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Financing SMEs in Europe: Stylised Facts, Policies, Challenges

by Daniele Ciani, Paolo Finaldi Russo and Valerio Vacca

ASIA-EUROPE MEETING

ABSTRACT

This paper describes the main features of European SMEs' financial behaviour and the policies recently put in place to support their funding. European SMEs are structurally more leveraged and charged with higher interest rates than large firms. Moreover, the crisis has deeply affected their fund-raising capacity, as banks reduced credit supply while non-bank funding was unavailable to most SMEs. Against this background, EU has focussed its policies on long-term investment and on a more favourable environment for SMEs financing, including through the launch of the Capital Markets Union. At the national level, most governments have provided guarantees and enhanced the role of national development banks. Nevertheless, key issues are still outstanding, such as the funding of innovative firms and the improvement of transparency and of the legal and regulatory frameworks.

Europe | Financial services | European Union | Economic governance

keywords

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Executive summary

Access to finance by SMEs is hindered by exacerbated information asymmetry between lender and borrower. These firms are therefore highly dependent on banks, which are better equipped to overcome these problems. The relatively high leverage experienced by small firms and their higher cost of credit with respect to larger ones increases the weight of financial expenses on their income, adding to their fragility; moreover, the long-lasting economic downturn has especially affected the ability of European small and medium entrepreneurs to fund their ventures. The gap between the borrowing rates applied to new loans of different size dramatically increased, while the reduced amount of extended credit was due to both demand and supply factors, with the latter especially worsening in 2009 and 2012. One reason for the bank tightening was the perception of firms' increased riskiness. Moreover, a perverse circle impends, as non-performing loans weighing on their balance sheets leave banks little room for extending new credit. Firms' capacity to replace bank loans with alternative sources of financing represents a mitigating factor in periods of credit constraints, but most non-bank sources of funding are not available to the vast majority of SMEs.

Against this background of market failures in financing SMEs, policy actions have been put in place both at the European Union (EU) and the national levels. The EU has focussed on long-term investment, including through mobilising private resources, and on a more favourable environment for SME financing. To this end, the issue of the lack of information on SMEs is being addressed and a number of suitable financial instruments have been supported, while the launch of an investment plan for Europe as well as the policy steps to build a Capital Markets Union should particularly benefit SMEs. At the national level, governments have enlarged public guarantees to SME loans and strengthened the role of national development banks. The consolidation of SMEs' capital structure has been pursued

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through fiscal incentives, addressing both demand and supply of funds and measures have been undertaken at the country level to assist distressed but still viable small firms.

Some key issues are currently outstanding. The funding of some segments of SMEs (e.g. export-oriented, young or innovative firms) is crucial to the growth potential of the economy and at the same time more challenging. Limited information on SMEs plays a significant role in hampering the access to both credit and market funding. Legal and regulatory frameworks – e.g. the procedures for working out and restructuring distressed debt, the fiscal treatment of debt with respect to equity financing – greatly affect SMEs' financing.

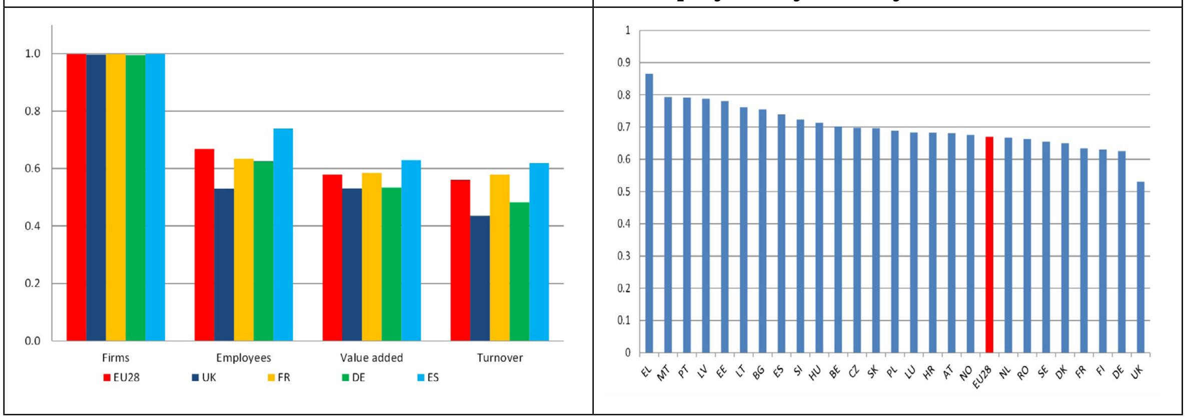
1. SME financing: structural features and recent trends

1.1 The role of SMEs in Europe

Small and medium enterprises (SMEs)[1] are conventionally labelled as "the backbone" of European economic activity. According to the last available data by Eurostat, in 2013 92.4 percent of non-financial firms across EU-28 countries had less than 10 employees, whereas European SMEs employed two-thirds of the workforce and produced 57.9 percent of the value added (fig. 1a).

Figure 1 | The weight of SMEs in Europe (percentage values)

(a) EU28 countries, selected indicators* | (b) employees, by country**



Notes: (*) Weight of SMES (up to 249 employees) on the total number of non-financial firms, employees, value added and turnover. Data for EU-28 refer to 2013 (apart from turnover, 2012), data for France refer to 2011, all other data refer to 2012. – (**) Weight of SMES (up to 249 employees) on the total number of employees, as at 2012. Data for France, Hungary and Portugal refer to 2011. Data for Cyprus, Ireland, Italy not reported.
Source: Eurostat.

[1] According to the European Commission, firms are defined as medium-sized enterprises if they have up to 250 employees and up to 50 million annual turnover or a 43 million balance sheet total; the corresponding thresholds for small (micro) firms are 50 (10) employees, 10 (2) million turnover or total assets. See *Recommendation concerning the definition of micro, small and medium-sized enterprises*, 6 May 2003, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32003H0361.

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The role played by SMEs is uneven across Europe, ranging from barely above half of workers employed in the UK to about three-fourths in Southern countries and in smaller economies (fig. 1b); in most countries, nevertheless, SMEs are key to ensuring stable and sustainable growth over time.

The definition of SMEs overlaps to some extent, but does not coincide, with that of family-owned businesses. According to an analysis conducted for the European Commission in 2008, across Europe about 70-80 percent of enterprises are family businesses and they account for about 40-50 percent of the employment. Family businesses are active in all sectors of the economy, even if they are largely predominant in traditional and labour intensive sectors.[2] The family ownership of the business is important in that it can affect the fund raising of firms in several ways. On one side, external investors could be disincentivised from financing a family firm, as they fear that family members could extract from the company undue private benefits thanks to the limited control placed on their managerial choices. On the other side, family shareholders may prefer to use debt instead of equity to finance their activity in order to avoid dilution of ownership. In addition, the preference for maintaining the management within the family perimeter might affect the ability of the firm to remain viable over time and across different generations.

1.2 The financial structure of European SMEs

The financial structure of European firms features a high leverage and a strong dependence on bank debt, compared to firms from other financial systems.

According to Orbis[3] data, a large proportion of European small firms have no debt,[4] but when they borrow their leverage tends to be high: the indicator amounts to about 40 percent for SMEs, whereas it is 36 percent for larger companies (fig. 2a). In this case as well, heterogeneity across countries is large (fig. 2b). The results of an ECB analysis on euro-area countries show that the institutional or financial environment plays an important role in explaining regional differences.[5] The analysis highlights that a higher corporate tax rate (a measure of the fiscal advantage due to the deductibility of interest expenses) is positively related to leverage;

[2] Cfr. Irene Mandl, *Overview of Family Business Relevant Issues*, Vienna, Austrian Institute for SME Research, 2008, p. 2, http://www.kmuforschung.ac.at/images/stories/Forschungsberichte/2011%20und%20Aelter/family_businesses2009.pdf.

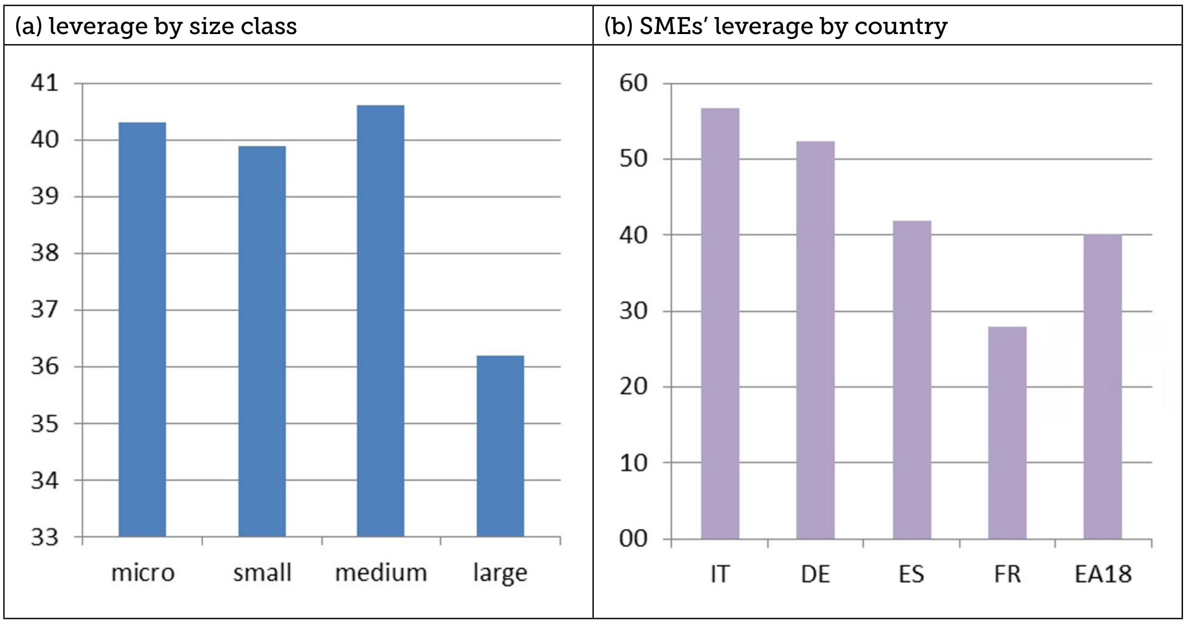
[3] The Orbis database, provided by Bureau van Dijk, includes harmonised and comparable financial information for public and private limited liability companies. This analysis is based on data from 2004 to 2013 for the 18 countries belonging to the euro area in 2014. The coverage of the sample is in general lower for smaller firms; among the largest euro-area countries it is high for France and very low for Germany.

[4] The share of firms without debt ranges from about 20 percent among medium-sized firms to 40 percent for micro-firms.

[5] ECB, "Corporate Finance and Economic Activity in the Euro Area. Structural Issues Report 2013", in *ECB Occasional Papers*, No. 151 (August 2013), https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp151.pdf.

moreover, a better judicial framework (and in particular a stronger protection of creditors' rights) is conducive to broader access to credit and therefore allows higher debt ratios. Instead, a negative correlation emerges with the development of equity markets (which provides a source of funds from shareholders) and the length of bankruptcy processes (which makes it more difficult for creditors to recover their funds).

Figure 2 | Leverage of non-financial companies in Europe* (percentage values)



Notes: (*) Data refer to 18 euro area countries. Averages of yearly median values between 2004 and 2013. Leverage is defined as the ratio of financial debt to the sum of financial debt and equity. Firms with no financial debt are excluded.
Source: Authors' computation on Orbis database.

SMEs typically rely to a large extent on bank debt due to structural disadvantages with regards to accessing non-bank external funding. The access of smaller firms to capital markets is often hampered by relatively higher fixed costs of listings and their more limited transparency towards external investors. On the other side banks, especially smaller ones, are structurally equipped to deal with problems stemming from information asymmetries. Between 2010 and 2014, the share of debt provided by banks to European non-financial companies has been about 43 percent, 10 percentage points higher than in the US. The share ranges from 33 percent in France and in the UK (where capital markets are more developed) to 65 percent in Italy.

The financing conditions of SMEs are structurally less favourable than for larger firms. To the extent that the size of the loan could be considered as a proxy for firms' size, in the period 2002-2015 interest rates on new business loans to SMEs (below 1 million euros) were on average 1.1 percentage points higher than those on larger loans. This spread is only in part related to the higher idiosyncratic risk of small ventures: according to analysis of Italian firm-level data, even controlling for

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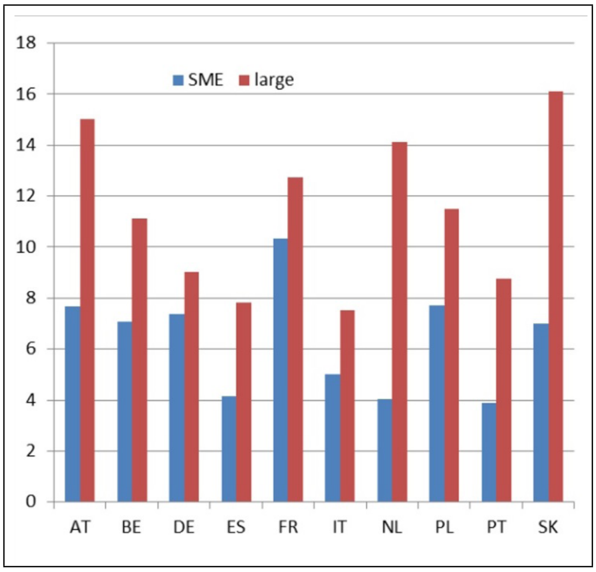
firm's riskiness, the size of the firm still correlates negatively with the interest rate charged by the banks. This evidence confirms a well-known result of the economic literature on firms' financing, which is usually associated with the opaqueness of smaller enterprises and with the fixed costs involved from credit assessment and monitoring.[6]

Figure 3 | EBITDA over interest on financial debt (median values)



Source: Batch database.

The prominent reliance on debt and the higher interest rates that SMEs pay on their external financing elicit a relatively high weight of financial expenses on the earnings before interest, taxes, depreciation and amortisation (EBITDA, fig. 3). The ratio of financial expenses to EBITDA is partly affected by the composition of SMEs' liabilities: the share of short-term loans, which are comparatively more expensive, over total loans displays a wide range of values across European countries, reaching high levels in Spain, Austria, Denmark, Belgium and Italy.[7] These features make smaller firms systematically more vulnerable than larger ones, as has become clear after the Lehman collapse.

[6] See, for instance, Mitchell A. Petersen and Raghuram G. Rajan, "The Benefits of Lending Relationships: Evidence from Small Business Data", in *The Journal of Finance*, Vol. 49, No. 1 (March 1994), p. 3-37; and Paolo Angelini, Roberto Di Salvo, Giovanni Ferri, "Availability and cost of credit for small businesses: Customer relationships and credit cooperatives", in *Journal of Banking & Finance*, Vol. 22, Nos. 6-8 (August 1998), p. 925-954.

[7] OECD, *Financing SMEs and Entrepreneurs 2015. An OECD Scoreboard*, April 2015, https://g20.org/wp-content/uploads/2015/05/OECD-Financing-SMEs-and-Entrepreneurs-2015-An-OECD-Scoreboard-April-2015.pdf.

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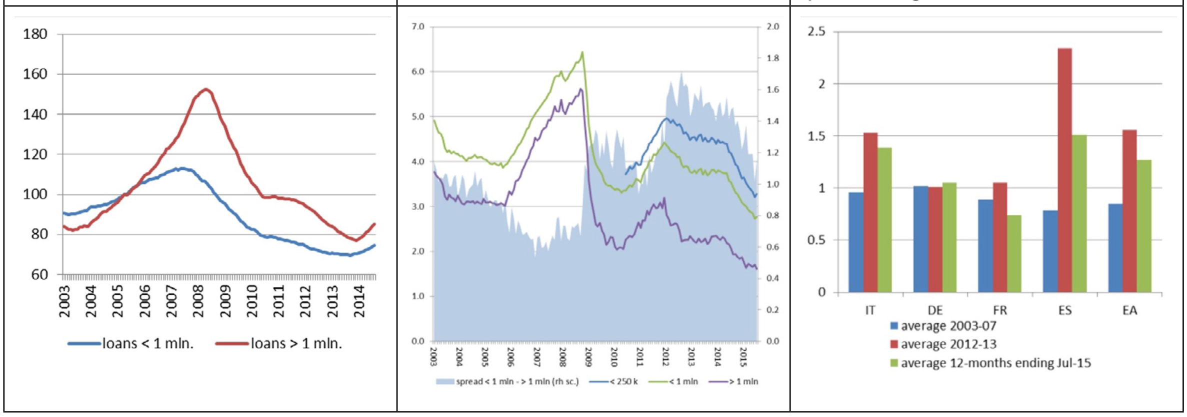
1.3 Recent trends in SMEs financing

In times of crisis, the financial weaknesses of SMEs become even more acute. The long-lasting economic and financial downturn has deeply affected the ability of European small and medium entrepreneurs to adequately fund their ventures, due to both the worsened access to credit and the limited availability of alternative sources of funding. Between 2008 and 2015, new bank loans decreased substantially for all firms, regardless of their dimension. At the same time, the reduction of credit has been more severe among smaller businesses: the current flow of loans below 1 million is still 25 percent lower than before the crisis, whereas the decrease is 15 percent for loans of greater amount (fig. 4a).

The gap between the borrowing rates applied to new loans of different size dramatically increased during the crisis, reflecting the more difficult financing conditions of SMEs (fig. 4b). The spread between the interest rate of loans below and above 1 million grew by about one percentage point between 2008 and 2012, reaching 1.8 percentage points during the first period of the sovereign debt crisis (first half of 2012). More recently, as from the second half of 2013, interest rates steadily decreased for loans of smaller size, thus reducing the gap with larger ones at about one percentage point, still higher, however, than in the years immediately before the crisis. The worsening of credit conditions for SMEs has been widespread across the main European countries, with the exception of Germany (fig. 4c); the recent recovery has been more relevant in Spain where the interest rate gap between smaller and larger firms had reached a very high level during the crisis.

Figure 4 | Credit to non-financial corporations (NFCs) during the crisis

(a) flows of new loans *(indexes: average 2003-07=100)*	(b) interest rates on new loans *(percentages)*	(c) spread between interest rates below and above 1 million *(percentages)*



Source: ECB, *Statistics: MFI interest rates*, https://www.ecb.europa.eu/stats/money/interest/interest.

The reduced amount of extended credit during the crisis was due to both demand- and supply-side factors. On the demand side, SMEs suffered more than larger firms from a weak progression of their turnover: according to the ECB survey on access to credit (SAFE), the share of SMEs reporting a positive change in sales with respect

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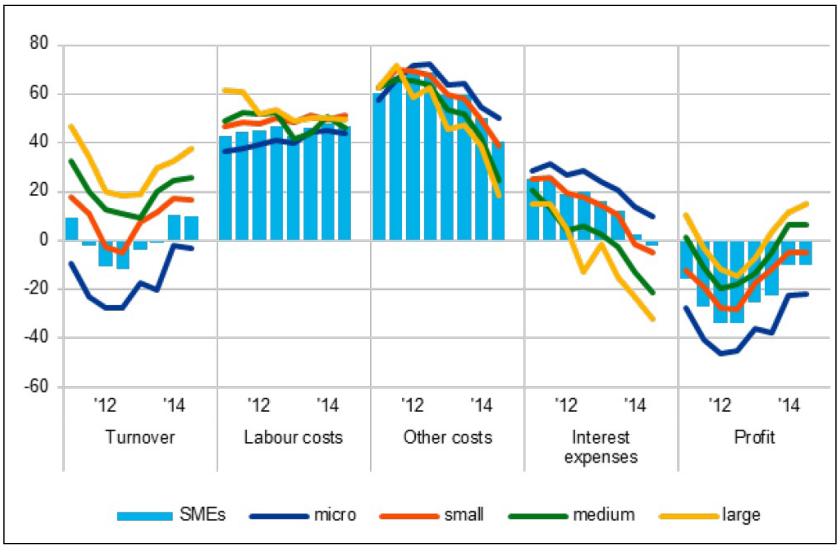
to the previous six months (net of those reporting a negative change) has been systematically lower compared to that of larger firms by about 30 percentage points (fig. 5). Small firms might have suffered from their typically strong dependence on domestic markets and, in particular, their peripheral position within the global value chains (GVC), whose importance is growing.[8]

Figure 5 | Components behind the change in the income of euro area enterprises (change over the preceding six months; net percentage of respondents)



Source: ECB.[9]

Sluggish turnover in turn affected profits: in 2014 the majority of SMEs still reported a decrease in profits, whereas for most larger firms profits started to recover, boosted by – among other things – a sharp decrease in financial expenses. Investment expenses, the main driver of firms' demands for external financing, dramatically dropped during the crisis. In 2014 fixed investments in the EU have been about 15 percent lower than in 2007; in countries more severely hit by the crisis, like Greece, Ireland, Portugal, Spain and Italy, the drop has been much higher (35 percent on average). Although the statistics currently available do not provide timely data on the investment expenses of SMEs for the euro area, evidences at the national level clearly show that smaller firms cut their investment plan more extensively.[10]

On the supply-side, the availability of loans both for SMEs and larger firms deteriorated significantly in the first phase of the crisis in 2008 and again in 2012,

[8] According to both theory and empirical findings, during economic downturns the periphery of a GVC is exposed to substantial swings in its turnover levels, the so-called bullwhip effect. See Hau L. Lee and Corey Billington, "Managing Supply Chain Inventory: Pitfalls and Opportunities", in *Sloan Management Review*, Vol. 33, No. 3 (Spring 1992), p. 65-73, http://sloanreview.mit.edu/?p=2651.

[9] ECB, *Survey on the access to finance of enterprises, October 2014 to March 2015*, June 2015, p. 2, https://www.ecb.europa.eu/stats/money/surveys/sme.

[10] In Italy, for instance, survey data show that on average between 2011 and 2015 investment expenses were reduced by 6 percentage points annually for firms with less than 50 employees, whereas they increased by 3 percentage points among large firms (data for 2015 were forecasts).

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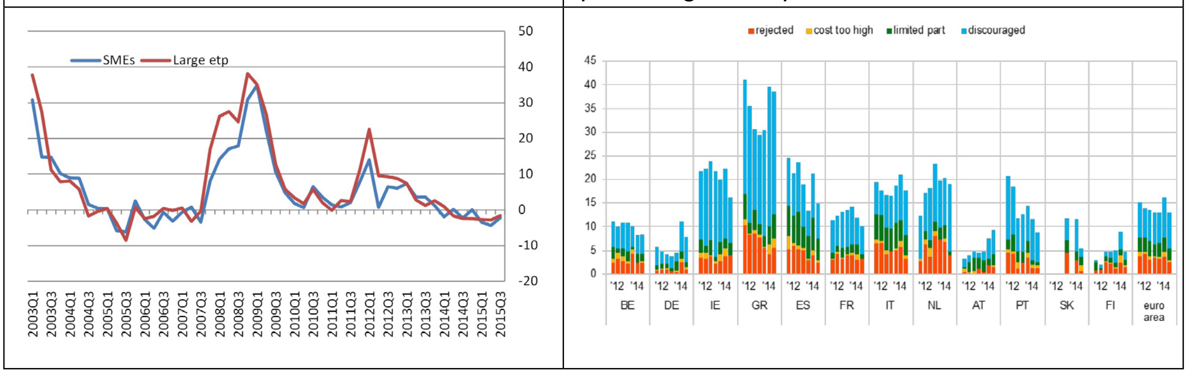
due to a sudden tightening of the credit standards applied by the banks (fig. 6a). According to SAFE data, the share of SME reporting obstacles in accessing bank loans grew rapidly and peaked in the first half of 2012, when about 15 percent of firms for which bank loans are a relevant source of funding could not obtain new financing. Since then the survey shows a reduction in SMEs' financing obstacles (fig. 6b): however, in several countries the share of credit-constrained firms is still above 15 percent. Overall, the impact of the crisis was harsher towards highly leveraged firms, which, according to ECB reduced their investment in 2009 (with respect to the 2007-08) to a greater extent than moderately leveraged firms.[11] Low-profit and high-leverage firms are still experiencing significant financing obstacles.[12]

Figure 6 | Credit supply indicators

(a) credit standards*
(diffusion index)

(b) obstacles to receving a bank loan**
(percentage of respondents)



Notes: (*) Positive (negative) values of the index stands for credit standards tightening (loosening). – (**) Percentages of SMEs for which bank loans are relevant.
Sources: (a) Authors' computations on ECB, *Bank lending survey*, https://www.ecb.europa.eu/stats/money/surveys/lend. – (b) ECB.[13]

One of the most important reasons for the enduring bank tightening during the crisis was the perception of firms' increased riskiness, especially for SMEs. The deteriorated quality of firms' balance-sheets strictly correlated with the reduced capacity of paying back their debt and, consequently, with massive waves of insolvencies. According to OECD,[14] Greece and Portugal displayed the largest increases of non-performing loans (NPLs) in banks' balance-sheets between 2007 and 2013, while the riskiness of SME loans with respect to large firms' is particularly high in Ireland, Greece, Italy, Spain and Portugal: these evidences suggest that differences in risk across borrower size intensify when economic and sovereign

[11] ECB, "Deleveraging Patterns in the Euro Area Corporate Sector", in *ECB Monthly Bulletin*, No. 2/2014 (February 2014), p. 97-114, https://www.ecb.europa.eu/pub/pdf/other/art2_mb201402en_pp97-114en.pdf.

[12] ECB, "SME Access to Finance in the Euro Area: Barriers and Potential Policy Remedies", in *ECB Monthly Bulletin*, No. 7/2014 (July 2014), p. 79-97, https://www.ecb.europa.eu/pub/pdf/other/art2_mb201407_pp79-97en.pdf.

[13] ECB, *Survey on the access to finance of enterprises, October 2014 to March 2015*, cit., p. 20.

[14] OECD, *Financing SMEs and Entrepreneurs 2015. An OECD Scoreboard*, cit.

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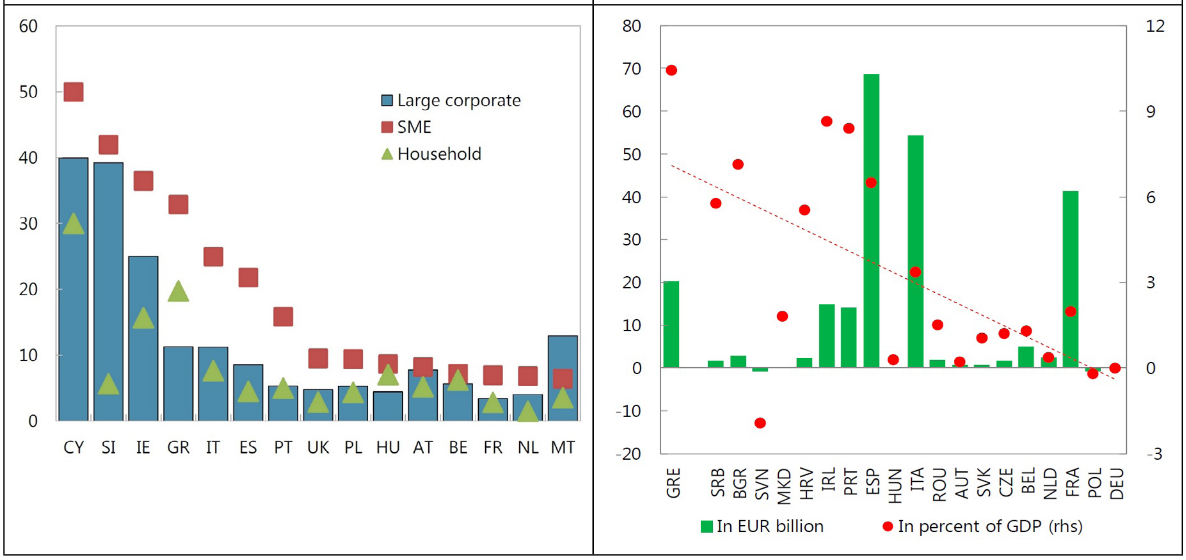
environment deteriorates.[15] The amount of SME-related NPLs on banks' balance sheet has reached an unprecedented level, especially as a ratio to total credit because of the weak dynamic of the denominator (fig. 7a).

Moreover, a perverse loop impends, as NPLs weighing on their balance sheets leave banks little room for extending new credit to customers. The increase of NPLs led to further bank credit tightening, which in turn weighed on firms' financial conditions and on their chances of recovery. This self-reinforcing negative spiral was particularly worrying in countries where loans to non-financial corporations (NFCs) accounted for a relevant share of banks' assets and banks were the main source of firms' financing. In these areas, a rapid disposal of the NPLs, through the market or via judicial and non-judicial procedures, could help restore normal credit flows to the economy (fig. 7b); for this reason some governments decided to intervene, and other are in the process of taking steps, more or less directly, to accelerate the removal of bad loans from the banks' balance-sheets.[16]

Figure 7 | SMEs' non-performing loans (NPLs)

(a) non-performing exposure* *(percentage values, as of December 2013)*	(b) estimated new lending capacity from NPL reduction *(2014; uniform 5% haircut)*



Notes: (*) Non-performing exposure as a percentage of the total exposure.
Sources: (a) European Banking Authority, retrieved from Bergthaler et al.[17] – (b) Aiyar et al.[18]

[15] ECB, "SME Access to Finance in the Euro Area: Barriers and Potential Policy Remedies", cit.

[16] Wolfgang Bergthaler et al., "Tackling Small and Medium Sized Enterprise Problem Loans in Europe", in *IMF Staff Discussion Notes*, No. 15/04 (March 2015), http://www.imf.org/external/pubs/cat/longres.aspx?sk=42614.

[17] Ibid., p. 7.

[18] Shekhar Aiyar et al., "Revitalizing Securitization for Small and Medium-Sized Enterprises in Europe", in *IMF Staff Discussion Notes*, No. 15/07 (May 2015), p. 12, http://www.imf.org/external/pubs/cat/longres.aspx?sk=42859.

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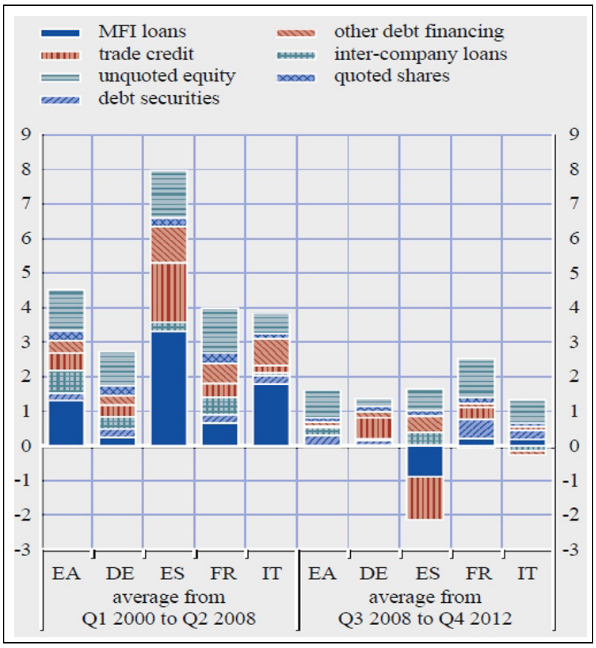
Firms' capacities to replace bank loans with alternative sources of financing represent an important mitigating factor in periods of credit constraints and could provide an effective backstop to the negative loop described above. During the crisis, non-bank funding increased its role in firms' financing with respect to the bank channel. Depending on the characteristic of the financial systems, the substitution effect differed noticeably across countries: debt securities increased especially in France, whereas inter-company loans and trade credit became more relevant in Germany (fig. 8).

Figure 8 | External financing instruments used by non-financial corporations (annual transactions; percentages of amount outstanding of external financing)



Source: ECB.[19]

In particular, net issuances of corporate bonds increased at about 100 billion on average between 2009 and 2014, more than twice the amount issued during the previous six years. In some countries also SMEs started approaching bond and equity markets, often stimulated by the interventions of local governments (see also section 2 below). As for equity financing, according to EVCA, European private equity investment, after peaking at 72.9 billion in 2007, sharply declined to 25 billion in 2009. Since then the volumes rebounded at around 40 billion per year (41.6 billion in 2014). On the opposite, venture-capital financing – the segment of private equity devoted to small, young and innovative firms – remained subdued throughout the crisis: venture capital investments accounted for 3.6 billion in 2014, well below the pre-crisis peak (6.6 billion in 2008); the drop in venture capital flows was quite widespread across countries (fig. 9). Business angels, the informal equity-investors in innovative start-ups, partly made up for the retrenchment of venture capitalists, displaying a double-digit growth in the last decade: although

[19] ECB, "Corporate Finance and Economic Activity in the Euro Area…", cit., p. 23.

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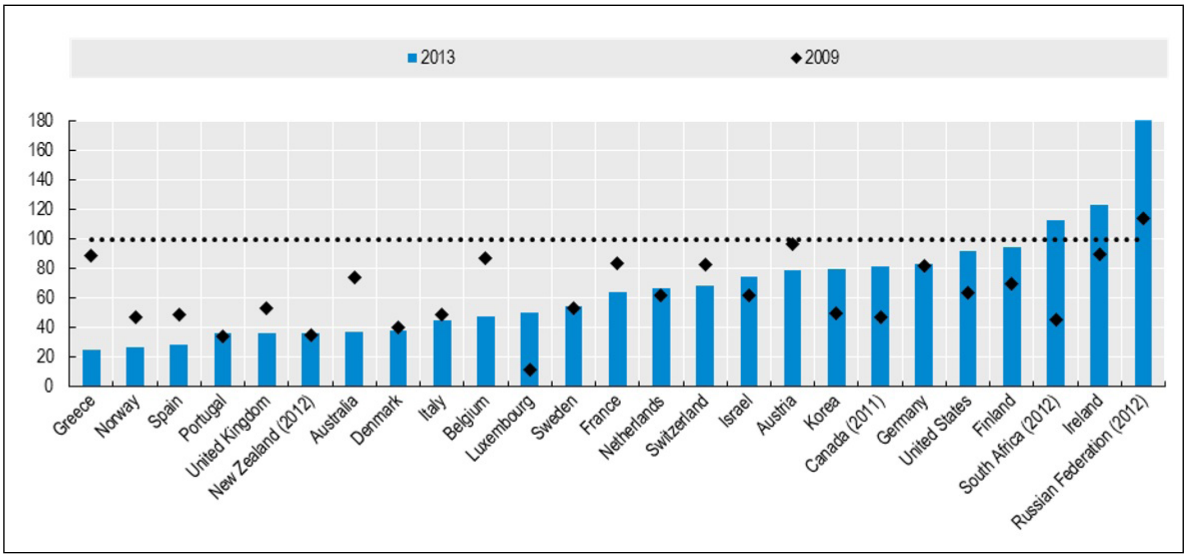
difficult to gauge, their investment volume has been estimated at 554 million in 2013 by their European network, EBAN.

However, most of these alternative sources of funding, as in the case of debt securities, are not actually available to the vast majority of SMEs, especially to those experiencing financial troubles. Moreover, also in the case of non-bank financing more clearly aimed at SMEs needs (such as venture capital), the funds are targeted to very specific types of firms (i.e. highly innovative start-ups, within high-tech industries) and largely insufficient, in terms of volume, to offset the reduction of traditional bank credit.

Figure 9 | Venture capital trends (2007 = 100)



Source: OECD,[20] StatLink: http://dx.doi.org/10.1787/888933064753.

2. Policies for SME financing

Against this background of market failures in credit extension to SMEs, policy actions have been put in place both at the European level and at the national levels to improve SMEs' access to external finance.

2.1 Policies at the European level

A wide range of initiatives have been adopted by European institutions in recent years, addressing credit flows, growth financing, long-term and investment financing, high-quality securitisation and broader capital markets. Even if the majority of these measures is not specifically targeted to SMEs, it is plausible that

[20] OECD, *Entrepreneurship at a glance 2014*, July 2014, p. 91, http://dx.doi.org/10.1787/entrepreneur_aag-2014-en.

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also smaller firms could gain some benefits from their implementation.

The conventional and unconventional monetary policy measures which have been implemented in Europe since the burst of the crisis have benefitted bank credit extension to firms. In particular, the persisting low rate environment fostered by the ECB through its Quantitative Easing in response to the sluggish economic activity attenuated to some extent the relevant burden of debt service. The Targeted Longer-Term Refinancing Operations (TLTROs) – explicitly targeting growing credit volumes to the private sector – have already been effective in at least reducing the pace of the fall in credit volumes in some countries, and taking them back to positive variations in others. However, evidence on specific effects of these measures on lending to SMEs is scant. There is some tentative evidence that credit to SMEs has benefited comparatively less than larger ones from these measures as from the second part of 2014 in terms of quantities,[21] whereas a narrowing in SMEs'-large firms' cost of credit spread was observed (see above, section 1). In addition, the Eurosystem also contributes to SME financing through its collateral framework, whereby non-financial corporations' debt is eligible for collateralising monetary operations in several ways (namely as bonds, as credit claims, or within the pool of asset-backed securities or ABS).

The EU institutions and particularly the European Commission (EC) have launched several initiatives addressing the specific financing problems of the SMEs (table 1). Forms of financial support were already established in the EU in the past. The most relevant are the use of EU structural and cohesion funds and the financial support by the European Investment Bank, or by the European Investment Fund specifically for SMEs, through the provision of loans, guarantees, structured finance, or trade financing to the SME sector in certain EU crisis countries.[22]

With a view to boosting the growth potential of the economy, the EU has increasingly dealt with the issue of growth financing over the last years, with a particular focus on SMEs, taking into account that smaller companies have suffered the most during the crisis. In 2011 the European Commission adopted an Action plan on SME financing, particularly aiming at improving the regulatory framework for SMEs.[23] Legislative action has followed. For example, SMEs financing needs have been explicitly taken into account within the CRD IV-CRR package (see below, section 3), the revised Markets in Financial Instruments Directive (MIFID), the revised accounting Directive and the new Regulation on Venture Capital. Moreover, SMEs' financing directly from the EU budget was fostered through new financial instruments set up at the Union level, such as those enshrined within the programme for the competitiveness of enterprises and small and medium-sized

[21] Philippe Andrade et al., "Did the Eurosystem's LTROs of 2011 and 2012 help to avert a credit crunch in the euro area?", in *Rue de la Banque*, No. 10/2015 (September 2015), https://www.banque-france.fr/uploads/tx_bdfgrandesdates/RDB-10_LTRO_GB.pdf.

[22] Within specific framework agreements, also non-EU countries can benefit from the EIB-group interventions.

[23] European Commission, *An Action plan to improve access to finance for SMEs* (COM/2011/870), 7 December 2011, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52011DC0870.

enterprises (COSME) and Horizon 2020. COSME, established with a Regulation in 2013, provides both an equity facility to support SMEs' growth and loan guarantees, including securitisation of SME debt portfolios. Horizon 2020, also adopted in 2013, is the EU's framework programme to support research and innovation in the current Multiannual Financial Framework for 2014-2020, which includes a part for SME access to risk finance, both through debt and equity.

Table 1 | Selected EU initiatives involving SME financing

Main initiatives	Responsible body	Year	Main objectives	Support to SMEs
Action plan on SME financing	Commission	2011	Improving the regulatory framework for SMEs	To take account of SMEs within the CRD IV-CRR, MIFID II, Accounting Directive and VC Regulation
COSME Regulation	Parliament and Council on Commission proposal	2013	New financial instruments, i.e. facilities for SME growth	Equity facilities and loan guarantees, securitisation of SME debt portfolios
Horizon 2020 Regulation	Parliament and Council on Commission proposal	2013	Support research and innovation	Section on SME access to risk finance (debt and equity)
High Level Working Group	Economic and Financial Committee	2013	Proposals to address the issue of SME financing	Improve: environment for SME financing, SMEs' data availability, new instruments (securitisation, PP, mini-bonds)
Green Paper on Long Term Financing followed by Communication	Commission	2013 and 2014	Proposals to address the issue of SME financing	Mobilise private long-term financing, develop capital markets and market access
SME initiative	Commission and EIB	2013	New financial instrument for SMEs	Portfolio guarantee and securitisation instrument
European Investment Fund Regulation	Parliament and Council on Commission proposal	2015	315 bn euros investments guaranteed by EU budget	75 bn euros will support SME initiatives
Proposal for a Regulation on simple and transparent securitisation	Commission	2015	It will create an EU framework for a safer securitisation	Common rules on simple and transparent securitisation, also backed by SME loans
Green Paper on building a Capital Markets Union followed by an Action Plan	Commission	2015	Improving access to finance, sources of funding, markets efficiency	Improving SMEs capital raising and availability of information, providing for new and tailored financial instruments for SMEs

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In the aftermath of the dramatic plunge in investment volumes followed to the Lehman collapse, further EU initiatives focused on long-term financing, particularly of SMEs and infrastructure. The European Commission launched a consultation on such issues through the publication of a Green Paper in March 2013,[24] while a High Level Expert Group (HLEG) set up by the Economic and Financial Committee published a report in December 2013.[25] Concerning SMEs, the report of the HLEG recommended measures and policies to make the financial environment more conducive to SME financing, to address the issue of the lack of data on SMEs, via database infrastructures and systems of credit scoring, and to support the development of a number of financial instruments, such as securitisation, covered bonds, private placements, credit funds and mini-bonds. The HLEG report was followed by a European Parliament's resolution in February 2014 on the same subjects and by a Commission's Communication in March 2014.[26] Taking stock of the HLEG recommendations, the 2014 Commission's Communication mainly focused on mobilising private sources of long-term financing, making better use of public finance, developing capital markets, also for SMEs, and improving SMEs' market access.

Recognising the structural hindrances to bank-SMEs relationships, in 2013 the Commission and the European Investment Bank proposed the so-called SME initiative, a joint financial instrument which aims to foster SME financing by providing partial risk-sharing for SME loan portfolios of originating financial institutions, through the use of European structural funds contributed by Member States, as well as COSME and Horizon 2020 resources. Via the SME initiative, the European Investment Fund offers intermediaries loss protection and capital relief, while intermediaries undertake to provide SME loans at favourable terms. The SME initiative is implemented via a portfolio guarantee instrument and a securitisation instrument, in order to produce a high leverage effect. It is currently operational in Spain and Malta.

From a broader point of view, plans to revive securitisation markets have been recently discussed in the EU, with a view to developing a new framework of high-quality securitisations, characterised by simple, transparent and comparable products. The second step will be to adjust accordingly the regulatory framework to allow a risk-sensitive approach. Indeed, the securitisation industry is still suffering the reputational consequences of having been at the hearth of the financial turmoil of 2007-08 through allowing excessive leverage and providing non-transparent instruments. A de-stigmatisation process is under way: one goal

[24] European Commission, *Green Paper: Long-term financing of the European economy* (COM/2013/150), 25 March 2013, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52013DC0150.

[25] European Commission, *Finance for Growth. Report of the High Level Expert Group on SME and Infrastructure Financing*, 11 December 2013, http://ec.europa.eu/economy_finance/financial_operations/investment/long_term_financing.

[26] European Commission, *Long-Term Financing of the European Economy* (COM/2014/168), 27 March 2014, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52014DC0168.

of the recent Commission proposal[27] is to explore the possibility of achieving a safer securitisation (with enhanced transparency and risk retention from the part of the issuer). Securitisation of SME loans can be made more effective by creating or strengthening the demand for issued securities. Special vehicles (public or partly public) have the aim of investing in securities (ABS) backed by SME loans. The ECB's Asset-Backed Securities Purchase Programme (ABSPP), launched at the end of 2014, might itself have a role in fostering SME loans'-backed securities, although purchased amounts are limited (11.1 billion as of the end of August 2015). As far as covered bonds are concerned, they are a complement to securitised debt, since assets remain on the originator's balance sheet, inducing an asset encumbrance issue; their final cost to the borrower is therefore halfway between traditional loans and securitised debt. Also on covered bonds, the EU is working within the context of the Capital Markets Union's project (see below, in this section).

SMEs will benefit from wide-ranging plans of investments in Europe. In 2014 the European Commission announced the Investment Plan for Europe (the "Juncker Plan"), a 315 billion euro investment plan to enhance growth in Europe and foster infrastructure investment along with SMEs' and mid-cap companies' financing. The initiative intends to address the subdued economic performance that has characterised Europe since the outburst of the financial crisis, and particularly the substantial drop in investment. The investment plan is built on three main pillars.

1. A legislative proposal for the establishment of the European Fund for Strategic Investments (EFSI) was adopted by the European Parliament and the Council in June 2015.[28] The creation of the EFSI, guaranteed with public money (16 billion euros from the EU budget and 5 billion from the European Investment Bank), should mobilise at least 315 billion euros of additional investment over the years from 2015 to 2017. While 240 billion will be devoted to strategic investments (infrastructure, education, research and innovation), 75 billion will support SME activity. The Fund is expected to achieve a multiplier effect of 1:15 to mobilise private resources along with public funds into real investment in the economy.
2. A supply of viable projects with a real added value for the European economy will be coupled with an assistance programme to channel investments towards infrastructures. In addition, the EFSI investments will support risk finance for SMEs and mid-cap companies across Europe.
3. The investment environment will be improved, in particular removing sector-specific and other financial and non-financial barriers to investment. Priority will be given to removing regulatory and non-regulatory barriers which remain across all the important infrastructure sectors including energy, telecommunications, digital networks and transport, as well as barriers in services and product markets.

[27] European Commission, *Proposal for a Regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised sucuritisation* (COM/2015/472), 30 September 2015, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52015PC0472.

[28] Regulation (EU) 2015/1017 on the European Fund for Strategic Investments, the European Advisory Hub and the European Investment Project Portal... – the European Fund for Strategic Investments, 25 June 2015, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32015R1017.

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The Fund has been initially scheduled to be fully operational beginning autumn 2015. Beyond the funds allocated at the EU level, Member States have already agreed to contribute to the capital of the investment plan, mainly through their national development banks.

Finally, in order to answer the call for a flexible and diversified financial system, the Commission issued a Green Paper in 2015 on a plan to build a full-fledged Capital Markets Union (CMU) to be completed by 2019.[29] The paper identified priorities for early actions, i.e. reviewing the prospectus regime, making it easier, especially for SMEs, to raise capital, developing a common minimum set of standardised credit quality information on SMEs, creating the already-mentioned high-quality securitisation market, increasing long-term investment in Europe and developing a market for private placement. Moreover, with a view to achieving a fully integrated, efficient and stable CMU, it recognised three critical areas of intervention in the medium-to-long term: to improve access to finance; to increase and diversify the sources of funding; to make markets work more effectively and efficiently in linking firms to investors both from inside and outside the EU. In this longer-term perspective, legislative differences across Member States should be reduced and harmonisation should be sought in areas such as securities law and investors' rights, corporate governance, insolvency law and tax regimes. A roadmap for policy action was presented by the Commission in September 2015.[30]

2.2 Country-level policies

The inherent heterogeneity of the SME sector across jurisdictions suggests that national and regional initiatives could effectively complement the policies adopted at the EU level,[31] since one-size-fits-all policies to sustain SMEs in different countries are prone to underperform. A large number of national policies have been put in place (or strengthened) during the crisis, addressing in particular, but not exclusively, the support to distressed firms, the provision of public guarantees, the incentives to recapitalisation and loan guarantees specifically addressed to exporting and innovative firms. This was the case for both European and non-European countries (table 2). Most of these policies have been implemented through national development banks (NDBs).

[29] European Commission, *Green Paper: Building a Capital Markets Union* (COM/2015/63), 18 February 2015, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=COM:2015:63:FIN.

[30] European Commission, *Action Plan on Building a Capital Markets Union* (COM/2015/468), 30 September 2015, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52015DC0468.

[31] ECB, "SME Access to Finance in the Euro Area: Barriers and Potential Policy Remedies", cit.

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Table 2 | Government policy responses to improve SME access to finance, 2007-13

Policy response	Countries
Government loan guarantees	Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Ireland, Israel, Italy, Japan, Korea, Mexico, the Netherlands, Norway, Portugal, Russian Federation, Serbia, Slovak Republic, Slovenia, Spain, Switzerland, Thailand, Turkey, United Kingdom, United States
Special guarantees and loans for start ups	Austria, Canada, Czech Republic, Denmark, Estonia, Mexico, the Netherlands, New Zealand, Serbia, United Kingdom
Government export guarantees, trade credit	Austria, Belgium, Canada, Colombia, Czech Republic, Denmark, Estonia, Finland, Hungary, Greece, Korea, the Netherlands, New Zealand, Spain, Sweden
Direct lending to SMEs	Austria, Belgium, Canada, Chile, Czech Republic, Estonia, Finland, France, Greece, Hungary, Ireland, Israel, Japan, Korea, Norway, Portugal, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Turkey, United Kingdom
Subsidised interest rates	Hungary, Portugal, Russian Federation, Spain, Turkey, United Kingdom
Venture capital, equity funding, business angel support	Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Ireland, Israel, Mexico, the Netherlands, New Zealand, Norway, Portugal, Slovak Republic Spain, Sweden, Turkey, United Kingdom
SME banks	Czech Republic, France, Portugal, Russian Federation, United Kingdom
Business advice, consultancy	Colombia, Czech Republic, Denmark, Finland, the Netherlands, New Zealand, Sweden
Tax exemptions, deferments	Belgium, Finland, Italy, New Zealand, Norway, Spain, Sweden, Turkey
Credit mediation/review/code of Conduct	Belgium, France, Ireland, New Zealand, Spain
Bank targets for SME lending, negative interest rates for deposits at central bank	Ireland, Denmark
Central Bank funding to banks dependent on net lending rate	United Kingdom

Source: OECD.[32]

[32] OECD, *Financing SMEs and Entrepreneurs 2015. An OECD Scoreboard*, cit. Data compiled from the individual country profiles.

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2.2.1 Public guarantees and their effectiveness

SME guarantee schemes have been reinforced in several countries after the Lehman collapse. Loans guaranteed by public funds have been widely acknowledged to be the most straightforward tool to overcome or at least reduce the negative effects of information asymmetries on SMEs' financing conditions. The amount provided to SMEs in the form of public guarantees is unevenly spread across different countries. In spite of ample heterogeneity in the growth rate of dedicated funds over the 2007-2013 period, the increase has been widespread, and in some countries exceeded 100 percent (Belgium, Denmark, Italy and Spain; table 3).

Table 3 | Government loan guarantees for SMEs in selected European countries, 2007-13 (percentage values)

	Change 2012-13	Change 2007-13
Austria	6	-51
Belgium	81	517
Czech Republic	112	69
Denmark	-31	354
Estonia	-27	87
Finland	-7	-9
France	5	53
Greece	-11	-63
Hungary	39	13
Italy	32	370
Netherlands	-30	4
United Kingdom	17	-46

Source: OECD.[33]

Public-sponsored funds have steadily enlarged the endowments committed to the guarantee of SME loans either directly or through existing intermediaries, like mutual guarantee institutions; the pool of eligible debtors has also been broadened over time. Even in those countries where the overall amount of public guarantees shrank in recent years, possibly due to tighter budget discipline, the number of operations increased, thus showing that smaller firms benefited progressively more from guarantees.

The available evidence provides mixed results on public guarantees' effectiveness: an Italian study suggests that these funds have supported credit flows to SMEs during the downturn, but no effect has been detected in terms of interest rates; moreover some concerns emerge about the cost of the policy, due to a higher

[33] Ibid. Data compiled from the individual country profiles.

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probability of default of the guaranteed firms.[34] A recent paper by the European Investment Fund (EIF) suggests that over the medium-term publicly guaranteed firms increase both employment and turnover, but not productivity.[35] The financial support of central or local governments to the guarantee of SME loans has also benefitted from new instruments, like mezzanine guarantees on securitised loans (tranched cover). These forms of public support often involve private lenders (banks) together with the public body: once the incentives have been aligned through *pari passu* schemes (the case, for example, of the facilities provided by the Germany's Kreditanstalt für Wiederaufbau, KfW), either the public agency or the private lender are charged with assessing the borrower's creditworthiness, with a preference for the latter, endowed with the required technical skills.

2.2.2 Assisting distressed SMEs

Several measures have been undertaken at the country level to assist distressed but still viable small firms. First, with regards to credit access, some banking systems (e.g. in Italy), in accordance with the governments, allowed SMEs to postpone debt redemptions, in order to help the latter overcome liquidity problems. There are studies gauging the effectiveness of these moratoria in bringing back the distressed firms on track with payments of their bank exposures (with a *cure rate* of about 60 percent of cases, according to country studies referred to the period from January 2009-January 2011).[36] Second, as regards the judicial and bankruptcy frameworks, especially after 2010, several European countries introduced pre-insolvency regimes to enable an early rehabilitation of distressed enterprises, adopted pre-packs[37] to enable a quick in-court approval of a settlement agreed out-of-court, strengthened incentives for fresh post-commencement financing (PCF),[38] or introduced simplified debt/equity swaps.[39]

2.2.3 Encouraging non-bank financing

Initiatives have been adopted to support the recourse to non-bank debt. This was the case of Italian "mini-bonds", issued by non-listed companies, after the

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[34] Guido de Blasio et al., "Public guarantees to SME borrowing. A RDD evaluation", in *Temi di Discussione*, 2015 (forthcoming), available at http://www.siecon.org/online/wp-content/uploads/2014/10/de-Blasio-De-Mitri-DIgnazio-Finaldi-Rossi-Stoppani-119.pdf.

[35] Pierfederico Asdrubali and Simone Signore, "The Economic Impact of EU Guarantees on Credit to SMEs. Evidence from CESEE Countries", in *EIF Working Papers*, No. 2015/29 (July 2015), http://www.eif.org/news_centre/publications/EIF_Working_Paper_2015_29.htm.

[36] Laura Bartiloro et al., "L'accesso al credito in tempo di crisi: le misure di sostegno a imprese e famiglie", in *Questioni di Economia e Finanza*, No. 111 (January 2012), https://www.bancaditalia.it/pubblicazioni/qef/2012-0111.

[37] Pre-packs are procedures under which the court expeditiously approves a debt restructuring plan negotiated between the debtor and its creditors in a consensual manner before the initiation of an insolvency proceeding.

[38] Post-commencement finance is finance provided to the company once business rescue proceedings have started.

[39] Wolfgang Bergthaler et al., "Tackling Small and Medium Sized Enterprise Problem Loans in Europe", cit.

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adoption in 2012 of a new, more flexible, regulation on corporate bond issuance. In 2014 there have been 48 mini-bond issuers (20 in 2013), two-thirds of those with less than 50 million sales; the issued amount was about 1.5 billion. Private placements might also play a role, although only for medium and large companies: Germany's *Schuldscheindarlehen* ("loan with debt recognition") – featuring the characteristics of both bonds and syndicated loans – is a domestic private placement market with approximately 12 billion euro of financing per year. Several initiatives recently attempted to develop a private placement market mirroring the US private placement model (USPP). The Banque de France has supported the Euro PP Market Initiative, aiming to help medium-sized companies to access new sources of financing, through a scheme which includes an arranger and ad-hoc documentation.[40]

The strengthening of the capital structure of SMEs has also been pursued through fiscal incentives, addressing both funds' demand (e.g. tax incentives for innovative start-ups) and supply (e.g. tax incentives for risk capital investors). According to a 2012 OECD survey on policy interventions to sustain seed and early stage financing in 32 countries,[41] policies largely focus on the supply-side measures, which are more visible and direct than demand-side support. The main policies observed include front-end tax incentives, i.e. tax deductions on investments in seed and early stage ventures, and back-end tax reliefs, which relate to capital gains and losses, and are often intended to encourage investors to reinvest in early stage firms. In the majority of countries, these types of support have increased in recent years, especially in the form of front-end tax incentives. The Italian *Aiuto alla Crescita Economica* (ACE) provided for tax allowances to capital increases, offering incentives to issuers and investors, which implies an effective stimulus at a relatively low cost for the Treasury, since they only apply to "additional" investment decisions. According to firm surveys, the Italian incentive has mattered for about one company in ten that decided to increase their capital in the 2012-14 period, with a stronger effect on larger firms.

Regulators are also paying increasing attention to equity crowdfunding: the features of the new generation internet have facilitated its development, e.g. by providing the infrastructure for payments, as well as information about the creditworthiness of the entrepreneurs. Regulators have already taken significant steps to deliver a clearer framework for the industry. In particular, Italy was the first country in Europe to adopt an ad-hoc regulation on equity crowdfunding, which came into effect in July 2013 and allows innovative start-ups to raise equity through crowdfunding platforms. In other countries, like France, regulatory reforms recently came into effect. In the United Kingdom regulation is framed in terms of exemption to the general rule that forbids offering securities to the general public. Public action may take the form of support to industry networks or aim at improving information

[40] ECB, "SME Access to Finance in the Euro Area: Barriers and Potential Policy Remedies", cit.

[41] Karen E. Wilson and Filipe Silva, "Policies for Seed and Early Stage Finance. Findings from the 2012 OECD Financing Questionnaire", in *OECD Science, Technology and Industry Policy Papers*, No. 9 (October 2013), http://dx.doi.org/10.1787/5k3xqsf00j33-en.

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about crowdfunding opportunities, also through development banks.

2.2.4 The visible hand: National development banks (NDBs)

The enlarged set of SME financing tools and the growing demand for such instruments have pushed some countries to set up or strengthen agencies dedicated to "development" finance. National development banks (NDBs) like British Business Bank (BBB, UK), Banque pour l'Investissement (BPI, France), Kreditanstalt für Wiederaufbau (KfW, Germany), Instituto de Credito (ICO, Spain) and Cassa Depositi e Prestiti (CDP, Italy), among others, have all devoted growing amounts of funds to sustaining SME access to finance, sharing the advantage from their comparatively low funding costs with the target firms.

Table 4 | National development banks (NDBs) in selected European countries

	KfW (Germany)	ICO (Spain)	BPI (France)	BBB (UK)	CDP (Italy)*
Raised funds (% GDP)					
- 2007	14.6	3.8	...	...	12.7
- 2013	17.0	10.0	2.6	0.2	20.2
Leverage					
- 2007	21.0	17.3	...	...	12.5
- 2013	20.1	21.2	1.0	0.0	16.2
Activities					
- direct financing	Yes		Yes		Yes
- indirect financing	Yes	Yes	Yes		
- co-financing	Yes		Yes	Yes	
- guarantees	Yes		Yes	Yes	Yes
- facilities	Yes	Yes	Yes	Yes	Yes
- V. capital, P. equity	Yes	Yes	Yes	Yes	Yes
- subsidies		Yes	Yes	Yes	Yes

Note: (*) Information on CDP is not fully comparable with other NDBs' information as in Italy public intervention to support SMEs' credit access is shared across several institutions. This includes, for instance, the government-sponsored "Guarantee Fund for SMEs".
Source: National development banks.

However, heterogeneities remain sizeable and cross-border cooperation among NDBs still negligible. The funds mobilised by these agencies range from 0.2 percent of GDP in the UK to 14.6 percent in Germany (table 4): this large range of variation depends on the different degree of public involvement and of the financial leverage of each model, the latter being larger in Germany and Spain.

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The tools deployed by development banks are particularly diversified in Germany and France, although the largest amounts of funds are devoted to credit access support rather than, for example, equity investment. Existing studies have shown that key factors in enhancing the effectiveness of the development banks' action are a sufficient degree of independence from government bodies, accountability on employed funds, and *pari passu* financing with private investors.

2.2.5 Supporting high-growth firms

Specific tools have been engineered to assist the most dynamic segments of SMEs, i.e. exporters and innovators, also within the development banks' activity. Export-related SME financing has been implemented in several countries, whereby a public agency provides asset-based financing (i.e. finance linked to specific foreign commercial credit). For innovative firms, government equity programmes are the common direct form of intervention to sustain the VC supply side. These include direct investment in start-up companies through government funds, fund-of-funds and public/private co-investment funds. According to the OECD, these programmes have been spreading in the recent past.[42] In particular, co-investment funds are often seen as a driver in building the seed and early stage investment market. These funds are often *pari passu* (on the same terms), but some schemes are asymmetric, i.e. they provide a premium to private sector investors, which get a higher proportion of the returns and a smaller share of the losses. Private lenders (banking groups) have made tentative experiments to provide external finance to ventures in their seed stage, without a short-term profit target, with a view to developing potential customers for later-stage bank financing.[43] OECD highlights a recent growth in demand-side programmes directed to innovative firms, such as match-making and networking services, incubators and accelerators.[44] Whereas business incubators ease the linkages of entrepreneurs with prospective financiers, including venture capitalists, accelerators invest in start-up companies in exchange for a certain amount of equity. The networking side of these facilities is important: as public equity markets stagnate and IPOs on stock exchange become difficult, the main option for entrepreneurs and their investors to realise gains is to sell or merge their firm with another company at an appropriate time. Building links with investors and large companies can increase the opportunities for this type of exit.

[42] Ibid.

[43] This multi-stage strategy would implement the "relationship hypothesis" by Hellmann et al. See Thomas Hellmann, Laura Lindsey and Manju Puri, "Building Relationships Early: Banks in Venture Capital", in *Review of Financial Studies*, Vol. 21, No. 2 (April 2008), p. 513-541.

[44] Karen E. Wilson and Filipe Silva, "Policies for Seed and Early Stage Finance", cit.

3. Outstanding issues

3.1 Funding

Against this background of stylised facts, recent developments and implemented policies, some key issues are currently outstanding. In what follows a few questions facing the adequate financing of SMEs are singled out, namely the funding of some key segments of SMEs, the development of non-bank funding, the urgency to revive investment financing and the role of regional leads and lags.

The funding of some segments of SMEs is crucial to the growth potential of the economy, and at the same time more challenging. New, innovative ventures (seed and start-ups) display a risk-return profile which is unappealing to the traditional bank debt financing, and therefore would require the development of alternative financing instruments. According to OECD,[45] the financing gap that affects these businesses is more about quality of funds than about quantity: they have a "growth capital gap." This calls for a more diversified and flexible financing system: table 5 provides a synopsis of non-bank external finance which should be available to SMEs, ranked according to their risk/return profile. In particular, notwithstanding the recent country-level initiatives, equity funding is still infrequently used by European SMEs: public equity listing has been encouraged through broader listing criteria and fiscal incentives, but IPOs on small and medium-sized firms remain small in both number and involved amounts.

Table 5 | Alternative external financing techniques for SMEs and entrepreneurs

Low Risk/ Return	Low Risk/ Return	Medium Risk/ Return	High Risk/ Return
Asset-Based Finance	**Alternative Debt**	**"Hybrid" Instruments**	**Equity Instruments**
• Asset-based lending • Factoring • Purchase Order Finance • Warehouse Receipts • Leasing	• Corporate Bonds • Securitised Debt • Covered Bonds • Private Placements • Crowdfunding (debt)	• Subordinated Loans/ Bonds • Silent Participations • Participating Loans • Profit Participation Rights • Convertible Bonds • Bonds with Warrants • Mezzanine Finance	• Private Equity • Venture Capital • Business Angels • Specialised Platforms for Public Listing of SMEs • Crowdfunding (equity)

Source: Thompson.[46]

[45] OECD, *Financing SMEs and Entrepreneurs 2015. An OECD Scoreboard*, cit.

[46] John Thompson, *Alternative Financing Instruments for SMEs and Entrepreneurs: The Case of Mezzanine Finance*, Paris, OECD, 8 February 2013, p. 17, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=CFE/SME(2012)9/FINAL&docLanguage=En.

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SMEs would also need to recur to non-bank finance when facing significant changes in their business, like turnaround or expansion: assisting SMEs during these phases would ensure a more efficient allocation of funds to sectors and firms with the strongest growth prospects, thus improving the allocation of resources within the economy. In perspective, technology applied to finance (the web 2.0-based "fintech revolution") will expectedly provide room for new financing devices, like peer to peer (P2P) lending; although still in their infancy, these players might emerge in the medium term as significant sources of external finance to some specific kind of SMEs.[47]

After a protracted economic slowdown, the core aim of SME financing should be reviving long-term investments. There is evidence that long-term investment has been subdued in recent years and many initiatives have been undertaken at the European level to counter the weakness of these investments.[48] Asset-based finance might be a useful tool to overcome traditional hindrances to SME funding, including their informational opaqueness; this would require an adequate regulatory framework, balancing the sometimes-conflicting objectives of protecting investors, ensuring financial stability and innovating SME-dedicated instruments. Moreover, the further development of the private equity market in Europe entails increased transparency (company information) and growing volumes (market liquidity): both might benefit from direct public involvement in standard-setting or market-making.

The financing of SMEs in Europe also suffers from non-negligible regional discrepancies. While in some countries effective systems have been engineered in order to ensure that sufficient quantity of external finance flow to the SMEs at reasonable economic conditions, other countries lag behind. Section 1 showed the extent of regional disparities in SME financing, which also in some countries translate into pervasive self-restraint (SME which do not apply for bank loans fearing rejection are widespread in Ireland, the Netherlands and some southern-Europe countries). The issue is relevant from a policy point of view, since regional disparities suggest that a one-size-fits-all policy might not be suitable to fill European gaps and a wide range of instruments should be provided. In some areas of Europe, improving the access to credit by the smallest businesses would also enhance the overall level of financial inclusion. In this respect, there could be some room also for microcredit: though less important in advanced financial systems than in developing countries, microcredit might be an useful driver to financial inclusion and empowerment in some less developed European countries. Financial inclusion would require, and in turn would itself foster, more widespread financial literacy on the part of potential entrepreneurs.

[47] Eleanor Kirby and Shane Worner, "Crowd-funding: An Infant Industry Growing Fast", in *IOSCO Staff Working Papers*, No. 3/2014 (February 2014), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD459.pdf.

[48] Giuseppe Grande and Giovanni Guazzarotti, "Il finanziamento degli investimenti a lungo termine: iniziative in corso e principali linee di intervento", in *Questioni di Economia e Finanza*, No. 238 (September 2014), https://www.bancaditalia.it/pubblicazioni/qef/2014-0238.

3.2 Regulation and information

In addition to direct or indirect funding, SME financing can be enhanced through the legal and regulatory framework and the quality of financial information.

The general environment surrounding the firms and in particular the legal and regulatory framework has a great impact on SME lending. The legal and fiscal framework – in particular the procedures for working-out and restructuring distressed debt, the fiscal treatment of debt with respect to equity financing – greatly affects the ability of SMEs to receive adequate financing; as reported above in section 2 and by the IMF, the EU and single member states have taken a number of steps to support distressed SMEs, from insolvency reforms and strengthened banking supervision to financial support, but more is needed to accelerate the resolution of problem loans.[49]

The regulatory wave which is being engineered and gradually implemented towards the European banking system, with a strong push in the aftermath of the Lehman crisis, will also shape the future landscape of SMEs' access to finance, given their strong reliance on bank credit. Tighter capital requirements might affect the banks' extension of new loans across different segments of customers. Basel-designed bank regulation can play a role in steering the allocation of bank funds, due to the incentives implicitly provided through capital loadings towards heterogeneous bank assets, including loans. The adoption – in 2016 – of a "SME supporting factor", allowing for a lower capital requirement against loans to SMEs, and justified by the reduced systemic impact of the latter,[50] should in principle contribute to reinvigorating the incentives of banks to finance SMEs.

Limited information on SMEs plays a significant role in hampering the access to bank credit and is also a major obstacle to the access of SMEs to markets. Possible actions were identified in this regard, in particular to facilitate credit analysis via public and private databases, the aggregation of business registers, a standardised and more widespread use of credit scoring and standardised loan-level information

[49] Wolfgang Bergthaler et al., "Tackling Small and Medium Sized Enterprise Problem Loans in Europe", cit.

[50] The introduction of the so-called capital conservation buffer (2.5 percent of risk-weighted assets) in addition to the current 8 percent total capital requirement could potentially affect SME lending. The EU legislator introduced a specific provision in the CRR aimed at safeguarding and increasing the flow of credit to SMEs. Capital charges for exposures up to 1.5 million euros to SMEs having a maximum annual turnover of 50 million euros are reduced through the application of a supporting factor equal to 0.7619 which neutralises the increase of capital requirements foreseen in Basel III (0.7619 is the ratio between the current ratio – 8 percent – and the new one inclusive of the capital conservation buffer, 10.5 percent). On 12 June 2012, the Economic and Monetary Affairs Committee (ECON) of the European Parliament adopted the Karas report, which already included an SME Supporting Factor. See European Parliament, *Report on the proposal for a regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms* (A7-0171/2012), 12 June 2012, http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0171&language=EN.

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on ABS.[51] The Green Paper on building a Capital Markets Union has stressed that a common minimum set of comparable information for credit reporting and assessment will enhance the funding opportunity for SMEs (see section 2). The standardisation of credit quality information should also help. In this respect, the European Commission has started work on credit scoring, with a view to providing information on the creditworthiness of SMEs. Moreover, the Green Paper has also set the goal to develop simplified and high-quality accounting standards tailored for certain SMEs, while minimising their burden. Finally, the European System of Central Banks (ESCB) is contributing in this regard through the ABS loan-level initiative, which enforces information requirements for ABS accepted as collateral. The ESCB is also working on a project for an analytical credit risk dataset, known as Anacredit. The aim is to make available at the ESCB level a set of granular data on credit granted by financial institutions to the nonfinancial sector, collected by national central banks, as a source of information for analytical processes on credit exposures and credit risks. The dataset will be based on harmonised definitions. As a first stage to be completed by 2018, this will enhance the set of tools of policymakers. Later stages might achieve a broadening of the scope and user base of Anacredit.

The insufficient quantity, quality and harmonisation of SME financial information stands as one major issue to be tackled. The "information issue" should also encompass the level of financial literacy of small entrepreneurs, e.g. the awareness of the benefits stemming from keeping an adequate degree of financial flexibility.[52] The high share of short-term debt featured by many SMEs, especially in some countries (see section 1), is a hint of unsophisticated financial planning on the part of these firms.

Updated 27 November 2015

[51] European Commission, *Finance for Growth*, cit.

[52] Annalisa Ferrando, Maria-Teresa Marchica and Roberto Mura, "Financial Flexibility Across the Euro Area and the UK", in *ECB Working Papers*, No. 1630 (January 2014), https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1630.pdf.

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