

European Union Funding and SME Competitiveness: Do Public Grants Produce Sustainable Private-Sector Growth?

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Abstract

Public grants to small and medium-sized enterprises constitute an important component of European Union cohesion, innovation, digitalization, regional-development, and competitiveness policy. Governments justify these interventions through market failures, financing constraints, regional disparities, and innovation externalities. Yet the central policy question is not whether recipient firms spend grant funding or complete subsidized projects. It is whether public support creates economic activity that would not otherwise have occurred and whether the resulting improvements persist after the subsidy ends. This paper examines the effects of EU grants on SME investment, sales, employment, productivity, innovation, and long-term competitiveness. The literature produces a nuanced conclusion. Grants frequently increase investment, assets, turnover, employment, and innovation, but effects on total factor productivity and long-term competitiveness are less consistent. Stronger causal evidence identifies substantial positive effects from targeted research and innovation grants, particularly among younger, smaller, financially constrained firms. Other evaluations show that poorly targeted schemes can finance firms that would have invested anyway or generate little measurable additional performance. The paper argues that the relevant distinction is therefore not grants versus no grants, but grants that relax genuine constraints versus grants that subsidize commercially viable investment that would already have occurred. Sustainable policy should emphasize additionality, competitive selection, productivity rather than expenditure, complementary managerial capabilities, private co-investment, and evaluation against credible counterfactuals.

Keywords: European Union; SMEs; public grants; cohesion policy; ERDF; productivity; competitiveness; innovation; additionality

1. Introduction

SMEs dominate the European business population, so programmes designed to improve their productivity and investment can influence regional and national economic performance. European funding supports machinery, research and development, digitalization, internationalization, training, energy efficiency, and many other business investments.

The policy rationale is strongest where markets underprovide finance. Young or innovative firms may lack collateral, while research projects create knowledge spillovers that the investing company cannot fully capture. In such cases a socially valuable project may be delayed or abandoned even though its broader economic return is positive.

The central evaluation problem is counterfactual. If a firm would have made the same investment without a grant, the programme changes who pays rather than what economic activity occurs. The concept of additionality is therefore fundamental to understanding whether public support creates sustainable private-sector growth.

2. Additionality and the Logic of Intervention

Additionality can be examined at several levels. Input additionality occurs when the grant causes a firm to invest more money, capital, or labour than it otherwise would. Output additionality occurs when that extra input generates higher sales, productivity, innovation, exports, or survival. Behavioral additionality occurs when the programme changes the way the firm operates, for example by creating formal research capability or improving management systems.

These forms of additionality do not necessarily appear together. A firm can purchase more machinery without becoming more productive if demand, skills, or management capability are inadequate. A company can hire additional workers and grow turnover while producing little improvement in output per worker.

The policy objective therefore needs to be explicit. A programme intended to create employment may rationally value headcount growth, while a competitiveness programme should place greater weight on productivity, innovation, and sustainable market performance.

3. What the European Evidence Shows

A broad systematic review of European SME grants found predominantly positive effects on firm survival, employment, assets, and sales, but mixed results for labour productivity and total factor productivity (Dvouletý et al., 2021). This pattern suggests that public money can expand the scale of firms more easily than it can improve the efficiency with which firms combine inputs.

Hungarian evidence similarly shows increases in employment, sales, capital intensity, and labour productivity among supported firms, while total factor productivity results are much less consistent (Muraközy & Telegdy, 2023). Portuguese quasi-experimental evidence finds positive effects on sales and labour productivity, but limited employment effects and important differences between tradable and non-tradable sectors (Alexandre et al., 2025).

The common lesson is that growth and competitiveness are not identical. A company can become larger because it uses more labour and capital without becoming structurally more productive.

4. Selection Bias and Counterfactual Evaluation

Grant recipients are rarely random firms. Evaluators often select companies with stronger business plans, better finances, or greater growth potential. As a result, a simple comparison between beneficiaries and the average SME can greatly overstate programme impact.

Credible evaluation therefore requires a counterfactual group that resembles recipients. Regression discontinuity around funding thresholds, matched unsuccessful applicants, natural experiments, and carefully designed difference-in-differences analyses provide stronger evidence than before-and-after comparisons (Mesquita et al., 2025; Santoleri et al., 2024).

Bulgarian evidence is particularly instructive. A counterfactual evaluation of a 200 million EUR scheme under the 2014-2020 Operational Programme ‘Innovation and Competitiveness’, combining difference-in-differences with propensity score matching, found a positive and statistically significant effect on beneficiaries’ assets and some positive effects on revenue and revenue per employee, but no evidence that the grants improved profitability or employment; the authors conclude that competitiveness schemes designed in this way may select better-performing companies without producing substantial additional effects (Nigohosyan et al., 2025). Positive selection is therefore not the same as causal impact.

5. Research and Innovation Grants

The strongest positive evidence often concerns research and innovation programmes. These projects are precisely where conventional finance faces difficulty because technological uncertainty is high, assets are intangible, and social spillovers can exceed private returns.

Regression-discontinuity evidence from the Horizon 2020 SME Instrument shows increases in intangible investment, innovation output, and subsequent equity investment, with especially strong effects among younger, smaller, financially constrained firms and firms in less developed regions (Santoleri et al., 2024). European Commission counterfactual evaluations also find persistent improvements in employment, assets, and revenue among funded R&D firms (European Commission, 2023, 2025).

These results support the market-failure interpretation. Grants are most valuable when financing is genuinely the missing input rather than when firms simply prefer public money to private capital.

6. Deadweight, Absorptive Capacity, and Incentives

The European Court of Auditors (2022) has repeatedly emphasized deadweight risk in programmes where many beneficiaries would have undertaken similar investments without support. Deadweight is costly because every euro spent on an unnecessary subsidy cannot support another project with stronger additionality.

Capital also becomes productive only when firms possess the complementary capabilities needed to use it. A manufacturer receiving an advanced production line may also need trained operators, maintenance capability, working capital, quality systems, sales growth, and logistics capacity. Without these complements, the funded asset can remain underutilized.

Private co-financing preserves commercial discipline because founders, banks, or investors retain financial exposure. Milestone-based funding can improve discipline further, particularly for innovative projects, by releasing support as technical, customer, regulatory, or co-investment milestones are achieved. These mechanisms can reduce waste without turning public programmes into purely private investment funds.

7. Measuring Sustainable Outcomes and Conclusion

Administrative monitoring often focuses on whether procurement rules were followed, invoices were paid, and assets physically exist. These controls are necessary but do not establish economic success. Impact monitoring should therefore continue beyond project completion and should examine revenue per employee, exports, value added, operating margin, innovation output, private follow-on investment, asset utilization, and survival.

European grants can generate meaningful private-sector growth, but the evidence does not justify treating all business subsidies as equally productive. Stronger results appear where funding targets genuine innovation uncertainty and financial constraints. The decisive concept is additionality: public support creates the greatest value when a capable firm faces a real constraint that prevents an economically valuable project from proceeding at the appropriate scale or speed.

Policy should therefore move from a culture of budget absorption toward a culture of causal impact. Competitive selection, explicit assessment of financing constraints, meaningful private risk, milestone structures, complementary capability support, and post-project evaluation can improve effectiveness. The ultimate test is whether the beneficiary possesses a capability, technology, market position, or productivity level after the grant that would probably not have existed without public intervention.

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