EVENT REPORT

EUROPEAN CAPITAL MARKETS INSTITUTE

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Ensuring proper access to finance for SMEs has been a topical issue in the European debate since the outbreak of the financial crisis. In order to take stock of the situation across a multitude of EU, national and regional initiatives, the European Capital Markets Institute (ECMI) organized a half-day conference bringing at the same table regulators, market participants and SMEs representatives to discuss which are the most effective available strategies to improve the access to finance for SMEs and which public policies and market-based initiatives can be developed to narrow the SMEs funding gap.

Speakers (session 1): Public Policies for SMEs

- **Thorsten Beck**, Professor of Economics, Tilburg University, Netherlands and Professor of Banking and Finance, Cass Business School, London
- **Lennart Grundberg**, Policy Officer - Industrial Policy, DG Enterprise, European Commission
- **Patrice Liauzu**, Adviser - Institutional Strategy, European Investment Bank
- **Margarita Tchouvakhina**, Vice President for Economic Research, KfW Bank
- **Gerhard Huemer**, Director Economic Policy, European Association of Craft, Small and Medium-sized Enterprises (UEAPME)

Speakers (session 2): Market-based solutions for SMEs

- **Francesco Papadia**, Chairman, Prime Collateralised Securities
- **Luca Peyrano**, Head of Italy & Continental Europe Primary Markets, London Stock Exchange Group
- **Rabah Ghezali**, Managing Director of Government Affairs, NYSE Euronext
- **Cornelius Mueller**, Head of Research, European Private Equity & Venture Capital Association
- **Miguel de la Mano**, Head of Unit, Analysis of Financial Market Issues, DG Internal Market and Services, European Commission

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IMPORTANT NOTICE: The views expressed by the speakers are their own individual views and do not necessarily reflect the views of their companies or institutions. The content of this event report is not a transcription from the speeches delivered by the speakers and should instead be understood as the interpretation of their views by the author. This report was authored by Cosmina Amariei and Federico Infelise. Contact ecmi@ceps.eu with any comments or questions.

Diego Valiante (ECMI) briefed the audience on the recent ECMI research activity in the area of SMEs financing. In particular, he discussed the findings of a recent ECMI commentary questioning the effectiveness of the European Commission's SMEs definition. He suggested the removal from the EU definition of micro firms and the creation of a new category, so-called 'M+', which would have between 150 and 500 employees. This would also allow the EU to devise better targeted policies for micro and large firms. Valiante also presented the early findings of an ECMI report that mapped public and market initiatives for SMEs in the five biggest EU economies, as well as a new ECMI research project aimed at gathering data on the liabilities structure of a newly defined set of SMEs.

The first session, dedicated to the role of public policies in support of SMEs financing, was opened by **Thorsten Beck** (Cass Business School and Tilburg University). In Beck's view, when designing and implementing policies for SMEs, a more granular approach should be taken; particularly helpful in this respect would be to differentiate policies for different types of firms, namely *subsistence* and *transformational* enterprises. Beck emphasized how solutions of the type "one size fits all" are to be avoided as the heterogeneity of demand and supply-side factors needs to be carefully taken in consideration. Bank finance continues to be the most important external source of financing for SMEs together with supplier credit, informal sources and reinvested profits, while market-based finance is significantly lagging behind. According to Beck the role of public policy is the one of supporting firms in overcoming market and institutional failures; sound public strategies should be aimed at enabling markets and not at replacing them.

Lennart Grundberg presented the main initiatives adopted by the European Commission in support of SMEs access to finance; Grundberg reported that during the planning period 2007-2013 more than €100bn have been mobilized through different EU financial instruments and discussed the main novelties foreseen for the planning framework 2014-2020. COSME will replace CIP, with a planned budget of €2.5bn, and it will be complemented by parts of the resources of Horizon 2020. Two different types of financial instruments will be available under COSME: 1) the Loan Guarantee Facility (guarantees and counter-guarantees for financial intermediaries, securitisation of SME debt finance portfolios) and 2) the Equity Facility for Growth (venture capital and mezzanine finance for high-growth potential SMEs and for firms undertaking internationalization programs). Grundberg promoted the use of the EU Finance Portal, a single access point to all EU financial instruments: CIP, RSI (SMEs and/or Small Mid-Caps), RSFF (large Corporates and Mid-Caps), Structural Funds, Progress Microfinance, EIB/ EIF own resources.

The EIB Group's strategy in support of SMEs financing was presented by **Patrice Liauzu**; EIB's direct efforts are built on three major pillars: co-investment, risk sharing and dedicated/targeted instruments. The EIB/EIF action is further broadened by the provision of indirect support to SMEs through an upstream network of partner institutions (banks, microfinance institutions, private equity firms, venture capital funds, etc) that facilitate access to a wide range of financial products (loans, equity and mezzanine investments, guarantees, etc). The strength of the EIB strategy is a system of governance particularly focused on creating synergies in the ecosystem and avoiding overlapping between existing financing programmes combined with very strict protocols for ex-ante, mid-term and ex-post evaluations.

A specific outlook on the current situation of German SMEs was given by **Margarita Tchouvakhina** (KfW). The German economy is characterised by the presence of large companies alongside a dynamic SMEs sector. According to the German definition, any business with an annual turnover below €500mn is an SME; this means that the SME sector accounts for 99.95 % of all companies (more than 3.6mn in total) and employs roughly 70% of the working population. The vast majority of these enterprises are small and service-oriented companies, 86% of them having an annual turnover lower than €1mn while less than 1% have a turnover above €50mn. The importance of the SME sector in the German economy is given by its three-fold role: as job creator, as economy stabilizer (during period of crisis) and as educator (German dual education system, SMEs train more than 80% of all German trainees). Tchouvakhina suggested that improving access to finance is indeed a task of primary importance, but that labour market conditions, corporate and income taxation should be given similar consideration within the SME public action plans. With regard to financing sources, German SMEs possess relatively strong internal financing ability: they employ equity as a means of financing for roughly 54% of their investment volume. More than 40% of the total external funding is represented by bank and promotional loans. Other sources (such as mezzanine finance or venture capital investments) amount to 6% of the total, while less than 1% of the financing needs are satisfied through shares or debt emissions.

Gerhard Huemer (UAPME) stressed that SMEs difficulties are not homogeneously distributed across Member States. In some countries, namely the Mediterranean ones, SMEs are facing considerably higher difficulties in securing their basic financial needs. Most importantly, financing needs vary from short-term (i.e. the provision of working capital) to medium and long-term financing (long-term loans and equity financing). Huemer emphasised the role played by cooperative banks and savings banks during the financial crisis; these small and decentralised banks managed to tackle more efficiently SME liquidity shortages and, thanks to their deeper knowledge of local businesses, were usually able to take higher risk exposures towards SMEs compared to larger banking groups. Huemer auspicated the establishment of a European standardized credit scoring system as this would have a large impact on decreasing the rejection rate for SMEs' loans applications. Public policies should be more focused on the provision of guarantees schemes as these have proved to be more efficient and less distortive than loan subsidies and grants. Concerning alternative financing sources, UEAPME is trying to encourage SMEs to approach capital markets through the dedicated stock exchanges but, according to Huemer, IPOs will always remain very rare for these firms. Securitisation would have the potential to spread risk intelligently. However, without having a better legal framework in place or confidence in this practise restored, it will remain a marginal source of finance for SMEs.

The second session, dedicated to market-based initiatives targeting SMEs, was opened by a presentation of **Francesco Papadia** (PCS). Papadia stressed that reviving the ABS market is a necessary but not sufficient condition to narrow the SME funding gap. This important step can be done through promoting concepts such the one of High Quality Securitisation (pioneered by PCS) or other similar quality labels. These in turn will contribute to restoring confidence and re-activating the demand for assets backed securities. Regulators will also have to do their parts in order not to penalise, through excessive burdens, ABS investors (especially in major pieces of legislation such as CRDIV and Solvency II). Papadia also indicated that the industry must engage in active dialogue with SMEs in order to better explain the benefits of securitization.

The efforts that stock-exchanges are making in order to encourage SMEs to approach capital markets have been described through two recent initiatives launched by the LSE Group/Borsa Italiana and NYSE Euronext, introducing to the audience the ELITE Programme and the EnterNext platform, respectively. **Luca Peyrano** (LSE Group) explained that it is indeed very difficult to attract SMEs on stock exchanged as these companies often perceive listing procedures as highly technical, time consuming and excessively costly. The ELITE Programme offers SMEs a three-stage, fast-track development scheme, which includes training of different kinds, strategy advice, and supports for funding options not limited to IPOs (also private equity, bond issuing, M&A transactions, etc.). The results obtained by ELITE companies have been judged very positively so that the program will further expand in the next years. ELITE, being supported by a number of Italian institutions and public companies, is a perfect example of how a partnership between private and public actors can drive innovative policies for SMEs.

EnterNext is a pan-European marketplace for SMEs recently launched by NYSE Euronext, reaching out companies with a capitalisation lower than €1bn. The aim of this initiative, said **Rabah Ghezali**, is to make financing through public equity more friendly and attractive for SMEs by integrating market operators with local business-systems (e.g. partnerships with Chambers of Commerce and Industry) in order to promote the benefits of stock-exchanges to both potential issuers and prospective investors. On the supply side, SME trading platforms could meet a potential high demand from retail investors who are keener to invest in local businesses. On the demand side, Ghezali reported that the majority of listed firms are in fact SMEs (firms with capitalisation lower than €1bn) contrary to the popular belief that associates stock-exchanges to blue-chip companies. Nevertheless, small and mid-cap equity segments are characterised by considerably low market liquidity and by high liquidity-fragmentation across national borders and this certainly represents a big obstacle to the development of these sources of funding.

The angle of the private equity and venture capital industry (PE/VC) has been presented by **Cornelius Mueller** (EVCA). The European PE/VC industry is much smaller and younger than the US one and its role in SMEs financing is in fact relatively low: in 2012 the investments made by the European PE/VC industry accounted for 0.26% of EU GDP and the total capital under management reached €534b; nevertheless the majority of these investments, roughly 70%, are directed towards SMEs. Undoubtedly there is much room from improvement, Muller said. A significant step forward would be the establishment of a data-warehouse to allow efficient data gathering. In this regard, EVCA has already developed its own pan-European private equity database (PEREP_Analytics) since 2007. According to Muller, from an economic theory point of view the PE/VC industry is in a very strategic position to supply finance to SMEs as it can overcome market failures generated by information asymmetries by assuming an intermediating role between investors and SMEs.

The last panellist to contribute to the discussion was **Miguel de la Mano** who shared the latest views of the European Commission on how to boost market-based solutions in support of SMEs and to reduce the overreliance of SMEs on bank lending. The Commission is aware that the current regulatory fragmentation constitutes a big barrier to the emergence of alternative sources of funding (e.g. debt vs. equity fiscal bias, stark difference in bankruptcy regimes etc.). De la Mano drew the attention to the lack of supporting evidence on SMEs financing strategies that are actually working and that can be replicated on large scale. However, the Commission is encouraging and fostering experimentation. Actions that need to be prioritised are those aimed at fostering both data availability and data sharing on credit history and financial conditions of SMEs, roughly 25% of European SMEs not being scored. This is considered an important step towards facilitating and improving the SMEs' credit worthiness assessment by financial providers e.g. through credit scoring practices with the final objective of substantially increasing the availability of credit to real economy.

Find more information about this conference and download the presentations from the speakers at www.eurocapitalmarkets.org.