ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

OECD
BETTER POLICIES FOR BETTER LIVES

Czech Republic Policy Brief

OECD Better Policies Series

MAY 2016

www.oecd.org/czech republic

Finance

IMPROVING ACCESS TO FINANCE FOR SMALL AND MEDIUM SIZED ENTERPRISES

- Despite some recent signs of improvement in the accessibility of bank finance, new business lending to SMEs in the Czech Republic declined by more than half over the 2008-2014 period.
- Czech SMEs are too dependent on bank financing. A more diversified set of financing options would strengthen SMEs and decrease their vulnerability to business cycle fluctuations and the credit environment.
- Assisting micro-enterprises to scale up is of crucial importance to the Czech economy, given the high weight of very small businesses in the economy compared to other EU countries.

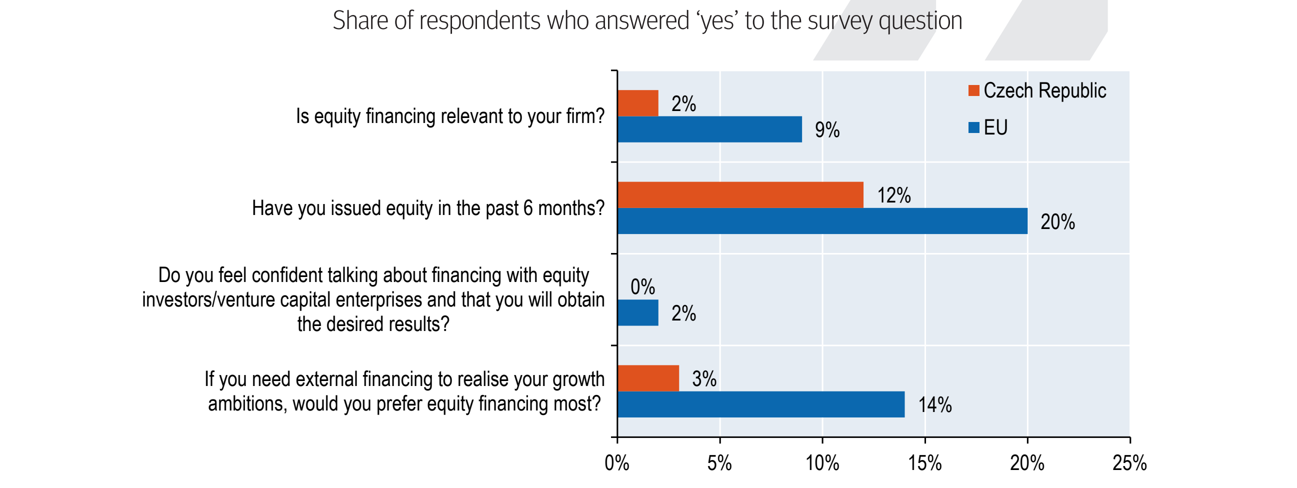
What's the issue?

The financial crisis had a pronounced impact on SME lending in the Czech Republic. New lending to SMEs dropped by 41% between 2007 and 2010, rose modestly in 2011 and 2012, only to plummet by 28% between 2012 and 2013. SME lending recovered again between 2013 and 2014, but only modestly. Credit conditions have relaxed since the second quarter of 2014 for financially healthy firms which have sufficient collateral, while less creditworthy SMEs face greater difficulties in accessing finance.

The financial situation of many small businesses remains weak. While non-performing loans (NPLs) for large enterprises halved over the 2010-2015 period, dropping to below 3% in 2015, SME NPLs remained high, especially for micro-enterprises, where the rate stood at 12% in the first quarter of 2015. The financial weakness of some SMEs, coupled with an increased risk aversion of the banking sector, is reflected in the interest rate spread between loans charged to SMEs and to large businesses, which stood at 1.75 percentage points in 2014, up from 0.68 percentage points in 2010. There is also evidence that many small businesses have become more hesitant to borrow and rely more heavily on internal financial resources instead.

Total venture capital investments (seed, start-up and later stage) plummeted in the aftermath of the financial crisis, dropping from EUR 32 million in 2008 to less than EUR 3 million in 2013 and EUR 9 million in 2014. Growth capital (expansion stage) investments declined even faster, from EUR 191 million in 2009 to EUR 4.4 million in 2013 and EUR 29 million in 2014. In addition, survey data from the SAFE survey by the European Central Bank and the European Commission suggest that Czech SMEs have a lower preference for equity-type financial instruments, feel less

Equity financing is sought and used less in the Czech Republic than in most other EU countries



Source: European Central Bank (2014), Survey on the Access to Finance of Enterprises (SAFE), April to December 2014.

confident around equity investors, and hence are less likely to make use of equity financing compared to the EU average (see Figure).

The Czech Republic has developed the Small and Medium Enterprises Support Strategy 2014-2020, a comprehensive strategy for the development of SMEs. It includes several tools, such as government loan guarantees, financing schemes for exporting SMEs (Czech Export Bank) and innovative businesses (INOSTART programme), as well as a programme to draw financial resources from the EU structural funds (OPEI), which distributes support to SMEs through grants, preferential loans and guarantees. The Czech-Moravian Guarantee and Development (CMZR) Bank is a specialised state-owned banking entity with a mission to facilitate primarily SME access to financing. In 2015, the organisation signed a "COSME counter-guarantee agreement" – an EU funding programme for SMEs. In addition, the bank's capital position was reinforced and several new financing tools such as venture capital are soon to become available. Although policy making in this area benefits from EU funding, the absorption capacity of those funds has remained low, averaging around 30% over the 2007-2013 period, more than 10 percentage points below the EU average. Moreover, there is a need to complement the comprehensive set of preferential loans, interest rate subsidies and government guarantees by measures to strengthen non-bank sources of finance.

Why is this important for the Czech Republic?

SMEs account for more than 99% of all businesses in the Czech economy, and for a share of around 60% of private sector employment. Micro-enterprises make up a larger share of businesses than in other EU countries and enterprises that just consist of the founder and have no employees are more prevalent than in any other EU country. Partly because of the small scale of the average Czech firm, SME value added remained below pre-crisis levels in 2015. Many Czech SMEs suffer from inadequate capitalisation, along with difficulties in accessing both bank lending and equity financing, holding back their potential for growth and their contribution to GDP, employment and social cohesion.

What should policy makers do?

- Expand support to facilitate SMEs' access to finance beyond subsidising debt, including through the measures that are developed under the EU Capital Markets Union Initiative to improve market-based financing alternatives.
- Advance the role of the CMZR in consolidating SME finance and move forward with the design of new financial instruments supported by the European Fund for Strategic Investments (EFSI).
- Increase the absorption of EU funds channelled to the SME sector, for example through closer involvement of financial institutions in the selection and implementation of EU co-financed programmes.
- Use high quality securitisation of SME loans by the banking sector (under the EU framework for simple, transparent and standardised securitisation) as a way to free up credit capacity in banks' balance sheets and promote further on-lending to SMEs.
- Support the development of financial skills and vision of small business owners and entrepreneurs within the existing national strategy for financial education.
- Focus policy attention on growing small businesses, including by addressing funding gaps for enterprises in their early and expansion stage.

Further reading

OECD (2016), *Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard,* OECD Publishing. http://dx.doi.org/10.1787/fin_sme_ent-2016-en

OECD (2015), *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments,* OECD Publishing. http://dx.doi.org/10.1787/9789264240957-en

G20/OECD (2015), *High-Level Principles on SME financing*. https://www.oecd.org/finance/G20-OECD-High-Level-%20Principles-on-SME-Financing.pdf

Nassr, I.K. and G. Wehinger (2015), "Unlocking SME finance through market-based debt: Securitisation, private placements and bonds", *OECD Journal: Financial Market Trends*, Vol. 2014/2. http://dx.doi.org/10.1787/fmt-2014-5js3bg1g53ln

Nassr, I.K. and G. Wehinger (2015b), "Opportunities and Limitations of Public Equity Markets for SMEs", *OECD Journal: Financial Market Trends*, Vol.2015/3. http://dx.doi.org/10.1787/fmt-2015-5jrs051fvnjk