

Final Report

# Barriers to Trade in Business Services

European Commission

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*Centre for*

**Strategy & Evaluation  
Services**

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# CONTENTS

SECTION	PAGE
EXECUTIVE SUMMARY	i
1. INTRODUCTION	1
1.1 Study Aims	1
1.2 Report Structure	2
2. BACKGROUND AND KEY ISSUES	3
2.1 Role of Business Services	3
2.2 Review of Previous Research	7
2.3 Key Research Issues	16
2.4 Methodological Approach	17
3. BUSINESS SERVICE MARKETS	20
3.1 Structure of Business Service Markets	20
3.2 Competition on Business Service Markets	27
3.3 Factors Driving Cross Border Trade in Business Services	34
3.4 Modes of Delivering Business Services on a Cross Border Basis	41
3.5 Role of Single European Market in Cross Border Trade in Business Services	44
3.6 Conclusions – Business Service Markets	46
4. BARRIERS TO TRADE	49
4.1 Classification of Remaining Barriers to Trade	49
4.2 Main Remaining Barriers to Trade	53
4.3 Barriers in Practice – Regulatory Barriers	56
4.4 Barriers in Practice – Administrative, Market and Socio-Cultural Barriers	68
4.5 Perceptions of Business Service Users	74
4.6 Perceptions of Public Authorities and Trade Associations	76
4.7 Reasons for Remaining Barriers to Trade and Scope for Action	77
4.8 Conclusions – Barriers to Trade	81
5. IMPACT OF BARRIERS TO TRADE	83
5.1 Impact of Barriers to Trade on Market and Company Structures	83
5.2 Analysis of Impacts by Business Service Sectors, Countries and Firm Size	99
5.3 Conclusions – Impact of Barriers to Trade	103
6. CONCLUSIONS	107

# CONTENTS

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APPENDICES		
1.	LIST OF INTERVIEWS	115
2.	SURVEY SAMPLE ANALYSIS	120
3.	SURVEY QUESTIONNAIRES	127
4.	SURVEY DATA - BUSINESS SERVICE MARKETS	138
	4.1 Competitiveness of Business Service Markets	138
	4.2 Market Dynamics – Demand and Supply Side Perspectives	147
5.	SURVEY DATA – BARRIERS TO TRADE	170
	5.1 Barriers to Trade in Business Services	170
	5.2 Cost of Barriers to Trade in Business Services	189
	5.3 Impact of Single European Market and Other Factors	208
6.	CASE STUDIES	212
	6.1 Accountancy, Audit and Tax Services	213
	6.2 Personnel Recruitment	222
	6.3 IT Consultancy	235
	6.4 Engineering Related Consultancy	241
	6.5 Leasing and Renting	251

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# EXECUTIVE SUMMARY

## **Study Aims and Methodology**

The study 'Remaining Barriers to Trade in Business Services' was carried out for the European Commission in 2000. The objectives of the study were, in summary, to provide:

- A stocktaking and classification of existing legislative, administrative and other barriers directly or indirectly affecting business services activities both at an EU and national level;
- Some quantitative indications of the extent to which any remaining barriers affect the cost-effectiveness and value added of the business services sector.

To investigate these and other issues, research was carried out across EU Member States focusing on eight business service sectors – IT Consultancy, Personnel Recruitment, Leasing & Renting, Accountancy and Audit, Tax Services, Contract R&D, Technical Testing, and Engineering Related Consultancy. The research involved a postal survey of business service providers and users, supported by interviews with national authorities, trade associations, and twelve case studies with business service providers. A total of 508 questionnaires were returned from the survey and 140 interviews were carried out as part of the fieldwork.

## **Background and Policy Context**

The business services sector has been one of the fastest growing sectors of most advanced economies throughout the 1990s and now accounts for over 7% of total employment in the EU economy as a whole. With the exception of Finland, in all other EU Member States the business services sector accounts for over 5% of total jobs whilst in four countries - Denmark, Netherlands, Spain and the UK, the figure exceeds 10%. Apart from the business service sector's direct contribution to employment and wealth creation, it has a key role to play in promoting the competitiveness and growth prospects of other sectors, thereby also contributing indirectly to job and wealth creation across a broad range of economic activities.

For these and other reasons, promotion of the business services sector has become an increasingly important aim of EU policy. This includes various legislative initiatives within the framework of the Internal Market to remove barriers to trade in the field of business and other services. But despite these initiatives, cross-border trade in business services lags behind trade in the manufacturing sector. At the Lisbon European Council, Heads of State and Government therefore agreed that a renewed effort should be made to bring about a 'fully operational internal market'. As part of this initiative, the European

# EXECUTIVE SUMMARY

Commission undertook to develop a strategy for the removal of the remaining barriers to trade in business services.

## **Summary of Key Research Findings**

Below we summarise the key research findings under three main headings – existing business service markets, remaining barriers to trade, and their impacts.

### ***Existing Business Service Markets***

*1. The current study, and previous research, suggests that whilst the business services sector is growing rapidly throughout the EU, the structure and maturity of markets are far from homogeneous.* First, the size of the business service sector in relation to the overall economy, and structure of the sector in terms of different types of activities, varies considerably from one EU Member State to another, as does the extent to which growth is being driven by the same factors. Second, whereas the market for some types of business services is becoming ‘Europeanised’ or more generally internationalised, most provision remains essentially domestic with relatively little cross-border trade in some sectors and countries. Third, there are very different ‘business models’ operating along side each other (large multinationals, medium-sized niche companies operating in a limited number of export markets, and small business service firms focusing mainly on local domestic markets).

*2. While domestic business services markets are generally seen as being very competitive, this is less true of export markets.* As far as domestic markets are concerned, there is some variation: whereas domestic markets for IT Consultancy, Personnel Recruitment, Leasing and Renting, and Engineering Related Consultancy all tend to be regarded as very competitive, this is less so with the other sectors covered by the study. But competition in domestic markets is seen as coming mainly from companies from the same country - just under half (46.6%) the business service providers surveyed as part of the research stated that this was so. With regard to export markets, a high proportion of companies indicated that competitive conditions are broadly similar across different EU markets. But amongst the remaining firms, export markets were seen as more competitive than domestic ones. Again there are differences between sectors: in sectors such as Contract R&D, Accountancy and Audit, and Technical Testing where a high proportion of respondents stated that their domestic markets are characterised by relatively low levels of competition, a relatively high proportion of firms stated that export markets were more competitive.

*3. The research suggests that levels of cross-border trade in the business services sector remain modest.* The survey work carried out as part of the study suggests that only 29% of users have purchased services on a cross-border basis. The extent of cross-border trade amongst providers is higher, as shown in Table 1:

# EXECUTIVE SUMMARY

*Table 1: Extent of Involvement in Cross Border Trade*

<b>Extent of cross-border trade</b>	<b>%</b>
1. Companies who have tried to sell services to client in other EU countries	23
2. Companies that have considered selling services in other EU countries but did not proceed	7
3. Companies that sold services to clients in other EU countries but are not doing so now	7
4. Companies that sold services to clients in other EU countries and continue to do so	54
5. Companies not providing information	9
<b>TOTAL</b>	<b>100</b>

The value of pure cross-border trade tends to be very small as a proportion of the overall turnover of business service firms – in most cases, the value of sales to other EU Member States accounts for between 1% to 10% of overall turnover. The modest level of cross-border activity is generally confirmed by other aspects of the research although this also highlights variations between sectors, providers in different size bands, and different export markets.

*4. Overall, domestic business service providers are not seen as having a clear advantage over those from other EU Member States in terms of price, the range of services offered, or quality.* To understand why companies purchase services on a cross-border basis, the research examined feedback from the user survey although national federations also expressed some views on this question (no case studies were undertaken with user companies). The survey feedback suggests that the criteria applied by business service users to identify and select suppliers tend to focus on quality and expertise rather than physical proximity. Even so, the overwhelming majority of firms purchase business services from domestic rather than other EU sources and this applies across the full range of services.

*5. Delivery of services from home country represents by far the most common method of selling business services to clients in other EU Member States.* The report highlights the fact that companies often use a variety of different methods to deliver business services to clients in different EU Member States. The table below summarises the survey feedback on the different delivery mechanisms used.

*Table 2: Methods of Delivering Business Services*

<b>Methods of Delivering Business Services</b>	<b>%</b>
1. Delivery of services from home country	52
2. Delivery by sending a team from the home base	20
3. Delivery of services via a local subsidiary, sister company or agent.	28
<b>TOTAL</b>	<b>100</b>

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# EXECUTIVE SUMMARY

The research suggests that the larger the provider, the more likely it is to deliver business services in other EU markets via a local subsidiary, sister company or agent. From a sectoral perspective, there are some quite pronounced differences with regard to modes of delivering services across borders. Thus, IT Consultancy and Labour Recruitment demonstrate very similar characteristics as far as the way in which services are delivered (with a broadly equal emphasis on selling from the home base and via local operations). But in the case of Leasing and Renting - but particularly with Accountancy and Audit - the use of local operations is much more common (reflecting perhaps the importance of national law). With Engineering Related Consultancy and Technical Testing delivering services from the home base stands out as the main delivery method.

**6. *The Single European Market is perceived as so far having had a far greater impact on domestic markets for business services than on export markets.*** According to the survey, around a third of business service providers consider that the Single European Market has had a significant impact on trading conditions in their domestic markets. There are some notable findings in this respect. Thus, a relatively high proportion of firms (34%) indicate that price competition has become more intense. But at the opposite extreme, relatively few (5%) companies indicated that the Single European Market had had a significant impact on input costs. Other developments – in particular e-commerce – are also viewed as having an important effect on markets but they have not succeeded in overcoming the fragmentation of structures.

### ***Remaining Barriers to Trade***

**7. *Different barriers are experienced by companies who sell services from home base, compared to those who chose to set up operations in another country.*** In the study, remaining barriers to trade have therefore been classified in terms of regulatory and non-regulatory factors, and by mode of delivery of business services.

**8. *Business Service providers face a number of regulatory barriers to trade.*** These include barriers relating to different legal systems – such as the additional complexity of dealing with foreign legal procedures, the absence of transparency in regulations and the absence of transparency in the implementation of regulations. In many cases these barriers represent a learning curve that businesses have to overcome in seeking to enter a new market. However, whilst they form barriers to entry they are not necessarily discriminatory against non-domestic companies seeking to enter a market. Table 3 identifies barriers that were mentioned as very important by at least 20% of respondents to the survey.

# EXECUTIVE SUMMARY

*Table 3: Main Regulatory Barriers to Trade (% of exporters considering the barrier to be very important)*

**Key:** (Provider Rankings): Column A = Selling from Home Base; Column B = Selling via Local Operation  
na = does not apply or ranked by less than 20% of respondents as very important.

Regulatory Barriers	A - Home Base	B - Local Operation
	%	%
Imposition of national standards, testing rules	30	46
Complexity of foreign legal systems	25	43
Inability to practice without license from professional body	na	30
Requirement to have a specific legal form	22	na
Absence of transparency in regulations	21	37
Absence of transparency in implementation of regulations	na	28
Administrative/legal regulations on setting up locally	na	23
Lack of mutual recognition of professional qualifications	na	21

9. *Other regulatory barriers to trade are more sector-specific.* The imposition of national standards and testing rules was the most frequently mentioned in this category. The case study work shows this barrier applies particularly in the Technical Testing sector and prevents a true single market developing in the sector. In the professional services field, the ability to practise without a licence from a professional body, the lack of mutual recognition of professional qualifications, and other restrictions on professional practice were frequently mentioned. The interview feedback suggests that restrictions on forming multi-disciplinary professional service firms are also seen as an important barrier to developing EU-wide corporate structures. Such professional services barriers are particularly important in Accounting, Auditing, Tax Services and Engineering Related Consultancy. Other sector-specific barriers include the requirement to have a specific legal form and/or administrative and legal regulations that complicate setting up a local operation in an export market.

10. *Market related and socio-cultural barriers generally apply to most sectors, but the extent to which they affect business service providers depends to some extent on the mode of service delivery.* After language, distance related barriers are the next most highly ranked. These include barriers such as the difficulty of supplying services at a distance from home base. Importantly, they also include the need to have a local track record and the need to be able to provide credible after-care services. Clearly, these barriers are beyond the control of public authorities although their effect may be alleviated by interventions, for example to encourage more use of e-commerce. Other market-related barriers which companies highlighted included the difficulty in obtaining information on tenders, the high cost of bidding and exemption clauses in public procurement as well as

## EXECUTIVE SUMMARY

the existence of subsidised local suppliers. The table below shows the principal barriers in this category on the same basis as regulatory barriers.

*Table 4: Market and Socio-Cultural Barriers to Trade (% of exporters considering the barrier to be very important)*

Key: (Provider Rankings): Column A = Selling from Home Base; Column B = Selling via Local Operation; na = does not apply or ranked by less than 20% of respondents as very important.

<b>Market and Socio Cultural Barriers</b>	<b>A - Home Base</b>	<b>B - Local Operation</b>
	%	%
Need to work in local language	40	52
Differences in local traditions	23	37
Difficulty in supplying services because of distance factors	32	na
Need for local track record	29	76
Excessive costs for setting up a local operation	na	44
Lack of necessary skills/costly training of workers	na	40
Subsidised local suppliers	23	35
Difficulty in obtaining information on tenders	23	30
High administrative costs of bidding	23	30
Need for local presence to provide after-care services	22	na
Exemption clauses in public procurement	na	29
Unacceptable delays in payment	na	24

11. *Business service users generally identified the same barriers as providers but placed greater emphasis on them.* Thus, over 60% of users thought that issues such as language and differing commercial practices were very important as factors constraining cross-border trade - a much higher proportion than amongst providers. However, as with providers, users ranked socio-cultural and market related the highest although regulatory barriers are still seen as important constraints on cross-border trade.

12. *Feedback from the interviews with national authorities is extremely mixed with regard to the extent and severity of remaining barriers to trade in business services.* National authorities monitor complaints from companies relating to the Single European Market and this was in most cases the basis of their judgement. National authorities did not, however, always have a clear picture of the barriers to trade specifically affecting the business services sector. The interviews with national authorities also indicated that there was a perception that business service companies are less likely to complain about barriers and more likely to organise themselves in such a way as to overcome them.

## EXECUTIVE SUMMARY

13. *In contrast, business service federations appear to be very aware of the seriousness of problems arising from barriers to trade in their particular sectors.* In general, this perhaps to be expected given that they have an important function in lobbying public authorities on regulatory and other issues. Several federations have carried out research to examine barriers to trade affecting their sectors. At a European level, good examples include work by the accounting and tax federation and by the consulting engineering association. In contrast, the IT Consultancy trade associations and counterparts in the Leasing and Renting, Technical Testing and Contract R&D fields appear to be less concerned with issues relating to cross-border trade.

15. *The scope for action by public authorities at a national and EU level to address problems arising from the existence of regulatory barriers is clearly greater than with non-regulatory ones.* Here, however, it is important to distinguish between situations where the problem facing business service companies stems from a failure to implement legislation rather than its complete absence (difficulties relating to the lack of mutual recognition of qualifications is a good example in this respect). This contrasts with some of the other regulatory barriers identified, for example in the field technical standards and arising from differences in national fiscal regimes and employment laws, where there is either a need to introduce harmonisation and/or close loop-holes in existing EU legislation.

### ***Impact of Remaining Barriers to Trade***

16. *The research suggests that remaining barriers to trade have resulted in fragmented EU markets in the business services sector, the relatively modest levels of cross-border trade having potential negative consequences for both users and providers.* From the perspective of business service users, the relatively modest levels of cross-border trade mean that companies may not be obtaining the best services available and may be paying more than necessary for the services they do use. From the perspective of business service providers, the fact that relatively few have so far traded only in domestic markets means that the potential additional growth and economies of scale to be obtained from exploiting wider EU markets is not being achieved. Similarly, where companies are exporting to other EU markets, the research points to relatively modest revenues being generated and a situation where the cost of selling into EU export markets is higher than it should be. High start-up and operating costs also deter potential new entrants to export markets.

17. *However, constraints on businesses operating on a truly European scale cannot be solely attributable to the existence of barriers to trade.* As the research makes clear, there are providers in most business service sectors that already operate internationally especially in the Accountancy and Audit, Taxation, Engineering Related Consultancy, IT Consultancy, and Leasing and Renting sectors. Of the sectors covered by this research, it

## EXECUTIVE SUMMARY

is only perhaps in the field of Technical Testing, and a lesser extent Contract R&D, where regulatory barriers have prevented the development of a significant number of international businesses. Similarly, the case study research highlights examples of smaller business service providers who are focusing on regional markets and whose strategies do not involve seeking to operate internationally.

**18. As such, the removal of barriers to trade is likely to have an incremental rather than a more fundamental effect on most business service sectors.** Across all businesses and sectors covered by the research, the effect of removal of remaining barriers to trade is likely to be primarily one of scale. The research suggests that in sectors such as Accountancy and Audit, Taxation, Engineering Related Consultancy, IT Consultancy, and Leasing and Renting there are already many international service providers, although their organisational structures and their cost structures might change if the regulatory environment changed. As noted above, of the sectors studied in this assignment, it is only perhaps in the field of Technical Testing, and a lesser extent Contract R&D, where regulatory barriers have prevented the development of a significant number of international businesses.

**19. The research suggests that, in the short-term, the effect of removing barriers to trade would be to liberalise markets with an increase in cross-border demand and/or a freeing up cross-border supply.** Business service users and providers were asked in the survey whether they would increase cross-border purchases/sales if barriers to trade were removed. The responses are summarised below:

*Table 5: Impact of Removing Barriers on Cross Border Purchases/Sales (% of Providers and Users Stating They Would/Would Not Increase Sales if Barriers Are Removed)*

Would company increase purchases/sales?	Users (%)	Providers (%)
	%	%
Yes – company would increase sales if barriers removed	33	53
No – company would not increase sales if barriers removed	23	20
Don't know or non response	44	27
TOTAL	100	100

The research suggests that increased cross-border trade could come in several ways: first, providers who are already exporting to other EU countries would be likely, according to the research, to increase the level of cross-border sales either in their domestic markets but more especially, in export markets. Analysis of the characteristics of companies in this category indicates that this category is dominated by business service providers in sectors where there is already a relatively high degree of export activity - Contract R&D, Technical Testing and Engineering Related Consultancy. Likewise, larger business service providers are likely to react more positively to a removal of barriers to trade than smaller providers. However, as far as the 'potential new entrants' are concerned, analysis

## EXECUTIVE SUMMARY

of their characteristics indicates that smaller firms employing up to 250 people are disproportionately represented. From a sectoral perspective, IT Consultancy, Personnel Recruitment, Tax Services and Engineering Related Consultancy account for a disproportionate share of ‘potential new entrants’

20. *The second potential effect of removing remaining barriers is that as a result of greater cross-border trade and competition, there will be pressure on business service providers to reduce prices, improve quality or a combination of these and other factors.* Here the research suggests that around two-thirds of providers who expressed an opinion expect to see an increase in the number of competitors in their domestic market. An even higher proportion foresees the more competition in export markets as the table below shows.

*Table 6: Effect of Removing Barriers on Prices (% of Providers Stating that There Would Be More/Less Competition on Price If Barriers are Removed)*

<b>Would there be more competition on basis of price?</b>	<b>Domestic Markets</b>	<b>Export Markets</b>
	%	%
Yes - More competition on price	57	72
No change in level of competition on price	36	24
No – there would be less competition on price	7	4
<b>TOTAL</b>	<b>100</b>	<b>100</b>

The extent of downward pressure on prices arising from greater competition in domestic and export markets is difficult to gauge. However, amongst those firms who did offer an opinion, just over a third said that they expected prices to fall by up to 10%.

21. *The extent to which business service providers would be able to absorb a downward pressure on prices depends on their profit margins and the scope for reducing costs by rationalising operations and/or achieving economies of scale.* In the short-term, the research suggests that existing ‘business models’ will probably accommodate these pressures. Moreover, the removal of barriers should make it easier for firms to reduce some costs. The research suggests that around a third of firms would be able to reduce their operating costs if remaining barriers to trade were removed. A ‘best estimate’ using feedback from the survey work and case studies suggests that provider costs would fall by an average of about 6%. In addition, the costs of starting up an operation in export markets would probably be reduced although the extent of this effect is not possible to gauge.

22. *In the longer term, the potential effect of removing remaining barriers to trade is that there will be pressure on firms to restructure and/or to investigate new forms of service delivery or to reduce their costs in other ways.* In particular, the removal of barriers

## EXECUTIVE SUMMARY

could lead to larger multinational operators introducing more integrated cross-border corporate structures to maximise economies of scale and extend their market ‘reach’. However, the research suggests that it is the mid-market operators – niche business service provider and medium-sized ‘general’ service operators – who stand to gain the most from the removal of barriers to trade. Firms in this category are often active in specialist niches of export markets already and the removal of barriers would reduce the marginal cost of extending their client bases and/or range of services. Firms of this type are also well placed to take advantage of new export opportunities – they generally have the human and financial resources required to support a development of operations into new markets and are already familiar with the logistics of cross-border trade. But at the same time, restructuring impacts will almost certainly result in some providers going out of business as competition becomes more intense and smaller firms are probably the most vulnerable in this respect.

23. *In addition to impacts on company cost structures and sales, there are likely to be other less easily quantifiable impacts on the business service providers and users arising from a removal of barriers to trade. Table 5.7 summarises the main benefits identified by the research:*

*Table 7: Other Benefits to Business Service Providers and Users (% of Providers and Users Stating That These Benefits Would Occur if Barriers Removed)*

<b>Providers</b>	<b>%</b>	<b>Users</b>	<b>%</b>
Improved service quality and innovation	38	Reduction project costs	35
More technology in services and delivery	33	Improved export performance	28
Cross-border links/improved competitiveness	32	Increased productivity	27
Investment in new markets, delivery methods	31	Recruitment of additional personnel	26
Networking to improve competitiveness	29	Improvements in company management	18
Restructuring to improve competitiveness	25	Increased R & D	17

24. *The report sets out a number of actions that might be considered as a follow up to the research. This includes a consultation programme with business service providers and their representative bodies with a view to agreeing on actions to eliminate remaining barriers to trade, reviewing and developing the mechanisms for systematic collection of data at on the barriers to trade in business services by encouraging national government to collect this data on a regular and consistent basis, and further work to fill gaps in research.*

Note: in the report, the case study research and feedback from interviews with national authorities and federations is used extensively to help develop findings based on the survey of business service providers and users. A detailed analysis of the survey data is presented in the appendices to the report together with other supporting material including a list of interviews and resumes of the case studies.

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# INTRODUCTION

# 1

This document contains the final report prepared by the Centre for Strategy & Evaluation Services (CSES) on the study 'Remaining Barriers to Trade in Business Services'. The study was carried out jointly for the European Commission's Directorates-General for Enterprise and Markets during the course of 2000.

## 1.1 Study Aims

The objectives of the study were, in summary, to provide:

- A stocktaking and classification of existing legislative, administrative and other barriers directly or indirectly affecting business services activities both at an EU and national level;
- Some quantitative indications of the extent to which any remaining barriers affect the cost-effectiveness and value added of the business services sector.

To investigate these and other issues, research was carried out across EU Member States focusing on eight business service sectors – IT Consultancy, Personnel Recruitment, Leasing & Renting, Accountancy and Audit, Tax Services, Contract R&D, Technical Testing, and Engineering Related Consultancy. The research involved a postal survey of business service providers and users, supported by interviews with national authorities, trade associations, and twelve company case studies.

The outputs from the study are as follows:

- *Preliminary Report* – this was submitted in March 2000 and contained an initial literature review, a first draft of the survey questionnaires and a suggested approach to other aspects of the Phase 2 fieldwork.
- *Interim Report* – this was submitted in August 2000 and contained an analysis of the 248 questionnaires completed by business service providers and users at an interim stage in the survey, together with an analysis of initial feedback from the interview programme.
- *Survey Databases* – two databases were designed, one for providers and the other for users. The final versions of the databases contain a total of 508 records and various tables providing a basic analysis of the responses to questions.
- *Final Report* – this draws together the results of the research – the survey of business service providers and users, twelve company case studies, interviews with representatives of national authorities and federations, and other material.

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# INTRODUCTION

# 1

## 1.2 Report Structure

The final report is structured as follows:

- **Section 2** - examines the background to the study, previous research, and key issues and summarises the overall methodological approach to the research.
- **Section 3** - examines the structural characteristics of the internal market for business services and extent of cross border trade and competition in these markets.
- **Section 4** – identifies the nature and extent of remaining barriers to trade affecting the business service sectors covered by the research.
- **Section 5** - considers the overall economic impact of remaining barriers to trade in business services.
- **Section 6** – presents the overall conclusions of the study and identifies the scope for action and further research.

As requested by the Commission most survey tables used for the analysis, as well as interview and case study material are presented in the appendices (bound separately). The appendices also provide a list of contacts in EU Member States who made an input to the research.

# BACKGROUND AND KEY ISSUES

## 2

### Overview

We begin by reviewing the background to the study and EU policy context. Previous research is then considered leading to the identification of a number of key issues for the current study.

### 2.1 Role of Business Services

The business services sector has been one of the fastest growing sectors of most advanced economies throughout the 1990s and now accounts for over 7% of total employment in the EU economy as a whole. Table 2.1, taken from a recent study for the Commission, provides an analysis.

Table 2.1: Business Services Employment in EU Member States (1997)

EU Member States	Total Employment	Business Services Jobs	% of all Employment
Austria	3,570,000	343,000	9.6
Belgium	3,744,000	214,000	5.7
Denmark	2,567,000	280,000	10.9
Finland	2,030,000	88,000	4.3
France	21,908,000	1,578,000	7.2
Germany	36,111,000	1,453,000	5.3
Ireland	1,149,000	85,000	7.3
Italy	19,898,000	1,206,000	6.0
Netherlands	6,640,000	691,000	10.4
Portugal	4,464,000	228,000	5.1
Spain	11,868,000	1,214,000	10.2
Sweden	3,912,000	339,000	8.6
United Kingdom	25,348,000	2,708,000	10.6
TOTAL/AVERAGE	146,924,000	10,427,000	7.1

Source: Ernst & Young Thematic Evaluation of Structural Fund Impacts on SMEs' (European Commission, DGXVI, 1998).

The analysis shown above underlines the importance of the business service sector as a source of employment in EU Member States and the EU as a whole. With the exception of Finland, in all other countries business services account for over 5% of all jobs whilst in four countries - Denmark, Netherlands, Spain and the UK, the figure exceeds 10%. Moreover, the business services sector is amongst the fastest growing sectors in the European economy. Detailed information on employment and output in respect of

# BACKGROUND AND KEY ISSUES

## 2

business services at a sectoral level is, however, incomplete although later studies by, for example OECD and Eurostat, do help to fill some of the gaps (see below).

### *European Policy Context*

Apart from the business service sector's direct contribution to employment, it has a key role to play in promoting the competitiveness and growth prospects of other sectors in most economies, thereby also contributing indirectly to job and wealth creation across a broad range of activities.

For these and other reasons, promotion of the business services sector has become an increasingly important aim of EU policy. The Commission's 1993 White Paper on 'Growth, Competitiveness and Employment' was a start in this respect. Subsequent efforts by the Commission to develop a common policy framework and to improve the availability of relevant statistical data vis-à-vis business services include 'The Contribution of Business Services to Industrial Performance: a Common Policy Framework' (1998) and 'Business Services in European Industry – Growth, Employment & Competitiveness' (Rubalcaba-Bermejo, 1999). At the same time there have been various legislative initiatives within the framework of the Internal Market to remove barriers to trade in the field of business and other services.<sup>1</sup> But despite these initiatives, cross-border trade in business services lags behind trade in the manufacturing sector. The potential (if not actual) consequences of this are twofold. In the first place, from the point of view of the business services sector itself, restrictions on cross-border activity reduce the scope for providers to exploit economies of scale associated with the development of pan-European markets and corporate structures. The second consequence is that, from the perspective of users, restricted choice means that companies are not necessarily obtaining the services required to maximise competitiveness and growth.

At the Lisbon European Council in 2000, Heads of State and Government agreed that a renewed effort should be made to bring about a 'fully operational internal market'. As part

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<sup>1</sup> This includes, for example, the general recognition of professional qualifications, establishment of general framework for mutual recognition (first system - 85/368/CEE), the second General System for the Recognition of Professional Education (-92/51/CEE - the second system extends the third system to the rest of professional education), the Directive to ensure Commission is informed of draft standards and technical regulations via notification procedure from Member States, which helps Commission to monitor observance of principle of mutual recognition of technical standards (98/34/EC, formerly Directive 83/189/EC). As of 1997, product withdrawals also need to be formally notified. Mutual recognition of accounting qualifications and other professional qualifications is regulated by the EU through the 8th Directive on mutual recognition. Likewise, the Services Directive (92/50/EEC, as amended 97/52/EEC) which establishes procedural rules for publication of calls for tenders and award of contracts in relation to public procurement - designed to open up cross-border competition for public procurement projects.

# BACKGROUND AND KEY ISSUES

## 2

of this initiative, the European Commission is committed to setting out a strategy for the removal of the remaining barriers to trade in services within the Internal Market.

### *Definitions and Scope of Research*

The term ‘Business Services’ covers all services mentioned under section K in the statistical classification of products by activity (Council Regulation (EEC) No. 369/93 of 29.10.93).<sup>2</sup> Within this broad category, this study focuses on a number of specific business service sectors. These are listed in Figure 2.1 with examples of some of the main types of services.

*Figure 2.1: Scope and Definitions - Business Services Sectors*

Information Technology Consulting	Consultancy on the type and configuration of hardware and associated software applications; database systems and data processing; analysis, design and programming of systems; other related IT consultancy activities.
Labour Recruitment	Personnel search, selection and referral services; executive search and placement; labour contracting; supply to others of temporary workers; and related activities.
Leasing and Renting of Equipment	Renting and leasing services for air, land and water transport equipment; agricultural, construction and civil engineering equipment; office machinery including computers; and related activities.
Contract R&D	Research and development activities carried out under contract for other organisations; and related activities.
Technical Testing	Measuring and testing related to water and air quality; food hygiene testing; testing of calculations for building elements; certification of ships, aircraft, vehicles, nuclear plants, etc.
Accountancy or Audit	Preparation of financial accounts, examination of accounts and certification; recording of commercial transactions; associated advisory activities and representation; other related activities.
Tax Services	Preparation of personal and corporate tax returns; associated advisory activities and representation; other related activities.
Engineering Related Consultancy	Engineering consultancy, project management and technical activities; machinery and industrial plant design; projects involving civil engineering, hydraulic and traffic engineering; other related activities.

Source: NACE Rev1

<sup>2</sup> The NACE Rev1 definition covers a wide range of services including Computer and Related Services (72.10 to 72.60), Professional Services (Legal Services, Accounting, Bookkeeping, etc, Business and Management Consultancy – 74.11 to 74.14), Marketing Services (74.13 and 74.40), Technical Services (Architectural, Engineering, Technical Consultancy, Technical Testing and Analysis – 74.20 to 74.30), Renting and Leasing Services (71.10 to 71.33), Labour Recruitment and Provision of Personnel (74.50), Operational Services (Investigation and Security, Industrial Cleaning – 74.60 and 74.70), and Other Business Services (Photographic, Packaging Secretarial and Translation, etc – 74.81 to 74.84).

# BACKGROUND AND KEY ISSUES

## 2

Because of the generally poor quality of statistics on business services, and differences in the way they are classified, it is not possible to provide a detailed analysis of current employment for all business sectors (including some covered by this study) in all EU Member States. For example, in management consultancy in Germany, although the industry has an annual turnover of around €12 billion, there is no employment estimate. Likewise, there is no estimate of employment for any country for several other sub-sectors in the 'Professional Services' category. Legal services and accountancy are the most obvious gaps while some services with large employment numbers (e.g. security and cleaning services) are excluded altogether from the available statistics, possibly because there is no substantial cross-border trade in these areas.

Nevertheless, Table 2.2 provides a summary of the analysis of business services employment for some of the sub-sectors covered by this study based on OECD data. This source appears to be the most comprehensive set of labour statistics for the services concerned. But the sectoral coverage is not comprehensive and the total employment shown in the table should be regarded as very much an underestimate.

*Table 2.2: Breakdown of Business Services Employment by Sub-sector (thousands)*

Sub Sectors	A	DK	FIN	F	D	IRL	I	NL	SP	SW	UK	TOT	%
Hardware Consultancy	0	0	0	61	12	0	5	20	0	2	18	118	3.2
Software Consultancy	5	14	10	60	77	15	86	50	0	33	216	566	15.5
Data Processing	8	5	4	52	68	0	81	8	0	5	32	263	7.2
Database Services	0	0	0	3	0	0	1	1	0	1	8	14	0.4
Research & Development	1	0	1	20	197	0	0	0	0	10	86	315	8.6
Technical Testing	4	3	2	31	40	0	0	0	6	7	26	119	3.3
Market Research	1	1	1	17	0	0	11	10	11	2	36	90	2.5
Advertising	9	10	5	93	138	0	31	37	47	15	84	469	12.8
Management Consultancy	5	8	5	136	0	0	84	35	11	17	153	454	12.4
Labour Recruitment	11	11	2	351	40	0	2	100	12	12	508	1049	28.7
Training	1	0	0	27	0	0	0	0	0	0	173	201	5.5
TOTAL	45	52	30	851	572	15	301	261	87	104	340	3658	100.0
PERCENTAGE	1.2	1.4	0.8	23.3	15.6	0.4	8.2	7.1	2.4	2.8	36.6	100.0	-

*Source: OECD (1997). Dates differ between countries. Note: No employment data available for Belgium, Greece, Luxembourg and Portugal.*

There is an important distinction to be made between different types of business services. The most significant difference is between 'strategic' services (e.g. management consultancy) and 'operational' business services (e.g. security, office cleaning). Whilst the former can broadly be defined as knowledge-intensive and having a bearing on the

# BACKGROUND AND KEY ISSUES

## 2

core activities and management of companies, the latter tend to relate to support functions and are often less knowledge-intensive. There is also a distinction (particularly relevant to this study) originally coinciding with the above categories but now becoming increasingly blurred, between business services that can be delivered 'remotely' and those that presuppose close physical proximity to clients.

### 2.2 Review of Previous Research

Because of its increasing strategic importance to European economies, there is a growing body of literature on issues relating to the development and 'internationalisation' of the business services sector. The growing importance of business services is recognised in, amongst others, a recent study by Rubalcaba-Bermejo:

'Business Services hold strong potentials for productivity and employment inside the sector itself: they are furthermore of strategic importance in improving the competitiveness of European Industry...we are convinced that they are instrumental in helping companies to lower costs, improve quality and adapt production structures to the new challenges of a global economy & information society'.<sup>3</sup>

Below, we review recent research, focusing on the nature and extent of remaining barriers to trade and the costs to European firms. We begin by considering research carried out at an EU level, starting with studies carried out in the late 1980s, and then review more recent research, including studies and surveys undertaken in different countries.

Research on the factors encouraging or constraining the 'internationalisation' of business services can be traced back to the late 1980s. Early research includes that by, for example, Wood (1987) who noted that compared with manufacturing, international trade in business services appeared to be much more 'barrier-ridden'. The factors explaining this were examined in some detail as part of the 1988 Cecchini work on the 'Cost of Non-Europe'. Since then, however, there has been relatively little research on this question.

The KPMG (1988) study – part of Cecchini series – on the 'Cost of Non-Europe for Business Services' study was based on a survey of users and providers, thereby giving both a demand and supply-side perspective on the barriers to trade across borders. The study began by examining the factors that lead to service provision being 'externalised'. Based on a survey of firms using business services, they identified the main factors - ranked in order of importance) - as being cost saving (26% of firms), lack of internal expertise (18%), and desire to cut employment (10%). The research established then that, on the demand-side, some 26% of companies that had tried to contract out the provision of business services had failed to provide a suitable supplier from their own country. In

<sup>3</sup> Rubalcaba-Bermejo, 'Business Services in European Industry' (European Commission, 1999).

# BACKGROUND AND KEY ISSUES

## 2

contrast, for these and other reasons, 68% of the companies had bought services from a foreign-owned organisation. In their study, KPMG concluded that from a demand-side perspective:

There is already considerable cross-border provision of business services within the EEC and generally firms are not averse to using those services, their main concern being to obtain the best available product. It was not, however, possible to tell from the replies [to the survey] how important lack of information was and whether the use of foreign firms would have been larger if their existence were known' (KPMG, 1998: 15).

The research also examined the reasons for barriers to trade in business services from a supply-side point of view. According to the research, only 17% of business service providers felt that barriers to trade were significant in the EU. Ranked in order of importance, the barriers identified were: financial, administrative, national standards and regulations, and legal factors. Views on the extent of barriers to trade varied across different sectors: thus, according to the KPMG research, engineering-related services faced the most severe obstacles whereas the view from representatives of the legal profession was that there were few constraints. This led KPMG to conclude that 'the overall picture from the supply side is that most business services are perceived by their suppliers to suffer from some barriers even though they are not considered to be of great significance' (KPMG, 1998: 16).

KPMG used the survey data to come up with an estimate of the cost of 'non-Europe' for business services. A number of direct and indirect costs were identified such as the higher costs of business services which result from limited competition; lower output across the economy which results from these higher business service inputs; lower demand for business services which results from higher costs and a more limited range of business services; and lower levels of (cost saving) 'externalisation' which results from higher costs, and a more limited range of business services. Taken together, these costs were estimated to be in the range of ECU 4 to 9 billion. KPMG stressed the methodological difficulties in estimating the cost of 'non-Europe'. The relatively small size of the survey samples of business service providers and users also meant that it was difficult to reach conclusions on a sector-specific basis. Similarly, the fact that the research was limited to seven EU Member States - the Benelux countries, France, Germany, Italy, and the UK meant that conclusions were limited in terms of their geographical scope.

More recent research - a 'Flash Eurobarometre 72' survey for the European Commission using a sample of 4,000 companies and carried out by Gallup (1999) - suggested that contrary to the somewhat upbeat conclusions of the earlier KPMG study, cross-border trade in business services remains at a low level. As the Gallup findings shows, with the

# BACKGROUND AND KEY ISSUES

## 2

exception of Transport Services, fewer than 10% of business service users purchase the required assistance from a supplier based in another EU Member State.

In a study of business services in European Industry for the European Commission, Rubalcaba-Bermejo (1999) concluded that 'services are far less internationalised than goods ... although in recent years the services trade has grown more than that of goods, although not in all activities'. In the study, four different types of barriers to trade in business services are identified. These are summarised below:

*Figure 2.2: Barriers to Trade in Business Services (RUBALCABA-BERMEJO)*

- *Legal barriers* - where there is a distinction between 'prohibitions on the development of specific activities and development difficulties due to horizontal laws'. The first of these categories includes restrictions on professional activities because of a lack of recognised qualifications, nationality, and/or residency. Horizontal barriers, according to Rubalcaba-Bermejo, include fiscal regimes, 'barriers to the circulation of capital and barriers to the free use of stock markets'.
- *Economic barriers* - the 'different distortions to competition and lack of adequate access to information'. The first category is seen as including 'the dominant position of private groups, oligopolies, and state interests'. Rubalcaba-Bermejo argues that political-administrative discrimination is 'one of the most relevant obstacles in business services' and can take the form of the discriminatory use of grants, or constraints on public procurement.
- *Intrasectorial barriers* - barriers that emerge from an activity due to its own dynamics and spatial diversity'. Here lack of harmonisation at EU level is seen as the major factor or, in some circumstances low or insufficient EU regulation (e.g. the demand for certificates or attestations which are not necessary for technical reasons but nevertheless required for 'corporate control mechanisms'). Many of these constraints, according to Rubalcaba-Bermejo, originate with national professional associations.
- *Social barriers* - which he describes as including ethical behaviour, linguistic diversity and cultural idiosyncrasies. According to Rubalcaba-Bermejo, these types of barriers are to be distinguished from the others because they 'do not directly affect any principle established for the Single Market but indirectly can have an impact'. Paradoxically, cultural and social differences can also promote cross-border trade in business services - 'the diversity of norms, regulations, and economic environments favours the recourse to business services by many other sectors wishing to overcome the difficulties in their path to internationalisation'.

According to his analysis of EUROSTAT data, the existence of barriers to trade meant that international transactions accounted for only 2% of the total trade (i.e. domestic and cross-border) in business services in 1993. This compared with 7% at the beginning of the 1990s. The study suggested that France, Germany, the Netherlands, and UK, are the leading exporters. Rubalcaba-Bermejo stresses the importance of customising services to particular national markets and clients as a factor influencing the extent to which business services can be and have been 'internationalised'. This, he argues, ultimately results in a tendency for cross-border trade to be replaced by establishing branch operations in non-

# BACKGROUND AND KEY ISSUES

## 2

national markets. A distinction is made in this respect between small and large business service providers: smaller providers, because of the cost and complexity of setting up branches in other countries, often rely on networks to ensure that they are able to sell into foreign markets.

More recently still, barriers to trade in business services have been examined by the OECD (1999). Like Rubalcaba-Bermejo, the starting point of this work is the observation that trade in business services is considerably less than merchandise trade. Taking commercial services as a whole, the study highlights the discrepancy between the fact that this sector accounts for 60% to 70% of GDP in most economically advanced countries whereas trade constitutes only 20% of merchandise and commercial services combined (WTO, 1998). Several reasons are suggested for the shortfall:

The large component of person-to-person interaction, often involving tacit information, which can only be provided through local presence. ... service providers are predominantly smaller firms and are therefore less globalised and less disposed than large-scale manufacturing or agricultural operations to export high-volume homogeneous products. Product differentiation and cultural preferences are another reason. Because of the customised nature of services, the geographical proximity of suppliers to clients is often important'. Finally, there are barriers to the supply of services by foreign firms, such as restrictions on local establishment and operations in some areas' (OECD, 1999: 22-23).

The OECD study, like Rubalcaba-Bermejo's research, points out that trade in commercial services - and especially 'strategic' business services - is nevertheless growing more rapidly than trade in merchandise (at an estimated rate of 8% per annum over the 1990-97 period compared with 7% in merchandise). Trade in business services such as computer and information services appear to have grown especially quickly, partly because of the growth of international outsourcing and the rapid globalisation of manufacturing and practice of service providers establishing a presence alongside their clients. Globalisation in the strategic services sector is seen as most advanced in consulting, personnel supply, and advertising. There are current WTO initiatives to liberalise the trade in business services.

Business services, according to the OECD research, are not as highly regulated as other areas of services with market access conditions tending to be fairly liberal. Restrictions arising from national regulations are seen as being common in the areas of engineering-related services, advertising, employee recruitment, and education services. However, the OECD study argues that professional services (defined as legal, accounting, architectural, and medical) are regulated the most stringently. Here barriers to trade include local presence and nationality requirements, restrictions on foreign investment and ownership of firms, the requirement for local partners and restrictions due to lack of recognition of foreign qualifications and expertise. The OECD study suggests that the liberalisation of

# BACKGROUND AND KEY ISSUES

## 2

communications and rapid growth of the Internet is likely to lead to an expansion in demand for business services to be traded across borders. Examples cited included the spread of distance learning and the direct selling of advertising and marketing services to consumers ('disintermediation') using electronic methods.

According to a recent study in Italy by Labory and Malgarini ('Regulation in Europe: Justified Burden or Costly Failure?' Confindustria, 1999), existing research offers no precise explanation of the factors hindering the proper functioning of markets in the business services field. One exception they highlight is the OECD survey discussed earlier. Their overall conclusion is that:

"Overall, the data provided shows that there is evidence of a performance gap between Europe and the US. The European market base is indeed still too fragmented, which inhibits European firms from rationalising activities (production, marketing, etc.) at a European level and, among other things, prevents them from truly benefiting from economies of scale' (LABORY and MALGARINI, 1999: 89).

The Confindustria study attests to the low level of 'pure' cross-border trade and the fragmented nature of the business services sector and emphasises the need for further regulatory steps at Community level towards harmonisation to bring about a fully functioning internal market.

A business survey of the single market conducted by the European Commission (1998) shows that differences in national regulations form a substantial part of technical barriers to trade within the EU. It suggests that such technical barriers impose requirements for either the use of technical specifications or standards defining some technical aspects of the product, or testing and certification of products or suppliers. The business survey in 'The Single Market Review' also shows that the application of the mutual recognition principle is problematic. In particular, the principle works best when there is either a formal mutual recognition arrangement or a mutually recognised standard developed for instance by CENELEC or another European standards body.

The 1998 Single Market Review highlighted some of the remaining barriers to trade encountered by businesses within the EU. Whilst the analysis did not focus specifically on barriers to trade within business services, the study examined barriers to trade encountered in the technical testing field on the input side, notably; lack of consistent enforcement of some directives and variations in interpretation at national level (in particular the New Approach Directives which enable Member States to develop detailed specifications); lack of information available to enterprises and poor understanding of the

# BACKGROUND AND KEY ISSUES

## 2

needs of the new directives, which causes unnecessary costs; and the often prohibitive costs of attestation.

The 1998 Commission report on European competitiveness makes a direct link between the elimination of institutional and regulatory barriers and the more efficient functioning of the internal market: 'A prime policy target is the elimination of institutional and regulatory barriers to the creative and flexible management of change. Such rigidities can be found in financial and labour markets'.<sup>4</sup> A further Commission publication (1999) 'Mutual Recognition in the context of the follow-up to the Action Plan for the Single Market', outlined problems in the application of mutual recognition and included a section dealing specifically with services. The study found that the percentage of firms experiencing obstacles within the Single Market had 'remained virtually unchanged between 1996 and 1998 (30% as against 24%)'.<sup>5</sup>

A gap in existing research is the failure to focus on the extent to which levels of cross-border trade in business services is influenced by the type of delivery methods and barriers specifically affecting these different mechanisms. One exception is a study by Nicolaidis, which found that the 'problem of liberalisation does not depend so much on the movement of factors as on the modes of service'.<sup>6</sup> Nicolaidis argues that despite the ongoing process of liberalisation in the business services sector, the constraints in service delivery mechanisms in the business services sector pose as great a barrier to the 'Europeanisation' and globalisation of business services as remaining regulatory and legislative barriers which he sees as being slowly being eradicated through an ongoing process of liberalisation.

### *Research at a National Level*

In addition to the mainly academic literature considered above, some research has also been carried out looking at barriers to trade within the Internal Market by national authorities and employers' confederations in individual Member States. It should be emphasised that, with the exception of Sweden, it would appear that very little research has been undertaken into barriers to trade specifically affecting the business services sector at a national level. The explanation given by several national authorities we spoke to for the absence of research includes the exceptionally low level of complaints received

<sup>4</sup> LABORY and MALGARINI, 'Regulation in Europe: Justified Burden or Costly Failure?' Confindustria, 1999

<sup>5</sup> DG Internal Market, 1999 (Mutual recognition in the context of the follow-up to the Action Plan for the Single Market, pg. 5)

<sup>6</sup> Nicolaidis, K. (1993) 'Mutual Recognition, Regulatory Competition and the Globalisation of Professional Services'.

# BACKGROUND AND KEY ISSUES

## 2

by the authorities in respect of barriers to trade encountered by business services firms.<sup>7</sup> The Swedish Board of Trade, for example, emphasised that whilst problems regarding the free movement of goods were often brought to the attention of the national authorities, complaints from business services companies were comparatively rare. Figures obtained from the Dutch national authorities corroborate this. Of more than 100 complaints, only ‘a handful’, we were told, related to business services. Similarly, in Spain, no complaints have been received at all by the complaints monitoring authority in the business services field. This means, in effect, that even where information has been gathered by national authorities regarding barriers to trade encountered by business service providers, the information is rarely sufficiently comprehensive enough to draw anything other than very tentative conclusions. As a result of this lack of information on problems faced by business service providers, the identification and eradication of barriers to trade has not been accorded the same significance at a national level as the removal of barriers to the free movement of goods.

Nonetheless, some research has been undertaken by national authorities which has a bearing on the business services sector. Thus, in Denmark, Dansk Industri (DI) conducted a survey of manufacturing and service companies on barriers to trade with a specific focus on technical testing. Whilst the survey does not focus exclusively on business services firms (all types of firms were included in the study), it nevertheless highlights the sorts of barriers (actual and perceived) that businesses face within the Internal Market in terms of market inputs in the technical testing and accreditation field. The survey found that Danish companies were still experiencing difficulties in terms of technical barriers to trade.

The most frequent problems identified in the Danish research were in areas where there is an ongoing transition process towards European harmonisation and mutually recognised standards - of those experiencing problems, meeting country-specific product specification requirements came top of the list. Some 58% of respondents stated that they had been required to submit products for renewed testing and certification by notified bodies in other countries. A further 32% had experienced excessive bureaucracy in the technical testing field. Of those interviewed by *Danske Industri*, 18.9% of survey respondents indicated that they still encounter technical barriers to trade within the internal market.<sup>8</sup>

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<sup>7</sup> Another reason is that, compared with manufacturing, relatively little emphasis has been placed by Governments until recently on the promotion of the business services sector as a driver of economic competitiveness and growth.

<sup>8</sup> Of those experiencing problems, the most common problem identified was meeting country-specific product specification requirements (69%), where documentation was required which differed from the

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# BACKGROUND AND KEY ISSUES

# 2

Likewise, in Sweden, the National Board of Trade (Kommerskollegium) conducted a survey in 1999 on mutual recognition in the service sector. The Board spoke to a number of trade associations and interest groups and conducted a review of some cases brought to its attention. The research found that problems could be categorised in a number of areas including: (1) administrative delays in the mutual recognition of standards and qualifications; (2) The existence of national regulations, not necessarily meant to create obstacles for foreign service providers but nevertheless making it more difficult for foreign companies operating in another EU country (for example rules concerning registration, labour laws etc.); and (3) Lack of competition with monopolies still present in some EU countries in certain sectors, for example in the technical testing field. In the report, the Board recommended a number of actions. Amongst these were the development of a strategy for services based on annual national review reports as well as on reports by national co-ordination centres and co-operation centres, and the possibility of developing a notification procedure similar to the one used for goods (i.e. Directive 98/34/EC as amended) to promote transparency. Further suggestions included raising awareness of the principle of mutual recognition, encouraging companies encountering barriers to bring specific matters to the attention of national authorities, and making sure that the development of electronic commerce is encouraged.

In Portugal, a study is presently being undertaken by APP Consultores on the Engineering Related Consultancy sector, and a first draft report has already been compiled. The draft report covers a range of issues facing the sector, for example highlighting a lack of transparency in the tender award procedures and increased use of negotiated procedures during recent years. However it does not indicate whether this specifically discriminates against suppliers from outside the country and there are few references to barriers to trade as being a problem.

Likewise, the Spanish Ministerio de Formento has undertaken a study of the civil engineering/consultancy sector. The report – ‘Estudio del sector de las empresas de ingeniería civil en España’ – was completed in 1998 and provides an analysis of the current state of the civil engineering sector in Spain and suggests actions to improve its competitiveness. Among the challenges identified are insufficient transparency and understanding of the engineering consultancy providers business in the purchasing process of public bodies, and an over reliance on economic and price-related criteria.

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Danish equivalent. 58% of respondents experiencing problems stated that they had been required to submit products for renewed testing and certification by notified bodies in other countries. 32% had experienced excessive bureaucracy. When share of the export market was taken into account, the analysis revealed that France and Italy followed by Germany, Austria and Greece caused the most problems to Danish exporters in the technical testing field.

# BACKGROUND AND KEY ISSUES

## 2

Another challenge identified is the tendency of regional public entities to favour local providers, as well as increasing competition from in-house providers. The study suggests that such practices shield many micro-enterprises from market forces, slowing down their development and indirectly reducing the number of Spanish companies in the engineering-related consultancy sector that are able to compete internationally. From the research perspective, this raises the interesting question of how national government and market influences can indirectly influence the capacity of service providers to compete in foreign markets.

Elsewhere, whilst there has been a considerable amount of research on the Single Market, there appears to be little material relating specifically to business services. In Finland, for example, the Confederation of Finnish Industry & Employers undertook a study in 1995 – ‘Assessment of the Single Market’ - on Finnish companies’ perceptions of the Single Market. However, it is difficult to draw any definitive conclusions from this study as over 80% of the sample were companies in the industrial sector with the remaining 20% comprising companies in the services sector and wholesale and retail trade. Overall, some 60% of the responding companies said their business environment had improved compared with the situation prevailing prior to EU membership, while the corresponding figure for the service sector companies was 50%. Another survey on trade barriers was undertaken by the Confederation in 1998 but this study covers both EU and third countries. Trade barriers that are identified run into the hundreds with only three types of trade barriers being raised in respect of the EU Internal Market. The Central Chamber of Commerce also undertook a survey (focusing on 500 Finnish companies) in 1998 but this only covered trade barriers within the Finnish market.<sup>9</sup> This research does nonetheless raise some interesting research issues that are relevant to the business services sector, such as the extent to which domestic trade barriers affect the willingness of firms to export their services in other EU markets.

Overall, this review of previous research suggests that volumes in the cross-border trade of business services are still modest compared with trade in goods although increasing more rapidly. However, despite the remaining presence of barriers to trade in the business services sector, previous research points to factors that are encouraging the ‘internationalisation’ of business services. On a second key question – the extent and nature of remaining barriers to trade - the literature review highlights a number of constraints - legal, economic, administrative, intra-sectorial, socio-cultural and others. However, in terms of the quantification of the cost of barriers to trade in the business

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<sup>9</sup> The biggest problems identified by companies were unfair competition from public organisations, followed by grey economy (e.g. tax avoidance), subsidised competition from technical and commercial schools, complications with public procurement tendering procedures and difficulties with VAT accounting.

# BACKGROUND AND KEY ISSUES

## 2

services field, there is a notable lack of research material. Likewise, there is only patchy coverage in existing research of the extent to which remaining barriers to trade affect specific business service sectors.

### 2.3 Key Research Questions

Based on the Commission's terms of reference and review of previous research, it is possible to define a number of overall questions for investigation in the current study (it should be noted that more specific questions are listed at the beginning of each of the sections of the report containing the analysis).

*Figure 2.3: Key Questions*

*Question 1:* Although the Single European Market has removed many barriers to trade, are there are still significant constraints in the field of business services?

*Question 2:* What is the nature and extent of remaining barriers to trade in business services? Are they social or cultural and to be tackled by market developments and are there also legal and regulatory constraints? What is the nature of any remaining legal or regulatory constraints?

*Question 3:* To what extent do remaining barriers to trade affect particular countries or sectors or sizes of companies – for example, are smaller business service providers and users more adversely affected than larger companies?

*Question 4:* What is the cost of remaining barriers – both in terms of direct cost and also in terms of opportunity cost both for providers and purchasers?

The first of these questions stems from a widely-held view, supported by the literature review, that the Single European Market has had an uneven impact with trade in manufacturing being opened up more so far than trade in services. The second question raises a number of key issues – in particular, whether remaining barriers to trade in business services in the EU are of a regulatory nature (caused by lack of harmonisation or a situation where common standards are not being implemented) or more socio-cultural and/or related to market failures. As the previous section shows, existing research points to all of these as being possibilities. It is also pertinent to ask precisely how remaining barriers to trade affect business service providers, i.e. whether this is in terms of selling from the home base or seeking to set up a local operation in another EU Member State.

A third question is whether firms in some countries or sectors or size bands are more adversely affected than others. There is very little existing research on this and the previous question.

# BACKGROUND AND KEY ISSUES

## 2

The last of the above questions relates to the cost of remaining barriers to trade. Although there is some earlier research on this question, the findings are now very dated. There is an important distinction to be made here between direct costs and opportunity costs, and also between impacts on the input and output side of company operations. At an early stage in the study, it was agreed that the research should focus on examining company-level costs rather than seeking to quantify them at a macro-economic level.

### 2.4 Methodological Approach

The methodology devised for this study involved three main activities:

- Background research and a literature review to examine the background to the study and to help identify key issues.
- A postal survey, conducted on an EU-wide basis, of business service providers and users to obtain their view on the key issues, in particular the nature and extent of remaining barriers to trade. A total of 508 questionnaires were completed.
- Interviews with European federations, national authorities and representatives of the business service sectors in each EU Member State, together with case studies with a total of 12 business service providers to help obtain further insights to key issues. A total of 140 individuals were interviewed for this aspect of the research.

The results of the background research and literature review were set out in a Phase 1 report that was submitted to the Commission in March 2000. This report included a further developed methodological framework for the research, including a basic typology of barriers to trade. The Phase 2 survey work and interviews was undertaken by CSES over a period of some six months with an interim report being prepared in August 2000.

As part of the Phase 2 research, we carried out interviews with national officials, representatives of sector federations and other business bodies using a checklist of questions that had been agreed with the Commission. The purpose of these interviews was to obtain views on:

- Barriers to trade – at a general and sector specific level (most government officials focused on the former aspect);
- What sort of actions need to be taken to remove any remaining barriers to trade in business services;

# BACKGROUND AND KEY ISSUES

## 2

- Additional background information such as studies and survey work undertaken in particular EU Member States with a bearing on the key issues being addressed by the study.

The second aspect of the fieldwork involved a number of case studies with business service providers from eight EU Member States to investigate the nature and extent of barriers to trade, and the impact on companies, in more depth. Almost all the companies concerned had participated in the postal survey and all had indicated that they faced barriers to trade.

Table 2.1 summarises the scope of the Phase 2 fieldwork. Most of the interviews were carried out on a face-to-face basis. It should be noted that the details provided below relate to the number of individuals participating in the interview programme (in some cases the interviews took the form of a discussion with more than one person).

*Table 2.1: Interview Programme and Case Studies*

Countries	Interview Programme and Case Studies				Total
	Federations	Authorities	Other Interviews	Case Studies	
Austria	2	3	1	0	6
Belgium	3	1	0	1	5
Denmark	5	4	3	0	12
Germany	5	4	2	1	12
Spain	6	3	1	1	11
Finland	2	7	3	0	12
France	2	8	3	2	15
Ireland	2	3	3	1	9
Italy	4	2	3	0	9
Netherlands	4	2	0	1	7
Portugal	2	2	2	0	6
Sweden	7	6	5	2	20
United Kingdom	4	1	1	3	9
EU Level	7	0	0	0	7
TOTAL	55	46	27	12	140

In parallel with the Phase 2 fieldwork, a postal survey of business service providers and users was carried out. The purpose of the survey work was to obtain first-hand views on barriers to trade in business services from both the demand and supply perspectives. The approach that was adopted to carrying out the survey work is summarised below:

# BACKGROUND AND KEY ISSUES

## 2

- Draft questionnaires for business service providers and users were produced and piloted with 50 firms from two countries. A total of 15 business service providers and users returned questionnaires to CSES. After being revised and finalised, the questionnaires and a covering letter from the Commission were translated into 11 EU languages (see Appendices 2 and 3 for copies of the survey questionnaires).
- Using a sample provided by Dun & Bradstreet, the provider and user questionnaires were mailed to some 5,000 firms. Two follow up surveys followed. The first of these involved sending a second copy of the questionnaires to the organisations targeted in the first mailing that had not responded (focusing on the four countries identified as demonstrating relatively poor response rates). The second ‘top-up’ survey involved obtaining a fresh sample from Dun & Bradstreet of providers from business service sectors/countries where response rates at the interim stage of the survey were particularly low.
- Copies of the questionnaires were also distributed via a number of European federations to their members and placed on the CSES web site. The questionnaires were sent to named senior executives in companies, i.e. managing directors (for smaller firms) or the finance/marketing directors (larger firms) using the contact details provided by Dun & Bradstreet.

Two databases were set up for the storage and analysis of completed provider and user questionnaires. Completed questionnaires were processed by NOP and where appropriate translated into English. The data was then transferred to CSES for analysis using the two databases. As noted in the appendices, a number of checks were made by NOP, and independently by CSES, to ensure that the information contained in the questionnaires was correctly transcribed.

A total of 511 completed questionnaires were obtained from business service providers or users. After eliminating invalid responses (one questionnaire was returned by an organisation based in Norway and there were duplicates), this total was reduced to 508. An analysis of the sample is provided in Appendix 2.

# BUSINESS SERVICES MARKETS

# 3

## Overview

This section examines the structural characteristics of the internal market for business services. Key questions defined by the Commission that are examined in the research are summarised below:

<i>Key Questions - Structural Characteristics of the Internal Market for Business Services</i>
<ul style="list-style-type: none"> <li>• What is the structure of the market? How far does the market structure vary by the nature of the service? Can we talk of one market for business services or do we need to differentiate by sector, country size and/or maturity of companies?</li> <li>• What sort of competition exists in the business service market(s)? Do providers' views correspond with users' views? What are the relevant markets and the main factors driving competition? Do these factors depend on sector, country or company characteristics, etc?</li> <li>• What is the main motivation behind cross-border trade in business services? Are they common to all sectors, countries, operators (providers and users)? How much cross border trade exists?</li> <li>• What is the main mode for delivering services on a cross-border basis?</li> <li>• What has been the role played by the Single European Market so far in this respect?</li> <li>• Does the analysis lead to the conclusion that barriers to trade still prevail within the Single European Market?</li> </ul>

The analysis contained in this section draws on the result of the survey of business providers and users, the interviews with national authorities, federations and other business organisations, and the case studies. The appendices to this report contain all survey tables and other supporting material.

### 3.1 Structure of the Business Services Market

What is the structure of the market? How far does the market structure vary by the nature of the service? Can we talk of one market for business services or do we need to differentiate by sector, country, and the size and/or maturity of companies?

The current study, and previous research, suggests that whilst the business services sector is growing rapidly throughout the EU, the structure and maturity of markets are far from homogeneous:

- The size of the business service sector in relation to the overall economy, and structure of the sector in terms of different types of activities, varies considerably from one EU Member State to another as does the extent to which growth is being driven by the same factors;

# BUSINESS SERVICES MARKETS

# 3

- Whereas the market for some types of business services is becoming ‘Europeanised’ or more generally internationalised, most provision remains essentially domestic with relatively little cross-border trade in some sectors and countries. The reasons for this are in many cases specific to the nature of the service, but in other cases more related to the existence of barriers to trade, market conditions and other factors such as corporate and industry structures;
- Likewise, whereas domestic markets and sectors tend to be dominated by relatively small business service providers serving mainly local and regional markets, these firms coexist alongside major multinational undertakings with very different ‘business models’ operating in international markets.

In the previous section, we reviewed data on the size and economic importance of the EU’s business service sector. It will be recalled that with the exception of Finland, in all other Member States business services account for over 5% of all jobs whilst in four countries - Denmark, Netherlands, Spain and the UK, the figure exceeds 10%. Whereas some countries have a very advanced business services sector, others are only recently experiencing growth in this field.

### *Factors Influencing Growth and ‘Europeanisation’ of the Business Services Sector*

Although there is relatively little research specifically on cross-border trade, factors influencing the growth of domestic business services markets have been researched in detail before.<sup>10</sup> A major driver for growth is the trend towards outsourcing. This is a comparatively recent phenomenon in some countries such as Denmark, Germany, Italy, Spain and Portugal where companies have tended to retain control and responsibility for non-core activities in-house, but is a more established practice in other countries with more developed business services markets.

The later development of the business services sector in Italy, for example, is reflected in the size and composition of business services companies which are predominantly SME-based. A consequence of this is that few firms are seen as having the necessary size and resources to compete beyond the domestic market. In Italy there are also regulations governing the legal structure of business services firms in certain professions such as lawyers and engineers which have influenced the development of the sector and its ‘Europeanisation’. In Germany, different factors explain the relatively late development of business services and the fragmented nature of domestic market structures: here, manufacturing companies have traditionally used in-house service provision to meet their

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<sup>10</sup> See for example Rubalcaba-Bermejo, ‘Business Services in European Industry’ (European Commission, 1999) reviewed earlier.

# BUSINESS SERVICES MARKETS

# 3

needs. According to the German employers' federation, this is now changing with a growing emphasis on outsourcing, but the legacy is that of a relatively under-developed business services sector that is not, in many sectors, well placed to compete internationally. In contrast, in the UK the business services sector has expanded rapidly, encouraged by public policies on deregulation and outsourcing, leading to large companies in some sectors such as Financial and Business Services, IT Consultancy, and Leasing & Renting with a strong position in domestic and international markets.

From the point of view of this study, the key issue is the extent to which the factors driving demand for business services are leading to an increase in cross-border trade with the most competitive providers being sought out irrespective of their location. Similarly, from a supply-side perspective, the question is whether corporate structures are emerging that make it possible to maximise economies of scale and to deliver business services on a cross-border basis cost-effectively and efficiently. Existing research<sup>11</sup>, and the results of this study (considered in more detail in Section 3.3) suggest that the level of cross-border trade remains relatively modest.<sup>12</sup> Despite the rapid growth of the EU's business services sector, the relatively modest levels of cross-border trade and corporate and industry structures mean that it is not possible to speak of one market.

## *Market Structures and 'Business Models – Sectoral Perspectives*

We now consider some of the sectoral differences in markets and the way in which the structure of companies are driven by the nature of the service provided. It is important to start by considering the structure of the market from the point of view of the different business models operating in different business service sectors. The research suggests that there are three basic business models common to many sectors:

- *Large multinationals* - these operate on a world-wide basis offering international clients a broad portfolio of services. In practice, depending on the sector, such companies may adopt a unitary structure, with a single company operating in different national markets, or a devolved structure with separate operations supplying services to their national markets, albeit under a common brand name;

<sup>11</sup> Although there are estimates of the extent of cross-border trade in business services at a macro-economic level (see Section 2 literature review), the type of available data does not provide a detailed insight to the extent to which EU-wide markets have developed in particular business service sectors or why there might be differences in this respect between one sector and another. Section 3 of this report helps to fill this gap.

<sup>12</sup> The survey work carried out as part of this research suggests that 29% of users and 53% of providers were purchasing/delivering business services on a cross-border basis at the time of the research. In both cases, the value of cross-border trade was, however, very modest compared with the value of transactions in domestic markets.

# BUSINESS SERVICES MARKETS

# 3

- *Niche companies* – these provide specialist services, rather than a broad portfolio, but also generally have an international client base. Because of the specialist nature of their services, expansion into export markets is necessary to generate sufficient demand. Some specialist providers have a physical presence in other markets but more often than not, services are delivered from the home base or through arrangements with other providers.
- *Small local business service firms* – these focus on regional if not local markets and often have neither the resources nor the inclination to engage in cross-border trade.

There are of course variations in the extent to which these different models characterise different business service sectors and markets.

**IT Consultancy:** The IT Consultancy sector illustrates this market segmentation particularly clearly. Here, the international market tends to be dominated by a small number of large firms operating world-wide and providing integrated solutions for major international companies and for the public sector. Within Europe such firms include companies such as Cap Gemini and Logica and system suppliers such as Software AG and Baan. These large international firms operate as a single entity with offices throughout Europe, and tend to use international multi-disciplinary teams to carry out projects. But at the same time, niche suppliers also have a strong position in the market. Niche suppliers also tend to operate on an international basis although where systems are being provided that relate to particular aspects of national regulations (e.g. aspects of payrolls systems) the market may be more nationally-orientated. Smaller IT consultancies generally operate on a purely national or local basis, either implementing systems supplied by larger firms or providing some systems or advisory support themselves.

**Personnel Recruitment:** Similar market structures and business models exist in this sector. Here, there are also a number of large multinational recruitment firms or specialist executive search companies. Internationally, the major companies tend to focus on the recruitment of senior executives, providing international clients with a single quality of service throughout the world to harness international brand potential. Cross-border recruitment is predominantly at senior or executive level and is used when applicants with the necessary skill set demanded by the client cannot be found locally. International Personnel Recruitment companies make use of international networks of affiliated partners or sister companies to find suitable candidates. Another group of personnel companies will supply contract workers on an international basis. Many medium-sized personnel recruitment firms also operate on an international or pan-European basis, but insofar as there is a focus on temporary and general recruitment market, there is a need to service clients on a localised basis. Interestingly, in many border regions there is an increasing level of cross-border recruitment activity at all levels of personnel. This is a

# BUSINESS SERVICES MARKETS

# 3

consequence of geographic proximity and the free movement of labour but the level of activity remains relatively small in percentage terms. Niche players also operate in this market, for example in the building trade, where recruitment firms will often be based in one country with lower labour costs but will supply workers on a short-term basis to other parts of the EU.

**Leasing and Renting:** In the leasing and renting sector, the market is characterised by very different structures for finance leasing and operational leasing. Finance leasing is dominated by financial institutions including banks and some specialist companies whereas operational leasing is increasingly dominated by specialist leasing companies, such as GE Capital. But this trend is not universal and in some EU Member States – Finland being a good example - the market has tended to be dominated by the subsidiaries of banking groups. There is, however, a general trend towards operational leasing rather than finance leasing, which favours operators that have the ability to package a number of different services together for clients. Accordingly, there is a trend among operational lessors to concentrate on particular areas of operation or products. This means that some operators in this field can be very small. In the sector as a whole, there are a wide variety of companies - some are international groups or franchises, such as car hire companies, but most equipment rental organisations focus on local markets. To the extent that the market is dominated by direct tax considerations, there is an incentive to companies to adopt a national structure. In specific sub sectors, as will be discussed later; regulation also implies a national structure.

**Accountancy, Audit and Tax Services:** The nature of the service offered in this sector relates to the operation of national company law and taxation, even though many clients will operate on an international basis. Accordingly, the typical model in the accountancy and audit sector consists of a series of local partnerships. These may either be part of an international grouping with the same name and an agreement to adopt the same standards and working procedures across different national markets. Typically, these groupings will be organised by means of an international organisation responsible for quality of service and for developing the network. But in this model, the local firms will retain their own profits and ultimately their own independence to leave the grouping if they so wish (as, for example, some ‘Big 5’ local firms have done at the time of mergers). A second model involves networks consisting of a number of similar firms in different countries, all with expertise in their own countries. Under this model firms will refer cross-border work to each other. Typically, the firm referring work to a firm in another country will receive a commission of a few percentage points of the fee. This model is relatively easy to set up and does not require substantial investment. It provides a vehicle for providing cross border services without trading outside the home base. Last but not least, there are many local firms of accountants who focus purely on local markets.

# BUSINESS SERVICES MARKETS

# 3

**Contract R & D and Technical Testing:** The contract research market is characterised by three principal types of organisations - independent Contract Research Organisations (CROs), Universities and Government Laboratories. The market for these organisations is composed of any institution that funds contract research and development, such as major companies, Governments, the military, trade associations etc.<sup>13</sup>. With reference to the CROs (increasingly referred to as RTOs – Research and Technology Organisations), it is possible to distinguish between two types - the large RTO's, which have considerable resources and work increasingly internationally (Frauenhofer, TNO, and PERA, etc) and smaller organisations which mainly serve the local market and do little work in other EU Member States. Globalisation of trade, resulting in an erosion of the idea of 'home' markets, the need for new products, processes and services to compete internationally, shortening "time to market", the levels of specialised knowledge increasingly required, privatisation of public research institutions, and consumer demand for better product quality, improved safety and health, environmental protection and sustainable development, are amongst the factors driving developments in the Contract R & D and Technical Testing sectors

However, the Contract R&D sector and especially the Technical Testing market is still largely structured on a national basis. The extent to which technical testing houses and conformity assessment bodies within Europe are open to competition within their own country varies greatly. Some markets, such as Sweden, have been fully open and deregulated for the past 10 years. Others, such as Germany and France, are still regulated, government-owned and have a testing monopoly in their own countries. Testing houses in countries which do not have an open market with private domestic and non-domestic companies competing can compete for business in EU countries where the market has already been deregulated, but trade is not reciprocated. For example, since 1992/93, Sweden has had an open system for conformity assessment, (illustrated by the fact that many former state-owned testing houses are now subsidiaries of foreign companies). As long as a company can prove its competence, it is free to conduct testing in Sweden. However, the UK, Finland and France do not have a true internal market in the field of technical testing. Instead, they have a mixture of open bodies and monopolies. Apart from Sweden, the Netherlands and (outside the EU) Switzerland have the most open systems.

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<sup>13</sup> The precise size of the contract R&D market in Europe is difficult to establish due to incomplete data. A Frost and Sullivan 1996 report on the sector calculated the total market size at \$16.69 billion in 1993 (this figure does not however include the Austria, Greece and the Republic of Ireland, for which date was not available). It is difficult to say what today's market size is – the combined turnover of the members of the main representative European body EARTO (European Association of Research & Technology Organisations) alone is Euro 5 billion. Approx. 90% of the market is accounted for by contract research undertaken for industrial companies and government.

# BUSINESS SERVICES MARKETS

# 3

**Engineering Related Consultancy:** The nature of the service offered is international but subject to local regulation. In this sector, there are some multinationals but, apart from individual consultants, specialist medium-sized providers tend to be more significant players than in the other sectors covered by this research. Also, compared with other business service sectors, in many EU Member States the market for Engineering-Related consultancy has been very sluggish, if not in decline. In Germany, for example, the domestic market for engineering-related consultancy projects has been in long-term decline. Interviews with the national federation, and case study feedback, indicates that whilst reunification temporarily reversed this trend, companies are now again finding it difficult to find project opportunities. This, in turn, is encouraging them to look further afield. Discussions with national federations in several countries suggests that with the exception of southern Europe, engineering related consultancy firms are now having to look outside the EU – to Central and Eastern Europe and particularly the Far East – to find business.

Overall, then, it can be concluded that the structure of the business services market – and the organisational arrangements that firms have adopted to serve the market – varies considerably depending on the sector and the nature of the services being offered. There is little existing evidence of a single market for business services, whether viewed from a global or sector-specific point of view and, as noted earlier, cross-border trade within the EU is still limited. This section highlights the importance of the nature of business service firms themselves – the different ‘business models’ - and shows how company characteristics such as size and maturity have an important bearing on the emergence of pan-European industry structures and markets.

The general impression we obtained from the fieldwork is that there are few initiatives to gather and/or compare information on the size, functioning and competitiveness of national business service markets. Many government officials we interviewed confirmed this. Although there have been surveys in Scandinavia and some other EU Member States, and the French government has recently started researching the business service sector, as the literature review in Section 2 makes clear, in most countries there is little research activity. Similarly, most of the monitoring information compiled under the Internal Market reporting requirements is heavily biased towards manufacturing and production-related sectors and not business services. Some government officials we consulted also doubted that they were receiving comprehensive feedback from local business services companies regarding how they were faring in other EU markets and the obstacles they might be encountering.

## 3.2 Competition in Business Services Markets

# BUSINESS SERVICES MARKETS

# 3

What sort of competition exists in the business service market(s)? Do providers' views correspond with users' views? What are the relevant markets and the main factors driving competition? Do these factors depend on sector, country or company characteristics, etc?

In the previous section, we considered the structure of business service sectors and provided an overview of the markets. Below, we further develop the analysis by examining the nature of competition in different business service markets and factors driving it from a demand and supply-side perspective. It is helpful in this respect to distinguish between domestic and export markets.

## *Domestic Markets for Business Services*

Starting with the survey evidence, Table 3.1 summarises the survey feedback from business service providers on the competitiveness of their domestic markets:

*Table 3.1: Competitiveness of Domestic Business Service Markets*

<b>Provider Views</b>	<b>No.</b>	<b>%</b>
1. Not very competitive – one or two firms dominate the market	21	6.8
2. Quite competitive – there is fair competition but not very intense	73	23.8
3. Very competitive – many firms have entered/may enter the market	210	68.4
Non responses	3	1.0
<b>TOTAL</b>	<b>307</b>	<b>100.0</b>

*Source: CSES Analysis of survey data.*

The survey findings also suggest that:

- Whereas domestic markets for IT Consultancy, Personnel Recruitment, Leasing and Renting, and Engineering Related Consultancy all tend to be regarded as 'very competitive', this is less so with the other sectors covered by the study;
- Although not clear-cut, the survey suggests that larger business service providers tend to regard their domestic markets as more competitive than smaller providers;
- Just under half (46.6%) the business service providers stated that most or all of their competitors are domestic although a significant proportion of firms (25.4%) indicated that competitors also came from EU and non-EU sources.

Below, we consider these and other research findings on the competitiveness of business service markets, in more detail. Perhaps not surprisingly, we found that business service providers and (to a lesser extent) users – rather than national authorities – had the most

# BUSINESS SERVICES MARKETS

# 3

detailed insights into the extent and nature of competition in their domestic and export markets (possible explanations for this are examined later).

The research suggests that there are a number of factors influencing the competitiveness of business service markets. The structure of different business services sectors is perhaps the most obvious factor but discussions with national sector representatives suggest that other factors are also important. These factors include the extent of regulation, market conditions and the extent of publicly owned or subsidised competition.

As noted above, the survey results suggest that whereas domestic markets for IT Consultancy, Personnel Recruitment, Leasing and Renting, and Engineering Related Consultancy tend to be regarded as very competitive, this is less so with the other sectors covered by the study.

The case study research and discussions with national sector organisations provided more detailed insights to the competitiveness of different markets and sectors. In the case of IT Consultancy, this feedback confirmed that domestic markets are already internationalised. Discussions with several firms indicated that whilst profit margins and value-added in the IT industry is relatively high compared with other business services, (since IT consultancy skills are in such high demand yet short supply), the industry is extremely fast-changing and competitive. Likewise, the main factors driving competition within the IT industry are seen as being globalisation and the need to homogenise IT systems on a pan-European and global basis in order to enable international companies to centralise their core functions and benefit from global economies of scale. One example, from a case study with a Swedish IT Consultancy firm illustrates this. The company concerned is operating in 13 European countries and regards the European market as very competitive indeed. However, given the shortage of suitably qualified personnel, profit margins remain high and price competition, whilst intense, has not experienced significant erosion.

Whilst the level of cross-border trade is less than in the IT Consultancy industry, which is the most global of the business services sectors covered by the study, the research suggests that the Personnel Recruitment sector is now also largely internationalised and highly competitive. The competitiveness of this industry is demonstrated by the fact that outside the Scandinavian markets, which are small in comparison with the main European markets such as the UK, Germany, France and the Netherlands, no one company has a market share in excess of 8%. Likewise, as pointed out in several interviews, at a European level the market is now very competitive with many firms competing for market share rather than several firms dominating the top end of the market.

The survey highlighted Leasing & Renting as another sector where domestic markets are relatively 'Europeanised'. But interviews with federations and the case studies suggested

# BUSINESS SERVICES MARKETS

# 3

a more mixed situation. This research suggests that there is a now great deal of price and innovation-led competition between the leading international players. However, despite some pan-European presence, the rental market is predominantly domestic-orientated since restrictive regulations on cross-border rentals have greatly restricted the level of cross-border activity. The degree of competitiveness of small, niche operators in the domestic market depends on the level of local competition, which varies from country to country across the EU.

In the case of the Engineering Related Consultancy sector, feedback from the interviews and case studies confirms the survey findings suggesting that domestic markets are becoming increasingly internationalised and price-competitive. Amongst the top 50 companies, there has been an intensive period of consolidation over the last 10 years. The extent to which a national market is competitive, however, is dependent on a number of factors including the degree to which other domestic and foreign competitors are seeking to gain market share and the type of pay structure agreed by the engineering industry on a national level. For example, the fixed scale system, a public procurement payments system, (used by a number of European countries) which guarantees engineering contractors a set amount per day irrespective of the type of project, was considered by some companies and federations we spoke to as reducing competition. This was because companies can only compete for tenders on the quality and reputation of their work alone rather than on price. Denmark has recently abandoned the fixed scale payments system with the result that public procurements contracts are now more price-competitive – the overall result has been increased competition within the domestic Danish engineering consultancy industry with profit margins down from 10-12% 10 years ago to 5% today. The low profit margin in Denmark is one reason why the domestic Danish market is dominated by domestic players rather than by new foreign entrants. In Germany and Ireland, conversely, where the fixed pay scale is still used for public procurement projects, profit margins are higher, therefore there are more foreign entrants competing in the market. A distinction has to be made therefore, between price competition and quality-led competition within the engineering consultancy industry.

Amongst the business service sectors where, according to the survey work, domestic markets are less competitive, feedback from a UK Technical Testing company provided especially useful insights into the factors encouraging – but also limiting – the ‘Europeanisation’ of markets. This firm has adopted an acquisition-led European expansion strategy in order to grow since the domestic market is extremely price-competitive and is seen as experiencing some signs of saturation (there was similar feedback from several Engineering Related Consultancy firms). The company believes that there are greater cross-border opportunities to expand its sales than in the domestic market. However, it is only with the opening up of the technical testing market in EU countries – many establishments were previously run by state-owned monopolies - that

# BUSINESS SERVICES MARKETS

# 3

there has been increased competition. This is, we were told in the interviews, leading to consolidation within the industry at a European level. For example, in Sweden several foreign entrants have taken over previously domestic-owned technical testing houses.

In the Accountancy and Audit industry, the case study feedback and discussions with national federations also pointed to a more complex situation than suggested by the survey results. The domestic market in most EU countries is segmented by type and size of firm: while the largest accountancy firms are competing for international clients (often at higher fee levels), clients not requiring such international expertise will use local firms. Thus, although there are a number of firms competing on an international basis under a common brand, notably the ‘Big 5’ accountancy and audit firms, the European accountancy industry as a whole still tends to be highly localised with many firms operating in each country.

Although not clear-cut, the survey results suggest – as might be expected - that larger business service providers tend to regard their domestic markets as more competitive than smaller providers.<sup>14</sup> This is not surprising and largely explained by a further finding, namely that the smaller the business service provider, the more likely it is that competition in domestic markets will come primarily from other local firms. Conversely, larger providers tend to compete more with rivals from other EU Member States or from outside the EU in their domestic markets.

From a national perspective, the survey data suggests that:

- In smaller EU Member States, competition tends to come primarily from other domestic companies, rather than from companies based in other EU Member States or outside the EU. Amongst these countries, Ireland and Luxembourg are obvious exceptions with heavily internationalised domestic markets in the business services fields.
- Amongst the larger EU Member States, there is less evidence of a clear pattern – the survey results suggest that the domestic markets of Germany, Italy and Spain are more Europeanised than those of France and the UK. However, in the latter cases it is possible that the presence of multinationals may result in the distinction between domestic/non-domestic competition being blurred.

National authorities we spoke to all emphasised the openness of their domestic business service markets to competition from companies based in other EU Member States. It was

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<sup>14</sup> Thus, whereas 57% of smaller providers employing between 10 and 100 people stated that their domestic markets are very competitive, the corresponding figure for large firms with over 1,000 employees was 83% (see Appendix 4).

# BUSINESS SERVICES MARKETS

# 3

argued that where restrictions exist (e.g. with regard to local registration requirements), these arrangements applied equally to domestic and non-domestic companies (see Section 5). National federations we spoke to adopted a broadly similar position.

For example, the German engineering consulting federation (VDI) argued that their domestic market is very open to consulting engineers from other EU Member States. They did, however, acknowledge that there can be difficulties in setting up a company in Germany and that taking over an existing domestic undertaking was therefore the preferred option. Likewise, to take another example, the Finnish Leasing and Rental market is seen by the national authorities and federation as being very open to competition from firms based elsewhere in the EU with the number of foreign entrants during the 1990's having grown rapidly (e.g. GE Capital, Leaseplan, etc.). Similarly, in Sweden, SWEDAC, the national accreditation and technical testing federation, argued that the Swedish market was extremely open to competition. This, it was argued, is demonstrated by the fact that since Sweden opened up the market to foreign competition through deregulation approximately 10 years ago, a number of foreign entrants (notably UK, Finnish and Norwegian) have bought out formerly state-owned Swedish testing companies. Likewise, the Italian Engineering and Technical Consultancy Association, OICI (Associazione delle Organizzazioni de Ingegnerie e di Consulenza Tecnica) also made the case that the Italian market was very open to foreign competition from within the EU. The fact that a number of large foreign firms (notably French) have been involved in large-scale construction projects such as the Rome Underground and other large public works projects is seen as an indication of Italy's commitment to the principles of the Single Market.

In general, we found that associations – like the national authorities - all considered their domestic markets to be open to competition from non-domestic providers, irrespective of the sector. However, as will be demonstrated later in this report, this view conflicts with other evidence from the research.

### *Competitiveness of Export Markets Compared with Domestic Markets*

Turning to export markets, in the survey, business service providers were asked to compare the competitiveness of their domestic markets with markets in other EU Member States. Table 3.2 summarises the results.

# BUSINESS SERVICES MARKETS

# 3

*Table 3.2: Comparison Between Competitiveness of Domestic/Other EU Markets*

<b>Export Markets are:</b>	<b>No.</b>	<b>%</b>
Less competitive	29	9.5
Similar competitiveness	114	37.1
More competitive	34	11.1
Don't know or non-response	130	42.3
<b>TOTAL</b>	<b>307</b>	<b>100.0</b>

*Source: CSES Analysis of survey data.*

As can be seen, the overwhelming view was that competitive conditions are broadly similar across different EU markets. But amongst the remaining firms, export markets were seen as more competitive than domestic ones.<sup>15</sup> Further analysis of the survey data suggests that:

- There are quite pronounced differences between the different business service sectors on the question of export market competitiveness.
- There is quite a close correlation between the survey responses shown above and those analysed earlier concerning the competitiveness of domestic markets. More specifically – and perhaps not surprisingly - in countries where domestic business service markets are generally perceived as being characterised by relatively low levels of competition, a comparatively high proportion of providers stated that export markets are more competitive (and visa-versa).
- From the perspective of firm size, the earlier conclusion concerning the competitiveness of domestic markets would also appear to hold true for export markets, i.e. smaller business service providers tend to regard their markets as less competitive than larger providers.

Taking the first of these points, the survey findings – and other research - on export market competitiveness generally, reflect the findings discussed earlier, i.e. the patterns detected in relation to the competitiveness of domestic business service markets are reflected in the findings for export markets. Thus, in sectors such as Contract R&D, Accountancy and Audit, and Technical Testing where a high proportion of respondents stated that their domestic markets are characterised by relatively low levels of competition, a relatively high proportion of firms stated that export markets were more competitive.

<sup>15</sup> In the case of the firms (42.3% of the total) indicating that they were not in a position to judge, most were not exporting services.

# BUSINESS SERVICES MARKETS

# 3

Likewise, from the perspective of different EU Member States, there is also quite a close correlation between the survey findings concerning the competitiveness of domestic and export markets. More specifically, in countries where domestic business service markets are generally perceived as being characterised by relatively low levels of competition, a comparatively high proportion of providers stated that export markets are more competitive (and visa-versa). Whereas the national authorities we spoke to generally expressed views regarding the competitiveness of domestic business service markets, we found that most did not feel able to comment on markets elsewhere in the EU. In some cases, however, they did offer opinions based on the complaints monitored by Single Market units in their administrations relating to other EU markets (see Section 5). Likewise, from the perspective of firm size, the earlier conclusion concerning the competitiveness of domestic markets would also appear to hold true for export markets, i.e. smaller business service providers tend to regard their export markets as less competitive than larger providers.<sup>16</sup>

Price differentials are also, of course, another indicator of export market competitiveness. On the question of price differentials, the survey indicates that views are more or less evenly divided between those business service providers stating that prices were higher in their home markets than in markets elsewhere in the EU, and those expressing the opposite view. A significant proportion indicated, however, that there are no differences in price levels.

The survey results, but more especially the feedback from the interviews with national federations and case study companies, emphasised an important factor that helps to explain the perceptions of domestic/export market competitiveness: whilst, as noted earlier, the EU's business services sector is generally experiencing high levels of growth in domestic markets, this does not apply in the case of all sub-sectors or countries. The best example in this respect is the Engineering Related Consultancy industry. Discussions with the national federations and several companies confirmed that in countries such as Germany and the UK, the reducing levels of public expenditure on large-scale infrastructure projects means that companies are competing in shrinking domestic markets. Because competition is intense, companies are increasingly looking to export markets as an alternative since the perception is that these are less competitive. In the case of one German Engineering Related Consultancy firm we interviewed, the point was made that although there are export opportunities in southern European countries, they are now having to look even further afield – to Central and Eastern Europe and the Far East – for business.

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<sup>16</sup> Thus whereas 20% of firms employing less than 10 people stated that export markets are less competitive than domestic markets, the corresponding figure for large firms with over 1,000 employees is 10%.

# BUSINESS SERVICES MARKETS

# 3

## 3.3 Factors Driving Cross-Border Trade in Business Services

What is the main motivation behind cross-border trade in business services? What is the extent of cross-border trade in EU markets? Are the factors driving cross border trade common to all sectors, countries, operators (providers and users)?

It will be recalled that existing research sheds relatively little light on the extent of cross-border trade in business services, except at a global level (see Section 2 literature review).<sup>17</sup> And yet, the level of cross-border trade is perhaps the clearest indicator of the extent to which business services are benefiting from the Internal Market. In this section, we consider the feedback from the survey work and interviews that sheds light on this question and the factors that drive cross-border trade.

### *Level of Cross Border Trade*

Turning to the survey work first, we asked firms to indicate the extent to which they were involved in cross-border activities. Table 3.3 provides an analysis the responses.

*Table 3.3: Extent of Involvement in Cross Border Trade*

Response	No	%
1. We have never tried to sell services to client in other EU countries	71	23.1
2. We considered selling services in other EU countries but did not go ahead	21	6.8
3. We have sold services to clients in other EU countries but are not doing so now	21	6.8
4. We have sold services to clients in other EU countries and continue to do so	165	53.7
5. Non responses	29	9.4
TOTAL	307	100.0

*Source: CSES analysis of survey data*

As can be seen, just over half the sample of business service providers (53.7%) were currently engaged in cross-border trade within the EU at the time of the survey. Further analysis of the survey data indicates that:

- Perhaps not surprisingly, larger business service providers are more likely to be engaged in cross-border trade than smaller companies;

<sup>17</sup> Rubalcaba-Bermejo (96:1999), for example, suggests that the level of cross-border trade in business services in the classical sense i.e. selling services from the home base is relatively low. Nevertheless, it is noted that 'it would not be surprising if the volume of transactions in statistical form were to underestimate real transactions in business services.' However, Eurostat data quoted by Rubalcaba-Bermejo suggests that the business services sector is 'internationalising' relatively quickly, with an annual growth rate in the exporting of services of 8.7% and an annual increase in the import of services within the EU of 10.2%.

# BUSINESS SERVICES MARKETS

# 3

- There are significant variations in the extent of cross-border trade according to sectoral characteristics and the country where the company's home base is located;
- In most cases (47.3%), the value of their sales to other EU Member States accounts for a modest proportion - between 1% to 10% - of overall turnover. As might be expected, the proportion of firms indicating that the proportion of turnover generated from exports was higher than this declines steadily.

Taking the first of these points, from the perspective of company size an analysis of the survey data shows that there are marked differences in the level of cross-border activity between large and small business services providers, with larger companies considerably more likely to be engaged in cross-border activity than their smaller counterparts in the same sectors.<sup>18</sup> As was made clear in the case studies and other interviews, these survey findings can be attributed to the fact that smaller business services companies tend to sell services to clients with whom they foster a close relationship on a localised basis. Smaller companies generally have neither the critical mass nor the necessary staff resources to explore and subsequently exploit new markets.

The research in Italy illustrates this situation particularly well: here, professionals in the Engineering-Related Consultancy field, for example, operate on a self-employed basis and are not permitted, under Italian law, to form companies. This, we were told in interviews with the national federation, in turn means that operators are not as well-placed to compete in other EU markets for larger contracts where scale is an important factor. Although specific legal constraints affect consulting engineers (and lawyers), the fact that the Italian business services sector is dominated by SMEs was seen by those we spoke to as an important factor explaining why the level of exporting is relatively low. Similarly, this and other research suggests that the age of companies is an additional factor determining the likelihood of a business services firm to seek cross-border work. Well-established companies are more likely to look for business beyond the domestic market because they will have acquired greater management expertise and are better able to analyse the risk/reward ratio than younger companies.

Whilst the survey data provides a useful starting point to the analysis, the limited size of the sample means that the extent of cross-border trade cannot be reliably gauged for some sectors. Alternative sources include national federations. Even here, however, the quality of information available from the federations on the level of cross-border trade in their

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<sup>18</sup> Taking the category of SMEs (1-250 employees) as a whole, a total of 96 providers (46.4% of the total classified as SMEs) indicated that they were currently selling services to clients located in other EU Member States. This compares with 69 (69.0%) of the 307 business service providers classified as large companies.

# BUSINESS SERVICES MARKETS

# 3

sectors is very mixed. The best information came from the engineering-related consultancy sector:

- According to the German engineering related consultancy federation (VDI), only 5% of its 2,800 members are doing business outside Germany.
- Feedback from OICE, the Italian engineering consulting association indicates that, of 300 members in Italy, only 30 or so work cross-border within the EU (another 70 work on EU-funded external aid projects).
- Likewise, in Spain, according to the national federation (ASINCE), exports account for only 12% of the total turnover of its members, with the corresponding figure for TECNIBERIA (the civil engineering association) being 15% (7,500 million pesetas). Some 55% of ASINCE members' exports go to European markets, with 22% to South American markets. No information seems to be available regarding the most important EU national markets but it was thought that the largest might be the UK.
- In Denmark, research undertaken by the Danish Engineering Federation over the past 5 years found that only 2% of EU public procurement projects in the engineering sector were awarded cross-border.

We were unable to obtain comparable data of this type on cross-border trade for other sectors covered by the research, in most cases because it is simply not available at a sectoral level from national federations or from the authorities.

Where available, the information was more of an anecdotal nature rather than being based on detailed statistics. In Portugal, for example, it is estimated that there are some 1,200 companies in the information technology consulting sector of which only 30 are said, according to the ICEP (the trade body), to be active in international markets. A further common feature of the information obtained from national sources is that it does not differentiate between different business service sectors. Thus, in Finland, the Finnish Confederation of Industry estimates that last year total exports from Finland accounted for €39 billion, with services accounting for only €2.8 billion of this amount. However, no data was available specifically on the business services covered by this study except accountancy and audit and 'business management services'. Likewise in France, the 'Centres Techniques de l'Innovations' in the Contract R&D field are thought to on average generate 5-6% of their revenues from activities outside the country but there appears to be no precise data on how this splits between EU and other markets.<sup>19</sup>

<sup>19</sup> It is worth pointing out that whilst the level of cross-border trade in the classical sense (i.e. selling from the home base) remains relatively slow, an increasing number of European business services firms are

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# BUSINESS SERVICES MARKETS

# 3

From a country perspective, the survey feedback (although not clear-cut) suggests that in smaller countries – Belgium, Denmark, Ireland, and Sweden – a relatively high proportion of business service providers are presently selling services from their home base to clients in other EU Member States. The explanation for this could be that because of the comparatively small size of their domestic markets, exporting is an obvious way of generating new business. Conversely, several larger EU Member States – Germany and Italy in particular – rank towards the bottom of the table. The survey feedback on the extent of cross-border trade is supported, albeit with patchy coverage, by information gained from a number of national federations and other business organisations during the course of the fieldwork.

We now consider some of the factors driving cross-border trade at the business services level in more detail. It is helpful in this respect to distinguish between demand and supply side perspectives.

## *Demand Side Perspective*

For an insight into demand-side factors influencing cross-border trade in business services, we have relied mainly on feedback from the user survey although national federations also expressed some views on this question (no case studies were undertaken with users). The survey feedback suggests that:

- The criteria applied by business service users to identify and select suppliers tend to focus on quality and expertise rather than physical proximity;
- The analysis suggests that, overall, domestic business service providers are not seen as having a clear advantage over those from other EU Member States in terms of price, the range of services offered, or quality;
- Even so, the overwhelming majority of firms purchase business services from domestic rather than other EU sources – this applies across the full range of services.

Taking the first point, the survey of business users suggests that quality; expertise and confidence in the capacity of the provider to deliver the services in question are the main factors determining the choice of a business service supplier. Feedback from users on the relative importance of these factors in selecting a supplier is summarised below:

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active in cross-border work through foreign branches and local partnerships or acquisitions, particularly in the more economically advanced Member States such as the UK, France, Germany and Scandinavia, where the market is less fragmented than in other EU countries. Any analysis of the extent of cross-border trade is thus likely to considerably under-estimate the actual extent of cross-border trade in business services if selling via local operations is taken into account.

# BUSINESS SERVICES MARKETS

# 3

*Table 3.4: Factors Influencing Selection of Business Service Providers*

Selection Criteria	'Very Important'	
	No	%
(1) Quality of service being offered	157	79.3
(2) Expertise of the provider	121	61.1
(3) Local presence of the provider	35	17.7
(4) Confidence in capacity of provider to deliver	114	57.6
(5) Quality standards applied by the provider	94	47.5
(6) Price of services being offered	90	45.4

*Source: CSES Analysis of survey data.*

Further analysis of the survey feedback from business service users suggests that there is no significant difference in the main criteria used to evaluate the merits of domestic as opposed to other EU providers. In both cases, the factors ranked highest are seen as more important than price. Moreover, the research suggests that domestic business service providers are not seen as having a clear advantage over those from other EU Member States in terms of these key selection criteria.<sup>20</sup>

Nevertheless, relatively few companies purchase business services on a cross-border basis: analysis of the survey data suggests that from the sample of 198 firms that made an input to the research, only 58 (29%) had done so. Likewise, even in cases where business services had been bought from non-domestic sources, the level of purchases from other EU Member States accounted for a relatively small proportion of total expenditure on business services for most firms. According to the survey, firms that were able to provide information were generally spending less than 5% of their expenditure on business services generally on suppliers located in other EU Member States. This is shown in Table 3.5.<sup>21</sup>

*Table 3.5: Proportion of Expenditure on Non Domestic Business Services*

<sup>20</sup> These findings should, however, be treated with some caution. In particular, the fact that some companies from the sample had not used services from abroad could be interpreted as meaning that they do not consider them competitive on these key factors. If this interpretation is accepted as valid, then the proportion of companies considering that domestic suppliers compare more favourably than suppliers from other countries would be higher.

<sup>21</sup> As Table 3.5 shows, there were a large number of 'don't knows' and non-responses to this question. This does not of course mean that the companies concerned had not purchased business services from another EU country. It could simply be that the extent of such activities cannot be precisely quantified.

# BUSINESS SERVICES MARKETS

## 3

Proportion of Total Expenditure	Number of Users	
	No	%
Nil	17	8.6
Less than 5%	34	17.2
5% to 10%	8	4.0
10% to 20%	14	7.1
Over 20%	2	1.0
Don't know or no response	123	62.1
TOTAL	198	100.0

*Source: CSES Analysis of survey data*

From a user perspective, a particularly relevant consideration here is whether the level of purchasing of business services from other EU sources is related to firm size. It might be expected that larger companies, because they usually have the expertise and easier access to information, will be more inclined to select suppliers from other countries than smaller firms. The survey data suggests that contrary to expectations, medium-sized companies employing between 50 and 250 people – rather than the largest firms - account for a disproportionate share of the survey respondents indicating that their purchases from other EU Member States accounted for 5% or more of total spending on business services. The explanation for this may be that larger companies with sites in different countries are more likely to source their business services from local providers whereas small and medium-sized companies are not usually in a position to do this. Similarly, manufacturing companies would appear to spend a relatively higher proportion of their expenditure on business services on purchases from other EU Member States than do service sector firms.

From a user perspective, the sourcing of business services broadly reflects the other findings (discussed below) regarding the extent to which different types of business service providers are engaged in cross-border trade.

### *Supply Side Perspective*

On the supply-side, the research points to a number of factors driving cross-border trade in business services:

- Some business services providers seek to operate in foreign markets because the market has reached saturation in their own country and better opportunities exist for expansion elsewhere within the EU.

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# BUSINESS SERVICES MARKETS

# 3

- Other larger business service providers seeking to create a pan-European entity are motivated by the opportunity to add shareholder value and maximise brand identity outside the domestic market.
- Likewise, in many cases the drive to develop cross-border operations is explained by the fact that client companies are globalising their operations;
- However, many firms – in particular, the smaller ones – do not actively seek opportunities to sell their services in export markets. There may be additional risk factors or knowledge requirements – or other barriers – which provide a hurdle to market entry.

Taking the first point, as noted earlier, in certain business service sectors where competition (on both price and quality) are intensive, companies are increasingly looking outside their traditional markets and seeking to gain market share. One example of this was provided by a UK-based Technical Testing and consultancy company which we interviewed. The company had entered through acquisition into the German and Italian markets, which were regarded as less competitive than the UK. Likewise, a case study carried out with a German Engineering Related Consultancy firm indicated that because of the lack of domestic demand, its strategy was now very much focused on export markets. In this particular case, however, the company had tried unsuccessfully to win tenders in other EU Member States and had therefore decided to concentrate on the Central and Eastern European markets instead. The survey work suggested that two sectors stand out as being affected by these pressures – Contract R&D and Engineering Related Consultancy.<sup>22</sup>

The other factors listed tend to apply to all types of firms irrespective of the business service sector: the desire to maximise shareholder value is a strong motivation driving expansion into new markets outside the home base. However the third factor, which applies more to medium-sized and larger business service providers, is the need to service companies that are Europeanising if not globalising their operations as a result of similar pressures. The case study research suggests that there is an interesting distinction to be made here. In some cases, for example in the Personnel Recruitment field where the focus

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<sup>22</sup> In the engineering-related consultancy field, we were told that the services directive which requires pan-European publication of public sector procurement tenders has not led to a dramatic increase in cross-border trade (i.e. companies selling their services cross-border from the home base). However, it has led to an increase in both transparency and general awareness of the possibility of bidding for cross-border work. Nevertheless the awarding of 'pure' cross-border contracts to engineering firms only represents a small percentage of the overall number of projects awarded. On average, less than 2% of public procurement projects advertised in the Official Journal averaged out over the past five years were awarded to non-domestic engineering consultants.

# BUSINESS SERVICES MARKETS

# 3

is on recruitment of senior international executives, the capacity to service client company requirements may not require an internationalisation of the provider's corporate structure in the sense of establishing local operations in other countries. This contrasts, however, with evidence from an Accountancy and Audit case study where the need for an increasingly global approach to delivering services to multinational clients meant having local operations in the same countries as the client.

However, many firms – in particular, the smaller ones – do not actively seek opportunities to sell their services in export markets. Although not researched empirically in this study, there is ample evidence from other studies to support this assertion.

### 3.4 Modes of Delivering Business Services on a Cross Border Basis

What is the main mode for delivering services on a cross-border basis?

A proposition developed at the outset of the study is that there are three ways in which business services can be delivered across borders – delivering services directly from the home base, by sending a team out from the home base or, thirdly, via a local subsidiary, sister company or agent.

Turning first of all to the survey evidence, this suggests that delivery of services from the home country represents by far the most common method of selling business services to clients in other EU Member States. Table 3.6 summarises the survey feedback.

*Table 3.6: Methods of Delivering Business Services*

Methods of Delivering Business Services	No	%
1. Delivery of services from home country	124	52.3
2. Delivery by sending a team from the home base	47	19.8
3. Delivery of services via a local subsidiary, sister company or agent.	66	27.9
TOTAL	237	100.0

*Source: CSES analysis of survey data*

Further analysis of the survey data suggests that:

- In a significant proportion of cases (34%), providers were using multiple delivery methods, largely reflecting the number of export markets targeted by companies but also the nature of the service itself;
- The larger the provider, the more likely it is to deliver business services in other EU markets via a local subsidiary, sister company or agent rather than selling services directly from the home base;

# BUSINESS SERVICES MARKETS

# 3

- From a sectoral perspective, there are some quite pronounced differences with regard to modes of delivering services across borders, again to some extent reflecting the nature of the service itself but also other factors (discussed below).

For reasons explored in more detail in Section 4, delivery of services from the home country represents the most common method of selling business services to clients in other EU Member States. The survey suggests that the main alternative – delivery of services via a local subsidiary, sister company or agent - is, however, commonly used in relation to certain export markets – Spain, France, Finland, Italy, and Portugal stand out in this respect. There are several ways of interpreting this. It could mean that in some areas of the EU – especially southern Europe – business service providers consider it important to have a local presence because of the complications of establishing a close relationship with actual or potential clients from a distance. Alternatively, it could be argued that these markets are more open from the point of view of regulations and procedures for establishing local operations (these issues are examined in Section 4).

Analysis of the survey returns, and case studies, suggests a further pattern, namely that the larger the provider, the more likely it is to deliver business services in other EU markets via a local subsidiary, sister company or agent. The explanation for this almost certainly lies in the fact that only larger companies are able to bear the cost of setting up and operating local operations. However, interestingly, according to the survey, the very smallest firms – those employing less than 10 people - also rely on local operations to sell services to clients in other countries. As first sight, this might seem to invalidate the above assertion. But another interpretation is that the smallest providers have of necessity to rely on local outlets – in this case most probably agents rather than sister companies or subsidiaries – to sell their services in other EU markets.

From a sectoral perspective, there are some quite pronounced differences with regard to modes of delivering services across borders:

- IT Consultancy and Labour Recruitment demonstrate very similar characteristics as far as the way in which services are delivered (with a broadly even split between selling from the home base and via local operations);
- In the case of Leasing and Renting - but particularly with Accountancy and Audit - the use of local operations is much more common (reflecting perhaps the importance of national law);
- With Engineering Related Consultancy and Technical Testing delivering services from the home base stands out as the main delivery method.

# BUSINESS SERVICES MARKETS

# 3

The case study research suggests that, in reality, a mix of methods is often used on particular projects. For example, one IT provider we interviewed - a multinational company – indicated that it would use a local operation to sell into domestic markets but would call on the support of experts from another part of the same firm located in a different country to help carry out a particular aspect of a project. Likewise, in the Personnel Recruitment sector, interviews with companies highlighted the fact (briefly discussed earlier) that in the senior executive recruitment field, multinational clients can be serviced from the home base. However, as feedback from an interview with a Swedish company made clear, in other fields (e.g. recruitment of temporary workers in the building sector), the capacity to operate on the ground, alongside client companies in their export markets, is far more important.

The cost of the various different delivery methods is also a factor explaining why some options are favoured over others. This is clear both from the survey feedback<sup>23</sup> and the case studies. Setting up a subsidiary or branch is clearly a more expensive course of action than selling the service concerned from the home base, or by sending a team from the home base. For smaller business service companies this is likely to be an especially important consideration. Also, the length of time firms have been attempting to or actually selling services in export markets is relevant: clearly, if a firm is testing a market, it will tend to opt for a method of delivery that minimises costs and has a simpler exit mechanism. In the case studies, these considerations were stressed by several smaller firms to whom we spoke, with the preferred option if a physical presence in an export market is required (e.g. in order to provide after-care) being partnership arrangements with local firms, rather than setting up a subsidiary.

There are other factors, too, that help explain the use or otherwise of different delivery mechanisms – the nature of the service itself and, more especially, the extent to which a physical presence is required in an export market – being the most obvious factors apart from regulatory and other trade barriers. These and other factors are discussed in Section 4.

## *Impact of E-Commerce on Delivery Modes*

An additional factor that needs to be considered is the impact of e-commerce on the way in which business services are delivered across borders. It will be recalled from the literature review in Section 2 that recent OECD research (1999) suggests that the liberalisation of communications and rapid growth in the Internet is likely to lead to an expansion in demand for business services to be traded across borders. Examples cited

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<sup>23</sup> In the survey, excessive cost was one of the highest ranked barriers to establishing a local operation in another EU Member State (44% of firms ranked this as ‘very important’ as a barrier).

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# BUSINESS SERVICES MARKETS

# 3

included the spread of distance learning and the direct selling of advertising and marketing services to consumers ('disintermediation') using electronic methods.

Our research suggests that e-commerce is having more of an impact on some business service sectors than others. In Finland, for example, e-commerce is perceived as having an important impact in the Finnish leasing and renting market. Its principal impact to-date has been in helping potential leasing customers obtain information on different leasing providers and compare their offers, as well as facilitating communication between the asset providers and the leasing companies (i.e. making the back office operations easier). Likewise, from a business service provider perspective, an Engineering-Related Consultancy firm we interviewed stated that e-commerce was now generally used in linking specialist staff at its headquarters with sales teams and project managers in the field. In addition, the capacity to advertise services on web sites is clearly helpful to firms in all sectors and may in some cases reduce the need for a local presence in other markets.

Interestingly, the survey work suggests that the impact of e-commerce is generally seen as more positive by business service providers than by users. There is no obvious explanation for this, however.

### 3.5 Role of Single European Market in Cross Border Trade in Business Services

What has been the role played by the Single European Market so far in this respect?

In examining this question, it is important to make a distinction between the impact of the Single European Market (SEM) on domestic business services markets and on export markets. We examine each of these aspects in turn below.

#### *Impact of SEM Domestic Markets for Business Services*

According to the survey, around a third of business service providers consider that the Single European Market has had a significant impact on trading conditions in their domestic markets. There are some notable variations in this respect. Thus, a relatively high proportion of firms (33.9%) indicate that price competition has become more intense. But at the opposite extreme, relatively few companies (6.5%) stated that costs had been reduced as a result of increased trading activity and even fewer (4.6%) indicated that the Single European Market had had a significant impact on input costs.

These findings with regard to 'input' and 'output' factors could be explained by the fact that labour is the most significant resource for most business services companies on the input side and costs are still driven largely by local labour market conditions (except at

# BUSINESS SERVICES MARKETS

# 3

very senior levels); in contrast, on the output side, with markets more international, there has been greater scope for the Single European Market to have an impact.

A second significant feature of the survey data is that it suggests that the Single European Market is seen as having had a far greater impact on domestic markets for business services than on export markets. In other respects, a broadly similar picture emerges as far as the impact of the Single European Market on export markets is concerned. As in domestic markets, a relatively high proportion of firms (15.0%) indicate that price competition has become more intense in export markets whereas the perception is that there has been little impact on costs.

From a sectoral perspective, the survey data suggests that the Single European Market is seen by firms in the Personnel Recruitment, Contract R&D, and especially the Accountancy and Audit sector, as having had a greater impact on domestic markets than is evident with other business service sectors where a considerably lower proportion of respondents indicated that there had been positive effects.

### *Impact of SEM on Export Markets for Business Services*

A much lower proportion of firms detected impacts attributable to the Single European Market in export markets. Moreover, with the exception of Accountancy and Audit, the sectors where such an effect is considered apparent - Leasing and Renting, Engineering Related Consultancy, and Contract R&D - are different to those in the case of domestic markets.

In addition to its impact on actual trading conditions, the case studies and other research suggest that the Single Market has played a significant role in changing the mindset of business services companies. Whilst the level of pure cross-border trade remains small, feedback from the interview programme suggests that the Single Market has made many companies more aware of the opportunities which exist outside traditional domestic markets. Growing awareness of the Single Market and EU directives enshrining mutual recognition in law have encouraged business services companies to look at the possibilities of pursuing a European growth strategy. Whilst barriers remain to doing business in another EU country such as cultural differences affecting business practices and linguistic differences, many of the regulatory and legislative barriers have been removed. Anecdotal evidence suggests that removing official barriers has had a psychological impact on business services companies. Companies are increasingly aware that in an era of globalisation, where the right to operate freely within Europe is enshrined in law by the Single Market, their attention should increasingly be focused on opportunities outside their traditional markets. Evidence of this emerged with the Danish engineering federation, which found that as a result of the Internal Market, Danish

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# BUSINESS SERVICES MARKETS

# 3

engineering companies were becoming increasingly international in their outlook and that the level of cross-border activity had increased several-fold since the Single Market came into effect.

## *Impact of the Euro*

In the survey, we also investigated business service provider and user views on the impact of the euro on their markets. The responses suggest that the euro is seen by most firms as having a positive effect on their capacity to engage in cross-border trade.<sup>24</sup> Feedback from the case studies and other research confirmed this. For example, one Swedish Engineering Related Consultancy firm covered by the survey commented that:

‘There's not really any barriers of trade for us, but however harmonising taxes and currencies would simplify service exports within the EU’.

Several national authorities we spoke to also expect the euro to benefit the capacity of their business services sectors to compete in other EU markets. The clearest example of this was in Italy where participation in the single currency is seen as making it possible for business service providers to take advantage of relatively low labour costs and increase their competitive offering. In the UK, in contrast, being outside the euro and consequent uncertainty over currency fluctuations was cited as a problem by several business service providers we spoke to (for example, it has a large impact on costing and bidding for large scale engineering consultancy projects elsewhere in the EU).

The survey work suggests that a considerably lower proportion of users see the euro (and e-commerce) as having a positive impact in encouraging an increase in the purchase of business services from other EU Member States. The explanation for this is not clear but may lie in the fact that the currency risk in a transaction is usually borne by the contractor rather than the client.

## **3.6 Conclusions – Business Service Markets**

Does the analysis lead to the conclusion that barriers to trade still prevail within the Single European Market?

The research suggests that although the business services sector is growing rapidly throughout the EU, it is not possible to speak of a single market.

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<sup>24</sup> According to the survey, 60% of business service providers but a lower proportion – 33% - of users considered that the euro was likely to have a positive impact on cross-border trade.

# BUSINESS SERVICES MARKETS

# 3

First, the size of the business service sector in relation to the overall economy, and the structure of the sector in terms of different types of activities, varies considerably from one EU Member State to another, as does the extent to which growth is being driven by the same factors. Second, across most business service sectors, competition remains essentially domestic (in the survey, almost half (46%) the business service providers stated that most or all of their competitors are domestic). Third, while domestic markets and sectors tend to be dominated by relatively small business service providers serving mainly local and regional markets, these firms coexist alongside major multinational undertakings with very different ‘business models’ operating in international markets. These and other features suggest that the EU’s business service sector is far from homogeneous and does not demonstrate the characteristics of a single market.

Following on from this, a second key conclusion from the research in this section is that despite the rapid growth of the EU’s domestic business services markets, the level of cross-border trade in business services remains modest – the survey work, for example, suggests that only 29% of users and 53% of providers were purchasing/delivering business services on a cross-border basis at the time of the research. Moreover, levels of pure cross-border trade tend to be relatively small as a proportion of the overall turnover of business service firms. The modest level of cross-border activity is generally confirmed by other aspects of the research although this also highlights variations between sectors, providers in different size bands, and export markets.

The research presented in this section nevertheless points to a number of factors driving cross-border trade in business services. On the supply-side, some business services providers seek to operate in foreign markets because the market has reached saturation in their own country and better opportunities exist for expansion elsewhere within the EU. Other larger business service providers seeking to create a pan-European entity are motivated by the opportunity to add shareholder value and maximise brand identity outside the domestic market. However, many firms – in particular, the smaller ones – do not actively seek opportunities to sell their services in export markets. On the demand side, the analysis suggests that ‘quality’, ‘expertise’ and ‘confidence’ are the main factors determining the choice of a business service supplier and that there is no significant difference in this respect in evaluating the merits of domestic as opposed to other EU providers. In both cases, these factors are ranked above ‘price’. Likewise, whether or not a provider has a local presence is generally regarded as unimportant.

Delivery of services from home country represents by far the most common method of selling business services to clients in other EU Member States. Although delivery methods are influenced by a number of factors, including the nature of the different business services, the high cost of establishing a local operation in an export market is set out in the next section as a major factor in explaining why most firms – especially smaller

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# BUSINESS SERVICES MARKETS

# 3

providers - opt for delivery from the home base. In the case of larger providers, the situation is more complex and as this section shows, a significant proportion of (mainly larger) firms use different delivery methods in different export markets.

The research suggests that the Single European Market is perceived as having had a far greater impact on domestic markets for business services than on export markets. Other developments – in particular e-commerce – are also viewed as having an important effect on markets. According to the survey, around a third of business service providers consider that the Single European Market has had a significant impact on trading conditions in their domestic markets. There are some notable findings in this respect. Thus, a relatively high proportion of firms (34%), indicated that price competition has become more intense. But at the opposite extreme, relatively few (5%) companies indicated that the Single European Market had had a significant impact on input costs. These findings with regard to ‘input’ and ‘output’ factors can be explained by the fact that labour is the most significant resource for business services companies on the input side and costs are still driven largely by local labour market conditions (except at very senior levels); in contrast, on the output side, there has been greater scope for the Single European Market to have an impact.

In addition to its impact on actual trading conditions, the case studies and other research suggest that the Single Market has played a significant role in changing the mindset of business services companies. Whilst the level of pure cross-border trade remains small, feedback from the interview programme suggests that the Single Market has made many companies more aware of the opportunities which exist outside traditional domestic markets. Nevertheless, despite these positive perceptions, as the next section makes clear, cross-border activity in business services is severely constrained by remaining barriers.

# BARRIERS TO TRADE

# 4

## Overview

This section examines the nature and extent of remaining barriers to trade in business services in the Internal Market. Key questions defined by the Commission that are examined in the research are summarised below:

### *Key Questions – Nature and Extent of Remaining Barriers to Trade in Business Services*

- How can we classify the remaining barriers to trade in business services?
- Are they primarily of a regulatory or non-regulatory (administrative or socio-cultural) nature?
- Do they prevail in all EU Member States or are some more severe in some countries than others?
- Do business service providers mainly perceive them or do they also prevent users from purchasing services in other EU Member States?
- What is the impact of these barriers on the mode of delivery, the competitive conditions in the relevant markets (home base or establishment abroad) and the ‘maturity’ of firms or markets?
- Have these barriers already been identified (in existing literature or by business organisations) and if so, what is the reason for failure to address them?
- Is there a need for corrective measures through some sort of legislative action or is it more a problem of enforcement, cooperation, etc? If corrective measures are required, would they affect sectors and countries individually or would some sort of grouping appear?
- What is the position of the national administrations concerning barriers identified in their own Member States?

As in the previous section, the analysis in this section draws on a combination of the results of the survey of business service providers and users, interviews with national authorities and federations, and the company case studies.

## 4.1 Classification of Remaining Barriers to Trade

How can we classify the remaining barriers to trade in business services?

Most studies in respect of barriers to trade have drawn a distinction between regulatory and non-regulatory barriers. Regulatory barriers can include both barriers to selling services from the home base and barriers to setting up operations in another country. Non-regulatory barriers cover administrative, market-related and socio-cultural factors. Many non-regulatory barriers will be outside the control of governments but some can be influenced by them.

Examples of the studies that followed this classification include the KPMG study into the cost of ‘non-Europe’ (1988) and more recent research by the OECD (1999) and Rubalcaba-Bermejo (1999): these and other studies all make a primary distinction

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# BARRIERS TO TRADE

# 4

between legal-regulatory barriers and other types of barriers relating to ‘softer’ factors such as market conditions and socio-cultural circumstances, some aspects of which have a horizontal relevance across most if not all types of firms, sectors and countries. But in the case of the OECD research, the classification of barriers to trade according to delivery methods used to sell business services into other markets also features in the framework for the analysis.

The method of delivering business services also has an important impact on the way business is carried out and therefore the on barriers which companies might encounter. Services can be delivered either by selling directly from home base, or by sending out a team, or establishing a physical presence in another EU Member State. Setting up a local establishment will have different requirements from selling services directly from the home base. In this study we have investigated potential barriers according to a classification both by mode of delivery and type of barrier, i.e:

- Barriers specific to selling services from home base;
- Barriers specific to setting up a local operation in another EU country;
- Barriers of a horizontal or socio cultural nature, and other barriers.

The main types of barriers to trade in each of these categories is considered below. This part of the analysis relies mainly on the results of the survey of business service users and providers. In each case, the analysis is based on the 186 companies who indicated that they were selling business services to clients in other EU Member States. A summary analysis is presented here and we discuss it in more detail later in this part of our report.

## *Barriers to Selling Services from Home Base*

The first group of barriers relates to selling business services from home base. Services may be sold directly from home base – ie at a distance – or possibly with the aid of a team sent from home base to the export market in question. But selling services from home base does not necessarily mean that there is no need to obtain local registration or to meet local regulations in the particular export market. The table below shows types of barriers and also shows the percentage of providers considering such barriers ‘very important’ – absolute numbers considering the barriers important are also shown for information.

# BARRIERS TO TRADE

# 4

*Table 4.1: Barriers to Exporting Business Services from Home Base*

<b>Barriers to selling business services from home base</b>	<b>No</b>	<b>%</b>
1. Requirement to obtain local registration	20	16.1
2. Requirement to have a specific legal form	27	21.7
3. Requirement to meet specific financial criteria	18	14.5
4. Need to be represented by a local agent	18	14.5
5. Lack of mutual recognition of professional qualifications	13	10.5
6. Restrictive local employment regulations	11	8.9
7. Need for local presence to provide after-care services	27	21.8
8. Difficulty in supplying services because of distance factors	39	31.5
9. Discriminatory tax on cross-border services	11	8.9

*Source: CSES analysis of survey data.*

Difficulty in supplying services because of distance-related factors and the need for a local presence to provide after-care (two factors that are linked) stand out as the main barriers to exporting business services from the home base. Amongst the regulatory-type barriers, the requirement to have a specific legal form would appear to be of most concern.

### *Barriers Specific to Setting up a Local Operation in Another EU Country*

The second group of barriers occurs when a provider wishes to set up a local operation in a particular export market. We can classify these barriers as shown in the table below; again we provide the numbers and percentage of firms considering such barriers to be very important.

*Table 4.2: Barriers to Setting Up a Local Operation to Sell Services*

<b>Barriers to setting up a local operation</b>	<b>Number</b>	<b>%</b>
1. Inability to practice without license from professional body	20	30.3
2. Stringent regulations on minimum capital requirements	4	6.1
3. Stringent regulations on branch operations	6	9.1
4. Excessive costs for setting up a local operation	29	43.9
5. Administrative/legal regulations on setting up locally	15	22.7
6. Lack of mutual recognition of professional qualifications	14	21.2
7. Restrictive local employment regulations	13	19.7
8. Restricted access to finance for foreign-owned firms	7	10.4
9. Inadequate infrastructure	4	6.1
10. Lack of necessary skills/costly training of workers	26	39.4

*Source: CSES analysis of survey data*

# BARRIERS TO TRADE

## 4

Three factors stand out as constituting the main barriers to establishing a local operation in another EU Member State market – the excessive cost of a local company formation, the lack of necessary skills/costly training of workers, and the inability to practice without a professional license. Barriers that are largely sector specific – for example lack of mutual recognition of professional qualifications – are not highlighted at an aggregate level of analysis although they are important to particular sectors (these are considered later in this report).

### *Horizontal, Socio-Cultural and Other Barriers*

The category of ‘horizontal’ barriers, i.e. market-related and cultural factors, can affect the capacity of firms to sell business services in other countries irrespective of the delivery mechanism used to do so. In the analysis set out below, a distinction is made between socio-cultural, market-related, and administrative barriers, and barriers arising from varying public procurement procedures.

In Table 4.3, ranking the horizontal barriers, a distinction is made between those relating to selling services directly from the home base (Column A) and those relating to setting up a local operation (Column B).

*Table 4.3: Horizontal Barriers – Socio-Cultural Factors*

Barriers	A - Home Base		B - Local Operation	
	No	%	No	%
1. Differences in local traditions	29	23.4	17	36.9
2. Differences in commercial practices	12	9.8	6	13.0
3. Need to work in local language	50	40.3	24	52.2
4. Planning and zoning restrictions	11	8.9	8	17.4
5. Need for local track record	36	29.0	35	76.1
6. Subsidised local suppliers	29	23.3	16	34.7
7. Unacceptable delays in payment	20	16.1	11	23.9
8. Complexity of foreign legal systems	31	25.0	20	43.5
9. Restrictions on cross-border marketing	10	8.1	8	17.4
10. Poor protection of intellectual property	12	9.7	7	15.2
11. Absence of transparency in regulations	26	20.9	17	36.9
12. Absence of transparency in implementation	19	15.3	13	28.3
13. Imposition of national standards, testing rules	37	29.8	21	45.6
14. Difficulty in obtaining information on tenders	28	22.6	14	30.4
15. Exemption clauses in public procurement	20	16.1	13	28.3
16. High administrative costs of bidding	28	22.6	14	30.4

# BARRIERS TO TRADE

## 4

*Source: CSES analysis of survey data. Note: In each of the categories A and B shown in the table, the denominator that has been used is the number of companies using these respective methods to export services. Again, the analysis shows the number/proportion of providers indicating that barriers are 'very important'.*

In summary, there is therefore a diverse range of barriers to trade in business services, some of which can be addressed by government action and some of which, such language, clearly cannot be dealt with governmentally. Also, some barriers were identified in particular business service sectors as a result of case studies and interviews.

### 4.2 Main Remaining Barriers to Trade

Are they primarily of a regulatory or non-regulatory (administrative or socio-cultural) nature?

We now consider the nature and severity of the main remaining barriers to trade. The survey provides information on the main barriers overall but does not always bring out at a sectoral or country level the way in which particular barriers affect individual companies or groups of companies. This latter point is considered in subsequent sections

Using the data from the previous section (which covers all barriers covered by the survey), we have separated out the main barriers from a provider point of view. For the purposes of the tables below, main barriers are those which are mentioned as very important by 20% or more of respondents. We then analyse the barriers in two groups, those of a regulatory nature, those relating to socio-cultural factors and market conditions. This analysis is broadly in line with the approach adopted in the OECD report referred to above. We then go on in subsequent sections to bring in case study and interview material.

#### *Regulatory Barriers*

Considering regulatory barriers first, the survey indicates that the main barriers are:

*Table 4.4: Main Barriers to Trade – Regulatory Barriers – Provider Views*

**Key:** (Provider Rankings): Column A = Selling from Home Base: Column B = Selling via Local Operation.

Barriers	A - Home Base		B - Local Operation	
	No	%	No	%
Imposition of national standards, testing rules	37	29.8	21	45.6
Complexity of foreign legal systems	31	25.0	20	43.5
Inability to practice without license from professional body	na	na	20	30.3
Requirement to have a specific legal form	27	21.7	na	na
Absence of transparency in regulations	26	20.9	17	36.9
Absence of transparency in implementation	19	15.3	13	28.3
Administrative/legal regulations on setting up locally	na	na	15	22.7
Lack of mutual recognition of professional qualifications	na	na	14	21.2

# BARRIERS TO TRADE

## 4

*Source: CSES analysis of survey data. Note: in the table and the ones following, barriers facing providers have been ranked, in the first place, according to the views of firms selling services directly from the home base on the grounds that this represents the predominant method. The table shows the percentage of providers and users who ranked the barriers as 'very important'.*

A key group of barriers relates to legal systems - including the complexity of dealing with foreign legal systems, the absence of transparency in regulations and the absence of transparency in the implementation of regulations. In many cases these barriers represent a learning curve which businesses have to overcome in seeking to enter a new market. They form barriers to entry but are not necessarily discriminatory against non-national companies seeking to enter a market.

Other barriers are more specific. The imposition of national standards and testing rules was the most frequently mentioned barrier in this category. In the professional services field, the ability to practise without a licence from a professional body, or the lack of mutual recognition of professional qualifications, or other restrictions on professional practice were frequently mentioned. From interview evidence, restrictions on forming multi disciplinary professional service firms are also seen as an important barrier. Other specific barriers include the requirement to have a specific legal form or the excessively complex administrative and legal regulations on setting up locally.

We now consider the main market related or socio-cultural barriers. Table 4.5 analyses market related barriers and classifies the principal barriers on the same basis as earlier.

*Table 4.5: Main Barriers to Trade – Market related – Provider views*

**Key:** (Provider Rankings): Column A = Selling from Home Base; Column B = Selling via Local Operation.

Barriers	A - Home Base		B - Local Operation	
	No	%	No	%
Difficulty in supplying services because of distance factors	39	31.5	na	na
Need for local track record	36	29.0	35	76.1
Excessive costs for setting up a local operation	na	na	29	43.9
Lack of necessary skills/costly training of workers	na	na	26	39.4
Subsidised local suppliers	29	23.3	16	34.7
Difficulty in obtaining information on tenders	28	22.6	14	30.4
High administrative costs of bidding	28	22.6	14	30.4
Need for local presence to provide after-care services	27	21.8	na	na
Exemption clauses in public procurement	20	16.1	13	28.3
Unacceptable delays in payment	20	16.1	11	23.9

*Source: CSES analysis of survey data*

Distance related barriers come out as of most concern to companies. These include barriers such as a difficulty of supplying services at a distance, and the need to have a credible local track record and to be able to provide a credible after-care services. Clearly,

# BARRIERS TO TRADE

# 4

these are barriers which are outside the scope of governmental action although their effect may be alleviated by the intervention of public authorities to encourage more use of e-commerce.

There are a number of other market related barriers which companies perceive, such as the difficulty in obtaining information on tenders, the high cost of bidding and exemption clauses in public procurement as well as the existence of potentially subsidised local suppliers. Other market related barriers include dealing with unacceptable delays in payment, and the cost of setting up a local operation where this is the chosen method of service delivery.

Two types of cultural factors - the need to work in a local language and differences in local business traditions – are highlighted by the research:

*Table 4.6: Key Barriers to Trade – Cultural Factors –Provider Views*

**Key:** (Provider Rankings): Column A = Selling from Home Base; Column B = Selling via Local Operation.

Barriers	A - Home Base		B - Local Operation	
	No	%	No	%
Need to work in local language	50	40.3	24	52.2
Differences in local traditions	29	23.4	17	36.9

*Source: CSES analysis of survey data*

Overall, socio-cultural factors were the most frequently mentioned barriers to trade together with the need to provide a credible local market presence. The need to work in a local language is part of the learning curve which many businesses have to overcome in entering a new market. And they have to be able to deal with local market conditions and traditions.

From a user perspective, the overall position is similar. Later in this section we consider user views in more detail. But below we show the proportion of users who ranked the barriers as ‘very important’.

# BARRIERS TO TRADE

# 4

*Table 4.7: Key Barriers to Trade – User Perspectives*

Note: The table shows the percentage of users who ranked the barriers as ‘very important’.

Users	%
Language complications	69.2
Differing commercial practices	64.6
Difficulty identifying suppliers	63.1
Uncertainty about after-care from abroad	62.6
Need for close interaction with suppliers	61.6
Legal complexities of foreign purchases	58.6
Lack of information on foreign suppliers	54.6
Complexity of cross-border payments	47.9

Source: CSES analysis of survey data

We draw two main conclusions from the analysis shown in this table. The first is that the nature of the barriers faced by users is similar to the type of barriers faced by providers, and that the most important barriers are cultural or market related. The second is that the proportion of users who consider particular barriers to be ‘very important’ appears higher than the equivalent for providers – in other words, users may consider cross-border trade more difficult than providers. This latter conclusion is supported by the research findings presented in Section 5 which suggest that business service users are less likely than providers to increase the level of cross-border transactions if remaining barriers to trade are removed.

In summary, market related factors and cultural factors such as language are the most important barriers to the cross-border provision of business services. But regulatory barriers are also important, especially in the case of particular business service sectors, and in the following sections we discuss in more detail individual regulatory barriers and other barriers.

### 4.3 Barriers in Practice - Regulatory Barriers

Do they prevail in all EU Member States or are some more severe in some countries than others?

What is the impact of these barriers on the mode of delivery, the competitive conditions in the relevant markets (home base or establishment abroad) and the ‘maturity’ of firms or markets?

This section describes in more detail the main regulatory barriers and comments where appropriate on the extent to which they affect particular countries and sectors (the next section examines non-regulatory barriers). We deal with each of the major barriers

# BARRIERS TO TRADE

# 4

identified by the survey or interview work in turn, under the following groups, broadly relating to the importance providers have placed on each type of barrier:

- Imposition of national standards;
- Inability to practice without a licence from a professional body, or lack of mutual recognition of professional qualifications;
- Requirement to have a specific legal form, or difficulties with administrative regulations in setting up locally;
- Dealing with the legal system of another country generally, including the absence of transparency in regulations and their implementation. This category also includes problems arising from differences in taxation systems and other fiscal barriers.

In addition, arising from our interview work, other regulatory barriers such as differences and restrictions applying to pension rights and other employment laws and barriers that are largely sector-specific were highlighted as barriers to trade.

### 4.3.1 Differences in National Technical Standards

Differences in national technical standards was the most frequently mentioned barrier overall, but analysis suggests that in practice its influence is heavily concentrated in a few sectors, ie technical testing and contract R&D, and to some extent engineering consulting,

The harmonisation of national technical standards has of course formed part of the Single Market programme. The Internal Market Single Market Review Series on the dismantling of technical barriers to trade (1996) identified two types barriers, namely: technical regulations imposed by national governments (mainly for health, safety and environmental protection of consumers) and, second, non-regulatory barriers imposed by users groups, trade associations, institutions, insurance bodies, or by non-mandatory government guidelines and advice to customers. Specific barriers in this field include:

- Barriers to trade in the technical field in areas of activity not yet covered by the New Approach Directives such as the construction industry;
- EU Minimum directives, where the effectiveness of a given directive is undermined by national variations in standards such as workplace minimum safety requirements governing hazardous substances in factories;

# BARRIERS TO TRADE

# 4

- New Approach Directives where there is an ongoing transition period which means that companies can still encounter problems in the field of mutual recognition in the technical testing field;
- Areas of activity theoretically regulated by the EU New Approach Directives such as Pressurised Boilers and Vessels which in practice are subject to national-specific testing requirements / nationally accepted codes of practice which predate the EU directive.

In the discussions with Engineering Related Consultancy national federations and companies, differences in technical standards with regard to construction practices were identified as barriers to trade but not insuperable ones. The view in respect was that there are only minor differences in technical standards/ requirements from country to country. For example, in country A, national safety requirements could demand that two windows were installed in an office as opposed to one window in country B. However, we were told that firms can live with such differences, which are relatively unimportant compared with the more obvious cultural, linguistic and other differences.

In the Technical Testing field, however, different national technical standards remain a very significant barrier to cross-border trade. There continue to be problems in areas where there is a basic EU Minimum Directive in place, but significant differences in its application across Europe. For example, the Swedish testing authority SWEDAC stated that in heavy vehicles testing, some countries have significantly more stringent national requirements than others. Operators are at liberty to use EU mutual recognition legislation to bypass national requirements by registering vehicles in a Member State requiring less frequent/rigorous testing than the home country. Another example of barriers in the technical testing field is the fire-proofing of trade show equipment. In one interview with a provider, we were told that if a company organises a trade show in a number of EU Member States it may be necessary to have separate fire safety certification for set of equipment in each case. Indeed in some countries (e.g. Germany) certification may also be required in each of the Länder. National consumer protection legislation, whilst not preventing the entry of goods tested elsewhere within the EU by corresponding Notified Bodies, in practice necessitates the re-testing of pressurised vessels to meet German standards (which vary from Länder to Länder – albeit marginally). We were also told that France and the Netherlands pose problems in the technical testing field by imposing *de facto* national codes of practice.

Also, whilst in the technical testing field the Mutual Recognition Directive demands that EU countries accept new goods tested elsewhere in the EU, several federations we interviewed claimed there is nothing to prevent a national testing house from demanding that a product is re-tested once it is on the market. Less attention appears to have been

# BARRIERS TO TRADE

# 4

paid to date to mutual recognition of goods already in use. Testing houses such as the TÜV in Germany, for example, have the right to enforce renewal testing on products already in use in the German market. In the interviews with companies, it was made clear that this is a expensive exercise for foreign suppliers who may have to pay the cost of taking an inspection team to the factory premises where the good was originally produced.

A further problem highlighted by the research relates to certification procedures that customers demand for local markets. According to feedback from interviews with Technical Testing organisations, even if companies have the CE-mark (which is now affixed to the product by the manufacturer in order to meet the EU directive's requirements for conformity assessment), they also often have to affix a private, national certification mark, e.g. the TÜV, VDE, BEAB or NF – due to customer demand. The different testing houses own these marks and can of course set the rules themselves. So they can also ask for a renewed testing - or at any rate ask for payment for recognising tests made by another test house. This is not an "official" trade barrier but a widely recognised private sector trademark acts as a "de facto" trade barrier. In addition to differing national standards, traditions and customs can therefore also hinder trade.

The research suggests that the problem of differing regional technical standards can be especially apparent in EU Member States with federal structures. Research in Germany and also in Spain confirmed that similar difficulties exist in these countries although the important point was made that domestic organisations can be as much affected as those seeking to sell services into these markets from other countries. Overall, the issue of differing technical standards make it difficult to develop a single market in the technical testing and research and development fields.

### *4.3.2 Lack of Mutual Recognition of Qualifications or Inability to Operate without a Licence from a Professional Body*

We now consider a second group of regulatory barriers, the lack of mutual recognition of qualifications or the inability to operate without a licence from a professional body. Also included in this area are restrictions on establishing multidisciplinary businesses. These barriers affect in particular the Accounting and Auditing professions, as well as Engineering Related Consultancy. Whilst the Personnel Recruitment industry itself is not directly affected, lack of mutual recognition of qualifications does, however, complicate the delivery of some services on a cross-border basis.

The mutual recognition of professional qualifications is of course another area in which the Single Market programme has been active for many years. According to a recent Commission publication, the application of mutual recognition is producing results, but grey areas persist, chiefly because of ignorance of the principles and of operational

# BARRIERS TO TRADE

# 4

consequences on the part of the users of the system, be they Member States or economic operators.<sup>25</sup>

Taking the Accountancy and Audit sector first, the mutual recognition of accounting qualifications is already regulated by the EU through the 8th Directive. In general, this Directive recognises that there is an element of international qualification required for auditing, and a further element of local qualifications. The international aspect relates to areas such as the preparation of accounts and certain international accounting standards. The local aspect relates to national law and tax and the application of international standards in particular countries. However, accountants and in particular their trade association the FEE, argue that there is a lack of consistency in the application of this Directive across different EU Member States.

The research confirms this, for example with regard to difficulties arising from the administration of regulations relating to local registration. The qualification for accountants – and the structure of the profession – varies from country to country. In Spain, for example, we were told that the exam which accountants are required to take to practice locally presents a number of difficulties for non-nationals. Whether or not such problems are fully justified is of course difficult to determine. But, the fact that we were told that there is a problem indicates that there is at least a perceived barrier to trade.

In the Engineering Related Consultancy sector, similar problems exist from the failure to accept mutual recognition of qualifications. In Austria, for example, we were told that many consulting engineers qualify by obtaining a 'Höhere Technische Lehranstalt' (HTL) diploma. After several years of professional practice HTL graduates are authorised by the Federal Economic Minister to use the professional title 'Ingenieur'.<sup>26</sup> However, at present the HTL diploma issued by Austrian institutions is not accepted in some other EU Member States, especially some southern European countries. Here, to qualify as a consulting engineer it is necessary to complete a five-year academic course leading to a university degree. Because the Austrian HTL qualification is not accepted as equivalent to this, Austrian firms feel they are at a disadvantage in seeking to satisfy tender specifications, particularly when a project manager must have an engineering

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<sup>25</sup> DG Internal Market, 1999 (Mutual recognition in the context of the follow-up to the Action Plan for the Single Market, p.3)

<sup>26</sup> An Austrian consulting engineer with this qualification is accepted as fully equivalent to a consulting engineer with a university degree is seen as being consistent with the EU's 2nd General System for the Recognition of Professional Education (92/51/EEC). According to an order of the Federal Economic Minister (federal law gazette BGBl. 726/1990) engineers with HTL diploma or university degree and a licence as Technisches Büro (engineering consultants) are entitled to use the term 'Beratende Ingenieure' (consulting engineer).

# BARRIERS TO TRADE

# 4

qualification. (In practice, Austrian firms often find a way round this problem by including locally-based engineers in their project teams). A further complication in the Engineering Related Consultancy field is that in some countries certain activities are reserved to architects or engineers. An example is the construction and fitting out of hospital, which may be large engineering project because of the amount of equipment but may have to be led by an architect rather than an engineer to meet national regulations – an example of restrictions on multidisciplinary practices discussed in more detail later.

As noted earlier, a lack of mutual recognition of qualifications also affects the Personnel Recruitment industry's capacity to deliver services on a cross-border basis. Difficulties arising because of a lack of mutual recognition of qualifications were, for example, highlighted by a Personnel Recruitment company from the UK involved in cross-border activities on behalf of clients in the engineering field. The main problem they faced was:

'Lack of consistency of training (tradesmen) certificates/validity accepted by member states for offshore safety training e.g. Denmark, the Netherlands and the UK have differing lengths/duration of validity for the same courses'.

A higher level in the Personnel Recruitment sector, our interviews with operators suggest that the problem is far less severe because senior executives and professionals are operating in an international market already.

Discussions with national authorities and employers associations corroborates the Commission's findings in its 1999 paper 'Mutual Recognition in the context of the follow-up to the Action Plan for the Single Market' that the majority of complaints received in the regulated professions relate to individuals rather than business services companies. Nevertheless, as this section shows, business service companies also require mutual recognition of qualifications if they are to move key staff or services across borders.

### *Inability to Operate without a Licence from a Professional Body*

Business service sectors covered by the research most affected this issue are Accountancy, Audit and Tax Services, and Engineering Related Consultancy (the reasons for this are similar to those highlighted earlier in connection with the mutual recognition of qualifications).<sup>27</sup>

In the Engineering Related Consultancy field, for example, requirements with regard to local registration vary across EU Member States. Thus, in Denmark and Sweden the

<sup>27</sup> Although these sectors are especially affected, inability to practice without a license was ranked by 30% of survey respondents engaged in cross-border trade as a 'very important' barrier.

# BARRIERS TO TRADE

# 4

profession is not regulated and there is no compulsory requirement to belong to a registered body, nor is any license required to practice. Danish and Swedish engineers do not have an equivalent to the UK Chartered Engineer or the Austrian Chamber of Engineers, where membership of a professional body is compulsory. Potential clients instead assess competency and suitability for a job by checking references from and previous clients.

As noted earlier, in most European countries, auditors or accountants have to sit a local test to demonstrate a comprehensive knowledge of local regulations governing the accountancy profession before they can be registered. Whilst not in itself a barrier to trade, in meetings with national federations in several countries – most notably Austria and Denmark – it was argued that this requirement, combined with legislative and regulatory differences within Europe, make the free movement of accountants, in practice, very difficult.<sup>28</sup> Illustrations of the complications in this respect were highlighted earlier.

### *Restrictions on Establishing Multi Disciplinary Practices*

Amongst the sectors covered by the research, restrictions on establishing multi-disciplinary practices affect in particular Accountancy, Audit and Taxation Services (legal services, not covered by the research, is also affected)<sup>29</sup>, and R Consultancy.

In the Accountancy and Audit, and Tax Services fields, the extent to which business service providers are permitted to offer all their services on a ‘one stop shop’ basis - or prevented from doing so because of independence rules requiring the separation of different functions - is a factor complicating the establishment of multi-disciplinary practices across the EU. The situation in this respect varies from one country to another.

Thus, in Belgium, there is a separation of the auditing and accounting professions. A similar situation exists in a number of other countries. For example in France, an organisation performing a statutory audit (*Commissaire aux comptes*) is required to maintain independence and is not generally allowed to provide accounting or other advisory services. The *Commissaire aux comptes* occupies a particular legal position and has some quasi-judicial roles in, for example, providing evidence. Accordingly, a company wishing to obtain a statutory audit and accounting advice needs to obtain these separately. Also, in France a further legal requirement is that an accountant (*expert*

<sup>28</sup> It was also pointed out that whilst recent EU-wide liberalisation in the legal field meant that lawyers can now use their home title in order to practice throughout Europe (barring the usual linguistic barriers and need to demonstrate local knowledge), this is not yet the case for accountants.

<sup>29</sup> More generally, in the survey the requirement on certain business service providers to adopt a specific legal form was identified by 22% of firms as a ‘very important’ barrier to trade.

# BARRIERS TO TRADE

# 4

*comptable*’) providing accounting advice to a client may also provide ancillary taxation advice. However, he may not provide taxation advice by itself (this function is reserved to the legal profession so some accounting firms have related legal practices). Likewise, in Italy, there is a special form of audit. In Belgium, as indicated earlier, auditors are not able to provide accounting advice. Instead, there are two separate groups for auditors of accounts, and for those providing accounting advice.

In contrast, in Germany, Ireland and the UK, we were told in the interviews with federations and others that although there are some restrictions, auditors can also provide accounting advice and other advisory services on a ‘one-shop-shop’ multidisciplinary basis. For the largest companies who choose to be quoted on US stock exchanges as well as European exchanges, European accounting organisations may also find themselves obliged to follow US independence rules which prevent the provision of some services to quoted clients. There is no evidence to suggest that any particular model is best but there is a clear inconsistency in the way in which the profession is able to work in different EU member states.

In the Engineering Related Consultancy field, the research suggests that there is a different problem relating to multi-disciplinary operations. In some EU Member States – for example, Belgium, Germany and Italy – discussions with case study companies indicated that architects generally take overall responsibility for, and manage projects involving the restoration and construction of buildings. We have commented earlier on some of the effects of this practice. However, any kind of work which is infrastructure-related remains the exclusive preserve of engineers. In France, where there is no direct equivalent of a consulting engineer, architects take full responsibility for major projects, which, in other countries would be managed by consulting engineers. Similarly, in some countries (e.g. in France and Belgium), only architects are allowed apply for planning permission. These practices can again restrict the capacity of firms to operate on a cross-border basis.

### 4.3.3 *Specific Legal Form and Administrative Procedures in Setting Up a Company*

We now consider a further set of barriers, in respect of setting up a local operation in an export market. Administrative procedures involved in setting up a company vary considerably between EU Member States with differing requirements depending on the precise legal form (i.e. limited liability company, partnership, etc) with varying lengths of time required to complete procedures. Complications of this sort were highlighted by an IT Consultancy firm from the UK, which stated that:

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# BARRIERS TO TRADE

# 4

‘We have opened four European offices in the last 18 months. The biggest problem we have faced in all markets is the incredible bureaucracy in forming a legal company compared to the UK. In the UK a Ltd company can be set up (including a bank account) in 2 weeks.

In addition to the purely administrative complications is establishing a company, differing national legislation on the legal form of company formations was also highlighted by the research as a barrier to trade in some business services fields. In Italy, for example, the reason why certain providers do not export significant volumes of their services abroad was attributed to the fact that they are forbidden by law to form companies and therefore do not have the necessary critical mass to field a large enough team to win work abroad. In particular, national legislation in Italy dating back to the 1920s/30s precludes engineers (and lawyers) from forming partnerships or private companies. Instead, professionals in this field operate on a self-employed basis. Paradoxically, foreign firms are allowed to set up private practices/companies in Italy. We were told that an attempt was made by the Ministry of Trade to liberalise the engineering (and legal) professions in order to make them more competitive and facilitate a wider range of legal structures but the proposal was met by fierce opposition.

#### *4.3.4 Differences in National Legal Structures*

The next group of barriers highlighted by the research relates to differences in national legal structures. This is an extremely broad subject and we concentrate on differences in the Personnel Recruitment field and the effect of differences in accounting and commercial legal systems.

#### *Differences in Employment, Tax and Other Regulations Affecting Personnel*

The survey work and other research suggests that differences in personal taxation, pension rights, and employment laws act as a barrier to the cross-border movement of personnel and, as such affect the capacity of business service firms to engage in cross-border trade.<sup>30</sup>

Whilst these differences directly affect the capacity of Personnel Recruitment firms to provide services of a cross-border nature to their clients, the research indicates that they can also have a negative impact, on the ‘input’ side, on the business services sector generally. This is the case especially where the nature of the service involves sending individuals or teams to work on a temporary basis in another EU Member State or recruiting workers locally to help implement projects. It is an issue raised by several firms in the survey of business service providers: according to a French IT Consultancy

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<sup>30</sup> In the survey, restrictive employment regulations was identified by 20% of firms engaged in cross-border trade as a ‘very important’ barrier.

# BARRIERS TO TRADE

# 4

firm participating in the research, the problem was simply that ‘salary conditions and working rights are totally different’. Another organisation we spoke to – a Danish Engineering Consultancy company - illustrated the difficulties with regard to longer-term projects in other EU Member States arising because of restrictive employment regulations:

‘In some cases where the co-workers are going to work in another EU country for a long period of time the administration and accounting of the workers taxes and social fees can take a long time, to get certificates etc’.

More generally, differences in employment legislation within the EU pose a barrier to trade in some countries by placing additional labour costs on employers. In Germany and Sweden, for example, unions have negotiated agreements with employers which stipulate that after six months, temporary staffing organisations must pay all registered temporary employees on their books a wage, irrespective of whether the recruitment agency is able to find them employment. In Germany, employers are obliged to pay the minimum wage to registered temporary workers for 100% of the minimum working week (37 and a half hours). Likewise, in Sweden, employers pay 75-80% of the number of hours constituting a working week (the exact percentage depending on a range of additional factors) at minimum wage level. Similarly, redundancy rules in Sweden are based on a last-in, first-out basis. In practice, this means that even for temporary personnel agencies, it is extremely difficult to terminate the employment of a long-term temporary worker who has worked for the staffing company for a minimum six months. Even if no suitable work is available or the employee has a negative attitude to work, the staffing agency is deemed financially responsible for finding the employee work. Similarly, the company is also responsible for the financial cost of dealing with social problems such as alcohol and drug addiction. The cost to an employer of redundancy in Denmark is substantially lower. Danish employers give just one month notice and are not constrained by the first in, last out rule.

## *Differences in Accounting, Corporate Tax and Legal Systems*

Differences in tax systems and related accounting and legal standards are a complication affecting the capacity of firms in all business services sectors to operate across borders. However, these factors have a particular impact on some of the sectors covered by the research – Accounting and Audit, Tax services, and Leasing and Renting. In respect of accounting, auditing and tax services, the business of the profession relates to corporate and tax law which is nationally based. In respect of leasing and renting, the differences are especially influenced by national fiscal systems.

Many leasing decisions are tax based and leasing provides a tax effective way for a new company to obtain value for set up costs. But the lack of harmonisation in corporate

# BARRIERS TO TRADE

# 4

taxation is a trade barrier that leads to decisions being made on a national basis because tax losses in one country cannot be set off against profits in another. A further factor suggested by the case study research is that because financial leasing companies have to manage and assess credit risk, they are often reluctant to trade outside their own national market. In instances where cross-border financing is required, companies use local partners in other Member States to facilitate financing deals in order to minimise their exposure to risk.

Also in the Leasing and Renting sector, there are differences between countries in the legal framework regulating activities. Thus, from a legal point of view leasing does not exist in France, rather it is 'credit-bail'. While credit-bail and financial lease are often used interchangeably they are not in fact the same. Credit bail comprises leasing with a purchase option and is regulated by a French law enacted in 1966, which stipulates that any company wishing to undertake credit-bail activities must be licensed as a credit institution. Likewise, in France no legal definition of operational leasing exists. Unlike other countries, in France the lessee is never considered the owner of the asset from a legal or accounting point of view, such that in France lessees cannot fully deduct rentals against tax. France's tax legislation therefore has not pushed people towards operational leasing, unlike for example the UK.

The car rental sector is a particular sub sector of leasing and renting where national legislation prevents a single market working effectively. Legislation governing the vehicle leasing and rental industry varies considerably from one country to another, restricting the number of intra-EU cross-border rentals. Although market leaders operate both globally and on a pan-European basis, there are considerable barriers in terms of the cross-border usage of cars. Restrictive legislation in place some countries only allows rental vehicles to be driven outside the country of registration for a limited period of time (14-28 days depending on the country). A further complication is that the period of time which constitutes renting a vehicle as opposed to leasing a vehicle varies between Member States and is dependent on country-specific legislation. For example, renting a car in Portugal for a 3-month period might constitute a lease agreement whereas renting a car for a period as long as 9 months in France might be classified as a car rental. The lack of standardisation in this respect affects the cost to a consumer of hiring a vehicle and is another barrier to a single pan-European pricing structure and market in the industry. Our interviews with key companies indicated that this places a significant extra cost on vehicle leasing and rental companies seeking to operate on a pan-European basis.

#### *4.3.5 Summary of Regulatory Barriers Affecting Particular Sectors and Export Markets*

The tables below summarise the effect of regulatory barriers in particular sectors and export markets.

# BARRIERS TO TRADE

# 4

On a sectoral basis, the regulatory and legal barriers considered above have a significant effect on many of the sectors studied. As explained earlier, Technical Testing and Contract R&D is affected by lack of technical standardisation. Accounting, Auditing and Tax Services are affected by having to work with national legislation. And tax based Leasing is effectively a national activity. IT Consultancy is perhaps the most open of the sectors. The effect can be summarised in the table below.

*Table 4.8: Summary Analysis of Barriers to Trade (Sectors)*

<b>Regulatory</b>	<b>IT Consultancy</b>	<b>Labour Recruitment</b>	<b>Accountancy, Audit and Tax</b>	<b>Contract R&amp;D, Tech Testing</b>	<b>Engineering Related Cons</b>	<b>Rental &amp; Leasing</b>
Differences in national technical standards				xx	x	
Lack of mutual recognition of qualifications		x	xx		xx	
Inability to practice without a licence		x	xx	x	x	x
Restrictions on multidisciplinary practices			xx		x	
Administrative procedures on setting up a company	x	x	x	x	x	x
Differing/restrictive employment regulations	x	xx	x	x	x	
Differences in accounting, tax and legal systems	x	x	xx	x	x	xx

Turning to an analysis by export market, the data from the survey at an aggregate EU15 level provides a useful insight into the perceptions of the relative importance of different barriers to trade of business service providers. But the relatively small number of survey respondents in some Member States identifying certain barriers to trade as ‘severe’ does not support a comprehensive, country-by-country analysis. Nevertheless, a number of general country-specific trends emerged from the survey data. Table 4.9, based on an analysis of the survey data, highlights the frequently mentioned barriers to trade by export market.<sup>31</sup>

*Table 4.9: Summary Analysis of Regulatory Barriers to Trade by Member State, as mentioned by providers*

<sup>31</sup> Where no barriers are listed, this signifies an insufficient number of survey responses to meet the minimum threshold criteria. The analysis is based on the two most frequently mentioned barriers in each of the categories exporting from home base, setting up locally and horizontal barriers. Where the number of most frequently mentioned survey responses tied, both barriers were listed. It should be noted that the number of survey responses varies from country to country. Barriers have then been reordered into regulatory and other. Strictly speaking, the data should be weighted to take account of the varying level of export activity in relation to different markets. However, given the relatively small number of survey responses, this was not considered appropriate.

# BARRIERS TO TRADE

# 4

Regulatory Barriers	A	B/L	D	DK	E	F	FIN	GR	I	IRL	NL	P	SW	UK
Differing national standards		x			x		x		x	x		x		
Complexity of legal systems	x	x		x							x			
Inability to practice without license from professional body		x		x	x				x	x	x	x		
Administrative / legal regulations on setting up locally				x						x				
Requirement to have a specific legal form	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Requirement to obtain local registration			x				x			x				

Whilst the findings are derived from a relatively small sample size, the table nevertheless provides a useful summary of the perceptions of business service providers on the ground. But it must be recognised that the fact that a barrier is not mentioned in this table does not mean that it is not important – for example, case study and interview evidence suggests that the issue of technical standards is important in Germany. However, in the survey respondents mentioned other barriers more frequently.

In the next section we consider some of the cultural and market barriers which have a horizontal effect on most sectors.

#### 4.4 Barriers in Practice - Administrative, Market and Socio Cultural Barriers

Do they prevail in all EU Member States or are some more severe in some countries than others?

What is the impact of these barriers on the mode of delivery, the competitive conditions in the relevant markets (home base or establishment abroad) and the ‘maturity’ of firms or markets?

This section describes the main administrative, market and socio cultural barriers and comments where appropriate on their effect on different countries and sectors. We consider each of the major barriers identified by the survey or fieldwork in turn under the following groups.

- *Distance related barriers* including barriers such as a the overall difficulty of supplying services at a distance, and the need to have a credible local track record and the need to be able to provide a credible following up service.
- *Market related barriers* including the perceived difficulty in obtaining information on tenders, the high cost of bidding and exemption clauses in public procurement as well as the existence of potentially subsidised local suppliers.
- *Other market related barriers* include unacceptable delays in payment, and the cost of setting up a local operation where this is the chosen method of service delivery.

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# BARRIERS TO TRADE

# 4

- *Cultural factors* including the need to work in a local language and differences in local business traditions.

In carrying out the research we found (as noted earlier) that business service providers had the most detailed insights into these types of barriers to trade in business services. Unlike regulatory barriers, cultural and market barriers affect most sectors and countries. Apart from identifying language and other socio-cultural factors, national authorities contributed very little to this aspect of the research.

#### 4.4.1 *Distance Related Factors*

The importance of distance-related factors as a potential barrier to trade, especially for smaller firms, were highlighted by the survey.<sup>32</sup> A Spanish engineering company summed up the problem facing SMEs in all sectors:

In the case of "peripheral" countries like Spain, travel costs make competition difficult. The alternative of setting up a local branch is only affordable for large companies/institutions.

A distinction needs to be made here between purely locational considerations, such as those highlighted above, and factors relating to the process involved in delivering a business service and, more specifically, providing after-care. The survey work suggested that in the case of Leasing and Renting, Accountancy and Audit, and IT Consultancy, the need for a local presence in order to provide after-care services is a significant requirement. This is likely to be because of the nature of the services firms in this sector provide which are typically of an on-going nature rather than one-off or project related. After-care requirements are far less evident in other business service sectors.<sup>33</sup>

Analysis of the survey data suggests that with the exception of providers employing less than 10 people, distance related factors and the need to be represented by a local agent are indeed of greatest concern to smaller companies. This is consistent with the earlier analysis concerning the methods of delivery of cross-border business services showing that the smaller the company, the more likely it is to rely on exporting from the home base. Larger companies have achieved the scale to operate cross border. Nevertheless, there is some evidence that e-commerce is assisting in this area.

#### 4.4.2 *Market Related Barriers*

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<sup>32</sup> In the survey, difficulty in supplying services because of distance-related factors was identified by 31% of providers engaged in cross-border trade as a 'very important' constraint.

<sup>33</sup> The need to have a local presence in order to provide after-care to clients was highlighted by 22% of providers currently engaged in cross-border trade as a 'very important' barrier.

# BARRIERS TO TRADE

# 4

In respect of market related areas, the first barrier which a company can face is finding sources of potential business. This applies particularly in the private sector but can also apply to the public sector. The public sector is of course much better documented and is subject to the EU public procurement regulations. Obtaining information on potential sources of business is a problem more affecting smaller rather than larger companies.

The EU public procurement market is, of course, open following the implementation of the Single Market programme. But discussions with national federations nevertheless highlighted what are perceived by them as discriminatory practices with regard to public procurement as a barrier to trade. One problem, it was argued, is a tendency in government entities to favour internal/in-house consultancy providers rather than the private sector (this is an issue that the European Engineering Consultancy Federation (EFCA) has signalled as an important barrier to fair competition within the EU market for engineering consultancy services).

Another issue, raised more often by those we spoke to, is what is seen as increasing use of negotiated procedures which tends to make it more difficult for businesses to sell their services to public sector clients in other EU Member States. Our research suggests that in Germany, Ireland and Luxembourg, negotiated procedure, which is only supposed to be applied in a limited number of circumstances, is nevertheless frequently used, in violation of the EU directive on public procurement.<sup>34</sup>

The perception that there are discriminatory commercial practices in the public procurement field would seem, however, to be largely confined to the Engineering Related Consultancy sector. The explanation for this perhaps lies in the fact that this sector (and, albeit to a lesser extent, Contract R & D and Technical Testing) tends to have a higher proportion of public sector clients than the others covered by the study.<sup>35</sup>

## *Unfair or Subsidised Competition*

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<sup>34</sup> Negotiated procedures can be applied in cases where contract specifications cannot be established with sufficient precision to permit the award of the contract by selecting one of the other procedures (design contest, restricted procedure, open procedure). However, the Commission noted in the *Greenpaper on Public Procurement*, 27<sup>th</sup> November 1996, that the negotiated procedure is 'an exceptional means of awarding contracts that may be used only in exhaustive list of cases' and concluded that 'the procedure is less favourable to the goal of market transparency'. The negotiated procedure was used in 82% of cases in Germany, 75% in Luxembourg and 63% in Ireland, which runs contrary to the principle of the EU public procurement directive.

<sup>35</sup> The Services Directive establishes procedural rules for the publication of calls for tenders and the award of contracts in relation to public procurement. Since 1994, FRI has been monitoring the percentage of calls (published notices) made by each Member State for architectural and consulting engineering services (in the Official Journal) according to the type of procedure used for the tender. FRI has identified a significant number of contraventions of the EU contract directive governing the tendering procedures.

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# BARRIERS TO TRADE

# 4

Subsidised or unfair competition was a further issue raised in the category of ‘differences in commercial practices’.<sup>36</sup> In the Contract R&D sector, for example, several organisations indicated that there is what is seen as unfair competition from local universities and other publicly-funded in the technical education and research field. The argument made in one interview we held was that professors and other professionals in these institutions often get involved in R&D consultancy in an attempt to valorise their existing research activities, but can offer their services at unrealistically low prices as their fixed costs are already covered by the public purse.

#### 4.4.3 *Other Market Related barriers*

Other market related barriers include delays in payment and the high costs of entering new markets

The difficulties of managing cross-border cash flow and obtaining prompt payment from creditors were commented on by one German leasing firm that made an input to the research:

‘We have enough problems with incoming cash flow from abroad (outstanding balances). It's very difficult to enforce claims in other EU countries. The costs are huge’.

Developments in the banking systems in the past decade – and in particular the introduction of the euro- have made the cross-border transfer of cash much easier. However, the problem highlighted here relates more to pursuing creditors where procedures and rights vary from one country to another.

#### 4.4.4 *Socio Cultural and Other Barriers to Trade in Business Services*

Language and related cultural barriers are perhaps the most important type of barrier to trade in business services but the research also highlights other factors such as differing commercial practices as barriers to trade.

##### *Language*

Overall, the need to work in local languages stands out as being the most significant socio-cultural barrier – indeed, the survey suggested that language ranks above all other

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<sup>36</sup> In the survey of business service providers, subsidisation of local suppliers was ranked by 23% of firms engaged in cross-border trade as a ‘very important’ barrier.

# BARRIERS TO TRADE

# 4

barriers – legal, regulatory, financial, market-related, etc – as a constraint on cross-border trade in business services.<sup>37</sup> The need to work in local languages, whilst ranked highest overall in the survey, was not however seen as a significant factor in a number of countries, most notably Denmark and the Netherlands. But in France for example, this barrier was raised repeatedly during the national research.

Linguistic and cultural diversity within Europe, is viewed as a barrier to trade in business services by many of the survey respondents. But as the literature review makes clear it can also increase local demand in European business services sector. The very diversity of doing business in different economic, linguistic and socio-cultural environments means that companies seeking to export their products might need to buy in specialist expertise from the business services sector. Rubalcaba-Bermejo points out that ‘in the same way that linguistic services are justified by the existence of different languages, many services are created in response to the diversity of the markets.’<sup>38</sup>

This view was supported by feedback from several operators in the Accountancy and Audit field who argued that smaller practices many smaller practices operating in local markets derive their competitive advantage from a familiarity with local regulations and practices. Similar arguments are clearly likely to hold true (in varying degrees) to smaller firms in other business service sectors, particularly those that deal with local regulations or languages.

## *Differing Commercial Practices*

The research suggests that differing commercial practices, ranging from the way in which tenders are rewarded and the need to maintain and develop contacts with those who will award tenders, to practices in respect of fixed fee scales are also seen as a barrier to trade.

The Engineering Related Consultancy sector illustrates this perhaps most clearly. Germany and Ireland both use a system of fee scales that guarantee engineering consultants a fixed fee, even for public sector projects, which means that there is very little price competition. Elsewhere, this practice is less common. This can be considered a barrier to trade in the sense that foreign firms cannot compete in countries using the fee scale on price – they can only compete on quality or experience.

Differences in commercial practices can cover a broad range of potential barriers to trade affecting business services. However, with the exception of what are seen as restrictive

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<sup>37</sup> In the survey, the need to work in local languages was highlighted by 40% of providers engaged in cross border trade from the home as a ‘very important’ barrier and by 52% of firms with a local operation in an export market.

<sup>38</sup> Rubalcaba-Bermejo, ‘Business Services in European Industry’ (European Commission, p. 323, 1999).

# BARRIERS TO TRADE

## 4

public procurement procedures and subsidies to competitors, the practices concerned tend to affect both domestic and non-domestic business service providers. Lack of familiarity with the local environment makes it more difficult, however, for non-domestic providers to overcome the complications.

### 4.4.5 Summary of Horizontal Barriers by Sector and Export Market

By the nature of horizontal barriers, they affect most sectors. But in some sectors, language is more of a problem than others. Leasing and rental (largely finance based) and IT consultancy (where English is widely used) perhaps have less of a problem. A summary of the ways in which barriers affect the main sectors is shown below.

*Table 4.10: Summary Analysis of Barriers to Trade (Sectors)*

<b>Market Related and Socio Cultural</b>	IT Consultancy	Labour Recruitment	Accountancy, Audit and Tax	Contract R&D, Tech Testing	Engineering Related Cons	Rental & Leasing
Linguistic and related socio-cultural barriers	x	xx	xx	xx	xx	x
Differing commercial practices	x	x	x	x	x	x
Distance-related factors affecting service delivery	x	x	xx	xx	xx	x
Other market related and socio cultural barriers	x		x	x	x	

From an export market point of view, the situation is similar. We have already mentioned in dealing with regulatory barriers that the relatively small number of survey respondents in some Member States identifying certain barriers to trade as ‘severe’ does not support a comprehensive, country by country analysis. Nevertheless, a number of general country-specific trends emerged from the survey data. Table 4.11, based on an analysis of the survey data, highlights the frequently mentioned horizontal barriers to trade by export market.<sup>39</sup>

*Table 4.11: Summary Analysis of Horizontal Barriers to Trade by Member State*

<sup>39</sup> Where no barriers are listed, this signifies an insufficient number of survey responses to meet the minimum threshold criteria. The analysis is based on the two most frequently mentioned barriers in each of the categories exporting from home base, setting up locally and horizontal barriers. Where the number of most frequently mentioned survey responses tied, both barriers were listed. It should be noted that the number of survey responses varies from country to country. Barriers have then been reordered into regulatory and other. Strictly speaking, the data should be weighted to take account of the varying level of export activity in relation to different markets. However, given the relatively small number of survey responses, this was not considered appropriate.

# BARRIERS TO TRADE

# 4

Horizontal Barriers	A	B/L	D	DK	E	F	FIN	GR	I	IRL	NL	P	SW	UK
Difficulty in supplying service because of distance-related factors	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Need to work in local language			x			x	x	x		x		x	x	x
Need for local track record			x		x	x			x	x	x	x	x	x
Excessive costs for setting up a local operation			x		x	x			x	x	x	x		x
Lack of necessary skills/ costly training or workers		x	x	x	x	x	x		x	x	x		x	x
Differences in local traditions													x	

Source: CSES analysis of survey data.

Unsurprisingly, distance factors and the need for a local track record was frequently mentioned. The need to work on local languages was mentioned in the larger markets – perhaps in those markets users are used to suppliers who speak their own language. Skills and training were also mentioned frequently.

## 4.5 Perception of Business Service Users

Do business service providers mainly perceive them or do they also prevent users from purchasing services in other EU Member States?

We now consider the perceptions of business service users. As noted in an earlier section, perceptions of barriers to trade vary according to whether companies are primarily providers or users of business services. Also, perceptions vary between companies (whether providers or users), national authorities and federations. This section considers the views of users as expressed in the survey or in interviews with national authorities. We did not carry out case studies with users.

Business service users were asked to identify factors, in addition to differences in range, price, and quality that might help explain why services from other EU Member States are not used. The table below provides an analysis of the responses. The analysis is based on the number of times the various factors were mentioned in the survey as constituting a barrier to trade. The total number of companies in the sample (198) has been used as the denominator. It should be noted that multiple responses were possible.

Table 4.12: User Views - Barriers to Trade in Business Services

Barriers to Purchasing Business Services from Other EU Countries	Survey Responses	
	No	%
(1) Language complications	137	69.2

# BARRIERS TO TRADE

## 4

(2) Different commercial practices and traditions	128	64.6
(3) Difficulty in identifying suitable foreign suppliers	125	63.1
(4) Uncertainty about after-care services from abroad	124	62.6
(5) Need for close interaction with suppliers	122	61.6
(6) Uncertainty about legal contracts with foreign suppliers	116	58.6
(7) Difficulty in getting information on track record of foreign suppliers	108	54.5
(8) Procedures for cross-border payments are more complex	95	47.9
(9) Use of domestic suppliers encouraged by national authorities	83	41.9
(10) Tax on foreign suppliers makes them more expensive	83	41.9
(11) Planning and zoning restrictions on foreign suppliers	82	41.4

*Source: CSES analysis of survey data*

As noted earlier, it is clear that the number of users identifying barriers to trade in cross border business services is higher than with providers. There are a number of possible explanations for this difference. Case study feedback from business service providers themselves suggests that the more dynamic companies tend to work around problems, modifying their service offering, delivery methods and marketing targets to suit circumstances, or in the case of larger companies perhaps even adapting the corporate business model itself. In the discussions, many barriers to trade, in themselves, were not highlighted as a ‘show-stopper’. This is, for example, evident in Ireland where we were told by the authorities and business representatives that there is now very much a ‘can do’ business culture. Another factor could be that at the company level – particularly amongst smaller firms – there is in many cases simply a lack of awareness and understanding of the role that regulatory factors can play in either facilitating or constraining cross-border trade. Also, business service providers have to both overcome barriers to trade, and carry out marketing work with potential users to convince them that they should buy services cross border.

### 4.6 Perception of Public Authorities and Trade Associations

Have these barriers already been identified (in existing literature or by business organisations) and if so, what is the reason for failure to address them?

Feedback from the interviews with national authorities is extremely mixed with regard to their perception of the extent and severity of remaining barriers to trade in business services. National authorities monitor complaints from companies relating to the Single European Market and this was in most cases the basis of their judgement. This information does not, however, always give a clear picture of the barriers to trade

# BARRIERS TO TRADE

# 4

specifically affecting the business services sector. We illustrate below some of the discussions with public authorities.

Thus, in Finland, the Ministry of Trade & Industry (Internal Market unit of the Trade Directorate) monitors complaints from firms relating to the Single European Market – it receives around 40 complaints a year ranging from very minor complaints to serious infringements of internal market law. It is estimated that 90% of these complaints are related technical trade barriers. However, the Ministry's database is not designed in a way that allows the originators of the complaints to be analysed by sector and the proportion specifically coming from business services firms is therefore not known. But the proportion of complaints from service sector companies generally is thought to be significantly lower than for the manufacturing sector. Government officials speculated that it might be that fewer barriers were encountered, or that the issues and legal situations regarding potential infringements are more complex in the services sectors (compared with manufacturing), or that service companies are less aware of relevant internal market legislation.

Likewise, to take another country, we were told by the Spanish authorities that they had received only five complaints from companies regarding barriers to trade affecting export markets elsewhere in the EU in 1999 and only 5-6 representations were received from other Member States concerning Spain (the majority of these were able to be resolved quickly as they were in part triggered by language problems or misunderstandings). In the Netherlands, between 1997 and 1999 114 complaints were received by the authorities. A breakdown of this number by type of complaint shows Free Movement of Goods (56), Free Movement of Services (22), Free Movement of Persons (2), Public procurement and VAT related complaints (15). The majority of the complaints tend to relate to goods or taxation, with few being related specifically to business services. In France, approximately 60% of all complaints made by companies to the Single Market monitoring unit are related to standards and technical harmonisation, VAT and mutual recognition. However these statistics are in respect of both manufacturing and services sectors.

For many national authorities, having access to reliable and up-to-date information on business service markets in other countries, and the real extent of barriers, would appear to be an important concern. Without time-consuming surveys and monitoring exercises, national authorities are often dependent on anecdotal feedback.

Overall, the interviews with national authorities provided two clear messages:

- That they are insufficiently aware of the potential effect of barriers to trade in business services and wish to obtain more information;

# BARRIERS TO TRADE

# 4

- There was a perception that business service companies are less likely to complain about barriers and more likely to organise themselves in such a way as to overcome them.

Turning to the business service federations, at a European and national level, the federations are very aware of the seriousness of problems arising from regulatory barriers to trade in their particular sectors. This perhaps to be expected given that their ‘raison d’etre’ partly lies in lobbying public authorities on regulatory and other issues.<sup>40</sup>

Several federations have carried out studies. Good examples are work by the accounting and tax federation the FEE and by the consulting engineering association EVCA. In contrast, we found little interest by IT consultancy trade associations in the subject (it was suggested that the market is open) and in the leasing and renting field and technical testing and contract R&D no good attempt to tackle the issues came to our notice.

The fact that there are such differing perceptions between business service providers, users, national authorities and federations of the extent and nature of remaining barriers to trade in business services does of course make it very difficult to prioritise them in a simple way.

## 4.7 Reasons for Remaining Barriers and Scope for Action

Is there a need for corrective measures through some sort of legislative action or is it more a problem of enforcement, cooperation, etc? If corrective measures are required, would they affect sectors and countries individually or would some sort of grouping appear?

The literature review suggests that although many of the barriers examined in this section have been previously identified, there is far less research available on how the different types of barriers affect different business service sectors, or the implications for the ways in which they operate and deliver services. Many of the barriers which affect trade in services also affect other parts of the single market programme such as the free movement of goods or the mutual recognition of qualifications.

In carrying out the research, we found that businesses in the different EU Member States generally have a good awareness of the remaining regulatory barriers to trade in their own sectors, and a general awareness of the more ‘horizontal’ barriers of a socio-cultural and administrative nature. From the perspective of national authorities, however, there appears to be a high-level view of market and sector conditions, and some information

<sup>40</sup> A technical factor that may help explain these differences is that the survey questionnaire used to obtain views from companies included a long list of possible barriers to trade with more scope for identifying non-regulatory than regulatory factors.

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# BARRIERS TO TRADE

# 4

on the Single Market issues facing companies obtained from monitoring complaints, but less detailed insights to the extent and nature of barriers to trade at a sectoral level. Moreover, in both the case of national authorities and federations, there is an apparent reluctance to admit that there may be barriers to entering their domestic markets.

In considering the cause of remaining barriers to trade in business services, and what can be done to remove them, there is an important distinction to be made between:

- Barriers of a market related and socio-cultural nature, as opposed to regulatory and administrative barriers;
- Situations where the problem facing business service companies stems from a failure to implement legislation rather than its complete absence;
- The need to focus any measures on smaller business service providers who are generally less well-placed to devise their own strategies for overcoming barriers to trade.

Taking the first of these factors, there is little that public authorities at a national or EU level can do to address the purely socio-cultural barriers that exist (e.g. difficulties arising from linguistic factors). There is, however, action that could be taken to help business service firms overcome the type of administrative and market-related barriers identified earlier, especially where this involves adopting different mechanisms for delivering services to export markets. In particular, in several interviews with national business organisations, and companies themselves (especially smaller providers), it was argued that more should be done to facilitate the formation of cross-border partnerships and other forms of networking between firms as an intermediate step to a situation where there are no barriers to trading across the EU in business service markets.

The scope for action by public authorities at a national and EU level to address problems arising from the existence of regulatory barriers is clearly greater. Here, however, it is important to distinguish between situations where the problem facing business service companies stems from a failure to implement legislation rather than its complete absence. We can summarise the extent of action taken so far and the action required in respect of the main regulatory barriers as follows:

# BARRIERS TO TRADE

# 4

Table 4.13 – Summary of Reasons for Remaining Regulatory Barriers and Scope for Action

Regulatory barrier	Principal sectors affected	Is there an issue of enforcement	Is there a current EU legislative programme	Is the current programme likely to deal with all problems
Differences in national technical standards	Contract R&D Technical testing	Some	Yes	Unlikely
Lack of mutual recognition of qualifications	Accountancy & audit Tax Engineering related consultancy	Some	Yes	Most
Inability to practice without a licence	Accountancy & audit Tax Engineering related consultancy	Not really	Some	Some
Restrictions on multidisciplinary practices	Accountancy & audit Tax Engineering related consultancy	No	No	na
Administrative procedures on setting up a company	All sectors	No	Yes	Most but will need to tackle legal form
Differing/restrictive employment regulations	All but in particular Personnel Recruitment	Not really	Yes	Unlikely
Differences in accounting, tax and legal systems	All But in particular Leasing and renting	Not really	No significant programme	na

The scope for action may be summarised as follows:

- *Differences in national technical standards* are already the subject of significant EU programmes. But even where standards have been brought together, local cultural issues still may require locally-based testing. Development of the existing single market programme will help, but there is scope for further action in respect of ensuring that technical testing houses are able to issue marks recognised by consumers in other countries. And there may be scope for providing further information in this regard.
- *Lack of mutual recognition of qualifications*. Where the profession concerned deals with local law or with local regulations, a body of local knowledge is needed. The scope for action in this area is limited, but the professions concerned have made some helpful proposals.

# BARRIERS TO TRADE

# 4

- *The ability of professionals to practice without a licence* raises conflicting questions of consumer protection and the encouragement of competition. There is scope for action where licences are being used in a protective fashion.
- *The issue of multidisciplinary practices* is similar – should accountants be permitted to carry out some functions in some countries but not in others? A similar situation exists with consulting engineers. Here there would appear to be scope for some action to bring the regulatory environment together.
- Action is already being taken by the Commission in respect of speeding up ways of setting up a company. But the need for a *particular legal form* is related to licensing needs and any action in this area can be based on licensing requirements
- *Differing employment regulations* affect the Personnel Recruitment sector in particular, although the issue affects all sectors. These are issues which are already the subject of existing single market programmes.
- *Differences in accounting, legal and tax systems* are more deeply-rooted and the scope for action may be less. But some sectors are particularly affected and, as explained earlier, there may be scope for legislation in the field of leasing and renting and in particular vehicle renting.

In respect of non-regulatory horizontal barriers the scope for action is clearly less. But there are issues of enforcement in some areas, for example in respect of subsidised competition that could be tackled in the context of encouraging cross-border trade in business services.

There are also important effects by size of company. Smaller business service providers are generally less well-placed to devise their own strategies for overcoming remaining barriers to trade. In the case of the very smallest firms, where there is generally little interest or capacity to trade across-borders, this consideration is of course less relevant. Likewise, the very largest business service providers are able to devise and implement their own strategies to operate in fragmented markets. They have the scale to set up locally in accordance with local needs. From a public policy standpoint, therefore, it could be argued that actions to remove remaining barriers to trade should focus on the mid-market – the niche player ‘business model’ discussed in Section 3 – where the potential to benefit from increased cross-border trade is probably greatest.

## 4.8 Conclusions – Remaining Barriers to Trade

This section suggests that the key remaining regulatory barriers are:

# BARRIERS TO TRADE

# 4

<ul style="list-style-type: none"> <li>• Differences in national technical standards</li> <li>• Lack of mutual recognition of qualifications</li> <li>• Inability to practice without a licence</li> <li>• Restrictions on multidisciplinary practices</li> </ul>	<ul style="list-style-type: none"> <li>• Administrative procedures on setting up a company</li> <li>• Differing/restrictive employment regulations</li> <li>• Differences in accounting, tax and legal systems</li> </ul>
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The research indicates that the above barriers affect a broad range of business services. Other barriers of a regulatory nature are more sector-specific in their effects. Problems resulting from a lack of mutual recognition of professional qualifications appear to mainly concern the Accountancy and Audit, and Engineering-Related Consultancy sectors – these are the areas where professional qualifications are required to practice. Whilst the Personnel Recruitment industry itself is not directly affected, lack of mutual recognition of qualifications does, however, complicate the delivery of some services on a cross-border basis. Likewise, whilst differences in personal taxation, pension rights, and employment laws generally directly affect the capacity of Personnel Recruitment firms to provide services of a cross-border nature to their clients, the research indicates that they can also have a negative impact, on the ‘input’ side, on the business services sector generally.

Amongst the sectors covered by the research, restrictions on establishing multi-disciplinary practices only affect Accountancy, Audit and Taxation Services (legal services, not covered by the research, is also affected) whilst differing national standards primarily affect the Technical Testing, and to a lesser extent, the Contract R&D sectors and Engineering Related Consultancy sectors.

In addition to remaining barriers to trade of an essentially regulatory nature, the research highlights barriers of an administrative and/or socio-cultural nature affecting business services. These include:

- Linguistic and related socio-cultural barriers
- Distance related factors affecting service delivery
- Market related barriers including obtaining information about contracts and the issue of unfair competition

Perhaps not surprisingly, the market and socio-cultural barriers identified in this section tend to affect all companies irrespective of the sector (although the IT Consultancy sector, for example, is less affected by language barriers than others due to the international characteristics of the sector, while conversely Accountancy and Audit, Contract R&D, and Engineering Related Consultancy - all of which tend to be particularly customised to local markets and client requirements – are especially affected by distance-related

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# BARRIERS TO TRADE

# 4

factors). Likewise, perceptions regarding the extent and severity of barriers vary with national authorities, business organisations and companies themselves often stressing different factors as being most significant.

# IMPACT OF BARRIERS TO TRADE

# 5

## Overview

This section examines the impact of remaining barriers to trade in business services and the possible effect of their removal. Key questions, as defined by the Commission, are summarised below:

### *Key Questions – Impact of Barriers to Trade in Business Services*

- What is the impact of barriers to trade market structures, the level of internal restructuring, economies of scale and operating margins and prices (overall, by sector, country, etc)?
- Is the situation common to the business services or can we draw some clear and interesting distinction between sectors, countries or firms' size?
- Are associated costs so important that the result is a high degree of market fragmentation?
- To what extent can we really claim that barriers to trade are so important as to prevent businesses from operating on a truly European scale?

The impact of barriers to trade can be assessed in several ways:

- The impact that barriers to trade have at present on company activities and market structures in the business services sector;
- What might happen if remaining barriers to trade were to be removed, i.e. the benefits that might be expected to arise in the future from a fully liberalised market for business services.

Below, we first consider the impact of barriers to trade and then the counterfactual question of how their removal might affect the way in business service markets operate. These two questions are of course closely linked but it is nevertheless helpful to make a distinction between them. Section 5.2 then examines the impact of removing barriers to trade from the point of view of different business service sectors and companies within them. Section 5.3 summarises the main findings and conclusions.

## 5.1 Impact of Barriers to Trade on Market and Company Structures

What is the estimated impact of barriers to trade on the market structure and level of internal restructuring, the economies of scale and operating margins and prices (overall, by sector, country, etc)?

The impact of remaining barriers to trade was examined at a company level in the survey and case studies (a caution needs to be added, namely that companies generally found it

# IMPACT OF BARRIERS TO TRADE

## 5

difficult to assess the impact of remaining barriers to trade on their activities, or to assess the effect of their removal, especially in terms of costs). Discussions with national federations, business organisations and public authorities shed light on the effects at a sector and national level.

### 5.1.2 *Impact of Barriers to Trade*

The previous sections of this report have examined the nature and structure of EU business services markets and the extent to which they are affected by barriers to trade. It will be recalled that:

- Whilst domestic markets are generally seen as already being very competitive, most of the competition comes from domestic firms;
- Business service users and providers face a variety of regulatory, administrative, market-related and socio-cultural barriers to cross-border trade;
- Existing levels of cross-border trade are relatively modest and there is evidence of price differentials between different EU business service markets.<sup>41</sup>

The survey work suggests that only 29% of users have purchased business services on a cross-border basis and that these purchases account for less than 5% of overall spending on business services. From the perspective of business service users, the relatively modest levels of cross-border trade mean that companies may not be obtaining the best services available and may be paying more than necessary for the services they do use.

From the perspective of business service providers, the fact that 47% have so far traded only in domestic markets means that the potential additional growth and economies of scale to be obtained from exploiting wider EU markets – and possibly establishing EU-wide corporate structures – is not being fully achieved. Similarly, where companies are exporting to other EU markets, the research points to relatively modest revenue streams (accounting in most cases for less than 10% of overall turnover) and a situation where the cost of selling into EU export markets is higher than it should be. High start-up and operating costs also deter potential new entrants to export markets.

Taken together, therefore, the analysis set out in the previous sections of this report points to fragmented EU markets for business services, the relatively modest levels of cross-

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<sup>41</sup> Amongst firms who claimed that a price differential exist, a majority of users expressed the view that prices were generally higher in their home markets than in other countries: 18.3% of respondents stated that prices were higher in their domestic markets compared with 12.2% who stated that prices were lower.

# IMPACT OF BARRIERS TO TRADE

## 5

border trade having potential negative consequences for both users and providers in terms of higher costs and lower sales. However, these negative effects may not be solely attributable to the existence of barriers to trade. Below, we examine what effect the removal of barriers to trade might have.

### 5.1.2 Effects of Removing Barriers to Trade

The potential effect of removing barriers to trade is that there could be a cumulative impact on business service markets and firms within them. In principle, it is possible to hypothesise a scenario under which the following impacts occur:

<i>Hypothetical Effect of Removing Barriers</i>
<p><b>Short Term Effects</b> - the first potential effect of the removal of barriers may be to liberalise markets with an increase in cross-border demand and/or a freeing up of cross-border supply. The effect of such liberalisation will be to increase competition. A symptom of a lack of competition may be large price differentials between what appear to be similar markets.</p>
<p><b>Intermediate Effects</b> - Increased competition is likely to put pressure on business service providers to reduce prices, improve quality or a combination of these and other factors such as a more innovative service offering. Existing 'business models' may be able to accommodate these effects (e.g. by reducing profit margins) but in some cases, and/or in the longer-term, more fundamental alterations to corporate strategies and structures may be necessary to remain competitive.</p>
<p><b>Longer Term Effects</b> - A reduction in prices (or increase in quality requirements) caused by increased competition will require firms to restructure and/or to investigate new forms of service delivery, or to reduce their costs in other ways to stay in business and remain profitable. As such, in the longer term, the effect of removing barriers to trade could be to stimulate corporate restructuring which if extended to include consolidation at a European level could lead to fundamental changes in the structure of business service sectors and markets as a whole.</p>

However, these scenarios need to be qualified by highlighting two considerations:

First, the removal of barriers to trade may not, alone, lead to all companies seeking to exploit Internal Market opportunities. As highlighted earlier in this report, smaller firms in particular often have neither the resources nor the desire to engage in export activity (however, they may of course be affected by greater competition in their domestic markets). Likewise, from a business service user perspective, similar considerations (e.g. the modest scale of procurement activities) may mean that opportunities arising from the removal of barriers to buy from suppliers based outside their country are not considered worthwhile investigating.

# IMPACT OF BARRIERS TO TRADE

## 5

Second, business service markets are strongly influenced by the nature of the service being supplied – some are capable by their nature of being supplied remotely whilst others require a physical presence in the export market concerned. Although this research has focused on services that have a relatively high degree of ‘transportability’ (compared, for example, with security or office cleaning services), the importance of a physical presence in export markets nevertheless varies, as the analysis earlier in this report makes clear. Factors such as these help determine the nature of the market and will not necessarily change because of changes in the regulatory environment.

Below, we consider the possible effects of removing barriers to trade and the extent to which the propositions set out above are likely to be valid.

### *Short Term Effects – Increased Cross Border Purchases and Sales*

As suggested above, the first potential effect of removing barriers to trade may to liberalise markets with an increase in cross-border demand and/or a freeing up cross-border supply.

Business service users and providers were asked in the survey whether they would increase cross-border purchases/sales if barriers to trade were removed. The responses, summarised in Table 5.1 suggest that in many cases they would do so<sup>42</sup>:

*Table 5.1: Summary Analysis - Impact of Removing Barriers on Cross Border Purchases/Sales*

Would company increase purchases/sales?	Users		Providers	
	No	%	No	%
Yes	66	33.5	162	52.8
No	45	22.8	61	19.9
Don't know or non response	87	43.7	84	27.3
TOTAL	198	100.0	307	100.0

*Source: CSES Analysis of survey data.*

The starting point of any analysis should, logically, be to examine the views of business service users – unless they react favourably to a removal of barriers, there is unlikely to be an increase in cross-border trade.

<sup>42</sup> Appendix 5 sets out a more detailed analysis of the survey responses.

# IMPACT OF BARRIERS TO TRADE

# 5

## *Business Service Users*

It will be recalled from the analysis in Section 4 that the criteria applied by business service users to select suppliers tend to focus on quality and expertise rather than physical proximity. Domestic business service providers are not seen as having a clear advantage over those from other EU Member States provided that there is a local track record and follow up service is assured. Even so, the overwhelming majority of firms purchase business services from domestic rather than other EU sources and the value of cross-border purchases is low.<sup>43</sup>

Against this background, there is clearly considerable scope, from a demand-side perspective, for cross-border trade to be increased and, indeed, the above analysis suggests that a significant proportion (33%) of business service users would increase cross-border purchases if barriers to trade were to be removed. However, a notable feature of the survey analysis shown in Table 5.1 is that the proportion of business service users stating that this would be the case is considerably lower than with providers. We can only speculate as to the reasons for this.<sup>44</sup> One possible explanation is that it almost certainly more difficult for users, in advance, to predict how they might react if barriers to trade were to be removed: except where users have previous experience of evaluating offers from non-domestic providers, or perhaps are engaged in activities where non-domestic providers are known to have a leading position in the market, they will lack the information required to make a judgement on an ex-ante basis.

Analysis of the survey responses from the business service users who stated they would increase cross-border purchases indicates that a disproportionate number come from the manufacturing sector.<sup>45</sup> From the perspective of the types of business services purchased, users who had previously bought Engineering Related Consultancy, IT Consultancy and Technical Testing services were less well-represented amongst those firms stating they would increase cross-border trade than those who had purchased other the types of services covered by the research. In terms of firm size, there was little difference between users in different size bands saying they would/would not increase cross-border

<sup>43</sup> See Section 3.3. The analysis of the survey data suggests that from the sample of 198 firms, only 58 (29%) had purchased services on a cross-border basis with the value of such purchases estimated at less than 5% of total expenditure on business services for most firms.

<sup>44</sup> The research involving users was confined to the survey and in this and so we do not have other research, as in the case of business service providers, that can be used to shed light on the survey findings.

<sup>45</sup> See Table 4.29(d) in Appendix 5. This shows that 44% of users from the manufacturing sector stated they would increase cross-border purchases if barriers to trade were removed compared with 41% of users from the service sector. However, manufacturing companies made up only 36% of the sample compared with 42% for service sector users.

# IMPACT OF BARRIERS TO TRADE

## 5

purchases. Last but not least, with regard to location, the survey work suggests that users in three EU Member States – Austria, Greece and Ireland – would be especially likely to increase their purchases from other EU Member States (these findings need to be treated with caution because of the relatively small sample sizes).

### *Business Service Providers*

How would business service providers react to an increase in tendering opportunities from other EU Member States?

As Table 5.1 shows, a relatively high percentage (53%) of business service providers stated that they would increase cross-border trade if remaining barriers were to be eliminated. The case study research suggests that most firms – certainly the larger ones – monitor export market opportunities quite closely and this is reflected in the greater certainty in the responses from providers than from users.

Analysis of the survey feedback and case studies that from the supply-side perspective, increased cross-border trade in business services could come in several ways:

- Providers who are already exporting to other EU countries increasing the level of cross-border sales, either in their own or related markets;
- Other firms who have so far only sold services to domestic clients taking advantage of a removal of barriers to trade and entering export markets for the first time ('potential new entrants').

The distinction between existing exporters and 'potential new entrants' is important since firms in these two categories will be influenced by different factors in reacting to a removal of barriers to trade. This distinction is examined in further detail below.

Analysis of the survey responses from business service providers who stated that they would increase cross-border sales indicates that a relatively high proportion (52%) are already exporting to other EU Member States. An additional 7% of providers had done so in the past (for the purposes of the analysis, we have defined these firms, along with the providers who have never exported, as 'potential new entrants'). Table 5.2 summarises the survey data and cross-tabulates the responses with the survey feedback from existing exporters and 'potential new entrants' on the likelihood of an increase in cross-border sales.

# IMPACT OF BARRIERS TO TRADE

## 5

Table 5.2: Providers Who Would Increase Exports If Barriers to Trade Are Removed

	Existing Exporters	Potential New Entrants
(a) Number of providers currently exporting/not currently exporting	165	142
(b) Providers stating they would increase exports if barriers removed	107	47
(b) as a percentage of (a)	64.8%	33.1%

Source: CSES analysis of survey data. Note: In the table 'Potential New Entrants' consist of firms that (1) have never considered exporting; (2) considered exporting but decided not to go ahead; and (3) exported in the past but are not doing so now.

It is perhaps not surprising that firms already familiar with export markets are most likely to take advantage of new opportunities.<sup>46</sup> Likewise, from a sectoral perspective, the research indicates that business service providers in sectors where there is already a relatively high degree of export activity - Contract R&D, Technical Testing and Engineering Related Consultancy (see Section 4, Table 4.2.6) - are more likely to take advantage of opportunities arising from a removal of remaining barriers to trade than firms in other sectors. The research also suggests that, in the short-term at least, larger business service providers are likely to react more positively to a removal of barriers to trade than smaller providers<sup>47</sup>. Evidence from the case studies supports this: for example, one of the larger accounting and auditing companies we interviewed said that the removal of remaining barriers to trade, specifically restrictions on multi-disciplinary operations, would allow them to increase their sales overall by an estimated 20%.

Case study feedback from companies provides some information on the way in which providers who are already active in export markets might seek to increase the level of cross-border trade – several suggested that it would be possible to increase sales either by selling existing products into new markets in other countries or by extending their range of products in their existing markets. A number of case study companies said that they would extend their sales to other countries provided that the barriers to entry were low and that they were not constrained by barriers that could not be removed, such as the need for additional local market knowledge or language skills.

<sup>46</sup> Thus whereas 32% of category providers who have never exported (a) stated that they might take advantage of the removal of barriers to sell services to other EU countries, the corresponding figure for categories (b) and (c) are 62% and 52%.

<sup>47</sup> Overall, a higher proportion of larger companies indicated that they would probably increase exports if barriers were removed than smaller firms. Thus, whereas 67% of companies employing over 1000 people fell into this category, only 45% of firms with between 10 and 50 employees did.

# IMPACT OF BARRIERS TO TRADE

## 5

### *Potential New Entrants*

As noted above, the removal of barriers to trade is also likely to lead to firms entering export markets for the first time. These ‘new entrants’ have a number of notable characteristics:

- In contrast to the profile of existing exporters, smaller firms employing up to 250 people are disproportionately represented in the category of potential ‘new entrants’;<sup>48</sup>
- Likewise, a high proportion of potential new entrants have a turnover of less than €10 million. Within the category of ‘potential new entrants’, average turnover is higher amongst firms that have exported in the past but are not doing so now;<sup>49</sup>
- From a sectoral perspective, IT Consultancy, Personnel Recruitment, Tax Services and Engineering Related Consultancy account for a disproportionate share of ‘potential new entrants’.<sup>50</sup> Again this is significant since it indicates that these firms come from a broader range of business service sectors than the existing exporters.

A theme running through this section is that firms with at least some experience of exporting are more likely to take advantage of a removal of barriers to trade and increase their sales abroad than those without such experience. This argument also applies to ‘potential new entrants’: within this category, it is possible to draw a distinction between firms that have at one time exported in the past where the proportion stating that they would sell abroad if barriers are removed (52%) is higher than with firms who have no previous experience at all of selling abroad (32%). The findings in relation to ‘potential new entrants are important and point to possible priorities future EU policy is concerned.

Perhaps not surprisingly, many business service providers could not quantify the likely value of increased exports if barriers were removed. However, as Table 5.3 shows, amongst the remainder, there is clearly an expectation that sales could rise substantially. This contrasts with the position for business service users and reflects the earlier finding

<sup>48</sup> See Table 5.25 (b) in Appendix 5. Firms in this category accounted for 75% of the total responses compared with 70% of the sample as a whole.

<sup>49</sup> See Table 5.26 (b) in Appendix 5. Amongst firms that had never exported, some 49% had a turnover below €10 million. The corresponding figure for firms that had exported in the past but were not doing so now was 50%. This compares with a figure of 37% for current exporters.

<sup>50</sup> See Table 5.25(c) in Appendix 5. Firms in these sectors accounted for 72% of total responses compared with 60% of the sample as a whole.

# IMPACT OF BARRIERS TO TRADE

## 5

that they generally foresee the removal of barriers having less of an impact on their activities than providers.

*Table 5.3: Summary Analysis - Likely Increase in Value of Cross Border Purchases/Sales*

By how much would purchases/sales rise?	Users		Providers	
	No	%	No	%
Up to 10% more purchases/sales	33	16.8	59	19.2
10% to 20% more purchases/sales	19	9.6	63	20.5
Over 20% more purchases/sales	8	4.1	28	9.1
Don't know or not relevant	138	69.5	157	51.2
<b>TOTAL</b>	<b>198</b>	<b>100.0</b>	<b>307</b>	<b>100.0</b>

*Source: CSES Analysis of survey data.*

Making assumptions as before about the distribution of the responses, we estimate business service providers consider that their sales in new markets might increase by some 13% if barriers are removed. Clearly, this is an important effect.

Overall the research confirms the proposition suggested at the outset of this section: a removal of remaining barriers to trade is likely to see an increase in cross-border purchases/sales in the business services field.

### *Intermediate Effects - Price, Quality and Range of Business Services*

At the outset of this section we suggested that increased cross-border trade resulting from the removal of barriers will lead to greater competition and this, in turn, will put pressure on business service providers to reduce prices, improve quality or a combination of these and other factors such as a more innovative service offering.

The research suggests that these 'intermediate' effects are likely to come about. More specifically:

- There will be greater competition between providers in both domestic and export markets, especially the latter;
- Providers expect to see an increase in competition on the basis of the quality and range of business services offered but especially on price;

# IMPACT OF BARRIERS TO TRADE

## 5

- The impact of removing barriers to trade is likely to vary by sector and, within sectors, according to the size of companies and the way in which they operate across borders.

Taking the first of these points, the survey results indicate that 66% of providers who expressed an opinion expect to see an increase in the number of competitors in their domestic market. An even higher proportion (72%) foresees the same situation arising in export markets although here the number of 'don't knows' here was not surprisingly higher.<sup>51</sup>

*Table 5.4: Summary Analysis - Effect of Removing Barriers on Competition*

Likely effect on number of competitors	Domestic Markets		Export Markets	
	No	%	No	%
Increase in number of competitors	173	65.8	153	72.2
No change	88	33.5	54	25.5
Decrease in number of competitors	2	0.7	5	2.3
TOTAL	263	100.0	212	100.0

*Source: CSES analysis of survey results. Note: Users were not asked this question.*

Greater competition could have an impact on the quality, range and/or price of business services. According to the survey, increased competition on the basis of quality is thought less likely than on price, particularly in home markets. The same applies to competition on the basis of the range of business services being offered although here the difference between domestic and export markets is less pronounced.<sup>52</sup> Company views on the effect on prices is summarised below.

<sup>51</sup> See Tables 5.30 and 5.31 in Appendix 5 for a full analysis of the survey data on the impact of removing barriers to trade on competition in domestic and export markets.

<sup>52</sup> See Tables 5.30 and 5.31 in Appendix 5. As far as domestic markets are concerned, 50% of firms who expressed an opinion anticipated an increase in competition on the basis of quality and 63% expected the same effect with regard to the range of services offered. The corresponding figures for export markets were 58% and 65%.

# IMPACT OF BARRIERS TO TRADE

## 5

*Table 5.5: Summary Analysis - Effect of Removing Barriers on Prices*

Competition on basis of price	Domestic Markets		Export Markets	
	No	%	No	%
More competition on price	149	57.3	149	71.6
No change	95	36.5	51	24.5
Less competition on price	16	6.2	8	3.9
TOTAL	260	100.0	208	100.0

*Source: CSES analysis of survey results. Note: Users were not asked this question.*

The scale of any downward pressure on prices arising from greater competition in domestic and export markets was difficult to gauge for many business service providers. However, amongst those who did offer an opinion, just over a third (35%) said that they expected prices to fall by up to 10%.<sup>53</sup> No companies that made an input to the research expected an increase in prices for business services if remaining barriers to trade are removed. The survey work suggests that the greatest downward pressure on prices is likely to be in the IT Consultancy, Personnel Recruitment, Accountancy and Audit, and Tax Service sectors.<sup>54</sup>

The extent to which business service providers would be able to absorb a downward pressure on prices depends on their profit margins and the scope for reducing costs by rationalising operations and/or achieving economies of scale. In the short-term, it is likely that these pressures could in many cases be accommodated by existing 'business models' especially if the removal of barriers to trade helps to reduce start-up/operating costs. But in the longer term, there could be fundamental changes in the models and market structures themselves. The nature and extent of these longer-term effects is examined below.

### *Longer Terms Impacts - Costs, Economies of Scale and Company/Market Structures*

The proposition advanced at the outset of this section is that a reduction in prices (or increase in quality requirements) caused by increased competition will require firms to restructure and/or to investigate new forms of service delivery, or to reduce their costs in other ways to stay in business and remain profitable.

Existing 'business models' may be able to accommodate these effects (e.g. by reducing profit margins) but in some cases, and/or in the longer-term, more fundamental changes

<sup>53</sup> 50% of providers indicated they did not know what the effect would be on prices or did not respond at all. See Table 5.33 in Appendix 5 for a full analysis of the survey findings.

<sup>54</sup> See Table 5.33(b) in Appendix 5 for a full analysis of the expected price changes by different business service sectors.

# IMPACT OF BARRIERS TO TRADE

## 5

to corporate strategies may be necessary to remain competitive. Below, we consider the extent of these likely effects.

### *Start Up and Operating Costs*

*Operating Costs:* Downward pressure on prices will require firms to operate more efficiently and could therefore lead to business service providers restructuring their companies with a view to reducing operating costs. At the same time, the removal of barriers could make it easier to do this. The survey results suggest that:

- 29% of firms would reduce their operating costs if remaining barriers to trade were removed;
- In these cases, operating costs might be brought down by up to 20% with an average reduction of around 6%<sup>55</sup>;
- However, some business service providers would not be able to reduce operating costs and these firms would be vulnerable to increasing competition in their markets.

Evidence from case study research supports these conclusions. For example, one firm, a medium-sized Spanish IT consultancy provider gave an estimate that the overall additional cost was an extra 15% of their existing operating costs. Another provider, in the technical testing field, suggested that administrative costs to the company arising from regional and intra-EU barriers to trade amounted to 18-20% of sales. Likewise, a company in the Engineering-Related Consultancy field suggested that the removal of barriers and other hidden barriers would enable the company to reduce its operating costs in Europe by up to 10%.

Discussions with several case study companies provided insights to the way in which barriers to trade can affect operating costs. Whilst the industry as a whole faces few barriers to trade compared with other business services sectors, the company concerned – from the IT Consultancy sector – explained that differences in taxation rates and accounting practices across Europe oblige it to bring in the specialist services of international accountancy and tax firms to tackle complex financial and taxation issues on cross-border projects. This is extremely expensive and, where such additional costs

<sup>55</sup> In carrying out this calculation we have assumed that responses are grouped the mid point of each range, and for the top range where there is no upper point, that responses are grouped a half range above the lower point. For example, for responses of over 20% we have assumed that these are grouped at 25%. The small number of ranges precludes more sophisticated analysis

# IMPACT OF BARRIERS TO TRADE

## 5

cannot be absorbed, reduces the profit margin on projects which in turn makes it more difficult to justify bidding for other cross-border projects. Another firm, a multinational in the Leasing and Renting sector, argued that barriers to trade have prevented it from capitalising on opportunities offered by its immense purchasing power to procure vehicles at lower price. Ideally, according to the firm, it would negotiate with car manufacturers on a pan-European basis but is unable to do so because of block exemption.

In these and other cases, the cost arising from barriers to trade had not been investigated in any detail and where estimated tended to be very much of a 'ballpark' nature. The difficulties of quantifying the effect of removing barriers to trade on operating costs were highlighted by a major accounting firm: it was pointed by the company that if barriers were removed, there would be a reduction in the number of separate corporate entities it operates in different countries. However, they were unable to quantify the total effect although clearly it would be substantial. For this firm, the indirect cost-savings were probably more important, for example being able to move staff around more easily to ensure that the right people were appointed to the right jobs in key export markets. In another case, an Engineering Related Consultancy firm from Germany, the cost of barriers to trade was seen as lying in the value of projects that the company might have pursued/won in export markets. However, it was argued this opportunity cost could not be quantified because there may have been other factors, in addition to barriers, that resulted in the firm not being awarded projects and it was impossible to separate these factors from barriers to trade.

Some business service providers would not of course be able to reduce their operating costs and these firms could be vulnerable to increasing competition in their domestic (and export) markets (analysis of the survey data suggests that medium-sized business service providers tend to fall into this category<sup>56</sup>). The removal of barriers to trade and opening up of new market opportunities could also increase provider costs in certain circumstances. These additional costs could come about in several ways:

- Additional resources might be needed to exploit new market opportunities, e.g. a greater investment in marketing, additional staff to deliver services;
- New entrants to markets will clearly have to make an investment in setting up the structures required to market and sell services to new clients;

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<sup>56</sup> See Table 5.22(b) in Appendix 5. This suggests that firms employing between 50 and 500 employees are disproportionately represented amongst the category of respondents giving a 'no change' or 'don't know' response to the question: 'What effect would the removal of remaining barriers to trade have on your company's operating costs?'

# IMPACT OF BARRIERS TO TRADE

## 5

- But, equally, firms that are already active in particular markets may incur additional costs if they decide to try and increase their sales.

In the survey, almost a third of respondents (30%) stated that there would be additional costs.<sup>57</sup> A disproportionate number of these firms come from two sectors – Engineering Related Consultancy and Technical Testing.<sup>58</sup> Likewise, although not clear-cut, the survey data suggests that smaller firms would be more likely to incur additional costs than larger firms.<sup>59</sup> The case study research points to possible explanations for this. In many cases, because business service providers – especially larger firms – already operate in other EU markets, there would not be significant extra costs incurred in increasing sales or they would be marginal to the company’s operating overheads. For smaller firms, however, the costs of entering new markets – especially if this involves establishing a physical presence – could be considerable. In many cases, however, the strategy (certainly in the short-term) for entering new markets elsewhere in the EU might involve linking up with local partners or agents rather than establishing a subsidiary, and this would clearly minimise costs. The nature of the business service also has a bearing on the survey findings: where services can be delivered ‘remotely’ or by sending a team from the home base, and any after-care requirements can be met in a similar way, the removal of barriers may not fundamentally alter corporate structures and delivery mechanisms.

*Start Up Costs:* A disproportionate number of providers who stated that they might increase cross-border sales if barriers were removed were exporting from their home base at present.<sup>60</sup> Other survey data confirms that the high cost of establishing a local operation is a major consideration in a company’s decision on whether or not to enter export markets by establishing a physical presence:

- 45% of companies surveyed indicated that set-up costs are a significant/very significant factor in making it difficult to establish an operation in another EU Member State<sup>61</sup>;

<sup>57</sup> See Table 5.27(a) in Appendix 5 for a full analysis of the overall responses on additional costs.

<sup>58</sup> See Table 5.27(b) in Appendix 5 for a full analysis of the sectoral breakdown of firms stating that they would incur additional costs.

<sup>59</sup> See Table 5.27(c) in Appendix 5 for a full analysis of the breakdown by company size of firms stating they would incur additional costs.

<sup>60</sup> Selling from the home base represents the most common delivery method accounting for 54% of cases where companies are already exporting compared with 48% amongst all exporters in the sample as a whole. Conversely, selling via a local operation in an export market accounts for a lower share than in the ‘control’ sample.

<sup>61</sup> It will be recalled from the previous section that the excessive cost of setting up a local operation was amongst the highest ranked barriers to trade.

# IMPACT OF BARRIERS TO TRADE

## 5

- Amongst firms that could answer the question, set-up costs are estimated to be equivalent to an average of around 6 months sales – a significant barrier to new entrants to the market. Perhaps not surprisingly, however, most firms were not in a position to quantify these costs;
- Analysis of the survey findings by firm size indicates that high start-up costs are of more or less equal concern to business service providers in all categories;<sup>62</sup>

It follows from this that if the removal of barriers makes it easier and cheaper to set up a local operation in export market(s), many firms would take advantage of the opportunity to do so, all other things being equal (business opportunities, availability of suitably qualified staff, the precise nature of the service and capacity to deliver from the home base, etc). It would not be unreasonable to argue that this is likely to apply most of all to smaller firms for whom the costs of entry to export markets are an especially relevant factor. However, analysis of the survey findings on the perceived importance of start-up costs as a barrier to establishing a local operation in an export market suggests this issue is of equal concern to business service providers in all size bands.

### *Balance Between Costs and Benefits*

A key question arising from the analysis so far in this section is whether the benefits arising from a removal of remaining barriers to trade would outweigh the costs that might arise from seeking to take advantage of new market opportunities. Whilst it is impossible to generalise about the precise balance between costs and benefits, the survey work provides some insights.

Taking the 162 firms who stated that a removal of barriers would lead to an increase in sales, Table 5.6 analyses the extent to which these firms would experience a net benefit in terms of their cost of sales.

*Table 5.6: Summary Analysis – Increased Sales - Costs and Benefits*

Effect on Company Costs	Survey Responses	
	No	%
<i>Scenarios:</i>		
(a) Reduction in operating costs	72	44.4
(b) Reduction in operating costs/no increase in cost of sales	31	19.1
(c) Reduction in operating costs/increase in cost of sales	21	12.9
(d) No reduction in operating costs/no increase in cost of sales	15	9.2
(e) No reduction in operating costs/increase in cost of sales	12	7.4

<sup>62</sup> See Table 5.21(a) in Appendix 5 for a detailed analysis of the survey findings.

# IMPACT OF BARRIERS TO TRADE

## 5

*Source: CSES analysis of survey data*

The above analysis suggests that there would be an overall benefit for most firms: the best case – a reduction in operating costs with no increase in the cost of sales scenario (b) – applies in the case of 19% of firms. Conversely, the worst-case scenario – no reduction in operating costs but an increase in the cost of sales (scenario (e)) – only applies with 7% of the firms expecting to increase cross-border sales.

In reality, the balance between costs and benefits will be driven by market forces and is likely to be one of timing: as argued earlier, most firms will need to make an additional investment in their operations to benefit from new opportunities created by a liberalisation of EU markets and it will take time for the benefits to become apparent.

### *Other Impacts on Providers and Users*

In addition to impacts on company costs and sales, there are likely to be other less easily quantifiable impacts on the business service providers and users arising from a removal of barriers to trade. Table 5.7 summarises the main benefits.

*Table 5.7: Other Benefits to Business Service Providers and Users*

<b>Providers</b>	<b>%</b>	<b>Users</b>	<b>%</b>
Improved service quality and innovation	38.1	Reduction project costs	34.8
More technology in services and delivery	32.6	Improved export performance	28.3
Cross-border links/improved competitiveness	31.9	Increased productivity	26.7
Investment in new markets, delivery methods	31.6	Recruitment of additional personnel	25.7
Networking to improve competitiveness	29.3	Improvements in company management	17.6
Restructuring to improve competitiveness	25.1	Increased R & D	17.6

*Source: CSES analysis of survey results*

The case study research highlights some of the less easily quantifiable benefits of a removal of barriers to trade. Thus, in the Technical Testing field, for example, the case study research suggests that the impact of removing remaining barriers to trade is likely to change the dynamics of competition in this market and this will have an effect on a sector that is seen by some as over-manned and inefficient, with an associated sectoral restructuring and competitive shakeout. As noted in the earlier analysis (see Section 3), many operators in this field – and in the Contract R&D sector - are publicly owned. Whether entities of this type would be affected in the same way is unclear from our

# IMPACT OF BARRIERS TO TRADE

# 5

research. However, the effects of greater competition could also have major effects on the Accountancy and Audit, and Tax Services, sectors where the smallest firms operating in local and regional markets could face pressures from new entrants to their domestic markets. Case study evidence suggests that in these circumstances, smaller Accountancy and Audit firms would be obliged to rationalise their operations and possibly adopt a strategy of seeking mergers and acquisitions to remain competitive. In other sectors – IT Consultancy and Personnel Recruitment in particular, the research suggests that the impacts are likely to be less far-reaching although, as noted earlier, nevertheless beneficial indirectly in making it less costly to undertake certain types of cross-border projects. These and other differences are examined further in the section that follows.

The overall effect could therefore be to bring about a restructuring of markets with greater competition and consolidation of providers as they strive to achieve scale economies and market share. In particular, the removal of barriers could lead to larger multinational operators introducing more integrated cross-border corporate structures whilst small and medium sized players would be better placed to replace their extend their operations to include a physical presence in other markets where the nature of the service suggests that this would be advantageous. These effects will vary across business service sectors with probably greater impacts on Engineering Related Consultancy and Accountancy and Audit than on the Personnel Recruitment or IT Consultancy sectors. We have discussed elsewhere evidence from the case studies, i.e. that firms in some sectors - in particular Accountancy and Audit and Engineering Related Consultancy - would expect to develop multi-disciplinary organisations providing a greater range of services if restrictions on specific forms were removed. But more generally, pressure on firms to increase the range of services, and to reduce costs, is likely to lead to potential restructuring or amalgamations.

## **5.2 Analysis of Impacts by Business Service Sectors, Countries and Firm Size**

Is the situation common to the business services or can we draw some clear and interesting distinction between sectors, countries or firms' size? Are associated costs so important that the result is a high degree of market fragmentation?

Below, we consider the effect of removing remaining barriers to trade on the different business service sectors and firms in them. The previous section considered impacts from a national perspective.

# IMPACT OF BARRIERS TO TRADE

# 5

## *Impact of Different Business Services Sectors*

As argued earlier, the nature of the business service being provided has a major influence on the structure of the sector and hence on the impact of barriers to trade and likely effects of removing them. It is necessary, therefore, to first to consider the extent to which the structure of companies and markets in each sector is driven by the nature of the service, and then to consider the effect of barriers.<sup>63</sup>

*Accounting, Auditing and Taxation* – as discussed in Section 3, the main subject matter requires an understanding of national taxation and company law. Accordingly, the basic organisation of companies is on national lines, with different business strategies to approach multinational clients. The removal of barriers would therefore open up competition and would lead to a restructuring of markets. But as long as there are different systems of national taxation and corporate law, accounting, audit and tax firms will choose to base their structure partly on national units because it is in this way that they can bring together the necessary grouping of local skills. That is not to say that other forms of organisation – structured around skills such as auditing or along client service lines – will not be important and in practice the bigger firms will adopt a matrix form of organisation. One of the most substantial effects on this sector of removing barriers would be if multi-disciplinary organisation some were allowed, thus permitting accounting auditing and tax firms to bring their services together. This will both allow a rationalisation of services currently offered (there are different rules in different EU Member States as mentioned in Section 3) and will also allow them to move into other service fields such as the legal services field.

*IT Consultancy* – by contrast here, the subject matter does not have national boundaries and therefore it is currently possible, as the research in Section 3 and 4 shows, for firms to adopt a multinational structures. In the case of IT Consultancy, our survey and case studies suggest that there are few regulatory constraints directly affecting the sector. Because of this, the conclusion is that there would be minimal restructuring impacts from the removal of barriers to trade although operating costs could be reduced.

*Leasing and Renting* – to the extent that the sector relies on national tax structures, harmonisation in this and related fields would make it easier to operate across borders. Currently, national tax rules make it difficult to transfer the benefits of leasing across frontiers. However, to the extent that operators are already integrated into major financial services groups, the impact on industry structures would be less evident except in

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<sup>63</sup> Reference should be made to Section 4.2 which includes a summary analysis of the impact of barriers to trade on the different business service sectors.

# IMPACT OF BARRIERS TO TRADE

# 5

regional markets or smaller EU Member States. There are some sub sectors of leasing and renting, vehicle renting in particular, where existing national rules prevent the introduction of a true single market.

*Engineering Related Consultancy* – the basic field of operation is not reliant on national rules so it is already possible for international structures to be developed. However, the removal of barriers such as the lack of mutual recognition of qualifications and constraints on multidisciplinary partnerships would facilitate this process. As with accounting and auditing, the rules on what professionals in this field are allowed to do in different EU Member States differ.

*Technical Testing and Contract R&D* – as with Engineering Related Consultancy, the basic technology is common to all countries but in this sector particularly regulatory constraints affect the structure driving it towards a national basis. The removal of barriers would therefore open up competition across borders and could lead to more EU-wide operations emerging. In respect of Technical Testing in particular, the existence of continuing national regulations means that it has been difficult for pan-European organisations to emerge. However, as noted earlier, public ownership of some entities could complicate this process.

*Personnel Recruitment* - language plays an important part in many forms of recruitment but in some sectors (senior management, some technical staff) the market is already international and the removal of barriers to trade is unlikely therefore to fundamentally alter existing company and market structures. However, as noted earlier in the report, Personnel Recruitment firms located in border regions that specialise in deploying workers on projects in adjacent countries, or providers that recruit temporary worker for clients involved in projects outside their home base, are likely to benefit significantly from greater harmonisation in national employment regulations. In addition, as in the IT Consultancy field, the removal of barriers is likely to reduce operating costs.

## *Impact of Business Services Firms of Different Sizes*

Viewed from the perspective of firm size, the research suggests that the impact of removing remaining barriers to trade would vary considerably:

- *Larger, multinational business service providers* already operate across national boundaries in the EU and it is doubtful whether the removal of barriers would significantly change their basic ‘business models’ or lead to fundamental changes in

# IMPACT OF BARRIERS TO TRADE

## 5

the level of cross-border activity, at least in the short-term. As discussed earlier, there would, however, be scope for rationalisation and cost savings<sup>64</sup>.

- At the opposite end of the firm size spectrum, *micro business service providers* are likely to be the least affected in terms of taking advantage of new export opportunities created by removing barriers to trade: often, these firms do not have the capacity to operate outside their immediate market. Here it is, however, important to distinguish between positive and negative impacts because the removal of barriers could threaten smaller providers operating in markets where their competitive advantage is derived from familiarity with local customs and regulations.
- It is likely that the mid-market – *niche business service provider* and medium-sized ‘general’ service operators would be the most affected and stand to gain most from the removal of barriers to trade. Firms in this category are often active in specialist niches of export markets already and the removal of barriers would reduce the marginal cost of extending their client bases and/or range of services. Firms of this type are also well placed to take advantage of new export opportunities – they generally have the human and financial resources required to support a development of operations, and are already familiar with the logistics of cross-border trade.

These conclusions are supported by the case study research: for example, in the IT Consultancy sector, several smaller companies we interviewed made it clear that they do not seek to become leading players in foreign markets. Their overriding strategic goal is to be a leading players in their domestic markets and establishing a presence in other EU markets is very much a secondary goal to be pursued in long-term (if at all). Moreover, if the decision were taken to internationalise as a strategic priority, then they would look at securing local alliances and partnerships, rather than a branch network. Likewise, as far as medium-sized operators are concerned, the German Engineering Related Consultancy case study established that the firm’s strategy is to grow by developing specialist services that can be sold in export markets. So far it has focused on markets outside the EU but discussions with the firm suggested that the removal of barriers to trade would lead to the tentative steps it has taken in relation to other EU markets being developed into more substantive initiatives.

These conclusions need to be refined by considering the options with regard to the methods of delivering cross-border services. The research suggests that there are a

<sup>64</sup> There are some sectoral differences as far as larger providers are concerned and, as discussed earlier, removal of restrictions on the formation of multi-disciplinary practices would have significant impacts on the Accountancy and Audit sector.

# IMPACT OF BARRIERS TO TRADE

# 5

number of reasons for the preference, especially amongst medium-sized business service firms, of operating in other EU markets through alliances and partnerships, rather than subsidiaries:

- The costs of entering other EU markets are significantly lower if the option of establishing a subsidiary is avoided. Similarly, the process of becoming operational is likely to be quicker and simpler, and linking up with existing entities through partnership arrangements means that it is easier to acquire local market knowledge.
- Second, there is a much easier exit mechanism under the model involving partnerships with local firms than with subsidiaries. This consideration is important where a firm is pursuing one-off contracts with potential clients in other countries, or testing the market.

These considerations suggest that in the short-term at least, the removal of barriers would probably not fundamentally change the way firms operate across borders. However, as opportunities to trade in other markets become easier, so firms might be encouraged to extend their own operations by way of subsidiaries and branches rather than agency agreements and partnerships as is currently the case. As argued earlier, these changes in the way business service firms operate are likely to effect the mid-market operators much more than either the very smallest or largest providers.

### 5.3 Conclusions – Impact of Barriers to Trade

To what extent can we really claim that barriers to trade are so important as to prevent businesses from operating on a truly European scale?

Based on the research findings presented in earlier in the report, this section has argued that remaining barriers to trade are having a negative impact on the business service sector.

First, from the perspective of business service users, the relatively modest levels of cross-border trade mean that companies may not be obtaining the best services available and may be paying more than necessary for the services they do use. Second,, from the perspective of business service providers, the fact that relatively few have so far traded only in domestic markets means that the potential additional growth and economies of scale to be obtained from exploiting wider EU markets is not being achieved. Similarly, where companies are exporting to other EU markets, the research points to relatively modest revenue gains and a situation where the cost of selling into EU export markets is

# IMPACT OF BARRIERS TO TRADE

# 5

higher than it should be. High start-up and operating costs also deter potential new entrants to export markets.

Taken together, therefore, the analysis set out in the previous sections of this report points to fragmented EU markets in the business services sector, the relatively modest levels of cross-border trade having potential negative consequences for both users and providers in terms of higher costs and lower sales and, in the case of providers, the failure to develop EU-wide corporate structures and delivery mechanisms.

However, this section has argued that the constraints on businesses operating on a truly European scale cannot be solely attributable to the existence of barriers to trade. As the analysis in Section 4 makes clear, providers exist in most business service sectors that already operate internationally especially in the Accountancy and Audit, Taxation, Engineering Related Consultancy, IT Consultancy, and Leasing and Renting sectors. Of the sectors covered by this research, it is only perhaps in the field of Technical Testing, and a lesser extent Contract R&D, where regulatory barriers have prevented the development of a significant number of international businesses. Conversely, the case study research highlights examples of smaller business service providers who are focusing on regional markets and whose strategies do not involve seeking to operate internationally.

This section argues that the impact of remaining barriers to trade - specifically the extent to which they prevent businesses from operating on a truly European scale - is best gauged from examining survey and case study feedback on the effects of their removal. The first potential effect of removing barriers to trade would be to liberalise markets with an increase in cross-border demand and/or a freeing up cross-border supply. Here, the research suggests that a third of business service users would increase cross-border purchases if barriers to trade were to be removed but that an even higher proportion (just over half) of business service providers would expect to increase cross-border sales.

The research suggests that increased cross-border trade could come in several ways: first, providers who are already exporting to other EU countries would be likely, according to the research, to increase the level of cross-border sales either in their domestic markets but more especially, in export markets. Analysis of the characteristics of companies in this category indicates that from a sectoral perspective, this category is, not surprisingly, dominated by business service providers in sectors where there is already a relatively high degree of export activity - Contract R&D, Technical Testing and Engineering Related Consultancy. Likewise, larger business service providers are likely to react more positively to a removal of barriers to trade than smaller providers. However, turning to the 'potential new entrants', analysis of the characteristics of these firms indicates that

# IMPACT OF BARRIERS TO TRADE

# 5

smaller firms employing up to 250 people are disproportionately represented. From a sectoral perspective, IT Consultancy, Personnel Recruitment, Tax Services and Engineering Related Consultancy account for a disproportionate share of 'potential new entrants'

The second potential effect of removing remaining barriers is that as a result of greater cross-border trade and competition, there will be pressure on business service providers to reduce prices, improve quality or a combination of these and other factors such as a more innovative service offering. Here the key research findings suggests that around two-thirds of providers (who expressed an opinion) expect to see an increase in the number of competitors in their domestic market. An even higher proportion foresees the more competition in export markets. The scale of any downward pressure on prices arising from greater competition in domestic and export markets is difficult to gauge. However, amongst those firms who did offer an opinion, just over a third said that they expected prices to fall by up to 10%.

The extent to which business service providers would be able to absorb a downward pressure on prices depends on their profit margins and the scope for reducing costs by rationalising operations and/or achieving economies of scale. In the short-term, the research suggests that these pressures will probably be accommodated by existing 'business models'. However, the third proposition advanced in this section is that a reduction in prices (or increase in quality requirements) caused by increased competition will, in the medium-term, require firms to restructure and/or to investigate new forms of service delivery, or to reduce their costs in other ways to stay in business and remain profitable.

With regard to these impacts, the research suggests that approaching a third of firms would reduce their operating costs if remaining barriers to trade were removed. In these cases, operating costs might be brought down by up to 20% with an average reduction of around 6%. In addition, the costs of starting up an operation in an export market would probably be reduced although the extent of this effect is not possible to gauge. However, at the same time, the research indicates that a significant proportion of firms that are already active in particular markets would probably incur additional costs if they decide to try and increase their sales. Likewise, 'new entrants' will clearly have to make an investment in setting up the structures required to sell services to new clients in new markets.

Overall, therefore, this section suggests that the removal of barriers to trade could lead in the medium term to fundamental changes in market structures. In particular, the removal of barriers could lead to larger multinational operators introducing more integrated cross-

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# IMPACT OF BARRIERS TO TRADE

# 5

border corporate structures to maximise economies of scale and extend their market 'reach'. However, the research suggests that it is the mid-market operators – niche business service provider and medium-sized 'general' service operators – who stand to gain the most from the removal of barriers to trade. Firms in this category are often active in specialist niches of export markets already and the removal of barriers would reduce the marginal cost of extending their client bases and/or range of services. Firms of this type are also well placed to take advantage of new export opportunities – they generally have the human and financial resources required to support a development of operations into new markets and are already familiar with the logistics of cross-border trade. Against this, restructuring impacts will almost certainly result in some providers going out of business as competition becomes more intense.

# CONCLUSIONS

# 6

*Below, we present a summary of the main conclusions of the study and suggest key points for further action and research.*

## ***Existing Business Service Markets***

***1. The research suggests that although most parts of the business services sector are growing rapidly throughout the EU, the structure of the market is still highly fragmented, making it impossible to speak of one European market.*** First, the size of the business service sector in relation to the overall economy, and structure of the sector in terms of different types of activities, varies considerably from one EU Member State to another, as does the extent to which growth is being driven by the same factors. Second, across most business service sectors covered by this study, competition remains essentially domestic (in the survey, 46% of business service providers stated that most or all of their competitors are domestic). Third, domestic markets and sectors tend to be dominated by relatively small business service providers serving mainly local and regional markets, but these firms coexist alongside major multinational undertakings with very different ‘business models’ and markets. These and other features suggest that the EU’s business service sector is far from homogeneous and still less demonstrates the characteristics of a single market.

***2. The absence of a single European market in business services is supported by evidence from the study pointing to the modest levels of cross-border trade.*** The survey work suggests that only 29% of users and 53% of providers are purchasing/selling business services on a cross-border basis at the time of the research. Moreover, the value of pure cross-border trade tends to be relatively small as a proportion of the overall turnover of business service firms. The modest level of cross-border activity is generally confirmed by other aspects of the research although this also highlights variations between sectors, providers in different size bands, and export markets. Likewise, whilst domestic markets are generally seen as already being very competitive, this is far less true of export markets.

***3. The research nevertheless points to a number of factors encouraging greater cross-border trade in business services.*** On the supply-side, the research indicates that some business services providers (e.g. in the Engineering Related Consultancy sector) seek to operate in export markets because the domestic market has reached saturation and better opportunities exist for expansion elsewhere within the EU. Other business service providers seeking to create a pan-European entity are motivated by the opportunity to add shareholder value and maximise brand identity outside the domestic market. However, many firms – in particular, the smaller ones – do not actively seek opportunities to sell their services in export markets. On the demand side, the analysis suggests that ‘quality’, ‘expertise’ and ‘confidence’ are the main factors determining the choice of a business

# CONCLUSIONS

# 6

service supplier and that there is no significant difference in this respect in evaluating the merits of domestic as opposed to providers from elsewhere in the EU. In both cases, these factors are ranked above 'price'. Likewise, whether or not a provider has a local presence is generally regarded as unimportant.

**4. In the sectors covered by the research, the degree of internationalisation is strongly influenced by the nature of the service as well as regulatory and other factors.** Some sectors, for example Accountancy, Audit and Taxation, operate in an environment based on national corporate and tax law and are therefore largely structured on national lines although able to service international clients. By contrast, the IT Consultancy sector offers a relatively homogeneous international product and therefore has a number of integrated service providers. Of the sectors covered by the research, Contract R&D and Technical Testing are where the structure of sectors and markets are fundamentally influenced by the regulatory environment. But generally, the nature of the product is a key determinant of industry structure.

**5. Delivery of services from home country represents by far the most common method of selling business services to clients in other EU Member States.** Although delivery methods are influenced by a number of factors, including the nature of the different business services, the high cost of establishing a local operation in an export market is highlighted by the research as a major factor explaining why most firms – especially smaller providers - opt for delivery from the home base. In the case of larger providers, the situation is more complex and as the study shows, a significant proportion of firms use different delivery methods in different export markets.

**6. The research suggests that the Single European Market is perceived as so far having had a far greater impact on domestic markets for business services than on export markets.** Other developments – in particular e-commerce – are also viewed as having an important effect on markets and delivery mechanisms. According to the survey, around a third of business service providers consider that the Single European Market has had a significant impact on trading conditions in their domestic markets. There are some notable findings in this respect. Thus, a relatively high proportion of firms (34%) indicate that price competition has become more intense. But at the opposite extreme, relatively few (5%) companies indicated that the Single European Market had had a significant impact on input costs. Other developments – in particular e-commerce – are also viewed as having an important effect on markets but they have not succeeded in overcoming the fragmentation of structures.

# CONCLUSIONS

# 6

## *Remaining Barriers to Trade*

**7. The study identifies a number of regulatory and non-regulatory barriers to trade in business services.** Key remaining regulatory barriers identified by the research are: differences in national technical standards, lack of mutual recognition of qualifications or the inability to practice without a licence and restrictions on multidisciplinary practices, the administrative procedures involved in setting up a company and restrictions on legal forms (affecting often those who deliver by means of a local subsidiary), differing/restrictive employment regulations, and differences in accounting, tax and legal systems.

**8. Regulatory barriers to trade affect a broad range of business services whilst others are more sector-specific in their effects.** Thus, problems resulting from a lack of mutual recognition of professional qualifications appear to mainly affect the Accountancy and Audit, and Engineering-Related Consultancy sectors – these are the areas where professional qualifications are required to practice. Whilst the Personnel Recruitment industry itself is not directly affected, lack of mutual recognition of qualifications does, however, complicate the delivery of some services on a cross-border basis. Likewise, whilst differences in personal taxation, pension rights, and employment laws generally directly affect the capacity of Personnel Recruitment firms to provide services of a cross-border nature to their clients, the research indicates that they can also have a negative impact, on the ‘input’ side, on the business services sector as a whole. Amongst the sectors covered by the research, restrictions on establishing multi-disciplinary practices affect both the Accountancy, Audit and Taxation Services and Engineering Related Consultancy sectors (legal services, not covered by the research, is also affected). Differing national standards primarily affect the Technical Testing and to a lesser extent, the Contract R&D and Engineering Related Consultancy sectors.

**9. In addition to remaining barriers to trade of an essentially regulatory nature, the research highlights barriers of an administrative and/or socio-cultural nature affecting business services.** Socio-cultural barriers are highlighted in the research as affecting the capacity of business service firms to pursue cross-border activities, in particular language differences, differences in commercial practices, and distance-related factors. Some companies are affected by subsidised competition.

**10. Market and socio-cultural barriers tend to affect all companies irrespective of the sector.** The research highlights exceptions in this respect. Thus, the IT Consultancy sector is less affected by language barriers than others due to the international characteristics of the sector. Conversely Accountancy and Audit, Contract R&D, and Engineering Related Consultancy - all of which tend to be particularly customised to local markets and client requirements – are especially affected by distance-related factors.

# CONCLUSIONS

# 6

Perceptions regarding the extent and severity of these barriers vary with national authorities, business organisations and companies themselves often stressing different factors as being most significant.

**11. *There are a variety of explanations for the continuing existence of barriers to trade in business services.*** The research underlines that there is an important distinction to be made between situations where an EU-level regulatory framework is in place but there is uneven implementation across countries, on the one hand, and situations where the framework itself does not exist, on the other. Likewise, the scope for action to remove barriers varies as does the effect of their removal on different business service sectors, company sizes and countries (see below).

**12. *National governments have carried out some research on barriers to trade in business services but do not generally consider that they have sufficient information.*** The view was expressed that business service firms are less likely to complain about barriers to trade than firms in other sectors and more likely to adopt organisational structures that allow them to get round barriers to trade.

### ***Impact of Remaining Barriers to Trade***

**13. *The research suggests that remaining barriers to trade have resulted in fragmented EU markets in the business services sector, the relatively modest levels of cross-border trade having potential negative consequences for both users and providers.*** From the perspective of business service users, the relatively modest levels of cross-border trade mean that companies may not be obtaining the best services available and may be paying more than necessary for the services they do use. From the perspective of business service providers, the fact that relatively few have so far traded only in domestic markets means that the potential additional growth and economies of scale to be obtained from exploiting wider EU markets is not being achieved. Similarly, where companies are exporting to other EU markets, the research points to relatively modest revenue being generated and a situation where the cost of selling into EU export markets is higher than it should be. High start-up and operating costs also deter potential new entrants to export markets.

**14. *However, constraints on businesses operating on a truly European scale cannot be solely attributable to the existence of barriers to trade.*** As the research makes clear, providers exist in most business service sectors that already operate internationally especially in the Accountancy and Audit, Taxation, Engineering Related Consultancy, IT Consultancy, and Leasing and Renting sectors. Of the sectors covered by this research, it is only perhaps in the field of Technical Testing, and a lesser extent Contract R&D, where regulatory barriers have prevented the development of a significant number of international businesses. Conversely, the case study research highlights examples of

# CONCLUSIONS

# 6

smaller business service providers who are focusing on regional markets and whose strategies do not involve seeking to operate internationally.

*15. As such, the removal of barriers to trade is likely to have an incremental rather than fundamental effect on most business service sectors.* Across all businesses and sectors covered by the research, the effect of removal of remaining barriers to trade is likely to be primarily one of scale. The research suggests that in sectors such as Accountancy and Audit, Taxation, Engineering Related Consultancy, IT Consultancy, and Leasing and Renting there are already many international service providers, although their organisational structures and their cost structures might change if the regulatory environment changed. Of the sectors studied in this assignment, it is only perhaps in the field of Technical Testing, and a lesser extent Contract R&D, where regulatory barriers have prevented the development of a significant number of international businesses.

*16. The first potential effect of removing barriers to trade would be to liberalise markets with an increase in cross-border demand and/or a freeing up cross-border supply.* Here, the research suggests that a third of business service users would increase cross-border purchases if barriers to trade were to be removed but that an even higher proportion (just over half) of business service providers would expect to increase cross-border sales. The research suggests that increased cross-border trade could come in several ways: first, providers who are already exporting to other EU countries would be likely, according to the research, to increase the level of cross-border sales either in their domestic markets but more especially, in export markets. Analysis of the characteristics of companies in this category indicates that from a sectoral perspective, this category is dominated by business service providers in sectors where there is already a relatively high degree of export activity - Contract R&D, Technical Testing and Engineering Related Consultancy. Likewise, larger business service providers are likely to react more positively to a removal of barriers to trade than smaller providers. However, turning to the 'potential new entrants', analysis of the characteristics of these firms indicates that smaller firms employing up to 250 people are disproportionately represented. From a sectoral perspective, IT Consultancy, Personnel Recruitment, Tax Services and Engineering Related Consultancy account for a disproportionate share of 'potential new entrants'

*17. The second potential effect of removing remaining barriers is that as a result of greater cross-border trade and competition, there will be pressure on business service providers to reduce prices, improve quality or a combination of these and other factors.* Here the research suggests that around two-thirds of providers (who expressed an opinion) expect to see an increase in the number of competitors in their domestic market. An even higher proportion foresees the more competition in export markets. The scale of any downward pressure on prices arising from greater competition in domestic and export

# CONCLUSIONS

# 6

markets is difficult to gauge. However, amongst those firms who did offer an opinion, just over a third said that they expected prices to fall by up to 10%.

*18. The extent to which business service providers would be able to absorb a downward pressure on prices depends on their profit margins and the scope for reducing costs by rationalising operations and/or achieving economies of scale.* In the short-term, the research suggests that these pressures will probably be accommodated by existing ‘business models’. Moreover, the removal of barriers should make it easier for firms to reduce some costs. The research suggests that around a third of firms would be able to reduce their operating costs if remaining barriers to trade were removed. A ‘best estimate’ using feedback from the survey work and case studies suggests that provider costs would fall by an average of 6%. In addition, the costs of starting up an operation in export markets would probably be reduced although the extent of this effect is not possible to gauge.

*19. The third potential effect of removing remaining barriers to trade is that, in the longer term, there will be pressure on firms to restructure and/or to investigate new forms of service delivery or to reduce their costs in other ways.* In particular, the removal of barriers could lead to larger multinational operators introducing more integrated cross-border corporate structures to maximise economies of scale and extend their market ‘reach’. However, the research suggests that it is the mid-market operators – niche business service provider and medium-sized ‘general’ service operators – who stand to gain the most from the removal of barriers to trade. Firms in this category are often active in specialist niches of export markets already and the removal of barriers would reduce the marginal cost of extending their client bases and/or range of services. Firms of this type are also well placed to take advantage of new export opportunities – they generally have the human and financial resources required to support a development of operations into new markets and are already familiar with the logistics of cross-border trade. Against this, restructuring impacts will almost certainly result in some providers going out of business as competition becomes more intense.

## ***Possible Actions and Further Research***

There are a number of actions that might be considered as a follow up to this research:

*20. First, consideration might be given to a consultation programme with business service providers and their representative bodies with a view to actions to eliminate barriers to trade.* The aim of this should be to build on this report by obtaining information directly from sector representatives on barriers to trade in services and their effect, with a view to preparing suggestions with them for the elimination of barriers. In some sectors – for example accounting and audit and consulting engineering – trade

# CONCLUSIONS

# 6

associations have already carried out much work. This report or a summary of this report could be helpful in this consultation.

**21. *Second, consideration might be given to undertaking a comprehensive analysis of the market drivers of other business service sectors in order to determine those sectors where business services are being or can be delivered at a distance.*** This analysis should cover all business service sectors and not merely the sectors covered in this report. For example, where a sector relies substantially on physical presence (e.g. security and guarding) it may be less susceptible to the removal of regulation covering cross border trade. The object of this analysis would be to determine those sectors where a programme for eliminating trade barriers might be most effective.

**22. *Reviewing and developing the mechanisms for systematic collection of data at on the barriers to trade in business services, by encouraging national government to collect this data on a regular and consistent basis.*** Many national governments commented that they were not as aware as they might wish to be about barriers to trade in services. In addition, consideration might be given to carrying out a review of existing single market programmes (for example in the area of mutual recognition of qualifications) in order to identify the extent to which they have had the desired effect in terms of opening up cross-border trade in business service sectors.

**23. *Consideration of a programme to assist small and medium-sized enterprises in the business service field take advantage of the liberalisation of the barriers to trade in services.*** It is likely that any further efforts to liberalise cross-border trade in business services will be taken advantage of first by larger firms and the Commission may wish to consider a programme to ensure that the advantages are shared fully by small and medium-sized enterprises, e.g. by means of encouraging cross-border partnerships or other links. This might be supported by further research to investigate the likely effect of the rationalisation off the business services market on vulnerable firms in the market and considering whether any programme needs to be put in place to help or assist the restructuring process.

**24. *To support any actions, consideration should be given to filling gaps in research.*** The focus of further research should be on supporting the actions suggested above. With regard to this research, the literature review suggests that although many of the barriers examined in this report have been previously identified at a general level, there is far less research available on:

- How the different types of barriers affect particular business service sectors;

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# CONCLUSIONS

# 6

- The implications for the ways in which firms in particular business services sectors and size bands operate and deliver services;
- The possible effects of removing barriers to trade in the business services sector in terms of company strategies and business models.

This study has sought to fill these gaps. In addition to the new research itself, the study has also reviewed work being undertaken at a national level. Much of this, however, is also either of a very general nature – applying to the service sector as a whole – or very specific in examining only Single Market issues facing particular types of business service activity (it is also, by definition, partial in only giving a national view). As such, despite the limitations on achieving depth of analysis, this study builds on recent and current research at a national level by giving a more comprehensive overview and more scope for comparative analysis.

25. Turning to the future, the report has identified many issues relating to the regulatory and ‘socio-cultural’ environment in which business services currently operate that warrant further investigation. In particular, there is a need to consider what can be done to remove the remaining barriers to trade and, likewise, where scope for action by public authorities at an EU or national level is limited, what alternative strategies can be adopted to facilitate cross-border trade in business services.