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Boosting the Development of Efficient SMEs in the Netherlands

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BOOSTING THE DEVELOPMENT OF EFFICIENT SMES IN THE NETHERLANDS

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ABSTRACT/RÉSUMÉ

Boosting the Development of Efficient SMEs in the Netherlands

Entrepreneurship is an important driver of economic growth, job creation and competitiveness. However, the small and medium-sized enterprises (SME) sector has been severely affected by the crisis, with access to bank finance being particularly difficult. Various government-sponsored schemes have been introduced to ease credit conditions. Developing alternatives to bank lending options for SME finance is important but will take time. Restructuring banks' balance sheets is essential to step up bank lending to SMEs in the medium term. Beyond financing issues, boosting innovation would support productivity gains, and SME competitiveness and growth. Also, easing labour market regulation would further support SME development. A large share of small businesses consists of self-employed with no employees. The tax system should minimise distortions for the creation and expansion of businesses. Despite significant progress made in lowering barriers to entrepreneurship, there is scope to further reduce administrative burdens.

This Working Paper relates to the 2014 *OECD Economic Survey of the Netherlands* (www.oecd.org/eco/surveys/economic-survey-netherlands.htm).

JEL classification: G01, G21, G23, J08
Keywords: Entrepreneurship, SMEs, finance, banks, bank lending, taxation, innovation, self-employment, EPL, PMR, administrative burdens, Netherlands.

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Favoriser le développement de PME efficaces aux Pays-Bas

L'entrepreneuriat est un vecteur important de croissance économique, de création d'emplois et de compétitivité. Néanmoins, le secteur des petites et moyennes entreprises (PME) a été durement touché par la crise, l'accès aux financements bancaires étant particulièrement difficile. Divers dispositifs ont été mis en place par les pouvoirs publics pour assouplir les conditions de crédit. Il est important que se développe une offre de financements alternatifs au crédit bancaire pour les PME, mais cela prendra du temps. La restructuration des bilans des banques est une condition essentielle de l'augmentation des crédits bancaires aux PME à moyen terme. Au-delà des problèmes de financement, des mesures favorisant l'innovation renforceraient les gains de productivité, ainsi que la croissance et la compétitivité des PME. Par ailleurs, un assouplissement de la réglementation du marché du travail contribuerait également au développement des PME. Une forte proportion des petites entreprises est constituée de travailleurs indépendants sans salariés. Il faudrait que le système d'imposition atténue les distorsions relatives à la création et au développement des entreprises. Malgré les progrès sensibles accomplis en termes de réduction des obstacles à l'entrepreneuriat, il est possible d'alléger encore les charges administratives.

Ce Document de travail se rapporte à l'Étude économique de l'OCDE des Pays Bas, 2014 (www.oecd.org/fr/eco/etudes/pays-bas.htm).

Classification JEL : G01, G21, G23, J08
Mots clefs : Entrepreneuriat, PME, finance, crédit bancaire, fiscalité, innovation, travailleurs indépendants, EPL, PMR, charges administratives, Pays-Bas.

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The role of SMEs in the Dutch economy

A snapshot of SMEs and key challenges facing the sector

In Europe, SMEs are defined as firms with fewer than 250 employees and an annual turnover and/or balance sheet of respectively less than EUR 50 million and EUR 43 million. They play an important role in the Dutch economy and are very heterogeneous as they represent 99.7% of all enterprises, very close to the European Union (EU) average of 99.8% (European Commission, 2013). They also account for about a 65% share of total employment and a similar share in value added and have a significantly higher labour productivity than the EU average.

Total early stage entrepreneurship activity, a measure of start-up activity, is higher than in many other OECD countries, which is partly explained by a policy environment favourable to small firms (European Commission, 2013). The internationalisation of Dutch SMEs is strong, as almost 40% are involved in international trade and investment (Deutsche Bank, 2011). In terms of industry structure, services are the largest sector and almost 45% of SMEs offer knowledge-intensive services (mainly accounting, marketing or legal services), against 30% for the EU average (European Commission, 2013). In the run-up to the global downturn and in its early stages, the overall SME sector fared well in comparison with other countries in terms of number of firms, employment, value added and productivity (Figure 1).

Nevertheless, SMEs have been hit hard by the crisis. According to Statistics Netherlands, total annual pronounced corporate bankruptcies rose on average from 5 300 between 2000 and 2008 to 8 100 between 2009 and 2013, although the number of bankruptcies has been gradually receding since mid-2013. The Netherlands scores high on entrepreneurial attitudes and has a high number of entrepreneurs in the country’s population, but the proportion of fast-growing firms is comparatively lower than in other innovation-driven economies (Van der Zwan et al., 2012). Access to bank finance has become the most important barrier for doing business according to *The Global Competitiveness Report* (Figure 2). Moreover, there are around one million of self-employed, who play an important role in the flexibility of the supply side and sustain entrepreneurial motivations, but over three quarters of them do not have employees (so-called ZZP-ers in Dutch). The development of dynamic SMEs is hampered by labour market impediments and remaining compliance costs for doing business (Figure 2), although the latter have been lowered significantly over the last 15 years or so. There is scope to improve the quality of SMEs by better exploiting their innovation potential and reforming taxation. Finally, women entrepreneurs could play a more prominent role in SME expansion. For instance, women are more represented in businesses with a lower turnover than men. However, women’s business creations appear to have been less affected by the crisis than those of men, which could partly be due to a higher propensity of the latter to enter sectors more affected by the crisis such as construction or manufacturing (Piacentini, 2013).

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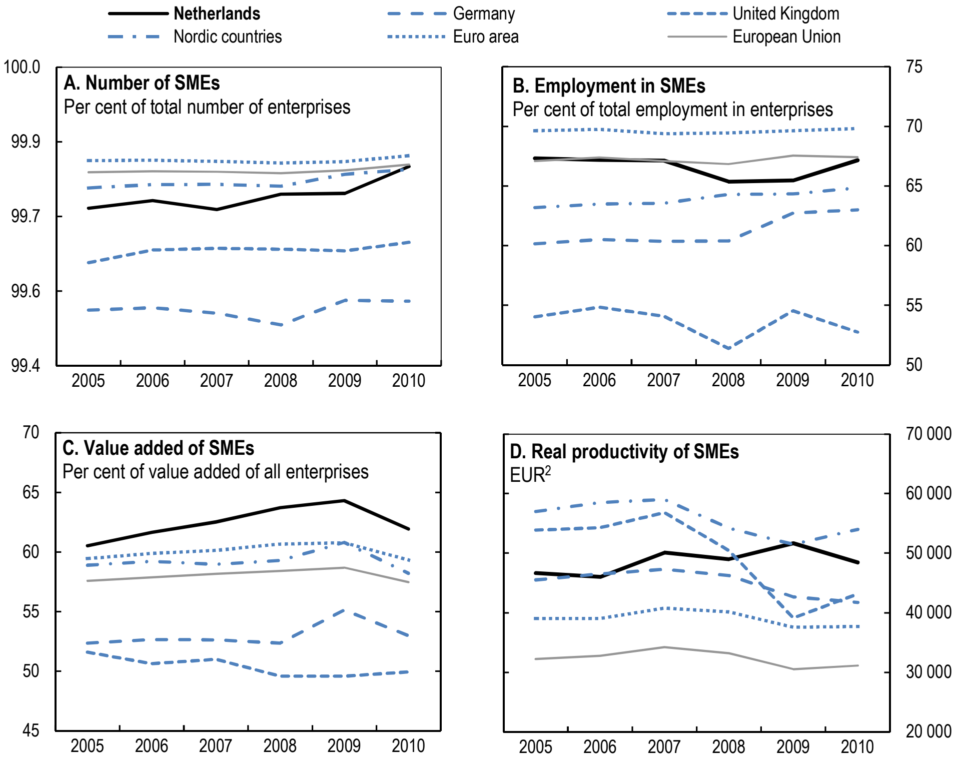
Figure 1. Small and medium-sized enterprise (SME) sector indicators[1]

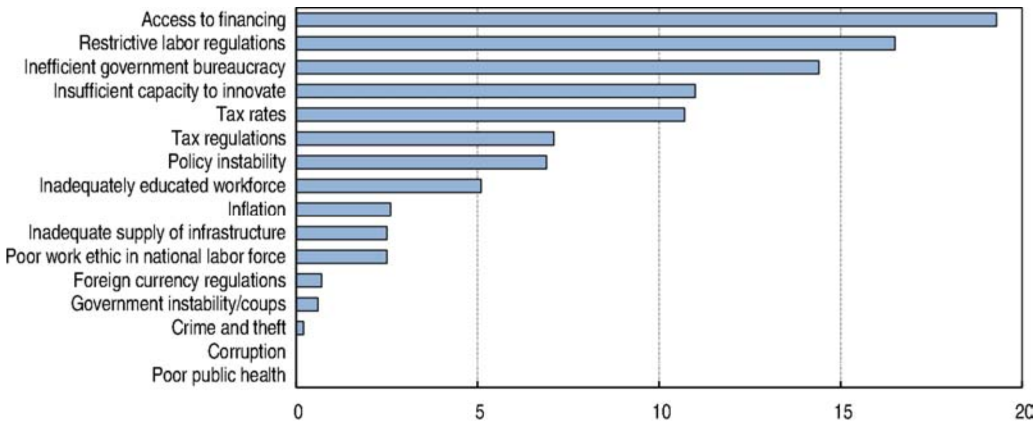


1. The data cover the "business economy" which includes mining and quarrying, industry, construction, trade and services. The aggregates for Nordic countries (i.e. Denmark, Finland and Sweden), Euro area (i.e. EA15) and European Union (i.e. EU27) are calculated as unweighted averages.
2. Real productivity is defined as real value added (in euros) per person employed. Value added of SMEs is deflated by GDP deflator.

Source: European Commission (2014), *Annual Report on European SMEs 2012/2013* (database), DG Enterprise and Industry, January.

Figure 2. The most problematic factors for doing business

Per cent of respondents, first half of 2013[1]



1. From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Source: World Economic Forum (2013), *The Global Competitiveness Report 2013-2014*, Geneva.

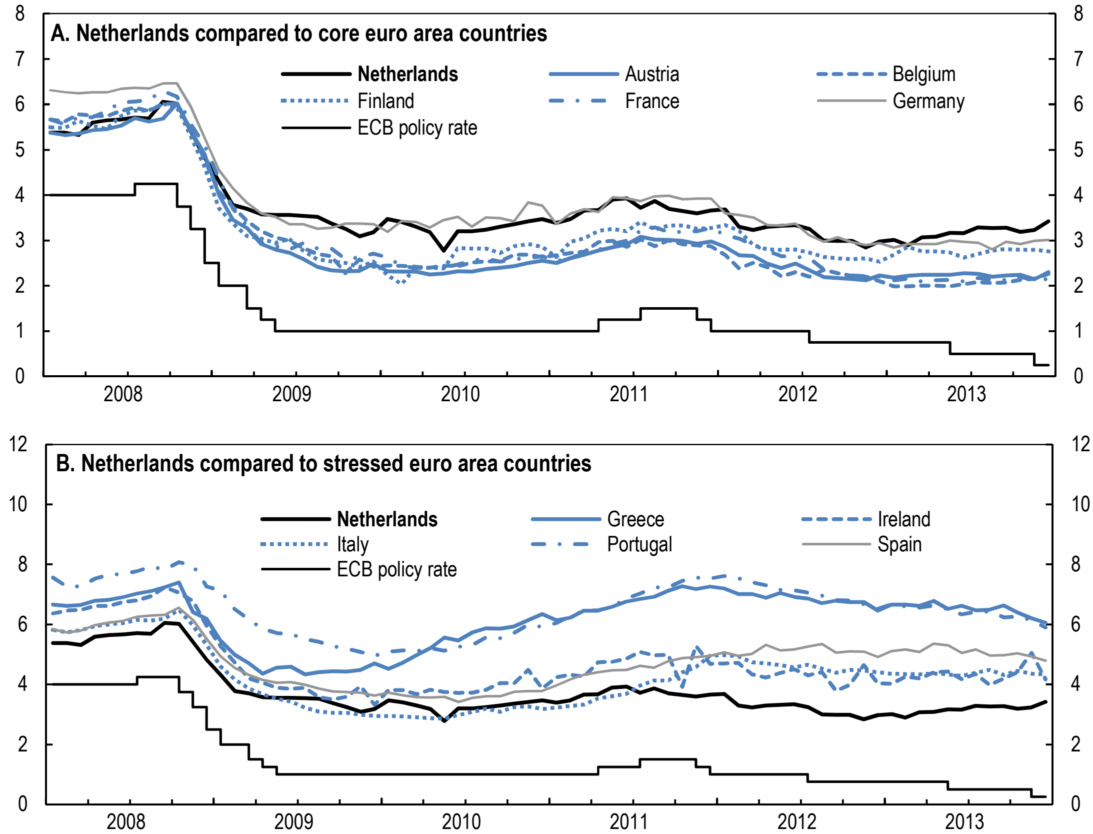
Poor access to finance is a major concern

Lack of statistics on lending to SMEs makes the analysis of credit availability difficult. Thus, a loan size of below EUR 1 million is used to approximate SME loans, which may introduce a bias to the extent that large firms seek smaller loans. Also, reporting is not harmonised across banks. It is important that the authorities implement plans to adjust reporting obligations of banks, so that the central bank (De Nederlandsche Bank, DNB) can get a timely, reliable and publicly available insight of SME bank financing. Nevertheless, there are indications that access to finance has been difficult during the crisis (OECD, 2013a). As opposed to large Dutch firms which fared better, start-ups, high growth and innovative SMEs have encountered major difficulties in getting finance.

The level of lending interest rates for loans below EUR 1 million has been broadly stable. It has been the highest among core euro area countries (Figure 3, Panel A) but still lower than in stressed euro area countries (Figure 3, Panel B). Given uncertainties about expected defaults in the context when non-performing loans for SMEs reached 6% of total lending volume in the third quarter of 2013 (DNB, 2013a), banks could consider that higher collateral requirements and lower interest rates would generate a higher *ex post* return than the counterfactual of higher interest rates and lower collateral standards.

Figure 3. Change in the cost of bank loans

Interest rate on loans up to and including EUR 1 million, per cent per annum[1]

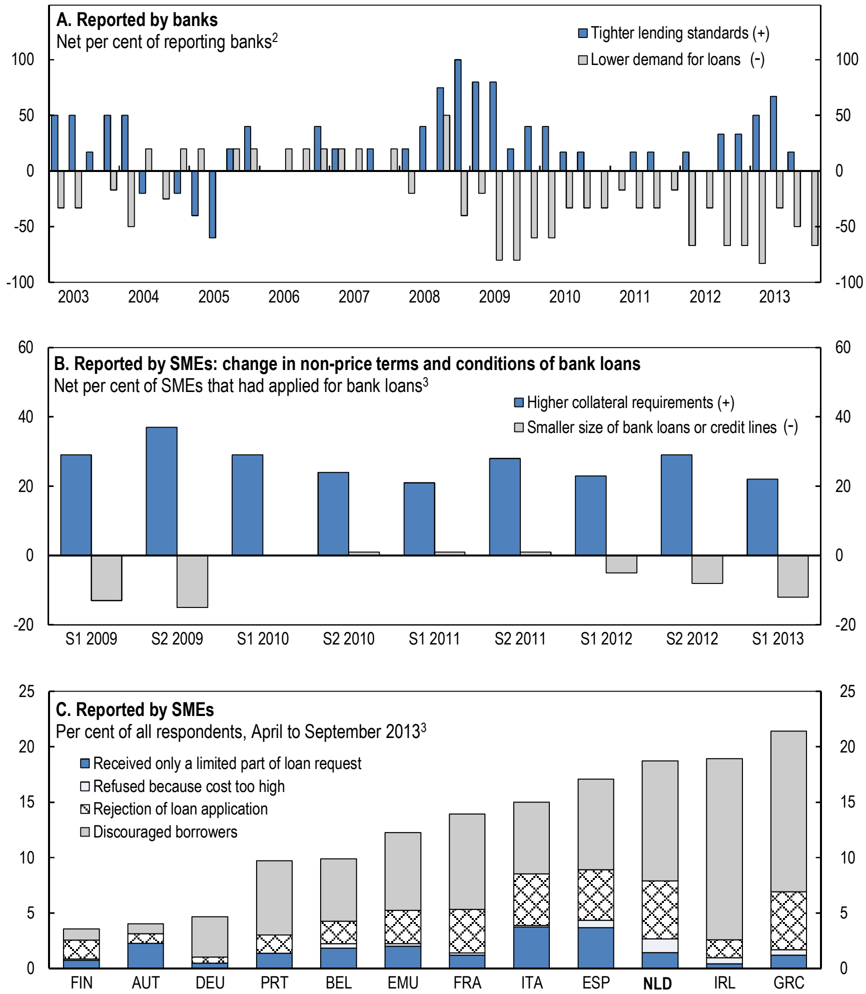


1. Figures refer to loans other than revolving loans and overdrafts, convenience and extended credit card debt.

Source: ECB (2014), "MFI Interest Rates", *Statistical Data Warehouse*, European Central Bank, March.

There is some evidence of credit rationing. While Dutch banks have been reporting reductions in loan demand, they have also been tightening lending standards, which occurred mainly through stricter collateral requirements as reported by SMEs (Figure 4, Panels A and B). In turn, tight credit standards have been weighing on business lending (Van der Veer and Hoeberichts, 2013). According to bank lending surveys, the influence of weaker balance sheets of SMEs – as captured by greater banks' risk perception of the general economic activity and the outlook for the industry/company in question – has been a stronger determinant of tight lending supply, rather than weak balance sheets of banks – as captured by banks' assessment of costs related to their capitalisation (Figure 5).

Figure 4. Bank lending constraints for SMEs are high[1]



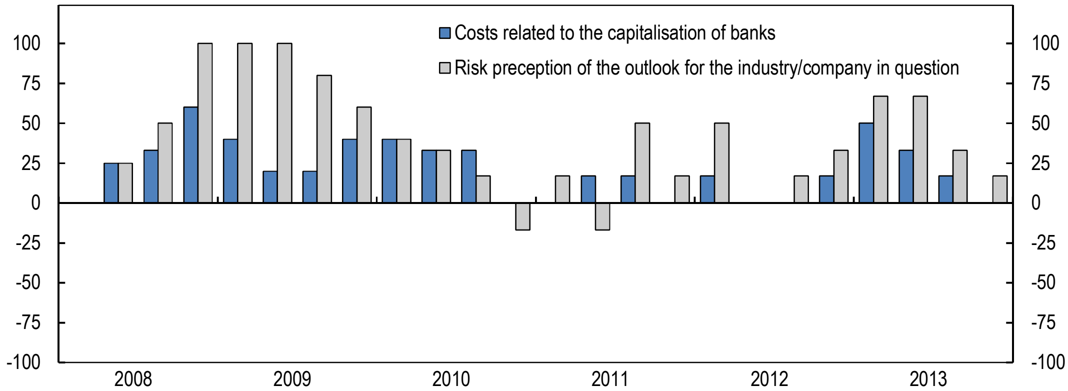
1. SME: Small and medium-sized enterprises. For Panels A and B, the values of net percentages may vary between +100% (e.g. all banks tighten their lending terms and conditions) and -100% (e.g. all banks ease their lending terms and conditions).
2. SMEs are defined as having a net annual turnover of less than or equal to EUR 50 million.
3. SMEs are defined as having 0-249 employees. First semester (S1) refers to the period between April and September. Second semester (S2) refers to the period between October and March. EMU: European Monetary Union.

Source: ECB (2014), "Survey on the Access to Finance of SMEs", *Statistical Data Warehouse*, European Central Bank, March and DNB (2014), "Domestic MFI-statistics", *Statistics DNB*, De Nederlandsche Bank, March.

How to read Panels A and B: For Panel A, net percentage of banks reporting an increase (+) of lending standards and reporting increases (+) or decreases (–) in demand for loans. For Panel B, net percentage of SMEs reporting an increase (+) of collateral requirements and reporting increases (+) or decreases (–) in bank loans or credit lines over time.

Figure 5. Factors influencing credit standards for loans to SMEs

Net per cent of banks reporting factors contributing to tighter credit standards[1]



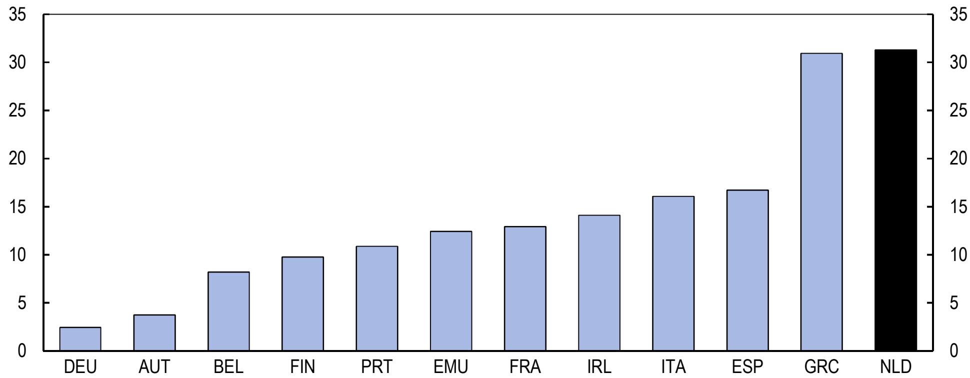
1. Figures refer to the question: "Over the past three months, how have the following factors affected your bank's credit standards as applied to the approval of loans or credit lines to enterprises?". Net percentages show the difference between the percentage of banks indicating that the factor in question contributed to a tightening of the credit standards and the percentage of those indicating that this factor contributed towards easing of the credit standards. The values may vary between +100% (e.g. all reporting banks indicate that costs related to their capitalisation contributed to tightening their credit standards) and -100% (e.g. all reporting banks indicate that costs related to their capitalisation contributed to easing their credit standards). Small and medium-sized enterprises (SMEs) are defined as having a net annual turnover of less or equal to EUR 50 million.

Source: DNB (2014), "Domestic MFI-statistics", *Statistics DNB*, De Nederlandsche Bank, February.

According to the latest European Central Bank (ECB) survey data from April to September 2013, financing obstacles facing SMEs remain high. A fifth of SMEs reported access to finance as the most pressing problem, similar to Ireland and Italy and more than twice the percentage in Germany and Austria (ECB, 2013). The gap between needed and available external sources of funding – bank loans, bank overdrafts, trade credit, equity and debt securities – increased further. The availability of bank loans continued to worsen driven by a decreased willingness of banks to grant loans. Around half of Dutch SMEs did not apply for a loan because they had sufficient internal funds, but a tenth did not do so because they expected rejection. Nearly 20% of all surveyed SMEs reported obstacles for receiving a bank loan, one of the highest ratios in the euro area (Figure 4, Panel C). Among those that applied for a loan, 30% declared a complete rejection of their loan application, a percentage as high as in Greece (Figure 6).

Figure 6. Rejection rates for credits of SMEs

Per cent of respondents applying for a loan, April to September 2013[1]



1. Figures refer to the question: "If you applied and tried to negotiate for this type of financing over the past six months, did you receive all the financing you requested, or only part of the financing you requested, or only at unacceptable costs or terms and conditions so you did not take it, or you have not received anything at all?". Small and medium-sized enterprises (SMEs) are defined as having 0-249 employees.

Source: ECB (2014), "Survey on the Access to Finance of SMEs", *Statistical Data Warehouse*, European Central Bank, March.

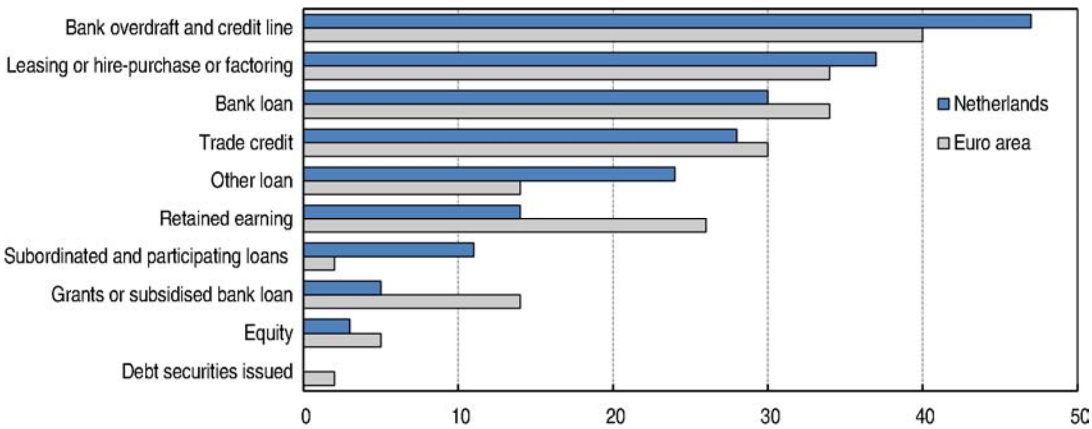
Creating appropriate framework conditions to promote the development of dynamic SMEs

Policy measures have aimed to improve access to bank finance

Sufficient access to finance for viable SMEs is indispensable to achieve a solid economic recovery and support growth. Bank overdrafts, credit lines and bank loans are the most important sources of external finance of Dutch SMEs (Figure 7). Tackling banking sector vulnerabilities would improve banks' ability to lend in the medium term. Even though bank lending is likely to remain a major financial channel for SMEs, the authorities have undertaken commendable policy efforts to facilitate access to bank finance and develop alternative sources of funding during the crisis.

Figure 7. Sources of external financing of SMEs

Per cent of all respondents, April to September 2013[1]



1. Figures refer to the following question: "Turning to the financing structure of your firm, to finance normal day-to-day business operations or more specific projects or investments, you can use internal funds and external financing. For each of the following sources of financing, could you please indicate whether you used them or not during the past six months?". Small and medium-sized enterprises (SMEs) are defined as having 0-249 employees. The category of subordinated and participating loans also includes preferred stocks and other similar instruments. The category of bank overdraft and credit line also includes credit cards overdraft.

Source: ECB (2014), "Survey on the Access to Finance of SMEs", *Statistical Data Warehouse*, European Central Bank, March.

The government has initiated and expanded several loan guarantee programmes to ease access to bank lending. In late 2008, the maximum loan amount of the SME loan guarantee scheme (*Borgstellingsregeling MKB*, BMKB) was increased from EUR 1 million to EUR 1.5 million per enterprise, the size of firms that are eligible was increased from 100 to 250 employees, and the maximum guaranteed percentage was first expanded from 50% to 80% for start-ups and for existing enterprises at a later stage. The BMKB scheme provides guarantees to banks for lending to SMEs with little or no available collateral. The size of loans and guarantee coverage depend on the type of SME, but the risk profile of targeted firms is low. Participants in the BMKB scheme were also offered the opportunity to postpone the repayment of their loans up to two additional years. Yet, owing to budget constraints and growing losses, access to the scheme was tightened in 2012, with a one-off commission increased by 20%, and the maximum guarantee reduced from 80% to 50% for existing firms and from 80% to 75% for start-ups.

In 2009, the government also launched a business loan guarantee scheme (*Garantie Ondernemingsfinanciering*, GO facility) targeted to low-risk firms in the expansion or consolidation stage of development. The GO scheme provides banks with a 50% guarantee on new bank loans ranging from EUR 1.5 million to EUR 50 million. The maximum guarantee had been temporarily increased to EUR 150 million, but was scaled back to EUR 50 million in 2012.

Credit guarantee instruments generally proved effective in improving financing for credit-constrained SMEs in the early stage of the financial crisis (OECD, 2010; Carnegie Consult, 2011). However, fiscal constraints, higher risk exposure and growing losses owing to corporate failures led the government to reduce their generosity between 2012 and 2013. More recently, in view of the persistent problems in accessing bank finance by SMEs, the Dutch government has again temporarily expanded the guarantee schemes (Ministry of Economic Affairs, 2013). In particular, the GO scheme has yet again been provisionally expanded to include loans up to EUR 150 million.

The crisis has increased guarantee schemes to SMEs to around 0.5% of gross domestic product (GDP). Back-and-forth changes in the generosity of the schemes reflect uncertainties about the appropriate level of state support. There is a trade-off between the level of risk taken by the authorities and related potential economic benefits on the one hand, and possible costs for the budget in case of failure on the other. The authorities should continue to evaluate policy instruments supporting access to finance while monitoring market inefficiencies faced by SMEs. Existing instruments should be adapted depending on results. For instance, not all guarantees are being fully used in the Netherlands. If this reflects supply rather than demand problems then access would need to be broadened for the most promising business cases within well-defined budget constraints. However, the government may not have the capacity to ensure the best assessment of risks and to avoid those that are excessive, and should not obstruct necessary restructuring of SMEs either. Therefore, an important involvement of banks should be sought for a given level of risk. Risk could also be evaluated by other private investors to achieve an appropriate screening of loan applications implying a high exposure for the public purse.

A Credit desk for entrepreneurs (*Ondernemerskredietdesk*) has been established to collect questions and complaints regarding difficulties to access to bank finance. Since the beginning of 2013 it has been made possible for entrepreneurs to request a second opinion at the bank, via this desk, when they feel that they are still eligible to qualify for bank financing despite an initial rejection of the loan application. This is a step forward as evidence suggests that the involvement of a third party between banks and borrowers (so-called credit mediator) has been an effective mechanism for helping SMEs who had been denied credit and in facilitating the reversal of lending decisions by banks (OECD, 2013b). However, it is important to assess the effectiveness of the scheme by monitoring the amount of finance that is mobilised through credit mediation and the amount of jobs that are saved as, for instance, is done in Belgium.

Beyond credit guarantees and credit mediation, other channels have also been used to ease bank lending constraints. In 2009, the authorities launched a microcredit institution, Qredits, in joint cooperation with banks. A programme to support financial coaching and advice for micro entrepreneurs has been started as well. More recently, both the government and insurance companies have allocated additional funds to support micro finance via Qredits.

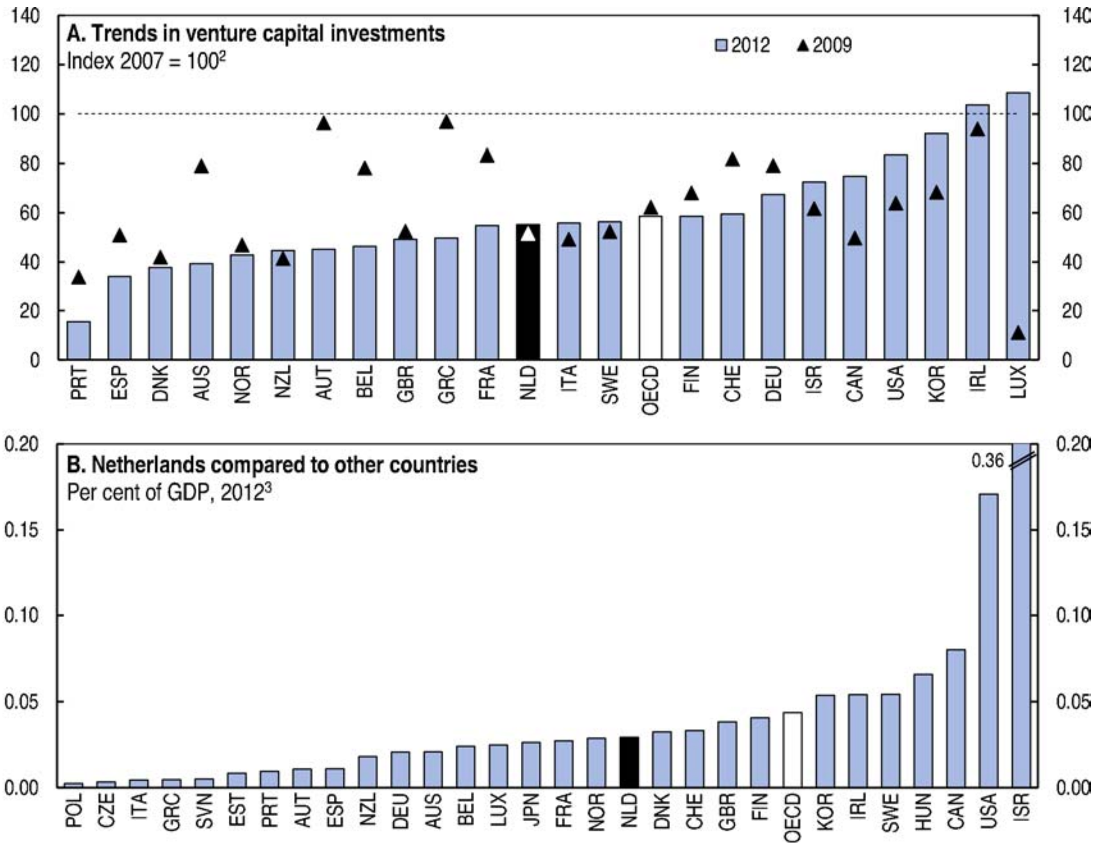
Developing alternative to bank lending sources of finance

Even with a sound bank lending channel, innovative start-ups, young firms and SMEs face particularly high barriers to obtaining finance due to their lack of collateral, cash flow and track record. Consequently, these SMEs have limited access to risk capital. This is exacerbated in the Netherlands by the impairment of the bank lending channel, further increasing the importance of other sources of finance for SMEs including angel investors, venture capital and public equity offerings (OECD, 2011, 2013c). Developing alternatives to bank lending sources of finance is necessary and welcome. Yet great care is required to ensure that public support broadening access to finance benefits mainly firms with the highest economic potential rather than firms that would minimise government's exposure. Also, public money should leverage private money at different stages of firm growth only for well identified market failures so as not to crowd out the emergence of private sources of finance.

Promoting equity finance

Various programmes have been started or are about to be launched to improve access of SMEs to equity finance. For instance, the amount of venture capital investments has dropped by half since early in the crisis and the Netherlands does not stand out compared to other euro area countries (Figure 8). Yet venture capital could play a more prominent role in financing growth and innovation of SMEs in the Netherlands (NVP, 2013). Moreover, angel investors and venture capitalists also provide other benefits to start-ups and SMEs beyond equity finance, including business expertise on commercialising an invention and creating connections that will facilitate an eventual trade sale.

Figure 8. Venture capital investments[1]



1. Aggregation of investment data according to the location of the portfolio companies (i.e. the investee companies), regardless of the location of the private equity firms. Exceptions are Australia, Japan and Korea where data refer to the location of the investing venture capital firms. Due to the lack of standard international definitions of venture capital and diverse methodologies employed by data compilers, data are not strictly comparable across countries.
2. The OECD aggregate covers 23 countries. 2011 instead of 2012 for Canada, Greece and New Zealand.
3. The OECD aggregate covers 29 countries. 2011 for Canada, Estonia, Greece, Japan, New Zealand and Slovenia.

Source: OECD (2013), *Entrepreneurship at a Glance 2013*.

To contribute to the development of the venture capital market, which is often a key channel to finance innovations, the government has created a programme called "SME+ Innovation Fund" to back innovative and fast growing SMEs covering SMEs in the start-up, growth, expansion and consolidation stage (Box 2.1). Moreover, the Fund is complementary to innovation tax credits, which benefit comparatively less young innovative SMEs that often lack taxable income. However, there are several risks. The targeted recovery rate on investments (80%) may be too high to select the most risky projects even though these projects are potentially the most radically innovative. There is also a risk of crowding out private financing for the less risky projects. Another potential issue with the target recovery rate is that assessing returns on investment takes time, as investments from private venture capital funds typically take 5-10 years to materialise.

Box 1. The SME+ Innovation Fund

In January 2012, the government launched the "SME+ Innovation Fund". The Fund is an umbrella for different (partly existing) innovation finance schemes. The aim is to mobilise private capital to close a perceived equity gap for investments, while avoiding interference with segments of the private market that work appropriately. The programme is designed as a “revolving fund”, where on average about 80% of the invested amounts should return for new investments. It is open to the entire private sector, though part of its spending is earmarked for the top sector “creative industry”. The Fund, with a budget of EUR 500 million for 2012-15, has three pillars.

The first pillar comprises direct "Innovation Credits" to support research and development (R&D) projects of enterprises, which are converted into subsidies in the case of failure of the project. If the project is successful, entrepreneurs must repay the credit and the accrued interest within ten years. For technical projects the interest rate is between 4% and 7%, and for clinical projects (development of a medicine or a medical product) it is between 7% and 10%. Small and medium-sized enterprises (SMEs) can use the Innovation Credit to finance 35% of the development costs of a project. Non-SMEs can finance 25% of the development costs. Companies can get a maximum Innovation Credit of EUR 5 million. Since December 2013, the government has increased the generosity of the instrument until the end of 2014. The credit percentage of the total funding for small businesses has been increased from 35% to 45%, and for SMEs that collaborate with a research institution or other companies up to 50%.

The second pillar includes the existing "SEED Capital", which is a co-investment scheme for early stage capital. Private equity funds that invest in risky technological start-ups can apply for a loan through the SEED capital, up to a maximum of EUR 4 million. The SEED capital facility has a flexible repayment schedule for investors. From the time that income is generated, the investment fund pays only 20% of the return to the government, until the private investment is recouped. Thereafter, 50% is paid until the government has recovered its loan. If after that the investment fund still receives income the revenue is split again in the ratio of 80-20% between the fund and the Dutch government.

The third pillar includes a new Dutch Venture Initiative (DVI) which is a "fund of funds" facility, i.e. it holds a portfolio of other investment funds. More precisely, it provides later stage capital for high growth innovative companies in the form of public participation in investment funds. In this pillar, the Dutch government works alongside the European Investment Fund of the European Investment Bank to manage the DVI with the aim to make a contribution to the financing of enterprises in the Netherlands.

Source: Ministry of Economic Affairs (2013), Rapportage Ondernemingsfinanciering (Reporting Business Financing), June.

Recently, the government has announced an addition to the SME+ Innovation Fund of an early stage instrument and a co-investment facility for business angels, both expected to be launched in the first half of 2014. The early stage instrument focuses on two target groups: innovative start-ups arising from research institutions and existing innovative SMEs. The government will co-invest with business angels via a Business Angel facility. The benefit of this scheme is that, besides leveraging private money with public money, it also helps to professionalise business angels.

To increase access to finance, the government is planning to attract long-term financial resources of pension funds and insurance companies as well as other domestic and foreign institutional investors. For this purpose, the authorities plan to set up a Netherlands Investment Institution (NII) (Box 2.2). The main objective of the NII is to remove barriers to long-term investment in the Dutch economy. As in the case of the National Mortgage Institute, which is planned to securitise part of the mortgage debt, it is important that the NII is conducive to adequate pricing of risks and that pension funds’ decisions remain undistorted to maximise returns from international investment diversification. Finally, public Regional Development Companies (ROMs) are also key players in providing risk capital to innovative starters and rapidly growing businesses in the Netherlands. A new ROM for the region of Zuid-Holland was launched in 2013 by the national and local authorities.

Box 2. The Netherlands Investment Institution

In September 2013, a number of major insurance companies, pension funds, pension providers and other stakeholders stated their intention to make more investments in the Netherlands. The statement followed a period of extensive exploration which was initiated by the government. The investments are intended to finance a range of societal challenges such as supporting small and medium-sized enterprises (SMEs), the transition to renewable energy and energy saving, innovation, the development of a private rental market, housing, investment in (residential) care real estate, school buildings, (energy) infrastructure and a competitive mortgage market. The increase of investment is planned to be achieved by the setting up of a Netherlands Investment Institution (NII) and the creation of an SME Financing Fund by insurance companies with a possible participation of pension funds.

The government, the pension funds and insurance companies intend to work together to establish the NII, in which banks can participate. The NII focuses on projects that cannot get the desired (bank) finance for various reasons. The core tasks of the NII would be to pool knowledge, standardise propositions, evaluate and select projects, and provide a sufficient scale and diversification of investments. The NII is planned to be an intermediary helping to attract long-term funding from institutional investors. It is expected to be given a broad mandate to be active in a wide range of sectors and investment categories. The NII will not attract investment capital (neither equity nor debt) and hence will not benefit from direct government guarantees or capital injections, except a one-off public transfer of EUR 10 million for the start of the institution. With time, the NII is expected to cover its operational costs with the fees charged for its services.

Source: Ministry of Economic Affairs (2013), "De oprichting van de Nederlandse Investeringsinstelling en andere resultaten uit het overleg van het kabinet met institutionele beleggers" (The Establishment of the Dutch Investment Institution and Other Results of the Consultation of the Cabinet with Institutional Investors), 17 September.

A vibrant Initial Public Offering market and secondary stock markets geared towards smaller firms are an important complement to earlier stage finance, allowing venture capitalists and angel investors to exit and recycle their funds into new companies (OECD, 2013c). While France and the UK have prosperous alternative stock exchange markets with lighter regulatory regimes for smaller companies, the Dutch alternative market, Alternext, has not taken off (KPMG, 2013). Alternext will be closed soon and stimulating alternatives is needed. The government should work towards a reduction of regulatory barriers for stock market listing of SMEs. These include high listing costs and very high standards for financial reporting. Considering the critical role that exit markets play, it may be more important for the government to improve such framework condition rather than only trying to “catalyse” the seed and early stage market through financing instruments (OECD, 2013c).

Encouraging mezzanine finance

In the middle of the risk/return continuum, from “pure” debt to “pure” equity, there is a range of financing instruments that can be characterised as "hybrid instruments", in that they have some features of debt and equity. Mezzanine finance is a particular kind of hybrid instrument that is relevant as a source of growth capital for SMEs, which gives the right to convert debt into equity if the loan is not paid back. Mezzanine finance takes place only in private capital markets, which are restricted to professional and institutional investors. Mezzanine finance is most frequently used in a later (expansion phase) life cycle of the firm, after the company has attained profitability, and typically when a firm with a positive cash flow is approaching a turning point in its development. To obtain mezzanine finance SMEs need an experienced management team and sound financial and business information reporting capabilities, allowing the providers of mezzanine finance to evaluate and monitor their key risks and success drivers (OECD, 2013d).

The use of subordinated loans and participating loans is significant relative to the rest of the euro area (Figure 7). The government has supported the most common mezzanine instrument, subordinated debt, via the instrument called Growth Facility (GF). The GF offers banks and private equity enterprises a 50% guarantee on newly issued equity or mezzanine loans up to EUR 5 million, providing a guarantee which is half of that amount. However, the evaluation on the GF (Carnegie Consult, 2012) showed that banks have significantly reduced the provision of subordinated loans and it is unlikely that they will expand their activities in this market. To the extent that banks have remained active in this area and needed a government guarantee, they made use of the GO facility. Therefore, the government should limit the use of the GF scheme to private equity firms and qualified business angels and continue the GO guarantee facility for the banks.

Supporting other sources of finance

New SME finance institutions like SME funds, credit unions and crowd funding, are in development and some of them have already been introduced by private parties. The Dutch government responded to these alternatives by temporarily opening the guarantee scheme BMKB since 2012 and the GO facility since late 2013 to these non-bank initiatives till the end of 2014. In the course of this year, the government will evaluate this opening. The authorities should continue to increase diversification of SME financing sources including asset-based finance, credit unions and crowd funding and to improve the awareness about these alternative funding sources for SMEs.

Given the need for companies to finance working capital and given the fact that it is difficult for them to get finance from banks, there remains a potential for the development of asset-based finance in the Netherlands. Asset-based finance includes asset-based lending, leasing, factoring, purchase-order finance and warehouse receipts (OECD, 2013e). According to recent research (Panteia, 2013a) on equipment lease, auto lease and factoring, the use of these alternatives in the Netherlands varies according to the awareness about these instruments. The government is therefore recommended to give more attention to asset-based finance in its efforts to increase awareness of entrepreneurs on alternative forms of finance.

Leasing is a common form of asset-based finance. A SME may need capital equipment, real estate or motor vehicles, but banks would not be willing to lend funds due to the company's credit rating. With leasing, the financial leasing company purchases for instance necessary equipment and retains ownership, but allows the SME to use it under a leasing contract while receiving lease payments. In case the company does not make the lease payments, the leasing company takes possession of the asset (OECD, 2014a). In the case of factoring, a company sells a receivable from a party with a good credit rating to a factoring company at a discount. In other terms, the factor buys the right to collect a firm's invoices from its customers, by paying the firm the face value of these invoices, less a discount.

The overall use of leasing, hire-purchase and factoring seems to be well developed in the Netherlands compared to the euro area average (Figure 7), but there is scope for further improvements in particular by increasing SME awareness about these instruments (Panteia, 2013a,b). The perception of leasing and factoring could be enhanced by drawing SME attention to the fact that costs are balanced by the service aspects of such sources of finance. Stronger demand would also encourage the development of supply. For instance, there are only a few companies that offer factoring services in the Netherlands.

The Netherlands does not have a tradition of credit unions. A credit union is a cooperative between SMEs with a view to creating a common fund and providing financing to SME entrepreneurs. Both lenders and borrowers are members and co-owners of the cooperative. Members who provide the credit funds act as coaches for experienced or novice borrowers. A credit union promotes solidarity between lenders and borrowers and has no profit objective as any benefits are redistributed to members at the end of the year. The Dutch government supports efforts aimed at the establishment of credit unions lending to SMEs and recently a new institution, Credit Union Netherlands, has been launched to stimulate their development. In early 2014, the Dutch Authority for Financial Markets (AFM) and the DNB announced that credit unions will be allowed to attract funds by issuing perpetual membership certificates. Since such certificates are not retrievable, credit unions will not need a banking licence. As with the other alternative forms of financing, the promotion, awareness and reputation of credit unions will also be of major importance for their success.

More recently, the use of online platforms to enable many unprofessional investors to invest small amounts in new ventures (so-called "crowd funding") has also started, making its way into the seed and early stage markets. Netherlands is one of the front-running countries (together with Belgium, France, Germany and the United Kingdom) that have active equity crowd funding platforms (OECD, 2013c). At the moment, there are eight operational platforms in the Netherlands. In 2012, 118 companies raised a total of EUR 11.4 million from this source, of which EUR 7 million was raised by only one company for the acquisition of two windmills (Panteia, 2013b). In 2013, EUR 32 million of crowd finance was raised and 1 250 projects and companies were supported. According to Douw & Koren (2013), a crowd funding consultancy firm, there is a strong potential to develop crowd finance in the near term, allowing SMEs to close part of their business finance gap. However, several obstacles remain. Most companies are not familiar with crowd finance yet. Platforms should work on professionalisation and have difficulties to finance their rapid expansion.

In the financial package of measures for 2014, the government has made EUR 5 million available to support alternative forms of financing such as crowd funding and credit unions, and for information and education for entrepreneurs seeking funding. The AFM together with the DNB has given an interpretation on how the financial Supervision Act applies to crowd funding, to protect consumers and investors, and has defined conditions to get a licence. To date, there are two crowd funding platforms in the Netherlands with a license.

Fostering innovation

The Netherlands has launched a two-pillar approach to promote a healthy entrepreneurial system with innovation at its core. As discussed in a chapter on policies for the business sector to harvest the benefits of globalisation of the 2012 *Survey* and latest OECD Review of Innovation Policy (OECD, 2012; Gerritsen and Høj, 2013; OECD, 2013g), the aim is to enhance framework conditions for the entire business sector (first pillar). Another goal is to develop sector specific policies to unleash research and development (R&D) and to address bottlenecks hampering the growth of nine "top sectors" (second pillar).

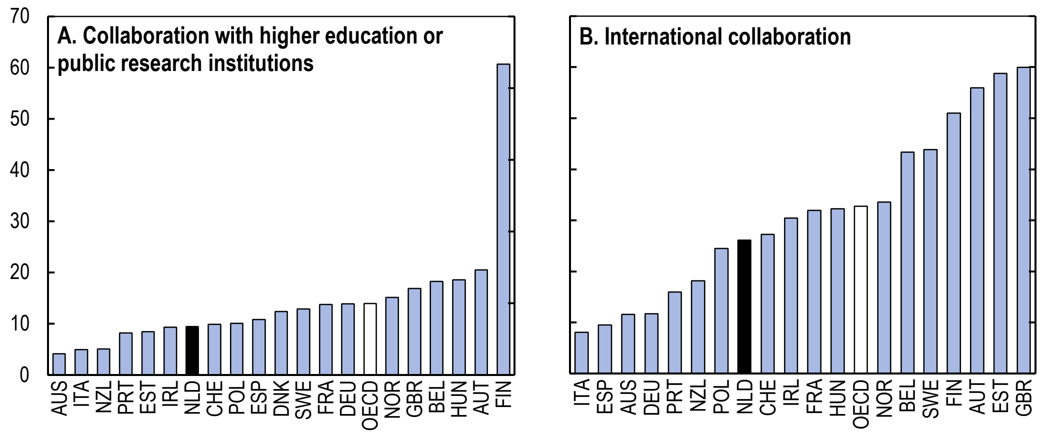
Regarding the first pillar, R&D incentives for all firms are mainly available through indirect tax instruments, although direct support measures could be more suitable for young firms who may not have the upfront funds to start an innovative project (OECD, 2013f). Yet innovation credits for SMEs developed as part of the SME + Innovation Fund represent a progress in this direction (Box 2.1). Concerning the second pillar, the previous *Survey* stressed the need to ensure that well established firms and industries within the top sectors do not effectively capture public support to the detriment of SMEs and emerging industries. A similar challenge appeared for the policy of competitiveness clusters in France (Kierzenkowski, 2009). The recent creation of knowledge and innovation contracts for "top sectors", involving an easier access of SMEs to the "top sectors" instruments through an SME innovation scheme (so-called MIT scheme), is a step forward. The approach in the composition and the number of "top sectors" could also be made more dynamic/flexible, both to promote the development of small businesses in the services sector or implementing non-technological innovation.

Public research institutions (PRIs) can commercialise their research through licence fees and all universities are participating in the government's "Knowledge Valorisation Programme" (in force until 2017) to promote the dissemination of their research. However, there is scope to further strengthen the collaboration of SMEs on innovation both with PRIs or higher education and internationally (Figure 9). Empirical evidence suggests that small Dutch firms that collaborate already with PRIs are more likely to expand their innovation potential (OECD, 2013g). Allowing PRIs to take equity stakes could be more affordable for young businesses rather than buying a licence. Moreover, R&D spillovers could be bolstered by permitting students to own their inventions, encouraging free access to university inventions (in particular to unexploited patents), merging technology transfer offices into regional centres, and promoting

PRIs' funding schemes for faculty spin-offs and student start-ups (OECD, 2013h). More recently, the government has taken welcome steps to tackle the shortage of technicians with the adoption of a Technology Pact. This should raise the second-lowest share of graduates with a science or engineering degree in the OECD, reduce skills mismatches and enhance R&D spillovers benefitting SMEs.

Figure 9. SMEs collaborating on innovation

Per cent of product and/or process innovative firms, 2008-10[1]



1. 2011 for Australia, 2006-08 for Ireland, 2009-10 for New Zealand and 2009-11 for Switzerland. SME: Small and medium-sized enterprises. The OECD aggregate covers 30 countries in panel A and 28 in panel B.

Source: OECD (2013), *OECD Science, Technology and Industry Scoreboard 2013*.

Expanding linkages between different stakeholders (or developing a so-called "ecosystem") would also enhance spillover effects of R&D beyond traditional grants and subsidies and, more generally, favour a growth-oriented entrepreneurship beyond national framework conditions (OECD and Ministry of Economic Affairs, 2013). Such promising approach would notably involve: *i*) developing entrepreneurial connections with a view to supporting learning and investment, the government's role being that of a facilitator; *ii*) promoting social values and organisational norms that are conducive to entrepreneurial risk-taking through education or awareness-raising campaigns (for instance, attributing awards for entrepreneurial successes); and *iii*) developing business advice and mentoring by experienced entrepreneurs.

Reforming employment protection legislation

Tight hiring and firing regulations can restrict the creation and development of SMEs

Strict employment protection legislation (EPL), which governs the hiring and firing of workers, may be an impediment to the development of high-growth firms through various channels. From the perspective of a potential entrepreneur, it increases the opportunity cost of starting a business insofar as this implies trading off a secure wage employment position against an uncertain position of a business founder (OECD, 2013i). Ambitious potential entrepreneurs could be discouraged from launching their activity if they consider that stringent labour regulations could prevent their future firm from reaching an optimal size (Van Stel et al., 2007). This could help to explain a significant discrepancy between high entrepreneurial attitudes (which refer to the perception of entrepreneurship) and low start-up intentions in the Netherlands (Van der Zwan et al., 2013).

More generally, overly demanding labour regulations could influence entrepreneurial choice by reducing firm entry in labour-intensive industries, driven by high compliance costs and difficulties in adjusting labour in downturns (Klapper et al., 2006). Exempting very small firms from some aspects of EPL (e.g. Germany, Italy or Portugal) could mitigate the negative impact of regulation on business creation, but its effect is likely to persist in the case of small and medium-sized firms (Scarpetta et al., 2002).

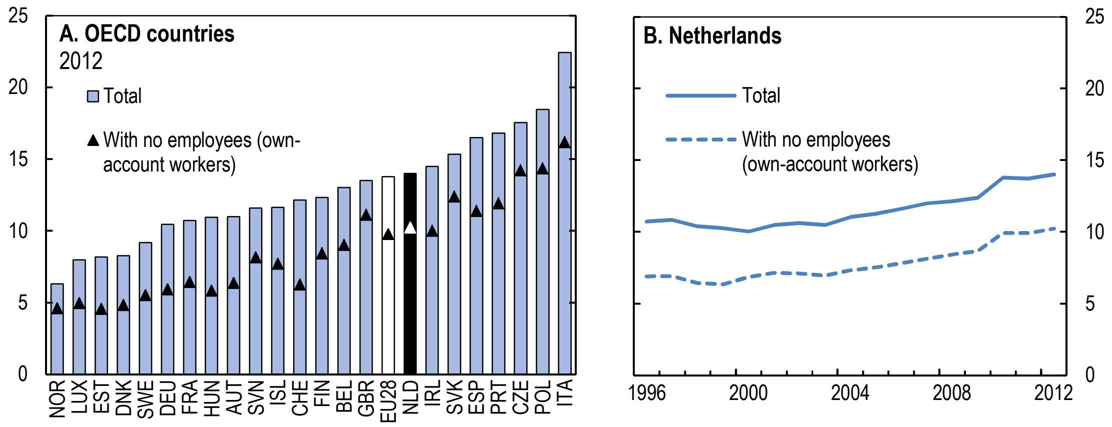
Tight labour market regulations weaken labour mobility among firms, which is likely to be necessary in the early stages of firm development (OECD, 2013i). Lighter EPL increases labour turnover and helps to reallocate labour resources towards more productive uses, both from less efficient to more efficient existing firms and by facilitating creative destruction with the exit of unproductive firms and the entry of new ones (Martin and Scarpetta, 2012; OECD, 2009a, 2013j). The net entry of firms in the manufacturing sector accounts for about a fourth of total labour productivity growth in the Netherlands (Martin and Scarpetta, 2012), though firm entry and exit generates a low job reallocation (OECD, 2009a). More generally, greater labour mobility supports productivity and growth performances notably by permitting a quicker adaptation to changes in technology or consumer demand, in particular if it is achieved through an easier use of permanent contracts (Bassanini et al., 2009). Inflexible labour markets lead to a less dynamic firm growth distribution (Bravo-Biosca et al., 2013). They hinder risk taking and favour more conservative firms' growth strategy, thereby reducing employment growth in innovative industries and lowering pressure on underperforming firms.

Labour regulations have an impact on the prevalence of self-employment

Self-employed are entrepreneurs who are sole owners, or joint owners, of the unincorporated enterprises in which they work. Men are usually motivated by pecuniary aspects, whereas a combination of family concerns as well as opinions of the family, friends and peers prevails for women (Allen and Curington, 2014). The Netherlands has witnessed a steady expansion of the share of self-employed in total employment from around 11% in 2000 to close to 15% in 2012 (Figure 10). This reflects entirely the increase in the number of self-employed without personnel, who have mainly a secondary and higher education and whose activity is predominantly in the service sector (CBS, 2012). The growth of self-employment has cushioned increases in unemployment while delivering higher levels of flexibility to firms, in particular in the construction and transport sectors (Van Steen and Pellenbarg, 2012).

Figure 10. Prevalence of self-employment

Per cent of total employment[1]



1. Population aged 15-64 years-old. The EU28 (i.e. European Union) aggregate is calculated as an unweighted average.

Source: Eurostat (2014), *Employment and Unemployment (Labour Force Survey)* (database), February.

Stringent labour market regulations affect the incidence of self-employment. Stricter EPL has a dampening effect on the probability of becoming self-employed for individuals with high educational attainment in comparison with those with low educational attainment (Baumann and Brändle, 2012). Tight EPL favours dependent self-employment (relying on contracting out or outsourcing with the objective of circumventing the most costly elements of labour regulation) to the detriment of independent self-employment (based on a business profit opportunity) (Román et al., 2011). Yet, it is also necessary to distinguish between self-employed with employees and self-employed without employees and the degree of EPL. In this context, beyond a certain threshold strong levels of employment protection can increase the transition of unemployed into dependent self-employment driven by insufficient opportunities for paid employment (Román et al., 2013). This research suggests that with an overall EPL index for the Netherlands slightly below 2.5 (Venn, 2009), which is considered to be the limit between flexible and rigid labour markets, an additional increase in the degree of EPL could either increase or decrease the probability of entering self-employment from unemployment.

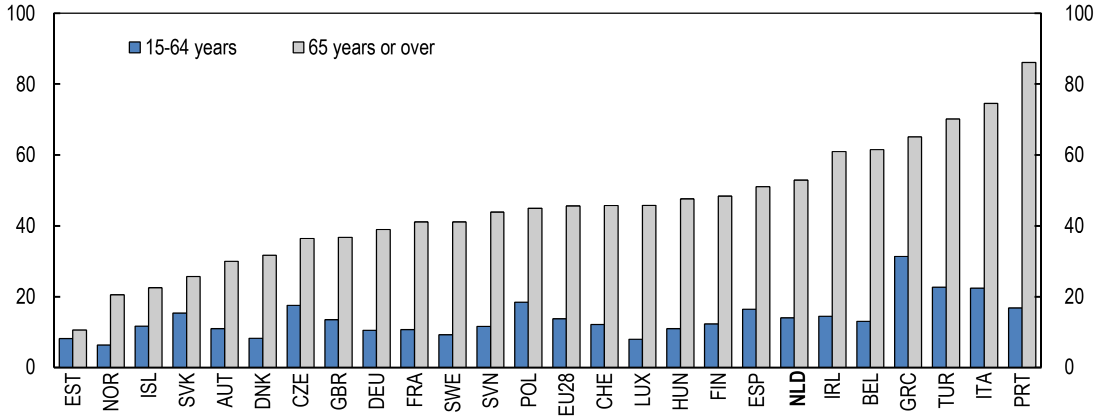
Stringent EPL may discourage hiring decisions of self-employed (Millán et al., 2013). This finding could explain the reluctance of Dutch own-account workers to take on employees. Almost three quarters of self-employed are without personnel and this percentage exceeds the euro area and EU 27 averages of respectively around 67% and 72%. At the same time, empirical evidence suggests that "necessity-driven" own-account self-employed (about 10% of all entrepreneurs in the Netherlands) have a lower entrepreneurial performance in terms of annual turnover levels compared to "opportunity-driven" solo self-employed, who start a firm to take advantage of a business opportunity (De Vries et al., 2013). Cross-country empirical evidence suggests that necessity entrepreneurs tend to have lower educational attainment, run smaller firms and have weaker growth expectations for their businesses (Poschke, 2013). Within the group of own-account self-employed there are also significant dynamics of entry and exit from self-employment. Therefore, notwithstanding tight labour market regulation, self-employment can also lead to salaried employment. Half of Dutch self-employed quit after five years from starting a business, with 60% moving to paid employment and 40% to inactivity (CPB, 2011). Empirical evidence for Denmark also suggests that switching between dependent employment and self-employment within the same sector would not have negative consequences for incomes, including for high-income earners (Kaiser and Malchow-Møller, 2011).

Beyond EPL, the extension of working lives and population ageing also affect the growth of self-employment. A 2004 reform introduced tighter job-search requirements for elderly unemployed between 57.5 and 62, hence reducing the attractiveness of unemployment as a pathway into early retirement (Been and Knoef, 2012). As a result, some older workers may choose self-employment out of necessity rather than opportunity and have a higher probability to enter self-employment than to join paid employment. More generally, the incidence of self-employment increases with age like in many other European countries, to amount to a fifth of employment between 50 and 65 and more than half above 65 (Figure 11).

While older workers may face fewer opportunities for paid employment, age also has a strong impact on entrepreneurial activity and this linkage follows heterogeneous patterns (Kautonen et al., 2013): it increases linearly for those who prefer to only employ themselves; follows a bell-shaped curve with a peak at late forties for those who would like to hire workers; and is weakly tied in with age for those who are forced into self-employment for want of alternative employment opportunities. Therefore, the occurrence of self-employment can be expected to rise as the Dutch population ages, but older entrepreneurs may have a lower contribution to job creation in comparison with young business founders. On the other hand, recent research also shows that some Dutch people can opt for self-employment after retirement, with opportunity rather than necessity being the main driver (Van Solinge, 2013). Such decision would be taken by retirees with significant human and financial capital, high entrepreneurial attitudes, sensitivity to the emergence of new business opportunities and who consider their retirement to be involuntary. These findings bode well for sustaining labour resource utilisation and innovation despite demographic ageing.

Figure 11. The incidence of self-employment increases with age

Share of self-employed to total employment by age groups, 2012[1]



1. The EU28 (i.e. European Union) aggregate is calculated as an unweighted average.

Source: Eurostat (2014), *Employment and Unemployment (Labour Force Survey)* (database), February.

Planned reforms of the Dutch labour market

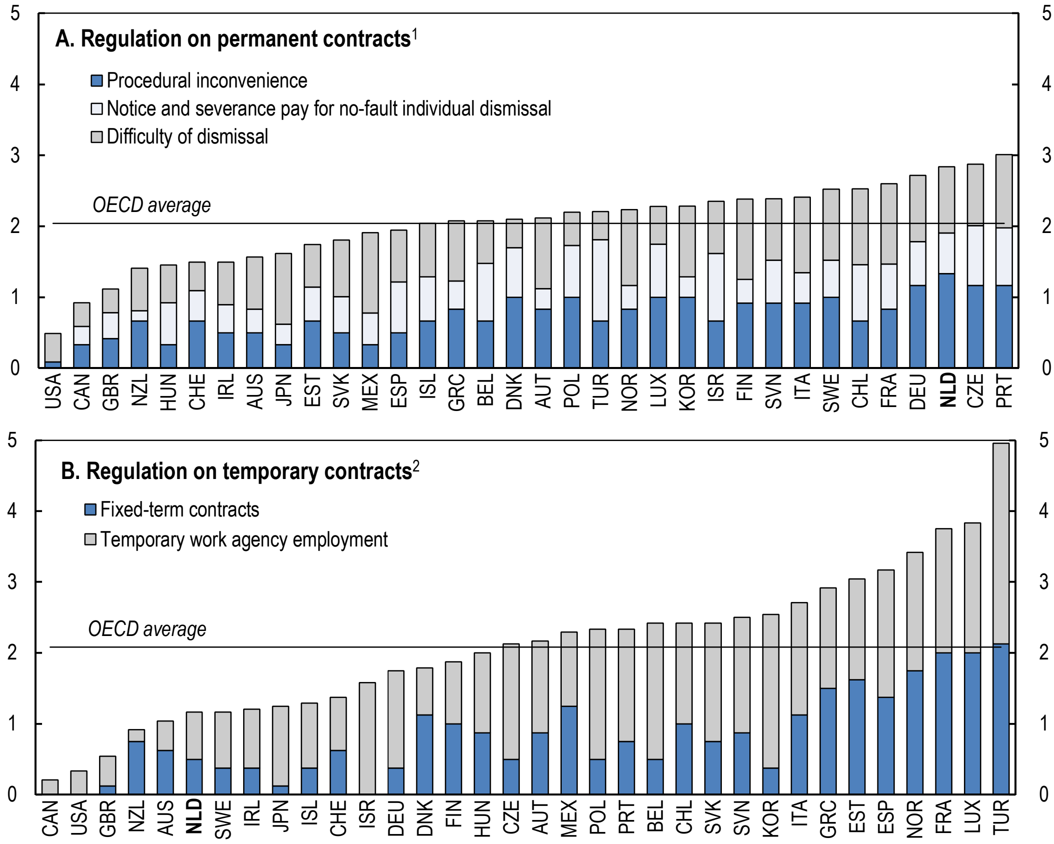
Employment protection for regular workers is high in the Netherlands as reflected by the EPL indicators computed by the OECD for 2013 (Figure 12, Panel A). For no-fault individual dismissal, mandatory periods of advance notice and severance pay are high for long job tenures. In parallel, procedural inconvenience is the greatest in the OECD, driven by cumbersome notification procedures and long delays before notice periods can effectively start. The difficulty of individual dismissal is high, mainly as a result of an extended length of trial period and, to a smaller extent, the definition of justified or unfair dismissal. Despite major constraints for individual dismissals, additional provisions for collective dismissals are also stricter than in the average OECD country (OECD, 2013j). Considering the protection of permanent workers against both individual and collective dismissals, the Netherlands appears to be the country with the most restrictive labour market regulation in this regard in the OECD after Germany and Belgium.

Recent policy proposals alleviate the strictness of employment law for permanent contracts. The agreement with the social partners concluded in April 2013 seeks to simplify the current dual system of the Dutch dismissal law. If employer and employee do not agree about a termination of an open-ended contract, its dissolution can be proclaimed either by the public employment service (UWV) or by the civil court. The new envisaged rule is to restrict from 2015 the use of court procedures for dismissal for personal reasons, and to introduce a single redundancy procedure for both economic reasons and long-term incapacity for work reasons that would be subject to approval of UWV. There are plans to shorten the decision-making process of the latter route and should UWV oppose the dismissal, the court would still be allowed to terminate the employment contract. To make the SME sector more dynamic, the dismissal system needs to be made simpler, more predictable and less time-consuming.

The authorities also consider introducing a cap on severance pay as from 2016, which would amount to up to a maximum of EUR 75 000 or a year's salary, whichever is higher. This would make the costs of lay-offs more predictable for employers. A more generous temporary scheme until 2020 is envisaged for workers over 50, although SMEs with fewer than 25 employees would be exempted. Also, courts would be allowed to grant an additional compensation (with no upper ceiling) should they find evidence of an employer's serious culpability. Overall, it is uncertain to what extent the overall reform would effectively cut dismissal costs for permanent contracts. As discussed in the previous *Economic Surveys* of the Netherlands (OECD, 2006, 2008, 2010 and 2012), a cap on severance pay would be welcome, but it is important that individual dismissals are made less costly and more predictable.

Figure 12. Differences in protection of permanent and temporary contracts are large

Strictness of employment protection legislation, scale from 0 (least stringent) to 6 (most restrictive), 2013



1. Contribution of sub-components to the indicator for employment protection for regular workers against individual dismissal (EPR). The EPR incorporates three aspects of dismissal protection: *i)* procedural inconveniences that employers face when starting the dismissal process, such as notification and consultation requirements; *ii)* notice periods and severance pay, which typically vary by tenure of the employee; and *iii)* difficulty of dismissal, as determined by the circumstances in which it is possible to dismiss workers, as well as the repercussions for the employer if a dismissal is found to be unfair (such as compensation and reinstatement).

2. Contribution of regulations for standard fixed-term contracts and for temporary work agency employment to the indicator of employment protection legislation concerning temporary contracts (EPT).

Source: OECD (2013), *OECD Employment Outlook 2013*.

In the Netherlands, the regulation on fixed-term contracts and temporary-work-agency employment is among the most lenient in the OECD (Figure 12, Panel B). The incidence of temporary employment is high in the Netherlands, reaching almost 20% of dependent employment in 2012, against close to 12% in the OECD. This share has grown significantly as it stood at 14% in 2000 after temporary employment legislation had been loosened between the late 1980s and the late 1990s. There are plans to tighten the protection of temporary contracts by allowing temporary employees to qualify for a permanent contract sooner. Temporary contracts are now automatically transformed into a permanent contract after the third successive temporary contract or after a period of three years. A planned rule is that a contract will become permanent after two years, unless the chain of temporary contracts has been broken by an interval of six months or longer. The rules on successive contracts may be overridden in collective labour agreements, but only if the use of temporary contracts is necessary because of the nature of the sector. Care is needed when reducing labour market segmentation by tightening the protection of temporary contracts as this may reduce needed flexibility for the development of SMEs, which on the other hand could benefit from greater labour supply driven by unemployment benefit reforms. In particular, there are plans to reduce the ability of the unemployed to reject job offers and to gradually shorten the duration of unemployment benefits as from January 2016. The overall impact of planned labour market reforms needs to be carefully evaluated and further action should be taken if needed.

Greater flexibility of labour costs would also enhance the adaptability of the labour market and encourage the development of SMEs. Employer-paid sickness leave has sharpened firms' incentives to contain the growth of sickness leave and the number of disabled workers. However, beyond a negative effect on the employment of older workers (OECD, 2010), employer-paid sickness leave of up to two years (amounting to 70% of the basic wage up to a certain maximum) could also constitute a barrier to growth and job creation by SMEs. Therefore, the authorities could explore ways to create a fund which would mutualise risks of disability across SMEs.

Despite low union density of about 20%, collective labour agreements cover about 80% of workers in the Netherlands. As discussed in the 2012 *Survey* of the Netherlands, moving towards a more decentralised wage setting system would better take into consideration macroeconomic and local productivity developments (OECD, 2012). Shifting away from co-ordinated sectoral wage negotiations would also limit incentives for contracting firms to seek greater wage flexibility through self-employment, which is not part of collective labour agreements. Alternatively, the wage setting system could become more centralised to better internalise the macroeconomic consequences of wage bargaining. Delinking minimum and contractual wages would prevent low-skilled workers, whose productivity does not keep up with average worker productivity gains, from being pushed into self-employment (Van Vuuren, 2012). Finally, encouraging social partners to adjust wage-setting procedures by focusing less on tenure and seniority and more on performance (OECD, 2014b) would also strengthen the flexibility of SMEs.

Reforming the tax system

Seeking greater tax neutrality between different forms of businesses

The authorities should strive to ensure a more neutral tax treatment in the way businesses are structured. When excluding the effect of social security contributions, the overall tax rate on incorporated businesses (when considering corporate income and dividend taxes) is lower than the tax rate levied on unincorporated businesses (liable to personal income taxes) in the Netherlands while, for instance, such distortions do not exist in the United Kingdom (OECD, 2009b). A proposal to reduce incentives for owner-managers (significant shareholders working in companies) to convert labour income into capital income would be a step forward to address tax avoidance in incorporated small firms (Van Dijkhuizen Committee, 2013). At the same time, there is a significant bias towards high-growth SMEs (when after-tax profits are retained) that are incorporated, with a tax rate on corporate profits significantly lower than the tax rate on unincorporated business income.

It is debatable whether the tax system should deliberately promote an increase in the number of small businesses in the economy (IFS, 2010; Crawford and Freedman, 2010; OECD, 2009b; IMF, 2007). Generic fiscal incentives for SMEs are probably not the best instrument to compensate for externalities, capital market imperfections or the higher compliance costs that they face. The small business sector is very heterogeneous, which implies that some firms are not credit constrained or do not generate spillover effects for the rest of the economy through greater employment, investment spending or research and development activities. Public support targeted to address well identified market failures would be more efficient than tax breaks on profits for all small businesses. For instance, government intervention could include loan guarantees in the presence of tight credit constraints, earned income tax credits to boost employment of low-skilled workers or investment allowances if there is evidence of higher social returns than for investment by larger firms. Such an approach would also obviate the need to develop costly anti-avoidance measures.

Since 2011, incorporated small businesses are taxed at a preferential corporate tax rate of 20% up to EUR 200 000 of taxable profit, against a basic rate of 25%. However, a two-rate structure may act as a disincentive for SMEs below the threshold to grow. This would call for the adoption of a flat-rate corporate tax, but without increasing the tax burden on SMEs. At the same time, broadening the corporate income tax base would also ensure a level playing field between small and big companies. The tax system should ensure a more symmetric treatment of profits and losses for all firms, which would encourage their risk-taking behaviour (IFS, 2010). Losses are “carried back” for only one year by offsetting them against past profits and “carried forward” for nine years by setting them against future profits, and they would also need to be adjusted by an interest rate to compensate for timing differences in their use.

Reducing tax incentives for self-employment

The growth of self-employment has also been spurred directly by government tax policies (Van Es and van Vuuren, 2010). There are various fiscal incentives to become self-employed. These include tax allowances for start-ups, the possibility for the unemployed to use welfare benefits to start a business (with a partial repayment depending on future income) and the opportunity for the disabled workers to get an extra tax credit to become self-employed. Unincorporated businesses benefit from several tax reliefs regarding personal income taxes, which are progressive with a top rate at 52%. This creates an additional inducement to choose self-employment over dependent employment. A Committee on personal income tax and allowances, also known as the Van Dijkhuizen Committee, recommended that the government discontinue an allowance for start-ups and abolish a lump sum deduction from the taxable income of self-employed (Van Dijkhuizen Committee, 2012). More recently, the government was considering implementing the latter proposal, but these plans failed in the budget negotiations for 2014.

The authorities should aim to align more closely the tax treatment of income from employment and self-employment in order to reduce distortions on the decision margin as to whether to remain in dependent employment or, instead, create an unincorporated business. This would imply that average personal taxes on self-employment income should be on a par with average personal taxes on wage incomes. A differential tax treatment could be justified mainly to alleviate some negative effects of labour market rigidities, with well-targeted tax incentives acting as a stepping-stone to employment of low-skilled workers and other groups poorly attached to the labour market (Van Vuuren, 2012). Compared to employees, self-employed could still be liable to lower marginal taxes as they are more responsive to taxation because of longer hours worked and a higher propensity for tax evasion.

Greater homogeneity is also needed with regard to participation of self-employed in social security schemes. They are entitled to only basic welfare benefits, mainly in the form of health insurance and state old-age pension (*first* pension pillar) and since 2012 are also allowed to retain active membership in mandatory pension funds (*second* pension pillar) for ten years. However, they cannot claim public social benefits related to unemployment, disability and sickness. Lower social charges create an incentive for employers to push employees into dependent self-employment and for employees with low unemployment, sickness and disability risks to self-select into self-employment. The exit of good risks from the social security system can in turn undermine the sustainability of the system. Many self-employed do not save (or not sufficiently) for an additional pension and do not insure themselves against other social risks (Bekker and Posthumus, 2010) while private insurance is costly due to adverse selection (CPB, 2011).

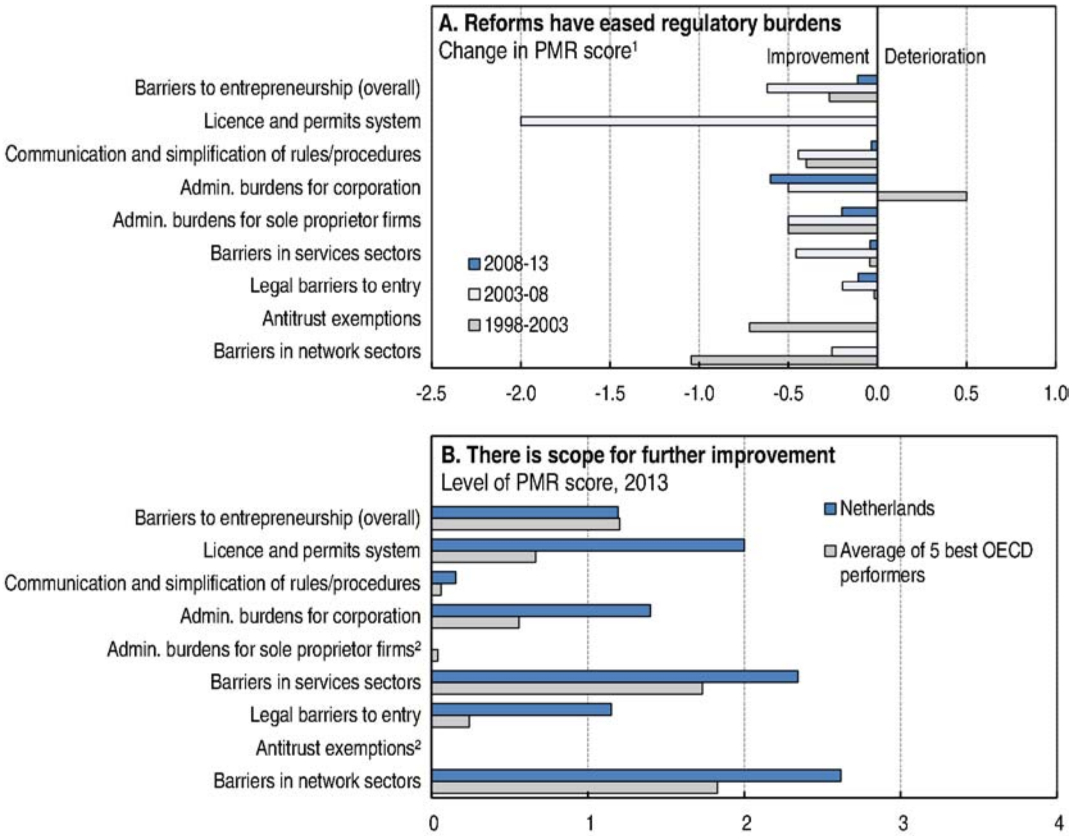
The authorities should consider broadening the social security entitlements and charges of the self-employed and making them closer to those of employed workers (paid by both employers and employees). The issue of levying pension and disability contributions on the self-employed has recently been mentioned in the policy debate. This would increase the protection of self-employed and also help to ensure that self-employment is driven by genuine entrepreneurial motivation and would reduce incentives for tax arbitrage by employees and/or employers.

Reducing barriers to entrepreneurship

Administrative burdens are perceived as another impediment by firms while the cost of such barriers is certainly higher for SMEs than for large firms (Figure 2). The Netherlands has the least restrictive product market regulation in the OECD. Barriers to entrepreneurship have been significantly lowered over the last 15 years and are the third lowest in the OECD (Figure 13, Panel A). However, there is some scope for improvement in specific areas compared to the best-performing OECD countries (Figure 13, Panel B). Making the licence and permits system more business friendly would be an additional step forward. Licences could follow the principle that “silence is consent rule” and be issued automatically beyond administrative deadlines. Moreover, the government could establish a complete record of the number of permits and licenses required. There is also scope to lower barriers in services sectors, in particular to start a national road freight business (a large set of conditions needs to be fulfilled) or create a new retail outlet for both selling clothing and food (a registration in a commercial register is required). Finally, in the sector of road transport, professional bodies or representatives of trade and commercial interests are involved in specifying or enforcing entry regulations, which could be another barrier for the development of SMEs in this sector.

Figure 13. Product market regulation (PMR): barriers to entrepreneurship

Index scale from 0 (least restrictive) to 6 (most restrictive)



1. There was no change in the PMR score for licence and permits system in 1998-2003 and 2008-13, nor for antitrust exemptions in 2003-08 and 2008-13, nor for barriers in network sectors in 2008-13.

2. For administrative burdens for sole proprietor firms the PMR score of the Netherlands is zero (i.e. least restrictive). For antitrust exemptions the PMR scores are zero.

Source: I. Koske, I. Wanner, R. Bitetti and O. Barbiero (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economics Department Working Papers*, forthcoming.

Exit policies are efficient as they imply little time and low cost to close a small business, but costs required to transfer property and enforce contracts could be lowered as they are comparatively higher than in other European countries (European Commission, 2013). The government aims to achieve a further reduction of administrative burdens by 2017, which is planned to be partly achieved by expanding information technology and digital service provisions.

The government has also launched a welcome rationalisation of its support network for businesses, which should further promote the development of SMEs. In 2014 the local Chambers of Commerce, the National Chambers of Commerce and the Syntens Innovation Centre were merged into a single Chamber of Commerce organisation. The aim is to centralise information on different support programmes and create one-stop shop services, notably through the internet. Various stakeholders are expected to collaborate in the new support network, including tax authorities and local governments.

Box 3. Policy recommendations to boost the development of sound SMEs

Improving access to finance

- Continue to evaluate policy instruments supporting access to finance in the light of existing market inefficiencies faced by small and medium-sized enterprises (SMEs) and, if needed, ensure broader access to those instruments and in particular public loan guarantees.
- Continue to develop alternative to bank lending sources of finance and enhance the information of SMEs about them, but ensure that public intervention is justified by well identified capital market imperfections.

Fostering innovation

- Strengthen incentives for universities to commercialise their research by allowing them to take equity stakes in small businesses, encourage free access to research and unexploited patents and continue to increase the share of direct innovation grants to SMEs.

Tackling labour market rigidity

- Reduce the protection of permanent contracts against individual dismissals, in particular by shortening the length of trial period and by easing procedural inconvenience in terms of notification procedures and delays needed before notice can start.
- Allow greater flexibility in labour costs by capping and lowering the accumulation of severance pay with tenure and delinking minimum and contractual wages.
- Monitor and evaluate the impact of planned labour market reforms reducing the protection of permanent contracts and simultaneously increasing the protection of temporary contracts, and take additional measures if needed.

Reforming the tax system

- To prevent fiscal distortions on self-employment, adopt a similar average tax treatment of income from self-employment and dependent employment within the personal tax system, and reduce the gap between social security coverage and contributions on both forms of employment. Consider mutualising the costs of disability through a dedicated fund for SMEs.
- Consider converting the two-rate corporate income tax into a flat-rate tax system while not increasing the tax burden on SMEs and levelling the playing field between smaller and bigger companies by broadening the corporate income tax base.
- Align more closely effective tax rates on income from capital and labour of owner-managed companies to reach greater tax neutrality between incorporated and unincorporated businesses.

Reducing barriers to entrepreneurship

- Ease access to licences by issuing them automatically if they are not delivered by the end of the statutory response period and lower the administrative costs of enforcing contracts and transferring property.

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