Financing SMEs and Entrepreneurs 2012
An OECD Scoreboard

Chapter 2

Emerging Trends in SME and Entrepreneurship Finance

This chapter analyses trends in SME and entrepreneurship finance for participating countries, based on data collected in the Scoreboard on financing SMEs and entrepreneurs and information from demand-side surveys. An overview of the global business environment and economic prospects sets the framework for the analysis of trends in lending to SMEs and equity financing over the period 2007 to 2010. The pre-crisis (2007) year serves as a benchmark to assess changes in SMEs' access to finance during the crisis (2008-09) and the recovery (2010). The chapter concludes with an overview of government policy responses to improve SMEs' and entrepreneurs' access to finance during the crisis.

Introduction

The objective of this chapter is to highlight emerging trends in SME and entrepreneur access to finance during the period 2007 to 2010, which covers three distinct economic stages: pre-crisis (2007), crisis (2008-09) and recovery (2010). 2007 serves as the benchmark year from which changes in SME access to finance are measured in 2008-10.

The analysis is based on the comparative assessment of trends in the core indicators of the report, which address, at country level, specific questions related to SME and entrepreneur access to finance (see Chapter 1). Most of the indicators are built on supply-side data. When appropriate, these are supplemented with information from demand-side surveys of SMEs undertaken by the European Central Bank and the European Commission. These surveys adopt a consistent methodology across countries and cover questions on SMEs' access to finance which are related to the indicators in the OECD Scoreboard on SME and entrepreneurship finance (see Box 2.1).

Box 2.1. **ECB/EC Survey on SME access to finance**

The survey on access to finance includes between 5 000 and 7 500 SMEs from the euro area. This survey was developed by the European Commission (EC) and the European Central Bank (ECB). A joint ECB/EC survey round is conducted every two years for all the EU member states and some additional countries. Every six months the ECB repeats part of the survey in order to assess the latest developments in the financing conditions for firms in the euro area. It has been undertaken four times: first half 2009 (1H2009), second half 2009 (2H2009), first half 2010 (1H2010) and second half 2010 (2H2010). Some of the questions covered are directly comparable with the supply side evidence provided by the OECD Scoreboard on SME and entrepreneurship finance. In particular:

- The % of SMEs whose need for a bank loan increased/decreased.
- The % of SMEs that feel the availability of bank loans has improved/deteriorated.
- The % of SMEs that feel the banks' willingness to lend has improved/deteriorated.
- The % of SMEs that sought a bank loan in the last 6 months.
- The % of SMEs that obtained all the financing they sought.
- The % of SMEs whose request was rejected.

Business environment and economic prospects

The 2008-09 financial crisis was the most severe in decades and its costs have been enormous. GDP contracted by about 3.5% in the OECD area as a whole in 2009 and unemployment reached a post-war high of close to 9% on average. The longer-term legacy of the crisis is also heavy. Public debt in OECD countries was expected to be 100%

of GDP at the end of 2011, some 30 percentage points higher than before the crisis. OECD countries may have lost about 3% of potential output. In 2012, world GDP is projected to increase by 3.4%, whereas across OECD countries GDP is projected to rise by 1.6% (OECD, 2010a, 2011a). However, uncertainty surrounding projections is high.

While the recovery may be underway in many OECD countries, it is uneven, and significant downside risks continue to cloud the growth horizon. In several OECD economies, the recovery came to a halt in the second quarter of 2011, earlier improvements in the labour market have been fading, and there appear to be greater risks that high unemployment could become entrenched. Economic growth slowed down also in non-OECD countries, including China, where manufacturing production weakened in the first half of 2011.

In particular, financial vulnerability remains, in spite of the strong adjustment efforts underway in several countries. Heightened risk aversion in financial markets is reflected in wide sovereign risk spreads in the euro area, tumbling share prices and increasing yields on higher-risk corporate bonds. Furthermore, renewed concerns over the balance sheets of banks point to possible further tightening of credit conditions (OECD, 2011b). At the same time, faster private sector balance sheet adjustment and bank de-leveraging could exert a significant drag on growth.

The crisis had a strongly negative impact on real economic performance of SMEs. Over 2008-09, output, sales, employment and exports were all adversely impacted. In line with the general decline in GDP, SMEs reported that final demand began to contract sharply in mid- to late-2008. This contraction accelerated in early 2009 and lasted until the second or third quarter, with the decline being sharpest in the first half of 2009 in most cases. Across OECD countries, indices of SME confidence fell well below their previous historic lows, which in most cases were reached in the early 1990s. Companies that were heavily engaged in exports experienced a sharper contraction than those mainly engaged in domestic production due to plunges in the levels of world trade.

Table 2.1. **Bankruptcies,[1] 2007-10**

Various measures, all enterprises

	Unit	2007	2008	2009	2010
Canada	Per 1 000 firms	3.1	3.1	2.9	2.2
Denmark	Number	2 401	3 709	5 710	6 461
Finland	% of firms in bankruptcy proceedings	0.9	1.0	1.2	1.0
France[2]	Number	48 111	52 104	58 930	56 883
Hungary	Per 10 000 firms	566	624	726	805
Italy	Number	6 165	7 521	9 429	11 289
Korea	Number	2 294	2 735	1 998	1 570
Netherlands	Number	4 602	4 635	8 040	7 211
Portugal	Number	26 446	31 167	24 917	26 990
Slovak Republic	Number	169	251	276	344
Sweden	Number	5 791	6 298	7 638	7 274
Switzerland	Number	4 314	4 221	5 215	6 255
United Kingdom	Number	12 507	15 535	19 077	16 045
United States	Number	28 322	43 546	60 837	56 282

1. Definitions differ across countries. Refer to the table of definitions in each respective country profile in Chapter 4.
2. Only SMEs.

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In 2010, conditions generally stabilised, and in most cases, a recovery began, although gains have generally been considerably less than those observed at comparable stages of earlier recoveries. The weak economic recovery and the credit crunch continued to take their toll on SME cash flows and survival.

The OECD Scoreboard on SME and entrepreneurship finance reveals that, in several countries, payment delays (however measured) increased during the recession (2009) and remained high or even increased during the recovery. The evidence on bankruptcies is unambiguous (Table 2.1). They were on the rise in 2009 in all countries monitored in this report except Canada, Korea and Portugal. They also continued to rise in 2010 in Denmark, Hungary, Italy, the Slovak Republic and Switzerland. While bankruptcies in Finland, France, the Netherlands, Sweden, and the United Kingdom declined during the recovery, they remained considerably higher than their 2007 levels.

Lending to SMEs in 2007-10

In the wake of the crisis, the financial situation of SMEs broadly deteriorated. This report shows that in most countries, business loans and SME loans declined markedly during the recession and, while they recovered somewhat in 2010, they did not reach their 2007 levels (Table 2.2). Lending to SMEs continued to decline during the recovery in Finland, New Zealand, Portugal, Slovenia, the United Kingdom and the United States. The exceptions were Canada, Chile, France, Italy, Korea, Switzerland and Thailand, which enjoyed positive, though slowing, SME loan growth throughout the entire period.

Loan authorisation rates for SMEs decreased considerably in a number of countries due to tighter credit standards and more negative prospects as a result of the crisis. According to the ECB/EC survey, in the euro area, rejection rates rose from 12% to 18% between the first and second half of 2009. The sole exception was France, where rejection rates decreased from 12% to 7%. During 2010 the rejection rate for the euro area declined to 11%.

Table 2.2. **Growth of SME business loans,[1] 2008-10**

Year-on-year growth rate, as a percentage

	2008	2009	2010
Canada	–0.1	3.7	–0.9
Chile	11.3	6.9	8.8
Denmark	–13.7	–19.2	22.9
Finland	2.6	–16.3	–22.0
France	4.3	1.0	5.7
Hungary	4.9	–6.8	1.3
Italy	2.1	1.2	6.6
Korea	14.1	5.5	–1.0
Netherlands	–5.0	–24.2	5.1
Portugal	9.2	1.8	–2.0
Slovak Republic	34.1	–0.3	. .
Slovenia	16.7	–0.9	–8.8
Sweden	7.2	20.4	. .
Switzerland	5.9	5.3	1.3
Thailand	9.5	7.4	7.2
United Kingdom	8.2	1.4	–6.1
United States	3.6	–2.3	–6.2

1. Definitions differ across countries. Refer to the table of definitions in each respective country profile in Chapter 4.

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SME loan shares across countries varied between 12% and 30%, well below the respective contribution by SMEs to national income and employment. During the recession, this share decreased even further, as SME lending declined more than lending to large enterprises. SME loan shares in Finland continued to suffer declines during the recovery, and in Denmark and the United States, they did not return to pre-crisis levels. (Table 2.3).

Table 2.3. **SME loan share of total business loans,[1] 2007-10**

As a percentage of total business loans

	2007	2008	2009	2010
Canada	17	16	18	18
Chile	17	15	18	18
Denmark	12	9	9	11
Finland	27	22	20	14
France	26	26	26	26
Hungary	59	58	58	60
Italy	19	18	18	19
Korea	87	83	84	81
Portugal	78	78	78	77
Slovak Republic	63	74	76	..
Slovenia	57	56	55	50
Sweden	89	89	92	..
Switzerland	81	..	..	..
Thailand	28	27	27	38
United Kingdom	11	11	12	12
United States	30	28	28	29

1. Definitions differ across countries. Refer to the table of definitions in each respective country profile in Chapter 4.

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However, in a number of countries, the SME loan shares were significantly higher than on average, exceeding 50%. A number of specific factors can explain these "outliers":

- large companies found external finance elsewhere, such as in the bond markets;
- intercompany loans may have been under-reported;
- government policy and commercial banks catered to the SME sector; and
- loan data are derived from balance sheets and may include more than credit from financial institutions.

Short-term loans vs. loans for investment

During a recession, the share of short-term loans could be expected to increase relative to long-term or investment loans, because short-term borrowing is needed to solve cash flow problems. Such a shift occurred in four countries in 2008 and reflects changes on the demand side, as SMEs sought working capital to offset declining revenues and increased payments delays, while cutting back on investment outlays. However, this trend has not been consistent across countries and over time. In five countries, the share of short-term loans decreased in 2009 and the downward trend continued in 2010 (Table 2.4).

The decline in short-term loans in a time of a recession could be the result of policies, such as those introducing or strengthening guarantee programmes. In fact, loan guarantees, which are usually granted on long-term loans, were extensively supported during the crisis. At the same time, however, this evidence could reflect the type of data collected at the country level. In the case of stock data, as opposed to flow data, the indicator includes prior years' investments, whereas it excludes the short-term loans that mature and/or are not being renewed. In fact, evidence points to a decline of short-term loan shares in countries such as France, Switzerland and the United States, which collected stock data.

Table 2.4. **Share of short-term SME loans,[1] 2007-10**

As a percentage of total SME loans

	2007	2008	2009	2010
Canada	42	. .	43	36
Chile	. .	. .	. .	60
Denmark	65	75	79	65
Finland	21	28	30	26
France	22	21	18	18
Italy	34	32	29	27
Korea	69	68	69	. .
Netherlands	56	55	57	48
Portugal	32	31	33	31
Slovak Republic	51	39	41	. .
Slovenia	43	47	43	38
Sweden	14	12	12	. .
Switzerland	83	79	77	74
Thailand	43	44	44	58
United States	31	32	27	24

1. Definitions differ across countries. Refer to the table of definitions in each respective country profile in Chapter 4.

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SME credit conditions compared to larger enterprises

Overall, SMEs faced more severe credit conditions than did large enterprises, in the form of higher interest rates, shortened maturities and increased requests for collateral. Over 2007-10, the SME interest rates trended downward but the interest rate spread between SMEs and large enterprises increased over the entire period, including during the recovery, indicating that large enterprises faced easier credit terms, and suggesting that smaller firms were considered to be higher-risk companies due to their poorer business prospects.

Data on collateral requirements were more difficult to obtain. Nevertheless, most countries reported that the percentage of SMEs required to provide collateral rose.

Demand vs. supply of financing

The downward trend of SME lending over 2008-09 was confirmed by both direct surveys of SMEs and surveys of bank lending officers (OECD, 2010b). However, whereas the former were largely negative in the assessment of the credit conditions, the latter generally pointed to declines in "credit demand" as the reason for the fall off in bank lending.

The evidence in the euro area from the ECB/EC demand survey is consistent with the findings in this report, especially with regard to stiffer credit conditions and a decline or a slowdown in lending in early 2010 (Table 2.5). In particular, the slowdown in lending recorded on the supply side is matched by SMEs' perceptions of availability of credit and the banks' willingness to lend. Of SMEs surveyed, 25% said that their need for a bank loan had increased during the crisis (2H2009), compared to 18% whose need increased during the recovery (2H2010). On the question of the availability of bank loans, the percentage of SMEs with negative views declined over the period (from 43% in 1H2009 to 23% in 2H2010). Over the first half of 2010, however, SMEs' perception of banks' willingness to lend did not improve greatly.

According to the survey, the percentage of SMEs that applied for a bank loan decreased slightly during the recovery, but those applying for a bank loan were more likely to receive the amount they requested, rising from 56% (2H2009) to 66% (2H2010). This might indicate that more credit-worthy SMEs had applied. However, SMEs reported that the terms of finance were stiffer, in particular interest rates. While low, they continued to rise. The view on the increase in collateral requirements did not change significantly over time. Indeed, the share of firms indicating less stringent collateral conditions decreased in 2010.

It is important to note, however, that SMEs indicated "finding customers" as their most pressing problem, both during the recession and the recovery. In particular, access to finance dropped from the second most pressing problem to third between 1H2009 and 2H2010. This also underscores that the recovery was weak in 2010. Furthermore, according to the ECB/EC survey, the use of overdrafts and credit lines outstripped the use of term bank loans (42% *vs.* 36%) during the recovery period, indicating that liquidity remained an important problem in the euro area. This is the only discrepancy with the OECD Scoreboard on SME and entrepreneurship finance, which shows that in some countries, such as France, the Slovak Republic and Switzerland, short-term lending declined.

Table 2.5. **European Central Bank/European Commission survey on SME access to finance**

As a percentage of total SMEs surveyed

Category	1H2009	2H2009	1H2010	2H2010
SME need for bank loan				
Increased	19	25	15	18
Decreased	9	9	12	11
Most pressing problem				
Finding customers	27	28	28	25
Competition	14	13	15	14
Finance	17	19	15	16
Availability of bank loans				
Improved	10	10	12	14
Deteriorated	43	42	24	23
Willingness of banks to lend				
Improved	17	8	13	13
Deteriorated	32	33	29	29
Applied for a bank loan				
	28	29	24	25
Outcome				
Granted in full	60	56	63	66
Rejected	12	18	11	11
Interest rate				
Increased	34	35	38	54
Decreased	29	27	20	10
Collateral				
Increased	34	39	37	34
Decreased	8	6	3	3

Source: ECB/EC.

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Stiffer credit terms, combined with weak sales, could have deterred some SMEs from seeking finance, especially for expansion purposes. There is evidence that, faced with declining demand for their output, SMEs largely responded by taking steps to lessen external borrowing rather than by seeking new external funding. In France, for instance, net credit demand (percentage of firms requesting increases in credit minus the percentage requesting less credit) fell from +40% in 3Q08 to –70% in 2Q09. In the United States, the *Federal Reserve Survey of Senior Loan Officers* indicated that SME demand for loans, which had been trending downward since 2007, fell precipitously in early 2009. The net percentage of respondents reporting stronger demand for Commercial and Industrial (C&I) loans fell to –60%, roughly equal to its earlier historic low in 2002. As an explanation, loan officers cited both sharply reduced demand for investment capital and less demand to finance inventories and accounts receivable (OECD, 2010b). Whether SME loan demand rebounded in the United States during the recovery is not clear as the surveys conducted by the Federal Reserve and the National Federation of Independent Businesses showed conflicting results.

Equity financing

The OECD Scoreboard on SME and entrepreneurship finance includes an indicator on equity financing, more precisely, venture capital and, for some countries, growth capital. Venture capital includes seed, start-up and early development capital. Growth capital includes later stage expansion capital, but generally excludes buy-outs, turnarounds, replacement capital.[1] The capital provided by business angels is not included in the equity section of the Scoreboard, since only a few countries can currently report on business angel investments.

This report shows a sharp decline in venture capital and growth capital between 2008 and 2009. In 2010 these types of funding had not recovered to their 2007 levels. A number of countries had government programmes promoting early stage and expansion capital, including Canada, Chile, Denmark, Finland, France, Italy, the Netherlands, New Zealand, Sweden and the United Kingdom.

It should be noted, however, that accurate and comparable reporting on equity financing was particularly difficult for the countries monitored. Specific challenges to the development of indicators on venture and growth capital have been identified in the framework of the OECD-Eurostat *Entrepreneurship Indicators Programme* (OECD, 2011c), namely:

- At the country level, venture capital data are not always broken down by stage of development. When this happens, definitions of the investment stages are not harmonised across countries.
- In some countries, venture capital figures may also include later stage expansion capital, referred to hereafter as “growth capital”.
- The data are not usually collected by the government, but rather by private bodies such as venture capital associations, which rely on the voluntary reporting of their members through periodic surveys.
- Depending on the methodology for data collection, a country’s data may capture only the portion of the market surveyed by venture capital associations and may therefore be incomplete.

The demand-side data provide further support to the view that the venture capital market was particularly affected during the crisis. The ECB/EC survey found that very few SMEs had used equity in the second half of 2010. Only 6% of the SMEs surveyed accessed external equity. 78% said that this source of financing was not relevant to their enterprise. As mentioned, SMEs were more likely to use bank overdrafts or a line of credit in 2H2010. SMEs that accessed external equity were more likely to be innovative firms with high growth potential.

Government responses

Governments were sensitive to the increasing difficulties faced by SMEs in accessing finance and responded by injecting capital into their loan guarantee programmes and direct lending programmes, two indicators collected in the Scoreboard on SME and entrepreneurship finance. Almost every country had a loan guarantee programme and/or direct lending programme that could be ramped up during the crisis, in terms of the total amount of guarantee funds and direct lending available, the percentage of the loan guaranteed, the size of the guaranteed or direct loan and the number of eligible enterprises. However, new elements were added to these programmes, or new instruments were created outside the traditional guarantee programmes (Table 2.6). These included:

- guaranteeing short-term loans and counter-cyclical loans;
- combining guaranteed loans with business advice services (get started loans);
- increasing the coverage of guarantees sometimes to 100%;
- postponing the repayment of guaranteed loans;
- using pension funds to augment loan guarantee schemes;
- guaranteeing equity capital;
- assisting mutual guarantee associations; and
- increasing co-financing by public agencies and banks.

Table 2.6. **Government policy responses to improve SME access to finance during the 2008-09 crisis**

Policy response	Countries
Increased amount government loan guarantees and/or % guaranteed, number of firms eligible, countercyclical loans	Canada, Chile, Denmark, Finland, France, Hungary, Italy, Korea, the Netherlands, Portugal, the Slovak Republic, Slovenia, Switzerland, Thailand, the United Kingdom, the United States
Special guarantees and loans for start ups	Denmark, the Netherlands
Increased government export guarantees	Denmark, Finland, the Netherlands, New Zealand, Portugal, Sweden, Switzerland
Government co-financing	Sweden
Increased direct lending to SMEs	Chile, Hungary, Korea, Slovenia
Subsidised interest rates	Portugal, Thailand
Venture capital, equity funding and guarantees	Canada, Chile, Denmark, Finland, France, Italy, the Netherlands, New Zealand, Sweden, the United Kingdom
New programmes: business advice	Denmark, New Zealand, Sweden
Tax exemptions, deferments	France, Italy, New Zealand, Sweden
Credit mediation	France

Source: OECD, 2010b.

Among the new programmes or programme elements were Canada's Business Credit Availability Programme, which allowed the Business Development Bank and Export Development Canada to provide financing support to businesses with viable models, whose access to financing would otherwise be restricted. Denmark created "get started loans", which combined loan guarantees and consultancy schemes for new businesses. Finnvera, a financing company owned by the government of Finland, introduced counter-cyclical loans and guarantees to finance working capital. Counter-cyclical loans were intended for small enterprises whose profitability or liquidity declined because of the crisis. The Enterprise Finance Guarantee Scheme of the United Kingdom also supported counter-cyclical lending and assisted viable enterprises that in normal circumstances would be able to secure lending from banks but could not because of the credit crunch.

Some governments also intervened in the private equity market. For example, the Netherlands created a "Growth Facility", which offered banks and private equity enterprises a 50% guarantee on newly issued equity or mezzanine loans. Canada, Chile, Denmark, Finland, France, Italy, the Netherlands, New Zealand, Sweden and the United Kingdom also provided assistance to equity financing.

The other emergency responses especially tailored to remedy the deterioration in SME finance included:

- deferring tax payments temporarily;
- capping interest rates;
- rolling over SME loans;
- converting short-term loans into long-term loans or overdrafts into loans;
- refraining from declaring loans non-performing; and
- setting up credit mediation systems.

A number of these measures were time-bound and were intended to be phased out. However, as the recession has continued in some countries, many of these measures have been extended. In countries that have exited from recession, the measures have been phased out or made more selective. Overall, a formal evaluation of these measures would have to be undertaken to determine their effectiveness in easing access to finance.

Notes

1. In the case of the Netherlands and Switzerland, the Scoreboard data for growth capital also include buy-outs, turnarounds and replacement capital.

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