Gertrude Tumpel-Gugerell: Thinking small first – how does it apply to the financing conditions and payments of small and medium-sized enterprises?

Speech by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the Annual General Assembly of UEAPME, the European Association of crafts and small business, Brussels, 2 December 2009.

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Ladies and gentlemen,

When I open a financial newspaper, the headlines are all about large companies, their activities and annual reports. We tend to be attracted – and distracted – by large things, by large companies with large numbers. It is easy to forget that the life-blood of the economy runs in smaller companies which are much more important to society than their actual size would suggest.

Small and medium-sized enterprises (SMEs) are a fundamental part of the euro area corporate sector. They account for 99.8% of all businesses, roughly 60% of gross value added and about 70% of total employment. The UEAPME represents around 12 million European small and medium-sized enterprises, employing some 55 million people. These are large figures and of great importance to Europe.

The importance of the SME sector is being more and more acknowledged in European policies. The European Commission made the point strongly when it launched the Small Businesses Act last year, stating that “vibrant SMEs will make Europe more robust to stand against the uncertainty encountered in the globalised world of today”. According to the Act, the “Think Small First” principle should apply to all public policies, including arrangements made to facilitate SMEs’ access to finance and to support timely payment in commercial transactions.

In my speech I would like to address two important issues related to the economic situation of SMEs. First, I will talk about how SMEs have been affected by the recent crisis and their specific financing situation. Given the mentioned importance of SMEs for the overall economy, this seems to be a crucial issue to look into to assess the future prospects of the euro area economy, particularly with respect to where we stand in moving out of the current crisis.

Second, I would like to highlight the many advantages and benefits of more harmonized and integrated payments markets specifically for SMEs. Being the main user of the retail payments business, SMEs are absolutely key for the further harmonization and integration process. Therefore – and let me give you this key message already up front – SMEs can make a crucial contribution by using harmonized payment products to the overall speed of the integration process.

SMEs’ financing conditions under stress

Let me start, first, with how SMEs have weathered the crisis and would therefore like to take a closer look at SMEs’ financing conditions. The resilience of our economy in the period of the financial crisis is crucially dependent on the ability of SMEs to appropriately provide for their financial needs. Unfortunately, very few quantitative statistics are available. Therefore, I am happy that direct evidence regarding SMEs’ access to finance is now available from a new, large-scale survey implemented jointly by the ECB and the European Commission, the first wave of which was conducted in July this year.

When asked what type of external financing they would prefer to use in order to fund growth opportunities, 70% of SMEs replied that they would apply for a bank loan. Hence, the financing conditions of SMEs are closely linked to the situation of the banking sector, i.e. the lending rates and the availability of credit. For us at the ECB, this aspect of the SMEs' financing structure is absolutely crucial for our assessment of the monetary policy stance and the transmission of our monetary policy decisions to the economy at large.

During the crisis, securing financing has proven difficult for many SMEs and a source of serious concern for monetary policy. Let me take this opportunity to stress that the decisions taken by the Governing Council of the ECB in terms of monetary policy and the support of the banking system via our refinancing operations have been instrumental in preventing the risk of credit drying up completely.

Nonetheless, it is clear that SMEs have experienced a severe deterioration in their economic environment over recent quarters and have seen their access to finance significantly constrained.

SMEs have been widely affected by sluggish demand and a slump in export markets. At the same time, they have also been affected in their role as suppliers, sub-contractors and service providers to large firms which themselves were struggling with economic difficulties. According to the survey evidence, SMEs experienced a significant deterioration in their turnover and profits in the first half of 2009, and they were more adversely affected by the crisis than large companies. Indeed, a higher net share of SMEs than of large firms indicated that their capital base had deteriorated. Of course, the economic uncertainty and unfavourable outlook was anything but conducive to an increase in firms' demand for loans. At the same time, the deteriorating situation of firms and particularly the uncertainty surrounding their economic outlook also made banks increasingly reluctant to grant loans to SMEs. Moreover, the financial crisis has put a strain on banks' balance sheets, leading them to increasingly tighten the terms and conditions for granting credit.

Therefore, the combination of lower demand for loans, on the one hand, and tighter credit supply conditions, on the other hand, has led to a decline in the annual growth rate of loans to enterprises. In the euro area loan growth declined from 17.5% in the last quarter of 2008 to about 2% in the third quarter of 2009.

So how bad has the situation been for SMEs? Let me briefly give you the answer to this question based on the evidence from our SME survey conducted on cooperation with the European Commission. Our survey evidence reveals that, amid exceptionally adverse economic and financial conditions, 77% of SMEs that applied for a bank loan in the first half of 2009 received some or whole amount they had applied for. As I mentioned, this is a new survey. So, it is not yet possible to compare these data over time, and hence, makes it difficult to assess whether the bank loan rejection rates indeed indicate severe supply constraints. In fact, even at times of sound economic growth, some bank loan applications will be rejected, for instance owing to the lack of a convincing business plan.

Nevertheless, the survey has also shown that 43% of euro area SMEs that had applied for a bank loan reported a deterioration in the availability of loans in the first half of 2009. This seems, in particular, point to increases in charges, fees and commissions or tighter procedures, collateral requirements and other types of required guarantees. Interestingly, large firms were somewhat more negative in their assessment of bank loan availability, with nearly 50% reporting a deterioration. Still, I believe, it has become clear that firms' access to finance came certainly under pressure during the current financial and economic crisis.

Looking further ahead, we expect that the growth of loans to enterprises is likely to moderate further before starting to recover. This, however, is in line with past recession patterns. We know that the growth of loans to non-financial corporations normally tends to lag real GDP growth by about three quarters. This is usually linked to the fact that firms tend to make use of their internal funds first before turning to external financing. So overall, once the severity and duration of the economic slowdown are taken into account, recent credit developments appear to be broadly in line with historical patterns. As a note of caution, let me emphasize, however, that there are still uncertainties ahead so that the full impact of the crisis is yet unknown.

Let me still mention that we see several positive signals ahead. Indeed, the most recent euro area Bank Lending Survey, released last month, confirms that banks' liquidity position is no longer a factor tightening credit conditions, which had been the case up to the first quarter of 2009. The positive message we can take away from our Bank Lending Survey is that credit conditions – though still tight – do not show any signs of further tightening as the funding problems of banks are solved with the support of the ECB policy measures.

Also the evidence from the SME survey reveals some cautious optimism regarding the availability of finance in the second half of 2009, at least in a majority of euro area countries. More than one year after the financial crisis intensified dramatically in September 2008, we can see increasing signs of economic stabilisation in the euro area and there are reasons to believe that a gradual recovery lies ahead. This will mean new opportunities for all of us and for all of you to seize.

The benefits of integrated payment systems in Europe

In addition to access to finance, the European Commission's Small Business Act identified liquidity constraints as a problem for SMEs. The integration of European retail payment markets will for one part contribute to eliminating this problem.

But most importantly, further integration will make payments more efficient and will bring cost savings to all firms and citizens in Europe. Around 50% of euro area exports and imports are within the euro area countries. When payments for this trade can be made in the same – or even more – efficient and low cost way as national payments, the benefit for the European economy is evident.

Indeed, the vision for the Single Euro Payments Area – SEPA – is for all European payments to be treated in the same way as domestic payments, with no difference between national and cross-border payments in euro. This will be achieved by using a single set of payment instruments which are as simple, safe and efficient as those used in the national context today. Today, we can trade goods and services without borders in Europe; we also use euro as our single currency; we must also have borderless and fully harmonized payments to complete the Single Market.

On January 2008 we introduced the SEPA credit transfers and the European cards framework. Only one month ago, we celebrated the launch of the SEPA direct debit, a truly new payment service at the European level. At the same time, the PSD went into effect which contributes greatly to the harmonization in the retail payments markets.

So what does all this mean for the small and medium sized companies?

At one of the SEPA conferences that I recently attended, a CFO of a medium-sized travel agency gave a presentation on her SEPA experience. She told us that when she received the SEPA brochures, her first reaction was rather hesitant. She wondered whether new burdens were being put on small companies. But when she started to understand what SEPA is all about, she became more and more enthusiastic. She realised how her company could directly benefit from cheaper and faster payments, from a simplified account structure and from using a single banking software application for all her euro payments.

I do not think that this company is an exception. At first glance, the harmonisation of European retail payments may seem like a mandatory replacement of existing products and admittedly implies that we need to get used to new standards and procedures. But when looked at more closely, the true benefits start to reveal themselves.

SEPA is a market-driven process which is strongly supported by the authorities like the European Commission, the National Central Banks and the ECB. To complement the common payment instruments, business rules and standards developed by the European Payments Council (EPC), the European Commission has issued harmonised legislation on payment services and euro-denominated cross-border payments. The combination of common standards, common payment instruments and a harmonised legal framework will benefit small and medium-sized companies in at least four ways:

First, it provides legal certainty all over Europe. This means that irrespective of where the company and its customers are located in Europe, there is no additional risk stemming from the existence of different payment rules and customs. Hence, trading across borders becomes more certain. In my view, this will remove one more important barrier from doing business Europe-wide.

Second, the faster execution of payments will enhance the cash flow and liquidity of companies. In the past it has taken up to five days or even longer for a payment to reach the beneficiary's account. This has been the case for some national payments, let alone cross-border payments. The SEPA credit transfer will ensure that all payments in Europe are credited to the beneficiary in a maximum of two days and, from 2012, in accordance with the Payment Services Directive, in just one day. In addition, no value dates are lost as the payment will be credited to the beneficiary's account as soon as it is received by the service provider.

Third, fees for cross-border payments cannot be higher than those for similar national payments. This is ensured by the regulation on cross-border payments. The harmonized and integrated European payment market will be a key driver for more competition, leading to lower costs, enhanced services and more innovation. This may also encourage the development of SME-specific services as there is now a Europe-wide market for them.

Fourth, standardisation makes the processing of payments simpler. Cross-border payments no longer require any additional effort. All companies have the option to make use of more inexpensive banking software and integrated accounting and reporting applications. Evidence from the Nordic market indicates that common standards have enabled even very small companies to use e-banking and related applications. The standardisation of payment card transactions means that payment card terminals will also conform to a European standard. Merchants will benefit from competition between terminal manufacturers and between acquirers.

All these benefits – legal certainty, enhanced liquidity owing to faster payments and no lost value dates, competitive services and standardised payment terminals and banking software – will be available to all companies – big and small – conducting cross-border business or operating locally.

But this is only the starting point for further developments. The European e-payment solution will offer further benefits. Also SMEs are increasingly using the internet as a channel for doing business. Growing numbers of consumers, especially young people, prefer to use the internet and e-commerce to make purchases. In countries such as Germany, the Netherlands and Austria, safe and efficient e-payment schemes are already available, but in many countries they are still lacking. With a common European e-payment scheme, both consumers and merchants will have a more secure way to pay. The Eurosystem has strongly encouraged the EPC to work on a SEPA solution for e-payments. This will also benefit very small enterprises, many of which operate in the services sector and need to use an easy and low-cost payment terminal or internet banking.

But how can we achieve these benefits? Making use of the opportunities that SEPA offers may simply require the use of the IBAN and BIC instead of national account identifiers. Countries such as Italy, Latvia, Luxembourg, Poland and Romania have already successfully switched to using these account identifiers without a problem. Banking software may need to be updated, but this can be accomplished in the course of the normal investment cycle of the firm in question. In my view, the transition costs are certainly outweighed by the benefits stemming from faster and cheaper payments, legal certainty and the ease of doing business throughout Europe.

I sometimes hear the question: Is it really working? Are banks really delivering? All the building blocks for an integrated retail payment market are in place. It is important that customers too demonstrate demand for SEPA benefits and urge their banks to make SEPA a reality. Small and medium-sized companies should aim for the benefits of SEPA.

Conclusion

Europe has come far in terms of integration. The Single Market for labour, goods, services and capital was fully established 16 years ago with the Maastricht Treaty. This Single Market now requires a single market for payments. The European retail payment systems will be integrated by means of common standards, common payment instruments and common business rules and conditions. The SEPA project is an integral part of this process. I highlighted four main benefits for end-users, which include SMEs.

- The legal certainty regarding payments will remove another important barrier to trade
- faster payments will improve liquidity conditions for all companies
- enhanced competition in payment services will contribute to lower costs and will be a key driver of innovation and
- standardisation will provide easier access to banking software and payment terminals, including for SMEs.

Given these tremendous potential benefits arising from SEPA and the overall harmonization process, we need to make a further leap forward in the SEPA implementation. This entails existing SEPA instruments, the credit transfers and direct debit, but also innovations in the field of eSEPA, such as e-payments which can greatly benefit the payments business of SMEs. The take up of the SEPA products – until now – is rather modest. The ECB is convinced that a binding migration end date for SEPA is needed. It is in the interest of all stakeholders to migrate quickly to the SEPA instruments.

And let me emphasize – once more – that also SMEs as key users of payment instruments can make an important contribution to the successful implementation of a harmonized and integrated retail payments market.

The financial crisis has put severe strains on SMEs and I have mentioned the results of our survey on the access to finance of SMEs conducted jointly by the ECB and the European Commission in this respect. Therefore, on the one hand, I understand that in difficult times changes are not always easy to bring forward. On the other hand, times of distress open up new opportunities and make change even more necessary.

The lesson we learnt from the crisis is that we need to better safeguard the stability and resilience of our financial system. I am convinced that efficient and harmonized financial markets can make an important contribution in this regard. Therefore, we continue to promote and work intensively on the further integration of payment systems and instruments. With this successfully achieved, the operating environment of SMEs can be greatly enhanced to the overall benefit of the economy. Because, as you know, when SMEs prosper, the economy prospers.

Thank you very much for your attention.