



# **Cost of the Cumulative Effects of Compliance with EU Law for SMEs**

Executive summary

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## **EXECUTIVE SUMMARY**

**Summarised below are the main findings, conclusions and recommendations from the study, 'Cost of the cumulative effects of compliance with EU law for small and medium-sized enterprises (SMEs),' undertaken in 2014-15 for the European Commission.**

The study concluded that **there is no single universal methodology to assess the costs of the cumulative effects of compliance with European Union (EU) law.** While the Standard Cost Model (SCM) and Cost driven Approach to Regulatory burden (CAR) provide the most reliable results, research needs to be clearly limited and focused (in terms of numbers of pieces of legislation). Even then, these can only partly answer the questions raised by cumulative cost studies. The toolbox on page 25 of the study gives an overview to when and in what kind of study one could use best the Standard Cost model, the CAR-methodology and other instruments.

Sector research found that **cumulative costs influence a range of enterprise operations by for example, increasing costs for innovation, adoption of flexible employment practices, and market entry and expansion.** However, interviewees and survey respondents **often considered the cumulative costs of EU legislation to be acceptable, because EU laws' requirements generally reflect and codify common sense or standard business practice.** In addition, **Member State interpretation, implementation and enforcement-related practices constitute an important source of cumulative costs** and undermine the EU level playing field.

This summary first sets out the objectives, definitions and scope of the study. Then the economic importance and policy context of SMEs in Europe is outlined. This is followed by a description of the approach to the study. The last three sections set out findings as regards the three objectives of the study.

### **1. STUDY OBJECTIVES, KEY DEFINITIONS AND SCOPE**

The **objectives** of this study were to:

- Develop **an appropriate methodology** to assess the cost of the **cumulative effects of compliance** with EU law for Small and Medium-sized Enterprises (SMEs);
- Identify and analyse the status of **SMEs in Europe regarding costs of compliance with EU law and national implementation** and application in five sectors;
- Assess the **cumulative effects of compliance with various types and scopes of regulation on individual SMEs** in specific economic sectors, and compare the cost in different countries.

Sections four, five and six below provide a summary of findings as regards the three study objectives.

Key terms used are **defined** as follows:

In this context, '**EU law**' refers to **EU Directives and Regulations**. Directives must be transposed into national law and require national implementation measures to be developed. These can include measures taken to amend or modify regulatory obligations at national and sub-national levels.

In this study, the term '**cumulative effects**' encompasses compliance with multiple pieces of EU legislation, how this leads to cumulative effects and costs for enterprises (distinguished from costs linked to complying with individual pieces of legislation) and how this affects SME behaviour. Secondly, the definition considers how national and sub-national authorities implement EU law, i.e. the extent to which legislation 'accumulates' at various legislative levels. Finally, the definition of cumulative costs relates to the overall amount of (EU) legislation and effects on SMEs over time.

The **definition of SMEs** used, in accordance with EU Recommendation 2003/61, is based on the **number of employees** and either **turnover** or **balance sheet total**. **In this study, the number of employees determines whether an enterprise is an SME and whether it is a micro-enterprise, a small, or a medium-sized enterprise.**

## **2. CONTEXT - SMES IN THE EUROPEAN ECONOMY**

SMEs contribute majorly to growth and employment in the European Union (EU) . In light of their importance, they are at the heart of EU policy. Key policy instruments to support SMEs relevant to this study include the Small Business Act of 2008 (SBA), the Europe 2020 Strategy, and the Regulatory Fitness and Performance Programme (REFIT).

A key theme underlying these policies is the need to ensure that the regulatory environment is supportive of SMEs and does not hinder their growth and development. This is enshrined in the 'Think Small First' principle in the SBA, which seeks to ensure that legislators consider effects on SMEs when designing legislation (the 'SME test'). It is also central in the combination of regulatory improvements with new orientations in major EU funding programmes (SMART growth), and in 'fitness checks' under REFIT, aimed at making EU law lighter, simpler, less burdensome and costly to implement, and generally fit for purpose.

### 3. STUDY APPROACH

The study involved a combination of desk research (a review of literature is provided in Appendix A), 54 interviews with industry associations, industry regulators and European Commission officials, and an interview programme with 250 SMEs.

Costs were categorised according to the Standard Cost Model (SCM)<sup>1</sup>, i.e.:

- **Familiarisation costs** (those incurred in the course of developing an understanding of legislative requirements);
- **Adoption costs** (costs of making required changes to comply with legislation);
- **Administrative costs** (carrying out the administrative obligations required by the legislation). A key task in the research was to distinguish between the costs that would incur even without legislation, i.e. "business as usual costs," and those only incurred to meet legislative requirements, or "administrative burden."

This study distinguished between **legislation which is sector-specific ('vertical') and that which is applicable to firms in general ('horizontal')** such as business or employment law. Appendix C summarises and describes the relevant general EU legislative frameworks and the legislation for the sectors selected.

In order to obtain more insight into the effects of cumulative costs, the study looks at how costs accumulate when businesses undertake **specific business decisions ('events'), and what the impacts of cumulative costs are on those 'events.'** The 'events' are: **employment; exporting to an EU Member State previously not exported to; new product development; investment in new buildings, plants, machinery or equipment; and, 'other', i.e. events that respondents considered important.**

In terms of scope, the **study focused on nine EU Member States and five economic sectors.** The Member States are Estonia, Germany, Ireland, Italy, Poland, Slovakia, Slovenia, Spain and Sweden. The sectors are bakeries (food manufacture), construction (residential and non-residential), electrical equipment, information and communication technology (ICT) services and retail (of bakery products). The rationale for the selection of these countries and sectors is explained in Appendix B.

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<sup>1</sup> SCM Network, International Standard Cost Manual; European Commission (2009), Impact Assessment Guidelines, Annex III

#### 4. METHODOLOGICAL FRAMEWORK FOR FUTURE STUDIES

**As regards the first objective of the study, it was concluded that there is no 'one-size-fits-all' methodology for studies on the cost of the cumulative effects of EU legislation.** Very little work has been published regarding cumulative costs and effects. A review of literature found that four different types of studies have been used to assess costs and effects arising from legislation: business perception surveys, cross-country comparisons, compliance cost/benefit studies, and qualitative studies.

**The literature review concluded that the 'Compliance Cost/Benefit Study' study category is the most suitable approach. It includes the Standard Cost Model (SCM) used by the Commission and the recently developed Cost driven Approach to Regulatory burden (CAR).** Detailed quantitative information from the SME about the steps involved in compliance for each piece of legislation is needed. This requires a very lengthy and detailed interview (or more than one) with each firm. Many SMEs are not willing to devote the time to this type of research.

**In addition, previous research suggested that an in-depth interview approach offers a better way of capturing some longer-term dynamic effects of legislation.** This applies especially to aspects of an SME's activities such as market entry, productivity and competitiveness, innovation, enterprise growth and development. It also affects those associated with future regulatory requirements. Overall, a combination of compliance cost and qualitative approaches would achieve the best results in future studies.

**Based on the literature review and the findings of this research, the conclusion is that there is no single, overall, one-size-fits-all methodology to deal with all the questions related to the cost of cumulative effects. It is preferable to have an overall methodological framework.** Within it, different types of studies can be conducted depending on the nature of the enquiry. Specifically, the design of a given methodology for a particular assignment will depend on the type of study and research tools best suited to the topic (section 2.2.5 provides guidelines for a toolkit to use in this respect). Simultaneously, there should be common elements so that findings from different studies can be compared.

The proposed **methodological framework allows a flexible approach to deal with the heterogeneity of SMEs and larger businesses.** It proposes a combination of different study types and research tools to deal with different kinds of costs of cumulative effects research. The specific combination will depend on the questions asked.

The proposed methodological framework consists of **13 key steps** with differing emphases placed on the steps depending on the nature of the study being undertaken. In summary, they are:

**Key Steps – Methodological Framework**

1. Clearly Identify the subject matter and specific study scope, which could be a single piece of legislation, legislation present in a specific sector or sub-sector(s), a type of legislation (e.g. environmental), an activity (e.g. manufacturing), products or services.
2. Identify, list and map the legislation relevant to the specific study to identify the obligations.
3. Carry out a detailed sector or (sub-sector) analysis (as appropriate to the scope and objectives of the study).
4. Identify sources of additional costs arising from national/regional legislation.
5. Identify relevant enforcement regimes, modes of enforcement and related costs.
6. Select a sample of key 'events,' areas, activities or product groups, depending on the nature and scope of the study, where there are significant amounts of legislation to focus on.
7. Analyse the potential effects of legislation in relation to each of the chosen focus areas.
8. Distinguish between direct financial costs, compliance costs (including substantive, administrative and burden costs), and long-term structural costs.
9. Distinguish between initial-impact costs – adjustments when the legislation is introduced – and ongoing, routine costs.
10. Estimate cumulative costs and identify where these costs have additive impacts, diminishing marginal impact (DMI), and increasing marginal impact (IMI).
11. Identify compliance cost reduction potential.
12. If appropriate for the study, scale up the results as required.
13. Validate the results of the study through consultation with experts.

**In order to support the practical applicability of the recommended methodological framework, a toolbox provided** in section 2.2.5 (Table 2.4) gives guidance regarding the specific types of studies, research methods for assessing types of cumulative costs, and relevant research tools:

- For assessing cumulative costs at enterprise level, enterprise-level interviews using compliance cost studies (e.g. SCM or CAR) complemented by in-depth interviews with firms and regulatory bodies and industry associations are more important.
- For studies dealing with national implementation-related cumulative costs, the emphasis should be on desk research and in-depth interviews with industry regulators, associations and experts.
- For studies looking at the effects of compliance costs over time, desk research and in-depth interviews with experts and businesses might be most appropriate.

### **Key points**

There are some **points to stress about applying the overall methodological framework**:

**Firstly, there needs to be a clear definition of the term 'cumulative effects' as there are different interpretations of the term among enterprises, industry associations and public authorities.** This is achieved in this study by defining the term as encompassing three key dimensions: (i) the effects arising from the need to implement different pieces of legislation; (ii) the effects that can be associated with multiple layers of government; and (iii) the accumulation of effects over time (see section 1.2).

**Secondly, given the complexity of the subject matter, a purely survey-based methodology is unsuitable.** There are several reasons for this. It is difficult to elicit a satisfactory response from businesses, especially SMEs. Many questions associated with an investigation into the costs of cumulative effects arising from EU laws cannot be easily researched without being discussed in detail with the businesses. SMEs overall also do not have sufficient knowledge of legislation and its origins to be able to distinguish between EU and national laws. This is especially true in 'grey' areas where, alongside implementation of EU legislation, additional national legislative elements may have been added. In addition, as the literature review highlighted, many of the alternative approaches taken on their own also have shortcomings. For these and other reasons, this study tested **an approach that combined different types of studies and research tools but put the emphasis on more in-depth research through an interview programme with SMEs (see section 2.2.2).**

**Thirdly, generating enough SME contacts for an in-depth interview programme requires a large-scale screening exercise.** For this assignment, 16,000 SMEs had to be contacted to generate 250 interviews. A screening exercise of this sort is necessary, especially if industry associations cannot be relied on to help identify SMEs for the research (see section 2.1).

**Fourthly, distinguishing between how firms of different sizes manage regulatory compliance needs more emphasis.** A distinction should be made between micro, small and medium-sized enterprises, rather than treating SMEs homogeneously in terms of the capacity to familiarise themselves with regulatory requirements and comply with administrative and legal obligations (see section 2.2.2).

**Fifthly, it is important to examine a time horizon beyond the present to assess costs of the cumulative effects of compliance.** Additional costs and effects (positive and negative) that may shape development of an enterprise or sector's future, or parts of it, may emerge over time that are not immediately apparent in a static cost study (see section 2.2.3).

**Sixthly, dynamic elements should be added to SCM methodology to identify behavioural responses to legislation (feedback loops), and 'psychological' costs should not be neglected.** Linked to the identification of dynamic elements, assessment of cumulative costs cannot be completely independent of the assessment of effects. In time, effects can either amplify negative aspects of cumulative costs (e.g. inhibit market development and growth) to be considered as a further cost, or they can contribute to development (e.g. by facilitating exports), mitigating cumulative costs (see section 2.2.3).

### ***Other considerations***

**Given the practical challenges involved with studies to assess the costs of cumulative effects, the recommended methodological framework includes practical suggestions on how studies should be conducted (see section 2.5).**

The most important among these is the need to define the scope of such studies very clearly, so that they focus on specific issues that can be researched in a way that provides meaningful results. As the scope expands and more pieces of legislation are included, the robustness of the research findings is likely to decrease (see also case study 2.1). There is a trade-off between the scope of study and reliability of results due to increasingly complex interaction between pieces of legislation as scope widens.

**The proposed methodological framework has certain strengths.** Those strengths include detailed research that can reveal a great deal about how cumulative costs emerge, what these costs are made up of, how they can affect firm behaviour and the development of the industry overall. There is also scope for flexibility within the overall framework that allows application of different types of studies using various research tools to help investigate the wide range of questions to be asked about cumulative costs.

**Regarding weaknesses, there is the issue of how robust and representative results based on a relatively small number of in-depth interviews are.** The SCM does not aim for statistical representativeness. In some situations, it may be possible to validate findings with a larger survey group. However, if the larger group being surveyed does not have a better understanding of the subject matter than the smaller group, this follow-up survey may not add anything more robust to findings based on a smaller sample. If a group of experts validates findings, criticism of lack of representativeness remains.

**The question of representativeness of results based on low sample numbers in large populations is compounded by data collection problems.** It can be very difficult to obtain responses from SMEs, and researchers collecting data must be highly knowledgeable about the legislation and SME business operations. This is particularly challenging given the wide range of legislation affecting an enterprise (or other organisation). It is also likely that the interviewee is not fully aware of all the legislation. To be thorough, field-based interviews could be required that take anything from a few hours to a whole day per enterprise, depending on the nature and the complexity of the organisation and topic being researched.

## 5. SMES IN EUROPE AND COMPLIANCE COSTS ARISING FROM EU LAW AND NATIONAL IMPLEMENTATION AND APPLICATION IN FIVE SECTORS

In this section the findings as regards the second objective are summarised. We **identify and analyse how different kinds of cumulative costs arise for SMEs in Europe through compliance with EU law and its national implantation in the sectors selected, and what the sector-related factors are that influence cumulative costs.**

### 5.1 *How different kinds of cumulative costs arise*

The research indicates that cumulative effects associated with EU legislation arise in several different ways:

**Firstly, cumulative effects can arise from the need to comply with different pieces or types of legislation.** This includes sector-specific, product safety, employment, health and safety, environmental, and business-related legislation. Cumulative effects arise because an individual SME must comply with many separate pieces of legislation. In addition, there is a need to comply with changes in legislation and in harmonised technical standards that, though voluntary, are commonly used to achieve compliance with 'essential requirements' set out in EU law.

**Secondly, cumulative effects also occur due to differing practices with regard to regulatory implementation, monitoring and enforcement.** Though there were only a few examples of gold plating<sup>2</sup> identified by the research, other types of compliance costs arise. Member States introduce additional or divergent requirements into public procurement procedures (e.g. affecting the ICT and construction sectors). Divergence between countries due to varying interpretations of EU legal requirements arises in the transposition of European Directives into national legislation (e.g. maximum or minimum harmonisation).

Additional burdens can also arise due to **how the implementation of EU regulations is monitored and enforced at the national level.** SME and industry associations acknowledged that progress has been made towards the goal of a fully harmonised legislative environment in the Single Market (for instance, through the adoption of a common EU framework to strengthen market surveillance in 2008<sup>3</sup> and 2013<sup>4</sup>). Nevertheless, SMEs in some countries are more likely to be subject to additional checks than in others, which undermines the notion of a level playing field to some extent.

**Thirdly, legislation accumulates over time, and the way legislation impacts enterprises can change over time.** Regulatory requirements can be introduced over time, but as an enterprise adjusts to new circumstances, additional aspects of the legislation may become relevant, creating new burdens. Conversely, routines are adapted and compliance is built into everyday procedures, reducing perceived impact.

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<sup>2</sup> In this study, "gold-plating" refers to situations in which national requirements differ from requirements of EC directives, and refers to "cost-adding" gold-plating, as opposed to neutral or cost-reducing gold-plating (Bertelsmann Stiftung, 2006, International benchmark of administrative burdens related to selected EC Directives in the Netherlands, Germany and Denmark, p.10).

<sup>3</sup> Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products.

<sup>4</sup> Proposal for a Regulation on market surveillance of products (COM(2013)75).

**There are also sector-specific factors that influence the emergence of cumulative effects and costs.** These are the result of sector structure and integration, firm size and predisposition to compliance. Individual country context also has an impact (see 5.3 below).

**Quantifying the cost of the cumulative effects of EU law is difficult because it arises at the EU level, but is implemented nationally at different levels of governance.** Moreover, in some Member States and sectors, despite cumulative effects leading to increased compliance costs, this is seen in a positive light (e.g. in Germany the use of more demanding construction industry standards than that required under EU law). In other Member States, similar cumulative effects are seen negatively (e.g. in the Spanish construction industry, the same EU standards are seen in a negative light).

## **5.2 Cumulative costs at SME and sector level**

This sub-section summarises the study's findings concerning cumulative costs and effects from a sector point of view. This is done in terms of the three types or dimensions of cumulative effects and costs: those resulting from compliance with multiple pieces of legislation; those resulting from the different ways in which national and sub-national authorities implement EU law; and, those resulting from the building up of the overall amount of EU legislation over time. These are discussed in turn.

### *5.2.1 First dimension - cumulative effects and costs of compliance*

The paragraphs below summarise findings as regards **compliance with multiple pieces of EU legislation (distinguished from costs linked to complying with individual pieces of legislation), how this leads to cumulative effects and costs for enterprises** and the effects on SME behaviour.

**There are significant differences in the levels of compliance costs that SMEs incur, and in how they respond to legislation.** These costs are dependent on legislation in the sector, the structure of the sector, the enterprise's size and predisposition to compliance, and the prevailing national enforcement regime. These interrelated factors generate a wide range of behavioural outcomes ranging from very strict to very lax compliance.

**At the sector level, the bakery, retail of bakery products, and ICT services sectors have little awareness of or preoccupation with cumulative costs (except for enforcement-related concerns in Spain). There is some awareness in electrical equipment and more awareness in construction.** Overall, enterprises and industry associations tend to identify other factors (such as the supply of appropriate staff, availability of finance and tax levels) as being of much greater relevance for business operations than cumulative costs arising from legislation.

**A wide range of SMEs experience positive effects of EU legislation.** EU legislation is considered to have raised standards across a broad swathe of SMEs, from building companies in Slovakia to bakers in Ireland. It is also clear that, in some parts of every sector in this study (electrical equipment, construction, ICT services and bakery sectors are prime examples), market behaviour imposes higher and costlier compliance requirements than EU law. In these instances, companies wishing to access a market in another EU Member State must comply with industry standards that are over and above those specified in EU legislation.

**A further factor is that many of the costs arising from EU law would be incurred by SMEs anyway.** The survey asked respondents, “How do you think the costs imposed by legislation affect your business?” Most SMEs responding to the survey said that the various requirements would have been undertaken anyway (33% agreed, ‘very strongly’, 28%, ‘strongly’). Differences between sectors exist in this respect. Survey findings suggest that a substantial proportion of the costs, including those related to cumulative legislative effects, are part of normal business expenditure.

**Many SMEs see compliance with EU laws as simply good business practice.** For example, in bakeries, ‘wearing a hair-net and gloves and keeping everything clean and hygienic,’ as one respondent put it, is a sensible business practice the law also requires. Many small businesses tend not to document all the steps taken to comply with EU laws unless inspected and required to do so because they integrate these practices in their everyday business processes. Many elements of product safety testing are ‘business as usual’ costs in the electrical equipment sector because they are an integral part of quality assurance and testing. Many enterprises would undertake them to manage reputational risk regardless of whether EU law was in place or not.

### *5.2.2 Second dimension - EU/Member States*

The second dimension of cumulative costs and effects considers **how national and sub-national authorities implement EU law, i.e. the extent to which legislation ‘accumulates’ at various legislative levels.**

**Cumulative costs can arise from differences in the implementation of EU laws by national authorities during national transposition.** Costs vary because minimum or maximum harmonisation approaches are implemented, which may undermine the level playing field in the EU’s Internal Market. In the ICT sector, there are differences in national interpretations of data protection legislation, which has implications for ICT firms in most of the countries covered by the study. Different levels of government may have varying competencies for specific aspects of legislation in different Member States. This means that costs of compliance differ. National authorities may enforce legislation diversely, with testing and inspection frequencies varying between Member States.

**Member States, rather than the EU, are often a source of further regulatory burdens for SMEs from EU legislation.** This can occur through ‘gold-plating’ during national transposition processes (e.g. the interpretation of legislation in an inflexible or unintended way, and variations in standards, as in the case of construction products). **Additional requirements are written into national legislation in public procurement and further variations are introduced during individual procurement procedures.** Based on the research, this appears to be particularly the case in the construction sector (although also found in electrical equipment and ICT services). There are also other drivers generating costs from the cumulative effects of legislation beyond the potential for ‘gold-plating’ during transposition processes. This includes the possibility of further requirements being introduced in Member States where legislation passes through multiple governance levels (e.g. due to the existence of a regionalised national regulatory structure).

**Different legislative instruments influence the extent of cumulative effects and costs. From the EU perspective, there could be advantages in implementing more legislation through Regulations rather than Directives. This could reduce the scope of divergence in national implementation within and between countries.** However, a change of this sort would not fully eliminate differences in national implementation. Even with Regulations, differences can arise in interpretation which must be resolved by the European Court of Justice (e.g. in the case of the REACH Regulation and the definition of 'articles'). Regulatory divergence not only relates to 'gold-plating,' but can stem also from different interpretations of legislation. However, Regulations minimise SMEs' administrative burdens since they reduce unnecessary complications from different interpretations between Member States.

**Imposition of onerous, overly frequent national testing and inspection to monitor compliance with EU law sometimes exacerbates its cumulative effects and costs.** In our research, this problem was more burdensome than 'gold-plating' EU legislation during the transposition process. Though legislation may be of EU origin, a challenge for EU policymakers is that Member States are responsible for national in-service and inspection regimes (e.g. monitoring and enforcement of employment, health and safety and product safety law).

### *5.2.3 Third dimension - Cumulative effects of EU legislation over time*

The third dimension of cumulative costs and effects relates to **the overall amount of (EU) legislation and effects on SMEs over time.**

**The costs of the cumulative effects of EU legislation can accumulate over time but evidence is very mixed as to whether EU legislation compliance costs are incremental due to its gradual accretion.** Three important points emerge from this aspect of the research.

**Firstly, a large percentage of SME respondents indicated they did not know if requirements they must comply with have become more or less burdensome or more costly (or less) over time.** This is because either they do not know the legislation sufficiently well to comment, or they have not been in the business long enough to have a view of developments over time.

**Secondly, a relatively small proportion of SMEs consider EU legislation to have become less burdensome and costly.** Mentioned in the bakery sector were Hazard Analysis and Critical Control Point (HACCP) systems that made compliance easier and reduced costs. Outside employment law, there is balance between SMEs who consider EU legislation more burdensome and costly, and those argue it has stayed the same. In the case of employment law, the view is that it has become less burdensome and costly.

**Thirdly, the costs of compliance with individual pieces of legislation tend to diminish as SMEs become more familiar with requirements.** EU Compliance costs tend to peak within the first five years or so of legislation coming into effect. So, as more legislation becomes applicable, cumulative effects are mitigated. Well-established legislation is generally easier and less burdensome to comply with as SMEs gain familiarity with earlier legislation.<sup>5</sup>

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<sup>5</sup> For example, monitoring working hours for the Working Time Directive was perceived as highly burdensome when introduced, but many SMEs are familiar with the legislation and have electronic time-keeping systems for internal management purposes. So the legislation has arguably become less burdensome over time.

### 5.3 Sector factors influencing cumulative costs

The sector analyses show that **various sector-specific factors underlie the emergence, extent and effects of cumulative costs**. These are:

**Firstly, the structure and nature of the industry, including the degree of integration – vertical and horizontal – is an important factor influencing the extent of cumulative costs.** In industries with many micro-enterprises, for example, levels of inspection and compliance tend to be lower (e.g. bakeries or retail of bakery products). On the other hand, in the electrical equipment sector, enterprises tend to be larger and there is greater visibility and likelihood of inspection.

**Secondly, a further factor influencing the extent and effect of cumulative costs is the industry supply chains and their degree of integration.** In the electrical equipment sector, supply chains are relatively long and monitored by the integrator, who is responsible for ensuring a fully compliant product. Similar forces are at work in some aspects of retail and construction as well, so market forces are strong drivers of compliance, independent of public sector intervention. By contrast, for a small local bakery in a country with many such bakeries, it may be possible to maintain a low profile with respect to inspection and enforcement. If the firm is part of a highly integrated supply chain, this cannot happen.

**Thirdly, firm size influences compliance costs. Medium-sized enterprises have higher visibility in the market and therefore tend to be inspected more regularly by authorities than microenterprises or small enterprises.** Larger SMEs are also generally more concerned with regulatory compliance from a risk management and reputation management perspective since non-compliance can lead to substantial losses. For example, they might have to stop production or suffer damage to their reputation due to a negative inspection or testing result. This could then have knock-on effects with customers and future sales. Businesses develop and implement systems to ensure compliance with EU law. Examples include preparing guidelines and risk management tools, developing monitoring processes, ensuring compliance with the Working Time Directive, hygiene and health and safety training, and record keeping. Additionally, larger firms tend to have more developed internal systems. Business is conducted on a more impersonal and market-based basis than in micro or small firms (often family businesses), where personal relationships developed over time are often more important.

**Micro and small firms generally have a less formalised predisposition to regulatory compliance than their medium-sized or large counterparts do.** Given the complexity of familiarisation tasks and the need to maintain detailed records, complying with EU law 'to the letter' is not considered a realistic option by many micro- or small firms. Instead, they either try to do what is considered reasonable to achieve a minimum level of compliance or make no effort to comply at all. However, this is harder to do in some sectors than others. SMEs we interviewed commented that when they do comply, their compliance costs are comparatively high. This is because they cannot spread specific compliance costs (e.g. product testing and conformity assessment) across large unit volumes, as larger firms do. Therefore, compliance costs per unit should be given greater attention in future cumulative cost studies.

**In addition, specific-country contexts have a bearing on the extent of cumulative costs incurred by SMEs.** Relevant factors include country size (which affects the size and structure of the industry, the size of the labour supply, and the size of the local and regional market), how legislation is implemented (different levels of government), and enforcement (business culture, assessment of risks). However, different drivers may be more relevant in determining cumulative costs in a given country.

For example, in the steel and aluminium sectors, the role played by the energy trading system and electricity contracts is critical. Significant differences in the costs of cumulative compliance effects with EU legislation between sectors and countries in this study arise from the factors identified above.

## **6. CUMULATIVE EFFECTS OF COMPLIANCE WITH REGULATION ON INDIVIDUAL SMES IN SPECIFIC ECONOMIC SECTORS AND A COMPARISON OF COSTS IN DIFFERENT COUNTRIES.**

This section summarises the findings as regards the third objective of the study: **to assess the cumulative effects of compliance with various types and scopes of regulation on individual SMEs in specific economic sectors, and compare the cost in different countries**. First the cumulative effects of compliance are assessed, then sectors are compared and comments made as regards country comparisons.

### **6.1 Cumulative effects – positive and negative impacts**

**Individual SMEs of a comparable size can be very differently affected by compliance costs**, as the case studies on the bakery sector make clear. However, as pointed out in 5.3 above, there are sector-specific factors that limit the extent to which compliance costs can vary between similar firms within a given sector.

There are not only negative, but also positive consequences of cumulative costs.

**Where negative effects are concerned, in addition to the actual costs themselves and their effect on cost levels in the sector (and potentially competitiveness), research found that there are many instances where management time is taken up by compliance activities.** Activities like familiarisation (information searches), adaptation (training) and administration (including burdensome actions such as record-keeping and public reporting) reduce the amount of 'productive' time available to a business.

**Cumulative costs can constrain SMEs from extending their markets, growing and developing.** Several examples were identified in the sector studies. These included: micro bakeries in Ireland that want to grow; ICT services firms that want to extend their employment to part-time, home-based work; bakeries wanting to set up their own retail outlets; electrical equipment manufacturers that want to enter other EU markets; ICT services companies bidding for public sector contracts in other EU countries; and engineering companies that want to move into residential construction.

**Cumulative costs can also add to product development costs in SMEs that want to respond to short-term market trends but must carry out time-consuming and costly tests.** Local decisions regarding enforcement can also lead to higher compliance costs in some Member States than others, or even in different parts of an individual Member State. These costs constrain the flexibility of SMEs and restrict their ability to expand. The medium- and long-term consequences of such constraints can negatively affect development of the industries.

**The most pervasive positive effects** on SMEs of compliance with regulatory requirements are improvement of working conditions, hygiene and standards, and consumer confidence in products and services. The effect of costs varies between sectors (especially in terms of short-term adjustments). However, 45% of enterprises across sectors indicated long-term costs are negligible and incorporable into product design. Positive effects also arise from a clearer regulatory environment and ready access to EU export markets for compliant firms.

## 6.2 Sector comparisons

As regards comparing sectors, the table below sets out our assessment of how they rank in terms of the costs of the cumulative effects of compliance with EU law (5 being the highest and 1 the lowest).

Sector ranking - costs of the cumulative effects of compliance with EU law		
Sector	Rank	Rationale
<b>Electrical equipment</b>	5 High	Compliance costs can be high but are often one-off and stem from EU legislation specific to electrical equipment ('vertical'), such as mandated conformity assessment procedures in product safety testing, Ecodesign requirements, etc. There is not a great deal of scope for non-compliance, given the integrated nature of the industry and the hazardous inputs involved (electricity). Enterprises tend to be relatively large and therefore attract more compliance and legislation, so the sector tends to have the highest costs of cumulative effects of compliance.
<b>Construction</b>	4 High	Compliance costs tend to stem from legislation of a 'horizontal nature' such as health and safety, waste disposal and transport legislation. Costs also arise from 'vertical' legislation such as construction product and building design laws (e.g. energy efficiency). This combination creates a wide-ranging mix of compliance costs that readily accumulate. There are differences between Member States regarding implementation and enforcement, which adds further effects. Public procurement legislation and 'business' legislation related to payment terms also increases cumulative costs.
<b>Bakeries</b>	3 Mode rate	Overall, compliance costs are moderate to low. There is not a great deal of onerous sector-specific legislation (hygiene, labelling). Costs mainly arise from meeting EU health, safety and employment standards. HACCP, documented and fully implemented, can impose significant costs, but it appears there is scope for less than full compliance in the large number of micro firms in the sector.
<b>Retail of bakery products</b>	2 Low	Costs generated by compliance in this sector are low. As with bakeries, the main types of legislation apply to firms in all sectors and there is little sector-specific legislation. There is no sector-specific legislation that is particularly onerous, other than, possibly, fully documented HACCP systems.
<b>ICT services</b>	1 Low	Compliance costs are low since there is no sector-specific legislation. Costs mainly arise from EU health, safety and employment rules, most of which are applicable to firms in all sectors. However, the Data Protection Directive (including safe storage of data and secure transmission) imposes some costs that could incur wider ranging adaptation costs. Micro and small firms may not always be in compliance.

### 6.3 Country comparisons

The study identified **four factors that determine the level of costs of the cumulative effects of compliance between Member States.**

- **The first factor is cost levels within Member States themselves, reflected in price levels in their product, service and factor markets.** For example, country differences exist in the price of hotel accommodation for employees undergoing training in food hygiene as part of a four-day off-site workshop, or in the cost of an ICT services consultant in Estonia (as compared to Sweden or Slovenia).
- **The second factor relates, at a country level, to the extent that national and sub-national bodies are involved in the modification of EU-originated legislation.** It is possible to argue that countries with multiple levels of administration (such as Spain) generate higher cumulative costs. However, the research has also found that even in more centrally governed countries such as Ireland or Slovakia, there is evidence of cumulative costs in areas such as public procurement. So while there is a predisposition for larger Member States with multiple levels of administration to generate more cumulative costs, this does not mean that smaller Member States with less levels of administration will necessarily generate less.
- **In the third place, Member States have different approaches to enforcement, again potentially an additional source of cumulative costs.** Evidence from the research reinforces the conclusion that **the more levels of government are involved in enforcement (e.g. in Spain – bakeries and electrical equipment sectors), the higher the cumulative costs of legislation.**
- **A further factor influencing levels of cumulative costs is industry structure in terms of the breakdown of firms by size categories and integration in industry supply chains.** Compliance varies by firm size and sector, but integrated sectors with relatively larger average firm sizes (in terms of employment) have higher levels of compliance (e.g. electrical equipment). Higher compliance means higher costs and cumulative costs.
- **Based on the above considerations, it is not possible to generalise regarding levels of cumulative compliance costs between Member States except to say that those with larger firms and more levels of government will tend to have higher costs.** The sector findings in section three of the report present inter-country comparisons at the sector level.



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