



TheCityUK

Innovative methods of SME financing

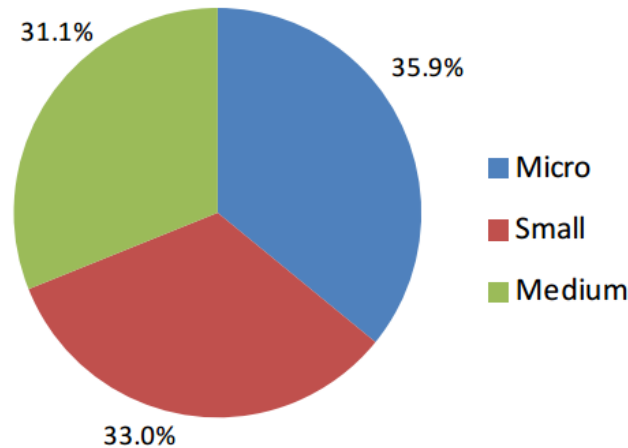
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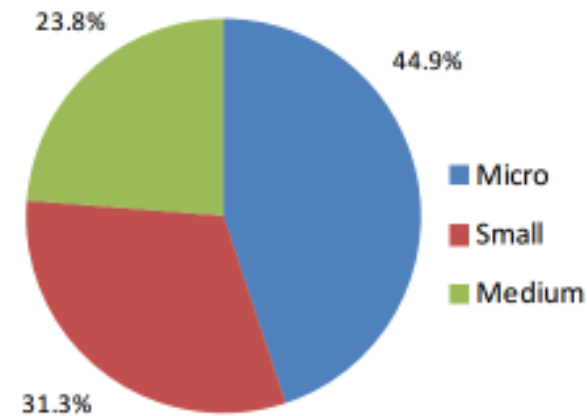
- 1. Context: why focus on SMEs?**
- 2. Barriers to SME financing**
- 3. Innovating to address the SME funding gap**
 - 1. Improving existing markets**
 - 2. Encouraging new markets**
- 4. Conclusion**

Why SMEs?

Shares of value added generated by micro, small and medium-size SMEs in EU28 in five key sectors



Shares of employment by micro, small and medium-size SMEs in EU28 in five key sectors



Source: European Commission, Annual Report on European SMEs 2013/14

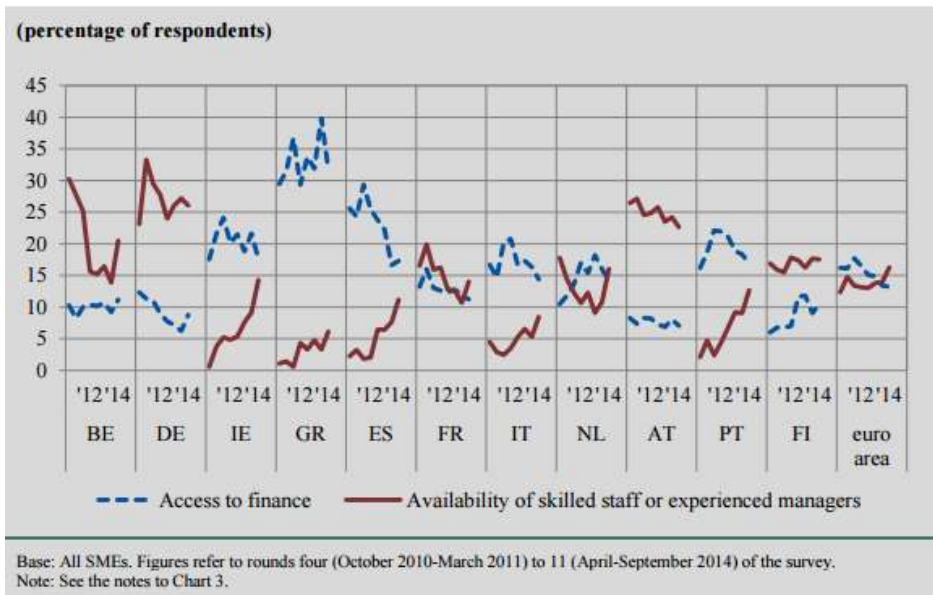
- Important for EU **employment** and especially **job creation**
- But also important to challenge long-held beliefs about the importance of small companies.

An economy's use of its resources is more important than the size of the companies that the market supports.

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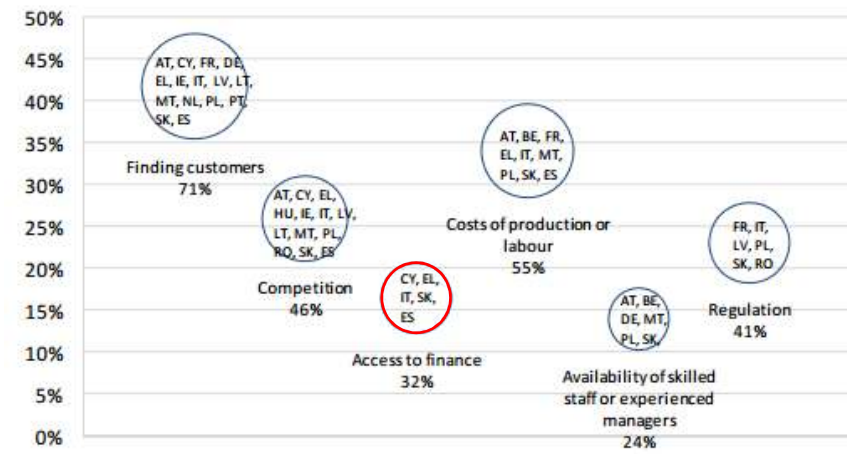
The funding problem varies widely across countries

The most pressing problems faced by euro area SMEs across euro area countries



Source: European Central Bank, Survey of the Access to Finance of Enterprises in the Euro Area, Nov 2014

Importance of problems facing SMEs within Member States, weighted by the proportion of EU SMEs per Member State

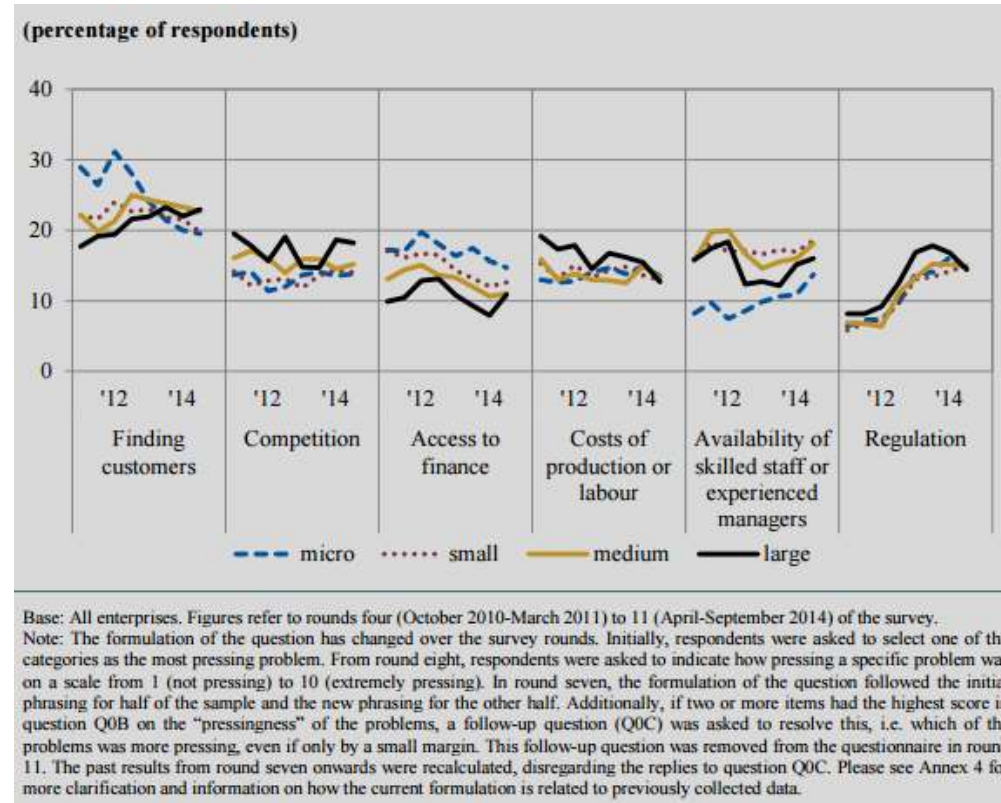


Note: The height of the bubble is constructed as the percentage of SMEs that cite each factor as a problem across the displayed Member States, weighted by the proportion of EU SMEs per Member State. This conveys the strength of the perception of a problem across the EU. The size of the bubble is the overall share of EU SMEs that declare the issue to be a pressing problem
Source: EC/ECB - SAFE Wave 9

Source: Annual Report on European SMEs 2013/2014 – A Partial and Fragile Recovery, July 2014

The funding gap is worst for the smallest firms

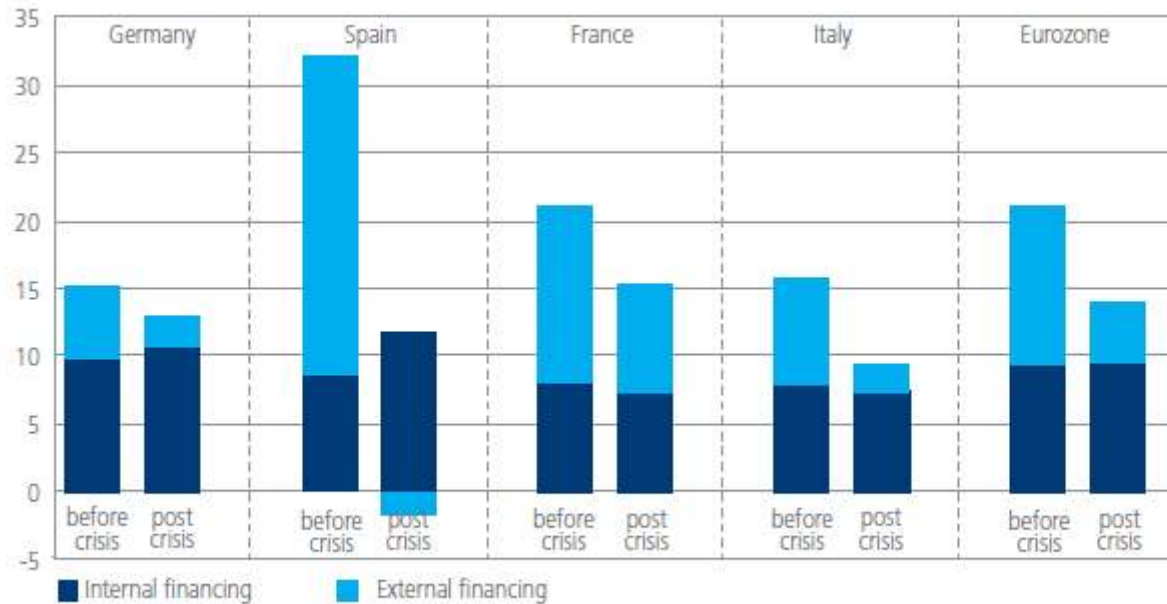
The most pressing problems faced by euro area enterprises



Source: European Central Bank, Survey of the Access to Finance of Enterprises in the Euro Area, Nov 2014

SMEs face cyclical funding barriers...

Non-financial corporations' internal and external financial flows in Eurozone countries (% of GDP)



Note: Figure 2.5. Internal financing is defined as gross saving and external financing includes total liabilities. Before crisis: average 2000Q1-2008Q2. Post crisis: average 2008Q3-2013Q4. Data from Eurostat and ECB

Source: Giovannini et al (2015)

Bank finance is especially important

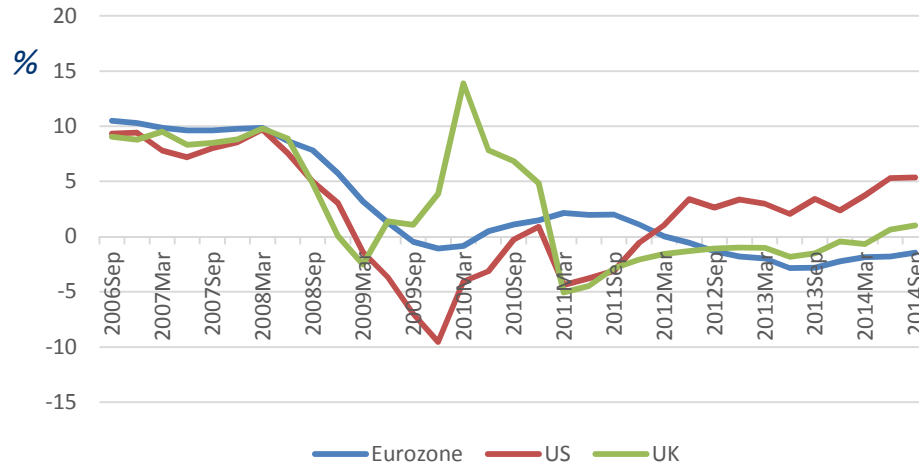
		UK	Bank vs. non-bank
Debt financing	Traditional bank lending	<ul style="list-style-type: none"> Loans: – £88bn Overdrafts: – £12bn 	<ul style="list-style-type: none"> Banks only
	Sales finance (factoring)	<ul style="list-style-type: none"> £10.3bn¹ 	<ul style="list-style-type: none"> Banks > 90% Non banks < 10%
	Asset finance (leasing)	<ul style="list-style-type: none"> £11.7bn² 	<ul style="list-style-type: none"> Banks > 90% Non banks < 10%
	Trade and supplier finance	<ul style="list-style-type: none"> £5.0bn³ 	<ul style="list-style-type: none"> Non bank only
Equity financing	Venture capital ⁴	<ul style="list-style-type: none"> £366m (seed and start up) 	<ul style="list-style-type: none"> Non bank only
	Business Angels ⁴	<ul style="list-style-type: none"> £314m³ 	<ul style="list-style-type: none"> Non bank only
	Small cap equity market ⁴	<ul style="list-style-type: none"> £980m¹ 	<ul style="list-style-type: none"> Non bank only
Trad. bank lend. as % of total		78%	
Bank lending as % of total		93%	

1. Estimation for SMEs 2. Data for Dec 2011 3. Data for Dec 2010 4. Data relates to investment for the year (stock data unavailable)

Source: ABFA, BBA, BBAA, EVCA, FLA, LSE AIM, Ares & Co analysis, *Alternative Finance for SMEs and Mid-Market Companies*, October 2013

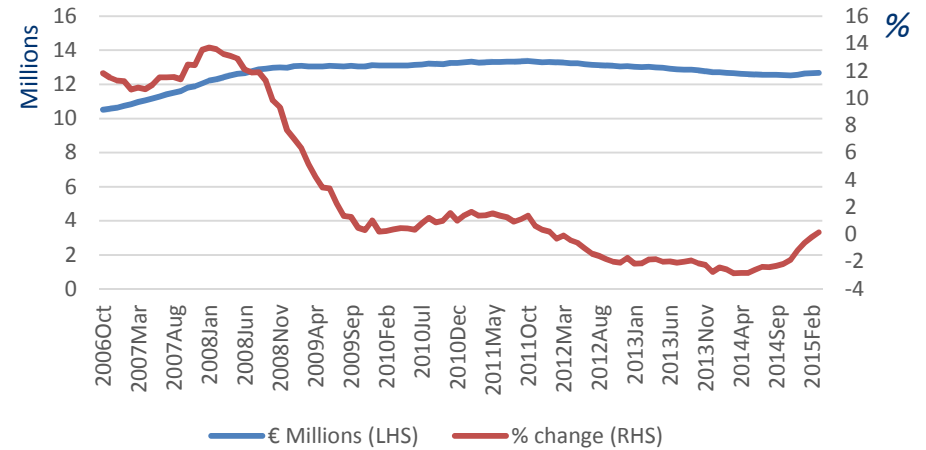
Bank-lending trends have posed a particular problem

Local-currency lending growth



Source: Bank for International Settlements

Euro area, lending to non-monetary and financial institutions excluding general government



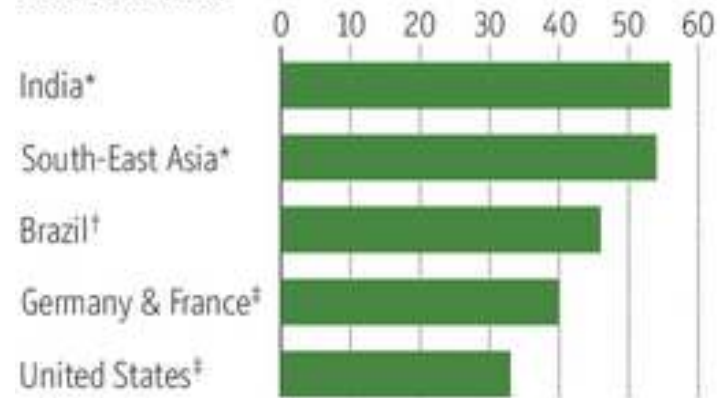
Source: European Central Bank

...but there are structural barriers, too

- Fragmented support-scheme landscape
- Regional focus of SMEs
- Culture & control

Family matters

Family businesses as % of top companies
latest available



*Top 200 companies by revenue
†Companies with revenues over \$500m
‡Companies with revenues over \$1bn

Source: *The Economist*, April 2015

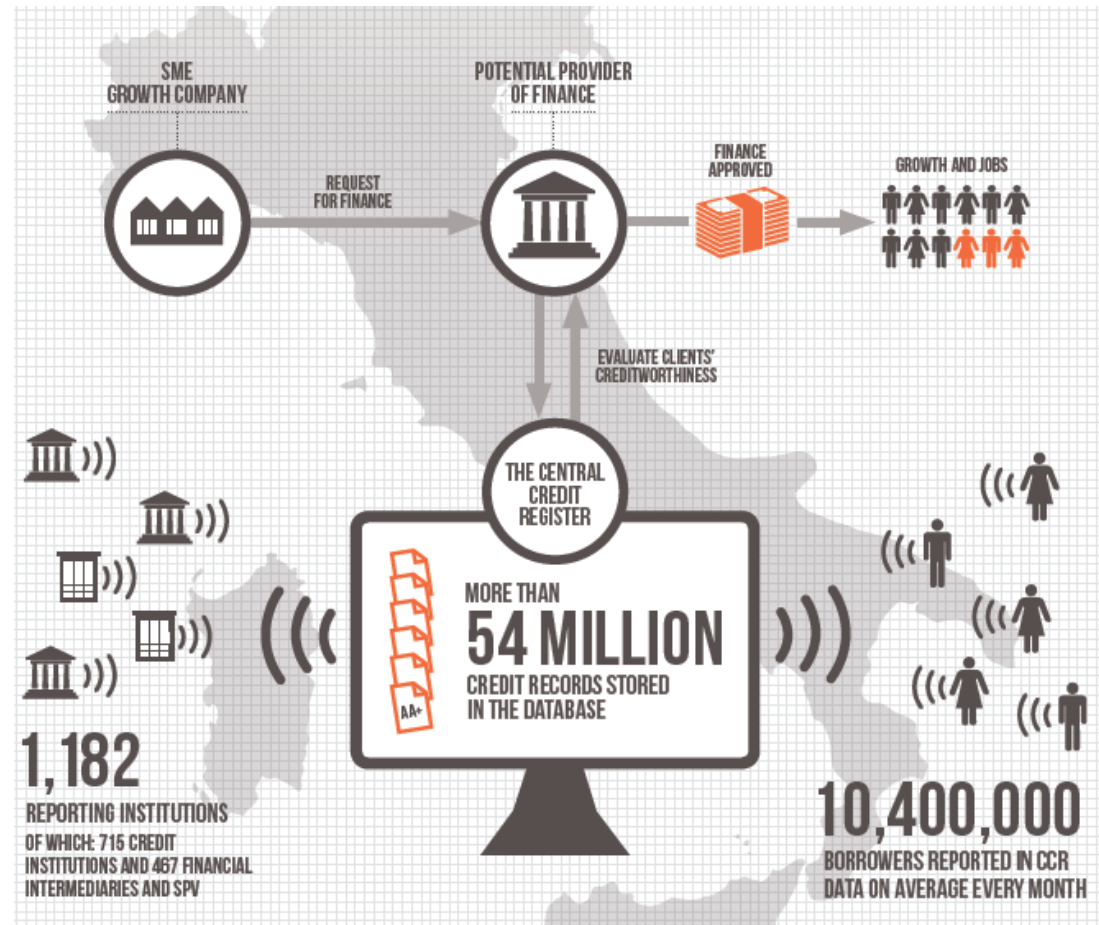
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TheCityUK's Independent Economists Group recommends that for CMU to work well, it should focus on:

- Reducing regulatory barriers that inhibit access to funding
- Ensuring that the EU is open to innovative sources of capital
- Facilitating the role of capital markets in corporate restructuring
- Encouraging best practice:
 - Mutual recognition
 - More effective enforcement of competition/Single Market rules
- Improving information flows



Improving info flows is crucial for non-bank SME finance



Growth of alternative debt finance depends on finding solutions to the problem of access to credit info and analysis skills

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New markets: SME finance for the future? **TheCityUK**

Alternative Finance Models in the UK, 2014

	Size of market (£mn)	Average amount raised (£)	Average number of funders	Average amount provided to a fundraiser per funder (£)	Average size of funder's total portfolio (£)
Peer-to-peer business lending	£749mn	£73,222	796	£92	£8,137
Invoice trading	£270mn	£56,075	7	£8,011a	n/a
Equity-based crowd funding	£84mn	£199,095	125	£1,599	£5,414
Pension-led funding	£25mn	£70,257	n/a	n/a	n/a
Debt-based securities	£4mn	£730,000	587	£1,243	n/a
Reward-based crowd funding	£26mn	£3,766	77	£49	n/a
Community shares	£34mn	£174,286	474	£368	n/a
Donation based crowd funding	£2mn	£6,102	55	£111	n/a
Peer-to-peer consumer lending	£547mn	£5,471	201	£27	£5,606

Note: ^aAuthor calculations. n/a indicates data not available.

Source: Baeck, Collins, and Zhang (2014) and Analytically Driven Ltd

- Uniquely suited to **micro firms**
 - Lack of credit info
 - Small sums
 - Catch-22: 'Survival mode' / 'Growth mode'
- **Non-financial benefits** are as important as funding advantages
 - Market research
 - Promotion
 - 'Wisdom of the crowd'

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Recommendations

- **Central Banks & Regulators:** maintain a central credit register in each EU Member State
 - Info collated by ECB for use across the EU
- **Central Banks, Regulators & Credit Reference Agencies:** collaborate to develop credit-scoring standards for growth companies
 - Facilitate x-border access and comparative analysis
- **Financial services industry:** enable growth companies to access the full range of finance opportunities



- SMEs play a crucial role in EU economies, particularly from an **employment** perspective
- The '**SME funding gap**' varies widely across firms, sectors and countries—but it persists
- **Improving existing markets** can help reduce the SME funding gap
- Fast-growing alternative finance platforms like crowdfunding offer considerable potential...
- ...but improved **information flows** will be crucial for realising this potential