EUROPEAN
INVESTMENT
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European Small Business Finance Outlook

2/2011

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Working Paper 2011/12
EIF Research & Market Analysis

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Luxembourg, December 2011

Disclaimer:

Executive summary

This European Small Business Finance Outlook (ESBFO) provides an overview of the main markets relevant to EIF (equity[1], securitisation, microfinance). It is an update of the ESBFO 1/2011 that has been published in June this year.

We start by discussing the general market environment, then look at the main aspects of equity finance and the SME Securitisation (SMESec) market. Finally, we briefly highlight important aspects of microfinance in Europe.

- Since the publication of the first version of this European Small Business Finance Outlook in June, the global economic situation has deteriorated and the divergence between growth in advanced and emerging economies are expected to persist. Economic forecasts for Europe were also revised downwards.
- Available data for the business environment of SMEs still show a relatively stable situation, however the downside risks have increased over the past months.
- The ECB bank lending survey reports a significant increase in net tightening of credit standards to non-financial corporations (NFCs) by Euro area banks. Looking forward to the fourth quarter banks assume, on balance, a further increase in the tightening of credit standards, which is expected to affect large firms more than SMEs, and long-term loans more than short-term ones.
- According to another ECB survey, access to finance remained a more pressing problem for Euro area SMEs than for large firms. For the period between April and September, an increased net percentage of SMEs reported a deteriorated availability of bank loans, mainly due to the general economic outlook. On balance, SMEs expect this process to continue in the next months.
- The economic recovery of the past year has been reflected in insolvency figures which have been falling, albeit with significant regional disparities. However, insolvencies are expected to remain above pre-crisis levels and insolvency forecasts, performed in HY1 this year might prove to be too optimistic, as the outlook for the economic environment has significantly worsened in the meantime.
- Venture capital (VC) *investment* has remained in the doldrums, despite the recovery in overall private equity. The latter reflects a partial rebound of the buyout sector which had suffered during the economic slowdown. Some of the gap left by the fall in venture investment has been filled by increased business angel activity; their proximity to the market has been beneficial during this difficult period.

[1] We are using the term "equity finance" to combine linguistically the areas of Venture Capital (VC) and Private Equity (PE). However, if we refer here to equity activities, we only consider the activities of EIF's investment focus which neither includes Leveraged Buy-outs (LBOs) nor Public Equity activities. The reader can find a Private Equity glossary in Annex 1.

- According to EVCA figures, private equity (PE) *fundraising* only slightly rebounded in 2010 and 2011, following the dramatic slump recorded in 2009. Venture capital fundraising even continued its downward trend in 2011, decreasing to EUR 1.7bn in the first three quarters, which is only slightly more than half of the total 2010 VC fundraising amount.
- PE *divestments* have continued to grow in 2011. In the first three quarters, total divestments conducted by private equity firms in Europe amounted to EUR 17.2bn which was 24% above the value in the similar period one year before. However, venture exits have decreased by 25%, amounting to EUR 1.0bn.
- Venture performance has remained weak, apart from those in the top quartile, emphasising the importance of careful selection by investors.

- Turning to SME securitization (SMESec), originators continue to mainly retain newly issued deals in order to create liquidity buffers and to use the assets as collateral with central banks.
- The SMESec market (excluding pure ECB-related transactions) slowly restarts from the more sophisticated markets, i.e. in the "traditional" countries (UK, Germany, Benelux, Italy etc.).
- Looking forward, regulatory reforms will impact the securitisation market. Investors will only return in volume if they regain confidence in the quality of transactions and if there is satisfactory secondary market liquidity. Originators will return if transactions are economically feasible.

- With regard to Microfinance, standardised, regularly available indicators to explain market developments for microfinance in Europe do not yet exist, or focus on Eastern Europe. Thus, in this report we focus on the framework conditions for microfinance which are covered by the regularly updated Eurostat indicators for poverty and social inclusion, and by data on micro-enterprises.

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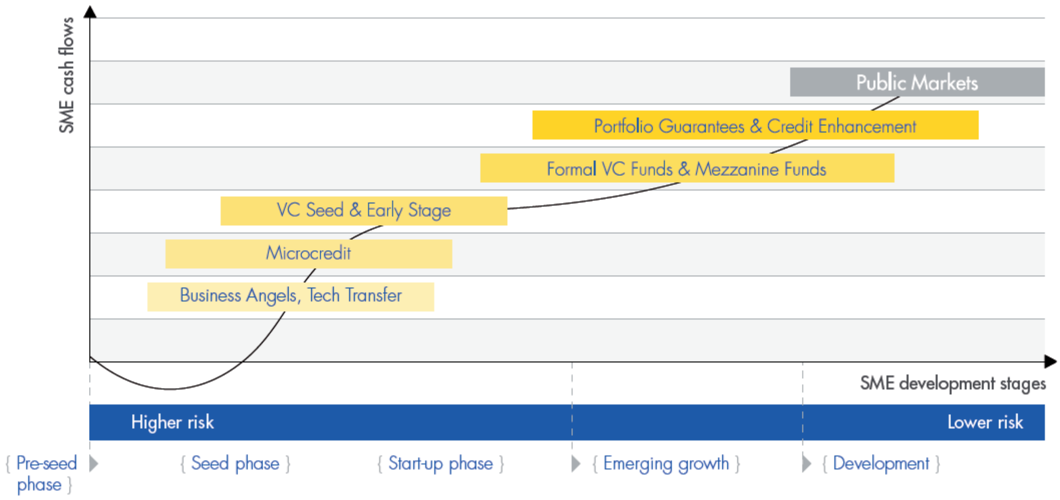
1 Introduction

The EIF is the EIB Group's specialist provider of risk financing for entrepreneurship and innovation across Europe, delivering a full spectrum of financing solutions through financial intermediaries (i.e. equity instruments, guarantee and credit enhancement instruments, as well as microfinance).

The following figure shows the range of EIF's activities:

Figure 1: EIF tool kit for SMEs



Source: EIF

The EIF focuses on the whole range of micro- to medium-sized enterprises, starting from the pre-seed, seed-, and startup-phase (technology transfer, business angel financing, microfinance, early stage VC) to the growth and development segment (formal VC funds, mezzanine funds, portfolio guarantees/credit enhancement).

Against this background the European Small Business Finance Outlook (ESBFO) provides an overview of the main markets relevant to EIF (equity[2], securitisation, microfinance). It is an update of the ESBFO 1/2011 that has been published in June this year.

We start by discussing the general market environment, then look at the main aspects of equity finance and the SME Securitisation (SMESec) market. Finally, we briefly highlight important aspects of microfinance in Europe.

[2] We are using the term "equity finance" to combine linguistically the areas of Venture Capital (VC) and Private Equity (PE). However, if we refer here to equity activities, we only consider the activities of EIF's investment focus which does neither include Leveraged Buy-outs (LBOs) nor Public Equity activities.

2 Economic environment

Since the publication of our first ESBFO in June, the global economic situation has deteriorated. The IMF (IMF, 2011) lowered its global growth forecasts, now expecting a world output growth rate of 4.0% in 2011 and similar for 2012. Even if this is still slightly above the longer term average for the years 1993-2010, the downside risks to worldwide economic growth have heavily increased, mainly due to larger financial and fiscal uncertainties.

The divergence between growth in advanced and emerging economies are expected to persist, as shown by the IMF forecast of 1.6% growth in advanced economies in 2011 and 1.9% in 2012, compared to 6.4% in emerging economies in 2011 and 6.1% in 2012. Output growth projections for the European Union were lowered to 1.7% for 2011 and to 1.4% for 2012 (Euro area: 1.6% and 1.1% respectively), and for Central and Eastern Europe[3] to 4.3% and 2.7% respectively. Other recently published economic outlooks expect even lower growth rates. Examples are the European Commission forecast (see table 1) of only +0.6% GDP growth for the European Union (European Commission, 2011b) and the latest OECD projections (OECD, 2011).

When looking at the European growth picture in more detail, the outlook is deteriorated by the financial turmoil and weaker confidence. These factors are weighing on private consumption and investment which the European Commission expects to grow by only +0.4% and +0.8% respectively in 2012. Fiscal consolidation is preventing public consumption from stepping in. However, net exports are expected to deliver a moderately positive growth contribution.

Table 1: Main features of the European Commission autumn 2011 forecast for the EU

(Real annual percentage change unless otherwise stated)				Autumn 2011 forecast		
	2008	2009	2010	2011	2012	2013
GDP	0.3	-4.2	2.0	1.6	0.6	1.5
Private consumption	0.3	-1.7	1.0	0.4	0.4	1.1
Public consumption	2.3	2.0	0.7	0.3	-0.2	0.1
Total investment	-0.9	-12.5	-0.3	1.9	0.8	3.0
Employment	0.9	-1.9	-0.6	0.4	0.1	0.4
Unemployment rate (a)	7.1	9.0	9.7	9.7	9.8	9.6
Inflation (b)	3.7	1.0	2.1	3.0	2.0	1.8
Governement balance (% GDP)	-2.4	-6.9	-6.6	-4.7	-3.9	-3.2
Governement debt (% GDP)	62.5	74.7	80.3	82.5	84.9	84.9
Adjusted current-account balance (% GDP)	-2.0	-0.8	-0.8	-0.8	-0.4	-0.2
			Contribution to change in GDP			
Domestic demand	0.4	-3.2	0.7	0.6	0.3	1.2
Inventories	-0.2	-1.1	0.8	0.2	0.0	0.0
Net exports	0.1	0.0	0.5	0.7	0.3	0.3

(a) Percentage of the labour force.
(b) Harmonised index of consumer prices, annual percentage change.

Source: European Commission (2011b)

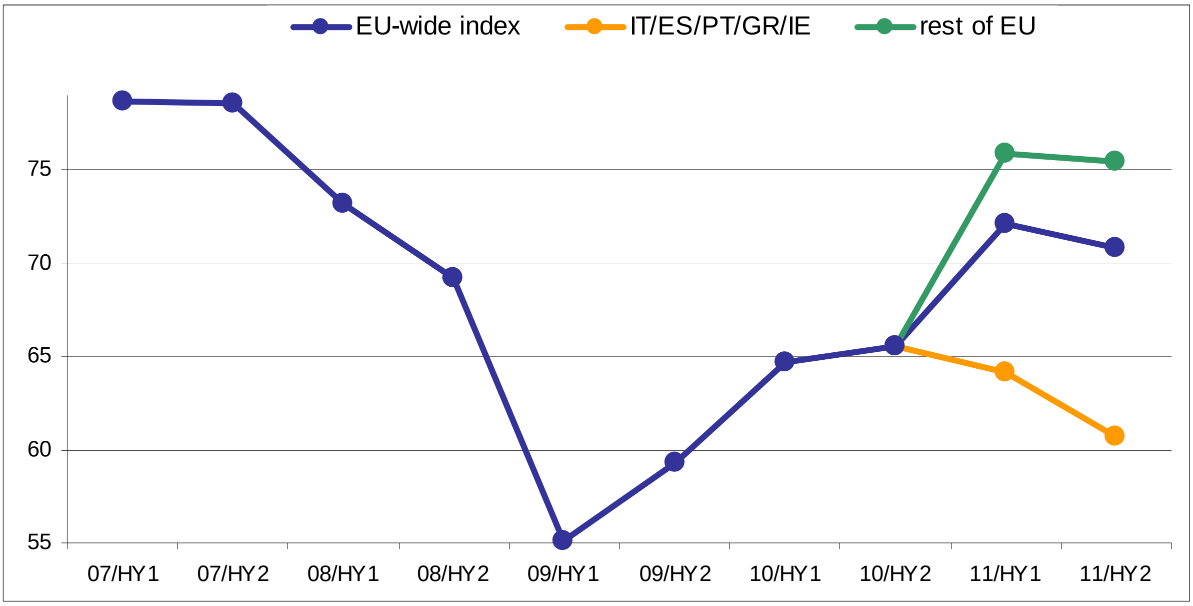
[3] In the IMF World Economic Outlook, the Central and Eastern Europe Country Group is composed of the 14 countries Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Kosovo, Latvia, Lithuania, Former Yugoslav Republic of Macedonia, Montenegro, Poland, Romania, Serbia, and Turkey.

3 Small business environment

3.1 SME business climate

Available data for the business environment of SMEs still show a relatively stable situation, however the downside risks have increased over the past months. The UEAPME SME Business Climate Index for the EU fell for the first time since the start of the latest recovery in early 2009 (UEAPME Study Unit, 2011).[4] Nevertheless, the index value still stands slightly above its "neutral" level, thereby suggesting neither a downturn nor an amelioration of the economic situation of SMEs in the EU as a whole. However, the index also points to increasing imbalances between EU Member States. At the beginning of the year, a strong difference in the SME business climate arose between the country group Italy, Spain, Portugal, Greece, and Ireland and the rest of the EU. This gap has even widened in the second half of 2011.

Figure 2: SME Business Climate Index



Source: UEAPME Study Unit (2011)

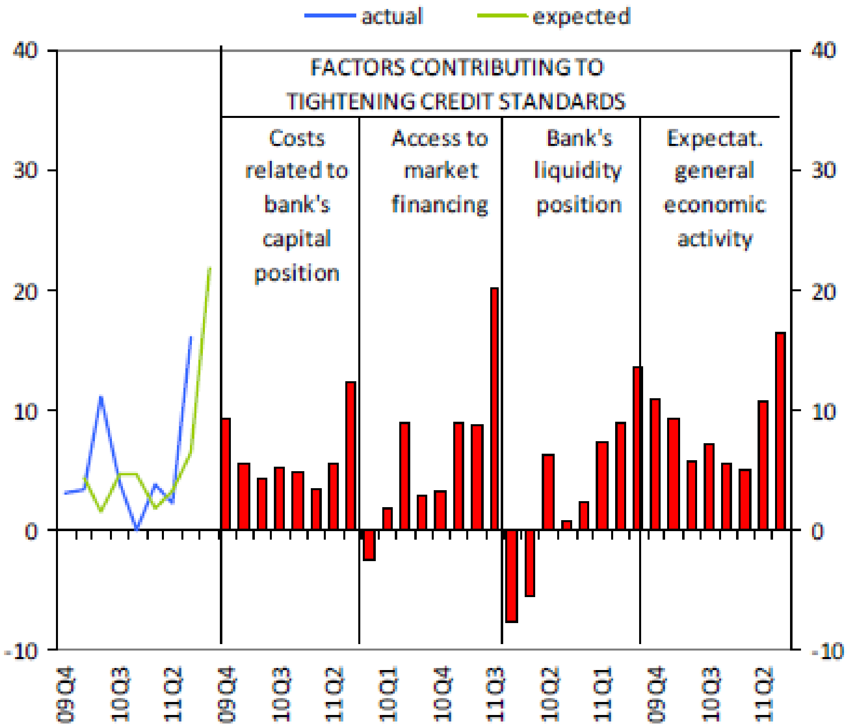
The data of UEAPME's European Crafts and SME Barometer are also published with respect to enterprise sizes. These data show that the balance between positive and negative answers is still worse for micro and small enterprises than for medium-sized ones.

[4] The index is calculated as an average of companies that have reported positive or stable business situations and expect a positive or stable development for the next period. Therefore the index can range from 100 (all positive or neutral) to 0 (all negative). For more details see: http://www.ueapme.com/IMG/pdf/111011_Barometer_2011H2_final.pdf

3.2 Bank lending activity

For information about the current status of bank lending, we use the latest European Central Bank (ECB)- Bank Lending Survey (BLS), which reports changes during the third quarter of 2011 and expectations of changes in the last quarter of 2011 (European Central Bank, 2011b). The survey was conducted on 124 Euro area banks.

Figure 3: Changes in credit standards applied to the approval of loans or credit lines to enterprises[5]



Source: European Central Bank (2011b)

The survey reports a significant increase in net tightening of credit standards to non-financial corporations (NFCs) by Euro area banks; a net 16% of banks reported a tightening in Q3/2011, compared to 2% in the previous quarter. Main drivers of this development were the deterioration of banks' funding conditions, stemming from the intensification of the sovereign debt crisis which put pressure on the perceived soundness of Euro area banks, and a worsening of the industry or firm-specific outlook, which is in line with generally weaker economic conditions. The increase in net tightening was only slightly less intensive for loans to SMEs than for loans to large firms. Net tightening of credit standards increased to a similar extent across all loan maturities. However, the level of net tightening was still higher for long-term loans than for short-term loans.

[5] The figure shows net percentages of banks contributing to tightening standards (difference between the sum of the percentages of banks responding "tightened considerably" and "tightened somewhat" and the sum of the percentages of banks responding "eased somewhat" and "eased considerably"). The net percentages for responses to questions related to the factors are defined as the difference between the percentage of banks reporting that the given factor contributed to a tightening and the percentage reporting that it contributed to an easing. "Actual" values refer to changes that have occurred, while "expected" values are changes anticipated by banks.

The net tightening of credit standards was also reflected in a general tightening of (price-related and other) terms and conditions, which could be observed to the most significant extent in the increase of banks' margins on loans to large enterprises. The (net) number of banks reporting higher margins for average loans to SMEs increased only slightly, while the margins on riskier loans to SMEs even decreased a little.

Looking forward to the fourth quarter banks assume, on balance, a further increase in the tightening of credit standards, which is expected to affect large firms more than SMEs, and long-term loans more than short-term ones.

The demand for loans to NFCs declined, on balance, for the first time since more than one year, according to banks' observations. This decrease was more pronounced for SMEs than for large firms. According to the banks' views, main explanatory factors were lower financing needs for fixed investments, inventories and working capital. However, lower financing needs for mergers, acquisitions, and corporate restructuring were reported as well.

Banks anticipate to a large extent a further decrease in demand, which is expected to come slightly more from large firms than from SMEs in the fourth quarter. Long-term loans are expected to be affected more than short-term ones.

In line with the results above, a substantially large part of banks reported that the access to their usual sources of wholesale funding and their ability to transfer risk has deteriorated during the third quarter 2011. A considerable share of banks expects this process to continue in the fourth quarter.

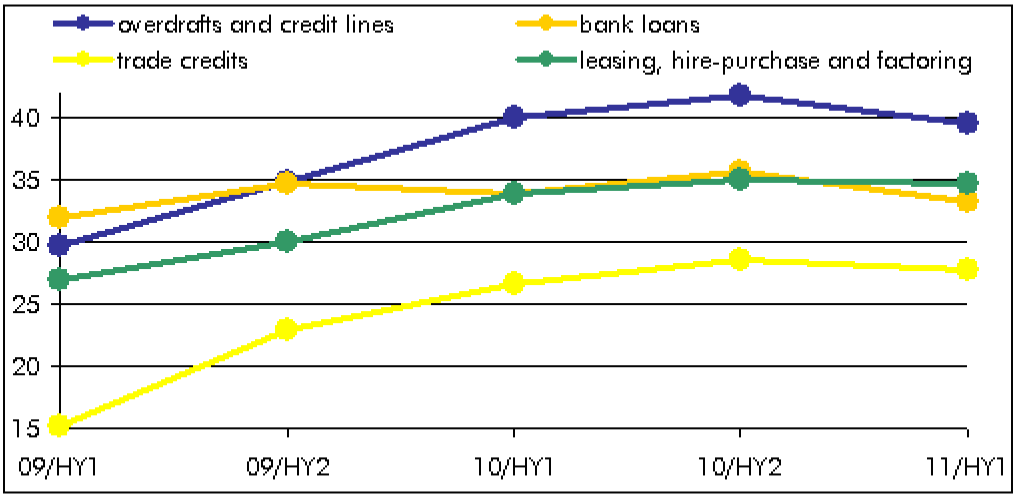
3.3 Access to finance

According to the ECB's "survey on the access to finance of SMEs in the Euro area"[6], covering April to September 2011 (European Central Bank, 2011c), access to finance remained the second most pressing problem for Euro area SMEs, and it appears to be a more severe concern for SMEs than for large firms. However, the most pressing problem for SMEs was still "finding customers".

Compared to the previous ECB survey (covering the period September 2010 to February 2011), there has been a slight decrease in the percentage of SMEs using external sources of finance. However, the composition of external financing sources remained broadly unchanged, with bank financing (overdrafts, credit lines, bank loans) remaining the most important source of external financing (see figure 4).

[6] Please note that recently Eurostat performed an additional survey related to SME finance. Please see box 1 below for more details.

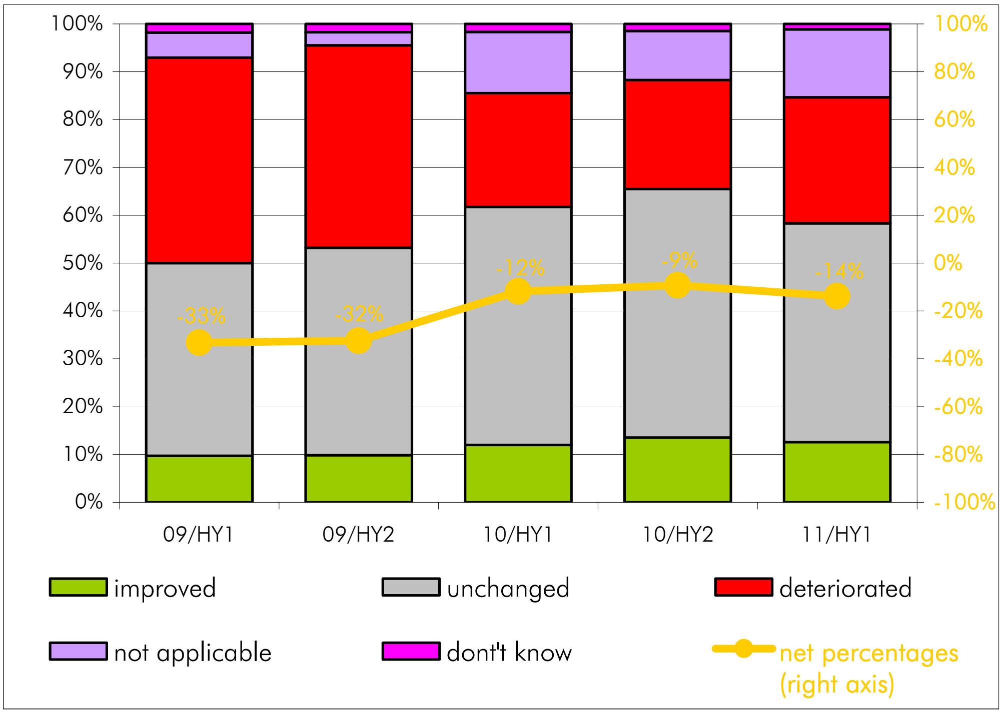
Figure 4: Sources of external financing of Euro area SMEs
(over the preceding six months; percentage of respondents)



Source: European Central Bank (2011c)

During the reference period, the net percentage of SMEs reporting an increased *need* for bank loans remained pretty much unchanged compared to the previous survey. However, the percentage of SMEs that perceived a deteriorated *availablity* of bank loans moderately increased (see figure 5). According to the responses of surveyed SMEs, the main factor which negatively impacted the availability of external financing was the general economic outlook. In addition, a larger share of SMEs reported a further decline in banks' willingness to provide loans. In line with these developments, the net percentage of SMEs reporting increases in interest rates rose considerably.

Figure 5: Change in the availability of bank loans for Euro area SMEs
(over the preceding six months; percentage of respondents;
base: SMEs that had applied for external financing)



Source: European Central Bank (2011c)

When looking at actual applications for external financing, 22% of SMEs applied for a bank loan between April and September. This is the lowest percentage since the start of the survey in 2009. The main reason for SMEs not to apply for a bank loan was the availability of sufficient internal funds. The share of SMEs giving this statement was the highest since 2009. When looking at the actual success of loan applications, SMEs continued to report a higher rejection rate than large firms.

Looking ahead, SMEs are expecting on balance a further deterioration of access to bank loans. Particularly pessimistic SMEs were observed in Greece and Portugal, but also in Ireland and France. When asked for the importance of factors affecting future financing, SMEs mainly emphasized the necessity to reduce administrative burdens for existing public support measures and the importance of tax incentives. Loan guarantees and business support services were on average also assessed as being important. The lowest relevance was stated for measures to facilitate equity investments and for export credit or export guarantees. These results reflect the number of SMEs which usually benefit from public support measures with the respective financial instruments.

Box 1: Results of Eurostat Access to Finance Statistics

In October 2011, Eurostat published results from a survey on access to finance for SMEs in the EU (Ushilova and Schmiemann, 2011).[7] The survey was a one-off exercise conducted in consultation with the users of Eurostat's business statistics, the OECD, the ECB, and the EIF. The aim was to shed light on the consequences of the financial crisis by comparing data for 2007 (considered as a reference point before the crisis) and 2010 (considered as the end of the crisis, at least in some EU Member States). An outlook for the years 2011-13 is also contained.

According to the study, more than half of the surveyed SMEs did not seek any external finance in 2007 and 2010. However, the financing needs are expected to grow for the period 2011-13. Loans were still the most desired financing type and the need is expected to increase, including a plus of 10 percentage points for "gazelles" and other high-growth enterprises[8]. However, the relative need for equity finance of these subsets of fast growing firms is expected to nearly double. Banks are expected to stay the most important financing source for the surveyed SMEs, followed by leasing companies. Only 5% of the respondents expected to receive financing from a local government body.

Asking the SMEs on how they perceive the changes in the financial environment between 2007 and 2010, 35% of all respondents stated that the financial situation of the business was unchanged. However, 14% observed a much worse willingness of banks to provide finance. This figure might even underestimate the situation as it includes those respondents who stated that they do not seek any external finance at all. It is in line with this result that the success rates in receiving external finance substantially decreased between 2007 and 2010.

[7] The survey was conducted among 25,000 enterprises which had between 10 and 249 employees in all EU countries with the exception of Austria, the Czech Republic, Estonia, Hungary, Portugal, Romania, and Slovenia. For more detailed information on the data source please see http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics.

[8] According to the Eurostat definition, a high-growth enterprise is an enterprise with an average annualised growth of more than 20% per year over a three-year period (growth can be measured by the number of employees or by turnover). A "gazelle" is a young high-growth enterprise (up to 5 years old).

Box 1 continued:

In the year preceding the crisis, 84% of SMEs were able to obtain loans (67% for equity). This rate plunged to 65% (52% respectively) in 2010. Banks saw the main reasons for refusing a loan in poor credit rating, lack of own capital or insufficient collateral, while loan-seekers cited high interest rates as the main reason for not having been fully successful in their demand.

Interestingly, SMEs do not expect access to finance to be the most limiting factor for business growth for the years 2011 to 2013. In fact, only 4% of the surveyed SMEs were of this opinion. Rather, the general economic outlook is seen as the most important growth constraint (by 22% of SMEs), followed by price competition/small margins (16%) and limited demand in the local/domestic markets (12%). However, the importance of access to finance as a growth constraint might again be underestimated, as these figures include those respondents who do not seek external finance.

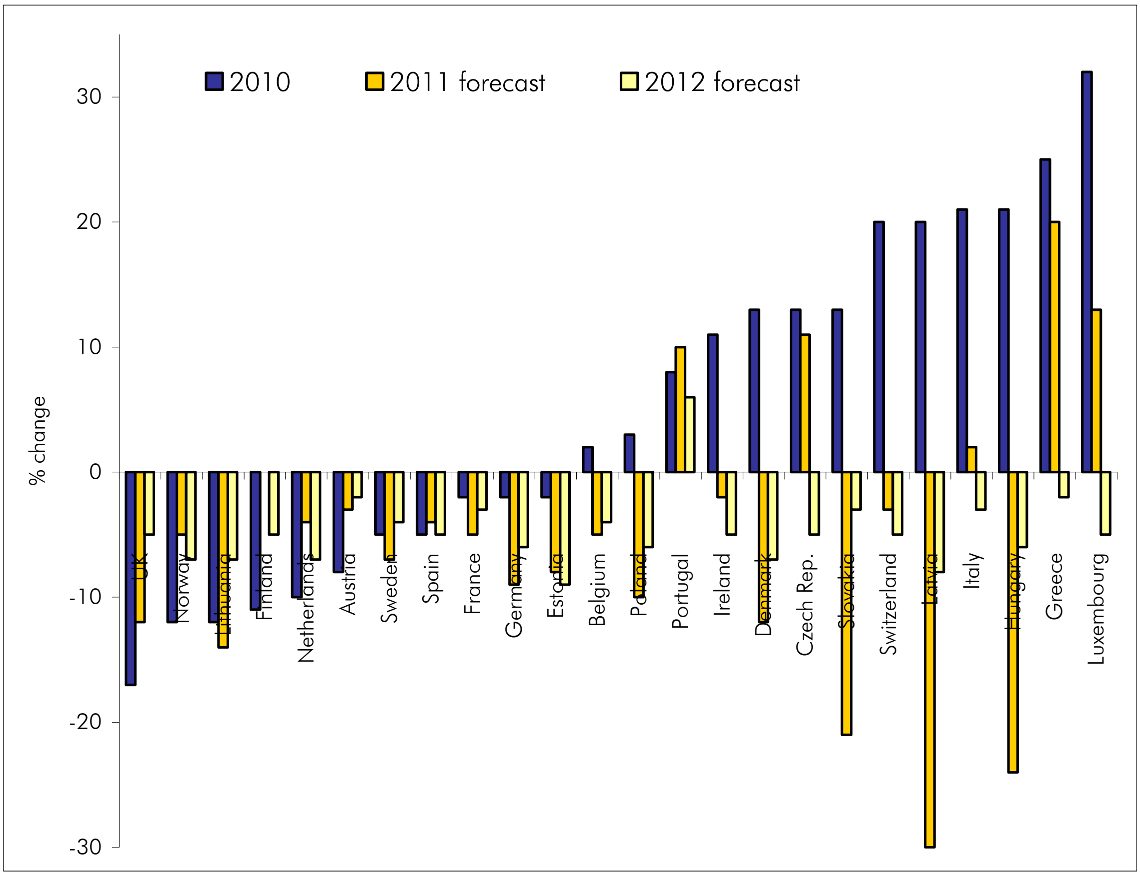
3.4 Insolvencies

The fall in global business insolvencies which was reported in 2010 for the first time after two record years is expected to continue in 2011. The Euler Hermes Global Insolvency Index (Euler Hermes, 2011), which analyses changes in business insolvencies across the world, forecasts a further decline by 7% in 2011 and by another 5% in 2012, following the drop by 5% recorded in 2010.[9]

At a European level (see figure 6), the development of insolvency figures was generally worse than in the Asia Pacific region (-12%) and in the Americas (-8%). Concerning the Eurozone, the index forecasts a drop of insolvencies by 4% both for 2011 and for 2012, following the slight decline of insolvencies by 1% in 2010. However, significant regional disparities remain (as indicated by the figure below) and insolvencies are expected to remain above pre-crisis levels in the Eurozone as well as in the majority of countries covered by the global index. Moreover, these forecasts might prove to be too optimistic, as they were published in June and the outlook for the economic environment has considerably worsened in the meantime.

[9] Please note that often national insolvency statistics are not completely comparable. For example, in some countries insolvent firms are less likely to initiate bankruptcy proceedings and opt instead for "voluntary" closures which are not included in the insolvency statistics. To overcome the heterogeneous nature of national statistics and circumstances, the Euler Hermes Global Insolvency Index monitors the change in insolvencies over time rather than their absolute numbers.

Figure 6: Rate of change in insolvency, 2010-2012



Source: Based on data from Euler Hermes Global Insolvency Index 2011

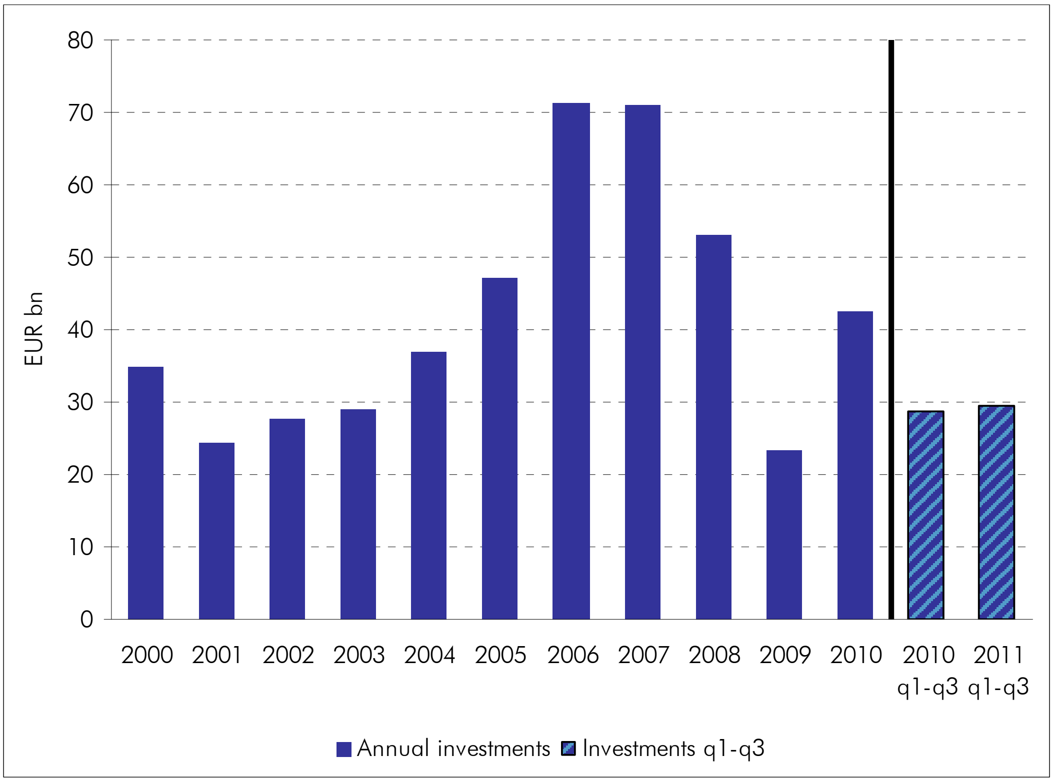
In 2010, perhaps unsurprisingly, the number of corporate collapses continued to increase in peripheral Europe, notably in Greece (+25%), Italy (+21%), Ireland (+11%), and Portugal (+8%). Some central and eastern European countries also recorded double-digit increases (Hungary +21%, Latvia +20%, Czech Republic +13%, Slovakia +13%), as well as Luxembourg (+32%), Switzerland (+20%), and Denmark (+13%). The most significant falls in European insolvency indexes were observed in the UK (-17%), Lithuania (-12%), Norway (-12%), Finland (-11%), the Netherlands (-10%), Austria (-8%), Sweden (-5%), and Spain (-5%). However, this followed large increases in the period before. France and Germany both recorded only slight decreases in insolvencies (-2% each) in 2010.

4 European private equity market

4.1 Investment activity

The strong recovery in overall private equity investment activity, which was recorded in 2010, has almost come to a standstill in 2011. While total investment had jumped by 77% to EUR 43bn in the last year, most recent EVCA statistics recorded only a tiny increase of +3.3% throughout the first three quarters of 2011 (compared to the same period one year before). In the first nine months of 2011, the total amount of private equity investment in Europe summed up to EUR 29.6bn.

Figure 7: Investment activity by private equity firms located in Europe[10]

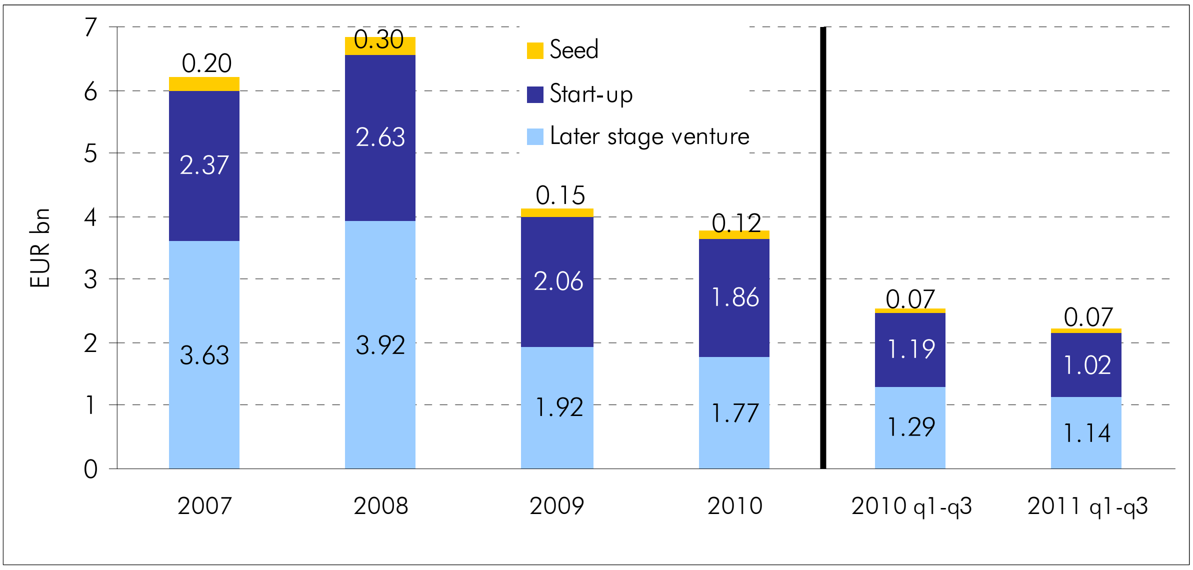


Source: Based on data from EVCA

[10] Annual figures are investment activity by PE firms located in Europe ("industry approach" or "office approach"), while figures for the first three quarters of 2010 and 2011 reflect investments in Europe (by country of portfolio company; "market approach"). We use different time series, because quarterly EVCA figures based on the industry approach are currently not available, while EVCA data based on the market approach are only available back until 2007. The use of these two different data sets is not problematic for the analysis which we conduct in this paper, as the message concerning the development of investment activity is almost the same for both time series: When comparing periods for which data are available for both time series (i.e. annual data for 2007 to 2010), the course of both is similar (annual changes always point into the same directions; differences in annual growth rates are between 0.2 and 0.4 percentage points; differences in levels are between 1.8% and 3.2%). We apply this approach also for the following analysis of VC investment activity.

All in all, private equity investment has partially rebounded after its deep slump in 2008/2009. However, this is mainly explained by the large contribution of the buyout sector, while figure 8 shows that venture capital investment activity is still declining over all stages.

Figure 8: Venture Capital activity evolution in Europe

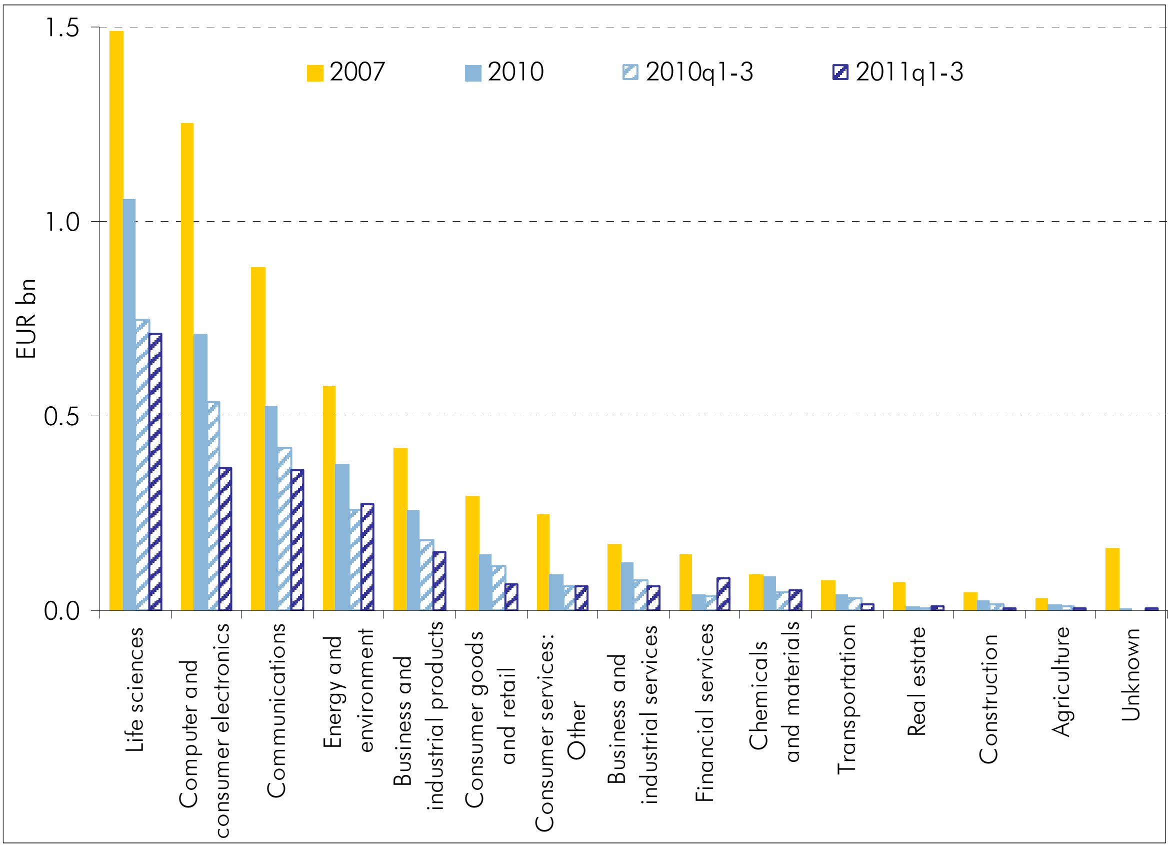


Source: Based on data from EVCA

It is interesting to note that the number of companies, benefiting from private equity investment, was lower in the first three quarters of 2011 than throughout the similar period one year before. Consequently, the average investment size rose by 38%. This was again to a large extent driven by the buyout activity (+30%). However, the size of an average venture investment also increased by 13%, and larger investment sizes were recorded for all VC investment stages.

In terms of sectors targeted by venture investment, figure 9 shows certain stability over time. Life sciences, computer/consumer electronics, and communications remain the most important - followed by energy and environment. From 2007 to 2011, VC investment in the life science sector as a share of total VC investment activity even increased from 25% to 32%, while the relative importance of computer and consumer electronics fell from 21% to 16%.

Figure 9: Venture investment in Europe by sector – 2011 and 2010 versus 2007[11]



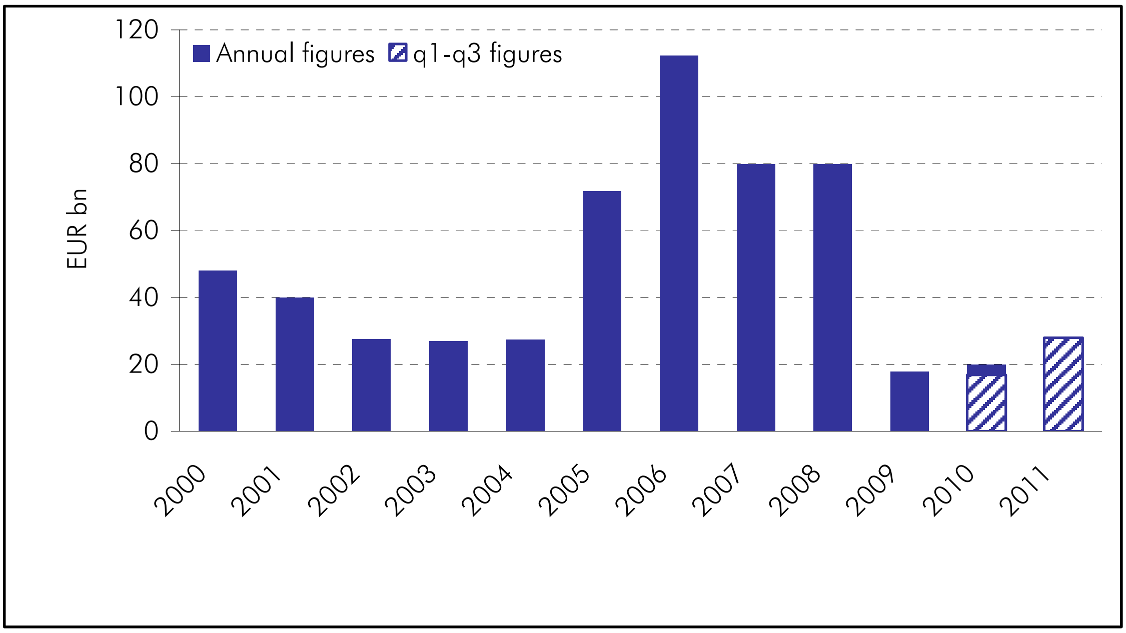
Source: Based on data from EVCA

4.2 Fundraising activity

According to EVCA figures, fundraising only slightly rebounded in 2010 and 2011, following the dramatic slump recorded in 2009. In the first three quarters of 2011, private equity firms located in Europe raised EUR 27.9bn total funds[12], which means almost 40% more than in the whole year 2010. However, this is still far from the numbers observed during the years 2005 to 2008, when EUR 86bn were raised on average per year. Moreover, venture capital fundraising continued its downward trend in 2011, decreasing to EUR 1.7bn in the first three quarters, which is only slightly more than half of the total 2010 VC fundraising amount. In contrast, the growth, buyout, and mezzanine sectors continued to grow in 2011, with growth capital funds and mezzanine funds already above their 2008 levels. However, buyout funds, accounting by far for the largest share of the market, are still far below pre-crisis amounts.

[11] Figures based on market approach.
[12] *Incremental* closings during year. The EVCA statistics for *final* closings (cumulative amounts raised since inception) by independent funds amounted to EUR 18.5bn for private equity in q1-q3/2011, and to 1.2 bn EUR for venture capital.

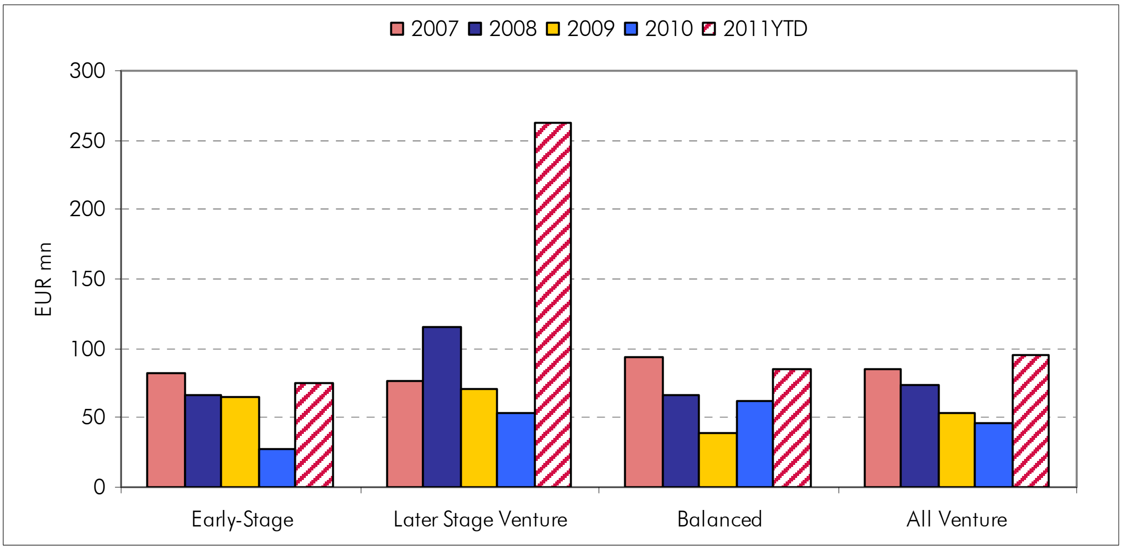
Figure 10: Funds raised by private equity firms located in Europe



Source: Based on data from EVCA

The EVCA figures for 2011 (year-to-date) also indicate that the average fund size has grown considerably across all VC sectors in 2011, meaning that the downward trend of the last years might have come to an end (see figure 11 below). However, the 2011 data should not yet be over-interpreted as it is so far based on a relatively small number of final closings compared to previous years. In particular, the figure for later stage venture is based on one fund only.

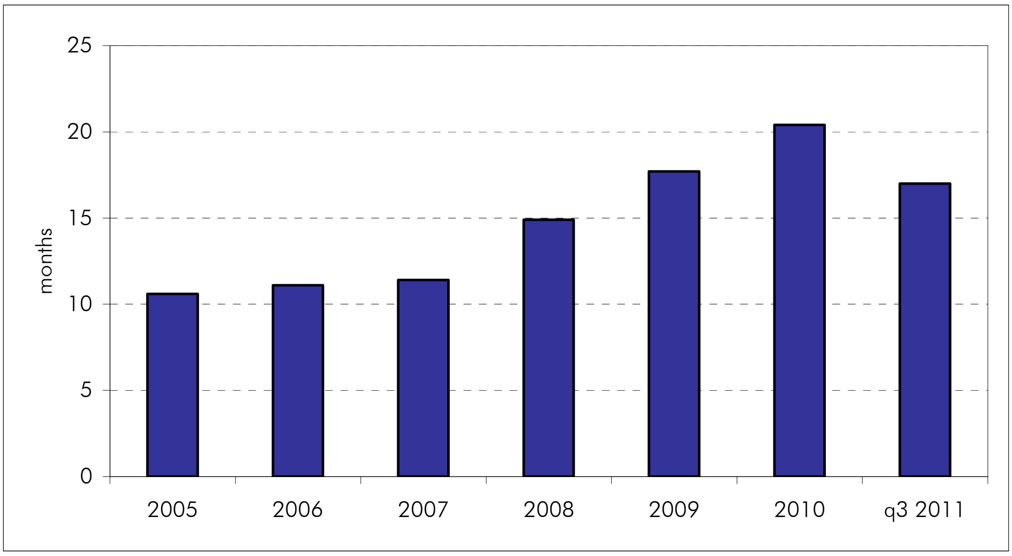
Figure 11: Average VC fund size



Source: Based on data from EVCA

There is a clear link between investor sentiment and the amount of time it takes to close a fund. Therefore, it is in principle a positive sign that the amount of time spent fundraising has come down in 2011, after having steadily increased since the onset of the crisis (see figure 12). Funds that closed during the third quarter of 2011 took an average of 17 months to fundraise. However, this is still far away from pre-crisis levels, and it shows also an increase compared to the figures which were published for the first half of the current year.

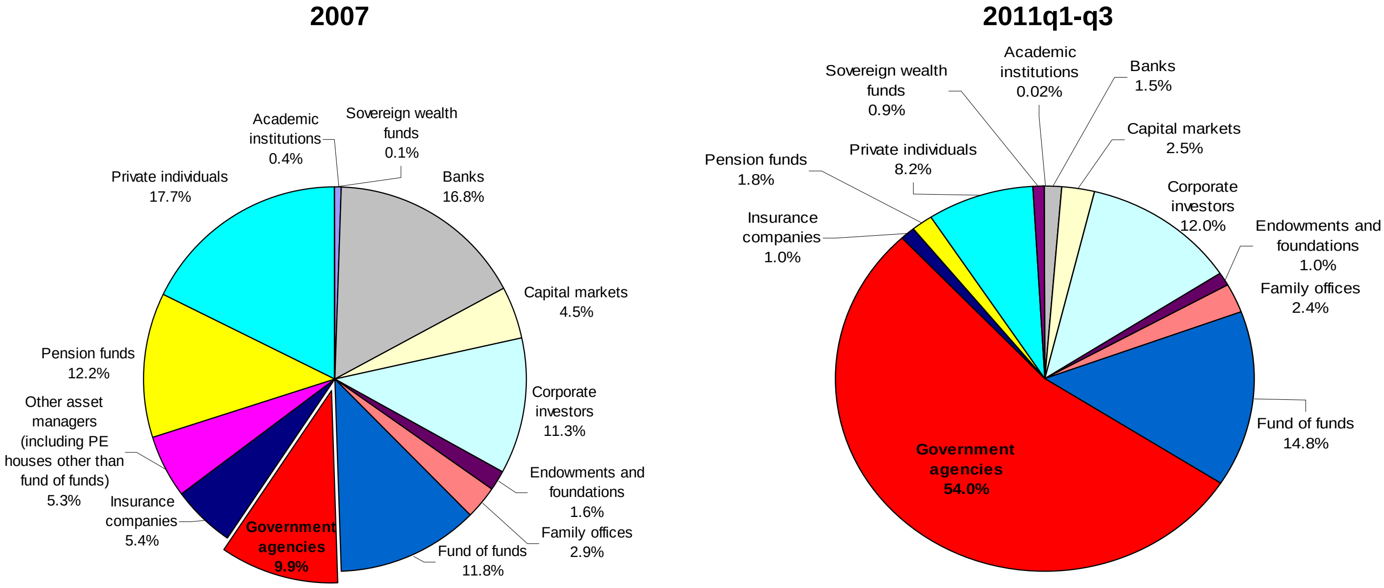
Figure 12: Average time spent fundraising by funds to achieve a final close



Source: Preqin

Another sign of investors' currently cautious sentiment towards venture capital is the shift in the investor base (see figure 13). In 2011, government agencies accounted so far for more than half of total known investors into venture capital funds. However, even if this share is unsatisfyingly large for the long term, it is noteworthy that government agencies currently play their role and support the market in a counter-cyclical way.

Figure 13: Investor base: Share of government agencies in VC fundraising[13]



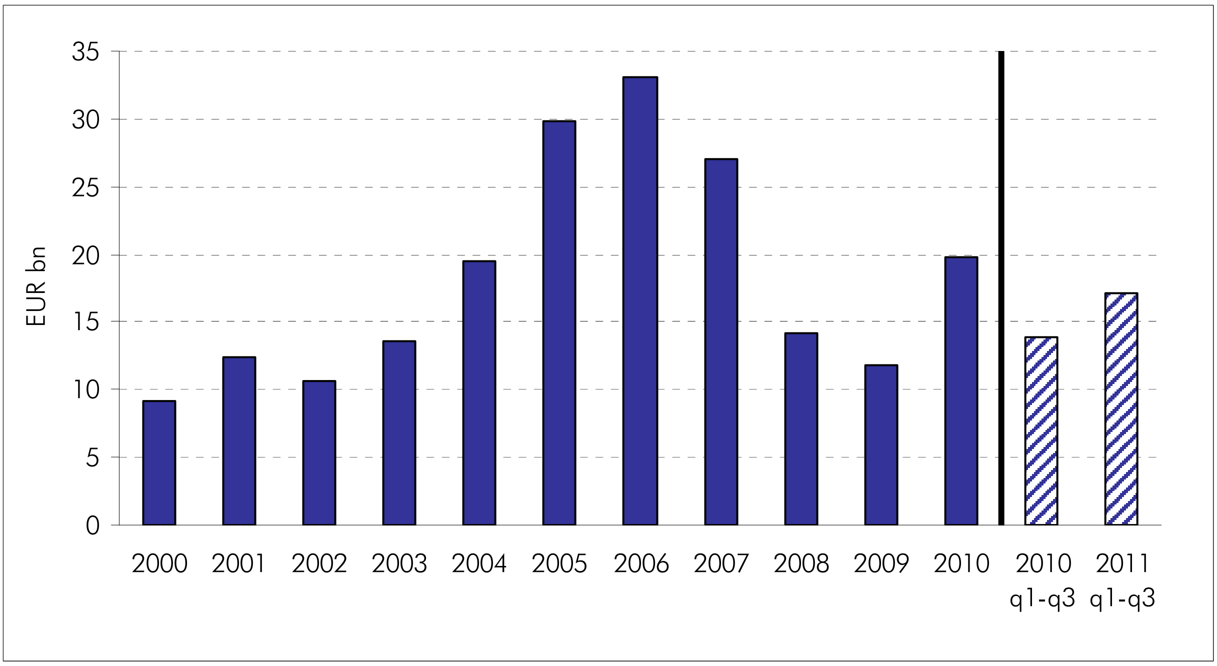
Source: Based on data from EVCA

[13] Figures exclude unknown investors (which accounted for 45% of total VC funds investments in 2007, and 16% in q1-q3/2011).

4.3 Divestment activity

Divestments have continued to grow in 2011. In the first three quarters, total divestments conducted by private equity firms in Europe amounted to EUR 17.2bn which was 24% above the value in the similar period one year before (see figure 14). This was again due to the contribution of the buyout end of the scale which increased by 30% to EUR 16.1bn. In contrast, amounting to EUR 1.0bn, venture exits have decreased by 25%.

Figure 14: Divestments by private equity firms in Europe[14]

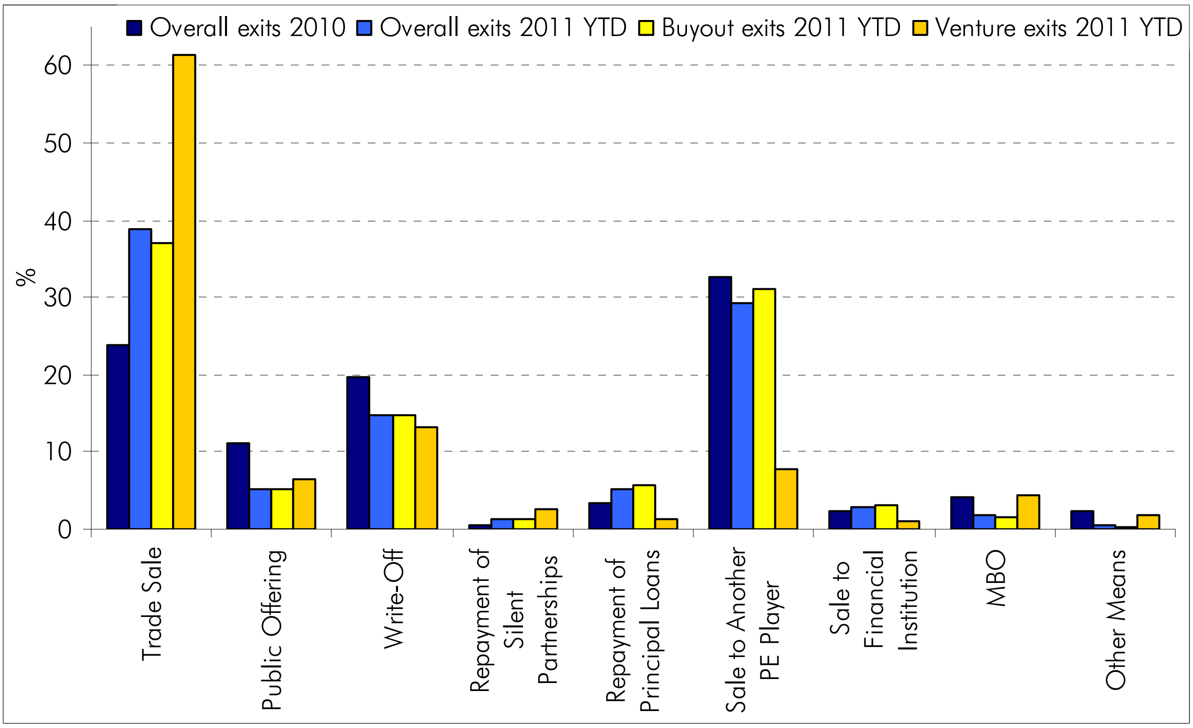


Source: Based on data from EVCA

Some comfort can be taken from figure 15 which shows that the relative importance of write-offs as a form of exit has continued to decline in 2011. Rather, trade sales and sales to another private equity player have become the most popular form of divestment, accounting together for more than two thirds of all exits. Moreover, as regards venture exits, the relative importance of trade sales alone has heavily increased to a share of 61% of divestments.

[14] Annual figures: office approach; quarterly figures: market approach. See footnote 10.

Figure 15: Divestment (by amount at cost divested)



Source: Based on data from EVCA

4.4 Performance trends

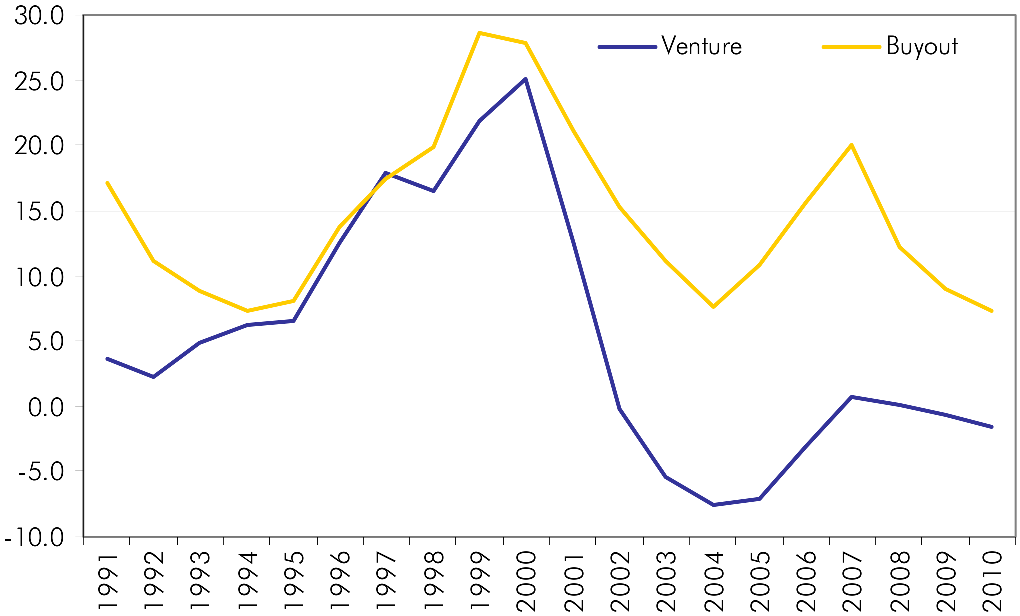
An analysis of European private equity performance was already provided in the previous ESBFO. As these data are only available on an annual basis, no update can be discussed in this issue. However, it is worth to look into some further details.

A study conducted by EVCA and Thomson Reuters (EVCA, 2011) shows a net-pooled IRR for all covered private equity funds of 9.6% from inception to 31 December 2010. Once again, the buyout sector contributed the largest share with a net-pooled IRR of 12.7% in contrast to 6.3% for mezzanine funds and 0.5% for all venture funds.

When looking only at the top-quarter, total venture performance was much better (13.2%), thereby emphasizing the importance of careful selection by investors. However, top-quarter buyout and mezzanine funds were still performing better than the venture capital benchmark.

This general picture holds even when looking at horizon IRRs until 31 December 2010. The venture sector as a whole has underperformed compared to the buyout sector for all reported horizons (one-year to 20-year horizon), with the seed/early-stage phase delivering the lowest results. For the 5-year horizon IRR, figure 16 shows that the relatively good performance of the buyout sector compared to venture capital holds true also when looking to the past.

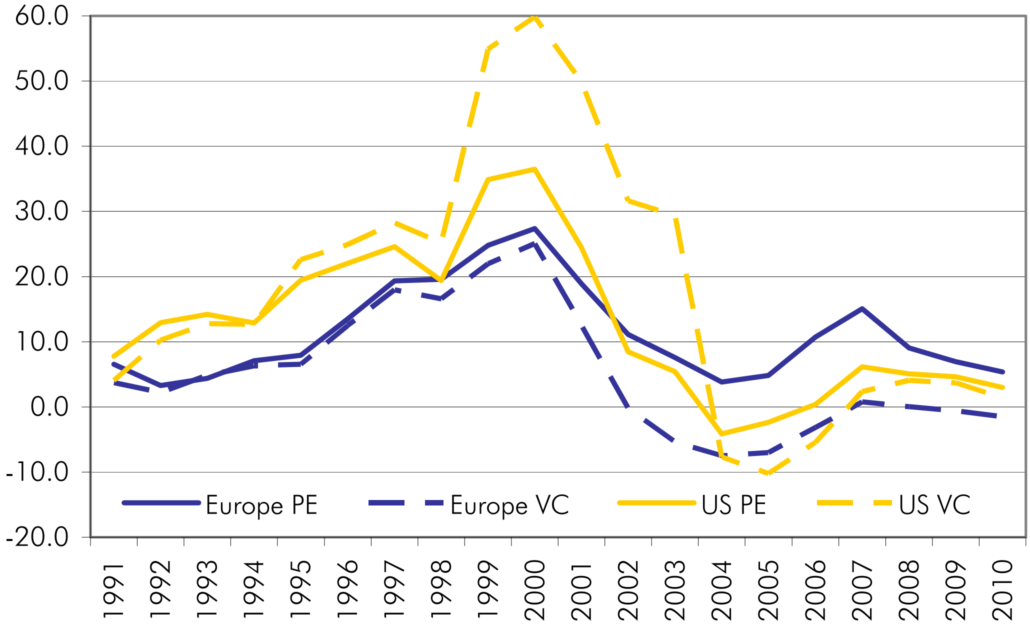
Figure 16: Five-year horizon rolling net IRRs for European venture and buyout funds



Source: Based on data from Thomson Reuters/EVCA

From a geographical point of view, the European picture is brighter for the private equity sector as a whole than for the venture capital part of it. Figure 17 shows that private equity performance in Europe was generally speaking better than in the US during the last years, while the European venture sector performed worse than its American benchmark.

Figure 17: Five-year horizon rolling net IRRs for Europe and the US



Source: Based on data from Thomson Reuters/EVCA

Looking ahead, the medium term performance outlook remains uncertain as the blurred outlook for the general economic and financial environment will also strain the performance of private equity. However, a crisis is also a source of opportunity in private equity as valuations are decreasing and acquisitions can be completed at more favourable prices.

Box 2: Business Angel activity[15]

As already stressed in our previous ESBFO, Business Angels (BAs) represent an important investor class and we present in this box updated information on the BA market, based on the latet available information from EBAN, the European Business Angel Network.

Business Angels tend to invest their own money directly in businesses which are not publicly traded, either individually or in formal or informal syndicates. They differ from VC funds, who primarily invest third parties' funds (e.g. Institutional Investors'). Typically companies that receive BA financing are smaller than VC-backed companies, and BA Investments are usually short term – the median holding period is approximately four years.

The past three years have seen an increase in Business Angel Investments in Early-stage high-growth companies as VC funds have migrated to less risky later stage investments. Business Angels offer a number of advantages compared to VC funds:

- lower transaction costs allow them to invest on a lower scale;
- BAs are geographically more dispersed, and often invest in local markets;
- they are very 'hands-on' investors

There are potential difficulties in measuring the size of the BA market, the main ones being identification and definition. BAs typically prefer to stay anonymous, and their investments tend not to be disclosed. Further, nothing can prevent an individual from identifying oneself as a "virgin" angel, although he/she may never actually invest. Others may have occasionally acted as angels, but are no longer looking for investment opportunities.

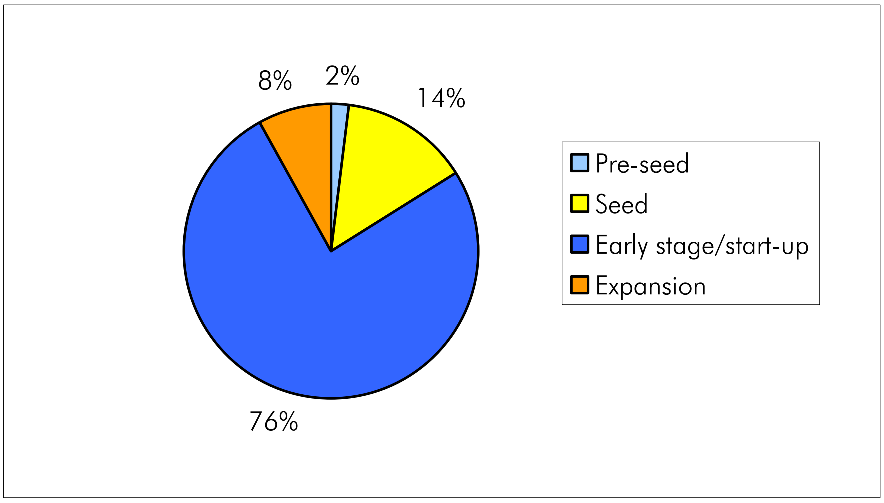
Such difficulties must be borne in mind when describing the market. According to EBAN, the number of angel investors active both within networks and independently (individually or in syndicates) is estimated at around 75k in Europe. Even though the market has been affected by the global financial crisis, the overall amount invested by angels annually is currently estimated to be in the area of EUR 4bn in the EU. Regarding the size of their funding, Business Angels, investing together in syndicates, provide on average EUR 200k per deal in Europe, with individual angel investments ranging from EUR 18k to EUR 500k.

[15] With regard to Business Angel financing we also recommend the reader to refer to the recent EIF working paper 2011/11 "Business Angels in Germany - EIF's initiative to support the non-institutional financing market".

Continuation of box 2:

Of the 392 identified Business Angel Networks in Europe (incl. Russia and Turkey), 15% are direct EBAN members.[16] The median number of investors in a typical European Business Angel Network is 79. The figure below represents breakdown by investee's growth stage of the Business Angel investments reported by EBAN members.

Figure 18: Investees' growth stages of Business Angels reported by EBAN members



Source: EBAN

[16] BAN federations are almost fully represented through EBAN, since 94% over a total of 17 European federations have EBAN membership status.

5 European SME Securitisation[17]

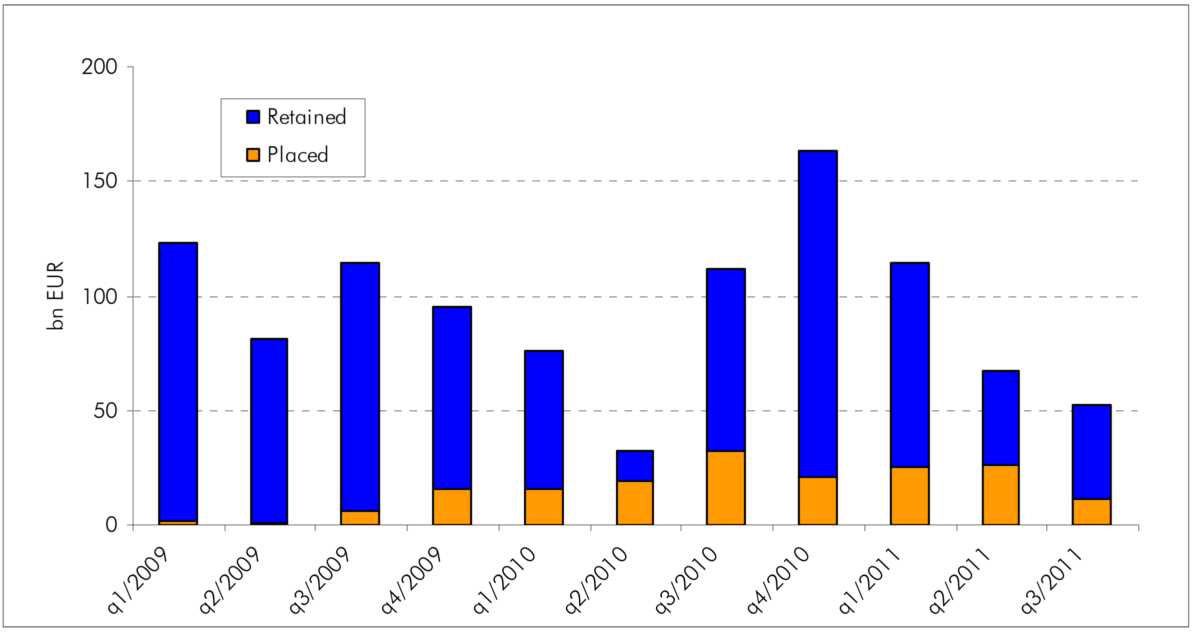
5.1 Market activity[18]

In the previous report, we stressed already the fact that over the past decade SME Loan Securitisation (SMESec) has become an important element of the financing of SMEs in Europe with growing significance in some European markets such as Spain, Germany, the UK and Italy. However, the near-collapse of the European structured finance market, in tandem with the other markets around the globe more generally, has profoundly affected the status and outlook of SMESec and unfortunately the situation has only slightly improved this year.[19]

In general, originators mainly retained newly issued deals in order to create liquidity buffers and to use the assets as collateral with central banks.[20] According to the rating agency Fitch transactions have become larger in issuance volume compared to pre-crisis levels, as banks take advantage of funding available from the ECB (Fitch, 2011).

As a consequence, overall securitization activity was so far high during the crisis, but this mainly reflected retained transactions. Also in 2011, most of the transactions have been retained for ECB re-financing purposes (see figure 19). For the full year 2010 the retention was at around 78%; in 2011 (q1 to q3), the picture was so far similar, with an average retention over the period of 73%.

Figure 19: European securitisation issuance by retention (bn EUR)



Source: Based on data from AFME (2011b)

[17] The reader can find a securitisation glossary in Annex 2.
[18] If not flagged otherwise, the data source is AFME, the Association for Financial Markets in Europe.
[19] For background information with regard to the importance of SME securitisation see: Kraemer-Eis et. al. (2010).
[20] The ECB's asset repurchase or "repo" facility allows (among other assets) Asset Backed Securities to be used as collateral for funding.

Currently, market demand is concentrated on plain-vanilla transactions with prime collateral from countries with low sovereign risk (ECB, 2011). The ongoing sovereign crisis is impacting the structured finance market via different ways; in box 2 we present a simplified view of the effects for ABS bonds.

Box 2: Potential impacts of sovereign crises on securitisation[21]

The main consequences can be summarised in three categories:

1) *Sovereign crisis* ➔ *Downgrade of country* ➔ *Impact on ABS due to rating cap*

Sovereign risk: due to the sovereign ceiling (or rating cap, maximum difference between the rating of the country and the rating of the highest rated bond) a downgrade of a country can have the consequence that the ABS cannot keep the highest rating. This is based on increased uncertainty for the economic and political development of the country. In practise, the maximum difference between the country rating and the highest achievable ABS rating is typically below 6 notches.

Box 2 continued:

2) *Sovereign crisis* ⟷ *Weak economic environment* ➔ *Impact on portfolio quality*

A sovereign crisis goes often hand-in-hand with a weak economic development/a recession with an immediate negative impact on the quality of the underlying loan portfolio (i.e. increase of default rates/decrease of recovery values).

3) *Sovereign crisis* ➔ *Impact on financial intermediaries* ➔ *Increased counterparty risk*

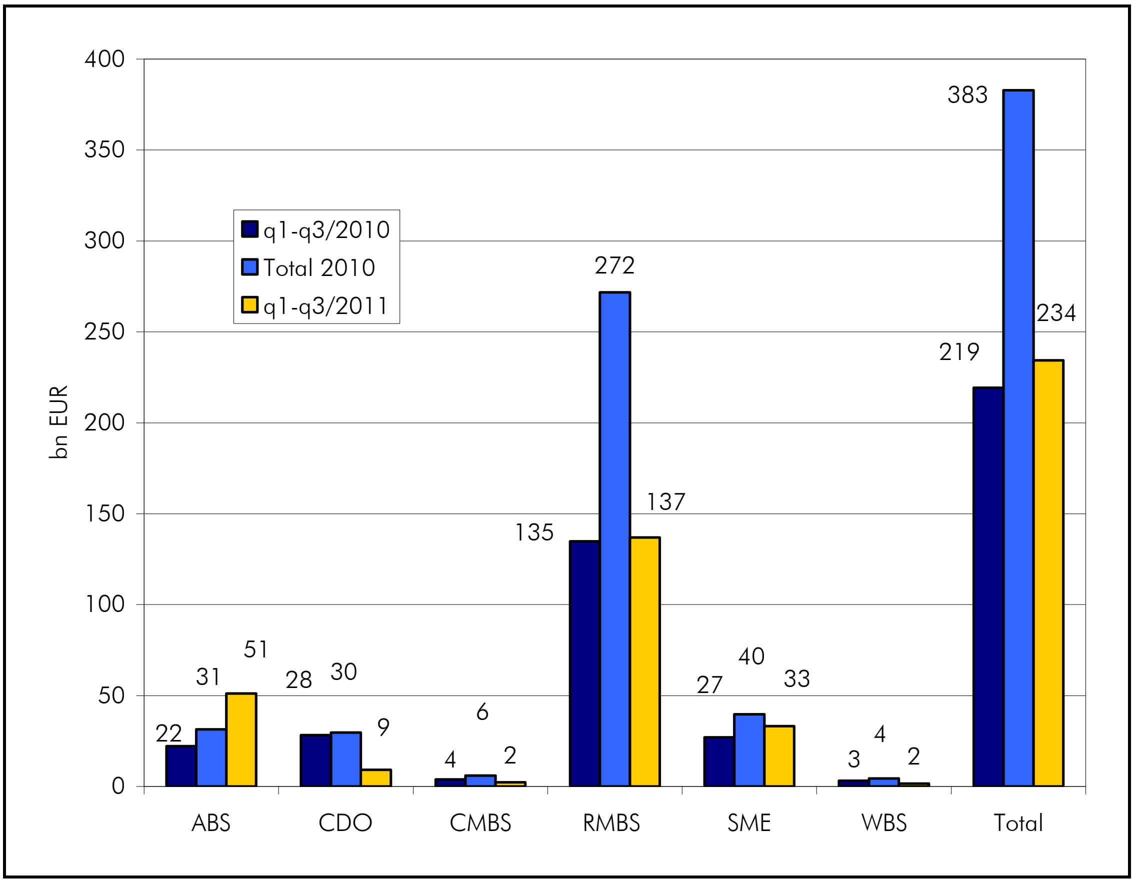
A third category of issues is linked to operational risks: the quality of a securitisation transaction is not only linked to the underlying credit risk, but also to the risks related to counterparties, participating in the transaction (servicer, swap counterparties, cash manager, etc.). Simply speaking, a high rating of an ABS can only be achieved if these counterparties have the required "standing" themselves and if the counterparties can be replaced quickly. Typically, these counterparties are financial intermediaries (i.e. banks) which themselves might suffer from sovereign crises.

The European Structured Finance market grew steadily from the beginning of the decade until the outbreak of the crisis. In 2009 and 2010 the overall market activity decreased to pre-crisis levels (after having peaked in 2008), i.e. because of regulatory uncertainties and tighter Eurosystem collateral rules. Rating downgrades, based on negative credit trends and revised rating agency criteria, contributed to the negative market sentiment. Moreover, since beginning of the financial crisis, large investor groups showed significantly increased risk aversion and reduced or stopped their activities (banks, insurances, structured investment vehicles (SIVs), conduits).

In the first three quarters of 2011 the total issuance was EUR 234bn, compared to EUR 219bn in the same period the year before (+11%), with the main activity in the UK (EUR 69bn), the Netherlands (EUR 62bn), and Spain (EUR 44bn). In terms of volumes, the overall market is dominated by RMBS (see figure 20). SMESec issuance increased to a volume of EUR 33.2bn (q1 to q3/2011), compared to EUR 27bn in the same period 2010 (+23%).

[21] This box is mainly based on DZ Bank (2011).

Figure 20: European Securitisation Issuance by collateral (bn EUR)[22]



Source: Based on data from AFME (2011b)

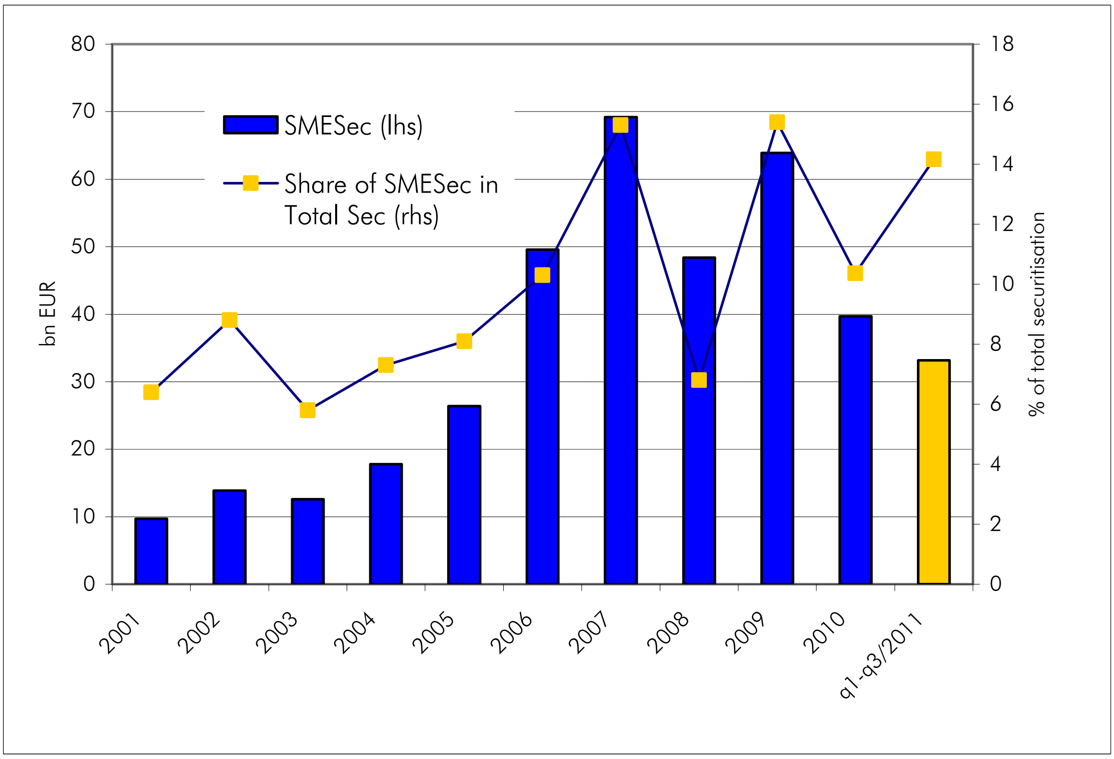
SME securitisation has remained a relatively limited but important segment of the European structured finance market (between 6% and 16% of total yearly issuance during the decade), see figure 21 below. In 2011, so far (until end of q3) the share of SMESec was around 14%. In terms of volumes, European SME issuance in the first three quarters of 2011 was EUR 33.2bn, significantly stronger than in the same period 2010 (EUR 26.9bn, + 23%).

Following the year 2009, in which there was no public placement of an SME transaction, in 2010 the SME securitisation market has shown some signs of reopening, with two benchmark transactions successfully closed in UK and Germany.[23] However, the SME securitisation deal flow - both in terms of number of transactions and volumes *placed with market investors* - is expected to remain well below pre-crisis levels for some time.

[22] AFME definitions: European ABS issuance includes auto, credit card, leases, loans, receivables and other. European CDO issuance numbers only include issuance dominated in a European currency regardless of the country of collateral. A substantial percentage of CDOs are backed by multi-jurisdictional collateral. Historical CDO issuance totals have been revised due to periodic updates of the sector. WBS: whole business securitisation – a securitisation in which the cash-flows derive from the whole operating revenues generated by an entire business or segmented part of a larger business.

[23] In both cases EIF played a key role in facilitating the placement of the notes and thus supporting the re-launching of effective fund raising through securitisation for bank originators and their SME debtors.

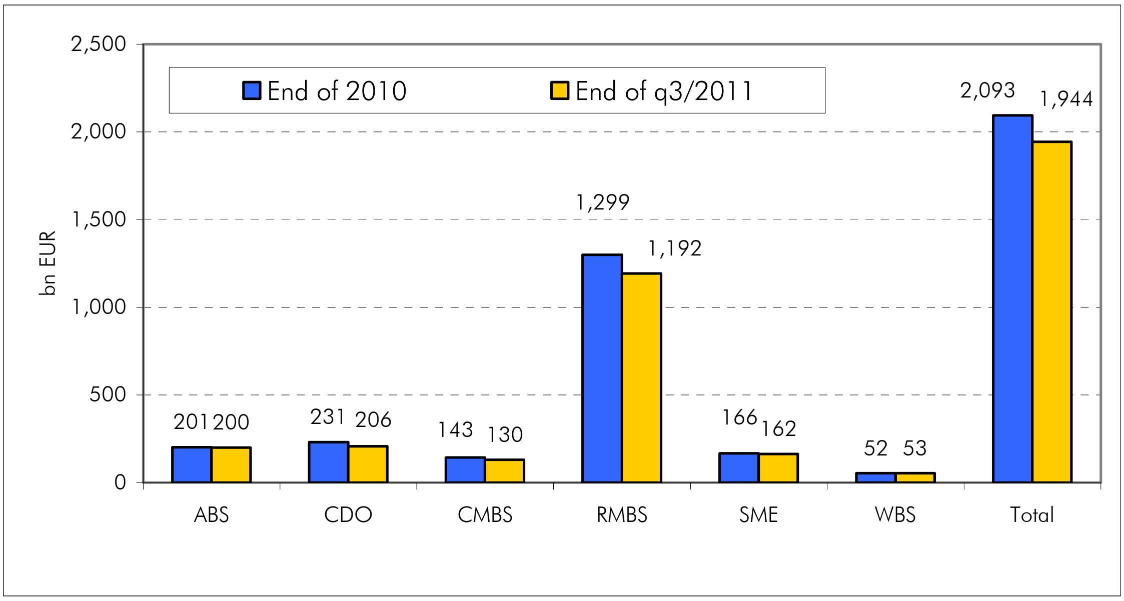
Figure 21: SMESec volumes in Europe and share of SMESec in total securitisation



Source: Based on data from AFME and KfW

With regard to the *outstanding transactions*, compared to end of 2010, the total outstanding (at end of q3/2011) decreased by 7% from EUR 2,093bn to EUR 1,944bn (see figure 22). The regional distribution of the outstanding is similar to the issuance: in terms of volumes, UK ranks first (30.2% of the EUR 1.944bn), followed by the Netherlands (15.1%), Spain (14.7%) and Italy (9.7%).

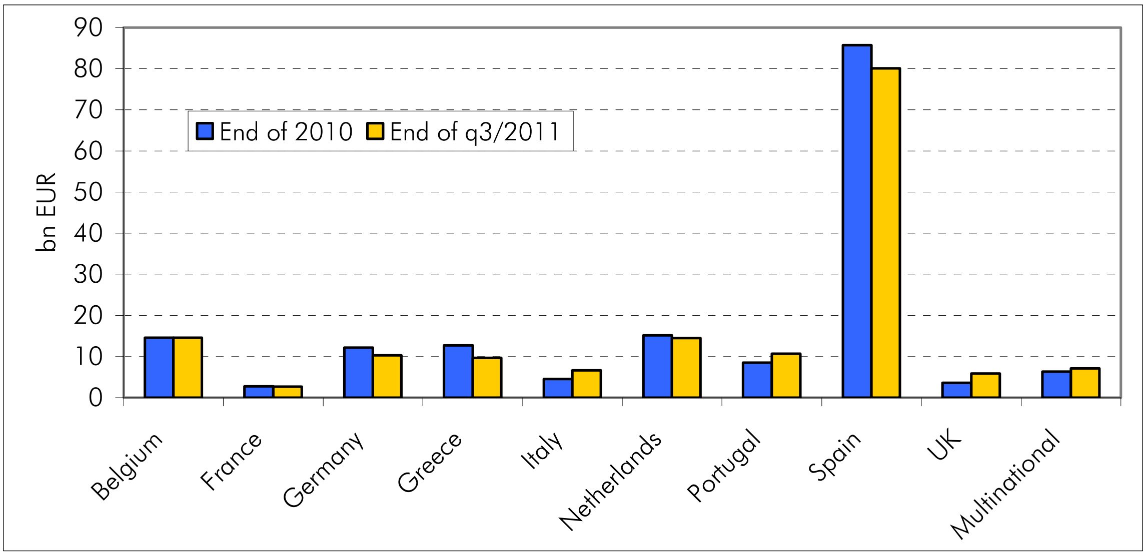
Figure 22: European outstanding securitisation transactions (by collateral, bn EUR)



Source: Based on data from AFME (2011b)

Since end of 2010, outstanding SMESec decreased only slightly (from EUR 166bn to EUR 162bn). If we break down the EUR 162bn of outstanding SMESec by country (end of q3/2011), the significance of the Spanish market becomes obvious. The regional market distribution for SMESec did not change much since end of 2010 (see figure 23)

Figure 23: European SMESec outstanding by country (bn EUR)



Source: Based on data from AFME (2011b)

5.2 Performance trends

Despite the financial and sovereign crisis, the European securitization market in general performed so far relatively well; and in general the outlook is stable (see e.g. Fitch 2011b)[24]. According to the rating agency Standard & Poor's the European structured finance default rate since beginning of the crisis (mid-2007, by original balance) is only 1.2% (Standard & Poor's, 2011), well below the defaults of comparable products like corporate bonds (cumulative default rate during the crisis is estimated to be in the area of 2.4%), but also compared to the American pendants.

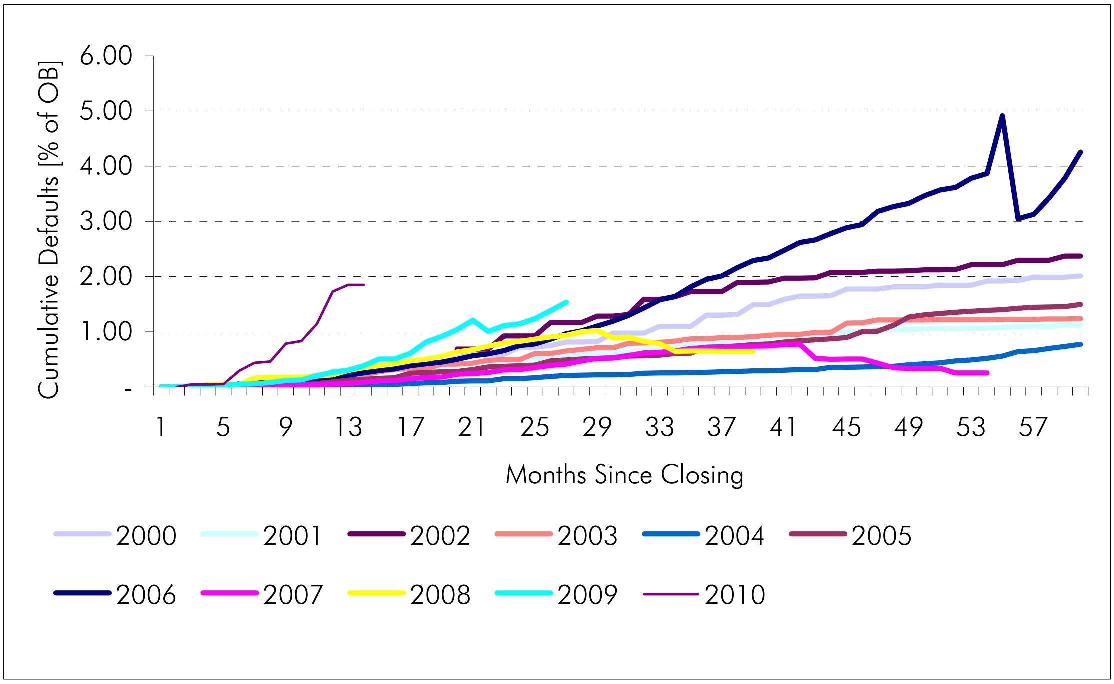
However, despite the solid performance of the overall sector, its image is still damaged (with related negative impact on the image of SMESec as well[25]), i.e. due to the understandably bad reputation of the US sub-prime products (see also DZ Bank, 2011).

With regard to SME transactions, figure 24 depicts cumulative credit events (or defaults) on original balance (OB) by vintage. It shows a relatively constant development over time for most vintage years (but mirrors the relatively bad performance of 2006 vintages as well as early defaults in more recent vintages).

[24] Fitch assumes i.e. that current ratings reflect their expectation of further deterioration across most markets and asset classes (i.e. based on downgrades earlier in the cycle and structural protections available to transactions (Fitch, 2011c).

[25] The contagion effects for SMESec have been discussed in more details in the previous version of the ESBFO and in our Working Paper 2010/7: http://www.eif.org/news_centre/research/index.htm

Figure 24: EMEA ABS SME cumulative credit events or defaults (seasoning by vintage)[26]



Source: Moody's Performance Data Service, periodic investor/servicer reports

Despite the solid performance of the sector with regard to defaults, there were many rating adjustments by the rating agencies. According to AFME data, Moody's adjusted in 2009 4,128 European securitisation ratings – with 98% being downgrades; in 2010 80% of the Moody's rating adjustments were downgrades (out of 826) but in 2011 so far (q1 to q3) upgrades became the majority (with 53% out of 1,659). However, this picture is not uniform across the rating agencies – e.g. Standard & Poor's' rating adjustments are still mainly downgrades (in 2011 so far 84% out of 2,037 rating changes).

Due to various reasons and as explained in more detail in our previous report, the SMESec market has also been hit by a wave of downgrades. The latest available rating transition data shows that the downgrade pressure for SME transactions was across all tranche levels. The following example (table 2) shows the tranche rating migration since transaction closing of the SME CLO transactions that have been rated by Fitch. For example: of all tranches that have initially been rated AAA, 23 (by number) have paid in full (pif), 39% are still AAA, 10% moved to AA etc.

[26] The "EMEA region" includes Europe, Middle East, and Africa; with regard to Structured Finance most of the transactions in this region are in Europe. There is a cut off after five years of seasoning. These vintage seasoning charts might move unexpectedly for the last few data points. This is because transactions start at different points in time within a vintage and therefore some transactions may be more seasoned than others. For example, as of Q4/2009, a transaction with a closing date in January 2008 would have been 23 months seasoned, whereas a transaction closed in December 2008 would only be 12 months seasoned. As Moody's uses the latest data point up to the maximum seasoning of a vintage for terminated transactions, this effect should decline over time and explains the different behaviour of the last few data points.

Table 2: Fitch European SMEs Rating Transition Matrix (October 2011) [27]

% of tranches		Current rating									
		PIF	AAAsf	AAsf	Asf	BBBsf	BBsf	Bsf	CCCsf	CCsf	Csf
Initial Ratings	AAAsf	23%	39%	10%	17%	8%	1%	1%	1%	0%	0%
	Aasf	7%	7%	26%	14%	14%	10%	14%	2%	5%	0%
	Asf	2%	0%	8%	41%	10%	20%	10%	6%	2%	2%
	BBBsf	0%	0%	0%	5%	17%	22%	11%	27%	11%	6%
	BBsf	0%	0%	0%	0%	3%	19%	23%	26%	16%	13%
	Bsf	0%	0%	0%	0%	0%	10%	70%	0%	0%	20%
	CCCsf	0%	0%	0%	0%	0%	0%	0%	0%	33%	67%
	CCsf	0%	0%	0%	0%	0%	0%	0%	0%	33%	67%
	Csf	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%

Source: Fitch (2011b).

5.3 Outlook

The SMESec market currently remains difficult despite some promising first attempts to revive the asset class. Only few deals, like for example the Sandown Gold series originated by Lloyds TSB Bank plc have been placed in 2011 with institutional investors (partially with EIF support) rather than central banks (Fitch, 2011b).

The instrument itself will remain an important tool for the refinancing and risk/portfolio management of banks, and in general a continuation of the gradual recovery of the European Structured Finance market is expected. However this will not only depend on the development of market fundamentals and the enhancement of investors' confidence but also strongly on the direct and indirect impact from regulatory preferences. We cannot go into the details here, but there are/will be key initiatives with significant impact on all elements of this market, e.g.:

- Originators are i.e. impacted by Basel III/CRD
- Products/structuring is i.e. impacted by Basel III/CRD, future EU regulation for rating agencies, EMIR (derivatives)
- Investors are i.e. impacted by Basel III/CRD, Solvency II, AIFMD

Currently, the SME securitisation (excluding pure ECB-related transactions) slowly restarts from the more sophisticated markets, i.e. in the "traditional" countries (UK, Germany, Benelux, Italy etc.). Poland and Turkey have significant potential as they both exhibit strong fundamentals (i.e. critical mass, important domestic/SME market, potential economic growth due to catching-up effect with the neighbouring countries, securitisation laws in place), which would make securitisation an efficient tool for banks to meet the growing domestic credit demand. In Turkey, also innovative structures are being tested (see box 3).

[27] The addition sf indicates a rating for structured finance transactions.

Box 3: Innovative structure

In the present chapter we focus on SMESec. However, as an excursus we mention here the approach to support SME financing via Covered Bonds, as this instrument provides originators with another funding option (but only in jurisdictions where an appropriate legal framework exists).

The first Covered Bond transaction, backed exclusively by loans to SMEs, was launched on 26.07.2011. Sekerbank T.A.S. Turkish Asset Covered Bonds is also the first Covered Bond deal to strip out refinancing risk thanks to a) the very short life of the collateral assets, b) an amortisation vector test designed to ensure that the time horizon during which the bonds amortise is always ten months or less, and c) the incorporation of non-performance event triggers (Moody's, 2011a).

The underlying, granular portfolio consists of loans (to Turkish SMEs) with a maturity of no more than 36 months - hence the amortisation of the assets is shorter than the legal maturity of the bonds. Given that the weighted average life of the assets is short and the repayment profile of the assets has to ensure the legal maturity of the notes in all circumstances, the cash flow profile and mechanics are essentially the same as in a securitisation.

The transaction benefits from the recently amended Turkish legal framework that increases credit enhancement in the transaction (Moody's, 2011b).

We stick to our statement in the previous report that investors will only return in volume if they regain trust in the quality of the transactions and if there is satisfactory secondary market liquidity. Originators will return if transactions are economically feasible. For both, a stable and reliable regulatory framework is a key precondition as well. Moreover, improved transparency is going to be important.

In this context, the ECB intends to progressively introduce requirements in its collateral framwork for ABS originators to provide loan-level data on the assets underlying these instruments and to establish a data warehouse to process, verify and distribute standardised securitisation information to market participants. This attempt will make more information available to market participants and may contribute to the re-start of the markets (ECB, 2011).

6 Microfinance

Microfinance in Europe consists mainly of micro-loans (less than EUR 25,000) tailored to micro-enterprises (91% of all European businesses) and people who would like to become self-employed but are facing difficulties in accessing the traditional banking services. Throughout the EU, 99% of all start-ups are micro or small enterprises and one third of those were launched by unemployed people.

Box 4: What is "micro"?

Microfinance is the provision of basic financial services to poor (low-income) people (who traditionally lack access to banking and related services) (CGAP Definition, Consultative Group to Assist the Poor).

Microcredit is defined by the European Commission as a loan or lease under EUR 25,000 to support the development of self-employment and micro-enterprises. It has a double impact: an economic impact as it allows the creation of income generating activities and a social impact as it contributes to the social inclusion and therefore to the financial inclusion of individuals.

A **microenterprise** is any enterprise with less than 10 employees and a turnover below EUR 2 million (as defined in the Commission Recommendation 2003/361/EC of 6 May 2003, as amended).

The European microfinance market is still a young and quite heterogeneous sector, due to the diversity of legal frameworks, institutional environments and microfinance providers in European countries. Only recently, the European Commission published a European code of good conduct which contains recommendations and standards for the provision of microcredit in order to foster best practice in the microfinance sector (European Commission, 2011a).

Standardised, regularly available indicators to explain market developments for microfinance in Europe do not yet exist, or focus on Eastern Europe. Thus, we will focus in this section on the framework conditions for microfinance which are covered by the regularly updated Eurostat indicators for poverty and social inclusion, and by data on micro-enterprises.[28]

One part of the Europe 2020 strategy[29] is the initiative "European platform against poverty and social exclusion" which sets out actions to reach the EU target of reducing poverty and social exclusion by at least 20 million people by 2020. Although combating poverty and social exclusion is mainly the responsibility of national governments, the EU can play a coordinating role for example by making funding available. One key action is the "better use of EU funds to support

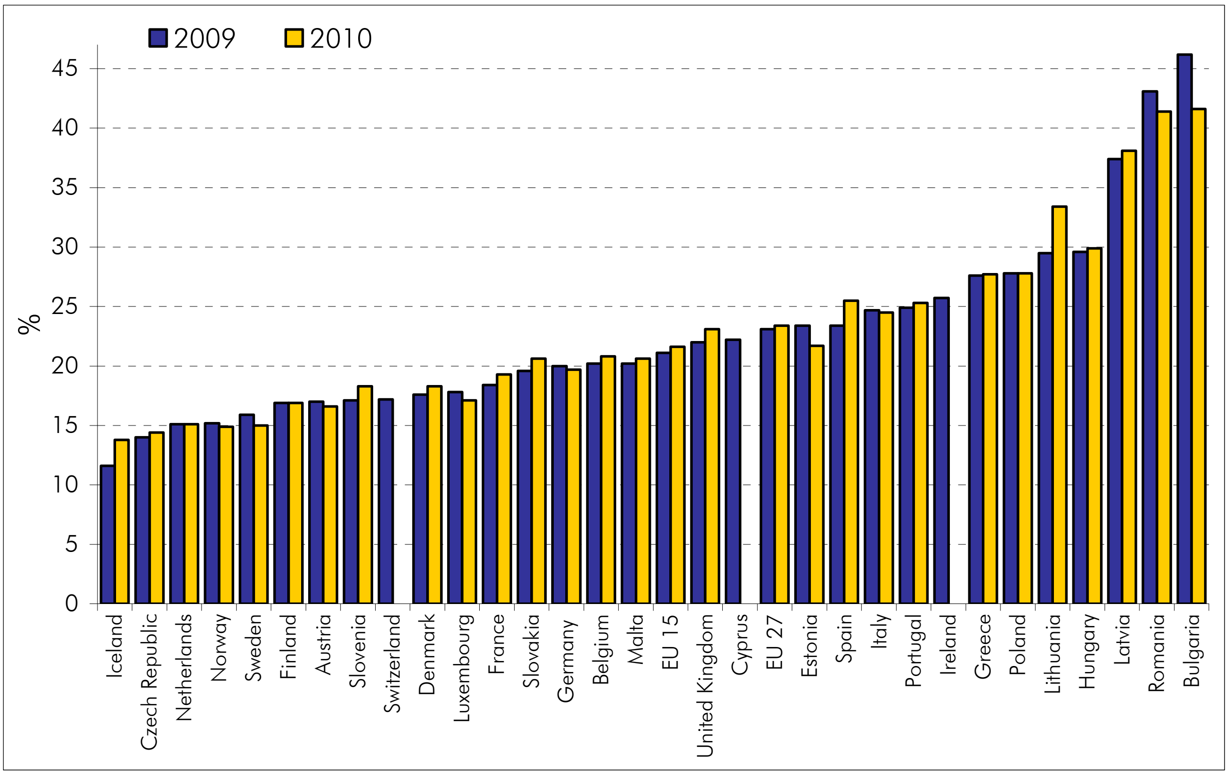
[28] For a general overview of the European microfinance market we refer to our working paper 2009/001: http://www.eif.org/news_centre/research/EIF_WP_2009_001_Microfinance.pdf. A second working paper about this topic is currently in preparation. Another insight into the microfinance market structure in Europe and in particular into its situation in the current difficult financial and economic environment is given in the first issue of this ESBO (Kelly and Kraemer-Eis, 2011).

[29] The Europe 2020 strategy is the growth strategy of the European Union for the current decade. For details please see the Europe 2020 website http://ec.europa.eu/europe2020/index_en.htm.

social inclusion and combat discrimination" including improvements in the use of microcredits (e.g. via the JASMINE initiative and PROGRESS financial instruments).[30]

In order to assess the achievement of the Europe 2020 poverty/social inclusion target, Eurostat measures the indicator "people at risk of poverty or social exclusion" as a union of the three sub-indicators "People living in households with very low work intensity", "People at-risk-of-poverty after social transfers", "Severely materially deprived people".[31] Figure 25 depicts the headline indicator, corresponding to the sum of persons who are at risk of poverty or severely materially deprived or living in households with very low work intensity (i.e. a combination of the three sub-indicators).[32]

Figure 25: People at risk of poverty or social exclusion



Source: Based on data from Eurostat

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[30] For more information on Europe 2020's social inclusion/poverty initiatives and actions please see http://ec.europa.eu/social/main.jsp?catId=961&langId=en and http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2010:1564:FIN:EN:PDF, page 8. For information on JASMINE, the European PROGRESS Microfinance Facility, and EIF microfinance activities please see http://www.eif.org/what_we_do/ microfinance/index.htm.

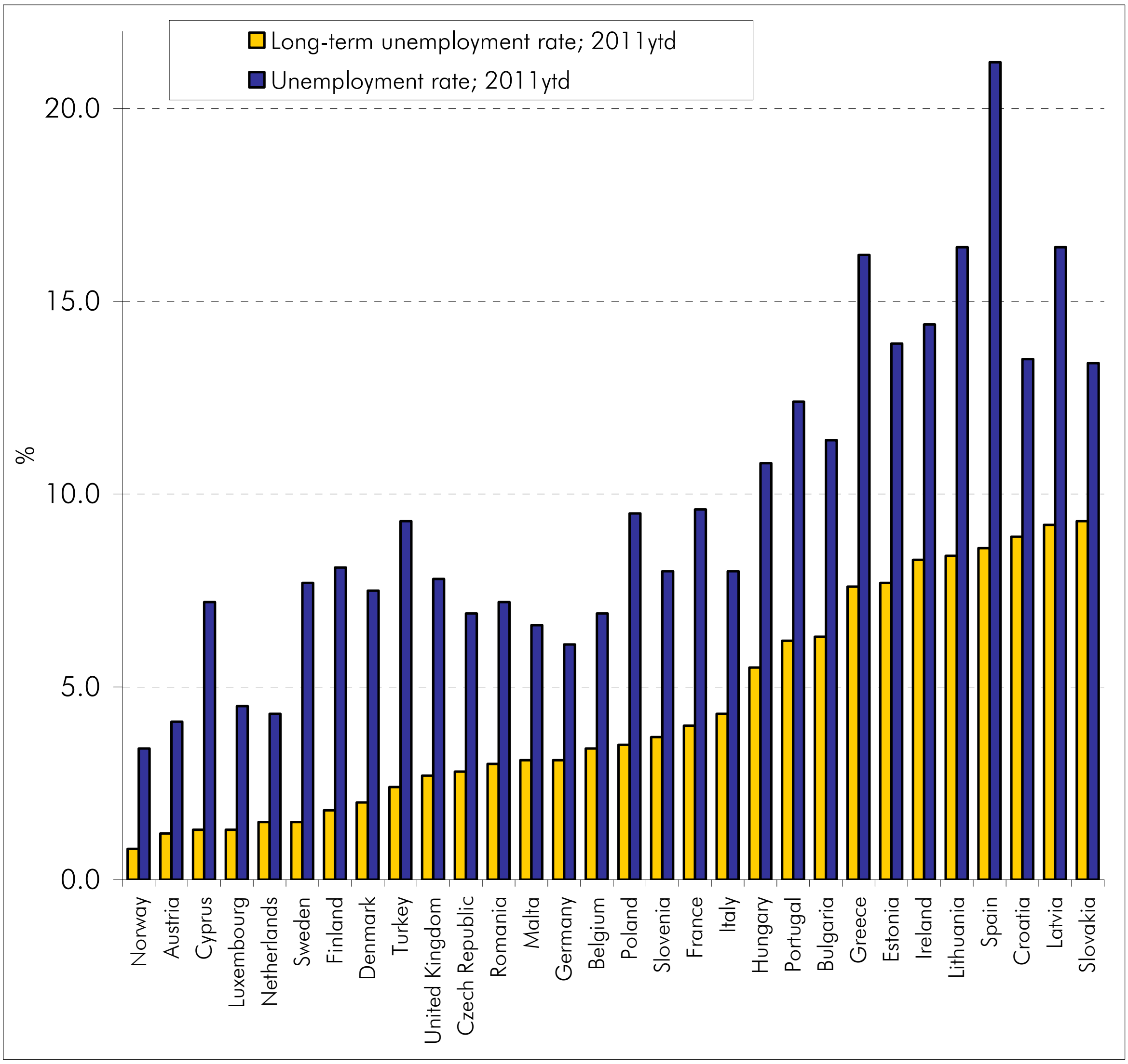
[31] See the Eurostat internet site on the Europe 2020 indicators at: http://epp.eurostat.ec.europa.eu/portal/page/portal/europe_2020_indicators/headline_indicators

[32] Persons are only counted once even if they are present in several sub-indicators. At risk-of-poverty are persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income (after social transfers). Material deprivation covers indicators relating to economic strain and durables. Severely materially deprived persons have living conditions severely constrained by a lack of resources. People living in households with very low work intensity are those aged 0-59 living in households where the adults (aged 18-59) work less than 20% of their total work potential during the past year. For more information please see: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=t2020_50

In Eastern Europe, the incidence of poverty or social exclusion is greatest, although the difference between the EU15 and EU27 figure is relatively small. When comparing 2009 to 2010, the situation became worse in most of the countries for which 2010 figures are available. Within the EU, the largest aggravation was observed in Lithuania, Slovenia and Spain. Remarkable improvements were recorded for Bulgaria, Romania and Estonia, however, they can still be found on the right-hand side of the diagram which is the case for most parts of Eastern Europe as well as for those West and South European countries which are suffering most from the impacts of the current sovereign debt crises (Greece, Ireland, Portugal, Spain, and Italy).

Figure 26 shows another indicator of social welfare, the unemployment rate and the long term unemployment rate. With only some exceptions (in particular Turkey and Germany), most countries recorded increases in both figures since 2010. Again, most Eastern European countries are placed at the right hand side of the chart (meaning higher long term unemployment).

Figure 26: Unemployment rate (long term and annual average)

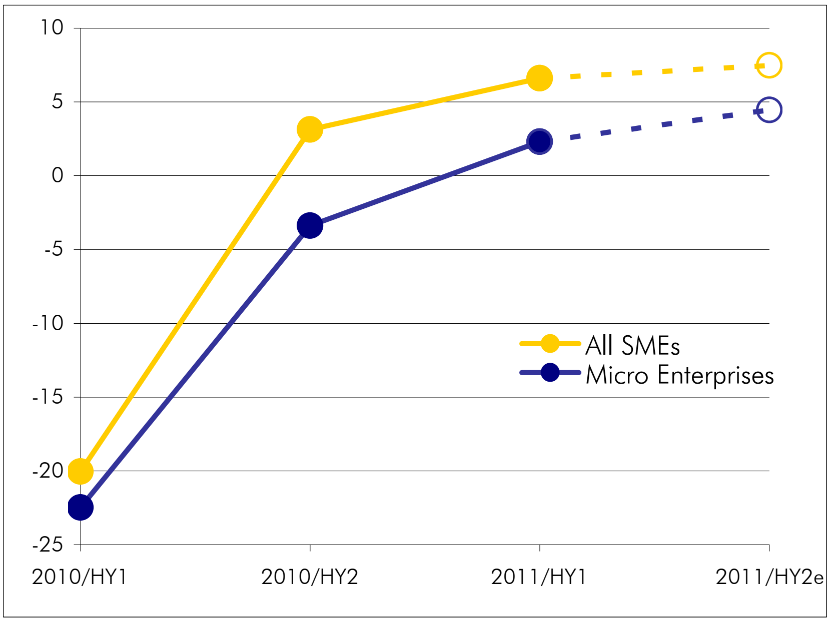


Source: Based on data from Eurostat

The relatively poor performance of East European EU member states in social welfare indicators is in part why there is a tendency for microfinance to be for social purposes in this region. Some surprising exceptions are likely to be due to the generally larger size of the informal economy in this part of Europe, and the less widespread incidence of benefits, making people less likely to register as unemployed.

When looking at the business climate of micro-enterprises, the EU Craft and SME barometer shows that micro-enterprises on balance estimated their overall situation somewhat less favourable than all SMEs in the first half of this year (see figure 27).[33] Nevertheless, the weighted difference between positive and negative answers increased, and the outlook for the second half of the year was even a bit better. Similar results were reported for the survey questions on turnover, prices, and orders. However, expectations for investments were on balance lower than their actual situation, and employment expectations resulted more or less in the same balance like the answers for the current situation. All in all, the figures reveal stronger difficulties for micro-enterprises to recover than for other SMEs.

Figure 27: Overall situation of European micro-enterprises



Source: UEAPME Study Unit (2011)

[33] The EU Craft and SME barometer builds on surveys that are conducted by UEAPME member organisations. The 2011HY1 results are based on about 30,000 answers collected between May and July 2011. The balanced figures mentioned in the text show the difference between positive and negative answers, with national results weighted by employment figures. The surveyed categories include overall situation, turnover, employment, prices, investment, and orders. For details see http://www.ueapme.com/IMG/pdf/111011_Barometer_2011H2_final.pdf

7 Concluding remarks

Europe shows a sluggish and uneven economic performance and there are a number of downside risks. Top issues are the concerns surrounding the large funding requirements of sovereigns and banks. Macroeconomic policy tightening with strong adjustments for fiscal consolidation in many advanced economies is important to ensure future growth.

We showed above that there are significant challenges for the financing of small businesses. Overall, and in addition to traditional structural issues, small business finance is suffering from the repercussions of the ongoing crisis.

The economic recovery of the past year has been reflected in insolvency figures, which have been falling. However, the decline in insolvencies will be tempered by the slowing in the rate of economic growth. That said, the number of SME insolvencies remains high and the overall picture hides some significant regional disparities.

In this context, public support is very important but it is also important to realise that public support cannot be the only solution – it needs to play a catalytic role to enhance access to finance for SMEs.

It is a key priority for the EIF to help establish a well functioning, liquid *equity market* that attracts a wide range of private sector investors, and develop new and pioneering financing instruments in order to reach to parts of the market currently not accessible through existing public support instruments. The objective is to leverage EIF's activity and seize market opportunities in all areas of the equity eco-system which are relevant for the sustainable development of the industry.

With regard to the *securitisation market*, the revitalization and further development of SMESec is pivotal for the future growth of SME financing. Properly applied SMESec can enhance access to finance for SMEs and it is a replicable tool for SME support that provides a multiplier effect; i.e. the investing in/guaranteeing of relatively small (mezzanine) tranches facilitates the securitisation of much higher volumes and is as such an efficient way of deploying public sector support.

Microfinance is a crucial tool to overcome the effects of the financial crisis and to support inclusive growth and EIF provides funding, guarantees and technical assistance to a broad range of financial intermediaries, from small non-bank financial institutions to well-established microfinance banks to make microfinance a fully-fledged segment of the European financial sector.

ANNEX

Annex 1: Private Equity Glossary

(selection, from EVCA)

- **Buyout:** A buyout is a transaction financed by a mix of debt and equity, in which a business, a business unit or a company is acquired with the help of a financial investor from the current shareholders (the vendor). See management buyout (MBO), management buyin (MBI), institutional buyout (IBO), leveraged buyout (LBO).
- **Buyout fund:** Funds whose strategy is to acquire other businesses; this may also include mezzanine debt funds which provide (generally subordinated) debt to facilitate financing buyouts, frequently alongside a right to some of the equity upside.
- **Capital weighted average IRR:** The average IRR weighted by fund size.
- **Captive Fund :** A fund in which the main shareholder of the management company contributes most of the capital, i.e. where parent organisation allocates money to a captive fund from its own internal sources and reinvests realised capital gains into the fund.
- **Carried interest:** A share of the profit accruing to an investment fund management company or individual members of the fund management team, as a compensation for the own capital invested and their risk taken. Carried interest (typically up to 20% of the profits of the fund) becomes payable once the limited partners have achieved repayment of their original investment in the fund plus a defined hurdle rate.
- **Closing:** A closing is reached when a certain amount of money has been committed to a private equity fund. Several intermediary closings can occur before the final closing of a fund is reached.
- **Commitment:** A limited partner's obligation to provide a certain amount of capital to a private equity fund when the general partner asks for capital.
- **Deal flow:** The number of investment opportunities available to a private equity house.
- **Disbursement:** The flow of investment funds from private equity funds into portfolio companies.
- **Distribution:** The amount disbursed to the limited partners in a private equity fund.
- **Divestment:** See exit.
- **Drawdown:** When investors commit themselves to back a private equity fund, all the funding may not be needed at once. Some is used as drawn down later. The amount that is drawn down is defined as contributed capital.
- **Early stage:** Seed and start-up stages of a business.
- **Early stage fund:** Venture capital funds focused on investing in companies in the early part of their lives.
- **Exit:** Liquidation of holdings by a private equity fund. Among the various methods of exiting an investment are: trade sale; sale by public offering (including IPO); write-offs; repayment of preference shares/loans; sale to another venture capitalist; sale to a financial institution.
- **Expansion capital:** Also called development capital. Financing provided for the growth and expansion of a company, which may or may not break even or trade profitably. Capital may be used to: finance increased production capacity; market or product development; provide additional working capital.
- **Follow-on investment:** An additional investment in a portfolio company which has already received funding from a private equity firm.
- **Fund:** A private equity investment fund is a vehicle for enabling pooled investment by a number of investors in equity and equity-related securities of companies (investee companies). These are generally private companies whose shares are not quoted on any stock exchange. The fund can take the form either of a company or of an unincorporated arrangement such as a limited partnership. See limited partnership.
- **Fund of Funds:** A fund that takes equity positions in other funds. A fund of fund that primarily invests in new funds is a Primary or Primaries fund of funds. One that focuses on investing in existing funds is referred to as a Secondary fund of funds.
- **Fund size:** the total amount of capital committed by the limited and general partners of a fund.

- **Fundraising:** The process in which venture capitalists themselves raise money to create an investment fund. These funds are raised from private, corporate or institutional investors, who make commitments to the fund which will be invested by the general partner.
- **General Partner:** A partner in a private equity management company who has unlimited personal liability for the debts and obligations of the limited partnership and the right to participate in its management.
- **General Partner's commitment:** Fund managers typically invest their personal capital right alongside their investors capital, which often works to instil a higher level of confidence in the fund. The limited partners look for a meaningful general partner investment of 1% to 3% of the fund.
- **Generalist fund:** Funds with either a stated focus of investing in all stages of private equity investment, or funds with a broad area of investment activity.
- **Holding period:** The length of time an investment remains in a portfolio. Can also mean the length of time an investment must be held in order to qualify for Capital Gains Tax benefits.
- **Horizon IRR:** The Horizon IRR allows for an indication of performance trends in the industry. It uses the fund's net asset value at the beginning of the period as an initial cash outflow and the Residual Value at the end of the period as the terminal cash flow. The IRR is calculated using those values plus any cash actually received into or paid by the fund from or to investors in the defined time period (i.e. horizon).
- **Hurdle rate:** A return ceiling that a private equity fund management company needs to return to the fund's investors in addition to the repayment of their initial commitment, before fund managers become entitled to carried interest payments from the fund.
- **Inception:** The starting point at which IRR calculations for a fund are calculated; the vintage year or date of first capital drawdown.
- **Institutional investor:** An organization such as a bank, investment company, mutual fund, insurance company, pension fund or endowment fund, which professionally invest, substantial assets in international capital markets.
- **Internal rate of return (IRR):** The IRR is the interim net return earned by investors (Limited Partners), from the fund from inception to a stated date. The IRR is calculated as an annualised effective compounded rate of return using monthly cash flows to and from investors, together with the Residual Value as a terminal cash flow to investors. The IRR is therefore net, i.e. after deduction of all fees and carried interest. In cases of captive or semi-captive investment vehicles without fees or carried interest, the IRR is adjusted to create a synthetic net return using assumed fees and carried interest.
- **IPO (Initial public offering):** The sale or distribution of a company's shares to the public for the first time. An IPO of the investee company's shares is one the ways in which a private equity fund can exit from an investment.
- **Later stage:** Expansion, replacement capital and buyout stages of investment.
- **Leverage buyout (LBO):** A buyout in which the NewCo's capital structure incorporates a particularly high level of debt, much of which is normally secured against the company's assets.
- **Limited Partnership:** The legal structure used by most venture and private equity funds. The partnership is usually a fixed-life investment vehicle, and consists of a general partner (the management firm, which has unlimited liability) and limited partners (the investors, who have limited liability and are not involved with the day-to-day operations). The general partner receives a management fee and a percentage of the profits. The limited partners receive income, capital gains, and tax benefits. The general partner (management firm) manages the partnership using policy laid down in a Partnership Agreement. The agreement also covers, terms, fees, structures and other items agreed between the limited partners and the general partner.
- **Management fees:** Fee received by a private equity fund management company from its limited partners, to cover the fund's overhead costs, allowing for the proper management of the company. This annual management charge is equal to a certain percentage of the investors' commitments to the fund.
- **Mezzanine finance:** Loan finance that is halfway between equity and secured debt, either unsecured or with junior access to security. Typically, some of the return on the instrument is deferred in the form of rolled-up payment-in-kind (PIK) interest and/or an equity kicker. A mezzanine fund is a fund focusing on mezzanine financing.

- **Multiples or relative valuation:** This estimates the value of an asset by looking at the pricing of "comparable" assets relative to a variable such as earnings, cash flows, book value or sales.
- **Pooled IRR:** The IRR obtained by taking cash flows from inception together with the Residual Value for each fund and aggregating them into a pool as if they were a single fund. This is superior to either the average, which can be skewed by large returns on relatively small investments, or the capital weighted IRR which weights each IRR by capital committed. This latter measure would be accurate only if all investments were made at once at the beginning of the funds life.
- **Portfolio company:** The company or entity into which a private equity fund invests directly.
- **Pre seed stage:** The investment stage before a company is at the seed level. Pre-seed investments are mainly linked to universities and to the financing of research projects, with the aim of building a commercial company around it later on.
- **Private Equity:** Private equity provides equity capital to enterprises not quoted on a stock market. Private equity can be used to develop new products and technologies (also called venture capital), to expand working capital, to make acquisitions, or to strengthen a company's balance sheet. It can also resolve ownership and management issues. A succession in family-owned companies, or the buyout and buyin of a business by experienced managers may be achieved by using private equity funding.
- **Private Equity Fund:** A private equity investment fund is a vehicle for enabling pooled investment by a number of investors in equity and equity-related securities of companies. These are generally private companies whose shares are not quoted on a stock exchange. The fund can take the form of either a company or an unincorporated arrangement such as a Limited Partnership.
- **Quartile:** The IRR which lies a quarter from the bottom (lower quartile point) or top (upper quartile point) of the table ranking the individual fund IRRs.
- **Rounds:** Stages of financing of a company. A first round of financing is the initial raising of outside capital. Successive rounds may attract different types of investors as companies mature.
- **Secondary investment:** An investment where a fund buys either, a portfolio of direct investments of an existing private equity fund or limited partner's positions in these funds.
- **Seed stage:** Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.
- **Start-up:** Companies that are in the process of being set up or may have been in business for a short time, but have not sold their product commercially.
- **Target company:** The company that the offeror is considering investing in. In the context of a public-to-private deal this company will be the listed company that an offeror is considering investing in with the objective of bringing the company back into private ownership.
- **Top Quarter:** Comprises funds with an IRR equal to or above the upper quartile point.
- **Track record:** A private equity management house's experience, history and past performance.
- **Venture Capital:** Professional equity co-invested with the entrepreneur to fund an early-stage (seed and start-up) or expansion venture. Offsetting the high risk the investor takes is the expectation of higher than average return on the investment. Venture capital is a subset of private equity.
- **Venture Capitalist:** The manager of private equity fund who has responsibility for the management of the fund's investment in a particular portfolio company. In the hands-on approach (the general model for private equity investment), the venture capitalist brings in not only moneys as equity capital (i.e. without security/charge on assets), but also extremely valuable domain knowledge, business contacts, brand-equity, strategic advice, etc.
- **Vintage year:** The year of fund formation and first drawdown of capital.
- **Volatility:** The volatility of a stock describes the extent of its variance over time.
- **Write-off:** The write-down of a portfolio company's value to zero. The value of the investment is eliminated and the return to investors is zero or negative.

Annex 2: Securitisation Glossary

- **Basket Trade:** A single order or trade in 15 or more securities, especially in large amounts.
- **Credit Default Swap:** An agreement used in synthetic securitisations where the originator (protection buyer) sells the credit risk of an underlying portfolio to a counterparty (protection seller) without transferring the ownership of the assets.
- **Credit Enhancement:** Refers to one or more measures taken in a securitisation structure to enhance the security, the credit quality or the rating of the securitised instrument, e.g. by providing a third party guarantee (such as the EIF guarantee). The credit enhancement could be provided in the form of:

  (i) Structural credit enhancement (tranching of the transaction in senior, mezzanine and junior tranches);

  (ii) Originator credit enhancement (cash collateral, profit retention mechanism, interest sub-participation mechanism);

  (iii) Third party credit enhancement (EIF or monoline insurers).
- **Credit Linked Notes (CLN):** A security issued by an SPV (or directly from the balance-sheet of the originator) credit-linked to the default risk of an underlying portfolio of assets. Usually used in synthetic securitisations for the mezzanine tranches of a transaction.
- **First Loss Piece:** Part of a securitisation transaction which is usually kept by the originator (as an "equity piece") and which covers the risk of first loss in the portfolio. Its size is a function of the historical losses, so as to protect the investors against the economic risk (estimated loss) of the transaction.
- **Issuer:** Refers to the SPV which issues the securities to the investors.
- **Mezzanine Risk:** Risk or tranche which is subordinated to senior risk, but ranks senior to the First Loss Piece.
- **Originator:** The entity assigning receivables in a securitisation transaction (funded transaction) or seeking credit risk protection on the assets (unfunded transaction).
- **Primary market:** The market in which securities are issued.
- **Secondary market:** The market where issued securities are traded.
- **Senior:** The class of securities with the highest claim against the underlying assets in a securitisation transaction. Often they are secured or collateralised, or have a prior claim against the assets. In true sale structures they rank senior in the cash flow allocation of the issuer's available funds.
- **Servicer:** Refers to the entity that continues to collect the receivables, enforcement of receivables, etc. Generally, the originator is also the servicer.
- **Special Purpose Vehicle (SPV):** Issuing entity holding the legal rights over the assets transferred by the originator. An SPV has generally a limited purpose and/or life.
- **Subordinated:** The classes of securities with lower priority or claim against the underlying assets in a securitisation transaction. Typically, these are unsecured obligations. They are also called Junior (or Mezzanine) notes and bonds.
- **Synthetic securitisation:** A transaction where the assets are not sold to an SPV but remain on balance sheet; and where only the credit risk of the assets is transferred to the market through credit default swaps or credit linked notes.
- **Tranche:** A piece, a portion or slice within a structured transaction.
- **True sale:** It refers to the separation of the portfolio risk from the risk of the originator, i.e. there is a non-recourse assignment of assets from the originator to the issuer (special purpose vehicle). To be contrasted with synthetic securitisations where only the underlying credit risk is transferred.
- **Whole Business Securitisation (WBS):** Securitisation of the general operating cash flow arising from a certain line or area of the business of the originator over the long term.

Annex 3: List of acronyms

- ABS: Asset Backed Securities
- AFME/ESF: Association for financial markets in Europe/European Securitisation Forum
- AIFMD: Alternative Investment Fund Managers Directive
- BLS: Bank Lending Survey
- CDO: Collateralized Debt Obligation
- CLN: Credit Linked Note
- CMBS: Commercial Mortgage Backed Securities
- CRD: Capital Requirements Directive
- EC: European Commission
- ECB: European Central Bank
- EIB: European Investment Bank
- EIF: European Investment Fund
- EMEA: Europe, Middle East, and Africa
- EMIR: European Markets Infrastructure Regulation
- ESBFO: European Small Business Finance Outlook
- EU: European Union
- EVCA: European Private Equity & Venture Capital Association
- GDP: Gross Domestic Product
- GP: General Partner
- IFC: International Finance Corporation
- IMF: International Monetary Fund
- IRR: Internal Rate of Return
- JASMINE: Joint Action to Support Microfinance Institutions in Europe
- LBO: Leveraged buy out
- LP: Limited Partner
- M&As: Mergers and acquisitions
- MENA: Middle East and North Africa
- NFC: Non-financial corporation
- NGO: Non Governmental Organisation
- OECD: Organisation for Economic Co-Operation and Development
- PE: Private Equity
- RMBS: Residential Mortgage Backed Securities
- SIFMA: The Securities Industry and Financial Markets Association
- SIV: Structured Investment Vehicle
- SME: Small and medium sized enterprise
- SMESec: SME Loan Securitisation
- SPV: Special Purpose Vehicle
- UEAPME: European Association of Craft, Small and Medium-sized Enterprises
- VC: Venture Capital
- WBS: Whole Business Securitisation

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The European Investment Fund (EIF) is the European body specialised in small and medium sized enterprise (SME) risk financing. The EIF is part of the European Investment Bank group and has a unique combination of public and private shareholders. It is owned by the EIB (61.9%), the European Union - through the European Commission (30%) and a number (25 from 16 countries) of public and private financial institutions (8.1%).

The EIF supports high growth innovative SMEs by means of equity (venture capital and private equity) and guarantees instruments through a diverse array of financial institutions using either its own funds, or those available through mandates given by EIB (the Risk Capital Mandate or RCM), the EU (the Competitiveness and Innovation Framework Programme or CIP), Member States or other third parties.

Complementing the EIB product offering, the EIF has a crucial role to play throughout the value chain of enterprise creation, from the early stages of intellectual property development and licensing to mid and later stage SMEs.

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