THE ECONOMICS OF INFORMATION AND SME POLICY IN THE EUROPEAN UNION

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INTRODUCTION

In this paper we seek to introduce a specifically European dimension to the discussions of small and medium sized enterprise (SME) policy. To a certain extent the aim is simply to be informative and to explain how the policies carried out by DG XXIII of the European Commission (EC) are developing. But it is also intended to explore the proposition that for a number of years DG XXIII has been addressing issues that have only recently been given their full weight at national level, particularly in the UK. The context of this discussion is, of course, the increased emphasis within European policy generally on the potential contribution of SMEs to economic recovery and growth, but the specific initiatives of DG XXIII that are to be considered are those relating to the Euro Info Centre network, the business co-operation networks and the SME Observatory. The theme to be explored is how all these initiatives respond to practical and theoretical problems in the information area.

On the 14th June 1993 by a Decision on a new multiannual programme (see EC 1993a), the European Council agreed to continue and intensify actions being taken in the Community’s Enterprise policy. The objectives of this policy as stated in the Decision are not only to improve the environment in which enterprises operate, particularly as far as Community measures are concerned, but also to strengthen the various instruments of the Commission that provide information or at least address problems that partially arise out of information deficiencies. These instruments are the Euro Info Centres, the co-operation networks BC-Net and BRE, the instruments that permit direct contact between entrepreneurs and that are increasingly promoting transnational subcontracting, namely Europartenariat and Interprise, and finally the European Observatory for SMEs.

THE POLICY INSTRUMENTS OF DG XXIII

The Euro Centres (EICs) form part of a network that has 211 members in the EU-12 and an increasing number of associated 'Correspondence Centres' in the EFTA area, Eastern Europe and the Mediterranean basin (for a full listing see 1993(b)). Their primary functions are to provide information about EU policies and programmes and to assist SMEs to respond to them. EICs are 'hosted' by organisations with close contacts with SMEs, such as Chambers
of Commerce, regional development organisations or agencies with a specific sectoral interest. They have an active promotional role rather than being mere repositories of information, and through their internal electronic information networks they are capable of going beyond formal published sources and accessing information of a less formal kind both in the Commission and on the ground across the European Union\(^1\).

The co-operation networks, BC Net and BRE, consist of organisations that undertake confidential (BC Net) or open (BRE) searches for business contacts across the Union and indeed the whole world. Varying degrees of support are given to enterprises, on a commercial basis, to follow up these contacts, which may lead to entry into new markets, finding new sources of supply, joint production arrangements or joint research and development\(^2\).

Europartenariat and Interprise are initiatives that organise events at which, in the former case, thousands of business people from the Union and beyond can come together in a structured programme of meetings to discuss possible business co-operation\(^3\).

The annual European Observatory for SMEs has a more fundamental function, namely to address the deficiencies in basic information and analysis concerning the situation of the SME sector in the EU, particularly in relation to monitoring SME participation in the internal market. It also analyses the trends affecting SMEs and investigates issues arising from economic and social developments that are of specific interest to the Commission. An outline

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1 At the end of 1992 the 200 plus EIC were supplemented by over 2,500 redistribution points. During 1992 they replied to 250,000 recorded questions (54% from enterprises, 16% from self employed persons, 14% from institutions like Chambers, and 16% from within the network itself). Some 81% of EIC customers were enterprises with under 100 employees. About 30% concerned manufacturing. Research and development was the most important single subject raised (22% of questions) followed by industrial policy and the internal market (18%).

2 See EC (1991) for details. Given the confidential aspect of the BC-Net system enterprises gain access through the network of advisers. Having been introduced in 1987 the system operated on an experimental basis until the autumn of 1990. The BRE network covers 47 countries across Europe and has substantially expanded its activities over the 1990-1992 period.

3 Europartenariat provides a good example of synergy between actions under the enterprise and regional policies. Interprise's main purpose is to support local, regional and national actions for cooperation between SMEs in at least three regions of three Member States and 10 enterprises.
of the approach used and context of the First Annual Report are provided in figures 1.1. and 1.2. The Observatory is produced by a partnership of leading SME research organisations in each of the Member States known as the European Network for SME Research (ENSR) and co-ordinated by EIM Small Business Research and Consultancy in the Netherlands as main contractor^4.

For the most part these instruments of DG XXIII have developed out of the framework of principles established at the early stages of EC Enterprise policy, notably in the SME Action Programme (CEC 1986). As well as helping to create an appropriate regulatory and economic environment at a European level for SMEs, it was recognised at these early stages that it was necessary to address market failures that would otherwise impede the integration of the European economy. Failures were identified in a number of areas, for example in SME access to finance and in relation to training, but for present purposes what was most significant was that problems of information at a European level were identified and responses were proposed. With the advent of the Single European Market the importance of these problems became even greater, and it was the European Commission rather than national and regional authorities that provided the most consistent response.

THE ECONOMICS OF INFORMATION

To address the central issue in this paper, it is necessary to set out certain points regarding the economics of information. In doing so we are not intending to claim that this theoretical framework is (or was) at the root of EC policy in this area or even that policy discussions ever took place explicitly in these terms. However, the framework will provide a perspective on some (at least) of the issues at stake and it will certainly be able to explain important aspects of some of the problems that are being tackled.

^4 See ENSR (1993) Ch.1, for a discussion of the background to the Observatory project. This first Annual Report focussed on internal border regions in its "theme" study. The second Annual Report (ENSR, 1994 forthcoming) gives particular attention to the craft sectors (in Chapter 10).
Figure 1.1 Conceptual Framework of the European Observatory for SMEs

**OVERVIEW**

**SME-FIELDS**
- collection of statistical data and qualitative information

**THEME STUDIES**

**THEMES**
- selection
  - aspect of SME activity
  - sectors of interest

**INTERNAL MARKET**
- impact on SMEs

**TRENDS**
- selection
- survey

**ANALYSIS**

**SITUATION AND PROSPECTS OF SMEs**

**SME-POLICIES**

**SITUATION OF AND PROSPECTS FOR ASPECT/SECTOR**

**SYNTHESIS AND POLICY RECOMMENDATIONS**
Figure 1.2 Framework of the First Annual Report

**PART A: OVERVIEW**

**SMEs IN THE EUROPEAN ECONOMY**
- Chapter 2
  - facts and figures at the Community level and by Member State

**INTERNAL MARKET**
- Chapter 3
  - general framework
  - impact by sector

**TRENDS**
- Chapter 4
  - macro-economics
  - demography
  - technology
  - internationalization

**PART C: SYNTHESIS AND POLICY RECOMMENDATIONS**
- Chapter 11 – Synthesis
  - key indicators
  - SWOT
  - internal market

- Chapter 12 – Policy recommendations

**PART B: THEME STUDY**

**SME-FIELDS**
- Chapter 5
  - Entrepreneurship
- Chapter 6
  - Markets and Sales
- Chapter 7
  - Employment
- Chapter 8
  - Capital and Financing
- Chapter 9
  - Regional Aspects

**THEME STUDY**
- Chapter 10
  - Internationalization of SMEs
Elementary models of economic behaviour assume that agents act in an environment of perfect information. Approximations to this model might be observed in real situations where there is not a great need for new information in an economy and if the information that is required can be generated at little cost. However, it is clear that in modern economies information is becoming more important, especially as the pace of change quickens, in relation to both consumers' requirements and production techniques. Information is also becoming more costly to obtain.

It used to be assumed that businesses could 'know' their market. This was not unreasonable in a situation where after some experience a business manager would have a 'feel' for customers' requirements, would know how to meet them, and would have a good acquaintance with rivals and their competitive potential. Much of the appropriate information was acquired, in effect picked up almost casually, through the appropriate contacts. Many small businesses still find themselves in a situation of this sort, but increasingly there are others who find that they need to manage their information flow in a more structured way. This will be particularly true of the more dynamic small businesses.

For larger enterprises the generation of information in a structured way is a matter of course. They have long had marketing specialists, for example, but even here a faster rate of change has caused a need for more information and a necessity to access it more rapidly. Being in possession of the information gives a market advantage and failure to possess it may turn out to be very costly. Information then, has a real economic value.

Economic theory would suggest that in these circumstances, as firms move from the situation where information is freely available to one where it is both more difficult to obtain and of greater value once it has been obtained, we should find a market for information emerging or rather the emergence of a series of markets for different types of information. Enterprises would then purchase information up to the point that its marginal benefits are equal to the additional costs of acquiring it. Some people therefore see the problem as one of ensuring that such markets are in fact created.
The difficulty with this view is that it ignores some important *market failures* that occur in such markets, sometimes to such an extent that the markets fail to come into existence at all.

The first of these failures to be considered arises because information can have many of the features that characterise a 'public good'. The basic distinguishing features of public goods were first described by Adam Smith, but the terms of the modern discussion of this economic phenomenon were set by Samuelson (1954). He pointed to the distinguishing features - now generally agreed - of 'non-rivalry' and 'non-exclusivity'. The problem is that it is difficult to get people to pay for goods, where they do not have exclusive rights to consume the good in question (non-exclusivity) and when their consumption of the good does not affect the good itself (non-rivalry). In the case of information we find that there are elements of both non-rivalry and non-exclusivity. Consumption does not reduce the amount available to other consumers, and, once gathered, information can be supplied at little extra cost to anyone else who wishes to make use of it. It can therefore be ascribed with an important degree of non-rivalry.

Non-exclusivity is also an important feature. It is possible to control the flow of some types of commercial information to a certain extent. A marketing study, for example, can be published with a limited number of (expensive) copies and the circulation of the results can accordingly be restricted, but it is impossible to control information completely and even having limited controls can be very expensive. Information is notoriously 'leaky'. It is therefore difficult to direct it exclusively to the person who is paying for it, or as it is sometimes put, to avoid the "free-rider" problem. In these circumstances, economic theory suggests, market provision will be less than socially optimal and some other means for provision needs to be explored.

The second market failure arises from the possibility of 'adverse selection'. This situation occurs when there is an information asymmetry as between participants in a business transaction. The classic illustrative example (Akerlof 1970) concerns the market for used cars. In this example, distrust of a seller's protestations about the reliability and performance of a car, in a situation where the purchaser is not in a position to establish the truth, has an important effect upon the market for used cars. It is assumed that all used cars
have something wrong with them and the price reflects this fact. This failure requires some form of intervention to redress the information asymmetry, in the form either of government regulation or self-regulation by a trade body that imposes strict conditions of probity on its members.

A similar situation exists in the market for information, especially when the information relates to markets in other countries. Foreign markets, of their nature, are difficult to get to know. Especially for those enterprises that are venturing into a new foreign market for the first time, the need for local information could be, and in fact is, supplied by agencies who sell their services on a commercial basis. But the problem is obvious. How is an enterprise to be assured of the quality of the information supplied in a situation where, by definition, the enterprise is not in a position to judge? There is a situation of asymmetric information and adverse selection can be the consequence. Unless the enterprise can be assured that the information provided is objective and unbiased, there will again be less than optimal provision.

A final area of market failure to be taken into consideration is the considerable externalities that arise in information markets. Externalities arise when the social benefits derived from some economic activity are different from the benefits derived by the beneficiaries that were primarily intended. In this context the total benefits derived by the business community from the generation and provision of information may be greater than those derived by the purchasers of the information.

There are a number of possibilities here. First of all an increasing amount of information required by enterprises concerns legislation, regulations and standards; in other words, the basic rules of the game. Charging by the appropriate authorities for such information may be justified in certain circumstances, but the benefits derived from the application of this type of information go considerably beyond those obtained by the enterprise. They may relate to the creation of a more open market or to environmental or health controls. In these cases the consumer (or the public at large) benefits. Or if the information relates to standards (that may in fact be voluntary) there is likely to be a cumulative effect upon the performance of the industry that is over and above the effect upon the enterprise directly concerned. Then
there are possibilities for externalities in other areas. For instance, even with marketing information, there may be an effect on other enterprises in the same industry or location, prompting them to investigate previously unexploited opportunities and possibly allowing them to economise on search costs.

There are then a series of important market failures in the area of business information that mean that the response to the need for a greater volume of information even for some of the smallest enterprises cannot be a matter of a straightforward market solution. The next question, therefore, is how have enterprises themselves and the public authorities responded to these problems.

THE RESPONSE OF SMEs

There has been some interest in recent years in the process of networking by SMEs. Unfortunately, the term 'networking' has several different (although sometimes inter-related) connotations. The meaning of the term as applied to the Danish experience would certainly have relevance for the issues under consideration here. However, the meaning that is of most significance for us is that which refers to the network of contacts built up by business people that provides them with important information about their business environment.

These networks of contacts in industry and in the wider business community including accountants, bank managers and so on would certainly have been of importance in the "traditional" small business situation described earlier, where business managers would derive 'free' information from such sources to enable them to 'know' their business. It has to be asked, however, whether such networks can continue to be of importance in the current (let alone future) situation.

Not everyone is agreed that discussion of networks in these terms is well founded. Curran et al (1992) question whether small enterprises do in fact make use of networks. However, their study refers mainly to micro enterprises rather than the broader range of SMEs and concentrates on relationships between enterprises and professional business advisers, such as accountants, bank managers and business consultants. Consequently it neglects the more
informal sources of information derived from networks of contacts in the industry, suppliers, trade organisations, etc. It also fails to see this question within an analysis of the economics of information and consequently neglects some of the dynamic aspects of a situation in which increasing pressures on enterprises are causing new developments.

There are some reasons to suppose that relatively informal business networks will continue to be of importance in providing information to business managers even in a situation where there is an increased requirement for information of all kinds. For a start, the networks may well economise on information search. A group of managers in an industry exchanging information about market conditions saves the time and expense of each individual doing the research on his own account. It also makes sense to have some sort of filter. There is now so much information available that there is increasingly a role for professional information managers, but in an enterprise that is too small to employ such a specialist, using an accountant, for instance, to filter information of a financial or fiscal kind clearly makes some sense. More informally, talking to contacts in the industry can act as a filter on information relating to industry-specific developments.

Making use of networks can also address some of the problems that arise from the market failures already discussed above. Since networks are built up through personal contacts the problem of having confidence in the information supplied does not arise to anything like the same degree as it does with a 'professional' information supplier. Networks can therefore be seen as a partial response to the problem of adverse selection. Similarly, if the information in the network is ultimately the common property of all the members, then it is worthwhile for each member to make a contribution without fearing that others in the industry will unfairly benefit.

Networks, then, may continue to be part of the response to the problems that have been outlined. But they cannot be the whole solution. For economic, personal or historical reasons it is not always possible to build a network in a particular industry with the degree of mutual trust that is required. Furthermore, networks have their obvious limitations and it may be that a more structured and systematic approach to information gathering is needed, especially in the international context. This is particularly the case when we consider the
newly established Single Internal Market.

THE RESPONSE OF THE PUBLIC AUTHORITIES

In contrast to the elaborate range of policies directed towards other areas in which there are market failures, for example in the areas of training or research and development, the response of public authorities to failures in information markets has generally been rather limited in scope. This is particularly true in the UK, where until the development of appropriate services by many of the Training and Enterprise Councils and Local Enterprise Companies (TECs and LECs), the situation had been very variable and dependent upon the local strengths of a variety of organisations, such as Chambers of Commerce, local authority business support services and (sometimes) academic institutions.

The weaknesses in provision were clearly exposed when an extra dimension to the problem was added with the prospect of the Single Market. Not only was there a need suddenly created for information provision on a broad range of new legislative, regulatory and administrative arrangements, but almost overnight it became necessary for firms to know much more about the market, technical and even employment conditions in other Member States of the Union. This amounted to a huge increase in the information required by even quite small firms.

Equally the new situation exposed new problems in the supply of information. Not only were the usual market failures exacerbated, but the informal means of obtaining information were similarly exposed as being completely inadequate. Even experienced business people would generally now 'know' the market in other Member States in the same way as they knew their own (national) markets. Nor could they rely on informal networks to supply the information. Often networks which had members from other European states simply did not exist.

There has been some market response to this situation. Consultants and specialist suppliers of European information have emerged and found a number of market niches, but this has been nowhere near the extent necessary. What is more, some of the suppliers of information
in this market are clearly finding it difficult to make a profit from their activities - precisely the result that would be expected if the market failures referred to earlier were of significant proportions.

With this extra dimension to the information problem, it is appropriate that the EC made a series of responses at a European level. These responses ranged from setting up the SME Observatory to the creation of networks to provide very specific information.

The point here is not to embark on an evaluation of the impact of these initiatives, although there is considerable evidence that some of them have been very successful, but rather the aim is to argue that they are at least right in principle and consequently that there are implications for public authorities at national and regional or local levels.

In effect the full range of problems identified earlier has been tackled via the various initiatives at a European level. Not only has the EC ensured some public provision of business information which would otherwise not be readily available to SMEs, it has also provided the means for extending the scope of informal networks, so that these might operate in the new European context. In addition, it has also facilitated the development of market solutions where these are viable.

At the most general level, there has been a need for an overview of the developments affecting SMEs in the European economy. The generation of this strategic information is of basic importance for the development of a long-term view by any enterprise that is geared to make proper use of such information. Furthermore, there has been a need to fill in some of the gaps that exist in the basic framework of statistical data relating to the activities of SMEs across Europe. This basic role has primarily been that of the SME Observatory supported by the excellent database development work of Eurostat.

Next, there has been the need to provide easy access to information on new EC legislation, compliance procedures, standards, etc. This is the 'public service function' which all Euro Info Centres perform.
Then there has been the necessity to address the provision of broader ranges of information relating to market conditions and other commercial factors. Here it was initially important to avoid the problem of adverse selection. Essentially this problem was tackled by selecting the host structures of EICs from among organisations that already had reputations that guaranteed the objective nature of the information supplied.

Dealing with the public good aspects of this type of information is less straightforward. Some appropriate balance between free provision and a commercial service is called for. This balance has been achieved in different ways, depending on how these matters are generally perceived by the business community and the public authorities in the various Member States, but it is not uncommon for Euro Info Centres to provide for free, or for a nominal charge, information that would be of interest to the industry generally, while charging commercial rates for information that is of specific interest to the client and that requires staff to make a special search. Often this would involve consulting other commercial suppliers of business information. This judicious mix between the 'public service' and the 'commercial' aspects of the Euro Info Centres' provision is one of their major strengths, helping them not only to properly address the complex economic issues involved, but also to maintain their credibility among their business clients and with the public authorities and sponsors that help to fund them.

Finally an aspect of DG XXIII's response to the problems of information that is under appreciated is the series of measures that have the effect of building informal information networks, even though their main purpose is conceived of in other terms. The business co-operation networks, BC-Net and BRE, and the Europartenariat and Interprise initiatives have as their general objectives the promotion of all types of direct contact between businesses. These contacts may lead to distribution agreements, identification of new sources of supply and possibly joint activities in such areas as research and development, to cite just some of the possible outcomes. But a further effect is to assist the process of extending national contact networks among SMEs to a European and international level. Central to all the activity that takes place within the frameworks established by the co-operation networks and the partnership conferences is the gathering of information by contacting and talking to business people, and also business advisers, who are in a position to provide the necessary
information. For many SMEs the best way to make a start at least in finding out about conditions in markets in other Member States of the Union is to spend a few hours talking to people in similar businesses in those other markets. This is what the co-operation networks and the partnership conferences have greatly facilitated, especially since many of the discussions between potential business partners generated by these initiatives begin with precisely this sort of conversation. A wide range of the instruments of DG XXIII therefore, including in this instance the contact services provided by the Euro Info Centres, are making an important contribution to bridging the information gap between the very informal and usually inadequate information gathering activities of traditional small firms and the more structured but more costly (in terms of both time and money) approaches that are often advocated but that are not always appropriate for smaller firms. In so doing it is extending the range of responses that it is helping enterprises to make as they confront the complex problems they face in developing an appropriate information strategy.

CONCLUSION

The argument has been that, notably because of the extra difficulties that arose with the "Europeanisation" of SMEs within the internal market, the EC has implemented a series of policy initiatives that have at least started to address some of the basic problems relating to important market failures in information markets. Taken together, these have the effect of providing for a range of responses to the need for information, including not only a mix of public service and market provision, but also in the encouragement of the development of informal networks at European and international levels, a means of information gathering that is particularly important for SMEs. To this extent the EC's responses to the problem of information have lessons that need to be considered elsewhere.
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