Saving the Job Creators in the Pandemic Context in Europe. The Role of Multilateral Development Banks

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Abstract

Small and medium-sized enterprises (SMEs) represent the backbone of global economic development because they account for creating private initiatives, innovation, and employment. In the wake of the Coronavirus outbreak, the SMEs were strongly affected, both from the demand and supply of products and services, tightening the ability to gather financial resources in order to meet short term liquidity demands and working capital requirements. Since the onset of the COVID-19 pandemic, many governments and multilateral development banks (MDBs) have provided financial resources to SMEs in order to tackle the effects of lockdown. This paper aims to characterize and assess current measures and initiatives adopted by MDBs to support SMEs. We highlight that international financial institutions act countercyclically in securing businesses and supporting jobs. The paper underlines the importance of transparency, a correct evaluation of risks and fiscal costs, and strong governance while dealing with MDBs support.

Key words: Coronavirus crisis, Europe, multilateral development banks, SMEs
J.E.L. classification: G32, O43, O52.

1. Introduction

At the European Union level, small- and medium-sized enterprises (SMEs) play an important role in job creation, value-added, and innovation. They create more than 58% of the gross value and represent 99% of all businesses, providing roughly three-quarters of all jobs. SMEs stimulate innovation, foster competition, and represent the main venue for job creation. Despite the high-growth potential, SMEs may encounter challenges in finding financing. In the wake of the coronavirus outbreak, the SMEs' financing capacity and ability to meet short term obligations have been strongly affected.

Also, on the eve of the coronavirus crisis, the banking system is facing some potential risks. In European emerging countries, claims in local currency represent around 60% of foreign claims, while short term claims account for roughly 50% of total claims, from the maturity perspective. The maturity profile lending in foreign currency and the share of foreign claims versus local currency claims drive the contraction of credit stock following a shock. It is shown that a lot of variations are expected among national banking systems as a response to a financial shock generated by the pandemic (CCSA, 2020).

The lack of immediate access to finance, affect not only the existence of SMEs but also the possibility of a quick recovery. In this context, multilateral development banks (MDBs) should play an important role not only in fighting against the pandemic but also in alleviating the impact on employment and economic recovery (Bartik *et al*., 2020, p. 12).

MDBs represent the main intermediaries on the international financial markets, and these institutions play an important role in ensuring and maintain economic development and financial stability. During the international economic and financial crisis from 2007-2008, MDBs acted countercyclically and supported both the public and the private sector.

In this paper, we look at the role of MDBs in supporting SMEs during the pandemic context by analyzing the support programs initiated by MDBs, in response to COVID-19. We performed a qualitative analysis, together with a critical approach and recommendations.

The paper is structured as follows: Section 2 presents a brief literature review on the impact of COVID-19 on SMEs; Section 3 describes the support programs taken by MDBs as a response to coronavirus crisis; Section 4 brings a critical approach and recommendations; while Section 5 summarizes the main ideas of the paper.

2. Literature review

A new stream of research recently emerged on the impact of COVID-19 on SMEs' activity. Donthu and Gustafsson (2020) appreciate that it is very challenging to estimate the long-term effects of COVID-19 on firms, as we are still experiencing a pandemic era. However, the implications of COVID-19 on firms are visible, mostly the lack of funding. Moreover, many firms were forced to close, especially from the tourism and hospitality area (Eggers, 2020, p. 201), or were in the position to move operations online. The impact of COVID-19 on SMEs activity is analyzed by Bartik et al. (2020) based on a survey of 5,800 small businesses from the United States. The findings indicate that 43% of responding firms are temporarily closed and SMEs were affected harder than larger firms. Table no 1 reports the results by firm size and it can be noticed that microenterprises are more financially fragile.

Table no. 1 The impact of COVID-19 outbreak on firms from US, breakdowns by firm size

Currently closed	**Mean**	**Standard deviations**
<5	.459	.498
5-9	.47	.499
10-19	.41	.492
20-99	.364	.482
100-499	.261	.444
Unknown	.413	.495
Total	*.446*	*.497*
N	*4,969*	

Source: Bartik *et al.* (2020), How are small businesses adjusting to Covid-19? Early evidence from a survey. *NBER Working Paper Series*, No. 26989, NBER, http://www.nber.org/papers/w26989

The survey shows that, averagely, businesses have decreased the number of employees by 40 percent compared to January. Also, the findings show that the implications vary across industries. Retail, arts and entertainment, personal services, food services, and hospitality businesses were the most affected domains and registered a decrease in employment by roughly 50%. On the other hand, finance, professional services, and real estate have been less affected.

There are also previous studies that highlight how the crisis affects asset structure, debt ratio, profitability, and liquidity, based on the experience of previous periods of financial distress (Duarte *et al.*, 2018; Lisboa, 2017). Some studies analyze the effects of different support programs on SME activity (Briozzo and Cardone-Riportella, 2016; Harrison & Baldock, 2015). Gurara *et al.* (2020) show that MDBs could have an increased role in supporting long tern projects via the syndicated loan market, due to high-level information and monitoring capacity. Therefore, in the context of the pandemic era, the MDBs have launched support programs to help viable SMEs that are facing troubles due to scale break operations across Europe.

Akhtaruzzaman *et al*. (2020) investigate financial contagion between financial and non-financial firms from China and G7 states, over the COVID–19 pandemic period. The authors show that more of the spillovers came from China and Japan and hedging costs registered an increase.

3. MDBs' responses to the coronavirus crisis

Since the onset of the COVID-19 pandemic, many multilateral development banks have pledged an unprecedented amount of financial resources to citizens and businesses to safeguard the European economy, in addition to the national programs. In table no 2 one can observe some expenditure policy measures taken at the national level as a response to coronavirus crisis.

Table no. 2 National expenditure measures to support businesses

Measures	Targeting method	Country
Loans, guarantees, and Capital supply	Financial conditions-sales decrease	New York
	Sector-based targeting	Armenia, Argentina, Indonesia, Russia, United States
	Place-based targeting	Italy
	SMEs directly or institutions that collaborate with SMEs	Argentina, Australia, Italy, Spain, United States
	National governments	United States
Deferral of payments (i.e. utilities, rents)	Sector-based targeting	Indonesia, Venezuela
	SMEs	France, Spain

Source: IMF Special Series on Fiscal Policies to Respond to COVID-19. 2020. Expenditure Policies in Support of Firms and Households. https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes#STA

European Investment Bank (EIB), the largest MDB in terms of assets under management and the lending arm of the EU, has already approved a financial package in order to improve liquidity and alleviate working capital constraints for small and medium-sized European companies. On 26 May 2020, the management of EIB has agreed on the Pan-European Guarantee Fund (EGF), by providing €200 billion additional financing, at least 65% of the resources being earmarked to SMEs. The financial support consist in: special guarantee schemes; special liquidity lines to banks to support working capital and, respectively special asset-backed securities (ABS) purchasing programs. The EGF is designed to support small and medium-sized European companies that present stable development perspectives in the long run, but are struggling in the short run, because of the coronavirus crisis. Moreover, as a response to the coronavirus pandemic, EIB will provide financial support up to €5.2 billion outside the EU (EIB, 2020). As can be noticed, the EIB reacted very fast to support the businesses environment by:

- bridging short-term financing needs of SMEs;
- supporting emergency measures, by allocating resources to companies engaged in high-risk research and development of vaccines;
- revising the existing loans to the EU Member States based on the new priorities in the context of the pandemic outbreak.

The mission of EIB is to support the objectives of the European Union and to finance sound projects from different domains such as SMEs, infrastructure, environment, and innovation. Therefore, the pan-European guarantee fund must become operational immediately through national banks to complement the measures taken at the national level.

On the other side, the European Bank for Reconstruction and Development (EBRD) has also reacted to mitigate the negative financial implications of coronavirus pandemic on SMEs' activity. EBRD is mainly focused on supporting the transition to an open economy and the promotion of private and entrepreneurial initiatives in Central and Eastern European countries. EBRD launched the Solidarity Package to support affected economies with €21 billion up until the end of 2021. The financial support is designated primarily to economic sectors that are strongly affected by the crisis, i.e. financial institutions, SMEs and corporate domains like tourism, automotive and transport providers, agribusiness, and medical supplies (EBRD, 2020). The objective of the Solidarity Package is to build a Resilience Framework able to provide financial resources to enhance the short-term liquidity and working capital requirements of the clients. Moreover, The EBRD's coronavirus Solidarity Package tends to improve the frameworks dedicated to SMEs to be accessible for those which are not EBRD's clients to increase the resilience of the real economy. As a response to COVID-19, EBRD is committed to offer both financial support and virtual technical assistance to help the clients in finding adequate solutions. The Solidarity Package is already operational, two loan agreements being signed:

- the first one is an agreement with the Bank of Africa to support Morocco with €100 million loan for on-lending to corporations and SMEs;
- the second one is an agreement with the National Bank of Kuwait Egypt (NBKE) to offer a loan up to US$ 100 million to support short term financing of private businesses in Egypt.

The EBRD plays an important role in ensuring the well-functioning of the private sector and the effectiveness of open markets.

Also, the World Bank, via International Financial Corporation (IFC), will offer $8 billion in financing to support firms affected by the outbreak. Another example is the creation of a start-up company, named "A Helping Hand,", in Ukraine, which is using financing from the World Bank to help poor people acquire new skills in order to find a new job or set up their firms.

Besides major MDBs (EIB, EBRD), there are other regional development banks involved in securing businesses and supporting jobs. The Black Sea Trade and Development Bank (BSTDB) is a financial institution whose purpose is to improve economic development and in the Black Sea Region by offering lending, guarantees, and equity participation in private enterprises and public entities for its 11 member countries. BSTDB collaborates with the Development Bank of Austria (OeEB) and offers a facility of EUR 30 million to fund the coronavirus crisis response. The financial resources will be allocated to the private sector, industry, agriculture, and service sectors, as well as to improve working capital and trade financing in six countries (Albania, Armenia, Azerbaijan, Georgia, Moldova, and Ukraine). The Facility is designated mainly for SMEs to help them during the post-pandemic economic recovery.

Also, Nordic Investment Bank (NIB), a financial institution whose mission is to improve the prosperity of Nordic and Baltic countries, has responded to Covid-19 pandemic. In order to maintain business continuity, NIB has increased the lending capacity, by extending loans to financial intermediaries for on-lending to SMEs and by offering direct resources to larger businesses that face short term liquidity issues. Therefore, NIB has offered loans to the Republic of Estonia (EUR 750 million), Republic of Lithuania (EUR 400 million), and Republic of Latvia (EUR 500 million). The agreed loans are supposed to help the most affected business sectors, such as SMEs, tourism, and transportation. Moreover, for the first time, EUR 1 billion NIB Response Bond, and a second SEK 4 billion Response Bond (NIB, 2020). The purpose is to gather resources to curb the negative impact of the coronavirus crisis in the member countries (Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden). Therefore, it can be observed that, as a response to the COVID-19 pandemic, NIB has increased its lending capacity and has issued inaugural Response Bond to support sustainable businesses from Nordic-Baltic states. Table no 3 provides a summary of financial support agreements offered by MDBs as a response to coronavirus crisis, listed by the date of the first announcement.

Table no. 3 MDBs financial responses to COVID-19 outbreak

Financial institution	**Type and value of financial support**	**Date of announcement**	**Targeted countries/region/sector**
European Bank for Reconstruction and Development (EBRD)	Solidarity Package of €21 billion	13 March 2020	38 emerging economies
World Bank (International Financial Corporation)	$8 billion	17 March 2020	Private Companies in Developing Countries
Nordic Investment Bank (NIB)	EUR 750 million	27 March 2020	Republic of Estonia
Nordic Investment Bank (NIB)	EUR 400 million	3 April 2020	Republic of Lithuania

Nordic Investment Bank (NIB)	EUR 1 billion Response Bond on Nasdaq Helsinki	6 April 2020	NIB's member countries
Nordic Investment Bank (NIB)	EUR 500 million	8 April 2020	Republic of Latvia
Nordic Investment Bank (NIB)	SEK 4 billion Response Bond on Nasdaq Stockholm	9 April 2020	NIB's member countries
Black Sea Trade and Development Bank (BSTDB)	EUR 30 million facility from the Development Bank of Austria	22 May 2020	Albania, Armenia, Azerbaijan, Georgia, Moldova, and Ukraine
European Investment Bank (EIB)	Pan-European Guarantee Fund up to €200 billion	26 May 2020	European SMEs

Source: The websites of financial institutions

Particular emphasis should be given to SMEs in emerging Europe given the sharp outflow of financial resources from this area (Kentikelenis *et al.*, 2020, p.15). Similar to the latest global financial crisis, this outflows decrease the resources available to governments and firms and ramp down real economic activity. Moreover, the need for financing is increasing with the length of the lockdown.

Therefore, the MDBs:

- should support the growth of available financial resources for SMEs given the fact that empirical evidence highlight that these international financial institutions can increase their lending room (Munir & Gallagher, 2020, p. 228);
- should use financing alternatives such as syndicated loans. Empirical evidence shows that when used, the cost and risk of some projects are reduced.

4. A critical perspective and recommendations

The financial support of MDBs represents an important crisis response instrument designed to help SMEs to recover from the pandemic. The financial assistance of MDBs should be timely, targeted, and temporary. Some firms may need resources to assure wages and working capital requirements, while others like systemically important firms will need large support to avoid bankruptcy. It is also necessary to decide the right mix between fiscal, financial, and monetary policy measures adopted at the national level and countercyclical financing of MDBs. It is also important to ensure that financial support is offered transparently, while risk and fiscal costs are evaluated. MDBs can be effective but fiscal risks and costs should be also considered.

The support programs should come with strong governance to build accountability. We strongly believe that, besides financial support, the MDBs should provide guidance on the interpretation and application for financial support in the current exceptional conditions. The MDBs have experienced management to achieve the assumed objectives and should provide technical assistance for the preparation, financing, and implementation of an individual support program to SMEs which have the potential to grow. Credit decisions should be based on a strong evaluation of the risk profile of the borrower to minimize losses.

MDBs should remain faithful to prudential regulations and risk management practices. Policy measures implemented by MDBs should be closely aligned with national measures to ensure effective deployment. We think that also a challenge is to reach the SMEs, particularly in emerging and developing economies, where SMEs have little available information (IMF, 2020). Therefore, the support can be directed towards SMEs in collaboration with national institutions. We highlight the importance of a strong collaboration between MDBs and local financial institutions.

Informing SMEs about MDBs measures that are available and how to access them is crucial. This action will mobilize the possible beneficiaries to create confidence in the joint effort. Disseminating information about MBDs response instruments on a dedicated portal, with sophisticated advice would be a good solution.

5. Conclusions

Small- and medium-sized enterprises (SMEs) represent the driver of job creation, and more than 99% of the total number of non-financial enterprises fall into the SME category. This explains the concern of national authorities and international financial institutions to support their activities, helping them to survive and preserve employment. The coronavirus crisis had a big impact on firms, because the demand for products and services decreased, the supply of inputs disrupted and, tightening the ability to gather financial resources in order to meet short term liquidity demands.

The MBDs deploy their existing instruments and put in place new measures to safeguard the SMEs and ensure economic recovery, complementing actions taken at the national level. MDBs are particularly committed to supporting SMEs to get access to finance in order to mitigate the negative consequences of COVID-19 pandemic. A coordinated and macroeconomic approach is necessary to help SMEs recovery and growth, taking into account the importance of preserving transparency, confidence, and stability. The paper underlines the importance of a timely, targeted, and temporary financial assistance of MDBs towards SMEs, together with guidance on the interpretation and application for the financial support, provided by the experienced international institutions. Also, informing SMEs about MDBs measures that are available and how to access them is highly topical to create confidence in the joint effort.

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