



EUROPEAN CENTRAL BANK

EUROSYSTEM

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(ECB)**

# **SMEs and Young Growth Firms in the Euro Area: How Monetary and Investment Policies Support Their Financing**

Venice  
7 October 2016

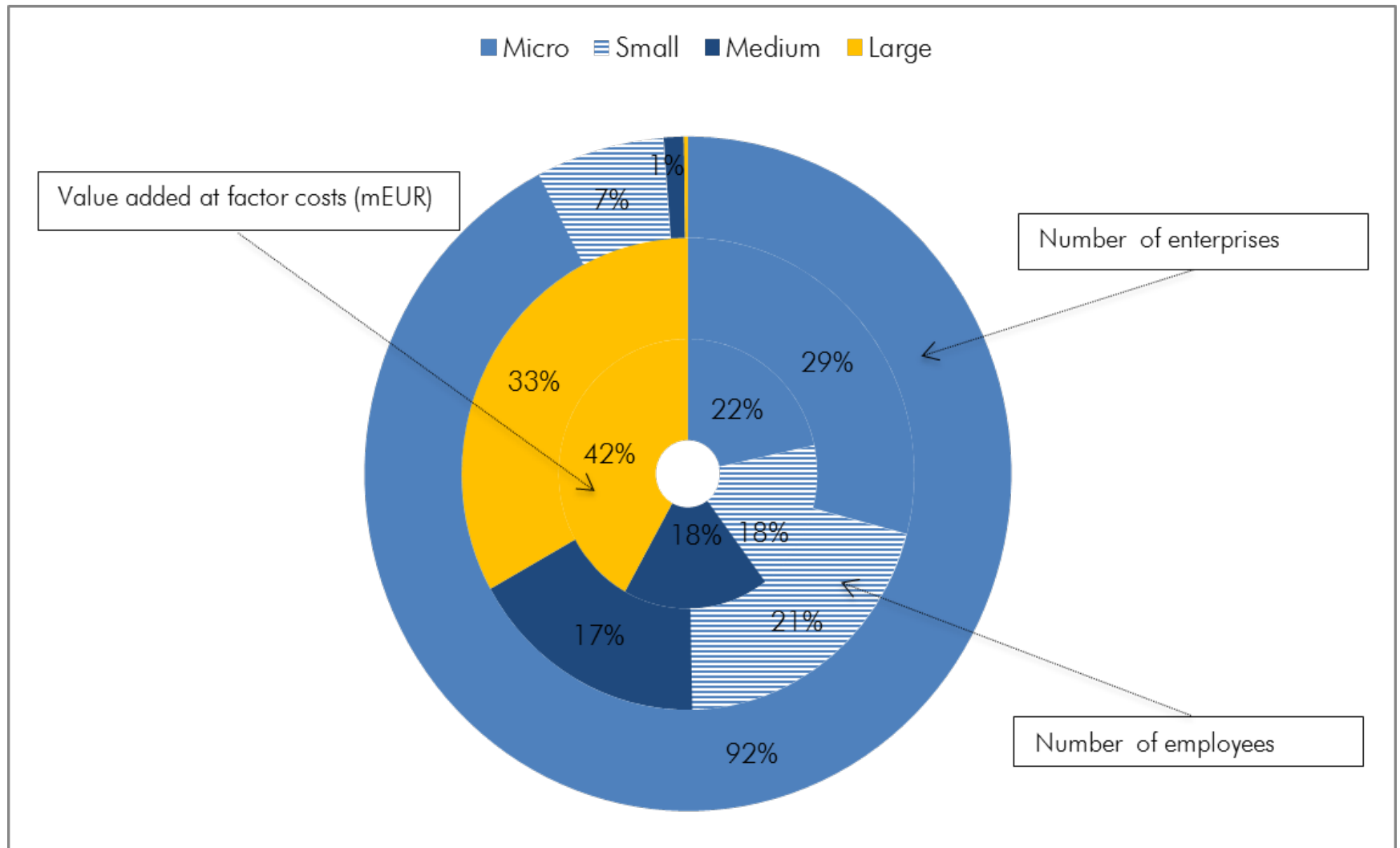
Keynote Speech at the 15<sup>th</sup> International C.R.E.D.I.T.  
Conference

**Disclaimer: Any views expressed are the speaker's own and should not be regarded as views of the ECB or the Eurosystem.**

1. The role of SMEs and young innovative firms in Europe and the world
2. Financing situation of SMEs and young growth firms in the euro area
3. What monetary policy can contribute to alleviating financial constraints of SMEs and young growth firms in the euro area
4. European policy initiatives for supporting the financing and investments of SMEs and young growth firms
5. Concluding remarks
6. Annex

# **1. The role of SMEs and young innovative firms in Europe and the world**

# SMEs are the backbone of the EU economy (and of other economies)



Source: Kraemer-Eis et al. (2014), based on data from Eurostat.

## ❑ Haltiwanger et al. (2013):

- **Using US data find an important role of startups and young businesses in job creation**

## ❑ Lawless (2013):

- **Using Irish data finds disproportionate contribution of small firms in job creation mainly driven by younger firms (entrants being most important)**

## ❑ Banerjee (2014):

- **Not only are young firms key contributors to employment growth, but also key contributors to profit growth**

## ❑ Criscuolo et al. (2014):

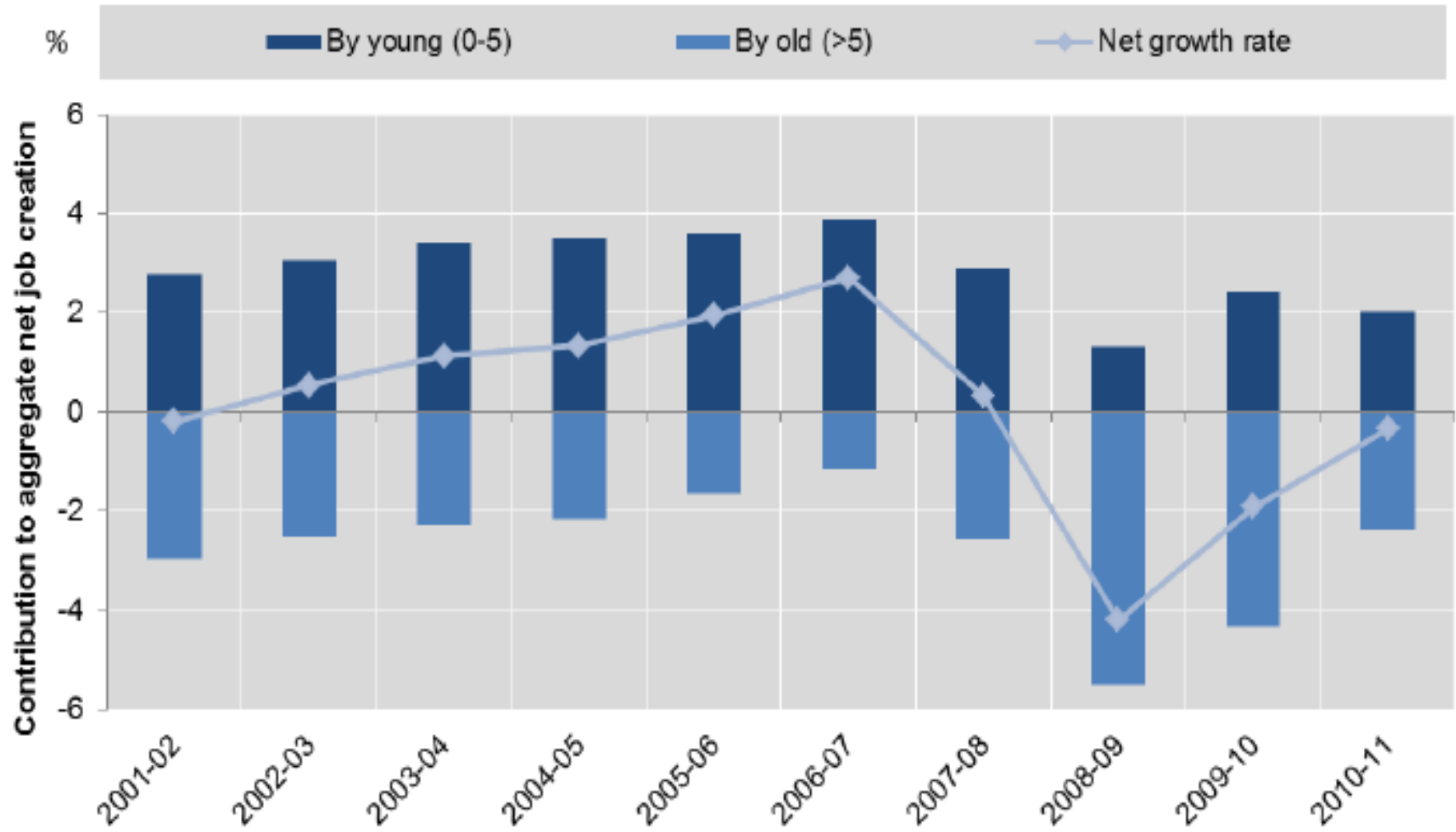
- **Using 18 OECD countries they find that young SMEs are always net job creators throughout the business cycle (see next slide)**

## ❑ Decker et al. (2015):

- **However, find that since about 2000 the share of young firms is declining in the US and so is their propensity to grow fast**

# Young SMEs are main contributors to net employment growth

Contributions to aggregate net job creation by firm age

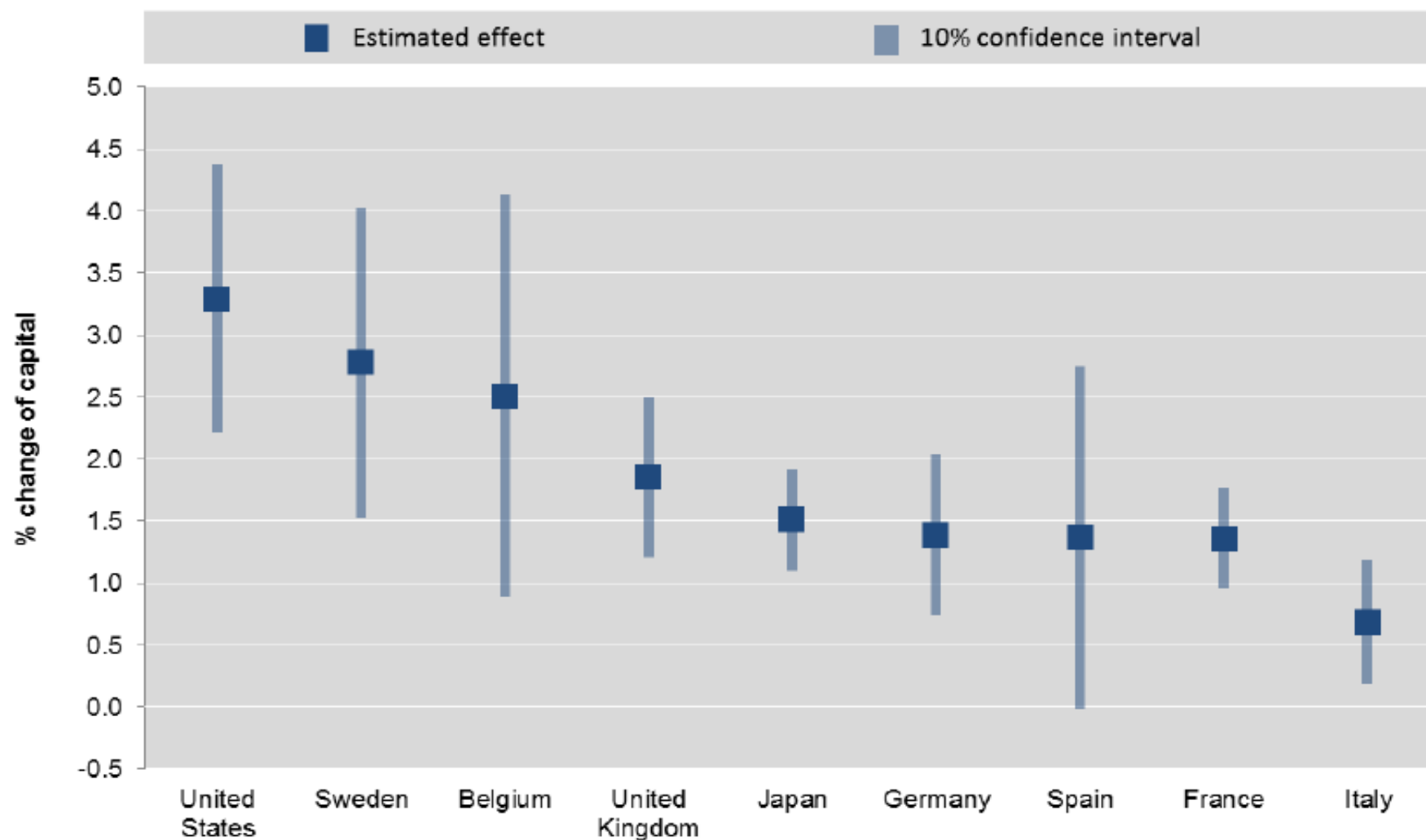


Source: Criscuolo et al. (2014).

- ❑ SMEs that tend to create jobs are
  - young
  - innovative
  - internationally active
  - located in urban areas and
  - run by skilled managers
- ❑ Have active growth and investment strategies and possess the capacities to implement these plans (Eurofound 2016)
  
- ❑ Europe has less of an “entrepreneurial innovation model” than the United States
- ❑ Much of our innovation takes place in large and well-established corporations and less in young firms
  - Innovative SMEs in Europe are still creating employment, but they do not create as “disruptive” innovations (the second component of “creative destruction”) as their US peers

# Sizeable cross-country differences in investment of young innovative firms

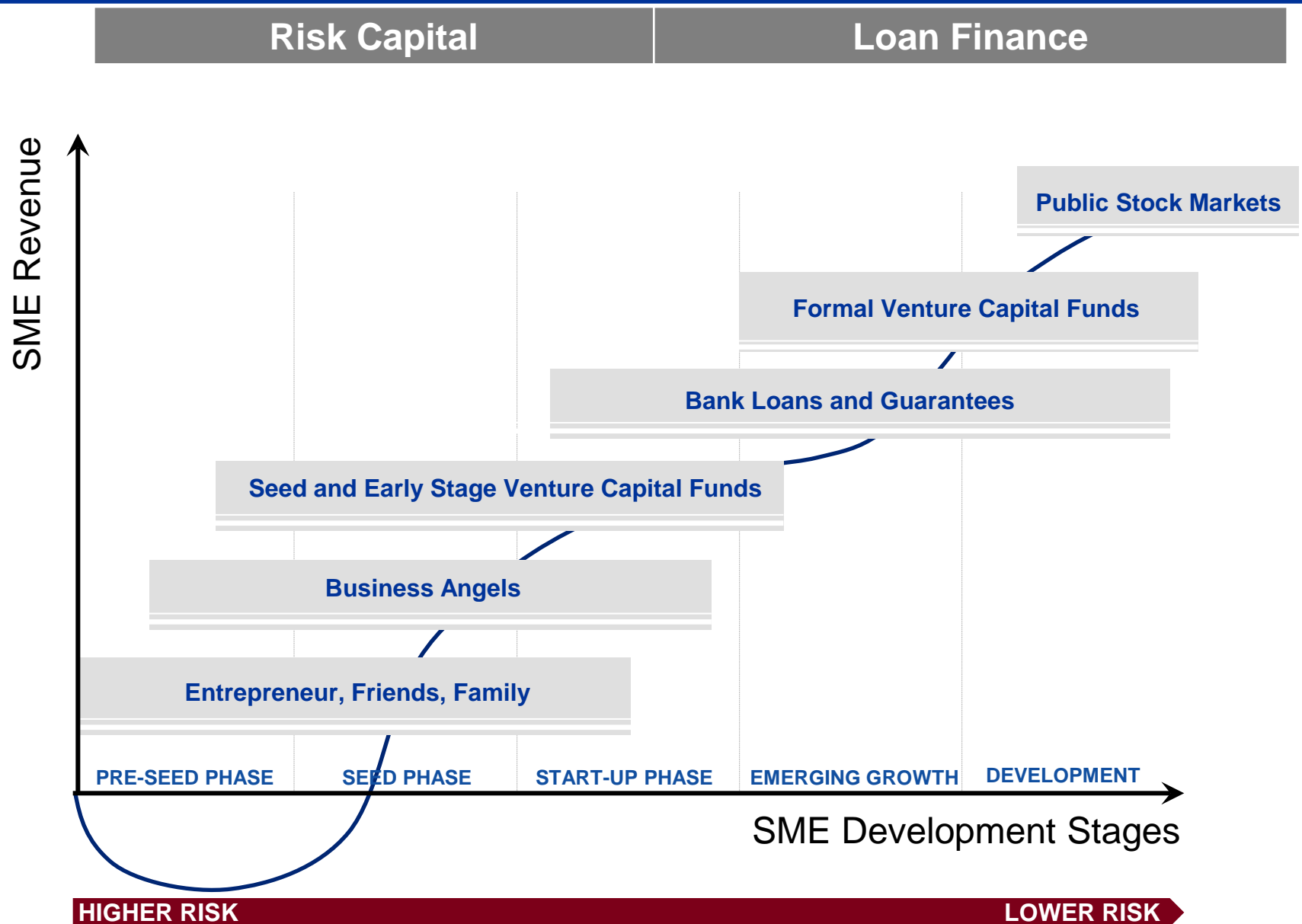
Change in capital stock associated with a 10% change in patent stock, selected OECD countries (2003-2010)



Source: Andrews et al. (2014).

## **2. Financing situation of SMEs and young growth firms in the euro area**

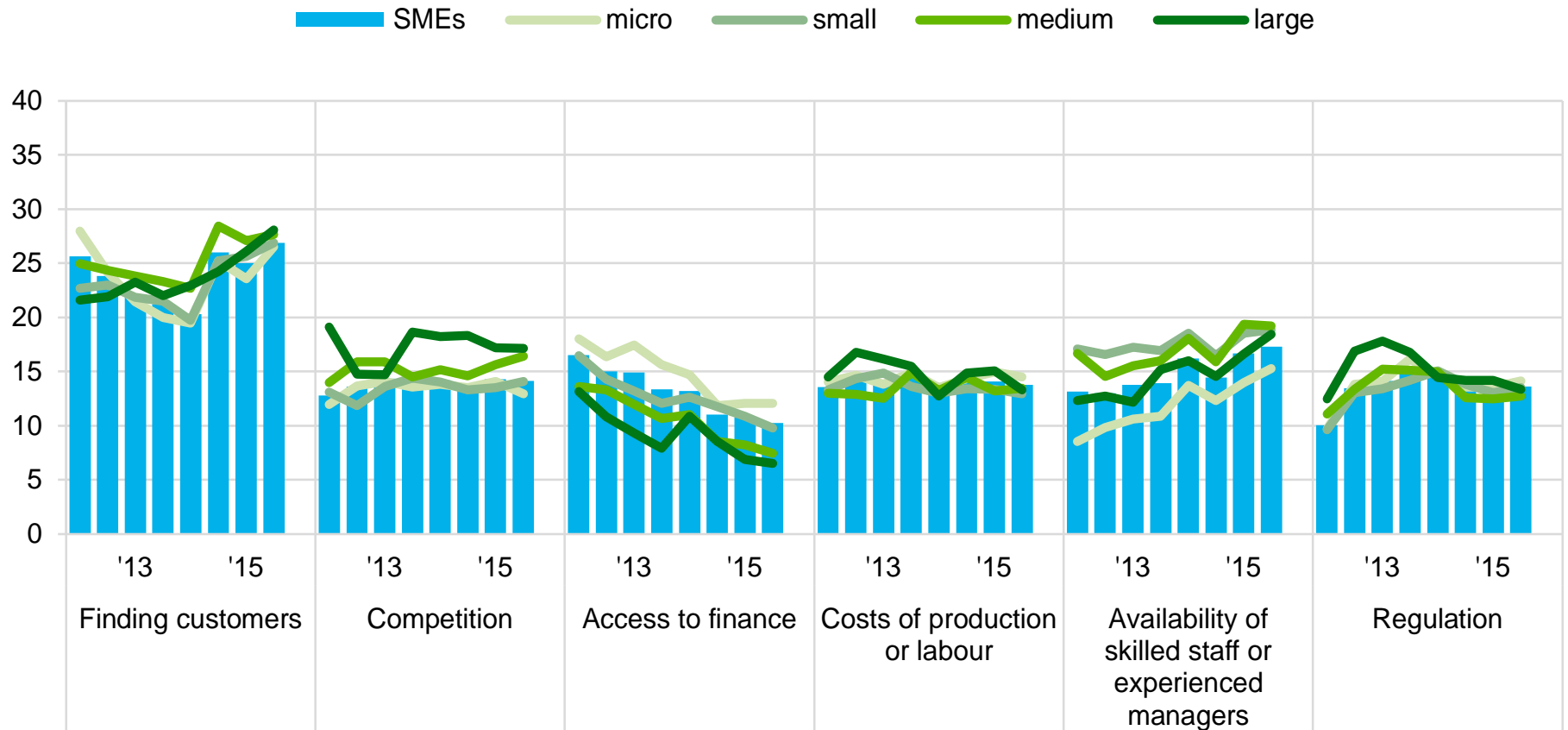
# “Risk capital” is the most relevant funding for young SMEs



- Angelini and Generale (2008):
  - **Using survey data for Italian firms find that financial constraints are relatively more frequent among young than among small firms**
  
- Ferrando and Grieshaber (2011):
  - **Using SAFE data find age and ownership to be important explanatory variables for euro area firm's perceived financing obstacles**
  
- ECB (2016):
  - **SAFE suggests firms of four years or below perceive greater financing constraints than firms older than that (see annex slide)**
  
- Kerr and Nanda (2015):
  - **Financing constraints can be considerable for firms engaged in R&D and innovation and capital structure plays a role for outcomes**
  
- Banerjee (2014):
  - **Policy initiatives which aim at easing financing constraints for start-ups could play an important role in boosting economic growth**

# But finance has recently become the least pressing problem for euro area SMEs

The most pressing problems faced by euro area SMEs  
(percentage of respondents)

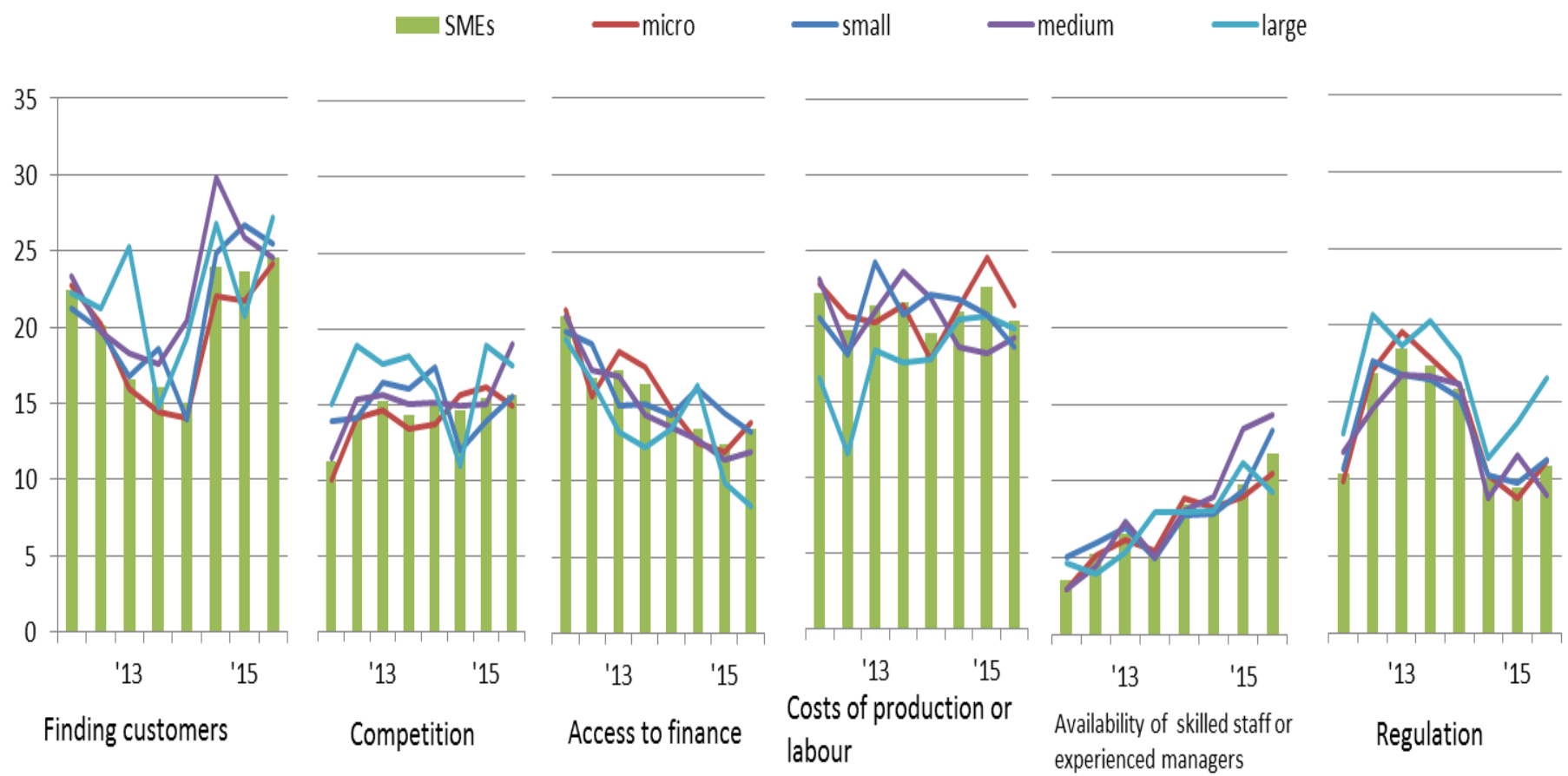


Source: ECB (2016).

Base: All SMEs in ECB and European Commission Survey on Access to Finance of Enterprises (SAFE). Figures refer to rounds 7 (April-September 2012) to 14 (October 2015-March 2016) of the survey.

# In Italy labour and production costs high and access to finance more difficult

**The most pressing problems faced by Italian SMEs**  
(percentage of respondents)



Source: ECB (2016).  
Base: All SMEs in ECB and European Commission Survey on Access to Finance of Enterprises. Figures refer to rounds 7 (April-September 2012) to 14 (October 2015-March 2016) of the survey.

### **3. What monetary policy can contribute to alleviating financial constraints of SMEs and young growth firms in the euro area**

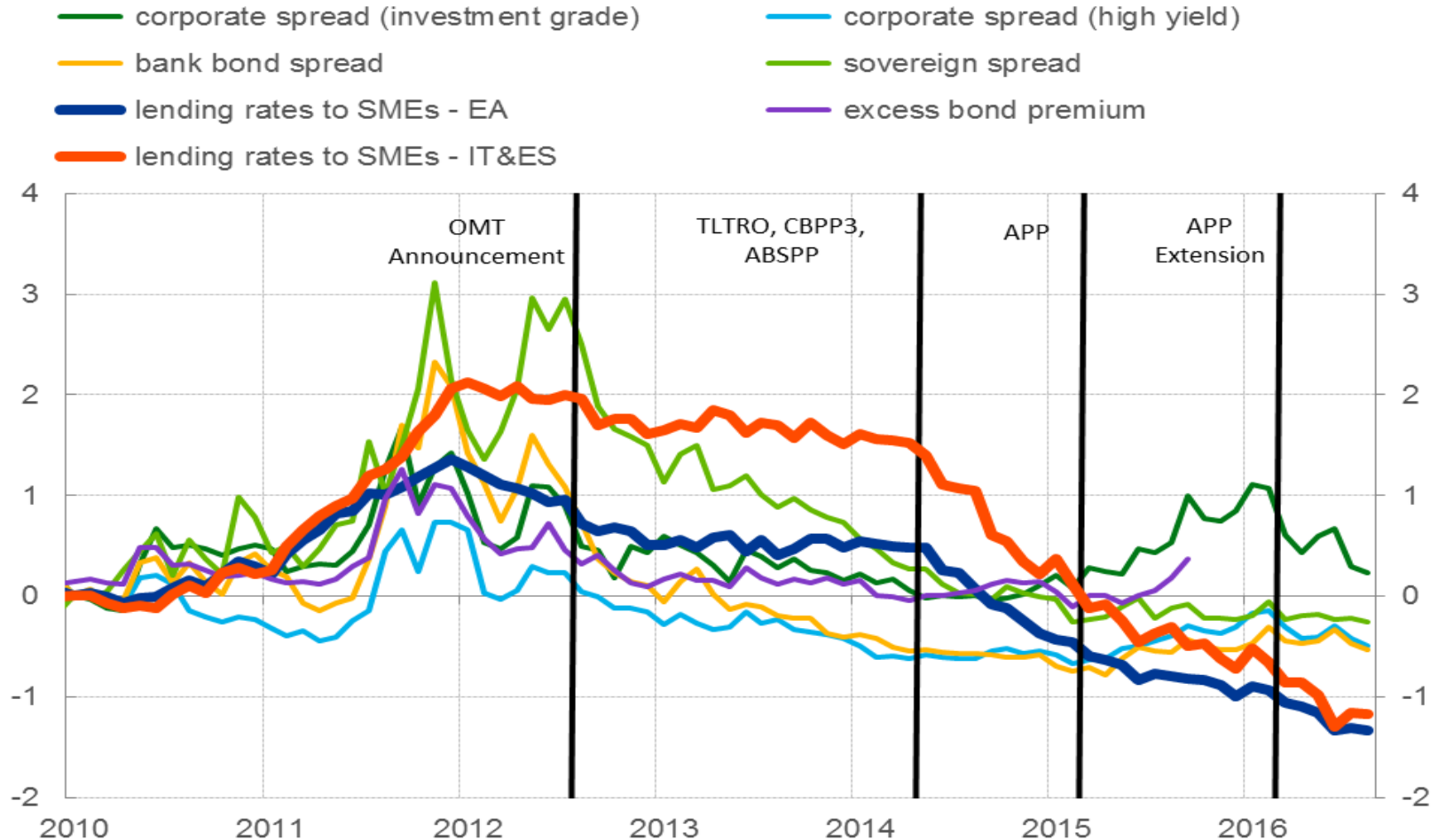
## Monetary policy can help alleviate

- ❑ Demand-side constraints: Low interest rates stimulate aggregate demand and make borrowing easier
- ❑ Credit supply constraints: Expansionary conventional and unconventional monetary policy reduces pressure on bank balance sheets to stimulate lending

# ECB monetary policy made a major contribution to reducing financing costs...

## Measures of risk compensation

(units of standard deviations distance from January 2010)



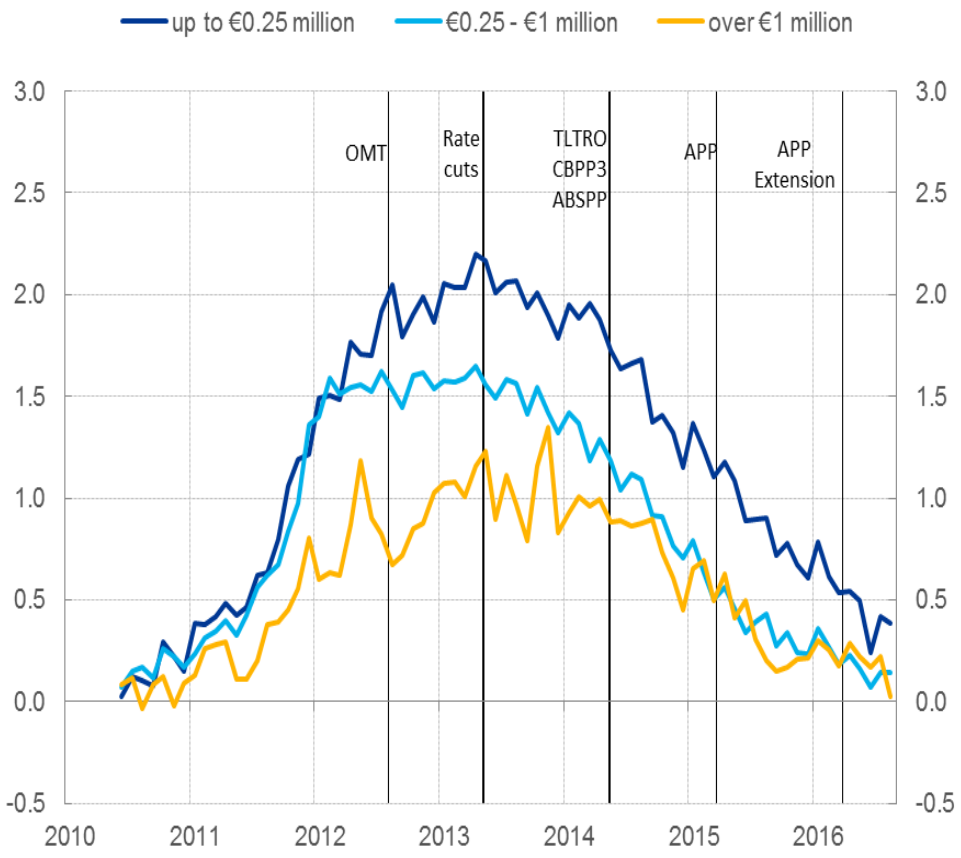
Notes: Spreads are with respect to OIS rates; Lending rates to SMEs refer to rates on loans up to 1 million EUR; The aggregated rate for IT&ES is weighted by the corresponding new business volumes.

Latest observation: September 2015 for excess bond premium and August 2016 for all other series.

Sources: Thomson Reuters, ECB and ECB calculations.

# ...including to reducing rates on small and medium-size bank loans (“SMEs”)

## Composite rates on small, medium and large bank loans: spread between Group A and Group B countries (annual percentage changes)



- Ferrando et al. (2016a):
  - With the European sovereign debt crisis firms in stressed countries became more likely to be credit constrained
  - But the same did not apply to less creditworthy firms

- Ferrando et al. (2016b):
  - Following the ECB’s OMT announcement credit access of SMEs borrowing from banks with high exposure to impaired sovereign debt improved

Notes: Based on a fixed sample of 10 countries; Group A countries are IE, ES, IT and PT; Group B countries are BE, DE, FR, NL, AT and FI; No data are available for GR and LU; Within each country group, national rates are aggregated using 24-month moving averages of new business volumes as weights; At the beginning of the sample weights are fixed at the first computable value.  
Sources: ECB and ECB calculations.

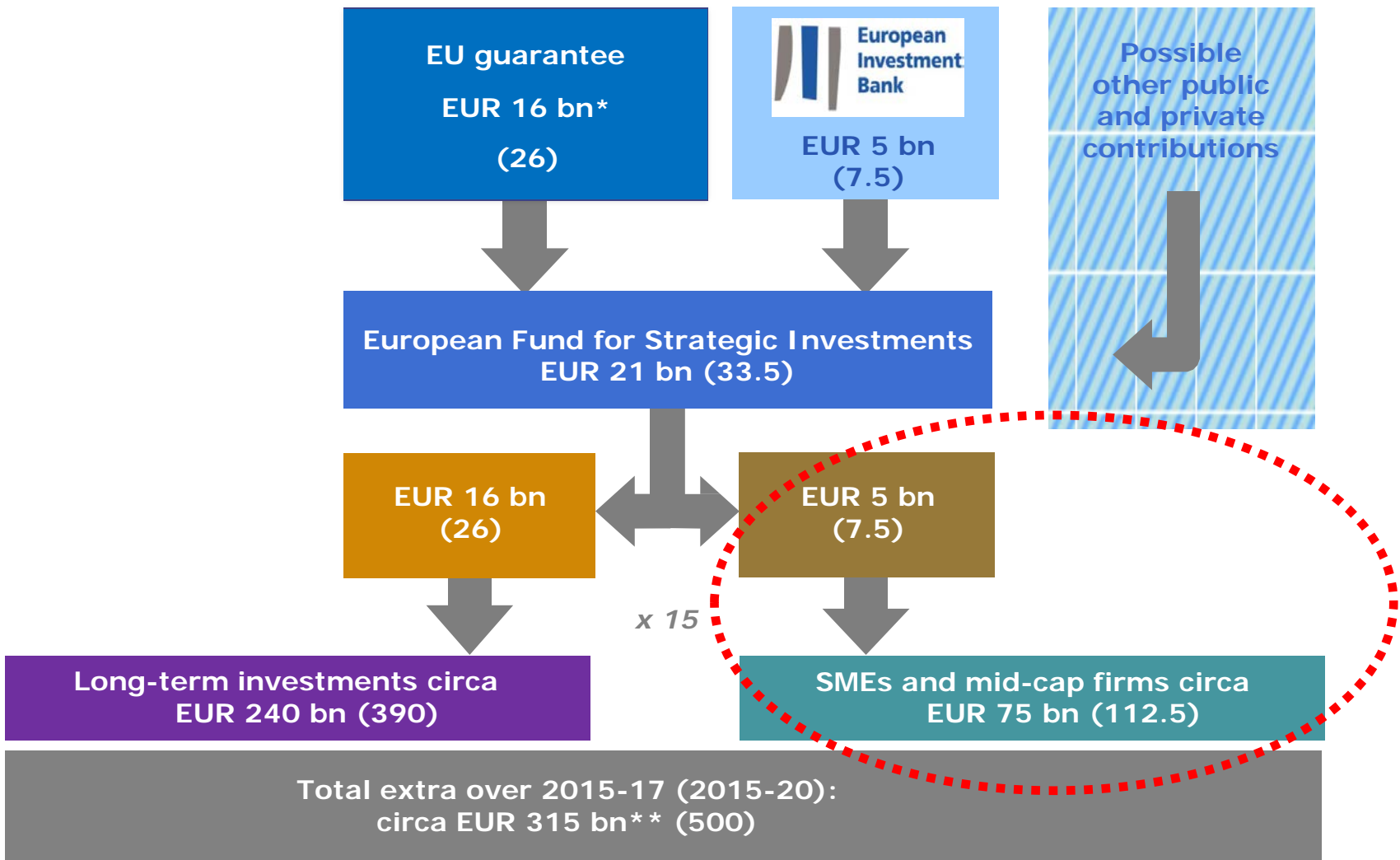
## **4. European policy initiatives for supporting the financing and investments of SMEs and young growth firms**

# Many European countries have a series of programs supporting SMEs

Policy response \ countries	AT	BE	EE	ES	FI	FR	DE	GR	IE	IT	NL	PT	SK	SI
Government loan guarantees	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Special guarantees and loans for start ups	X		X				X				X			
Government export guarantees, trade credit	X	X	X	X	X		X	X			X			
Direct lending to SMEs	X	X	X	X	X	X	X	X	X			X	X	X
Subsidised interest rates				X			X					X		
Venture capital, equity funding, business angel support	X	X	X	X	X	X	X	X	X		X	X	X	
SME banks						X						X		
Business advice, consultancy					X		X				X			
Tax exemptions, deferments		X		X	X					X				
Credit mediation/review/code of conduct		X		X		X	X							
Bank targets for SME lending									X					

Source: OECD (2015) and ECB elaboration based on internal questionnaires to NCBs.

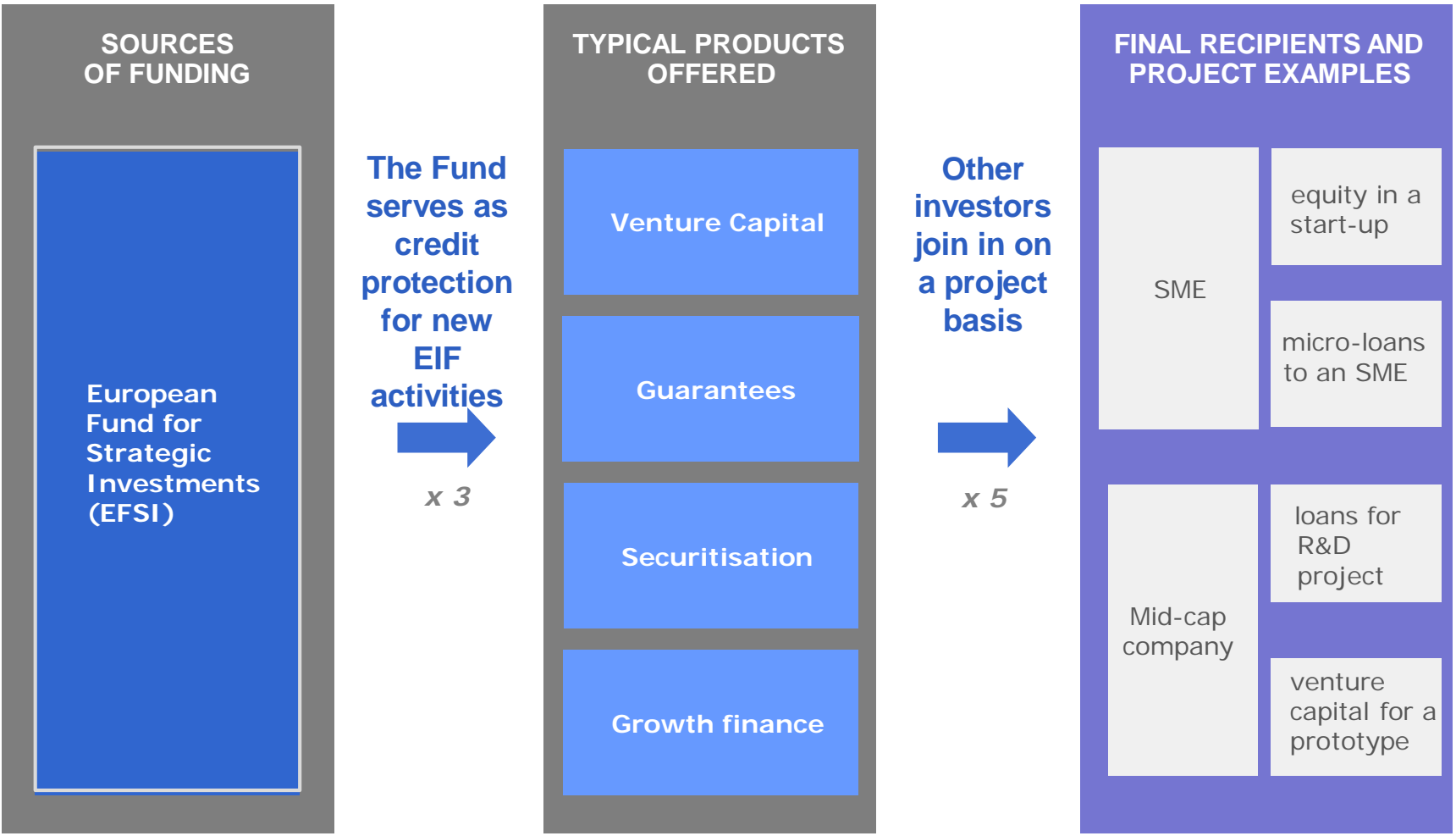
# Investment Plan for Europe (“Juncker Plan”)



Notes: \* 50% guarantee = EUR 8 bn from Connecting Europe Facility (3.3), Horizon 2020 (2.7) and budget margin (2); \*\* Net of the initial EU contributions used as guarantee: EUR 307 bn; numbers in the figure in parentheses refer to the proposal by the European Commission (2016b) to increase the size of the plan.

Source: EC (2014) and ECB staff based on EC (2016b). 20

## SMEs and mid-cap



EUR 1 of public contribution => circa EUR 3 of financing => EUR 15 of total investment

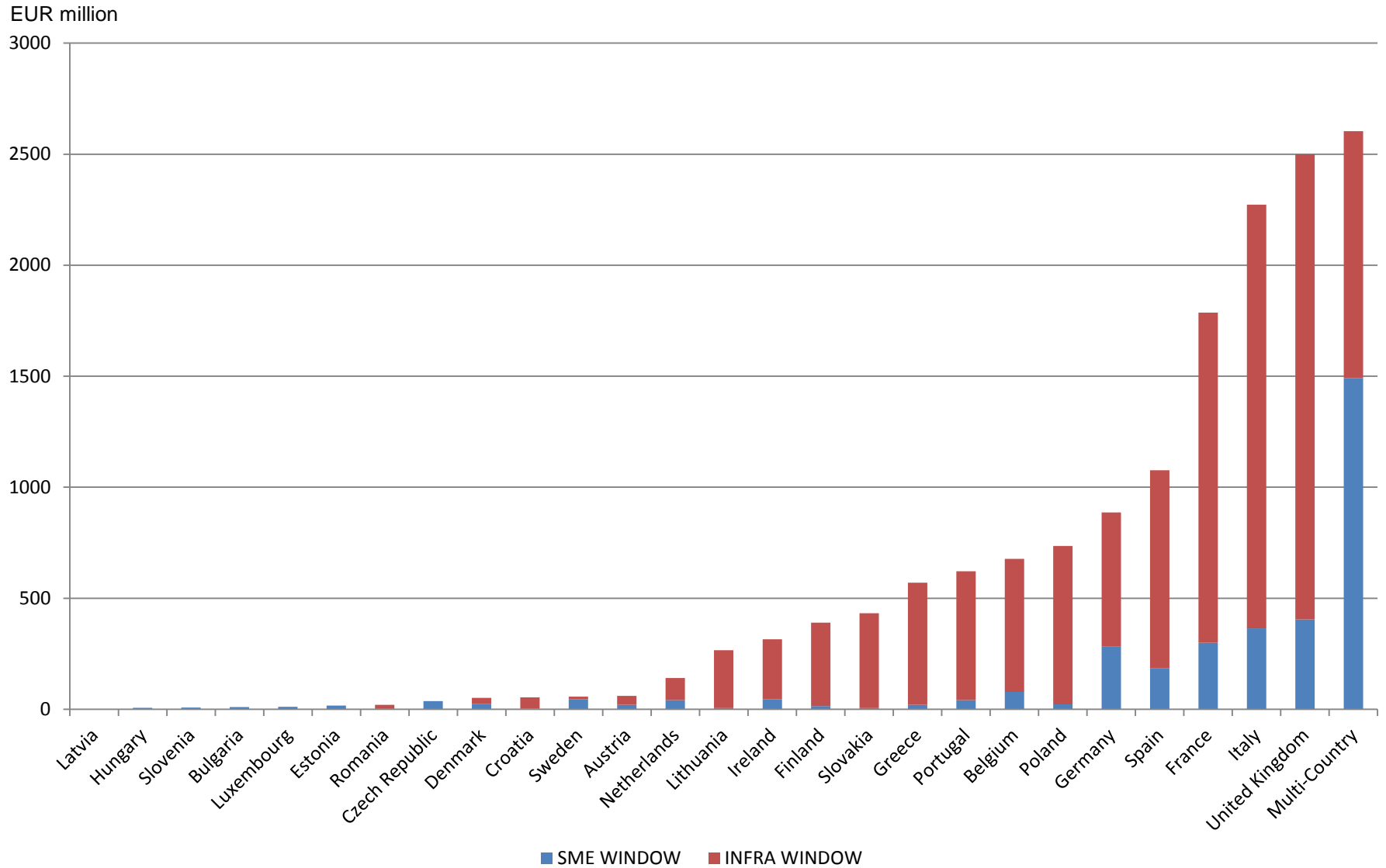
Source: EC (2014).

# Current overall progress of the Juncker Plan

	Number	Financing under the EFSI	Total expected investment triggered
<b>Infrastructure and innovation projects approved</b>	<b>97</b>	<b>€13.6 billion</b>	<b>€115.7 billion</b>
<b>SME financing agreements approved</b>	<b>192</b> agreements benefitting more than <b>200,000</b> start-ups, SMEs and mid-caps	<b>€6.8 billion</b>	

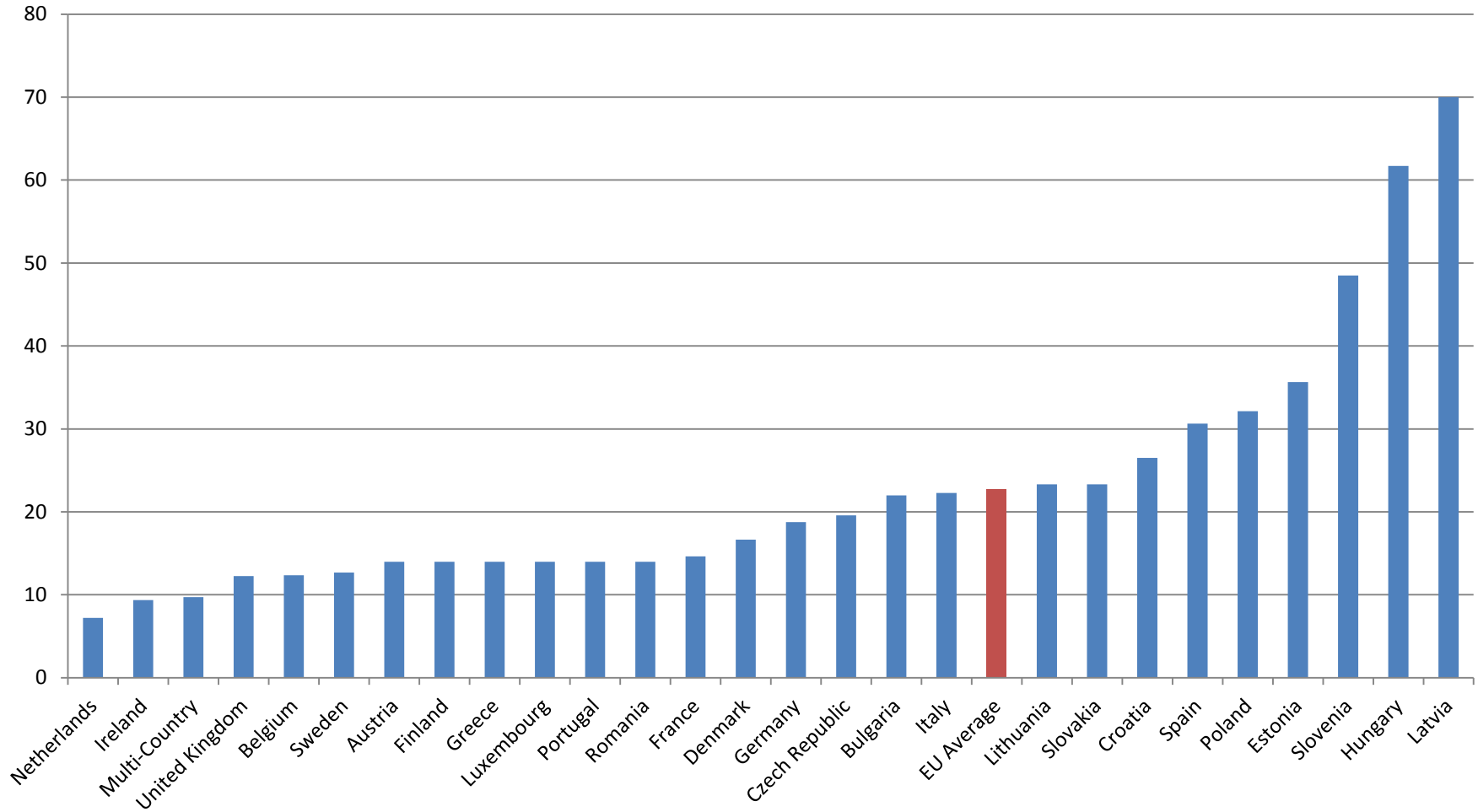
Source: EC (2016a).

# Current progress of the Juncker Plan: Country breakdown of approved financing



Source: ECB calculations based on 2016 EIB data.

## SME window



Notes: Leverage ratios are computed as the ratio of total expected investment triggered and total financing under the European Fund for Strategic Investment.

Source: ECB calculations based on 2016 EIB data.

## **5. Concluding remarks**

- ❑ Young, innovative SMEs are key drivers of growth and employment in Europe and elsewhere
  - Aggregate demand still remains low, finding customers major obstacle faced by euro area SMEs
  - Availability of skilled staff or experienced managers is diminishing
  - But access to finance problems have diminished and are presently euro area SMEs' least important concern!
  - Also material cross-country differences (Italian SMEs: labour and production costs perceived to be higher than in the euro area and access to finance somewhat lower)
- ❑ Various policies address SME financing problems (alongside recovery)
  - Monetary policy had an important impact
  - European and country-level financing support initiatives (Juncker Plan recently proposed to be extended, in particular SME window)
  - Future: Parts of the Capital Markets Union (and Banking Union)

- ❑ Given the favourable financing conditions but difficult customer situation and skill shortages, further policy considerations are advisable
  - Maintaining demand stimulus
  - Training, education, skill matching and managed immigration
  - Structural reforms improving the environment for small businesses
- ❑ I have not addressed many highly relevant issues for the well-functioning of SMEs and young innovative firms today
  - Flexibility of product and labour markets
  - Structural change from manufacturing to services
  - Interaction between universities and innovative firms
  - Adoption of existing (information and communication) technology
  - Secular stagnation scenarios/productivity slowdowns
  - Broader issues of legal efficiency and corporate governance
  - Education and managerial capabilities
  - Cultural differences across countries
  - etc.

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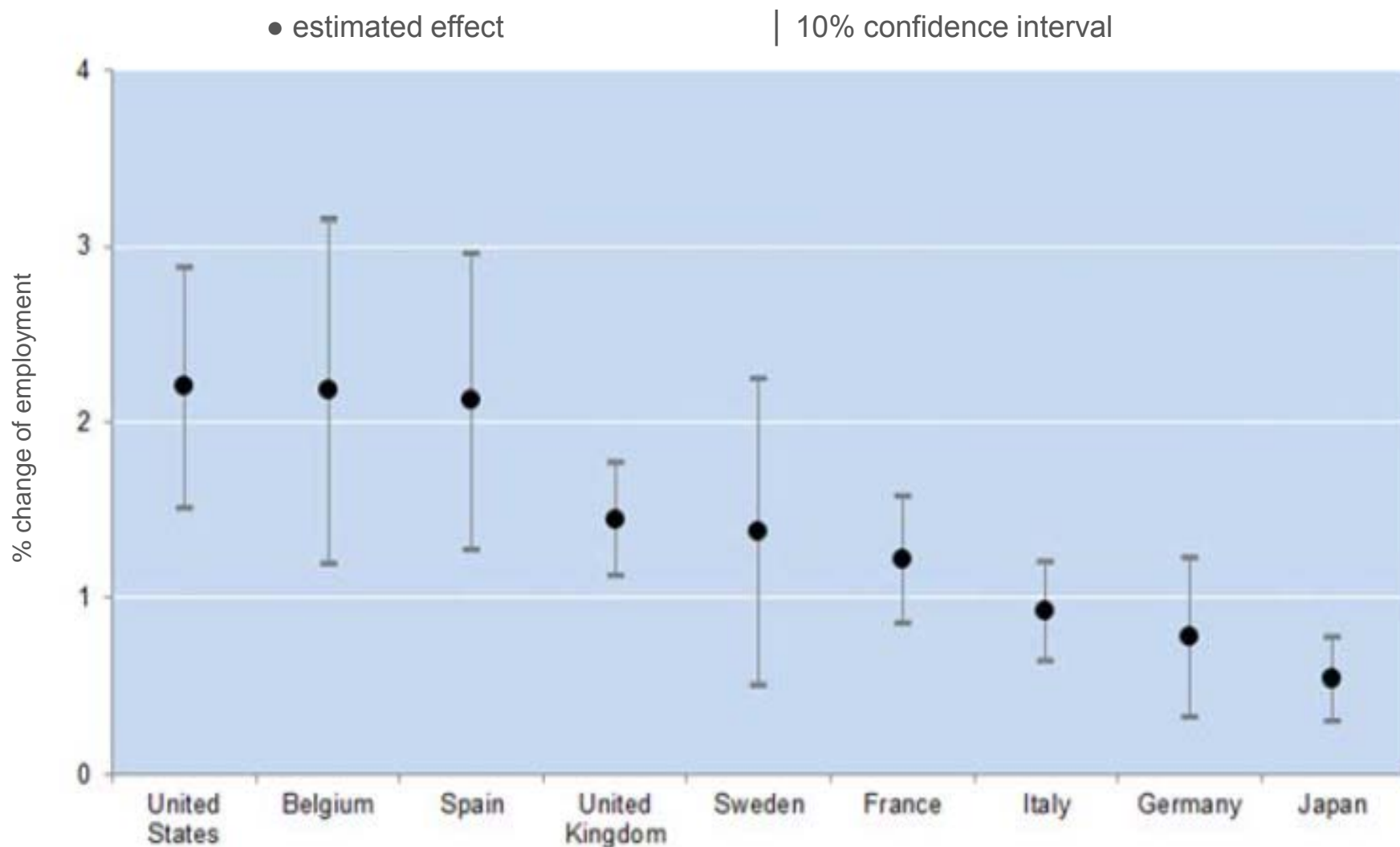
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## 6. Annex

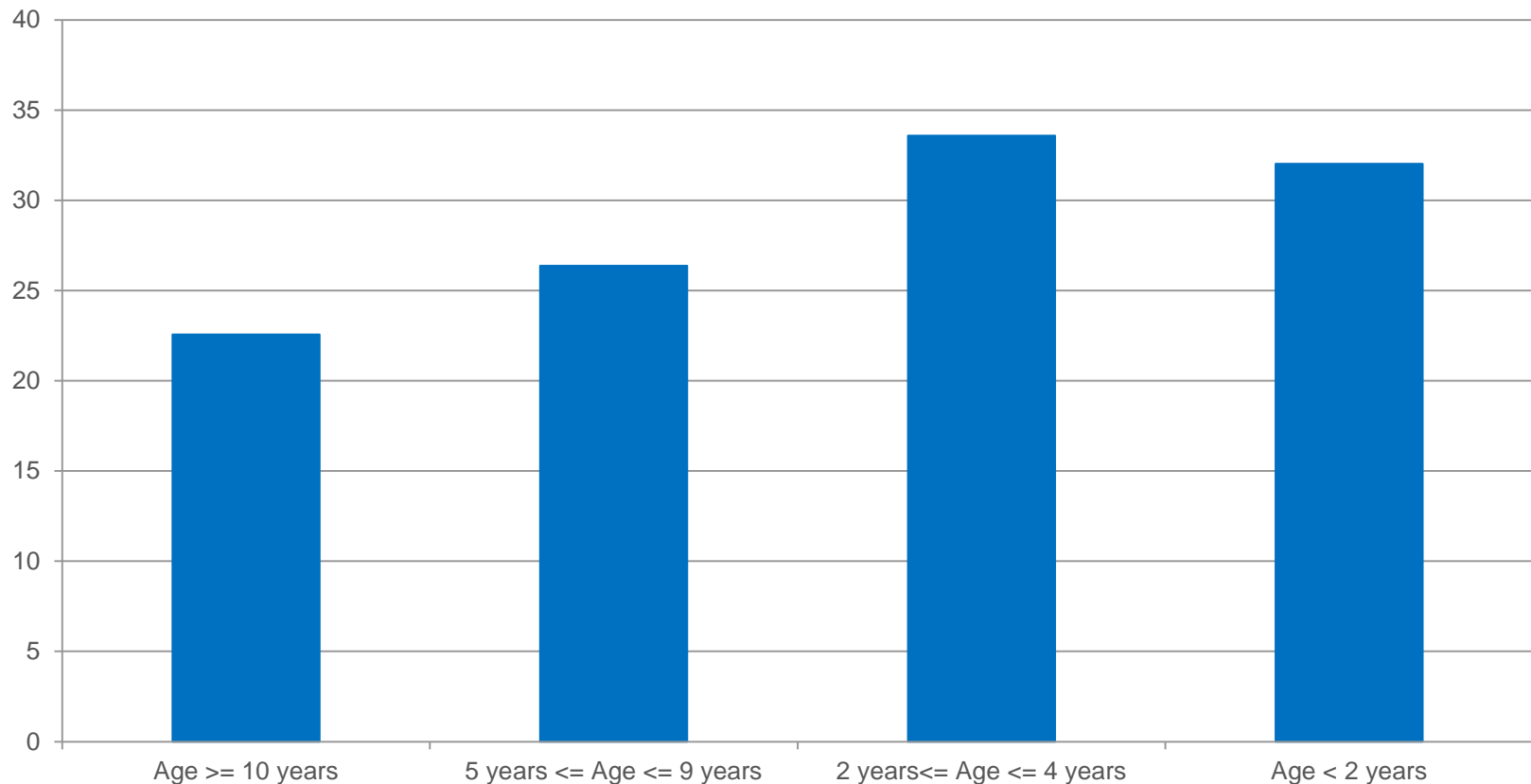
# Cross-country differences in employment growth of young innovative firms

Change in employment associated with a 10% change in patent stock, selected OECD countries (2003-2010)



# In the euro area SMEs below four years of age are more constrained

**Financially constrained SMEs**  
(percentage of respondents that reported being financially constrained)

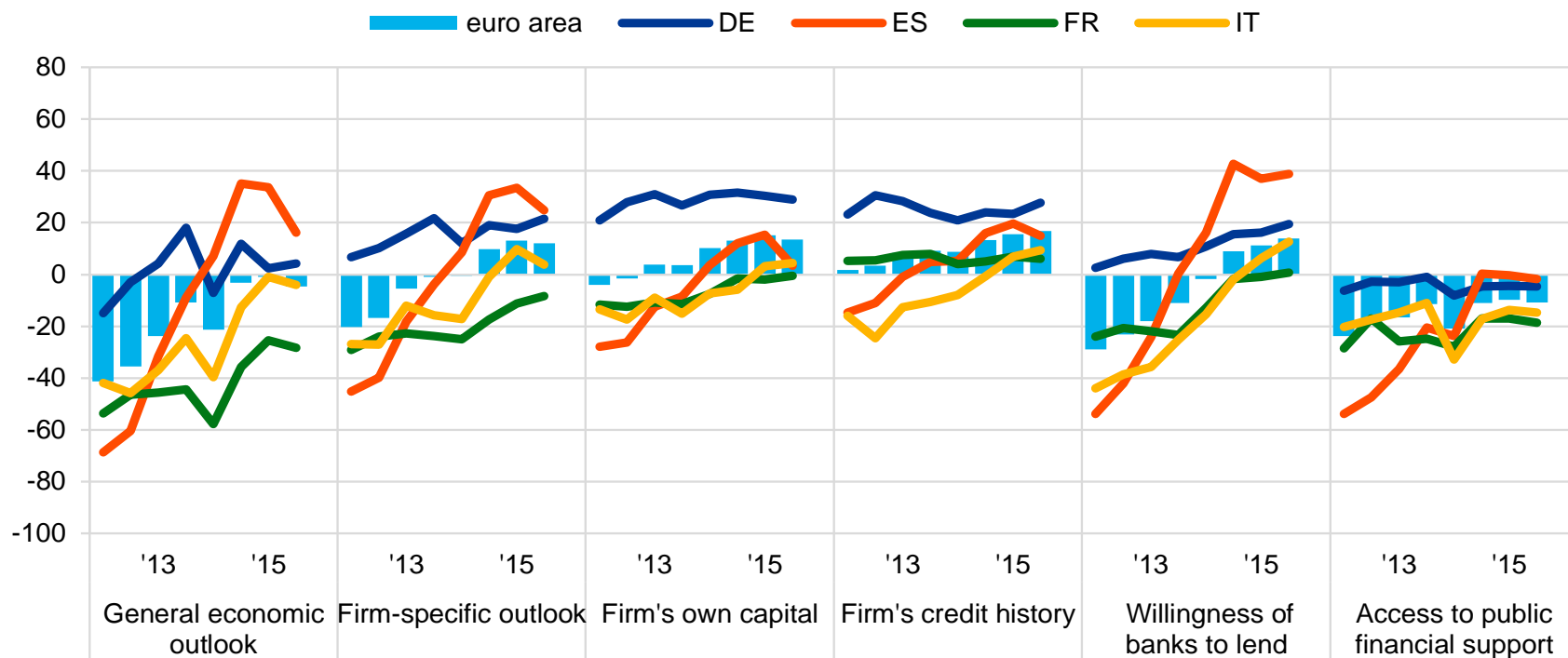


Source: ECB (2016).

Base: All SMEs in ECB and European Commission Survey on Access to Finance of Enterprises (SAFE). Figures refer to round 14 (October 2015-March 2016) of the survey.

# Factors influencing finance availability have improved in the last few years

## Changes in factors having an impact on the availability of external financing to euro area SMEs (over the preceding six months; net percentage of respondents)



Source: ECB (2016).

Base: All SMEs in ECB and European Commission Survey on access to finance of enterprises. Figures refer to rounds 7 (April-September 2012) to 14 (October 2015-March 2016) of the survey.

# ...also at EU level various initiatives already exist

## What is available

## Who is eligible for EU Funding?

Programme	Type	Amount	Focus	Size of the company		
				Micro	SMEs	Small mid-caps
Social Change & innovation	Microfinance	<€25k	Micro-enterprises	✓		
	Investments	<€500k	Social enterprises	✓	✓	
COSME	Guarantees		General	✓	✓	
	Equity		Growth, expansion stage	✓	✓	
Creative Europe	Guarantees		Cultural and creative sector	✓	✓	
InnovFin (Horizon 2020)	Guarantees	€25k-€7.5m	Research, development & innovation	✓	✓	✓
	Equity		Start-up, early stage	✓	✓	✓
Private Finance for Energy Efficiency	Loans	<€5m	Energy efficiency	✓	✓	✓
Natural Capital Financing Facility	Loans, equity	€5m-€15m	Preservation of natural capital, climate change	✓	✓	✓
EIB, EIF, European structural and investment funds	Loans, guarantees, equity		General	✓	✓	✓

Source: ECB based on European Commission, European Investment Bank and European Investment Fund data.

## ❑ COSME (Competitiveness of Enterprises and SMEs)

- Aims at facilitating SMEs' access to finance in all stages of their life cycle (creation, expansion or transfer)
- Runs from 2014-2020
- Budget EUR 2.3 billion

## ❑ InnovFin (as part of Horizon 2020)

- Aims at supporting research and innovative projects of firms (small and large)
- Runs from 2014-2020
- Budget EUR 24 billion for supporting EUR 48 billion of investment (SMEs less)

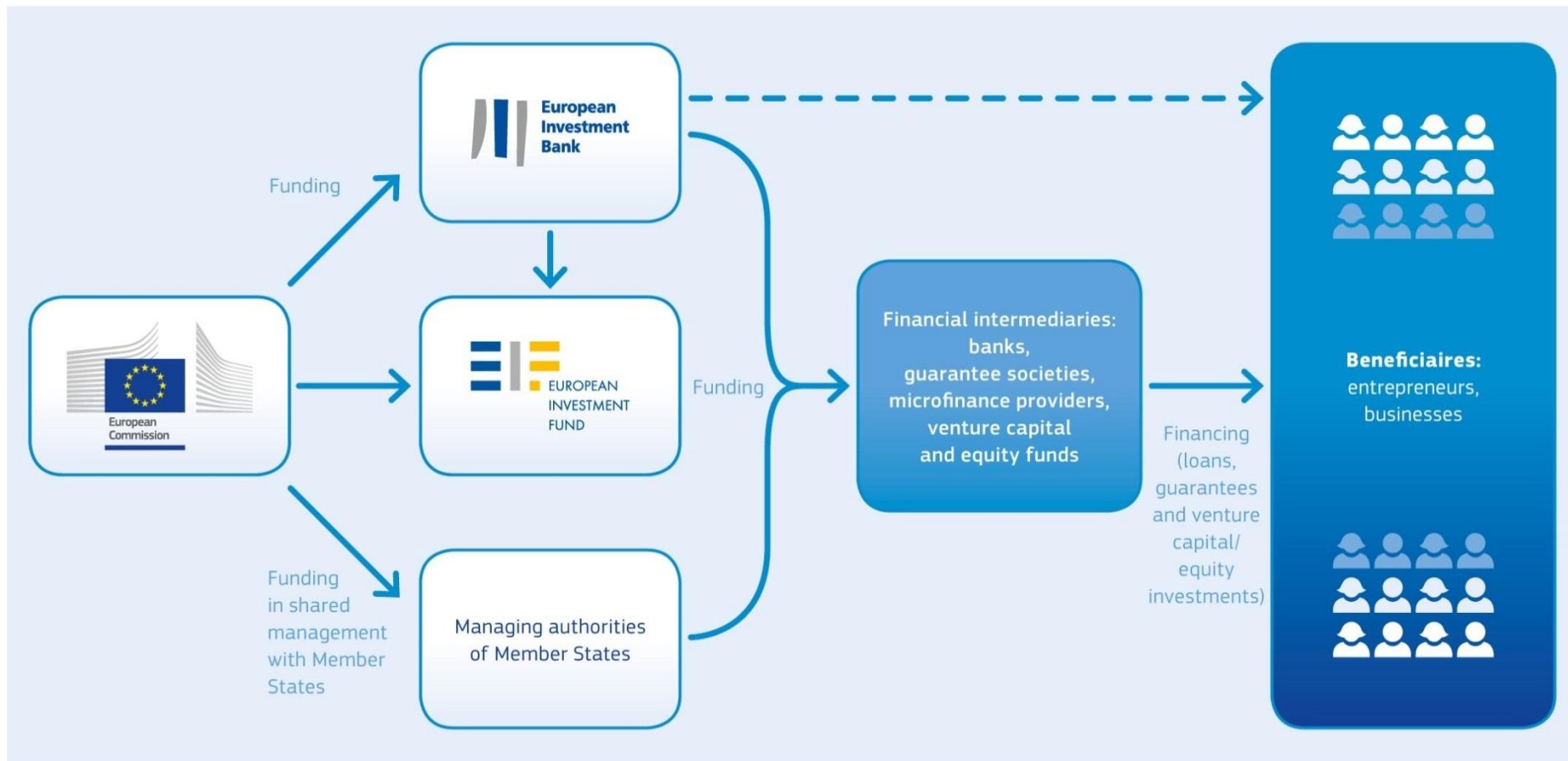
## ❑ Investment Plan for Europe (“Juncker Plan”)

- Aims at stimulating additional investment (long-term/infrastructure and SMEs/mid-caps)
- Runs from 2015-2017 (proposal to extend until 2020)
- Budget for SMEs/mid-caps EUR 5 billion for supporting EUR 75 billion investment (proposal to increase to EUR 7.5 billion supporting EUR 112.5 billion)

## The Investment Plan is based on three mutually reinforcing strands:

- ❑ Mobilising at least EUR 315 billion in additional investment over next three years
  - Creation of a European Fund for Strategic Investment (EFSI)
  
- ❑ Targeted initiatives to make sure extra investment meets the needs of the real economy.
  - Setting up a project pipeline at EU level
  
- ❑ Provide greater regulatory predictability and remove barriers to investment
  - Banking Union, Capital Markets Union, ...

# How do EU financial instruments work in practice?



- EU support businesses via local financial institutions
- EIB Group works through a wide network of financial institutions and investment funds across Europe but can also support innovative midcaps with direct loans.

## ❑ Concrete legislative proposals

- Prospectus Directive: Reduction of barriers for listing smaller firms on markets
- Capital Requirements Regulation: Prudential treatment of securitisation
- Solvency II Directive: Prudential treatment of securitisation

## ❑ Consultations and Green Papers

- Consultation on a pan-European covered bond framework
- Consultation on venture capital fund regulation
- Call for evidence on the EU regulatory framework for financial services
- Green Paper on retail financial services

## ❑ Commission's six priorities for potential future actions include

- Financing for innovation, start-ups and non-listed companies

## ❑ ECB opinion on CMU action plan: Three priorities

- Revitalising the EU securitisation market
- Enhancing the availability/standardisation of information (especially of SME credit information)
- Further developing Private Placement markets

- ❑ Association for Financial Markets in Europe (AFME 2016) makes the case for capital market development and its growth implications
  - Adopting minimum standards would improve recovery rates in a number of countries
  - This would reduce corporate bond spreads
  - Translating into growth and employment effects
  
- ❑ But it would also benefit SMEs, including innovative ones
  - A forgiving regime could stimulate entrepreneurship and innovation
  - But should also not go too far, so that the supply of credit is not adversely effected
  - Moreover, SMEs often don't have the expertise, financial resources or mobility to benefit from better insolvency laws in other European countries