BUSINESSEUROPE

SPEAKING NOTES

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MEETING WITH THE PARTICIPATION OF THE PRESIDENT OF THE EU COMPETITIVENESS COUNCIL, MR RICHARD BRUTON

IMPROVING ACCESS TO FINANCE FOR SMES

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1. Overall picture

Access to finance is vital for companies. However, lending to non-financial corporations continues to fall dramatically (-4.2% between February 2012 and February 2013 in the euro area).

On the supply side, interest rates charged for bank loans to businesses continue to diverge, depending on both the size of the business and the country where the business applied for bank loans. For example, the bank lending interest rate for short-term loans (maturity below one year) to businesses in February 2013 was at around 5.2% in Spain and 4.4% in Italy, against an average of 3.8% in the euro area. As a result, a number of businesses remain excluded from bank funds regardless of the quality of their business projects.

Terms and conditions under which banks are willing to lend remain very tight and are likely to stay so as banks will continue to withdraw from on-balance-sheet lending as a response to new financial regulations. There is thus a significant risk that as economic growth returns, banks will be unable to meet the funding requirements on the desired scale. Private-sector investment from other sources such as investment funds, insurance companies and pension funds also fell significantly during the crisis and is likely to stay subdued as a result of the uncertain economic climate and new financial regulations.

Against that background, it is vital to:

a. ensure that financial market reforms strike the right balance between safeguarding financial stability and the financing needs of companies. This calls in particular for calibrating the parameters implementing new EU financial regulation in a way that does not generate undue negative impacts on lending
b. and to support the market-led development of alternatives to traditional bank finance.

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2. Improving access to capital markets

SMEs have little or no access to the capital market (corporate bonds). The barriers that prohibit direct access of SMEs to the capital market are numerous: a lack of liquidity of and high costs for issuing SME bonds (linked inter alia to the drafting of prospectus and related due diligence), high information requirements (especially the IFRS requirement on regulated market issues) and a lack of resources at the level of institutional investors to analyse the credit risk of small companies.

In a limited number of countries, corporate bond trading platforms have been created, resulting in an improved situation for big mid-sized companies. Examples of these platforms are:

-the Stuttgart Bond platform in Germany
-the First North Bond Market in Denmark
-the Alternext market in the Netherlands
-the UK market for SME bonds.

On the Stuttgart market, issuances at a level of 25 million € can occur. On the other hand, on the London market, the minimum size of an issuance is 100 million £ (117 million €). This shows that further efforts are needed with a view to easing access of small and mid-size companies to the capital market.

With this in mind, the Breedon report (UK, 2012) recommended to aggregate a large number of SME loans and finance them via the corporate bond markets. The Breedon report has proposed to create an Agency (the Agency for Business Lending – ABL) that would be instrumental for this. ABL would aggregate and finance SME loans, by establishing a large-scale fund to buy SME loans and SME loan-backed securities from the originating banks. ABL would finance these activities by issuing securities on the public bond markets to institutional and retail investors.

The Commission should promote dissemination of best practices and of advanced policy thinking regarding the establishment of bond markets accessible to SMEs and intermediate size companies.

3. Securitisation

Securitization is the financial practice of pooling various types of contractual debt such as company debts, commercial mortgages, or credit card debt obligations and selling said consolidated debt as asset-backed securities (ABS) to various investors.

Typically a bank cedes a credit portfolio to a Special Purpose Company (SPC). The SPC issues asset-backed securities and pays a price to the bank. This technique helps the bank reducing the risks in its balance sheet, and makes it possible for the bank to increase lending.

The image of securitization has suffered due to the lack of transparency of some financial products (mainly in the US) in the wake of the financial crisis, despite European assets performing very well from a credit and secondary market standpoint. The Commission should take initiatives aimed at ensuring a careful revival of securitization. This may also require changes in bank regulation that now clearly discourages securitization through higher capital cost.

4. Venture capital

Venture capital is a key financing tool from a macro-economic point of view. Venture capital accounts for 8% of private employment in Europe. But between 2003 and 2010, uptake of venture capital (VC) in Europe dropped from € 17 to € 3 bn. This has left VC operators with increased difficulties for accessing stable financing for their VC operations, which is a worrying development for fast growing SMEs.Today, pension funds and insurance companies play a very limited role as a source of finance for venture capital funds. This limitation should be addressed.

5. Other equity finance

For a particular class of small and mid-size companies, a public listing on specialized SME stock exchanges ("growth markets") is a logical option to grow their business. Yet listing has become more difficult in the EU, in particular because its cost has increased significantly in recent years.

BUSINESSEUROPE welcomes the Commission's intention to improve access to information about listed SMEs, thereby improving their ability to obtain financing. BUSINESSEUROPE also welcomes the fact that the Commission will reduce the burden on listed companies by eliminating mandatory quarterly reporting.

6. EU SME-geared financial instruments

The EU financial instruments for SME and mid-caps introduced under the CIP (Competitiveness and Innovation Program) and the 7th RTD Framework Program (FP) have demonstrated a strong leverage effect for stimulating the provision of credit and equity finance. Given this positive experience, it is essential to fund properly the relevant EU successor programs. Under the 2014-2020 structural funds, there is scope for deploying EU financial instruments (debt finance instruments, equity finance instruments,…) on a broader scale. In certain countries, this should be done while improving the implementation of the EU financial instruments linked to regional policy.

The following summary recommendations put a particular emphasis on how to improve access to finance for SMEs and for the lower end of intermediate size companies.

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BUSINESSEUROPE recommends:

- Promote the dissemination of best practices regarding the establishment of bond markets accessible to SMEs and intermediate size companies.

- Calibrate EU regulations that will implement the EU framework legislation on bank capital requirements (CRD IV-CRR) to support the contribution that securitization can make to filling future finance gaps. This also applies for the implementation of the new capital requirements for insurers (Solvency II).

- Regulations for pension funds and insurance companies should consider their stimulating role as a source of finance for venture capital funds.

- Create positive framework conditions (including tax incentives) at national level for venture capital investors.

- Explore how to facilitate public listing of SMEs, inter alia on growth markets. Initiatives in this area should not impose excessive administrative burdens and should allow participation of a large range of companies. This includes the adoption of incentives for SMEs willing to be listed on a stock exchange or an SME market, at Member State level.

- Fund properly the EU financial instruments proposed under COSME (the EU program for the competitiveness of SMEs) and Horizon 2020, in line with the Commission budgetary proposals.

- BUSINESSEUROPE strongly supports the introduction of the Equity Facility for Growth (EFG) and of the Loan Guarantee Facility (LGF) proposed in COSME. Because of the high leveraging effect of these two instruments, the budget proposed for the EGF and LGF (i.e. € 1.4 billion for 2014-2020) should be significantly increased.

- Further implement the innovative financing approaches developed by the EIF (European Investment Fund) under the current Multiannual Financial Framework (MFF), with a view to stimulating the supply of debt finance, equity finance and mezzanine finance needed by SMEs. Also use a significant part of the recent EIB capital increase (EUR 10 billion) to improve SME access to finance.