

Department of Trade & Industry

Impact of the proposed EU Directive on Services in the Internal Market: case studies of UK businesses

Final report

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Executive summary

Introduction

- 1 This report is the principal output of a study commissioned by the Department of Trade & Industry (“DTI”) and carried out by PricewaterhouseCoopers LLP (“PwC”) into the potential impact of the proposed EU Directive on Services on UK businesses.

Scope of the study and approach

- 2 The study was based on 38 case studies of UK firms which had recently established and/or provided services without establishment within one of six other Member States. They aimed to understand the regulatory barriers that currently prevent or deter UK firms from expanding their business elsewhere in the EU, and the benefits and costs to these firms, or others which might consider expanding their business in the future, from the Services Directive.
- 3 The case studies were drawn from a number of sub-sectors within the business services and construction sectors, as shown in Table 1.
- 4 The firms chosen ranged in size, but the sample of case study firms was not intended to be ‘representative’ of the sectors as a whole. Instead, the case studies were selected with the aim of assessing the range of potential impacts of the barriers to the Internal Market.

Table 1: Case study sub-sectors

Business services	Construction
<ul style="list-style-type: none">• Advertising• Estate agents• Industrial cleaning• IT consultancy• Management consultants• Legal services	<ul style="list-style-type: none">• Commercial construction• Construction – advisory• Building services• Sub-contractors

Summary of key findings

Business context

- 5 The study found that most case study firms think of the EU as consisting of many individual Member States, each of which has its own distinctive features as a market. It therefore follows that there may be various different barriers by Member State and by sector. The potential benefits from the proposed Services Directive may be fairly small for individual firms, but could be significant when considered across all firms in the UK services sector.
- 6 Policy-related barriers to trade and business development were only one of many factors which businesses considered when determining whether

there was a good business opportunity in a given Member State. Firms' decisions whether or not to expand in the EU could sometimes be quite subjective, as could perceptions of the difficulties of doing so. The study suggests that it should not be assumed that firms will always assess situations entirely rationally in deciding how to develop their business within the EU.

Impact on right to establishment

- 7 The study found that a number of different routes had been taken by UK service sector firms when they sought to establish elsewhere in the EU, including forming a new limited company in the target Member State, acquisition of an existing local company, setting up a branch office of the UK company in the target State or merging with an existing partnership.
- 8 Establishment was seen as a relatively expensive approach to doing business elsewhere in the EU, due to the high fixed costs of leasing and equipping an office, hiring staff and developing a client base. Firms needed evidence, prior to establishing, that sufficient revenues were likely to be generated; typically, this was the "acid-test" for determining whether to establish.
- 9 Because of these fixed costs, proportionately more large case study firms established compared to small or medium-sized firms. Overseas offices needed critical mass to be profitable, and this was often difficult for smaller firms.
- 10 Case study firms often differed significantly in their experiences of the barriers relating to establishment, even when they appeared to have taken the same route in the same Member State. Policy-related barriers, whether covered by the Services Directive or not, were rarely seen as changing the economics of establishing an office. Whilst often costly and time consuming, they tended to be seen as irritants, rather than the key factor in decision-making and/or success.
- 11 Approximately 40% of the barriers to establishment cited by case study firms would potentially be addressed by the proposed Services Directive. For example, firms encountered:
 - The requirement to have all documents notarised, which gave rise to additional delays;
 - The need to follow a strict order during the establishment process, and long wait times for responses from authorities;
 - Restrictions over the legal form which a branch could take;
 - Different organisations requiring the same information but in different formats and with different certifications; and
 - The need for senior staff to make personal representation in order to obtain authorisations.
- 12 A number of firms were able to attribute costs to these barriers. However, the lack of detail in some aspects of the draft legislation and the difficulties in establishing the extent to which the barriers identified were discriminatory, disproportionate or unnecessary (and therefore to what extent the Directive would remove or reduce them) meant that it was often difficult to be precise about the savings which might accrue to firms as a result of the Services Directive.
- 13 Overall, the barriers which appeared to have the most impact on the case study firms in terms of their willingness to establish in new EU markets and their success in doing so were natural ones, such as business culture and language.
- 14 One feature of the proposed Services Directive is the obligation for Member States to provide a single point of contact for businesses seeking to establish. Most firms were positive about the principle of a single point of contact. However, there were complex messages about the extent to which such an initiative would deliver tangible benefits. In particular, firms appeared to see considerably greater benefit from a system which accelerated the process of establishing in other Member States than from one which simply provided information on the process which needed to be followed, which many firms said they had little trouble accessing at present. However, this may partly reflect the sample of case study firms

which are predominantly those that have already established, as opposed to those which have so far not been successful or decided against establishing in another Member State.

- 15 There was also interest in a system which provided information on wider issues relating to doing business elsewhere in the EU, for example on tax and employment regulations, since these often proved more problematic than the establishment process itself. This goes beyond what is currently proposed in the Services Directive.

Impact on provision of services

- 16 Provision of services in another Member State without establishment involves delivering services in that State without having a permanent physical or legal establishment there. The study found that, in practice, firms were using a wide variety of service delivery models to achieve this.
- 17 There appeared to be a strong bias towards provision of services without establishment amongst smaller firms. Provision of services without establishment was seen by most case study firms as a relatively easy, cheaper and more flexible approach to developing business elsewhere in the EU compared with establishment.
- 18 Case study firms reported encountering few barriers to the provision of services within the EU which would be reduced by the Services Directive. One possible reason for this is that these firms had spent relatively little time exploring the regulatory environment in other Member States, prior to providing their services there (and were thus perhaps not aware of all obligations). Some industry-specific barriers which would be addressed by the Services Directive were cited in case studies. However, many other barriers mentioned, including those which applied to wider groups of firms, would not be impacted by the Directive.
- 19 Natural barriers, particularly those related to culture, were the most significant barriers faced by firms seeking to provide services elsewhere in the EU; in some cases, these issues had been strong enough to prevent firms providing services successfully.

Compliance costs

- 20 No case study firm considered the cost of its compliance with the Services Directive to be significant, based on its present understanding of it.
- 21 However, the majority of firms considered that the information available from the current draft of the Directive which related to the potential requirements placed on firms was not specific enough to be able to give a robust indication of the costs that could arise. The study suggests that conclusions on the potential costs of compliance to UK firms should not be drawn until there is more detailed information about the requirements. In particular, compulsory professional indemnity insurance has the potential to drive significant extra costs to UK businesses, but no estimate of these costs can be made before it is known to which sectors this would apply.

Impact on the UK market

- 22 Most case study firms broadly supported the principles behind the Directive and believed that opening up the market in services would be beneficial to themselves and to the UK as whole. Some firms voiced concerns, but these tended not to be sufficient to colour firms' views of the benefits of a single market overall.
- 23 A common belief amongst case study firms was that the UK market was already very open to competition from firms from other EU Member States, and, therefore, that there would be no additional threat as a result of the Services Directive.

1 Introduction

Background

- 1.1 Despite the commitments made in the Lisbon Agenda and the considerable evidence of the economic benefits of the Internal Market in goods, the EU has been slow to extend the Internal Market to include services as well as goods. Only relatively recently has progress been made to develop the proposed Services Directive, which was published by the European Commission along with an Extended Impact Assessment in January 2004¹. In parallel, the European Commission has begun to address the broader competitiveness agenda linked to the services sector, notably in its Communication of December 2003².
- 1.2 Assessing the impact of the barriers to the Internal Market in services trade is difficult, as this study, like the DTI's Partial Regulatory Impact Assessment, acknowledges. This reflects four inter-related factors:
- The diversity of the services sector which means that there is and can be no 'single view' of the impacts;
 - The relatively poor quality of official statistics and other data covering

¹ Commission Staff Working Paper SEC(2004) 21, 'Extended impact assessment of proposal for a Directive on Services in the Internal Market', January 2004

² Communication from the Commission COM(2003)747, 'The competitiveness of business-related services and their contribution to the performance of European enterprises'

the sector;

- The limited historic research into the economics of the sector, in part reflecting the relative dearth of reliable data, although the European Commission has recently published an economic impact assessment³; and
- The limited number of organisations which represent the interests of firms in the sector, in part reflecting the diversity of the sector.

Our terms of reference

- 1.3 Against this background, PwC was commissioned by the DTI to undertake a series of 38 case studies spanning the business services and construction sectors. The aim of the case studies was to make assessments of the likely benefits and costs to UK firms in the two sectors arising from the existing barriers to the Internal Market so as to inform the potential impact of implementing the proposed Services Directive.
- 1.4 The case studies were expected to cover firms which had recently established or considered establishing elsewhere in the EU and/or provided or considered providing services temporarily within another

³ 'Economic Assessment of the Barriers to the Internal Market for Services', Copenhagen Economics, January 2005

Member State. In particular, each case study was intended to draw on firms' recent experience to generate information as to the costs and benefits of reducing:

- The regulatory barriers that prevent or deter service providers from establishing in other Member States;
- The barriers to the free movement of services across borders, by allowing companies to operate in other EU Member States according to the law of the Member State where they are based (the 'country of origin' principle);
- The administrative burden on companies, both in the UK and abroad, particularly through the creation of a single source of information or alternatively a single point of contact, where all procedures could be completed; and also
- Complying with the Services Directive.

1.5 As part of the analysis, the case studies were expected to collect firms' perceptions of both the potential business opportunities that could be created by the Services Directive and its potential impact on firms operating in the UK market.

Report structure

1.6 The rest of our report is structured in five further sections:

- Section 2 describes our approach to the case studies;
- Section 3 provides an overview of the business context within which the case study firms have considered the actual and perceived barriers to the Internal Market and the potential impact of the Services Directive;
- Section 4 analyses the evidence from the case studies which relates to the right of establishment in the EU and the existence of a single point of contact;

- Section 5 examines the evidence from the case studies in relation to the provision of services across the EU;
- Section 6 considers the evidence as to the potential compliance costs of the Services Directive and its likely impact on the UK market for services; and
- Section 7 draws together the key conclusions from the case studies, considers the study's limitations and how its conclusions relate to those of other work on the potential impact of the Services Directive.

1.7 A series of Annexes provide further information on the template used to collect case study data, the sample frame used, and the structure of the sub-sectors from which the case studies were drawn.

2 Our approach

Introduction

2.1 Our approach to the case studies involved six stages. Below, we explain how we have approached each of the main tasks:

- Scoping the case studies;
- Identifying case study companies;
- Recruiting case study companies;
- Undertaking the case studies; and
- Analysing each case study.

Scoping the case studies

2.2 One of our first tasks was to develop a case study template which we could use to structure the collection of information about the experience of case study firms which had either:

- Considered and, in some cases, established a subsidiary in another EU Member State; and
- Considered and, in some cases, provided services to customers in another EU Member State.

2.3 Our template was structured in five parts:

- Company background – this was designed to collect factual information about the case study company and was largely completed ahead of the interview(s);
- Company vision and strategy – this was intended to understand each company's strategic objectives and its approach to realising these objectives (it was important to understand what factors each company took into account when assessing international business opportunities and prioritising between geographical markets – say the US rather than parts of the EU – and what factors influenced their mode of entry – say establishment rather than service provision);
- Barriers to the development of successful pan-EU business operations linked to the freedom of establishment and/or the free movement of services: the format was designed to enable a structured and systematic analysis of the barriers encountered by each case study firm including how the barriers manifested themselves in terms of higher costs, for example whether they gave rise to compliance costs, what drove the scale of the costs and whether the costs were one-off or recurring;
- The potential opportunities foregone in the EU Internal Market – this was intended to collect views and evidence as to the nature and scale of the opportunities which UK firms have (potentially) foregone as a

result of having to overcome the barriers identified; and

- The costs of compliance (in the UK) with the EU Services Directive for all firms and the likely impact on the UK market.
- 2.4 A key aim of the case studies was to establish the broad nature of the barriers encountered by the case study firms distinguishing between those which:
- Were prohibitive in their effect;
 - Involved regulations and legislation which were ‘discriminatory, disproportionate or unnecessary’;
 - Arose from opaque administrative requirements and lack of information: these were problems which would potentially be addressed through the establishment of a single point of information;
 - Were linked to administrative inefficiency and a requirement to complete multiple applications: these were problems which would potentially be addressed through the establishment of a one-stop shop; and
 - Resulted from ‘natural’ barriers, such as language and cultural differences.
- 2.5 In developing our checklist of possible barriers to the freedom of establishment and the free movement of services in the EU Internal Market under each of the headings above, we drew upon a range of sources including the DTI’s Consultation Document on the EU Directive on Services in the Internal Market. At the same time, we also recognised that there were likely to be other economic, social and cultural barriers which could have impacted on the case study firms. For example, the development of the most knowledge intensive parts of the business services sector is, to some extent, limited by access to appropriate skills.

Our experience, based on previous research⁴, suggests that this is exacerbated by restrictions on the mobility of workers within the EU which, in turn, reflect other aspects of the incomplete Internal Market such as limitations in relation to the recognition of professional qualifications.

- 2.6 The aim in each case study was to compare the position of UK-owned firms with that of other firms, especially domestic firms in the Member State concerned.
- 2.7 The template we developed and used is at Annex A.

Case study identification

- 2.8 Another early task was to identify the desired characteristics of the case study firms. Following discussion with the DTI, we identified and agreed selection criteria to be used to identify potential case study companies:
- The business (sub-)sector;
 - Whether or not the company had considered establishing in another Member State or providing services to another Member State: the initial focus was on companies which had made a decision in the last two years but this was subsequently relaxed to include companies which had made a decision in the last five years;
 - The Member State of interest to the company: following discussion, it was agreed to focus on six Member States (France, Germany, Italy, the Netherlands, Poland and the Slovak Republic) representing a range of circumstances;
 - The size of the firm in terms of either turnover or employment; and
 - The ownership of the firm; the focus was on UK-owned businesses.
- 2.9 Our case studies were drawn from two parts of the services sector:

⁴ PricewaterhouseCoopers, ‘Managing mobility matters’.

business services and construction.

2.10 The business services sector, which is covered by Standard Industrial Classification (SIC) categories 70 to 74, covers a wide range of activities. Some are knowledge intensive, for example professional services such as accounting, legal advice, and management and IT consulting, and others are more operational in nature, for example industrial cleaning, security and secretarial services.

2.11 The sector has some important characteristics:

- It is the biggest part of the service sector in the EU economy, employing 16 million people in 2002 (in the EU-15) and generating value added exceeding €1,600 billion: it is especially important in the UK;
- It is dynamic: the knowledge-intensive parts of the sector are relatively fast growing, and have contributed disproportionately to the growth of the EU economy;
- It supplies all parts of the economy: business services are pervasive throughout the value chain with all sectors benefiting from access to competitive business services; and
- It is seen as crucial to the future performance of the EU economy: scope exists to improve the international competitiveness of the EU business services sector.

2.12 The construction sector was taken to embrace those activities covered within the DTI's Construction Statistics Annual (August 2004). However, the case studies were selected to focus on services rather than materials. An overview of the principal components of the sector, examples of the nature of the services which these would include and to what extent they form part of the study's scope is set out in table 2.

Table 2: Scope of construction sector

Sub-sector	Activities	Within scope
Advisory	<ul style="list-style-type: none"> • Surveying • Architects • Construction engineers 	All activities
Sub-contracting services	<ul style="list-style-type: none"> • Electrical, gas, roof, tiling, plastering, etc 	All activities
Building services	<ul style="list-style-type: none"> • Facilities management (e.g. document handling, catering, cleaning) • Repair and maintenance (e.g. electrical, gas, air conditioning etc) • Other (e.g. storage, removal) 	All activities
Construction products	<ul style="list-style-type: none"> • Manufacturers of boilers, pumps, plant, etc 	Maintenance contracts
Commercial construction	<ul style="list-style-type: none"> • Public (e.g. schools, hospitals, leisure, etc.) • Offices, industrial, retail 	PFI – supply of services
Infrastructure	<ul style="list-style-type: none"> • Roads • Rail • Airports • Etc 	PFI – supply of services
Capital equipment	<ul style="list-style-type: none"> • Manufacture and hire of plant 	Aftermarket services Hire
Materials	<ul style="list-style-type: none"> • Bricks, glass, doors, etc 	Testing and other services

2.13 The construction sector has some important characteristics:

- It is large: the construction element alone exceeds £60 billion in the UK;
- It is diverse: construction activity includes not only large prestigious projects but also a large number of small projects;
- Diverse services are provided within the sector, undertaken by a range of different sized organisations, including a large number of small organisations and one-man businesses;
- It is a sector in which there have been major changes:
 - There is significant industry consolidation, evidenced by merger and acquisition activity across national boundaries;
 - There is a discernible movement from the Design and Build form of contract to Design, Build, Finance and Operate contracts for service delivery (e.g. PFI models);
 - There is growth in the “total facility management” service delivery model which usually involves bundling smaller individual supply contracts (e.g. cleaning, catering, security); and
 - There is a strong movement towards an outsourcing model.

2.14 The case studies focused on ten sub-sectors within the business services and construction sub-sectors, as shown in Table 3. Further information on these sub-sectors is provided in Annex C.

Table 3: Case study sectors

Business services	Construction
<ul style="list-style-type: none"> • Advertising • Estate agents 	<ul style="list-style-type: none"> • Commercial construction • Construction – advisory

Business services	Construction
<ul style="list-style-type: none"> • Industrial cleaning • IT consultancy • Management consultancy • Legal services 	<ul style="list-style-type: none"> • Buildings services • Sub-contractors

2.15 The size and heterogeneity of the business services and construction sectors have important implications for the potential interpretation of the results emerging from the case studies as do the diversity of barriers to the Internal Market in services and the role of firm size in shaping this impact. In particular, it was clear from the outset that the sample of case study firms could not, in any sense, be ‘representative’ of the sectors as a whole. Instead, the case studies were selected with the aim of assessing the range of potential impacts of the barriers to the Internal Market. This meant focusing on a small number of well-defined sub-sectors where there were significant differences in the wider business economics. For example, we were interested in contrasting firms operating in knowledge-intensive sub-sectors with those working in more operational sub-sectors since the key business drivers were expected to be different, as too were the potential opportunities and threats arising from completion of the Internal Market and from broader international competition.

2.16 We focused the case studies on firms which had actively considered the options of establishing in another Member State or providing services without establishment. In this way, we were able to get a sense of both the attractions of the Internal Market and the perceptions/experience of the existing barriers to the Internal Market based on recent investigations of the opportunities. We recognise, however, that these firms may not in any sense be typical of firms in the services sector. They were, however, better placed to provide insights into the issues associated with operating cross-border than those firms which had done little to assess the opportunities.

2.17 The characteristics of the target case study firms are summarised in Annex B.

Case study recruitment

2.18 Our recruitment process to secure 38 case studies meeting the target profile involved two main steps:

- We used a range of sources including contacts with trade associations, company databases such as Dun & Bradstreet and suggestions from Government officials to identify a long list of potential case study firms; and
- PwC's International Survey Unit (ISU) then contacted the firms in question to determine whether they potentially met the required criteria and, if so, whether they were prepared to participate in the study.

2.19 No case study firms were offered any incentives to participate in the programme.

2.20 In the circumstances, the ease with which it was possible to identify the case studies varied considerably between sub-sectors (see Table 4).

Table 4: Case study recruitment process

Sub-sector	Companies contacted	Interviews completed
Legal services	13	4
Management consultants	101	4
IT consultants	89	4
Industrial cleaning	74	2
Estate agents	35	4
Advertisers	115	5
Commercial construction	114	2
Construction – advisory	52	7

Sub-sector	Companies contacted	Interviews completed
Construction – sub-contractor	34	5
Building services	31	1
Total	658	38

Approach to the case studies

2.21 Our approach to each case study involved four steps:

- Desk-based research to identify and collate key relevant data and information about each case study firm and the market in which it operates, drawing on firms' annual reports and websites, press searches and existing industry/market studies. This enabled us to reduce the burden on case study firms and allowed our case study interviewers to understand the likely issues ahead of the interviews;
- Face-to-face interviews with the owners/directors/senior managers in each case study firm to gather the further information, data and opinions required to complete the data collection described in the agreed case study guide and develop a case study report along the lines of the agreed template. In some cases, it was necessary to speak to more than one person in order to get all the relevant information;
- Writing-up the case study findings using the agreed template; and
- Agreeing the case studies with the interviewees.

2.22 This has produced a series of 38 case study reports which have been agreed by the subject firms. All the case studies have been undertaken on the basis of confidentiality.

Post case study analysis

2.23 The final stage of our approach involved an analysis of the actual and/or

perceived barriers to the Internal Market (i.e. the freedom to establish and to provide services across borders without establishment) to determine the impact if the barriers were removed through implementation of the Services Directive. This involved addressing a series of questions:

- For each barrier, what is the scale of the costs associated with the barrier in incremental, opportunity cost terms?
- Is the cost a one-off or does it recur and, if so, how often?
- Would the barrier be removed by the Directive or is it outside the scope of the Directive?
- For those barriers addressed by the Directive, to what extent would the impact of the barrier be likely to be reduced by the relevant articles of the Services Directive?
- What would have been the impact on the business concerned if the barrier had been removed?
- What would be the (additional) costs of complying with the Directive (e.g. training, filling out forms and adapting systems)?
- To what extent does the Services Directive offer a potential threat to UK firms from other Member States entering the UK market?

2.24 Thus, in the case studies, we focused on collecting information about the implications of the Services Directive from an individual company's perspective. Specifically, we identified how the Internal Market barriers affected the costs of establishing a business in another Member State and/or providing services in another Member State (without being established there).

2.25 These incremental costs may take one of three broad forms:

- Higher search costs for those businesses looking to expand their activities (for example, resulting from difficulties in identifying the

procedures required to establish);

- Additional administrative costs as a result of the complexity of Member States' existing regulations (for example, where delays are encountered in completing establishment procedures); and
- The need to adopt a different (less efficient) business model in different Member States (for example, where a certain legal structure is acceptable in one member state but not in another).

2.26 As part of the case studies, therefore, it was important to understand the scale of the costs and to distinguish between 'one-off' costs (e.g. those costs which are incurred as firms take advice on how to deal with the regulatory processes) and recurring costs. In addition, we sought to differentiate between the cash costs to firms (e.g. of taking legal advice) and the opportunity costs not only of staff time but also of missed business opportunities. In order to ensure the widest applicability of the case study evidence, we also tried to identify the key cost drivers for each of the case study firms since this would potentially extend our ability to generalise the results across other firms in the services sector.

2.27 In undertaking this analysis, we have been very mindful that there are other barriers not affected by the Services Directive, which may potentially have more important impacts on the behaviour and, ultimately, the performance of firms in the services sector. Furthermore, other initiatives, such as GATS, could also have important implications for the business environment and for the choices facing UK firms.

3 Business context

Key findings

3.1 The study found that:

- Most firms think of the EU as consisting of many individual Member States, each of which has its own features as a market. Policy-related barriers to trade and business development were only one of many factors which businesses considered when determining whether there was a good business opportunity in a given Member State.
- Firms' decisions as to whether to expand in the EU can sometimes be quite subjective, as can perceptions of the difficulties of doing so. It should not be assumed that firms will always assess situations entirely rationally in deciding how to do business within the EU.

Factors affecting the decision to expand within the EU

- 3.2 The case studies showed that businesses' reasons for expanding within the EU varied across sectors and firms. There was also significant variety in the quality and rigour of the decision-making process justifying such expansion. The way in which case study firms expanded elsewhere in the EU, and their decision-making process, had a strong impact on the barriers they encountered and the way in which these barriers affected them.
- 3.3 The case studies suggested that all or some of the following factors may play a part in a business's decision to expand within the EU:

- Its industry, business model and existing customer base;
- Consideration of the target market; and
- Its attitudes, strategies and resources.

3.4 We discuss each of these in turn below. We then consider in Sections 4 and 5 the additional factors which led to the decision to seek either to establish or to provide services.

Industry, business model and existing customer base

- 3.5 Despite the wide variety of businesses we spoke to, most businesses shared some characteristics with other firms in their industry sub-sector which were important factors in the decision to consider expanding within the EU. The maturity of the UK market, competitor and customer activity and other underlying industry drivers such as social trends were all major considerations for firms.
- 3.6 Nevertheless, even the most homogeneous of the industry sub-sectors examined in this study contained firms using a wide variety of business models. Firms differed significantly from one another in terms of the services they sold and how they delivered them, their customers and their suppliers. These factors often had quite a significant impact on the desirability and feasibility of entering another EU market, particularly when considered in conjunction with the business's strategic aims and

resources.

- 3.7 Within the business services sector, many firms we spoke to counted major multi-national corporations amongst their customers. These global businesses were increasingly looking to use the same supplier wherever they operated in the world. They thus acted as a powerful driver towards development of a significant EU network of delivery capability. In some cases, this required case study firms to establish permanently overseas simply in order to be close to a small group of such clients.
- 3.8 These client pressures appeared to have most impact on larger firms in our sample, probably because such firms are more likely to service very large customers. This trend was visible to some extent in most sub-sectors, although appeared stronger within the business services sector.
- 3.9 The trend towards globalisation was seen as a double-edged sword by some businesses. Even those who were able to expand in tandem with their clients regretted their heavy dependence in some territories on one or two major clients. This was likely to be particularly problematic where the service company was significantly smaller than its client.
- 3.10 Some firms also said that they found it difficult to retain and attract customers in some markets. This was where they did not have the resources or inclination to keep pace with the expansion of large existing and potential clients.

Target market

- 3.11 Case study firms' perceptions of their target markets were a key factor in determining their likelihood of entering them. Both the nature of the market for their services and the ease of entry were considerations.
- 3.12 As previously discussed, some businesses followed their clients into new EU Member States. However, other firms we spoke to primarily saw expansion in the EU as an opportunity to access new, attractive, markets for their services, and were not intending to rely on existing clients once they had entered these new markets.

- 3.13 The reasons cited for particular markets being attractive varied considerably across sectors, and will be discussed in more detail in later sections of the report. However, independent of industries, common themes were broad socio-economic trends, such as the size and growth rate of the target economy. The accession countries of Poland and Slovakia were particularly attractive to construction-related businesses, as investment in public infrastructure projects was perceived to be resulting in a significant appetite for foreign engineering-related expertise. The larger estate agents were also finding their clients interested in property investment in these countries and were responding by developing practices in these locations.
- 3.14 Firms differed in their views of the EU as a market in itself. Significantly, most firms we spoke to viewed the EU as consisting of several distinct markets, each of which might singularly prove attractive. Only a minority of firms already thought of the EU as one market. In these cases, they often believed that they could service this market from one location. By the nature of our sample, for the firms we spoke to, this location was the UK. Such firms often had major US companies as their customers. These clients typically saw the UK as the gateway to Europe and preferred to use UK firms to service their entire European need, due to the perceived cultural and linguistic similarities with the US. One case study firm reported that its major clients in Germany were US firms, and again cited the perception amongst US firms that using UK suppliers in Europe could help them overcome cultural and linguistic barriers.
- 3.15 For those businesses that were not primarily entering new markets in response to existing clients, predictably, a key concern was the strength of local competitors in the chosen market. Serving a niche market or having a distinct competitive advantage was considered key. Many firms reported that the existence of strong local competition had dissuaded them from certain markets. However, for some businesses, a strong local firm was seen as a positive signal to acquire or partner in order to expand. This is discussed further in the next section.
- 3.16 The difficulties of entering the chosen market were also an important consideration for the businesses we spoke to. It was often considered in

conjunction with an assessment of the overall attractiveness of the market. As discussed below, the perceived (rather than genuine) ease or difficulty of entry was all-important. Barriers to market entry are discussed in greater detail in the next two sections of the report.

Attitudes, strategies and resources

- 3.17 Case study firms' perceptions of market attractiveness or ease of entry had a role to play in decisions about expanding within the EU. However, their attitudes to these perceptions were also important. This adds a second layer of subjectivity to business decision-making.
- 3.18 The evidence from these case studies suggests that two businesses, similar in their industry, business model and customer base, considering entering the same market on the basis of the same information may still take different views about whether to proceed, and if so, how to do so. These views will be grounded in such matters as the business's history, value system, prior experience and strategy and, also ultimately, in the personalities of the key decision-takers.
- 3.19 In our case studies, the collective attitudes of the business appeared to have significant bearing on the firm's attitude to risk, its overall assessment of the attractiveness of the proposition and its response to it. It was often the determining factor in whether the business investigated the opportunity fully before committing itself, or whether it was prepared to "suck it and see". This last point is particularly important for this study since businesses which do not carry out full due diligence on opportunities are unlikely to identify some of the potential barriers which may hold back others. If potential barriers are not identified by firms at the time of decision-making, measures within the Services Directive to reduce them will have little chance of affecting their decisions to enter new EU markets.
- 3.20 Firms which do not identify potential barriers during the decision-making phase will nevertheless benefit from their reduction (in terms of management time and/or costs) once their expansion plans are put into operation.
- 3.21 The extent and nature of a firm's resources were also important factors

affecting decision-making. Resources were essential to almost all attempts to enter a new market and the availability of appropriate resource was often a determining factor in the mode of entry chosen, since some modes were seen as being more resource-intensive than others. Many of the barriers that will be reduced by the Services Directive can currently be overcome by firms if they are able to commit sufficient resources, although these firms would still benefit through saved costs if the barriers were removed.

- 3.22 Attitude and resources varied significantly across the firms we spoke to. Factors influencing them included:
- **Strategy:** particularly in larger companies, the fit with a stated strategy was a key determinant of the attitude towards a plan to expand in a given Member State, and of the resources made available for it;
 - **Firm history and prior experience of expansion:** the firm's own experience of overseas expansion often coloured its view of future opportunities;
 - **Brand and values:** a firm's stated brand, mission or values sometimes had an important role to play in determining the attractiveness of expansion in a given Member State; and it could also influence the route taken to entry: for example, a network of affiliates was less attractive to a firm with a strong brand identity and a strong preference for control;
 - **Financial position and the availability of funds:** cash resources, and the ability of a firm to raise finance, were key elements of the overall resources available to support expansion; a firm in a weak financial position is likely to be more risk-averse than one secure in its financial arrangements;
 - **Staff experience (including from roles in other firms) and personalities:** staff experience guided firms in their expansion plans. Its impact could be quantified when it enabled a firm to save on advisors' fees; the personalities and previous experiences of, in

particular, senior staff often had a significant impact on a firm's interest in a given overseas market, and its perception of and attitude to the risk involved; and

- **Contacts:** contacts in a target Member State, or having experience of doing business in that State, were often invaluable sources of information which reduced a firm's reliance on paid advisors; contacts might also lead firms to think more positively about one market rather than another.

3.23 Size had a significant bearing on these factors. Smaller firms tended to have fewer financial resources to draw upon, and a smaller financial cushion to fall back on should unexpected difficulties be encountered. Also, they sometimes had a smaller pool of individuals with international business experience. Nevertheless, we found there was no general rule. Some small businesses appeared very well-placed to deliver their proposed expansion, especially when they had planned well, for example by recruiting personnel with appropriate specialist knowledge. Some small businesses appeared more flexible and willing to take on risk than larger firms.

4 Impact on right of establishment

Key findings

4.1 The study found that:

- A number of different routes were taken by UK firms when they sought to establish elsewhere in the EU, including forming a new limited company in the target Member State, acquisition of an existing local company, setting up a branch office of the UK company in the target State or merging with an existing partnership.
- Establishment was seen as a relatively expensive approach to doing business elsewhere in the EU, due to the costs of leasing and equipping an office, hiring staff and developing a client base. Prior to establishing firms needed evidence that sufficient revenue would be generated and typically this was the “acid-test” for determining whether to establish.
- There was a strong bias in larger case study firms towards establishment compared to small or medium-sized firms because of the fixed costs; overseas offices need critical mass to be profitable, and this is difficult for a smaller firm.
- Case study firms often differed significantly in their experiences of barriers relating to establishment, even when they appeared to have taken the same route in the same Member State.
- Policy-related barriers, whether covered by the Services Directive or not, rarely changed the decision to establish an office for the case study firms; they tended to be seen as irritations rather than factors in decision-making and/or success.
- Nevertheless, approximately 40% of the barriers to establishment cited by case study firms would be addressed by the Services Directive. Many firms considered that processes in their target Member State were more time-consuming than those in other Member States, and this gave rise to wasted management time and, in some cases, lost profits.
- The lack of detail in some aspects of the draft legislation and the difficulties in establishing to what extent the barriers identified were discriminatory, disproportionate or unnecessary, and therefore might be reduced or removed under the Services Directive, meant that it was difficult to be precise about the savings which might accrue to firms as a result of the Services Directive.
- Overall, the barriers which appeared to have most impact on the case study firms in terms of their willingness to enter new EU markets and their success in doing so were natural ones, such as business culture.
- Most firms were positive about a single point of contact. There were complex messages, however, about the extent to which such an initiative would deliver tangible benefits. In particular, firms appeared to

see greater benefit from a "one-stop shop" for completing all formalities, which could accelerate the process of establishing in other Member States, than from a system which simply provided information on the process which needed to be followed. In addition, there was considerable interest in a system which provided information on wider issues relating to doing business elsewhere in the EU, for example on all tax and employment regulations. This goes beyond what is currently proposed by the Services Directive.

Section overview

4.2 In this section, we present the findings from the 21⁵ case study firms which sought to establish in other EU Member States. In the following sub-sections we discuss:

- The definition of "establishment";
- The business context to establishment, including consideration of the primary reasons for establishment;
- The evidence from the case studies regarding the experience of, and barriers to, establishment;
- The impact of firm size on these issues; and
- Issues and specific barriers arising within sub-sectors.

Defining "establishment"

4.3 Establishment in another EU Member State requires a permanent establishment in which the provider undertakes actual economic activity in the State. This is distinguished from temporary provision of services without establishment.

⁵ This figure includes one firm which talked about its experiences both of providing services and of establishing. Further details are provided in Annex B.

4.4 In its rulings on the case-by-case distinction between establishment and temporary service provision, the European Court of Justice has consistently held that the temporary nature of the activities in question must be determined in the light not only of the duration of the provision of the service, but also of its regularity, periodical nature or continuity. The Court has also made clear that the fact that the activity is temporary does not mean that the service provider may not equip himself with some form of infrastructure in the host Member State, such as an office, chambers or consulting rooms, in so far as such infrastructure is necessary for the purposes of providing the service in question. Therefore, the distinction between establishment and temporary provision of service is not simply one of physical establishment in a Member State.

4.5 Some work has been done to remove uncertainties in this area, but there remains a recognition that a better distinction between temporary service provision and establishment is required before the Directive is finalised. Our experience of carrying out the case studies has highlighted the variety of business models which exist in practice and the difficulties inherent in classifying them into the two classes.

4.6 We have used a working definition which reflects the above points and which classes the following as examples of establishment:

- Setting up a limited company or other legal entity;
- Setting up an office with the intention of providing services on a continuous basis with no pre-agreed exit date; and
- Acquiring a limited company or subsuming a partnership.

4.7 We have excluded from this definition models consisting of relationships other than ownership or identity with other businesses. Therefore, we have classed affiliate - or agency - networks as examples of temporary provision of services, except where the other members of these networks are jointly owned with the UK firm, or form part of the same legal entity (as is the case with a branch network.) We recognise that, in practice, such models are often used as alternatives to establishment, for reasons which

will be discussed.

Context to establishment

- 4.8 The previous section of the report discussed the factors which case study companies considered in deciding whether to do business elsewhere in the EU. Here we discuss the reasons cited specifically for establishing elsewhere in the EU.
- 4.9 In our case study firms, the decision to seek to establish was invariably linked to a belief that a continuous presence was needed in the Member State in question in order to provide services to local customers. This could be for several reasons, for example:
- The service is such that its physical delivery requires continuous physical presence and there is an intention to deliver services to a large number of customers;
 - The appearance of establishment is required to ensure credibility in the market place;
 - It is necessary to be seen as a local player and this can be better achieved through establishment; and
 - Significant effort is needed to develop the market and this demands a physical presence.
- 4.10 In many cases, more than one of these factors appeared to be at play.
- 4.11 Establishment was often perceived by case study firms as the “Rolls Royce” approach to expansion overseas. Almost invariably, establishment involved significant costs, and these often needed to be committed before it was possible to know with certainty what financial benefit would accrue from this investment. For example, establishment was likely to require:
- Office rental and other buildings overheads;
 - Staff recruitment (and payment of ongoing wage bills);
 - Business development; and
 - Additional branding/advertising.
- 4.12 Overall, the decision to establish was usually based on an assessment (formal or informal) that the costs of establishing were outweighed by the revenues expected to be generated.
- 4.13 An important, related, point is that there was a very strong bias amongst larger case study firms towards establishment, and amongst smaller firms towards provision of services. As shown in Annex B, 94% of the large firms we spoke to had established in their target Member State compared with 27% of medium-sized firms and 18% of small firms. Whilst our sample was not representative in its selection of firms, this skew appears intuitively correct: a critical mass (of staff) in another Member State is likely to be needed to win and deliver the work needed to justify a firm’s fixed costs of establishment. For firms with less than 50 employees, such a critical mass is unlikely to make business sense: one (medium-sized) consultancy firm, for example, considered that 30 members of staff were needed in an overseas office to make it viable.
- 4.14 It is important to remember, therefore, that the evidence of establishment from case studies is skewed towards the experience of larger firms. For the reasons discussed, it may be reasonable to assume that such a skew is likely to exist in the population as a whole. However, it is not possible to say what degree of bias should be expected.
- 4.15 Within our sample, there were examples of acquisition as well as establishment from scratch as the preferred mode of entry. Amongst those who favoured acquisition, several reasons were cited for preferring this:
- The speed with which presence can be established, compared with organic growth;
 - The opportunity to obtain a significant market share quickly; in mature markets this is particularly important as it may be very difficult for a new entrant to gain a foothold;

- The opportunity to remove a significant potential competitor from the market; and
- The availability of an existing workforce with the relevant experience.

4.16 Significantly, businesses did not tell us that acquisition was a way of avoiding the regulatory barriers which might otherwise have been faced.

4.17 Acquisition was an alternative, rather than preferred, route to establishment. An attractive target was required for an acquisition, and this was not always available. Acquisition sometimes brought its own problems, such as those of merging distinct cultures and brands. A firm's internal resources, particularly the international experience of its staff, were a factor in determining whether acquisition was considered a safer route to establishment than starting from scratch.

Evidence of barriers to establishment

Prohibitive barriers

4.18 None of the case study firms had encountered any barriers which specifically prevented them from establishing in a given country. One reason for this may be that we found it difficult to recruit case study firms which had sought to establish in a Member State but had failed.

4.19 This difficulty could have been because few firms overall in the UK decide to establish in another EU Member State and then find themselves unable to. However, there might also have been a disinclination amongst firms to admit that this had been the case.

Barriers which relate to regulation and legislation

4.20 Our case studies suggested that there were a large number of regulatory and/or legislative barriers which businesses experienced in establishing in other EU Member States. Roughly 25% of the individual barriers cited by firms (counting a barrier once each time it was mentioned by a firm) were of this type. Many of these related to the legal form of businesses and/or the process of incorporation. For example, firms found difficulties such as:

- The lack of “off the shelf” companies, which increased the time needed to establish;
- Unduly complex accounting and administrative procedures, such as the need to have all documents notarised, which gave rise to additional delays and costs;
- The strict order in which the stages of the establishment process had to take place, which increased the time taken; and
- Restrictions over the legal form which a branch could take.

4.21 These are described in more detail in the case study examples below.

Case study 1: advertising firm

An advertising firm of approximately 130 employees established in three other Member States before establishing in the case study Member State, and this Member State has been found to be the most difficult location in which to set up a new business. The firm cited as barriers the difficult procedures necessary in order to set up a company (the purchase of ‘off the shelf’ companies not being possible), which required the firm to engage lawyers, something which had not been required to establish in the other Member States. Additional delays and costs also arose from the strict order in which the stages of the process had to take place. For example, a bank account could not be set up until the lease for the office had been signed. This increased the time required to establish.

Establishing took 6 months from taking the decision to having a company ready to trade. The advertising firm estimated the total additional costs of the process (compared with its experiences in other Member States) at £20k - £30k. Of this, £10k-£15k related to lawyer and notary fees and the balance to the lost earnings arising from the management time spent on establishing.

Case study 2: architects' firm

The case study firm is a small firm of architects, having approximately 40 staff. It has a considerable history of working within the EU.

It has recently sought to incorporate its branch in a certain Member State under the law of that State. In contrast to its experience of setting up the branch, which it found "simple and fair", it has found the process of incorporation complex and time-consuming, taking approximately one year from making the decision to incorporate to successful formation of the company. It was estimated that it took one month of a senior manager's time over the year to organise this. This equates to approximately £7k of lost earnings.

In addition, as a limited company in the Member State, the firm is required to adopt a more complex accounting system compared with when it was a branch. The firm considers regulations to be a lot more stringent compared to those in other Member States. As a result, the local administrator spends much longer maintaining records and accounts, given the size of the local office. This equates to additional cost in the region of £2-3k per annum.

Case study 3: law firm

The case study firm is an international law firm with 165 partners and approximately 600 staff within a worldwide partnership. The firm has recently expanded its European operations to include branches of the partnership in two Member States outside the UK.

The major issue the firm has encountered in both States related to the UK firm's legal status as a Limited Liability Partnership (LLP). The firm wished its overseas offices to be branches of this LLP. In neither State was this acceptable to the authorities. In one State, a compromise was reached whereby the office became a branch of the US firm, which has a different (US rather than UK) form of LLP status. For the case study firm this is an acceptable solution, though not one which would be open to a firm without a US base.

In the other Member State, however, the authorities (believed to be the relevant Law Society) do not accept law practices having any kind of limited liability. Therefore, the firm was forced to create a small, additional, unlimited partnership in the UK, solely with the purpose of operating the branch in this Member State. This had led to significant ongoing administrative costs for the firm of about £50k per annum relating to the additional administrative burden of managing separate

legal structures (which has legal, profit share and taxation implications.)

In addition, the partners suffer increased risk through operating in the Member State where they do not have limited liability protection. This impacts all partners, not just those who work in the office in that Member State, by exposing them to increased risk of claims from clients, which is not being insured against.

- 4.22 As these examples suggest, firms have quite different experiences of doing business in other EU Member States. In some cases, firms which seemingly had taken very similar routes to achieve their aims recounted their experiences quite differently. For example, firms which had subsidiaries in the same Member States as those cited in the examples above could recall no difficulties in setting up their offices. It is difficult to establish, from our case studies, why this might be. A possible explanation relates to the flow of information within organisations: this may mean that interviewees had different levels of awareness of the difficulties which arose.
- 4.23 Many firms had very clear views that the difficulties they had encountered in their target Member State were greater than a firm (domestic or otherwise) would have encountered in other Member States. Establishment in some Member States may be inherently more complex than in others for legitimate reasons. However, if establishment in one Member State is significantly more time-consuming than in another, this could be because the process is unnecessarily complicated or discriminatory. Therefore, we consider that in many cases cited by case study firms, the regulatory barriers experienced might, in theory, be reduced by the Services Directive. However, case study firms were often unable to say to what extent barriers experienced were specifically "discriminatory, disproportionate or unnecessary" and, therefore, it was not possible to establish with certainty the extent to which the barriers, in practice, would be reduced by the Directive.
- 4.24 Even where firms had identified barriers, they were not always able to specify the impact they had on costs. When costs were provided, they varied considerably. In part this is because the specific barriers encountered differed; in part it is also likely to be due to differences in approach to overcoming barriers and differences in assessing the cost. As

indicated in the preceding case study boxes, costs varied from less than £10k as a one-off cost, to £50k per annum in ongoing costs.

- 4.25 These costing issues, combined with uncertainty over the extent to which the Services Directive would, in practice, reduce the barriers (and the costs) cited, mean that it is very difficult to quantify the potential overall impact the Services Directive would have on firms intending to establish elsewhere in the EU.
- 4.26 In addition to regulatory barriers which related specifically to the establishment process, many firms cited the lack of consistency in tax, social security, and accounting regimes as a significant driver of higher costs relating to establishment in other EU Member States. Approximately, a further 10% of barriers to establishment were of this type. Costs arose not just through the need to seek advice on the differences (which is discussed in more detail below) but also from the need to amend procedures and administer different systems to meet the requirements of different Member States. For example, some firms mentioned the need to amend their financial reporting arrangements or accounting procedures in order to be able to produce accounts for submission in other Member States as well as those needed for Group reporting in the UK.

Barriers arising from opaque administrative requirements and lack of information

- 4.27 Case study firms varied considerably in their views of the significance of barriers of this type. Whilst there was a tendency for smaller businesses to find accessing relevant information more difficult, this was not universal.
- 4.28 The difficulty of accessing information was often mitigated by:
- Use of local nationals to establish and lead new offices, so that local knowledge and contacts could be drawn upon; this was often as important for winning business as for going through the administrative process of establishing;
 - Previous experience and contacts amongst UK staff, for example from previous jobs; and

- The use of professional advisors.

- 4.29 Only about 5% of barriers cited specifically related to difficulties in identifying requirements for establishment, or understanding them. Indeed, lack of information often appeared to have been more of a problem for case study firms in respect of the requirements placed on a firm once it started to trade. Taxation, social security and pensions regulation were commonly cited as complex areas, particularly in some countries where firms found it difficult to obtain sufficient information. This is discussed further in Section 5 on provision of services without establishment.
- 4.30 Most firms considered that a single point of contact was a “good idea”. However, it was sometimes difficult to understand what firms specifically saw as being potentially useful to them. A number of firms, for example, did not cite any problems they had had in obtaining information about how to establish, but still considered that the single point of contact was of benefit.
- 4.31 We perceived there to be an inclination amongst firms to say that the single point of contact was a good idea, without considering in detail how specifically it might help either themselves, or another firm wanting to establish elsewhere in the EU. A number of firms, either of their own accord, or when challenged, mentioned that the single point of contact would be of most benefit if it acted as a “one-stop shop” which helped a firm through the process of establishing, and was able to speed it up. They believed that a simple “sign-posting function” (i.e. a single point of information) was unlikely to be of significant assistance, since it was already fairly straightforward to gather information about what was required to establish.
- 4.32 The firms that have already established in the EU are likely to be better informed about how to do this than those firms who have not yet sought to establish elsewhere but might in the future. We therefore tried to determine to what extent a single point of contact might have helped case study firms, had it been available when they first sought to establish.
- 4.33 Despite the generally positive responses, a significant number of firms

believed that a single point of information, which did not assist firms through the process of establishment but only provided information about establishment requirements, would be of greater help to other firms than themselves, even when they considered the position they were in when they first sought to establish. This seemed to be because case study firms were generally confident in their ability to gather the relevant information, even before the firm had begun its expansion. Various reasons were given for this view, including:

- Individual managers had previously been involved personally in similar expansion in a role at a previous firm and, therefore, had experience which made it easier to know where to seek information;
- Individual managers had personal experience of the Member State in question (for example, they had lived there), and therefore knew where to seek information already;
- The firm had used professional advisors and would always do so, even if a single point of contact existed;
- The firm had hired local staff to establish the new office in question and perceived that these individuals already had the knowledge required; and
- The firm had found that adequate information resources were already available in the Member State in question.

4.34 Potentially, these factors are more prevalent in firms which have already sought to establish: firms which do not have these “aiding” circumstances might be unable to establish due to a lack of readily available information. If this were the case, we should suspect that the single point of information would be a much greater potential benefit for firms in general than was indicated by the case study firms.

4.35 However, evidence from the case studies suggests that it is not only to make the process of establishment itself easier that firms might rely on personal experience of another Member State or hire local staff, but also

to help them overcome natural barriers. Knowledge of the local market, the business culture, and potentially the language, are all very important in building a successful business outside the UK. This suggests that firms seriously considering establishing outside the UK might well want to have the benefit of the “aiding” circumstances mentioned above, even if the single point of information were in existence. This might be either because firms would decide, for example, to appoint local professional advisors or hire local staff, in order to help them overcome cultural barriers in their target Member State, or because firms would tend to target Member States for which managers already had, for example, personal experience or relevant language skills.

4.36 If it is the case that, in order to overcome natural barriers, firms seeking to establish in other Member States act in such a way that they have access to good information about the procedures required to establish, a single point of information may not be of significant benefit to them.

4.37 The evidence from case study firms suggests that a “one-stop shop”, if it is able to speed up the process of establishment, could be of benefit to a larger number of UK firms than a single point of information. This is because a significant number of firms indicated that the complexity of the establishment processes, and therefore the speed of establishment, was a driver of higher costs.

4.38 There is also evidence from the case studies that, if a single point of information were created, it would be of benefit to more firms if it also provided information about the wider ongoing regulatory requirements for businesses trading in the EU (for example, regarding tax and employment legislation in different Member States), since lack of information about these issues was regularly cited by case study firms. However, a single point of information of this sort goes beyond what is currently proposed by the Services Directive.

Barriers linked to administrative inefficiency and a requirement to complete multiple applications

4.39 Firms considered that approximately 10% of barriers cited related to administrative inefficiency in the establishment process, although, in

practice, it was sometimes difficult to separate these barriers from those relating to disproportionate regulation. The examples of the firms in case studies 1 and 2 above contain reference to barriers which might equally be classified here.

- 4.40 The most significant example of how administrative inefficiency can impact on businesses whilst they are trying to establish is given in the example in the box below.

Case study 4: construction advisory firm

The case study firm is a large partnership providing advisory services to the construction industry. It has a significant history of successfully establishing in other EU Member States, which it typically achieves through partnering with an existing local firm.

However, in the target Member State for the case study, it decided to establish a business from scratch, having won a major contract in that country. A British senior member of staff spent approximately a year trying to overcome difficulties to establish the business. Some of these difficulties related to commercial problems. However, the firm considers that contributory factors were the unnecessarily and disproportionately bureaucratic procedures required to establish. Specific examples include:

- Different organisations requiring the same information but in different formats and with different certifications;
- Long delays in receiving approvals and answers to applications;
- Multiple requests for the corroboration of corporate documents;
- Personal representation by senior staff needed to obtain authorisations; and
- The senior member of staff charged with setting up the business did not speak the native language of the Member State, which may have been a significant contributory factor in the scale of the difficulties faced.

The firm was not able to put a cost on the barriers it experienced. We consider that, at a minimum, a large part of the cost of a senior executive (estimated at £130k per annum including on-costs) should be considered to be attributable. The lost profits which might have been made are also attributable in part to the administrative barriers faced. These could not be quantified but are likely to be much greater.

- 4.41 A number of case studies cited examples of additional administrative burdens experienced in other Member States once they had established, for example onerous requirements for company reporting (general and tax-related). Around 10% of barriers cited related to this. In some of these cases it was by no means clear whether the Services Directive would lead to any reduction in administrative burdens, as the requirements appeared to relate to general company and tax law in the Member State in question.

Natural barriers

- 4.42 Barriers in this group were cited very frequently by case study firms. They included:

- Language; and
- Culture and specifically business culture. This was experienced in a wide variety of ways: for example, firms mentioned differences in personal behaviour in the workplace, approaches to performance appraisal, and differences in customer preferences which had given rise to additional costs or management time.

- 4.43 Around 20% of barriers cited in connection with the Member States on which the case studies were based related to natural barriers (excluding the fixed cost barriers to establishment, discussed above). Very few were able to give any indication of the financial impact these barriers had. Firms did not think of such barriers in financial terms, even though they often designed their approach to establishing in other Member States with cultural and linguistic barriers in mind, and therefore were certain that such barriers were significant. This often appeared to be because the cultural barriers were very closely bound with commercial issues around the viability of an establishment in a target Member State and were implicitly taken account of at the earliest stage in developing a business plan for the target State, without any explicit financial value being attached to them.

- 4.44 Indeed, many firms talked about cultural barriers in connection with other Member States, in which the firm had not established. It was apparent in many cases that the firm had avoided establishing primarily to avoid the

perceived cultural barriers. In these cases the cultural barriers often specifically related to local commercial practice and there was a perception that a UK firm would not be able to win a sufficient share of the market.

4.45 The case studies, therefore, indicate that for some firms, natural barriers are more significant than any other type of barrier, and overcoming them is a pre-condition for doing business elsewhere in the EU.

Other barriers

4.46 Around 15% of barriers related to miscellaneous issues that the firms we spoke to had encountered. These varied significantly from firm to firm, but the two most frequent issues raised were:

- The lack of an integrated banking system within the EU; and
- The additional cost of employing staff in Member States with high levels of labour regulation.

4.47 None of these barriers identified would be impacted by the Services Directive.

Experience of establishment across firms of different sizes

4.48 As discussed above, only a small number of the small firms in our sample had sought to establish. Therefore, specific evidence of the impact of barriers to establishment on small firms is limited. There are inherently proportionately higher costs to establishment than provision of services. This means that smaller firms are likely to be less inclined to establish than larger firms, regardless of any improvements the Directive might make.

4.49 Nevertheless, our discussions with case study firms of all sizes help us to hypothesise about how small firms experience barriers to establishment, and how the Directive may help.

4.50 Our study suggests that different issues pull in opposing directions. For

example, larger companies may be more likely to have:

- Experience and contacts which help them to gather relevant information about regulatory, legislation and administrative requirements in other Member States;
- Greater potential revenue streams against which to offset any fixed costs of establishment; and
- More flexibility and resilience in staffing arrangements in order to dedicate staff to resolving problems relating to establishment on a timely basis, should they arise.

4.51 These factors should reduce the impact of barriers to establishment. On the other hand, such companies may also:

- Carry out more extensive due diligence, thereby identifying a greater number of potential issues which require resolution;
- Place a greater premium on “getting it right first time”, due to the perceived increased likelihood of coming to the attention of the authorities and the need to protect their reputation; and
- Be more ambitious in their plans to do business overseas and, therefore, more likely to encounter potential barriers.

4.52 It is evident from the case studies that there are some differences in attitudes towards the costs of overcoming barriers amongst businesses. Some businesses of all sizes considered the costs of overcoming legal, regulatory and administrative barriers to establishment as “immaterial” or “at the edges” in terms of their overall impact on decision-making. Other businesses, which did not appear to have experienced particular difficulties in establishing, considered that the costs were significant.

4.53 To some extent, these differences in perception may simply be a result of differences in the prevailing management style within the business. However, another factor is the way in which a business sees its expansion

into other Member States. For a small business which is only ever likely to expand into one or two states, the costs associated with overcoming barriers to establishment are likely to be measured only with reference to the overall costs of the establishment, and projected revenues. If a firm has taken a decision to establish, the revenues should in any case significantly exceed the total costs.

- 4.54 For some larger businesses, establishment in a given territory was part of a long-term and continuous process of establishment in different locations in which the same or similar barriers may need to be overcome repeatedly. For such businesses, the costs associated with overcoming barriers to establishment may take on an additional perceived significance because they have an aggregate impact across a large number of individual establishments. This is a further reason why barriers to establishment may sometimes be more important to larger businesses than smaller ones.

Experience of establishment across sectors

- 4.55 This section considers in detail the experiences of firms within the different sub-sectors covered by the case studies.

Legal services

- 4.56 The market for legal services has become increasingly international in the last decade, driven by increasing globalisation of trade and the capital markets. As a result, many firms, including all the case study businesses in this sector, perceived the need to enhance their ability to advise on matters of local overseas law, and handle cross-border deals.
- 4.57 Some firms in our sample had sought to do this by developing a network of offices in their key perceived overseas markets; others had avoided establishing themselves and had instead developed relationships with a network of “friendly firms” in these markets with the aim of cross-referring and collaborating on international client work.
- 4.58 Firms in our sample had only sought to take the former route where they believed that the potential rewards of doing so exceeded the costs and

risks involved, including the risk to their reputation which would result if they subsequently decided to withdraw. It is, therefore, unsurprising that only the two larger of the firms we spoke to had established.

- 4.59 One of these firms was the law firm in case study 3, whose experiences were described on page 22. The other firm had established in the same group of EU Member States, but was not an LLP and therefore did not encounter the same barriers. It mentioned the complexity and administrative burden of accounting for partner taxation across the EU territories in which it operated, and also the lack of a harmonised EU banking system. The latter barrier was estimated to give rise to an annual additional cost of £30k, relating to lost interest. This firm did not cite any barriers which might be reduced by the Services Directive.
- 4.60 Both firms believed that the equivalent of the Bar Association rules in different EU Member States were such that it was easier for a lawyer qualified in another EU Member State to practice their local law in the UK than it is for an English lawyer to practice English law elsewhere in the EU. In practice, however, this was not a major issue, since the majority of lawyers in both firms’ overseas offices practiced local law.

Estate agents

- 4.61 The estate agency case studies were clearly divided between major multi-location organisations having a strong focus on international commercial clients, and much smaller organisations focusing primarily on the domestic residential market.
- 4.62 The businesses in the former group saw expansion within the EU as a natural extension of their existing business, which already had an international element. A key driver was commercial investors’ interest in new markets. Both firms encountered different difficulties in establishing, including:
- Bureaucratic notary systems and large amounts of red tape;
 - A lack of clarity over regulation;

- Inflexible working practices and employment law;
- Taxation regimes which are different from those in the UK and are difficult to understand; and
- Inefficiencies arising due to the lack of a pan-Europe banking system.

4.63 Of these difficulties, the first three might be reduced by a greater or lesser degree by the Services Directive. However, neither firm was able to be more specific about the problems encountered, or to quantify their time and/or cost implications.

Management consultants

4.64 The management consulting case studies formed a heterogeneous group in terms of client base and type of work. They included a strategy consultancy, a market research consultancy, a provider of franchises and a construction-related management consultancy. Of these, only one business was currently established elsewhere in the EU, although a second had been established but was now providing services temporarily. A firm's business model and its ability to provide services remotely or on a project basis emerged as key factors determining the approach to doing business elsewhere in the EU in this sub-sector. However, ultimately, the deciding factor was the likely revenues available in the target Member State compared with the projected fixed costs of establishment.

4.65 The business which was currently established elsewhere in the EU was a large firm with its roots in the construction trade and had seen EU expansion as part of its overall strategy for growth. It had opted to set up a limited company from scratch in each new territory.

4.66 This firm cited the administrative burden of establishing as an issue, and perceived this to be considerably higher in other EU states than in the UK. However, this burden had not led it to re-consider this approach, since there was a strong business case for establishing despite the difficulties involved in doing so. This may have been partly because it did not cost these issues at the decision-making phase. Most of the costs related to management time and as a large firm it was able to absorb such costs

easily; indeed it was not able to provide us with an estimate of the additional costs incurred. It mentioned, however, that the establishment process in the case study country took 4-6 months to complete, far longer than in other EU Member States.

4.67 After establishment, it encountered other difficulties, including:

- Understanding nuances in language and culture;
- Being required to use different accounting systems to meet local and Group requirements;
- Complex VAT procedures in some countries; and
- Complex and restrictive labour, social security and pension laws.

Again, however, it was not able to quantify the additional costs these issues had given rise to.

4.68 In contrast, the firm which had previously established and subsequently shut down its offices did not consider the administrative costs of set up to be significant. It had found cultural differences and the complexities of labour, social security and pension laws to be issues. The office was closed because the market proved to be less attractive than had been expected, rather than because of any barriers experienced. However, the cost of closure was particularly high as a result of the stricter employment legislation in the Member States in question.

IT consultants

4.69 Four case study firms fell into this sub-sector: one large firm and three medium-sized. Only the large firm had established. This fact appeared to be reflective both of the general comments made above about the attractiveness of establishing for smaller firms, but also of the relative ease with which firms in this sub-sector are able to service their customers at a distance.

4.70 The firm which had established sold software to the telecoms sector to

help with billing management. It was a new, rapidly growing business, which had decided to establish in a number of EU markets in the last five years, in order to help it service its international customers, which included a number of major European telecoms companies.

- 4.71 This firm considered that every Member State had its own “way of doing things”. However, because the firm had a large and experienced legal and finance team, it was able to work through these processes methodically, and did not find any barriers prohibitive. It was not able to identify any procedures which were onerous or unnecessary, and did not have a view as to whether the processes in some Member States were simpler or less time-consuming than in others.

Advertising

- 4.72 Five case studies were undertaken in this sector. Of these, two were large agencies, two medium and one small. Four of the five businesses had established overseas and, unusually, this included the small firm.
- 4.73 This sub-sector showed clear evidence of the trend towards following global clients and setting up in other EU territories in order to service them. This was a factor even for the (medium-sized) firm which provided services without establishing; it acknowledged that providing services to large clients often called for a local presence and indeed had set up a local project office in the past to deliver a particular assignment.
- 4.74 There were clear contrasts in the experiences of different firms in establishing in other EU Member States, even where the States in question were the same. For example, two firms, including the small firm, found it difficult to identify any non-natural barriers which they had experienced elsewhere within the EU. For the small firm, this appeared to be because the subsidiary in the other EU Member State had been set up by an employee who was a native of that country. This individual had undertaken all the set-up administration, and the UK management was not aware of any difficulty or delay in the procedure.
- 4.75 The large firm gave different reasons for not being able to identify any barriers experienced. It was a large, international, firm and had a large

legal team, experienced in dealing with issues relating to the set-up of new subsidiaries. From management’s perspective, potentially “costly and complex procedures” were an expected part of doing business overseas. The time spent on them for different countries was therefore not considered significant enough to notice or record. Of interest, however, was management’s view that “barriers no longer exist once countries are within the EU”. This appeared to be based on the perception that, although time might be required to deal with the necessary processes to establish, EU Member States did not have the kind of prohibitive barriers to establishment that the firm frequently encountered in other parts of the world.

- 4.76 One of the two firms which had sought to establish and was able to cite barriers was the firm in case study 1 on page 21. The other firm had a similar experience, citing the high levels of bureaucracy and inflexibility in the process of establishing in some Member States, giving rise to delays in establishing, and extra costs, as described below.

Case study 5: advertising firm

A large advertising firm is just beginning a planned expansion elsewhere in the EU. The target Member State for this case study is the second country apart from the UK in which the firm has established.

It has found the process of establishing far more complex than that in the first States it established in. For example, all documents have to be notarised. In addition, it appears to be difficult to change the structure of a company once it has been set up. The firm has therefore deferred setting up the company until the desired structure is clear. The additional time spent establishing is estimated to be as much as 20 – 50% higher than that required in the other Member States of which it has experience. It estimated that this amounted to an additional month of elapsed time. The additional complexity had also given rise to legal costs of £4k.

Construction - advisory

- 4.77 This was a large and varied group of case studies. It comprised three architects and four mixed construction advisory practices: the former were SMEs whilst the latter were large, multinational, firms.

- 4.78 Of these firms, all but two had established in the case study Member State, although in most cases the businesses also had some experience of provision of services, in some cases in the State in which they had later established.
- 4.79 In all the cases of intended establishment, the case study firms had provided services in the Member State in question prior to establishment, often as a result of an existing client asking them to do work in that State. One firm specifically stated that it preferred to provide services first as it provided an opportunity to develop an understanding of the local market and business practices.
- 4.80 All these case studies also cited language and cultural barriers as being significant. Three of the five examples of establishment involved the same Member State, and there were striking similarities in the barriers cited by these firms, although there appeared to be differences in the extent to which these barriers had impacted them. One of the firms in question was case study 4, discussed earlier in this section. The other two firms which established in the same Member State also mentioned that the administrative processes required to establish were time-consuming and often slow. However, the specific elements of the process cited varied, as illustrated by the following case study summaries, one of which discusses bureaucratic processes during establishment and the other which only experienced additional burdens once it was trading.

Case study 6: construction advisory firm

The case study firm is a large firm providing advisory services to the construction industry. It has already established in a small number of other EU Member States. In 2004, the firm decided to establish in a particular Member State, as it saw this as a potential growth market for its services. It found that the process of setting up a subsidiary in the Member State was more bureaucratic and time-consuming, compared with other States. It cited specifically:

- Notarisation of documents;
- Swearing in procedures; and
- Requirement to have at least two shareholders.

However, due to having a capable individual who was “skilled at keeping the

process moving”, the process took 4-6 weeks, which the firm considered to be a good result. It estimated that, in Member States having more streamlined processes, this could take as little as 1 week. The firm was not able, however, to quantify the financial impact this time-saving could have.

The firm mentioned that it had benefited from information provided by a “sign-posting” facility, run by the government of the target Member State, which it said negated the need for an additional single point of contact in respect of this Member State.

Case study 7: construction advisory firm

The case study firm is a large firm providing advisory services to the construction industry. It has already established in a number of other EU Member States.

It could not recall any specific barriers to establishing in its target Member State. However, it cited the ongoing high level of administrative costs in its office there. These costs were largely driven by requirements to prepare and file complex documents with the state administration on a regular basis, including:

- Monthly tax returns; and
- Extensive annual statutory accounts.

The firm believed that its administrative staffing was three times that in a comparable office in other EU Member States, as a result of these requirements.

- 4.81 The two other firms which had established had different experiences again. One of them was the firm in case study 2 on pages 21-22, which encountered particular problems with incorporating its branch in a Member State. The final firm was a large firm, which did not recall any difficulties in establishing its offices elsewhere in the EU. It acknowledged that it was a large firm, with a substantial history of working overseas, which might have been a factor in this.

Industrial cleaning and building services

- 4.82 Three cases studies were completed in these two sub-sectors. We discuss both sub-sectors together since they share many characteristics and the activities of two of the case study firms straddle both sectors.
- 4.83 One of the firms in these sectors had established. This was a very large,

multinational group. Another much smaller firm had established in the recent past, but had just shut down this operation, and had continued to develop business elsewhere in the EU by providing services without establishment. The third firm, also large, also only provided services. It is discussed in Section 5, on provision of services.

- 4.84 The experiences of the two firms which had established were very different, and provide very different perspectives on the issues facing efforts to create a single market for services within the EU. To a large extent, this may be as a result of their difference in size.
- 4.85 The large firm had expanded rapidly over the last 15 years, as part of an aggressive strategy of diversification and acquisition. From its perspective, the main barriers to a single market for services within the EU were:
- Effective restrictions on the free movement of labour: as a highly labour intensive business, where costs are a key source of potential competitive advantage, the firm often found it difficult to employ workers from the new Member States of Eastern Europe within other, more established Member States;
 - Differences in the restrictions facing vehicle drivers taking laundry across borders which hindered the company in achieving efficient logistics operations; and
 - Restrictions on the firm's ability to use the same cleaning chemicals in different Member States because of differences in restrictions on their use.
- 4.86 The much smaller firm found that its greatest difficulty in establishing in another Member State had been its relationship with its chosen business partner in that State. The UK firm had decided to set up a joint venture in the other Member State as a result of an approach by a business in that State. The decision to enter into a partnership was not driven by concerns about administrative barriers to UK firms establishing, but was seen primarily as a good way for a fairly small firm to mitigate the risk inherent in entering a new market with a different language and culture.

4.87 In practice, however, the relationship had proved difficult, and the UK firm believed that weaknesses in the business plan developed for the joint venture had led to its running into difficulties. The jointly-owned business closed after approximately 7 years of trading.

4.88 The UK firm perceived that proposals in the Services Directive might be of use to it in the future, since it would make it easier for UK firms to enter other EU markets independently of local partners.

Commercial Construction

- 4.89 Two case studies were carried out in this sub-sector. Both of them were very large, international, firms, which had considerable experience of doing business elsewhere within the EU. Both had recently sought new establishments in other Member States, and had done this through acquisition. The preference for acquisition appeared to arise from the nature of these businesses: both were mature and were seeking to complement their existing portfolios with established businesses in geographic markets and market sectors which presented good opportunities for growth and good profitability.
- 4.90 Both firms had found that regulation in the Member States in which their target companies were established made the process of acquisition more complex and costly. For example, they mentioned:
- Difficulties in obtaining clear financial and other due-diligence related information about target companies;
 - Greater regional government regulation, resulting in more complex legal proceedings;
 - Increased trade union involvement in decision-making; and
 - Shares with right-of-veto being held by local municipalities.
- 4.91 In some cases, such matters had impacted on the success of acquisition proceedings. However, none of them appear to be matters which could be influenced by the Services Directive. Indeed, given the preference of the

firms we spoke to for acquisition, it is unlikely that they would benefit significantly from the Directive when seeking to establish, since most measures are aimed at the processes required to establish from scratch.

Sub-contractor services

- 4.92 This sub-sector consists of five firms: one large, two medium-sized, and two small. Of these, the large and one of the medium-sized firms have established.
- 4.93 A key theme which emerged for this sector was the current system of product standards. Many firms in this sector manufactured products, in connection with which they provided services. They found that they were required to obtain product testing certificates in each Member State in which they wanted to trade. In some cases, this gave rise to a significant cost relating to each new product and new market. For one firm, discussed in Section 5, this issue had a very significant impact on its ability to sustain a business elsewhere in the EU.
- 4.94 The large firm in this sub-sector recently established in two different Member States, both via the acquisition of an existing business. The only barrier it encountered to doing business elsewhere in the EU related to product testing.
- 4.95 The medium-sized firm which established also identified this issue, and estimated the cost of its impact at £10k per product. These costs related to obtaining the necessary certifications in all the Member States in which it wanted to trade. However, this firm also found the ongoing costs of running a business in another Member State significantly higher than it expected. It felt that regulations on finance were very complex in the Member State in question, at a cost of approximately £35k per annum, including on-costs.

5 Impact on provision of services

Key findings

5.1 The study found that:

- In practice, firms were using a wide variety of service delivery models to provide services without establishment in another Member State.
- There appeared to be a strong bias towards provision of services rather than establishment amongst smaller firms.
- Provision of services without establishment was seen by most case study firms as a relatively easy, more cost effective and flexible approach to doing business elsewhere in the EU compared with establishment.
- Case study firms had encountered few barriers to the provision of services within the EU which would be reduced by the Services Directive; one possible reason for this was that, at present, these firms spent relatively little time exploring the regulatory environment in other Member States, prior to providing their services there.
- Some industry-specific barriers which might be reduced by the Services Directive were cited in case studies; however, many other barriers, including those which applied to wider groups of firms, would not be impacted by the Directive.

- Natural barriers, particularly those related to culture, were the most significant barriers faced by firms seeking to provide services elsewhere in the EU. In some cases, these issues had been strong enough to prevent firms providing services successfully.

Section overview

5.2 In this section we present our findings in connection with those businesses which have sought to provide services in other EU Member States without establishing, being 17⁶ of the 38 cases. The section covers:

- The definition of “provision of services”;
- The business context to providing services in other EU states, including consideration of the primary reasons for doing this;
- The evidence from the case studies regarding the experience of, and barriers to, provision of services;
- The impact of firm size on these issues; and
- Issues and specific barriers arising within sub-sectors.

⁶ This figure includes one firm which talked about its experiences both of providing services and of establishing. Further details are provided in Annex B.

Defining “provision of services”

- 5.3 Establishment in another EU Member State requires a permanent establishment at which the provider undertakes actual economic activity in the State. This is distinguished from temporary or remote provision of services without establishment.
- 5.4 As discussed above, the distinction between establishment and temporary provision of service is not simply one of physical establishment in a State. A service provider can equip himself with some forms of infrastructure in the host Member State, such as an office, chambers or consulting rooms, in so far as such infrastructure is necessary for the purposes of providing the service in question without being considered to have established.
- 5.5 As we have noted, some ambiguities in the two definitions remain. A particular grey area arises where businesses are providing services on a regular and permanent basis, but do not have any kind of permanent physical presence and have not registered with any local authorities. This can arise in several ways, for example:
- Services may be delivered on a project basis: for a given client, a one-off project is initiated which is delivered in the client’s home Member State. Such projects may form a significant part of the supplier’s business and, therefore, provision of services in the client’s state does not appear temporary from the perspective of the supplier; or
 - Services in the client Member State may be delivered by a third party (an agent or affiliate): transactions take place between the UK firm and the overseas agent/affiliate on a regular and permanent basis but the UK firm does not appear to have established in the client Member State.
- 5.6 Our case studies highlight the variety of business models which exist in practice. We have included the two examples above as provision of services for the purposes of this report.

Context to provision of services

- 5.7 Our case studies indicated that provision of services typically takes place when there is a desire to enter a given overseas market but there is not a sufficient case to justify the investment required to establish.
- 5.8 Some of these firms were providing services as a prelude to establishment. This gave them the opportunity to test the opportunities in the overseas market for their services without incurring the fixed costs of establishment and the potential associated exit costs. Others were providing services after closing their offices in the Member State due to insufficient revenue levels.
- 5.9 Some case study firms never expected to establish and saw provision of services as an end in itself: either because they believed it was the most cost-effective way of servicing a specifically identified overseas market, or because they had only done business elsewhere in the EU in response to specific client requests and therefore ad hoc provision of services was the only feasible approach. In both these types of cases, however, the underlying reason for providing services was that there were insufficient revenue opportunities, given the firm’s strategy, to justify establishment.
- 5.10 The industry sector and underlying business model of a firm were key factors in determining the attractiveness and feasibility of provision of services. For example, provision of services without establishment was more attractive to businesses where services could largely be provided remotely, such as telephone market research, communications advice or software development, or where typical projects were relatively short.
- 5.11 As discussed in the previous section, our sample of case study firms providing services are overwhelmingly small or medium-sized businesses. There is reason to suspect that this might be the case in the population of UK firms as a whole.
- 5.12 Businesses in our sample were using a wide variety of models to provide services in other EU states, including:
- Remote provision of services where no physical presence is required

to deliver service;

- Remote provision of services where only occasional physical presence is required to deliver service;
- Intermittent provision of services (therefore not requiring/meriting establishment); and
- Appointment of overseas agent(s) or business partner(s).

5.13 This diversity was reflected in the variety of barriers encountered. Generally, however, provision of services without establishment was seen as a lower cost and more flexible route to market. It was also perceived as being relatively easy to do.

Evidence of barriers to provision of services

Prohibitive barriers

5.14 The case studies revealed no examples of prohibitive policy-related barriers.

Barriers which relate to regulation and legislation

5.15 Slightly over 20% of all barriers to provision of services cited by firms fell into this grouping, and this was the single largest group of barriers apart from natural barriers. A wide variety of barriers were mentioned, many of which appeared to be specific to certain types of business. Some of the more significant of these included:

- The need to obtain a licence in order to operate as an estate agent in one Member State: the process for obtaining a licence was found to be bureaucratic, costly and slow;
- The need to produce long legal documents in order to sell franchises in some Member States; and
- The time required to investigate and comply with the regulatory framework in numerous Member States.

5.16 These are discussed in context in the following examples:

Case study 8: estate agency

The owner-manager of a small estate agency (with less than 10 members of staff), though based in the UK, has strong connections with a particular Member State.

The firm was seeking to sell property in this Member State, primarily to buyers in the UK. Initially, the firm decided to enter into an arrangement with a business partner in the target Member State in order to avoid the requirement to obtain a professional licence to sell property there as well as the need to employ staff and set up offices.

However, the business experienced serious difficulties in reaching a satisfactory arrangement with its proposed business partner and decided to apply to obtain the licence needed to be able to sell property there directly to UK customers.

The process for obtaining the licence has proved time-consuming and expensive. The applicant considered it to be unnecessarily bureaucratic, in that it required formal evidence of sufficient qualification in the trade and of an ability to speak the native language of the Member State, both of which are self-evident from the circumstances of the applicant. A bank account and a financial guarantee from a bank in the Member State were also required. The applicant expected the process to take a year to complete and involve a cash cost in the region of £10k. This covered advisors' fees and the cost of making the required financial arrangements. In addition, a significant amount of the owner-manager's time had been spent on the process, which the individual has been unable to quantify.

Case study 9: management consultancy

The case study firm is a small firm which both sells franchises and provides management advice and support to franchisees. It is a sister business of a UK-based international firm of recruitment consultants, whose name and business model are purchased by the customers of the case study firm.

The case study firm provided its services (the recruitment and support of franchisees) in a number of EU Member States. In some of these States, the law required that franchisors provide long disclosure documents to franchisees, providing very detailed information about their firms. This degree of disclosure is not required under UK law.

Collecting the additional information and obtaining legal advice on presenting it

gave rise to significant costs to the firm, estimated at £25-30k in legal fees and 60-70 hours of management time (indicatively costed at around £75 per hour, or £5k in total) per Member State in which services are provided.

In addition, prior to providing services in a new Member State (and assuming that management had no prior knowledge of the State) the firm estimated it spent between 20-40 hours of management time and £2-6k in cash, on legal and market research.

- 5.17 Some other legal and regulatory barriers to service provision were cited by case study businesses, which are discussed in the sub-section on sub-sectors below. However, these were very specific in nature and seem unlikely to be impacted by the Services Directive.
- 5.18 No firms seeking to provide services had encountered difficulties relating to posted workers.

Barriers arising from opaque administrative requirements and lack of information

- 5.19 Case study firms appeared to vary considerably in the extent to which they had experienced difficulties in obtaining information about legal, regulatory or administrative requirements placed on them by their provision of services to other Member States. Many firms said that they had experienced none or very few difficulties.
- 5.20 Of the difficulties cited, almost all related to taxation. Indeed, of the barriers mentioned by firms, 12% related to tax. Firms said that tax systems were inherently complex, that it was a particular challenge when they sought to do business across several Member States and that even when advice was sought from professional advisors or from the tax authorities, it was difficult to get a clear or definitive answer. As discussed in the sub-section on the single point of contact, UK firms may benefit from improved systems for providing information relating to tax regimes in other EU Member States. Evidence from the case studies suggests that this benefit could accrue to firms seeking to provide services, as well as those seeking to establish.

- 5.21 Most firms indicated that they had spent little time in advance of providing services investigating the legal and regulatory regimes in their target markets. However, there were some exceptions to this, for example in the case of the firm in case study 9, discussed above.

Barriers linked to administrative inefficiency and a requirement to complete multiple applications

- 5.22 Only one firm cited a barrier which related to administrative inefficiency. This related to the need to have invoices approved by the local tax office before the client could pay them. The fact that no other firms had experienced barriers of this type is, in our view, likely to be linked to the relatively low level of administrative requirements which firms had encountered in providing services without establishment.

Natural barriers

- 5.23 Nearly 60% of the barriers to provision of services cited by firms were natural. Of these, cultural and language barriers were those most often cited.
- 5.24 Natural barriers appeared to be by far the most significant barriers faced by case study firms providing services temporarily in other Member States. In a significant number of cases, firms stated that they had decided not to pursue, or continue to pursue, business in one or more Member State because of natural barriers encountered. In all these cases, the firms in question had successfully provided services or established in other Member States.
- 5.25 Experiences of natural barriers included:
- Markets in which suppliers needed to be perceived as “local” in order to win work;
 - Markets in which procurement processes were difficult to understand and comply with unless a firm had a local base;
 - Markets in which there was a strong preference for doing business

face-to-face, making it difficult to sustain business relationships without a permanent base in a target Member State;

- Markets in which there was a culture of slow payment, leading to cashflow difficulties for UK firms which had to pay suppliers well in advance of receiving payment from customers; and
- Markets in which the final 10% of the invoiced price was assumed by customers to be a discount.

5.26 In some cases, these barriers resulted in firms considering the market for their service in certain Member States to be “closed” to overseas firms. However, in other cases, natural barriers did not prevent firms from winning work in their target Member State, but led to the work being unprofitable, due to the associated costs.

5.27 Some case study firms which had identified potential natural barriers to service provision had developed business models which involved the use of local partners to help them overcome these barriers. However, for these firms, a related difficulty was often finding and building a relationship with a suitable local partner with whom to do business.

Experience of provision of services across firms of different sizes

- 5.28 Many of the points made in connection with establishment by firms of different sizes apply also to the provision of services.
- 5.29 An additional factor appeared to be at play amongst the smallest case study firms, say those having fewer than 20 employees. In some of these firms, though not all, a lack of senior management time appeared to have been a limiting factor in overcoming barriers to providing services elsewhere in the EU. In these cases, it appeared that there was only one person in the firm in a position to oversee the expansion in question, and little opportunity for that person to delegate tasks downwards. If barriers were encountered, they had to be dealt with on top of that person’s usual workload. As a result, the businesses seemed to find the barriers particularly difficult to overcome. In one case, they had resulted in a decision not to seek further overseas work; in another, plans to expand

elsewhere in the EU were ongoing, but significant difficulties were being experienced in realising them.

Experience of provision of services across sectors

5.30 This part considers in detail the experiences of firms within the different sub-sectors covered by the case studies.

Legal services

5.31 As discussed in Section 4, the two smaller law firms we spoke to had responded to the internationalisation of the market for legal services by seeking to provide services temporarily in other EU countries rather than to establish. Both these firms had primarily done this by developing relationships with firms in other Member States with whom they could collaborate on cross-border cases. This reflected the fact that each Member State had its own law, and often clients needed specialist advice on this local law, which UK firms generally were not able to provide.

5.32 These two case-studies focused on doing business in different EU Member States. One firm, the larger of the two, found the main barriers were language and lack of face-to-face contact. These were largely overcome by using a local law firm whose staff could speak the local language and meet face-to-face with potential clients; however, they would pose a barrier should the firm wish to do more business in the Member State, and consider establishment in the future.

5.33 The smaller firm encountered a number of difficulties such that it now no longer actively pursues opportunities in other countries. The primary difficulty faced was the complexity of VAT rules relating to cross-border work. The firm had tried to clarify the issues but was still concerned that it might not be accounting correctly for VAT. This made it reluctant to undertake cross-border work. This firm had fewer than 20 employees. In our view, its small size was a factor in the impact that the barrier encountered had on the firm.

Estate agents

5.34 The two smaller estate agents we spoke to were both seeking to extend

their residential property business to the sale of properties in the same Member State. Both had decided not to establish initially but instead to enter into an arrangement with a business partner in the Member State.

- 5.35 Both firms had less than 25 employees. One of them had not experienced any difficulties in developing its arrangement to provide services. A key factor in this appeared to be the fact that the local business partner was an old friend of the Sales Director. The former individual initiated the arrangement, and appeared to have had a strong interest in ensuring the arrangement worked satisfactorily for the UK firm.
- 5.36 In contrast, the other case study firm, that described in case study 8, encountered significant difficulties in providing services. At the time of the case study, it had not yet succeeded in making sales in the target Member State.

Management consultants

- 5.37 Three of the four case study businesses in this sector were currently providing services elsewhere in the EU without having established.
- 5.38 One of these businesses was the firm in case study 9, which encountered some costs associated with meeting legal and regulatory requirements associated with its services as a franchisor, which might be saved under the Country of Origin principle. This was the sole barrier of any significance that businesses in this sector cited in connection with providing services elsewhere in the EU.

IT consultants

- 5.39 Four case study firms fell into this sub-sector: one large firm and three medium-sized. As will be discussed in Section 6, all but the large firm were providing services without establishing. This appeared to be largely due to the ease within which these firms believed they could service clients in mainland Europe whilst avoiding a local establishment and the cost this would involve.
- 5.40 The primary barriers cited, which all three firms experienced, were

language and cultural differences between themselves and their customers.

- 5.41 In addition to these, one firm mentioned that they found it difficult and time-consuming to agree contracts for the sale of licences to third-party resellers of their software (for example, consulting firms which designed and installed systems using the case study firm's software.) Reasons for the difficulties included the difference between UK and other EU law, and the differences in interpretation of the same law. In particular, there are differences in intellectual property law. In theory, this might be something that the Country of Origin principle might assist with. However, it seems difficult to see how this might work in practice, since the underlying issue – the difficulty of agreeing contract terms that all parties are comfortable with – would remain.
- 5.42 Another firm mentioned that withholding tax proved complex to reclaim in a particular Member State. However, this does not appear to be an issue that the Services Directive will improve.

Advertising

- 5.43 Of the five case studies undertaken in this sector, one, medium-sized business was providing services on a temporary basis.
- 5.44 This firm considered that the fixed costs of establishment were the key issue in determining the approach to be taken to doing business elsewhere in the EU. It had considered setting up an office in one Member State, but had decided that the projected revenues were insufficient to justify the costs involved. Policy-related barriers to establishment had not played a part in this assessment of costs. It did not do a significant amount of business outside the UK, but was willing to provide services abroad to its existing clients on a temporary basis where they wanted this. It had not encountered any problems except those of language in doing this.

Construction – advisory

- 5.45 Two of the six construction advisory services firms we spoke to were providing services in the case study market. Both were medium-sized

international firms of architects.

- 5.46 The first firm's business model for overseas work was to win a select number of projects, for which a local project office would be set up, staffed by the firm's employees and employees from local partner firms. Using partner firms to deliver the work alongside the UK firm helped the firms to overcome language and cultural barriers. By focusing on a small number of EU markets in which the UK firm had already established partner relationships, it had been able to work effectively to the tight timetables many projects required without having a permanent establishment in the market. An additional advantage of the partner model was that it was able to mix expensive UK staff with cheaper local resource in order to be competitive and meet local budget requirements. This was often particularly important in Member States in Eastern Europe.
- 5.47 In its case study market, this firm saw the barriers to provision of services to be primarily the cultural and language issues it sought to overcome through the use of local partners. It had not encountered any administrative or policy-related barriers.
- 5.48 The firm also mentioned, however, that it saw certain EU Member States as "closed markets", where it was very difficult to win work. The firm was not certain why this was, but perceived that clients had a strong preference for local firms. It had therefore chosen not to focus on pursuing opportunities in these markets.
- 5.49 The second firm had taken a similar approach, except that its network of partner firms in other Member States was more formal. Firms within this network, known as the Alliance, were bound by a memorandum of understanding. They bid jointly for work, having decided amongst themselves which members of the Alliance were best placed to deliver it. Often, projects required specialist expertise, and the team for the work would comprise firms local to the project along with a number of specialists from other territories to provide expert input. The model therefore improved firms' competitive advantage as well as helping them to overcome barriers to working overseas.

- 5.50 This firm had no specific knowledge of regulatory or administrative barriers to doing work overseas, due to its membership of the Alliance.

Industrial cleaning and building services

- 5.51 Three case studies were completed in these two sub-sectors. We discuss both sub-sectors together since they share many characteristics and the activities of two of the case study firms straddle both sectors.
- 5.52 One of the firms in these sectors only had experience of providing services elsewhere in the EU without being established. This was a large UK firm. Another, much smaller firm, had established in the recent past, but had just shut down this operation, and had continued to develop business elsewhere in the EU by providing services on a temporary basis.
- 5.53 The larger firm providing services was doing so via an alliance of firms from other EU Member States. This alliance was a separate legal entity: a European Economic Interest Grouping (EEIG). This enabled companies from different EU countries to enter together into contracts without the complications which arise from their being governed by different legal systems.
- 5.54 Commercially, the EEIG worked by allowing multi-national clients to contract with a single building services provider with pan-European reach. Services were provided in each locality by the member of the EEIG based in that locality. The revenues and costs from the contract were shared between members in order that they each receive the profits made in their locality.
- 5.55 The decision to enter into such an arrangement was primarily a commercial one: the UK firm was a family-owned business which had experienced very rapid growth in the UK. To win major contracts with multinational customers by providing a pan-European service would have required a great deal of financial resources and significant risk. The alliance allowed the firm to avoid this. However, a recognised additional benefit of this approach is the avoidance of certain linguistic and cultural barriers which would otherwise be encountered.

5.56 From this firm's point of view, however, there were no barriers to a single market which might be addressed by the Services Directive. Apart from the natural barriers mentioned, the only difficulty it had experienced was regional differences in the minimum wage in one Member State, which made it very difficult to agree appropriate pricing arrangements with customers.

5.57 The much smaller firm, which had continued to provide services after closing its joint venture in another Member State, reported that it had not encountered any policy-related barriers to doing this. However, it found that transporting bulky cleaning equipment was a problem, and also that some potential customers elsewhere in the EU were reluctant to employ UK-based firms. However, the firm did not perceive there to be any specific reason for this reluctance.

Commercial construction

5.58 As discussed above, we spoke to two firms within this sector, both of which were large firms established in their target markets.

Sub-contractor services

5.59 This sub-sector consisted of five firms, of which three were providing services on a temporary basis. None of these firms cited barriers which might be addressed by the Services Directive.

5.60 As discussed in the section on establishment, many of the sub-contractor firms provided services in conjunction with manufactured products. The issue of product standards was relevant to firms which were providing services on a temporary basis, as well as those which had established. Two such firms mentioned this issue.

5.61 For one firm, testing standards across the EU was the overwhelming problem the business faced. Its products were being produced to a standard which was nominally the same across the EU. In practice, however, despite harmonised standards, there were still independent testing houses in different Member States and firms were required to obtain testing certificates for each of the countries in which their products

were sold. The firm believed strongly that UK tests were more stringent than those in some other Member States. The firm believed that, as a result, UK-made products met higher standards and were, therefore, more expensive. However, when they were sold in other parts of the EU market, they received the same certifications as other products of lower quality.

5.62 This had had a significant impact on the firm's business. Export sales had declined significantly since the testing regime had been in place, as lower quality products meeting the same product standards entered the market elsewhere in the EU. Export sales had been around £1.8m per annum 5-10 years ago, and were currently £0.4m. In addition, each testing house charged £4-10k per test, which gave rise to a significant cost of entry to each Member State market.

5.63 For another firm, although standards were having a less significant impact on the business, they were still mentioned. This firm cited one Member State where a separate certification was required for each federal state within the country. They gave the average cost of this as £17k per product sold in this Member State.

5.64 These were the only non-natural barriers cited by firms in this sub-sector.

6 Other impacts on UK firms

Key findings

- 6.1 No case study firm considered the costs of its compliance with the Services Directive to be significant, based on its present understanding of it.
- 6.2 However, the majority of firms considered that the information available from the Directive relating to potential compliance requirements was not specific enough to be able to give a robust indication of the costs that could arise. We consider that conclusions on the potential costs of compliance to UK firms should not be drawn until there is more detailed information about the requirements for firms. In particular, compulsory professional indemnity insurance in some sectors has the potential to drive significant extra costs to UK businesses, but no estimate of these costs can be made before it is known which sectors this might apply to, and what level of cover would be required.
- 6.3 Most case study firms broadly supported the principles behind the Directive and believed that opening up the market in services would be beneficial to themselves and to the UK as a whole. Certain firms voiced some concerns, but these tended not to be sufficient to colour firms' overall belief in the benefits of a single market.
- 6.4 A common belief amongst case study firms was that the UK market was already very open to competition from firms from other EU Member States, and, therefore, that there would be no additional threat as a result of the

Services Directive.

Compliance costs

- 6.5 Transposition of the Services Directive in its current form into UK law has the potential to generate additional costs for UK businesses in the services sector. Our case studies set out to identify and, where possible, quantify the extra costs that the case study businesses would potentially incur.
- 6.6 The main requirements under the Directive which may lead to compliance costs are:
 - Awareness training;
 - Provision of information to consumers regarding:
 - Key features of the firm and its services;
 - Details of any after-sales guarantee or warranties; and
 - Contact details in case of a complaint/need for additional information.
 - Possible requirements for professional indemnity insurance in some sectors, giving rise to additional costs where such insurance is not already standard.

- 6.7 The precise obligations which will be placed on firms by the Directive are not yet clear. As a result, many businesses did not find the information available sufficient to estimate the costs which might be involved.
- 6.8 Potentially all firms within the services sector could be impacted by this aspect of the Directive. The businesses we spoke to are not representative of the entire sector. Indeed, it may be that the firms we spoke to are less likely to experience additional costs as a result of the Directive since they are, by definition, firms with greater than average experience of doing business elsewhere in the EU. Such firms may be better prepared to respond to the requirements of the Directive as a result of being, on average, larger and more sophisticated than other businesses which might seek to do business elsewhere in the EU in the future. This is an issue which must be considered when interpreting the findings from the case studies.
- 6.9 Some businesses we spoke to were able to provide some comments on certain aspects of the proposals, which we discuss below.

Awareness training

- 6.10 Many businesses did not see the Directive as giving rise to a significant need for awareness training. Where businesses believed awareness training might be required, they typically considered that this could be done at little or no extra cost by adding it to existing training events.

Provision of information to customers

- 6.11 Most businesses which expressed an opinion believed that they already provided good quality information to their customers. From the information in the draft Directive it proved difficult to identify areas where information requirements might incur extra cost.

Professional Indemnity (PI) Insurance

- 6.12 A number of case study firms indicated that they either already had PI insurance covering their work throughout the EU, or were intending to get it. However, this was not the case for all case study firms. The impact of compulsory PI insurance for some certain sectors under the Directive

would be dependent on the identity of the sectors in question. PI cover is common in most of the sub-sectors covered by the case studies, for example, the legal services, IT and management consultancy, advertising and construction advisory sectors. Evidence from case studies suggests that smaller firms may be less likely to hold PI insurance, and therefore be more likely to incur additional cost if the Directive were to require cover in their industry.

Impact on UK market

- 6.13 Most case study firms broadly supported the principles behind the Directive and believed that opening up the market in services would be beneficial to themselves and to the UK as a whole.
- 6.14 Few firms were well-informed about the Services Directive prior to our interview, either in general terms or, in particular, as regards the details. As a result, few were able to give considered views about the potential impact on their business or the UK as a whole. Nevertheless, most case study firms had a clear view of their competitive position, and how this might, in principle, be impacted by the Directive.
- 6.15 There was also a general perception that there would be little increased threat from overseas firms resulting from it. A number of case study firms based this view on consideration of their own competitive position, saying that they were:
- Niche players;
 - Market leaders; and/or
 - Had strong connections with their clients in the UK.
- 6.16 Others based their belief on their perception that firms from other EU Member States had limited interest in doing business in the UK. Many firms believed that being English-speaking gave UK firms a strong competitive advantage in doing business in the UK. They also considered that, relative to other EU languages, they had an advantage in doing business outside their home Member State, since they perceived that

English was more widely spoken and understood in the EU as a second language than other EU languages.

- 6.17 Many case study firms believed that the UK market was already highly open, and that the Directive would therefore have little impact on its attractiveness to overseas firms. Indeed, many considered that their major EU competitors were already active in the UK.
- 6.18 In contrast, a small number of firms perceived a potential threat to the UK related to its relatively high levels of employment and health and safety regulation, especially when compared to the recently acceded Member States.
- 6.19 Some case study firms specifically mentioned the importance of excluding health and safety from the Country of Origin Principle. Others needed reassurance that the Principle would not allow overseas firms to circumvent the UK minimum wage and were concerned that cheaper labour from elsewhere in the EU might undercut domestic labour.
- 6.20 Some firms appeared to believe that the Directive might increase the flow of workers from the EU into the UK. This was seen as a potential benefit by some firms, particularly in construction-related sectors, where skills shortages exist in some areas.

Differences by firm size and sector

- 6.21 There were no clear messages about how the potential impact of the Directive was viewed differently by firms in different sectors.
- 6.22 There was some evidence that larger firms were more aware of a potential competitive threat from the Directive. However, this was not universal. In part this awareness might be explained by the fact that larger firms often had greater awareness of the Directive and, therefore, gave more considered answers.
- 6.23 Views on the extent of any threat appeared to vary from business to business with little regard to industry sub-sector.

7 Conclusions

Key findings

7.1 The case study approach used in this study allows us to see how a range of UK firms have approached decisions about whether to provide services cross-border or establish in other EU Member States. This has identified the key factors influencing these firms in their decisions and, specifically, the role played by various barriers to the Internal Market, including those addressed by the proposed Services Directive. This has given us an understanding of how the Services Directive would potentially impact on these firms.

7.2 From the evidence of the case studies, we can begin to characterise the firms and, in particular, those firms that would be likely to benefit from larger than average savings as a result of the introduction of the Directive. For example, such firms are likely to be:

- Seeking to establish, rather than provide services, elsewhere in the EU;
- Intending to grow their market share and/or have multinational organisations amongst their clients;
- Able to draw on only limited levels of internal expertise relating to doing business elsewhere in the EU;
- More inclined to establish from scratch rather than to acquire an

existing business;

- Seeking to establish in EU Member States typically having higher levels of regulation or administration connected with establishment; and
- Intending to use UK rather than local staff to establish: case study firms reported that local staff often had good contacts or local knowledge which appeared to make it relatively easy for them to find out what was needed to establish and/or to complete complex establishment processes; firms using UK nationals rather than locals to establish in other Member States might therefore be expected to benefit more from the Services Directive.

7.3 Given that such firms will be seeking to establish elsewhere in the EU, the majority of them are likely to be large firms (i.e. having more than 250 employees). However, it will be important to consider those smaller businesses which also meet these criteria, as they may, individually, benefit more from the Services Directive.

7.4 Other firms which might benefit significantly from the Directive include those very small firms (those with less than 20 employees) which are considering temporary provision of services. As we have discussed, these might be put off provision of services by the current complexity of regulation involved.

7.5 A case study approach, however, has some key limitations, as we discuss below. In particular, the non-representative nature of the businesses we spoke to means that we cannot assume that the Services Directive will impact all firms in the UK service sector in the way that the experiences of the case study firms suggest. Nevertheless, the detailed understanding which is generated by the case studies points to some tentative conclusions about the way in which the Services Directive might impact on UK firms. These are set out below.

Impact on the right of establishment

- The study provides little indication that the Services Directive would have significantly increased case study firms' proclivity to establish in other EU Member States, for two reasons: first, these firms perceived few, if any, prohibitive policy barriers at present; second, those barriers which would be reduced by the Services Directive do not appear to give rise to costs which would have been significant enough to alter the decision about establishment. However, given the limited number of case study firms, the study was unable to verify whether this would also be the case for firms which have not already established in another Member State.
- The Services Directive could reduce the cost of establishing in other EU Member States, for example by:
 - Reducing the cash costs involved, for example, by reducing the need for notaries' services; and
 - Reducing the opportunity costs involved, for example by:
 - Reducing the elapsed time required to complete establishment procedures; and/or
 - Reducing management time required to oversee the establishment process or administer changes to the business structure.

Estimates of the potential cost reduction vary significantly, from less

than £10k of one-off costs to £50k of ongoing costs.

- Any reduction in costs may be a more significant proportion of revenues for smaller firms, since policy barriers to establishment appear to give rise to costs which do not vary significantly with firm size. However, due to the similarly fixed overall costs of establishment (driven by the need to lease an office, hire staff and develop business), smaller businesses are less likely to establish in other Member States than larger firms. However, of the population of firms seriously considering establishing elsewhere in the EU, small firms may benefit, individually, more from the Services Directive than larger firms.

Impact on the right of provision of services

- Some industry-specific barriers which might be reduced by the Services Directive were cited in case studies; however, many other barriers, including those which applied to wider groups of firms, would not be impacted by the Directive.
- On the basis of these studies, it is therefore difficult to make an assessment of the general impact of the Services Directive on UK firms which are seeking to provide services temporarily elsewhere in the EU, since few firms in these case studies currently perceive themselves as encountering significant barriers to the provision of services which would be reduced by the Services Directive. One possible reason for this is that these firms spend relatively little time exploring the regulatory environment in other Member States, prior to providing their services there, and are thus not fully aware of the full impact the Directive would have.
- The possible exception to this perception is very small firms (those with about 20 employees or less), which appear to find it disproportionately difficult to identify and comply with regulations which might apply to their businesses elsewhere within the EU. This may be due to a lack of resilience in senior management capacity.

Compliance costs

- Estimation of the potential costs of compliance with the Services Directive is hampered by the lack of detail in the current draft of the requirements that will be placed on firms. Evidence from the case studies suggests that the costs of compliance are unlikely to be significant. However, this should be reassessed in the light of any development of further detail about the requirements of the Directive for UK firms.

Impact on the UK market

- UK firms do not feel significantly threatened by the Services Directive and are, in general, positive about the benefits of a single market in services within the EU.

Limitations of this study

- 7.6 Whilst the case studies provide some important insights into the potential impacts of the Services Directive, there are some important limitations surrounding the interpretation of the case study evidence within this framework.
- 7.7 As noted, the case study firms are not representative of firms within the UK as a whole. Therefore, they cannot be used alone to understand how the Services Directive will impact the whole population of UK firms. Significantly, our case studies included only a few firms which had considered doing business elsewhere in the EU but had decided not to do so as a result of the barriers they had encountered, including a number of firms which had provided services in certain other Member States. These firms tended to cite natural barriers as reasons for not pursuing opportunities in particular Member States. We do not know how representative of services firms as a whole this might be.
- 7.8 We also do not know to what extent the group of businesses which have yet to expand elsewhere in the EU (at all, or into further Member States), but which might do in the future, resembles the group of businesses which have already done so. The case studies are based on the latter group of firms. However, firms in the former group are the key potential

beneficiaries of the Services Directive.

- 7.9 It proved more difficult to recruit case studies that had recently expanded into some Member States compared with others. Since different Member States have different barriers associated with them, we do not know how representative the case studies were in terms of the types of barriers faced by businesses.
- 7.10 The case studies highlighted the difficulty of obtaining good quality cost information from some firms. The case studies revealed that, in some cases, different firms experienced very similar barriers, yet some firms could cost their impact whilst others could not. This often seemed to be because firms did not themselves think of incremental management activities as giving rise to costs. As a result, they often did not capture the information needed to cost the impact of a given barrier. Where costs were provided it was difficult to assess their accuracy. Studies of this type can suffer from bias: for example, respondents may systematically overestimate the missed opportunities that the barriers preclude and underestimate the potential competitive threats.

Relationship with other work on the Services Directive

- 7.11 This study forms part of the evidence base on the potential impact of the Services Directive in the UK. Due to the complex nature of the issues involved, and the lack of systematic data on the services sector, a number of approaches are necessary to explore the numerous potential consequences of the Directive. This study, with its case study approach, complements other work, such as the analysis of national statistics, econometric modelling, and analysis of the effects of earlier product market liberalisations in the EU. It contributes to the evidence base by allowing a detailed investigation into impacts at the micro level. It enables us to understand how and why the Directive can benefit UK firms. However, as discussed, it does not itself provide an explanation of how the Directive will impact the economy as a whole, since it is not based on a representative or statistically significant sample.

Areas for further work

7.12 There are several areas of further work which may strengthen and develop the conclusions reached, and assist in quantifying the benefit from the Services Directive. These include:

- Desk-based research to identify those Member States where there are particularly high barriers to establishment and provision of services, and the sectors to which they apply;
- Desk-based research to identify those barriers to temporary service provision in other EU Member States which might be reduced by the Country of Origin principle, and the sectors to which they apply;
- A survey of businesses to help identify how many businesses are likely to have the characteristics which suggest they will benefit substantially from the Services Directive;
- A survey of businesses to identify the extent to which firms have decided not to pursue business opportunities in other EU Member States as a result of barriers which might be reduced by the Directive; and
- In the light of the above work, additional case studies with specific types of businesses in order to understand in more detail the issues which are identified. (For example, case studies might be undertaken with businesses which have either sought to provide services in Member States or operate in sectors which desk-based research suggests have specific barriers which would be reduced by the Services Directive.)

Annex A – Case study template

The following potential barriers were identified at the start of this study, in order to inform development of the case study template.

Barriers to establishment

Prohibitive barriers

- Nationality requirements in respect of shareholders, management and staff teams
- Requirements that a percentage of the firm's management board must be residents in the Member State
- Requirement (direct or indirect) to give up an establishment in another Member State in order to become established in the (Case Study) Member State

Barriers which relate to regulations and legislation

- Specific instances of disproportionate or unnecessary regulation
- Obligation to register with an administrative authority, a professional body or trade association in order to establish in the Member State
- Obligations to be registered or have exercised activity for any period of time in order to establish
- Requirements from the Member State for firm to have any form of reciprocal trading in the UK
- Restrictions on the number of authorisations
- Requirement that firm has to provide other services jointly with its service
- Requirements which stipulate a minimum number of employees in order to establish

- Tax related barriers
- Issues repatriating capital/dividends and branch profits to UK from the Member State in which the firm is established or wished to establish
- Restrictions on advertising by firm of the skills it provides e.g. by regulated professions
- Demands for joint working with firms operating in the Member State e.g. some form of mandatory joint venture
- The incremental costs of non-domestic legal and administrative requirements increasing the cost of business in a Member State leading to the service providers business being less efficient and competitive than those of domestic providers
- Prohibition on the supply of a service by self-employed providers or by providers who are not publicly appointed
- Obligation to provide a financial guarantee or to take out insurance with a provider from the host Member State
- Demands for documents which are not required in the UK
- Demands for documents that are not required of local firms
- Requirements to provide work permits for staff from third party territories who the firm requires to work in the Member State in which it has established
- Territorial restrictions
- Requirements as to businesses' legal form
- Requirements relating to shareholding
- Reserving right to service activity to particular providers, other than due to qualification or EC Law
- Ban on more than one establishment in the territory
- Fixed minimum or maximum tariffs
- Prohibitions or obligation on underselling and sales
- Requirements that providers must allow access to other providers services

- Requirement to carry out an economic (needs) test
- Involvement of competing operators in authorisation or supervision procedures
- Provision of financial incentives to competitors, to which UK firms are not entitled
- Situations where consumers in the Member State in which a firm is trading or wishes to trade have been prevented or dissuaded from using the services of the firm by virtue of local measures

Barriers arising from opaque administrative requirements and lack of information

- Difficulties in getting information about establishing or setting up a subsidiary in the Member State
- Procedures lacking objectivity and transparency

Barriers linked to administrative inefficiency and a requirement to complete multiple applications

- Requirement to supply notifications and declarations or documentation in a particular format (e.g. an original, a certified copy or a certified translation)
- Requirement to visit multiple locations to complete the necessary formalities and applications for authorisation
- Inability to complete forms "electronically" which is not also faced by domestic firms
- Specific instances where authorisation has been delayed beyond point of establishing the conditions for authorisation have been met
- Failures to provide fully reasoned explanations of refusals/withdrawal of authorisations

Natural barriers

- Language and cultural differences in consumption and commercial preferences
- Costs associated with working in a language other than English (e.g. translation, recruitment, etc)
- Factors which affect consumers' confidence to buy services from which are not experienced in the UK
- Risks linked to the absence of a common currency

Barriers to provision of services

Prohibitive barriers

- Any requirements to be established in the Member State in question before they can provide a service?
- Any requirement for specific contractual requirements between the provider and the recipient which prevent or restrict the supply of a service by providers?

Barriers which relate to regulations and legislation

- Any requirement to obtain prior authorisation in any form e.g. to obtain a permit or licence?
- Any obligation on firms to possess an identity document issued by the relevant Member State competent authority?
- Any restrictions on the use of services provided by operators established in another Member State?
- Any discriminatory requirements based on nationality/place of residence?
- Any requests for prior authorisations for workers who are temporarily posted to the Member State of posting
- Requirements to provide work permits for staff from third party territories who the firm requires to work in the Member State in which it has established
- The lack of information to users concerning availability and quality of service provision, which stops them from using services from another Member State
- Any obligation to provide means of redress to service recipients (i.e. customers) in the home Member State (i.e. case study country)
- Any incremental consumer protection requirements which have added to the costs of providing services?
- Any restrictions on advertising of the skills a firm provides e.g. by regulated professions?
- Any specific instances of disproportionate or unnecessary regulation? If so, what?
- Any requirements for firms to supply notifications declarations or documentation in a particular format?

Barriers arising from opaque administrative requirements and lack of information

- Difficulties in getting information about regulation or other requirements in the Member State
- Procedures lacking objectivity and transparency

Barriers linked to administrative inefficiency and a requirement to complete multiple applications

- Requirement to supply notifications and declarations or documentation in a particular format (e.g. an original, a certified copy or a certified translation)
- Requirement to visit multiple locations to complete the necessary formalities and applications for authorisation
- Inability to complete forms "electronically" which is not also faced by domestic firms
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Natural barriers

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- Factors which affect consumers' confidence to buy services from which are not experienced in the UK
- Risks linked to the absence of a common currency

Case study template

The following template was used to collection information relating to the case study businesses.

Company background

Company name
Sub-sector
Size of firm/employee numbers
Legal form of firm
Market capitalisation (where applicable)
Profit before tax and Interest (PBIT)
Profit after tax (PAT)
Turnover by principal activity
Turnover by principal country/region
Which EU Member States? When? What mode of entry? What record of success?

Company strategy

STRATEGIC OBJECTIVES What was the company's strategic vision (when the case study decision was made)? What were the firm's strategic objectives over the next few years? How was entry into the [case study country] expected to contribute to realising these objectives?
MARKET ATTRACTIVENESS How did you prioritise and select your target markets? Which markets did you regard as your priority – distinguish between the UK, the rest of the EU and the rest of the world (e.g. Australasia, Africa, the Americas)? What did you see as the specific attractions of the market in the [case study country] (e.g. market size, market growth potential, set-up/operating costs, intensity of competition, potential profit margins, previous experience of EU market)?
CUSTOMERS Who were your target customers in the [case study country]? Were they from the public or private sectors (or both)? Were you looking to serve any other (geographic) markets from the case study country? How easy or difficult have you found it to penetrate/ access the EU markets which you have targeted compared with doing business in the UK? What were the major issued you encountered?
COMPETITION Who were your principal competitors? How did they compare with your firm in terms of size and market share? What was your perception of the intensity of competition in the [case study country] – was it dominated by domestic providers or was there significant penetration by providers from other EU Member States?
ORGANISATIONAL STRUCTURE How is your firm organised? What are the key drivers of the organisational structure? What organisational structure supports the firm's

activities in the case study country? Is the structure different to the adopted in other EU Member States markets or elsewhere in the world?
SUPPLIERS What are your key inputs – distinguish between materials and people/skills? How important is access to materials? What was the expected availability of local suppliers of materials? What type of skills was required? To what extent could they be outsourced/sub-contracted?
MODE OF ENTRY What was your preferred method of entry into new EU markets? Distinguish between agent/distributor, export, acquisition. Does your preferred method of market entry vary between countries/Member States? If so, why?

Barriers to the Internal Market in services and the potential impact of the Directive

Complete based on discussion with the firm and potential barriers identified, for the EU market in question; Identify whether barrier would be reduced by the Directive; Qualify impact on case study business, distinguishing cash costs and management time (costed) and one-off and ongoing costs.

Potential opportunities created by the Services Directive

To what extent have the barriers identified prevented your firm from expanding its activities in the EU, especially within the case study country?
Without the barriers, how much greater would you have expected your volume of output and your turnover to have been?
Would this additional turnover have been earned at the expense of your competitors (or would the market have been larger, because you would have been able to offer lower prices)?
Who would you have expected to be your closest competitors?
Without the barriers, how much greater would you have expected your profits to have been?

Impact of the Services Directive on the UK market

When the EU Services Directive enters into force, do you anticipate greater competition from firms currently established in other EU Member States?
How significant is the likely threat? Where will the greatest competitive threat come from? What can you do to respond to the threat?

Compliance costs

What do you estimate the costs of compliance with the Directive to be for your firm?
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Annex B – Case study sample frame

The following sample frame was used to recruit case study firms.

Recently established and/or provided services	25	Decided not to establish and/or provide services	13
• Business services	15	• Business services	15
• Estate agency	2-3	• Estate agency	2-3
• Advertising	2-3	• Advertising	2-3
• Management consultancy	2-3	• Management consultancy	2-3
• Industrial cleaning	2-3	• Industrial cleaning	2-3
• IT consultancy	2-3	• IT consultancy	2-3
• Legal services	2-3	• Legal services	2-3
• Construction	10	• Construction	10
• Commercial construction	2-3	• Commercial construction	2-3
• Advisory	2-3	• Advisory	2-3
• Subcontractor services	2-3	• Subcontractor services	2-3
• Building services	2-3	• Building services	2-3
• France	4-5	• France	2-3
• Germany	4-5	• Germany	2-3

Recently established and/or provided services	25	Decided not to establish and/or provide services	13
• Italy	4-5	• Italy	2-3
• Netherlands	4	• Netherlands	2-3
• Poland	4-5	• Poland	2-3
• Slovakia	4	• Slovakia	2-3
• Small (less than 50 employees)	say 50%	• Small (less than 50 employees)	Say 50%
• Medium (50-249 employees)	say 30%	• Medium (50-249 employees)	Say 30%
• Large (250 and over employees)	say 20%	• Large (250 and over employees)	Say 20%

The sub-sectors were defined by the Standard Industry Codes (SIC) shown below:

Market Sectors and SIC (2003) codes	Illustrative description of activities
Business Services	
Estate agency 7031	Intermediation in buying, selling, renting and appraising real estate
Management consultancy 7414	Provision of advice, guidance or operational assistance to business and the public sector
Legal services 7411	Activities of patents and copyright agents, barristers at law, solicitors, other legal activities (e.g. notaries)
Advertising 744	Sale or leasing activities of advertising space or time. Planning, creation and placement of advertising activities.
Industrial cleaning 747	Includes traditional cleaning services (e.g. floors and walls), Window cleaning, Disinfecting, specialised cleaning, (e.g. hospitals), furnace and chimney/flue cleaning
IT consultancy 721, 722	Hardware and software consultancy

Market Sectors and SIC (2003) codes	Illustrative description of activities
Construction Services	
Subcontractor services 452, 453, 454	Including; Electricians, gas fitters, roofers, plasterers, kitchen and bathroom fitters
Commercial construction 45211	Construction of offices and business premises such as warehouses and business units shells (not factories or civil engineering projects)
Construction - Advisory 7420	Including Surveyors; Architects; Construction Engineers.
Building services 7487 (classified under SIC(92) as 7484 ⁷), 74701, 74602	Including; repairs and maintenance services related to facilities management - post, document handling, catering office cleaning

⁷ The SIC codes were updated in 2003, and as a result of this, code 7484 was discontinued. Businesses classified in 7484 under SIC (92) are classified under 7487 in SIC (2003).

The following tables show the mix of case studies achieved in practice.

Table to show case studies by sector

Sub-sector	Companies contacted	Interviews completed
Legal services	13	4
Management consultants	101	4
IT consultants	89	4
Industrial cleaning	74	2
Estate agents	35	4
Advertisers	115	5
Commercial construction	114	2
Construction – advisory	52	7
Construction – sub-contractor	34	5
Building services	31	1
Total	658	38

Table to show number of cases studies by size and whether they established or provided services

Size	Case studies involving establishment	Case studies involving provision	Case studies involving both establishment and provision	Total	Percentage of case studies by size
Small (less than 50 employees)	2	9	0	11	29%
Medium (50 -250 employees)	3	7	1	11	29%
Large (more than 250 employees)	15 ⁸	1	0	16	42%
Total case studies	20	17	1	38	100%
Percentage case studies by type of activity in EU (%)	53%	45%	3%	100%	

Table to show percentage of cases of each size which established and provided

Size	Case studies involving establishment	Case studies involving provision	Case studies involving both establishment and provision	Total
Small (less than 50 employees)	18%	82%	0%	100%
Medium (50 -250 employees)	27%	64%	9%	100%
Large (more than 250 employees)	94%	0%	6%	100%

⁸ Of these firms, 7 established from scratch in their target Member State, 5 established by acquisition, and 3 had used both approaches in (different) target Member States. None of the small and medium-sized firms which had established in their target Member States had done so by acquisition.

Annex C – Sector structure

This annex provides information about the number and size of firms in the UK in each of the sub-sectors from which we recruited case study firms.

Estate agency (all relevant SIC codes)

Turnover (£)	Businesses	Employees	Total Turnover (£)
0 <1,000	11,311	40,132	2,108,190
1,000 <5,000	569	15,012	1,078,799
5,000 <10,000	57	5,035	386,149
0,000 <20,000	22	2,909	303,390
20,000 <40,000	10	4,418	295,018
40,000 and over	19	27,020	1,725,682
Total	11,988	94,525	5,897,228

Management consultants (all relevant SIC codes)

Turnover (£)	Businesses	Employees	Total Turnover (£)
0 <1,000	72,822	127,422	6,935,210
1,000 <5,000	1,462	28,023	2,962,725
5,000 <10,000	196	9,137	1,337,462
0,000 <20,000	96	9,192	1,340,887

Turnover (£)	Businesses	Employees	Total Turnover (£)
20,000 <40,000	62	9,678	1,694,828
40,000 and over	30	25,695	4,877,349
Total	74,668	209,148	19,148,462

Legal services (all relevant SIC codes)

Turnover (£)	Businesses	Employees	Total Turnover (£)
0 <1,000	22,252	85,094	4,420,039
1,000 <5,000	1,735	65,581	3,513,174
5,000 <10,000	218	22,423	1,508,811
0,000 <20,000	116	18,550	1,575,688
20,000 <40,000	54	17,266	1,520,037
40,000 and over	46	45,862	5,340,349
Total	24,421	254,776	17,878,099

IT consultancy (SIC code 721)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	3,650	10	636	96.1	49.0	23.3
Small (10 - 49 employees)	125	2	222	3.3	10.9	8.2
Medium (50 - 249 employees)	20	*	*	0.5	*	*
Large (250 or more employees)	5	*	*	0.1	*	*
Total	3,800	20	2,726	100.0	100.0	100.0

IT consultancy (SIC code 722)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	20,545	61	4,800	86.7	20.5	12.9
Small (10 - 49 employees)	2,515	50	5,544	10.6	16.6	14.9
Medium (50 - 249 employees)	550	57	8,133	2.3	19.0	21.9
Large (250 or more employees)	100	132	18,643	0.4	44.0	50.2
Total	23,710	299	37,121	100.0	100.0	100.0

Advertising (all relevant SIC codes)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	6,195	22	3,251	83.2	26.5	18.4
Small (10 - 49 employees)	1,050	20	4,125	14.1	23.6	23.3
Medium (50 - 249 employees)	165	*	*	2.2	*	*
Large (250 or more employees)	35	*	*	0.5	*	*
Total	7,445	83	17,712	100.0	100.0	100.0

Industrial cleaning (all relevant SIC codes)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	8,005	31	1,181	77.3	8.3	17.5
Small (10 - 49 employees)	1,600	34	705	15.5	9.1	10.5
Medium (50 - 249 employees)	545	61	639	5.3	16.4	9.5
Total	10,355	372	6,740	100.0	100.0	100.0

Subcontractor services (SIC code 452)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	50,435	179	18,582	85.9	29.4	20.2
Small (10 - 49 employees)	7,080	138	15,362	12.1	22.6	16.7
Medium (50 - 249 employees)	955	94	14,281	1.6	15.5	15.5
Large (250 or more employees)	220	199	43,741	0.4	32.6	47.6
Total	58,690	610	91,966	100.0	100.0	100.0

Subcontractor services (SIC code 453)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	23,475	85	6,032	84.0	31.0	21.5
Small (10 - 49 employees)	3,970	77	6,168	14.2	28.1	22.0
Medium (50 - 249 employees)	425	41	3,647	1.5	15.1	13.0
Large (250 or more employees)	60	71	12,153	0.2	25.8	43.4
Total	27,930	273	28,000	100.0	100.0	100.0

Subcontractor services (SIC code 454)

	Number of Enterprises	Employment ('000s)	Turnover (£m)	% of Enterprises	% of Employment	% of Turnover
Micro (1 - 9 employees)	21,975	77	6,484	88.2	46.0	46.8
Small (10 - 49 employees)	2,680	49	4,187	10.8	29.3	30.2
Medium (50 - 249 employees)	240	20	1,897	1.0	12.1	13.7
Large (250 or more employees)	25	21	1,294	0.1	12.6	9.3
Total	24,920	168	13,861	100.0	100.0	100.0

Commercial construction (all relevant SIC codes)

Employees	Businesses	Employees	Total Turnover (£)
0 <50	18,238	35,279	3,711,493
50 <250	74	6,799	1,022,823
250 and over	12	7,659	3,034,752
Total	18,324	49,737	7,769,068

Construction – advisory (all relevant SIC codes)

Turnover (£)	Businesses	Employees	Total Turnover (£)
0 <1,000	51,793	120,694	6,115,734
1,000 <5,000	2,087	56,048	4,288,082
5,000 <10,000	275	19,109	1,903,046
0,000 <20,000	150	23,337	2,046,052
20,000 <40,000	86	19,196	2,425,388
40,000 and over	72	62,500	7,388,400
Total	54,463	300,884	24,166,702

Building Services (SIC Code 7484)⁹

Turnover (£)	Businesses	Employees	Total Turnover (£)
0 <1,000	74,314	149,883	7,345,914
1,000 <5,000	1,972	46,141	4,028,047
5,000 <10,000	290	14,588	2,020,284
0,000 <20,000	122	13,289	1,724,915
20,000 <40,000	78	12,178	2,127,636
40,000 and over	60	45,811	7,664,530
Total	76,836	281,890	24,911,326

⁹ This data is drawn from the Annual Business Inquiry (ABI) for 2002. This was conducted using the SIC (92) codes. The SIC codes were updated in 2003, and as a result of this, code 7484 was discontinued. Businesses classified in 7484 under SIC (92) are classified under 7487 in SIC (2003).

Building Services (SIC Code 74602)

Employees	Businesses	Employees	Total Turnover (£)
0 <50	4,835	33,678	1,124,622
50 <250	238	23,010	655,260
250 and over	62	102,836	2,148,848
Total	5,135	159,524	3,928,730

Building Services (SIC Code 74701)

Employees	Businesses	Employees	Total Turnover (£)
0 <50	8,552	80,132	1,516,086
50 <250	592	59,347	617,551
250 and over	212	239,553	2,250,613
Total	9,356	379,032	4,384,250

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