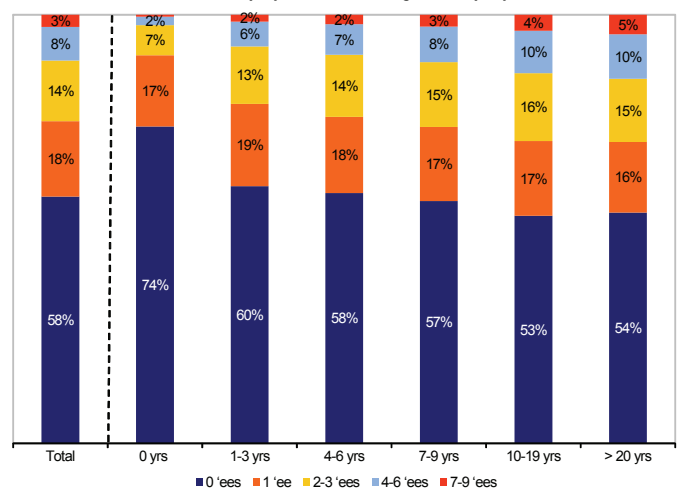


Access to financing for French VSEs

- Very small enterprises (VSEs), which make up 96% of French businesses, fare an essential component of the French economy. They are the main local economic driver, cross-cutting a wide range of sectors, including retailers, crafts and tradespeople, self-employed professionals, service providers, accommodation and food services. They are also present in manufacturing and information and communications technology (ICT). Although at first glance the VSE ecosystem appears straightforward, a closer look reveals greater complexity. VSEs cover a very wide range of businesses, encompassing three million companies with diverse profiles across different sectors and legal statuses, and boasting varying levels of employment and growth.
- VSEs' contribution to the economy in 2013 in the main non-farm market sectors may seem modest, providing 17.1% of added value, 18% of salaried employment and 14.7% of investment. But behind these figures lies a more mixed story. Their contribution to employment is underestimated due to the large number of self-employed persons. VSEs did however play a significant role in those sectors where they are traditionally more prevalent, i.e. personal services, accommodation and food services, and the construction industry.
- Most VSEs are small: some 60% (excluding *autoentrepreneurs*, a simplified entrepreneur scheme) do not boast salaried employees and the number of employees increases only very gradually with the age of the company. Job creation is an important issue. VSEs' recruitment plans are strongly related to their growth targets. In addition, staff numbers depend on a range of economic and non-financial factors that vary depending on the company's strategy. While there appears to be a certain degree of reluctance to hire new staff, a small section of the ecosystem stands out due to the significant growth momentum it is enjoying; this in turn has a positive knock-on effect by feeding into the various layers of the economy.
- The VSE landscape is constantly changing on the one hand and relatively stable on the other. Many new businesses are starting up, but many others are closing down. Furthermore, VSEs established during the recent financial crisis have reported a greater number of bankruptcies. The weakening of this type of business in the wake of the financial crisis has raised questions as to whether or not VSEs have access to sufficient funding during tougher economic times. They appear to have sufficient access to investment loans and this does not seem to have a negative impact on their capital expenditure projects. By contrast, the results of a survey on their access to lines of credit paint a different picture. However, our interpretation of these results must take into account the company's financial situation ; for example, the survey revealed that 17% of VSEs are in a very difficult financial position.
- To avoid putting a strain on short-term cash flow, VSEs can opt for other funding options such as pre-financing of the CICE (competitiveness and employment tax credit). A new, more suitable factoring service could offer a solution to certain business-to-business sectors. At the same time, company managers must enhance their financial knowledge to boost their companies' access to the loan products provided by retail banking networks.

Share of salaried employment based on age of company (2013 data)



Source: INSEE, Esane, Fare.

Scope: France, excluding agriculture, healthcare and financial services. VSEs excluding *autoentrepreneurs* and microbusinesses as defined by French tax legislation.

The high proportion of VSEs means that understanding what VSEs are is a sine qua non to understanding the French economic fabric. However, knowledge of this densely-populated but heterogeneous sector is still very limited:

- **The lack of a standard definition for VSEs has made it difficult to analyse the economic fabric.** The various players in the field of corporate financing (e.g. banks, guarantee institutions and trade associations) have often applied different definitions to VSEs based on the type of business conducted. To provide a clear definition of VSEs in France and better reflect their role in the economy, the 2008 Economic Modernisation Act (EMA¹) defined a VSE as an autonomous economic unit² which employs 0-9 persons and whose annual turnover or annual balance sheet does not exceed €2 million³.
- **Statistical tools have for many years been confronted with a lack of data, or have found**

it difficult to collect and reconcile. Progress made by INSEE on the methodology used to process business data has helped to significantly improve our knowledge of VSEs. At the same time, the *Banque de France* has enhanced its statistics by collecting data on VSEs' outstanding loans and by carrying out non-financial surveys on their access to funding.

Given the very diverse make-up of the VSE ecosystem, it has been necessary to set boundaries at various points in our analysis to avoid any statistical bias that might skew interpretation of the results. The first part of our analysis will be devoted to assessing the economic contribution made by VSEs and to analysing the ecosystem. After looking at several aspects of this ecosystem in detail, we will then take a closer look at VSEs' access to credit against a background of ongoing economic uncertainty, although there are some encouraging green shoots of recovery.

1. The VSE ecosystem is an important one for the French economy, although it is still difficult to understand given its very diverse make-up

1.1 Although at first glance VSEs appear to make only a moderate contribution to the French economy, their role in creating jobs and the contribution they make to some sectors of the economy are in fact more important

In 2013, there were over three million VSEs operating in France's economy outside agriculture, healthcare and financial services⁴, i.e. 96% of French businesses. VSEs comprise *autoentrepreneurs* (as well as the microbusiness tax scheme) which started operating relatively recently, and companies with a more "traditional" legal status (companies or sole proprietorships). According to our figures, over one million *autoentrepreneurs*/microbusinesses as defined by the microbusiness tax scheme make up one-third of the VSE ecosystem; the other two-thirds consist of some 750,000 sole proprietors and 1.3 million companies.

Based on the definition in the Economic Modernisation Act, the economic weight of VSEs appears less significant than their actual number would suggest (see Table 1):

- **Employment:** over 2.4 million people are employed by VSEs, a full-time equivalent of 2.1 million, i.e. 18% of full-time employees.
- **Growth:** VSEs' turnover account for 13% of total turnover while they contribute 17.1% of added value.
- **Investment:** VSEs' capital investment accounts for 14.7% of total capital expenditure.
- **International trade:** VSEs play a very small role, accounting for 2.8% of total exports.

-
- (1) The Economic Modernisation Act refers to the notion of microbusiness and not VSE, while the latter is used more frequently in everyday speech. Microbusiness as defined in the Act differs from the tax definition of microbusiness; the freelancer scheme was renamed microbusiness scheme on 19 December 2014. To avoid any confusion from a semantic perspective, we will use the term VSE when talking about microbusinesses as per the Economic Modernisation Act and we will continue to use the term freelancer.
 - (2) Companies that boast a certain degree of autonomy as regards financing and capital expenditure decisions are looked upon as independent economic units; this automatically excludes companies that are part of a group, even if they meet the VSE headcount, financial and economic criteria.
 - (3) Decree No 2008-1354 of 18 December 2008 regarding the criteria used to determine which category a company fits into for the purposes of statistical and economic analysis.
 - (4) VSEs in the finance sector are excluded from this report due to the significant differences in their tax treatment.

Table 1: economic weight of VSEs in 2013

Category	Number of companies	Salaried employees 31/12/2013	Full-time salaried employees	Turnover	Export sales	Added value	Investment
	in number			In billions of euros			
VSEs excluding <i>autoentrepreneurs</i> and microbusinesses as defined by French tax legislation	2,126,810	2,437,956	2,147,921	463.2	16.6	164.5	25.7
<i>Autoentrepreneurs</i> and microbusinesses as defined by French tax legislation	1,035,049	Insignificant	Insignificant	10.6	~0	4.2	1.2
Total VSE	3,161,859	2,437,956	2,147,921	473.8	17.1	168.7	26.9
Total weight of VSEs	96.0 %	17.5%	18%	13%	2.8%	17.1%	14.7%

Scope: France, excluding agriculture, healthcare and financial services.

Source: INSEE *Ésane, Fare*.

These figures, which show how concentrated France's manufacturing base is, should be looked at in context:

- **The *autoentrepreneurs* and microbusinesses as defined by the microbusiness tax scheme that make up one-third of the ecosystem, have very limited economic weight.** By their very nature, their turnover is automatically lower than the thresholds set for the microbusiness tax scheme⁵, which helps explain their relatively weak contribution. In addition, according to ACOSS⁶, a significant portion of registered *autoentrepreneurs* do not generate sales. In 2013, 72% of this category was economically active, i.e. they reported a positive earnings figure. At this point, it is worth mentioning that more than one-third of *autoentrepreneurs* set up their business as a way of supplementing their income from paid employment. According to INSEE⁷, in 2010 36% of *autoentrepreneurs* were already in paid employment.
- **Analysing only salaried employees in VSEs gives a skewed picture of reality.** By excluding self-employed workers, this approach underestimates VSEs' actual contribution to employment figures. In reality, a significant number of VSE directors fall under the self-employed social security regime (RSI = *régime social indépendant*: for *autoentrepreneurs*, sole proprietors and spouses) or have opted to do so. In 2013, 2.8 million self-employed workers were registered with the RSI (over one-third were *autoentrepreneurs*). Although *autoentrepreneurs* appear to earn very modest sums (€4,900 on average; one-third of *autoentrepreneurs* declared zero income), around two million self-employed workers excluding *autoentrepreneurs* report an average income of around €30,000⁸. According to DARES, at 31 December

2013 almost half of all VSEs employed at least one non-salaried worker. These figures therefore provide evidence of VSEs' more significant contribution to employment than first impressions would indicate, split between salaried employees and non-salaried workers.

VSEs appear to make a significant contribution to sectors where they boast a significant presence, such as the personal services, accommodation and food services sectors, as well as the construction sector:

- VSEs provide close to one in two jobs in the personal services sector, 38% in the accommodation and food services segments, and 32% in the construction sector. In contrast, VSEs provide few jobs in the transport, information and communication⁹ and manufacturing sectors (6-8%) and occupy the middle ground in the real estate, wholesale and retail trade and services to business.
- The economic weight of VSEs measured in added value is on a par with their economic weight in terms of employment figures: VSEs account for 40% of added value in the personal services, accommodation and food services sectors and 34% in the construction sector.

It is worth mentioning that these results are due to composition effects within economic sectors. If we look at the VSE ecosystem in terms of numbers, the split is completely different: VSEs are mainly present in the wholesale and retail trade (22%), services to business (20%) and construction sectors (17%). And despite the significant economic contribution to all personal services, real estate, and accommodation and food services sectors, VSEs are less present than other companies in these three sectors (see Chart 1).

(5) €82,200 for proprietors and €32,900 for service providers.

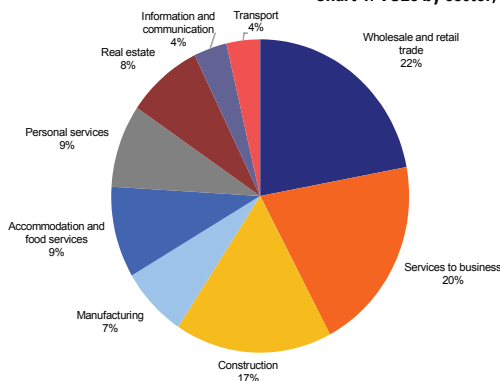
(6) Central social security agency.

(7) Entrepreneurs: new profiles with the rise in auto-entrepreneurship, *INSEE Première*, February 2014.

(8) Average income varies depending on the type of profession: €23,500 for crafts and tradespeople, €22,000 for traders and €51,000 for the self-employed. Source: L'essentiel du RSI, 2013 data.

(9) As per the French classification of activities.

Chart 1: VSEs by sector, 2013



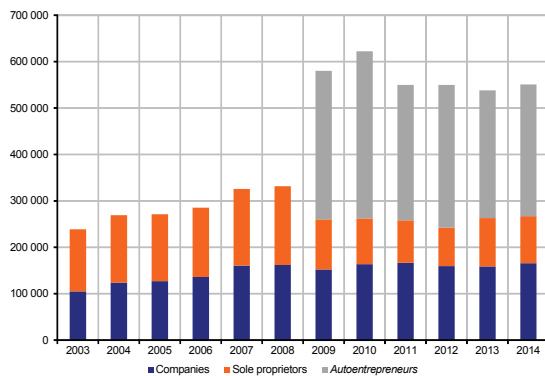
Scope: France, excluding agriculture, healthcare and financial services.

Source: INSEE, *Ésane, Fare*.

1.2 The VSE landscape is constantly changing on the one hand and relatively stable on the other

Business creation is a key facet of the VSE ecosystem. Some 550,000 companies have been created each year since 2011. This number has nevertheless been substantially inflated by *autoentrepreneurs* who make up over half. Stripping out the latter, 263,000 VSEs were created in 2013. The new *autoentrepreneur* status introduced in 2009 has boosted entrepreneurship in France, although it was already relatively vibrant: between 2003 and 2008, the number of businesses created grew by 40% (see Chart 2).

Chart 2: number of businesses created in France



Scope: all non-agricultural commercial activities.

Source: INSEE, *Sirene business register*.

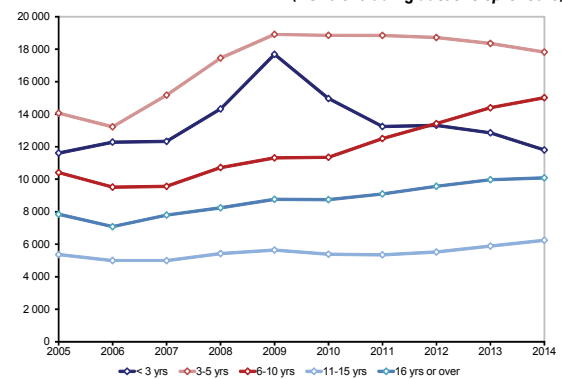
The significant number of companies created and *autoentrepreneurs* registered did not result in a like-for-like increase in the total number of VSEs. In 2013, the number of VSEs (excluding agriculture, healthcare and financial services) grew by 4.5%, whereas the portion of businesses created in the same year corresponded to 17% of VSEs. This gap can be largely explained by the significant number of discontinued operations, which increased even more when the free-lance status was introduced in 2009.

Various indicators reflect the extent of companies that have gone out of business:

If we look at the number of bankruptcies amongst VSEs excluding *autoentrepreneurs* that led to insolvency proceedings (administration or recei-

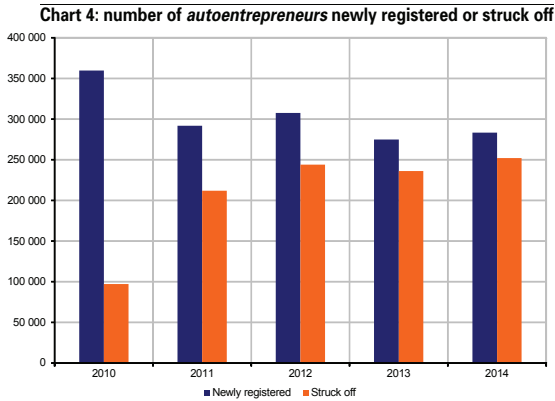
vership), we obtain only a partial view of companies that have gone out of business - the majority of VSEs cease operations without going through insolvency proceedings. In 2013, almost 54,000 VSEs filed for bankruptcy, while 263,000 new businesses were created (excluding *autoentrepreneurs*). Analysing bankruptcies by company age shows how vulnerable businesses that were created shortly before or during the financial crisis were. While bankruptcies of businesses less than three years old peaked in 2009 in a highly unstable economy, companies created around that time are finding it increasingly difficult to survive beyond the five-year mark: the number of bankruptcies of companies of between 6-10 years old jumped 32% between 2010 and 2014 (see Chart 3).

Chart 3: number of bankruptcies by company age over a 12-month period (VSEs excluding *autoentrepreneurs*)



Source: *Altarex*.

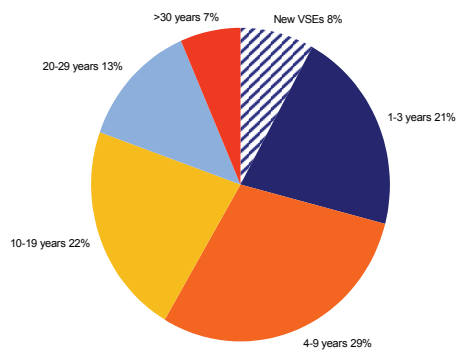
- Annual SINE surveys on, the **business survival rate of newly-created businesses** (excluding *autoentrepreneurs*), also point to the vulnerability of VSEs. On average, the businesses surveyed report attrition levels of 10% per annum; two-thirds remain in business after three years and roughly half after five years. In the wake of the financial crisis, the 2006 set recorded a lower survival rate than the 2002 set (50% at the five-year mark for companies founded in 2006 compared to 54% for those founded in 2002). In contrast, the 2010 set had greater staying power: 71% reached the three-year mark compared to 65% for the 2006 set.
- **The number of *autoentrepreneurs* struck off was roughly equal to the number of new registrations.** The growth in popularity of the *autoentrepreneur* status stimulated business creation during the period analysed by almost doubling the number of new companies created. However, it also increased the ecosystem's vulnerability by adding to the ongoing renewal of the economic fabric. As of 2011, *autoentrepreneurs* are no longer entitled to their status if they report zero sales over eight consecutive quarters. According to ACOSS, the number of *autoentrepreneurs* struck off peaked in 2014 at 252,000 versus 283,000 new *autoentrepreneurs* registered (see Chart 4).



Source: ACOSS, INSEE.

While many new VSEs are seeing the light of day or going out of business, there is also considerable stability within the sector: a little more than 40% of VSEs excluding *autoentrepreneurs* are over ten years old. Almost half of the companies making up this 40% are more than twenty years old (see Chart 5). The remaining VSEs are split equally between those less than three years old and those falling into the 4-9 year bracket. Note that new businesses created account for only 8% of the ecosystem.

Chart 5: VSEs (excluding entrepreneurs) split by age (2013 data)

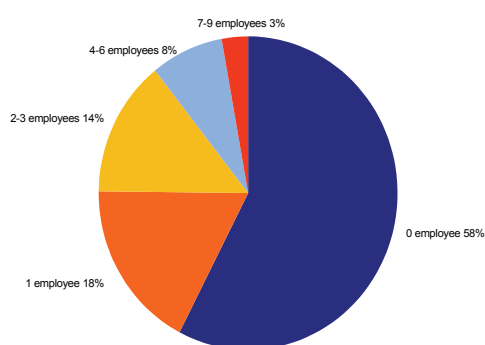


Scope: France, excluding agriculture, healthcare and financial services.

Source: INSEE, *Ésane*, *Fare*.

The VSE ecosystem comprises a mixed bag of company profiles, from young businesses to companies that

Chart 6: breakdown of salaried employees in VSEs (2013 data)



Scope: France, excluding agriculture, healthcare and financial services. VSEs excluding *autoentrepreneurs* and microbusinesses as defined by French tax legislation.

Source: INSEE, *Ésane*, *Fare*.

have proven their staying power regardless of the economic climate.

NB: the scope of the remainder of our analysis, which focuses on the demographic and financial characteristics of VSEs, is limited to VSEs excluding microbusinesses as defined by the microbusiness tax scheme due to the lack of reliable data:

- for microbusinesses, there is very little data available, which leads to an adjustment by INSEE based on data from the previous year or on the company's economic profile.
- for *autoentrepreneurs*, balance sheet data is not systematically available and often inexistent as around one-third of this category was inactive in 2013.

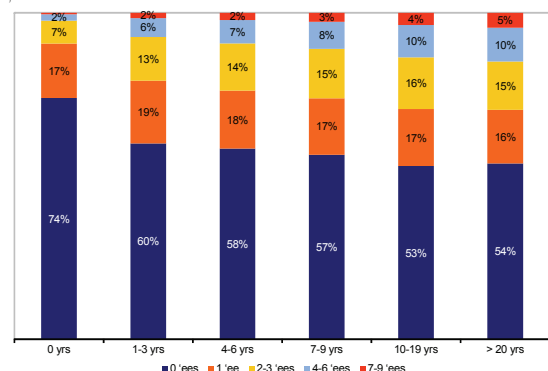
1.3 Three-quarters of VSEs boast more than one employee and the decision to hire depends on a variety of financial and non-financial constraints

The number of full-time equivalent staff employed by VSEs stands at 2.1 million, which seems relatively low compared to the number of companies analysed, also 2.1 million (excluding *autoentrepreneurs*). This is a result of:

- the **high proportion of VSEs (excluding autoentrepreneurs) with zero employees (58%)**;
- the **high concentration of employment in a small number of companies:** three-quarters of VSEs do not have more than one employee whereas 11% of VSEs, i.e. 230,000 companies, boast more than three staff members (see Chart 6).

Headcount does not necessarily increase as companies get older. The majority of VSEs still have no employees, regardless of their age: 74% of newly-created VSEs have zero employees. This falls to 60% for the youngest businesses of 1-3 years, and is over 50% for VSEs of over ten years. Overall, 3% of VSEs boast 7-9 employees, i.e. roughly 60,000 companies (see Chart 7).

Chart 7: salaried employees by company age (2013 data)



As a result, the stability over time shown by the majority of VSEs is not necessarily combined with growth in headcount. This is in keeping with the growth targets set by entrepreneurs from the outset. According to the 2010 SINE survey, 64% of entrepreneurs set the target of guaranteeing their own employment, while only 22% intended to employ more staff.

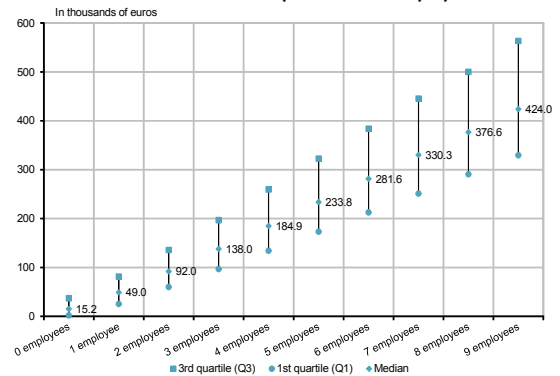
This data nevertheless presents a skewed picture of VSEs' job creation as it does not take into account the VSEs acquired by bigger companies or the VSEs that expanded significantly and employed more than nine staff members. Now classified as SMEs, they are automatically excluded from the VSE scope even though they began to grow when at the VSE stage; VSEs have in actual fact created a significant number of jobs. According to the 2006 SINE survey, of the 50% of VSEs that were still in existence after five years, 3.2% of them moved up into the SME category. An OECD¹⁰ study corroborates these results: of new companies created with fewer than ten employees, three years later only 4% employed more than ten staff (23% went out of business and 73% still employed fewer than ten). The percentage of VSEs seeing rapid growth may seem minuscule compared to the entire ecosystem. Nevertheless, they do make a significant positive net contribution to job creation and offer a considerable lever to employment growth by feeding into the various layers of the economy.

There may be several reasons for this. If the growth targets set by the company's manager have been reached, there may be no incentive to grow the business any further. In addition, VSEs may be reluctant to take on their first employee. Growing from zero employees to one generates a significant marginal cost in proportion to turnover that only those VSEs that have exceeded a certain level of turnover can afford. VSEs with no employees report median turnover of around €15,000, which is not enough to absorb the cost of a salaried employee. Recruiting one extra employee generates a lower marginal cost if the VSE already boasts one employee. However, only one-quarter of VSEs boast at least two employees. The decision to employ an extra member of staff would appear to depend on the level of turnover achieved. For VSEs that already boast one employee, recruiting one extra person requires an increase in turnover of around €45,000 on average (see Chart 8).

Other non-financial factors also come into play when making recruitment decisions, such as concern about managing the related paperwork, or the question of trust vis-à-vis the new employee, which can often lead company owners to recruit within their family circle first and foremost. For VSEs with close to ten employees, the propensity to expand may be held back

by social security or tax thresholds which place an additional, significant burden on employers.

Chart 8: VSE turnover per number of employees (2013 data)

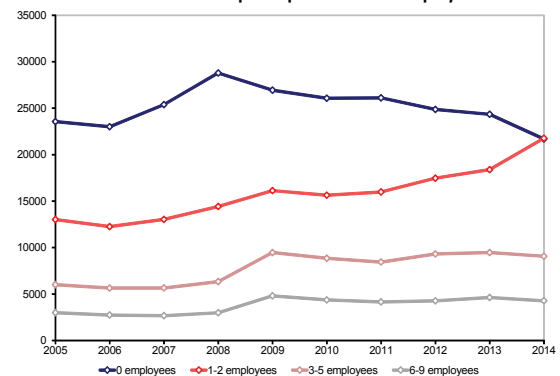


Scope: France, excluding agriculture, healthcare and financial services. VSEs excluding *autoentrepreneurs* and microbusinesses as defined by French tax legislation.

Source: INSEE, *Ésane, Fare*.

An analysis of the number of bankruptcies based on the number of employees highlights the difficulty for businesses with 1-2 employees to survive in the long term, particularly since 2011. The number of bankruptcies filed for this category of VSE soared 36% between 2011 and 2014, a trend that may well explain why directors of VSEs are reluctant to take on a first employee. In contrast, it is worth noting that the number of bankruptcies for VSEs with zero employees contracted by 16% over the same period (see Chart 9).

Chart 9: number of bankruptcies per number of employees since 2005



Source: *Altarex*.

This reluctance to recruit staff may explain why VSEs offer fixed-term employment contracts more frequently than other types of business. According to a recent DARES¹¹ study, 13.7% of VSE employees were hired on a fixed-term employment contract at end-2013 compared to only 7.6% in companies with more than ten employees, with over half of those fixed-term employment contracts subsidised by the government. This more widespread use of fixed-term contracts can be partly explained by structural factors, with many VSEs involved in seasonal activities. However, the

(10) OECD (2014), "The Dynamics of Employment Growth: New evidence from 18 Countries", May.

(11) Dares (2014), "L'emploi dans les très petites entreprises fin 2013" (Employment in very small enterprises at end-2013), December.

percentage of employees on fixed-term contracts increased significantly in 2012 from 11.7% to 13.9%. This can be interpreted as the VSEs' need for greater flexibility to cope, for example, with economic downturns that could potentially trigger a loss in market

share. Several initiatives aimed at boosting employment within VSEs have been introduced since 2013 and added to in 2015 following government announcements (see Box 1).

Box 1: Key initiatives to boost VSE employment

On 9 June 2015, the Prime Minister unveiled a series of measures designed to ease constraints for small enterprises and boost their employment levels:

- **A hiring bonus of €4,000 for the recruitment of the first full-time employee** by a VSE, sometimes a difficult hurdle for a VSE with zero employees, has been introduced. This temporary measure applies to any company that has not had an employee in the last 12 months and intends to hire someone between 9 June, 2015 and 8 June, 2016 on an open-ended employment contract or fixed-term employment contract of over 12 months.
- To encourage companies to keep on employees on a fixed-term employment contract and improve their chances of being offered an open-ended employment contract, **company managers will be authorised to renew fixed-term employment contracts twice rather than once on condition that all three fixed-term employment contracts do not exceed a total of 18 months.** This measure offers VSE directors more room for manoeuvre against a still fragile economic background.
- **It will be made easier for employers to join forces for recruitment purposes.** This practice, which exists in certain sectors such as the agriculture, helps to create jobs while adapting to employers' needs.
- **There will be no extra taxes or social security contributions for SMEs exceeding the 50-employee mark** for the three years following the year in which the threshold is exceeded. Moreover, nine and ten-employee thresholds will be raised to eleven.
- **HR management support services will be introduced** to meet the specific requirements of VSEs and SMEs. This will be particularly useful for VSE directors who must carry out a wide range of tasks on their own, including recruitment and training.

These measures confirm the government's commitment to bolster employment in VSEs and provide backing to policies that have already been implemented:

- **The cost of hiring low-wage employees has been reduced by lowering employers' social security contributions** as of 1 January, 2015 under the Responsibility and Solidarity Pact. This will be of particular help to VSEs who have a higher proportion of low-wage employees than other types of businesses. The exemption from employers' social security contributions has a high impact on the employment of minimum-wage workers.
- Since 1 January, 2015, **the self-employed and crafts and tradespeople are entitled to a reduction of more than three percentage points in their family allowance contributions.**
- **Since 2013, the Competitiveness and Employment Tax Credit (CICE) is akin to a reduction in labour costs** since it is applied to salaries equivalent to 1-2.5 times the minimum wage. With a view to improving business competitiveness, the recipients should use the tax credit to recruit and invest. All VSEs with employees that pay corporation tax are entitled to the CICE. Microbusinesses as defined by French tax legislation, *autoentrepreneurs* and VSEs with zero employees are not eligible. Based on 2012 figures, 43% of VSEs excluding *autoentrepreneurs* and microbusinesses were entitled to claim the CICE.

It is still too early to assess the impact of these measures on VSE employment and growth.

While they are a step in the right direction, their impact will nevertheless vary depending on each company manager's growth strategy. There are two discernible trends: some company managers will first and foremost strive to create a job for themselves and stay in business. They will generally be sole proprietors, which seems to be the most logical option for those looking to start a business quickly. Directors in charge of a private

limited company (SARL) or simplified limited company (SAS) are more likely to target growth, which in turn will imply creating jobs if conditions allow. At the same time, they will be more prone to invest in the business.

Each VSE is therefore shaped by its director's strategy, i.e. by the choice of growth target or business model. These choices must be taken into account when analysing the financial structure of VSEs and their access to funding.

2. The diverse make-up of VSEs is mirrored in their access to funding. The situation varies widely and a large portion of VSEs are on unstable financial ground

2.1 VSEs' access to investment loans is generally satisfactory and is not a barrier to investment

The ability of a company manager to obtain financing is a key element in meeting a firm's investment needs and helping a business grow. In contrast with other types of firms, which obtain financing from multiple sources, VSEs are nearly completely dependent on the banking sector for their financing needs.

VSEs' relatively low share of total investments (14.7%, see section 1.1) raises the issue of the banks' ability to grant investment loans in a satisfactory manner. Banque de France survey of VSEs' access to credit reveal that, even though it is more difficult than for SMEs, VSEs' access to these types of loans is relatively satisfactory¹². In Q2-2015, 84% of loan requests submitted by VSE directors surveyed were fully or mostly granted, against 94% for SMEs.

Since requests for loans are generally granted, access to investment loans is theoretically not a barrier to investment per se. The explanation for low levels of investment in VSEs lies more in weak demand - 11% of VSEs surveyed contacted their bank in Q2-2015 to obtain a line of credit, against 24% of SMEs.

Looking at the rate of investment, we observe that these results could be ascribed to specific actions by VSE directors. Young companies have much higher investment rates than older VSEs. Newly-created VSEs had a rate of investment that exceeded 100% in 2013, which is hardly surprising since initial investments are crucial for getting the business off the ground. However, the high rate of investment (calculated as the ratio between tangible investments excluding capital contributions and added value) can be attributed to VSEs' low added value in the startup phase, and is not necessarily indicative of large amounts invested (see Chart 10). When it comes to businesses that are more than four years old and operating "normally", investment rates decline markedly, to about 11% on average. The director's growth strategy can be a factor in the weak rates of investment in older VSEs. In cases where the director's growth targets have been met, he or she has little incentive to increase investments, except for the purposes of

renewal. Conversely, directors who want to grow their businesses significantly by investing and recruiting quickly leave the ranks of VSEs and enter the SME ecosystem, and thus no longer contribute to VSE investment statistics. For these companies, which are highly inclined towards investment, the VSE stage is a transitional one in which directors get their companies off the ground and hire their first employees.

Another reason for the low rate of investment can be seen by examining the frequency of investment, which shows that investment needs are by and large infrequent. VSEs that invest on a regular basis are generally those that have employees, and this type of firm is in the minority among VSEs. 31% of them invested four years running. Conversely, the majority of VSEs without employees invest very little: 42% made no investments over four years, and only 9% invested four years in a row (see Chart 11).

Beginning with the startup phase, the size of a VSE and its growth strategy appears to have little impact on the company's investment behaviour, whereas access to investment loans from banks does not seem to be a serious problem.

Chart 10: 2013 rates of investment by age of company

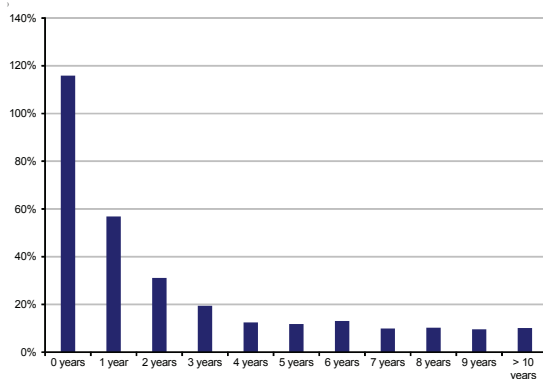
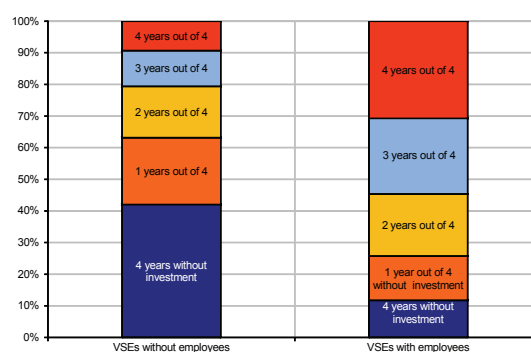


Chart 11: investment frequency over the past four year (2010-2013)



Scope: France, excluding agriculture, healthcare and financial services. VSEs excluding *autoentrepreneurs* and microbusinesses as defined by French tax legislation.

Source: INSEE, *Ésane, Fare*.

Various mechanisms make it easier to obtain investment loans while maintaining optimal financing conditions:

- **Providing a guarantee** is proof of a project's quality and feasibility, and serves as a financial counter-guarantee if the loan is not repaid. Bpifrance, along with other support structures that focus primarily on companies operating in the social and cooperative economy, is active in the guarantee market.
- For VSEs that qualify, the Banque de France's **Fiben rating**, which assesses a company's long-term creditworthiness, provides an additional source of financial information when granting loans. The

rating gives VSEs with satisfactory ratings access to better financing conditions than comparable firms with no Fiben rating. In 2013, 130,000 VSEs (i.e. 6% of all VSEs excluding *autoentrepreneurs*) qualified for a Fiben rating by reporting turnover in excess of €750,000.

2.2 Lines of credit are more difficult to obtain, leaving a number of VSEs in financial straits

Managing cash flow is critical to keeping a business afloat. Cash flow problems can be triggered by adverse economic conditions that lead to a drop in demand or customers taking longer to pay. Cash flow issues may also be indicative of more structural problems connected to working capital requirements that are too conservative. In times of crisis, it is difficult to distin-

(12) Each quarter, the Banque de France surveys a sample group of businesses in the manufacturing, service and construction sectors (3,700 SMEs and 2,300 VSEs) about their access to financing from banks.

guish between cash flow problems that are the result of poor management and those due to a more sluggish market.

A dispersion analysis of cash balances reveals that a significant portion of VSEs have cash balances of nearly zero. Leaving aside the information and communication sector, where cash balances are considerably higher than elsewhere, all sectors taken together show that some 25% of VSEs have low levels of cash flow. According to a study by INSEE¹³, SMEs with lower cash balances resort more frequently to outside financing, and thereby prefer to contract bank loans than hold cash. This effect has been even more evident in recent years, when interest rates have been low.

The Banque de France's survey shows that demand for lines of credit is relatively weak, involving only 9% of VSEs surveyed during Q2-2015. Overdrafts, which are more flexible and easier to use than lines of credit, are the preferred solution for directors of VSEs. Nevertheless, overdrafts are more expensive, which could be a roadblock and the reason behind the low demand.

Of those VSEs that did not seek lines of credit during Q2-2015, in 7% of cases, the director did not feel that the company was in a good position to do so, while 13% stated that they did not want to go into debt on principle. Self-censorship and a preference for self-financing are more common among VSEs than SMEs. Only 3% of SMEs had not applied for a line of credit out of self-censorship, and 5% did not want to go into debt on principle. It should be pointed out that self-censorship can take various forms, including an expectation that the request will be denied, underestimation of the company's debt capacity or discouragement given the complexity of the dossier that has to be compiled.

When it comes to accessing lines of credit, the results reveal certain difficulties. In Q2-2015, sixty-five per cent of VSEs successfully obtained most or all of their requested line of credit, compared with a success rate of 84% of VSEs seeking investment loans. These results should be analysed carefully and by contextualising the need for credit:

- The motive for a loan request can partially have an effect on the rate of refusal. Granting an investment loan is based on the examination of a dossier that presents a complete and detailed description of the project to finance. When it comes to lines of credit, the administrative formalities are less cumbersome and are generally based on an assessment of the company's balance sheet.
- The difficulties VSEs report facing in obtaining lines of credit should also be examined in light of their financial situation. Given the lack of information about the financial structure of the companies in the sample, it is difficult to be conclusive. Of those business managers that applied for a line of credit, some allowed the situation to deteriorate to such an extent that, by the time they approached their banker, they were in dire straits. In some cases, an application for a line of credit reflects a somewhat tense situation that is not without a high risk of default, whereas requests for investment loans are more often part of a project strategy and the applicant companies usually have sufficient own funds and cash levels.

By highlighting situations of concern in a portion of VSEs, a dispersion analysis of capital ratios is germane to an analysis of the financial situation of these firms. Prior to doing so, it is important to eliminate sole proprietors from the scope of the analysis due to the accounting particularities of such firms. The absence of share capital and the fact that there is no distinction between the company's assets and those of its director does not allow us to correctly assess the level of capitalisation of this type of VSE. Sole proprietors aside, about a quarter of VSEs - some 340,000 of them - reported serious shortfalls in own funds.

By crossing capital ratio data with that for cash balances, we can see that 17% of VSEs (excluding sole proprietors) have both low cash balances and own funds, for a total of 230,000 companies. Twenty per cent of companies between one and six years old experience difficulties, a figure that drops to 13% for VSEs over ten years old (see Table 2).

Table 2: VSEs (excluding sole proprietors) with negative or zero own funds and low cash balances

Age of company	Less than 1 year	1-3 years	4-6 years	7-10 years	>10 years	Total
0<Cash balance < €5,000 & own funds <= 0	12,666	48,217	30,743	21,468	29,506	142,600
Cash balance <= 0 & own funds <= 0	3,354	26,328	21,429	14,820	21,404	87,335
Total number of companies in difficulty	16,020	74,545	52,172	36,288	50,910	229,935
<i>Share of total</i>	<i>12.7%</i>	<i>20.5%</i>	<i>20.1%</i>	<i>16.1%</i>	<i>12.9%</i>	<i>16.8%</i>

Scope: France, excluding agriculture, healthcare and financial services. VSEs excluding *autoentrepreneurs*, microbusinesses as defined by French tax legislation and sole proprietors.

Source: INSEE, *Ésane, Fare*.

(13) Picart C. (2008), "French SMEs: profitable but not very dynamic?", INSEE, *Working document*.

2.3 VSEs could imagine other short-term financing sources that, for some of them, are poorly-understood

The authorities have enacted several measures to improve cash lending to businesses. In addition to boosting its co-financing activities with banks via guarantees for eligible VSEs, Bpifrance has introduced several short-term financing products designed to help companies improve their cash balances (see Box 2).

By cutting payment times, factoring reduces cash-flow problems as companies receive payment for receivables without having to wait for due dates. Factoring can be complemented with other services, such as receivables management, which lightens administrative burdens on firms by taking over their dunning and collection activities, and debtor insolvency risk prevention.

Box 2: Bpifrance's liquidity support products

Bpifrance provides short-term financing for businesses experiencing cash-flow problems, particularly in connection with lengthy payment times. This helps companies that are viable in the long term avoid insolvency. In 2014, 24,700 separate firms took advantage of this type of financing, for a total of €6.4bn.

Bpifrance has three main categories of financing (see Table 3)^a:

- **Factoring receivables** helps companies collect on invoices connected with order fulfilment and with public procurement contracts (as well as some private-sector contracts). In 2014, factoring accounted for more than half of Bpifrance's short-term financing, and benefited some 6,500 businesses, more than one-quarter of which were VSEs.
- **Pre-financing for the Competitiveness and Employment Tax Credit (CICE)** provides companies with immediate liquidity support by monetising up to 85% of their CICE. The increasing popularity of this scheme is a key factor in explaining the upswing in Bpifrance's short-term financing in 2014. A total of 2,600 VSEs took advantage of this type of financing in 2014, against 1,500 in 2013.
- **Guarantees:** by covering part of the loan default risk run by banks, they help lift roadblocks to short-term financing. In contrast to other measures, guarantees are largely dependent on the banks' risk policies. Previously, banks could decide whether or not to apply guarantees to loans of less than 100,000 to VSEs. This figure has now been raised to €200,000^b for loans to SMEs.

As part of this scheme, the **Cash Consolidation Guarantee** provides guarantees to SMEs and VSEs covering up to 70% of lines of credit granted by the banks. The goal is to finance increased working capital requirements or to consolidate existing short-term loans into new medium-term loans. In 2013, the Cash Consolidation Guarantee was given fresh impetus as part of the National Pact for Growth, Competitiveness and Employment. During 2013-2014, the Pact released more than a billion euros in financing, close to a quarter of which went to VSEs. Concurrently, almost the same amount was released in the form of the other guarantees granted by Bpifrance as part of its regular activity.

Table 3: Short-term financing offered by Bpifrance in 2013 and 2014 (in millions of €)

Cash flow financing products	Target businesses	2013	2014
Cash Consolidation Guarantee	SMEs and VSEs	551	484
Other loan guarantees	SMEs and VSEs	480	497
CICE pre-financing	All types of businesses	814	1,780
Factoring	All types of businesses	3,439	3,565

Source: Bpifrance.

a. In addition to the short-term financing schemes mentioned above, Bpifrance also offers co-financing, but there were few takers in 2014 (€25 million).

b. For amounts under €100,000, by signing an agreement with Bpifrance, banks can make the decision of whether or not to grant guarantees themselves. For guarantees over €100,000, applications are forwarded to Bpifrance for examination.

According to the ACPR, the French prudential supervision and resolution authority, some 36,000 businesses use factoring to finance a total of €28bn in healthy acquired receivables. Fifty-four per cent of cases concern VSEs, accounting for 11.2% of total debt. Factoring is little-used by VSEs - about 20,000 companies, or 1% of the total ecosystem (excluding *autoentrepreneurs*). This can be attributed to the relatively large number of VSEs involved in the B2C sector. VSEs in the B2B sector, and whose signature as principal is acknowledged by the factoring firm, are more likely to make use of factoring services. Low recourse to facto-

ring can also be explained by the fact that it is viewed negatively by company managers. Over and beyond the qualitative aspect, factoring is not always economically viable for VSEs, according to the Charpin Report¹⁴, since contracting costs are proportionally higher for the smallest firms.

Aware of this, factoring firms have developed more flexible offers with an eye to adapting to the specific issues of VSEs, particularly their need for occasional financing, based on flat-rate fees that are calculated in function of total receivables sold. This new approach offers greater flexibility as it allows firms to select which

(14) IGF Report, "Le crédit inter-entreprises et la couverture du poste-client", January 2013.

invoices to turn over and to take out credit insurance; the all-or-nothing approach to factoring is no longer systematic.

Following the Prime Minister's announcement in 2015, in which he proposed extending Bpifrance's guarantee to certain receivables of factoring firms, the use of factoring is expected to expand amongst SMEs/VSEs.

2.4 Concurrently, the moment has come to improve VSE directors' grasp of financial management

An analysis of the financial structure of VSEs (excluding *autoentrepreneurs*) reveals that 17% of them have negative own funds and low cash reserves. These firms in financial difficulty have problems obtaining a line of credit and cannot ease cash-flow problems by using outside guarantees (applications for which would be turned down in most cases). Leaving aside the issue of a sharp economic downturn, the shaky financial situation of these firms suggests poor financial management in certain cases. The self-censorship that is much more prevalent among VSEs than SMEs could also be an indication of weaker financial management skills.

Making company managers more aware of the issues of financing and running a business, and thereby levelling the information asymmetry between them and bank managers, would contribute to improving access by VSEs to financing products offered by banks. To do so, a sort of basic training would be a good idea. Training sessions for those starting businesses are offered by

Pôle Emploi and the Chambers of Commerce and Industry, but these are not well attended. For directors of VSEs, who would be obliged to put their activity on hold while attending sessions, training is more of a hindrance than a help. Larger companies have a training budget, which allows them to improve employees' skills without necessarily increasing their compensation.

Poor attendance of dedicated training courses leads to a persistent lack of financial culture among certain VSE directors, which in the end is prejudicial to a company's financial health. In order to raise the general skill level among directors, an educational approach in terms of financial management needs to be taken well upstream. For business managers who are the most pressed for time, making public- or private-sector tools available to help them ask useful questions would be a welcome step. Several initiatives of this type have led to the publication of guides. In 2011, the Credit Mediator's Office published such a guide targeted at business managers on how to improve their relations with banks ("*Chefs d'entreprise, facilitez vos relations avec vos banques*") with an eye to improving directors' financial culture. At the end of 2014, following the recommendations in the report on VSE financing published earlier that year¹⁵, the French Banking Federation (FBF) published a guide to short-term financing for VSEs on its website.

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**This paper was made possible by the contribution of Hervé Bacheré, chargé d'études at INSEE's Business Statistics Directorate.*

(15) *Observatoire du financement des entreprises, "Rapport sur le financement des TPE en France"*, June 2014.

Do VSEs help drive growth?

As this study has shown, "very small enterprises" that are focused on growth and innovation are rare; most of them supply goods and services that are already provided by a number of other businesses (albeit somewhat differentiated) on markets that are relatively mature (Hurst et al., 2011). The vast majority of VSEs are present in sectors such as personal services, accommodation and food services, and construction, all of which have relatively low entry costs. These businesses are thus little affected by credit problems because their needs are limited. This was already shown by Picart (2008) and by Lelarge, Sraer and Thesmar (2008).

And yet, should we conclude from this that financing for VSEs is not a problem? Not necessarily - although only a small portion of VSEs are likely to encounter financing problems, it is possible that some of them are businesses with excellent growth potential. It should be pointed out that VSE-specific funding schemes are probably too dispersed to reach this particular target population. Moreover, programmes with size criteria tend to place more (and perhaps excessive) emphasis on startups rather than growth, particularly since businesses lose support if they grow too quickly (Garicano et al., 2012). In order to target companies with high growth potential, it might be more beneficial to employ criteria that focus on company maturity or innovation content (Hsieh and Klenow, 2014), but these are difficult to define in a robust manner. Given the formidable hurdles faced by industrial policy to target these companies, would it not be perhaps more useful to focus on general measures of support for new innovation-focused companies (R&D, initial and ongoing training, etc.)?

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Publisher:

Ministère des Finances et
des Comptes Publics
Ministère de l'Économie
de l'Industrie et du Numérique

Direction Générale du Trésor
139, rue de Bercy
75575 Paris CEDEX 12

Publication manager:

Michel Houdebine

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Jean-Philippe Vincent
+33 (0)1 44 87 18 51
tresor-eco@dgtresor.gouv.fr

English translation:

Centre de traduction des
ministères économique
et financier

Layout:

Maryse Dos Santos

ISSN 1962-400X
eISSN 2417-9698

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