PUBLIC POLICIES TO SUPPORT SMES' ACCESS TO FINANCING: BETWEEN CHALLENGES OF CRISES AND THE FUNCTIONING OF MARKETS

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Abstract: *Access to finance for small and medium-sized enterprises has been identified in many studies as the most important factor determining the survival and growth of SMEs in both developing and developed countries. Access to financing means access to working capital to finance current activity, but also investments and the acquisition of modern technologies, thus ensuring the competitiveness of SMEs, as well as the performance of the economy and society as a whole. Governments, through specialized agencies, often in cooperation with financial regulatory authorities and banking associations, develop various measures and programs aimed at better access to finance for SMEs. Of course, the motivations, scope and success of these initiatives are influenced by the level of development and sophistication of the financial banking sector, by its orientation and composition, by the way in which the various objectives and needs of small and medium businesses are understood. The implementation and prioritization of these programs and schemes are dramatically influenced by the availability of financial and non-financial resources, organizational skills and, finally, the sincerity and stability of dedicated public policies. This paper aims to analyze the impact of financial support policies for SMEs, the effects of crises (economic, financial, pandemic) on these policies, but also the evolution of interest in this type of support at the level of European companies. We found that government financial assistance helps SMEs to improve their financial performance and thus be able to access, in the future, various forms of financing, but also that there are significant differences, by activity sectors, types of companies and, respectively, countries, in regarding the importance and impact of public support to the business sector.*

Keywords: SME; financial institutions; financial support polices

JEL Classification: G21, G28

1. Introduction

Small and medium-sized enterprises generally do not receive sufficient funding and therefore require special attention because of their information opacity and limited available funding resources. Given this imperfect ability to obtain funding, many researchers and practitioners consider government intervention justified. Government intervention often takes the form of financial assistance, focusing on directly subsidised credit programmes and indirect credit guarantee schemes. There are numerous pros and cons about their impact, and the question that emerges is whether they are for the general benefit of society, or whether the results are outweighed by the costs.

Policy at European Union level supports the financing of SMEs using forms of direct assistance, including tax benefits, grants, and subsidies, as well as indirect assistance, using credit guarantee schemes, especially during the recent global financial and health crises, when many SMEs have faced additional restrictions on their access to finance due to the deterioration of their financial situations. There is a concern that direct and indirect financial assistance will encourage intensive capital use, repayment for longer periods, but there are also signals that it allows the survival of weaker or unprofitable firms (Hallberg, 1999), leading to lower productivity of sectors.

However, the general argument is that government financial assistance plays an important role in mitigating the financial constraints of SMEs, helping to generate additional cash flows and/or supporting SMEs in obtaining more complex financing.

In this article we intend to analyze the impact of financial support policies for SMEs, the effects of economic, financial, and pandemic crises on these policies, as well as the interest shown by European companies in these support measures. Thus, after this Introduction, we will analyze the main ideas and currents regarding public assistance for SMEs as they appear in the literature, later supplemented by a section dedicated to the rationale behind the policies and measures to support access to finance for SMEs in times of crisis. Next, we will make an analysis of the public support for SMEs funding in Europe, and finally we will present the main conclusions of our research.

2.Literature review

A considerable literature focuses on the limited capacity of SMEs to obtain financing due to their informational opacity (Beck et al., 2005, 2008; Berger and Udell, 2006; Guiso and Minetti, 2010; Dietrich, 2012). On the one hand, SMEs are less likely to have direct access to finance through the capital markets and thus they rely heavily on financing brokered by banks and other financial institutions (Iturralde et al., 2010). On the other hand, lenders can fail in allocating loans effectively because they consider both the interest rate they will receive on the loan and its risk when deciding to borrow. In this case, the adverse selection emerges from the informational asymmetry, leading to the conclusion that an interest rate suitable for both creditors and debtors has a low probability of existing. Adverse selection is a consequence of an environment in which creditors relate to the risk characteristics of a group of debtors, but not of each individual borrower. In these circumstances, moral hazard can make the situation worse, as higher interest rates can cause firms that initially incurred lower risks to commit riskier projects (Craig et al., 2009). As a result, lenders, such as banks, may want to have less exposure to SMEs, or they may require SMEs to have higher commissions and interest rates relative to the size of the loan, in order to achieve the returns provided by lending to larger firms (Beck et al., 2008). It can be said that these market conditions can justify government intervention. Traditional approaches to financial assistance to SMEs have focused on subsidised credit programmes and indirect credit guarantee schemes. Compared to direct government assistance, credit guarantee schemes are considered a market-oriented strategy for improving SMEs' access to finance and have been widely adopted by many countries to alleviate the problems faced by SMEs looking for credit, and so that they can ultimately achieve economic benefits (Boocock and Shariff, 2005; Chandler, 2012; Riding et al., 2007). There are also controversies around credit guarantee schemes. De Rudy (2007) argues that banks could push SMEs towards secured loans because guarantees make them more profitable (and secure) customers for banks.

Given the administrative costs of the schemes, a question arises: whether the benefits of the programmes exceed their costs (Craig et al., 2009). Guarantee schemes represent indeed a continuous stream of government subsidies disguised as providing free or low-cost facilities and services, as well as costs with the secondment of staff from other public departments (Green, 2003). That is why the question should be asked whether guarantee schemes are the best way to help SMEs finance themselves at the lowest possible social cost, because, from the point of view of the costs and of the access improvement to finance, a more efficient way could be to implement training programmes on lending to SMEs for bank employees, grants or direct grants, tax reductions, etc. (Green, 2003).

In theory, government financial assistance can help SMEs in two main ways. First, financial assistance can help the business improve its performance and thus generate cash flows, directly reducing financial constraints. Secondly, SMEs that have received government financial assistance are more likely to obtain financing from creditors, having similar effects to the presentation of a guarantee. Thus, public financial assistance helps to diminish information asymmetries and, respectively, improves the skills and capabilities to provide guarantees for obtaining loans (Liu et al., 2011), (Kon and Storey, 2003).(Badulescu, 2013).

Unit borrowing costs tend to be higher for smaller firms, obtaining information requires more resources as a percentage of the loan given, visiting borrowers to assess their activity and monitoring them are expensive activities and not always economically rational when the size of a loan is small (Green, 2003). Adverse selection is another problem arising from information asymmetry. In this context, adverse selection begins with the market phenomenon whereby the probability of default increases with the interest rate. As interest rates rise, safer borrowers are removed (they pay off committed loans faster and/or avoid applying for new loans), while more risky borrowers remain in the banks' portfolio and/or apply for new loans. This leads to an increasingly risky loan portfolio for lenders. However, the inflexibility of banks prevents many SMEs from obtaining credit, even if they would be willing to pay higher interest rates, and the result is the rationalisation of loans. Both the opposing selection and the administrative costs of the loan can lead to a selection process largely based on the size of the firm and the provision of collateral. As a result, profitable projects that do not meet these conditions may not be able to obtain financing, leading to a sub-optimal allocation of credit. Thus, credit guarantee schemes can help banks overcome information asymmetries, helping to accurately identify credit risk and improve banks' ability to make appropriate lending decisions (Levitsky, 1997).

3. Fundamentals of policies and measures of supporting the access to finance for SMEs in times of crisis

In all European countries, recovery, and resilience plans from crises (economic, financial, health) have included moratoriums on loan repayments, tax deferrals, grants, capital facilities and wage subsidies, credit guarantee schemes as fundamental instruments in the set of public policies implemented by governments aimed at supporting the liquidity need of enterprises, SMEs in particular (Anderson et al., 2021; Lehmann & Lenaerts, 2021). The increase in the volume of guarantees, as well as the number of firms, raises important questions both about the sustainability of public finances and about the real effectiveness of these programmes in terms of economic growth (Ciani et al., 2020; European Banking Authority, 2020).

The debate on the accessibility of bank financing is highly polarised: entrepreneurs accuse banks of not lending enough funds to small businesses, while banks complain about the lack of a demand for credit from entrepreneurs. Previous studies show that the amount of credit available to SMEs has fallen sharply since the onset of the global financial crisis in 2008, but it is not clear whether this decrease was caused by low demand from firms, or by the limited supply from creditors (Ayadi and Gadi, 2013; Popov and Udell, 2012; Kremp and Sevestre, 2013; McGuinness and Hogan, 2016). Regarding the years preceding the Covid-19 health crisis, in the period 2014-2019 the lending conditions were favourable, the bank interest rates registering a decline, the conditions regarding the access to financing being relatively relaxed. After the financial shock of 2008-2009, SMEs restored their profit margins and according to data provided by the European Commission (European Commission, 2019), during this period, few SMEs considered the access to finance to be their most pressing problem. Compared to the year 2018, in 2019, lending to SMEs registered a decreasing trend in many OECD countries, even if the attitude of financial institutions on lending was much improved. Regarding non-performing loans, they were at a low level in the years leading up to the health crisis. There was also an increase in non-bank financing, especially in Central and Eastern Europe (Slovakia by 255%, Poland by 154% and Estonia by 121.87%), according to the study published by the OECD (2020).

The restrictions prompted by the COVID-19 pandemic have triggered a severe global recession, all sectors of the economy have been directly or indirectly affected, and SMEs have felt these shocks strongly, many of them being forced to drastically reduce their activity or even suspend it. On the financial front, they had to cope with the sharp drop in revenues and face a liquidity deficit. According to the study conducted by the OECD and the World Bank, among the SMEs that continued their activity during May-December 2020 in the European Union countries, a percentage of 55-70% recorded a decrease in income, of which, two thirds said that their incomes decreased by more than 40% (OECD, 2020).

Along with the outbreak of the crisis, many of the measures were aimed at providing aid to viable but non-liquid companies and limiting bankruptcies. These measures were taken for short periods of time and were addressed to a large number of beneficiaries. Given the unexpected nature of the crisis, policymakers demonstrated flexibility and a willingness to adjust their approaches as implementation continued. This often-included simplifying schemes and adapting eligibility criteria; governments mainly worked with banks to channel support to SMEs.

The demand for and availability of public funding increased in the years after 2020 thanks to the support provided by governments through monetary and fiscal policies, as well as through banks, guarantee institutions, and similar organizations. However, as the profits of SMEs have been hit hard, SMEs seem to be taking on more and more debt, which is in fact replacing the decrease in revenues generated by current activity.

In the United States, for example, 46% of the firms that have accessed a loan in the last 12 months, plan to contact additional debts to cover the financial gap left by the COVID-19 crisis (Federal Reserve Bank of New York, 2020).

During the crises, governments have taken packages of necessary measures to stimulate SMEs according to the specifics of each country. International institutions have also taken steps to ensure the liquidity of SMEs. However, while there is broad agreement regarding the need for further measures to support and incentivise SMEs, the sustainability of public finances has become a concern. On the one hand, given the fragility of the global economy and of many small businesses, the support measures taken should not be withdrawn too abruptly (OECD, 2020). On the other hand, governments are aware that the current support measures are not indefinitely.

Thus, government policies also include measures to support the liquidity of SMEs, measures that do not include the increase of their debt such as: supporting start-up firms in the field of technology and with a rapid development and which would require investments from private actors; loans convertible into equity if the borrower is unable to repay; providing grants, so that a wide spectrum of firms can benefit without increasing their indebtedness; fiscal policies that support the consolidation of SMEs' own capital, a key mechanism that can increase the capacity of SMEs to maintain their cash flow; supporting the spread of crowdfunding tools, etc.

Often, however, the above instruments have a limited adoption, driven by the reluctance of SME owners, implementation difficulties, the risk of public support not going to the right beneficiaries, attempted fraud, and misappropriation of funds (OECD, 2020). In addition to the fiscal impact, supporting a very large number of companies without strong conditionalities brings with it the risk of misallocating resources and keeping afloat non-viable companies, thus affecting the dynamism of the economy and hindering competition (OECD, 2020). So, policymakers must find a balance between avoiding the bankruptcies of viable firms, on the one hand, supporting non-viable firms, on the other, and preventing the growth of the non-performing loan portfolio of banks (Badulescu & Simut, 2012).

We could consider that a failing firms are actually a market failure in evaluating the potential of a new businesses by lenders, private investors or makers. On the one hand, an investor, a lender, may lose if the individual financed firm fails, but there are also positive externalities generated by the failure of new firms, which may contribute to the success of other firms. From a public policy perspective, it does not matter which firm succeeds and which disappears, as long as some businesses continue to emerge, and some to growth, and the general development in term of business and entrepreneurship are useful to the region or sector supported. However, it is required that decision-makers support and promote entrepreneurial initiatives,

become partners for the business sector, allowing and encouraging the establishment and development of companies, thus their success to be constituted as strong models for others (Audretsch, 2003).
Thus, during more than a half of century, public policies have gone through different phases, from regulations to stimulate competition and temper the dominance of large companies, to de-regulation and privatization policies, and finally to a new approach, which focuses on the creation and commercialization of knowledge and the support of small firms, high growth oriented, of those in knowledge-based fields, the stimulation of entrepreneurial behaviours through publicly funded programs (Cenan (Ciucoș), 2022). There are numerous programs and measures that aim to remove bottlenecks in the development and financing of new companies in high research and technology fields, the creation of innovation centers to support the development of small technology-based companies, research parks to promote the competitiveness of a certain region or sector, of business incubators and accelerators, on the entrepreneurial education of young generations (see Table 1). Regarding access to diverse types of credits there are various financing schemes and loan guarantees, where SMEs without their own guarantees get access to bank loans, and the state acts as a guarantor. Generally, all are considered useful, but with minor impact on overall SME financing in most countries. Also, access to equity financing, through different investment arrangements as tax breaks for wealthy people to become "business angels" are considered to have ”blurry effects” on general development on private productive sector (Audretsch, 2003), (Storey, 1994), (Cenan (Ciucoș), 2022).

4. General trends of SMEs' access to public financing in Europe

In order to understand the size of the problem, the importance and accessibility of different forms of financing and, in particular, of public support for SMEs, we will call on different Surveys on the Access to Finance of Enterprises, as the main tool for monitoring the evolutions of the access to SMEs the European Commission's funding.

4.1. The size and importance of the problem

According to the SAFE report for the year 2022 (European Commission, 2022) access to financing is, at the end of 2022, the most important concern for (only) 8%-10% of EU companies (around 10% for micro-enterprises, 8% for companies small and medium and below 7% for large companies). The situation in this area has improved considerably in the last ten years (2009-2019), as this concern decreased from an average of 17% in 2009 (even 21% for micro-enterprises) to 10% in 2015

and 9% in 2019. In -a ranking of the most important/pressing problems for a company, access to financing is continuously decreasing, from 2nd place in 2009 (after "Finding customers"), to 5th place in 2014, and finally to 7th place in 2019 - 2022. However, we note that the percentages tend to increase slightly during the pandemic and post-pandemic period (2020-2022).
Of course, the problem appears somewhat more important for micro-enterprises, but here too the trend is similar, access to finance being gradually considered a less and less acute problem in the last decade. However, results differ between countries and the highest proportion of SMEs experiencing the effects of difficult access to finance in the last 3-4 years) appear in Greece (an average of around 19%), Malta and Lithuania (13 %-14%) and Cyprus (12-14%). The problem of financing is reported not only among small companies, but also among relatively young companies (established in the last 2-5 years), those oriented towards sustained growth, exporters and innovative ones, with about 2-3% in above average (European Central Bank, 2019), (European Commission, 2022).
The diversity of forms of financing and support for companies to choose the most suitable financing is reflected in the relative importance of the different sources of financing used, but it is also obviously influenced by the level of development of different types of financial institutions and segments of the financial markets, such as be it stock market, bond market or securitization.

4.2. The relevance and effectiveness of public support for SMEs

In recent years (2017 - 2022), EU SMEs considered credit lines and overdraft as the most relevant forms of external financing, followed by leasing and bank credit (in its various forms.).
In all EU Member States, the majority of SMEs (82%) used debt financing in one form or another in 2022. Thus, 47% of respondents mentioned the credit line or overdraft as relevant in 2022, (although in a slightly lower proportion than in previous years). Leasing (and similar forms of financing) is the second type of financing in order of relevance, about 47% of respondents mentioning them. Finally, bank loans and trade credit are also presented as a relevant type of financing, although there was a decrease in the relevance of these types of financing in the pre-pandemic period (from 57% in 2014 to 46% in 2019 and, respectively, from 36% in 2014 to 31% in 2019) and a slight resumption of growth in the last two years (2021-2022). Bank loans and trade credits are followed by public grants and subsidized bank loans and domestic funds, respectively. Other loans, raising equity capital, factoring, debt securities are mentioned as relevant by smaller percentages of SMEs than the other types of financing, and their relevance gradually decreased during the

analysed time period (European Central Bank, 2019), (European Commission, 2019), (European Commission, 2022).

Depending on the country, the relevance of debt financing has important but not dramatic variations, in all the countries examined, the vast majority of SMEs indicated that at least one type of debt financing was (constantly) relevant to their enterprise for a certain period of time. For the EU countries, the proportion varied from 90% for SMEs in Malta to 69% for those in Luxembourg, compared to an EU average of 82%.

In net terms, companies in the euro area reported a considerable increase (with percentages varying between 4 and 15%) in the demand for external financing, compared to previous years, both for bank loans, especially lines of credit (from 7%), but also other forms of commercial credit, leasing, such as informal loans from family and friends, from affiliated companies or shareholders, or equity and debt securities. The increased demand signals the need for companies to diversify their external financing, both to ensure survival and growth needs, which cannot be covered from internal sources, but also to negotiate favourable financing conditions - costs, guarantees, flexibility (Badulescu, 2011). The 2022 SAFE report notes that, in contrast to previous years (2019-2021), the growth in demand for external financing was sustained slightly more by large firms than by SMEs for most instruments.

A few reflections from the latest SAFE report (2022) are worth considering here. Thus, grants or subsidized bank loans are considered as an important source for many SMEs, although in significant decrease in the last decade (from 54% in 2012, to around 42% in 2022), an interval that also contains, however, a short, but fast, increase during the pandemic period. The decrease of almost 12% is explained either by mitigating the impact of the pandemic crisis in 2022 and, implicitly, the concerns of the business environment related to it, but probably also the difficulties of access. Thus, although almost half of the respondents at the EU level consider it an important form of financing, only 11% of the total say they used it in 2022 (compared to about 16% in 2021). Finally, almost a third of the respondents (31% at the EU level) say that they did not consider accessing such support during 2022. At the national level, the differences are significant, the use of this form of financing has high percentages in Hungary (17%), Romania (16%) and Italy (15%), while only 1% of firms in the Netherlands, or 2% in Cyprus, Slovakia or Latvia state that they used this form of financing. Regarding the relevance or the possibility of considering, in the near future, the use of this form of financing, the interest is very low in countries such as the Netherlands or Denmark (81-83% are not interested).

By sectors, dimensions or degree of internationalization, the differences are also significant, as averages at the EU level. Small and medium-sized companies (with less than 50 employees), construction and exporters are more inclined to use (also) these forms of financing, and the percentages are about 3-10% higher compared to large companies (with over 250 employees), od firms from construction, trade or services, or companies without relevant export activity. Similarly, innovative firms or high-growth firms or gazelles indicate much higher interest percentages compared to the other types of firms (see also Table 1).

Table 1. Interest and use of public support, grants and subsidized loans depending on the activity sector, size and type of company), in 2019 and 2022 (% of responses)

Sector/type of firm	**Used in the past 6 months**		**Did not used in the past 6 months**		**This source of financing is not relevant to my firm**		**This source of financing is relevant to my firm, but I don't know is I used**		**Don't Know/Non-answer**	
	2019	2022	2019	2022	2019	2022	2019	2022	2019	2022
Industry	12%	15%	28%	35%	57%	46%	2%	1%	1%	3%
Construction	6%	10%	22%	28%	68%	58%	3%	0%	1%	4%
Trade	6%	10%	22%	30%	68%	56%	3%	1%	1%	3%
Services	7%	10%	22%	31%	68%	56%	3%	1%	0%	3%
Micro (1-9 employees)	5%	8%	23%	30%	69%	58%	2%	0%	1%	4%
Small (10-49 employees)	8%	11%	25%	33%	65%	52%	2%	0%	0%	4%
Medium (50-249 employees)	11%	15%	23%	30%	63%	51%	3%	0%	0%	1%
Large (over 250 employees)	10%	15%	19%	26%	67%	56%	3%	0%	1%	3%
High-growth	9%	15%	24%	34%	64%	48%	3%	0%	0%	3%
Exporters	10%	13%	25%	32%	63%	52%	2%	3%	0%	3%
Non-exporters	6%	10%	23%	31%	68%	56%	3%	3%	0%	0%
Innovative	10%	14%	26%	36%	61%	47%	3%	1%	0%	2%

Non-innovative	5%	8%	21%	27%	71%	62%	2%	0%	1%	3%

Sources: (European Central Bank, 2019), (European Commission, 2019), (European Commission, 2022)

Probably also as an expression of the gradual elimination of several support measures in the EU, about 15% of companies considered that access to subsidized grants or loans (and implicitly their consideration for future business development) has decreased. In terms of firm's size, it appears that SMEs are more pessimistic than large firms in this regard.

Regarding public financial support (see Figure 1), the number of SMEs perceiving deterioration was higher than the number of SMEs considering improvement, for the entire analysed period, although the difference tends to decrease, from around -15 % (in 2014) to – 7/8% in recent years.

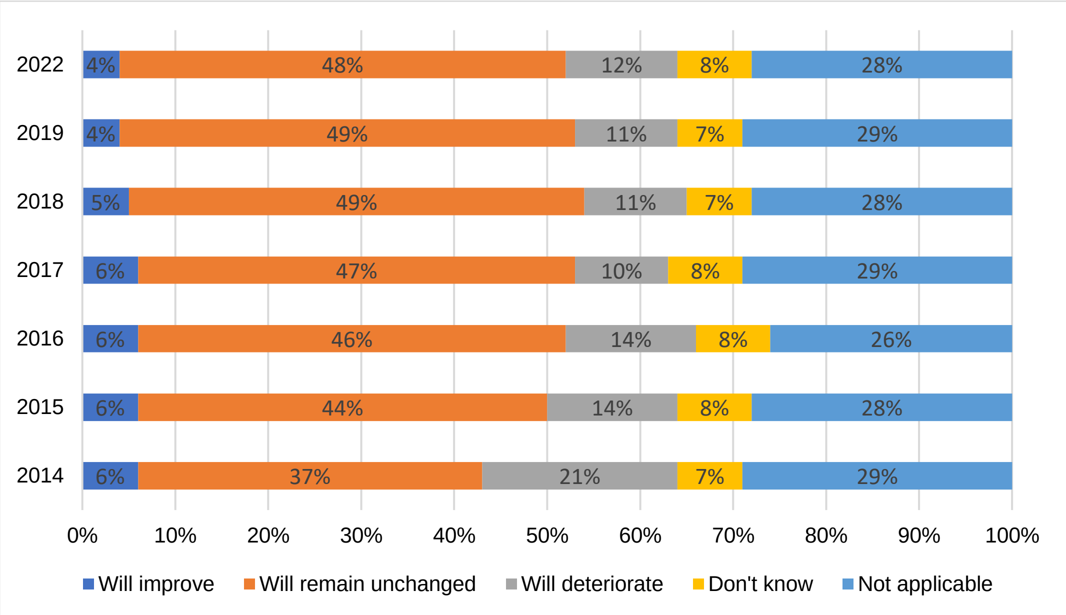

Figure 1. Changes in the perception of public financial support, able to affect the availability of external financing for SMEs in the EU member states (2014-2022, in %)

Sources: (European Commission, 2019), (European Commission, 2022)

5. In conclusion

After the economic and financial crisis of 2007-2009, national and regional government interventions aimed at supporting small and medium-sized enterprises, contributed to the stability of the banking industry and minimized the economic impact of the crises; the lessons learned on this occasion proved useful also throughout the COVID-19 pandemic, supporting the activities of the private sector in many countries. The banking industry has facilitated and helped address many of the challenges faced by governments, industries, markets, and individuals, during the health crisis.

The issue of access to finance and government measures put in place to ease financing constraints, has a different impact on SMEs depending on the country, the sector of activity, and their size, the general conclusion being that government assistance helps SMEs to improve their financial performance and thus in the future be able to access various types of financing, which leads to economic development.

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