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2003/2 SMEs and access to finance

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SMEs and Access to Finance

This report has been prepared from information provided by all partners of the European Network for SME Research ENSR (see Annex III) and was coordinated by Mr. Peter Voithofer from the Austrian Institute for SME Research, the Austrian ENSR partner.

OBSERVATORY OF EUROPEAN SMEs

A series of reports submitted to the Enterprise Directorate-General of the European Commission (see also Annex III to this report) by:

KPMG Special Services and EIM Business & Policy Research in the Netherlands

in co-operation with:

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These are the abbreviations used in this report for the Europe-19

A	Austria	NL	Netherlands
B	Belgium	P	Portugal
DK	Denmark	S	Sweden
D	Germany	UK	United Kingdom
EL	Greece	EU	European Union
E	Spain	IS	Iceland
F	France	LI	Liechtenstein
FIN	Finland	NO	Norway
IRL	Ireland	EEA	European Economic Area
I	Italy	CH	Switzerland
L	Luxembourg	Europe-19	EEA plus Switzerland

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Preface

Enterprises are at the heart of the strategy launched by the European Council in Lisbon in March 2000. Reaching the objective of becoming the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, creating more and better jobs, and developing greater social cohesion will ultimately depend on the success of enterprises, especially small- and medium-sized ones.

The *Observatory of European SMEs* was established by the Commission in December 1992 in order to improve monitoring of the economic performance of SMEs in Europe. Its task is to provide information on SMEs at the national and European level.

The reports of the *Observatory* provide an overview of the current situation in the SME sector in Europe through statistics on the number of enterprises, on total employment, and on production by size of enterprise. In addition, the *Observatory* reports cover a range of thematic issues.

The *Observatory of European SMEs* covers 19 countries: the 15 countries of the EU, plus Iceland, Liechtenstein, Norway, and Switzerland.

In 2003 and 2004, the following reports are planned:
– Competence Development in SMEs
– SMEs and Access to Finance
– SMEs in Europe 2003
– Highlights from the 2003 Survey
– Internationalisation of SMEs
– SMEs and Co-operation
– The Impact of EU Enlargement on European SMEs
– SMEs and the Liberalisation of Network Industries

The research for the *Observatory* reports is carried out on behalf of the Enterprise Directorate-General of the European Commission by ENSR, the European Network for SME Research, co-ordinated by EIM Business & Policy Research from the Netherlands in a consortium led by KPMG Special Services from the Netherlands.

The *Observatory of European SMEs* is managed in the Enterprise Directorate-General by Unit A-5, 'Competitiveness Analysis and Benchmarking'.

For a description of the activities of the Enterprise DG, see the website of the European Commission: http://europa.eu.int/comm/dgs/enterprise For more information on the Observatory of European SMEs, including how to access or order the reports, see:
*http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/observatory.ht*m
Information on previous reports of the Observatory may be found there as well.

Summary

<u>SMEs and Access to Finance</u>

- Many small and medium-sized enterprises (SMEs) have consistently considered access to finance to be a problem. This relates to access to equity as well as access to debt financing.
- There is no clear link between the equity ratio (equity as a percentage of total capital) and firm size. In some countries (like Austria, Denmark, Finland, Germany, and Spain) the equity ratio of small enterprises is lower than in medium-sized enterprises. In other countries it is higher.
- In spite of the growing importance of alternative sources of debt financing, the majority of European SMEs still depend on banks and this is not expected to change in the near future.
- In most countries, the importance of short-term financing is usually higher for SMEs than for large enterprises, a feature that correlates to the need of SMEs for (relatively) more working capital.
- The majority of SMEs maintain a relationship with just one bank, usually covering a relatively small credit amount (< 100,000 euro). 52 % of the micro-enterprises rely on one single bank, but also one third of the medium-sized enterprises has a relationship with only one bank.
- At country level, Denmark (approximately 90 %) and Norway (80 %) have the highest percentages of SMEs having credit lines with only one bank. By contrast, in several southern European countries SMEs tend to have credit lines with more than one bank.
- Concerning the costs of financing, SMEs have a competitive disadvantage compared to LSEs. Usually interest rates as well as bank charges are higher to SMEs.
- The new Basel Accord might result in still stricter credit procedures. In preparation for the future regulations, financing institutions are already adopting new framework credit conditions (amount of credit lines, interest rates, collateral).
- The ENSR Survey 2002 reports that European SMEs are satisfied with bank services. About two thirds of the SMEs are satisfied, approximately 12 % dissatisfied. The major reasons for dissatisfaction are: poor service, bank charges and frequent changes of contact persons. Especially in the case of medium-sized enterprises, banks do not seem to offer the best solutions to their clients. Medium-sized enterprises are also more often concerned by the refusal of additional loans or the withdrawal of existing credit facilities.
- In the last three-year period, according to the ENSR-Survey, 76 % of SMEs which asked for a bank loan, received it. Nevertheless access to debt financing can be difficult due to additional collateral requirements and/or high interest rates.
- The reasons for not obtaining bank financing differ between size classes: lack of collateral mostly affects micro and small enterprises, while poor business performance and insufficient information are the main reasons for medium-sized firms.
- Most SMEs reportedly do not switch banks due to its perceived complexity and the comparatively small financial benefit so that only 12 % of them changed accounts within the last three years. More favourable conditions with the new bank (36 %) and better services (31 %) are the major reasons for switching. In some Member States, such as the United Kingdom, switching banks has recently been facilitated by implementing a mutually agreed banking code.
- Trade credit is one of the main sources of short-term financing for SMEs. In some countries and sectors the use of trade credit is more widespread than bank financing. In general, micro enterprises use trade credits more often than medium-sized enterprises. This may be explained by the fact that smaller enterprises often lack sufficient working capital also because of non-cash payments (i.e. credit transfers) and late payments by their customers.

- The effective payment periods differ by country. In Italy, for example, it takes on average 87 days before payment is made, while Swedish firms collect their debts within an average of 34 days. This difference is due to different payment terms (Italy: 66 days; Sweden: 26 days) but also different payment habits (Italy: 21 days average delay; Sweden only 8 days average delay).
- Leasing offers some advantages to SMEs as it does not tie up capital and, usually, leasing companies do not require collateral. However, leasing is often more expensive than bank loans. The average penetration[1] of leasing is estimated to be about 12 % in the European Union. Leasing seems to be particularly important in Italy, Sweden, Germany, United Kingdom, and Portugal.
- Factoring, formerly associated with low-performance companies, is now becoming a more acceptable way of external financing. 91 % of the clients of factoring companies in Europe are SMEs with an annual turnover of less than € 15 million. There are, however, considerable differences in the use of factoring between countries. While, for example, 32 % of French enterprises use factoring, only 2 % do so in Germany.
- In most of the European countries covered by this report loan guarantee funds and mutual guarantee schemes offer guarantees to SMEs with insufficient collateral, especially micro enterprises. Loan guarantee schemes are often used by 'young' enterprises (12 % of SMEs with less than 5 years compared to 8 % of SMEs with more than 10 years in business).
- According to the ENSR Enterprise Survey 2002 more than 80 % of European SMEs do not make use of financial support measures. Specifically, almost 70 % reportedly do not need financial support, while another 14 % do not know about the existence of financial support schemes. Awareness of these measures is a precondition for the use of financial support services and SMEs are not always informed by their banks of their participation in such schemes.
- Transparency is a key issue for both banks and SMEs. Banks only receive balance sheets and profit and loss statements from about two thirds of their SME clients. More sophisticated documents such as budgets or financial plans are seldom provided to banks. The quality of information has not been adequate although this has recently improved. In fact, SMEs are getting used to providing information about their structure and their business performance on a regular basis.

  On the other hand, bank procedures, such as rating and risk assessment, need to be transparent to SMEs. In this respect a code of conduct between banks and SMEs is being discussed at national as well as European level.

1 I.e. proportion of assets financed by leasing out to the total amount of investments.

Chapter 1
Introduction

Many small and medium-sized enterprises (SMEs) have consistently considered access to finance as a problem. This relates to access to equity as well as access to debt financing. This report focuses on finance through borrowing/debt financing and provides a comprehensive analysis of the actual situation of debt financing for SMEs. Debt financing includes not only financing through overdrafts and bank loans, but also other forms of finance like leasing and factoring. The report does not focus on equity financing.

The use of debt financing differs by country: in some countries SMEs rely more on debt financing than others. The equity structure of an enterprise seems to depend more on the financial system and the culture and traditions of the country in which the enterprise operates than on the characteristics of enterprise such as size, sector, age or even profitability[2].

In previous reports of the Observatory of European SMEs, attention has been paid to access to finance by SMEs but those reports focused on different sources of finance used by SMEs, such as equity, internal and informal funding (i.e. from friends or relatives, business angels).

In order to assess the situation with respect to access to debt financing by SMEs in Europe, this report provides detailed answers to the following questions:

- Which are the major developments in the financial, economic and policy frameworks affecting SMEs access to finance?
- What are the characteristics of SMEs' bank financing (e.g. number of credit lines, terms of loans, etc.)?
- What information do banks demand from SMEs? Is the quality of the information provided by SMEs adequate from the bankers' point of view? Vice versa, do SMEs receive appropriate information from banks?
- Do SMEs use trade credits and which factors influence such use?
- Are leasing and factoring primarily used by undercapitalised SMEs or have they become general financing instruments?
- What is the relevance of loan/mutual guarantee schemes for SMEs and are such schemes an appropriate way to facilitate SMEs' access to finance?

The information included in the report is based on a broad range of information sources, such as:

- Existing literature, publications (national as well as international) and case studies provided by the ENSR-partners
- Information from central databases (e.g. BACH-database[3])
- The ENSR Enterprise Survey 2002[4] conducted amongst European SMEs in the period May- August 2002. This Survey is carried out in the frame of the Observatory project.
- Interviews, conducted in spring 2003 by the ENSR-partners, with experts from banks, leasing companies and mutual/loan guarantee organisations in all countries covered by this report.

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2 European Commission, The European Observatory for SMEs - Sixth Report, submitted to the Enterprise Directorate General by KPMG Consulting, EIM Business & Policy Research, and ENSR, Luxembourg, 2000.

3 Drawing conclusion from analysing the BACH database is quite difficult as differences by country can be roughly subdivided into three groups: (1) accounting differences, (2) differences in the statistical treatment and (3) economic differences. The BACH project aimed at neutralising some of the differences related to the first two groups, in order to enable the analysis of purely economic differences (BACH-guide for the database user, 2001).

4 For further details on the ENSR Enterprise Survey 2002 see Annex II to this report.

Chapter 2 of this report describes recent changes in the framework conditions influencing the access to finance by SMEs. Chapter 3 focuses on debt financing by SMEs and in particular on bank financing, trade credit, leasing and factoring. In Chapter 4 attention is paid to the role that guarantee schemes can play in easing bank financing to small enterprises. Finally, a summary and conclusions based on the analyses are presented.

Chapter 2
Recent changes in the framework conditions

2.1. Changes in the structure of the financial sector

The financial sector has changed fundamentally during the last twenty years. Progress in information and communication technologies, deregulation and globalisation constitute the main impetus for these changes. The new information and communication technologies enable banks to collect and process large amounts of data. Hence, the degree of automation of routine tasks has increased significantly (e.g. automated teller machines, standardised granting of loans or computer-backed risk assessments). At the same time, banks need to make large investments in employees and systems to cope with the flood of information. The acquisition of information and communication technologies requires major investment in fixed assets that commit the banks financially for long periods of time. Deregulation enables banks to widen their scope of action and to engage in new business activities, while globalisation implies an increasing integration of capital markets. In this context, the introduction of the euro has led to substantial changes in the European financial markets. New debt issues are widely denominated in euro and many international enterprises operate in euro, which in the long-term might lead to a further integration of the European financial markets, resulting in a continuing process of mergers and acquisitions[5].

Financial decisions are increasingly made on the basis of worldwide comparisons of profitability and risk involved. This means that the economic performance of banks and enterprises is closely monitored, resulting in high competitive pressures. In the last years, the financial sector of various Member States of the European Union has undergone significant changes concerning e.g. internationalisation and the merging of credit institutions. Since 1992, the European financial market has been characterised by a continuing change of structure, a trend of consolidation can be observed. The number of credit institutions has been declining for the last decade in most European countries[6]. Similarly this holds true for the United States and Japan where a wave of mergers was observed throughout the 1990s[7].

According to the European Central Bank[8], the number of monetary financial institutions in the euro-area has declined by about 5 % p. a. during the last couple of decades. This has led to a greater concentration[9] of banks in the euro-area (from 36 % in 1998 to 39 % in 2000). However, this figure differs among the various countries (from above 80 % in Portugal to around 20 % in Germany). Within the European Union the number of banks decreased by 14 % to 7 620 in the period 1997-2000. The number of bank branches continuously increased between 1994 and 1996 and then started to drop. This decrease might at least be partly due to the introduction of online services, telephone banking and automated payment systems.[10] Between 1997 and 2000, the number of bank branches was reduced by 3.0 % to 198 159.

5 Eurostat, Statistics in focus, Industry, Trade & Services, Theme 4-8/1999, Brussels, 1999.
6 Eurostat, Statistics in focus, Industry, Trade & Services, Theme 4-8/1999. Brussels, 1999.
7 Eurostat, News Release No. 4/2000, Brussels, 2000.
8 European Central Bank, Report on Financial Structures, Frankfurt/Main, 2002.
9 Measured here by the top five's share of total assets in percent.
10 Eurostat, Statistics in focus, Industry, Trade & Services, Theme 4-8/1999, Brussels, 1999.

Despite these significant changes in the structure of this sector, employment remained stable. In 2000 2.7 millions employees worked in the banking sector. This was about 1.7 % of total employment[11] in the European Union. In the period 1997-2000, the decrease in the number of financial institutions could be observed in all Member States except Ireland, Greece and Sweden. Despite the overall trend, the number of bank branches, in six Member States (Denmark, Greece, Spain, Ireland, Italy and Portugal) increased.

Given the trend of mergers and concentration, there is no evidence that the degree of competition has decreased or that the service given by the banks was substantially degraded. Cutbacks were mainly directed at back office activities, not at the front-office services to the customers. The European Central Bank even reported growing competition due to factors like deregulation and internationalisation[12].

During recent years, fundamental changes in the income structure of the banking sector also took place. The net interest income of the banking sector in the European Union increased by about 8.3 % between 1997 and 2000 and the net commission income rose by about 64.4 % in the same period. This increase can partly be explained by the fact that banks have started to sell supplementary products. In different Member States (like Spain) the banking sector plays a fundamental role in selling insurance products. By offering a broader product range, banks more and more act as one-stop shops for all kinds of financial services. A drop in the ratio between interest income and commission income (e.g. from 2.64 in 1998 to 2.3 in 1999 in the European Union)[13] indicates the increasing importance of supplementary products.

The changes in the structure of the banking sector were partly caused by fundamental technological developments. The use of electronic payment services, including the Internet, continues to increase. Banks encourage their customers, private persons as well as firms, to make use of electronic services by price differentiation. In a number of countries the prices for paper-based services clearly increased, while the charges for clients applying telebanking or other less costly payment instruments decreased. On average, more than half of the European enterprises use electronic banking. According to recent studies, the number of European online banking users will almost double to more than 100 million by 2007[14].

As a result of this technological transformation, enterprises have more information on the products of the different banks and the relative costs. They are more easily able to compare the different offers, which makes switching banks much easier (see also Section 3.2.4). Also bank relationships with widespread providers of financial services are facilitated by the technological development[15]. This applies to standard products, but not generally to specialised and/or tailor made solutions. Table 2.1 provides an overview of the possible impacts these changes might have on SMEs.

11 Eurostat, Statistics on credit institutions, Theme 4-26/2002, Brussels, 2002.
12 European Central Bank, Structural analysis of the EU Banking Sector, Year 2001, Frankfurt/Main, November 2002.
13 Eurostat, News Release 128/2001, Brussels, 2001.
14 Hamilton, C, T. Torris and B. Ensor, Sizing Europe's Online Banking, Forrester Research, Cambridge, 2003.
15 Vesala, J., Technological Transformation and Retail Banking Competition: Implications and Measurement, Helsinki, 2000.

Table 2.1: Possible impact of the structural changes of the financial sector on SMEs

Possible positive impact on SMEs	Possible negative impact on SMEs
– Higher cost effectiveness may lead to decreasing charges and/or interest rates. – A broader range of financial products, better services and an expansion towards new markets covering new SME segments, which could facilitate SMEs' access to finance. – The increasing use of electronic banking services leaves bank staff more time for consulting their clients. Thus, a more client-based approach might be adopted by banks (rather than a product-based approach). – New technology and efficiency considerations could push decision-making downwards to the local bank managers who know the situation of the specific SME better.	– SMEs might be confronted with a reduction in the number of banks available in their region. – As a consequence of the merger and acquisition process the total credit amount attributed to SMEs might be reduced*. Enterprises usually have a credit ceiling in each bank they work with. However, the credit line resulting from a merger or acquisition would normally be less than the sum of the credit lines in each individual bank. – SMEs might be confronted with more frequent changes of the contact person (not only due to mergers, but also because of job rotation or changes in positions within the bank). Thus, it might take more time for entrepreneurs to get a close and confidential relationship with the bank manager, which usually is considered an important factor with respect to the access to finance. – Bigger organisations usually have a more formal structure; therefore, the decision-making period is longer. As a result of concentration, contacts with the banks might deteriorate and become therefore less frequent. – As the relative difference between the size of the SME and the size of the bank increases, SMEs might loose negotiating power. – A less dense network of local branches may be considered as a decrease in service, as entrepreneurs might have to travel further to go to their nearest bank**. A reduction of local branches might also imply less competition, at least at local/regional level.

* This possible consequence only refers to those SMEs with more than one bank connection.
**The distance to the nearest bank - as service criteria - will become less important as the use of telebanking will further increase (see below).

2.2. Changes in the framework conditions

SMEs' access to finance is not only influenced by the changes in the structure of the financial sector, but also by the changes in the framework conditions. This section looks at major changes in the *legal* framework for the financial sector and at developments in the *economic* framework, which determine SMEs' access to finance. Finally, it examines recent developments in European and national *policies* for improving SMEs' access to finance.

2.2.1. Legal framework

The most relevant, current change in the financial sector is the New Basel Capital Accord ('Basel II'). It signifies recent and impending changes in the legal and economic framework of bank financing. This Accord is to replace the initial capital measurement system commonly known as the Basel Capital Accord, which was introduced by the Basel Committee on Banking Supervision[16] in 1988. During the 1990s, the Capital Accord became an internationally accepted standard, being applied in more than 100 countries[17].

16 The Basel Committee was established by the central bank Governors of 10 countries in 1974 and has, by now, members from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States.
17 Bank for International Settlements: The New Basel Capital Accord: an explanatory note, Basel, January 2001.

New Basel Capital Accord ('Basel II')

Since January 2001, the New Basel Capital Accord ('Basel II') that should replace the 1988 Capital Accord[18] has been discussed extensively. In April 2003, the current consultative document[19] was published. The new framework is intended to align regulatory capital requirements more closely with underlying risks, and to provide banks and their supervisors with several options for the assessment of capital adequacy. Basel II should have the capacity to adapt to changes in the financial system and should enhance safety and soundness in transactions. The proposal is based on three mutually reinforcing pillars that allow banks and supervisors to evaluate properly the various risks that banks face. The New Basel Capital Accord focuses on:

- Minimum capital requirements which seek to refine the measurement framework set out in the 1988 Accord
- Supervisory review of an institution's capital adequacy and internal assessment process
- Market discipline through effective disclosure to encourage safe and sound banking practices

According to the recent timetable, the implementation of the New Capital Accord is planned to take place by the end of 2006. A new EU system will be put in place under a revised EU Directive on Capital Requirements. The Commission aims to present a proposal in early 2004. This Directive should be implemented in the Member States by the end of 2006 (in parallel with Basel II).

Responding to the widespread fear that SMEs might face worse financing conditions due to this new Accord, the Basel Committee took account of the fact that SMEs constitute different credit risks, by suggesting different ways to treat SMEs and large-scale enterprises (LSEs)[20]. As credits to SMEs of up to € 1 million will then generally be included in the regulatory retail portfolio, the necessary banks' capital requirements for SME credits will be lower than for the LSEs[21]. The new Accord will allow banks to treat credits to small companies as 'retail credits' that have to be backed by considerably less equity than those to large enterprises. This is supposed to facilitate small enterprises' access to finance, and improve their terms of credits.[22] The results of the Quantitative Impact Study 3 (QIS 3)[23] show that capital requirements for banks on loans to SMEs will generally be lower than they are currently.

Apart from the New Basel Capital Accord, some recent changes in European legislation also affect the financial position of SMEs. The regulation of the European Parliament and of the Council of the European Union on „Cross-Border Payments in euro' (Regulation 2560/2001) ensures that charges for cross-border payments in euro are the same as charges for payments made in euro within a Member State. After July 1st, 2003, charges levied by an institute for cross-border credit transfers in euro up to € 12 500 are the same as the charges levied by the same institution for corresponding credit transfers in euro transacted within the Member State. As of January 1st, 2006 the amount will be raised to € 50 000. Due to this regulation the charges for cross-border payments in euro will be reduced, resulting in decreasing bank fees.

The 'Late Payment Directive' (Directive 2000/35/EC of the European Parliament and of the Council of the European Union of June, 29th 2000 for combating late payment in commercial transactions) came into force in August 2000, following the discovery that a quarter of bankruptcies of European enterprises were caused by late payments. The Directive aims at protecting businesses and SMEs, in particular, against the heavy administrative and financial burdens resulting from excessive payment periods and late payment. Its main impact should be a shorter payment period and a better compliance with the payment terms. The Directive is limited to payments for commercial transactions (i.e. delivery of goods or services) between companies or between companies and public authorities and does not regulate transactions with consumers. The level of interest for late payment ('the statutory rate'), which the debtor has to pay refers to the sum of the reference rate of the European Central Bank plus at least 7 %-points, unless otherwise specified in the contract. However, in Spain, Greece, Portugal, the Netherlands and Luxembourg no similar measures have yet been included in national legislation[24].

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18 www.bis.org/publ/bcbsca.htm - The New Basel Capital Accord.

19 http://www.bis.org/bcbs/cp3ov.pdf - Consultative Paper: Overview of The New Basel Capital Accord, April 2003.

20 Bank for International Settlements, Basel Committee on Banking Supervision: Overview paper for the Impact Study, October 2002.

21 European Parliament: Working document on banks' minimum capital requirements (capital adequacy), Brussels, 2002.

22 Friedrich Ebert Stiftung, Arbeitskreis Mittelstand (Work Group for SMEs), Bonn, July 2003.

23 Bank for International Settlements, Basel Committee on Banking Supervision: Quantitative Impact Study 3 - Overview of Global Results, Basel, May 2003.

24 European Commission, Enterprise Europe No. 10, January-March 2003, Brussels, 2003.

2.2.2. Economic framework

The economic climate influences both the availability and the cost of capital for SMEs. The current economic framework is characterised by a weak business cycle[25]: In 2002, the economy of the euro-area grew by only 0.9 % (EU: 1.1 %). For 2003, an economic growth of 1 % in the euro-area (1.3 % in the EU) is expected which should increase to 2.4 % in 2004.

The availability of capital for SMEs

Due to the weak business cycle, the growth rate of bank lending has slowed down reflecting lower demand as well as more selective lending. In the euro-area, the growth rate of bank lending has declined from more than 9 % in early 2001 to about 4 % at the end of 2002.[26]

A potential '*credit crunch*' for SMEs was identified some time ago due to the attitudes of banks towards lending to SMEs. Banks limited loans to SMEs. This was not an indication that the banks lacked money to lend but evidence of a more cautious lending approach as a consequence of higher bank profitability requirements[27]: In general, the higher returns requested by investors lead to the development of a shareholder value culture, where banks compete intensively for investors on a world-wide scale. Therefore, high profitability and low risks are important for banks in order to prove their efficiency and to obtain favourable ratings, which are also needed to decrease refinancing costs. In this context, every business segment of a bank has to be profitable on its own merit (without cross subsidisation). Financial institutions have to pay attention to the risk adjusted return on capital (RAROC)[28]. There are some indications that the banks are actually reviewing their portfolios, particularly in some specific sectors (e.g. construction). This would suggest that banks need more current information on enterprises and that enterprises with a poor business performance are asked to adapt their bank liabilities to the firms' actual economic situation, i.e. by increasing collaterals, reducing existing liabilities etc.

The costs of capital for SMEs

The early nineties were characterised by a steady decline of long-term and short-term interest rates. The gap between the interest rate in the United States and the interest rate in Europe became narrower in the last years and it is expected that the interest rate in the euro-area and the United States will converge by 2004. However, from the SMEs' point of view, the cost of borrowing (interest rates as well as charges) is still an important issue. External finance tends to be more expensive for smaller enterprises than for large ones as the fixed costs of lending (e.g. administrative costs and the costs of collecting information about the borrower) are not proportional to the size of the loan and make small loans more expensive than large ones[29]. This price difference is also caused by different risk positions taken by banks[30] and some other size-related factors such as the greater financial acumen existing in LSEs and the greater leverage often available to LSEs.

The costs of bank transactions

Beside interest rates, additional cost, such as bank fees and/or charges are relevant factors for SMEs. In recent years, an increasing tendency to issue and transmit payment instructions electronically was observed, as manual payments are often more expensive than payments by Internet-banking (see Section 3.2). In the future, the trend to move towards electronic banking will further increase, and especially Internet-banking is expected to have high growth potential[31]. Thus, Internet-banking may constitute a possibility for SMEs to decrease their bank charges (see Section 3.2.3).

Changes in the payment attitudes of the customers (increase of non cash-payments, also caused by the growing acceptance of card-based payments by retailers) have a direct impact on the financing costs of SMEs: Credit transfers and direct debits are now the most widely used means of payment in the euro-area. Cheques have been increasingly replaced by other payment methods, and European banks no longer provide a guarantee to cash

25 European Commission, Economic Forecast Spring 2003, Brussels. 2003.
26 Aernoudt, R. (red.), Financing SMEs, the European Approach, proceedings of the European Conference in Louvain la Neuve 24-25/10/2001, organized by Minister Serge Koubla, Luxembourg, 2001.
27 European Central Bank, Structural analysis of the EU Banking Sector, Year 2001, Frankfurt/Main, November 2002.
28 National Bank of Belgium, Report 2001 and Report 2002, Brussels, 2001 and 2002.
29 Wagenvoort, R., Are finance constraints hindering the growth of SMEs in Europe?, EIB Papers, Vol. 7, No. 2, 2003.
30 Bulletin de la Banque de France: Le coût du crédit aux entreprises (The cost of credit for enterprises); data of end October 2002, No. 109, Paris, January 2003.
31 European Central Bank, Blue Book, Frankfurt/Main 2001.

cheques (up to a certain amount) like they used to do. With this continuous replacement of cash payment by non-cash payment, the capital demand of SMEs for working capital increases. This is caused by the fact that it takes several days or weeks, depending on the contracts, to transfer the respective money from the credit card institution to the firm's account.

2.2.3. Policy framework

Policy initiatives concerning the financial sector and/or the access of SMEs to debt finance have been discussed extensively in recent years. This has resulted in some important changes, both in the policy framework conditions and in concrete financial support measures.

On December 5th, 2001, the Industry Council asked the Commission to explore the possibility of drawing up a code of conduct between banks, financial institutions and SMEs, in order to encourage contacts between the parties and to strengthen their mutual understanding.

Code of Conduct for Banks and SMEs:

The objective of the European Code of Conduct between banks, financial institutions and SMEs is the improvement of the understanding of each other's position. Since January 2002[32] the possibility of setting up this Code of Conduct has been assessed. This confidence building measure on a voluntary basis will be based on a set of common principles. According to respective drafts of this Code of Conduct, general principles as well as principles regarding the credit process will be established. The general principles will refer to building mutual trust, boosting transparency, opening up a dialogue, respecting privacy and confidentiality, and non discrimination. Regarding the credit process, the focus will be on transparency on both sides: With respect to the financial institutions, the application process and the terms and conditions will be settled and with regard to SMEs, information on changing circumstances (e.g. business performance) is mentioned.

Drafts of this Code of Conduct exist already and are subject to on-going discussion.

The European Commission has recognised the financing difficulties of smaller enterprises and acknowledges the existence of a market failure due to information problems and transaction costs. A large range of measures to support SMEs is now available within the Member States; this includes measures that subsidise a certain proportion of the costs of investment and consultancy services in particular.[33]

Furthermore, some good experience has been acquired in several countries with respect to loan and mutual guarantee schemes. Through its own funds, EU financial instruments, and funds from the European Investment Bank (EIB), the European Investment Fund (EIF) provides support for guarantee schemes (i.e. guarantee funds and mutual guarantee associations) in the form of co- or counter-guarantees (covering usually up to 50 % of the losses incurred by the national organisations if they increase their risk profile by supporting higher risk SME investments)[34]. In Chapter 4 loan and mutual guarantee schemes are discussed in greater detail.

The future policy framework at EU level will be affected by the Financial Services Action Plan. It is planned to implement the Action Plan, which is a crucial part of the Lisbon European Economic Reform Agenda, by 2005. In order to meet this deadline, April 2004 has been fixed as final cut-off date for the adoption of legislative proposals.

32 European Commission, Report from the Commission to the Council and the European Parliament on the Implementation of the European Charter for Small Enterprises. Brussels, 2003.

33 Aernoudt, R. (red.), Financing SMEs, the European Approach, proceedings of the European Conference Louvain la Neuve 24-25/10/2001, organized by Minister Serge Koubla, 2001.

34 European Commission, Guide to Risk Capital Financing in Regional Policy. Brussels, 2002.

Financial Services Action Plan (FSAP)[35]:

The FSAP will be established for the following reasons:
- It will reinforce the safeguards for financial stability and market integrity;
- It will pave the way for the implementation and enforcement of a common EU financial legislation;
- Significant economic benefits are expected:
1. A single market for securities and improved market access could result in an increase of 1.1 % in EU GDP in the next decade;
2. A single infrastructure for clearing and settlement could be expected to further reduce administrative/back office costs by as much as 42 %-52 %;
3. Further integration of retail financial markets might yield potential gains in terms of interest rate reductions corresponding to 0.7 % of EU GDP.

One conclusion of the presidency of the Brussels European Council in March 2003 was that a European Entrepreneurship Action Plan should be proposed, with special attention to improve the access to finance[36]. The Commission was invited by the European Council to propose an Action Plan paying special attention to the access to low-cost finance and, in particular, to venture capital and micro-credits.

In Finland, the first micro-credit system was implemented in 1996:

Case study: Finland/micro loans of Finnvera plc[37]

Finnvera plc is one of the major providers of financial support services in Finland. It is owned by the Finnish State. Finnvera acts as a provider of complementary risk financing services in close association with banks and other financing organisations.

The Finnvera 'micro loan' scheme was introduced in 1996 and aimed at promoting entrepreneurship and job creation in Finland. 'Micro loan for women' was introduced in 1997. Both schemes have identical terms and conditions, except that 'micro loan for women' can only be admitted to enterprises, which are managed by women or the major part of which are owned by women. 'Micro loan' finances investments as well as working capital in start-ups and in established enterprises. Loans are available for micro enterprises employing less than five persons in the industrial or service sector. 'Micro loan' is often used as a supplementary financial instrument in combination with traditional bank loans or other methods of financing. The maximum amount of a micro loan is € 20 000 and the maturity period of the loan is five years with a one-year grace period. The interest rate is lower than market rates, which, is a factor contributing to the popularity of the scheme. Many of the entrepreneurs participating in the 'micro loan' scheme are self employed. Among the users of 'micro loan for women' the share of self employed is even higher. In a respective evaluation report it has been found, that this type of loan scheme is particularly suitable for start-up enterprises, due to their lack of collateral. According to the evaluation, entrepreneurs regard the terms of the loans positively. Some potential for improvements could be identified, e.g. the repayment of the loan might be more flexible as some entrepreneurs were able to repay faster, however, in seasonal business activities the level of liquidity varied considerably.

Policy initiatives concerning the financial sector and/or the access to finance have also been implemented in other Member States of the European Union. To prevent the risk of an SME credit crunch in Belgium, for example, a working group was established under the auspices of the Minister of Finance in 2001[38]. In its report, the working group recommended an observatory for bank loans to be established within the National Bank of Belgium. This observatory should provide information concerning the development of loan conditions (prices and volume).

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35 http://www.europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm.

36 www.europa.eu.int: Presidency Conclusions; Brussels European Council, 20 and 21 March 2003.

37 Stenhom, P., Pien- ja naisyrittäjälainan evaluaointi (Evaluation of loans for micro and women entrepreneur). Internal publication of Finnvera plc., Helsinki, 1999.

38 Werkgroep Toegang van de KMO's tot bankkrediet en de beursmarkten, Verslag van de Medevoorzitters Eric André en Aimé Desimpel, aan de Heer D. Reynders, federaal Minister van Financiën (Work group Access of the SMEs to bank lending and the stock exchange, Report of the Co-chairmen Eric André and Aimé Desimpel, to D. Reynders, Federal Minister of Finance), Brussels, 2001.

Generally, new financial support measures to facilitate the access of SMEs to finance often focus on specific target groups, such as start-ups, innovation or technologically-oriented enterprises, or female entrepreneurship (e.g. in Luxembourg, Norway, Spain). In France, for example, the PCE ('Prêt à la Création d'Entreprise'/loan for the creation of an enterprise) was established in October 2000 to support the creation of very small firms and to give them an opportunity to balance their financial structure better. Therefore the amounts of the loans are quite small (max. € 8 000). In Germany, a programme for micro-credits (up to € 25 000) will be launched by the DtA-Mittelstandsbank by October 2003. The credits will have a maturity period of 5 years, repayment starting after six months, with a fixed interest rate for the whole period of 8.5 %. The DtA-Mittelstandsbank also pays a fixed handling fee to the applicant's house bank making the micro-credits more profitable for the house bank[39]. In Belgium[40], starter loans for unemployed who intend to become self employed have also been available for people older than 50 since 2002.

These examples show that a number of European countries are actively supporting SMEs' access to finance. However, 96 % of European enterprises feel that national governments as well as the European Union could be more active in this field[41]. Among others, the following improvements are suggested by enterprises:
- Easier access to loan guarantee schemes;
- Encouraging the establishment of regional development banks;
- Easier access to financial information/advice;
- Help with finance applications.

39 http://www.bmwi.de/Homepage/F%f6rderdatenbank/F%f6rderdatenbank.jsp.
40 Federal Minister of SMEs, KMO en Middenstandsbeleid; Tussentijdse balans (SME and SME policy; An interim balance), Brussels, September 2001-June 2002.
41 Eurochambres, Access to finance within European Chambers of Commerce and Industry, 2001, Brussels.

Chapter 3
Debt financing situation of European SMEs

3.1. General overview

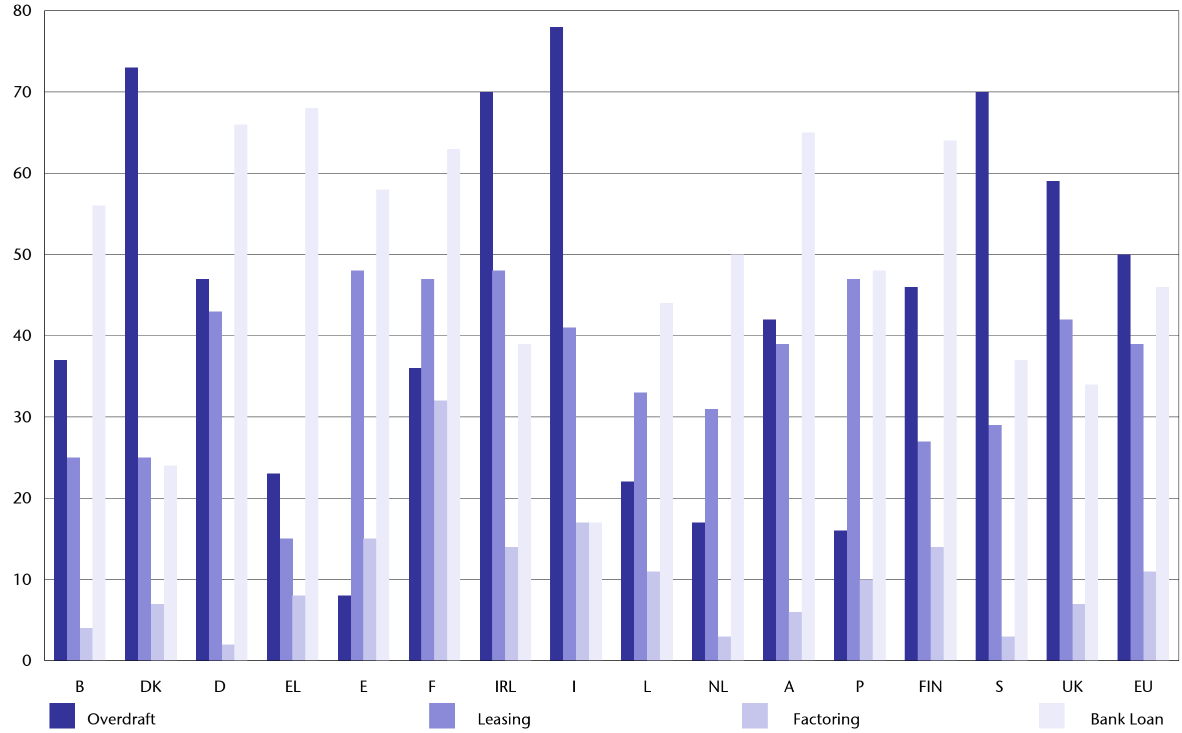
In the ENSR Enterprise Survey 2002, SMEs were asked about *the* major constraint on their business performance. Some 13 % of the European SMEs consider access to finance as the major barrier; the majority however considered lack of skilled labour the major constraint.

Basically, two financing systems can be observed in Europe: A bank-based system, as in Germany and Austria, and a market-based financial system as in the United Kingdom. In a bank-based financial system loans are the preferred source for financial investment, i.e. banks play the most important role at providing finance. Market-based financial systems are, in contrast, characterised by competitive markets, where other forms of finance (e.g. equities and bonds) are more important than bank loans[42]. The importance of bank borrowing varies in the different countries. However, the majority of European SMEs depend on bank financing and there seems to be a lack of alternative funding sources.

The Grant Thornton Business Survey gives an indication of the different types of *debt finance* used by medium-sized enterprises only (see Figure 3.1). In the majority of Member States these enterprises use mainly bank finance (i.e. overdrafts and bank loans). But also leasing constitutes an important source. In Spain, France, Luxembourg, the Netherlands, and Portugal leasing is used more often than overdrafts. Factoring, on the other hand, seems to be especially important in France.

42 Allen, F. and Gale, D., Comparing Financial Systems. 2000, Cambridge.

Figure 3.1: Percentage of SMEs using debt financing in EU-15, by country



The survey was conducted among independent medium-sized enterprises (50-250 employees).

Source: Grant Thornton, The European Business Survey, London, 2001.

The capital demand of SMEs can be either provided by its own capital or by debt capital. The debt capital required by SMEs from different lenders (e.g. banks, suppliers etc.) is the difference between capital demand and available own capital. Information on the *equity ratio*[43] of smaller enterprises can be derived from the Bach database of the European Commission. This database includes balance sheet details for enterprises in a large number of Member States[44].

The data show that there is no clear link between the equity ratio and firm size. In some countries (like Austria, Denmark, Finland, Germany, and Spain) the equity ratio of small enterprises is lower than in medium-sized enterprises. In other countries it is higher (like Belgium and France). Differences in the equity ratio by country might be a consequence of differing taxation systems (e.g. percentage of income tax or corporation tax), financial systems (e.g. market-based or bank-based financing system), legal framework conditions (e.g. accounting regulations or requirements of minimum equity for start-ups), and 'financing traditions'. Differences by sector are primarily due to differing capital demands. The general fact that the smaller the company the lower the equity ratio, when applicable, shows the small companies have a higher need for external finance than larger ones. Therefore, a 'general' barrier to external finance is assumed to constitute a larger handicap for small companies than for larger ones.

43 Equity ratio = equity as a percentage of total capital.
44 The Bach data include a bias in favour of large corporations (e.g. the equity ratios of the small enterprises are overestimated).

Table 3.1: Capital and reserves (equity), by sector, enterprise size, and country, 2000, percentage of total capital

	Manufacturing		Retail Trade		Transportation, Communication	
	Small	Medium	Small	Medium	Small	Medium
Austria	19.69*	33.08	5.34*	31.48	8.14*	41.95
Belgium	38.40	36.41	29.33	27.13	32.80	34.62
Denmark	29.61	35.93	26.21	34.15	26.80	24.45
France	36.90	36.88	35.81	31.05	28.99	27.04
Finland	38.75	43.61	31.64	39.59	31.47	40.19
Germany*	20.57	27.95	11.00	13.13	n.a.	n.a.
Italy	27.92	26.83	24.95	20.77	39.68	26.93
Netherlands	34.45	34.94	35.95	30.11	30.44	26.67
Portugal	34.28	38.45	31.99	30.91	20.98	27.94
Spain	42.68	45.26	40.34	43.21	44.66	68.04
Sweden	32.33	31.35	28.35	23.79	21.98	14.21

* Data refers to 1999.
n. a. = no data available.
Manufacturing refers to the following sectors of NACE Rev. 1: 13-22 and 24-36.
Retail Trade refers to the following sectors of NACE Rev. 1: 52.1-52.6 and 50.5.
Transportation and Communication refers to the following sectors of NACE Rev. 1: 60-64.
Small enterprises are those with an annual turnover of less than € 7 million.
Medium-sized enterprises are those with an annual turnover between € 7 million and € 40 million.

Source: BACH Database: August 2003.

In general, the *intensity of investments*[45] of large enterprises exceeds that of SMEs. This can partly be explained by the differences in sector structure between the two groups (large enterprises and SMEs). But even within the same sector (or line of business) large enterprises have a larger capital intensity than SMEs. Larger enterprises have a better equity position, enabling them to own the fixed assets (like buildings, office equipment etc.) instead of renting/leasing them. In most countries, the importance of short-term financial debt is usually higher for SMEs than for large enterprises, a feature that correlates to the need of SMEs for (relatively) more working capital requirements.

Furthermore, the ratio of *financial debt to balance-sheet total* (all debts bearing financial charges to the balance sheet; i.e. trade credit is not included) is different between SMEs and larger enterprises in many countries, and the ratio also varies by country[46]. It is large in Germany and Austria, whereas the difference is rather small in France, Italy and Spain. Conversely, in Belgium large enterprises tend to be slightly more indebted that small ones.

3.2. Bank financing

In 2000, bank loans to non-banks amounted to about € 7 392 billion in the euro area, an increase of more than 25 % compared to 1997. 90 % of the credits provided were domestic, 3 % within the euro area and the remaining 7 % referred to credits to non-banks in other countries[47]. Interest rates dropped considerably during the last few years due to lower inflation rates and in most Member States, SMEs can obtain bank loans at a rate between 7 % and 9 %. Apart from bank loans SMEs use overdrafts to finance their activities. In general, overdrafts are more expensive, but often preferred by enterprises because of their higher flexibility[48]. Nevertheless, loans usually exceed overdrafts. In the euro-area the majority of loans are in euro. Foreign currency borrowing is only an issue in a few Member States. In Finland and Portugal, for example, borrowing in currencies other than euro is practically non-existent whereas in Austria, by mid-2002, almost 20 % of the banks' loans to enterprises constituted foreign currency borrowings (compared to 7.8 % in 1995). The exact reason for this growth in foreign cur-

45 Ratio of fixed assets to total assets
46 Rivaud-Danset, D., E. Dubocage and R. Salais, Comparison between the financial structure of SMES and that of large enterprises (LSE) using the BACH database, European Communities, Brussels, 2001.
47 European Central Bank, Annual Report 2000, Frankfurt/Main, 2001.
48 European Commission: Enterprises' Access to Finance, Commission Staff Working Paper, Brussels, 2001.

rency borrowing is not fully understood but it has been suggested that the Austrian banks used cheaper foreign currency loans (yen or US $).

3.2.1. The importance of bank financing for SMEs

As shown in Section 3.1 smaller enterprises use relatively more bank financing than larger enterprises. However, from the BACH database no comparable, recent, detailed information on bank finance for the enterprises in the different size classes, sectors and countries is available. Therefore the SMEs participating in the ENSR Survey were asked to provide details about the number of banks they have credit lines with, the size of the loans and the maturity period of the loans.

As Table 3.2 shows, 41 % of European SMEs have credit lines with one single bank. Almost one third of European SMEs has credit lines with two or three banks and only 5 % have credit lines with more than three banks. Thus, approximately 80 % of all European SMEs have at least one credit line. SMEs in manufacturing, wholesale and transport/communication need relatively more credit than SMEs in other sectors and therefore more frequently SMEs active in these sectors have credit lines with 3 or more banks. SMEs in the business and personal services sector hardly need credits and 24 % of these SMEs have no credit lines at all. Also in retail, a relatively large proportion of the SME do not have credit lines, but, as will be described in Section 3.3, use trade credit as an important source of finance.

Table 3.2: Percentage of SMEs with credit lines, by number of banks and sectors in Europe-19

	Manufacturing	Construction	Wholesale	Retail	Transport/ communication	Business services	Personal services	Total
No credit line with any bank	18	15	17	23	14	24	24	21
Only 1 bank	36	46	33	41	43	39	42	41
2 or 3 banks	32	29	37	30	34	29	26	30
4 banks or more	9	6	9	3	7	5	3	5
Don't know/no answer	4	3	5	3	3	3	5	3
Total*	100	100	100	100	100	100	100	100

* The sum of each column is not always 100 %, due to rounding.

Source: ENSR Enterprise Survey 2002.

Significant differences in the use of bank credits can be observed between countries. In some countries such as Iceland and Ireland, almost every SME (95 % and more) has one or more bank credit line whereas, in other countries such as Finland, this applies to about 70 % of the SMEs, only.

In total, more than 54 % of those SMEs that have credit lines with banks concentrate all their credit lines to one single bank. There seems to be a correlation between the size of an enterprise and the number of banks with which the enterprise has credit lines. As Table 3.3 shows 52 % of the micro enterprises have credit lines with only one bank against 33 % of the medium-sized enterprises. Only 6 % of the micro enterprises have credit lines with 4 or more banks compared with 22 % of the medium-sized enterprises.

Table 3.3: Percentage of SMEs with credit lines, by number of banks and size class in Europe-19

	< 10 employees	10-49 employees	50-249 employees
Only 1 bank	52	39	33
2-3 banks	38	42	31
4 or more banks	6	11	22
Don't know/no answer	4	7	14
Total*	100	100	100

* The sum of each column is not always 100 %, due to rounding.
Data referring only to those SMEs having credit lines.

Source: ENSR Enterprise Survey 2002.

At country level, the highest percentage of SMEs having credit lines with only one bank is found in Denmark (approximately 90 %) and Norway (80 %). In contrast, in several southern European countries SMEs tend to have credit lines with more than one bank. In Spain, for example, only about one third of the SMEs have credit lines with only one bank, in Greece 37 %, and in Italy 38 %.

It is not only the number of banks that SMEs use that gives an indication of SMEs'bank financing, but also the size of the credit. Almost 60 % of SMEs participating in the ENSR survey who were asked about the size of the credits[49] have bank liabilities of up to € 100 000, another 16 % of them have bank liabilities between € 100 000 and € 500 000. About 3 % of the SMEs have bank liabilities between 500,000 and 1 000 000 euro and only 1 % of more than € 1 million (20 % fall in the category Don't know/no answer). Finally the SMEs were asked about the maturity period of the loans. Most of the SMEs' largest bank loans have a maturity period of over three years. As Table 3.4 shows, the focus on short-term bank financing is most pronounced in the wholesale sector. There is not much difference between the other sectors. Loans of 5 years and longer are frequently used in the personal services sector. These long-term debts might be the result of low profitability, cash flow or of high investments due to e.g. a take over, business transmission or capital asset procurement.

Table 3.4: Percentage of SMEs, by maturity period for the largest bank loan and sector in Europe-19

	Manufacturing	Construction	Wholesale	Retail	Transport/ communication	Business services	Personal services	Total
Less than 6 months	7	7	18	9	5	9	6	8
6 months to 1 year	9	7	7	8	8	5	5	7
1 to 3 years	14	22	14	14	18	17	18	17
3 to 5 years	26	26	18	23	26	18	16	21
5 years or longer	21	24	22	26	29	28	43	27
Don't know/no answer	24	15	21	21	14	22	22	20
Total*	100	100	100	100	100	100	100	100

* The sum of each column is not always 100 %, due to rounding.

Source: ENSR Enterprise Survey 2002.

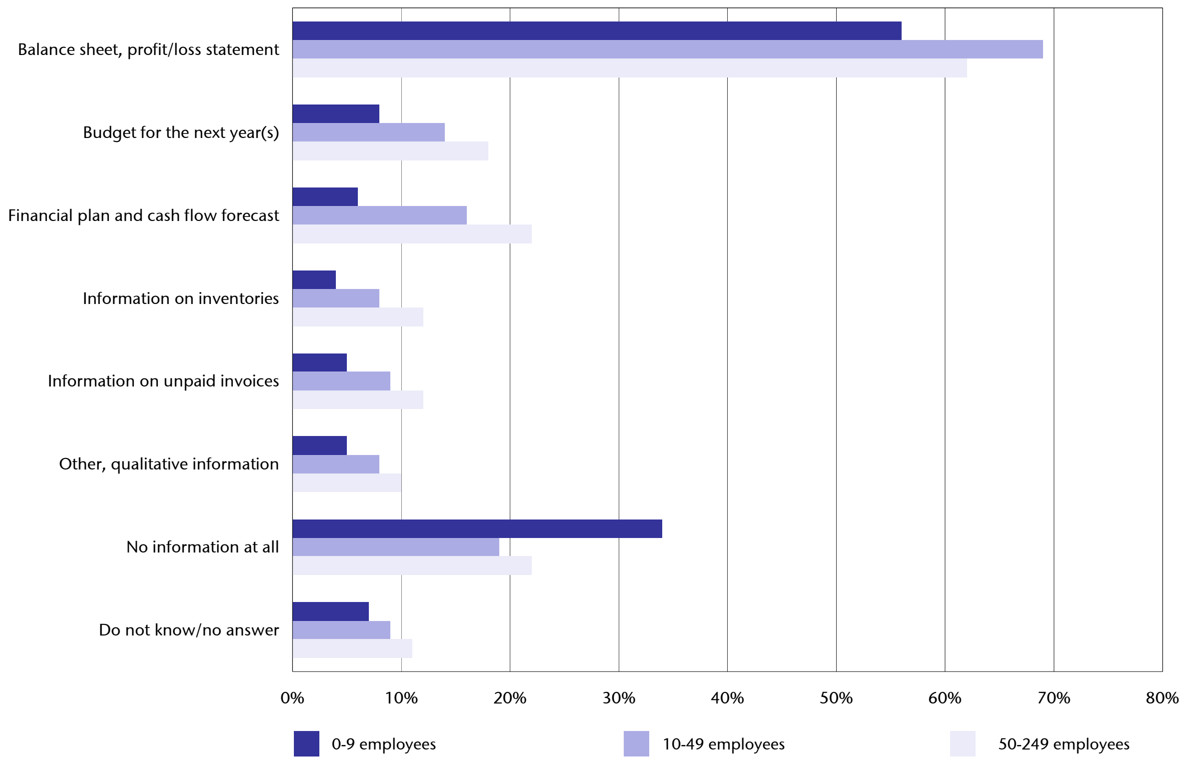
3.2.2. Information flow between SMEs and banks

A basic condition for providing loans to enterprises is that the banks have sufficient information about the enterprises to assess the applications. Often the problem of inadequate information is mentioned as one of the main aspects hampering bank finance to SMEs[50]. The balance sheet and the profit and loss statement are the documents most commonly requested by European banks. Nevertheless, as Figure 3.2 shows only about 60 % of the SMEs regularly provide this type of information. In addition to general, retrospective information, banks also require specific financial updates and strategic information. Around 8 % of the SMEs hand over to their financier their annual budget, whilst 7 % also share financial plans or cash flow forecasts with them and about 4 % provide information on inventories or unpaid invoices. Provision of all required information is often a precondition to extend a loan or an overdraft.

49 See Annex II, II.3 for sample stratification. The same applies for all of the ENSR Enterprise Survey 2003 results.

50 Graaff, C.C. van de, E.A. van Noort, Stimulering van het MKB; De effectiviteit van het beleidsinstrumentarium (*Stimulating the SME sector; The effectiveness of policy instruments*), EIM, Zoetermeer, 2002.

Figure 3.2: Information regularly provided to the most important bank, by enterprise size (in percent), in Europe-19



Most important bank in terms of credit.
More than one answer allowed.

Source: ENSR Enterprise Survey 2002.

Figure 3.2 reveals that there is a positive correlation between the size of an enterprise and the information provided to banks. About one third of all SMEs do not provide any information to banks. The majority of these SMEs can be found among micro enterprises that have a bank account, but no credit line. From the entrepreneurs' point of view there is no necessity to hand over detailed information and 70 % of SMEs without credit lines do not share financial information with the bank. Another reason for not providing information is when the entrepreneur has full personal liability because of the legal structure. In these cases banks do not always need detailed information; e.g. banks receive no information on 42 % of the sole proprietors (see Table 3.5).

Table 3.5: SMEs from whom the banks have no relevant information at all, by legal status, in Europe-19 (in percent)

Legal status	No information
Sole proprietor	42
Partnership	44
Private limited enterprise	33
Public limited enterprise	14
Other	32
Don't know/no answer	38

Source: ENSR Enterprise Survey 2002.

Considering the prospective changes in the financial sector, such as Basel II (see Section 2.2.1), more transparency in the financial situation of SMEs towards banks will be demanded. In a few years it will probably be a standard requirement for all enterprises in Europe to at least hand over the balance sheet to every bank with which the enterprise has a business relationship - whether there are credit lines or not. In fact, this is also a precondition for creating a 'rating culture' in Europe, which is necessary for Basel II.

Improvements to the information flow have already been observed by bank experts. Compared to some years ago, SMEs now take more initiative. They more readily deliver their financial statements and inform the banks about major developments in their businesses. Also the quality of the information provided is essential for the assessment of a loan application. According to interviews carried out by ENSR partners, in several countries such as Spain and Luxembourg, the quality of information provided to banks by SMEs has in general improved during the last few years. A broad variety of reasons, e.g. new information and communication technologies, new national laws, higher information requirements by the entrepreneurs themselves as well as by the banking sector, and the dynamics in the consulting sector may have contributed to these improvements. However, in general, the information provided by SMEs is less sophisticated and not so structured or validated as the information provided by LSEs. Often the information received is not complete, which basically applies to strategic information (e.g. financial plans and cash flow forecasts). Also financial projections from SMEs tend to be too optimistic from the bankers' point of view.

Small enterprises usually have very small accounting departments and often they have no accounting department at all. The entrepreneurs themselves may lack financial administrative skills and they are so involved in day-to-day business matters that the documents required by the bank (e.g. cost accounting documents or business plans) are often neglected. Thus, small enterprises need counselling and assistance to produce the required information. In some countries standardised business plans, simulation software, etc. are provided by banks to support SMEs in preparing loan applications and business plans. However, in general, external advisors (tax or business consultants) are engaged to help with business plans. Nevertheless, banks often prefer information received directly from the entrepreneur, rather than information prepared by a third party.

Vice versa SMEs also need better information from their banks. Communication should not be limited to reasons for not granting bank loans or withdrawing existing credits. The kind of information, which banks should share with their clients is mentioned in the Code of Conduct for Banks and SMEs (see also Section 2.2.3) and includes bank procedures, such as rating and risk assessment, more transparent to entrepreneurs. Such communication should create a basis of mutual trust and encourage enterprises to take more initiative with regard to financial matters.

3.2.3. Satisfaction of SMEs with the bank services received

The ENSR Enterprise Survey 2002 reveals that the majority of SMEs (about two thirds) are satisfied with the bank services received, 20 % are rather 'neutral' about the service quality and 12 % are not satisfied, for different reasons[51]. In Figure 3.3 the reasons for dissatisfaction are presented. Poor service is mentioned as the most important reason followed by high bank charges, high interest rates and that the solutions offered by the banks did not meet the SME needs.

Dissatisfaction with the service might also be related to 'frequent change of contact persons'. Usually, it takes time to build up confidence between the entrepreneur and the contact person in a bank. Banks are aware of this fact, however, changes of contact persons cannot always be avoided.

Case study: Ireland/relationship management by banks[52]

The enterprise support unit of the Bank of Ireland introduced a relationship management to the benefit of both, the bank and the clients. This approach is complemented by a range of financial and advice services geared to the particular circumstances of start-up and developing enterprises and also include 'first steps' loans, which are interest-free for a three-year period.

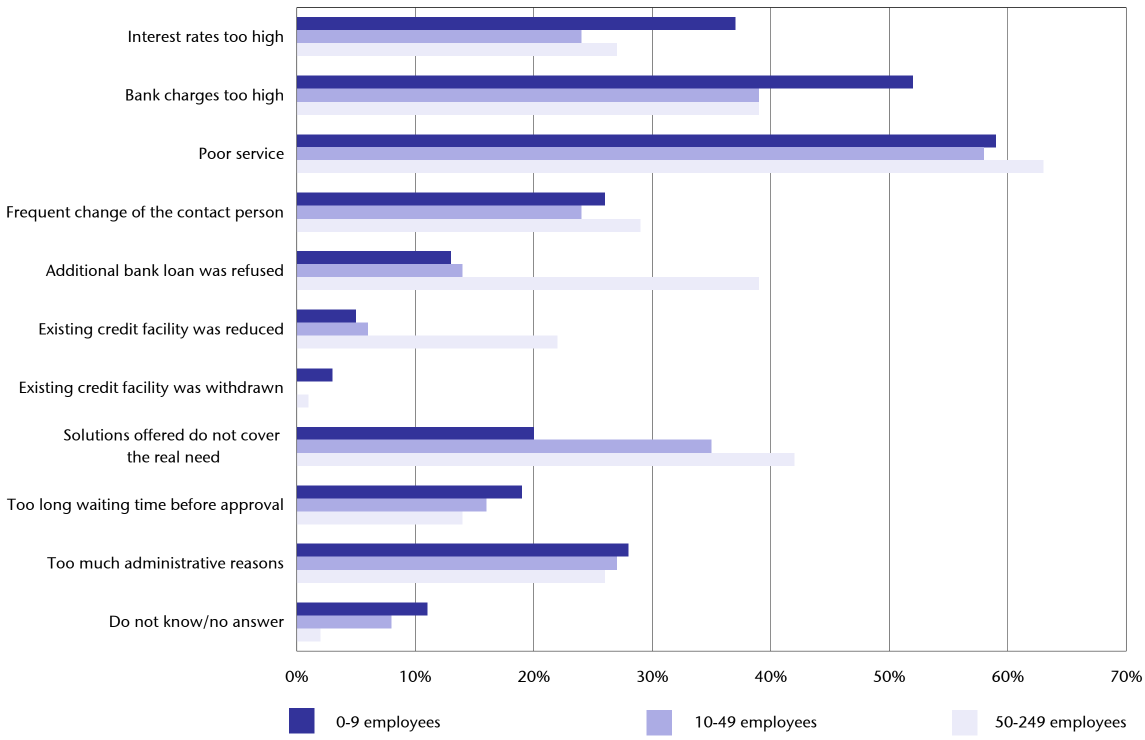
Dissatisfaction with the bank charges may be a result of cost increases for paper-based services while not all SMEs make use of, the relatively cheaper, Internet-banking facilities.

51 See also Studio Department of UNIZO, KMO en Financiering: UNIZO-onderzoek en actieplan (SMEs and Financing, UNIZO-research and action plan), Brussels, 2002.

52 European Commission, Helping businesses start-up - a good practice guide for business support services, Brussels, 2000.

An analysis by size class shows that *medium-sized enterprises* are especially concerned by the mis-match/imbalance in the solutions offered by banks, which frequently do not meet the needs of these enterprises. On the one hand, medium-sized enterprises seem to be more critical than small enterprises and might therefore be more easily dissatisfied. On the other hand, many banks offer 'packages' suitable for small enterprises and have special advisors for large companies. For medium-sized enterprises there often exists no tailor made offer. As a result, medium-sized enterprises might have a feeling of 'being left out'.

Figure 3.3: Reasons for dissatisfaction with the most important bank, by enterprise size (in percent), in Europe-19



More than one answer allowed.
Data referred exclusively to those SMEs which are dissatisfied with their most important bank (in terms of credit).

Source: ENSR Enterprise Survey 2002.

3.2.4. Switching of banks by SMEs

In order to ensure a competitive market in banking services for SMEs, it is important that businesses can switch banks quite easily and that they believe it is simple to do so.

In general SMEs are not used to switching banks due to the perceived complexity of switching for comparatively little financial benefit. Changing bank account requires additional work for the entrepreneur. Apart from all the activities related to opening a bank account at another bank (e.g. negotiating tariffs, providing the relevant information needed), other activities also have to be carried out once the new account is opened such as changing the company paper in which the account is included and informing all clients. Even if the latter is properly organised it is common practice that customers keep paying to the former bank account, which may lead to delays in processing the money, as the former bank has to transfer the money to the new bank account. Finally, SMEs in most cases wish to maintain relationships with a particular bank or a particular relationship manager[53].

Although technological developments (ICT) have made changing banks easier for banks' clients, the change of a bank account might often be seen as the ultimate solution to be taken by an entrepreneur when negotiations do

53 www.competition-commission.org.uk/reports/2002.htm#2002.

not show the desired results. In some Member States, such as the United Kingdom, switching banks has recently been facilitated by implementing a mutually agreed banking code.

Case study: Switching of banks in the United Kingdom

The British Bankers Association's new business banking code[54] requires banks to pass on details of all direct debits and standing orders to a new bank within five working days of receiving a switching request and the account transfer to be completed within five weeks. This should encourage firms to consider, periodically, whether their current bank represents the best value for money.

Some banks now have services available to help small firms switching their account. In addition, all major banks in the United Kingdom have committed to facilitate account switches.

The results of the ENSR Enterprise Survey 2002 indicate that 12 % of European SMEs changed accounts within the last three years. The major reasons for the switch were more favourable conditions with the new bank (36 %) and a better service (31 %). These results are in line with a study carried out in the United Kingdom. According to that study, the main reason for the decision of small enterprises to switch or consider switching were difficulties in obtaining financing and dissatisfaction with the services provided[55].

The main reasons mentioned for a switch are similar in all size classes. However as Table 3.6 shows, medium-sized enterprises more often state that the change in bank conditions was a reason to switch banks. In addition, the results show that medium-sized enterprises consider better services one of the important reasons but less important than micro and small enterprises. These differences can be explained by the fact that larger enterprises have greater negotiating power for obtaining more advantageous conditions from a new bank and, thus, more often switch banks.

Table 3.6: Most important reason for changing a major bank account, by size class (in percent), in Europe-19

	0-9 employees	10-49 employees	50-249 employees
More favourable conditions with the new bank	36	44	48
Better service with the new bank	31	26	14
As a result of the merging of banks	2	1	3
Contact person with former bank changed	4	3	2
Former bank changed conditions	3	4	14
Additional loan was refused by former bank	3	1	5
Existing credit facility was reduced by former bank	1	0	1
Existing credit facility was withdrawn by former bank	1	1	1
Other reason	18	20	12
Don't know/no answer	1	0	0
Total*	100	100	100

* The sum of each column is not always 100 %, due to rounding.
Data referred exclusively to those SMEs which have changed one or more major bank accounts during the last three years.

Source: ENSR Enterprise Survey 2002.

3.2.5. Reasons for not obtaining bank financing

The ENSR survey shows that during the last three years about 60 % of European SMEs asked for additional bank loans. Of those enterprises requiring additional loans, the vast majority (more than 83 %) received the money requested. However, in the case of 13 % of the SMEs the bank refused to grant additional loans. Reasons for not receiving loans are:

- Lack of sufficient guarantee collateral;
- Bank was not satisfied with business performance;
- Bank was not satisfied with the information provided.

54 British Bankers Association, The Business Banking Code, London, 2002.
55 Howorth, C., M.J. Peel and N. Wilson, An examination of the factors associated with bank switching in the UK small firm sector (http://www.cmrc.co.uk/switching.pdf).

The results of the ENSR survey also shows that a large number of SMEs chose the category 'other reasons'. Although no details are available on these reasons, it may be assumed that SMEs did not wish to discuss this subject which may be related to the weak performance or bad policy of the enterprise.

Lending to SMEs is more often based on collateral than it is for larger enterprises[56]. Collateral is necessary for most SMEs to obtain bank financing. In this context it is necessary to define what kind of assets are accepted as collateral from the banks point of view. The most common form of collateral is real estate (either owned by the business or privately owned by the entrepreneur). It may also happen that SMEs assign (private/personal) savings books to banks as collateral for bank credits to the enterprise. Other assets like inventories are normally not suitable as collateral (e.g. because of the retention of title by the suppliers and difficulties in handling them). However, SMEs generally lack sufficient collateral[57] and an economic slowdown may have a negative effect on the value of the collateral. A Swedish study showed, that in disadvantaged areas, for instance, a decrease in property values results in lower chance to borrow money. [58] The second reason for not receiving loans is a poor business performance of SMEs. Poor business performance can be assessed by criteria such as a low equity ratio, insufficient or negative earnings before interest and taxes (EBIT) and insufficient liquidity. For micro and small enterprises the lack of sufficient collateral is the main constraint, while poor business performance and insufficient information flow are the most important reasons for medium-sized enterprises. As mentioned before, lending based on collateral becomes less important as the enterprise size increases, whereas the importance of good business performance and suitable information flow rises. In addition, credit checks by banks are more complex and detailed when higher credit amounts are concerned.

Table 3.7: Most important reason for not obtaining additional bank loans, by size class (in percent), in Europe-19

	0-9 employees	10-49 employees	50-249 employees
Not enough guarantee collateral	23	34	3
Bank not satisfied with business performance	7	4	17
Bank not satisfied with information given	5	10	20
Other reasons	55	38	47
Don't know/no answer	11	14	12
Total*	100	100	100

* The sum of each column is not always 100 %, due to rounding.
Data referred exclusively to those SMEs which did not receive all the additional required bank loans within the last three years.

Source: ENSR Enterprise Survey 2002.

A recent German study[59] reported that access to bank finance has become more difficult for SMEs within the last twelve months. The reasons for this trend have been higher collateral demand, increased transparency requirements (business data and strategy) and increased documentation requirements (regarding investment projects). According to the bank experts, with whom the ENSR Survey results were discussed, collateral is not the only or the most important criteria for assessing a loan application. More important criteria are the entrepreneurial capacity and the business performance. If these criteria are assessed as negative, many banks will not provide a credit line even if the SME can offer enough collateral.

Both, national studies[60] as well as the ENSR Enterprise Survey 2002 (see Figure 3.3) provide evidence that the reduction of existing credit facilities occurs more often than the withdrawing of all the facilities extended to a firm. A reduction of credit facilities due to the banks' decision is primarily a consequence of the bad risk situation for the bank. Facing the new Basel Accord, the extension of existing credit lines (e.g. overdrafts) might become more difficult for SMEs as this will provide an opportunity for banks to adapt the conditions of the credit facilities

56 OECD, Small Businesses, Job Creation and Growth: facts, obstacles and best practices, Pris, 1997.
57 European Commission, Enterprises' Access to Finance, Commission Staff Working Paper, Brussels, 2001.
58 Kamsvåg, C., Företag och finansiering - problem och möjligheter för småföretag (Enterprises and financing - problems and possibilities for small enterprises), Stockholm, 2001.
59 Kreditanstalt für Wiederaufbau (KfW), Unternehmensfinanzierung in schwierigem Fahrwasser; Wachsende Finanzierungsprobleme im Mittelstand; Auswertung der Unternehmensbefragung 2002, (Business financing in stormy weather; growing problems for SMEs to get access to finance; elaboration of the 2002 survey), Frankfurt, 2003. (http://www.kfw.de.).
60 Neiger, F., Die Zusammenarbeit der kleinen und mittleren Unternehmen mit den Banken. Ergebnisse der KMU-Befragung von Sommer '98, (Cooperation of small and medium-sized enterprises with banks. Results of the SME survey, summer 1998), Prognos, Basel, 1998.

(amount of the credit lines, interest rates, collaterals, documentation requirements etc) to the new standards set by the new accord.

3.3. Trade credits

Trade credit is one of the main sources of short-term financing for SMEs, especially for micro and small enterprise[61]. The use of trade credits is widespread among European SMEs, in some countries and sectors it is even more common than bank financing. Trade credit however can be an expensive form of financing for the customer/credit user. The supplier charges financing costs and a risk premium. Frequently, a cash discount for immediate payment is offered by the supplier, which if not used by the client, constitutes an additional cost. Because the trend towards non-cash payment is noticeable (see also Section 2.2.2.), in several sectors (e.g. retail) the need for trade credit (or other forms of short-term finance) will increase. Many SMEs are not able to pay their suppliers before they are paid by their customers due to liquidity constraints.

Generally, a trade credit is a legitimate financial instrument which may be used by SMEs when banks are unwilling to finance them and/or to avoid direct bank costs and the complexity of bank credits. For these reasons, micro enterprises use trade credits more often than small and medium-sized enterprises[62]. This is due to the lack of financial skill in the micro enterprise and the fact that young entrepreneurs and micro-firms experience more barriers to finance than other companies. [63]

The BACH data confirm, that in the majority of countries small enterprises make greater use of trade credit than larger enterprises. This holds true for all sectors of activity. At country level, the data show that generally trade credit is used more frequently in France and Italy than in Finland and Sweden. Retail trade is the greatest user of trade credit in all countries. Enterprises active in transportation and communication make relatively little use of trade credits, except in Belgium and in France. In manufacturing the use of trade credits is relatively low in Finland and Sweden. In general, the differences between sectors are a result of different commercial customs and the differences between Member States are a result of the different legal conditions.

Table 3.8: Amounts owed to trade creditors becoming due and payable within one year, 2000, percentage of total capital

	Manufacturing		Retail Trade		Transportation, Communication	
	Small	Medium	Small	Medium	Small	Medium
Austria	12.01*	8.53	21.17*	15.36	16.12*	9.49
Belgium	17.18	20.98	21.11	28.84	17.55	22.97
France	25.55	25.88	28.70	32.50	24.78	19.23
Finland	7.63	3.92	20.47	13.40	11.12	5.72
Germany*	13.23	10.80	24.21	19.01	n.a.	n.a.
Italy	23.94	26.46	31.82	39.99	13.89	21.76
Netherlands*	n.a.	8.37	n.a.	7.75	n.a.	7.30
Portugal	16.05	15.56	27.73	26.78	10.61	3.50
Spain	21.04	19.33	27.35	26.33	11.17	5.24
Sweden	10.84	16.93	18.01	22.24	10.68	11.67

* Data refers to 1999.
n. a. = no data available.
Manufacturing refers to the following sectors of NACE Rev. 1: 13-22 and 24-36.
Retail Trade refers to the following sectors of NACE Rev. 1: 52.1-52.6 and 50.5.
Transportation and Communication refers to the following sectors of NACE Rev. 1: 60-64.
Small enterprises are those with an annual turnover of less than € 7 million.
Medium-sized enterprises are those with an annual turnover between € 7 million and € 40 million.

Source: BACH Database: August 2003.

61 Maroto Acín, J. A., Las PYME con forma societaria en las Comunidades Autónomas españolas (The society-regime SMEs in Spanish Autonomous Communities), in Cuadernos de Información Económica, No. 169, see complete study in www.ipyme.org, Madrid, 2002.

62 Kvinge, T., Finansiering av investeringer i små industriforetak (Financing investments in small industrial factories), FAFO -notat 1997-7, Oslo, 1997.

63 Reitan, B., En empirisk undersøkelse av de finansielle vilkår for SMB i Norge - med spesiell vekt på betydning av private investorer (An empirical survey of the framework for Norwegian SME finance - with a special focus on private investors), Ernst & Young, Trondheim, 2001.

One has to take into account that - by definition - the amounts owed to trade creditors (see Table 3.9) are larger in countries with longer payment periods. The payment period is part of the contract between the supplier/ and its client. There are significant differences between the contractual payment period and the effective payment period. The difference between the two periods is the payment delay (late payment).

The effective payment periods differ by country: In Italy, for example, it takes on average 87 days before payment is made, while Swedish firms collect their debts within an average of 34 days[64].

Payment delays are quite usual. There are many reasons for suppliers to grant longer payment terms. They may either be requested by their customers or may be granted voluntarily by the supplier for marketing reasons (e.g. to hold on to a special customer). According to a study of Kokalj, Paffenholz and Schröer[65] (2000) two thirds of the German SMEs allowed some of their clients to benefit from longer than usual payment terms, due to competitive pressure.

Table 3.9: Payment behaviour in Europe, 2001-2002, in days

	Payment target		Payment delay		Total	
	2001	2002	2001	2002	2001	2002
Italy	64	66	24	21	88	87
Belgium	41	39	20	22	61	61
France	45	46	12	10	57	56
United Kingdom	29	31	28	23	57	54
Netherlands	26	26	21	20	47	46
Germany	23	23	18	17	41	40
Austria	25	27	13	10	38	37
Switzerland	24	22	16	14	40	36
Sweden	24	26	9	8	33	34

Source: Creditreform, Insolvenzen in Europa, Jahr 2002/2003 (Insolvencies in Europe, Year 2002/2003), Neuss 2003.

Usually, differences in the repayment of trade credits from country to country result from different legal framework conditions (e.g. extended retention of titles), the specific role of the banking sector and from different trade practices (e.g. use of cash discounts). Also the different extent of internationalisation (e.g. exports) plays an important role. However, the payment behaviour of enterprises has remained almost stable for the last two years (see Table 3.10). [66] As described in Section 2.2.1 the late Payment Directive is aimed at reducing payment periods. However, in practice SMEs still have difficulties in collecting their debts due to their dependency on a few major customers. The results of a Swedish study show that 4 out of 10 small enterprises do not request delay interest because they fear losing their customer[67]. There is also evidence, at least in some Member States like Germany[68], that, on average, SMEs have to wait longer for payments by the public sector than by private clients.

3.4. Leasing

Leasing is increasingly used in Europe. Usually, it is applied to acquire goods with a substantial second-hand value (like e.g. cars, machines, real estate, etc.). Compared to an investment backed by a loan, the advantages of leasing for enterprises can be summarised as follows:

64 Creditreform, Insolvenzen in Europa, Jahr 2002/2003 (Insolvencies in Europe, Year 2002/2003), Neuss 2003.

65 Kokalj, L., G. Paffenholz and S. Schröer, Zahlungsverzug und Forderungsmanagement in mittelständischen Unternehmen (Payment delays and management of outstanding debts in SMEs), in: Institut für Mittelstandsforschung (IfM) Bonn (ed.): Schriften zur Mittelstandsforschung, Nr. 86 NF, Wiesbaden, 2000.

66 Creditreform, Wirtschaftslage Mittelstand, Herbst 2000 (SMEs' economic situation, Autumn 2000), Neuss, 2000.

67 Linder, S., Småföretag agerar bank åt både stat och storföretag, (Small enterprise acting as bank for the government and large enterprises), Företagarnas Riksorganisation (Federation of Private Enterprises), Stockholm, 2003.

68 Kokalj, L., G. Paffenholz and S. Schröer, Zahlungsverzug und Forderungsmanagement in mittelständischen Unternehmen (Payment delays and management of outstanding debts in SMEs), in: Institut für Mittelstandsforschung (IfM) Bonn (ed.): Schriften zur Mittelstandsforschung, Nr. 86 NF, Wiesbaden, 2000.

- There is no tie-up of capital: Leasing does not tie up as much capital as the 'traditional' acquisition of assets and thereby improves liquidity and financial scope. Because of this advantage leasing often had the image in the past of a financing method for undercapitalised firms.
- Possibility to finance 100 % of the investment: While bank loans for investments generally cover a maximum of 70 % of the value of the investment (the enterprise having to invest the other 30 % by itself), leasing requires no investment on the part of the leaseholder.
- No need for additional collateral: As the leasing company is the owner of the leased objects, usually no additional security/collateral are needed.
- Orientation on micro-economic aspects: The minimum lease period can, at least partly, be defined by the customer. It is not necessary to use a tax depreciation period (therefore the income or corporation tax, will be paid later). The adaptation between the terms of operation and the 'useful' life of the goods financed seems to be one of the most important advantages.
- Finally, leasing may not have an effect on the balance sheet (depending on the specific contract). This means that in most cases the total sum of the leased asset is not part of the total sum of assets in the balance sheet (only the periodic payment is an expense appearing in the Profit & Loss account). Thereby, leasing increases the equity share of total capital.
- The option of sale and leaseback additionally provides a way to clear capital that has already been tied to investments[69].

The main disadvantage of leasing is that the 'effective' interest rate is usually higher compared to bank credits. Still, leasing constitutes an interesting source of funding especially for SMEs and for enterprises with low revenues, but high growth opportunities. In 2001, leasing in the EU rose by about 8.5 % compared to 2000; in real terms this equals € 193 billions[70]. The average penetration[71] of leasing is estimated to be about 12 % in the European Union, and this form of financing seems to be particularly important in Italy, Sweden, Germany, United Kingdom and Portugal. Although no overall data differentiated by size class exist, several indicators suggest that leasing is mainly used by SMEs. In those countries where statistics or studies are available, the majority of leasing contracts and of the total leasing volume derive from SMEs[72]. Also the low average volume per leasing contract might lead to the conclusion that primarily SMEs use this financing method.

With respect to the goods, real estate leasing, motorcar leasing, and moveable property leasing can be distinguished. According to Leaseurope, more than 80 % of the total leasing volume in Europe concerns equipment. However, during the last few years a trend towards real estate leasing has been observed. Motorcars are the most frequently leased good, followed by machinery and industrial equipment (see Table 3.10). Whereas in the case of machinery and industrial equipment enterprises are always the lessee, cars are often leased by private persons. Most leasing contracts (77 %) last between 2 and 5 years.

Table 3.10: Equipment leased by type of asset, 2001 (in percent)

	2001
Machinery and industrial equipment	25.0
Computers and business machines	13.9
Road transport vehicles	17.1
Motorcars	33.5
Ships, aircraft, railway, rolling stock	3.9
Others	6.6

Source: Creditreform, Insolvenzen in Europa, Jahr 2002/2003 (Insolvencies in Europe, Year 2002/2003), Neuss 2003..

Leasing is a common financing method for fixed assets. Whereas in the 1980s, leasing used to be a preferred financing instrument for companies experiencing financial difficulties, at present credit guarantee procedures and the demands of the leasing companies are such that leasing is no longer obtainable unless enterprises can provide secure financial coverage.

69 European Commission, Enterprises' access to finance; Commission Staff Working paper; Enterprise Directorate General, SEC 1667, Brussels, 19th October 2001.
70 Leaseurope, Leasing activity in Europe, Key facts and figures, Brussels, 2002.
71 I.e. proportion of assets financed by leasing out of the total amount of investments.
72 I.e. Germany, Luxembourg, Portugal, the Netherlands.

In many countries leasing seems to be used particularly by fast growing SMEs (e.g. in Belgium, Finland, Ireland and Spain) as experts of leasing companies observe. This might be explained by the fact, that an expanding strategy requires money for investments and working capital, which is more easily available by applying leasing, as the capital is not tied up in fixed assets and therefore does not reduce liquidity.

To avoid getting 'bad risks', leasing companies can either adapt the contract design (shorter contract duration, degressive instalments) or ask for additional measures (like an advance/initial payment or further collateral like a bank guarantee). Generally, however, no additional securities are necessary as the leasing institution remains owner of the item on lease. Nevertheless, there are differences by countries: In Portugal, for example, all leasing contracts require a promissory note personally guaranteed by the owners of the enterprise.

In some countries leasing can have tax advantages compared to an investment financed by loans, as the leasing period is shorter than the tax depreciation period; therefore the tax (income or corporation tax) is paid later. In Denmark, for example, 1.5 % stamp duty is avoided when opting for leasing. This is the fee that has to be paid to the authorities when mortgaging an asset purchased by the company in order to obtain a loan covering the purchase. To avoid tax advantages of leasing, some countries, like Austria, for example, have adopted new tax regulations (e.g. a 'virtual' depreciation period of 8 years for all cars, regardless of the method of financing, has been established).

3.5 Factoring

Factoring is a debt financing method for working capital and refers to the sale of book debts by a company to a factor institution on a continuous basis, normally for immediate cash. The sales accounting functions are then provided by the factor institution, which manages the sales ledger, and the collection of accounts under the terms agreed by the seller. It may also assume the credit risk within agreed limits. Factoring, thus, is a composite product offering a mix of finance, credit insurance, and financial management services. It is a business-to-business service, though not suitable for all businesses, as not all debts can be factored. On average, financial charges, calculated on an interest basis, typically range from 2 % to 3 % above bank base rates. The service fee differs depending on the level and breadth of service offered, however, average fees range from 0.5 % to 2 %[73].

Factoring is continuously gaining importance in Europe. About 1 000 companies currently offer factoring services throughout the world, 435 of which were situated in Europe in 2001. Europe counts for 66 % of the worlds factoring market. Between 1996 and 2001 the factoring turnover has risen in Europe, reaching € 474 billions purchased debt in 2001 (an increase of 15 % compared to 2000). This kind of development can be observed in all Member States with the exception of Sweden and France, where a decrease of about 35 % and 76 %, respectively, was achieved between 1996 and 2001. The highest increases of factoring turnover can be seen in Spain (+300 %) and Greece (+547 %)[74]. In Spain, factoring was, at least indirectly, promoted by legal changes. Chapter III of the New Law of the Financial System (Ley 44/2002 de Medidas de Reforma del Sistema Financiero), introduced in 2002, aimed at the improvement of financing conditions for SMEs. With this aim, the law facilitates the use of factoring as a financing instrument for SMEs, allowing the transfer of their public administration customer portfolio to factor companies.

About 11 % of SMEs in Europe use factoring, but considerable differences can be observed between countries. Whereas SMEs in France, for example, are using factoring (32 % of them take advantage of it), it is hardly ever used in Sweden (3 %)[75]. Factoring is specifically targeted at and suitable for smaller enterprises. On average, 50 % of the total number of European factoring company clients have an annual turnover of less than € 2 million, 81 % of less then € 5 million and 91 % of less than € 15 million[76]. As factoring is a relatively new financing instrument, up to now the penetration rate of 11 % is rather low.

'New' methods of financing seem to have an image problem. With regard to factoring, it is often said that enterprises facing financial problems use factoring to increase, at least for a short period, their liquidity. To a certain extent, enterprises deciding to use factoring are indeed less profitable, but this seems to be due to their high

73 Greater London Enterprise Ltd., Analysis of Use of Factoring, Brussels, 2003.
74 Factors Chain International, Annual Review 2002, Amsterdam, 2002.
75 Grant Thornton, European Business Survey, London, 2001.
76 Greater London Enterprise Ltd., Analysis of Use of Factoring, Brussels, 2003.

growth and/or higher capital demand. Furthermore, factoring provides businesses' access to finance based on their growth in sales rather than on bank loans and overdrafts.

Chapter 4
Guarantee schemes and other financial support measures

4.1. Guarantee schemes for SMEs

One of the instruments used to ease SMEs' access to finance are guarantee schemes. Under such schemes, guarantees are issued to financiers in return for a fee to cover the risks as well as the administrative and processing costs. Such schemes have already existed for many years in various countries. As described in Chapter 2 the European Commission supports several measures to ease SMEs' access to finance. It has set up a co-financing mechanism that provides additional finance to existing and new loan guarantee schemes in the Member States.

There are two main types of guarantee schemes, which show some similarities[77]:

- Loan guarantee funds are usually publicly funded by regional or national authorities. They provide guarantees either directly to SMEs, or indirectly by counter-guaranteeing loan commitments set up by mutual guarantee associations. Some guarantee funds also offer loans to SMEs.
- Mutual guarantee associations are established by SMEs, business federations, or Chambers of Commerce, sometimes in partnership with banks. By grouping together as a cooperative, mutual guarantee associations are able to negotiate bank loans on preferential financial terms and are often also able to provide professional business support services to their clients, drawing on their in-depth specialised knowledge of the business sectors in which they operate.

Guarantees work on the principle of shared risk between the bank and the guarantee association, thereby significantly reducing the degree of risk for the bank. In the context of regional policy, guarantee schemes can play an important role in improving access to finance, creating private sector funding leverage and encouraging the development of SMEs. Guarantee schemes are especially suitable for very small loans to micro enterprises unable to provide the lender with the required collateral. In Table 4.1 the advantages and disadvantages for the participating parties are listed[78].

In some of the schemes, investment projects have to pass a feasibility check to benefit from guarantees. Therefore, enterprises have to deliver information to the support organisations. The aim of the feasibility check is that guarantees should only be provided for realistic and feasible projects.

77 European Commission, Guide to Risk Capital Financing in Regional Policy, Brussels, 2002.
78 European Commission, Guide to Risk Capital Financing in Regional Policy, Brussels, 2002.

Table 4.1: Advantages and disadvantages of guarantee schemes

Advantages	Disadvantages
– SMEs, which cannot easily get finance, benefit from facilitated access to loan financing on better terms. – Risk sharing between the guarantee society or fund and the bank reduces the capital requirement of the Basel rules. – Through guarantee societies and funds, private sector financing for SMEs is leveraged promoting regional development. – Guarantee societies and funds provide local input and tailored business support and advice.	– Only a part of the risk is covered by the guarantee society or fund. – By reducing the risks to banks, guarantee schemes may also reduce the extent to which banks scrutinise new loan applications. – The extent to which guarantee associations and guarantee funds receive support from public authorities varies across the European Union and is mainly dependent on the prevailing banking culture.

Source: European Commission, Guide to Risk Capital Financing in Regional Policy, Brussels, 2002.

The availability of *mutual guarantee schemes* varies considerably among the European countries (see Table 4.2). Whereas the majority of countries do not offer any of these financial support services, they are well established in some Member States (namely in Germany, France, Italy, Luxembourg, Spain, and Portugal). There are, for example, 21 mutual guarantee societies in Spain, 19 of them are regional and only 2 are national.

Case study: mutual guarantee schemes in Spain

In Spain, there are the Mutual Guarantee Associations (Sociedades de Garantía Recíproca - SGR) and the Spanish Re-guaranteeing Association (Compañía Española de Reafianzamiento - CERSA). The main activity of Mutual Guarantee Associations consists of providing the guarantees SMEs need to get access to long-term bank credits. Furthermore, they give financial advice to SMEs and sign specific agreements (lines of credit) with financial entities in order to lend money on advantageous conditions to their partners. If such an agreement does not exist, Mutual Guarantee Associations may try to improve the conditions of the loans offered to SMEs by banks. To benefit from these services SMEs must become shareholders of the association. For some operations, a complementary guarantee might even be required by CERSA. CERSA strengthens the guarantees offered by Mutual Guarantee Associations to SMEs. If a SME does not pay its debts to the lending bank and the bank recovers the amount due from a Mutual Guarantee Association the association will be entitled to demand the percentage of the quantity agreed by contract between CERSA and the Mutual Guarantee Association from the CERSA.

The socio-economic relevance of Mutual Guarantee Associations in Spain is shown by the following data[79]:

- Between 1978 and 2001, more than 60 000 SMEs have benefited from their services and more than € 7 000 million have been guaranteed. It is estimated that these guarantees have contributed to the creation and maintenance 875 000 jobs.
- Approximately 80 % of the enterprises, which benefited from mutual guarantee schemes have less than 50 employees (75 % less than 10 employees). The average size of an enterprise benefiting from mutual guarantee schemes in 1995 was five employees.
- SMEs from all sectors have benefited from the mutual guarantee system. However, almost half of them belong to the service sectors, with lower participation from industrial, building and primary sector enterprises.
- Nearly 60 % of the guarantees are used to finance investment credits, about 10 % to finance current assets, and around 30 % for deposits and other needs.
- The activity of Mutual Guarantee Associations has shown a very important growth of the participating partners (SMEs) and of the outstanding guaranteed risk in the last years.

79 CESGAR. Web page and 2001 Annual Report.
Banco de España, Las sociedades de garantía recíproca: actividad y resultados en 2001 (Mutual guarantee societies: activity and results in 2001), in: Boletín Económico, Madrid, 2002.
García Tabuenca, A., El sistema español de garantías recíprocas (Spanish mutual guarantee system), in Documento de Trabajo No. 3, SERVILAB, Madrid, 2001.

In some countries, the system of mutual guarantees schemes is relatively young: In Portugal, for example, the first mutual guarantee association was established in 1994. Ten years later, new associations entered the market to extend mutual guarantee mechanism to new geographical areas and sectors of activity. In Sweden, the first association for mutual guarantees was established in 2000 and in Belgium, the re-activation of the regional guarantee funds was proposed in 2001[80].

In spite of these positive experiences, there also exist examples of mutual guarantee schemes that did not work as effectively as planned. In the United Kingdom, for example, there was an attempt to strengthen and develop such initiatives recently through the creation of a mutual guarantee association, which, however, was forced to close in December 2002. This scheme was relatively small and had limited resources; in addition it faced considerable competition from commercial banks at the higher end of the market and from CDFIs[81] at the lower end.

Apart from differences in the availability of mutual guarantee schemes in the Member States there are also considerable differences in the way schemes operate. The role of the public administration, for example, varies from legal promoter to helper and even acting as a supervisor. In Germany, for example, the Chamber of Commerce and Industry and the Craft Chamber act as evaluators of the economic viability of the underlying investment project whereas in Spain the regional governments and the Chambers of Commerce hold equities in the mutual guarantee associations. Another difference is the existence and non-existence of reinsurance or co-guarantee programmes. Furthermore, there are different degrees of bank dependency. In some schemes, banks are represented on the board of administrators or on the executive board of the mutual guarantee fund. For example, German guarantee associations use a selection committee, including representatives from banks, to select those enterprises whose investment projects are to be supported. In Spain and Portugal, banks are shareholders of the mutual guarantee associations. In general, most of the mutual guarantee schemes address all sectors of the economy.

L*oan guarantee schemes* in Europe are more common than mutual guarantee schemes (see Table 4.2), but, no such schemes exist yet in Greece, Ireland, Italy, Luxembourg and Sweden. In Greece loan guarantee schemes will start operating in the near future according to the provisions of the third structural fund-programming period 2000-2006. Sweden is also considering the establishment of a respective association.

Many countries have only one single loan guarantee scheme, some of which are quite new. In Denmark, for example, a loan guarantee scheme was introduced in August 2000 within the Danish Investment Fund[82], while the Belgian loan guarantee system has been in operation since 1959. On average, loan guarantee schemes provide guarantees covering about 50 %-70 % of the credit. In France and Finland the level might be slightly lower, while in Austria, Germany and Spain guarantees might be cover as much as 100 %.

80 Werkgroep Toegang van de KMO's tot bankkrediet en de beursmarkten, Verslag van de Medevoorzitters Eric André en Aimé Desimpel, aan de Heer D. Reynders, federaal Minister van Financiën (Work group Access of SMEs to bank lending and the stock exchange, Report of the Co-chairmen Eric André and Aimé Desimpel, to D. Reynders, federal Minister of Finance), Brussels, 2001.

81 CDFI = Community Development Finance Institution.

82 VækstKaution, http://www.vaekstfonden.dk.

Table 4.2: Availability of financial support services and extent of guarantee in percent, by country

	Mutual Guarantee Schemes	Loan Guarantee Schemes	
	Availability	Availability	Maximum Extent of Guarantee in % of the credit
Austria	-	X	50-100
Belgium	-	X	70-75
Denmark	-	X	50-66
Germany	X	X	80-100
Greece	-	-	-
Spain	X	X	100
France	X	X	40-70
Finland	-	X	30-75
Ireland	-	-	-
Italy	X	X	n.a.
Luxembourg	X	-	-
Netherlands	-	X	90
Portugal	X	X	50-75
Sweden	-	-	-
United Kingdom	X*	X	70-85
Iceland	-	X	50
Liechtenstein	**	**	-
Norway	-	X	n.a.
Switzerland	X	X	50-60

N. a. = no information available.
* The programme was closed down in December 2002.
** In Liechtenstein the theoretical possibility exists to use Swiss loan guarantee schemes, but the entrepreneurs hardly know about this and therefore they are rarely used.

Source: Information from ENSR partners.

Guarantees are mostly established for purposes such as stimulation of start-ups, internationalisation, transfer of businesses etc. In some cases, the granting of guarantees is linked to some eligibility criteria, such as the age or gender of the entrepreneur (e.g. in Iceland's loan guarantee fund for women), the sector, the stage of the business (start-ups in particular) or the purpose of the loan (investment, internationalisation, etc.).

The Loan Guarantee Scheme for SMEs (BBMKB)[83] in the Netherlands proved to be an effective measure for meeting the needs of SMEs. One of the important success factors of the scheme is that the loans are provided by the banks. Banks have to inform the government of the guarantees provided, but they do not have to ask for government permission to grant the loan. The basic condition is that the banks have to run the same risk as the government does, with the exception for loans to start-ups. Also an evaluation[84] of the French Loan for the Creation of an Enterprise (PCE)[85] shows that this loan guarantee scheme is a good tool for financing start-ups. The evaluation of the British Small Firm Loan Guarantee Scheme (SFLGS)[86] shows that the scheme is used by a large number of small enterprises and that the majority of the support was additional to that already available from other sources. The economic benefits (e.g. impacts on employment) are quite encouraging. The recommendations of this evaluation are:

- Equalising the guarantee level[87]
- Considering the opportunities to develop new lenders to operate the scheme;
- Developing new material to increase awareness of the target groups;
- Introducing a tighter use of a classification system to govern the use of loans for working capital;
- Investigating possible and best approaches for linking advice and counselling with the loans

83 BBMKB = Besluit Borgstelling MKB-kredieten (Loan Guarantee Scheme for SMEs).
84 IFOP, Impacts et potentialités du Prêt à la Création d'Entreprise, (Impact and potentialities of the PCE), Document de synthèse, Paris, 16th October 2002.
85 PCE = Prêt à la Création d'Entreprise, (Loan for the creation of an enterprise); PCE is both a loan and a loan guarantee.
86 http://www.dti.gov.uk/about/evaluation/sflgs.pdf (Evaluation summary report).
87 The percentage of the guarantee varies (70 % or 85 %); also the premium is different (0.5 % or 1.5 %).

The main results of the evaluation of the Flemish Guarantee Funds[88] show a more critical point of view and point out the challenges SMEs face:

- The guarantee asks for a lot of administrative work. Especially drawing up separate application files, besides the internal loan files from the credit institution, makes the administrative costs exceed the benefits from the guarantee.
- The conditions are severe, complex and inflexible, especially concerning the credit type, the redemption structure, the use of the loan and the maximum interest rate.
- The guarantee system is quite expensive for SMEs (an annual premium of up to 1 % of the guarantee sum).
- The guarantee is not always a prerequisite for lending. About half of the enterprises where the guarantee had been refused still got the loan from a bank (the majority with the original conditions). This indicates that also feasible projects were rejected.

4.2. Use of financial support measures

As Table 4.3 shows, loan guarantee schemes are the most common form of financial support services, with about 10 % of European SMEs using them. The importance of the other forms of financial support services (mutual guarantee schemes, interest subsidies, non-refundable aid on capital) is rather low (each about 2 %). In total, 18 % of European SMEs benefit from financial support services. As SMEs are not always aware that they participate in a support programme (e.g. because the bank did not inform them that they take part in a loan guarantee scheme), the real figures might be higher. The target groups of many financial support services are start-ups or young enterprises. Whereas 19 % of the SMEs with less than 5 years in operation benefit from direct financial support services, only 16 % of the older enterprises (more than 10 years) have used these services during the last three years.

Table 4.3: Use of financial support services during the last 3 years, by class of years in operation (in percent), in Europe-19

	< 5 years	5-10 years	> 10 years
Loan guarantee schemes	12	11	8
Mutual guarantee schemes	2	2	1
Interest subsidy	2	2	2
Non refundable aid on capital	2	1	2
None of these	78	80	84
Don't know/no answer	6	6	5
Total*	100	100	100

* The sum of each column is not always 100 %, due to rounding.

Source: ENSR Enterprise Survey 2002.

More than 80 % of European SMEs did not benefit from direct financial support services according to the ENSR Enterprise Survey 2002. The reasons for not using these facilities are quite similar in all size classes: Almost 70 % have, from their own point of view, no need for this kind of support, 14 % do not know about the existence of such schemes and 6 % operate in a branch of industry which, for whatever reason, is not eligible for funding in the respective schemes. The results of the ENSR Enterprise Survey 2002, however, show considerable differences between countries, which can be explained by the different cultures and history of financial support services:

- In several countries 20 % or more SMEs do not know about the availability of support services. This is the case in Austria (32 %), Iceland (29 %), Belgium (26 %), Denmark (23 %), and the Netherlands (23 %).

88 IDEA Consult, Evaluation of the Flemish Guarantee Fund 2000-2001, Brussels, 2000-2001.

- In five countries (Finland, Greece, Switzerland, Sweden and Iceland) more than 75 % of the SMEs think that they have no need for financial support. To some extent this may point to the fact that SMEs are not aware of alternative ways to satisfy their financial needs, and therefore believe that there is no need for financial support.

The use of financial support services is quite high among those SMEs for which access to finance is the major constraint for business performance: 17 % of these SMEs (compared to 9 % in average) have been using loan guarantee schemes during the last three years. Thus, the conclusion might be drawn that financial support services are in fact used more often by enterprises really needing them.

The comparatively low use of financial support services can be seen as an indicator that financing is a kind of 'taboo-topic' especially for those SMEs that have problems in this area. To benefit from these services, enterprises have to deliver information to the support organisation. Usually, the entrepreneurs know after analysing their balance sheet and profit/loss account that their application will be rejected and therefore do not apply for support. It is however also possible that SMEs are not aware of the existence of financial support services. This might partly be improved by better information by bank officers, accountants, and trade organisations.

Chapter 5
Summary and conclusions

As the results of the European Business Panel show, almost all European businesses feel that national governments and/or the European Union could do more to help small enterprises to get access to finance. The main areas of improvement should be the facilitation of access to financial support services, encouraging the establishment of regional development banks, the provision of financial information/advice, and support in writing financial applications. It shows that both, the European Commission and national governments, are continuously trying to improve access to finance for SMEs. Nevertheless, the access to finance remains one of the major business constraints. As the results of the ENSR Enterprise Survey 2002 show, European SMEs consider access to finance as the second most important barrier for their business development.

There is no clear link between the equity ratio (equity as a percentage of total capital) and firm size. In some countries (like Austria, Denmark, Finland, Germany, and Spain) the equity ratio of small enterprises is lower than in medium-sized enterprises. In other countries it is higher.

Bank loans and overdrafts are the most widespread debt financing methods for SMEs and this will most probably remain unchanged in the future, despite the increasing importance of leasing and factoring (the average penetration[89] of leasing is estimated to be about 12 % in the European Union; leasing seems to be particularly important in Italy, Sweden, Germany, United Kingdom and Portugal).

Trade credit also is an important short-term financing method used by SMEs and in some countries (e.g. France and Italy) and sectors (e.g. retail sector) the use of trade credit is even more widespread than bank financing. In most countries small enterprises make greater use of trade credits than larger enterprises.

The ENSR survey[90] shows that the majority of European SMEs maintains a relationship with one single bank and most SMEs have credit lines with one bank only, usually covering a relatively small credit amount (less than € 100 000). 52 % of the micro-enterprises rely on one single bank, but also one third of the medium-sized enterprises has a relationship with only one bank. At country level, the highest percentage of SMEs having credit lines with only one bank is found in Denmark (approximately 90 %) and Norway (80 %). In contrast, in several southern European countries SMEs tend to have credit lines with more than one bank.

SMEs financing from the banks´ point of view involves higher risks compared to large-scale enterprises. SMEs do not always provide the banks with the information needed and the quality of the information is often inadequate. Only 60 % of SMEs provide the balance sheets and the profit and loss statement annually. Financial updates and more strategic information are often not delivered at all. In several countries including Spain and Luxembourg, the quality of the information provided to banks has in general improved during the last few years. A wide variety of reasons, e.g. new information and communication technologies, new national laws, higher information requirements by the entrepreneurs themselves as well as by the banking sector, and the greater use of consultants may have contributed to these improvements.

However, transparency is a key issue for both banks and SMEs. Due to the fact that many banks do not explain their loan decision procedures, entrepreneurs are not confident when applying for credits and they feel they have not been treated fairly if the credit is denied. Knowing the rating procedures might encourage enterprises

89 I.e. proportion of assets financed by leasing out to the total amount of investments.
90 For further details on the ENSR Enterprise Survey 2002 see Annex II to this report.

to develop active strategies to improve their rating. In this respect a code of conduct between banks and SMEs is being discussed at national as well as European level.

Despite these facts, the ENSR Survey shows that in the last three years most SMEs (about 85 %) reportedly received the bank loans they requested and up to now, there exists no general credit restraint for SMEs.

In order for financing institutions to accept risks, collateral is usually required when providing credits. The lack of collateral is often a barrier for SMEs seeking bank loans. The reasons for not obtaining bank financing differ between the size classes: For micro and small enterprises it is mainly lack of collateral, for medium-sized enterprises poor business performance and insufficient information flow.

There are some indications that the access to bank financing will become more difficult for SMEs in the future: The new Basel Accord might result in still stricter credit procedures and in preparation for the future regulations, financing institutions are already adopting new framework credit conditions (amount of credit lines, interest rates, collateral). Due to these developments and to safeguard competition, it is important that switching banks is not difficult, since most SMEs rely on a relationship with one bank. Only 12 % of the European SMEs changed bank accounts within the last three years. More favourable conditions with the new bank (36 %) and better services (31 %) are the major reasons for switching to another bank.

Guarantee schemes are an important instrument for governments to support SMEs and various loan and mutual guarantee schemes are available in the countries covered by this report. Loan guarantee schemes are commonly used (about 10 % of the European SMEs) Evidence shows that such schemes are preferred by 'young' enterprises (12 % of SMEs with less than 5 years compared to 8 % of SMEs with more than 10 years in business). The use of financial support services is quite high among those SMEs for which access to finance is the major constraint for business performance. 17 % of these SMEs (compared to 9 % in average) have been using loan guarantee schemes during the last three years. However, SMEs are not always aware of the existence of these schemes and often do not realise that such schemes might improve their financial situation.

SMEs' need for working capital also increases due to their customers' late payments. The effective payment periods differ by country. In Italy, for example, it takes 87 days on average before payment is made, while Swedish firms collect their debts within an average of 34 days. Payment delays are quite usual (on average up to at least 20 days). Shorter payment periods might contribute to improve the situation for SMEs and the Late Payment Directive has been developed for this purpose. However, SMEs, in particular those with only a limited number of clients, are reluctant to collect interest on overdue payments for fear of losing their clients.

A combination of soft aid measures and financial support schemes may be an appropriate way to facilitate SMEs' access to finance. Soft aid measures (advice, training etc.), should aim at raising SMEs' awareness of the existence of support schemes and of the conditions under which support is provided. In addition, entrepreneurs' knowledge of financing issues should be encouraged and greater transparency of banks' loan decisions and rating procedures should be ensured.

Finally, increasing SMEs' equity endowment (by means of tax reduction for retained profits, for example) may contribute to improve SMEs' access to finance and reduce their need for debt financing.

Annex I
The position of SMEs in Europe-19

<u>93 % of all European enterprises have less than 10 employees</u>

There are 20.5 million enterprises in the European Economic Area (EEA) and Switzerland, providing employment for 122 million people. Some 93 % of these enterprises are micro (0-9 employees), 6 % are small (10-49), less than 1 % are medium-sized (50-249) and only 0.2 % are large enterprises (250+). Of all these enterprises nearly 20 million are established within the European Union. Two thirds of all jobs are in SMEs, so one third of all jobs is provided by large enterprises. Within SMEs, total employment is split up roughly equally between micro enterprises (employing less than 10 employees), and small and medium-sized enterprises.

The size-class distribution of employment differs, however, between countries. For example, the share of micro enterprises in total employment is 48 % in Italy, and 57 % in Greece.

On the other hand, the share of large enterprises in total employment is over 45 % in Iceland and the United Kingdom.

Table I.1: The basic facts about SMEs and large enterprises, in Europe-19, 2000

		SME	Large	Total
Number of enterprises	(1 000)	20 415	40	20 455
Employment	(1 000)	80 790	40 960	121 750
Occupied persons per enterprise		4	1 020	6
Turnover per enterprise	Million €	0.6	255.0	1.1
Share of exports in turnover	%	13	21	17
Value added per occupied person	€ 1 000	65	115	80
Share of labour costs in value added	%	63	49	56

Source: Estimated by EIM Business & Policy Research; estimates based on Eurostat' s SME Database. Also based on European Economy, Supplement A, June 2001 and OECD: Economic Outlook, No. 65, June 2001.

<u>The average European enterprise employs 6 people</u>

On average, an enterprise in Europe - even including all very large enterprises- provides employment to 6 people; the average for SMEs only is 4 people. However, this varies between 2 people in micro enterprises, and over 1 000 in large enterprises. Between countries, there are large differences as well. On average, an enterprise has 2 occupied persons in Greece and 3 in Italy, compared with 10 in Ireland, Luxembourg, Austria and the Netherlands.

<u>Most jobs in Europe are created by micro enterprises</u>

On balance, large enterprises lost jobs between 1988 and 2001, while employment in the SME-sector increased. In the early years this growth was concentrated in micro and small enterprises, as significant employment growth in medium-sized and large enterprises only started in 1997. In 2001, employment growth slowed down. Current estimates show that this occurred both in SMEs and large enterprises, but the slow down is slightly more pronounced in large enterprises.

Annex II
Set-up and structure of Survey

II.1. Introduction

The ENSR Enterprise Survey 2002 is designed to make uniform data on SMEs available from nineteen European countries. This enables the Observatory of European SMEs, in addition to using Eurostat and other secondary data, to make comparative analyses based on recent and comparable SME data. Data have been collected from enterprises in each of the 19 countries covered, i.e. the 18 Member States of the EEA and Switzerland.

Interviews were conducted using the CATI-system of Intomart. CATI stands for Computer Assisted Telephone Interviewing. The overall design and implementation of the stratification, the questionnaire and the fieldwork were done in close collaboration between staff from EIM Business & Policy Research in the Netherlands, partners in the ENSR network and Intomart.

In this annex the sample size and stratification plan of the ENSR Enterprise Survey 2002 are described. This will foster a proper use and interpretation of the data that have been collected. The 2002 ENSR Survey of SMEs was carried out from May-August 2002. Highlights from the survey were published in a separate volume[91]

II.2. Sample size

The size of the sample was determined by considering the need to report on dichotomous variables at country and size class level, with reasonable accuracy and confidence. Statistical theory shows for dichotomous variables that if sample errors are not to exceed ± 10 %, at a confidence level of 95 % a total sample size of about 90 is needed for that level. This applies to estimates at the country-size class level combined. As three size classes are distinguished in nineteen countries, the minimum required sample size can be calculated as 3 * 19 * 90 = 5 130 interviews. Estimates at the country or size class level separately are of course much more precise at the same level of confidence, as there are many more respondents at these levels.

To allow additional analyses, i.e. by various subgroups to be distinguished in the group of sampled enterprises, the planning did not aim at 5 130 interviews but at about 50 % more: 7 750 interviews. Finally 7 669 completed interviews were obtained.

II.3. Stratification plan

Interviewing 7 750 SMEs means covering about 0.04 % of all SMEs. A simple random sample would imply that in total only about 65 medium-sized enterprises (spread over nineteen countries and seven sectors) could be expected in the sample. Obviously this would be insufficient to reach any valid conclusion about the group. Therefore a disproportionately stratified sample is used; this means interviewing less than a proportional number of smaller enterprises and more than a proportional number of larger enterprises. Consequently, observations from the survey must be weighted in order to arrive at representative results.

91 European Commission, Observatory of European SMEs; Highlights from the 2002 Survey; Report submitted to the Enterprise Directorate General by KPMG Special Services, EIM Business & Policy Research and ENSR, Brussels, 2003.

The stratification of the ENSR Enterprise Survey 2002 is defined in terms of industry (i), enterprise size (s), and country (c). The stratification aims to minimise the standard deviation of the weights used in raising sample results to population levels, taking account of the fact that, in many cases, data by country and/or by enterprise size class or by sector of industry are presented. In order to guarantee a sufficient number of observations for these subsets of the European enterprise population, the following constraints A to E have been imposed:

A. In each country/size class combination: at least 100 observations.
B. In each industry/size class combination: at least 100 observations.
C. In each country/industry combination: at least 35 observations.
D. In each individual industry/size class/country combination: at least 2 observations.
E. In each individual industry/size class/country combination: an upper limit of 10 % of the stock of enterprises.

Restriction E supersedes the other restrictions if conflicts arise. So if 100 observations at the country/size class level (restriction A) would exceed 10 % of the stock of enterprises, the 10 % was set as an upper limit.

The stratification plan that resulted from this procedure is presented in Table II.1, by country and all size class sectors.

Table II.1 Stratification plan: country by size class (for all sectors)

Country	Micro (0-9)	Small (10-49)	Med.-sized (50-249)	Total
Austria	108	100	100	308
Belgium	161	100	100	361
Denmark	146	100	100	346
Finland	105	100	100	305
France	461	100	100	661
Germany	472	100	100	672
Greece	161	100	100	361
Iceland	132	100	13	245
Ireland	100	100	100	300
Italy	581	100	100	781
Liechtenstein	194	22	3	219
Luxembourg	100	100	50	250
Netherlands	122	100	100	322
Norway	124	100	100	324
Portugal	169	100	100	369
Spain	346	100	100	546
Sweden	149	100	100	349
Switzerland	127	100	100	327
United Kingdom	505	100	100	705
Total	4 264	1 821	1 665	7 750

Source: Sample optimisation developed by EIM.

The stratification procedure results in a sample of 4 264 micro firms, 1 821 small firms and 1 665 medium-sized firms (see Table II.1). Although there are many more micro firms than larger firms in this sample, the differences in sample size between the three distinguished size classes are much smaller than the corresponding differences in the population. In other words, micro enterprises are still underrepresented in our sample, while small and especially medium-sized enterprises are over represented.

Disproportionate stratifications have also been made regarding country. The sample size ranges from 219 for Liechtenstein to 781 for Italy. Again, while the sample size is larger for large countries, small countries are overrepresented in the survey. Without this overrepresentation, it would not be possible to make valid statements concerning the smaller countries.

The overrepresentation of certain countries, sectors and size classes is corrected by weighting the survey results. Therefore, all percentages in text and tables in this report refer to weighted results.

Annex III
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More information on Enterprise DG

Additional useful information on the work of Commissioner Erkki Liikanen and the Enterprise Directorate-General is available through printed publications and on the web.

Commissioner Erkki Liikanen, responsible for Enterprise and the Information Society:
http://europa.eu.int/comm/commissioners/liikanen/index_en.htm

Enterprise DG on the web:
http://europa.eu.int/comm/dgs/enterprise/index_en.htm

CORDIS (Community Research and Development Information Service):
http://www.cordis.lu

Enterprise DG work programme:
http://europa.eu.int/comm/dgs/enterprise/work_programme_2002.htm

Enterprise DG's printed publications:
http://europa.eu.int/comm/enterprise/library/index.htm

Enterprise Publications

Enterprise Europe is a free-of-charge newsletter published quarterly in the 11 Community languages by the Enterprise Directorate-General. It covers the whole range of Enterprise DG's work, announcing new initiatives as well as providing practical information.
http://europa.eu.int/comm/enterprise/library/enterprise-europe/index.htm

CORDIS focus is published twice a month in English, French, German, Italian and Spanish. It provides a review of the main developments in all aspects of European Union research and innovation activities, covering general policy developments, programme implementation, calls for tenders and results, events, legislative activities, and much more.
http://www.cordis.lu/focus/en/src/focus.htm

Innovation & Technology Transfer is published six times a year in English, French, German, Italian and Spanish by the European Commission's Innovation Programme, which aims to promote innovation at Community level and encourages SME participation under the Fifth Research Framework Programme. The emphasis is on timely news relevant to these objectives and in-depth 'case studies' of successful projects.
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Euroabstracts is published six times a year in English by the 'Innovation and SMEs' programme, part of the European Commission's Fifth Research Framework Programme. The Innovation and SMEs programme promotes innovation and encourages the participation of small and medium-sized enterprises in the Framework Programme.
http://www.cordis.lu/euroabstracts/en/home.html

European Trend Chart on Innovation newsletter. The Trend Chart project develops practical tools for innovation policy makers in Europe. It pursues the collection, regular updating and analysis of information on innovation policies at national and Community level. The newsletter is published quarterly in English, French and German.

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