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Opinion of the European Economic and Social Committee on 'Strengthening MSMEs' financial resilience and promoting second chance for entrepreneurs'

(own-initiative opinion)

(C/2024/869)

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1. Conclusions and recommendations

1.1. The recent crises have emphasised the need to strengthen MSMEs' financial resilience. The sharp increase in energy prices, high inflation and interest rates as well as disruptions to supply chains have led to the highest number of bankruptcies since 2015, significantly impacting MSMEs, which generally have limited reserves to weather financial challenges and rely more heavily on external financing, particularly bank loans.

1.2. The EESC expresses serious concern over the low MSME investment rates and the weakened ability of MSMEs to finance innovation and the green and digital transitions.

1.3. The tightening of financial regulations has led to a situation where MSMEs' access to bank finance is increasingly conditional on the involvement of a public actor such as a guarantee institution or promotional bank. The EESC urges the Commission to closely monitor the overall impact of all financial regulation on MSME customers.

1.4. EU funding instruments have a role in supporting MSMEs' financial resilience. Sufficient funds via the InvestEU SME window need to be ensured. Also, more EU regional funds should be directed to MSME activities. To ease MSMEs' access to EU funds, the EESC has previously suggested introducing a single-page application process for SMEs ([1]).

1.5. A fully-fledged European Capital Markets Union (CMU) would offer MSMEs broader and more flexible financing options. The EESC regrets the limited progress in this regard and calls for further actions to deepen the Capital Markets Union.

1.6. The EESC welcomes the planned revision of the Late Payments Directive and encourages the EU legislators to ensure a speedy adoption. The revision should not only establish fair payment times but also implement an independent and effective monitoring and enforcement system.

([1]) OJ C 194, 12.5.2022, p. 7.

1.7. Detecting early signals of financial distress allows MSMEs to take proactive measures to mitigate risks, implement turnover strategies, and seek necessary mentoring and support. The EU must encourage the development and take-up of digital tools based on data analytics, AI and machine learning to enhance the early detection of MSMEs' financial distress.

1.8. The EESC emphasises the importance of effectively monitoring the implementation of the recent Directive on restructuring and insolvency. Access to robust support mechanisms tailored to the specific needs of financially distressed MSMEs that go beyond mere informational websites need to be guaranteed.

1.9. To support entrepreneurs' second chance and reduce the stigma around business failure, the EESC asks the Commission to conduct a thorough assessment of the existing barriers to second chances that European entrepreneurs encounter following a business failure.

1.10. The EESC acknowledges the substantial influence of the regulatory environment on the financial resilience of MSMEs. It supports the European Commission's plan to reduce SMEs' reporting obligations by 25 % and suggests setting more ambitious targets going forward, with regular monitoring and evaluation. Furthermore, the EESC raises concerns about the additional compliance costs arising from national 'gold-plating' practices, which not only burden MSMEs but also create unfair competition within the Single Market.

1.11. The EESC draws attention to the impact of Member States' tax regulations and policies on the financial resilience of MSMEs. Complex tax systems, high tax rates and administrative burdens can create difficulties for MSMEs, especially those with limited resources for tax planning and compliance. On the other hand, tax incentives and simplified tax regimes can alleviate the tax burden on MSMEs and contribute to their financial stability.

1.12. Diversifying supply chains is highly relevant to the financial resilience of European MSMEs. Reducing their dependence on a single supplier or market helps mitigate financial risks and allows them to adapt more effectively to changing market conditions, price fluctuations, or disruptions in supply chains. The EESC calls for support for MSMEs' internationalisation and access to foreign markets to enable them to diversify their supply, ensure higher liquidity and participate in global trade.

1.13. Business transfers play a crucial role in ensuring business continuity and resilience. The EESC calls for EU action to facilitate business transfers in Europe in its recent Opinion on business transfers ([2]).

2. **Introduction**

2.1. Micro-, Small and medium-sized enterprises (MSMEs) constitute a significant majority, accounting for around 99 percent of businesses in Europe. They are responsible for two-thirds of employment in Europe and contributed 3,9 trillion euros to the European economy in 2022, according to Eurostat. Among MSMEs, micro-enterprises with fewer than 10 employees dominate, making up approximately 92 percent of European MSMEs. MSMEs play a vital role in European societies, generating employment, producing goods and services, and adding value to the economy.

2.2. In the last years, European MSMEs have faced unexpected crises that have put their financial stability to the test, emphasising the need to strengthen their financial resilience. The COVID-19 relief coming to an end, sharp increase in energy prices, high inflation and interest rates, as well as disruptions in the supply chain has led to the highest number of bankruptcies since 2015, significantly impacting MSMEs ([3]). Compared to larger enterprises, MSMEs generally have limited financial reserves to weather financial challenges and rely more heavily on external financing, particularly bank loans. The EESC recognises the Commission's efforts to support MSMEs with policy measures. The recently published *SME Relief Package* includes measures such as simplification of cross-border tax procedures, introducing stricter payment terms in commercial transactions and nominating an EU SME Envoy to voice SME concerns. These measures offer partial solutions to the struggle of MSMEs.

([2]) OJ C 486, 21.12.2022, p. 9.
([3]) Eurostat data on business registrations and bankruptcies 2022, https://ec.europa.eu/eurostat/en/web/products-eurostat-news/w/DDN-20220217-2

2.3. The aim of this own-initiative opinion is to examine strategies for enhancing the financial resilience of MSMEs through actions at both the European and Member State level. The opinion will look into MSMEs' access to finance, late payments, financial literacy and management, early warning and second chance, impact of regulatory framework, diversification of supply chains and business continuity. Financial resilience, in the context of this opinion, refers to the ability of MSMEs to withstand and recover from financial shocks and difficulties. This opinion builds upon previous work by the EESC on MSMEs, further advancing the understanding of their financial resilience.

3. **Access to finance**

3.1. The COVID-19 pandemic significantly affected the financial stance of MSMEs. Many businesses experienced a decline in customer demand, resulting in reduced revenues and cash flow. Payment delays from customers led to liquidity shortages, making it challenging for MSMEs to meet their financial obligations. Moreover, price increases and supply chain disruptions put additional pressure on their financial reserves. As a result, many MSMEs have faced increased levels of indebtedness and financial uncertainty during these challenging times. Although bank lending and interventions from the government were able to provide some relief to MSMEs, according to the OECD, other sources of finance declined, in particular early-stage equity ([4]). Many MSMEs are still burdened with debt as they continue to repay the loans they took on to overcome the financial challenges brought on by the pandemic.

3.2. Since the onset of the pandemic and the war in Ukraine, MSMEs worldwide have faced significant financial challenges also due to high inflation and a series of interest rate hikes ([5]). These factors have led to tighter financial conditions, making it more difficult and expensive for MSMEs to access finance. Furthermore, the deteriorating access to equity markets has added to the difficulties, as investors are more inclined towards lower-risk investments.

3.3. While the EESC supports the intention of European institutions to enhance the resilience and sustainability of the financial system, there are concerns regarding the potential adverse impact of tightening regulations on the access to bank finance for MSMEs, leading to a situation where MSMEs' access to finance is increasingly conditional on the involvement of a public actor such as guarantee institutions, development and promotional banks. While acknowledging the important role of development banks for MSME financing, the EESC urges the Commission to closely monitor the overall impact of all financial regulation on MSME customers. The EESC also expresses serious concern over the low MSME investment rates and the weakened ability of MSMEs to finance innovation and the twin transition and underlines that MSMEs must continue to have access to finance at reasonable prices.

3.4. Alternative financing, such as crowdfunding and business angels offer an option for some MSMEs facing difficulties in obtaining funding from traditional lenders. The EU can facilitate the uptake of alternative financing by establishing a supportive regulatory framework, promoting data sharing and open banking initiatives, and investing in targeted financial education programs for MSMEs. Also, venture capital, equity and bond markets should be developed to be more attractive for MSMEs.

3.5. Also, the EU itself has an important role in strengthening the financial resilience of MSMEs through funding instruments. These instruments provide MSMEs with access to capital that may be difficult to obtain from traditional sources, and guarantee instruments to help mitigate the perceived lending risks. Sufficient funds for MSME support via InvestEU SME window need to be ensured. Regarding the European Innovation Council (EIC), the EESC supports the call of the European Parliament ([6]) for the EC to improve the EIC participation of SMEs and design funding instruments more accessible for small and micro enterprises. The EESC also finds that more of the EU regional funds should be directed to MSME activities. To ease MSMEs' access to EU funds, the EESC has previously suggested introducing a one-sheet-application process for SMEs ([7]).

([4]) OECD (2020), 'The impact of COVID-19 on SME financing: A special edition of the OECD Financing SMEs and Entrepreneurs Scoreboard', OECD SME and Entrepreneurship Papers, No 22, OECD Publishing, Paris, https://doi.org/10.1787/ecd81a65-en

([5]) See e.g. OECD (2023), 'OECD Financing SMEs and Entrepreneurs Scoreboard: 2023 Highlights', OECD SME and Entrepreneurship Papers, No 36, OECD Publishing, Paris, https://doi.org/10.1787/a8d13e55-en

([6]) EP 2022/2063/(NI).

([7]) OJ C 194, 12.5.2022, p. 7.

3.6. Finally, a fully-fledged European Capital Markets Union (CMU) would offer MSMEs broader and more flexible financing options. The EESC regrets the limited progress in this regard and calls for further actions to deepen the Capital Markets Union.

4. **Tackling late payments**

4.1. The EU Late Payments Directive ([8]) establishes a legal framework to ensure that businesses receive timely payment for their goods and services. EU rules on late payments have improved the situation of payment delays, however more than 60 % of EU businesses are still not paid on time, and small and medium-sized companies (SMEs) are most affected, including when accessing public procurement.

4.2. Prompt payment culture can strengthen MSMEs' financial resilience and help to avoid unnecessary bankruptcies. Therefore, the EESC welcomes the ongoing revision of the Late Payments Directive and encourages the EU legislators for a speedy adoption of the proposal before the end of the current political mandate.

4.3. The EESC believes that the revision should not only establish fair payment times but also build an independent and effective monitoring and enforcement system. Therefore each Member State should be required to designate a responsible authority that can oversee compliance and intervene upon the request of small businesses or their organisations. Additionally, authorities should have the power to impose sanctions when non-compliance occurs.

4.4. Also, the EESC calls for prompt payments in European project funding for SMEs and suggests that the late payment rules should be applied to them.

5. **Strengthening financial literacy and management**

5.1. The financial management skills in MSMEs vary, some of them having strong financial skills whereas others may lack the necessary knowledge and expertise in financial management which can lead to challenges in budgeting, cash flow management, financial analysis, and accessing appropriate financing options. Improving financial literacy and skills in MSMEs enables effective financial management, improves their access to finance, and makes them more resilient for crisis.

5.2. The EESC strongly advocates for the integration of entrepreneurship education across all levels of education, emphasising the importance of equipping individuals with the necessary skills for entrepreneurship. Furthermore, there is a need for accessible and readily available financial advisory services for entrepreneurs, supporting the development of financially resilient business models from the outset. Business organisations play a crucial role in enhancing financial literacy of MSME business owners, therefore it is important for the EU and Member States to support these organisations.

5.3. The EU should invest in training programmes that enhance financial management and investment skills in MSMEs. As an example, Entrepreneurship4all-platform aims to increase the number of successful entrepreneurs in Europe through digital education and training, providing training on entrepreneurs' financial literacy as well. The EU can also facilitate MSMEs' access to financial expertise and advice for example through mentorship programmes or networking platforms connecting MSMEs with experienced professionals. It is important that entrepreneurs can access these support tools in their own language.

6. **Investing in early warning and second chance**

6.1. Early detection of financial distress is essential in improving MSMEs' financial resilience. Detecting early signals of financial distress allows MSMEs to take proactive measures to mitigate risks, implement turnover strategies, and seek necessary mentoring and support. Early warning systems enable businesses to make timely decisions, such as adjusting their operations, seeking additional financing, or implementing cost-saving measures, which can help prevent insolvency and ensure the long-term viability of the business.

([8]) Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (OJ L 48, 23.2.2011, p. 1).

6.2. The EU has taken proactive steps to promote early detection of financial distress and facilitate bankruptcy and restructuring processes for MSMEs. The Directive on Restructuring and Insolvency ([9]) aims to establish streamlined and efficient procedures for early restructuring and provide a second chance for entrepreneurs facing financial difficulties. Member States are required to offer access to support mechanisms that assist businesses in financial distress, such as support programs developed under the Early Warning Europe project ([10]). The EESC calls for effective monitoring the implementation of the Directive and highlights the need to ensure access to robust support mechanisms for distressed MSMEs, going beyond mere informational websites.

6.3. The EU must encourage the development and take-up of digital tools based on data analytics, AI and machine learning to enhance the early detection of MSMEs' financial distress. These tools can offer real-time monitoring, risk identification, and timely alerts enabling proactive interventions to prevent and mitigate financial difficulties, thus strengthening the financial resilience of businesses.

6.4. When MSME owners have the opportunity to bounce back from financial difficulties or business failures and embark on a 'second round' as entrepreneurs, they are more likely to succeed and demonstrate increased resilience. Second chance allows entrepreneurs to learn from past mistakes, apply their newfound knowledge and experience, and navigate future challenges with greater confidence and adaptability. By fostering an environment that supports and encourages second chances in Europe, MSMEs can benefit from the resilience and growth potential of entrepreneurs who have learned from their previous experiences.

6.5. The EESC asks the Commission to conduct a thorough assessment of the existing barriers for second chance that European entrepreneurs encounter following a business failure. These obstacles, both legislative and non-legislative in nature, can impede honest entrepreneurs from starting a new business. These obstacles can be for instance difficulties in obtaining a bank account or necessary insurances. While these obstacles may vary across Member States and business cultures, a comprehensive mapping of such barriers would allow for the identification of best practices and the development of joint solutions to address common challenges. The EESC believes the EU has to take an active role in reducing the stigma associated with business failure and creating a supportive environment for entrepreneurs.

7. **Regulatory framework and taxation**

7.1. The EESC acknowledges the substantial influence of the regulatory environment on the financial resilience of MSMEs, considering the potential strain of compliance costs on their limited resources that can limit their capacity for investments in growth and innovation. The EESC supports the European Commission's plan to reduce SMEs' reporting obligations by 25 % and suggests setting more ambitious targets going forward, with regular monitoring and evaluation. Furthermore, the EESC raises concerns about the additional compliance costs arising from national 'gold-plating' practices, which not only burden MSMEs but also create unfair competition within the Single Market.

7.2. Streamlining and simplifying permitting and licensing processes can enhance financial resilience of MSMEs as it reduces administrative burdens, facilitates quicker business establishment, and supports their expansion. Thus, the EESC emphasises the need for regulatory simplification and acceleration of permitting processes for investments and other business activities.

7.3. The EESC draws attention to the impact of Member states' tax regulations and policies on the financial resilience of MSMEs. Complex tax systems, high tax rates, and administrative burdens can create difficulties for MSMEs, especially those with limited resources for tax planning and compliance. On the other hand, tax incentives and simplified tax regimes can alleviate the tax burden on MSMEs and contribute to their financial stability. As tax authorities often act as creditors for

([9]) Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) (OJ L 172, 26.6.2019, p. 18).

([10]) Early Warning Europe project launched national advice and support networks to companies in distress, see https://www.earlywarningeurope.eu/

MSMEs, they play a crucial role in strengthening their financial resilience. This can be achieved through measures such as offering payment relief, providing compliance support, and streamlining and digitalising tax processes. These actions can help MSMEs manage their tax obligations more effectively and enhance their overall financial well-being.

8. **Diversifying supply chains and ensuring business continuity**

8.1. Diversifying supply chains is highly relevant for the financial resilience of European MSMEs. Reducing their dependence on a single supplier or market helps mitigate financial risks and allows them to adapt more effectively to changing market conditions, price fluctuations or disruptions in the supply chain.

8.2. However, MSMEs face inherent challenges in building diversified supply chains due to their limited capacity, knowledge, and resources. Furthermore, MSMEs often have less bargaining power in supply contracts compared to large companies, which further complicates their ability to navigate and negotiate in supply chain arrangements. The EESC calls for support for MSMEs' internationalisation and access to foreign markets to enable them to diversify their supply, ensure higher liquidity and participate in global trade.

8.3. Business transfers play a crucial role in ensuring business continuity and resilience. When a business is transferred to a new owner or management, business operations are maintained, jobs preserved, and relationships with customers, suppliers, and other stakeholders sustained, minimising disruptions and preserving the value of the business. The EESC calls for EU action to facilitate business transfers in Europe in its recent opinion on business transfers ([11]).

Brussels, 25 October 2023.

The President
of the European Economic and Social Committee

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([11]) OJ C 486, 21.12.2022, p. 9.