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Austria's Small and Medium-sized Enterprises in the Financial Market Crisis

Austria's economic structure is strongly characterised by small and medium-sized enterprises (SMEs), as more than 99 percent of all Austrian enterprises fall into to this category. Bank finance is more important to SMEs than for larger firms, and a credit crunch developing in the course of the financial market crisis would therefore have a great effect on SMEs. This has not, however, occurred, as the volume of bank loans also grew in 2009 despite financing conditions becoming more averse. The average credit margin of banks in 2009 clearly exceeded that of the previous year, however it remained close to the average for the past ten years.

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Global financial crises persist longer and generate higher costs than recessions which are limited to individual countries. The collapse in growth, the decrease in consumption and investments as well as the loss of wealth is much more significant (*IMF*, 2009, *Reinhart – Rogoff*, 2009). A financial crisis can cause a reduction in the credit supply of banks, which can develop into a credit crunch[1] under unfavourable conditions. A credit crunch affects both large and small enterprises. However, the possibilities of accessing external sources of financing are limited for small and medium-sized enterprises. Within this context, the article examines the consequences of the financial market crisis for the financing of small and medium-sized enterprises[2].

SMEs in Austria

According to the definition of the European Union, more than 99 percent of all Austrian enterprises are "small and medium-sized enterprises" (SMEs), as they employ fewer than 250 persons. These 99 percent of Austrian firms employ approximately 67 percent of the Austrian employees. The majority of SMEs are micro-enterprises employing 1 to 9 persons, which account for approximately 25 percent of Austrian employees. The size distribution of enterprises is surprisingly similar across European Union countries (*Hölzl – Reinstaller*, 2009). Germany exhibits a somewhat smaller share of SMEs than Austria, while the southern European countries of Spain, Portugal, Italy and Greece have a larger number. The size class structure has changed only very slowly over time in the European Union (*Hölzl – Reinstaller*, 2009). SMEs are unequally distributed across industry sectors. While they are particularly prevalent in the construction, wholesale and retail trade, hotel and restaurants, as well as in business services, they play less of a role in energy, gas and water supply, mining, manufacturing or transport, storage and communications.

Because SMEs constitute the majority of Austrian firms and are active in all industries, they are not uniformly affected by the economic crisis. With respect to large enter-

[1] One speaks of a credit crunch if the credit supply of financial institutions is significantly reduced (*Bernanke – Lown*, 1991, *OeNB*, 2009).

[2] For SMEs in specific industries in different countries, specific measures were introduced. However such measures, such as for instance the German model of the craftsman bonus, which has also been discussed in Austria, are so industry-specific that their presentation would go beyond the scope of the article.

prises there are clear structural differences. For example, the capacity utilisation of small enterprises is on the average smaller than that of larger enterprises (*Brunner – Schwarz,* 2006). Two specific characteristics indicate that SMEs would suffer particularly under a reduction of credit supply (credit crunch; *Udell,* 2009), which could also develop in Austria in the wake of the financial crisis:

- Despite a clear improvement in the average equity ratio among SMEs in the period between 2003-04 and 2007-08, a study in SME research shows that in Austria the equity ratio generally increases with firm size. On average, micro-enterprises have equity of scarcely 10 percent of their balance sheet total (2007-08), while small firms have an equity ratio of about 20 percent and medium-sized firms of around 29 percent. In contrast, the equity of larger firms is generally larger than 36 percent of their balance sheet total. At the same time, the equity base of SMEs is strongly polarised: 41 percent have a good equity base with an equity ratio of over 20 percent, while 35 percent have a negative equity capital ratio. About 11 percent have an equity capital ratio between 0 percent and 10 percent and another 12 percent have an equity ratio between 10 percent and 20 percent of their balance sheet total (*Voithofer,* 2009).
- Because SMEs have limited access to financial markets due to high transaction and information costs, bank loans are their most important source of external financing. In Austria, these carry much more weight for small enterprises than for larger ones. According to *OeNB* (2009) the median debt ratio of very small firms was approximately 50 percent in 2007, while that of small enterprises was approximately 33 percent, and that of medium-sized enterprises approximately 29 percent. At the same time, large and very large enterprises showed a debt ratio of approximately 25 percent and 12 percent, respectively.

More than 99 percent of Austrian enterprises have fewer than 250 employees. The equity ratio of SMEs is smaller than that of larger enterprises, and SMEs have limited access to financial markets. Bank loans play a very important role in SME financing in Austria. Very small enterprises tend to exhibit a median debt ratio of approximately 50 percent, while this figure characteristically amounts to about 12 percent for very large firms.

Firm financing in the crisis

In autumn 2008 it became clear that the bursting of the real estate bubble in the USA would have a substantial effect on the international financial system. After the bankruptcy of Lehman Brothers on 15 September 2008, uncertainty mounted and the interbank market almost broke down. In the USA the bursting of the real estate bubble, the high percentage of "toxic" securities and the banks' refinancing difficulties resulted in the insolvency of more than 90 credit institutions. In Europe several banks were placed under state control. At the beginning of October 2008, Iceland had to nationalise its three largest banks, bringing Iceland close to default.

In light of the uncertainty about the soundness of bank's balance sheets, discussions arose on the stability of the Austrian banking system and its ability to fulfill its task of SME financing. In Austria, as in all other European Union countries, a set of measures was agreed upon to strengthen the banks' liquidity and equity position, thereby supporting the banks' ability to provide loans.

The financial crisis has seriously shaken the public's confidence in the banking system. However, the effect on the credit volume has been moderate. In 2009 the credit volume grew less than in the years before. In light of the serious economic crisis, however, this does not amount to a credit crunch.

The crisis has not only shattered confidence in the banks, but has also had an effect on the entire financial market and therefore on financing conditions for firms (Figure 1).The development of the earning yield in 2009 has been influenced by the collapse of the earnings of listed firms. Also under "normal" conditions, as shown in Figure 1, bank loans are the most cost-efficient form of financing, cheaper than the emission of bonds and shares. However, bank loans must generally be collateralised. The distortions on the international financial markets not only affected banks in 2008 and 2009, but also the emission of bonds and shares. While the cost of credit adjusted quickly to the lowering of the interest rates of the European Central Bank, we only begin to observe a relaxing of the situation on the bond market by mid-2009.

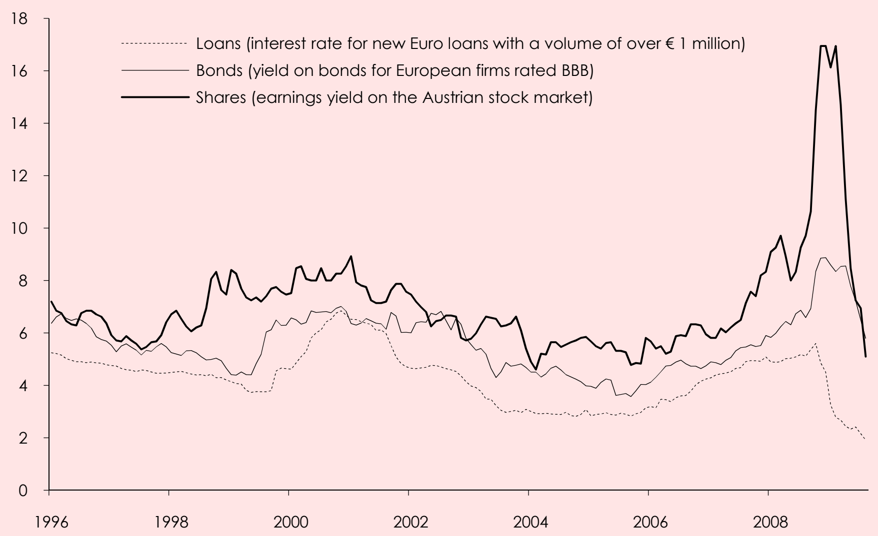
Bonds play a particularly important role as a financing instrument for larger companies. As the development of financing costs of bonds and stocks shows, this area was also affected by uncertainty, significantly limiting the financing of even very large firms. However, the bonds market recovered in the course of 2009. After the collapse at the end of 2008, new emissions rose manifestly at the beginning of 2009 (*OeNB,* 2009).

On average, the volume of credit in Europe and Austria continued to increase in 2008 and 2009, although it did so at a slower rate than before the financial crisis

(Figure 2). In Austria, it had risen at a slower rate than the European average between 2004 and 2008, and the reduction of credit growth since the end of 2008 was also less severe (*OeNB,* 2009).

Figure 1: The financing conditions of firms

In percent



Source: OeNB, Thomson Reuters, Wiener Börse AG.

Figure 2: Volume of credit to non-financial firms in Austria and the Euro area

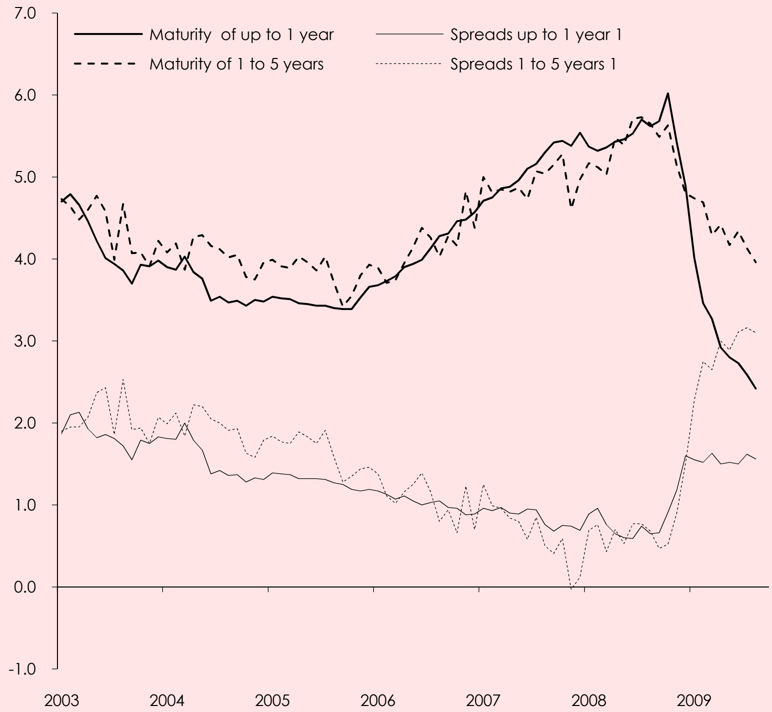
Source: European Central Bank.

The interest conditions for firm loans became less expensive with the lowering of interest of the European Central Bank (Figure 1). In the area of short-term bank credit, which is the predominant form of loan in Austria, the lower interest rates were nearly completely passed on, whereas for long- and medium-term loans we observe a greater gap between the money market and credit interest rates (*OeNB,* 2009). For new loans of up to € 1 million, a category which is very important to SMEs, interest rates responded very differently to the lowering of the money market interest rate (Figure 3). In contrast to periods pre-dating the financial crisis, short-term loans are currently cheaper than long-term loans. For short-term loans, the spread between interest rates and the three-month Euribor corresponds approximately to the level of 2006, while medium-term loans are significantly more expensive than they were before the financial crisis. In general, the credit conditions are approximately on par with those of 2003.

The interest rates for short-term loans developed in accordance with the interest policy of the European Central Bank. The spreads between the interest rates for firm loans and the inter-bank interest rate increased, rising above the values of recent years. However, the spreads for short-term loans corresponded approximately to those before 2003.

Figure 3: Interest rates for new firm loans with a volume of up to € 1 million

In percent



Source: OeNB. - [1] Spreads: Interest rate minus three-month-Euribor.

No credit crunch for SMEs

Based on a survey on loans to very small firms carried out in June, 2009, by the Austrian Federal Economic Chamber, about 15 percent of micro-firms (0 to 9 employees) saw an improvement in their credit conditions and only 7 percent saw a deterioration.

In March, June and September, 2009, WIFO carried out a special survey on credit financing conditions by commission of the Austrian National Bank within the context of the WIFO business tendency survey. In contrast to the survey conducted by the Federal Economic Chamber, this survey was based on a representative sample of rather large SMEs and large enterprises. According to the results, over 30 percent of firms saw a worsening of conditions for existing loans and about 13 percent experienced a significant worsening. In the case of new loans, 38 percent of firms said the conditions deteriorated, with 20 percent calling this deterioration significant. Based on size class, the results from June and September 2009 showed barely statistically significant differences, while restrictions for large firms were more marked in March. In general, the results indicate a slight overall improvement of credit conditions over time. Over 40 percent of firms saw no change in conditions for new loans (Table 1).

Overall, about 45 percent of firms expect a further worsening of credit conditions in the next three months. Over time, expectations have improved.

Approximately 60 percent of those firms which reported a significant deterioration in credit conditions in June gave the same answer in September. About 80 percent of those firms which had observed no change in credit conditions again said in September that they had observed no worsening of credit conditions. This persistence in the answers shows that certain types of firms had been affected more than others. These were most likely firms whose branches had been struck particularly hard by the crisis, or whose equity ratio and profitability had already been unfavourable before the crisis. It is not possible to speak of a general credit crunch or an extreme tightening of the situation.

Table 1: Assessment of loan conditions of firms by size classes 2009

	0 to 49 employees			50 to 249 employees			250 or more employees		
	March	June	September	March	June	September	March	June	September
	Percentage shares								
How have conditions for new loans to your firm changed at your house bank in the past three months?									
Significantly tightened	14.5	19.1	19.0	16.6	20.8	22.2	29.1	34.4	19.5
Slightly tightened	21.5	21.9	16.1	16.6	25.4	21.4	20.0	12.5	26.8
Unchanged	44.1	44.9	44.8	54.1	36.2	41.3	38.2	50.0	39.0
Slightly relaxed	1.2	0.7	2.8	2.2	5.4	1.6	0.0	0.0	7.3
Significantly relaxed	0.7	0.0	0.8	0.6	0.0	0.8	0.0	0.0	0.0
Not specified	17.9	13.4	16.5	9.9	12.3	12.7	12.7	3.1	7.3

Source: WIFO.

Conclusion

In Austria in the course of the financial crisis we do not observe a credit crunch for small and medium-sized enterprises, because economic policy took rapid measures and the banking system proved more stable than feared. In the future, however, the strengthening of the equity capital supply of SMEs should receive special attention from economic policy makers.

The financial market crisis did not provoke a credit crunch for SMEs, despite a slowing in the growth of the volume of credit (since early 2009 on average –0.15 percentage points per month; *OeNB*, 2009). However, the rate of change continues to be positive while the gross domestic product shrinks. Clearly, banks are requiring much higher risk premia and are handling loans in a somewhat more restrictive way than before the crisis. In general, the volume of credit and credit demand is strongly pro-cyclical (*Url*, 2009). While banks have seen a reduction in the demand for loans, based on the credit report of the *OeNB* (2009), the firm survey conducted by WIFO does not reflect this tendency. A higher credit demand could therefore be limited by the credit supply. Reduced supply could be explained by the risk and cost considerations of banks, in particular in light of the worsened credit rating (scoring) of many firms in the course of the financial market crisis and the high costs of refinancing , especially in the long-term segment (*OeNB*, 2009).

The Austrian credit system has fulfilled its task of providing liquidity for firms during the financial crisis. As a result, the Austrian financial system proved more stable than it was initially feared to be at the start of the crisis. Economic policy makers introduced early measures, such as the extension of state guarantees for firm financing, as well as the bank package, in order to prevent a credit crunch. Although the data for a founded estimation of the effectiveness of these instruments are not yet available, the goal of securing the provision of loans to Austrian firms appears to have been achieved[3]. At the same time, SMEs were affected by the effects of the crisis on the credit market. In particular those SMEs which already had a low equity capital ratio and low profitability before the crisis, as well as those operating in industries more seriously affected, have observed a worsening of credit conditions.

In order to better prepare Austrian SMEs for future crises, the capital structure should be improved. The basis for this is a neutral tax system with respect to firm financing. The tax exemption of credit interest, but not of the implicit interest on equity, makes

[3] According to the Austria Wirtschaftsservice (AWS), the measures were adopted and the number of subsidised cases rose significantly in the year 2009. As many AWS instruments target the financing of investments and firms have noticeably reduced their investment activities, this can be interpreted as a first sign of the effectiveness of the measures.

bank finance more attractive for SMEs than equity capital finance. In the context of sought-after structural change toward a knowledge-based economy, this would also be advantageous from the point of view of structural policy, as financing instruments with an equity character are better suited than loans for the financing of risky innovation projects and in industries with few tangible assets that can be used as collateral for bank loans (*Hölzl et al.*, 2006).

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Austria's Small and Medium-sized Enterprises in the Financial Market Crisis – Summary

The global financial crisis, which had its origin in the bursting of the real estate bubble in the USA, affected the confidence in the functionality of the modern financial system. Such a situation bears the risk that the restriction of credit supply turns into an outright credit crunch. The latter is defined as a significant contraction of the credit supply and a tightening of credit conditions. Smaller enterprises are likely to be particularly vulnerable to a credit crunch as they do not have access to capital markets.

In Austria more than 99 percent of all enterprises are SMEs. On average the equity ratios of SMEs are lower than those of larger firms and small firms are unable to raise funds in the capital markets. Therefore, banks play an important role for financing SMEs. In Austria the bank debt ratio is around 50 percent for the median very small firm whereas bank loans account for only around 12 percent of total assets for the median very large firm.

The financial crisis led to a confidence crisis in the global banking system that may affect the domestic lending behaviour of banks. In Austria total outstanding debt grew at a lower rate in 2009 than in previous years. Given the pro-cyclicality of credit demand and the severity of the economic slump this is no evidence of a credit crunch. Interest rates for short-term credits have developed in line with the interest rate policy of the ECB. The spreads between the interest rates for bank loans to the non-financial private sector and the three-month Euribor are substantially higher than in recent years. However, the spreads for short-term bank loans are close to the average of the last ten years. The higher the spreads can be explained by the deterioration of enterprises' creditworthiness in the wake of the crisis and banks' still relatively high refinancing costs.

The results of a set of surveys on the financing conditions of enterprises conducted by WIFO on behalf of the OeNB show that approximately 38 percent of SMEs are experiencing a deterioration of the conditions for new loans. This share has remained largely unchanged during the three waves of the survey conducted in March, June and September 2009 and there is no difference between the answers of small and large firms. Further analysis shows a high persistence in the replies of enterprises during the three waves. The SMEs reporting a deterioration of financing conditions mostly belong to industries that were hit hard by the crisis or showed a low equity ratio and profitability already before the crisis.

Overall, the evidence does not suggest a credit crunch for SMEs in Austria. Policy measures were implemented early on and the banking system has proved more resilient than expected at the onset of the crisis.