

## Multilateral Development Banks and Their Role in Supporting European SMEs during the Current Financial Crisis

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**Abstract:** The impact of the ongoing financial crisis on the availability of finance to small and medium-sized enterprises (SMEs) represents an important topic nowadays. The access to finance for SMEs is a major barrier for their growth, especially during severe conditions such as the global financial crisis. Financing the SMEs represents a priority for the most of the multilateral development banks. The aim of the paper is to analyze the activity of European multilateral development banks - European Investment Bank Group and European Bank for Reconstruction and Development - in the support of SMEs. We found that SMEs financing increased during the period 2008-2011 and the international financial institutions took several measures in order to improve the SMEs access to finance.

**Keywords:** multilateral development banks; small and medium-sized enterprises (SMEs); firms' financing; financial crisis; financial constraint

**JEL Classification:** G32; F34

### 1. Introduction

One of the priorities of Multilateral Development Banks (MDBs) is to support small and medium-sized businesses by facilitating access to finance and by offering advisory services. In attaining this goal, MDBs cooperate with a wide range of financial intermediaries, such as commercial banks, leasing and guarantee companies, micro-credit providers, and private equity funds.

The aim of the paper is to analyse the activity of Multilateral Development Banks in the support of European SMEs after the onset of financial crisis. We have chosen to analyse only the activity of the most important MDBs from Europe – European Investment Bank (EIB) Group and European Bank for Reconstruction and Development (EBRD). Other regional development banks, such as Black Sea Trade and Development Bank (BSTDB), have an insignificant impact on the activity of SMEs.

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These two MDBs have a long history and experience in support for micro, small and medium-sized enterprises (MSMEs) in their countries of operations. The MBDs have recognized the importance of supporting SMEs as they are important providers of entrepreneurship, innovation, and job creation.

## **2. The Importance of SMEs for the European Economies**

In the financial literature, the term “Small and medium-sized enterprise” (SME) is defined differently from one country to another and across financial institutions. The European Union (EU) defines SMEs as enterprises with less than 250 employees and with a turnover smaller than EUR 50 million, and/ or an annual balance sheet total not exceeding EUR 43 million (European Commission, 2003).

The importance of SMEs for the economic development is well recognized in the literature (Onofrei & Anton, 2010, pp. 26-27). SMEs represent an important source of job creation, economic growth, entrepreneurship and innovation, competitiveness, dynamism and flexibility in advanced industrialized countries, as well as in emerging and developing economies.

SMEs represent the dominant form of business organization, accounting for over 95% and up to 99% of enterprises, depending on the country (OECD, 2006, p. 1). In the European Union, nearly 98% of all enterprises are SMEs, while 92.2% of them are micro enterprises (Ecorys, 2012, p.15). For 2012, the SMEs account for approximately 67% of total employment. In economic terms, SMEs generate around 58% of the gross value added to the European economy. Small businesses are very important for stimulating innovation, which contributes to enhancing the competitive of the economy and to the creation of new jobs. For these reasons, small and medium-sized enterprises are considered to be the backbone of EU economy.

## **3. Access to Finance as a Constraint on SMEs**

Even if SMEs play an outstanding role for the European economies, they face significant difficulties in finding the appropriate source of finance. Many studies (Vos et al., 2007, pp. 2648–2672; Beck et al., 2008, pp. 467–487) found that SMEs face higher financial constraints as large firms and the lack of external financing represents a barrier in their development. Financing constraints can be defined as „the inability of a company to obtain a sufficient amount of financing to fund its investment needs at current, or even higher, interest rates” (Antão et al., 2007, p. 35). As a response to these financial constraints, many multilateral development banks and governments initiated programs to foster SME financing including

government subsidized lines of credit, public guarantee funds, (public) venture capital funds, and other public SME support schemes.

Financial constraints can be measured using surveys or econometric analyses. For the euro zone area, the European Central Bank (ECB) and the European Commission (EC) are conducting biannual surveys on the access to finance of SMEs in the European Union (SAFE). According to the latest ECB's "survey, covering the period April to September 2012, access to finance is still the second most pressing problem for euro area SMEs, after the "finding customers" concern (European Central Bank, 2012). We noticed significant differences across countries and industries regarding the importance of "access to finance" concern. In some countries – Italy, Portugal, and the Netherlands – the concern has reached the highest level since 2009.

Despite that many private financial institutions have entered into SMEs financing market segment and have built institutional capacity for on-lending to small borrowers, SMEs continue to experience a lack of access to credit. SMEs show a far more volatile pattern of growth and earnings, with greater fluctuations, than larger companies. At the same time, their survival rate is lower than for larger companies. For these reasons, banks are reluctant to finance SMEs relative to larger and more established firms. Furthermore, commercial banks and other traditional sources of credit may consider that SMEs are riskier than larger companies, and respond by asking for higher interest rates. In these conditions it is difficult for SMEs to borrow from banks than for bigger companies. This fact has been exacerbated after the onset of current economic and financial crisis, when many financial intermediaries have restricted their lending to SMEs in response to pressures on their balance sheets.

#### **4. The Role of Multilateral Development Banks in Supporting SMEs**

Since the onset of current economic and financial crisis, MDBs took several measures in order to enhance SMEs access to finance. Firstly, MDBs increased the cooperation among them in order to support private sector development in those countries affected by the ongoing financial crisis. At the beginning of 2009, three important MDBs - the European Investment Bank Group (EIB Group), the European Bank for Reconstruction and Development (EBRD) and the World Bank Group - have agreed on a Joint IFI Action Plan undertook to provide up to EUR 24.5bn in support of lending to the real economy through private banking groups in Central and Eastern Europe, in particular in favour of SMEs. In December 2012, the same MDBs signed a new joint IFI Action Plan for economic growth and recovery in Central and South Eastern Europe. Once again, the above-mentioned international financial institutions committed EUR 30 billion for the period 2013-

2014 in order to finance private and public sector initiatives, including infrastructure, corporate investment and the financial sector.

Secondly, MDBs expanded their cooperation with financial intermediaries in order to reach the greatest number of SMEs and magnify the presence and scale of local/regional financial institutions.

Thirdly, almost all the important MDBs have increased the level of commitment to the supporting of SMEs after the crisis. As a response to the current financial crisis, in 2009 the EIB has increased the overall volume of its SME lending in the European Union by 76% compared with 2008; financing more than 50,000 new SMEs (see table no.1). Intermediated loans via local or regional commercial banks represent the EIB's core instrument, with EUR 40.20 billion signed during the period 2008-2011 (European Investment Bank, 2013). More than two hundred thousand SMEs in the European Union have benefited from EUR 45,681million during the period 2008-2011.

**Table 1. EIB Lending Targeting SMEs in Member States 2008-2011 (EUR Million)**

	2008	2009	2010	2011	Total 2008-2011
Approvals	8,589	15,126	10,978	10,988	45,681
Signatures	8,192	12,628	9,972	9,492	40,285
Disbursements	5,623	10,042	10,010	10,027	35,702
Allocations	6,980	7,072	9,987	12,718	36,757
Numbers of SME allocations - EU27	50,043	48,373	63,424	64,495	226,335

*Source: European Investment Bank, www.eib.org*

The European Investment Fund (EIF) is the European Investment Bank (EIB) Group's specialist provider of risk financing to the benefit of SMEs across Europe (European Investment Fund, 2013). Through financial intermediaries (commercial banks, guarantee and leasing companies, micro-credit providers, and private equity funds) EIF delivers three types of instruments for SMEs: equity instruments, guarantee and credit enhancement instruments, as well as microfinance.

**Table 2. EIF Funding for SMEs in Europe 2009-2012 (EUR Billions)**

	2009	2010	2011	2012	Total 2009- 2012
Commitment					
Private equity	0.7	0.9	1.1	1.4	4.1
Guarantees & microfinance	0.2	0.6	1.5	1.2	3.5
Total	0.9	1.5	2.6	2.6	7.6
Leverage					

Private equity	3.1	4.6	6.1	7	20.8
Guarantees & microfinance	2.2	3.2	7.6	5.2	18.2
Total	5.3	7.8	13.7	12.2	39

*Source: European Investment Fund, www.eif.org*

During the period 2008-2012 EIF made equity commitments of EUR 4.1 billion which catalyzed over EUR 20 billion from other investors (see table no. 2). EIF played a critical role in stimulating the development of private equity market in Europe as a provider of funds and, in the same time, as a manager of some venture capital funds. EIF also committed EUR 3.5 billion into guarantees and securitisation transactions, stimulating new loan portfolios for SMEs worth EUR 18.2 billion.

By enhancing the access to financing for SMEs, the EIB Group aims to improve employment opportunities, to stimulate innovation, and to accelerate growth and reduce poverty.

The EBRD support to SMEs comprises loans, equity, guarantees, microfinance, and trade financing. Credit lines to local or regional banks and to leasing companies represent the EBRD's core instrument to support small businesses (European Bank for Reconstruction and Development, 2013).

Relative to EIB's activity in support to SMEs, EBRD covers only SMEs from CEE and CIS countries and the value of financial commitment is much lower. One common feature for both MDBs is the sharp increase in the number of financed projects and in the value of financial commitment (see table no. 3). At the end of 2011, EBRD had SME projects in 25 countries, involving over 130 financial intermediaries. Furthermore, EBRD offers technical assistance (advisory services) through its Small Business Support unit.

**Table 3. EBRD Credit Lines Targeting SMEs in Member States 2008-2011 (EUR Million)**

	2008	2009	2010	2011	Total
Number of projects	28	36	49	49	162
Credit lines value	257	753	761	547	2,318
Number of countries	15	15	17	18	-

*Source: European Bank for Reconstruction and Development, www.ebrd.com*

Another finding of our study is that multilateral development banks made efforts to broaden the range of their products in order to meet the SMEs financing needs. In the last five years, EIB and EBRD have introduced new instruments and facilities in order to improve SMEs access to finance. EIB Group, the most important MDB in terms of financial commitment to the SMEs in the European Union, has

launched several new products in the last years, the most important being Progress Microfinance (March 2010) and Risk Sharing Instrument (December 2011).

Progress Microfinance (European Progress Microfinance Facility) aims to increase the availability of finance in form of micro-loans (up to € 25,000) for certain vulnerable groups (ethnic minorities or female entrepreneurs) for starting or developing a microenterprise (with less than 10 employees).

Within the *Risk Sharing Finance Facility*, EC (DG Research and Innovation), EIF, and EIB introduced a new instrument (*Risk Sharing Instrument*) aimed to enhance the access to debt financing for innovative SMEs and small mid-caps (companies with fewer than 500 employees) undertaking Research & Development and innovation projects. EIF offers direct financial guarantees covering principal and interest loss to selected financial intermediaries, which are making loans and financial leases to research-based SMEs. Financial intermediaries are transferring the benefit of the guarantee (reduced interest rate) to the entrepreneurs.

## 5. Conclusions

Addressing the SMEs' financial gap represents one of the priority objectives of the multilateral development banks. MDBs provide financial products to SMEs that lack sufficient access to private sources of capital. Analyzing the activity of MDS after the onset of current financial and economic crisis we found that the financial commitments to the SMEs have grown significantly during the period 2008-2012. Consequently, the number of SMEs financed by local financial intermediaries has increased significantly. All multilateral development banks made efforts to broaden the range of its distribution channels and products. Currently, MDBs deliver a mix of financial instruments, including debt, equity, guarantees, local currency loans, and political risk insurance. During the period 2008-2012, MDBs have been deepening their partnerships to enhance the impact of funds allocated to the SMEs and to support economic recovery in the EU.

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