# Study project on "*The importance of Financial Intermediaries in SME financing and assessment of different economic effects especially of EU Financial Instruments in light of direct guarantee vs. counter-guarantee contracts*"

AECM - European Association of Guarantee Institutions

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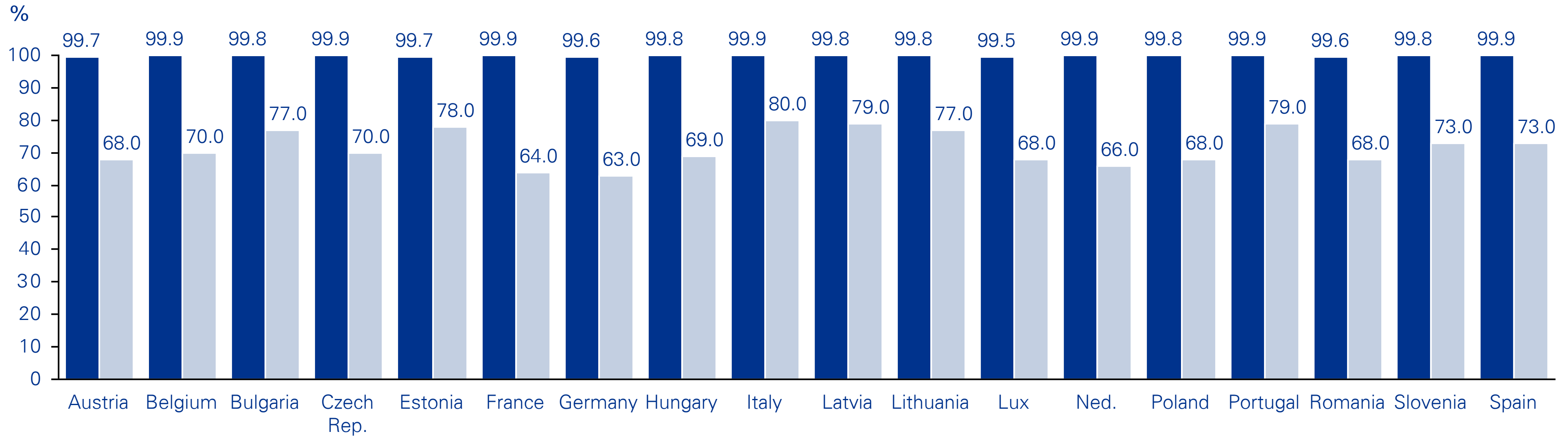
# The importance of SMEs in Europe

- SMEs represent the majority of European enterprises. More than a half of employees are employed by SMEs. In some countries, such as Bulgaria, Estonia, Italy, Latvia, Lithuania and Portugal the ratio reaches levels which are greater than 75% of the working population




Percentage of SMEs in each particular Country

Incidence of employment within SMEs

**Key figures in Europe**

**At least 99** Out of every 100 businesses are SMEs

**9** Out of 10 of EU SMEs are Micros (<10 employees)

SMEs generate **58% of the GDP**

Note. The chart does not represent Croatia, Greece, Slovakia, Russia, Bosnia and Turkey due to lack of data on SMEs employment level, and it does not represent Russia, Bosnia and Turkey due to lack of data on the number of SMEs

Source: KPMG elaboration on Eurostat data, 2013 (percentage of SMEs in Europe). KPMG elaboration on Eurostat data, 2015 (incidence of employment within SMEs)

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# The importance of a Guarantee system

**Market failure**

- **SMEs are typically at a disadvantage with respect to large firms when accessing finance,** owing to **opacity, information asymmetry**, under-collateralisation, high transaction costs and lack of financial skills
- **The financial crisis contributed to widening the financing gap, generating a market failure,** where supply of credit (particularly for SMEs and entrepreneurs) has not been able to meet an increasing demand

**Impacts on the EU potential for growth: less innovation, less growth, less job creation, less social cohesion**

**Guarantee system**

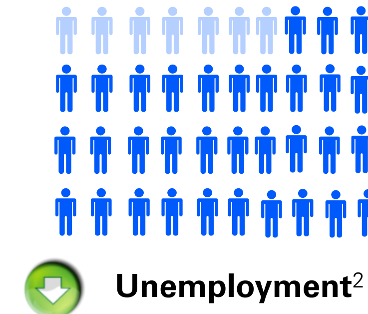
- SME financing remains high on the political agenda in most areas of the world and **credit guarantees remain the most widely used instrument to ease access to finance for SME**
- **Credit guarantee schemes alleviate the market failure and stimulate investment and social and economic growth**

**Guarantee System stimulates the economic growth**

- **An increase in investments generated by an increase in guarantees**, calculated in line with historical market trends, **might have a relevant impact on a country's GDP and on the labour market**, especially when **guarantees are granted for innovation and growth-oriented projects**

**Impacts on GDP**[1]

**Impacts on labour market**



**Unemployment**[2]

*Note 1: The impact on GDP goes from 1.3 €/bn to 1.8 €/bn for the Countries taken into account (it must be noted that the absolute value could vary depending on the different size of the Country's economy)*
*Note 2: Reduction by as much as 33,000 units in economies such as the Italian economy*

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# Advantages of Guarantee Institutions: qualitative evidence

- There is wide agreement (both in empirical studies and in the literature) that the main advantages brought by Guarantee Institutions to SMEs include, at least, the following

Guarantee Institutions, thanks to deeper knowledge of the local market (hence better selection skills) and provision of additional services and products are able to thoroughly assess SMEs needs for financing and to select projects with a higher quality, therefore creating a significant economic additionality

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# Advantages of Counter-guarantees: qualitative evidence

In case of Counter-guarantees the impacts on the economy are even higher thanks to a higher input/output relation (amount of Guarantee/impacts on the economy)

## Advantages of Counter-guarantees

- In case of Counter-guarantees involving Guarantee Institutions, the impacts are even higher, thanks to the significant economic additionality (growth, innovation, employment) they generate
- They can reach out to all SMEs, whereas banks have a more limited portfolio of clients. This helps to make the distribution model more efficient

## European funds: two different ways

- In the last few decades there has been greater availability of European Funds promoting access to credit, channelled in two different ways:
  - **Direct Guarantees**, issuing guarantee contracts directly to commercial banks
  - **Counter-guarantees**, issuing guarantee contracts with a Guarantee Institution

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# Advantages of Guarantee Institutions and Counter-guarantees

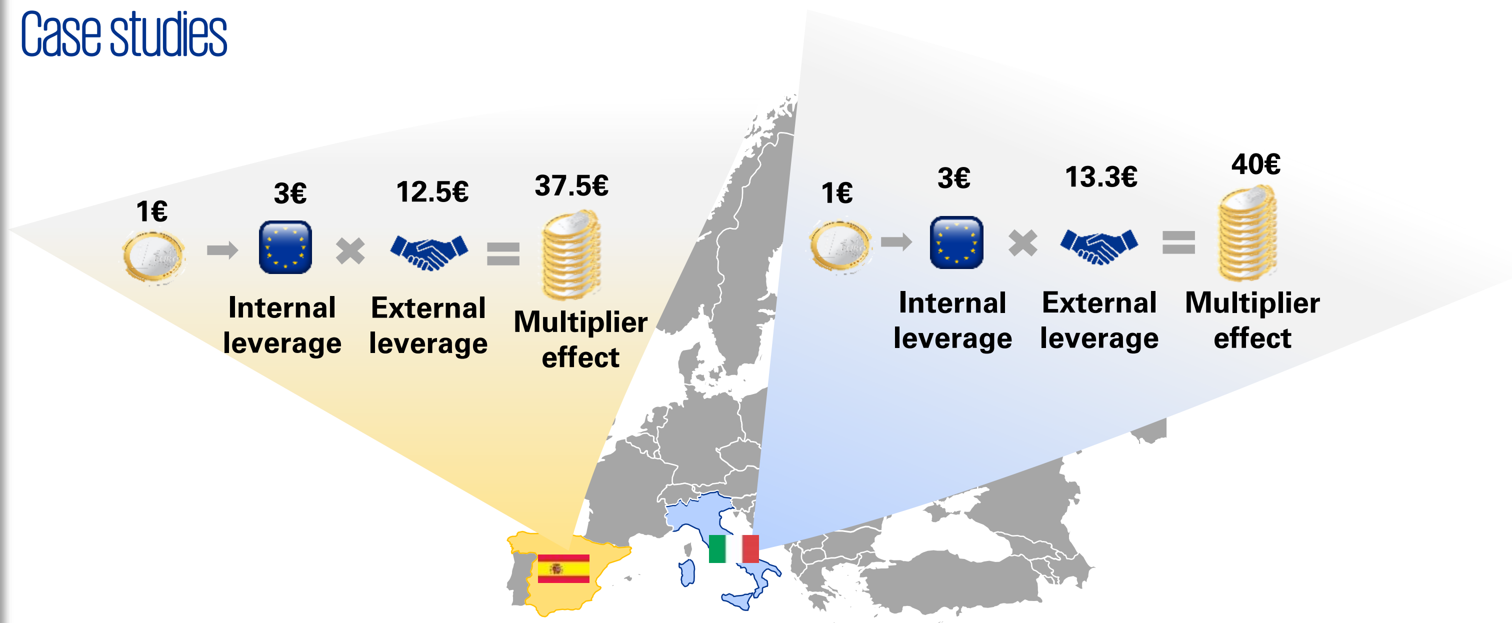
- To evaluate the potential benefits to the economy of **issuing Counter-guarantees** is important to look at **the multiplier effect generated by them**

**What is the multiplier effect for every 1 euro invested in Counter-guarantees?**

## Key Points

- Part of the **risk is kept and born by Guarantee Institutions**, allowing the system to **grant even more loans to SMEs**. It follows that the **same funding amount provided by EU** Institutions, if channelled **through Counter-guarantees, generates a larger amount of loans and investments** and a more sustained economic growth
- To estimate the **multiplier effect** it is necessary to multiply the **internal leverage effect** (generated within the EU Institutions and equals to 3x[1]) with the **external leverage effect** estimated (i.e. in Italy is almost 40x (=3x*13.3x), whereas in Spain is 37.5x (=3x*12.5x))

## Case studies




*Note: According to the data provided by CESGAR for the Spanish Case Study, the leverage effect is higher than the one reported here (and equal to 37.5x). This difference is mainly due to the effect of the national counter-guarantee (CERSA, in the case of Spain) which guarantees for the Guarantee Institution (such as SGR, in the case of Spain). Therefore, this leverage effect is possible due to the risk sharing model among the Guarantee Institutions, the national counter-guarantee public company (CERSA) and its counter-guarantee agreement with EIF*

It is important to note that the estimates reported here are computed using a different method as compared to that adopted by the European Commission[1] and the EIF to estimate the multiplier effect generated by guarantees. Since two different methodologies are used, estimates are not directly comparable (for more details, please see the Annex)

*Note 1: Source:* COM(2014) 903 final, "An investment Plan for Europe"

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# Policy recommendations

- In light of the evidence gathered, a few recommendations to relevant stakeholders can be summarised as follow

1. **Greater complementarities and synergies between existing instruments and players**: synergies should be pursued at all levels, from regional to national and supranational, in order to align incentives and create "win-win" situations for all players along the guarantee value chain, including Guarantee Institutions, banks, national and supranational public institutions, and SMEs

2. **Counter-guarantee schemes should be offered at more convenient conditions** as compared to Direct guarantees: because of a higher input/impact ratio, Counter-guarantees should be provided at conditions that recognise the beneficial policy impact/additionality and the SMEs' coverage which Guarantee Institutions can deliver

3. **Increased efficiency in the use of public money**: achievable through a greater deployment of public money channelled through Counter-guarantees. It means that Guarantee Institutions need to be included in the distribution chain whenever it is possible and priority should be given to their integration, also because they generate a greater leverage effect and serve all SMEs within a Region or a Country, whereas banks are able to reach out to a more limited clients portfolio

4. **Increase in data availability**: for systematic measurement of efficiency in the deployment of public money, allowing for market performance and efficiency measurement

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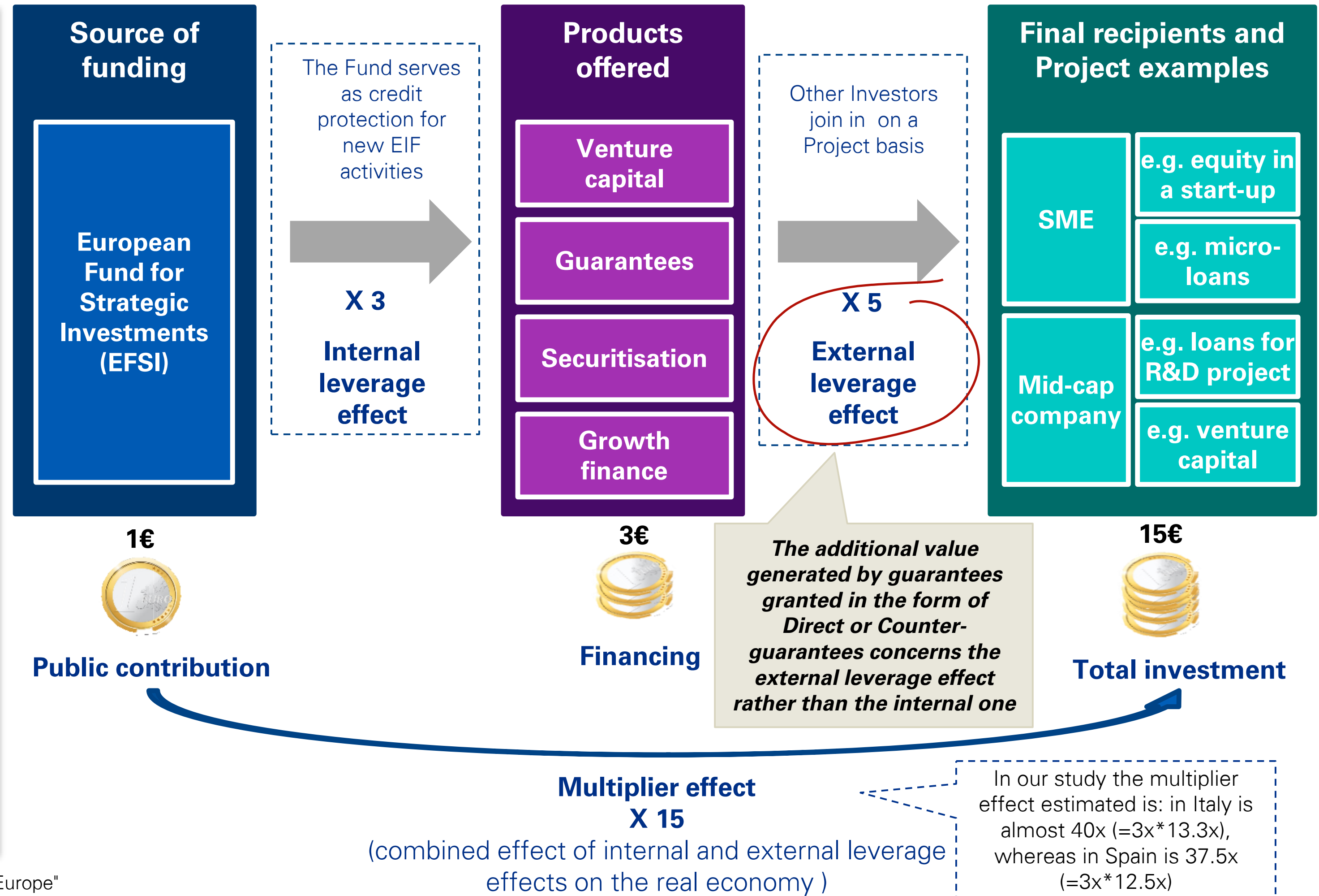
# Annex

# Multiplier effect in the Investment Plan for Europe

The Investment Plan for Europe estimates a multiplier effect of 1:15 on investments in the real economy brought by the new European Fund for Strategic Investments (EFSI)

## Multiplier effect

- The multiplier effect for the European fund is the ratio between total investment and EFSI contribution
- It is the result of two combining effects:
  - **internal leverage effect**. The initial investment of the EFSI provides partial risk protection (a 'first loss guarantee') to the EIB and EIF, which should enable them to finance three times this amount by issuing bonds
  - **external leverage effect**. The EIB investment should help improve investors confidence and encourage private investors to invest five times that amount
- The internal leverage effect is the same across all Financial Instruments whereas **the external leverage effect could vary**. Therefore we focus on the latter in the analysis of Direct vs Counter-guarantee




Source: COM(2014) 903 final, "An investment Plan for Europe"
Note: More details on the calculations are available upon request

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