



EUROPEAN COMMISSION

**A STUDY OF BUSINESS SUPPORT SERVICES
AND MARKET FAILURE**

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O. MARKET FAILURES AS A RATIONALE FOR PUBLIC INTERVENTION

1. Market failures have been identified as an underpinning rationale for public funding to support SME development, in particular in terms of the provision of State Aid. The 2002 Barcelona European Council indicated that such aid should be targeted to “identified market failures.”¹ This focus on market failures as a rationale for public intervention has occurred within the context of the ongoing development of policy and policy thinking on enterprise in the EU. There is, however, little documented analysis and consideration of market failures at present that can offer clear and agreed frameworks for policy development and intervention. This study seeks to address this “need to know” challenge by developing a rigorous conceptual framework by which to map and understand market failure in the business support market for SMEs seeking information and advice.
2. There is a wider policy framework relating to SME development that embraces the Lisbon objectives, the European Charter for Small Business, and recent considerations of what constitutes a top-class business support services. The overall objective of the Lisbon European Council meeting in 2000 was for Europe “to become the most competitive and dynamic knowledge-driven economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.”² A primary conclusion of the Council was that there is a need to make Europe more entrepreneurial and to foster entrepreneurship by “creating a friendly environment for starting up and developing innovative businesses, especially SMEs.”³ Benchmarking was identified as a primary means of achieving these goals, reflected in the development of the Best Procedure, which provides a mechanism for identifying and exchanging best practice.⁴ It also led to the development of a series of Best Procedure projects, as reported in the 2001 Best Procedure Report⁵, one of which was on business support services. The role and nature of support services to SMEs, as such,

¹ Presidency Conclusions. Barcelona European Council, March 15 and 16 2002. SN 100/02, en.

² Bulletin EU 3-2000 (en): News in brief.

³ Ibid.

⁴ COM (2000) 256, 26.4.2000.

⁵ SEC (2001) 1704, 29.10.2001.

is integral to the fulfilment of the conclusions of the Lisbon European Council.

3. A further outcome from the Lisbon European Council was the development of the European Charter for Small Enterprises. This Charter underlines the importance of SMEs in the EU economy, in terms of several dimensions including their dynamism and flexibility, and their contribution to employment and social and regional development. The Charter identified ten key lines for action, many of which refer to the need to provide support services to SMEs and to create “top-class small business support.”⁶
4. The 2001 Commission Staff Working Paper ‘Creating Top-Class Business Support Services’⁷ addressed several key issues relating to improving and enhancing business support services. Specifically, consideration was given to the proliferation of support services, their cost and effectiveness, and to the impacts of public provision of support services on private providers, in particular the possibility of ‘crowding out’ private provision. The Staff Working Paper identified the existence of market failures, i.e. conditions in which the private sector will not provide services, as a key criterion for determining the provision of public business support services. Market failures, in other words, provide a rationale for public business support services because they indicate conditions in which there will be no or minimal competition with the private sector.
5. Market failures as a rationale for public intervention can, therefore, be seen as a development of thinking on the role of public funding in achieving the Lisbon objectives. The concept builds on the importance of SMEs to employment and wealth creation and the concomitant need to encourage start-up and business development within this sector. It provides a mechanism for identifying instances in which SME development needs will not or cannot be met by the private sector, in part or in full.
6. Although market failures provide a useful framework for identifying and considering rationales for the provision of public services, they are by no means the only basis for

⁶ European Charter for Small Enterprises, adopted by the General Affairs Council on 13 June 2000 and welcomed by the Feira European Council on 19-20 June 2000.

⁷ SEC (2001) 1937, 28.11.2001.

the development of public business support services and interventions. Other rationales are currently used to underpin public inputs, including: responses to wider social issues, such as exclusion and inclusion; a focus on developing and supporting particular sectors; employment retention and creation; and a desire to enhance and increase the small business base in the EU and in member states. Intrinsic to the development and assessment of rationales for business support by public intervention is the importance of building an evaluation culture in order to effectively determine impacts and results. The need for an evaluation culture that has clear objectives and evaluation criteria built into the initial project or service conception and design has been identified in the European Charter for Small Enterprises: *“We will use effective indicators to assess progress over time and in relation to the best in the world to reinforce our learning, searching for better practice in all fields that affect small business to continuously improve our performance.”*

7. A market failure can be defined as “the inability of a system of private markets to provide certain goods either at all or at the most desirable or ‘optimal’ level.”⁸ Market failures occur, therefore, when private companies cannot or will not provide business support services because they cannot make a commercial return even where there is demand or need for a service. The result of a market failure is that the needs of certain SMEs are either not met or are only partially met. Under these conditions, the rationale for public provision of support services is that they will lead to employment and wealth creation that would not otherwise have occurred precisely because these services were not available. Two primary criteria for the provision of public support services, therefore, are that: (i) the service is not offered privately, even though there is a need, and; (ii) the provision of the service will enable the business to develop, leading to the generation of new wealth and/or employment.
8. This report focuses solely on market failures relating to the provision information and advice services for SMEs. There are four principal reasons for this: (i) the provision of services to SMEs is extensive and involves a wide variety of inputs and delivery mechanisms, making an assessment of market failures relating to all SME support

⁸ Pearce D (1996). MacMillan Dictionary of Economics. It can also be defined as follows: “an imperfection in a price system that prevents an efficient allocation of resources.” Samuelson and Nordhaus (1989). Economics, 13th Edition.

services extremely complex; (ii) a focus on information and advice provides a focus for the study, and hence a starting point for a wider consideration of market failures relating to the public provision of all forms of SME business support services; (iii) a significant component of publicly-funded support for SMEs is based on information and advice; (iv) a market already exists for certain types of advice and information, indicating that there is a market mechanism for these forms of support services.⁹ The existence of this market also highlights a need to develop clear and substantive rationales for public intervention and to address issues relating to public-private sector provision.

9. Information is often identified as a service that may not be provided because of market failures, typically for two reasons. Firstly, the costs of collecting and preparing information may be very high, making the initial expenditure prohibitive for a single business. Secondly, the value placed on the information by SMEs, as reflected in the market price, may be lower than the costs of collecting and providing the information. The existence of market failures relating to the provision of information does not, however, imply that these market failures exist for all information. There is evidence across the EU of markets for particular forms and types of information, indicating that in these cases market failures do not exist, or do not present a sufficient barrier to provision of this information.
10. The provision of advice to SMEs may also be constrained by market failure. In general, market failures relating to the provision of advice to SMEs arise when advice is considered or perceived to be of low or insufficient value. Multiple factors can contribute to this, including: the nature of the advice service on offer; the experience and skills of the adviser; the expectations of the SME; the ability (or otherwise) of those involved to diagnose the needs of the SME and the appropriate response; and the nature of interactions between the provider and the SME consumer. A particular issue relating to the provision of advice to SMEs, therefore, is that it is not only an issue of making available such support services, it is also a matter of ensuring that the appropriate form of service (and service provider) is made available on appropriate terms.

⁹ The existence of market failures is predicated on the existence of a market mechanism, in that failures represent a discontinuity or breakdown in such a system.

11. Four principal types of market failure can be associated with the provision of public information and advice support services to SMEs. These are:
- (i) inefficiencies and discrepancies that arise via and during the exchange of information (*adverse selection issues*);
 - (ii) services, often information, that are not provided because no return can be made by the private sector (*public goods*);
 - (iii) services that are not provided because insufficient return can be made (*mixed goods*), and;
 - (iv) the wider impacts and effects on other businesses that arise from the provision of services to an SME but which are not calculated into the price (*externalities*).

Adverse selection outcomes in information exchange

12. Inefficiencies and discrepancies arise via and during the exchange of information under three conditions: (i) when there are different levels of information held by the provider and the SME customer, i.e. when one 'knows' more or has additional information that is not shared by the other; (ii) when both the provider and the customer have incomplete information about the service and the transaction; (iii) when the information that exists is inaccurate. In all three cases, the outcome may be that an inappropriate service is taken up by the SME or that no service is taken up. Inappropriate services will be consumed in three instances: (i) when the individual with inferior, i.e. less, information cannot make the best or right decision (i.e. around which service to provide or to take up); (ii) when incomplete information prevents the most appropriate decision, and; (iii) when inaccurate information leads to an inappropriate decision. Research on SMEs and their take-up of support services indicates that all three conditions exist, suggesting that inappropriate take-up of business support services occurs.

Provision of public and mixed goods where private sector incentives are insufficient

13. In cases where there is demand for an information or advice service but the returns are either insufficient for the private sector or do not exist, then there may be a rationale for public sector provision of these services. Two forms of public sector response are possible under these conditions: (i) the provision of a service that is available to all SMEs without payment (a 'public good'), and; (ii) the provision of a service that is available to some SMEs without payment or to all SMEs at a non-commercial rate (a 'mixed good').
14. The provision of certain forms of information is often considered an appropriate type of public good, should a commercial market not exist (or have the potential to exist). When information is provided as a public good, it is available to all SMEs without distinction or barriers, i.e. it is generally and publicly available. A primary driver for the provision of information as a public good is that it will have a beneficial impact on any SME that receives it, either in terms of reducing costs (e.g. as a result of compliance) or in terms of increasing opportunities (e.g. tenders). An underpinning rationale for the provision of such information is that it would not, or could not, be offered commercially by private sector entities. There are also indications that government intervention may be beneficial in information markets where public inputs will create incentives and opportunities for private businesses to offer new information (and advice) services on a commercial basis. Public intervention under these circumstances is focused on 'market-making' for the private sector.
15. The rationale for the provision of a mixed good is the same as that for a public good, namely that there is a tangible SME need that cannot be met or satisfied on commercial terms. There are two general forms of mixed good. The first form of mixed good is provided without charge but to a limited group of SMEs, i.e. it is not available to all SMEs. These conditions may apply in several ways, including: a subscription requirement exists in order to acquire the information; the information or advice that is provided is of a specialist nature and so of relevance to a particular group of SMEs; the information and advice is provided without charge only in certain areas or to certain businesses.

16. The second general type of mixed good is an SME business support service that is available to all, but at a price or rate that is not commercially viable. In these situations, public funding bridges the 'gap' between the price charged to the SME and the full cost of delivering the service. These types of mixed goods are often associated with the provision of advice and training, in that these forms of support service can be of value to SMEs but they are not affordable when offered at commercial rates. As with other mixed goods and with public goods, the rationale for the provision of a service that is partly publicly funded is that there is a demonstrable SME need that is not or could not be offered on a commercial basis.

The wider impacts and effects arising from the provision of SME business support services

17. Under certain conditions, the provision of information and advice support services to SMEs can have an impact on other smaller businesses. In these cases, the provision of support has had a 'knock-on' or multiplier effect, in that it has affected SMEs other than those taking up or using the support service. These wider, 'knock-on' effects are labelled externalities, in that their impacts occur outside the transaction between the provider and consumer of SME business support services. In general, two forms of externality exist: one is positive, in that the wider impacts assist and are helpful to other SMEs. The other form of externality, however, has a negative impact on a wider group of SMEs. One example of a positive externality is the provision of information or advice to a single SME that, once proven as beneficial to that business, is communicated to other SMEs that use this input to their advantage.
18. Negative externalities can arise via the provision of information and advice services to SMEs. Typically, negative externalities occur when the take-up of information or advice leads to a change in the behaviour of that SME in ways that are harmful to other businesses. This can occur when consultants provide advice to SMEs about how to develop or improve the business. For example, advice on delaying payments beyond agreed terms, and statutory requirements, may be provided to businesses in which cash flow is critical to survival and to further development. This advice may lead to cash flow problems for other businesses as the SME delays payments in order to retain cash.

How can market failures inform the provision of SME information and advice services?

19. The analysis outlined in this report identifies market failures as a useful framework for developing SME information and advice support services. Market failures provide a rationale for such interventions in that they can be identified and validated via application of the key concepts, namely adverse selection, public goods, mixed goods and positive and negative externalities. In addition, market failures occur where there is a tangible SME development need that can be identified and validated. Market failures also resolve issues related to the relationship between public and private provision, in that they occur only under conditions in which the private sector does not or will not offer commercial services. As such, market failures provide a rationale for public intervention that is clearly focused on tangible need and that is distinctive from private sector activities.
20. Three primary strategies can be identified to support the use of market failures concepts in justifying public provision of SME information and advice services:
 1. The assessment of the significance of specific instances of market failure, based on their identification via empirical evidence and their subsequent evaluation for severity, impact and the feasibility of public response.
 2. The development of new services and the validation of existing services against tangible and empirically validated instances of market failure.
 3. The assessment of SME information and advice services explicitly in terms of how they overcome or mitigate the effects of failures within the business support market, based on an evaluation framework that starts with, and builds on the initial identification of the market failure.

I. INTRODUCTION: MARKET FAILURES AND SME INFORMATION AND ADVICE SERVICES

1. Market failure as a concept can be used to develop clear rationales for the provision of business support services to SMEs. At the recent Barcelona summit of European leaders, explicit reference was made to the need to base intervention and business support on identified and validated cases and instances of market failure:

“18. *In addition, the European Council:*

- *renews its call to Member States to reduce the overall level of State Aid as a percentage of GDP by 2003, and onwards, and to redirect such aid towards horizontal objectives of common interest, including economic and social cohesion, and target it to identified market failures*” [Presidency Conclusions – Barcelona European Council, 15 and 16 March 2002].

2. Recognition of the importance of establishing market failures as a rationale and basis for public intervention has not, as yet, generated a detailed and comprehensive analysis of the nature and characteristics of market failures as they relate to the provision of business support services to enterprises. This ‘gap’ has been identified in the recent Commission Staff Working Document “Creating Top-Class Business Support Services” [Doc. SEC(2001) 1937]:

“...when a specifically economic rationale for support measures is presented there is usually a reference to market failures. This may be a matter of pointing to the systematic disadvantages suffered by small and medium-sized enterprises or, in relation to support services, a more definite reference to the market failures associated with the provision of information (a public good) and advice (problems of asymmetric information and adverse selection). Even in the latter case, however, justifications of public provision as a response to an actual or potential market failure are rarely set out in any detail and there has been little analysis of this issue in the academic literature.”

3. This report analyses one aspect of the debate relating to market failures, namely its relevance and significance in terms of the provision of information and advice services to small and medium enterprises. The rationale for this focus on SME information and advice support services is laid out in paragraph 8 of Section 0. Specific consideration is made of relevant market failures, which are categorised and mapped in terms of their implications for business support services providers to SMEs. A full description is provided of the nature of each major market failure. The report also offers options for applying market failures concepts to business support services, via the development of a clear rationale for intervention and the design of support services to address these failures.
4. The analysis underpinning this study is based on an in-depth assessment of available documentation on market failures. This includes publications in the academic, policy, and practitioner literatures. Based on an audit of key journals and publications related to concepts and theories of market failure and to the small and medium enterprise, an extensive bibliography of references was identified. These references were then assessed in terms of their relevance and applicability to the provision and take-up of SME information and advice services. Four principal market failures were identified as being of particular relevance to these services. In addition, four market failures were determined to be of broader relevance to business support services to SMEs. Both types of market failure are considered in this report, with particular focus placed on those relating explicitly to information and advice services.
5. A critical starting point for this analysis of market failures related to business support information and advice services is to establish broad definitions for both terms.
6. A market failure is defined as “*an imperfection in a price system that prevents an efficient allocation of resources*” [Samuelson and Nordhaus, 1989]. It can be seen, in other words, as “*the inability of a system of private markets to provide certain goods either at all or at the most desirable or ‘optimal’ level*” [Pearce, 1996], indicating that market failures exist when the conditions for perfect markets do not exist. In terms of the provision of business support services, a market failure can be defined as occurring when demand for services and their supply do not meet at an optimal level. Typically, market failures relating to business support are considered in terms of:

‘gaps’, i.e. non-provision of services; ‘weaknesses’, i.e. sub-optimal services that could be improved; or ‘mis-matches’, i.e. the provision of services that are either fully or partially inappropriate. From this perspective, market failures may justify intervention, in order to: ‘fill gaps’, ‘remove weaknesses’, or ‘match up supply and demand.’

7. Although this report focuses on market failures as a rationale and underpinning driver for the development and provision of support services to SMEs, the wider policy context as summarised in Section 0 is based on alternative justifications for public intervention. The analysis presented in this report, therefore, is based on a recognition that market failures approaches represent one framework for developing SME support measures. Other rationales, in general, relate to the wider socio-economic and political economy concerns and issues associated with the developmental constraints and issues faced by SMEs, and the opportunities and contribution that smaller businesses can make to economic and social development.
8. The report focuses on information and advice business support services only. It does not, therefore, consider market failures related to the provision of resources, such as finance, nor does it concern itself with other forms of support, including facilities and premises, training and promotion. The analysis uses as its starting point the definition of business support services outlined in the Commission Staff Working Paper “Creating Top-Class Business Support Services [SEC(2001) 1937]. Information and advice services to small and medium enterprises are defined as follows:
 - (i) They are the direct result of a public policy initiative;
 - (ii) They are significantly publicly funded;
 - (iii) They focus on the key decision-makers and owners of small and medium enterprises.

II. CHARACTERISING BUSINESS SUPPORT AS A MARKET MECHANISM

9. In order for the concept of market failures to be valid, and hence underpin public intervention, there is a need to establish that a market¹⁰ mechanism exists in some form. A market mechanism is in operation if it fulfils two conditions. Firstly, there is both demand for and supply of business support services. Secondly, there is some form of sale and purchase exchange between suppliers and consumers.
10. The first condition is self-evident, in that there is demand in the EU for both private and public sector information and advice, and the response has been the development and provision of services by both sectors.
11. In terms of the second condition, a case can be made that a market mechanism exists, in that representatives of small and medium enterprises make explicit purchasing decisions when taking up business support services. There is, in other words, a valuation of the service that is made before consumption. In conditions in which these services are provided for free and without charge, the value may be calculated in terms of ‘opportunity cost’¹¹, i.e. the time, effort and input that is demanded in terms of participation, as well as by the anticipated or perceived impact and benefit. When payment is required, an explicit assessment of benefit is made, typically in financial terms. Moreover, many providers of business support services market themselves and the services they offer, as well as considering the businesses that take up these services as customers.
12. The case for a market for information can be made via a consideration of these markets as exchange mechanisms in which perfect information does not exist. The existence of adverse selection through information asymmetries and as a result of incomplete and inaccurate information, as considered later in this report, suggest that the market for SME information is not perfect. There is, as such, a market for information precisely because the market is not efficient, i.e. because market failures

¹⁰ A market is defined in the Macmillan Dictionary of Modern Economics as “*any context in which the sale and purchase of goods and services takes place.*”

are inevitable. From this perspective, a perfectly efficient market for information does not exist and the rationale for public intervention is to create the incentives and opportunities for agents to both provide and acquire information. This perspective on the development of markets for information is based on the Grossman-Stiglitz paradox, which has been used to analyse multiple informational markets:

“...the Grossman-Stiglitz paradox: if a market were informationally efficient – i.e., all relevant information is reflected in market prices – no agent would have an incentive to acquire the information on which prices are based. But if everyone is uninformed, then it pays some agent to become informed. Thus, an informationally efficient equilibrium does not exist” [‘Markets with Asymmetric Information’, October, 2001].

III. WHAT MARKET FAILURES CAN BE RELATED TO THE BUSINESS SUPPORT SERVICES MARKET FOR SMALL AND MEDIUM ENTERPRISES?

13. There is a broad range of market failures that can be identified from the academic and policy literature that relate to the general provision of business support services to small and medium enterprises, rather than solely to the provision of information and advice. These market failures are of relevance to the market for these services to SMEs as a whole, and so represent a broader context within which to place the analysis of information and advice services that is the focus of this report. Their broader relevance indicates that these market failures are of defining importance to the provision of services and funding for services by the public sector. It also indicates that the market failures analysed in this section can be considered inherent, or generic, to the SME support services market, rather than as particular cases relating to specific forms of service provision.
14. The market failures that are examined reflect four aspects of the market for SME support services. The first aspect of this market is SME demand for services, i.e.

¹¹ From this perspective, a shadow price exists for the take-up of public business support services that equates to the transactional costs of ‘consuming’ the service.

‘demand-side’ considerations of the constraints and barriers that affect these enterprises. The primary ‘demand-side’ market failure identified in the literature review and synthesis was capacity (and capability) constraints in small and medium enterprises. A second aspect, or component, of the market for SME support services is the nature of the network of service providers and funders. This consideration of the ‘supply-side’ identifies resource constraints that limit the ability of providers to provide services. The third aspect of the market for SME services is its structure, in particular in terms of the effects on information and advice services of consolidation of provider power, through concentration of resources for services provision. The fourth aspect of the market for SME information and advice support services is the market interface or transaction, i.e. the exchange mechanisms that bring together consumers and suppliers.

‘Demand-side’ considerations: SME capacity constraints

15. Small and medium enterprises have been identified as operating with scarce, or stretched, resources. Capacity constraints, when they occur, appear to be due to a combination of factors, including: constraints in access to resources such as finance and structures such as financial markets; operating at scales that may be considered as below minimum efficiency; tendencies for smaller enterprises to pay lower salaries than larger businesses, and; the holistic management and task structure of small firms, as compared with the functional specialisation seen in larger businesses.¹² These conditions have been identified as occurring in many smaller enterprises, and are sometimes considered ‘generic’ or inherent characteristics of small and micro enterprises. The heterogeneity of the small business population, however, suggests that even though these characterisations of smaller enterprises may be valid in many cases, they cannot necessarily be considered as universal or intrinsic to every small

¹² The 2001 Observatory of European SMEs identified the following three constraints as of greatest concern to businesses interviewed in the study: ‘lack of skilled labour’; ‘access to finance’; ‘implementing new technology’. All three are factor inputs (see factor rigidity issues below). In addition, EIM Research Report 9902/E, as quoted in the 2002 Observatory of European SMEs, suggests that small manufacturing businesses generally “operate below minimum efficient scale” [Observatory of European SMEs 2002, No. 2, ‘SMEs in Europe, including a first glance at EU candidate countries’]

and medium business.¹³ At best, this characterisation offers a broad fit to most smaller enterprises and so provides a ‘flavour’ of their resource endowment or status.

16. Smaller enterprises that operate with scarce or stretched resources experience constraints in terms of time to search for services, and may have limited resources to search for these services. In situations where there is limited time for search or limited resource to search, this can result in inappropriate take-up or non take-up of business support services (a consequence, also, of adverse selection due to incomplete or inaccurate information), because insufficient information is acquired on the options available. There may also be an opportunity cost for the search process in terms of a trade-off with inputs into the business and its development. If search is costly and cumbersome for enterprises, they are less likely to engage with the business support market, leading to lower rates of take-up of publicly-funded services by SMEs.
17. As well as capacity constraints, many small and particularly micro businesses have been associated with capability constraints or limitations. There are several reasons for this:
 - (i) A dependence on a single owner-manager or small group of owner-managers for most decisions and for the overall development of the business, based on their ability to start a business rather than on their broader management skills and abilities;
 - (ii) Arising from this, the tendency for smaller businesses to have holistic management task structures and requirements which require, and generate, broad skills and understanding rather than a depth of knowledge in all areas;
 - (iii) Smaller businesses tend not to have high levels of specialisation, for example in functional areas of business activity, unlike larger businesses which are more likely to have functionally specialised departments and teams with extensive skills and experience in multiple aspects of the business;

¹³ High technology, growth-oriented start-ups with significant venture capital or other formal external finance, for example, often do not demonstrate these characteristics.

- (iv) Many owner-managers and partners managing smaller businesses tend not to access formal education and training for business and personal development.

‘Supply-side’ considerations: provider constraints

- 18. Business support services providers also operate under conditions of finite, i.e. constrained, resources. This is generally the case for public agencies, in that annual government and Commission expenditure is budgeted according to public receipts of income. It also applies to non-governmental agencies that rely significantly on public funding. Typical outcomes of public sector budget constraints are the targeting of particular customer groups and the development of eligibility criteria, both in order to ration finite resources.
- 19. As well as resource constraints, there are some indications that providers of publicly-funded support services to SMEs can also experience capability constraints. Capability constraints arise when the skills and competencies of staff in service provider organisations are either inappropriate or are not of sufficient quality to satisfy SME client expectations and requirements. These capability constraints can also be based on insufficient empathy or understanding of the small and medium enterprise and its concerns, priorities and operating requirements.

Market structure issues: the impact of provider concentration on provision

- 20. Monopolies and oligopolies occur in markets where producers have definitive market power, which enables them to influence and shape prices and consumption. Market failures arising from monopoly or oligopoly provision manifest themselves in several ways, including: pricing, and in particular price-setting or -making; reduced levels of innovation; increased barriers to start-up and entry of competitors, and; reduced likelihood of substitution of products by consumers in the short-term.
- 21. Price-making behaviour that results in higher prices can also lead to reduced ‘market governance’, or a need for ‘watchdog’ bodies, because of a lack of competition.

Higher prices result in the extraction of excess profits ('rents') by producers and have negative implications for consumers. Reduced 'governance' through the market leads to a need for greater regulation, due to decreased levels of competition, and may result in the production of inferior quality goods. Reduced innovation manifests itself in terms of reduced investment rates and lower expenditure on research and development.

22. The public provision of SME information and advice services can be seen, in theory and in practice, to occur under oligopolistic, and in some cases near-monopoly, conditions. The development of 'one-stop' and 'first-stop' shops in several EU countries, along with the emergence of a conceptualisation of public agencies as brokers operating between the SME client and private and public sector providers, can place significant market power in the hands of these public support service agencies. An implication of the consolidation of public provision of SME support services into a single or small number of provider agencies or networks, therefore, may be monopolistic or oligopolistic market conditions.
23. Two rationales can be applied to the concentration of provider power in public sector agencies and networks. The first is that this will make the business support system more efficient, in that it will reduce the transaction costs that arise from taking up support services. The second justification, which relates to the wider economics literature, is that minimum economies of scale are required in order to fund innovation and the development of new services, given the initial investment required. Both rationales can be assessed, in that monitoring of instances of provider concentration can evaluate reductions in transaction costs and improved levels of innovation.
24. The concentration of provider power in public sector organisations can produce rigidities in the market for SME information and advice services. Rigidities occur under conditions where factor inputs into production are relatively immobile or fixed in the short-term. Factor inputs are defined as the resources that are deployed in order to produce a product or service. The three traditional factor inputs are land, labour and capital (in the form of investment in the production function). Typically, in perfect markets, factor inputs flow without cost or delay to the production functions and market transactions where they will generate the best, or optimal, returns. Factor

rigidity occurs when these flows are prevented or hindered due to particular conditions. These factor inputs are rigid, therefore, in that they are partially trapped in, or 'stuck to', a production activity (or function). Under these circumstances, economic efficiency is lost due to the additional costs associated with changing the factor inputs involved in a particular production process.

25. Three forms of factor rigidity can be identified that are of potential relevance to concentrations of market power relating to the provision of business support services producer behaviours. The first case focuses on funding, i.e. capital, in that the concentration of provider power in one or a small number of support organisations is also likely to lead to a consolidation of funding towards these agencies. Under these conditions, funding streams can become fixed in the short- to mid-term as a result of financing agreements between the funder and the agency. Indeed, financing protocols agreed between the public funder and the support agency may lead to delays in the provision of information and advice services to SMEs. The second rigidity that may arise from consolidation of provider power in public agencies is based on the competency and skills sets that exist within these organisations. These may be inappropriate for the provision of information and advice services to SMEs, or they may not evolve and develop in response to changing client needs and priorities. The third possible rigidity that may arise emerges from a general standardisation of procedures and service models that tends to occur in larger SME support organisations and, in particular, networks. Standardisation tends to reflect a 'streamlining' of the management of organisational activities that can come into conflict with the desire for customised or tailored services from many SMEs.

Market exchange considerations: consumer and producer behaviours

26. The behaviour of consumers and producers can generate market failures and imperfections under conditions in which these behaviours are based on perceptions, interpretations and analyses of market conditions and signals that are inaccurate, incomplete or unfounded. Under these circumstances, consumer and producer responses can be unpredictable, inconsistent or not rational. Consumer behaviour is affected by several factors, including: attitudes of key staff and owners; the cognitive

‘stance’ of decision-makers, i.e. their heuristics and mental schema; resource deficiencies and constraints (see ‘demand-side considerations’ above; motivations to start and own a business, and; differing views and notions of rationality. A common aspect of consumer behaviour that can affect business activity, and hence consumption of business support services, relates to the motivations for being in business. Most economic considerations of business creation and ownership assume that owner-managers maximise their profits. However, research into motivations and drivers related to business owner-management indicates that profit maximisation is not necessarily a prime motivation.¹⁴

27. Producer behaviour, like consumer behaviour, is affected by rationality and the scope for making rational decisions. It is also influenced by activities undertaken by the producer, such as advertising and marketing and by the structure of a market sector.

IV. WHAT MARKET FAILURES CAN BE RELATED TO THE PROVISION OF ADVICE AND INFORMATION TO SMALL AND MEDIUM ENTERPRISES?

28. Four key market failures were identified that are of particular relevance to the provision of information and advice services to SMEs. These failures, therefore, represent specific cases for the development of rationales to underpin the development of policy and delivery of publicly-funded information and advice to small and medium enterprises. They are: adverse selection; public goods¹⁵; mixed goods; and externalities. Adverse selection is based on scenarios in which there are information asymmetries or discrepancies, leading to the take-up of services that are not the most beneficial or appropriate for the enterprise. As such, adverse selection is a primary focus for analysis of market failures in that it depicts the process of information exchange and transfer. Public and mixed goods relate to business support services that cannot or will not be provided in full by the private sector and so, if they are

¹⁴ The diversity of drivers and motivations of entrepreneurs and owner-managers has been a focus of academic research for some time. An early analysis of non-profit maximising motivations can be found in Scase, R. and Goffee, R. (1980). *The Real World of the Small Business*. London: Croom Helm.

¹⁵ The term ‘good’ is used throughout this paper to describe commodities, i.e. the tangible outputs from the production process. In this sense, information and advice business support services can be considered as goods.

offered, must be supported by public funding. These types of goods are particularly relevant to public funding of information and advice services for two primary reasons. Firstly, the provision of full or comprehensive information to SMEs has been identified as an area of potential policy intervention [European Charter for Small Enterprises]. And, secondly, there has been a tendency for public information and advice services for SMEs to be designed as public or mixed goods. Finally, externalities are market failures that arise outside the market exchange mechanism. Negative externalities, i.e. situations in which externalities are harmful to consumers or producers, are the focus of the analysis of externalities, in that they produce wider harmful effects on the economy and society and so imply some form of response by government. There are also cases of positive externalities that provide wider benefits to groups of SMEs not involved in the market transaction.

29. These four market failures represent primary forms and sources of inefficiency in markets for information and advice, as established in the academic and research literature. They also reflect policy considerations of market failure as a basis for intervention and public funding. They have, in other words, been identified as primary market failures relating to the provision of business support services in the form of information and advice.
30. Each key market failure has been mapped out in terms of its broad consequences, and these are included as diagrams in each section.

V. MARKET FAILURE 1: ADVERSE SELECTION THROUGH INFORMATION 'DISCREPANCIES'

31. The causes of adverse selection arise from inefficiencies in the exchange of information. Map 1 (page 24) explores market failures related to adverse selection. Three specific instances can lead to these inefficiencies:
 - (i) asymmetric information, i.e. conditions where each agent in an exchange has different levels of information relating to that exchange;

(ii) incomplete information, i.e. conditions in which all agents lack information;

(iii) inaccurate information, i.e. conditions where more than one consumer and/or producer has information that is not representative or is misleading.

32. Asymmetric information occurs where one side of a market transaction has information the other does not. In terms of business support services, this can mean that providers have greater knowledge, typically of the service itself, than the enterprise. It can also mean that enterprises possess superior knowledge in relation to aspects of the transaction; for example of their own business development needs and priorities. Asymmetric information may result in the mis-allocation of resources as a result of conditions such as:

- moral hazard (influence over the purchasing decision by one of the agents involved);
- the selection of inferior quality goods, termed ‘lemons’ in the literature, as a result of less information being held by the buyer than the seller;
- principal-agent issues, i.e. differences in interests between a principal and her/his agent.

33. Moral hazard arises in cases where an individual’s superior knowledge, often either of themselves or their business, leads them to behave differently than if others possessed the same (rather than inferior) knowledge. The principal factor in moral hazard situations, therefore, is the unobservability of the actions of consumers or producers. The nature of the moral hazard will depend upon which of the consumer or provider/seller has the greater knowledge in the market transaction. In situations where the provider has greater knowledge, then they may knowingly circulate inferior quality goods, they may charge higher prices than other providers, and they may insist on unnecessary or inappropriate ‘sell-on’ terms (e.g. after-sales services and other conditions of sale such as guarantees or warranties). All of this can lead to inappropriate provision or take-up by the consumer. In contrast, where a consumer

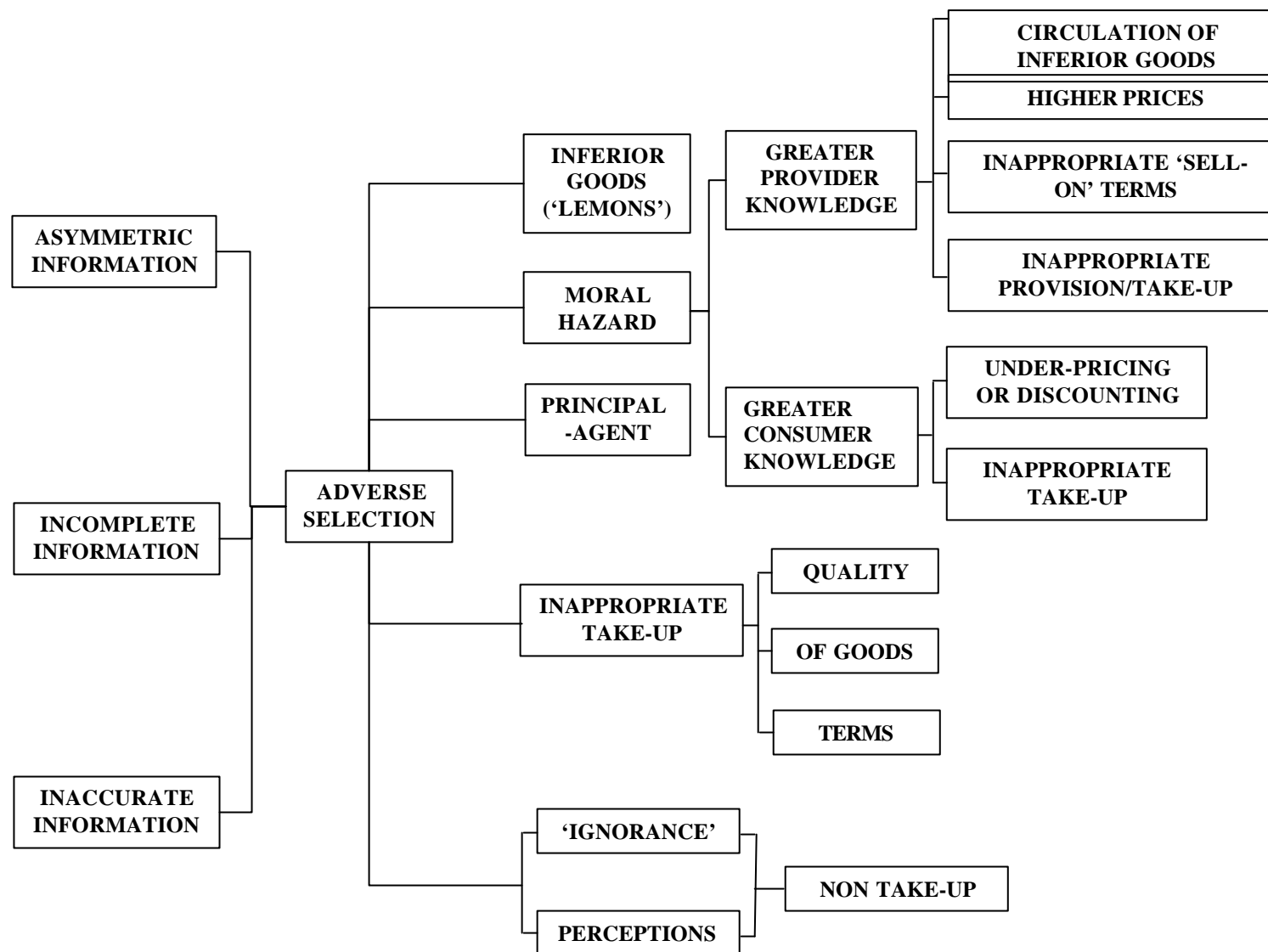
has greater knowledge, then the consumer may take advantage by paying lower prices than elsewhere and extracting higher value. The consequences of this will be distortion of market prices, in that the consumer will be more able to negotiate a lower price or discount due to the provider's inability to make a full valuation of the good as a result of lacking knowledge possessed by the consumer. As with provider moral hazard issues, greater consumer knowledge can also lead to inappropriate take-up and provision (albeit under different circumstances), as providers make uninformed or partially informed decisions.

34. Adverse selection leads to inappropriate take-up or to non take-up of services. Inappropriate take-up may, in turn, be the result of several factors, including: the quality of the service not being appropriate to the enterprise; the service not matching in full or part the needs of the small businesses; or, the contractual terms under which the service is being provided being inappropriate (e.g. fee rates, payment terms, or consumption of 'bundles' of service packages in order to access one service).

Table 1: Examples of Adverse Selection in the Provision of SME Advice and Information Services

<i>Information Asymmetry</i>	<ul style="list-style-type: none"> • Information about the nature of the service not communicated to the SME • Adviser recommends non-optimal or inappropriate service • SME more aware of own needs than adviser or counsellor • SME more aware of alternative options on offer
<i>Incomplete Information</i>	<ul style="list-style-type: none"> • The needs of SMEs are not known in full by the business support organisation • The extent or scale of the SME need is not known in full by the business support organisation • Available services are not known to SMEs
<i>Inaccurate Information</i>	<ul style="list-style-type: none"> • SMEs have perceptions (either positive or negative) of the information and advice service(s) on offer • SMEs have perceptions (either positive or negative) of the provider(s) of information and advice service(s) on offer • Service providers develop services based on information that does not reflect the actual needs of SMEs

MAP 1: ADVERSE SELECTION AND INFORMATION



35. Non take-up may be caused by ignorance or lack of information about the service. It may also occur as a result of the formation or emergence of perceptions on the part of the representative of the enterprise. In the case of lack of information, this may result because the enterprise is not aware of the existence of the relevant provider organisation, or it may be because of lack of awareness of the service itself. In the case of perceptions, incomplete information may lead to a partial or inappropriate representation of the provider and the provider's service. This partial representation of the provider can lead the representative of the enterprise not to take up business support services, because they did not have sufficient information to make a fully informed decision. Inaccurate information may lead to perceptions that the business support services provider does not have the service that the enterprise is seeking or that the services offered are not appropriate or as expected.

VI. MARKET FAILURE 2: INFORMATION AND ADVICE AS A PUBLIC GOOD

36. A public good is one that offers benefits to all enterprises at no additional cost if (and once) it is offered to one enterprise. It is, in other words, available to and accessible by all enterprises. Map 2 (page 27) explores market failures related to the provision of public goods. The two defining characteristics of a public good are that it is '*non-rival*' and '*non-excludable*'. Non-rivalry means that the consumption of the good by one individual does not reduce the ability of other individuals to consume that good. Non-excludability means that it is impossible to prevent individuals from consuming the good, even if they have not paid for its provision.
37. In the context of the business support services market for information and advice, there is a tendency for information to be a public good. Once in the public domain, the benefits of information can be consumed by others on a non-excludable basis, in that it is difficult to prevent others from acquiring publicly available information. Information also tends to be non-rival, in that once generated and made public, its consumption by one individual will not reduce its availability to others.¹⁶

¹⁶ There are measures that enterprises take to prevent the public release of information, such as confidentiality agreements, that provide the temporary characteristics of excludability.

38. A key implication of non-rivalry and non-excludability is that the private sector will not provide these goods because obtaining payment for them will be difficult or impossible (because individuals cannot be prevented from consuming goods that are non-excludable). The provision of public goods, therefore, can be undertaken either by government or by voluntary agreement. In either case, the principal risk is that individuals may seek to be '*free-riders*', i.e. not pay for the good or pay less than its value, by concealing their true valuation of the good. When free-riders exist, the consequence is that the market will either under-provide or not provide the market good.¹⁷ Under-provision and non-provision of information will lead to information asymmetries and incomplete information, causing adverse selection (see Section V and Map 1).
39. In cases of compulsory provision of public goods, taxation is used to pay for these goods. This raises two issues related to small and medium enterprises. The first implication is that the marginal cost of taxation may not lead to a direct benefit for the business (for example, because there is a cost in acquiring and processing the information that a smaller business can not bear). This generates a net loss of resource, albeit generally of a very minor scale for individual businesses, that may be significant when calculated across the small and medium enterprise population as a whole. The implication, therefore, is that the re-distributive impact of taxation to provide public goods needs, from a policy perspective, to be based on a positive assessment of the impact on smaller enterprises (individually and as a whole).
40. The second issue in terms of taxation relates to the wider political economy of small business advocacy. An increase in taxation to provide a public good (if directly attributable) can generate dis-satisfaction amongst SMEs and, as a result, involvement in business representation organisations and support of lobbying activities. In extreme cases, it may also lead to instances of tax avoidance.

¹⁷ Cases of under-provision can occur under voluntary agreements by the private sector to provide a public good. These instances occur when not all of those involved provide the goods, in full or in part. They also occur under conditions of compulsory provision, in instances where individuals under-estimate their preference for a public good.

MAP 2: INFORMATION AND ADVICE AS A PUBLIC

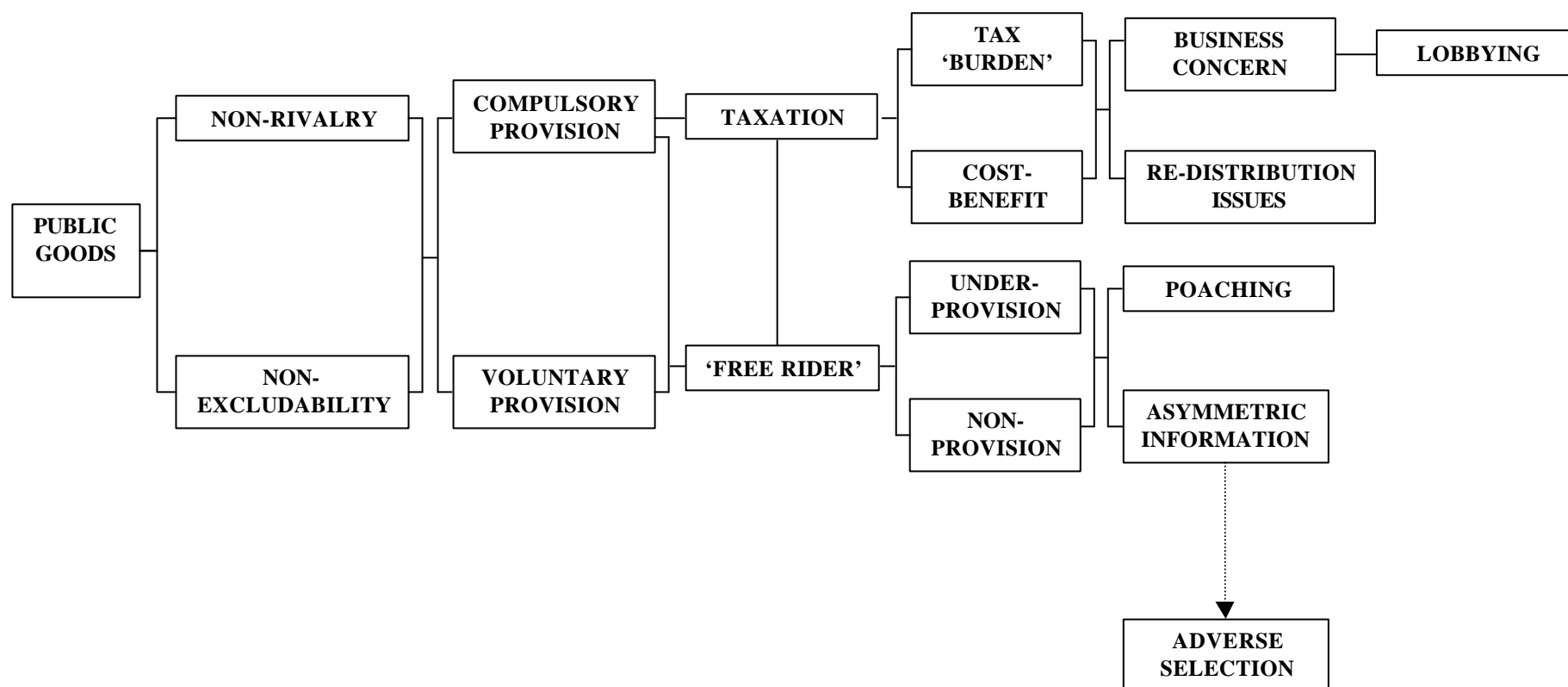


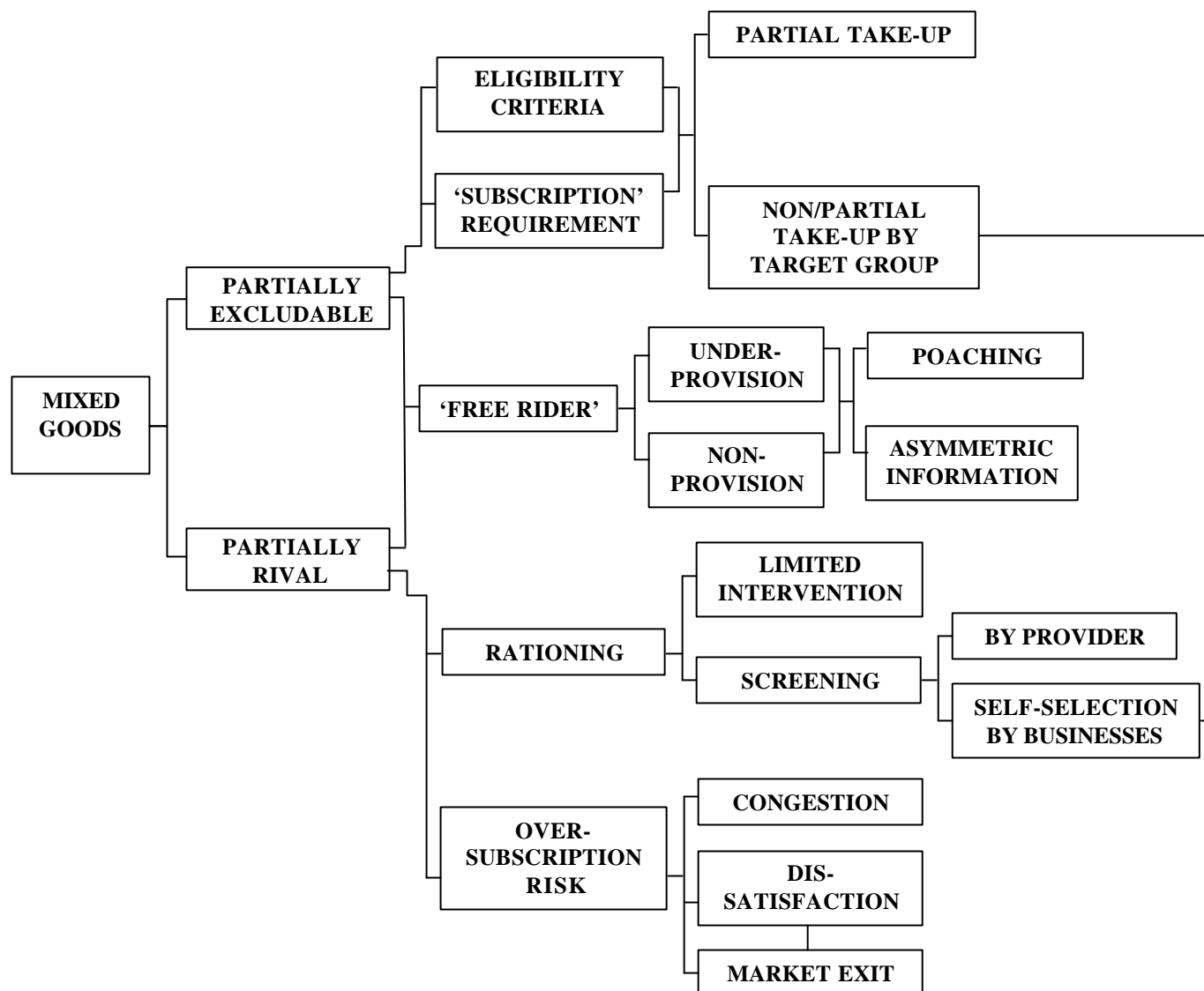
Table 2: Examples of Public, Mixed and Private Information and Advice Services

<i>Type of Service</i>	<i>Public Good</i>	<i>Mixed Good</i>	<i>Private Good</i>
INFORMATION:			
- Compliance information	<ul style="list-style-type: none"> - Information on existing laws - News on new legislation 	<ul style="list-style-type: none"> - Consultancy or audit to ensure compliance 	<ul style="list-style-type: none"> - Commercial service based on cost-benefit
- Market information	<ul style="list-style-type: none"> - Data provided about general conditions 	<ul style="list-style-type: none"> - Tailored information at subsidy 	<ul style="list-style-type: none"> - Commercial market research
ADVICE:			
- Technical consultancy	<ul style="list-style-type: none"> - Public centres of excellence - Referral to third party expert 	<ul style="list-style-type: none"> - Offered at a subsidised rate for SMEs 	<ul style="list-style-type: none"> - Commercial service

VII. MARKET FAILURE 3: INFORMATION AND ADVICE AS A MIXED GOOD

41. Goods that are partially public, i.e. where exclusion of some consumers is possible or where consumption is partially rival, are considered mixed goods. These goods, in other words, do not satisfy one of the conditions for pure public goods at all. Mixed goods either demonstrate excludable properties, i.e. producers can prevent certain consumers from taking up the good, or rival properties, i.e. not all consumers can take up the good. Map 3 (page 30) provides an outline diagrammatic representation of market failures related to mixed goods.
42. In terms of rivalry, the benefits of mixed goods are neither confined to one individual alone nor are they equally available to all. Mixed goods, in other words, exist when consumption is neither rival, i.e. consumption by one individual prevents consumption by anyone else, nor non-rival, i.e. consumption is available to everyone. The partial rivalry of a mixed good, therefore, indicates that groups rather than the whole population of enterprises can consume that good. From the perspective of the provision of business support services, this will lead to rationing, in that due to their rival nature, services that are mixed goods cannot be provided to all. This rationing will tend to occur on a 'first come, first serve' basis.
43. The second effect of partial rivalry is that it can lead to an over-subscription risk, particularly under conditions of incomplete or asymmetric information (see the analysis of Adverse Selection above). Over-subscription occurs because consumers will not necessarily know whether the provision of the good is offered under rival terms, i.e. its consumption precludes consumption by others, as opposed to partially rival terms. These conditions can result in instances of congestion, i.e. where there is excessive demand in response to the finite capacity for consumption of a mixed good that increases the consumption costs of taking up that good for all consumers. Over-subscription also leads to dis-satisfaction from those who seek the good but do not consume it because it is already depleted. This dis-satisfaction can lead SMEs to exit the market for publicly supported information and advice, either temporarily or over the longer-term.

MAP 3: INFORMATION AND ADVICE AS A MIXED



44. The consumption of mixed goods that are partially excludable will be determined by the producer rather than the consumer. Two possible scenarios exist that have relevance to business support services. The first is the development of eligibility criteria to determine which individuals will be allowed to consume a mixed good. In certain cases, these eligibility criteria may relate to governance of public spending. In other cases, they could reflect policy priorities or customer segments targeted by the provider (or providers) of business support services.
45. The second aspect of excludability that can affect the provision of business support services is a subscription requirement for users. In some cases, this subscription may be monetary. In others, however, it may involve registration with the provider (and, as such, increases the costs of taking up the good). Under conditions of subscription requirement, and of eligibility criteria, there will be some enterprises that decide not to take up the service because of the actual or perceived costs involved, both monetary and in terms of opportunity cost.¹⁸ There will also be cases where there is only partial take-up of the mixed good, i.e. where supply exceeds consumption levels that are lower than real demand.

VIII. MARKET FAILURE 4: EXTERNALITIES

46. Externalities arise as market exchange outcomes that affect others than those involved in the transaction. Externalities occur, in other words, when economic agents are involved in transactions where they do not bear the full cost or receive the full benefit of their actions. There are two forms of externality: positive and negative. Negative externalities are harmful to other consumers or producers, and so represent a potential case for public intervention (in that these ‘third party’ effects need to be managed and, in many circumstances, mitigated). Negative externalities manifest themselves in several forms, including: differences or discrepancies between market price and the full social cost; negative spill-over effects; inter-temporal distortions, and; neglect of

¹⁸ In many situations, the decision not to take up a good because of its subscription requirement is articulated by the representative of the small or medium enterprise in terms of the additional ‘hassle’ factor required. Excludability based on subscription strategies, therefore, may have as an outcome an increase in perceptions by businesses of ‘red tape’ associated with public services.

future values. The market failures arising from externalities are summarised in Map 4 (page 33).

47. Market price-social costs discrepancies occur when the market price does not fully reflect all the costs associated with production and provision of a good. This leads to over-provision of a good or service, in the sense that not all costs are calculated when decisions are made to provide that service. Over-provision manifests itself in several ways including: discounting; circulation of inferior goods; greater take-up of inappropriate goods (particularly if the social costs vary between specific goods), and; reductions in consumer valuations of the benefits of a particular good. Discounting, in turn, will result in lower price expectations on the part of customers (the discounted price becoming perceived as the 'standard' price). Circulation of inferior goods will lead to increased customer dis-satisfaction. Greater take-up of inappropriate goods and lower valuations of goods will eventually lead to reduced take-up.
48. Negative spill-over effects can occur when the provision of information or advice leads to an adverse or harmful outcome for other businesses. In these cases, the impact on the recipient or client SME is positive, but the wider effect on others is negative. Negative spill-over effects can be identified in changes in competitive behaviour that arise as a result of the provision of advice and support services.
49. Inter-temporal distortions coupled with neglect of the future values of goods can lead to over-pricing, resulting in a declining markets as consumers substitute other goods or exit. Where over-pricing occurs, this may lead to new entrants gaining advantages over existing providers who are locked in to existing pricing structures. However, new entrants may also face disadvantages in the market as existing providers may be in a position to raise barriers to entry, and so lock in market power to maintain higher prices. In this case, market failures that arise from monopolistic market conditions will also be relevant (See Section III, paragraphs 20 to 25).

MAP 4: EXTERNALITIES

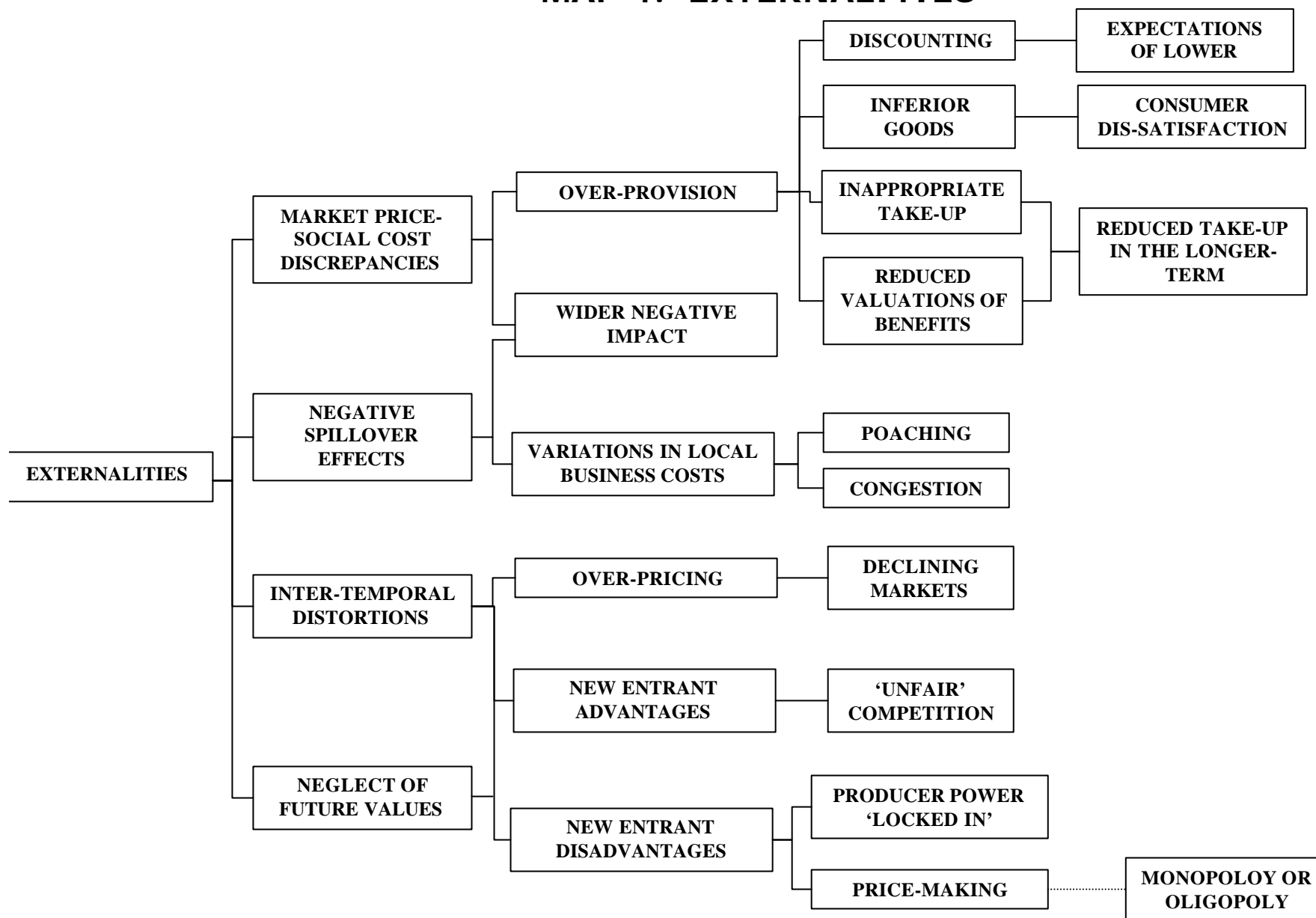


Table 3: Examples of Positive and Negative Externalities

Positive Externalities	<ul style="list-style-type: none"> • Demonstration effects arising from positive outcome for one SME influences other SMEs to take up the service • Information/advice passed on voluntarily to others • Benefits of staff training passed on as staff change employment • Encouragement of collaboration attracts additional SMEs to participate
Negative Externalities	<ul style="list-style-type: none"> • Advice leads to more harmful treatment of others, e.g. extension of creditor days • Poaching of trained staff • Negative demonstration effects that occur should there be no discernible advantage or effect from taking up information and advice services

50. Positive externalities can also be identified, in particular in relation to the provision of advice and information to SMEs. Positive spill-over effects relating to the provision of information to SMEs should occur inevitably should the information be a public good, in that these services would then be non-rival and non-excludability. Non-excludability means that such information, even if provided to a single business will ‘leak out’ to others. In the case of information provided as a mixed good, there should be some ‘knock-on’ effect, in that these goods tend to be partially excludable only.
51. In terms of the provision of advice, the positive externalities tend to occur for two reasons. The first is as above, i.e. as a result of the non-excludable or partially excludable nature of advice provided as a public or mixed good. The second positive externality occurs as a form of ‘demonstration effect’, whereby improvements in the performance of SMEs receiving advice will be noticed by other SMEs who will then be interested in taking up advice or analysing the SME receiving the advice to understand the reasons for their improvement.

IX. SUMMARY AND IMPLICATIONS

52. This report has identified a series of market failures that relate to the overall provision of business support services to SMEs and to the specific case of the provision of information and advice. Four key market failures were identified and analysed in terms of their implications and significance for public provision of information and advice. These market failures related to:

- (i) The nature of the market and its exchange mechanism (adverse selection as a result of information discrepancies and market structure issues). Market failures arising from discontinuities in information exchange, therefore, indicate a potential rationale to intervene in order to stimulate or enhance market transactions that would not otherwise occur or that would not be optimal or economically efficient;
- (ii) The nature of the good itself, in terms of its characteristics when publicly-funded (mixed and public goods). Mixed and public goods, in other words, represent a policy response that is conditional on the development of new offers of services to SMEs that would not be provided, in part or at all, by the private sector;
- (iii) The broader impact of the provision of goods on SMEs. Negative externalities provide a possible case for public intervention when there is a need to develop enabling guidelines and 'rules' for market exchange in order to avoid or minimise wider harmful effects on others. Positive externalities offer a wider leverage effect arising from public intervention.

53. Two broad implications can be identified from this analysis of market failures relating to SME information and advice services. The first is that market failures can serve as a useful framework for developing rationales for the provision of public business support services to SMEs. Specific market failures relating to information and advice services, as analysed in this report, can be identified and considered in terms of their implications for SME development and support. The application of market failures

concepts to the development of rationales for public intervention ensures that such intervention occurs only if there is no adverse impact on private sector activity, in this case the provision of commercial information and advice services.

54. The second broad implication is that the nature of these market failures and how they are manifested in the market for business support services to small and medium enterprises can inform the development of these services and the ways in which they are marketed and delivered. In broad principle, a conclusion is that SME support services should be designed to respond to and explicitly address market failures. As such, the evidence of SME need is considered, along with considerations of the feasibility and impact of addressing specific instances of market failure. In order to achieve this, and in order to develop broader insight into market failures and their manifestations, there is a related need to develop monitoring mechanisms that are based on the nature of the market failure and the resultant public response. These two notions – of rationales for and design of interventions – are linked, in that they can be seen as part of a process of supporting small and medium enterprises and their development.

X. DEVELOPING RATIONALES FOR BUSINESS SUPPORT

55. The analysis of market failures in this report suggests, on a conceptual level, that they can be used as rationales for the development of business support, in that they identify areas of intervention need or opportunity that would not be undertaken by the private sector. This does not, however, justify public expenditure in itself. Instead, it generates the potential for public intervention based on a logical framework of justification. The critical next step is to establish the importance and significance of the identified market failures in terms of their impacts and implications for business survival and development, and for wider economic development and social conditions. In order to assess their significance, therefore, in policy terms, there is a need to consider several issues, including:
- i. The extent and ‘severity’ of market failures (i.e. are they important or serious enough for something to be done?);

- ii. Their impact on small and medium enterprises, their survival and development;
 - iii. The possible responses and resolutions to identified market failures deemed to be significant or important enough to require a response;
 - iv. the ‘cost’ of intervention, particularly in terms of: the funding requirement, the opportunity cost related to transferring or raising the required funds; barriers or constraints that may prevent or limit impact.
56. A critical next step in terms of applying the concepts of market failure to the provision of business support services is to validate these concepts empirically. There is a need, in other words, to apply the rationales for intervention that are identified via a consideration of market failures to specific instances, institutions, services and contexts. The challenge, therefore, is a “how-to” issue of translating concepts into implementable practice. Specific issues to consider when addressing this translation challenge include:
- i. Are market failure rationales used to identify areas of public intervention need and requirement, i.e. are they solely focused on the initial identification of ‘gateways’ for public intervention?
 - ii. Can market failures be used to inform and direct the design and development of services? And, if they can, how, i.e. what would be effective and achievable techniques and methodologies to achieve this?
 - iii. Should market failures be used to evaluate and assess the impact and success of public interventions? And, if yes, how might this be done effectively?
 - iv. How and in what ways can conceptual analysis of market failures be communicated effectively and in relevant ways to policy, business support and practitioner communities?

57. Finally, multiple strategies for dissemination and engagement could be usefully developed, in order to ensure wide-ranging involvement of different stakeholders. General approaches to dissemination include the following broad areas of activity:
- (i) clarification of the technical document, vocabulary and analytical process in policy and practitioner terms and language;
 - (ii) consideration of the concerns and priorities of potential users of the analysis in developing broader dissemination strategies and approaches;
 - (iii) development of outputs and means to make sense of and inform how to use and apply the analysis.

Annex 1. Glossary of key terms relating to market failures in the SME information and advice services market

Key Term	Definition and Literature-Based Examples	Sources
Market Failure (All Maps)	<p>a. "An imperfection in a price system that prevents an efficient allocation of resources. Important examples are externalities and imperfect competition".</p> <p>b. "The inability of a system of private markets to provide certain goods either at all or at the most desirable or 'optimal' level".</p> <p>c. "The failure of a more or less idealised system of price-market institutions to sustain "desirable" activities or to stop "undesirable" activities".</p> <p>d. "Market failure is usually associated with a general problem of free access to the environment or monopolistic behaviour in a number of industries".</p>	<p>a. P.A. Samuelson & W.D. Nordhaus (1989) <i>Economics</i>, 13th Edition</p> <p>b. D.W. Pearce (Ed.) <i>Macmillan Dictionary of Modern Economics</i>, Macmillan, Basingstoke (1986)</p> <p>c. F.Bator, "The Anatomy of Market Failure", <i>Quarterly Journal of Economics</i>, Vol. 72 (3) pp. 351-379, (1958)</p> <p>d. A.W.Dnes, "The Case of Monopoly and Pollution", <i>Journal of Industrial Economics</i>, Vol. 30(2) pp.213-216 (1981)</p>
Adverse Selection (Maps 1, 3)	<p>Adverse selection is related to asymmetric information and is defined as "making a sub-optimal decision as a consequence of incomplete or imperfect information regarding either risks or quality".</p> <p>Examples:</p> <p>a. "Adverse selection arises from the fact that suppliers of the cheapest low quality products will drive from the market any producer who for whatever reason wishes to supply higher quality products".</p> <p>b. "[A situation] in which the insurer cannot determine some characteristics of the insured that are relevant to the determination of the probability of the future state of nature".</p>	<p>L.Philips (1988) <i>The Economics of Imperfect Information</i>, Cambridge University Press</p> <p>a. T. Von Ungern-Sternberg & C.C. Von Weizsaecker, "The Supply of Quality on a Market for "Experience" Goods", <i>Journal of Industrial Economics</i>, Vol. 33 (4) pp. 531-540 (1985)</p> <p>b. M.V.Pauly "Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection", <i>Quarterly Journal of Economics</i>, Vol. 88(1) pp.44-62 (1974)</p>
Asymmetric Information (Maps 1,2,3)	<p>Asymmetric information occurs where one side of a market transaction has information the other side does not have. This may result in the misallocation of resources due to inefficient decision making on the</p>	

	<p>part of organisations or individuals.</p> <p>Example:</p> <p>a. “An asymmetry in available information has developed: for the sellers now have more knowledge about the quality of a car than the buyers. But both good cars and bad cars must still sell at the same price – since it is impossible for a buyer to tell the difference between a good car and a bad car”.</p>	<p>a. G.A.Akerlof “The Market for “Lemons”: Quality, Uncertainty and the Market Mechanism”, Quarterly Journal of Economics, Vol. 84(3) pp.488-500 (1970)</p>
Compulsory Provision (Map 1)	Occurs when public goods are provided as a result of government decision or legislation, paid for by taxation revenues.	
Congestion (Map 2)	a. “A situation in which one individual's consumption reduces the quality of service available to others”.	a. R.Cornes & T.Sandler (1996) <i>The Theory of Externalities, Public Goods and Club Goods</i> , 2nd Edition, Cambridge University Press
Cost-Benefit (Analysis) (Map 1)	a. “Cost-benefit analysis is a practical way of assessing the desirability of projects, where it is important to take a long view (in the sense of looking at repercussions in the further, as well as the nearer, future) and a wide view (in the sense of allowing for side-effects of many kinds on many persons, industries, regions, etc.), i.e. it implies the enumeration and evaluation of all the relevant costs and benefits.”	a. A.R.Prest and R.Turvey “Cost-Benefit Analysis: A Survey”, Economic Journal, Vol. 75, pp. 683-735 (1965)
Eligibility Criteria (Map 2)	The criteria set by an individual or organisation in determining whether or not a potential consumer qualifies to have access to a good or service.	
Excludability (Map 2)	a. “[A situation] where a producer or seller can prevent some individuals from consuming his product – generally speaking, those individuals who do not pay for the good – then the product can be supplied by a	a. D.W. Pearce (Ed.) <i>Macmillan Dictionary of Modern Economics</i> , Macmillan, Basingstoke (1986)

	<p>market”.</p> <p>b. “While perfect exclusion need not be required for markets to function reasonably well, as numerous examples of the presence of externalities amply illustrates, it is easily seen that exclusion does provide basic motivation for exchange”.</p>	<p>b. O.A.Davis & A.B.Whinston “On the Distinction between Public and Private Goods”, <i>American Economic Review</i>, Vol. 57(2) pp.360-373 (1967)</p>
Externalities (Map 4)	<p>A side effect of an action that affects the wellbeing of third parties. This may be negative (where there are adverse side effects of an action) or positive (where there are beneficial side effects of an action).</p> <p>Examples:</p> <p>a. “Technological externalities [occur where] one individual's or firm's actions affect another only through effects on prices”.</p> <p>b. “A beneficial externality, that is, where an externality-generating activity raises the production or utility of the externally-affected party is known as an external economy. An external diseconomy is where the externally-generating activity lowers the production or utility of the externally-affected party”.</p> <p>c. “When the beekeeper's bees fly into the adjoining apple orchard and pollinate the apple-grower's apple blossoms, they are conferring a positive benefit on the apple-grower that the beekeeper cannot take advantage of directly (i.e. a positive externality). The beekeeper's inability to capture the value created by her bees means that she will tend to keep too few of them from a social standpoint”.</p> <p>c. “Smoke, for example, is not only a disservice or negative good; it cannot be appropriated and exchanged. Consequently, a market, say, for smoke-absorbing services cannot be established,</p>	<p>a. B.C.Greenwald & J.E. Stiglitz, “Externalities in Economies with Imperfect Information and Incomplete Markets” <i>Quarterly Journal of Economics</i>, Vol. 101(2), pp.229-264 (1986)</p> <p>b. D.W. Pearce (Ed.) <i>Macmillan Dictionary of Modern Economics</i>, Macmillan, Basingstoke (1986)</p> <p>c. E.S.Maskin, “The Invisible Hand and Externalities”, <i>American Economic Review</i>, Vol. 84(2) pp. 333-337 (1994)</p> <p>d. E.J. Mishan, “The Relationship between Joint Products, Collective Goods, and External Effects”, <i>Journal of Political Economy</i>, Vol. 77(3) pp.329-348 (1969)</p>

	and a common price for such a service cannot emerge”.	
‘Ignorance’ (Map 3)	A state of lack of knowledge on the part of individuals or organisations.	
Inaccurate Information (Map 3)	A situation where the information set used by a consumer or producer to make decisions contains inaccuracies. This may or may not lead to adverse selection depending upon the severity of the inaccuracies.	
Incomplete Information (Map 3)	<p>Incomplete information exists where there are significant gaps or “holes” in the information set being used to make decisions.</p> <p>Examples:</p> <p>a. “[...] Information is “incomplete” when the players do not know some of the elements which define the rules of the game itself....An auction in which the bidders do not know what value the other bidders attach to the auctioned object is thus a “game with incomplete information” because the players do not know each others payoffs”.</p>	a. L. Philips <i>The Economics of Imperfect Information</i> , Cambridge: Cambridge University Press (1988)
Inferior Goods (‘Lemons’) (Map 3)	Goods which are of lower than average quality. “Lemon” is a colloquial American English expression for a poor quality second hand car.	
Inter-temporal Distortions (Map 4)	<p>Inter-temporal distortions are situations where the allocation of resources between different time periods is changed as a result of an external action (e.g. the imposition of a tax on an asset or other resource).</p> <p>Example:</p> <p>a. “...all taxes on new capital cause intertemporal</p>	a. D.Fullerton & Y.K. Henderson “The Marginal

	distortions by raising the price of postponed consumption".	Excess Burden of Different Capital Tax Instruments", Review of Economics and Statistics, Vol. 71(3) pp.435-442
Market Price – Social Cost Discrepancies (Map 4)	Market price-social cost discrepancies occur where market prices fail to take into account externalities (actions which have an impact upon third parties). As a result, resources may be misallocated.	
Mixed Good (Information and Advice) (Map 2)	<p>Mixed goods have the characteristics of either rivalry or excludability.</p> <p>Examples:</p> <p>a. "[Mixed Goods are] Goods which combine the non-rivalness in consumption characteristic of a pure public good with the "costless excludability" characteristic of a pure private good".</p> <p>b. "Impure public [mixed] goods are those goods characterised by partial rivalry or some excludability of benefits".</p>	<p>a. G. Brennan & C. Walsh "A Monopoly Model of Public Goods Provision: The Uniform Pricing Case", American Economic Review, Vol. 71(1) pp.196-206 (1981)</p> <p>b. T. Sandler & J.T. Tschirhart, "The Economic Theory of Clubs: An Evaluative Survey", Journal of Economic Literature, Vol. 18, pp.1481-1521 (1980)</p>
Monopoly (and Oligopoly) Provision (Map 4)	<p>Strictly interpreted, monopoly exists in a market where there is only one seller of a product or service. In practical applications of competition policy by governments world-wide, the term "monopoly" has been extended to situations where a particular firm has or could potentially have a dominant share of a market. Oligopolies exist in markets where there are a small number of sellers of products or services.</p> <p>Examples:</p> <p>a. "In the strictest sense of the term, a firm is a monopoly if it is the only supplier of a homogeneous product for which there are no substitutes and many buyers. Such conditions are sometimes termed</p>	<p>a. D.W. Pearce (Ed.) <i>Macmillan Dictionary of Modern Economics</i>, Macmillan, Basingstoke (1986)</p>

	<p>absolute monopoly.”</p> <p>b.” Section 1. Rules Applying to Undertakings</p> <p>Article 85. 1. The following shall be prohibited as incompatible with the common market; all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention restriction or distortion of competition within the common market, and in particular those which:</p> <p>(a) directly or indirectly fix purchase or selling prices or any other trading conditions;</p> <p>(b) limit or control production, markets, technical development, or investment;</p> <p>(c) share markets or sources of supply;</p> <p>(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;</p> <p>(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.</p> <p>2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.</p> <p>3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:</p> <p>- any agreement or category of agreements between undertakings;</p>	<p>b. <i>The Treaty of Rome</i></p>
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	<p>- any decision or category of decisions by associations of undertakings; - any concerted practice or category of concerted practices;</p> <p>which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:</p> <p>(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;</p> <p>(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.</p> <p>Article 86. Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:</p> <p>(a) directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions;</p> <p>(b) limiting production, markets or technical development to the prejudice of consumers;</p> <p>(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;</p> <p>(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the</p>	
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	subject of such contracts.	
Moral Hazard (Map 3)	<p>Moral hazard is defined as a situation in which individuals, who do not bear the full cost of their actions, have an incentive to behave in ways which are not beneficial to the other party in a market transaction.</p> <p>Examples:</p> <p>a. "The moral-hazard problem arises because of the inability of the insurance firm to monitor the actions of the insured".</p> <p>b. "The insurer can observe the outcome, but cannot observe separately the initial state and the action of nature".</p> <p>c. "[Moral hazard] arises not only in formal insurance markets, but also in a variety of other contexts in which there is implicit insurance, in which individuals do not bear the full cost of their actions."</p>	<p>a. R. Arnott & J. Stiglitz "Moral Hazard and Nonmarket Institutions: Dysfunctional Crowding Out or Peer Monitoring?", American Economic Review, Vol. 81 (1) pp.179-190 (1991)</p> <p>b. M.V. Pauly "Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection", Quarterly Journal of Economics, Vol. 88(1) pp.44-62 (1974)</p> <p>c. B.C. Greenwald & J.E. Stiglitz, "Externalities in Economies with Imperfect Information and Incomplete Markets" Quarterly Journal of Economics, Vol. 101(2), pp.229-264 (1986)</p>
Negative Spill-over Effects (Map 4)	<p>Negative spill-over effects occur as a consequence of an action or sequence of actions which have a negative impact upon third parties.</p> <p>Example:</p> <p>a. "EC countries have used their financial support programs, procurement decisions, and other industrial and administrative policies to enhance the market-share positions of their domestic national champions in both home and export markets, with associated negative spillover effects on the performance of firms from other countries".</p>	<p>a. G. Dang N'Guyen & R.F. Owen "High-Tech Competition and Industrial Restructuring in Light of the Single Market", American Economic Review, Vol. 82(2) pp. 93-97 (1992)</p>

Neglect of Future Values (Map 4)	A situation in which a decision maker fails to take into consideration, in full or in part, the future value of a good, service or asset.	
Non-Excludability (Map 1)	a. "Producers are not free to exclude people from consuming the commodity once it has been produced (non-excludability)".	a. E. James, "Joint Products, Collective Goods and External Effects: Comment", Journal of Political Economy, Vol. 79 (5) pp.1129-1135 (1971)
Non-Rivalry (Map 1)	a. "A collective (public) good is one "which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good".	a. P.A.Samuelson, "The Pure Theory of Public Expenditures", Review of Economics and Statistics, Vol. 36 pp.387-389 (1954)
Oversubscription Risk (Map 2)	The possibility that a good or service will be demanded by more consumers than can be met by existing supply.	
Perceptions (Map 3)	Interpretations and understanding of particular phenomena by individuals.	
Poaching (Map 4)	a. "Poaching occurs when firms recruit skilled labour which has been trained by other firms rather than train to meet their own requirements. Obviously the scope for poaching arises because labour is mobile between firms and industries".	a. J.J.Hughes "In Defence of the Industrial Training Act", Journal of Industrial Economics, Vol. 21(2) pp. 126-144 (1973)
Price-Making (Map 4)	Price-making behaviour is closely associated with the market power held by monopolies. In a concentrated market firms within that market are able to determine the price that they will charge consumers. By contrast, in highly competitive markets, firms are assumed to be price-takers.	
Principal-Agent (Map 3)	A principal-agent relationship between economic agents occurs where there is a separation between the ownership of resources (where the owner is the principal) and control over decisions related to the	

	<p>allocation of those resources (where the controller of the resources is the agent). A moral hazard problem may exist where the owner of the resources requires the agent to undertake certain actions in order to achieve a particular return but cannot monitor their actions to ensure that they do not shirk.</p> <p>Examples:</p> <p>a. "In agriculture the bank (principal) corresponds to the landlord and the borrower (agent) to the tenant while the loan agreement corresponds to a rental agreement. The central concern in those principal-agent problems is how to provide the proper incentives for the agent. In general,..., too little effort will be forthcoming from the agent".</p>	<p>a. J. Stiglitz and A. Weiss "Credit Rationing in Markets with Imperfect Information", American Economic Review, Vol. 71(3), pp.393-410 (1981)</p>
<p>Producer Power 'Locked In' (Map 4)</p>	<p>A situation in which the dynamics of a market are such (for example, high barriers to entry) that existing producers within a market are able to raise prices and exploit consumers without significant threat of new competition.</p>	
<p>Public Good (Information and Advice) (Map 1)</p>	<p>Public goods are goods which have the characteristics of non-rivalry and non-excludability. The characteristic of non-excludability may create problems for organisations which provide such goods in getting a price from consumers since by its very nature consumers can use the good without paying for it.</p> <p>Examples:</p> <p>a. "Private [consumption] goods...must be parcelled out among persons with one man getting a loaf more if another gets a loaf less. ...A public [consumption] good is available for each person to enjoy or not,</p>	<p>a. P.A. Samuelson, "Diagrammatic Exposition of A Theory of Public Expenditure", Review of Economics and Statistics, Vol. 37(4) pp. 350-356 (1955)</p>

	<p>according to his tastes. Each man's consumption of it...is related to the total by a condition of equality rather than summation".</p> <p>b. "...Private consumption goods, like bread, must be parcelled out among persons with one man getting a loaf more if another man gets a loaf less. A public consumption good, on the other hand, differs in that one man's consumption does not diminish the quantity available for another".</p> <p>b. "In many respects, knowledge is like a public good. Firms may have a difficult time appropriating their returns to knowledge, resulting in an undersupply; and to the extent that they are successful in appropriating, underutilisation results (since they will have to charge for its use).</p> <p>c. "A collective (public) good is one which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good".</p> <p>d. "Each individual partakes jointly of the benefits of any unit of the collective service".</p> <p>e. . "Producers are not free to exclude people from consuming the commodity once it has been produced (non-excludability)".</p>	<p>b. O.A.Davis & A.B.Whinston, "On the Distinction Between Public and Private Goods", <i>American Economic Review</i>, Vol. 57(2) pp. 360-373 (1967)</p> <p>c. J.E.Stiglitz, "Markets, Market Failures, and Development", <i>American Economic Review</i>, Vol. 79 (2) pp.197-203 (1989)</p> <p>d. P.A.Samuelson, "The Pure Theory of Public Expenditures", <i>Review of Economics and Statistics</i>, Vol. 36 pp.387-389 (1954)</p> <p>e. E.J. Mishan, "The Relationship between Joint Products, Collective Goods and External Effects", <i>Journal of Political Economy</i>, Vol. 77 pp.329-348 (1969)</p> <p>f. E. James, "Joint Products, Collective Goods and External Effects: Comment", <i>Journal of Political Economy</i>, Vol. 79 (5) pp.1129-1135 (1971)</p>
Rationing (Map 2)	<p>a. "Any means of allocating a scarce product or service other than by means of the price mechanism.</p>	<p>a. D.W. Pearce (Ed.) <i>Macmillan Dictionary of Modern Economics</i>, Macmillan, Basingstoke (1986)</p>

	b. "Rationing of some form must occur if, within a market, price is artificially maintained at a level below equilibrium [where demand equals supply]"	b. F.Bator, "The Anatomy of Market Failure", Quarterly Journal of Economics, Vol. 72 (3) pp. 351-379, (1958)
Re-Distribution Issues (Map1)	The overall impact on the SME sector in terms of the loss of resources from taxation balanced against the additional benefits from the provision by the State of public goods.	
Screening (Map 2)	<p>A process which is used to separate groups of consumers. Screening may be undertaken through self-selecting actions by consumers or by the producer of the good or service.</p> <p>Example:</p> <p>a. "No credit rationing will occur in equilibrium if banks compete by choosing collateral requirements and the rate of interest <i>to screen</i> investors' riskiness... Investors with a low probability of bankruptcy are more inclined to accept an increase in collateral requirements for a certain reduction in the rate of interest than those with a higher probability of failure".</p>	a. H.Bester "Screening vs. Rationing in Credit Markets with Imperfect Information", American Economic Review, Vol. 75(4) pp. 850-855 (1985)
'Subscription' Requirement (Map 2)	In situations where goods display elements of partial rivalry and partial excludability (mixed goods) there may be the need for an exclusion mechanism such as a subscription, hence the term 'subscription' requirement.	
'Free-Rider' Problem (Map 1)	The 'free-rider' problem occurs as a result of incentives for individuals to consume non-excludable goods free of charge ('free-ride'). The consequence of this behaviour is that non-excludable goods may	

	<p>not be available or will be underprovided through the market mechanism. This may or may not result in intervention by governments or other organisations to provide a good.</p> <p>Examples:</p> <p>a. "This behaviour is said to arise when prohibitive costs make exclusion of individuals from the consumption of a good impossible. People will then act strategically by (depending on the mode of financing) stating a willingness-to-pay for the public good which is either higher or lower than their true willingness-to-pay."</p> <p>b. "It is remarkably difficult to produce a satisfactory theory of how public goods come to be supplied through voluntary activity when many individuals are involved. The problem, of course, is the incentive for each individual to take a free ride".</p>	<p>a. F.Schneider & W.W. Pomerehne "Free Riding and Collective Action: An Experiment in Public Microeconomics", Quarterly Journal of Economics, Vol. 96(4), pp.689-704 (1981)</p> <p>b. R. Sugden "Reciprocity: The Supply of Public Goods Through Voluntary Contributions", Vol. 94, pp.772-787 (1984)</p>
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**Annex 3. Developing a bounded definition of information
and advice services to SMEs**

Study on Business Support Services and Market Failure

Business Support Services Definitions Working Paper

M.F. No. 02/02

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0. Overview

- 0.1 This document seeks to define the 'domain' of business support to be considered in the study. In doing so it seeks to provide:
 - ⇒ An agreed and clear scale and scope of analysis for the research study
 - ⇒ A focus for the recommendations and conclusions of the research study
- 0.2 In order to achieve the above this document seeks to clarify the definition of business support services outlined in Annex 1 of the Commission Staff Working Document "Creating Top-Class Business Support Services" SEC(2001) 1937 (attached as Annex 1). The definition provided in that paper is taken as the starting point for the study and the parameters of the research.
- 0.3 This paper proposes that the study "Business Support Services and Market Failure" focus upon three areas of business service support provision, namely: Professional Information Services, Advice & Direct Support and SME-Specific Training¹⁹. The rationale for this is that these areas represent 'services' (which is the area of focus of the Directorate General Enterprise) whereas the other SME Support Measures predominantly refer to the provision of 'resources' which are not.

1. Understanding 'Business Support Services'

- 1.1 Annex 1 of the Commission Staff Working Document "Creating Top-Class Business Support Services"²⁰ refers to 'Business Support Services' in the following terms:

'Business Support Services' refers to those services, originating in a public policy initiative, that aim to assist enterprises or entrepreneurs to successfully develop their business activity and to respond effectively to the challenges of their business, social and physical environment.

- 1.2 In addition, it defines the term 'support measures' as follows:

The term 'support measures' refers to the broadest group of public business support actions that includes 'business support services', but also indirect support provided by grants, programmes intended to support businesses and tax incentives with the same intention.

¹⁹ As defined within Annex 2 of SEC(2001) 1937 (attached as Annex 2 to this paper).

²⁰ SEC (2001) 1937

- 1.3 The above definition of ‘Business Support Services’ contains within it a number of terms which need to be defined in order to determine the appropriate ‘domain’ for the research study. It is the aim of this paper to explore those definitions and to highlight implications for the research study.

Definitional Issues

- 1.4 Breaking the quote in paragraph 1.1 into its constituent parts requires us to address the following issues, namely:
- ⇒ How do we define “business support services”?
 - ⇒ How do we define “originating in a public policy initiative”?
 - ⇒ How do we define “assist enterprises or entrepreneurs to successfully develop their business activity”?
 - ⇒ How do we define “respond effectively to the challenges of their business, social and physical environment”?
 - ⇒ What are the implications of these issues for the sphere of analysis of the research study?

Table 1 - Business Support Services

2. Professional Information Services

- Legislation
- Market information (including export markets and public procurement)
- Company & Financial
- Technical
 - standards and certification
 - patent and copyright
 - specific areas (e.g. environmental)

3. Advice and Direct Support

- Business planning
- Advice on functional areas of business activity – (marketing, design, finance, production etc.)
- Mentoring
- Consultancy (general management, quality, health and safety etc.)
- Development of business contacts (assistance with business co-operation, commercial agents, distributors, joint ventures etc.)
- Schemes to provide direct experience (e.g. of foreign markets and business practices)

4. SME-specific Training (Excluding Formal Training Programmes)

- SME management
- Start-up
- Growth and Development
- Conversion courses
- Targeted training (women entrepreneurs, ethnic minorities etc.)

Source: Creating Top-Class Business Support Services, Commission Staff Working Document, SEC(2001) 1937

Defining “Business Support Services”

- 1.5 Referring to Annex 2 of the Commission Staff Working Document, ‘A typology of SME Support Measures’, it is clear that within the listing of SME support measures are a number of

resource-based initiatives (e.g. Finance and Premises within the definition of SME-specific Strategic Measures). In compiling a preliminary glossary of key terms related to SME support measures (please see Annex 3) it emerged that to some extent there was a conflation of “SME support measures” with the term “business support services” and that *resource*-related business support measures can be distinguished from business support *services*.

- 1.6 It is proposed that this research study should exclude resource-based initiatives and focus exclusively on business support **services** for clarity of analysis. The business support services listed within the definition in the working paper are reproduced in Table 1 above. They are:
- ⇒ Professional Information Services
 - ⇒ Advice and Direct Support
 - ⇒ SME-Specific Training

Public Policy Initiatives

- 1.7 It is also important for definitional purposes that we achieve clarity in what is meant by “originating in a public policy initiative”. There are two ways of addressing this issue:
- ⇒ Firstly, in terms of how the business support service is funded;
 - ⇒ Secondly in terms of whether the business support service is a direct or indirect response to a public policy initiative.
- 1.8 In terms of funding, a key issue is to determine the nature and influence of public funding. One major consideration is the share of funding from the public sector. There are two possible observations which would make a direct link between a business support service and a public policy initiative, namely:
1. That the majority of funding for a business support service is from the public sector
 2. That while the business support service has leveraged some private sector resources it has nevertheless had to secure some public sector funding in order to exist.
- 1.9 Secondly, there is a need to consider whether or not the business support service has **directly** resulted from a public policy initiative. For example, the publication in the UK of a White Paper on Competitiveness can result in the creation of policy initiatives such as institutions (e.g. the Small Business Service) and ‘business support services’. Sometimes initiatives are created as an **indirect** consequence of a public policy initiative, for example, due to the unforeseen consequences of a policy change. Sometimes a ‘business support service’ may come into existence as part of a general policy trend but which has either a tenuous linkage or no linkage to a specific public policy initiative. For the purposes of this research study therefore it is proposed to only focus upon those ‘business support services’ which have a **direct** link to public policy initiatives, i.e. services that arise as a direct result of public allocation of resources.

Enterprises Versus Entrepreneurs

- 1.10 The next issue to consider is whether or not the business support service is focused upon the entrepreneur/owner-manager or upon managers and staff as well. There is a critical difference between the two since owner-managers have the capacity to make key strategic decisions affecting the business and others may not necessarily have that authority. It is proposed that the research study focus upon ‘business support measures’ **to owner-managers/entrepreneurs of businesses**.

“Assisting Enterprises to Develop Business Activity”

- 1.11 The relationship of business support services to the ‘development of business activity’ can be analysed in two ways:

- ⇒ Firstly in terms of assisting the business to respond to actual or immediate needs
- ⇒ Secondly, in terms of the development of future potential which may or may not be used. It is proposed explore both types of capacity and capability building service in this research study.

Responding to Challenges

- 1.12 In terms of “respond effectively to the challenges of their business, social and physical environment” there are again a number of ways of analysing these challenges:
- 1.13 Firstly it is possible to look at internal versus external challenges. Internal challenges may result from resource constraints such as non-existent or underdeveloped management information systems, problems with premises or industrial relations between management and the workforce.
- 1.14 Secondly, the external environment presents challenges that can be categorised in two ways; i.e. in terms of the ‘immediate’, task driven requirements and broader contextual issues.
- 1.15 In the case of the immediate external or task environment a challenge to the business may take the form of a problem (e.g. outgrowing premises), an opportunity (a new market) or a threat (new competitors). These challenges will create needs within a business.
- 1.16 In the case of the broader environment this will impact upon the business in terms of the general regulatory environment for business in a Member State, the general economic conditions, the attitudes of policy makers, and wider societal attitudes towards small business. The challenge is either (a) compliance with the regulatory environment or (b) operating in or managing the context for the development of the business.
- 1.17 It is most likely that business support services will be delivered to SMEs to address immediate challenges, both internal and external and hence the research study will concentrate on those services which address immediate environmental challenges.

2. Implications for the Research Study

- 2.1 The first main implication of the above discussion is that the definition of business support services is based upon that provided in Annex 1 of the original project Terms of Reference and in particular, sections 2 (Professional Information Services), 3 (Advice and Direct Support) & 4 (SME specific training).
- 2.2 Furthermore, the research study will focus upon business support **services** which can be identified as the **direct** result of a public policy initiative, are significantly **publicly** funded and focused upon **entrepreneurs** rather than (non-owner) managers and staff in SMEs. The business support services will enable the business to respond in the main to internal and external challenges in the business, social and physical environment.

ANNEX 1 – Definitions of Terminology Used in the Context of the Best Procedure Project on Business Support Services

‘Business Support Services’ refers to those services, originating in a public policy initiative that aim to assist enterprises or entrepreneurs to successfully develop their business activity and to respond effectively to the challenges of their business, social and physical environment.

The term **‘support measures’** refers to the broadest group of public business support actions that includes ‘business support services’, but also indirect support provided by grants, programmes intended to support businesses and tax incentives with the same intention.

A **‘support programme’** is a structured set of activities, encouraged by the public authorities, usually involving a well-defined set of objectives and actions and on the basis of funding provided to individuals or groups that meet specific criteria. Often access to the funding will be on a competitive basis and require a response to a formal call for proposals or call for tender.

A **‘framework programme’** is a set of more specific programmes that are brought together in a framework designed to promote coherence and consistency.

Best Practice Criteria

The following is a list of criteria for best practice in relation to Business Support Measures, defined in a Working Group on Best Practice Methodology in the context of the Concerted Actions.

In the context of the Concerted Actions on Business Support Measures, a practice will consist of either:

- a public policy measure, or coherent set of measures,
- or:
- a particular service or set of services (either public or private),

that aim to assist enterprises or entrepreneurs either to develop their business activity or to avoid making mistakes in the operation of a business that would be detrimental to the business or to the wider community.

To be a ‘best practice’:

- (1) The practice should exist already.
- (2) It should have clearly identifiable aims and objectives.
- (3) It should be user-friendly and accessible for SMEs.
- (4) It should be adaptable and transferable.
- (5) Its results should be identifiable and capable of evaluation.
- (6) Its being coherent with other good practices, both in concept and delivery, would be advantageous.
- (7) Over a range of relevant indicators, it should clearly out-perform other practices in terms of efficiency and effectiveness.
- (8) It should be capable of being continuously improved.

ANNEX 2 – A Typology of SME Support Measures: Category Listing

1. Reception, Facilities and Basic Information, Referral
2. Professional Information Services
3. Advice & Direct Support
4. SME-specific Training
5. Finance
6. Premises
7. SME-specific Strategic Measures

1. Reception, Facilities and Basic Information, Referral

- First-Stop-Shops
- Official registration and documentation
- Distribution of publications, information packages
- Promotional activities
- Provision of facilities (e.g. meeting and office facilities, video-conferencing)
- Initial diagnosis
- Signposting

2. Professional Information Services

- Legislation
- Marketing Information (including export markets and public procurement)
- Company & Financial
- Technical
 - standards & certification
 - patent & copyright
 - specific areas, (e.g. environmental)

3. Advice and Direct Support

- Business planning
- Advice on functional areas of business activity – (marketing, design, finance, production etc.)
- Mentoring

- Consultancy (general management, quality, health and safety etc.)
- Development of business contacts (assistance with business co-operation, commercial agents, distributors, joint ventures etc.)
- Schemes to provide direct experience (e.g. of foreign markets and business practices)

4. SME-specific Training (Excluding Formal Training Programmes)

- SME management
- Start-up
- Growth and Development
- Conversion courses
- Targeted training (women entrepreneurs, ethnic minorities etc.)

5. Finance

- Equity finance
- Loans
- Loan Guarantees
 - direct guarantees
 - mutual guarantees
- Grants & subsidies (e.g. participation in trade missions, assistance to unemployed)

6. Premises and Environment

- Incubation units
- Business units
- Technology Parks

7. SME-specific Strategic Measures

- Conferences & Seminars
- Trade Fairs
- Buyers' Exhibitions
- Trade Missions
- Promotion of Networking
- Supply Chain Development
- Cluster Promotion