

## **EFFECTS OF THE CURRENT ECONOMIC CRISIS ON SMALL AND MEDIUM ENTERPRISES SECTOR IN SOME EU MEMBER COUNTRIES - A COMPARATIVE STUDY**

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### **-Abstract-**

*Small and medium enterprise sector is considered the engine of economic and social development of a country, appreciation resulting from the fact that, according to statistical data, it generates much of a country's gross domestic product and provides jobs for most employment population. Such an assessment justifies our concern for the research in this field.*

*One of the fundamental problems of any company and, in particular of the small and medium enterprises (SME) is the access to finance, as a condition for their creation, survival and development. Starting from this assessment, our study aims to highlight the possibilities of financing the SME sector in some EU countries and especially the differences that arise between them, and the obstacles that SMEs face in the way of the access to finance, based on studies initiated by the European Commission, the European Central Bank and the World Bank. Also, the study aim to highlight the impact of the current crisis over the access to financing for SMEs in the countries examined and measures taken by the national government to support access to finance, particularly bank financing of this sector.*

**Key Words:** *Economic crisis, SME sector, external financing, bank loans*

**JEL Classification:** *G01, M10.*

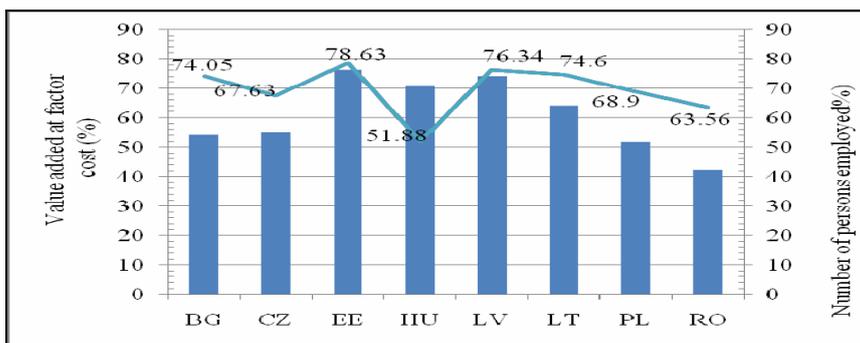
## 1. INTRODUCTION

The SME sector is of critical importance for economic and social development of a country because these firms through their dynamism are considered a driver of innovation and growth and contribute to poverty reduction because they are an important source of job creation (World Economic Forum, 2010: 49).

In the case of the studied countries (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania) and the importance of the SME sector is resulting from its significant contribution to creating added value and providing jobs, but with some differences between countries (see figure 1).

Regarding the contribution to the creation of added value, we remark especially the countries that are far below the EU27 average (58%), namely Romania (42.16%) and Poland (51.71%). Regarding employment, it appears that SMEs sector uses over two-thirds of the workforce in the four countries that are well above the EU27 average (68%), namely: Estonia (78.63%), Latvia (76.34%), Lithuania (74.6%), and Bulgaria (74.05%).

**Figure 1: The role of the SME sector in the studied countries\***



\* estimated data for 2008.

Source: processed data from European Commission: 2010.

This paper is structured as follows: the second section addresses the main ways of financing that SMEs use in the case of EU member states taken in the analysis, with emphasis on highlighting the differences that arise between them. The third section highlights the main effects of the current crisis over the access to finance for SMEs in the studied countries and the main measures adopted by the national government to support access to finance, particularly bank debt financing of this sector. The study ends with conclusions.

Our study is based, in particular, on the surveys of firms, including SMEs from some EU member countries, but which are not members of the euro zone, compiled by the World Bank, the European Commission and European Central Bank.

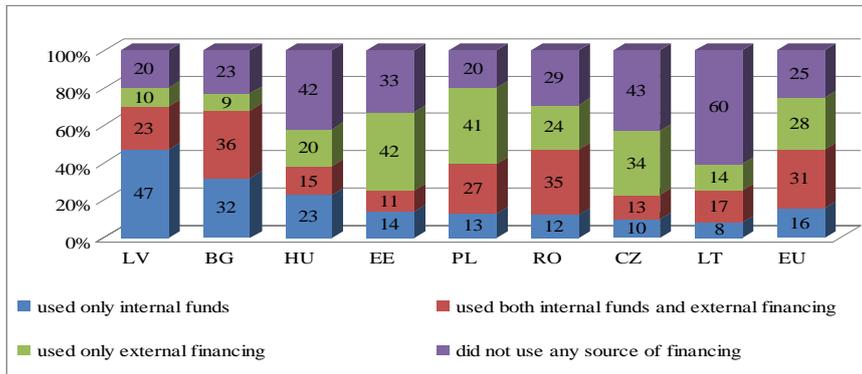
## **2. METHODS OF SMES FINANCING IN THE STUDIED EU COUNTRIES**

To highlight the sources of financing used by small and medium enterprises in the studied countries, the differences between them and as well as the difficulties that these firms face when are trying to access financing, we will take into consideration the results of the survey conducted by Flash Eurobarometer no. 271. This study was conducted by the European Commission and Central European Bank in order to identify the access to finance of enterprises from the EU member countries and from other three countries.

The study focused on approximately 9.000 enterprises in the EU, Croatia, Iceland and Norway, and took place over the period January – July 2009. The interviews were taken over the period June – July 2009, and the analyzed sample of enterprises was structured according to their size class, distributed as follows: 50% - micro enterprises (1-9 employees), 30% - small (10-49 employees), 10% - medium enterprises (50-249 employees) and 10% - large enterprises (with 250 employees and over). As it results from the distribution of the sample, small and medium enterprises cover an overwhelming segment (90%); hence, one can consider that the results of the Flash Eurobarometer survey are relevant to this research.

Based on the survey conducted by Flash Eurobarometer we observe the existence of significant differences between countries regarding the methods of SMEs financing (see figure 2) as follows: the highest percentage of firms that preferred using only internal resources are found in Latvia (47%), while the largest percentage of companies that appeal only to the external financing are in Estonia (42%) and Poland (41%). Lithuania, the Czech Republic and Hungary have the highest percentage of firms, 60%, 43% and 42% who did not use any source of financing during the period under review (January-July 2009). Firms in Bulgaria and Romania are individualized by the fact that they used in the highest proportion, 36% and 35%, both internal and external financing. If we consider the average situation in the EU 27 we find that the highest percentage of firms (31%) preferred to use both internal and external financing.

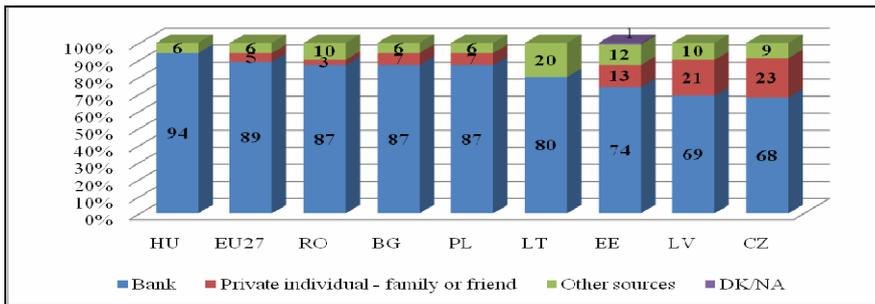
**Figure 2: Methods of SMEs financing in the analyzed countries**



Source: European Commission : 2009 : 29.

As concerns external financing, the results of the Flash Eurobarometer study show that the bank was the popular source for all the countries that participated to this survey (see figure 3). Such a result is natural if we consider that the financial systems of the EU countries rely, to a great extent, on banks.

**Figure 3: Sources of external financing of SMEs**



Source: European Commission : 2009 : 42.

The significant dependence on bank financing of SMEs is explained by the fact that this type of firms have fewer options than large firms. On the other hand, while bank loans have an overwhelming share in the financing resources of SMEs in the studied countries, these firms encounter a number of obstacles when they are trying to obtain this bank loans. Thus, we may notice that some banks refuse to grant loans or increase interest rates for operational SMEs that do not offer adequate guarantees or do not have a credit history, because they have just started

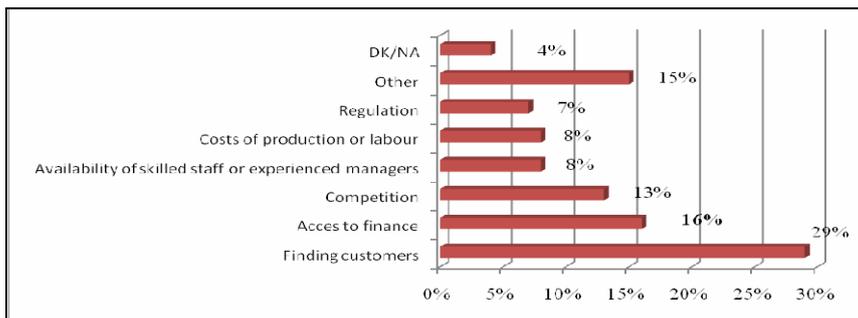
their activity or they have a degree of solvency that does not fall into the limits imposed by the banks in question.

### 3. THE IMPACT OF THE CURRENT CRISIS OVER THE ACCESS TO FINANCE OF SMES IN THE STUDIED COUNTRIES AND MEASURES TAKEN BY PUBLIC AUTHORITIES

The growth and the development of SMEs is influenced by a number of factors, from global business environment to the availability of educated workforce, but the lack of access to finance appears consistently as one of the most important obstacles of doing business, as it is evidenced in the numerous surveys conducted by the World Bank, regarding the enterprises in over 100,000 countries (CGAP, 2010: 35).

Access to finance of the firms is their main concern, as shown in the Flash Eurobarometer survey, realized from June 17 to July 23, 2009. Thus, to the question "What is currently the most pressing problem your firm is facing?" 29% of companies surveyed identified as the most pressing problem finding customers, and access to finance was considered as the second pressing issue, as identified by 16% of respondents (see figure 4).

**Figure 4: SMEs' main problems**



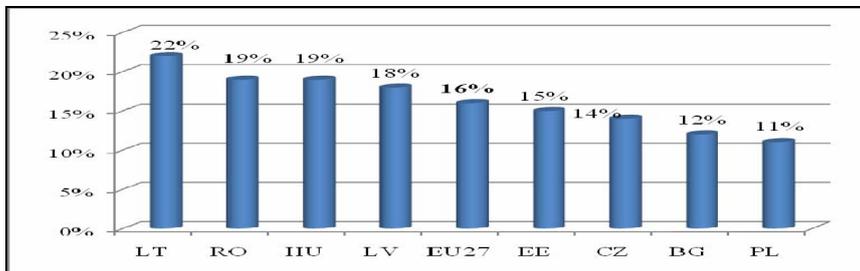
Base: all companies EU-27, in %.

Source: European Commission : 2009 : 27.

Regarding the response of the managers of the companies from different countries to the mentioned question, the survey results show significant differentiation between some countries (see figure 5). The highest percentage of firms that had identified the access to finance as the most pressing problem are the firms in Lithuania, Romania and Hungary, while at the other pole are situated the firms

from Poland. Therefore, we observe that the access to finance is not a pressing issue in all the countries.

**Figure 5: Companies identifying access to finance as the most pressing problem**



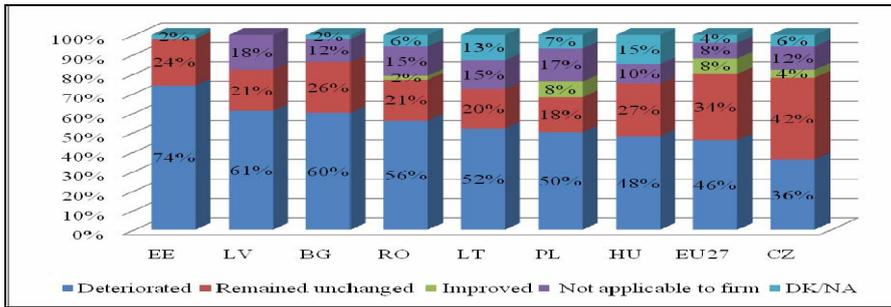
Source: European Commission : 2009 : 28.

The current international crisis has affected more severely the SMEs sector compared to large firms because SMEs are generally more vulnerable in times of crisis for several reasons, among which we mention: it is harder for them to reduce their activities since they are already small; they are less diversified individual within their business; they have a weaker financial structure (e.g. lower capitalization); they have a lower credit rating; they are strongly dependent on credit and have fewer financing options (OECD: 2009: 15).

The deterioration of the economic environment and, implicitly, of the financial situation of small and medium enterprises and the rise of the costs of the financing resources on international financial markets determined banking institutions from numerous countries to be reticent in granting credits. The reaction of the banks was to make the crediting standards harsher and to increase interest rates. Thus, microenterprises and small firms in particular meet significant difficulties when trying to obtain financing resources.

In the context of the reduction of the bank credits supply and demand, a diminution in the availability of bank credits was registered. For example, according to the Flash Eurobarometer study, almost half (46%) of the interviewed firms that requested at least one type of external financing over the period January – July 2009 reported the reduction of the availability of bank credits. As regards the studied countries, the availability of bank credit has significant differences from one country to another (see figure 6) due to the different implications of the current crisis on national economies and their financial systems.

**Figure 6: The availability of bank loans in the analyzed countries**

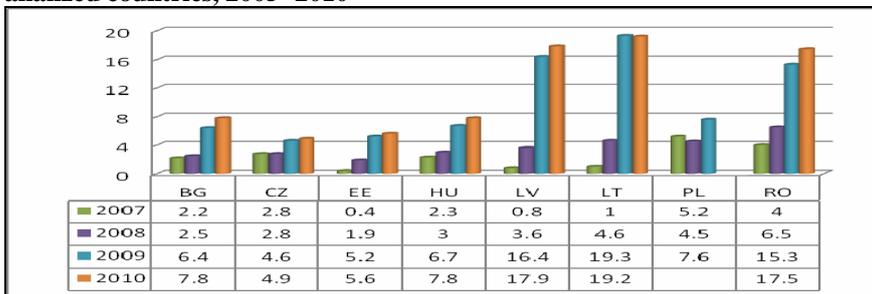


Source: European Commission : 2009 : 56.

Based on data from figure 6 we observe that Estonia, Latvia and Bulgaria occupies the first place with the highest percentage of firms that reported a deterioration in bank credit availability, respectively 74%, 61% and 60% compared with 36% in the Czech Republic.

In the context of the significant deterioration in economic activity and hence the financial situation of SMEs in the surveyed countries, the national currency depreciation and the high interest rates on bank loans led to a significant increase in the rate of nonperforming loans (see figure 7) which are situated at extremely high levels, especially in Lithuania, Latvia and Romania.

**Figure 7: The evolution of bank nonperforming loans to total loans (in percent) in the analyzed countries, 2005- 2010\***



\*March for BG, CZ, EE, HU, LV, LT and April for Romania.

Source: IMF: 2010.

Rising the risk aversion and the ratio of bad loans, banks from the studied countries have shown reluctance in granting loans, especially for small and medium enterprises taking steps to tighten lending standards and higher interest

rates. Therefore, SMEs and, in particular micro and small firms, which are considered by banks as posing a risk far greater than large firms face significant difficulties in securing borrowed financial resources.

The ability of countries to deal with the current financial crisis depends to a large extent on their fiscal and monetary policies. Many countries have now put up some anti-crisis packages combining in different proportions three lines of action: stimulating demand (consumer packages, infrastructure programs, tax policies), measures to improve the lending activity, including recapitalization of banks, which in some cases, include explicit provisions or mechanisms to maintain or develop the capacity of banks to finance SMEs, such as public credit guarantees, and labor market measures (reduction of taxes on employment or social taxes and social unemployment programs temporarily enlarged).

Regarding the support of bank financing is important to emphasize that banks should promote a separate credit system for SMEs. This process should permit the incorporate of the specificity of these companies in business lending and avoid increasing complexity of banking products and services offered at a level that is not necessary. This approach would not only have a positive impact on the banking business conducted in SMEs sector but, more, should meet those customer needs and expectations. Some banks have already started the process of specialization, by implementing specific banking products to SMEs, but the benefits will be seen when the process will extend to the entire banking sector in the analyzed countries.

One of the measures used by the public authorities from the analyzed countries involves the expansion and diversification of public security systems, or in some cases even direct lending by public institutions. These policy measures are addressing one of the key reasons that might explain the reluctance of banks lending to SMEs, which represents their constraining regarding the capital requirements ratio.

Public credit guarantee schemes for SMEs are expected to be an incentive for bank loans for this segment of customers. Loan guarantee schemes can improve access to finance for SMEs, as an incentive for banks. For EU countries, the potential leverage of public guarantees on bank loans to SMEs has been extended by the European Commission decision to allow member states temporarily to facilitate access to finance for companies, through subsidized guarantees and loan subsidies for investments. Moreover, some countries have resorted to measures of

discipline, which in some cases complement incentives in order to press the banks to continue lending to businesses.

To prevent loss by SMEs of their competitive advantage in the medium term and to help them be prepared to revive economic activity, some governments have implemented measures to strengthen capital base and to develop their capacity or both. These measures are either tax incentives or providing specific funding opportunities such as grants or loans guaranteed (Czech Republic, Hungary). In addition, the existence of structural funds within the European Union new member states gives the flexibility to support investment projects of SMEs in specific technologies, sectors or regions (Romania and Czech Republic).

## **CONCLUSIONS**

One of the fundamental problems of any company and, in particular of the small and medium enterprises (SME) is the access to finance, as a condition for their creation, survival and development. Compared with large firms, SMEs face a number of difficulties when aiming to procure financial resources. Such difficulties are related, in particular, to insufficient guarantees offered for creditors and even to fully inform them about the situation and development prospects of SMEs.

The analysis of the financing modalities of small and medium enterprises in the analyzed EU member countries, conducted in this paper, emphasizes the significant importance of bank credits in the external financing of enterprises. This aspect can be explained by the fact that microenterprises and small firms in particular have fewer financing options in comparison with large enterprises.

The SMEs, in terms of size and the specifics of their activities, face difficulties in procuring external financing resources, in conditions of normal operation of the economy. Moreover, in the context of the current international crisis, the SMEs access to financial resources is more difficult due to the deterioration of the economic environment and due to the increasing of the uncertainties about its progress.

One of the extremely serious consequences of the current global economic crisis is the changes in the access to credit for SMEs. In this context and given the crucial importance of the SME sector for economic and social development, public authorities in the studied countries were oriented towards the adoption of special measures to stimulate lending to SMEs by subsidizing interest and

guarantee schemes. But so far there has been only a slow recovery of bank lending. The significant revival of bank lending depends significantly on the expectations of the improvement in overall economic situation, the real economic recovery, which in turn is conditional on improved access to finance for the SME sector.

Restore the normal functioning of SME sector and hence the national economic recovery depend significantly of the improved access to finance for SME sector, which can be achieved by implementing appropriate economic policy measures and strengthening cooperation between the banking and financial institutions and SMEs.

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