

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMMITTEE ON FINANCIAL MARKETS**

SME financing: options for future work under the 2015-16 PWB

Note to guide the discussion

23-24 October 2014

This note is to guide the discussion on future CMF work on SME financing.

Action requested: Delegates are asked to comment on the issues raised in the note and express their preferences regarding work on SME financing by the Committee.

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SME FINANCING: OPTIONS FOR FUTURE WORK UNDER THE 2015-16 PWB

Note to guide the discussion

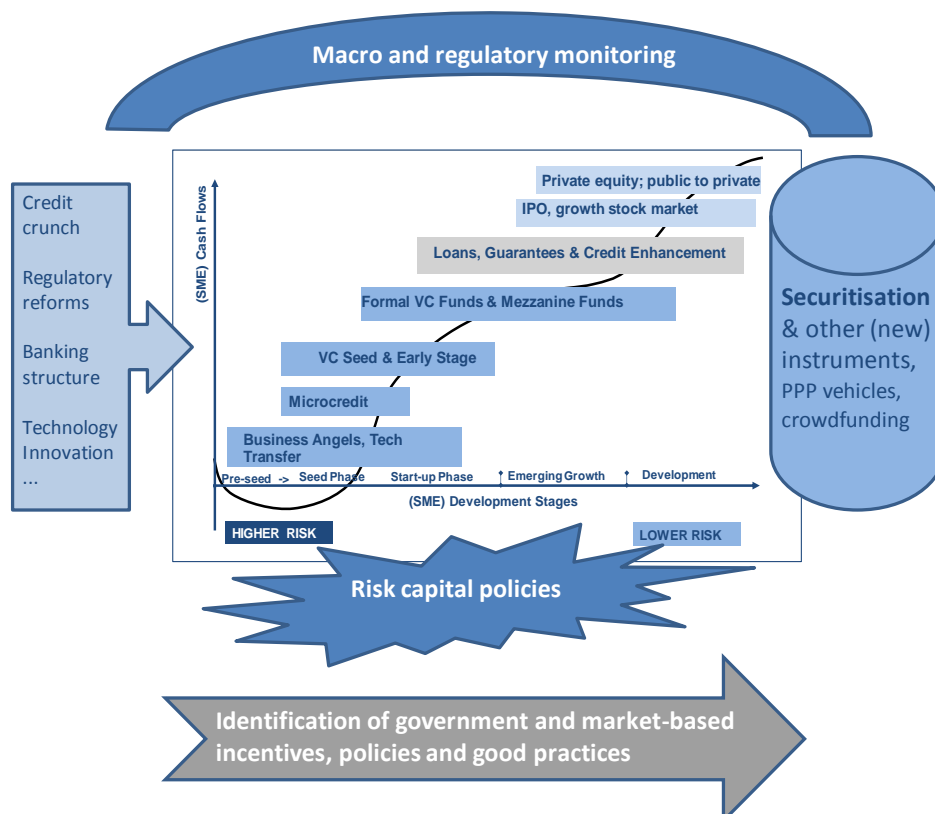
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A. Background

1. Financing inclusive and sustainable growth by enhancing the contribution of financial markets and institutions to long-term investment and SME financing has been identified as one of the **major work priorities** in the CMF Programme of Work & Budget (POW), both in the POW for the biennium ending this year [DAF/CMF(2011)22/REV1], and in the POW for the 2015-16 biennium [DAF/CMF(2014)9/REV1]. The purpose of this short note is to briefly discuss possible avenues for further work regarding SME financing for the coming biennium and invite Delegates to comment on identified proposals.

2. SMEs play a significant role in their economies, but many nonetheless face funding challenges, which in the post-crisis environment have become more pertinent for some. Given the traditional reliance on bank funding, policy interventions to ease access to bank credit have historically focused on guarantees, subsidies or other measures to provide credit on preferential terms. But times have changed and recent policy efforts have sought ways to foster non-bank financing alternatives to ensure that small firms at every stage of the financial ladder can obtain access to the most suitable financial instruments (figure 1).

Figure 1. SME finance: stylised overview



Source: OECD Secretariat, based on an exhibit by the European Investment (EIF).

3. A mapping report on the range of SME financing instruments, conducted under the aegis of the Working Party on SMEs and Entrepreneurship (WPSMEE) [[CFE/SME\(2013\)7/REV2](#)], is being submitted to CMF Delegates for information. The CMF has been contributing to this project with a report on “SME debt financing beyond bank lending: the role of securitisation, bonds and private placements”, a draft of which [[DAF/CMF\(2014\)24](#)] will be discussed at this meeting. A case study on crowd funding by the WPSMEE is also being shared with CMF Delegates for information.

4. SME financing remains on the agenda for G20 Finance Ministers and Central Bank Governors. On 20-21 September, in Cairns, G20 Finance Ministers and Central Bank Governors asked the IMF, OECD, and World Bank Group to work with other relevant organisations to identify where advances can be made with financing instruments which could further promote financing for SMEs and infrastructure.

B. Avenues for further work

5. Current CMF work on SME financing follows the results of **deliberations at the April 2013 meeting**, where the CMF discussed a note on “SME financing: Roadmap for future work” [[DAF/CMF\(2013\)3](#)], also taking note of an Addendum [[DAF/CMF\(2013\)3/ADD1](#)]. The note proposed the following:

- “Building on existing overviews and assessing work, including by the WPSMEE, and further information and cost/benefit analysis as needed, **identification of international and national government and market-based good practices for SME financing and analysis of factors which prevented selected practices to be successful**. The Committee would focus on identifying good practices in areas that are germane to the Committee. This work to be carried out together with the WPSMEE would be based on the main financial policies related to SME financing undertaken in OECD and G20 countries since the last ten years.
- Integrating SME financing issues in the work of the G20/OECD (joint CMF/IPPC) **Task Force on Institutional Investors and Long-term Financing** (including the related G20 work), the G20/OECD Task Force on Financial Consumer Protection and the International Network on Financial Education (INFE).
- **Contributing and providing CMF expertise to other projects** developed by the OECD and other fora (such as the G20 and GPFI), including for instance contributing to work related to risk capital with a CMF focus on venture capital and private equity, analysing issues related to medium-sized enterprises, etc.”

6. In discussing that note, delegates were specifically supportive of:

- Work to explore options for **market-based measures** to promote SME lending more generally. This could include issues related to securitisation, peer-to-peer-lending, private equity (including venture capital), development of corporate bond markets and SME-specific solutions for credit ratings and credit scoring systems, and the use of factoring.
- Delegates welcomed proposals for work on **cost-benefit analyses** and **best practices** regarding policies to promote SME lending. This could include looking at the budgetary impact of these measures specifically, and conducting an analysis of central bank policies to support SME lending put in place in various countries (e.g. the UK funding for lending or the Hungarian funding for growth schemes).

- Delegates also welcomed proposals to conduct further work on **structural bank reforms** to foster bank lending to SMEs. It was also pointed out that further analyses of issues related to SME finance may need to distinguish between very small firms and medium-sized enterprises.

7. As stated in the 2015-2016 POW [[DAF/CMF\(2014\)9/REV1](#); see also Annex for delegate proposals on work related to SMEs], “there is interest in further **examining options for policy intervention aimed at easing SME access to finance**, via debt and equity capital instruments and including securitisation. Most OECD countries have a variety of interventions aiming at easing SMEs access to finance. A typology of these interventions has been undertaken but little is known about the effectiveness of these interventions. The CMF might wish to undertake a **survey of existing evaluations of effectiveness of policy measures** to promote SME financing.”

8. The POW also highlights the **importance of securitisation** and other forms of non-bank debt finance for SMEs as a particular measure to be examined. Based on current work undertaken on these topics [[DAF/CMF\(2014\)24](#)], it proposes to continue work on specific issues that arise in this context, also **leveraging private sector input via Financial Roundtables** (Table 1) for follow-up analysis. This could include further investigation of the extent to which labeling initiatives (such as *e.g.* the prime collateral security (PCS) label in Europe) can make securitisation markets more transparent and the degree to which investors rely on such labels.

Table 1. Selected OECD Financial Roundtable topics covering risk capital, SME finance and securitisation

Topic	Date
Issues in securitisation	June 1993
Financing of small and medium-size enterprises in OECD countries	November 1995
Prospects for venture capital in the present economic cycle	October 2001
Developments and prospects in the market for risk capital	November 2005
Recent market developments, the boom in private equity and the rise of hedge funds	May 2007
Fostering long-term investment and economic growth (<i>special High-level Roundtable on the occasion of the OECD 50th anniversary</i>)	April 2011
Bank deleveraging, the move from bank to market-based financing, and SME financing	April 2012
Financing investment for the long-term: challenges, players, instruments	April 2013
Long-term investment and non-bank debt financing for SMEs: the role of securitisation, private placements and bonds	April 2014
Public SME Equity Financing – exchanges, platforms, players	October 2014

Source: OECD, CMF Secretariat.

C. Next steps and issues for discussion

9. Notwithstanding the broad range of potential work suggested above, two areas could be the **immediate focus of future work** of the Committee in light of feedback received and G20 priorities:

- An **evaluation of policy interventions to support SME financing**, evaluating the cost of government guarantees for SMEs financing (cost-benefit analyses). This area is ripe for analysis and is being demanded by policymakers seeking to evaluate the effectiveness of

interventions to support SME financing. It could also be part of, and benefit from, the work on financial sector guarantees the Committee has been working on over the past few years. Given the scarcity of Secretariat resources, such in-depth work would require additional funding, perhaps also via secondments of experts.

- **Deepening analysis of the opportunities and constraints of market-based financing for SMEs.** This could be a broad-based report covering a range of market-based financing instruments or, alternatively, a staged series of reports, e.g., on securitisation, equity financing, corporate bond markets. Potential policy interventions could be discussed as part of these reports. Such work would support G20 priorities to identify scope for improvement in financing instruments for SMEs.

10. Such work does not preclude, as part of future work for 2015-16, the **identification of good practices for SME financing and analysis of impediments** in conjunction with the WPSMEE which had previously been considered. It should be noted that work on SME financing by the Committee will support, and benefit from, efforts to promote long-term financing, including for SMEs, undertaken under G20 auspices (via the G20/OECD Task Force on Institutional Investors and Long-term Financing).

11. **Delegates are asked to comment and express their preferences**, in particular on the following issues:

- *In the view of Delegates, what should be the focus of CMF work related to SME Finance? Do Delegates agree with the broad directions discussed in this note?*
- *Do Delegates agree with the immediate focus of future work as proposed under this section (C)? If so, is there a preferred order of priority and timeline for the specific projects?*
- *Are there particular issues Delegates would wish to be addressed in other areas, and are there specific projects they may wish to propose?*
- *For the near-term, are there specific issues related to SME finance or risk capital that Delegates would wish to discuss at the Committee's next meetings in the context of the Roundtable or (or perhaps other specific sessions, e.g. jointly with the WPSMEE)?*

ANNEX

DELEGATE PROPOSALS FOR WORK ON SME FINANCING FOR 2015-16 PWB

(from [DAF/CMF\(2014\)9/ADD1](#))

BELGIUM

Proposed general theme / priority	Comparative advantages of bank intermediation and market financing
Context, rationale, and expected policy impact (domestic, international)	Assessment of impact of Basel III in Europe versus United States ; consequences of ring fencing of trading activities on market activities
Possible specific project(s)	To what extent can market finance be a substitute for bank credit f. ex. to SMEs

FRANCE

Proposed general theme / priority	Evaluation of policy intervention aiming at easing SMEs access to finance (debt/capital)
Context, rationale, and expected policy impact (domestic, international)	Most OECD countries have a variety of interventions aiming at easing SMEs access to finance. A typology of these interventions has been undertaken but little is known about the effectiveness of these interventions.
Possible specific project(s)	Survey of existing evaluations.

GERMANY

Proposed general theme / priority	Importance of securitisation for SME-financing
Context, rationale, and expected policy impact (domestic, international)	In the context of the financial crisis there has been a serious withdrawal from the European markets of securitisation. In spite of a slow recovery of these markets during the last years there still seems to be a stable group of investors only for specific segments. On the one hand, the gross issuance volume decreased significantly over the last years, on the other hand, the securitized products are not publicly issued but used by the issuers as collateral for refinancing at the central bank. Moreover, the spreads strongly differ between countries and segments. We are interested in how important this type of financing still is for the small and medium enterprises in the different countries and if (and in case that yes, which) alternatives are used for refinancing. Moreover, it might be worthwhile investigating to which extent labeling initiatives (such as e.g. the prime collateral security (PCS) label in Europe) can make securitization markets more transparent and to which degree investors rely on such labels.

ITALY

Proposed general theme / priority	SMEs access to finance: the option of going public
Context, rationale, and expected policy impact (domestic, international)	<p>As indicated by a large body of empirical evidence, SMEs in several countries still face severely restricted access to financing, if not credit crunch, as a result of the crisis. Moreover, SMEs often rely heavily on bank credit and still don't like the option of going public.</p> <p>While OECD has long paid attention to the topic, neither specific recommendations have been delivered by the CMF nor best practises have ever been identified as regards policies for promoting SME access to finance.</p> <p>Since SMEs assistance programmes are likely to continue expanding, also because the recovery remains jobless in many countries, some broad principles could help guide their design and targeting, while minimizing distortions. The project would also give important insights for financial policy and regulation. In order to highlight the relevance of the topic for the CMF, first of all it could be useful to have a clear picture of the access to equity financing in OECD countries and of the administrative and regulatory costs weighing on the firms planning to go public; secondly a review of the initiatives eventually carried out at national level to spur public listing could be undertaken.</p>
Possible specific project(s)	<p>Some issues might be usefully addressed:</p> <ul style="list-style-type: none"> • How can we develop institutions that are specialized in "private debt" (including debt securities issued by unlisted companies and non-bank loans to unlisted companies)? • Possible undersupplied analyst coverage on small- or mid-cap listed companies. The information conveyed by analyst reports is particularly valuable for SMEs given that they are characterized by a high degree of information asymmetries. An increased supply of equity research may contribute to the success of public listing. How to foster the coverage of (listed and unlisted) SMEs by credit risk analysts and financial analysts? • Costs and burdens for SME's accessing markets for equity funding; to have a clear picture on this topic the data collection exercise could be complemented with a a questionnaire administered, on a national basis, to a sample of private firms; • How can we reduce the administrative costs, informational burdens and any other costs associated with SMEs' (public or private) equity funding? Drawing on the experience of some advanced countries, under what conditions a "guided path" to public listing for SMEs might turn out to be successful?

MEXICO

Proposed general theme / priority	Recognizing the importance of Financing SMEs.
Context, rationale, and expected policy impact (domestic, international)	<p>SMEs are a fundamental engine for development and economic growth, the financial system must serve as an opportunity to increase financing for businesses with potential of growth, and ultimately foster financial inclusion within people who are employed by them.</p> <p>In line with one of the main objectives of this Committee “<i>promoting the contribution of financial markets and institutions to savings and investment, to the financing of business and individuals and to growth</i>”. We propose the aforementioned priority; recognizing the importance of Financing SMEs.</p> <p>Financing of SME’s must be done within a sound and solvent financial system; hence policy making must be done along the FSB mandates.</p> <p>Financing of SME’s is a priority in Mexico. Mexico’s Government has recently approved an ambitious financial reform aimed at strengthening regulation and increasing SMEs funding.</p> <p>In the National Development Plan 2013-2018, the Objective 4.2 “Democratizing access to financing projects with growth potential”, has the Strategy 4.2.2 “Expanding the coverage of the financial system to a greater number of people and companies in Mexico, particularly for segments of the population currently excluded”.</p> <p>The incorporation of financing SME’s as a priority in this Committee, will definitely have a high policy impact, and will cause lasting positive change in policy orientation.</p>
Possible specific project(s)	<ul style="list-style-type: none"> • Development of a deeper domestic securities market that finances SME’s. • Developing a solid domestic securities market can improve the economy’s ability to sponsor ventures with high potential projects by diversifying the risk among qualified investors. These benefits to financial stability complement the critical role that securities markets play in efficient resource allocation and in reducing over-reliance on the banking sector for the mobilization of savings and financial intermediation. Diversified securities markets provide to investors alternative asset classes in times of financial stress. However, developing such markets is a long-term process that requires proper planning and commitment as well as appropriate prioritization and sequencing. (<i>Financial Stability Issues in Emerging Market and Development Economies, FSB</i>).
Possible specific contributions	<ul style="list-style-type: none"> • On-site or distance staff secondments to the OECD to work on projects. • Participating in the analysis or drafting of documents.