

Position paper

***Measures to increase the size of
companies***



Introduction

Spain needs larger companies to make its economy more competitive and stable and thus meet the challenges of the global economy. At present, 99.3% of the country's firms are micro-enterprises or are classified as small (fewer than 50 employees), a situation that is in sharp contrast to Germany, the UK and the USA, where the small firms coexist with a large number of bigger companies, thus forming an ecosystem in which the so-called midmarket plays an essential role.

The midmarket in these countries, made up of companies with billings of between 20 million and 1,100 million euros, generates around a fifth of their respective GDP and a third of their total employment. Specifically, in 2013 they created a total of 1,300,000 jobs. They are predominantly industrial companies, with a high level of innovation and internationalization.

The high level of unemployment in Spain, 23.78%, and the potential of medium-sized companies for creating stable, quality jobs, require us to make our companies bigger. Indeed, if Spain had the same company setup as in Germany, our aggregate productivity would be 13% higher than it is now. This would probably create 15,000 new companies (12,000 of them medium-sized) and 400,000 new jobs.

Likewise, to make the Spanish economy more international, we need larger companies. The small average size of our companies affects the exporting base: only 30% of the firms with fewer than 50 employees export, as against the 80% of the medium-sized firms and the 90% of the large ones.

Likewise, it is the largest companies that will probably be most capable of adapting to the global challenges. These challenges include: competing with emerging countries, across many borders; changes in consumer habits caused by an ageing population in the developed countries and a growing middle class in the emerging ones; new migratory flows of talent; and the "new technological revolution", which will change the traditional concept of work. The larger companies will be able to better adapt to these new surroundings, become more international, innovate, access technology and greater financing, and attract, train and retain talent.

In any case, to make a company larger demands that our businessmen be more ambitious, more professional and better trained, and on occasion they must take on investment by outsiders and reconsider their policies of indebtedness.

Conscious of this situation, the Círculo de Empresarios, in its role of helping generate more competitiveness and social wellbeing –and following the philosophy of our Spanish Medium-sized Company project*– present a series of recommendations to lessen the effects of regulations that discourage company growth.

1. Regulatory barriers to increasing the size of companies

In Spain there are some fiscal, labor and bureaucratic measures that discourage making Spanish companies larger. If a company goes beyond 50 employees and/or a certain figure in billings or assets, it faces new obligations that reduce its competitiveness: management expenses increase, and it is harder to finance operations with its own funds.



1.1 Taxation

The last tax reform represented progress by setting a flat rate in the Corporation Tax, which in 2016 will be 25% for all companies, regardless of their size. It also created two new types of reserve: capitalization and leveling. The application of both reserves can lower the rate to 20%.

The companies that bill more than 6 million euros are part of the Unit of Large Taxpayers, with a higher rate in their installment payment to the Corporation Tax, moving from 18% to 20% or more over the tax base. As for VAT, their payments go from being quarterly to monthly. All this makes it harder to find financing reduces current assets and increases management costs.

* Each year the Medium-sized Spanish Company project presents an Annual Report, as well as the Top 50 ranking of the Spanish medium-sized firms that have had the best results in terms of EBIT margin, productivity and ROA.

1.2 Labor

The Workers' Statute establishes that in companies with fewer than six workers they do not have a personal delegate, and that in those with 50 or more employees, these employees can decide if they want to set up a workers' council. The composition of the council, and the number of paid monthly hours of its members, depends on the size of the company ¹.

1.3 Administrative

Current regulations make it obligatory to formulate and audit accounts starting from certain thresholds. Specifically, the companies must audit their accounts if, at the end of the year, there exist two of the following three circumstances: total assets of more than 2.85 million euros; a turnover of more than 5.7 million; and/or 50 or more workers.

The companies can present abbreviated accounts when they comply with two of the following three requisites: total assets of less than 4 million euros; annual net turnover of less than 8 million euros; and/or fewer than 50 workers.

Paradoxically, the companies with assets of between 2.85 and 4 million euros and a turnover of between 5.7 and 8 million euros can present abbreviated accounts, but they have to be audited.

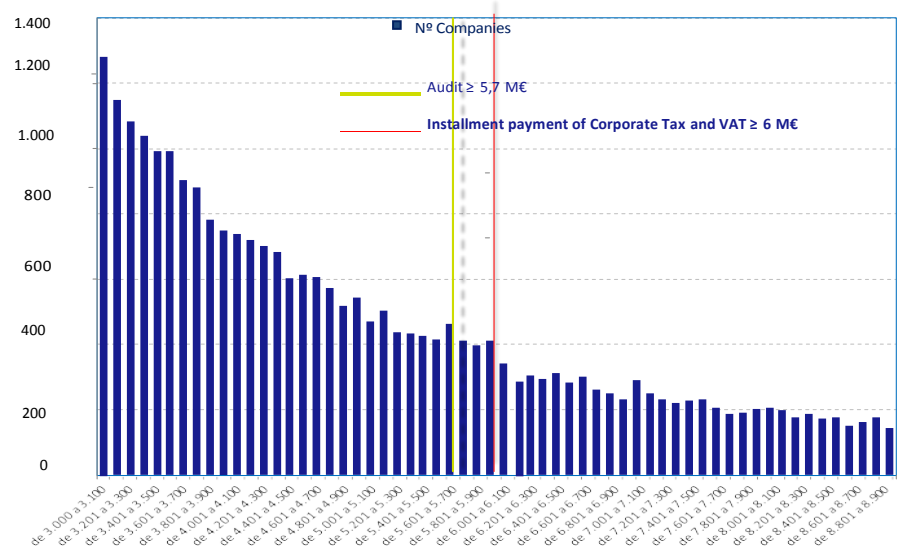
¹ In a company of between 50 and 100 employees the committee is made up of five members, while in a firm of between 101 and 250 workers there are nine members; and in a company of between 251 and 500, there are 13 members. As far as hourly credits for these representative, it increases from 15 paid hours a month to each member of the committee or delegate in workplaces of up to 100 employees, to 40 monthly hours if the number of workers is the same or greater than 751 employees.

2. Recommendations

Here at the Círculo de Empresarios we feel that there should be a change in all the regulations that discriminate against a company because of its size (number of employees, total billings or assets). It is precisely these regulations that explain in part the high number of small companies and micro-enterprises.

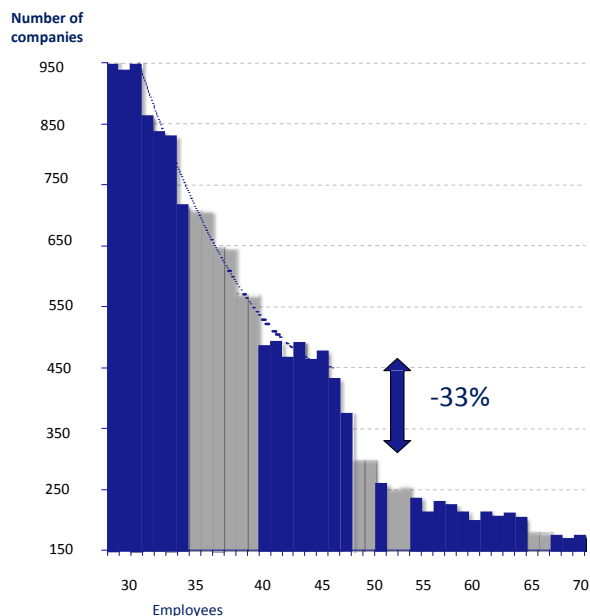
As seen in diagrams 1 and 2, the thresholds of 6 million euros in billings and 50 employees produces a step effect in the distribution of companies by size, which creates less incentive to become medium-sized companies.

Diagram 1: Distribution of companies by sales figures, 2013



Source: INFORMA, data from 2013

Diagram 2: Distribution of companies by number of employees 2013



Source: INFORMA, data from 2013

2.1 Fiscal

We feel it is necessary to simplify the Corporate Tax, eliminating deductions and bonuses and establishing a flat tax of 20%, following the lead of the UK and Finland, so that all companies can compete under equal conditions.

In addition, we think it would be advisable to raise the billing threshold for installment paying of the Corporate Tax and VAT, as well as integration in the Unit of Large Taxpayers, from 6 to 20 million euros, taking as a reference the lower figure, from the studies about mid-market.

2.2 Labor

Likewise, when employees want to set up a workers' committee, it should be based on at least 100 or more employees, as is the case in neighboring countries. There can also exist other legal or trade union representations (as is the case now) in smaller companies (personnel delegates, for example).

Their hourly credits can be agreed upon by the companies and the workers' representatives depending on the needs and condition in each firm, without it being dictated by law.

Easing both thresholds would avoid the step effect, and bring about an increase in the average size of our companies through the appearance of new medium-sized ones.

2.3 Administrative

Establish a new "abbreviated" audit for companies that satisfy two of the following three criteria: assets of between 2.85 and 4 million euros; a turnover of between 5.7 and 8 million euros; and/or fewer than 50 workers. In this way conditions would be the same for presenting abbreviated accounts and having them audited.

2.4 In other areas

To become more competitive, viable operations, Spanish companies should work toward more internationalization and innovation. To do this, it is necessary to have larger and better access to financing and to trained, professional human resources, often carrying out processes of company cooperation and concentration.

Access to financing

An increase in the average size of companies and the diversification of the productive fabric require greater access to credit and new sources of financing. At the same time, this greater company size and diversification will lead to just such larger and more diversified credit sources.

- ✓ Revise banking regulations with regard to company financing, so as not to penalize loans to small and medium-sized companies. In granting these loans, it is necessary to evaluate the solvency and credit rating of the companies, based on accounts that have been duly audited, in the “abbreviated” form in the cases already specified in proposal 2.3 above. In addition, the stress tests for banks should all be applied using the same criteria.
- ✓ Promote the use of, and reduce the costs associated with, non-banking finance: debt funds, risk capital funds, development of the Alternative Fixed-Interest Market (MARF, in Spanish) and the Alternative Stock Market (MAB).
- ✓ Reconsider the limitations of crowd funding, following the model in the United States.
- ✓ Harmonize the Risk Capital Law with European regulations.²

Internationalization

Size is an essential factor in making companies more international. Along with the measures proposed to make firms larger, we think there should be others to promote their presence on the international scene and increase Spain’s exports.

- ✓ Improve financing for exporting companies by means of credit insurance, co-risk programs with financial entities through CESCE (Spanish Credit Insurance to Exports Company), promoting mutual guarantee schemes through ad hoc government guarantees, and developing and following up on alternative channels of financing.
- ✓ Give the ICEX (Spanish Institute of Foreign Trade) more resources and strengthen economic diplomacy (through embassies, commercial offices, and the Invest in Spain program).

Innovation

There is also a correlation between company size and the capacity to innovate. To accelerate the pace of innovation in Spain, our companies must be bigger.

- ✓ Promote company cooperation with higher education and research groups and institutions.
- ✓ Limit the guarantees that are required to receive financing for R+D projects.
- ✓ Include as deductibles the costs of the certification process for companies involved in R+D projects.
- ✓ Permit the simultaneous application of R+D fiscal deductions and the bonuses to all companies.

² This law has created problems with the risk managers of venture capital companies that take part in the initial phases of projects. While there are lower management requirements for firms that invest in small projects, these requirements are maintained in case the funds that are traded among different kinds of investors. In practice, the managers must assume some administrative and compliance charges that are inappropriate to their size, which produces the opposite effect from the aims of Ascri (Spanish Association of Risk Capital Entities).

Bankruptcy: guaranteeing the survival of viable companies

There have been advances in the Bankruptcy Act, included in the Royal Decree Law 4/2014, with regard to urgent measures about refinancing and restructuring company debt, and in the Second Chance Law.

We feel there are aspects in the Bankruptcy Law that could be improved:

- ✓ Facilitate the sale of production units and refinancing agreements.
- ✓ Specifically, we propose that, when business units are acquired, previous debts to the Treasury and to Social Security be eliminated.³
- ✓ In the meetings of creditors, allow for the approval of agreements through smaller majorities, and make them binding for all creditors, including the Treasury Department and Social Security.
- ✓ Speed up trials and judicial procedures, and promote arbitrage and mediation, all of which would result in greater legal certainty.

Cooperation and company concentration

Integration and concentration make it possible to increase the size of companies. In view of the complexity of the process, we feel that these firms should receive advice and support throughout these processes.

- ✓ Promote new support programs for companies with a high potential for growth, in which experience and best practices are shared. A good point of reference for this is the Cre100do, 100 new large companies initiative, started by the Fundación Innovación Bankinter, ICEX and the Círculo de Empresarios, along with 13 other associated organizations.
- ✓ Support the processes of company concentration and integration by identifying and defining of areas of opportunity in different sectors.
- ✓ Support cooperation or company alliances that will allow firms to reach their optimum size so as to access overseas markets or receive public contracts.
- ✓ Reactivate the tax deduction of the fund for commercial mergers, which disappeared in January of 2015. In addition, introduce some kind of specific deduction for expenses incurred by small and medium-sized companies in this kind of processes.

³ One of the most effective ways to save bankrupt companies is for a new party to acquire the firm or its production plant. With the measure introduced in the latest modification of the Bankruptcy Law, the new party acquires Treasury and Social Security debts, which is an obstacle when trying to sell the company or its production plants.