1. INTRODUCTION

Access to finance is crucial for small and medium-sized enterprises (SMEs) for their growth and innovation.

According to the EU-wide survey published on 30 November 2016 access to finance is the most important concern for 9% of EU SMEs.

The situation in this area has considerably improved over the last few years, as the percentage of SMEs with this concern went down from 16% in 2009 to 9% in 2016.

However, the results differ from country to country. The highest proportion of SMEs specifying access to finance as the most important issue is in Greece and Cyprus (24% in both countries).

This financing problem is also reported by the smallest companies (10% of micro companies) and young high-growth companies (13% of what are known as 'gazelles')¹.

There are significant differences in how financing to SMEs is channelled in EU countries.

This diversity is reflected in:

- the relative size of the various funding sources used by companies;
- the level of development of various types of financial institutions, e.g. banks, investment funds, insurance and pension funds;
- the level of development of segments of financial markets such as the stock exchange, bond market and securitisation markets.

The most important direct sources of external financing for SMEs are credit lines, bank loans and leasing.

By contrast, for innovative, high-growth companies and start-ups, equity financing is essential. Even if not substantial in total size compared to other financing sources, equity financing has a great potential for growth and employment, also because of the innovation generated by beneficiary companies.

¹ ‘Gazelles’ are defined in the survey as companies younger than 5 years and growing on average 20% per year over the last three-year period; European Commission/European Central Bank, 2016, Survey on the access to finance of enterprises (SAFE), http://ec.europa.eu/growth/safe.
Member States have put in place various policies and programmes to tackle the various barriers SMEs face when accessing different sources of finance.

At EU level, the European Commission works with financial institutions to improve the funding available to SMEs. It does this by stimulating the provision of loans and venture capital through financial instruments such as those available within the Programme for the Competitiveness of Enterprises and SMEs (COSME), Horizon 2020, European Structural and Investment Funds and the European Fund for Strategic Investments. Moreover, SMEs receive European Investment Bank’s financing mainly through selected partner commercial banks and other intermediaries.

Through the Capital Markets Union initiative (CMU) the Commission aims to achieve greater diversification in the funding of the economy, particularly for SMEs.

The Commission also helps EU countries share good policies on improving access to finance so that they benefit from each other's experience. Access to finance is one of the principles of the EU's flagship policy initiative to support SMEs — the Small Business Act for Europe (SBA). Every year the Commission publishes its 'SBA factsheets', which aim to improve understanding of recent trends and national policies affecting SMEs. Access to finance is one of the areas of the SBA covered by the factsheets.

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This European Semester thematic factsheet aims to briefly present the key policy challenges in this area, as well as a description of some policy tools which Member States are putting in place to address them.

2. POLICY CHALLENGES: SME ACCESS TO FINANCE MARKETS IN THE EU COUNTRIES

2.1. General funding ecosystem for SMEs

The EU countries have taken several policy measures to improve SMEs’ access to finance, with varying results.

In SBA factsheets, the Commission measures each country’s performance on SME access to finance as compared to the EU average.

It takes into consideration indicators reflecting the availability of different financing sources and other relevant conditions.

The latest figures allow for grouping the EU countries in three categories:

• broadly in line with the EU average (+/- 0.5 standard deviation): Luxembourg, Bulgaria, Croatia, the Czech Republic, Denmark, France, Germany, Hungary, Ireland, Lithuania, Romania, Slovakia and Slovenia;
• above the EU average: Belgium, Estonia, Finland, Latvia, Poland, Sweden and the UK;
• below the EU average: Austria, Cyprus, Greece, Italy, the Netherlands, Portugal and Spain.

The European Investment Fund (EIF) has also proposed a new composite indicator for SME financing in Europe. It is built on three financing sources for which there is a sufficient amount of quality data available: loans, credit and leasing, and equity finance. An indicator reflecting macroeconomic conditions is also included. The results for 2016, plus 2013, 2014 and 2015, are presented in the graph below.

3 In the SBA factsheets, SME access to finance is one of 10 monitored areas. It is composed of the following indicators: venture capital investments, strength of legal rights, depth of credit information, total duration in days to get paid, bad debt loss, cost of borrowing for small loans relative to large loans, rejected loan applications and loan offers whose conditions were deemed unacceptable, access to public financial support including guarantees, willingness of banks to provide a loan, equity funding available for new and growing firms, professional business angels funding available for new and growing firms, private lenders' funding (crowdfunding).


5 In total, a set of 23 time series were included and grouped into those four sub-indices. More details in EIF, 2017, European Small Business Finance Outlook, pp. 7-9, http://www.eif.org/news_centre/publications/eif_wp_43.pdf.
In general, all different financial institutions and financial markets play an important role in creating a funding ecosystem, which is important for all companies\(^6\). In the case of SMEs, even if they are not offering a direct financing option, they are often an exit point for investors.

In this way, investors can transfer their investment, releasing funds to be recycled to new SMEs. Whereas bank lending (see below) is still the dominant funding source for most SMEs, fast-growing innovative firms rely to a greater extent on equity financing. Moreover, access to finance in general is a greater barrier for fast-growing innovative firms than for other types of SMEs\(^7\). While the absolute number of such firms in the EU is relatively small, still they represent 18.8\% of total EU employment\(^8\). Those jobs also tend to be more persistent and more knowledge-intensive\(^9\). Such firms also exhibit higher average productivity growth and R&I activity, thus helping to improve the

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\(^6\) A more detailed analysis of financial intermediation in the EU countries is available in the Commission’s, 2015 Economic analysis supporting the CMU Action Plan, SWD(2015)183; the Commission’s 2017 Economic analysis supporting the CMU Mid-Term Review, SWD(2017)224 final; and European Commission, 2016, European Financial Stability and Integration review 2016, SWD(2016)146, chapter 2.

\(^7\) Based on successive waves of the Community Innovation Survey; analysed in Hözl, W., & Janger, J., 2013, Does the analysis of innovation barriers perceived by high growth firms provide information on innovation policy priorities?, Technological Forecasting and Social Change, 80(8), pp. 1450-1468.


competitiveness and knowledge intensity of EU economies\textsuperscript{10}.

2.2. Bank lending

Banks are the largest financial intermediaries in all EU countries, although their relative importance varies significantly from one country to another. While loans typically represent the bulk of banking assets, most banks also invest in capital markets.

On average, in 2016 SMEs perceived an improvement in the availability of bank financing alongside a decrease in interest rates. However, SMEs also reported increases in the non-interest rate costs of financing and collateral requirements.

The difficulties of accessing bank loans are particularly affecting smaller and innovative companies. Since the rejection rate includes both projects that are viable from an economic point of view and those that are not viable, on a country-to-country level the rejection rate provides a rough indicator of tightened or eased credit standards applied by banks to the approval of loans or credit lines. Furthermore, some SMEs do not even apply for bank loans because of fear of rejection, especially in Greece (26\%\textsuperscript{11}).

The approval rate for SMEs' bank loan applications increased from 60\% in 2014 to 70\% in 2016 on average. Yet rejection rates remain high in some EU countries such as Greece (20\%), Lithuania (20\%), Latvia (20\%) and the Netherlands (17\%).

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\textsuperscript{11} SAFE (2016), ibid.
2.3. Other financing sources for SMEs

**Venture capital**, even if limited in all EU countries, is an important source of funding, especially for higher risk and innovative projects and companies. Taking into consideration the size of the market, venture capital can still be regarded as a niche solution compared to traditional financing venues. Venture capital activity is highest in the most developed capital markets (the large EU countries, Benelux, the Nordic countries). While more tailored to the needs of start-ups and more risky undertakings, venture capital constitutes a small fraction of private equity and is most developed in Sweden, Finland, Ireland and the UK. Insurance companies and pension funds are among the key institutional investors in venture capital funds.

**Crowdfunding** is an emerging source of financing involving open calls to the public, generally via the internet, to finance projects through donations or monetary contributions in exchange for a reward, product pre-ordering, lending or investment. Any type of organisation can launch a crowdfunding campaign. SMEs, artists, innovative start-ups and social entrepreneurs may all benefit from different forms of crowdfunding. Crowdfunding has been developing rapidly in some EU countries. It is estimated that the total European online alternative finance market, which includes crowdfunding, peer-to-peer lending and other activities, grew by 92% to reach EUR 5 431 million in 2015. Excluding the UK, the largest market, the European online alternative finance industry grew 72% from EUR 594 million in 2014 to EUR 1 019 million in 2015\(^2\).

**Business angels** are private individuals, often of high net worth, and usually with business experience, who directly invest part of their personal assets in new and growing private businesses. Business angels can invest individually or as part of a syndicate where one angel typically takes the lead role. Besides capital, angel investors provide business management experience, skills and contacts for the entrepreneur. Business angels play an important role in the economy as in many countries they constitute the second largest source of external funding in newly established ventures, after family and friends. They are increasingly important in providing risk capital, as well as in contributing to economic growth and technological advances. The UK leads the European business angel market, followed by Spain, Germany, France and Finland\(^3\).

**Securitisation** is the process where a financial instrument is created, typically by a lender such as a bank, by pooling assets (for example SME loans) for investors to purchase. This facilitates access to a greater range of investors, which in turn increases liquidity and frees up capital from the banks for new lending. The level of development of securitisation varies greatly between EU countries. The Netherlands has the largest securitisation market (32% of GDP), with the bulk of the collateral being mortgage loans. Some countries also have relatively developed securitisation markets, with stocks of securitised assets representing between 10% and 20% of GDP in Belgium, Portugal, Ireland, Spain, Greece and the UK). In some other large European countries, even though the amount of securitised assets outstanding is relatively low as a percentage of GDP, the securitisation market is also sizeable in absolute numbers. This is the case in France, Germany and Italy. In most other EU countries, the value of the outstanding securitised assets relative to the size of the economy is very small.

Listing on a **stock exchange** provides SMEs with access to a potentially wider equity investor base. Especially important for SMEs are growth stock

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\(^3\) EBAN, 2016, European Early Stage Market Statistics 2015.
markets, which offer listing opportunities with simplified requirements for firms that cannot or do not want to be listed on the main stock markets.

Leasing, as a form of asset-based financing, is often a very attractive source of financing for SMEs to finance a wide range of asset types. Usually it does not require any supplementary guarantees or collateral. Providers of leasing include commercial banks, but also other credit non-bank organisations or leasing companies. According to 2016 SAFE survey results, leasing is relevant for 47% of the EU SMEs, and ranging from 23% in Cyprus to 68% in Finland. It was used in the previous 6 months by 23% of the EU SMEs.

Microfinance might be an additional financing source for existing micro-enterprises, but also for those who are eager to create a business in order to escape poverty or unemployment and contribute to job creation.

European microfinance providers are very diverse across Europe. In addition to commercial banks that target microenterprises as part of their general SME lending activity, the spectrum of European microcredit developers includes many profit-oriented and non-profit associations.

Corporate bond markets are relevant only for larger SMEs and more for mid-caps or large companies. In all EU countries, corporate bond markets are smaller than stock markets. However, national differences still exist.

Figure 4 — Venture capital investments as % of GDP, market statistics: location of the portfolio company

[Image]


14 SAFE (2016), ibid.
3. POLICY LEVERS TO ADDRESS THE CHALLENGES

To address the issues that SMEs face in accessing various forms of finance, various policy recommendations have been proposed by academic literature, international organisations and other sources. Given the diversity of financial markets available for SMEs and the multiple challenges presented by each of them, the focus of the present assessment is on a few policy areas and is not intended as an exhaustive analysis of the field.

On the lending side, the European banking sector is facing the huge challenge of non-performing loans (NPLs), which are weighing heavily on some national banking systems. NPLs have a significant adverse impact on banks' profitability and their ability to lend, including to SMEs. Consequently, policies to improve banks' ability to deal with NPLs are very useful. Possible solutions could include: (i) ways to promote more efficient and more predictable loan enforcement and insolvency frameworks designed to enable swift value recovery by secured creditors; (ii) more transparency so that potential secondary market purchasers of NPLs can enter the market for these 'products'.

The small size and fragmented nature of the venture capital market in the EU makes it quite challenging to attract big investors to the sector. For this purpose, a number of policy levers are available to attract such investors back to the venture capital asset class. These include adapting regulatory and prudential measures to the needs of institutional investors (i.e. insurance companies). Tax incentives are another tool which can be useful to make the venture capital asset class more attractive for institutional investors.

In response to the rapid growth of crowdfunding in some Member States, those countries are taking steps to clarify the conditions for this new business model, sometimes through targeted legislation. However, the continued expansion of this emerging source of finance will need to be carefully balanced with ensuring investor protection.

Following the crisis, EU securitisation markets remain significantly impaired, damaged by concerns surrounding the securitisation process and the risks involved. Policies to support investor confidence could be an effective means of ensuring that securitisation can act as an effective funding channel to the wider economy and as a mechanism to diversify risks.

4. CROSS-EXAMINATION OF POLICY STATE OF PLAY

The EU countries have taken several policy measures to enhance SMEs' access to finance, with varying results. Most of the regulatory activity has taken place in those countries where bank lending to SMEs worsened more during the crisis. The most widespread measure has been to strengthen loan guarantee schemes, mainly by broadening their scope and increasing the allocation of public funds into such guarantee schemes.

Other and less widespread policy measures at national level have been implemented to:

- facilitate the securitisation of SME loans;
- boost the public venture capital sector (both through public venture capital funds that directly invest in young innovative companies, and through fund-of-fund instruments).

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that invest in private venture capital funds;
- ease the access and transfer of financial information;
- further develop corporate bond markets and alternative markets for SMEs.

In parallel, promotional financial institutions exist or are being set up in various EU countries\(^{19}\). Finally, some Member States offer tax incentives for venture capital investments in young innovative companies in order to mobilise private financing sources\(^{20}\). Whereas loan guarantee schemes dominate the mix of policy instruments supporting access to finance as a whole, support schemes directed at fast-growing innovative companies focus more on providing equity.

In Italy, several initiatives were taken to improve start-ups and SMEs' access to bank financing. The Public Guarantee Fund for SMEs has been reinforced, also by allowing innovative start-ups to enjoy a fast-track, simplified and free-of-charge access to the Fund. The guarantee covers up to 80% of the bank loans granted to innovative start-ups, up to a maximum of €2.5 million per company.

Public venture capital funds investing directly in companies exist in most Member States. They concentrate their investments mostly in ICT, biotech and advanced production technology. Although some focus explicitly on companies in the scale-up stage, in an attempt to foster their rapid growth, earlier stage start-ups make up the largest share of public venture capital funds' portfolios. Available evaluations indicate that such schemes are usually an effective way of boosting young firms' growth and competitiveness. However, as most of the schemes are still relatively new, not much data are available on the success of their investment exits. In some Member States (for example Germany and Finland) public funds-of-funds that invest in private venture capital funds receive larger funding volumes than direct public venture capital. This type of financial instrument allows for higher portfolio diversification and, concomitantly, the possibility to harness the sector-specific experience of private fund managers in multiple sectors. However, there is no robust evidence available on the economic impact of funds-of-funds on beneficiary firms compared to that of direct public venture capital schemes.

According to the SBA factsheets, close to 500 policy measures have been adopted or implemented in the area of SMEs' access to finance since 2011. Among these, more than 80 policy measures were adopted or implemented over the current reference period for the SBA factsheets (2015 and the first quarter of 2016), mainly distributed across financing programmes, cohesion programmes used for SMEs and tax incentives for investments.

The graph below shows the result for the EU countries in terms of their recent performance (2015 and the first quarter of 2016) and progress over time (2008-2016) on the indicators under the 'access to finance' SBA principle. According to the data, just a few countries achieved little or no progress. Most EU countries achieved moderate progress and performance since 2008.

\(^{19}\) For more, see the Country Report of each Member State: https://ec.europa.eu/info/strategy/european-semester/european-semester-your-country_en; see also the SBA factsheets for individual countries: http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review-2016_en.

Figure 5 — SBA factsheet recent performance and progress over time for SME access to finance (2008-2016)

Source: 2016 SBA factsheet, summary report.

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