

# “Finance access of SMEs: what role for the ECB?”

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## Finance access of SMEs: what role for the ECB?

### Abstract

Small and medium size enterprises (SMEs) of southern euro-area economies (e.g. Italy, Spain) pay significantly higher borrowing rates than their peers of the core (e.g. Germany, France) and this divergence is widening. It is argued that severe market failures prevent SMEs in southern euro area countries from access to key inputs, in particular access to finance. This paper makes an assessment of feasible options to improve finance access of SMEs, available to EU institutions as well as to the ECB in the context of its price stability mandate. Because of non-negligible moral hazard issues, the paper is sceptical about a stronger involvement of the ECB in the (indirect) financing of SMEs through the securitization of bank loans or their use as collateral for monetary policy operations. The paper concludes with some proposals for extending finance access of SMEs, including through mutual guarantee institutions along the lines recently pursued by the European Investment Bank.

**Keywords:** ECB, financial crisis, bank-firm relationships, credit guarantee schemes, monetary policy transmission, small business finance.

**JEL Classification:** E23, E51, G21, O16.

### Introduction

Small and medium-sized enterprises (SMEs) are an essential component of the euro area economy. In all Member States, and particularly in the southern countries of the euro area, SMEs represent a significant proportion of the overall number of firms in the private sector and employ a large share of the workforce. Therefore, SMEs provide a substantial contribution to economic growth and job creation and SMEs dynamics has important macroeconomic effects (De Nederlandsche Bank, 2013).

Typically, SMEs rely mainly on bank funding to finance their activities as compared to large firms which have easier access to alternative sources of credit. As a consequence, SMEs decision-making process may be heavily affected by changing credit conditions. The smooth working of the monetary transmission mechanism is, therefore, of central importance for the supply of credit to SMEs, particularly in the distressed economies of the euro area. This point has been emphasised on many occasions by Draghi, the ECB President, with reference to both conventional and unconventional monetary policies.

The current fragmentation of financial markets is affecting some euro area Member States more than others and smaller firms such as SMEs more than larger ones. Financial fragmentation has a strong geographical connotation and can lead to a dry up of financial resources (the so-called credit crunch) for otherwise identical cross-border neighbouring SMEs, albeit located in different countries. While fears of a Eurozone break-up have receded more recently (Steen, 2013), financial fragmentation remains a critical feature of the area and calls for prompt policy action. The impact of financial frag-

mentation on SMEs financing and the need of prompt actions on this matter is the main topic of this paper.

Recent ECB data show that Italian and Spanish SMEs still pay significantly higher borrowing rates than their German and French counterparts, even though this divergence is shrinking (ECB, 2013). But difficult financial conditions are widespread. Following the release of the ECB 'Report on the results of the survey on the access to finance of SMEs in the euro area (SAFE)' on April 26, 2013, Draghi (2013) commented that (w)hile some signs of stabilisation are emerging, the Survey on the access to finance of small and medium-sized enterprises (SMEs) in the euro area indicates continued tight credit conditions, particularly for SMEs in several euro area countries. Moreover, the available information indicates high risk perception on the part of banks."

Only recently have EU institutions stepped up their efforts to address this problem. On May 2, 2013, the European Commission and the European Investment Bank (EIB) released a joint report<sup>1</sup> on the finance access of SMEs. The report summarizes various EU initiatives in the area of SME financing, including the Competitive and Innovation Framework Program (CIP), the new Program for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (Program for the Competitiveness of the SMEs, COSME), the implementation of EIB capital increase to ensure increased lending volumes to SMEs and help restoring normal lending to the real economy, better integration of venture capital markets and improving long-term financing for SMEs. Finally, the ECB, the EIB and the Commission are currently co-operating on exploring options how to foster finance access of SMEs in the

periphery of the euro area<sup>1</sup>. The ECB is also assessing how and whether to broaden collateral requirements for SME financing, e.g. through the securitization of SME loans (Governing Council meeting of May 2, 2013)<sup>2</sup>.

Against this background, the objective of this paper is to evaluate options available to the ECB to improve SMEs financing using either existing instruments or developing new ones, without jeopardizing ECB mandate of price stability. Moreover, this paper puts this into context and examines which other institutions have to be potentially involved.

The remainder of the paper is structured as follows. Section 1 starts with some general theoretical and empirical considerations on the key factors underlying high credit risk in southern euro area SMEs and argues that severe market failures are preventing SMEs from sound access to key inputs, in particular access to finance. Section 2 deals with the securitization of SME loans and its potential use as collateral for monetary policy operations to reduce the risks of a credit crunch. Section 3 discusses the role of and scope for broadening venture capital funds and stock markets as well as extending mutual guarantee institutions to foster SME financing. In this context, this paper also focuses on other market compatible solutions delivered by the European Investment Bank as potential sources for SMEs financing. The final section concludes with a brief research agenda on unresolved issues.

## 1. General considerations

**1.1. Finance access: define and prove the existence of a market failure.** Problems of finance access of SMEs are well-known in the academic literature. For instance, Schneider and Veugelers (2008) using German data show that firms featuring a combination of newness, smallness and high R&D spending generate a significantly high number of sales of innovative goods through innovative channels. It is especially these young innovative firms which rate internal and external financial constraints as a very important factor hampering their innovation activities. The so-called *access to finance problem* is often referred to as a rationale for government intervention (ECORYS, 2012, p. 48).

<sup>1</sup> See EIB (2013).

<sup>2</sup> See Draghi (2013): "On the other part, it is actually broader than a standard measure category and it relates to funding measures, broadly defined. One is collateral, and the second set has to do with purchases of assets. Now, you have got to be careful here, because let me say once again what the ECB cannot do. The ECB certainly cannot supplement governments for their lack of structural reforms. Secondly, the ECB cannot clean banks' balance sheets. And third, the ECB is not in the business of monetary financing, i.e. buying government bonds. When you consider all this, you look at what assets could be purchased and then you look at what States 80 per cent of credit intermediation goes via the capital markets. Capital markets rate and price assets in a right or wrong way, but it's fairly transparent".

There is a broad consensus in the academic literature that SMEs frequently face *greater financing obstacles than larger firms* and thus deserve support from public institutions. Two main arguments are used: First, *severe market failures* inhibit SMEs from fair access to important inputs, in particular access to finance (ECORYS, 2012, p. 51). Second, the key contribution of SMEs for growth in advanced economies calls for some form of public support. In particular, *positive externalities* stemming from the SMEs' innovative activities justify government support including better access to finance (Colombo and Delmastro, 2002).

**1.2. Fundamental determinants of SME credit risk in the euro area – north versus south.** SMEs operating in southern euro area economies are less productive than northern SMEs. The default of a certain number of SMEs in these countries is, therefore, likely.

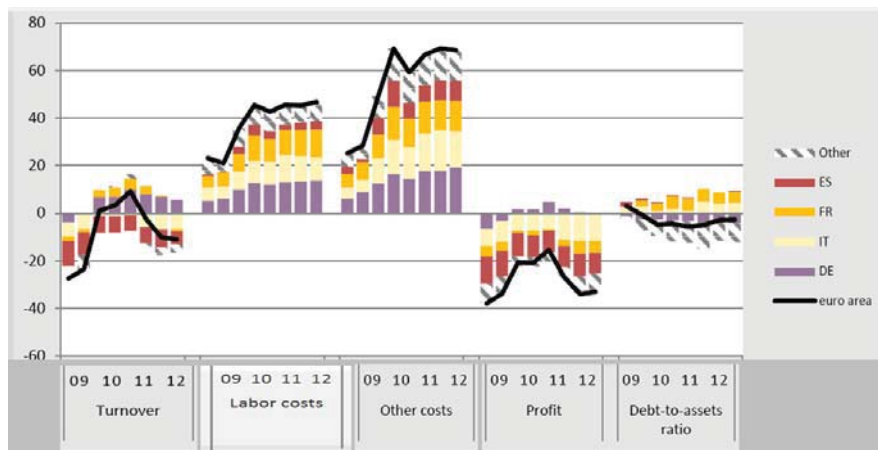
This is especially the case for Greece and Portugal, two economies undertaking severe restructuring partially cushioned by EU structural funds. But it is also the case for Spain given the high number of involvement of SMEs following the burst of the real estate bubble (Belke, 2013). In the same vein, European Commission data consistently indicate that, above all, Spanish and Italian SMEs display *lower productivity* than the average of all domestic firms and that their productivity is still falling. This quite naturally gives banks "good reasons to impose an additional risk premium" on their lending (Steen, 2013a).

Moreover, any comparison of cross-border financing conditions (e.g. large interest rate differences between South-Austrian and North-Italian SMEs) has to take into account that SMEs belong to *different and autonomous political entities* and correspondingly *different qualities of institutional infrastructure* but also *structurally different levels of unemployment* (Belke, 2013). According to Gros (2011), "(t)here are profound differences among Member States in the degree to which their political systems and administrations work in reality. The World Bank provides a useful databank of "governance indicators" which allows us to compare countries on the quality of their administrations and the extent to which the rule of law is actually adhered to. These are key elements if a euro area political union is to work. However, even a cursory glance at these indicators reveals that the differences are so large that a political union is unlikely to work".

Further determinants of significant higher credit risk premia in southern euro area SMEs can be drawn from the most recent *survey on the access to finance of small and medium-sized enterprises in the Eurozone* (ECB, 2013). According to this survey, SMEs in Italy, Spain, Portugal and Greece were among the largest *negative contributors to turnover develop-*

ments (Figure 1). This does not come as a surprise: among others, Italian SMEs continue to report *increases in labor and other production costs*, despite a persistently weak business climate. As a direct consequence, SMEs in Italy, Spain and some other Southern euro area member countries like Greece and Portugal continue to suffer from low profitability. Instead

of reducing their leverage against the background of high corporate indebtedness and the heightened risk aversion of banks, Italian and Greek SMEs have *increased their debt-to-assets ratio* in the period from October 2012 to March 2013 (Figure 1). This can only be partly explained by the concomitant decrease in asset values.



Source: ECB (2013, p. 2).

Notes: Base is all SMEs. Net percentages are defined as the difference between the percentage of firms reporting an increase for a given factor and the percentage reporting a decrease.

**Fig. 1. Country contributions to the change in the income and debt situation of euro area SMEs (over the preceding six months; country contributions to net percentage of respondents)**

Over the last decade, Italian and Greek SMEs have performed poorly in terms of labor costs (Figure 1) and debt-to-asset-ratios and at the same time witnessed the largest losses in terms of World Bank Governance indicators. In this respect Gros (2011) reports that: “However, the data show that there is a large difference between the core countries and the “Club Med” (Greece, Italy, Portugal, and Spain). Especially Greece and Italy perform particularly poorly even if compared to Portugal and Spain, whose standards are still clearly below the core euro average. On almost any measure the observations for both Greece and Italy are more than two standard deviations below the euro area average.”

Against this background, a higher *interest rate risk premium is absolutely justified* even among cross-border neighbouring SMEs. *Interest rates within the euro area should therefore differ* to reflect different qualities of political governance, incorporate the risk premium stemming from a potential haircut on and/or a restructuring of country-specific debt or even for the probability of a euro area exit of a specific member country.

**1.3. Implications: further evidence.** According to the ECB survey (ECB, 2013, p. 3), a large number of SMEs in Spain, Italy and Portugal (but also in Ireland, Greece and France) reported an increase in their net interest expenses, reflecting less favorable financing conditions (Figure 2). But for Italian and Finnish

SMEs, high labor and production costs are the main problem.

Across all euro area countries, the net percentage of SMEs reporting an *increase in bank lending rates* was highest in Spain (66 per cent), Italy (62 per cent) and Portugal (56 per cent), which potentially indicates *strong risk aversion of banks* “in an environment of weak economic activity and difficulties in the banking systems” (ECB, 2013, p. 16). This risk aversion reflects, among others, bad business cycle conditions (see section 3) and, in the case of Italy, worsening governance quality of the banks’ home countries. With respect to collateral requirements, SMEs in Spain, Greece, Italy and Ireland (43 per cent) suffer from the largest tightening (Figure 2).

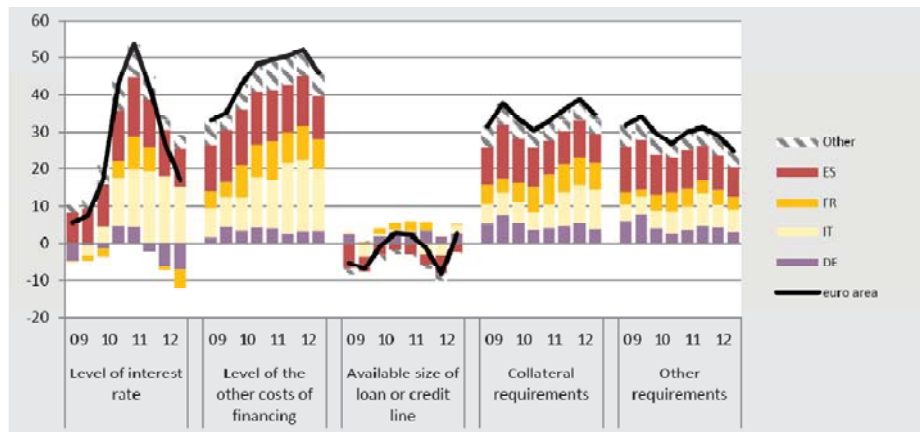
Difficult *access to finance* was the concern mentioned by the second largest percentage of euro area SMEs (16 per cent), albeit with a wide divergence across countries<sup>1</sup>. On the negative side, 38 per cent of the SMEs in Greece, 25 per cent in Spain, 24 per cent in Ireland and 21 per cent in Portugal mentioned “Access to finance” as the most pressing problem, compared to only 8 per cent of the SMEs in Germany and Austria. With respect to *banks’ willingness to provide a loan*, SMEs in all euro area member countries, except Germany, reported, on average, a deterioration. It was

<sup>1</sup> This figure is down from 18 per cent in the previous survey period. Also from this perspective, the problem of finance access for SMEs appears to become less relevant over time.



especially strong not only in Greece, Spain, Italy, Portugal, but also in the Netherlands, reflecting wor-

sening economic conditions and strong deleveraging needs in the private sector (Figure 2).



Source: ECB (2013, p. 17).

Notes: Base is SMEs that had applied for bank loans. See notes to Figure 1.

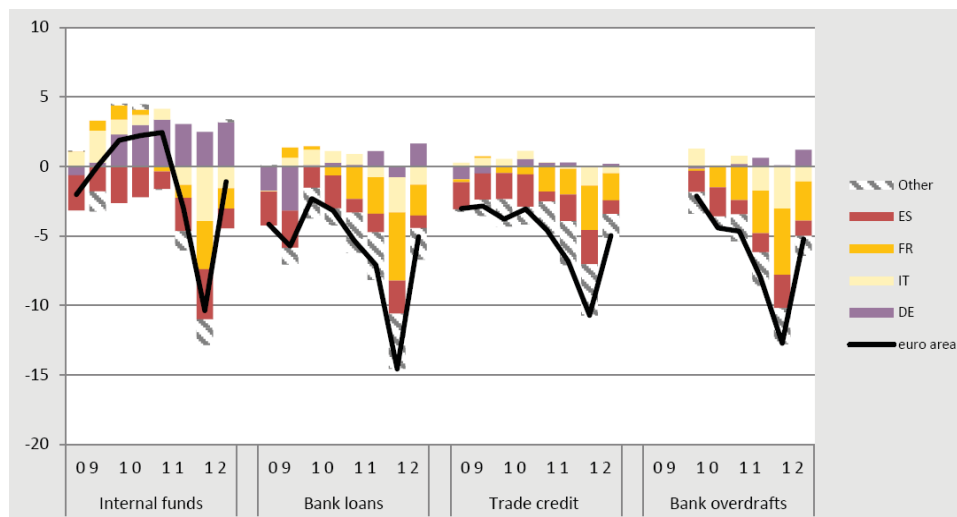
**Fig. 2. Country contributions to the change in terms and conditions of banks loans granted to euro area SMEs (over the preceding six months; country contributions to net percentages of firms that had applied for bank loans)**

On a more positive note, in most countries the percentage of SMEs reporting a deterioration in financing conditions was smaller compared with the previous survey period. Expectations for the next survey period until September 2013 also revealed a less negative assessment, in particular for SMEs in France, Italy and Spain (Figure 3)<sup>1</sup>.

In terms of success rate of SMEs bank loan applications, the *situation clearly improved* in all euro area countries, but Greece<sup>2</sup>. As a mirror image, the percentage of SMEs reporting rejection of loan applications was highest in Greece, followed by SMEs

in Ireland, Spain and, as a newcomer, the Netherlands, whereas it was the lowest in Germany.

A relevant issue is to what extent difficulties in the SMEs access to finance are caused by supranational factors rather than by standard country-specific determinants of the SMEs' credit risk? This identification problem is quite absent in both official ECB statements and public discussions. But its policy relevance can be appreciated in the context of ECB main task: guaranteeing a euro-area level playing field for finance access of firms.



Source: ECB (2013, p. 19).

Notes: Base is all SMEs. See the note to Figure 1.

**Fig. 3. Country contributions to the change in euro area SMEs' expectations regarding the availability of financing (over the preceding six months; country contributions to net percentage of respondents)**

<sup>1</sup> SMEs' expectations regarding the availability of bank loans during the period from April to September 2013 were most negative in Greece.

<sup>2</sup> It makes economic sense that a complete rejection of an SME loan application was reported mostly by SMEs in Greece (31 per cent). See ECB (2013, p. 14).

## 2. Securitization of loans to small and medium-sized enterprises

He still high degree of the fragmentation depicted in section 1 has stifled an intense debate about whether and how the ECB should get more actively involved in facilitating finance access of SMEs. For instance, the bank could extend its collateral requirements to allow commercial banks to increase their access to ECB funding through the use SME loans. If this was insufficient to increase lending volumes, the ECB could directly buy bundles of SME loans. Understandably, the ECB is unwilling to move down along this road (Steen, 2013a) as giving financial support to SMEs deteriorated balance sheets in distressed economies is clearly outside ECB mandate. According to the ECB, the reduce availability of credit in some southern euro area SMEs is the result of weak bank balance sheets. As such, this does not warrant any direct non-intermediated intervention by the central bank.

However, this leaves still unexplained why the ECB is apparently exploring the possibility – in cooperation with the the European Investment Bank (EIB) – to conceive and develop methods of broadening the access to finance for SMEs, e.g. by reviving the market for asset-backed securities (EIB, 2013; Irish Observer, 2013). Draghi himself admitted that the ECB had consulted the EIB and the European Commission on similar initiatives and that “We looked at a variety of things, one of which was this ABS”<sup>1</sup>. Although there is no official commitment yet<sup>2</sup>, fears emerged in Germany Securitization has both pros and cons. Banks balance sheets would improve, allowing more lending, thereby reducing the risks of a credit crunch. Admittedly, a thorough assessment of the balance sheets of largest banks is needed as a precondition for these banks to extend credit to SMEs. On the other hand, borrowing activities of firms in the euro area periphery are by far concentrated on the smallest banks, on which the ECB will have little say in terms of capital requirements. Hence, some analysts argue that the upcoming capitalization review conducted by the ECB will most probably not solve the problem (Financial Times, 2013).

Moreover, SMEs need help now, while the ECB review is unlikely to be completed before early 2014. The UK’s Funding for Lending Scheme

(FLS), according to which commercial banks receive cheap lending in exchange for expanding their SME loan book, is another option (Financial Times, 2013). However, figures published in June 2013 by the Bank of England showed that FLS was not particularly successful (Jones, 2013). Some have deplored the ECB’s backsliding from securitization. In particular in the editorial of the Financial Times (2013) it was argued that “This is regrettable. It has been clear for some time that in parts of the currency union the monetary transmission mechanism is broken. Ultra-cheap interest rates engineered by the ECB do not reach businesses in countries like Italy and Spain. The credit crunch is forcing thousands of SMEs to shut down, with disastrous consequences for local jobs. Smaller businesses provide about 75 per cent of jobs in the euro area”. “It has been argued that a more effective course of action might have been for the ECB to purchase bundles of SME loans directly. While radical, this would be legal under the central bank’s mandate (own emphasis), which prohibits monetary financing of sovereigns but does not rule out buying corporate debt”.

Under this proposal, governments would have to share parts of the credit risk. Some even propose that this could be realized through a less rigid use of the ESM (Financial Times, 2013). However, this would raise serious issues of moral hazard and likely delay of necessary structural reforms. In this context, an additional remarkable argument is that credit policy will not, on its own, save the crisis-hit SMEs. It is argued that improving demand by relaxing euro area-wide austerity policies is more important, even though this is not an argument for the absence of action on the monetary side. Overall, the euro area economy is confronted at the same time with a cyclical problem, i.e. weak banks unable to perform core functions, and a long-run structural problem, i.e. the excessive reliance of firms financing needs on bank credit<sup>3</sup>.

It follows that any solution to the crisis must involve fixing the banks. Even ambitious solutions to the SMEs’ finance access problem, such as developing a market for asset-backed securities for SME loans, still needs a well-capitalized banking system as a precondition of success. However, “Acquisitions in the ABS market are not easy for the ECB to do because we’re in a completely different setup from the US, where you have a capital market. So the ABS, in this case, would have to contain assets from the banking system of the euro system and you can understand what sort of moral hazard there is there” (Draghi, reported by Irish Observer, 2013). To put it simply, the debate is more or less about

<sup>1</sup> The Irish Observer (2013) mentions complementarily on May 13 that “ECB executive board member Joerg Asmussen said last week that the central bank has discussed ABS purchases, while his fellow board member Yves Mersch said the same day that it was “looking at ways to restart the ABS market”.

<sup>2</sup> According to the Irish Observer (2013) Draghi remains rather cautious and reluctant on ABS as an option to support lending to SMEs: “We’re still looking at that, it’s one of the many options. We don’t have a position, certainly, on that.”

<sup>3</sup> See, for instance, [http://ec.europa.eu/enterprise/newsroom/cf/getdocument.cfm?doc\\_id=3127](http://ec.europa.eu/enterprise/newsroom/cf/getdocument.cfm?doc_id=3127)

who should do the stuff (Barwell, 2013). It is exactly this moral hazard argument which makes the ECB concerned about ABS purchase.

It should be remarked that banks are already allowed to exchange bundles of loans for central bank cash in the context of the standard ECB refinancing operations. In this case, the ECB applies a significant discount to the face value of loans. Under any securitization proposal, the collateral is priced. The higher this price, the larger the benefits for banks in terms of reinforcing the capital-asset ratio and, therefore, lending capabilities. However, the higher the price of collateral, the bigger the risk of market losses is if the borrower defaults. In any case, purchasing ABSs would be a radical step and difficult to justify for the ECB, within the remits of its price stability mandate as the ECB is “not in the business of cleaning up banks’ balance sheets” (Steen, 2013a). Fixing the fragmentation of SME finance access in the euro area should not be considered a ECB task. “A country in a deep recession certainly has different financing costs compared to a country that has nearly full employment,” said Mario Draghi. Bundesbank President Jens Weidmann reinforced the argument: “Not every difference in the financing costs indicates the need for political action. The author rather sceptical that they could or should use monetary policy instruments to absorb the different financing conditions for SMEs in certain countries”<sup>1</sup>. Regenerating undercapitalized banks is governments – not central banks – responsibility. This is even more so when elements of fiscal cross-border transfer are likely to be involved (Belke, 2013; Barwell, 2013).

On the basis of the arguments above, asking central banks to support SMEs’ access to finance could jeopardize financial market efficiency and therefore produce a misallocation of bank lending. Even worse, putting the ECB under pressure to over-extend its mandate to include direct financing of specific groups SMES would “put(s) its reputation at stake, and lets politicians off the hook” (Barwell, 2013). The ECB has done its part to restore more normal lending conditions through the longer-term refinancing operations (LTROs) and the outright monetary transactions programme (OMTs). It is now time for politicians to act (Belke, 2013; Barwell, 2013).

Any securitization of SMEs’ loans raises questions about which loans to consider and the selection criteria to be used for the assessment. EIB-President Hoyer, while recognizing that securitization could be a useful tool to revive SME lending, stressed that

prudence was needed “bearing in mind the experience of the subprime crisis”<sup>2</sup>. While SME financing could benefit from a deeper ABS market, the ECB risks creating an entirely new problem.

Hence, Mario Draghi reservations should not come as a surprise: “But if you go this way, you want to find a way of packaging these loans in a way that they can be priced. And that is where the reference to other institutions more suited for this job of packaging and guaranteeing the loans comes in: the reference to the European Investment Bank and the reference to the European Commission itself” (Draghi, 2013).

Improving access to finance of SMEs may be key to economic recovery, but appropriate solutions need to involve close partnership between the European Commission and the European Investment Bank (EIB). Cooperation with the ECB should be seen only in terms of delivering the micro-data necessary for an in-depth assessment of the financial situation of SMEs (European Commission, 2013).

The European Commission and the European Investment Bank have already made important steps in that direction, as mentioned in this paper. The rest of this paper focuses on further options which could, potentially, improve finance access of SMEs.

### 3. Other recommendations

The government may help to alleviate SMEs financial problems. A recent study by the Center for Strategy & Evaluation Service (2013), presents a synopsis of guarantees, equity schemes and loans backed by national resources. Thus, the study provides SMEs with an overview of available funding resources and financial support. The report also provides a more in-depth analysis of public support programmes for five EU Member States (France, Germany, Poland, Sweden and the UK).

#### 3.1. Fostering seed and venture capital funds.

Seed capital (the initial capital to start a business), early stage funds, venture capital funds are also feasible ways for financing SMEs with private funds and, even more important context of this paper, to reduce public risks (Belke and Fehn, 2004). Recent research generally confirms the existence of a corresponding and relevant “equity gap” for mature SMEs<sup>3</sup>. For younger and micro SMEs the issue is that investors might refrain from financing small transactions because of the high transaction costs involved (Center for Strategy & Evaluation Service, 2013).

**3.2. Developing stork markets.** A positive development of over the past two decades has been the increased reliance of SMEs on stock markets as a

<sup>1</sup> Already section 1 of this paper stresses that “bad business cycle conditions” represent an important country-specific factor of SME credit risk in the euro area.

<sup>2</sup> See EIB (2013).

<sup>3</sup> See, for instance, BIS (2009).



source of financing. However, bank credit remains, by far, the most important source of external funding and financial guarantees for SMEs (Center for Strategy & Evaluation Service, 2013).

### 3.3. Extending mutual guarantee institutions.

Asymmetric information is one of main reasons making access to finance difficult for SMEs. This is well-documented in the literature (Berger and Udell, 2006; Petersen and Rajan, 2006). Collateral or more intensive customer relationships between banks and firms can help to alleviate the information mismatch. However, new companies are short of collateral and credit reputation. This also hampers access to bank funding. By joining Mutual Guarantee Institutions (MGI), small/new companies can enhance their borrowing capacity (Columba, Gambacorta and Mistrulli, 2010). Their empirical analysis provides evidence that firms belonging to MGIs enjoy lower credit costs than comparable firms. A possible explanation is that banks are not able to monitor non-transparent enterprises as well as MGIs do. According to data published by the European Mutual Guarantee Association, more than 1.4 mio. SMEs joined so far an MGI in the EU. MGIs are rather common in Germany, France, Spain and Italy. For example, 37 per cent of the total outstanding volume of SMEs' guarantees is represented by Italian MGIs, the biggest mutual guarantee sector in the EU.

There is scope to support an increase of the size of MGIs as they help small companies to access credit lines. Nevertheless, a problem might be that larger MGIs could suffer from poor monitoring incentives (Columba, Gambacorta and Mistrulli, 2010).

A study by Bartoli, Ferri, Murro and Rotondia (2013) based on a large database on Italian SMEs, finds that SMEs belonging to the MGI network show a lower probability of financial tensions, even if their external environment features a high degree of financial stress. Moreover, it appears that MGIs work as a signalling device which goes beyond the simple collateral provision. Obviously, the information provided by MGIs is important for bank-firm relations as pro-cyclical scoring and rating systems have turned out to be less informative during the crisis. The message for policy-makers is therefore to further *strengthen the presence and functioning of Mutual Guarantee Institutions* (MGIs).

**3.4. Other sources of finance.** Other sources of finance, like private placements, listings on the regulated stock exchanges or the issuing of bonds, are not easy to access by SMEs (Center for Strategy & Evaluation Service, 2013). The literature, however, tends to recognize a lack of awareness among SMEs about

financing *opportunities in debt capital markets* which could allow them to *diversify funding sources*<sup>1</sup>.

Other promising avenues are market compatible solutions proposed jointly by the European Commission/EIB. Following the EIB's paid-in capital increase of EUR 10 billion last year, the bank will lend an additional EUR 15 billion to SMEs during 2013 to 2015 (EIB, 2013) and is planning to increase the number of EIB-supported companies by expanding the range of its banking partners (EIB, 2013).

Member States may also be a source of good practices for SME financing. For instance, the German government will increase lending to Spanish SMEs by EUR 1 bn at the currently very low German interest rates. Moreover, Germany's state-owned bank Kreditanstalt für Wiederaufbau (KfW) will provide financial support to Portuguese SMEs. "In the area [of small-to-medium sized enterprises focused on exports], we can benefit from cooperation with Germany, especially of the KfW, which is available to explore the possibility of extending credit lines to Portugal and participating in the capitalization of SMEs indirectly through Portuguese institutions", said former Portuguese finance minister Vito Gaspar (WSJ, 2013).

### 4. Limitations of the study and further agenda for research

How to best finance access of SMEs ranks high on the policy agenda and progress is being made on various fronts. What is perhaps still lacking is (a) the analysis of the role of the different financing sources in shaping the dynamics of SMEs; and (b) an assessment of best practices for SME financing already available in several euro area Member States.

A preliminary list of elements of analysis worth investigating include: the interaction between SMEs' business activities, loan conditions and the dynamics of the euro area economy as a whole (De Nederlandsche Bank, 2013), the assessment of the credit cycles and conditions and their impact on SMEs financing and dynamics (e.g. in terms firm entry and exit, growth, job creation and destruction, investment decisions, innovation), the role of trade finance and trade credit in SME funding, the impact of fiscal and monetary policy on business decisions of SMEs, the impact of structural reforms in labor and goods markets on SMEs and the impact of new banking regulation on SMEs' access to credit.

### Conclusions

Recent survey data from ECB Bank Lending Survey shows that small and medium size enterprises (SMEs) in Italy and Spain pay significantly higher

<sup>1</sup> See BIS, HM Treasury (2010, p. 15).



borrowing rates than their German and French peers and the divergence is widening. This contribution has made an assessment of feasible options to improve finance access of SMEs, available to EU institutions as well as to the ECB in the context of its price stability mandate.

The paper started with some general theoretical and empirical considerations concerning fundamental factors underlying heightened credit risks for SMEs in southern euro-area economies. Moreover, it assessed the generally shared view that severe market failures prevent SMEs from sound access to key inputs, in particular access to finance. As these market failures call for public intervention, they must be properly identified and addressed to preserve the smooth functioning of financial markets and the optimal allocation of financial resources. In the following we looked at those factors which are empirically relevant when modeling of credit risk and “optimal” interest rate for SMEs in the euro area.

The paper also discussed the highly relevant issue *to what extent are the difficulties in the SMEs access to finance reflecting supra-national rather country-specific factors of SMEs’ credit risk*. This identification problem is almost absent in official ECB statements and related public discussions. But its policy relevance can be appreciated in the context of the ECB’s main task: guaranteeing a euro-area level playing field for finance access of firms.

The results of the latest (April 2013) ECB Bank Lending Survey suggest that the standard nation-specific (but not any euro-area wide) fundamental factors of

credit risk largely explain the difficult access to finance for southern euro area SMEs. The paper then dealt with the securitization issue and, in particular, the securitization of SMEs loans and their potential use as collateral for monetary policy operations and improve bank lending. Our view clearly was that the ECB should not be involved in the purchase of asset-backed securities (ABS) for SME loans (any further).

We shared the view that any solution to the financial crisis requires the fixing of banks. Even a well-developed market of asset-backed securities for SME loans needs a sound and well-capitalized banking system as a precondition of success. Acquisitions in the ABS market are not that easy for the ECB to pursue because the bank finds itself in a completely different setup from the US, where there is a capital market. So the ABS, in this case, would have to contain assets from the banking system of the euro system and it is thus easy to grasp what sort of moral hazard is out there.

The paper argued that it is exactly this moral hazard argument which makes the ECB concerned about ABS purchase. How to best finance access of SMEs ranks high on the policy agenda. While recent cooperation between EU Commission and the European Investment Bank is likely to provide some relief to the financing of SMEs, what is perhaps still lacking is an assessment of the different instruments of finance on the dynamics of SMEs and of best the practices already implemented in several euro area Member States.

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