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# Significance of the EU Funds in Investments of Small and Medium-Sized Enterprises

**JEL classification:** *D24; D29*

**Keywords:** *Small and medium-sized enterprises; investments; EU funds*

**Abstract:** *Nowadays competitiveness of enterprises is determined by the size and range of implemented investment projects. The investments need to involve necessary resources. In the case of the SME sector, enterprises have limited financial assets. Therefore, Poland's accession to the European Union and the opportunity to use its funding is a chance for development of this sector. The aim of the paper is to discuss the significance of EU funds in investments of SMEs and to present the most important advantages and barriers to their spending.*

*The research methods used in this paper are: study of literature and analysis of secondary data. The research material comprises programming documents and the results of research carried out at the request of the European Leasing Fund, the Polish Agency for Enterprise Development and the Polish Confederation Lewiatan.*

*Conclusions: EU funding is an attractive source of financing investments for enterprises. It is one of the most affordable forms of obtaining capital. Acquisition of additional financial means can determine the start of an investment, extend its*



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*scope, increase its rate and improve its quality. However, in practice the share of EU funds in financing SMEs investments is still small and entrepreneurs face many barriers to using this form of support. Major obstacles include: excessive bureaucracy, strict procedures, over-scrupulous office workers, lengthy verification of payment applications, as well as delays in payments to beneficiaries.*

## Introduction

Nowadays, innovations are indispensable and established elements in the process of building the market position of an enterprise. Their significance for shaping the competitive potential of a company was emphasized already by such classics of management as P.F. Drucker and M. Porter (Drucker, 1992; Porter, 2006). Originally, innovations were perceived as implementation of new ideas in practice (Schumpeter, 1960, p. 104). These days, for contemporary enterprises innovation means primarily: introduction of new products, implementation of new techniques and technologies, development of information networks, changes in production and distribution infrastructure, as well as actions aimed at better use of expertise and skills of employees (Sosnowska *et al*., 2005).

Owing to the significance of innovations for the functioning and development of enterprises, innovation strategies have become a key element of long-term strategies in contemporary companies. The most frequently used innovation strategies in SMEs include strategies of new products and new technologies.

Innovations need investment because without investment it would not be possible to reinforce and/or increase the innovative potential of a company.

Investment is expenditure on various undertakings whose goal is to achieve the planned effects. In the case of enterprises, such effects may include: increased profitability of the enterprise, maintaining or solidifying the market position, extending the scope of services rendered, modernization of machinery etc. (Skowronek-Mielczarek & Leszczyński, 2008, p. 261).

Thus, the following aspects of investment can be distinguished: tangible (buildings, machines, and equipment), financial (acquisition of securities or stocks of other enterprises) and intangible (training of employees, promotions) (Michalak, 2007, p. 21).

Investment is a difficult process for an enterprise because it has to involve various kinds of resources. For investors it means, on the one hand, the need to give up current consumption in favour of desirable and expected, but uncertain effects. On the other hand, involvement of own funds makes them freeze, while using the services of external entities (such as financial institutions) generates additional costs.

In the case of the SME sector, investments involve higher risks resulting from limited resources, especially financial. Moreover, these enterprises face significant problems with obtaining financial means from external sources, especially in the initial phase of their functioning on the market.

Without doubt, Poland' membership of the European Union and the opportunities to benefit from various forms of financial support offered by the Community are a great chance for these enterprises.

The aim of this paper is to analyse the significance of EU funds in investments of small and medium-sized enterprises. Detailed objectives are the following:

– identification of the types of EU financial support aimed at SMEs,
– analysis of EU funds significance in financing of SMEs investments,
– discussion of the most important advantages and barriers connected with using EU assistance funds.

The research material comprises programming documents and the results of research carried out at the request of the European Leasing Fund, the Polish Agency for Enterprise Development and Polish Confederation Lewiatan.

## Methodology of the research

The research method used when writing this paper was a study of literature, which included Polish publications in the discussed field, especially programming documents, articles, monographs and economic reports.

## The EU programmes of financial support for small and medium-sized enterprises in Poland

The European Union is aware of the economic significance of the SME sector, which covers as many as 99% of enterprises operating on the community market and which employs about 75 million people. Therefore, this group of enterprises has a special position in the entrepreneurship policy pursued by the EU.

The main objectives of the EU entrepreneurship policy are: promotion of entrepreneurship, creating an environment which supports changes and innovations, and providing enterprises with access to markets (cf. Kaliszuk & Tarnawa, 2004). These objectives are consistent with the provisions of the Maastricht Treaty of 1992, which emphasize not only the economic significance of small and medium-sized enterprises, but also the role of the EU government in supporting operation and development of these companies (The Maastricht Treaty 1992, Art. 130).

A crucial moment in development of the EU innovation policy was the meeting of the Council of the European Union in Lisbon, during which the main goal of the European Union was adopted and defined as development of the most competitive and dynamic economy in the world. This aim was supposed to have been achieved by 2010. The key factor in its accomplishment was implementation of the principles specified in the European Charter for Small Enterprises (Wyciślok, 2012, p. 4).

Today it is already evident that this goal has not been reached. The Lisbon strategy is continued by the Europe 2020 document (2010) defining tasks of the Community for the years to come. The objectives adopted in this document include: raising the level of employment among people in the economically productive age, increasing expenditure on R&D up to 3% of GDP and building knowledge-based economy (Stanisławski, 2011, p. 32).

Pursuing of the innovation policy is costly. Expenditure on this policy accounts for ca. 16.5% of the EU budget for the years 2007–2013 and is made through various programmes (Anvert *et al.*, 2010).

For the development of the regions in which income per inhabitant does not exceed 75% of the EU average, the European Union allocated means from the following four structural funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agriculture Guidance and Guarantee Fund (EAGGF) and the Financial Instrument for Fisheries Guidance (FIFG). For economies of the countries where GDP per capita does not exceed 90% of the EU average, the Cohesion Fund was established whose goal is to support initiatives which enhance competitiveness of these states. Furthermore, the so-called Community Initiatives operate throughout the European Union. These are the tools of the complementary character, supporting actions undertaken within the framework of the structural funds.

Poland's accession to the European Union gave our country a great chance for progress. Due to its development level, Poland is fully eligible to obtain all types of assistance offered by the EU. However, in order to enable Polish beneficiaries to receive support, the government prepared the National Strategic Reference Framework (NSRF), which sets the priorities, scope and the implementation system of the ERDF, the EFS and the Cohesion Fund (CF) within the Community budget for 2007–2013. The strategic objective of the NSRF is "[…] to create conditions for better competitiveness of knowledge-based economy and entrepreneurship, resulting in increased employment and higher level of social, economic and spatial cohesion […]" (the Ministry of the Regional Development 2007, p. 40). The objectives of the NSRF are implemented through six operational programmes supervised by the Ministry of Regional Development and sixteen regional operational programmes managed by local governments of particular Provinces:

- Infrastructure and Environment Programme – ERDF and CF (absorbing 42.2% of total funds)
- Innovative Economy Programme – ERDF (absorbing 12.9% of total funds)
- Human Capital Programme – ESF (absorbing 14.9% of total funds)
- Development of Eastern Poland Programme – ERDF (absorbing 3.6% of total funds)
- Technical Assistance Programme – ERDF (absorbing 0.8% of total funds)
- European Territorial Cooperation Programme – ERDF (absorbing 0.73 % of total funds)
- Sixteen regional programmes – ERDF (absorbing 25.7% of total funds)

Owing to its economic significance, the SME sector is an important group of beneficiaries. EU funds are currently available to those enterprises under the Human Capital Operational Programme, the Innovative Economy Operational Programme, the Development of Eastern Poland Operational Programme and the Regional Operational Programmes for 2007–2013.

The Human Capital Operational Programme is an answer to the challenges provided to the EU states by the amended Lisbon Strategy. These tasks include: enhancing the attractiveness of EU member states as places of locating investments and taking up employment, increasing the number of permanent jobs, development of innovations and knowledge.

The main goal of the Human Capital Operational Programme is boosting employment and social cohesion. Hence, the actions undertaken within the framework of this Programme aim at: raising the level of employment, creating better and permanent jobs, improving adaptation abilities of enterprises and their employees, boosting the level of employees' education, increasing the share of innovative products of the Polish economy on international markets, and stimulating social and territorial cohesion (the Ministry of Regional Development 2008a). The objectives of the programme are fulfilled through soft projects, i.e. training courses, seminars, development programmes and consultancy.

The Innovative Economy Operational Programme is an EU programme financed from the ERDF. Its main goal is economic development of the country based on innovativeness of enterprises. Detailed objectives leading to accomplishment of the major goal are: improvement of innovativeness of enterprises, enhancement of competitiveness of Polish science, strengthening of the role of science in economic development (the Ministry of Regional Development 2008b).

This Programme is primarily directed at entrepreneurs. It offers financial support to these projects which directly or indirectly facilitate establishment and development of innovative enterprises and, consequently, reinforce competitive advantage of the Polish economy on the international markets. Small and medium-sized enterprises can count on support for financing innovative undertakings, also those involving high-risk capital.

Additionally, SMEs from the Lublin Province, Podkarpacie Province, Podlasie Province, Świętokrzyskie Province and Warmia-Masuria Province can apply for funds from the Development of Eastern Poland Operational Programme. The objective of the Programme is to increase the rate of social and economic growth in this region, in accordance with the sustainable development principles. Funding can be requested by these enterprises which plan to expand the scope of their operation and to modernize their technical facilities and/or products on offer. The Programme is implemented in six axes. The initiatives under Priority Axis I: Modern Economy and Priority Axis II: Infrastructure of the Information Society are directed specifically at small and medium-sized enterprises (the Ministry of Regional Development 2008c, p. 2).

The Programmes discussed so far have a supraregional character. However, we should also bear in mind the financial assistance obtained by SMEs from regional operational programmes conducted in particular Provinces of Poland. The projects carried out within these programmes have a similar character to the undertakings which were financed from the Sectoral Operational Programme "Increase of Economic Competitiveness" in 2004–2006. Unfortunately, due to the limited length of this paper, particular initiatives implemented within these programmes will not be discussed. The author wishes to draw attention to this issue and to emphasize the significance of these forms of support for SMEs.

According to data of the Polish Agency for Enterprise Development, enterprises from the SME sector have received the funding of 8 billion PLN from the Human Capital and Innovative Economy Operational Programmes since the beginning of their operation, with 90% of this sum from the Innovative Economy Programme.

## Significance of the EU funds in the process of financing investment projects of SMEs

Investment process is, on the one hand, an indispensable condition for efficient functioning of an enterprise on the market, but on the other hand – a tremendous financial and organizational challenge. Business entities wishing to make investments need to save necessary financial resources or to find them in other ways. Involvement of own funds makes them freeze. Obtaining money from external financial and/or credit institutions incurs additional expenses connected with credit management. The EU funds provide enterprises with an opportunity to receive affordable financial means for their projects.

Small and medium-sized enterprises appreciate the importance of investments which have become established elements of their strategies. Even the current economic downturn has not stopped this trend, but only weakened it. Since the scope and rate of investment is determined by the resources allocated to this purpose, the question worth considering is: what are the sources of financing investments in small and medium-sized enterprises?

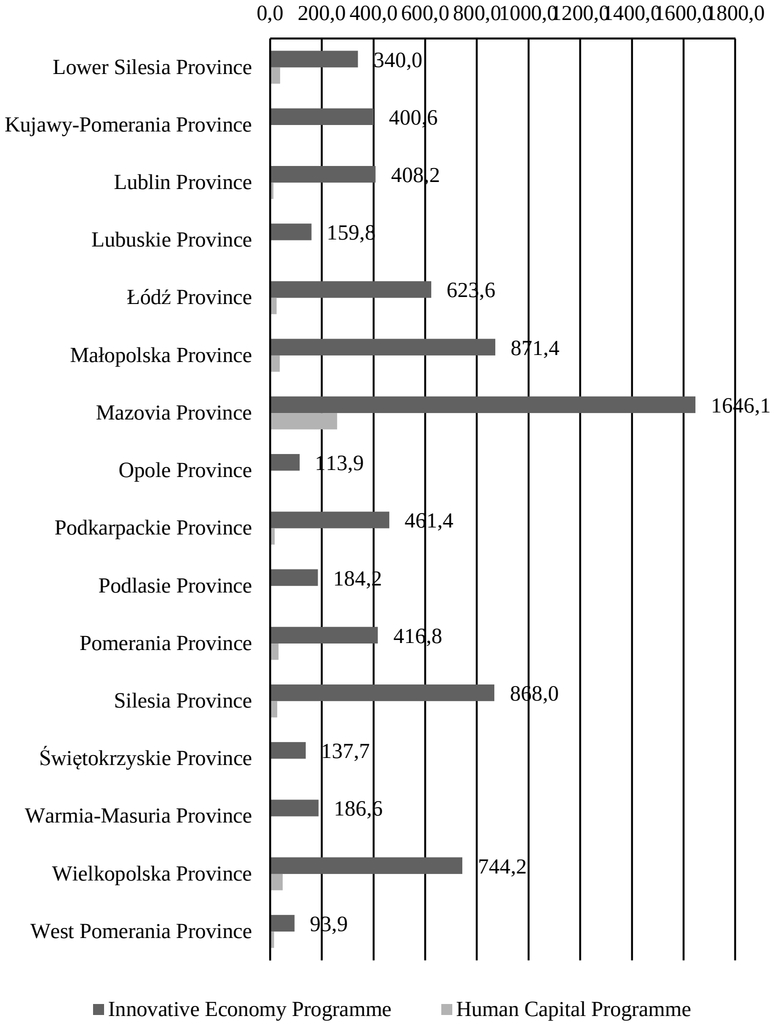
In the research1 conducted on 9-23 August 2011 by TNS Pentor at the request of the European Leasing Fund, 92% of the surveyed entrepreneurs from the SME sector replied that they financed investments from their own funds. The second most frequently selected source was a bank loan, even though only 46% of the examined companies mentioned this method. Only 10% of small and medium-sized enterprises declared that they used EU funding. The smallest number of entrepreneurs financed their investments with loans from other companies and with factoring.

The results of the research are consistent with the data gathered by the Polish Agency for Enterprise Development in 2010, according to which 60% of SMEs financed their investments from their own funds, 56.5% took out a loan and 32.7% used a lease. Moreover, 30.3% of small and medium-sized companies borrowed money from other economic entities, 13.6% used EU funds, and 10.5% benefitted from other forms of support (the European Programme for Modernization of Polish Enterprises 2011, p. 18).

The development level and operational efficiency of companies from the SME sector differ depending on the region of their functioning, similarly to the level of EU funds received by these enterprises.

[1] The research covered 600 SMEs selected by the random-quota sampling

**Chart 1**. Funds obtained by SMEs from EU programmes (in million PLN).

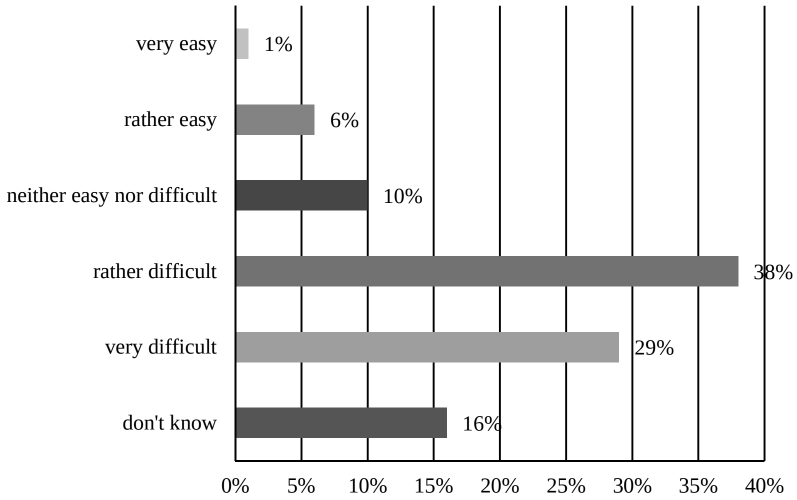



Source: The European Programme for Modernization of Polish Enterprises (2011, p. 22)

Analysing the value of the EU funds obtained by SMEs from the regional perspective, it can be noticed that the unquestionable leader in this category is the Mazovia Province with about 20% of funds distributed so far. It is followed by the Małopolska Province and the Wielkopolska Province. Enterprises from the West Pomerania Province are at the bottom of this list, with only 1.3% of funds allocated by the EU.

For enterprises, the EU funds are among the most affordable ways of raising money for investment. Thus, in order to find the answer to the question why this form of support is used so infrequently, SMEs entrepreneurs were asked about their opinions on difficulty with obtaining money from EU funds.

**Chart 2.** How easy is using EU funds?

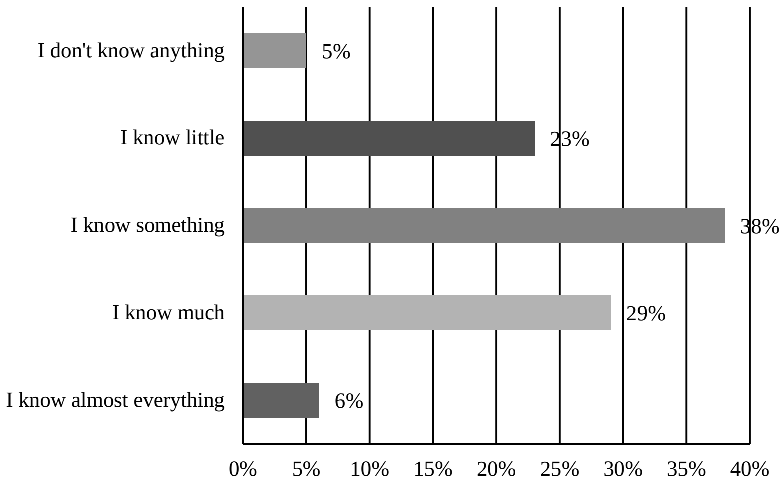



Source: Prepared by the author on the basis of the Programme for Modernization of Polish Enterprises (2011, p. 35).

Only 1% of the surveyed companies claimed that it was very easy to obtain EU funds, while 38% of the surveyed SMEs replied that it was rather difficult to receive EU support, and 29% of them answered that it was very difficult.

In order to find out the reasons for such a negative evaluation of accessibility of EU funds to the SME sector, the owners of those enterprises were asked to estimate their own knowledge concerning the opportunities for receiving EU funds.

**Chart 3.** How do enterprises evaluate their knowledge of EU funds?




Source: Prepared by the author on the basis of the Programme for Modernization of Polish Enterprises (2011, p. 36).

In reply to this question, only 6% of the surveyed enterprises claimed that they knew almost everything about this issue, while 29% declared that they knew much. The majority of the surveyed enterprises (38%) replied that they only knew a bit about opportunities for obtaining EU funds, whereas 5% of the questioned companies from the SME sector did not know anything about this.

## Main advantages and barriers to using EU funds by enterprises from the SME sector

There are many advantages of using EU funds for investment by small and medium-sized entrepreneurs. The most important include:

- the low cost of gaining money for investment – obtaining the same amount of money from financial institutions in the form of credit or loan would entail additional costs connected with credit management, i.e. interest, commission for arrangement of loan, commission for application processing, insurance, etc.
- the opportunity for implementation or extension of an investment – the opportunity for investment co-financing is frequently a decisive factor in its implementation. Sometimes, additional financial means enable

extension of the planned scope of investment or enhancement of its quality.

- increasing the rate of investment – investment plans of companies are prepared for a specific period of time. Prolonged implementation can weaken the effects or can make the aims outdated.

An indirect but equally important benefit from EU funding is improved competitive advantage of these enterprises and their better position on the market.

Nevertheless, business practice demonstrates that SMEs encounter many obstacles in the process of obtaining and using EU funds. In the "Blacklist of Barriers to Enterprise Development 2012" the Polish Confederation Lewiatan devoted one chapter to the restrictions faced by business entities which apply for EU funding. In accordance with their character, particular barriers were classified into four groups: project financing, institutional efficiency, information system, and partnership.

**Table 1.** Barriers to using structural funds

| Item | Description |
|---|---|
| **Project financing** | – long time of verification of payment applications<br>– delays in payments to beneficiaries<br>– a bureaucratic system of financial settlements in co-financed programmes (the need to submit and verify all financial and other documents confirming expenses in payment applications<br>– limited flexibility of project budgets (too many details in the cost and task schedules cause problems with adjustment of the project to the current situation and make it necessary to amend the co-funding agreement many times)<br>– lack of the unambiguous definition of the "competition rule" used at selecting contractors of building works / suppliers of goods and services in projects carried out by the entities which are not obligated to follow the provisions of the Public Procurement Law |
| **Institutional efficiency** | – poor quality of service offered to applicants and beneficiaries<br>– bureaucratized procedures of applying for grants, resulting from high complexity and excessive details of competition rules<br>– too complicated formal criteria (in most cases, formal assessment of the application was more important than substantive evaluation)<br>– substantive criteria which do not match the realities of running a business<br>– low credibility of appeal measures, as the applications were re-examined by the same institutions whose previous evaluation was protested or appealed against by the applicant |

Table 1 continued

| Item | Description |
|---|---|
| **Information system** | – limited opportunities for rational planning of investment (due to the necessity to stick to the competition schedule it is not possible to plan a project well in advance or to prepare and submit an application at convenient time)<br>– exceeding the announced deadlines<br>– scattered information about available instruments of support for entrepreneurs<br>– poor quality of information for applicants - entrepreneurs (unclear structure of websites, no updates, incomplete or limited information e.g. in the form of FAQ, lack of quick replies to questions)<br>– lack of professional training offer for beneficiaries of the regional operational programmes at the level of implementing institutions. |
| **Partnership** | – limited influence of beneficiaries on the form of programmes and procedures of their implementation |

Source: Compiled by the author on the basis of data of the Polish Confederation Lewiatan (2012, pp. 40-50).

It should be emphasized that the above-mentioned barriers occur with various intensity in particular programmes and regions.

## Conclusions

Owing to the internationalization of the contemporary markets and the resultant increase in competition, enterprises which want to be successful on the market should permanently include investment projects into their strategies.

Investment is a demanding process because it entails contributing of own funds necessary to implement an investment or otherwise obtaining funds from external sources. This process is especially difficult for SMEs due to their limited tangible, financial and intangible resources. Therefore, an opportunity to obtain co-funding is a chance for these enterprises.

Nevertheless, business practice demonstrates that the most frequent way of investment financing in the SME sector is own funds. Only 13% of entities admitted that they received EU assistance.

Such small interest of entrepreneurs from the SME sector in EU funding is definitely an unfavourable phenomenon. Firstly, because this is one of most affordable ways of obtaining capital for investment projects. Secondly, an opportunity to receive financial support can be the decisive factor in implementation of investment. Furthermore, additional funding can extend the scope of investment, increase its rate or/and enhance quality of its implementation.

Unfortunately, small and medium-sized entrepreneurs face many obstacles on their way to EU funding. All these obstacles are reflected in specific expenses incurred by these entities. Even though they are not registered anywhere, these costs are neither trivial nor small. For instance, if the verification process is too long the application can become outdated, or a prolonged period of waiting for payment can result in problems with maintaining financial liquidity of an enterprise. Therefore, initiatives of the state facilitating the system of applying for grants and monitoring of their usage and are definitely needed and expected by the SME sector.

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