Finanzgruppe
Deutscher Sparkassen- und Giroverband

Finance Watch conference

“The Long Term Financing Agenda – the way to sustainable growth?”

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Key note speech

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Ladies and Gentlemen,

I would like to thank Finance Watch for inviting me to this conference and giving me the opportunity and pleasure to address such a distinguished audience.

Over the last years, our attention has been focused on crisis management. First the bank crisis and then the sovereign crisis.

Unfortunately, we cannot yet say that we are out of the woods. The aftermath of both crises is still felt today.

But the modest performance of the European economy obliges us to look beyond short term 'firefighting' and to focus on long-term growth.

On a growth model that is smart, sustainable and inclusive.

In this context, Long Term Finance has an important role to play. It will contribute to the investment needed to help Europe to exit these problems, as well as to respond to global challenges.

To this end the Commission has published last year the Communication on Long Term Financing of the European Economy.
Herein the Commission proposes a number of policy initiatives to increase the availability of funding to the real economy.

In this context the new Commission - for which financing growth is a priority - tabled the Green Paper on building a Capital Markets Union.

One has to agree that capital markets funding will have a certain role to play. Large medium-sized companies find it easy to draw their funding from the capital markets.

But the smaller ones are facing difficulties.
For them, capital market finance is today

- too costly,
- too inconvenient,
- too complicated.

In its Green Paper on Capital Markets Union the Commission identifies a number of ideas to tackle these problems. Securitization seems to be one of the most important issues in that context.

The benefits and drawbacks of the Commission's proposals will be discussed by the following speakers of today's conference.

To avoid duplication, I would like to draw your attention to another topic: the starting point of the discussion about access to finance for SME's.

In the introductory part of the Communication on Long Term Finance the Commission makes three statements:

1. European businesses have been heavily reliant on bank lending.

2. Banks' ability to extend credits to companies has been significantly reduced by the financial crisis. The consequences of this are felt particularly by small and medium sized enterprises, which form the backbone of the European economy.

3. As a consequence policy efforts are needed to reduce the reliance on bank funding for example by improving the capacity of financial markets to fund the real economy.

Let us take a closer look at these statements:

The first statement concerning the reliance of SMEs on bank lending is certainly true in Europe.

When comparing the European economy with the US-economy one can see that in Europe three quarters of the SME rely on bank funding and only one quarter on the financial markets. In the States exactly the opposite is true.

The second statement refers to the financial crisis and its impact on banks' ability to extend credits to SMEs.

The Communication analyses that SMEs suffered the most during the crisis. I quote: "They are still finding it challenging to obtain loans, particularly in the periphery economies due in part to the fragmentation of the banking sector."

This analysis deserves a closer look.

Concerning the lack of access to funding the Commission states that these problems are common in Greece, Spain and Italy whereas in the northern Member States, like Sweden, Denmark, Germany, Austria, the situation is far better, if not to say the problem doesn't exist.

First remark: The general statement on funding problems for SMEs in Europe is only partially true.

Second remark and question: Is this funding problem due to the fragmentation of the European Banking sector?

Using the argument of fragmentation in this context addresses financial groups, which are active across the borders.
They have, in fact, a tendency to withdraw their engagements in difficult times from foreign territories and to concentrate them in their home country.

It is logical that this behavior doesn't apply for banks which are only active in one Member State.

This brings us to the question of who are the banks that finance predominantly SME's in normal times and how did they behave during the crisis.

At European Level the issue of access to finance for SME is under scrutiny since 2000, long before the crisis.

As of this year the Commission launched a number of surveys and initiatives to analyze and tackle the problem which was then discussed under the headline of 'Credit Crunch'.

A series of round table meetings between banks and SME organizations were organized by the Commission on that issue. I am sure, many of you will remember these.

By the way, among the topics discussed at that time was also the securitization issue.

The outcome of the surveys and round table discussions was straightforward:
The access to finance for SMEs turned out to be problematic especially in those peripheral countries, which are now named in the Communication on Long Term Finance: Greece, Spain, Italy.

In Northern Europe, except of the UK, this was hardly a problem.

This allows for the following conclusion: The phenomenon of a credit crunch is not directly linked to the financial crisis.

But the question remains: Why is the situation so different for SMEs in the European Member States? In other words, what causes this discrepancy?

To find the answer we have to consider two aspects:

- First: The soundness and viability of the SMEs which demand for a loan
- Second: The business model of the banks to which they turn to for funding.

The first aspect is very simple:

No one will get a loan from a third party unless he is able to pay it back one day. And it makes no difference whether the third party is a bank, an investor or even a member of the famous 3 Fs: Family, Friends and Fools.

And we do know that - unfortunately - the economies in the peripheral countries face heavy problems due to a lack of competitiveness and viability of lots of their businesses. It is clear that this situation has an impact on their access to finance, be it in their country or outside.

The SMEs must overcome these problems on their own. Neither banks nor investors can do this job for them.

For this reason we highly appreciate all the initiatives undertaken by the Commission to help those economies in becoming more competitive.

The second aspect refers to the business model of the banks to which the SMEs turn for funding.

It turned out of the surveys conducted in the context of credit crunch that the access for finance for SMEs is far easier in those countries with banks which mainly concentrate on the so-called traditional business model.

Traditional business model means: Collecting savings and channeling them to the businesses.

In other words, we are talking about retail banks with stable private and corporate clients and no significant capital market activity.

Banks with the main purpose of servicing to the needs of the savers on the one side and the real economy on the other.

Of course, also those banks refuse sometimes loans to corporate customers.

But they take this decision on the basis of their knowledge of their customers, a long track record and deep insight into their businesses.

This funding selection promotes the growth of good and competitive businesses and disciplines the uncompetitive ones, leading to an overall stronger economy in the long term.

It is clear that the proximity of the bank to the corporate customers matters under these circumstances.

This proximity is secured by regional and local banks like the around 5 – 6,000 cooperative banks, savings banks and small commercial banks in Europe.

And by those larger banks which have no centralized credit units but give their local branches the decentralized competence to grant credits, like Handelsbanken in Sweden.

The business policy of these banks is focused on maintaining lifelong business relationships with their customers.

For them, sustainable growth of the corporate customers is more important than striking a quick deal. Long term profitability trumps the short-term cash. That motivates them to stay at their customers' side even during difficult periods for as long as this is economically and financially justifiable.

Now you may understand why during the financial crisis these banks didn't withdraw the credits even from those SME customers, who have heavily been hit by the decline in demand.

At least in Germany, the savings banks even increased the loans, providing SMEs with the opportunity to invest in order to increase their productivity and to emerge leaner and more competitive once demand came back.

In the European Union we count around 8,000 banks. I guess nearly 5-6,000 of them are proximity banks and maintain this traditional banking model. They have been and they have to remain the backbone of the SMEs finance.

The strong SME segment in the economies in Northern Europe would not be conceivable without a corresponding structure in the banking system, in other words, the banks which focus specifically on the needs of SMEs.

But the question arises as to whether the continued existence of these banks is assured.

Unfortunately, it is not certain for all of them.

There are two reasons for major concern:
The regulatory burden and costs and the low interest policy of the ECB.

In its Communication on Long-Term Financing the Commission found very clearly that various regulations may impact a bank's ability to channel funds to the real economy, in particular to small and medium sized enterprises (SMEs).

I fully share this concern. The increasingly tight regulatory framework pushes banks to excessive restrictions on maturity transformation.

Furthermore, the need for banks to increase retained profits in order to boost regulatory equity leads them to withdraw from long-term lending and less profitable operations such as project or export finance.

Finally, the new regulation brings higher administrative costs that increase the costs of lending.

Therefore, I highly welcome the Commission's promise to do its best to find the right balance between improving the resilience of the banking sector on the one side and avoiding excessive restrictions on maturity transformation on the other.

And I would add that regulation must follow the proportionality principle more. Because the regulation is a "one rule fits all" and neglects the specific conditions of thousands of European banks, which maintain the traditional banking model in their regions.

To this challenge and concern adds the low interest policy of the ECB.

We all know that extremely low interest rates involve substantial collateral damage if they are allowed to persist for too long.

This applies particularly to the traditional banks.

On the one side, this policy discourages the savers by generating a disincentive to the propensity to save.

On the other side, it squeezes the overall net interest margins of these banks and put - since they have no significant capital market activity - their survival at risk.

So we live in a paradox.

On the one hand, central bankers are creating abundant liquidity in order to boost lending to the real economy.

But, on the other hand, lawmakers and regulators make bank lending more troublesome.

Let me conclude:

1. The ability of the financial system to channel funds to the real economy will be essential in securing Europe's position on a sustainable growth path.

2. It is of course justified to look for alternative sources of finance but this should not distract us from recognizing the fact: SMEs not only need bank lending but they also need an expansion of bank lending if we want to allow a strong economic recovery.

3. The traditional business model of thousands of regional and local banks in Europe has proved its efficiency to finance SMEs even during the crisis. This model must not be jeopardized.

4. Finally: To promote long-term corporate financing we do need a coherent strategy which includes capital market players as well as those banks that traditionally focus on the needs of SMEs.

   In the absence of such a strategy the economic recovery of Europe will be compromised.

   I thank you for your attention and I will be pleased to participate in the debate today.