EBRD coronavirus policy response

European Bank for Reconstruction and Development

Strengthening the SME framework in Türkiye

Strategic guidance to Turkish SME agency KOSGEB

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Overview

In most of the economies where the European Bank for Reconstruction and Development (EBRD) operates, micro, small and medium-sized enterprises (MSMEs) were disproportionately affected by the pandemic, particularly those in wholesale and retail trade, air transport, accommodation and food services, real estate, professional services and other personal services. In Türkiye, the SME sector comprises 3.3 million enterprises, representing 72 per cent of total employment and about 25 per cent of foreign trade in the economy. This note describes how the EBRD supported the Small and Medium Enterprises Development Organization of Türkiye (KOSGEB) in its analysis of data to identify signs that SMEs were deteriorating financially, and how KOSGEB could use that data to design more targeted assistance programmes.

What was the context of the policy engagement?

KOSGEB introduced new support measures during the pandemic. The agency's mandate is to increase the productivity and competitiveness of SMEs through innovation, digitalisation, research and development, and capacity building, and to promote entrepreneurship via support programmes.

When the pandemic hit, KOSGEB launched a series of support measures for SMEs, such as longer deadlines for project evaluation, deferred repayment of reimbursable financial support, digitalisation of procedural matters and new credit lines. This was done with the support of the World Bank and the Japan International Cooperation Agency.

While KOSGEB provided short-term relief, SME indebtedness increased during the pandemic. These support measures seem to have helped prevent a sudden economic downturn, but did not prevent SMEs from being more indebted after the pandemic than they were before, while final economic spillovers of the pandemic are yet to be observed.

In 2020 KOSGEB ran three surveys to map the general sentiment of Turkish SMEs.[1] Overall, 28,000 companies took part. An average of 75 per cent of respondents were micro firms, 50 per cent were in the services industry and 30 per cent were in manufacturing. At the time, all responding companies were older than four years. More than 90 per cent revealed they were facing cash flow problems and half were expecting sales to drop by more than 50 per cent.

[1] In April, May and December of 2020, KOSGEB conducted surveys of SMEs and the results are available at https://www.sanayi.gov.tr/covid-19/rapor-yayin-ve-bilgilendirmeler#kosgeb-raporlari.

However, only 16 per cent of Turkish SMEs were able to access government support, well below the OECD average of 33.6 per cent.[2] Those unable to access support were largely micro firms. As a result, they were hit the hardest by the pandemic, as the difficulty in accessing government support was a major source of vulnerability.

SMEs in Türkiye do not tend to be well-informed about financial markets – they have inadequate access to bank credit and almost none to the capital markets. In recent years there has been a fast-growing interest in alternative sources of financing, such as venture capital and crowdfunding, and relevant regulations have been put in place. However, these markets are still in their infancy. In 2020 impediments to accessing finance and secure governmental support resulted in more than 90 per cent of SMEs declaring cash flow problems, around 80 per cent needing to raise new debt to survive, and more than 30 per cent expressing fear of imminent insolvency.[3]

To manage these risks, the EBRD aimed to provide KOSGEB with a set of tools and indicators that would allow it to identify "systemically important" SMEs. Systemically important SMEs are those firms that influence other firms or entire ecosystems due to their operating nature (size, complexity, interconnectedness, dependence, and so on). When facing the risk of possible financial deterioration, this risk can spread to other SMEs within the same subset or other interconnected subsets (either vertically or horizontally), creating a systemic risk within the SME ecosystem. Identifying systemically important SMEs would help determine which companies should receive financial support and which vulnerable companies should be avoided, as they bear distress risk.

What were the scope and key findings of the policy engagement?

The EBRD commissioned a team of local and international experts[4] to identify the appropriate indicators through a data-driven methodology.

The main goals were to identify available data and analyse them in order to extract specific indicators that would enable the potential financial deterioration of a micro, small or medium-sized enterprise to be measured.

The indicators are: (i) trends in standard financial indicators; (ii) foreign trade intensity (iii) company age and gender composition; and (iv) deterioration in reporting quality.

The algorithms used for data extraction and analysis provided a tool that could be used to isolate any specific subset of SMEs or companies serving different diagnostic purposes. The data analysis, together with consultations with government officials, provided the foundation for specific recommendations on public policy for SMEs in Türkiye.

Some of the core findings include:

i) companies that are becoming illiquid are not able to generate working capital, and hence have lower current ratios

ii) importers have better financial performance than exporters, both at the SME level and the large company level

iii) the share of companies becoming inactive is up to 16 per cent in the first year, declines to a minimum of 6 per cent at age 13, stays below 8 per cent until 30 years of age, and gradually increases to 11 per cent at ages 45 and older

iv) the gender composition of critical positions in companies does not seem to constitute a significant difference in financial performance

v) quality and amount of reported information (that is, transparency) is strongly correlated with SMEs' financial health.

[2] OECD, 2021, *OECD SME and Entrepreneurship Outlook 2021* - Country Profiles.

[3] Idem as footnote 1 .

[4] The project team consisted of financial, legal and data experts from Boğaziçi University of Istanbul: Vedat Akgiray (Professor of Finance), Ali Coşkun (Associate Professor of Accounting) and Serhat Çevikel (PhD candidate, data scientist), supported by Serdar Çelik (Head of Corporate Governance and Corporate Finance Division, OECD) and international legal expert Professor Rodrigo Olivares-Caminal (Queen Mary University of London).

What were the key recommendations?

The project team came up with two sets of recommendations on public policy for SMEs in Türkiye.

Specific recommendations for short-term action

1. Investigate the behaviour of the four indicators described above for the SME sector and certain subsectors during the last two to three years before the year that any government/KOSGEB assistance programme was deployed.
2. Companies with higher export intensity are more fragile financially than those with higher import intensity. Export support programmes should therefore be more selective in identifying exporters with better financial prospects.
3. Consider introducing further checks when helping companies that are either less than four years or more than 35 years old, since these have a higher probability of insolvency.
4. Consider refining the selection criteria to reduce assistance to companies that disclose and report less information. A decrease in the number of reported items over time signals a higher probability of potential distress leading to insolvency.

General recommendations

1. Design and implement a coordinated and coherent programme of financial support for SMEs.
2. Facilitate the development and enhance the resilience of SMEs by strengthening the insolvency (liquidation and reorganisation) framework with adequate procedures corresponding to SMEs' needs.
3. Enhance SMEs' access to financial resources and business networks by refining the existing credit model and supporting further alternative sources of financing, such as factoring, crowdfunding and equity-based sources.

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