcomes in Sweden has been the Solidarity Wages Policy. Unions have been committed to equal pay for equal work and they have negotiated annual national wage increases based on productivity and performance across the whole economy, rather than within individual firms or industries. The strategy of labour has been influenced by the view that employees should not be disadvantaged because of the region, sector or firm in which they work. As in the German system, firms with low profits have been unable to pay the high wages set through the centralised bargaining system and have been 'squeezed' out of the market (Meidner, 1993, 217).

It is as a consequence of the strategies of the labour movement that the Swedish model has favoured large enterprises with good profitability. From the mid 1950s, these large profitable firms became increasingly international in their orientation. Despite the small size of the domestic economy in Sweden, a large number of multinational corporations have developed. The increasing international orientation of Swedish firms has been demonstrated by growing exports and net investment abroad and the increasing import content of their exports (Pontusson, 1994, 42–43).

It has also been argued that the financial systems of France, Germany and Sweden have supported large rather than small firms (Audretsch and Thurik, 1997, 49–51). Significant differences have existed in the financial systems of the three countries (Zysman, 1983), however, they have had a common characteristic in that the capital market has not been dominant in financing industry. In France, special publicly controlled credit institutions have played a significant role, although the French financial system has recently undergone changes which have some similarity to the German model of industrial banking (Menon and Hayward, 1996, 370–377). Germany has had a long established system of industrial banking which has involved cross-ownership between banks and industry and mutual representation on boards of directors. In Sweden, there has been a strong tradition of state intervention in the financial sector. The state has played a significant role in influencing capital allocation by influencing the price of capital. Despite the differences in the financial systems of the three countries, there has been a common outcome in that the dominant form of state-finance-industry relations has resulted in a high concentration and stability of ownership centred on large firms (OECD, 1995a, 69).

So in all three countries in the post-war period, the national policy framework favoured large firms. The adoption of diversified quality mass production (DQMP), based on the mass production of high quality products in large firms, was an offspring of the solidarity wages policy and centralised wage fixing in Sweden and Germany because they imposed high wage costs on business (Streeck, 1992). The French system of industrial relations has not been a major factor influencing the structure of firms and the organisation of production because in France, collective bargaining has not been dominant and both unions and employer organisations have been organisationally weak (Goetschy, 1998). Instead, in France the development of large 'national champions' was directly promoted by the state for a lengthy period and saw a brief resurgence with the nationalisations of the early 1980s. In all three countries, the economy was heavily regulated and supported large industrial conglomerates and involved a centralised, co-ordinated and stable financial system.

In recent times, the outcomes of these policy regimes have been described by reference to measures of business competitiveness – labour costs and labour market regulation, taxation and access to venture capital (OECD, 1997c; OECD, 1997d). It is because of high costs, extensive regulation and underdeveloped venture capital markets that it is often suggested that the business environments in France, Germany and Sweden are less conducive to the emergence of small firms. The OECD has recently reported that 'the development of the German economy has often been accompanied by laws and regulations that raise overhead costs and make German SMEs less competitive internationally' (OECD, 1997d, 99). It has also been suggested that the centralised and co-ordinated nature of European economies has stifled individual creativity, which is said to be an integral element of an entrepreneurial culture.

A Change in Policy Focus

A growing emphasis on SMEs can be seen throughout the OECD countries. An OECD survey of industry support programs in the OECD countries in 1993 showed that industry policy programs, which had support for SMEs as their primary or secondary objective, made up more than one-third of all industry programs. However, expenditure in support of SMEs accounted for only 7.6 percent of total expenditure in support of industry in 1993, down from 13.9 percent in 1989. The nature of support was principally in the form of consultancy and advisory services and improved access to finance (OECD, 1996, 18, 35–37).

The changed focus on SMEs is being accompanied by erosion of traditional policy regimes, which were seen to be conducive to the promotion of national champions rather than smaller firms. This policy shift is associated with increased emphasis on competition policy and privatisation throughout the advanced economies. This has emerged from the view that extensive public ownership, highly regulated labour markets and the taxation burden of the social charter has stifled economic growth and structural change in Europe. France, Germany and Sweden conform with the OECD trend in that increasing attention is being given to SMEs, competition, privatization and deregulation of the economy. The following discussion highlights the major policy changes in the three nations which are consistent with the broader OECD trends and which depart significantly from post-war policy approaches.

France

Support for SMEs emerged in France from the late 1980s (Schmidt, 1996a, 181–190). The government of Michel Rocard, which took office in 1988, provided subsidised loans and tax breaks to SMEs, particularly new enterprises. The purpose of these programs was to encourage the start-up of SMEs. In addition, support for intangible investments including information and training was available through networks of technical advisers in the regions whose role was to improve the management of SMEs. Specific support was provided to improve the technological capabilities of SMEs through programs for the diffusion of computer technologies and the inclusion of microelectronic applications in products and production processes. Programs were also established to encourage various government agencies, universities and technical centres to enhance the commercial application of research in SMEs. Finally, there were ongoing efforts to reduce the administrative burden of enterprises (OECD, 1989, 94, 98, 107; OECD, 1991, 42). The emergence of growing concern with SMEs in the late 1980s is revealed not only in the extensive nature of programs developed to support SMEs but also in the level of public expenditure devoted to SMEs. In 1990, the OECD reported that 42% of the expenditure of the Ministry of Industry was targeted at SMEs (OECD, 1990b, 36).

The Edith Cresson and Pierre Bèrègovoy governments (1991–1993) diverted further attention from the large enterprises to the smaller enterprises, in part through the development of a global plan for SMEs announced in September 1991 and a support plan passed in late 1992. These programs included tax concessions to encourage enterprise expansion and training. In addition, there was a refinement of administrative procedures through the simplification of social security declarations (OECD, 1992, 54). Programs were also developed and financed at the regional level in order to improve access to finance for SMEs and to promote intangible investments. Venture capital funds were provided to improve access to high-risk loans and interest rate preferentials were given on loans to SMEs (OECD, 1993, 44).

The Balladur government, which took office in 1993, significantly increased funding for investment and innovation in SMEs. A new Ministry was established for 'Enterprises and Economic Development'. One of its principal goals was to improve entrepreneurial initiative. A law passed in 1994 on 'Initiative and the Individual Enterprise' was aimed at improving the status of individual entrepreneurs and simplifying administrative procedures and requirements in relation to taxation and social security. Increased funds were also made available for the provision of risk capital and physical and intangible investments (OECD, 1994, 44).

Policies to support the creation of SMEs continue in France. There has been strong support for business creation and development. The Ministry of Industry has recently focused on the survival of new businesses and the provision of initial guidance and information combined with ongoing support in the form of advice and training. The French Company, SOFARIS, provides guarantees for finance for SMEs. The aim is to encourage business creation, innovation, foreign investment and product development (OECD, 1995b, 25–35; OECD, 1997c, 109). Support for intangible assets including training and the development of management skills has taken place through regional consultancy services (OECD, 1995b, 121–127; OECD, 1997e, 109).

Information services also form an important component of current technological support provided to SMEs. A network of technological development advisers exists to help SMEs identify their technological needs and to link them with providers of technology. There are also programs to encourage the recruitment of technological personnel in SMEs to help them identify and implement appropriate technologies for their organisation. A National Research Exploitation Agency (ANVAR) exists to encourage innovation in products or processes in SMEs by providing interest free loans which are refundable in the event of success (OECD, 1995b, 167–175). This institution has an increasing regional focus that is designed to promote regional development by supporting SMEs at a regional level (Peterson, 1996, 237).

As a consequence of a range of decentralisation reforms implemented by the Socialists in the 1980s, local governments in France have gained greater autonomy over regional economic development and are therefore playing an increasingly important role in the promotion of SMEs. In many respects, they have adopted the *dirigiste* pattern of policy making characteristic of the French state (Schmidt, 1996a), although different local authorities have pursued different approaches to regional economic development. Some have sought to promote SMEs by bailing out companies on the point of bankruptcy, providing tax incentives and loan guarantees. There is a divide between those local authorities that have sought to promote SMEs directly through interventionist measures and those which have utilised improved local autonomy to implement deregulatory reforms for the purpose of promoting SMEs. In the first category are local authorities that have focused on promoting those SMEs with entrepreneurial initiative in high technology sectors that are utilising progressive work practices and are participating in industrial networks. In the second category are local authorities that have sought to promote SMEs through deregulatory measures, particularly through the contracting out of municipal services (Schmidt, 1990, 302–303).

The change in policy emphasis in France towards a greater concern with the role of SMEs has been accompanied by erosion of state involvement in industrial development, particularly at the national level. The post-war regime began to be undermined in the 1970s with the more liberal oriented presidency of Valéry Giscard d'Estaing. In the early 1980s, policy focused once again on the promotion of national champions as a consequence of the nationalisations in the early stages of the Mitterrand presidency. However, there was an almost immediate shift in approach associated with the U turn in economic policy and the replacement of Jean Pierre Chevènement with Alurent Fabius as Minister of Industry in 1983. From that point, greater emphasis was placed on competition and deregulation. This has been reinforced by the commitment to the Single Market (Cohen, 1995; Lombard, 1995, 367).

Despite these significant changes in France's post-war industry policy regime, it is important not to overstate the extent of departure from the grand projects of the 1960s. In the 1980s there was significant support for supra-national industry policy developed through the European Union. There was strong national support for a Europe-wide industry policy designed to create European champions. In the face of globalisation, this was thought to be not only desirable, but also the only avenue open for industry policy (Ramsay, 1992). However, the European Community had a greater concern for competition policy, which was an impediment to more traditional forms of state assistance to industry (Schmidt, 1996a, 172–173).

While it failed to encourage a European approach to the promotion of national champions, the state continued to influence the structure of ownership of French industry at a national level, particularly through its approach to privatisation. It severely restricted the competitive element of privatisation by selecting stable consortia of large investors as the hard core of stockholders (Menon and Hayward, 1996a, 276–277; Schmidt, 1996a, 132–164). In addition, the privatisation of nationalised industry in France led to a situation where both public and private financial institutions and industrial corporations held shares in one another and were mutually represented on each other's boards of directors. This created a solid alliance between French banks and industry that mirrored the German model of industrial banking and protected French industry from hostile take-overs and foreign ownership, although it was not always successful (de Bandt, 1998, 94–95; Menon and Hayward, 1996, 276–277; Schmidt, 1996a, 370–377).

In summary, since the 1970s French industry policy has involved a greater emphasis on SMEs, although there has not been a complete abandonment of the traditional support for large enterprises, as demonstrated by the nature of recent privatisation (de Bandt, 1998, 96). Support for SMEs has involved policies to improve access to finance, increase investment in intangible assets and improve the technological capabilities of SMEs. The regional delivery of policies and services has been an important characteristic of support for SMEs. Changes in the focus of industry policy have been linked to deregulatory reforms, particularly in relation to privatisation and the acceptance of market rather than state led industrial adjustment. Some effort has been made to reduce taxation and labour costs, which have been seen to be a particular constraint on SMEs. Despite these changes, France is still distinguishable from its Anglo-Saxon counterparts because it still has comparatively high taxation, high government expenditure, more generous welfare provision and a more highly regulated labour market (OECD 1997c).

Germany

Despite the tendency for public debate to suggest that SMEs, the *Mittelstand*, are a neglected source of potential growth, there has been a significant emphasis on small enterprises in German public policy since the 1980s. From the early 1980s a number of programs have been in place to encourage the start-up of SMEs. The Equity Capital Aid Programme and the Marshall Aid Counterpart Fund have provided financial assistance to new firms. In some cases loans have been linked to advisory services in recognition of the fact that firms that obtain advice from consultants have a much higher chance of survival. Particular emphasis has been given to the upgrade of technological capabilities within firms through the provision of finance for projects that relate to the diffusion of new technologies, recruitment of researchers, commissioning of research and counselling on innovation (OECD, 1989, 93, 95).

The Federal Government has been particularly interested in improving the awareness of SMEs regarding opportunities both in the new *Länder* in the former East Germany and the European market. It has provided consultancy services to improve management skills and knowledge of market opportunities (OECD, 1990b, 40; OECD, 1993, 44; OECD, 1994, 45). The EURO-FITNESS program is accompanied by information centres and is designed to provide German SMEs with information on opportunities in the European market (OECD, 1992, 54). Support for SMEs has heightened with reunification because SMEs have formed a central part of the policy platform of East German renewal. German support for SMEs has focused on the growth of these enterprises (Lane, 1995, 108). Financial assistance has been provided in various forms in different programs in order to promote start-ups and capital injections in the new *Länder* (OECD, 1994, 45).

The *Länder* have also played a role in supporting SMEs. Through the provision of infrastructure and transportation systems as well as training and education activities, the *Länder* and local authorities have played a significant role with regard to industry and regional policy (Esser, 1998). Support for SMEs is an entrenched component of regional policy and legislation in the *Länder* requires local authorities and regional bodies to consider the interests of small business in undertaking their activities. The *Länder* have implemented their own support programs encouraging education and training in SMEs (Lauder, Boocock and Presley, 1994).

The government has also developed a sophisticated system of banking support for small enterprises. It is based on small public savings and co-operative banks that have well-established links to regional and national banking outlets and are therefore able to provide access to a full range of services for small enterprises. The state has sought to improve research and development expenditure by small enterprises by subsidising the cost of R&D personnel and providing funding support for specific types of innovations including microelectronics, manufacturing technology, information technology and biotechnology (Vitols, 1997, 24–25, 28–29).

As with France, support for SMEs in Germany has been accompanied by growing pressures on the unique German model of industrial development. In 1983, Chancellor Kohl's newly formed government supported the deregulation of the economy while indicating a strong commitment to social market principles. In practice, this meant that the government emphasised market-led adjustment and a relatively passive role for the state. Although Kohl established the Deregulation Commission to identify areas of over-regulation in the German economy, opposition from major social and economic groups dampened advances in the implementation of its recommendations (Esser, 1995, 58).

The government has sought to encourage labour market flexibility and reduced labour costs on the grounds that high hourly wages and short working hours render production more expensive in Germany. It has also been suggested that contributions by employers to unemployment insurance, health and pensions should be reduced (OECD, 1997g, 68). An example of a labour market reform specifically designed to address the problems of SMEs is the narrowing of the application of employment protection provisions to firms with ten employees when the provisions had previously applied to firms with only five employees

(OECD, 1997a). Destabilising forces are at play in the industrial relations system and while the foundations of German industrial relations remain intact, there is increasing pressure for deregulation (Jacobi et. al., 1998).

In Germany, there has been a broad program of deregulation that has been designed to improve the economic conditions for business and to enhance competitiveness. Significant emphasis has been placed on reducing public expenditure, lowering taxes and privatising public enterprises. A recent report on German industrial competitiveness noted that:

> the federal government has been guided (since 1982) by the principle that the more the state limits itself to its central tasks and leaves freedom for the individual, the more successful the economic system will be (OECD, 1997g).

Privatisation has formed an important part of the process of economic reform and it was the *Treuhandanstalt* that was vested with responsibility for privatising 10,000 state-owned enterprises in East Germany. One of the stated objectives of the process was that 'in the privatization and restructuring of companies, the formation of small and medium-sized companies should be particularly promoted' (OECD, 1991, 44). Privatizations have also taken place in West Germany in the manufacturing, transporation and banking industries (OECD, 1990b, 37) and policy debate is focusing increasingly on telecommunications, transportation and utilities and infrastructure at *Länder* and municipal levels such as water, gas and electricity (OECD, 1994, 51; OECD, 1997g, 71). However, it remains to be seen whether Germany will undertake a broad process of privatisation (Esser, 1998, 121).

In summary, the German government has provided increased support for SMEs since the 1980s. This has involved programs which address concerns about the access of SMEs to finance, as well as policies which have sought to improve the awareness and access of SMEs to markets in East Germany and Europe. Policies have also sought to improve the technological and research capabilities of SMEs. As with France, many policies in support of SMEs have been delivered at a regional level. In addition, the increasing focus on SMEs in Germany has been accompanied by changes to the traditional postwar policy regime which have been designed to improve the competitiveness of business. Tax reductions, cut backs in government expenditure and privatisation of public enterprises have provided the conditions for market rather than state led adjustment. However, the social partners continue to have a significant influence over wages and conditions through their formation of collective agreements which is an important aspect of the traditional German model that remains intact (Vitols, 1997).

Sweden

The Swedish government has taken longer to direct its attention to SMEs than either the French or German governments. The sluggishness of the Swedes in the development of new programs in support of SMEs is related to deteriorating economic conditions in the 1980s and 1990s, which increased pressure on the government to reduce public spending and threatened many existing public programs. In particular generous levels of social provision meant that the massive growth in unemployment in the 1990s placed significant pressure on public sector budgets (Stephens, 1996).

Despite the economic environment, which limited the capacity of the government to develop new programs, some policies in support of SMEs were developed to encourage the start-up and growth of SMEs as well as product and process innovation in SMEs. In 1991 six new venture capital companies were established under the umbrella of two holding companies to provide risk capital for SMEs. These companies were financed from the Wage Earners Investment Funds[1]. In addition, a Fund for 'Industry and New Enterprises' was established to grant preferential loans to SMEs to encourage start-ups and provide financial support for the development of innovations in products and processes (OECD, 1991, 42; OECD, 1992, 56; OECD, 1993, 45).

In 1994 the government announced a program to provide temporary aid to small enterprises in order to improve the growth potential of those enterprises. This program included investment support for building, machinery, marketing and product development (NUTEK, 1996, 16). More recently, the Swedish government has emphasised the need to further address poor access to risk capital and skills deficiencies in small enterprises in order to improve the long term viability and competitiveness of small enterprises. A number of measures to improve management skills and access to finance have been established (NUTEK, 1996, 11).

In addition to specific programs to support SMEs, there has been an attempt throughout the 1990s to improve the economic environment for enterprises in order to encourage their establishment and growth. This involved policies designed to reduce the tax and administrative burden on SMEs, to deregulate the economy and break up public and private monopolies (OECD, 1997e, 253). A Special Committee on Deregulation and Simplification was established in Sweden in 1983 to provide information on regulations which impact upon business and to make recommendations regarding the simplification of rules and guidelines (OECD, 1989,108). These changes are linked to a broader shift in Swedish public policy that involves a significantly reduced role for the state and labour in the co-ordination of the economy and the labour market.

It is now often argued that the capacity of the Swedish economy to develop new industries will depend on altering the economic policy framework and the high cost structure of the domestic economy (Carlsson, 1996). There have been various attempts to cut government spending in Sweden, including a reduction in spending on active labour market programs, the fundamental hallmark of the Swedish policy regime. This has been combined with the collapse of the Solidarity Wages Policy and the system of centralised wage fixation. The employers' confederation (SAF) has withdrawn from centralised wage negotiations and unions have become fragmented.

The Swedish National Board for Industrial and Technical Development now cites restrictive fiscal and monetary policy, reductions in company taxation, competition policy and the restructuring of health and unemployment insurance as structural reforms which have improved the conditions for growth of enterprises and enhanced market incentives for entrepreneurial activities (NUTEK, 1996, 10). These policy developments have occurred because of the view that the regeneration of the Swedish economy depends on the existence of 'more enterprises and more entrepreneurs'. The view of NUTEK is that the problems in the Swedish economy are a result of the tendency for large firms to expand employment offshore rather than in Sweden, increasing the dependence of the Swedish economy on small enterprises for employment growth (NUTEK, 1996, 9).

There is therefore a clear support for SMEs in Swedish public policy, although it developed more recently than in France and Germany. This has resulted in the development of a number of programs to improve information and skills for SMEs, enhance innovation and expand access to capital and to support services and programs at a regional level. Support for SMEs has also resulted in a number of deregulatory changes including company tax reform, a reduction of the administrative burden of SMEs and competition policy reforms. Other developments in Sweden, such as the breakdown of elements of the corporatist model of wage negotiation, have further eroded fundamental characteristics of the Swedish Model. Thus, as with France and Germany, Sweden has experienced a significant transformation of its post-war policy regime. However, as in the case of Germany, many important elements of the post-war model remain intact in Sweden including universal welfare provision, high government expenditure and taxation and high levels of trade union membership and collective bargaining coverage. These factors ensure that Sweden remains quite distinct from the Anglo-Saxon traditions of the UK and the USA.

Changes in national policy regimes and increased support for SMEs have occurred partly as a result of international influences over domestic policies in France, Germany and Sweden. The globalisation of economic activity, which is increasing competitive pressures, is seen as creating the necessity for more rapid development and diffusion of technology and more flexible forms of industrial production. SMEs are seen as playing a central role in the global economy and international organisations such as the OECD strongly support the encouragement of SMEs (OECD 1997d, 1997e). At the same time, the links between large firms and the domestic economy have been undermined as a consequence of globalisation and the increasing international orientation of many large firms. As such, national policy efforts have focused on SMEs, which are seen as having a close connection with the domestic economy. Finally, the European Union has played a significant role in encouraging support for SMEs through its emphasis on innovation, its support for inter-firm cooperation amongst small enterprises and its provision at the community level of support for intangible investments by SMEs. Despite the existence of international pressures for policy change in all three countries, and the growing influence of the European Union, national level policies and institutional arrangements remain important foundations of the industrial policy regime (Menon and Hayward, 1996).

The contribution of SMEs to innovation and employment

France, Germany and Sweden have all experienced a shift in their post-war policy regimes that has involved a greater emphasis on the promotion of small enterprises. All three countries have sought to encourage SMEs by providing targeted support in the form of intangible investments such as information and advisory services and training. Programs have been established to improve the utilisation of advanced technologies and to expand access to venture capital funds and high risk loans. The regional delivery of programs and services has been undertaken for the benefit of SMEs and has included research and development support and financial support. The desire to support SMEs has been a significant impetus for changes in the broader policy environment which were introduced in an effort to improve the economic conditions for business. These 'reforms' were based on general measures including labour market deregulation, taxation reform, privatization and competition policy reform.

The rest of the paper seeks to reach a conclusion about the appropriate policies to be adopted in support of SMEs, based on an analysis of the contribution of SMEs to innovation and employment. This analysis reveals that SMEs should not be seen as a panacea for employment problems and industrial stagnation. In addition, the diversity in SMEs should be recognised, given that different SMEs have quite different records on employment generation and innovation. As a result, policies in support of SMEs need to be formulated with an awareness of the different implications of policies that specifically seek to improve employment skills and technology in SMEs and those general measures that encourage the creation of SMEs of all kinds.

Why Support SMEs?

The case in support of SMEs is usually based on the argument that globalisation and post-Fordism require countries to adopt more flexible, small-scale entrepreneuereal approaches to economic development (Audretsch and Thurik, 1997). It is increasingly argued that SMEs are the key to overcoming stagnation and decline throughout the advanced economies. The 'flexible specialization' thesis developed with the pioneering work of Piore and Sabel (1984) emphasised the innovative problem solving capacity of small firms that were embedded in an appropriate social institutional framework that facilitated co-operation through close ties. The localisation of production in regional networks of firms was viewed as a positive development stemming from globalisation and increased demand for more specialised rather than mass-produced standardised products. Industrial networks of small firms were seen as involving positive work conditions based on co-operation and participation and new forms of work organisation including greater reliance on team work. A recent OECD report on SMEs has argued that SMEs are more flexible and entrepreneurial and have a better capacity to respond to changing consumer demand, to adopt different forms of work organisation and to introduce new technologies, products and processes (OECD, 1997d, 17–20).

There is therefore a body of literature and research which suggests that SMEs have potential both to be innovative in a turbulent era and to utilise progressive forms of work organisation that enhance employee participation. This would seem to justify the introduction of general policy measures designed to promote SMEs. However, closer examination suggests that not all SMEs are characterised by high quality employment and innovation.

Innovation, Technology and SMEs

It is usually argued that large firms in France, Germany and Sweden are successful at innovation in a range of medium technology industries such as engineering, machine tools and chemicals. It has often been said that Swedish and German industries are successful at 'incremental innovations in high quality products', rather than more radical innovations that involve new technological trajectories and depend on significant changes in a firm or its personnel (Audretsch and Thurik, 1997, 13–15; Carlsson, 1996, 275–276; Matraves, 1997, 37–52; Soskice, 1997, 75). Part of the reason why SMEs are receiving so much attention is because empirical evidence, although not unproblematic, indicates that SMEs are important in radical innovations in new industries (Carlsson, 1996). These firms are therefore thought to be of critical importance at a time when technological developments and structural economic change are occurring at a rapid pace.

However, the evidence concerning the role of SMEs in both invention and the commercial application of new products and processes is somewhat problematic. Research indicates that less than five percent of small firms (< 200 employees) undertake formal research and development expenditure. Although fewer small firms than large firms engage in R&D, there is evidence to suggest that those firms that do engage in R&D do so at a high level of intensity and with higher productivity than large firms (Freeman and Soete, 1997, 228; Nooteboom, 1994, 338). It also seems that the relative importance of small and large firms in the process of innovation varies between industries, with innovations in capital intensive industries or industries with high development costs being dominated by large firms. Small firms appear to play a more significant role in those industries where capital intensity, development costs and barriers to entry for new firms are all low (Freeman and Soete, 1997, 227–241; Nooteboom, 1994). The literature on invention and innovation therefore indicates that neither small nor large firms are more important – their role and contribution differs according to the industry or the different stages of an industry life cycle.

Innovation is particularly important in the current context of rapid structural change and increasing global economic pressures because of its role in transforming the industrial structure of nations in favour of high technology industries. Close examination of the industrial structure of France, Germany and Sweden does not reveal any systematic inferiority to the UK and USA in relation to high-technology industries, even though the UK and USA are thought to provide a more competitive environment for SMEs.

Figures 1 and 2 show the science-based and specialist-supplier components of the industrial structure of the five countries. It is these two categories of industry that are maintaining or increasing their contribution to overall output and trade in the OECD countries in the face of

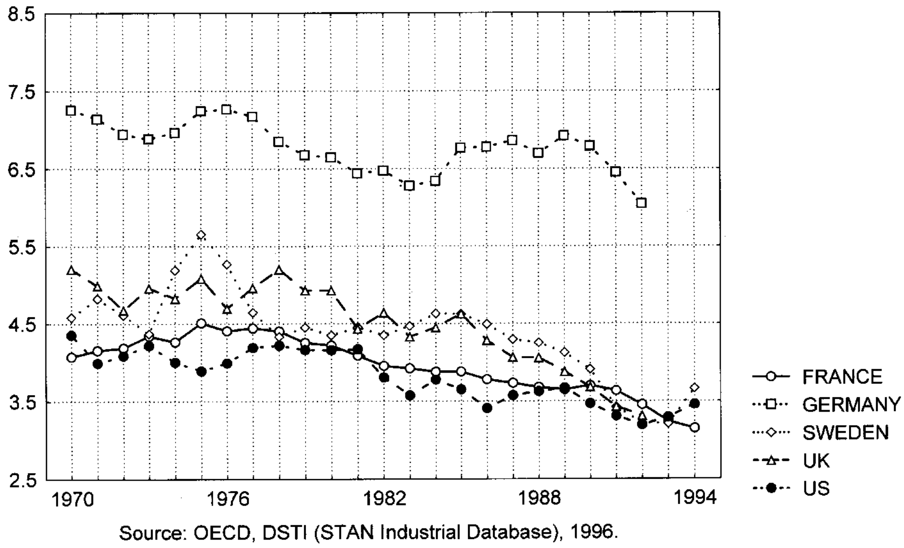

FIGURE 1: *Specialist Supplier Industries – Value-Added as a Percentage of GDP.*

decline in resource-based, labour-intensive and scale-intensive industries. Science-based industries are those that depend on the rapid application of scientific advance as the primary source of competitiveness. Science based industries include aerospace, computers, pharmaceuticals and scientific instruments which are all high-technology industries (high R&D intensity). Specialist supplier industries are those industries whose competitiveness rests primarily on the degree of differentiation of products (OECD, 1993, 84). Specialist supplier industries include non-electrical and electrical machinery, communications equipment and semiconductors. These are all high technology industries except for non-electrical machinery, which is a medium technology industry.

Germany significantly outperforms the UK and US in terms of the contribution of specialist supplier industries to GDP (Figure 1). The US outperforms Germany in relation to science based industries and Germany performs slightly better than the UK for most of the post-1970 period (Figure 2). The gap between the US on the one hand and France and Sweden on the other is significant in relation to science based industries, although the position of Sweden has improved in recent years while the lead of the US has declined (Figure 2). These aggregate data do not allow for any general claims that Anglo-Saxon countries, which are seen as more supportive of SMEs and new indus-

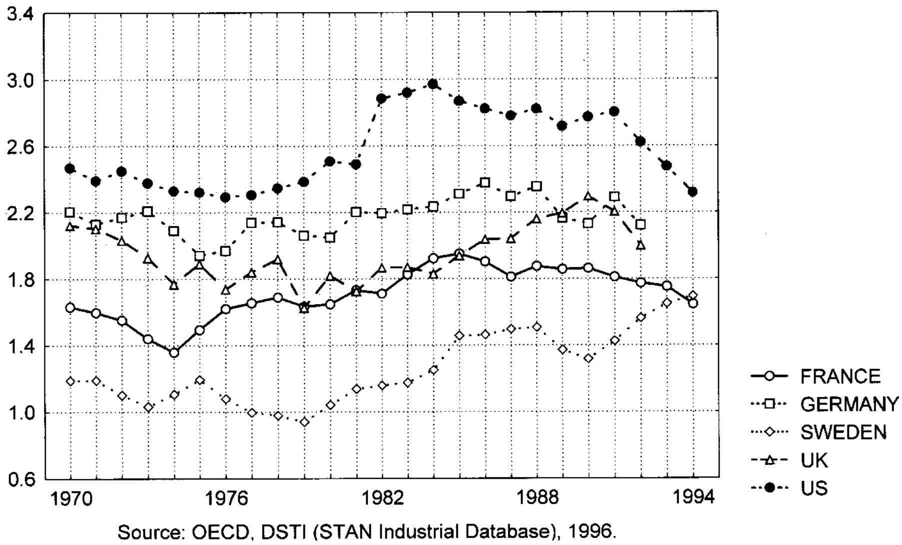

FIGURE 2: *Science-Based Industries – Value-Added as a Percentage of GDP.*

tries (Audretsch and Thurik, 1997,13-15), are characterised by a more technologically advanced industrial structure than France, Germany and Sweden.

Employment and SMEs

A further claim about the importance of SMEs relates to their contribution to employment. Table 1 shows that SMEs have been responsible for an increased share of employment in the four countries for which data were available. The greatest increase has occurred in very small firms with less than 20 employees. Growth in the share of employment in very small firms has been largest in the USA where it increased by 7.4 percentage points and France where it increased by 3.0 percentage points. However, the importance of these small enterprises for employment has been quite different cross-nationally. In the most recent year for which data is available, the share of employment of firms with less than 20 employees ranged from 18.8 percent in Germany to 38.5 percent in Sweden. There was a decline in the share of employment in all other size categories for all countries except for the category of small enterprises that employ between 20 and 99 employees in the case of France and the UK. This category of small enterprises did not record either a decline or increase in employment share in France and recorded an increase in employment share in the UK where the

TABLE 1: *Employment by Size of Establishment*

		Percentages			
		1–19	20–99	100–499	500+
France	1985	25.8	20.4	18.3	35.3
	1990	28.8	20.4	16.4	34.4
	Change	3.0	0.0	−1.9	−0.9
Germany	1988	16.7	27.5	17.3	38.4
	1990	18.8	26.8	16.9	37.5
	Change	2.1	−0.7	−0.4	−0.9
Sweden	1992	38.5	18.4	15.9	27.2
UK	1988	32.1	15.0	17.7	35.2
	1991	33.0	16.1	17.2	33.8
	Change	0.9	1.1	−0.5	−1.4
USA	1988	17.7	19.9	14.9	45.5
	1990	25.1	18.8	13.4	42.7
	Change	7.4	−1.1	−1.5	−2.8

Source: OECD 1997f,19

increase was actually higher than for the category of very small enterprises.

SMEs are therefore responsible for a growing share of total employment. However, it is important to explore the factors that explain this growth. It is sometimes suggested that the growth in the share of employment in SMEs is due to the fact that small firms are more dynamic and competitive in an era of globalisation and changing production strategies. However, growth in the share of employment in SMEs is at least partly a result of the shrinking size of large firms resulting from outsourcing or recession. It is also partly a consequence of the changing sectoral or industrial composition of production as demonstrated by the shift to services sector activity which is composed of smaller organisational units than manufacturing (Loveman and Sengenberger, 1991, 4–8). It should be realised that the increased share of employment in SMEs is sometimes a result of broader policy changes rather than the existence of a dynamic entrepreneurial culture. In some cases it appears that the establishment of SMEs is a response to outsourcing, privatisation, downsizing and unemployment rather than the more positive goal of responding to market needs or introducing a new product into the market. In Sweden, over one quarter of new businesses cite unemployment as their strongest motivation for starting their own business. Privatization in the education and health sectors in Sweden appears to have encouraged a significant growth in business start-ups in those sectors (NUTEK, 1996, 60–61).

Research on the contribution of SMEs to employment often highlights the role of SMEs in job generation rather than their increasing employment share. It is usually asserted that SMEs are responsible for the largest portion of total job generation and this has been a guiding force in policy making world-wide.

> What do Bill Clinton, George Bush and Bob Dole have in common? All have uttered one of the most enduring homilies in American political discourse: That small businesses create most of the nation's jobs (Susan Dentzer, quoted in Davis et al., 1996, 298).

Static statistics on job generation are usually cited as evidence in support of such an assertion. The problem with cross-sectional rather than longitudinal data on job generation is that it inadequately accounts for firm births and deaths and it does not control for movements of firms between size categories.

Longitudinal data on job creation in US manufacturing plants indicates that while small firms are responsible for very high rates of job creation, they are also responsible for high rates of job destruction, so that their contribution to *net job creation* is not significant relative to size (Davis et al., 1996, 298–299). Longitudinal job generation studies in Europe indicate that very few firms in the very small category (up to 20 employees) grow to employ above 20 employees. The very limited number of highly successful firms that do grow are responsible for a large proportion of the total increase in employment in SMEs (Loveman and Sengenberger, 1991, 18–19). In Sweden, around 60 per cent of small enterprises do not employ anyone other than the owner and only 10–15 per cent of small enterprises are growing (NUTEK, 1996, 1). Net job creation rates in the manufacturing industry in Germany have been found to be unrelated to firm size. Small firms are responsible for both the creation and destruction of a large proportion of all jobs indicating that 'size alone should *not* be a cause for concern in establishing industrial policy programs to promote firms' (Wagner, 1995, 474).

There is also some evidence to dash the hopes that SMEs involve more progressive work practices. It is sometimes the case that SMEs engage in undesirable employment practices, are more difficult to regulate, seek exemptions from labour standards and wage provisions, involve more insecure employment and have lower rates of unionisation of their workforces than larger firms (Lane, 1995, 111; Loveman and Sengenberger, 1991, 23). Employment growth in small firms needs to be balanced against the insecurity associated with the high failure rates of SMEs in their initial stages (Davis et al., 1996, 310–312). In the mid-1980s, thirty seven per cent of insolvencies in Germany were in firms less than four years old. In France, fifty per cent of small firms disappear within their first four years (Lane, 1995, 105).

In summary, only a very small number of small firms are innovative, contribute to net job growth and utilise progressive employment practices. The vast majority perform no research and development, are associated with job destruction and poor employment practices. There is therefore great diversity in the nature of SMEs and policy programs in support of SMEs need to be formulated with an awareness of that diversity. This suggests that general measures to promote SMEs will not necessarily have positive benefits for net job creation, quality of employment and innovation. Policy programs need to be developed with an awareness that not all SMEs are alike and the promotion of innovation and high quality employment may depend on specific programs designed to encourage the start-up and growth of the small number of innovative SMEs that also contribute to net job creation. The following section elaborates on the implications of this analysis for policies in support of SMEs.

Policy Implications

The empirical evidence on the contribution of SMEs to employment and innovation indicates that a small number of SMEs make an important contribution to net job creation and innovation, with the bulk of SMEs engaging in low quality activity with insecure employment. Although the rationale for policies in support of SMEs is often that SMEs are important for innovation and employment, the preceding analysis suggests that there is great diversity in the nature of SMEs. Policies in support of SMEs need to be formulated with an awareness of that diversity so policy objectives can be more readily achieved. If the objective of policy is to stimulate business activity of all kinds, regardless of its quality, then indiscriminate deregulatory measures might be appropriate. However, if the objective of policy is to promote high quality SMEs, then a more complex targeted policy regime may be required.

One approach to the promotion of high quality SMEs, suggested in some parts of the OECD literature, would require a reconfiguration of institutional arrangements in the three countries so that they were more supportive of small scale production in high quality SMEs, rather than mass production in large firms (OECD 1997d, 1997e). This would require a transformation of policies and institutional structures, which have favoured large rather than small firms. The first section of this paper showed that in France, Germany and Sweden, postwar policy regimes favoured high quality activity in large firms. The policy regimes of France, Germany and Sweden were unfavourable for small scale production. Hollingsworth and Boyer have argued that the social system of production that has characterised Germany and Sweden is a flexible system of production, diversified quality mass production (DQMP). However, it is quite different to a system of flexible specialisation such as that which is associated with the small scale production in small enterprises in the industrial districts of the Third Italy. In the case of DQMP, new technologies, particularly in the area of microelectronics, have enabled large firms to shift away from a Fordist system of mass production to a system of quality production with reduced batch sizes utilised for the production of specialized products. As a result, large firms have themselves become more flexible (Hollingsworth and Boyer, 1997, 28).

The system of diversified quality mass production in Germany and Sweden is embedded in social arrangements and a *national* institutional framework based on a particular system of industrial relations, finance-industry relations, training, inter-firm linkages, state-industry relations, management-employee relations and norms, rules, laws and values (Hollingsworth and Boyer, 1997, 2,28). Flexible specialisation is also dependent on institutional support mechanisms, although they are more localised and regional in basis than is the case for DQMP.

If the aim of policies in support of SMEs is to create a flexible system of small scale production in small firms which will result in innovation, growth and progressive forms of work organisation, then a transformation of the broader political and institutional structures of France, Germany and Sweden is required. However, as the work of Piore and Sabel and other flexible specialisation researchers has suggested, it is extremely unlikely that nations can simply create the conditions for the adoption of flexible specialisation. It does not seem likely that nations such as Germany and Sweden which have had strong *national* institutional support for a system of DQMP will be able to easily promote a more localised and regionally focused system of industrial networks consistent with a model of flexible specialisation. Nor is it clear that systems of flexible specialisation, based around small enterprises, are superior to flexible systems of diversified quality production, based around large enterprises (Hollingsworth and Boyer, 1997). As indicated in the previous section, the evidence on the superiority of SMEs over large firms in employment generation and innovation is ambiguous.

A second and more viable approach to the promotion of high quality SMEs would involve the adoption of a range of policies in support of SMEs, which focus on innovation and employment generation in SMEs. These policies would be designed to encourage the start-up and growth of those SMEs that are innovative and engage in progressive employment practices. However, these policies need not involve significant changes to the institutional structures and post-war policy regimes of the three countries. This approach would need to be based on policies that target the improvement of information resources, management techniques, access to capital and the utilisation of technology in SMEs. Policies that provide R & D support, regional access to capital and technology and support for intangible investment would form part of such an approach.

Rather than seeking to promote high quality SMEs, public policy programs might instead aim to stimulate SMEs of all kind, regardless of their contribution to innovation and net job creation. In that case, a deregulatory policy stance designed to encourage the start-up and growth of SMEs, through reduced costs and an improved economic environment for business, might be appropriate. As explained above, recent pressures for policy reform in France, Germany and Sweden have been driven by a concern to reduce the cost of the business environment and have involved policies to allow higher wage differentials, reduce the coverage of collective agreements, reduce taxation and universal social provision. These policy reforms need to be evaluated with reference to the evidence presented in the previous section, indicating the dubious nature of assertions concerning the superiority and contribution of SMEs. General policy measures that have been designed to improve the economic environment of SMEs are likely to create the conditions for the emergence of isolated low cost firms in low technology industries, which utilise poor work conditions and have high failure rates. As Streeck has argued, it has been the high-cost environment of Germany and Sweden that has encouraged their industries to avoid cost competitive strategies in the pursuit of success (Streeck, 1992). Policies that generate low quality business activity may not be well received in countries which have historically encouraged the creation of high quality, high paid and secure employment in advanced industries.

This paper has argued that the objectives of policy changes that focus on SMEs need to be evaluated in light of empirical evidence about the contribution of SMEs to innovation and employment. If the aim of policy programs is to encourage innovative and flexible enterprises which engage in progressive employment practices then a targeted approach to policy development is required. Targeted policies are more likely to encourage the very small number of high quality SMEs, which are innovative and have the potential to grow into larger firms, than are general deregulatory measures. Many of these targeted policy programs are already in place in France, Germany and Sweden and they do not require significant changes to the political, institutional and social structures of the three nations.

Conclusion

As these three nations face significant global and domestic challenges to their traditional policy regimes, it seems that the tendency to view SMEs as a panacea for current ills including high unemployment and industrial stagnation is misplaced. While there is evidence that SMEs are responsible for an increasing share of total employment, there is also evidence to suggest that their contribution to *net job creation* is less significant because of the high level of job destruction in SMEs. On the whole, employment in SMEs appears to be characterised by lower wages, higher insecurity and relatively poor working conditions. There is also evidence to show that neither large nor small firms are more important in innovation – their contribution varies between industries and at different stages in the life cycle of an industry. In summary, it is only a very small number of SMEs that make a significant contribution to net job creation and innovation and utilise progressive work practices.

Policy programs designed to support SMEs need to be formulated with an awareness of the diverse nature of SMEs and the fact that only a very limited number of SMEs make an important contribution to employment and innovation. Specific programs that provide R&D support, improve SMEs intangible investments and regional access to capital and technology are more likely to encourage the start-up and growth of high quality SMEs than are general deregulatory measures. Many targeted programs already exist in the three countries and do not require a significant transformation of institutional structures that have characterised post-war policy regimes. More general neo-liberal policy measures designed to support SMEs, including tax reductions and labour market deregulation are likely to encourage an environment in which low quality, low wage employment is generated in SMEs with little future. If the aim of policy is to stimulate activity in small enterprises, regardless of quality, then indiscriminate measures might be appropriate. However, such an approach should be based on an awareness that the bulk of SMEs engage in low quality activity and do not contribute to net job creation.

Research on SMEs is particularly important for France, Germany and Sweden, which are experiencing significant pressure to change aspects of their traditional policy models which have favoured large firms. However, the findings of this body of research are of relevance to other countries that are seeking to promote SMEs in an effort to deal with problems such as industrial stagnation and unemployment.

NOTES

1. The Wage Earner Funds consisted of five small regional funds established from an excess profits tax which was developed in recognition that some corporations, especially large export

oriented firms, paid wages below the level that they would have to pay if the unions' solidarity wages policy did not restrain wage claims in highly profitable sectors. They were a compromise that resulted from a much more extensive proposal of the trade union movement which was designed to expand the influence of unions over the investment and employment decisions of corporations by enabling unions to gain shares in corporations (Meidner 1993).

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