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SUSTAINABILITY FOCUS

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THE ROLE OF BANKS IN SUPPORTING THE REAL ECONOMY

KEY TAKEAWAYS

SMEs are increasingly attracting governments' attention as a source of economic growth and employment. However, access to finance is consistently cited as one of the top obstacles to unlocking the segment's growth and employment potential.

The banking sector worldwide appears engaged to support the SMEs segment; however, the impact of its efforts remains unclear.

Serving SMEs can have positive effects for the financial sector in terms of new market opportunities and reputation.

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INTRODUCTION

Small and Medium Enterprises (SMEs) play a vital role in economic development, as they are the main source of employment generation and output growth, both in developing as well as in developed countries. Access to finance has a positive impact on firms´ growth; it assists enterprises in overcoming liquidity constraints, in exploiting growth potentials, and in capitalizing on investment opportunities. Furthermore, it helps enterprises to achieve a larger long-term equilibrium size.

The global crisis has exacerbated the financing constraints on SMEs. They have suffered a double shock: a drastic drop in the demand for the goods and services they provide and a credit crunch. These events have had a severe effect on SMEs' cash flows and liquidity, forcing many into bankruptcy and contributing to record levels of unemployment in many countries.

What emerges from our analysis is that banks in every region provide a good disclosure of their engagement to contribute to local development through the support to SMEs and business start-ups, but the reporting on performance indicators, that could provide an evidence of the effectiveness of such efforts, is often missing or incomplete.

THE CONTEXT

More than 99% of all European businesses are SMEs[1]. They provide two out of three of the private sector jobs and contribute to more than half of the total value-added created by businesses in Europe. But according to the 2013 Annual Report by the European Central Bank, SMEs' financing conditions are still heterogeneous across euro area countries, with generally larger financing obstacles for SMEs in countries that were more strongly affected by the financial crisis[2].

Enterprises, Employment and Gross Value Added of SMEs in the EU-27, 2012

	Micro	Small	Medium	SMEs	Large	Total
Number of Enterprises						
Number	18,783,480	1,349,730	22,628	20,355,839	43,454	20,399,291
%	92.1%	6.6%	1.1%	99.8%	0.2%	100%
Employment						
Number	37,494,458	26,704,352	26,615,906	86,814,717	43,787,013	130,601,730
%	28.7%	20.5%	17.3%	66.5%	33.5%	100%
Value Added at Factor Costs						
Million Euros	1,242,724	1,076,388	1,076,270	3,395,383	2,495,926	5,891,309
%	21.1%	18.3%	18.3%	57.6%	42.4%	100%

Source: Eurostat, National Statistical Offices, DIW, DIW econ, London Economics

A similar situation is observed in emerging markets. SMEs are critical for their economic and social development but it is calculated that more than 200 million SMEs in emerging and developing markets do not have access to the finance they need to grow and thrive[3].

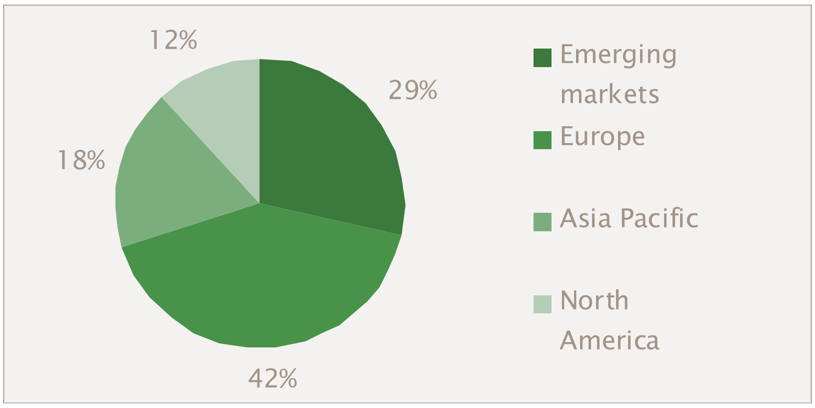
As a result, fostering the access to financing for SMEs has become the focus of an international debate. G20 leaders recognized access to financial services as a cross-cutting issue for development and economic system stability. At its December 2013 meeting, the **G20** Development Working Group[4], discussed on how to improve access to financial services[5]. Also, the **OECD** launched in 2012 the first edition of "Financing SMEs and Entrepreneurship: An OECD Scoreboard" with the aim of establishing a comprehensive international framework for monitoring SMEs' and entrepreneurs' access to finance over time[6]. The **United Nations Secretary-General's Special Advocate for Inclusive Finance for Development** (UNSGSA), is working with stakeholders to share knowledge, inspire deeper commitments, and take action that results in meaningful impact for poor people and smaller enterprises[7].

The **International Finance Cooperation** (IFC) works to increase access of SMEs to financial services in developing countries by providing funding for equity, loans, and mezzanine finance to financial intermediaries focusing on SMEs, by building their capacity and raising awareness on best practices[8]. Finally, in the Asia Pacific region, the **Asia Pacific Economic Cooperation**, forum composed by 21 member economies for facilitating economic growth in the region, considers strengthening the access of SMEs to financing among the priority areas of its strategic plan 2013-2016 to secure the growth of this business segment[9].

VIGEO FINDINGS

Vigeo analysed 200 banks in the four geographic regions on their support to social and economic development, through the provision of products and services tailored to SMEs and start-ups, micro-finance and the cooperation with stakeholders to promote the access of small businesses to financial services.

Geographical breakdown of banks in VIGEO universe

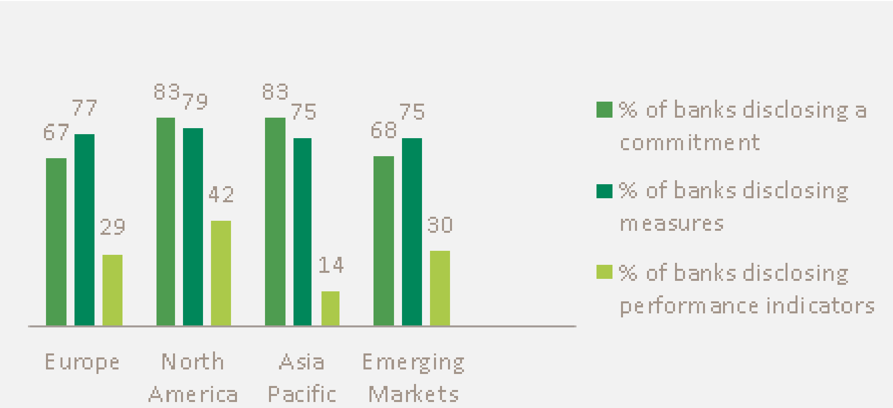


We observed that 71.5% of banks report either a commitment or efforts generally addressing local development. Concrete measures to support SMEs are described by 139 out of 200 banks (69%), 23% report to be involved in microfinance and 28% to cooperate with stakeholders in this regard.

Looking at the different zones, 68% of banks in Europe, 79% in North America, 66% in Asia Pacific and 68% from Emerging Markets report their support to SMEs, while the provision of micro-finance appears more widespread in European and North American companies, as well as the cooperation with stakeholders.

A first finding is that supporting access to credit for SMEs appears as a common practice across the four zones. According to a 2014 OECD Report on SMEs and the credit crunch[10], the crisis has had a negative effect on bank lending and when bank lending is reduced, SMEs tend to be more vulnerable and affected than larger corporations. Governments launched specific measures to address this problem, in some cases targeted to the banking sector. For example, the *US Community Reinvestment Act,* is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low and moderate-income regions[11]. This initiative probably contributed to the better performance of U.S. banks, in comparison with other regions, as appears in the graph on the following page.

The second interesting finding is that although 71.5% of the panel reports on supporting local development through facilitating SMEs' access to credit or offering microfinance, only 56 out of 200 banks (28%) disclose indicators that measure the effectiveness of their efforts. On one side the banking sector worldwide appears engaged to support local economies, on the other side the impact of their efforts remains unclear since few companies disclose performance indicators to measure it. Such weak disclosure questions the effectiveness of banks' strategies in this regard.



HOW BANKS CAN SUPPORT THE REAL ECONOMY: SOME EXAMPLES FROM THE FOUR REGIONS

One of the actions observed is the support to SMEs in coping with the negative effects of the economic crisis by suspending the payment of principal instalments of medium to long term loans as reported by the Italian **Banca Monte Dei Paschi Di Siena**. **Sberbank** (Russia) refers to its offer of programs tailored to support start-ups and SMEs and to the establishment of a Small Business Development Centres (SBDC) network which offers free consulting services and training sessions in addition to the bank's products. Workshops dedicated to SMEs are also offered by other banks as **Westpac** (Australia) and **Mandiri Bank** (India). **Bank of America** (US) offers microenterprise loan funds that primarily serve low to moderate-income communities. **HSBC** (UK) has signed a Memorandum of understanding with Grameen -Jameel to volunteer its employees' financial, technical and professional expertise to support microfinance institutions through the Bankers without Borders (BwB) program. In Sweden, **Nordea** launched the 'Nordea Business School' that is open to unemployed customers and to the general public who would like to establish their own business. As to **Banco Santander S.A**, the Santander Microcredits Brazil program grants loans to small businesses, mostly in the informal sector, which would otherwise not have access to loans.

CONCLUSION

Borrowers' risks in relation to the economic outlook remained dominant in explaining the tightening of credit standards. However, the current public debate of reorienting the financial system to economic growth focuses on finding ways to unlock financing to SMEs. They represent the cornerstone of every economy with their significant contribution to GDP growth and their ability to innovate.

For the financial sector, serving small and medium-sized enterprises (SMEs) can have positive effects in terms of **new market opportunities.** Bank revenues are estimated to increase from USD 150 billion in 2010 to about USD 367 billion by 2015[12] in the emerging markets (a growth rate of 20 per cent per annum) as, amongst others, there is an increased penetration of the large number of unserved and under-served SMEs.

On top of that, the core business of the banking sector is to act as an intermediary to channel funds in support of the real economy. The efforts of banks in this sense can, therefore, have a clear impact on their **reputation.**

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DISCLAIMER

Notes and Sources

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3) Transforming Excess Liquidity into Finance for SMEs in Emerging Markets, April 2013, UNSGSA, http://www.unsgsa.org/

4) G20 working group created with the aim of agreeing on a development agenda

5) "Empowering Development". www.g20.org

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