Financial regulation / Banks

SMEs and market financing: Myth or reality?

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Small and medium-sized enterprises (SMEs) form a fundamental part of the business fabric, not just in Spain but throughout the European Union (EU). They account for more than 90% of the total number of businesses in the EU, provide 70% of its jobs and contribute nearly 50% of its added value. For this reason any setback suffered by these businesses can end up having consequences for economic growth and employment.

The negative effects of the last financial crisis on the flow of credit laid bare one of the main problems of SMEs in Europe: heavy dependence on bank financing. Compared with other jurisdictions, European SMEs were more dependent on their banks for expanding and generating employment, and when the crisis led to tighter credit supply conditions, many of them encountered difficulties in meeting their financing needs, with the negative consequences that this entailed for the real economy.

In view of this the European Commission, as part of the Capital Markets Union (CMU) project, set as one of its basic objectives the expansion of financing options for SMEs, on the premise that greater diversification would contribute to reducing their risks, making them less vulnerable to banking cycles. Thus, since 2015 various legislative initiatives have been put forward aimed at diversifying their sources of financing.

In this regard last year saw the approval of, among other things, a simplification of the information requirements for issue prospectuses, to reduce the administrative burden on the smallest firms while still maintaining adequate investor protection. Apart from this the creation of specific financing markets, known as Growth Markets for SMEs, has also been addressed. The idea behind these proposals is clear: if we want these companies to diversify their financing mix and access the markets to issue capital or debt, we must generate the necessary incentives for them to opt to move in that direction.

Nonetheless, despite these legislative advances, the promotion of this kind of alternative financing may run into barriers. On the one hand, those deriving from the strongly entrenched attachment to bank financing (partly due to the long-standing business relations between banks and SMEs and partly due to the lower costs and administrative barriers involved.) On the other hand, there are also factors affecting the supply of lendable funds through the markets, such as asymmetrical information on these firms’ repayment capacity, the possible lack of liquidity, and geographic fragmentation, which may hamper access to a broad base of investors.

The European Commission acknowledges the importance of bank financing, which continues to be the main source of financing for European SMEs. Therefore the banking regulations include provisions to encourage and promote exposures to these firms and to ensure that the flow of credit to SMEs is more stable and less affected at times of difficulty in the banking system. These kinds of measures have contributed to normalising lending to SMEs, as reflected in the fact that in the latest survey carried out by the ECB of more than ten thousand European SMEs, access to financing has moved down the list of challenges facing the sector.

The overall CMU project, and the specific objective of achieving a more diversified financing model for SMEs, may bring beneficial consequences for the economy. The emergence of new sources of financing contributes to the stability and resilience of European SMEs as a whole, since they see their risks reduced as a result of the diversification. However, we must keep in mind that the CMU project is a long-term objective. Legislative initiatives – even those already approved – may take a long time to be translated into a change in the market that starts to have tangible effects. So in the meantime we must make sure that we have a robust banking system that can provide credit to solvent demand at any stage of the cycle, and so contribute to economic growth.

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