

# Crafts, trades and smes need better access to finance



[[pic] | union europeenne de l'??™ artisanat et des petites et moyennes entreprises || | Europäische Union des Handwerks und der Klein- und Mittelbetriebe || | European association of craft, small and medium-sized enterprises || | Unione europea dell'??™ artigianato e delle piccole e medie imprese | Crafts, Trades and SMEs need better access to finance Policy actions are needed in order to meet the challenge of: ??? SMEs??™ high dependence on external finance ??? new capital requirements (Basel II) ??? increasing risk awareness for Banks UEAPME Position Paper on the Future of SME finance final October 27, 2004 Background ??“ the environment for SME finance has changed Future economic recovery will depend on the possibility of Crafts, Trades and SMEs to exploit their potential for growth and employment creation write my history paper . SMEs make a major contribution to growth and employment in the EU and are at the heart of the Lisbon Strategy, whose main objective is to turn Europe into the most competitive and dynamic knowledge-based economy in the world.

However, the ability of SMEs to grow depends highly on their potential to invest in restructuring, innovation and qualification. All of these investments need capital and therefore access to finance. Against this background the consistently repeated complaint of SMEs[1] about their problems regarding access to finance is a highly relevant constraint that endangers the economic recovery of Europe. Changes in the finance sector influence the behaviour of credit institutes towards Crafts, Trades and SMEs. Recent and ongoing developments in the banking sector[2] add to the concerns of SMEs and will further endanger their access to finance. The main changes in the banking sector which influence SME finance are: ??? globalisation and

internationalisation have increased the competition and the profit orientation in the sector; ??? worsening of the economic situations in some institutes (burst of the ITC bubble, insolvencies) strengthen the focus on profitability further; ??? mergers and restructuring created larger structures and many local branches, which had direct and personalised contacts with small enterprises, were closed; ??? up-coming implementation of new capital adequacy rules (Basel II) will also change SME business of the credit sector and will increase its administrative costs; ??? stricter interpretation of State-Aide Rules by the European Commission eliminates the support of banks by public guarantees; many of the effected banks are very active in SME finance.

All these changes result in a higher sensitivity for risks and profits in the finance sector. The changes in the finance sector effect the accessibility of SMEs to finance. Higher risk awareness in the credit sector, a stronger focus on profitability and the ongoing restructuring in the finance sector change the framework for SME finance and influence the accessibility of SMEs to finance. The most important changes are: ??? in order to make the higher risk awareness operational, the credit sector introduces new rating systems and instruments for credit scoring; ??? risk assessment of SMEs by banks will force the enterprises to present more and better quality information on their businesses; ??? banks will try to pass through their additional costs for implementing and running the new capital regulations (Basel II) to their business clients; ??? due to the increase of competition on interest rates, the bank sector demands more and higher fees for its services (administration of accounts, payments systems, etc.), which are not only additional costs for

SMEs but also limit their liquidity; ??? small enterprises will lose their personal relationship with decision-makers in local branches ??“ the credit application process will become more formal and anonymous and will probably last longer; ??? the credit sector will lose more and more its ??? public function??? to provide access to finance for a wide range of economic actors, which it has in a number of countries, in order to support and facilitate economic growth; the profitability of lending becomes the main focus of private credit institutions.

All of these developments will make access to finance for SMEs even more difficult and / or will increase the cost of external finance. Business start-ups and SMEs, which want to enter new markets, may especially suffer from shortages regarding finance. A European Code of Conduct between Banks and SMEs would have allowed at least more transparency in the relations between Banks and SMEs and UEAPME regrets that the bank sector was not able to agree on such a commitment. Towards an encompassing policy approach to improve the access of Crafts, Trades and SMEs to financeAll analyses show that credits and loans will stay the main source of finance for the SME sector in Europe. Access to finance was always a main concern for SMEs, but the recent developments in the finance sector worsen the situation even more. Shortage of finance is already a relevant factor, which hinders economic recovery in Europe. Many SMEs are not able to finance their needs for investment.

Therefore, UEAPME expects the new European Commission and the new European Parliament to strengthen their efforts to improve the framework conditions for SME finance. Europe??™s Crafts, Trades and SMEs ask for an <https://assignbuster.com/crafts-trades-and-smes-need-better-access-to-finance-2/>

encompassing policy approach, which includes not only the conditions for SMEs' access to lending, but will also strengthen their capacity for internal finance and their access to external risk capital. From UEAPME's point of view such an encompassing approach should be based on three guiding principles: risk-sharing between private investors, financial institutes, SMEs and public sector; increase of transparency of SMEs towards their external investors and lenders; improving the regulatory environment for SME finance.

Based on these principles and against the background of the changing environment for SME finance, UEAPME proposes policy measures in the following areas: 1. New Capital Requirement Directive: SME friendly implementation of Basel II Due to intensive lobbying activities, UEAPME, together with other Business Associations in Europe, has achieved some improvements in favour of SMEs regarding the new Basel Agreement on regulatory capital (Basel II). The final agreement from the Basel Committee contains a much more realistic approach toward the real risk situation of SME lending for the finance market and will allow the necessary room for adaptations, which respect the different regional traditions and institutional structures.

However, the new regulatory system will influence the relations between Banks and SMEs and it will depend very much on the way it will be implemented into European law, whether Basel II becomes burdensome for SMEs and if it will reduce access to finance for them. The new Capital Accord from the Basel Committee gives the financial market authorities and herewith the European Institutions, a lot of flexibility. In about 70 areas they

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have room to adapt the Accord to their specific needs when implementing it into EU law. Some of them will have important effects on the costs and the accessibility of finance for SMEs. UEAPME expects therefore from the new European Commission and the new European Parliament: ??? The implementation of the new Capital Requirement Directive will be costly for the Finance Sector (up to 30 Billion Euro[3] till 2006) and its clients will have to pay for it.

Therefore, the implementation ??? especially for smaller banks, which are often very active in SME finance ?? has to be carried out with as little administrative burdensome as possible (reporting obligations, statistics, etc.). ??? The European Regulators must recognise traditional instruments for collaterals (guarantees, etc.

) as far as possible. ??? The European Commission and later the Member States should take over the recommendations from the European Parliament[4] with regard to granularity, access to retail portfolio, maturity, partial use, adaptation of thresholds, etc., which will ease the burden on SME finance.

2. SMEs need transparent rating procedures Due to higher risk awareness of the finance sector and the needs of Basel II, many SMEs will be confronted for the first time with internal rating procedures or credit scoring systems by their banks. The bank will require more and better quality information from their clients and will assess them in a new way. Both up-coming developments are already causing increasing uncertainty amongst SMEs. In order to reduce this uncertainty and to allow SMEs to understand the

principles of the new risk assessment, UEAPME demands transparent rating procedures ??“ rating procedures may not become a ??? Black Box??? for SMEs: ??? The bank should communicate the relevant criteria affecting the rating of SMEs. ??? The bank should inform SMEs about its assessment in order to allow SMEs to improve. The negotiations on a European Code of Conduct between Banks and SMEs[5], which would have included a self-commitment for transparent rating procedures by Banks, failed. Therefore, UEAPME expects from the new European Commission and the new European Parliament support for: ??? binding rules in the framework of the new Capital Adequacy Directive, which ensure the transparency of rating procedures and credit scoring systems for SMEs; ??? elaboration of national Codes of Conduct in order to improve the relations between Banks and SMEs and to support the adaptation of SMEs to the new financial environment.

3. SMEs need an extension of credit guarantee systems with a special focus on Micro-Lending Business start-ups, the transfer of businesses and innovative fast growth SMEs also depended in the past very often on public support to get access to finance. Increasing risk awareness by banks and the stricter interpretation of State Aid Rules will further increase the need for public support. Already now, there are credit guarantee schemes in many countries on the limit of their capacity and too many investment projects cannot be realised by SMEs. Experiences show that Public money, spent for supporting credit guarantees systems, is a very efficient instrument and has a much higher multiplying effect than other instruments.

One Euro from the European Investment Funds can stimulate 30 Euro investment in SMEs (for venture capital funds the relation is only 1: 2).  
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Therefore, UEAPME expects the new European Commission and the new European Parliament to support: ??? the extension of funds for national credit guarantees schemes in the framework of the new Multi-Annual Programme for Enterprises; ??? the development of new instruments for securitisation of SME portfolios; ??? the recognition of existing and well functioning credit guarantees schemes as collateral; ??? more flexibility within the European Instruments, because of national differences in the situation of SME finance; ??? the development of credit guarantees schemes in the new Member States; ??? the development of an SBIC-like scheme in the Member States to close the equity gap (0.2 - 2.5 Mio Euro, according to the expert meeting on PACE on April 27 in Luxemburg). ??? the development of a financial support scheme to encourage the internalisation of SMEs (currently there is no scheme available at EU level: termination of JOP, fading out of JEV).

4. SMEs need company and income taxation systems, which strengthen their capacity for self-financing Many EU Member States have company and income taxation systems with negative incentives to build-up capital within the company by re-investing their profits. This is especially true for companies, which have to pay income taxes. Already in the past tax-regimes were one of the reasons for the higher dependence of Europe's SMEs on bank lending. In future, the result of rating will also depend on the amount of capital in the company, the high dependence on lending will influence the access to lending. This is a vicious cycle, which has to be broken. Even though company and income taxation falls under the competence of Member States, UEAPME asks the new European Commission and the new European



Parliament to publicly support tax-reforms, which will strengthen the capacity of Crafts, Trades and SME for self-financing.

Thereby, a special focus on non-corporate companies is needed. 5. Risk Capital ??“ equity financing External equity financing does not have a real tradition in the SME sector. On the one hand, small enterprises and family business in general have traditionally not been very open towards external equity financing and are not used to informing transparently about their business. On the other hand, many investors of venture capital and similar forms of equity finance are very reluctant regarding investing their funds in smaller companies, which is more costly than investing bigger amounts in larger companies. Furthermore it is much more difficult to set out of such investments in smaller companies. Even though equity financing will never become the main source of financing for SMEs, it is an important instrument for highly innovative start-ups and fast growing companies and it has therefore to be further developed.

UEAPME sees three pillars for such an approach where policy support is needed: Availability of venture capital ??? The Member States should review their taxation systems in order to create incentives to invest private money in all forms of venture capital. ??? Guarantee instruments for equity financing should be further developed. Improve the conditions for investing venture capital into SMEs ??? The development of secondary markets for venture capital investments in SMEs should be supported. ??? Accounting Standards for SMEs should be revised in order to ease transparent exchange of information between investor and owner-manager.

Owner-managers must become more aware about the need for transparency towards investors ??? SME owners will have to realise that in future access to external finance (venture capital or lending) will depend much more on a transparent and open exchange of information about the situation and the perspectives of their companies. ??? In order to fulfil the new needs for transparency, SMEs will have to use new information instruments (business plans, financial reporting, etc.) and new management instruments (risk-management, financial management, etc.).

[1] Access to finance of small and medium-sized enterprises Commission communication COM(2003) 713; (<http://europa.eu.int/comm/enterprise/entrepreneurship/financing/index.htm>)

[2] SMEs and access to finance ([http://europa.eu.int/comm/enterprise/enterprise\\_policy/analysis/doc/smes\\_observatory\\_2003\\_report2\\_en.pdf](http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/doc/smes_observatory_2003_report2_en.pdf))

[3] Study on financial and macroeconomic consequences of Basel II ([http://europa.eu.int/comm/internal\\_market/regcapital/docs/studies/2004-04-basel-impact-study\\_en.pdf](http://europa.eu.int/comm/internal_market/regcapital/docs/studies/2004-04-basel-impact-study_en.pdf))

[4] Radwan Report, A5-0258/2003, 9 July 2003

[5] Draft European Code of Conduct between Banks and SMEs