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Companies

SMEs and VSEs in France: an improved financial situation and easier access to credit

Compared to the mid-2010s, the economic and financial situation of French SMEs/VSEs has improved. Most of the accounting ratios used to assess the health of companies have evolved positively, while remaining generally at less favourable levels than in the pre-crisis years. VSEs remain more fragile than SMEs. Access to credit has never been so easy, both for SMEs and VSEs. Lending is particularly dynamic and its cost very low. The relationship between SMEs/VSEs and banks is rather satisfactory and has improved in recent years. However, attention should be paid to three points: (i) payment times; (ii) strengthening the financial expertise of small business leaders (a point on which the Banque de France has recently launched various actions) and (iii) the major challenges ahead (such as digital transformation or taking environmental issues into account).

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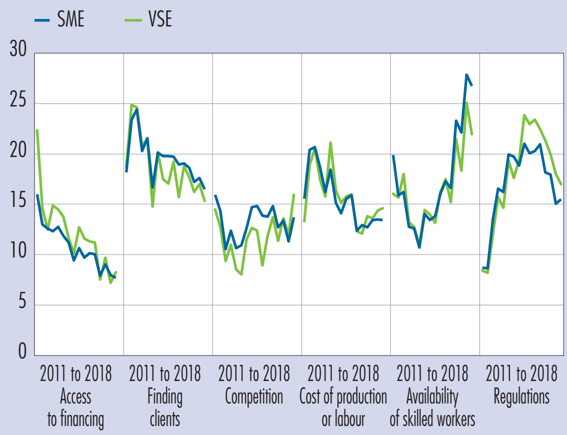
JEL codes
G30,
G31, G32

80%
SME debt ratio in 2017 (financial debt/equity), compared to 100% on average over the period 2006-2012

+7.5 percentage points
increase, between 2015 and 2019, in the acceptance rate following an application for an investment loan by a VSE

1 VSE out of 5
shows negative or no equity, compared with 7% for SMEs

Main problem encountered by SMEs and VSEs in France
(%)



Source: ECB SAFE survey (*Survey on the access to finance of enterprises*) (period: April 2011- March 2019).

The *Observatoire du financement des entreprises* (Observatory for Business Financing) brings together the main organisations representing companies and the financial sector, public players in the field of financing, chambers of commerce networks and the main providers of public statistics and economic analysis.

The Observatory's reports are the subject of a consensus between its member institutions, and the work carried out throughout 2019 led to the publication of a report on 18 December 2019 on the **"Financing of SMEs-VSEs"**.[1] Indeed, the last complete overviews of the economic and financial situation of SMEs and VSEs, carried out by the Observatory, date back a few years.[2] 10 years after the crisis, it seemed important to carry out a thorough review of the financing of companies, focusing on SMEs and, more specifically, on VSEs.[3]

1 A gradual improvement in the economic and financial situation of SMEs-VSEs

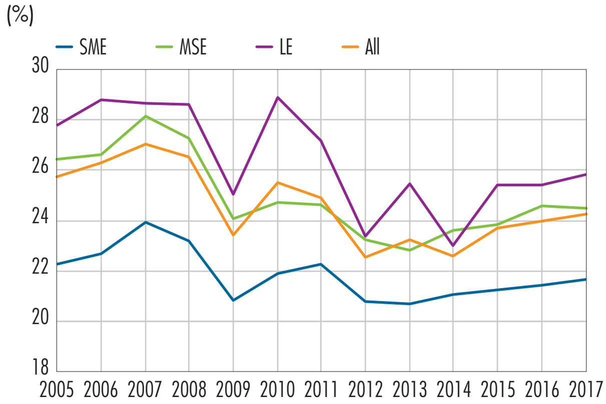
Compared to the mid-2010s, the situation of SMEs and VSEs has improved. Most of the various accounting ratios used to assess the health of companies have improved significantly, while generally remaining at less favourable levels than in the pre-crisis years.

This is particularly the case for margin rates and the various ratios measuring corporate profitability. However, according to the first available data, developments in 2018 were slightly unfavourable.

SMEs' equity capital has strengthened, more markedly in recent years than at the beginning of the decade. The contribution of profits played a crucial role in this development from 2014 to 2017.

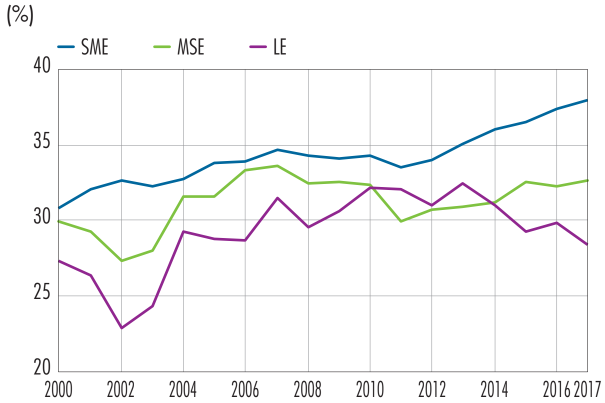
Over the decade, SMEs' investment effort remained below the pre-crisis level, and therefore not very strong. However, and partly as a result of the weakness of investment, self-financing of investment increased significantly, boosted by the rise in profits, which was

C1 Margin rate
(gross operating surplus/value added)



Source: Banque de France, FIBEN database.

C2 Equity capital in total funding sources



Source: Banque de France, FIBEN database.

in turn brought about by the rise in margin rates and the fall in interest charges. Similarly, SMEs' cash position improved significantly as the share of cash in their balance sheet increased.

This development took place against a backdrop of relatively stable working capital requirements, "frozen", in particular, by indicators relating to payment times that have hardly changed in recent years.

In general, the improvement concerns all sectors. For margin rates, this trend is marked in industry and trade. Conversely, in construction, the improvement

1 Downloadable from the following address: *https://mediateur-credit.banque-france.fr/liste-chronologique/les-rapports-de-lobservatoire-du-financement-des-entreprises*

2 See the Observatory's reports on "Le financement des TPE en France" (2014) and "Le financement des entreprises et nouveaux défis de la transformation numérique" (2017).

3 I.e. SMEs with fewer than ten employees and with a turnover of less than EUR 2 million.

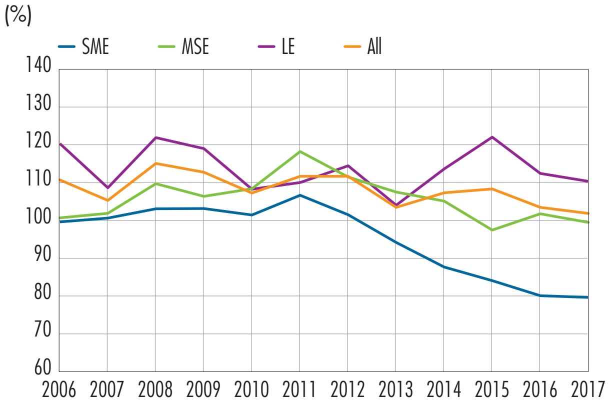
is extremely limited compared to the fall observed between 2007 and 2012. Similar developments are observed for rates of return.

The statistical data needed to deepen this analysis of VSEs are not sufficient to rigourously trace the evolution of their situation over time.[4] Based on a very broad scope,[5] the report provides a snapshot of the situation of VSEs in 2017 (distribution of turnover, sectoral breakdown, main accounting and economic ratios, cash position). It seems that the trend is relatively similar to that of SMEs. However, one of the variables, payment deadlines, does not seem to be moving in the right direction, as a result of the deterioration in VSEs' "trade balance".[6] The overall situation of VSEs is worse than that of SMEs. **One in five VSEs has negative or zero equity capital, compared to 7% for SMEs.** The proportion of VSEs considered to be in financial difficulty, i.e. whose equity capital and cash position have deteriorated, is 14% (250,000 VSEs out of the 1.8 million VSEs included in the analysis).

Business demographics data (mainly VSEs, given their very large weight in business creations or failures) **are particularly positive**. Business creations have been rising sharply since 2011-2015, driven by self-employed entrepreneurs but also by other types of sole proprietorships and traditional companies. The business survival rate (at one, two and three years) improved markedly over the decade, with the generations of recently-created businesses surviving longer than previous generations. It is, however, a little early to say whether the large number of companies set up after 2015 will be as long-lasting as those of the previous generation. As a result of these developments, the number of business failures, after having increased in the first half of 2010 following the economic crisis, fell from 2015 onwards until 2018.

As regards debt and financing, it should be noted that the debt levels of SME-VSEs are widely dispersed; two categories of companies can be distinguished: those that regularly resort to credit and the others (that have recourse to self-financing or, as a matter of principle, are opposed to resorting to credit). Overall, **the debt ratio for all SMEs fell steadily throughout the 2010s**, with financial debt roughly equivalent to equity capital in the 2000s and until 2012, and dropping to less than 80% of equity capital in 2017. This decline was mainly brought about, at the start of the period, by the decrease in debt and, in the recent period, by the rise in equity capital. The decline in the SMEs' debt ratio concerns all sectors, in particular services, construction, to a lesser extent trade and, to a marginal extent, industry.

C3 Gross debt ratio
(financial debt/equity capital)



Source: Banque de France, FIBEN database.

2 Easier access to credit

The sources of this debt have changed very little for SMEs over the past 15 years, unlike for large enterprises (LEs) and mid-sized enterprises (MSEs), for which disintermediation through recourse to the market has continued. In 2017, **85% of SMEs' financial debts consisted of bank credit** and this proportion was the same in 2005. The share of leasing has remained significant for SMEs (unlike for GEs and MSEs). Conversely, direct market financing, which was marginal in 2005 (2%), has increased (5% in 2017), benefiting more particularly certain categories of SMEs (larger, internationalised, innovative SMEs).

4 The methodology has evolved and data that can be interpreted today are not available for previous years.
5 This field includes 1.8 million VSEs out of the 3.7 million VSEs surveyed by INSEE. Certain categories are excluded, such as self-employed persons, microenterprises in the tax sense, VSEs in the agricultural, financial and non-market sectors and some of the other VSEs for which accounting information is not sufficiently complete.
6 Difference between days payable outstandings and days sales outstandings.

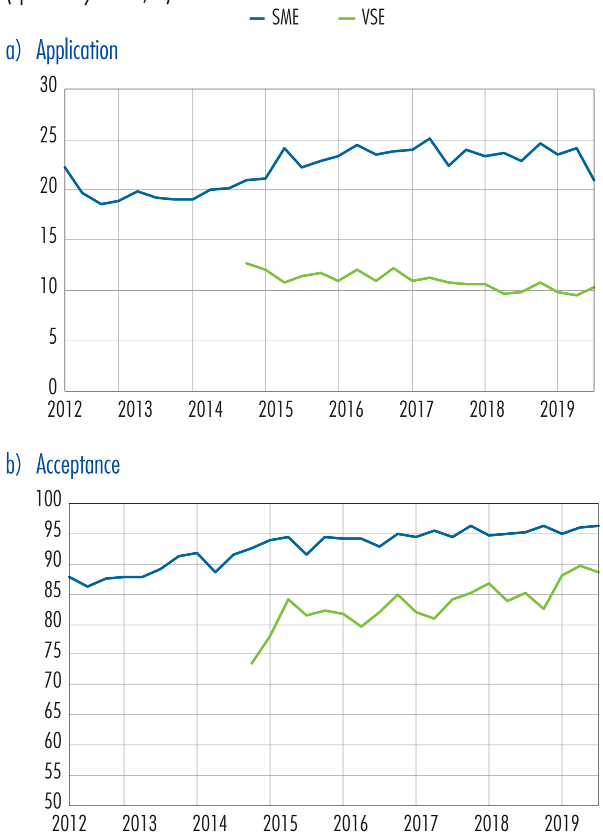
The cost of financing has never been so low. This is particularly the case for bank financing, which is the main source of financing for SMEs and VSEs. As a result of monetary policy action, of its smooth transmission by banks and of strong competition between networks in this customer segment, interest rates are at historic lows, with a fairly sharp downward trend between 2012 and 2017. This trend concerns: (i) all sizes of companies (the rates paid by the smallest are slightly higher than those paid by the largest, which is consistent with their risk profile, but interest rate spreads have narrowed); (ii) all rating categories (the rates paid by the lowest rated companies remain higher than those paid by the highest rated) and (iii) all types of loans and credit maturities (equipment, real estate, cash, overdrafts, with, however, a slower decline in the rates applying to overdrafts). This general downward trend in rates is not unique to France. It is common to other euro area countries, but rates remain lower in France.

Bank lending, as recorded in the Banque de France's Central Credit Register, **has been particularly buoyant in recent years**. The *Haut Conseil de stabilité financière* (HCSF – High Council for Financial Stability) has monitored these trends and has highlighted the risks they pose in terms of excessive debt. Year-on-year growth in new lending to SMEs has averaged 4% in recent years, but this rate stood at 2% in 2014-2015 and has been above 6% since mid-2018. For VSEs, the increase is even stronger, exceeding 8% since mid-2018. It is driven by the rise in real estate loans and, in the very recent period, cash loans. Equipment loans have also posted a marked acceleration. Given the distribution of loans to the different company rating categories, it appears that credit is granted to all companies (with the exception of companies with the lowest ratings).

As a result of the improvement in companies' financial situation, **levels of access to credit have reached unprecedented levels** in recent years, whether for SMEs or VSEs, both for investment and cash loans. These levels are unlikely to increase further for SMEs: the credit acceptance rate has averaged close to 90% over the last four quarters for short-term loans and more than 95% for investment loans. For VSEs, these rates remain lower, especially for short-term loans, for which the average

C4 SMEs' and VSEs' applications for new investment loans and their acceptance

(quarterly data,%)



Source: Banque de France.

acceptance rate has stood at around 70% over the last four quarters (compared to an average of over 87% for investment loans over the same period), but there is a marked improvement.

Given the levels of utilisation of the credit lines granted, it also appears that the intensity of the drawing-down of credit lines has decreased, which can be interpreted as an easing of the constraint for the SMEs concerned. Similarly, the frequency of the bank's reviews of credit lines (e.g. termination of a line) has slowed slightly between 2012-2014 and recent years.

If credit applications are turned down, this is not related ("all things being equal") **to the company's size, its age** (once it has been set up) **or its sector, but to its financial situation**, which can be summarised by solvency and profitability indicators. This is particularly true for SMEs. In the case of VSEs, the primacy of solvency and profitability indicators also holds true. On the other hand, the size effect may come into play (VSEs with a larger number of employees are more likely to have their credit application accepted) and while there is no difference between industry and services, VSEs in the building sector would be less likely to obtain credit with the same balance sheet. The requirement for guarantees, by banks, for SMEs (where applications have been accepted) has become rather lax over the decade. The situation is less clear for VSEs on this point. It is also confirmed that access to credit for intangible investments is more complicated for SMEs and VSEs; in these cases, recourse to self-financing is more frequent.

3 Recent diversification of sources of financing

While bank credit remains predominant for SMEs, this should not mask **the diversification of sources of financing which appeared after the crisis** and which has been encouraged by the legislator.

- Bank credit itself has become diversified and can take on different forms, in particular for short-term loans, which are granted through different products. For example, factoring has considerably developed, with a special effort to reach a greater number of very small enterprises. The financing of international trade operations is also evolving.[7] For medium-term loans, risk management has changed somewhat, with more co-financing between banks to share the risk and greater use of counter-guarantees for bank loans extended, in particular, by Bpifrance. In general, the public bank's action expanded significantly in the 2010s, in particular towards SMEs and VSEs. The structuring of the social and solidarity economy (ESS law of 2014) has also left its mark on the corporate financing ecosystem and has guided the action of the financiers concerned, be they traditional or more specialised. The law on the new territorial organisation of the Republic (NOTRe law, 2015), a landmark over the period, concentrates the territories' public instruments, as regards corporate financing and support at the regional level.

7 See the Observatory report: "Financement de l'exportation et de la conquête de l'international" (2018).

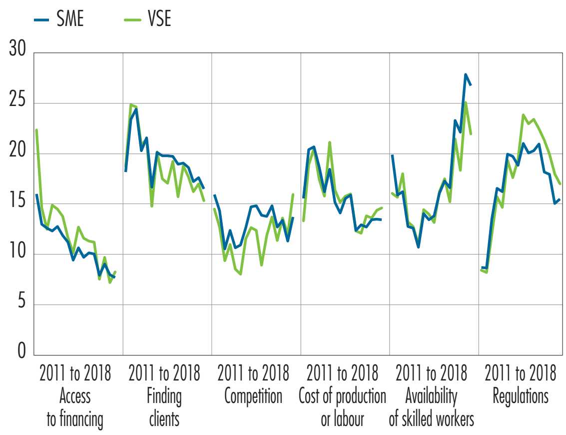
- Although they concern a small share of SMEs, debt products (such as loan funds or private placement) are now part of the corporate financing landscape. Participatory financing, which had raised great expectations in the mid-2010s, has developed well, in different forms and in an evolving manner, the model for this sector having not yet stabilised. As a result of cultural changes, using an asset being considered more important than owning it, leasing had already developed significantly before the crisis. Hundreds of fintechs have also been lastingly established, and the capital invested in these companies has grown strongly in recent years. These fintechs, of which participatory financing is a particular form, aim to facilitate the financing of SMEs and VSEs in almost all its possible dimensions. While there used to be a divide between "traditional" finance players and fintechs, the sector has matured and many traditional players have now integrated them into their strategy.

These new possibilities, still barely used by SMEs and VSEs, are now among the array of financing tools available to them.

In view of these various elements, the issue of financing is no longer a priority in business leaders' preoccupations. Finding customers, facing competition, managing production and labour costs, and assimilating regulations are much more important problems. Above all, finding skilled workers is a growing concern for managers of SMEs and VSEs. This observation is not specific to France, but common to the other euro area countries.

C5 Main problem encountered by SMEs and VSEs in France

(%)



Source: ECB SAFE survey (*Survey on the access to finance of enterprises*) (period: April 2011- March 2019).

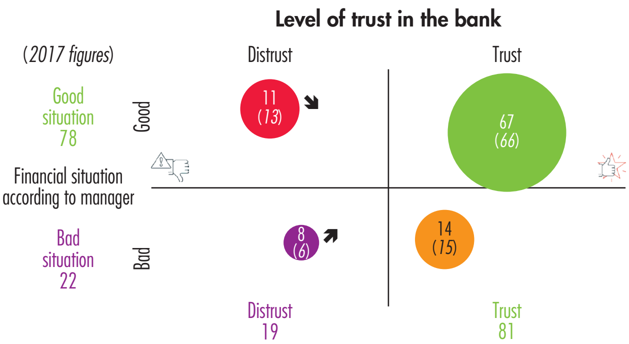
4 An improvement in relations between SMEs/VSEs and banks, but a greater need to support business leaders

Partly owing to this rather favourable picture, the relationship between business leaders of SME-VSEs and their bankers is clearly positive. However, it appears that this relationship can be deteriorated even when the company "considers" itself to be in good financial health and/or when there are no particular financing pressures (such as, for example, the cancellation of an overdraft). **The unsatisfactory relationship may result from a lack of communication** with the banker (instability, lack of follow-up) or from prices considered to be too high. At a time when many banking groups are reorganising their networks, the question of the proximity of the bank branch appears important, but not crucial ("if the branch is close, so much the better, if it is not, too bad"). In particular, when the situation of the company is deteriorated, this issue does not arise. Moreover, the trend is more towards remote and less face-to-face communication, which also corresponds to some clients' expectations. **The question of the bank branch's physical proximity should therefore be put into perspective.**

According to exchanges within the Observatory, relations between SME-VSE managers and banks have improved in recent years. Areas of friction have dissipated. This improvement is also the result of objective efforts made by the players concerned.

C6 Trust in the bank and companies' financial situation

(%)



Source: In Extenso.

In this respect, the Observatory's work, based on certain unfavourable observations, led to the issuance of several recommendations in 2014 and 2016. These were taken into account by bankers and factors to improve, in particular, relations with VSE managers.[8] It appeared that these players had indeed taken action to implement the recommendations, even if attention still needed to be paid to several important points.[9] The economic disruptions caused by the "yellow vests" movement may have strained this company-bank relationship. It appears that, from the sole point of view of the quality of this relationship, the "test" that this episode constituted was rather positive.

On the other hand, **one difficulty is regularly brought up in the exchanges: the level of financial and managerial skills of a significant proportion of the managers of small enterprises is not sufficient**. This lack of competence may impede the proper management of the company, in particular when difficulties arise or when financing choices have to be made to promote the company's development. It also affects the relationship with financiers. Of course, the latter must make efforts to adapt their language and educate their interlocutors, whose job, in the case of small business managers, is not to be experts in financial products. The Observatory's past recommendations stressed the need for greater dialogue, transparency, explanations (on the different sources of financing, their costs, the decisions taken by the bank), simplification and improvement of the legibility of the fee schedule. However, it is also essential that business leaders are all well aware of what they can expect from financiers, how they should envisage the relationship with the latter, address their financing issues, agree to be transparent, etc. To do this, they must possess, as far as possible, the essential keys to understanding the subjects of corporate financing. According to all the members of the Observatory, there is still considerable room for progress. While business creations have risen from around 550,000 per year over the period 2011-2015 to close to 800,000 today, it is important that these "new" managers be as well equipped as possible to ensure the longevity of their business.

8 See the Observatory's above-mentioned reports of 2014 and 2016.
9 See the Observatory report: "Évaluation de la mise en oeuvre des 5 mesures prises par la FBF pour améliorer les relations banques-TPE/PME" (2015).

One way of providing these skills is to support managers in their endeavours, both when setting up their business and afterwards, in particular as regards their day-to-day management and development strategy. This support may take different forms and the range of players involved is wide and varied. However, the organisations concerned carry out their actions with limited means at a time when the number of companies is increasing sharply. This context represents a challenge for these organisations in terms of their ability to monitor and support these companies. However, these actions are crucial, in particular in order to address the issue of financing. The report presents a series of new initiatives within this support ecosystem aimed at meeting this key objective of strengthening business leaders' financial and management skills. The Banque de France has explicitly included this priority in its strategy: the brand new mission (2018) aimed at strengthening business leaders' financial expertise completes its range of services to companies, such as Credit Mediation (2008) and VSE correspondents (2016). The banking sector itself has also taken steps in this direction.

In conclusion, the issue of financing is, on the whole, no longer a problem for SMEs and VSEs. The SME/VSE-bank relationship is rather satisfactory and has improved in recent years.

The recommendations put forward by the Observatory in 2014 and 2016 have been implemented in broad terms. **However, these recommendations remain relevant.** Their proper implementation is particularly important in view of the risk of a future economic downturn and/or a tightening of access to financing. It is important to be "ready" and to prevent any difficulties that are bound to arise in such an event.

Attention should be paid to three points:

- **The issue of payment times**, which is monitored by the *Observatoire des délais de paiement*, is an important element for which it seems essential that the public authorities pursue their actions to improve companies' situation, in particular SMEs and especially VSEs.
- **The priority that emerges today is that of strengthening the financial skills of managers of small businesses, where these skills are insufficient.** The actions carried out by the various organisations to support entrepreneurs on this issue are now essential. Although the subject is not new, it has become particularly acute and emerges more clearly at a time when other signals have turned "green" in recent years and in the context of a sharp rise in the number of entrepreneurs.
- **Today, business leaders of SME-VSEs are facing major strategic challenges.** Whether it is a matter of digital transformation, innovation or a shift towards a more environmentally conscious economy, their needs are changing. At the same time, financing solutions have diversified. Here too, this new situation must lead business leaders to increase their skills in order to take the best advantage of their new financing environment. It is crucial that businesses be able to finance these priorities, which also raises the question of the right balance between self-financing, debt and equity. Business leaders must have the right keys to understanding and easy access to the relevant sources of information and training if they wish to see their business succeed.

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