SME Envoys Finance

SME access to finance situation in EU Member States

Final Report 2019

Introduction

This report is the outcome of a one-year process that started in 2018 through a call by the SME Envoys Network to conduct further research on SME access to finance under the patronage of Pieter Waasdorp, the SME Envoy for the Netherlands and rapporteur for access to finance. The European Commission followed up to that request, that was aimed at better identifying the financing gaps and understanding what policy responses could be the most effective. In collaboration with the Dutch Ministry of Economic Affairs and Climate Policy, the Commission asked each SME Envoy to nominate an SME financing expert who could provide further insights from that country in perspective and fill in a survey aimed at assessing the SME access to finance situation in each country.

This report summarises the replies to the consultation and was validated through a meeting held in Brussels on May 17th 2019 among the financing experts nominated by the SME Envoys, aimed at discussing the outcomes of the survey and share best practices among each other. The outcomes were presented at the following SME Envoy meeting on June 27th-28th in Stockholm, where the combined results of both the report and the expert meeting were discussed in the plenary session of the SME Envoys group, with the aim of sharing issues and best practices on SME access to finance at the highest level.

The final objective of the process was to channel the replies to the consultation and its conclusions into the policy-making and legislatives processes, including within the Commission's Capital Markets Union initiative, bearing in mind the start of the new Commission mandate at the end of 2019.

The report is composed of two parts, based on responses to the above-mentioned consultation: part 1 describes the situation on SME access finance in Member states; part 2 describes Member States' good practices on a number of policy areas.

Part 1 – Assessment of the SME access to finance situation

1.1 The overall finance gaps

Financing gaps differ widely across Member States. Although SMEs' access to bank finance largely recovered after the financial crisis, market failures and structural challenges remain, including information asymmetries, high transaction costs in servicing SMEs, and lack of financial skills/ knowledge among small business owners.

Bank finance

Most of SME financing in EU is provided through bank loans and their availability differs widely across Member States. In Germany, bank loans are very well available: the financing gap[1] is modest (less than 1%). In Austria, bank lending has been rather stable over the past few years, and the lending conditions did not discourage many potential borrowers. In Poland, large and medium-sized non-financial enterprises do not encounter any significant barriers in access to bank financing, also due to a good and stable situation of the banking sector. In Denmark, the banking sector is mature, ensuring low costs of business loans. In Portugal, most banks have overcome the severe difficulties suffered during this recent banking crisis and they are now trying to approach the SMEs in a more efficient way. In France and Belgium, generally SMEs seem not to face difficulties in accessing finance, due to favourable bank credit conditions.

On the other hand, in Greece access to bank finance continues to be a central problem for SMEs. In Croatia and Slovakia, a key problem is that SMEs lack equity capital and collateral, particularly in the growth and expansion phase, and are over-indebted or not sufficiently capitalised. In Finland, finance gaps exist especially in case of SMEs that are looking for finance when starting-up, scaling-up or internationalizing their businesses, as well as in succession processes or other changes in business. In these situations, banks are in short of securities and therefore assessing the risk associated to an SME may be difficult for them.

Some Member States report that major constraints are also the impact of bank regulation, which has resulted in banks being even more risk-averse and could make bank lending to SMEs more difficult in the future, and the role of Non-Performing Loans in some Member States (e.g. Greece and Italy) that could still impede the recovery of the financial sector.

Alternative finance

In most of EU Member States, finance gaps exist mainly for early stages and innovative business models. Access to finance for start-ups and innovation projects can be more difficult, as their risk profile and their capital structure require different financing approaches compared to funding for traditional SMEs. Investors treat small, innovative, young firms differently from others, due to their elevated risk profile and the high share of intangible

[1] For a definition of financing gaps, see the Impact Assessment accompanying the European Commission's proposal establishing the Programme for Single Market, p. 325 ss.

capital in their assets. In Finland, there is a lack of patient investors who can invest in risky long-term projects/companies. Another issue is that Finnish venture capital market suffers a lack of funds from the private sector. In most of the countries, including Austria and Malta, venture capital is very small and there is a supply side gap. Some countries report that, especially when it comes to using venture capital to finance growth, there is a supply-side gap. On the other hand, in Denmark and Germany the markets for venture capital and other alternative types of SME financing are increasing.

In France, alternative sources of financing[2] like crowdfunding and venture capital are quite dynamic. However, access to finance remains more difficult for small companies and for innovative development projects, e.g. for the digital transformation of SMEs. Some low-value or intangible investments are more difficult to finance, as well as some particularly risky investments that are postponed by companies due to lack of financing.

In some other countries, SMEs have difficulties finding second or third round financing: they can easier find partners and instruments that support them at the beginning such as guarantee funds to support a loan. The threshold estimated is around EUR 1 million: when SMEs exceed this threshold, they need to find a private partner, such as an equity fund or a business angel willing to support them.

<u>Other dimensions</u>

An important dimension is the location of the company: SMEs that are not established in city centres are more constrained in their access to finance than urban ones. Bank concentration is also an issue: in Ireland, the three main Irish Banks held 86% of new lending flows in Q1 2018. In Finland, the supply of financing for SMEs is centralized and provided by large institutions (dominated by two big bank groups); therefore smaller and more agile providers are missing.

Access to external finance could be a second priority in some Member States: in Poland for instance there is a hierarchy of investment financing, according to which financing projects mainly from own resources is preferred (in the third quarter of 2017, about 45% of investments were financed from own funds). In the Netherlands, SMEs in recent years deleveraged their liabilities on their balance sheets, and so did banks.

1.2 Main challenges in bank financing for SMEs

In some countries like Denmark, Germany, France, Austria there are few challenges in bank financing. The number of banks is high and they have a large network of subsidiaries, which are embedded in the local environments in which the SMEs seeking finance operate. In other countries like Estonia and the Netherlands there are four large banks on the market which

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[2] For an overview and a definition of alternative finance for SMEs, see the 2017 European Semester Thematic Factsheet – SMEs Access to finance, p. 6 ss. (https://ec.europa.eu/info/sites/info/files/file_import/european-semester_thematic-factsheet_small-medium-enterprises-access-finance_en.pdf)

have 80% market share: this means less favourable financing terms for enterprises. The same applies to Ireland, where the three main Irish Banks hold 86% of new lending flows in Q1 2018. Uncertainties on Brexit also have an impact on credit conditions in Ireland.

The demand side (SMEs)

In many countries, the environment for investment financing via bank loans is favourable for SMEs. However, despite the good overall picture, access to bank financing is much more difficult for innovative, smaller and younger SMEs. Micro-businesses, and young SMEs in particular, often lack sufficient collateral and well-established relationships with credit institutions. Information asymmetries (e.g. lack of reliable and timely information) are high, as well as lack of sufficient financial knowledge by entrepreneurs. From the lenders' perspective, the requested loan volumes are low, so processing costs are relatively high.

In the Netherlands, banks indicate that the main causes for rejection rates on SME loans are a poorer balance sheet position and lack of quality of financing plans and of business plans. Some countries, like Croatia, report high interest rates (especially for micro clients) in terms of higher risk-premium compared to larger firms. Some Member States report low capitalisation that leads to higher default risk. Another challenge lies on the situation of small business owners and managers, who often lack sufficient financial skills or awareness about financing opportunities, including public schemes, or are risk adverse.

The supply side (banks)

Legislation is forcing banks to become more risk adverse, therefore making it more difficult for SMEs to obtain a bank loan. In some countries, like Poland, banks maintain high regulatory capital surpluses above requirements, which enables them to increase their lending.

The current low-interest policy is also raising the pressure on banks' earnings. Moreover, rules on risk-appropriate capital requirements are increasing the cost of lending to SMEs, which often have a lower credit rating (and therefore a higher probability of default). On balance, these factors increase risk premiums on interest and lead to more extensive documentation requirements, significantly higher costs, or increased collateral requirements. Increased standardisation in the credit granting process as well as centralisation of bank branches has enhanced the degree of conformity regarding business models, capital structure etc. These aspects makes access to finance challenging for SMEs in sparsely populated areas.

In some countries like Greece and the Netherlands, an important problem of the banking sector is the size of the Non-Performing Loans, which also hampers the availability of bank finance to SMEs. Some Member States have activated legislative mechanism to tackle these issues that are expected to have an impact. Particularly lengthy and complicate procedures for loan approvals can be an issue in some countries like Croatia and Poland: better digitalization of banking systems could help make the procedures swifter.

1.3 Loan rejection rates for SMEs: what are the main market failures/financing gaps in credit markets

In some Member States, like Germany, Austria, Denmark and France, the environment for loan negotiations with banks and savings banks is favourable. In general, borrowing costs are affordable and access to credit is open. In some other countries, like Ireland, transaction costs and cost of credit are high, also due to a high level of NPLs. Nevertheless, structural issues still remain: loan negotiations clearly fail more often for small SMEs than for larger SMEs. Moreover, for riskier investment projects, such as for innovative, technology-intensive SMEs and start-ups, access to bank financing is much more difficult. Indeed, they lack regular cash flows and hold a substantial part of their capital in form of intangible assets such as intellectual property (e.g. patents, property rights), which hardly can be valued by standardized approaches. Moreover, the availability of reliable information about the larger firms is easily accessible compared to smaller ones.

In some countries like Czech Republic, loan rejection rates are higher than in other countries, possibly because of higher caution of banks to lend to very small enterprises or because the economy starts showing signs of overheating. Banks can attempt to reduce their exposure to particularly vulnerable SMEs in order to better withstand the next downturn. In some countries like Ireland, the reason of rejection rates lays in the fact that SMEs, particularly micro-businesses, may not have the same levels of financial literacy or the resources to obtain a loan as larger firms. They can have difficulty in presenting credit proposals that are fitting for their banks' credit decision systems, as these have moved from a local bank manager model to a more centralised system, and banks are trying to reduce their operational costs. In Poland and Luxembourg, the most common reasons for refusing a bank loan from SMEs are the lack of creditworthiness and lack of adequate loan collateral. In Finland, main market failures areas for SMEs are: (1) Start-up finance, where the total need of finance exceeds EUR 100.000, (2) Growth companies with a short history, (3) Growth companies with fast growing exports, and (4) Transfer of ownership.

In Sweden and Estonia, loan rejections may be explained by the fact that the company is not located in the main economic centres or close to them. In Estonia, real estate market activity in less populated places is slow and the prices are lower: this means that companies from peripheral areas need much more collateral.

In other countries like Germany, Ireland, Austria, Poland, Czech Republic, Denmark, Finland, while rejection rates were recorded at higher levels in the immediate aftermath of the financial crisis, they have lowered and remained constant in the last few years. The monetary easing of the European Central Bank enabled better credit conditions. In France, the cancellation of an indicator for entrepreneurs who experienced only one bankruptcy helped give them a second chance and allowed them to obtain credit more easily from the banks. Luxembourg reports as main reason for negative variations the overall less favourable banking regulations that are making banks more risk adverse.

1.4 Main challenges or market failures in the alternative credit financing markets (factoring, leasing, crowd-lending, credit unions, debt funds, securitization, bond issuances)

Traditionally banks are the main source of financing for SMEs in all EU countries. Germany reports that the lack of awareness and familiarity by borrowers with alternative financing market is probably a challenge. This makes it difficult for alternative loan providers to be distinctive in terms of visibility, reliability and, not least, financial attractive and competitive. Nonetheless, many Member States are trying to broaden competition in the SME finance market beyond the banking system and diversify the types of finance available to SMEs. Alternative credit financing markets, e.g. factoring or crowd-lending, have recently shown strong growth rates in some Member States.

Some countries like Malta, Estonia, Czech Republic report that, traditionally, the size of the banking sector means that alternative credit financing remains on the sidelines. Despite rapid growth in the last few years, its low contribution to SME financing limits its viability as a serious alternative.

<u>Factoring, leasing</u>

In France, the Netherlands and Greece, factoring volumes have increased in the last years. In France, the increase could be found in the collective effort made by factors to target SMEs, with simpler offers without time constraints and the possibility to cover only part of their trade receivables. In Greece, leasing is still well below pre-crisis levels. In Finland, factoring and leasing finance are growing quite rapidly among SMEs and this market is working quite well without any major failures. In Slovakia, leasing is very popular and developed: entrepreneurs mainly use it to finance vehicles.

In Ireland, access to an invoice discounting facility in a main bank is limited by the required facility size, as there are standing monthly charges. Alternative finance providers who are not included in the Central Bank of Ireland’s data are supporting the market with some innovative products e.g. invoice auctions (InvoiceFair). Anecdotally, there does not seem to be any significant increase in the number of users and the challenge for alternative finance providers is primarily the cost of finance to enable them to compete with established players. Experience suggests that the amount of users of this product is stagnant; any increase is driven by the sales activity of the product users. Consequently, the challenge for the alternative finance providers will be the cost of finance to enable them to compete with established players. Alternative finance providers are competing in niche areas when it comes to leasing e.g. second hand machinery. The pillar banks and equipment manufacturers compete heavily in the “new” space.

<u>Crowd-lending</u>

In some countries like France, crowd-lending is increasingly used, while its risks are carefully followed by the regulators, particularly in a context of an emerging market where default rates are beginning to materialize. In Greece and Luxembourg, alternative markets like crowd-lending are not yet regulated and, therefore, these types of financing do not exist or are poor. In Finland, crowd-lending has been a gradually developing area after the financial crisis but still lacks the larger scale.

In Denmark, crowd-lending has grown significantly in recent years. However, the market is still lacking a broad foundation as it is still quite small and is dominated by experienced investors (not the crowd). The Danish market for crowdfunding is regulated within the existing regulation (PSD2 and MiFID II) unlike in other Member States that have developed bespoke national regimes on crowdfunding.

In Ireland, some institutional investors seeking to offer funding through crowd-lending platforms appear to be experiencing an issue of access to liquidity. Similarly, businesses seeking funding via crowd-lending are experiencing difficulty in obtaining funding of more than EUR 300.000 and for longer than three years. There is currently no regulation of crowdfunding (including both crowd-lending and equity-based crowdfunding), however, crowdfunding represents a useful source of non-bank finance for Irish small businesses. It is intended to introduce national regulation of crowdfunding which will also help ensure the necessary consumer protections are in place so that non-professional investors have all of the relevant information and are made aware of the risks involved. Regulation will also hopefully support the competitiveness and growth of the crowdfunding industry in Ireland.

Credit unions

In Ireland, credit unions have the capacity to lend to SMEs but, at present, there are several challenges to the growth of SME lending. Firstly, credit unions do not have a recent history in this market and as a result do not currently have the skills and expertise. Secondly, credit unions can only lend to SMEs whose owners are members of their Common Bond (in most cases a geographic area). Thirdly, the size and scale of many credit unions (only 54 have more than EUR 100 million in assets) makes it most likely that SME lending would have to be a collaborative effort between credit unions and/or SME lenders. Certain individual credit unions may have expertise which is not generally available at a sector level and may have greater penetration of SME lending in their own common bond. The Central Bank is currently reviewing the lending regulations for credit unions, including in relation to SME lending.

Debt funds, securitisation, bond issuances

In France, small and mid-cap companies have the possibility of issuing bonds through Initial Bond Offer and Euro PP. In Greece, debt funds, securitization and bond issuances have not been developed yet to meet the specific needs of small and medium sized businesses, according to their size and their life cycle.

In Denmark, the corporate bond market has grown substantially in recent years, after being far behind that of neighbouring countries for many years, as a bill was passed in 2014 introducing trustees and the possibility of securitization in order to stimulate the bond market.

However, the market is still dominated by a limited number of very large firms. This is probably a result of the bond market being too heavy for many SMEs, who therefore seek other sources of credit.

In Finland, debt funds have been providing complementary financing, initially in the form of mezzanine and later in form of unitranche, but mainly to private equity-owned companies. Bond issuance has typically been limited in the issuance sizes below EUR 50 million, driven by the investor demand for meaningful investment sizes per issuance. In reality, there is no bond market for SMEs in Finland.

1.5 Main challenges or market failures in the alternative credit financing markets: scorings

Answers were given on a 1 to 5 scale (1 = no challenge at all; 5 = very important challenge)

<u>Maturity of the markets</u> *(average score: 3,6)*

The maturity of alternative markets depend on the type of financing. In many Member States asset-based finance (leasing & factoring) markets are mature while debt funds, crowdfunding and bond issuance are not very common.

<u>Lack of awareness/familiarity by borrowers</u> *(average score: 3,5)*

SMEs are aware of only the most used types of financing, such as leasing, bond issuance and factoring, but they are more used by bigger firms. The market structure is highly dominated by banks are more conservative, while borrowers are more oriented on classical banking products. Lack of awareness about e.g. crowd-lending is definitely an issue, however is increasing. In the Netherlands, policy has aimed to increase awareness for alternative finance. The market could benefit from higher awareness that would increase demand. Banks focus more on senior loans, which provides possibilities for alternative finance providers to gain a complementary market – possibly in cooperation with banks. Lack of awareness/familiarity by SME advisors is slowing the adoption of alternative finance by SMEs.

<u>Inherent risks in the market</u> *(average score: 2,2)*

Risks differ according to the type of financing. Considering the small scale of this type of investments, even a potential downturn in the economy cycle will have a reduced impact. Leasing is collateralized, so the risk is smaller than in the other types of financing. In France, depending on the nature of the proposed funding, crowdfunding platforms may or may not need to have regulated status to carry on their business. If the platform proposes to fund projects in the form of a loan with or without interest, it must be registered in a specific register as a crowdfunding intermediary.

<u>The market is underdeveloped, in terms of professionalism, transparency and trust</u> *(average score: 2,1)*

In many countries, leasing is well developed in terms of professionalism, transparency and trust, but mainly for lease of vehicles and real estates and less for the equipment, followed by the factoring providers. Market for other sources of financing (debt funds, bond issuances) is not developed, especially for the SMEs. Some more efforts should be made in order to further provide the appropriate information to SMEs in terms of transparency and trust. Secondary markets are underdeveloped and access to 'cheap' funding, i.e. through institutional players, is limited.

1.6 The main challenges or market failures in the alternative equity financing markets (venture capital, business angels, equity crowdfunding, IPOs)

<u>Venture Capital/Business Angels</u>

In many countries, including Germany, the availability of venture capital is limited if compared with international benchmarks, such as USA or Israel. In Estonia and Denmark, VC is doing very well but a large part is invested abroad. In some Member States, business angels' market is small: for this reason, these investors are to some extent an untapped potential. In Finland, the number of business angels has increased significantly as a consequence of growing number of serial entrepreneurs and other experienced businessmen willing to share their expertise with new business founders.

Supply side (investors)

The reasons for the rather small venture capital markets are manifold: compared to the USA, the share of institutional venture capital investors is relatively low and they are traditionally more risk averse. Moreover, the size of their financing needs makes SMEs unattractive to institutional investors like pension funds or insurance companies, which tend to look for single investment opportunities of at least EUR 5-10 million. From an investor perspective, the minimum size that an investor wishes to invest is often larger than the needs of most SMEs.

Both business angels, including their networks, and venture capital focus on high-growth/high-potential firms in high tech areas such ITC, biotech, clean tech and health-related technologies. Similarly, there appears to be a low level of seed and early stage venture capital available to small businesses and in some countries, despite an apparent increase in the amount/volume of venture capital, the number of firms receiving venture capital has remained much more static.

Another reason for low venture capital may be a limited supply of investment projects with a satisfactory rate of return. In Czech Republic, the share of turnaround, replacement capital and buyout to total private equity seems disproportionately higher than in its peers, reflecting lower interest of investors, in the particular in the segment of early stage, risky companies.

In some countries like Finland, large institutional investors have limited allocations for early stage equity financing. The limited partner base should be much broader in order to increase the size of venture capital funds. As a result, the growth in investment volumes has been mainly driven by international investors.

Demand side (SMEs)

Innovative SMEs and start-ups tend to look for venture capital in the form of equity stakes as their business models are risky and can hardly cover pre-specified repayment schedules, maturities and interest rates regardless of their success. Other challenges related to alternative equity financing markets from the perspective of SMEs include a low demand for equity finance, a lack of understanding of the benefits of equity instruments and lack of financial knowledge. Besides this, SMEs often refrain from equity funding, because they are concerned about loss of control.

<u>Equity Crowdfunding/IPO</u>

On equity crowdfunding, a major challenge lays in regulation. In France, crowdfunding platforms benefit from a specific regulatory framework since 2014 (special legal status) that enables them to operate without a minimum amount of equity. Their activity is regulated in order to guarantee transparency and investors' protection. The growing demand and the strong competitiveness of the sector could contribute to a deterioration in the quality of projects submitted on these crowdfunding platforms. In Denmark, the approach until now has been to have the same investor protection regulations for crowdfunding as for IPOs and not to promote one over the other, which has limited use compared to other countries. In this country, the number of IPOs is low but increasing.

In Estonia stock markets are not very active: in 2018 there was the first IPO after many years of silence. Companies do not see much benefits in getting listed, because bank loans are cheap and easy to get. In Austria, the Alternative Financing Act is a well established regulatory regime for crowd-investing and lending. It is suggested that EU proposal for a Regulation on European Crowdfunding Service Providers does not lead to a situation where national regimes are no longer applicable for platforms offering only within the territory of one Member State.

1.7 Main challenges or market failures in the alternative equity financing markets: scorings

Answers were given on a 1 to 5 scale (1 = no challenge at all; 5 = very important challenge)

<u>The market is immature, in terms of size</u> *(average score: 2,9)*

The situation varies according to the type of financing, e.g. venture capital markets are more mature than crowdfunding. It depends also on Member States, e.g. in Estonia and Denmark, venture capital markets are quite significant while stock markets are limited. In some countries like Croatia these types of financing are still very new and are not used extensively;

there is also a lack of professional teams providing alternative equity financing and entrepreneurs are reluctant to transfer part of their ownership and decision-making.

<u>Misfit between demand and supply</u> *(average score: 3,0)*

There are various misfits in place between demand and supply:

- access to capital in the scale-up phase, which requires larger amounts of capital, is limited (Denmark, Czech Republic, Austria, Slovakia)
- mid-size manufacturing companies established away from capital cities find it harder to get financing (Estonia)
- early stage companies find it difficult to raise equity finance (Denmark, the Netherlands, Slovakia)
- there is still some work to do on pursuing and matching companies to alternative equity financiers. Entrepreneurs often lack the willingness to open capital up to investors, and they often address the wrong financing sources (Belgium)
- fragmentation of business angels communities, hence demand and supply hardly find each other (Sweden)
- the market structure is highly dominated by banks, whose approach is more conservative regarding alternative equity financing (Croatia)
- companies with physical products (material technology, components, devices etc.) still face difficulties in raising expansion capital (Finland).

<u>Reliance or lack of foreign capital</u> *(average score: 2,6)*

In some countries like Denmark, relatively little foreign capital is invested compared to the amount of capital going out of the country. Due to the small size of the home market, foreign investors are not always aware of investment opportunities. In some other countries like France and Czech Republic, the majority of capital is domestic. In France, nearly two thirds of private equity capital raised in 2017 came from French investors. In some countries like the Netherlands, reliance on foreign capital is mainly for larger rounds.

<u>The market is underdeveloped, in terms of professionalism, transparency and trust</u> *(average score: 2,4*

In some Member States, markets have been going up in the last decade and there has not been significant crisis, therefore the market has not been tested much. Some countries do not report transparency issues, in some other countries more efforts should be made in order to provide the appropriate information to SMEs in terms of transparency and trust. Digitalisation of innovative financial services involves an evolution of the regulatory and supervisory framework to balance the opportunities and risks of the Fintech. Insufficient track-records can have negative impact on trust.

Part 2 – Member States' good practices on SME access to finance policies

This section describes Member States' good practices on a number of selected policy areas. They are the outcome of a selection of responses given to a consultation with Member States, with a focus on a few major areas: fiscal policies, legislative initiatives, public financing programmes, initiatives to give SMEs a second chance to be financed, policies to improve SME's investment readiness and financial awareness. A selection of three good practices per each item is provided.

2.1 Fiscal policies in the area of SME financing – selected good practices

Belgium

The Belgian corporate income tax was reformed in 2017. This recent law reform decreases the standard corporate income tax rate from 33.99% to 29.58%, as from 2018. For SMEs, a reduced corporate income tax rate of 20.4% is applied to the first EUR 100.000 of income. Any taxable income exceeding EUR 100.000 becomes subject to the standard corporate income tax rate of 29.58%. To benefit from the preferential tax treatment on the first EUR 100.000 of income earned, SMEs must ensure that an annual remuneration is paid to at least one of the company's directors. The annual remuneration should at least be EUR 45.000 (if the company's taxable base exceeds EUR 45.000), or an amount equal to the company's taxable base (if the company's taxable base is below EUR 45.000). The minimum remuneration is not required during the first four years for SMEs to benefit from the reduced corporate income tax rate. Starting in 2020, the standard corporate income tax rate will be further reduced to 25%.

France

The Government introduced in 1994 an income tax discount, "IR PME", for cash subscriptions to SMEs capital under certain conditions. This income tax discount is currently equal to 18% of the cash injected into SMEs capital, for the SMEs that comply with various conditions related to their activity, age and development phase. Cash subscriptions to SMEs capital are allowed within an annual limit of EUR 18.000 for a single person. Cash subscription exceeding the limit of EUR 18.000 during a year may benefit from the same tax reduction for the next five years up to a limit of EUR 50.000. This fiscal mechanism resulted in an investment of EUR 300 million in SMEs for the year 2017. The average investment ticket per household was EUR 6.719 in 2017.

Slovakia

In 2017 two modifications were introduced, which significantly supported the business environment in Slovakia. The first was the reduction of the corporate tax rate from 22% to 21%. The second was an increase of flat rate expenses for natural persons - entrepreneurs from 40% to 60% - up to EUR 20.000.

Also, a new legal form was introduced - a simple stock company, whose advantage is the need for a low share capital of 1 Euro - making the business accessible to all.

2.2 Legislative initiatives in the area of SME financing – selected good pratices

Germany

Since the 1960's, the ERP-Sondervermögen (ERP special fund) is used to finance promotional programs for SME financing in Germany. To do so, the promotional activities of the Federal Ministry of Economic Affairs and Energy are authorized by the legislative branch on a yearly basis. Accordingly, the German parliament passes the so-called ERP-Wirtschaftplangesetz (ERP-Economic Plan Law) each year. The law sets the frame of SME financing policies by defining the planned funds available to support SME financing. The long-term continuity of this process is an example of a successful legislative initiative as it provides SMEs with the necessary stable and reliable conditions for their investment decisions. For the year 2019, the law approves low-interest loans and equity capital with a total volume of EUR 7.8 billion.

In 2018, the Federal Government expanded the equity financing of the German promotional bank KfW by establishing a new private equity entity of KfW ("KfW Capital"). The aim of the creation of KfW Capital is to have a market-oriented entity which operates autonomously and independently. In 2018 the German Parliament amended the German prospectus law ("Wertpapierprospektgesetz"). Since then, security flotation up to an yearly volume of EUR 8 million can be made without providing a prospectus. Instead, a short handout (max. 3 pages) has to be provided.

Austria

In September 2015, the Austrian Federal Government has adopted the "Alternativfinanzierungsgesetz (AltFG)" and amended the "Kapitalmarktgesetz (KMG)" in order to improve the regulatory framework for alternative financing in Austria. This policy measure focuses on facilitating Crowdinvesting by eliminating existing legal barriers, increasing the threshold for a full capital market prospectus up to EUR 5 million and introducing at the same time standards to ensure investor protection.

The Austrian Federal Government recognizes in its current "Government Programme 2017-2022" the importance of the Austrian Capital Market for improving access to finance for companies -- particularly for later stage and large growth investments. Therefore, the current regulation should be modernized and become more flexible in order to increase the scope of investments and reduce the costs for companies.

With this approach in mind, the Vienna Stock Exchange introduced in June 2018 the new market segment "direct market plus" as a first and easy access to the capital market. This segment addresses particularly SMEs and offers therefore low stock exchange fees and less strict listing requirements.

Finland

The crowdfunding act came into force in Finland in September 2016. The main instruments are the loan and investment based crowdfunding forms. Crowdfunding has gained in significance as a funding source for SMEs and start-ups in recent years. Statistics on crowdfunding have been collected only from 2018 onwards by the Bank of Finland. In 2017, loan and investment-based crowdfunding totalled EUR 76 million and EUR 63 million, respectively.

2.3 Public financing programmes in the area of SME financing – selected good practices

Germany

Digitalization and innovation financing: classical bank rating systems have difficulties in assessing the credit risk of digitalization projects. One reason is that the chances of success of digital projects are difficult to value. In addition, digital investments oftentimes occur in intangible assets. These assets, however, are usually not suited to collateralize loans. Given the negative risk profile of digitalization projects, banks often refuse to provide debt financing. Similarly, fundamental difficulties exist in the area of innovative projects. In light of the insufficient provision of debt financing the Federal Ministry for Economic Affairs and Energy and the state-owned promotional bank KfW have successfully launched two programs specifically designed to provide access to finance for the digitalization of SME. They have been started in July 2017 and are called: "ERP Digitization and Innovation Credit "and "ERP-Mezzanine for Innovation". The latter uses a so-called InnovFin-Guarantee from the Horizon 2020-program/ EFSI. This guarantee program of the European Commission allows KfW to release banks from up to 70% of the credit risk.

INVEST program: In Germany, venture capital market is not fostered by direct tax incentives. Instead, it was introduced a 20% grant (acquisition grant) on the investment of business angels into young innovative companies. Since 2017 a new grant (exit grant) was added, which compensates the capital gains tax on venture investments. Both measures have a very similar effect on the incentive structure of private investors as tax incentives have.

ERP/EIF growth facility (in cooperation with the European Investment Fund): In 2016, the Federal Government launched the EUR 500 million ERP/EIF growth facility. It focuses on more mature start-ups and young innovative companies, which need capital for growth. With this instrument, it is addressed a segment which is still especially underserved in Germany.

High Tech Gründerfonds: with more than 480 assisted companies so far, this Fund is Europe’s most active seed fund, and remains the key instrument for the financing of innovative start-ups. In 2017, HTGF III was launched, with a budget of EUR 319,5 million. Around EUR 100 million of this is private-sector capital which has been raised from some 33 established companies.

Denmark

The Danish Growth Fund is a state-owned investment fund founded in 1992 and has since together co-financed, with private investors, growth in more than 7.300 Danish companies with a total commitment of more than DKK 22.5 billion. The Danish Growth Fund invests in equity and provides loans and guarantees for small as well as medium-sized enterprises in collaboration with private partners and Danish financial institutions. Danish experiences have shown that there is a demand for these programs and they have generated a healthy surplus, thus demonstrating new investment opportunities for private investors that have historically been reluctant to enter into the market of early stage SME financing.

The Netherlands

The Netherlands has six regional development agencies. These are private entities, owned by public shareholders (i.e. the Ministry of Economic Affairs, provinces, cities and universities). Providing growth and venture capital to innovative SME’s is one of their main tasks. In 2017, the regional development agencies were involved in approximately half of all venture capital investments in the Netherlands and in roughly 40% of all growth capital investments.

Another example is DVI and SEED. DVI-I is a fund-of-funds initiative of the EIF and PPM Oost, supported by the Dutch Ministry of Economic Affairs and the Brabantse Ontwikkelings Maatschappij (“BOM”), launched in 2013 to boost equity investments into innovative and/or high-tech early and development stage enterprises in the Netherlands. Using the Seed capital scheme, the Ministry of Economic Affairs and Climate Policy aims to support technical and creative start-ups. The ministry grants capital to investment funds that invest risk capital in innovative entrepreneurs in the technological and creative sector through this scheme. The Netherlands Enterprise Agency is responsible for its implementation.

2.4 Policy initiatives to give SMEs a second chance to be financed – selected good practices

Ireland

The Credit Review Office (CRO) was set up in 2010 as a response to the financial crisis to ensure viable SMEs and farmers in Ireland are getting fair access to credit. It provides a simple, effective review process for Small and Medium Enterprises, including sole traders and farm enterprises, who have had requests for credit refused or existing credit facilities reduced or withdrawn. The review process covers all applications from new loans or restructured credit facilities from EUR 1.000 up to EUR 3.000.000.

The CRO invites applications from borrowers who have had their written applications for credit refused or reduced, or their existing facilities withdrawn, and feel that the bank's decision is unjustified. The review process operates after the borrower has unsuccessfully appealed through the bank's own internal credit appeals process. If an internal appeal is unsuccessful, the Credit Review Office will undertake an independent and impartial re-evaluation of the bank's decision.

The CRO has no regulatory or statutory powers to override bank lending decisions, which are a matter for the internal policy and governance of the banks. The outcome of the review process for the borrower will be an independent and impartial opinion on the credit decision.

If the Credit Review Office's opinion is that the lending could have made within acceptable risk boundaries, the bank will be required to comply with the recommendation or explain to the Credit Review Office why they will not do so. Since 2010, the CRO has had 54% of the banking decisions that were brought to it overturned.

Belgium

The Credit ombudsman was established in 2009 by the federal government. This initiative was a part of the Federal Plan for SMEs. Following the transfer of competences linked to the 2014 state reform, this task is now the responsibility of the regions.

<u>The Flemish Region.</u> In Flanders the credit ombudsman, who is active within the Flanders Innovation & Entrepreneurship, offers free credit mediation to SMEs and independents. The credit mediation scheme is offered in case the credit demand has been (entirely or partially) rejected by financial institutions but also in case of conflicts over existing credits and problems of communication. In 2017 the Flemish credit ombudsman was able to close 120 files, another 32 files were still being processed. The credit ombudsman receives 15 files per month on average. Most files concerned refusals of a new loan. 37% of the requests in 2017 were referred to other financers. If the mediation process could be completed, they found a positive result in 71% of the cases.

The Walloon Region. In Wallonia, Concileo is a credit mediation service set up by the Walloon Government and managed by Sowalfin. Concileo helps Walloon SMEs experiencing difficulties to resume communication with their financial partners. Concileo works in consultation with the relevant banking organizations to identify appropriate solutions whenever possible. Concileo receives on average 50 requests per year and works closely with the « entreprises en rebond » (Recovering Enterprises) scheme in order to provide SMEs with a complete service. Indeed, degraded relationships with financial partners often find their origins in wider difficulties that a SME may be experiencing.

The Brussels-Capital Region. In Brussels, a mediation service is set to be operationalized in 2019 by hub.brussels, the Regional business support agency.

France

Enterprises encountering difficulties with their bank or their credit insurer can request help from the service of the Credit mediation, created in 2008. The mediation services in Paris, assisted by departmental mediators from the Banque de France, assess the eligibility of the requests and contribute to finding a solution between the requesting firms and the financial institutions at local, or if necessary, national level.

In 2017, 1.394 mediations have been set up, assisting 909 enterprises with a total of 11.172 employees and unblocking a total of EUR 193 million of credit. However, the number of requests has decreased in comparison with the average number in previous years, partly due to the economic outlook, as well as to the overall global easing of access to bank financing.

Since the creation of the scheme in 2008, 53.468 enterprises have sought mediation and 61.5% have been successfully mediated. On the whole, the credit mediation scheme has supported 22.470 firms of all sizes, unblocked EUR 6.5 billion in credit, and preserved 403.574 jobs.

In 2015, the Credit mediation has signed an agreement with Finance Participative France, the association of crowdfunding platforms. Firms in mediation will be informed of the possibility to use crowdfunding to address their financing needs, and crowdfunding platforms will inform firms which are not selected on their website that they can turn to the Credit mediation.

2.5 Policy initiatives focused on improving SMEs’ investment readiness and awareness about financial opportunities

Greece

In Greece, it is operational a single digital portal to inform public audience on available financial instruments. The portal was created by the Directorate for the Support of SMEs of the General Secretariat of Industry & SMEs of the Hellenic Ministry for Economy & Development. The web page is client-oriented, provides updated information regarding each financial instrument, and guides SMEs to accredited organisations that provide these various financial instruments in Greece. The website is available at: http://www.ggb.gr/el/node/1040 (in Greek language) and http://www.ggb.gr/en/Finance_SMEs_instruments (in English).

Ireland

The Supporting SMEs Online Tool is a cross-government initiative launched in 2014. It brings together over 170 Government business supports from 30 Departments and Agencies to one simple-to-use website. This Online Guide is to help Irish start-ups and small businesses navigate the range of Government supports. The practical tool can be easily accessed at this link: https://www.supportingsmes.ie/BusinessDetails.aspx

Austria

The new programme "AWS Pitch your Idea" is a so-called "fast-lane" for start-ups to facilitate their access to public funding instruments. Selected young entrepreneurs can present their ideas and business models directly to public funding experts from AWS - the national promotional bank of Austria. They immediately receive feedback and are informed about possible funding solutions.

Conclusion

This report is the outcome of a process that started in 2018 through a call by the SME Envoys Network to conduct further research on SME access to finance. The European Commission followed up to that request and, in collaboration with the Dutch Ministry of Economic Affairs and Climate Policy, asked SME financing experts from each EU country to provide insights on the SME access to finance situation in perspective, by filling in a survey aimed at assessing the situation in each country.

Replies to the consultation have been summarised in a draft report that was subsequently validated through a meeting among financing experts in May 2019. The outcomes were presented at the following SME Envoy meeting in June 2019 in Stockholm, where the combined results of both the report and the expert meeting were discussed within the plenary SME Envoys group, with the aim of sharing common issues and best practices on SME access to finance at the highest level.

The report highlights that, in the majority of EU countries, access to bank finance is showing less constraints than in the aftermath of the crisis, however major gaps still exist especially for start-ups and smaller companies who lack proper collateral. Alternatives to bank finance are developing, especially in some Member States. Among those, venture capital seems to be maturing in many countries, crowdfunding is still in its developing phase, while some other traditional tools like factoring and leasing are widely used in many countries. On the other hand, bond issuances, access to debt funds and IPOs are less a relevant option for SMEs in most of EU Member States.

Challenges still exist for SMEs accessing different sources of finance. Banks are constrained by the low interest-rate policy, regulatory burden and, in some countries, the size of Non-Performing Loans. Alternative sources of finance also present challenges: the small size of EU venture capital funds is a hurdle for institutional investors, while crowdfunding markets face regulatory issues, such as fragmentation between national regimes.

Member States are putting in place various initiatives in the field, by using all the leverages in their hands: fiscal policies, regulation, public financing programmes, soft measures aimed at improving SMEs' financial awareness.