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**REPORT ON THE STRATEGIC RESPONSE:**

**THE IMPACT OF THE GLOBAL CRISIS ON SME AND ENTREPRENEURSHIP FINANCING AND  
POLICY RESPONSES**

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## THE IMPACT OF THE GLOBAL CRISIS ON SME AND ENTREPRENEURSHIP FINANCING AND POLICY RESPONSES<sup>1</sup>

### Background

1. Access to financing continues to be one of the most significant challenges for the creation, survival and growth of SMEs<sup>2</sup>, especially innovative ones. The problem is being exacerbated by the most severe financial and economic crises in decades. Financing has been a key area of work for the OECD Working Party on SMEs and Entrepreneurship (WPSMEE) for several years. In June 2004, *Financing Innovative SMEs in a Global Economy* was one of the themes addressed by the 2<sup>nd</sup> OECD SME Ministerial Meeting in Istanbul. In March 2006, the *OECD Global Conference on Better Financing for Entrepreneurship and SME Growth*, held in Brasilia, assessed the SME financing gap. Further work and research on *Financing Innovative and High- Growth SMEs* was carried out in 2007-2008. In October 2008 the 34<sup>th</sup> Session of WPSMEE engaged in a preliminary exchange of views on the impact of the global crisis on SME and entrepreneurship financing and discussed strategies so far adopted by governments to deal with the problem.

2. In order to further the debate on policy responses to the global crisis, a Round Table on the *Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses*<sup>3</sup> was held in Turin on 26-27 March 2009 under the auspices of the OECD WPSMEE and hosted by Intesa Sanpaolo. The Turin Round Table had before it an issues paper which was based on the responses of 29 OECD Members and non-Members, as well as the European Commission and the European Investment Fund, to a questionnaire which covered the supply of financing to SMEs, their demand for financing, the credit conditions, loan approvals and defaults as well as information on equity financing. The responses also described in detail the policy measures taken by governments for SME and entrepreneurship financing. The presentations and discussions of the Turin Round Table have been incorporated into this report. The Round Table was an important milestone in the WPSMEE's commitment to contribute to the OECD Strategic Response to the Financial and Economic crisis which may have persistent effects on SME and entrepreneurship financing. The outcomes of the Turin Round Table will be further developed for the OECD High-level (possibly Ministerial) Meeting on SMEs and Entrepreneurship, "Bologna + 10", to be held in November 2010.

### Importance of SMEs in "normal times" and in times of crisis

3. SMEs and entrepreneurs play a significant role in all economies and are the key generators of employment and income, and drivers of innovation and growth. In the OECD area, SMEs employ more

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<sup>1</sup> The present document reproduces the Executive Summary of document CFE/SME(2009)3/REV1.

<sup>2</sup> There is no single agreed definition of what constitutes a SME. A variety of definitions are applied among OECD member countries and non member economies, and the number of employees is not the sole defining criterion. Generally speaking, the OECD WPSMEE considers SMEs as non-subsiary, independent firms which employ less than a given number of employees.

<sup>3</sup> The Turin Round Table was attended by more than 100 participants from 37 countries/economies [OECD Members: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States -- Non OECD Members: Chile, Chinese Taipei, Indonesia, Malaysia, Peru, Philippines, Romania, Russian Federation, South Africa, Thailand], the European Commission (EC), the Business and Industry Advisory Committee to the OECD (BIAC), the Trade Union Advisory Committee to the OECD (TUAC), 4 international financial institutions [the European Association of Mutual Guarantee Societies (AECM), the Bank for international Settlements (BIS), the European Central Bank (ECB), the European Investment Fund (EIF)] and an international organisation [the International Labour Organisation (ILO)].

than half of the labour force in the private sector. In the European Union, they account for over 99 percent of all enterprises. Furthermore, 91 percent of these enterprises are micro-firms with less than 10 workers. Given their importance in all economies, they are essential for the economic recovery.

4. Even in 'normal' economic conditions governments have recognised that, to survive and grow, SMEs need specific policies and programmes – hence the comprehensive range of SME measures currently in place across the OECD members. However, at the present time, SMEs have been especially hard hit by the global crisis. These firms are more vulnerable now for many reasons: not only has the traditional challenge of accessing finance continued to apply, but new, particularly supply-side, difficulties are currently apparent. It is important to stress that SMEs are generally more vulnerable in times of crisis for many reasons among which are:

- it is more difficult for them to downsize as they are already small;
- they are individually less diversified in their economic activities;
- they have a weaker financial structure (i.e. lower capitalisation);
- they have a lower or no credit rating;
- they are heavily dependent on credit and
- they have fewer financing options.

SMEs in global value chains are even more vulnerable as they often bear the brunt of the difficulties of the large firms.

### **Impact of the global crisis on SME and entrepreneurship financing**

5. Although there is no internationally agreed definition of small and medium sized enterprises (SMEs), the evidence suggests that these firms are being affected by the financial and economic crisis across economies. There is evidence that SMEs in most countries are confronted with a clear downturn in demand for goods and services if not a demand slump in the fourth quarter of 2008. Many expect a further worsening to come. For SMEs there are two related stress factors: a) increased payment delays on receivables which add - together with an increase in inventories- to an endemic shortage of working capital and a decrease in liquidity and b) an increase in reported defaults, insolvencies and bankruptcies.

6. *Extended payment delays on receivables, especially in times of reduced sales, are leading rapidly to a depletion of working capital in many countries.* For example, in Belgium 43 percent of surveyed SMEs recently experienced extended delays in their receivables and in the Netherlands 50 percent of SMEs have to deal with longer payment terms from their customers. In New Zealand, the share of enterprises waiting over 60 days for payment has risen dramatically from 4.8 percent to 29.5 percent between February 2007 and 2008. In Denmark, Italy, Ireland, Norway and Spain the surge in corporate insolvencies was higher than 25 percent. In Finland, while short-term solvency problems among SMEs normally involve 6-8 % of these firms, in January 2009 more than 17 % of small firms with less than 50 employees declared insolvency problems. In Sweden, according to ALMI (the Swedish state owned company for SME promotion), bankruptcies increased over 50% in the first two months of 2009 compared to the same period in 2008.

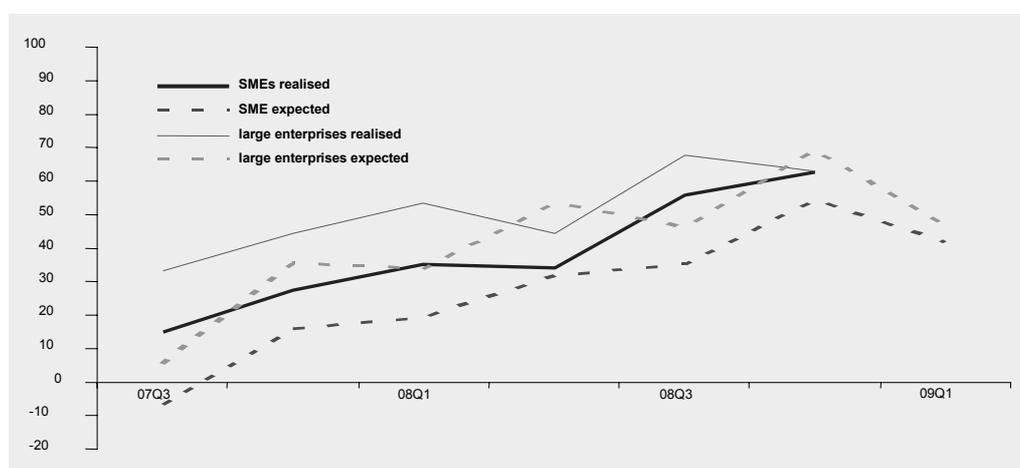
7. *Increased insolvency rates appear to confirm SMEs' increased inability to obtain short-term financing.* In all countries using the Bankers' Lending Survey method, the tightening of credit conditions by banks<sup>4</sup> was clearly evident for all the banks' clients. The European Central Bank (ECB) data also confirmed the tightening (see figure below). The ECB attributes the tightening to the banks' ability (or

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<sup>4</sup> Loan conditions encompass many aspects among which the most important are the spread between banks cost of funds and their interest rate, their commissions and fees, the difference between the amounts granted and those demanded by enterprises; the level of collateral required, and the duration of loans.

inability) to access capital, the banks' liquidity positions, expectations regarding the recession and higher risk on collateral. Interest rate spreads have risen to unprecedented levels, thereby partially offsetting the effects of the easing of monetary policy. The main factors exacerbating the banks' attitude towards lending to SMEs are: a) the poor SME economic prospects already discussed; b) stagnation in inter-bank lending and increased cost of capital; and c) the desire to rebuild bank balance sheets. In all reporting countries, banks are under pressure and are trying to preserve or strengthen their capital base. As a result, they are seeking fully collateralised transactions. In consequence, by choosing to keep only the strongest clients, banks and other financial institutions are contributing to a polarisation process. For example, Korea reported that lending to blue-chip SMEs has increased whereas lending to SMEs with poorer credit ratings has deteriorated. For many banks this may be a sensible survival strategy and their survival is vital. In some countries it is also a case of returning to "normal" lending practices after a number of years of excessive flexibility and generosity in lending.

**Tightening of credit standards for loans to enterprises**  
SMEs and large enterprises  
Net percentages



Source: European Central Bank

8. *The stagnation in lending is true even of banks in countries where governments have deliberately strengthened banks' balance sheets to allow them to grant additional credit to SMEs and/or where credit guarantee schemes exist.* As it will be seen later in the summary, most countries have not only recapitalised their banks, but also extended the funds and guarantees available for SME financing. But the effects of the incentives to lend to SMEs put in place by governments in some countries (such as the provision of additional capital) have not yet yielded the desired results. Some governments are closely monitoring this situation or have put in place "credit mediators" to ease the flow of credit to SMEs or have enacted binding codes of conduct for SME lending.

9. During the Round Table there was much discussion about the fact that large banks have evolved into very complex institutions where loan decision making is centralised and based on automated credit assessment systems. Thus, SMEs often lack face-to-face contact with bank managers who understand their specificities. Inappropriate and indiscriminate use of credit scoring mechanisms can lead even deserving SMEs to be denied credit. To some extent, a proper use of individual assessment through "relationship banking" can be used to counteract this, and it has survived in some countries because the banking sector is composed of many "local" or "regional" banks which have been less affected by the crisis, are liquid, and continue to lend to SMEs (Switzerland and the United States, for example). There are also some large banks that are aiming at preserving "relationship banking" at the local level (in Italy, Intesa Sanpaolo is one of them and in Indonesia, the Bank Rakyat)

10. *Confronted with worsening access to credit, SMEs are exploring alternative sources of finance such as the mobilisation of reserves, self-financing and factoring.* Access to venture capital and private equity also appears to be constrained but there are no official statistical data available covering the fourth quarter of 2008. The financial crisis has had a three-fold impact on venture capital and private equity markets. *First*, exit opportunities are reduced. *Second*, fundraising activities seem to be shrinking. *And thirdly*, invested capital has stagnated or even slowly started to decline, especially investments in new projects.

11. Global venture capital fundraising slowed down between 2007 and 2008. The current economic recession and the global downward pressure on prices are expected to influence the future prospects for fundraising in the markets in the long run. Institutional investors providing funding will simply be less willing to supply new funds with fresh capital. Figures from Canada confirm the global trend as fundraising has decreased by roughly 25 percent in 2007 and 2 percent in 2008. Similar declines have been registered in Australia and the UK.

12. Under the influence of these trends, public funds (both direct and indirect investment funds) will be impacted as much as the private funds. In markets with public or semi-public investment funds, which provide capital to funds-of-funds activities, such public funds are likely to witness a more limited possibility for co-investment with private funds, simply because the private funds increasingly reduce their investment activities. As a result, public funds cannot be expected to provide the same leverage effect as before the crisis, unless supplied with more capital.

### **Policy responses of governments**

13. The participants in the Round Table stressed that the appropriate broader framework conditions are a critical determinant for SME financing. Indeed there is a need for “reliable governance, tax, regulatory and legal frameworks that provide a level playing field for all economic entities irrespective of size” as stated in the *OECD Brasilia Action Statement on SME and Entrepreneurship Financing* (March 2006). In particular, participants noted that any government measures taken to ease SME financing should not impair fair competition and should avoid contributing to a rise in protectionism.

14. Countries’ abilities to deal with the crisis depend to a large extent on the margin provided by their respective fiscal and monetary policies. Many of the reporting countries have recently put in place anti-crisis packages combining in different proportions three lines of action: *stimulation of demand* (consumption packages, infrastructure programmes, tax policies); *credit enhancement* measures, including *recapitalisation of banks* which, in some cases, include explicit provisions or mechanisms to preserve or enhance banks’ capacity for financing SMEs such as public credit guarantees; and *labour-market measures* (reduced employment taxes or social security charges and extended temporary unemployment programs).

15. *The anti-crisis packages and accompanying measures address, in many countries, the financing problems of SMEs.* The measures put in place by countries can be classified in three different groups: (a) measures supporting sales and preventing depletion of SMEs’ working capital such as export credit and insurance, factoring for receivables, tax reductions and deferrals, and better payment discipline by governments, (b) measures to enhance SME’s access to finance, mainly to credit through bank recapitalisation and expansion of existing loan and credit guarantee schemes; (c) measures aimed at helping SMEs to maintain their investment level and more generally their capacity to respond in the near future to a possible surge in demand through investment grants and credits, accelerated depreciation, and R&D financing.

16. *Many governments have implemented measures to maintain or increase cash flows.* For instance, they have allowed accelerated depreciation for investments already undertaken. Some countries are also

giving tax credits, cuts, deferrals and refunds. In Japan, the Government has reduced the corporate tax rate from 22 percent to 18 percent for the SMEs with 8 million yen (€61 thousand) or less in annual income in the coming 2 years. In the Netherlands one of the tax brackets has been reduced from 23 percent to 20 percent for both 2009 and 2010 for amounts up to 200,000 euros and Canada increased the income threshold for which the small business rate applies. The Czech Republic, France and Spain are refunding VAT payments immediately or monthly. The idea was introduced during the Turin Round Table that governments concentrate first on reducing those taxes that are “profit-insensitive”, that is, taxes that are paid regardless of whether the SME is making a profit. This would increase the ability of SMEs to finance working capital internally.

17. *Governments are taking moves to shorten payment delays for public procurement* (Australia, France, Hungary, Italy, the Netherlands, New Zealand, and UK) and enforce payment discipline (France). The European Commission has suggested that public authorities should pay their bills within 30 days. In parallel, the Commission commits itself to speed up payment of goods and services so to fully respect the targets for paying bills. In the case of the UK it has cut government payment times to 10 days. Governments are also easing tendering and procurement procedures and policies (Australia, France, the Netherlands, New Zealand and the United Kingdom). Lastly, in order to maintain employment, some governments are giving wage subsidies to enterprises so that employees can receive full wages while working part time.

18. *The most widely used policy measure to increase access to finance has been until now the extension of loans and loan guarantees.* These measures vary widely in their design and execution. Although some measures such as new credit guarantee scheme for working capital by Greece, launched in December 2008, are already showing positive results, time is too short to draw conclusions about what are the “best practices” in the field of emergency measures and in the field of loan guarantees. The OECD WPSMEE has, in the past, identified a few schemes in the field of loan guarantees<sup>5</sup> which could lay the groundwork for future comparisons and evaluations.

19. *In some countries, the governments have found the response of the newly recapitalized banks to the needs of SMEs unsatisfactory or insufficient even though guarantees are available.* These countries have resorted to discipline measures that in some cases complement the incentives, in order to pressure banks to continue lending to enterprises. Belgium and France have appointed a “credit mediator”, who at regional and central levels, may intervene to ease difficulties and help enterprises obtain bank funding. The US has chosen to strictly monitor, on a monthly basis, the credit activities of banks that have been rescued by public funding. Furthermore, it is requiring all banks to report on a quarterly basis. Ireland has enacted a legally binding code of conduct on SME bank lending. The Belgian Ministry for SMEs is giving pre-fund agreements directly to SMEs which can be taken to the banks to obtain guaranteed loans.

### **Proposals for Further Action**

20. The discussions during the Turin Round Table revealed the participants’ sense of urgency to alleviate the shortage of working capital SMEs are facing. SMEs are caught in a vicious circle because of the causal connections between the demand shock and the decline in working capital. At the same time the impaired credit markets are not responding to the SMEs’ need for liquidity. As was highlighted during the Round Table, “... a downward spiral has been created which is damaging the fabric of many economies”. Therefore, governments were urged to review the policy measures already taken with the aim of reinforcing them or complementing them with new measures. The Round Table distinguished between the short-term emergency measures such as tax measures that could be reversed and the long-term measures

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<sup>5</sup> Cf. OECD Framework for the Evaluation of SME and Entrepreneurship Policies and Programmes, OECD 2007.

which need to be undertaken to make structural improvements and institutional changes in the SME financial environment in order to restore growth.

21. In addition to the policy measures reviewed above, countries may wish to consider the following policy recommendations related to measures which are more institutional or structural in nature to remedy the long-standing deficiencies in the SME financial environment:

- Encourage banking competition across economies and, to alleviate the stagnation in bank lending, consider the *monitoring of SME lending by banks* through timely reporting and the establishment of *a code of conduct for SME lending by banks*.
- To know the real situation of SMEs, policy makers also need more timely and SME specific data on the supply of and demand for financing so that they can determine if their measures are working. Already several OECD countries are improving transparency in bank lending by encouraging the timely public disclosure by banks of the composition of their loan portfolios by size of firm.
- As SMEs often lack face-to-face contact with bank managers due to the current impersonal structure of the modern banking system, banks could consider using their scoring methods for assessing SME credit-worthiness with appropriate discretion so that *adequate room would be left for the specificities of the client, as happens with "relationship banking"*. Appropriately balanced use of any assessment method could help in cases where the circumstances and viability of individual businesses can be accounted for. Consequently, staffing local branches with personnel who have adequate skills in dealing with SME lending becomes important. Banks could also enter partnerships with business service providers to help them reduce the risks in SME lending.
- Evidence was offered that automatic systems of credit evaluation do not always function to the effect that viable companies can obtain credit, which could be addressed with a more appropriate and discriminate use of these methods. Systems are needed to evaluate the credit risk of SMEs on a company basis rather than on a sectoral basis, while being consistent with prudential management practices in terms of sectoral allocation of funds.
- The specific financing needs of micro-enterprises (less than 10 employees in the EU) which dominate the SME sector were considered at the Round Table. Research on start-ups by the Ewing Marion Kauffman Foundation (United States) revealed that they also need modest capital injections and that the most important source was outside credit averaging USD 32,000. This could be provided through micro-finance in countries which do not already have such schemes.
- Improving the means by which SMEs are informed about the availability of SME-related government support measures, especially those that are responses to the current crisis, is crucial for the implementation of government policy and programmes. It could be facilitated in partnership with business service providers or business associations. As indicated in the OECD Brasilia Action Statement "*...informing SMEs of the range of financing options (e.g., public guarantee programmes, business angels, and bank loans) will ensure greater take-up of schemes*".
- Also competence building should spur the demand for financing among SMEs. The managerial competencies of SMEs—especially in the field of finance—have to be supported. Governments should take the opportunity offered by SME owners' realisation that they did not have all the skills needed to help their firms survive the crisis to encourage participation in general managerial skills development, including mentoring and business advice.

- SMEs should be engaged in the design of relevant finance-related policies and programmes from the outset to ensure that their perspectives and needs are well understood and taken into account. Examples were given of regular communication and consultation with the representatives of SMEs through forums and round tables to raise awareness and to assess the effectiveness of existing measures and programmes to help SMEs to access finance.

### **Preparing SMEs and entrepreneurs for recovery and innovation-led growth**

22. It was also noted that the crisis brings certain opportunities to improve the SME legal framework and the business environment. The crisis could accelerate the redeployment of resources to new activities. Emerging firms and those redesigning their processes should be encouraged to focus on sustainability and knowledge-based outcomes.

23. Both the Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs (2004) and the OECD Brasilia Action Statement on SME and Entrepreneurship Financing (2006) acknowledged that SMEs' financing requirements differ at each stage of their development. In particular innovative SMEs need have access to appropriately structured risk capital.

24. The OECD Brasilia Action Statement highlighted the fact that access to appropriate types of financing structures and facilities are especially required to allow SMEs and entrepreneurs to take advantage of the opportunities provided by innovation. The Statement proposes actions which could contribute to preparing SMEs and entrepreneurs for recovery and innovation-led growth which are relevant in the current situation.

- *“A lack of appropriate financing notably represents a hindrance to the creation and expansion of innovative SMEs (...). Comprehensive efforts are needed to bolster the early stages (i.e. pre-seed, seed and start-up) of SMEs, which are marked by negative cash flows and untried business models. This can be done by entrepreneurs themselves leveraging the capital lying dormant in their personal assets, or by “business angel networks” or venture capital markets (...). Successful approaches to developing early stage venture capital markets include both tax-based programmes and programmes that use government’s ability to leverage private risk capital such as co-investment.*
- *Business incubators, clusters of innovative SMEs, science and technology parks, and development agencies play an important role in facilitating appropriate access to financing for SMEs at local and regional level. Cities and regions can underpin and strengthen this function through partnerships with private financial institutions and universities. Appropriate financial incentives can correct market failures and stimulate equity investment in local enterprises.*
- *There is a need to promote enhanced awareness, educate and communicate more broadly the value of equity financing, including raising the recognition among entrepreneurs of fair value and transparency in valuing investments.*
- *The combined legal, tax and regulatory framework should ensure that risk capital is not discriminated against, including by safeguarding orderly, equitable and transparent exit routes. Taxes should not put SMEs, entrepreneurs or their financial backers at a disadvantage. There should be neutrality between alternative sources of risk capital, such as domestic versus foreign venture capital funds. Maintaining neutrality between debt and equity should also be an aim for tax policies.*

- *There is no venture capital without venture capitalists and business angels greatly enhance the effectiveness of informal finance. Representing an evolving entrepreneurial breed, these actors thrive on their ability and courage to assume risk. Obstacles should be identified and eliminated. Effective role models can also be promoted to spur the dynamism of these actors. Ways should be explored to facilitate the establishment of “business angel networks”, which may greatly enhance information and capital flows.”*

25. The review of measures recently implemented by Governments reveals the paucity of measures directed to venture capital. As such, there is some scope to provide additional incentives to encourage investors to participate in venture capital funds or to act as business angels. Governments may want to consider greater support for venture capital such as increasing guarantees for risk capital and/or more co-investment as well as fiscal incentives such as tax credits for venture capital investments, or tax reductions on capital gains from venture capital investments and enhanced efforts to prepare SMEs to be more ‘investment-ready’. In sum, governments should not stop with the current short-term measures for SME survival but consider the medium and long-term measures for preparing SMEs and entrepreneurs for recovery and innovation-led growth.

### **Proposed Role for the OECD**

26. One of the principal recommendations in the *Brasilia Action Statement* was that the OECD considered the development of definitions, indicators, and methodologies for gathering data on the supply of financing available to SMEs and the demand for financing by SMEs. In response to this recommendation, the OECD has already undertaken the following:

- i) A review of terminology on business financing used by national and international organisations;
- ii) An overview and assessment of some of the main sources of data on both the supply of and demand for financing for SMEs;
- iii) A collection of policies and programmes related to SME and entrepreneurship financing, in particular to financing innovative and high growth SMEs.

27. In light of the extreme importance of data availability for effective policy responses, as revealed by the current global crisis, the OECD should continue efforts to improve availability and international comparability of data sets on SME and Entrepreneurship Financing. The OECD Working Party on SMEs and Entrepreneurship (WPSMEE), in close cooperation with its parent Committee, the CIIE:

- *Could promote a Scoreboard on SME and entrepreneurship financing data and policies* (a pilot project will be carried out in the framework of the 2009-2010 programme of work in view of the “Bologna +10” High level Meeting) ; *and*
- *Should monitor, report on, and discuss SME and entrepreneurship financing trends on a regular basis.*

28. As a follow-up, the WPSMEE should also carry out, in the framework of its programme of work 2009-2010, an *assessment of the effectiveness of measures* taken to assist SMEs and entrepreneurs in weathering the financial and economic crisis, as reported in the present report.

29. Finally, the OECD should also continue facilitating the *Tripartite Dialogue between governments, SMEs and the financial institutions*, to periodically review progress in strengthening SME and entrepreneurship financing.