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European Small Business Finance Outlook

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Executive summary[1]

This European Small Business Finance Outlook (ESBFO) provides an overview of the main markets relevant to EIF (equity[2], guarantees/securitisation, microfinance). It is an update of the ESBFO June 2014.

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

Market Environment:

- Europe continues with an uneven and gradual recovery. The labour market is still expected to register a double-digit unemployment rate.
- Most of the business indicators have started improving in 2014 and confidence has increased. Bankruptcies are expected to decrease in Europe.
- The ECB Bank Lending Survey shows that, on balance, the overall net tightening of credit standards remained unchanged for SMEs.
- According to the European Commission's and the ECB's latest ''Survey on the Access to Finance'' of SMEs (SAFE), access to finance moved down from being the third to being the fifth most pressing problem for euro area SMEs compared to the previous survey round.
- Great disparities in access to finance by country persist. In distressed countries, such as Greece, Ireland, Spain and Portugal, access to finance is a very pressing problem for SMEs, while in Germany or Austria less than 10% of SMEs reported access to finance as the most pressing problem.
- It is not exactly measurable to what extent current weaknesses in bank lending to SMEs are driven by demand- or by supply-side factors. However, even in countries where weak bank lending is driven by the demand side, it is uncertain whether banks are able and/or willing to provide the necessary lending once the demand picks up. In an increasingly risk-averse environment, the tendency not to lend to small and young firms is also increasing further, as these are by nature more risky than their larger peers.

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[1] This paper benefited from comments and inputs by many EIF colleagues, for which we are very grateful; we would like to express particular thanks to Rémi Charrier, Jacques Darcy, Per-Erik Eriksson, Cyril Gouiffes, Ulrich Grabenwarter, Carsten Just, Nicolas Koch, Marco Natoli, George Passaris, Simone Signore, Aglaé Touchard-Le Drian, Arnaud Vanbellingen, Thierry Wolff, and Dariusz Zwierzynski. We would also like to thank colleagues from AECM, AFME, EBAN, the ECB, the EIB, EMN, Euler Hermes, Eurochambres, the European Commission, the EVCA research team, Go4Venture Advisers, the OECD, and the UEAPME study unit for their support. All errors are of the authors.

[2] We are using the term "equity finance" to combine semantically the areas of Venture Capital and Private Equity. However, if we refer here to equity activities, we only consider those of EIF's investment focus, which includes neither Leveraged Buyouts (LBOs) nor Public Equity. The reader is also referred to the Private Equity glossary in Annex 1.

Private equity:

- Following the big crash of European private equity (PE) investment in 2008/2009, PE had partially rebounded over 2010-2011. However, the recovery suffered a further setback in 2012, but stayed well above the 2009 crisis trough. In 2013, PE investment stabilised at EUR 37.7bn, according to EVCA figures. In the first three quarters of 2014, PE investment increased by 19%, according to *preliminary* EVCA data. In terms of amounts invested, the growth capital market segment performed remarkably well. VC investments have remained rather stable, although with a persistent declining trend at the seed stage.
- Some of the gap left by the fall in venture capital (VC) investment since 2008 has been filled in by business angel activity in recent years; their proximity to the market has been beneficial during this difficult period.
- The considerable recovery of total PE *fundraising* in 2013 seems to have suffered a setback in 2014 so far, while VC fundraising seems to have remained rather stable, according to EVCA preliminary figures. The *exit markets* have remained remarkably strong in 2014.
- Despite the recent positive developments, as mentioned above, PE and VC investments as well as VC fundraising and the number of VC funds are at approximately half the levels compared to the pre-crisis years. According to the EVCA figures, government agencies had accounted for 38% of total VC fundraising in 2013, thereby continuing to support the market counter-cyclically in the current crisis (the 2014 data is not available yet).
- European VC performance has stabilised, albeit at a low level, according to the most recent (i.e. 2013) Thomson Reuters data. Moreover, EIF is observing a number of auspicious early-stage companies, which show a promising pattern of growth and good potential to produce a positive impact on the funds future performance.

SME Guarantees / Securitisation:

- Credit guarantees have continued to be the most widely used policy instrument to alleviate market failures in SME financing and to ease related financial constraints (OECD, 2015).
- According to AECM statistics, Italy and France exhibit the largest volume and number of outstanding SME guarantees. Related to GDP, Italy and Portugal have the largest markets.
- AECM data of outstanding guarantees reports a decrease in volumes and a parallel increase in the number of guarantees for 2012 and 2013. Hence, the guarantee size has on average declined, probably due to an increase of guarantees with smaller amounts, as well as of short-term guarantees (i.e. working capital loan and bridge financing guarantees), suggesting a reversal to the pre-crisis levels. Preliminary data for the first half of 2014 indicate a certain stabilisation of new guarantee business.
- Lower guarantee amounts are, inter alia, caused by weak economic activity and public budget cuts. Support from the European level could help to improve the situation at least on the supply side. In this respect, several new initiatives have been implemented, and others are under preparation.

- In the SME securitisation market, actual activity remains low. Despite the financial and sovereign crisis, the European securitisation market has performed relatively well so far, with the SME segment showing low default rates.
- The reputation of the SME securitisation market segment is continuously improving; a de-stigmatisation is happening, and the general perception is shifting from one of "toxic waste" to a means that could help overcome the negative effects of the crisis.
- With regard to future /potential regulatory treatments of SMESec, a holistic view should be taken and the impact of the "regulatory wave" duly analysed. The regulatory framework should reflect the actual risks of SMESec.
- Transparency is a prerequisite for any structured transaction; the introduction of a properly defined concept of "high quality securitisation" could add substantial information, and such a definition should include SMESec transactions.
- The ECB's Asset Backed Purchase Programme started recently. At this stage, it is not yet possible to judge the overall impact of these measures on the revival of a sustainable SMESec market and in particular the involvement of the EIB Group, i.e. as the eligibility criteria for guaranteed mezzanine tranches have not yet been disclosed. Discussions between the Group and the ECB are underway.

Microfinance:

- Microfinance is generally associated with social and economic objectives, and it is an important financing channel for job creation. However, the European microfinance market is still young and heterogeneous, especially with regard to the diversity of lending approaches. In a still risk-averse environment for credit allocation, lending is expected to be allocated away from small and young firms, as they are more risky than other SMEs.
- According to the data from the latest ECB survey on the access to finance of SMEs in the euro area, the share of enterprises which see access to finance as their most pressing problem is larger among microenterprises than among their larger peers. Moreover, microenterprises, have perceived an increase in the external financing gap.
- The recent EMN survey reports a remarkable growth both in the overall total value and the number of microloans provided by the surveyed MFIs. With regard to future trends, MFIs expect less public support in the coming years, due to public budget restrictions.

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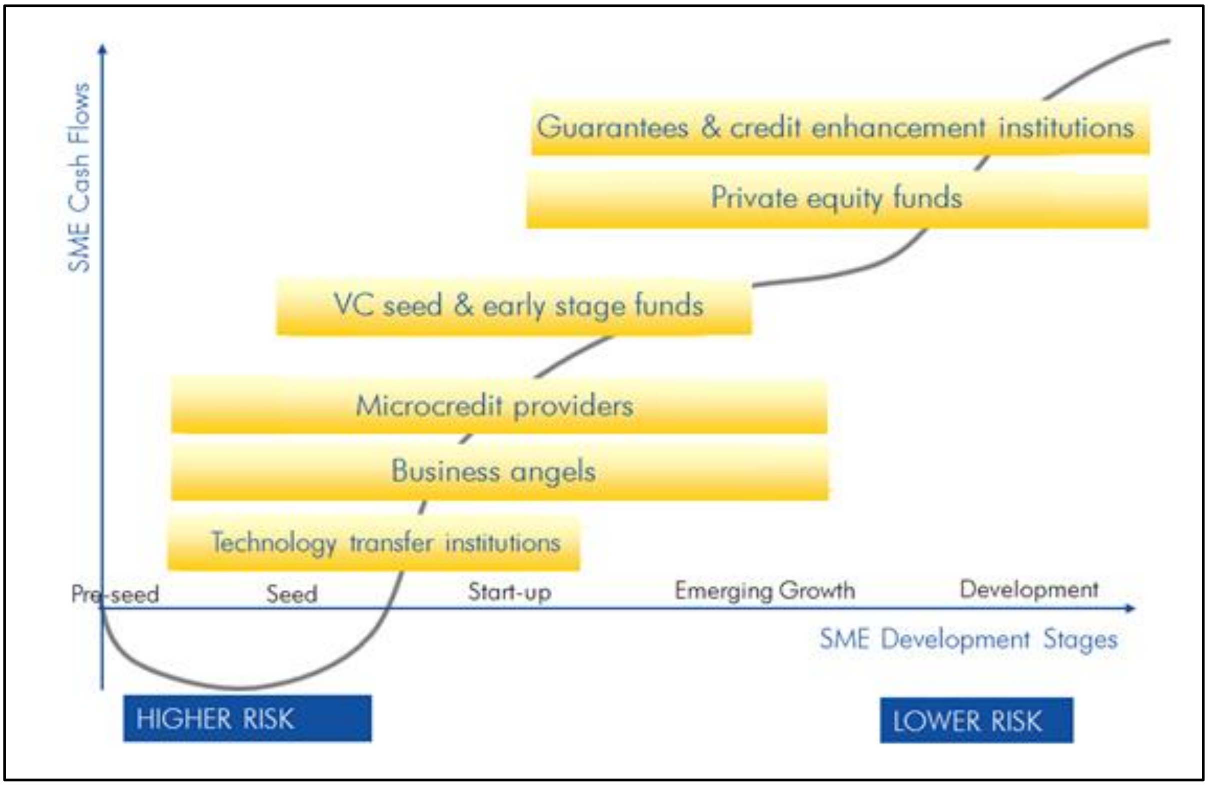
1 Introduction

The European Investment Fund (EIF) is the European Investment Bank (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 1 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 start-up-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[3], guarantees/securitisation, microfinance). The present edition is an update of the ESBFO June 2014.

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

[3] Please see footnote 2 concerning the term "equity finance".

2 Economic environment and insolvencies

Since the publication of the previous ESBFO in June 2014, the global economic outlook has slightly weakened. The International Monetary Fund (IMF) has recently estimated a slowdown of global growth from 3.4% in 2012 to 3.3% in 2013. Global growth is expected to increase again to 3.3% in 2014 and 3.8% in 2015. However, compared to IMF's previous projections (April 2014), the estimated growth for 2013 has been increased by 0.3 percentage point, while the forecast for 2014 has decreased by 0.3 percentage points (IMF, 2014b).

The European Commission has also updated its projections for the European Union (EU), expecting a positive (+1.3%) growth rate for 2014, followed by higher growth in 2015 (+1.5%) and in 2016 (+2.0%), see Table 1. For 2014 and 2015, the labour market is again expected to register a double-digit unemployment rate in the EU. However, private and public consumption are both expected to expand moderately. As over the past three years, net exports have remained the most powerful growth driver in 2013. For the years 2014-2016, domestic demand is expected to take over as the main contributor to growth (European Commission, 2014a).

Table 1: Main features of the European Commission autumn 2014 forecast for the EU

(Real annual percentage change, unless otherwise stated)				Autumn 2014 estimates / forecasts		
	2011	2012	2013	2014	2015	2016
GDP	1.7	-0.4	0.0	1.3	1.5	2.0
Private consumption	0.3	-0.7	-0.1	1.1	1.4	1.6
Public consumption	-0.2	0.2	0.4	0.8	0.4	0.8
Total investment	2.1	-2.5	-1.6	2.0	2.9	4.5
Employment	0.1	-0.2	-0.4	0.7	0.6	0.8
Unemployment rate (a)	9.6	10.4	10.8	10.3	10.0	9.5
Inflation (b)	3.1	2.6	1.5	0.6	1.0	1.6
Government balance (% GDP)	-4.5	-4.2	-3.2	-3.0	-2.7	-2.3
Government debt (% GDP)	81.3	85.0	87.1	88.1	88.3	87.6
Adjusted current-account balance (% GDP)	-0.3	0.5	1.1	1.1	1.1	1.1
Contribution to change in GDP						
Private and Public Consumption	0.2	-0.4	0.0	0.8	0.9	1.1
Investment and Inventories	0.7	-1.1	-0.4	0.5	0.6	0.9
Net exports	0.9	1.1	0.4	0.0	0.1	0.0

(a) Percentage of the labour force.

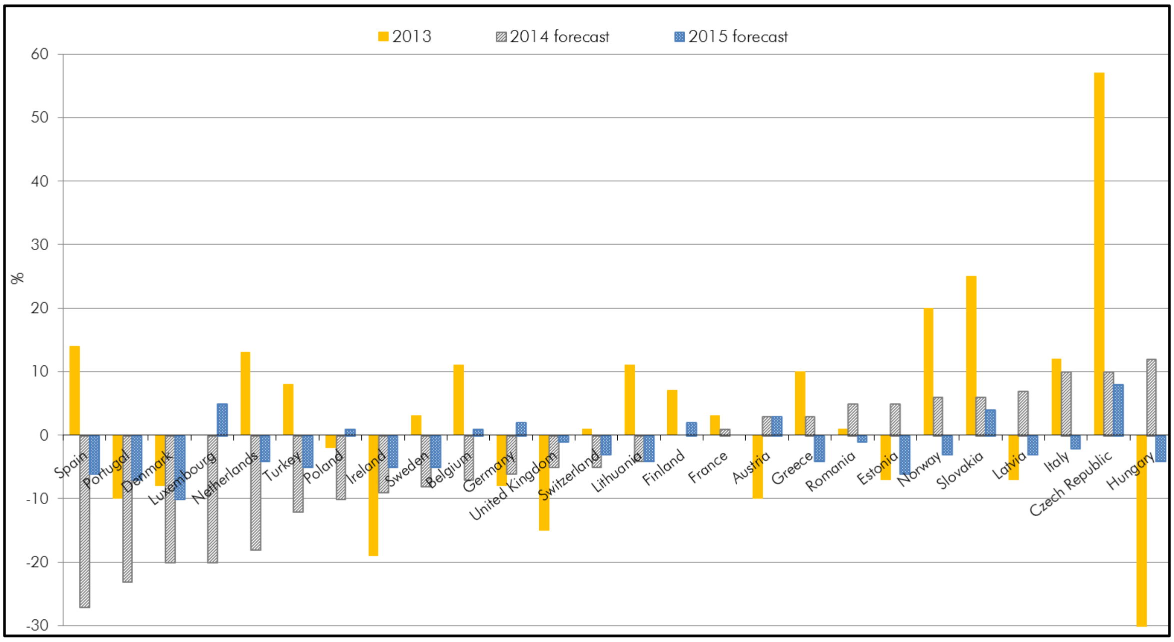
(b) Harmonised index of consumer prices (HICP), annual percentage change.

Source: European Commission (2014a)

The improvement in business conditions also affects the expected development of business insolvencies. The Euler Hermes Insolvency Index for the euro area is expected to decrease in Western Europe (from -14% in 2014 to -3% in 2015) and in Central and Eastern Europe (-2% in 2015, after -7% in 2014).

However, at the same time, the regional disparities have remained prevalent (Figure 2). In 2013, the insolvency indexes increased at a record rate of 57% in the Czech Republic, while double-digit increases were also recorded in Slovakia (+25%), Norway (+20%), the Netherlands (+13), Italy (+12%) and Spain (+12%). On the other hand, the most significant falls in the European insolvency indexes were recorded in Hungary (-40%), Ireland (-19%) and the UK (-15%). In 2014 the indexes are expected to decrease in Spain (-27%), in Denmark and Luxembourg (-20%). Moderate increases are expected in Hungary (+12%) and in the Czech Republic and Italy (+10%).

Figure 2: Rate of change in insolvency, 2013-2015



Source: EIF, based on data from Euler Hermes (2014)

3 Small business environment

3.1 Importance of SMEs

SMEs are defined by the European Commission as having fewer than 250 employees. They should also have an annual turnover of up to EUR 50m, or a balance sheet total of no more than EUR 43m (Commission Recommendation of 6 May 2003), see Table 2.

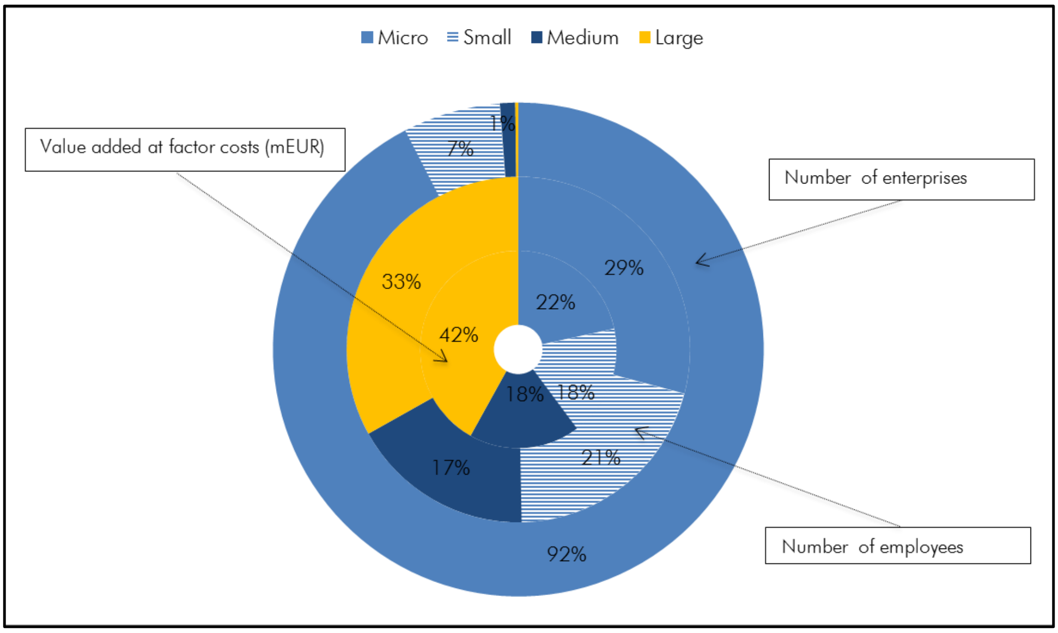
Table 2: EU definition of SMEs

Enterprise category	Employees	Turnover	Balance sheet total
Micro	<10	≤ EUR 2m	≤ EUR 2m
Small	<50	≤ EUR 10m	≤ EUR 10m
Medium-sized	<250	≤ EUR 50m	≤ EUR 43m

Source: European commission (2014d)

Small and medium-sized enterprises are often called the backbone of the European economy, contributing to job creation and economic growth. In 2013, more than 21.5m of SMEs in the European Union made for 99.8% of all non-financial enterprises, employed 88.8m people (66.9% of the total employment), and generated 58.1% of total added value (see Figure 3).[4]

Figure 3: SMEs, Employment and Value added, 2013

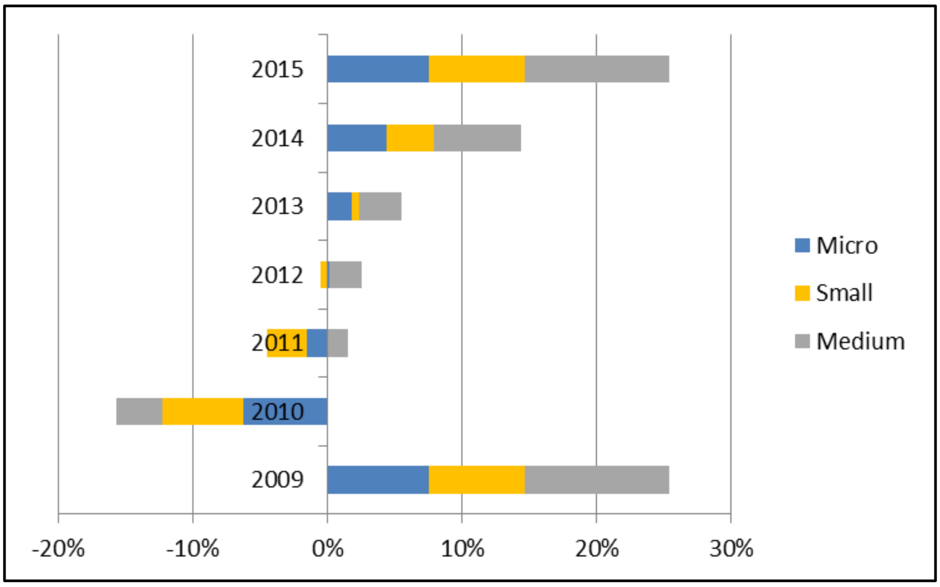


Source: European Commission (2014d)

[4] Gross value added is the difference between output and intermediate consumption. As an aggregate measure of production, GDP is equal to the sum of the gross value added of all resident institutional units (i.e. industries) engaged in production, plus any taxes and minus any subsidies, on products not included in the value of their outputs. http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Category:Glossary

Forecasts concerning the value added of SMEs in the EU are significantly optimistic. The level of value-added produced by SMEs is expected to grow by 14% in 2014 and by 25% in 2015, compared to the 2008 level (see Figure 4).

Figure 4: Value added, 2011-2015, 2008=100

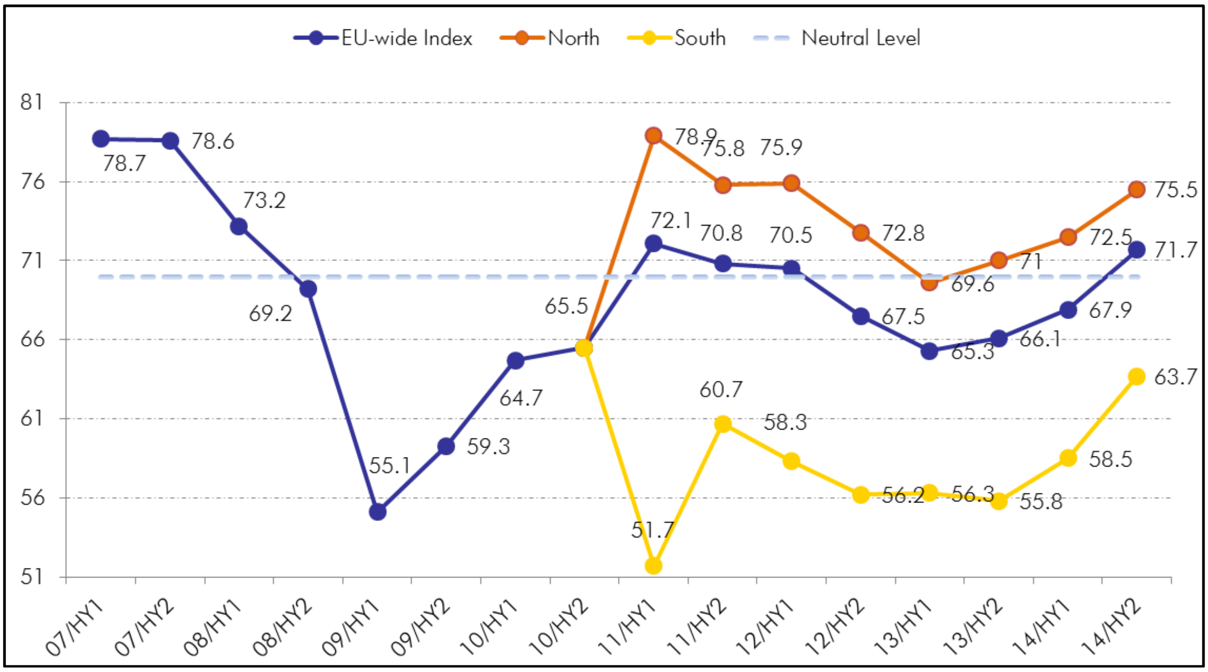


Source: European Commission (2014d)

3.2 SME business climate

The financial, debt and economic crisis had dramatically worsened the business environment of European SMEs since 2008, and in particular in those countries that had suffered the most of the crisis. However, in the recent past, some changes to the better have become visible, and SMEs' business climate has improved again. Significant progress was, inter alia, observed in the countries of the south/the periphery (Croatia, Cyprus, Greece, Ireland, Italy, Malta, Portugal, Slovenia and Spain). The SME Business Climate Index for these countries increased by 5.2 percentage points in the second half-year of 2014 (see Figure 5), which is higher than the 3 percentage point increase in the countries of the north and the centre (Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Latvia, Lithuania, Luxembourg, Netherlands, Poland, Romania, Slovakia, Sweden and UK). As a result, the imbalance between the two diverse country groups has diminished, with the current gap equal to 11.8 percentage points, compared to 14 percentage points in the first half-year of 2014. Moreover, the EU-wide index has risen above the neutral level for the first time since 2012, which indicates that the EU sees the beginning of a recovery (UEAPME Study Unit, 2014).

Figure 5: SME Business Climate Index[5]



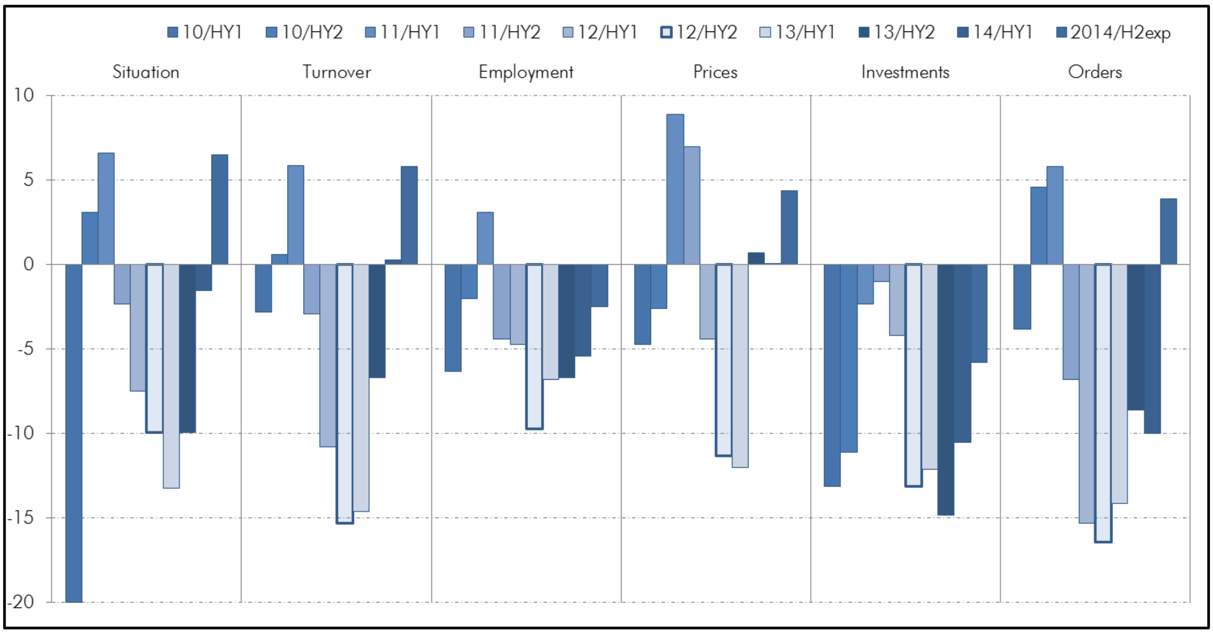
Source: Based on UEAPME Study Unit (2014)

The recent results of the European Commission economic sentiment indicator (ESI) remained broadly stable for both, the EU and the euro area. The Business Climate Indicator (BCI) for the euro area has slightly improved (European Commission, 2014b and 2014c).

Figure 6 shows the balance of "positive minus negative" answers reported by European SMEs, according to UEAPME Study Unit (2014), with reference to situation, turnover, employment, prices, investments and orders on a semi-annual base, starting from the first half-year 2010, with the last column being expectations for the second half-year of 2014. Specifically, for the second half of 2014, the overall situation, turnover, orders and prices are on balance expected to increase. However, the improvements expected in situation and orders are not yet strong enough for SMEs increases in investment and unemployment.

[5] The UEAPME SME Business Climate Index is calculated as the average of the current situation and the expectations for the next period resulting from the sum of positive and neutral (meaning: no change) answers as regards the overall situation for the business. For example, for "semester A" with 25% positive, neutral 55%, and 20% negative answers, the Index would be (25 + 55 =) 80 and for "semester B" with 40% positive, 30% neutral, and 30% negative answers it would fall to (40 + 30 =) 70. However, the respective balances of positive minus negative answers would show an opposite result growing from "semester A" (25 – 20 =) 5% to "semester B" (40 – 30 =) 10%. Therefore, these balances should also be examined and are reported in UEAPME's EU Craft and SME Barometer.

Figure 6: Main Results of the EU Craft and SME Barometer HY2/2014[6]



Source: EIF, based on data from UEAPME Study Unit (2014)

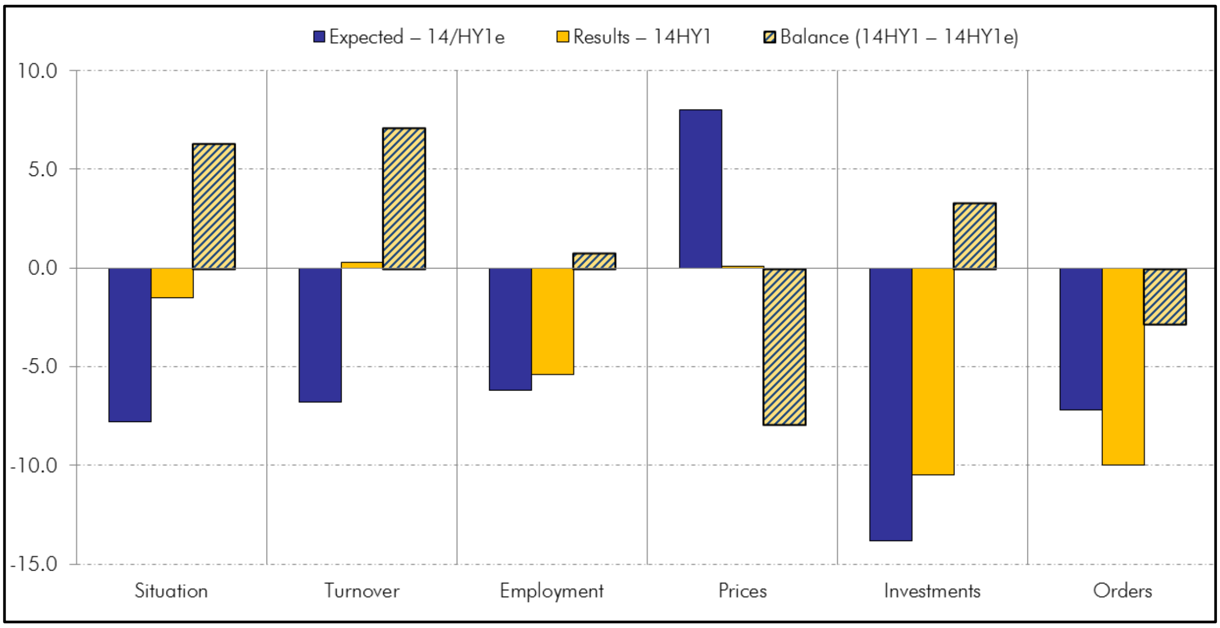
The balance between the expectations and the final results for the first half of 2014 is shown in Figure 7. The indicator results for the first half-year of 2014 were significantly better than expected with the exception of prices, which turned out worse than expected. The most remarkable difference was observed in the turnover for which the balance of expectations (-6.8%) contrasts significantly with the balance of the actual reported results (+0.3%); see UEAPME Study Unit (2014).

The results of the recent Eurochambres (2014) Economic Survey[7] point in a similar direction. According to this study, all economic indicators, including business confidence, show a clear improvement in outcomes in 2014. Improvements are expected for 2015, but with a smaller rate of growth. Despite the general positive expectations for 2015, great disparities in business confidence by country persist. Lithuania remains the most optimistic. The highest increase in business confidence was observed in Portugal. The highest level of pessimism was observed in Austria and in Slovakia.

[6] The EU Craft and SME Barometer builds on the results of surveys that are conducted by UEAPME member organisations two to four times a year in different regions all over Europe. The 2014/HY1 results are based on about 120,000 questionnaires, with 30,000 answers received. The data for the most recent survey were collected between May and September 2014. The balanced figures mentioned in the text show the difference between positive and negative answers, with national results weighted by number of employees. The surveyed categories include overall situation, turnover, employment, prices, investment, and orders. For details see UEAPME Study Unit (2014).

[7] The Eurochambres Economic Survey is a European qualitative survey of business expectations for the year ahead. Conducted annually by the Chambers of Commerce and Industry, and coordinated by Eurochambres, the survey records the expectations of approximately 60,000 businesses in EU Member States and EU Candidate Countries on six economic indicators: business confidence, domestic sales, export sales, employment & investment. The Eurochambres Economic Survey has been conducted since 1993. For details on the methodology see Eurochambres (2014).

Figure 7: Expectations of SMEs and real outcome for HY1/2014



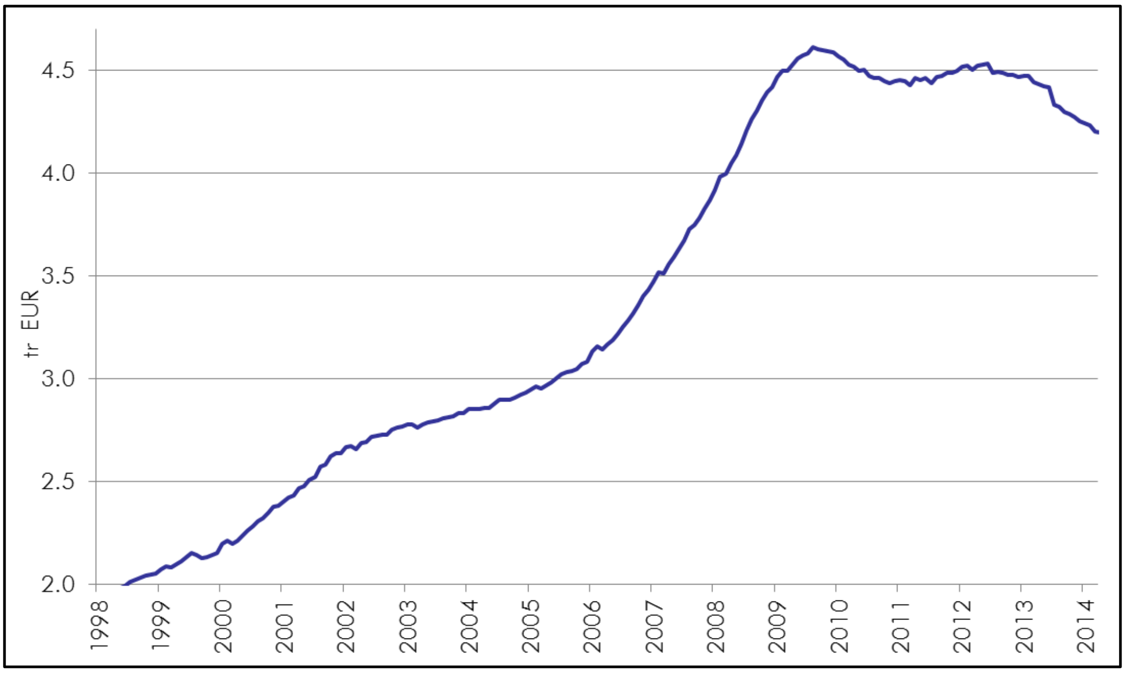
Source: EIF, based on data from UEAPME Study Unit (2014)

3.3 Bank lending activity

According to ECB data, the trend in lending to non-financial corporations (NFCs) in Europe has been declining since 2009 and still has to bottom out (see Figure 8). Compared to the peak of EUR 4.6tr reached at the beginning of 2009, the volume of outstanding loans has decreased by 11.8% to EUR 4.1tr in the Euro area in October 2014[8].

[8] SME loan data do not exist at the European level. With respect to financing cost for SMEs, Huerga et al. (2012) suggest that interest rates charged on small loans to NFCs (up to and including EUR 0.25m) could be used as a proxy. Even if new business volumes are also reported for small loans, the time series contains data going back only to June 2010. A longer history (back to 2003) exists for the size-class differentiation between loans to NFCs up to, and including, EUR 1m, and loans over EUR 1m. Looking at moving averages of the preceding 12 months, loans ≤ EUR 1m grew relatively steadily and reached their peak in April 2008 at EUR 86bn, which was 25% larger than by end-2003. Loans > EUR 1m grew for one year longer and peaked in April 2009 at EUR 276bn, which was 81% larger than by end-2003. Following their respective peaks, loans of both size-classes decreased continuously until June 2013, by 36% for loans ≤ EUR 1m and by 42% for loans > EUR 1m. While loans ≤ EUR 1m are today 20% below their 2003 levels, loans > EUR 1m are still 6% above the corresponding level. This particularly reflects the strong differences between the pre-crisis growths of both loan-size classes. However, it is questionable if the growth in loans to NFCs of ≤ EUR 1m can be taken as a proxy for the development of SME loans. For example, since 2011, loans to NFCs ≤ EUR 0.25m have decreased by 13%, while loans to NFCs ≤ EUR 1m (as well as loans to NFCs > EUR 1m) have (both) decreased by only 10%.

Figure 8: Outstanding Loans to Non-Financial Corporations in the Euro Area



Source: EIF, based on data from ECB

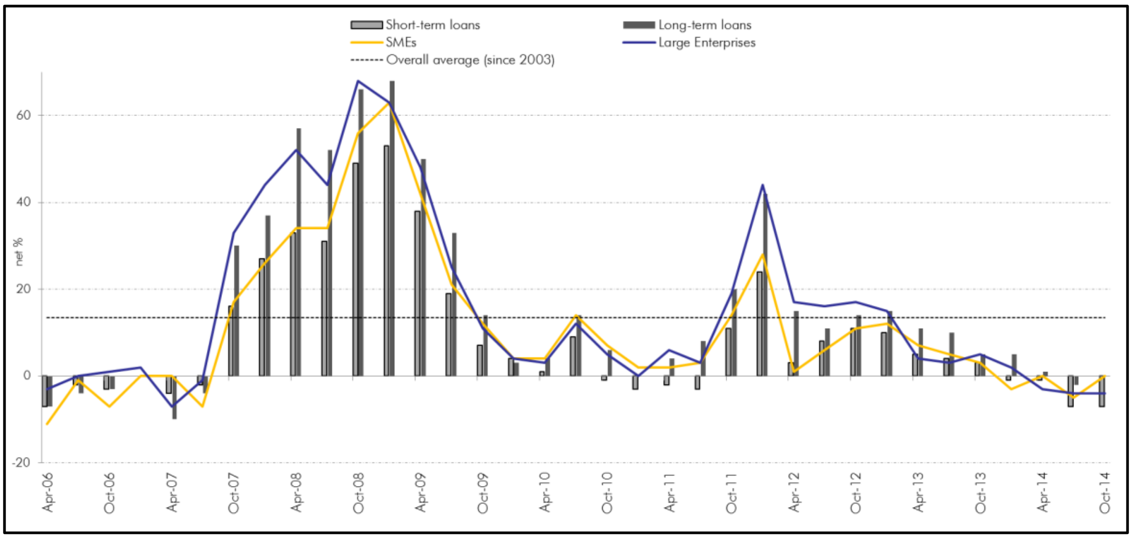
The current status of bank lending has also been analysed in the ECB's latest Bank Lending Survey (BLS, see ECB, 2014b)[9]: the net tightening of credit standards in the third quarter of 2014 still stands below its historical averages. Moreover, on balance, the reporting euro area banks have continued to ease their credit standards to non-financial corporations (NFCs). The survey shows that a net 2% of banks reported an easing in Q3/2014 (compared to 3% in the previous quarter). This is the second time in a row that banks reported, on balance, a net easing in credit standards, following the continuous net tightening that had been observed since 2007.[10]

As shown in Figure 9, the overall net tightening of credit standards remained unchanged for SMEs compare to the previous period (0%, from -5% in Q2/2014), while banks continued reporting a net easing for large firms at (-4%), the same pace as in Q2/2014, where the negative number indicates that the net percentages of banks contributed to an easing of credit standards (ECB, 2014b). According to the BLS, the credit standards remained, on balance, unchanged for loans with longer maturities, while a significant net easing was reported for short-term loans.

[9] This survey was conducted on 135 euro area banks and reports changes during the first quarter of 2014 (Q1/2014) and expectations of changes in the second quarter of 2014 (Q2/2014).

[10] Text and diagram refer to *net* percentages of banks contributing to tightening standards (the 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").

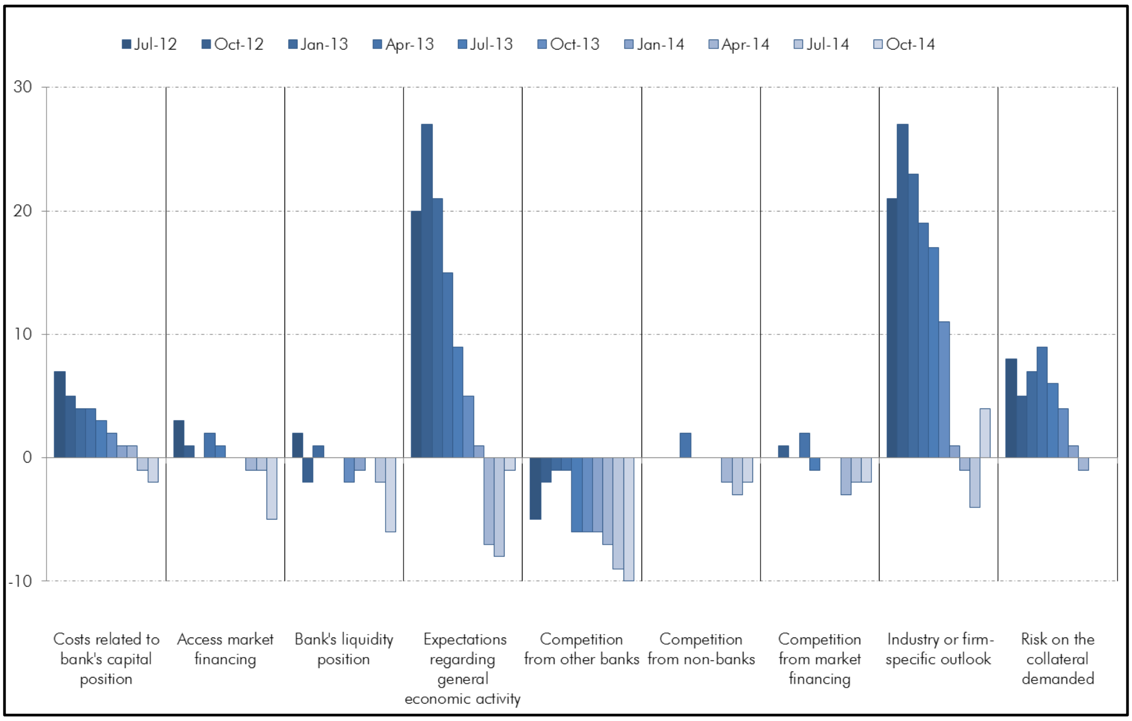
Figure 9: Changes in credit standards applied to the approval of loans or credit lines to enterprises (SMEs versus large enterprises)



Source: EIF, based on data from ECB (2014b)

In Q2/2014, in net terms, all the factors including the costs related to bank's capital position, the expectations concerning the industry (or firm) specific outlook, and the expectation regarding the general economic outlook, contributed to the easing of credit standards for SMEs (ECB, 2014b), see Figure 10.

Figure 10: Factors contributing to tightening credit standards for SMEs[11]



Source: EIF, based on data from ECB (2014b)

[11] 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.

Positive signs have also been observed in the demand for bank lending. According to the reporting banks of the ECB's Bank Lending Survey, net demand for loans to NFCs continued to be positive and recovered further in Q3/2014 (6% compared to 4% in Q2/2014) and reached levels above its historical average. This was mainly driven by the increased financing needs for mergers and acquisitions and by debt restructuring. Concerning the projections for Q4/2014, banks expect a significant increase in demand (for all categories of loans), (ECB, 2014b).

The recent EIB bank lending survey for CESEE (Central, Eastern and Southeastern Europe) showed that supply conditions have stabilised in the last six months and banks reported an increase in demand for credit. Looking ahead, supply conditions are expected to be eased, driven by an expected increase in credit demand perceived by banks (EIB, 2014).

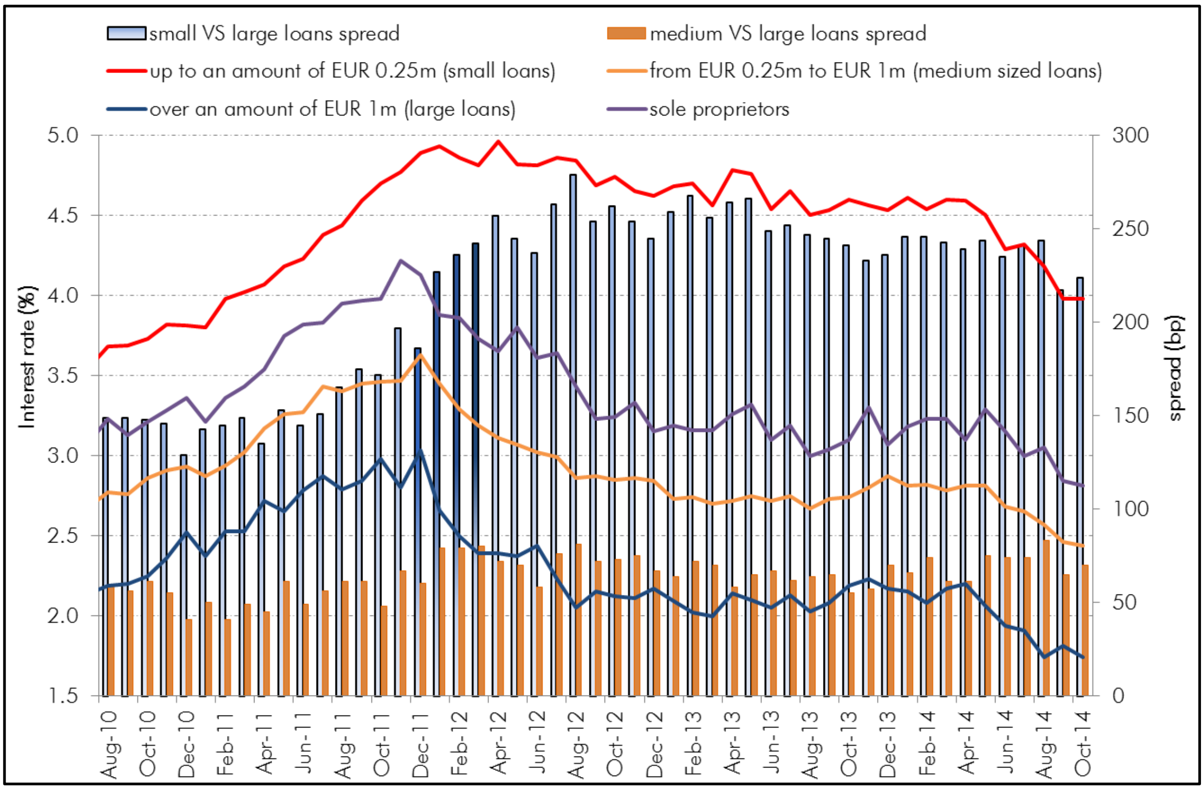
3.4 ECB interest rate statistics

The interest rate statistics for monetary financial institutions, published by the ECB, provide information about the interest rates and volumes for different size classes of new euro-denominated loans. Since June 2011, the former category of loans (of up to EUR 1m) to the euro area, extended to non-financial corporations, is divided into two sub-categories. One category includes loans up to and including EUR 0.25m, and the other loans over EUR 0.25m and up to EUR 1m.

Loans of amounts over EUR 0.25m up to EUR 1m (medium-size loans) had a rather stable spread over loans of more than EUR 1m (large loans), averaging 64 basis points (bp) over the period from June 2010 to October 2014 (see Figure 11). In contrast, the interest rate spread between loans of up to EUR 0.25m (small loans) and large loans was higher, but relatively stable at an average level of 145bp from the start of the time series in June 2010 until July 2011. In the following months, this spread had showed an increasing trend until August 2012 when it reached a record high of 279bp. Since then, the spread has been rather stable, averaging 214bp.

Overall financing costs for euro area MFIs have continued to fall across most external financing sources. The aggregate improvement in financing conditions was driven by the gradual economic recovery. However, the difference between the loan pricing conditions for small and large firms remained high in more vulnerable countries, where SMEs remained more dependent on bank funding (ECB, 2014e).

Figure 11: Evolution of monetary financial institutions interest rates on new loans to non-financial corporations[12]



Sources: EIF, based on Huerga et al. (2012), ECB (2014g), ECB SDW, and own calculations

3.5 SMEs' Access to finance

According to the European Commission / ECB latest Survey on the Access to Finance of Enterprises (SAFE), covering April 2014 to September 2014 (European Commission, 2014e and ECB, 2014f)[13], access to finance moved from the third to the fifth most pressing problem for euro area SMEs compared to the previous survey round. The percentage of companies that mention access to finance as their most pressing problem has remained broadly unchanged at the level of 13% (Figure 12).

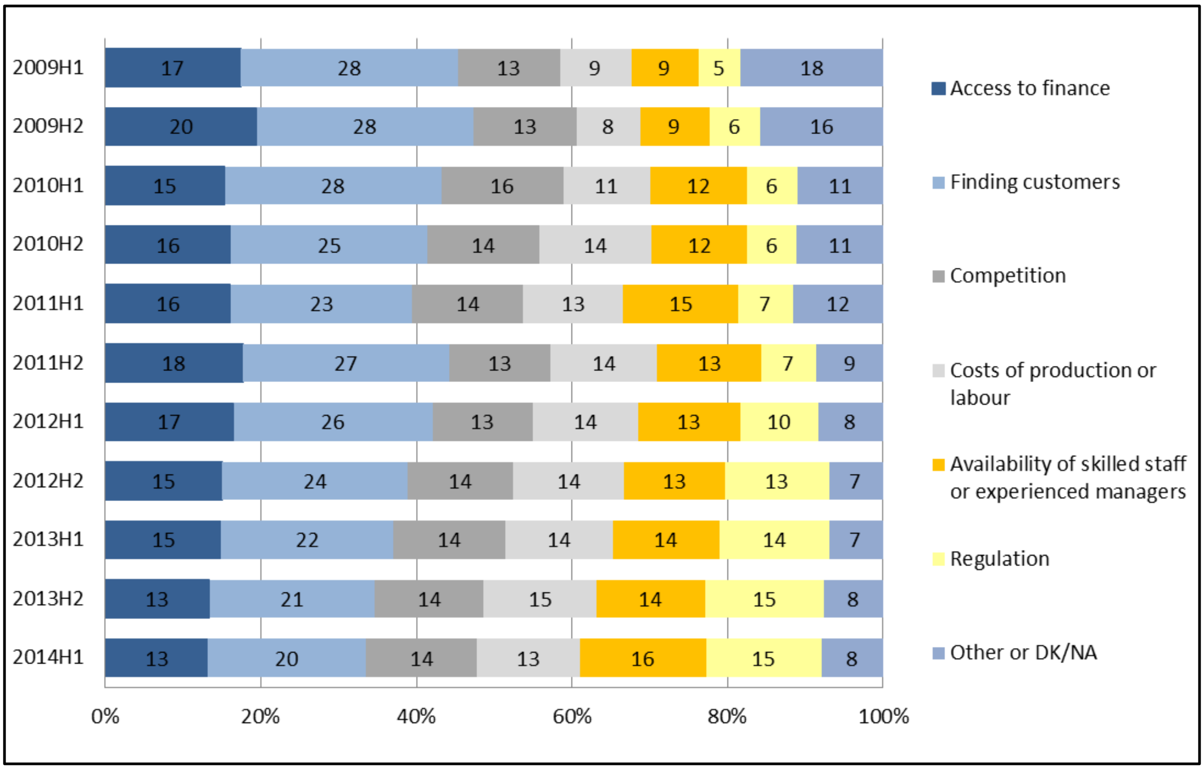
'Finding customers' stayed the most frequently mentioned concern. Unsurprisingly, the divergence across the countries remained large. On the high side, 32% of the SMEs in Greece, 18% in Ireland, and 17% in Spain and Portugal mentioned 'access to finance' as the most pressing

[12] New loans to non-financial corporations, with floating rate and up to three-month initial rate fixation by loan size, and new loans to sole proprietors (percentages per annum excluding charges; period averages). The series about new loans to "sole proprietors" have an initial rate fixation period of up to one year, and not up to three-months, as the rest of the series used in the graph, because data for lower rates of fixations are not collected.

[13] The European Commission and the European Central Bank decided in 2008 to collaborate on a survey on the access to finance of enterprises in the European Union, and they established The Survey on the Access to Finance of Enterprises (SAFE). SAFE ECB waves are run every 6 months, covering the Euro area countries. The SAFE Commission waves are published every year, covering all EU countries and other countries participating in the Entrepreneurship and Innovation Programme of the CIP.

problem, compared with around 9% of the SMEs in Germany and 7% in Austria on the low side (ECB, 2014f).

Figure 12: The most pressing problem SMEs are facing



Source: EIF, based on SAFE, ECB (2014f), Statistical Data Warehouse

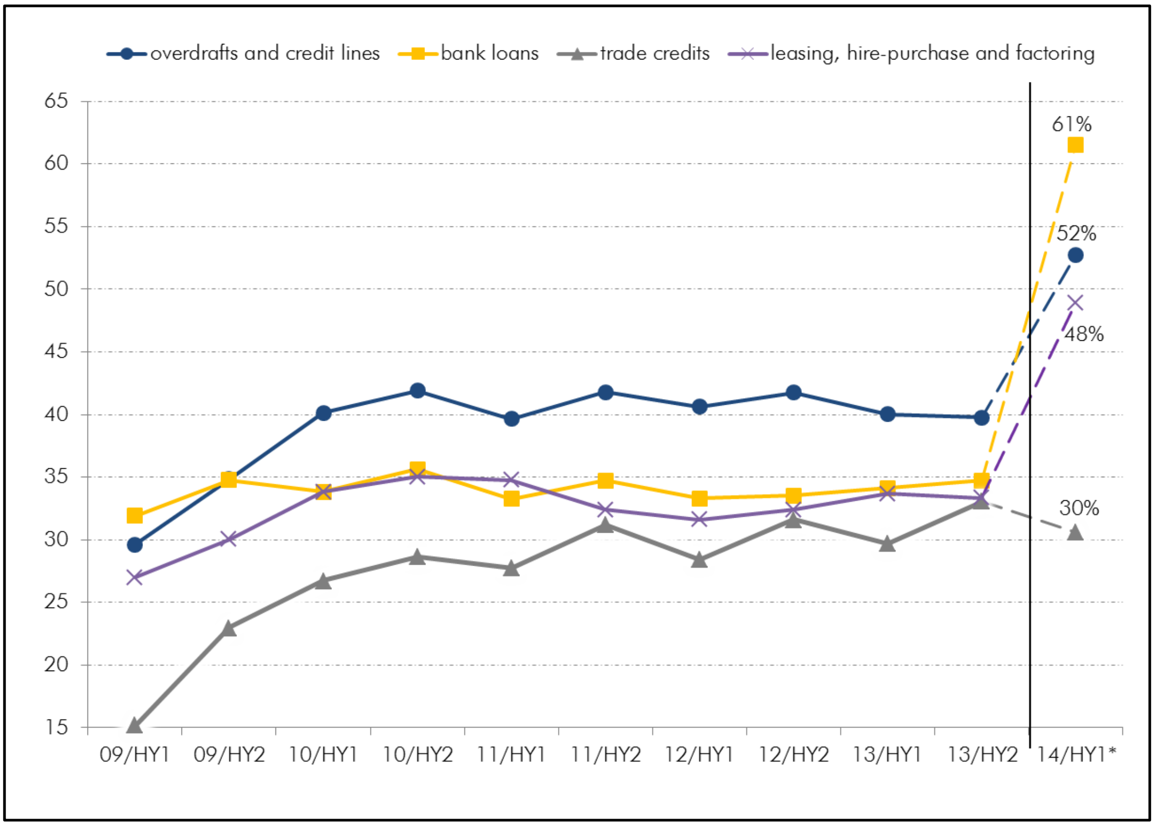
According to the latest survey, the most popular sources of debt financing for SMEs was bank loans followed by overdrafts and credit lines (see Figure 13).

During the reference period, the net percentage[14] of SMEs reporting a higher *need* for bank loans has decreased in comparison to the previous survey (+1% down from +5%). At the same time, the net percentage of SMEs that perceived a deteriorated *availablity* of bank loans decreased significantly (see Figure 14), (ECB, 2014f).

[14] "Net percentage" means the difference between the percentage of firms reporting an increase (or an improvement) for a given factor and that reporting a decrease (or deterioration).

Figure 13: Sources of external financing of euro area SMEs

(over the preceding six months; percentage of respondent SMEs that used the different financing sources)

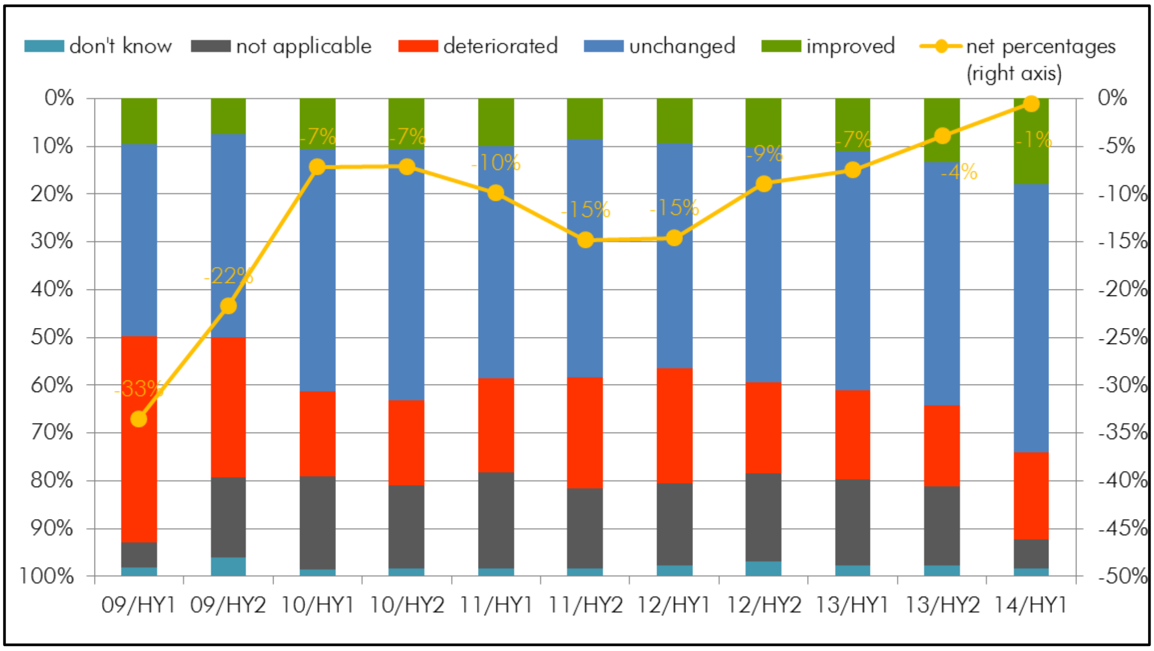


Source: EIF, based on ECB (2014f), Statistical Data Warehouse

**Note: SAFE has changed question nr. 4 from 2014. Since then, respondents are asked whether the different financing sources are relevant to them (ECB, 2014f).*

Figure 14: Change in the availability of bank loans for euro area SMEs

(over the preceding 6 months; % of respondents)



Source: EIF, based on ECB (2014f), Statistical Data Warehouse

According to the responses of surveyed SMEs, the main factor which negatively impacted the availability of external financing remained the general economic outlook. Moreover, on balance, a more negative impact was observed compared to the previous period (-21% compared with -11%).

Euro area SMEs reported, on balance (+9%), a fall in interest rates for the first time since the launch of the survey. The net share of SMEs which observed increases in costs of financing other than interest rates (+35% from +40%) has decreased, albeit at high levels, while the net share of SMEs which observed increases in collateral requirements (+29% from +26%) has increased.

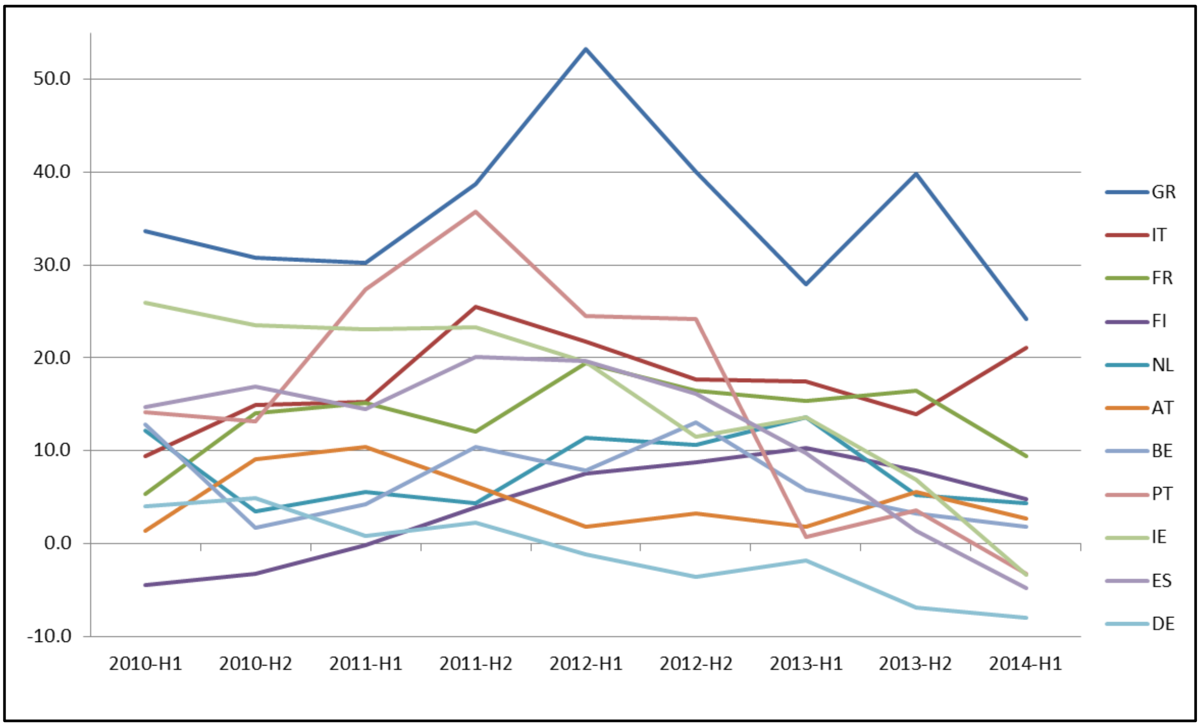
"The net percentages of SMEs reporting an increase in bank lending rates declined sharply [compared to the previous survey round] in Ireland ([to] +19%), Greece (+9%), Portugal (+1%) and Finland (+10%). By contrast, the net percentages for the Netherlands increased from 1% in the previous survey round to 8%. SMEs in Belgium (-42%) and Austria (-23%) reported, on balance, a decline in bank lending rates." (ECB, 2014f).

When looking at actual applications for external financing, the percentage of SMEs that applied for a bank loan between April and September 2014 has remained broadly unchanged (+30%) compared to the previous survey. The main reason for SMEs not to apply for a bank loan still remains the availability of sufficient internal funds. The success rates of actual loan applications by SMEs have decreased compared to the previous survey. 65% of the euro area SMEs reported that they had received the full requested amount (compared to 71% in the previous round). SMEs continued to report a higher rejection rate than large firms (+13% versus +3%).

Looking ahead, and on balance, the euro area SMEs expect neither improvement nor deterioration in the availability of bank loans and bank overdrafts. In addition, SMEs expect a somewhat stronger increase in the availability of internal funds.

There are also disparities in the perception of external financing gaps across countries. At country level, Germany, Spain, Ireland and Portugal reported negative net balances (i.e. no perceived financing gap). The other countries reported positive net balances but with a clearly declining trend. The overall gap for SMEs, declined from 7% in the previous survey period to 3% (Figure 15).

Figure 15: Perceived change in the external financing gap (by country)



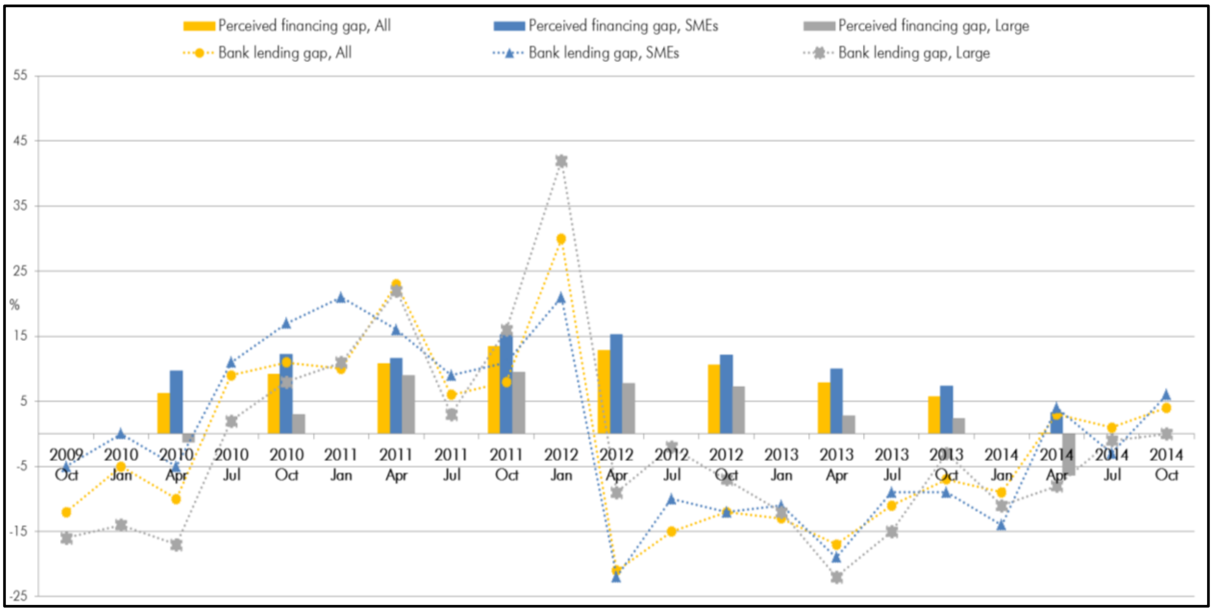
Source: EIF, based on ECB (2014f), Statistical Data Warehouse

The SAFE data (demand-side data) has calculated a new composite indicator on perceived changes in the needs and availability of external financing of firms[15]: The ECB's Bank Lending Survey (BLS) data allows us to calculate the gap from the supply side (albeit only for bank loans) and compare it to the gap from the demand side. The BLS bank lending gap is defined as the difference between the net percentage of banks reporting an increase in the demand for bank loans and the net percentage of banks reporting an easing in credit standards. In 2010 and in 2011 the perceived gaps in bank loans reported by the firms were in line with the gaps reported by the banks in the BLS (see Figure 16).

In 2012 and 2013, a mismatch in perceptions has been observed: on balance, SMEs perceive a positive gap, while banks mostly perceived no gap. In 2014 the perceived gaps in bank loans reported by the firms were again closer to the gaps perceived by the banks.

[15] For each of the five financing instruments (bank loans, trade credit, equity, debt securities, bank overdraft), an indicator change in a perceived financing gap takes the value of 1 (-1) if the need increases (decreases) and availability decreases (increases). If firms perceive only a one-sided increase (decrease) in the financing gap, the variable is assigned a value of 0.5 (-0.5). The composite indicator is the weighted average of the financing gap related to the five instruments. A positive value of the indicator suggests an increasing financing gap. Values are multiplied by 100 to obtain weighted net balances in percentages.

Figure 16: Perceived change in the external financing gap, reported by borrowers and lenders[16]



Note: Weighted net balance for enterprises and net percentage for banks. The number of banks responding to questions about all enterprises is different from the number of banks responding to questions about large enterprises or SMEs. Hence, the bank lending gap line for "all" does not necessarily lie between the lines for "SMEs" and "Large"

Source: EIF, based on SAFE, BLS and own calculations

In addition, information on enterprise finance is compiled in the OECD Scoreboard on financing SMEs and entrepreneurship (see Box 1). This is an important step towards developing a comprehensive framework to monitor trends in access to finance by SMEs and entrepreneurs at the country level.

Box 1: Financing SMEs and Entrepreneurs: An OECD Scoreboard

The OECD is preparing the Third Edition of its *Financing SMEs and Entrepreneurs: An OECD Scoreboard* (OECD, forthcoming 2015)[17] as a step towards developing a comprehensive framework to monitor trends in access to finance by SMEs and entrepreneurs at the country level. The analysis covers 34 countries and examines indicators of debt, equity, asset-based finance and general market conditions, complemented by recent developments in public and private policy measures.

The report confirms our view that, based on 2013 data, SMEs' access to debt and equity finance – and the conditions at which they were granted – varied significantly across countries. SME lending conditions eased in some countries but generally remained tight, particularly in those countries that were most affected by the financial crisis.

[16] On this figure the distinction between large enterprises and SMEs is based on annual sales as defined by the BLS.
[17] EIF closely cooperates with the OECD on this project and other projects related to SME finance.

Box 1 continued:

The stock of outstanding SME loans and new lending to SMEs decreased in a majority of countries in 2013. Despite the decrease of SME interest rates, a drop in SME lending was observed, suggesting a possible decrease in the demand for credit. In the majority of participating countries the interest rate spread between small and large enterprises increased – indicating that often banks view lending to SMEs as higher-risk, with stricter lending conditions applied to SMEs than to large firms.

From the banks' perspective, available data indicates high non-performing loans (NPL) (although it has to be born in mind that the NPL definition varies across countries), which results in a deterioration of the overall quality of banks' asset sheets and in bank losses. This weakens SMEs' access to finance, in particular in the light of a rapid increase of SME NPLs in some European countries.

The SME securitisation market remains relatively undeveloped due to a lack of credit data and the existence of asymmetric information. Equity market developments in 2013 broadly varied across the Scoreboard countries. In approximately half of the countries, where many government initiatives to develop non-bank financial instruments (in particular equity investments) were introduced, overall equity investment rose.

Looking ahead, according to the OECD Scoreboard, SME financing conditions are expected to remain challenging in 2014-2015, although a recovery of growth and demand appears to be on track.

In general, as shown by the analyses above, the slowly recovering macro-economic situation in Europe, combined with the continuing balance sheet evolution of many banks, limits the volume of new lending.[18] This leads to the even increasing need for guarantee and securitisation solutions to incentivise bank lending – as discussed in chapter 5. Moreover, alternative financing solutions to complement the lending and to diversify the sources of funding are playing an important role, in particular private equity – as described in chapter 4.

[18] It is worth mentioning that, for an economic recovery, the availability of sufficient external financing is very important, but it is only *one* element, as a significant portion of SME financing is based on internal sources (cash flow, reserves). However, according to Pelly and Kraemer-Eis (2011), "[t]he level and availability of internal funding [...] depends not only on the firm itself, but also on the business environment. Hence, policies aiming to boost growth must look beyond pure financial support to the entire business-enabling framework, including well-functioning labour, product and financial markets".

4 Private equity

4.1 Investment activity

Box 2: Introductory information on EVCA data

In this chapter, numbers, diagrams and statements are to a large extent built on statistics from the European Private Equity & Venture Capital Association (EVCA), and we would like to thank our colleagues from the EVCA research team for their support. Please note that all EVCA figures for 2014 are based on the first three quarters of 2014 ("2014/Q1-Q3"). Conclusions from quarterly EVCA data should be drawn much more carefully than when interpreting annual data. A significant number of funds report business figures to EVCA only in the fourth quarter of a year. Thus, annual data can differ to a relatively large extent from the data of the first three quarters of a year, and quarterly figures should be seen as having preliminary character. In addition, and in order to make reasonable assessments for the recent past, we often have compared the 2014/Q1-Q3 data with 2013/Q1-Q3 data that had been reported at a comparable time (i.e. in November 2013). These data may differ from 2013/Q1-Q3 figures that are reported today (which we also occasionally mention in footnotes), due to data revisions that have been carried out in the meantime.

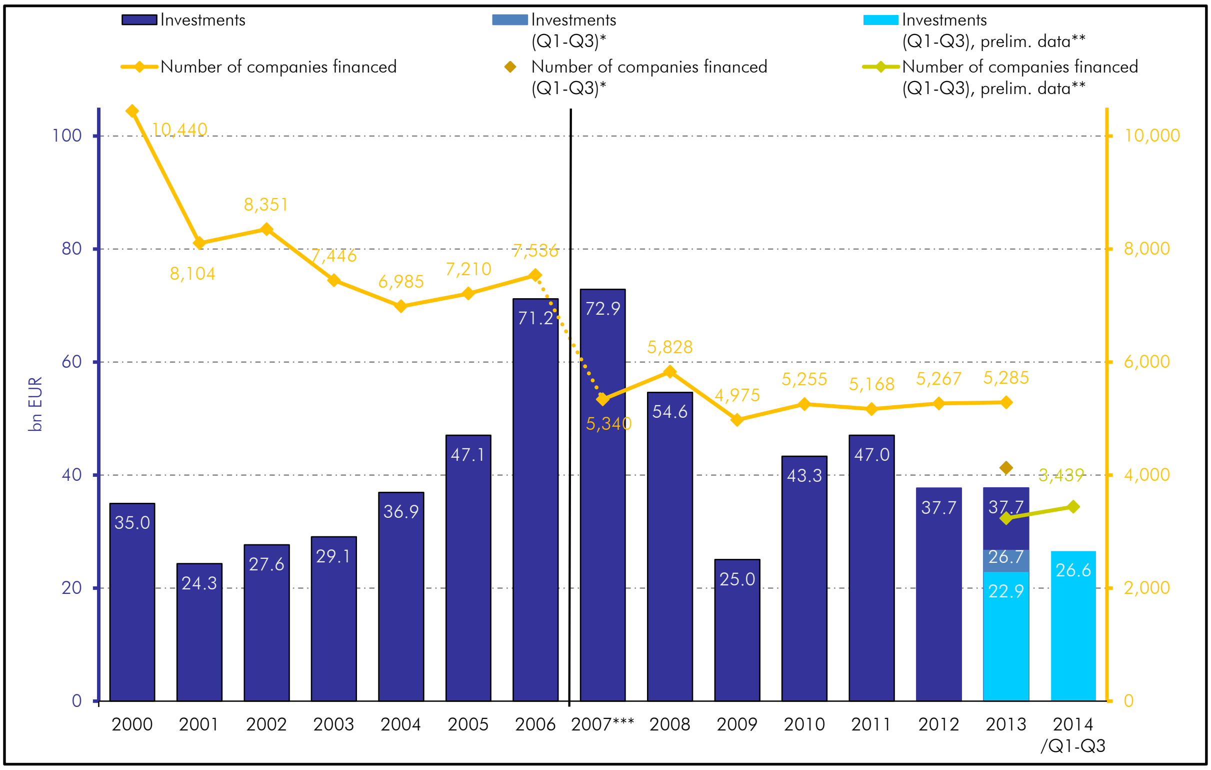
Please do also note that EVCA private equity (PE) statistics do not include infrastructure funds, real estate funds, distressed debt funds, primary funds-of-funds, secondary funds-of-funds and PE/VC-type activities that are not conducted by PE funds. This means that the activity of business angels, hedge funds, and CVC activity that is not conducted by a corporate VC fund is not included in the statistics. Please note that the EVCA investment figures show investment activity by PE firms located in Europe ("industry approach" or "office approach"). EVCA statistics can differ from the numbers reported by other data providers for the reasons just mentioned and due to, e.g., different definitions and interpretations of the PE fund and investment stages and geographical definitions (e.g. of "Europe"). See, also for more details, EVCA (2014b), (2014c) and the EVCA website (www.evca.eu).

Following the severe crash of European private equity (PE) investment in 2008/2009, PE had partially rebounded in the years 2010 and 2011. However, the recovery then suffered a setback in 2012, but stayed well above the 2009 crisis low (see Figure 17). In 2013, PE investment stabilised at EUR 37.7bn. The number of companies which benefited from PE investment in 2013 remained at a level of almost 5,300. In the first three quarters of 2014, PE investment amounted to EUR 26.6bn, according to the preliminary EVCA data. This is an increase by 19%, compared to the EUR 22.9bn that had been reported at the same time of the previous year (i.e. the preliminary data as at Nov. 2013).[19] These EVCA data also indicate a considerable increase in the number of companies financed in the first three quarters of 2014.

[19]Based on data available at Nov. *2014*, PE investments amounted to EUR 26.7bn in the first three quarters of *2013*.

The share of investments in the buyout sector over total PE investment amounts remained stable at 78%. In contrast, the growth capital segment of the market performed remarkably well. In the first three quarters of 2014, growth capital investments have almost reached the total investment amount that had been recorded for the whole year 2013.

Figure 17: Investment activity by private equity firms located in Europe[20]



Notes:
*As reported at November 2014.
**As reported at November of the respective year.
***EVCA had changed the data provider with effect from 2007 on. Since then, EVCA PE activity statistics are based on data from PEREP Analytics.

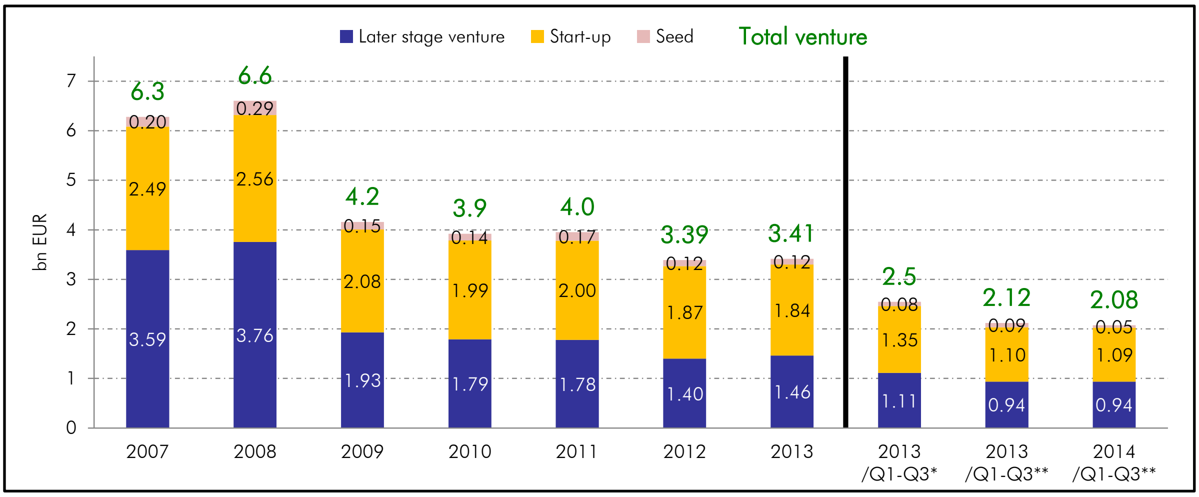
Source: EIF, based on data from EVCA

Total VC investments amounted to EUR 2.08bn in the first three quarters of 2014. They have thus remained rather stable, when compared to the figures that had been reported at the same time of the previous year.[21] (Please note that the market segment Business Angels is not included in PE or VC statistics from EVCA. As business angel financing is important for the financing of SMEs and innovation, we present more information in Box 3.)

Within the venture capital market segment, investments with a start-up or later stage focus have remained relatively stable, while investments with a seed stage focus seem to have continued to decrease (see Figure 18).

[20]The EVCA figures mentioned in this chapter show investment activity by PE firms located in Europe ("industry approach" or "office approach"). All investment figures are equity value, i.e. excluding leverage.
[21]Preliminary data as at November 2013. Based on data available at November *2014*, VC investments amounted to EUR 2.5bn in the first three quarters of *2013*.

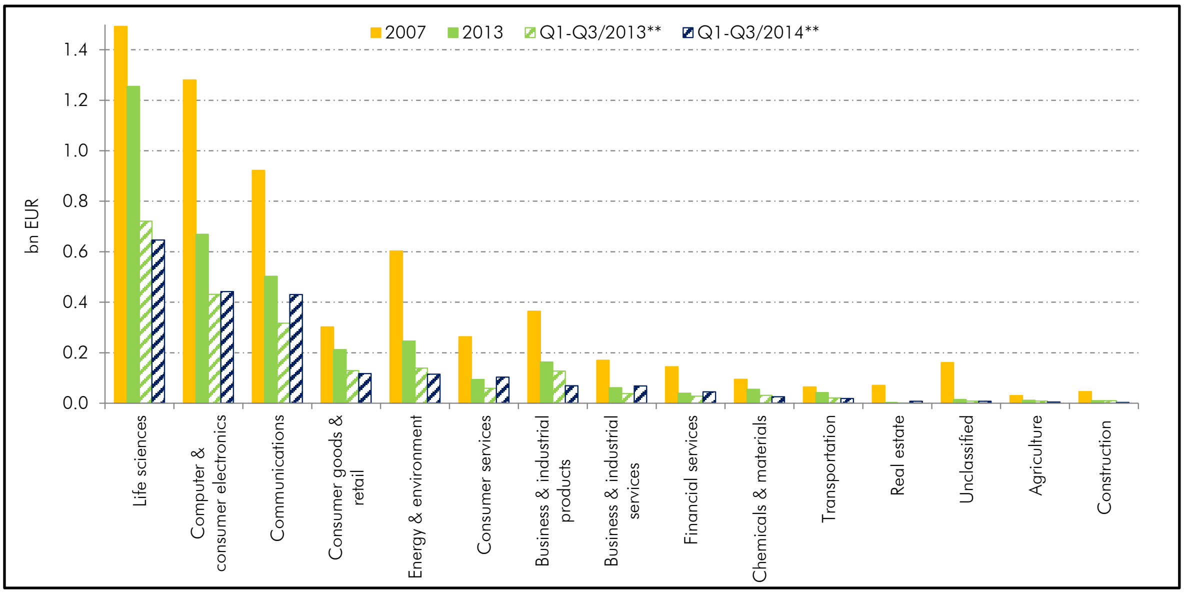
Figure 18: Venture Capital investment activity evolution in Europe



Notes:
*As reported at November 2014.
**Preliminary data as reported at November of the respective year.
Source: EIF, based on data from EVCA

Recent developments in venture investment by sector are shown in Figure 19. The relative importance of sectors shows certain stability over time: life sciences, computer/consumer electronics, and communications remain by far the most relevant industries for venture investment. The *share* of life science in total VC investment activity even increased from 25% in 2007 to 37% in 2013. This is broadly in line with the results of a recent Coller Capital (2014) survey among investors in PE and VC funds (the so-called Limited Partners or LPs), which was conducted in Feb. and March 2014, according to which "LPs are currently looking most favourably on the IT sector – although European LPs show a significantly higher preference for biotech than other investors".

Figure 19: Venture investment in Europe by sector, 2007, 2013 and 2014[22]



**Preliminary data as reported at November of the respective year.

Source: EIF, based on data from EVCA

[22]This diagram and the related text are based on market approach (i.e. by country of portfolio company), due to data availability.

Box 3: Business Angel activity

Business Angels represent an important class of private equity investors, primarily consisting of high-net-worth individuals. They tend to invest their own money, either individually or in formal or informal syndicates, in businesses which are not publicly traded.[23]

Business Angels differ from VC funds, which primarily invest third parties' funds (e.g. institutional investors'). Angel-financed companies are typically in earlier stages of their development, compared to the VC-backed ones. Moreover, the holding periods of Business Angel investments are typically shorter than the corresponding periods in Venture Capital funds (Kraemer-Eis and Schillo, 2011). The past 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 (Kraemer-Eis, Lang and Gvetadze, 2013b). Business Angels offer a number of advantages compared to VC funds:

- Lower transaction costs allow them to invest on a lower scale,
- Business Angels are geographically more dispersed, and often invest in local markets,
- They are very 'hands-on' investors.

There are difficulties in measuring the size of the business angel community, the main ones being identification and definition. Business Angels typically prefer to stay anonymous and the details on their investments are rarely disclosed. Further, nothing can prevent an individual from identifying oneself as a 'virgin' angel, although he/she may have never actually invested. Others may have occasionally acted as angels, but are no longer looking for investment opportunities.

Moreover, the so called "invisible market" makes a precise estimation of the angel market difficult. There are studies that the invisible part of the market is up to seven times greater than the visible part (CSES, 2012), while others estimate even a multiplier of around ten (EBAN, 2014b). Such difficulties must be borne in mind when describing the market.

For the visible market segment, data is collected by angel associations from angel groups and networks. EBAN[24] (2014b), for example, reported an average increase in the number of Business Angel networks of 17% over the past 10 years to 468 in Europe in 2013, with estimated investments by the approximately 28k BAN members of EUR 554m. Most of the BA activity within the EU is concentrated on the UK, Spain, France, Germany, Finland and Sweden.

According to EBAN (2014b), the average amount invested per company decreased over the past three years to EUR 166k in 2013. This is well in line with the results of other studies on the size of funding (e.g. CSES (2012)), which estimated that Business Angels provided on average around EUR 100k to 200k per deal. Individual angel investments are varying significantly, and EBAN (2014b) reported a slight increase in the average investment per BA to EUR 20.4k in 2013.[25]

[23] For a general description of Business Angel financing we refer Kraemer-Eis and Schillo (2011) and to OECD (2011).

[24] The European Trade Association for Business Angels, Seed Funds, and other Early Stage Market Players.

[25] However, according to EBAN (2014b), the business figures "are not representative of the entire European market", because they cover only a certain part of the visible market. See also EBAN (2014a) for more information on EBAN statistics.

Box 3 continued:

As explained, the invisible part of the market is dominant – therefore, data availability for general statements is limited. However, it can be assumed that during the crisis Business Angels behavior did not move in the same direction like bank lending or venture capital supply. Mason and Harrison (2013), e.g., show for the UK that angel investment activity has held up since the onset of the crisis and they emphasise the economic significance of this market segment. Moreover, they underline the need for ongoing government support.

As a part of its support for this market segment, the EIF has implemented the European Angels Fund (EAF). The EAF is a co-investment fund to provide equity to business angels for the purpose of SME financing. It has been launched in March 2012 in Germany with an initial volume of EUR 70m and been increased and extended to Spain and Austria since then and currently reaches a volume of c. EUR 188m. Further roll-out to other countries is foreseen and the launch of the program in the Netherlands and Ireland is scheduled for 2015. Aim of EAF is to co-invest with experienced business angels in order to build a joint portfolio over a time of 5-10 years.[26] Complementary approaches allowing to co-invest with a broader target group including less experienced business angels or syndicates, e.g. via managed co-investment funds, have occasionally already been made in the past and will be focused further in the future.

4.2 Fundraising activity

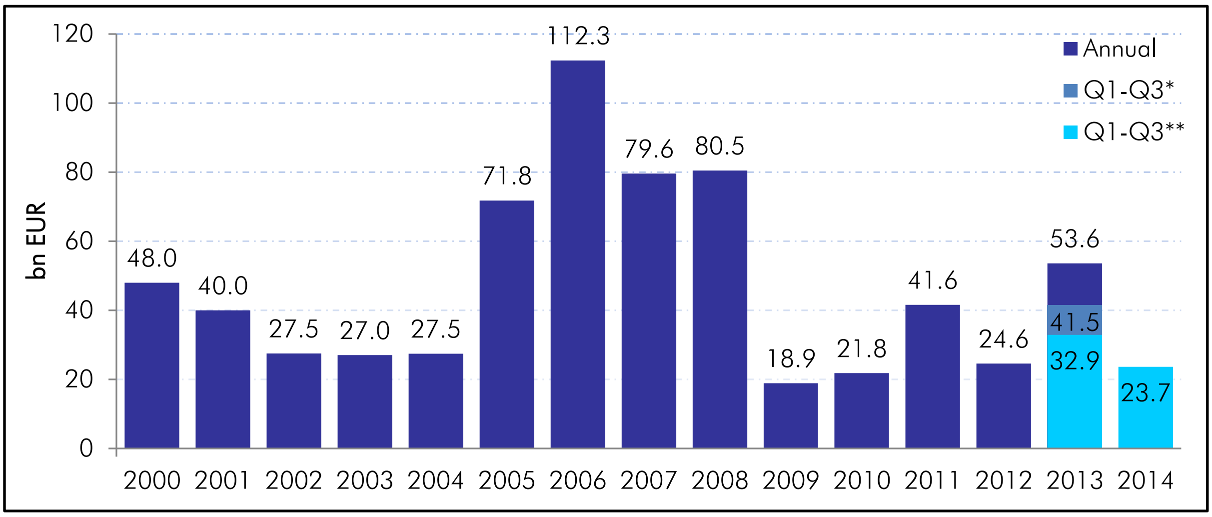
Total PE fundraising substantially recovered in 2013. EVCA figures report a 118% increase (compared to the year before) in funds raised by private equity firms located in Europe to EUR 53.6bn (see Figure 20).[27] However, this positive development seems not to have continued in 2014. In the first three quarters of the year, total PE fundraising amounts dropped by 28%, compared to the figures that had been reported in November 2013 for the first three quarters of 2013. Nevertheless, the EVCA statistics also indicate that the PE fundraising figures for the whole year 2014 should lie well above the amounts observed during the crisis years 2009, 2010 and 2012.

The seemingly weak fundraising activity during the first three quarters of 2014 was mainly driven by the buyout sector (–30%, compared to the figures that had been reported in November 2013, to EUR 19.6bn), which by far forms the largest part of the market. In contrast, fundraising is indicated to have increased considerably in the growth capital (+64% to EUR 1.0bn) and the mezzanine capital (+17% to EUR 0.4bn) segments of the market.

[26]More information on the EAF is available here: http://www.eif.org/what_we_do/equity/eaf/index.htm.

[27]Figures show fundraising activity (incremental amounts raised during the year) by private equity firms located in Europe ("industry approach" or "office approach"), except where otherwise stated.

Figure 20: Funds raised by private equity firms located in Europe
(incremental amounts raised during year)

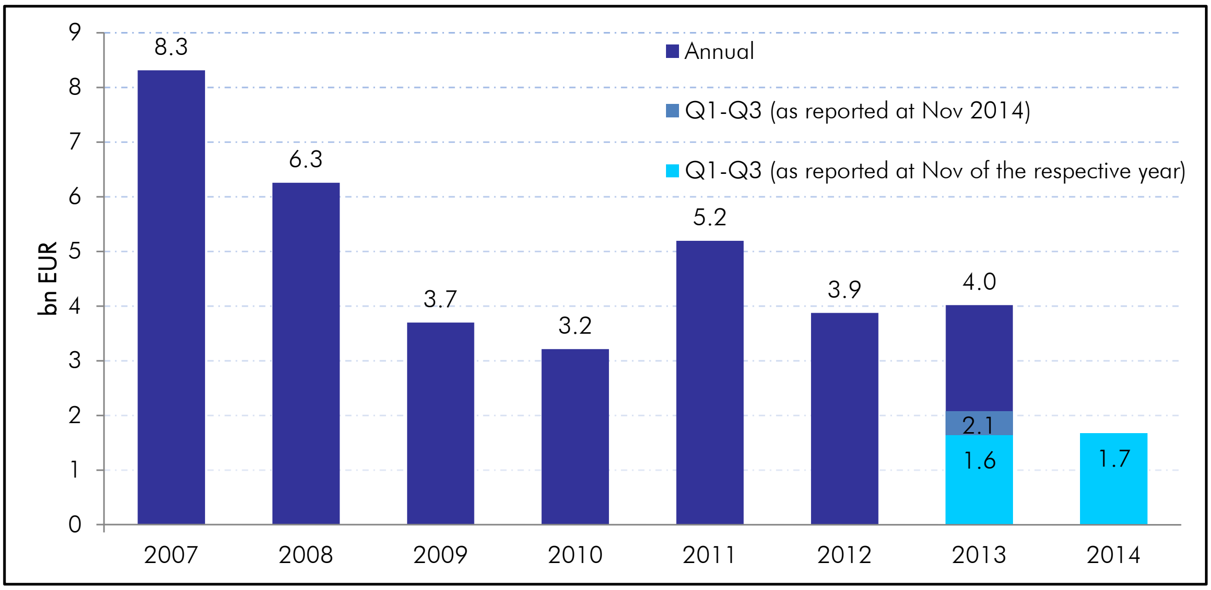


Notes:
*As reported at November 2014.
**As reported at November of the respective year.
EVCA had changed the data provider with effect from 2007 on. Since then, EVCA PE activity statistics are based on data from PEREP Analytics.

Source: EIF, based on data from EVCA

For European VC fundraising, the figures so far indicate a relatively small growth (+2% to EUR 1.7bn) in the first three quarters of the year (see Figure 21). Both, the early-stage (+16% to EUR 0.8bn) and the later stage segments (+38% to EUR 0.2bn) contributed positively to this result, while funds with a "balanced" stage focus are indicated to have raised less funds (–17% to EUR 0.7bn). Total *annual* venture fundraising might, however, not substantially exceed the levels of recent crisis years.

Figure 21: Funds raised by VC firms located in Europe
(incremental amounts raised during year)

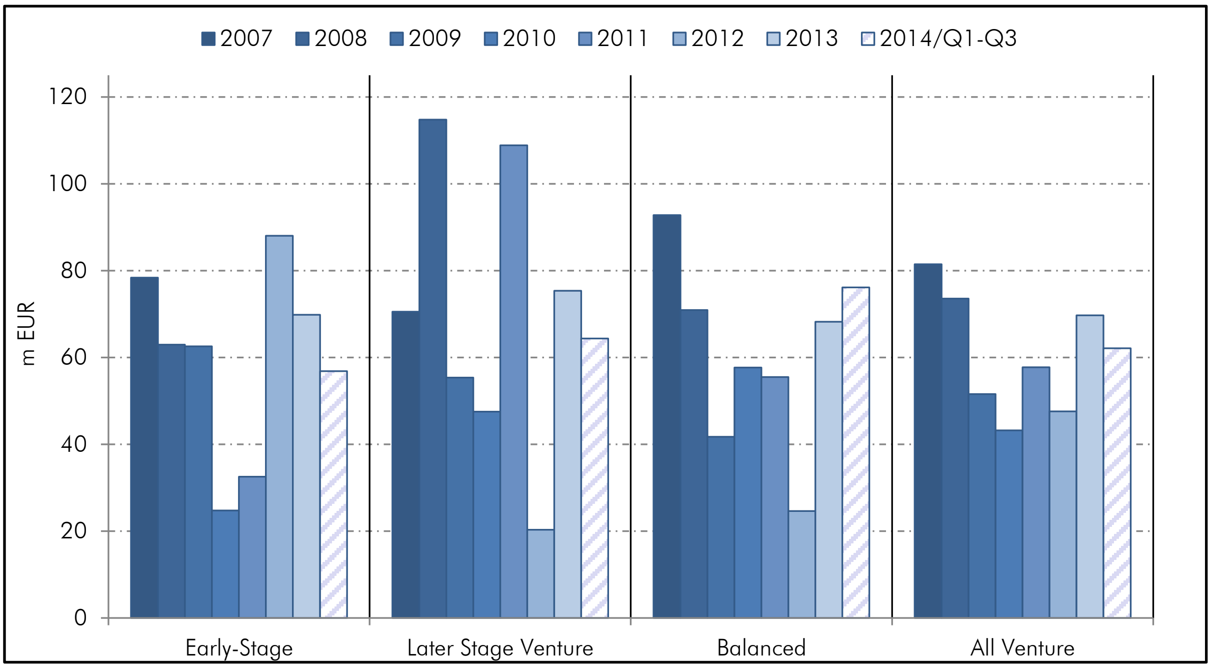


Source: EIF, based on data from EVCA

The average VC fund size has slightly decreased to EUR 62m (see Figure 22), based on 25 final VC fund closings reported in the EVCA statistics for the first three quarters of 2014. Given the evidence in previous studies, which indicated that small fund size was one of the reasons for poor European VC performance (Kelly, 2011), the current finding might mean negative news. However, the preliminary EVCA figures should not be overstated, in particular when looking at the results for the different stages of the VC market, as they are based on the small number of final fund closings that had been reported to EVCA so far. In particular, for later stage venture, EVCA figures show only two final closings. Moreover, EIF internal analysis and other findings suggest that large funds indeed perform better, but are managed by teams that previously had smaller funds that performed well. Thus, the size would be a consequence rather than a cause. Larger fund size (as reported by EVCA statistics for funds with a "balanced" stage focus) would be a sign of more careful due diligence by LPs.

Figure 22: Average VC fund size

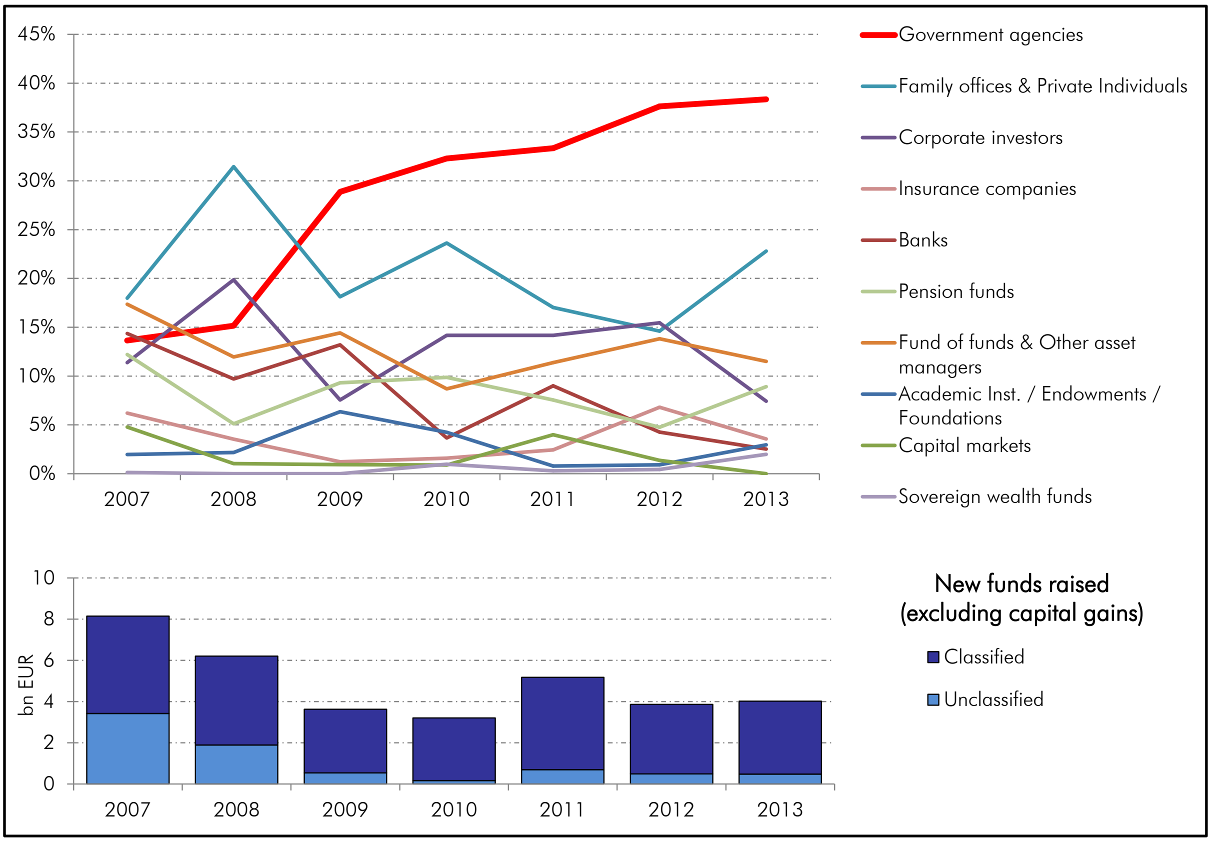
(based on final closings, cumulative amounts raised since inception)



Source: EIF, based on data from EVCA

A sign of investors' still cautious sentiment for venture capital is the shift in the investor base, which has been going on during the past years (see Figure 23). According to EVCA figures, government agencies accounted for 38% of total investors into venture capital funds in 2013. (More recent data on the investor base is currently not available.) However, even if the importance of government agencies is unsatisfyingly high for the long term, it is noteworthy that government agencies, rather than "killing the continent's start-ups with kindness" (The Economist, 2014), continue to play their role and support the market in a counter-cyclical way, in particular in the current times of an economic and financial crisis when total VC fundraising levels came down from EUR 8.3bn in 2007 to EUR 4bn in 2013 (and have not picked up substantially in 2014). This led almost "naturally" to an increased share of government agency fund investors. Moreover, the number of VC funds "on the road" has approximately halved during the crisis.

Figure 23: Investor base: Share of government agencies in VC fundraising[28]



Source: EIF, based on data from EVCA

In order to put EIF's activity in context, one needs to take into account that EIF investment represented 15% of all VC fund investments in Europe in 2013. Assuming that the average stake in each fund ranges between 25 and 30% implies that EIF has invested in more than two-thirds of all VC funds launched in that year. Not even 30% of VC funds in which EIF invested since 2011 managed to close with their full target size until mid-2014, and nearly 60% of the EIF-backed funds would not have had a first closing at a viable fund size without EIF's support. This clearly indicates EIF's catalytic role, rather than a crowding-out effect, in times of an ongoing severe crisis for European VC. This view was confirmed in a recent Unquote Intelligence (2014) survey among General Partners (GPs) and Limited Partners (LPs), which found that "the overriding benefit of [public funding bodies'] (PFB) money is the crucial role it plays in attracting other investors". Moreover, "[h]aving PFB money in a fund does not deter other LPs from committing". However, even though EIF strives to stimulate market activity by its investments, it would not invest into funds which are not majority-financed by private investors.

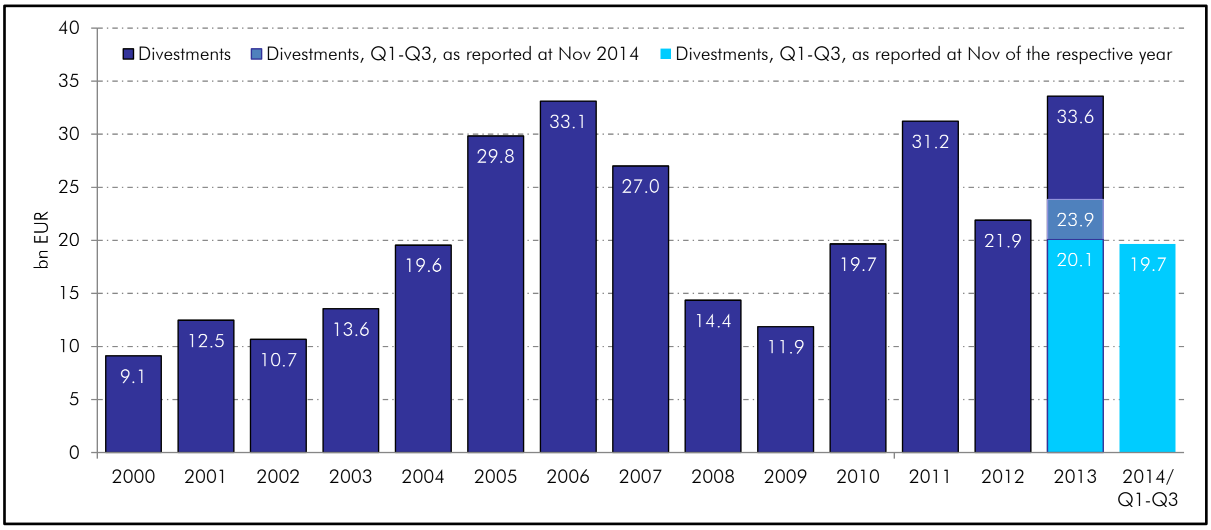
4.3 Divestment activity

Following the record year 2013, when PE divestment activity recorded the highest levels ever, the exit market seems to have remained remarkably strong in the current year. Total divestments by PE firms located in Europe amounted to EUR 19.7bn in the first three quarters of 2014, which is only 2% lower than the value that had been reported for the first nine months of 2013 at a similar time

[28]Based on incremental amounts raised during year (in contrast to final closings only).

of the previous year (see Figure 24).[29] Divestment amounts in the VC market segment increased by 9% to EUR 1.1bn in the first three quarters of 2014, while the EVCA preliminary data show drops in buyout divestments by (–5%) to EUR 16.7bn and by (–8%) to EUR 1.0bn in growth capital divestments.[30]

Figure 24: Divestments (by amount at cost divested) by private equity firms located in Europe



Note: EVCA had changed the data provider with effect from 2007 on. Since then, EVCA PE activity statistics are based on data from PEREP Analytics.

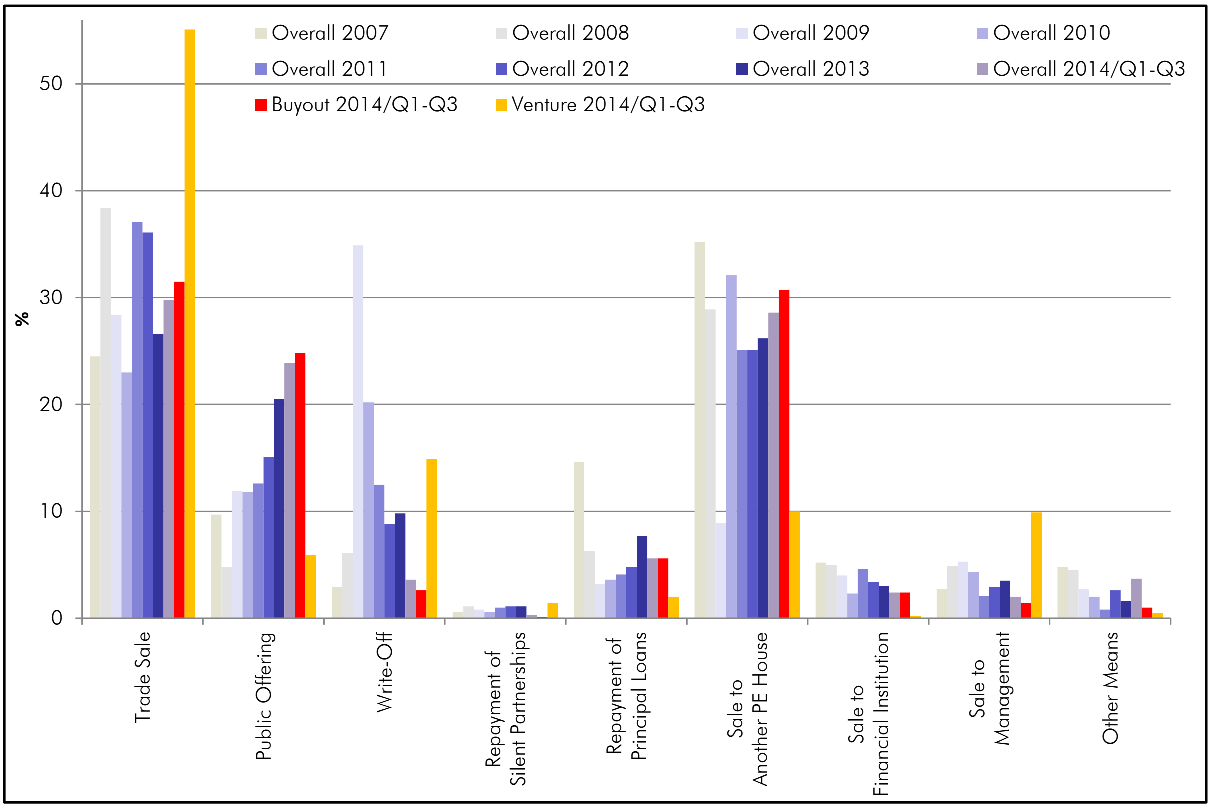
Source: EIF, based on data from EVCA

A closer look at the details of the EVCA divestment statistics shows the strength of the exit markets in the recent past. The relative importance of write-offs as a form of divestment has continuously decreased since 2010, except for a slight increase in 2013 (see Figure 25). Trade sales and sales to another PE house are still the most popular form of divestment and have even grown in importance in the first three quarters of 2014. Together, they account for more than half of the total divestment amounts. At the same time, the share of public offerings in total divestments increased to almost one quarter. In the buyout sector, the relative importance of write offs decreased substantially to less than 3% of all divestments. In the VC market, the relative importance of write-offs decreased as well, to 15% of all divestments. Another positive sign for the VC exit market can be taken from the increase in the relative importance of initial public offerings (to a share of 2.4% in total VC divestment amounts at cost) in the first three quarters of 2014. If these figures will be confirmed by the annual EVCA statistics, this would constitute the largest share since 2007. Examples of recent exits of companies held by EIF-supported funds included, inter alia, IPOs of the British online property portal Zoopla, the French biopharmaceutical firm DBV Technologies and the Dutch biotech company arGEN-X.

[29] EVCA statistics show divestment amounts at cost, i.e. the total amount divested is shown as the total amount that had been previously invested, hence not including any profit on the investment.

[30] The numbers for VC, buyout and growth divestments do not sum up to total PE divestments, as total PE divestments additionally include the rescue/turnaround and replacement capital market segments. Moreover, due to data availability, divestment activity for the sub-segments of the PE market (buyout, growth, and VC) is shown on the basis of statistics that follow the market approach (i.e. by country of the portfolio company), but not the industry approach (or office approach, i.e. by country of the PE firm).

Figure 25: Divestment routes (shares)[31]



Source: EIF, based on data from EVCA

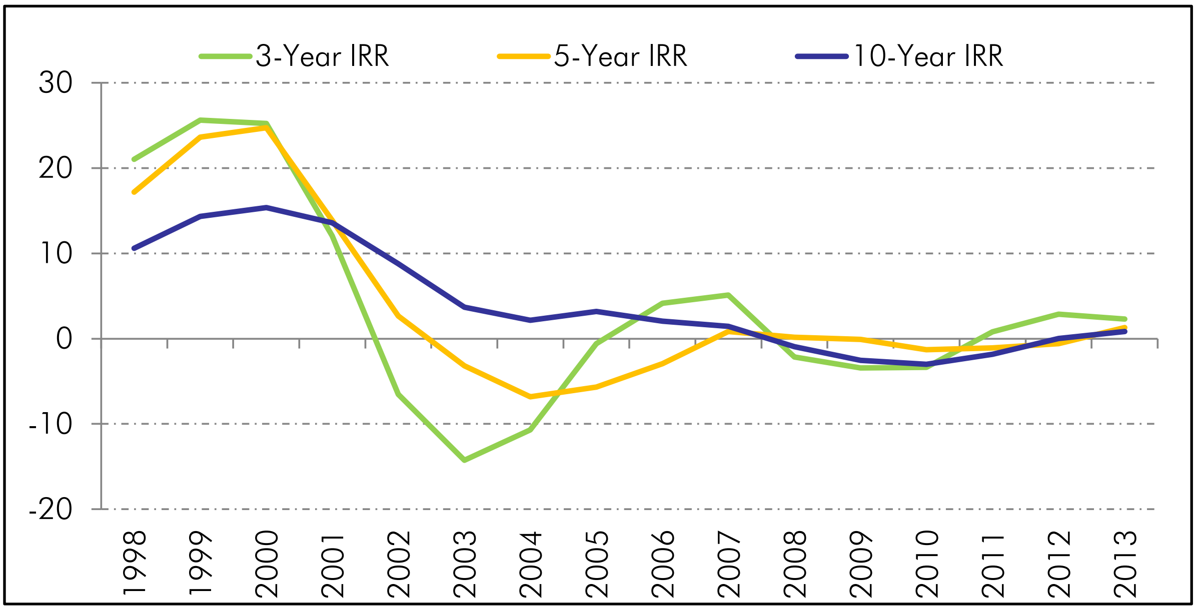
4.4 Performance trends

According to Thomson Reuters data, European venture capital performance has stabilised in 2013, albeit at a low level. (2014 data is not yet available; however, Preqin, 2014c, recently reported a pick-up in VC[32] performance in the first quarter of 2014.) Following three increases in a row, the 3-year rolling-horizon Internal Rate of Return (IRR) recorded only a small setback in 2013, and amounted to 2.3%. This is still good news, in particular when taking into account the long period of negative returns during the years 2008 to 2010. The longer term performance figures also convey a slightly optimistic message (see Figure 26). For the first time since 2008, the rolling-horizon IRRs for the 5-year (+1.3%) and the 10-year (+0.8%) periods are reported to be in the positive territory at the same time.

[31] Shares based on amounts at cost divested. "Overall" figures are *not* the weighted average of the "buyout" and "venture" figures, as "overall" figures additionally include the growth, rescue/turnaround and replacement capital market segments. Shares for buyout and venture divestment in 2014 are based on market statistics, as EVCA data based on industry statistics were not available.

[32] Please note that the VC definition of EVCA/Thomson Reuters and Preqin may differ.

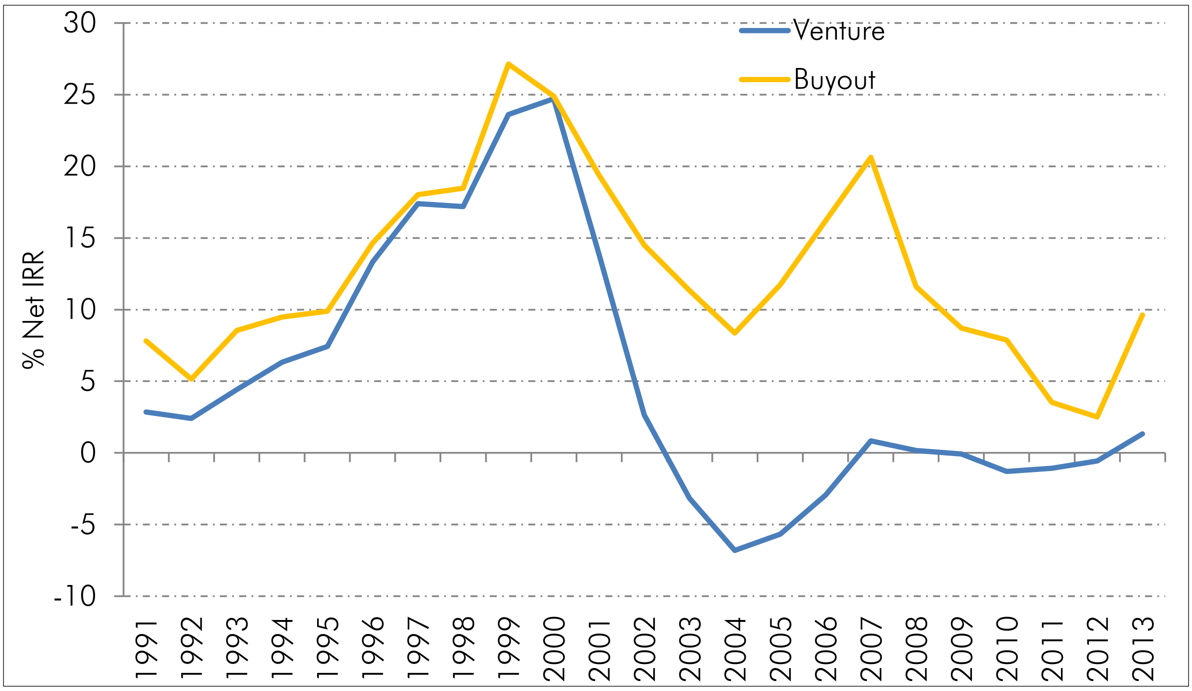
Figure 26: Rolling Horizon IRR European Venture Capital (in %)



Source: EIF, based on Thomson Reuters data

VC performance in Europe, however, is still below the level of returns reported for the private equity industry as a whole, which also includes the buyout and the mezzanine segments of the market. For the 5-year rolling-horizon IRR, Figure 27 shows that the relatively good performance of the buyout sector compared to venture capital in Europe holds also true when looking at the past, in particular since 2001. However, the IRR figures for the buyout and the venture sectors had converged until 2012, before the performance picked up stronger in the buyout sector than for VC in 2013.

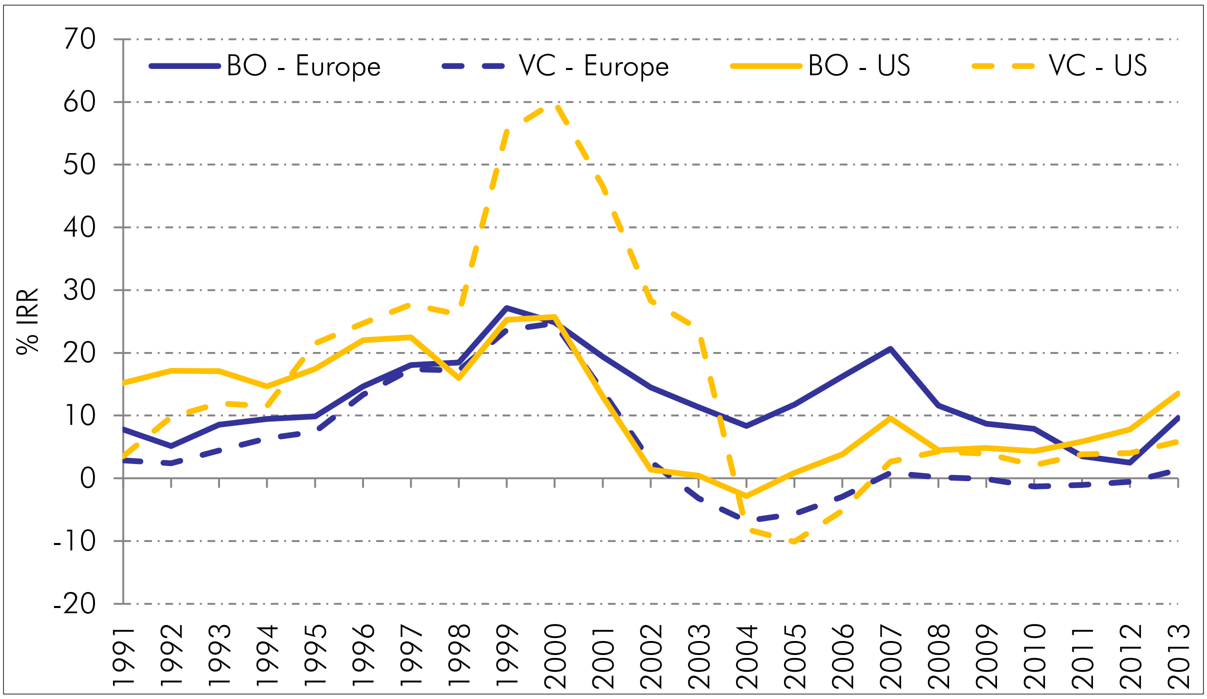
Figure 27: Five-year rolling-horizon net IRRs for European venture and buyout funds



Source: EIF, based on Thomson Reuters data

From a geographical point of view, the European picture looks relatively brighter for the buyout sector than for venture capital. Figure 28 shows that buyout performance (measured as a rolling five-year-horizon IRR) in Europe was better than in the US between 1998 and 2010 (with the year 2000 being the only exception). However, the US buyout sector has been picking up over the last three years and, consequently, outperformed the European buyout market. The European *venture* sector performed worse than its American benchmark in almost all years. Only during 2004 and 2006, when US VC performance entered negative territory, did its European counterpart perform slightly better.

Figure 28: Five-year rolling-horizon IRRs for Europe and the US



Source: EIF, based on Thomson Reuters data

4.5 Prospects

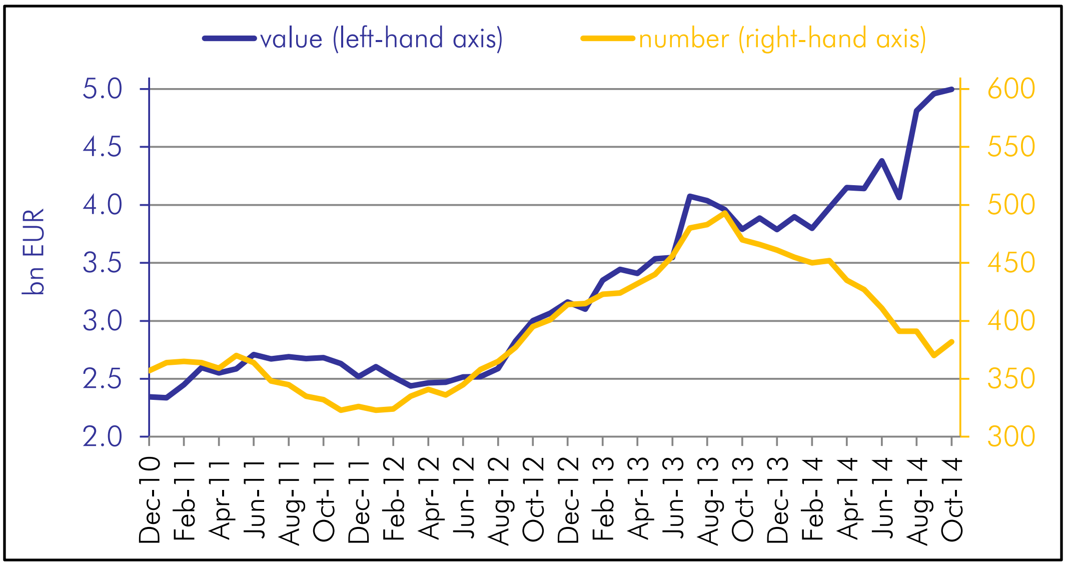
The relatively positive developments in European PE and VC activity figures were confirmed by confident outlooks reported in surveys among fund investors. According to Preqin (2014b), the proportion of investors that find European investment opportunities attractive, has considerably increased in the last years. In particular, the share of North-America-based Limited Partners (LPs) that consider Europe as an attractive region for investment had grown from 27% in December 2012 to 60% in December 2013. A Coller Capital (2014) survey[33] found that, while in particular

[33]Coller Capital's Global Private Equity Barometer is published twice-yearly and intends to give an overview of the plans and opinions of institutional PE investors (LPs) based in North America, Europe and Asia-Pacific (incl. the Middle East). The summer edition of the Global PE Barometer captured the views of 115 PE investors from round the world, surveyed in February-March 2014 (a more recent issue is not yet available). According to Coller Capital (2014), the "findings are globally representative of the LP population by: investor location, type of investing organisation, total assets under management, length of experience of PE investing".

“North American LPs […] are not yet convinced about Southern Europe”, the majority of PE investors “see good opportunities in Northern Europe in the next three years”. According to Go4Venture Advisers (2013a), the “renewed interest in European venture” has been “partly driven by the search for growth in the context of a moribund macro environment [and] low interest rates”.

Go4Venture Advisers’ early indicator, the European Tech Headline Transactions Index[34], has recorded, on average, strong increases in terms of investment values since summer 2012, while the number of deals have followed, on average, a declining trend since autumn last year (see Figure 29, which shows the index development on a 12-month rolling-horizon basis).

Figure 29: European Tech Headline Investment Transactions (12-month rolling horizon)[35]



Source: EIF calculations based on Go4Venture Advisers data.

However, the current economic situation and various regulatory changes continue to make the general market environment very challenging. EVCA (2014a) provides a comprehensive overview of some 30 regulatory initiatives and changes and their potential impact on PE in Europe. We cannot go into a detailed assessment of all the different rule sets here (e.g., just to mention a few names, AIFMD, Solvency II, EuVECA, CRD IV and CRR, and various taxation rules), however, according to a Preqin survey (Preqin, 2014a), regulation, performance and the economic environment had been perceived as the biggest challenges that investors were facing (similar findings were reported by Unquote Intelligence, 2014).

[34] Go4Venture Advisers’ European Tech Headline Transactions Index “is a derivative index” which is “compiled […] based on the deals reported in major trade publications and news feeds […] as an early indicator of evolutions in the private investments market for European TMT companies. […] TMT is defined to include Technology, including IT and Life Sciences (except drug discovery); Media, including Internet & Digital Media; Telecom Services (alternative operators only)”. For this and more information on definition and methodology see Go4Venture Advisers’ (2013b), Go4Venture Advisers’ (2013c) and Go4Venture Advisers’ (2014) and www.go4venture.com/research/.

[35] In the two lines in the diagram, each data point shows the sum of the total value of deals (blue line) and the sum of the total number of deals (yellow line) observed in the month to which the respective data point is related and over the 11 months prior to that data point. For example, in July 2013, the total value of deals observed during the period from August 2012 to July 2013 amounted to EUR 4.1bn, and a total number of 480 deals were observed during the same period.

All these challenges continue to create access to funding problems, in particular for new funds, in the European VC market. Moreover, a Coller Capital (2013) study found that more than half of the global LPs believe that there are insufficient sources, other than VC, available to finance innovation and growth in Europe. This supports a view that public backing is especially needed for this market segment in order to strengthen, inter alia, the early-stage part of the market. We had outlined recent OECD findings on policy measures taken by governments to support seed and early-stage financing in previous issues of the ESBFO (see Kraemer-Eis, Lang and Gvetadze, 2013b, 2013c and 2014). Indeed, a recent Unquote Intelligence (2014) survey found that "public money remains absolutely critical to the European venture industry and is likely to remain so for the next five years", and this has been particularly true for new funds, as most public funding bodies support first-time funds, while this is true for only approximately half of private investors. Besides the additional funding volumes, public investors' participation in a PE/VC fund can also have a positive signalling effect on private investors, e.g. due to perceived strong due diligence requirements and an assumed relatively high stability of public LPs' commitment to a fund. These advantages seem to outweigh the potential disadvantages (e.g. a possibly negative impact on speed and responsiveness or imposed restrictions in the investment strategy of the fund) of public investors' participation.

In this context, several empirical studies analyse the relationship between private VC activities and governmental support: According to Colombo, Cumming and Vismara (2014), the design of a public VC investment scheme is important for their impact. In particular, governmental VC schemes seem to have been more successful when they acted alongside private investors, which would favour a governmental fund-of-funds set-up over direct public investments. Moreover, Brander, Du and Hellmann (2014), in an continuation of their 2010-study, find that enterprises funded by both governmental VC and private VC obtain more investment than enterprises funded purely by private VCs, and much more than those funded purely by governmental support. There is also a positive association between mixed governmental/private funding and successful exits, as measured by initial public offerings and acquisitions, attributable largely to the additional investment. These findings are in line with Bertoni and Tykvová (2012), who concluded that "that syndicates between private and governmental venture capital investors, in which the private investor takes the lead, are the most efficient form in terms of innovation production that outperforms all other forms." The recent award of the German "Zukunftspreis" (the Federal President's Award for Technology and Innovation) to the food technology company Prolupin, which is, inter alia, backed by an EIF-supported VC fund, could be taken as another sign for the success of a "partnership" approach of governmental and private resources for VC financing for the support of young innovative companies.

Moreover, EIF market insight shows a number of VC-backed companies in the early-stage segment that show increasing revenues and are now achieving profitability, positioning them well for sustained organic growth and ultimate strong returns for investors. However, while in some cases performance is indeed driven by fundamental economic value, part of the upside performance may also be driven by higher demand due to dry powder looking for investments. This is to be looked at with caution. It is then, however, important to support those companies in their continued growth that have well-developing economic fundamentals, and to also help, through the support of financial intermediaries, additional and complementary businesses to maintain and strengthen the backbone of the European VC market, i.e. a strong and continued supply of new innovative companies. In addition, the VC ecosystem is developing, including the emergence of more and more successful incubators and accelerators. Should these trends continue, the potential returns of early-stage companies would have significantly positive impacts on the performance of VC investing. In consequence, the medium-term perspective of the European VC market would be more positive than the backward-looking statistics reveal.[36]

To summarise, it remains to be seen if the positive developments observed in the recent past could develop into a longer-term positive trend. As a reference catalytic investor in European venture and growth capital funds, EIF is actively working in that direction: EIF has increased its counter-cyclical role by providing financing solutions to boost entrepreneurship and innovation. In the coming years, EIF will continue to act as a cornerstone investor across the spectrum from technology transfer to venture capital to the lower mid-market and mezzanine financing (see Box 4 for more information concerning "mezzanine").

Box 4: Mezzanine finance

OECD (2014b) writes about mezzanine finance that "this form of finance has not received as much public attention as venture capital or specialised exchanges for SMEs, but it holds potential to respond to […] critical problems in SME finance." However, mezzanine finance is a diverse asset class in between traditional senior debt and equity instruments. It can take any form of hybrid debt/equity securities, ranging from junior loan without any equity component, to convertible debt, or debt with equity warrants. Most of the mezzanine volumes are used to finance acquisition by Private Equity funds in leveraged transactions denominated "sponsor-led" or "equity sponsored" by reference to the PE fund providing equity for the transaction. However, similar instruments can also be used to finance company growth (both organic and external, through add-on acquisitions and project roll-outs) or working capital facilities in transactions denominated "sponsor-less", for which neither the capital markets (too small amounts) nor the banks (not sufficiently capitalised companies or regulations) are able to provide equity or senior debt. This type of hybrid debt/equity instruments is also welcome by companies whose shareholders are not ready to accept the level of dilution of a full equity investment. However, despite its importance as injector of liquidity into the economy, this type of financing is often viewed as expensive debt, and so has been given limited attention and marketing.

The recent financial crisis revealed that "sponsor-less" mezzanine was not sufficiently developed in Europe. Consequently, in 2009, EIF began supporting this market and started investing in funds providing hybrid debt/equity finance (mainly focussing on those privileging "sponsor-less" transactions) through a new mandate, the Mezzanine Facility for Growth (MFG), which was a EUR 1bn fund-of-funds program from the EIB.

With a view to playing a catalytic role in the creation of new market players, the MFG was established to meet the underlying market demand. It provided financing to support the growth plans of entrepreneurs who try to keep control of their companies, or of the shareholders of companies that need reorganisation of their capital structures. This hybrid mandate also included a technology window under which venture debt could be provided to companies supported by venture capital investments, which, however have still no access to standard bank funding. EIF is usually involved well ahead of most of the other potential investors in the set-up of funds, making significant participation before or at the first closing.

[36] For example, EIF currently sees a positive trend in VC/Growth stage performances, and the vintage years 2007 and beyond currently show encouraging interim results.

Box 4 continued:

By Q1 2013, the MFG mandate was fully committed, demonstrating the ability of EIF to meet a substantial market demand with this new product. Following this successful implementation, during 2013, the mezzanine mandate granted by EIB has been doubled (EUR 2bn), converted into a revolving structure and merged within the other EIB mandates. These additional resources expand EIF's capacity to support mezzanine funds in the EU, making investments in hybrid debt/equity funds one of the pillars of EIF's support to European SMEs.

In 2013, a total of EUR 110m was committed in mezzanine funds, catalysing EUR 300m of capital and EIF continued to play a catalytic role in this field, committing capital to new hybrid debt/equity funds, enabling new market players to become established, increasing the visibility of the asset class to (new) investors and providing alternative sources of finance to SMEs and small mid-caps as well as to late stage technology companies. For the first time, EIF supported managers of hybrid debt/equity funds in Greece, Ireland and Portugal.

Under the same umbrella, EIF established the "Mezzanine Dachfonds für Deutschland" (MDD) in 2012, a mezzanine fund-of funds program for Germany. MDD is a EUR 200m fund-of-funds funded by the BMWi (German Federal Ministry of Economics and Technology), LfA Förderbank (the development bank of Bavaria), and NRW.BANK (the development bank of North Rhine-Westphalia). For each MDD investment in a hybrid debt/equity fund with activities in Germany under MDD, EIF is co-investing an amount that is at least equivalent to MDD's.

In addition, in particular in the framework of the EIB Group Risk Enhancement Mandate (EREM), EIF is in the process of implementing financing instruments (equity and guarantee solutions) to support the development of the "Debt Funds" market segment. Please see for details box 7 further below.

EIF's activity in the equity sphere also includes the launch and extension of new and pilot initiatives, such as, for example, the European Angels Fund (EAF), which we described in box 3 further above. Moreover, EIF is also active in the field of Technology Transfer in order to support the commercialisation of research know-how – see Box 5 for further information.

Box 5: Technology transfer activity

Technology transfer (TT) encourages collaboration between research organisations and industry, the licensing of intellectual property rights, and the creation of start-up businesses and university spin-out companies. EIF continues to engage selectively in this key area for the establishment of long-term sustainable innovation in the EU, and whilst continuing to engage with world leading research centres, during 2014 has continued to address new, less developed TT ecosystems such as Turkey. This strategy, involving a greater level of risk is dependent on EIF being entrusted with funding sources with same objectives and risk profile. Thus discussions continue with the European Commission (EC) to set up a Technology Transfer Finance Facility (TTFF). Assuming EC funding can be invested on a subordinated basis, this facility, with its more aggressive risk profile, would open up a new market for EIF and address the needs of a larger number of European TT players particularly in their proof-of-concept phases. The overall amount of this pilot facility is under discussion. Also, Member States are increasingly willing to dedicate substantial resources to TT. (Source: EIF.)

Other examples of EIF's initiatives are partnerships with corporate investors, structured as a Corporate Innovation Platform (CoriP)[37], to establish collaboration between fund managers, strategic investors and portfolio companies, as well as another pilot initiative – the Social Impact Accelerator (SIA)[38], the latter has been started to satisfy the growing need of equity finance for support to social enterprises (see as well Box 6). This segment of the business world is becoming increasingly instrumental in promoting social inclusion, providing alternative sources of employment to marginalised social groups, and contributing to growth.

Box 6: Social entrepreneurship and impact investing

There is no universally accepted definition of *social enterprises* or *social entrepreneurship*. Nevertheless, typically, social enterprises are meant to show the following common features: their primary goal is to serve a social interest (social, societal, environmental objectives) instead of profit maximisation, but alongside a financial return, they are often of an innovative nature (through the inputs and output), and they often employ society's most fragile and marginalised members who are typically excluded from the mainstream labour market - socially and financially excluded persons, disabled people, ex-prisoners, minorities.

The growing presence of social enterprises in Europe is a direct response by the private sector to provide certain public services, which are either not currently funded, or can no longer be funded from state or municipality budgets. The growth of the social entrepreneurship market segment also illustrates the current change of paradigm that marks a shift from a subsidy-based approach to sustainable economic models for the resolution of long-term social issues. The increasing gap in public services has triggered an increased number of "change-makers" to set up social enterprises that propose innovative ways to tackle current societal challenges. (Source: EIF.)

Investing activity related to social entrepreneurship is traditionally considered as *impact investing*. Impact investing is a profit-seeking investment activity that intentionally generates measurable benefits for society. Impact expectations and objectives are formulated prior to investing and the progress towards achieving these objectives are measured during the term of the investment.

True impact investors have no trade-off between financial returns and social impact, as these two elements are positively correlated. A recent survey of impact investors revealed that the majority (71%) of impact investors consider determining impact objectives essential and even more (80%) consider generating financial returns essential. Moreover, more than half of them targets "competitive, market rate returns" from their investment (J.P. Morgan, 2014).

With regard to the financial return prospect of Social Impact Funds, little evidence is publically available at this stage. This lack of information is largely due to the fact that most of the realised track record in Social Impact Investing is linked to the activity of family offices, which typically do not publicly disclose figures in relation to their investment performance. Nevertheless, dedicated research on the impact investing activities of family offices suggests that net returns to investors of 5% to 10% are achievable, depending on the investment's target sectors (Source: EIF).

[37]More information on the CoriP is available here: http://www.eif.org/what_we_do/equity/corip/index.htm.
[38]More information on the SIA is available here: http://www.eif.org/what_we_do/equity/sia/index.htm.

Box 6 continued

<u>EIF activities</u>

The European Investment Fund (EIF), with the collaboration of private sector investors, has launched the Social Impact Accelerator (SIA), the first pan-European public-private partnership for social impact investing. SIA is a pilot initiative which addresses the growing need for availability of equity and hybrid finance to support social enterprises, a segment of the business world which is becoming increasingly instrumental in promoting social inclusion, providing alternative sources of employment for marginalised social groups and contributing to growth.

Beyond simple financial return targets, these social impact funds seek to trigger positive societal change as a result of their impact conscious investment activity. In addition to enhancing the availability of finance for social enterprises, SIA aims to build up the existing market infrastructure for social impact investing in such a way that this emerging asset class is placed on a path to long-term sustainability.

Social impact funds in which SIA is invested are social impact funds supporting social enterprises, which are defined as economic entities having at the core of their business model the scalable resolution of a recurring social issue. The sectors in which those SMEs are active are typically, employment, education, social inclusion, public health, social housing, and consumer services. Within SIA's portfolio, there is also the first investment fund dedicated to financing social impact bond schemes.

Under SIA, EIF has to date approved EUR 57m to six social impact funds across the EU (2 in the UK, 1 in Italy, 2 in France and 1 in Germany). An additional commitment has been approved by EIF BoD and should be signed early in 2015. Moreover, the pipeline of investment for the SIA is strong and shows a high market demand for a large and stable source of funding for social entrepreneurship across the EU.

The EIB has supported the initiative through a capital increase of the SIA, now reaching EUR 239m (further discussions with private investors are ongoing). Through the capital increase of the SIA, social impact investing has now become a mainstream pillar of EIF's business, expanding its operations to a broader array of European SMEs to ensure appropriate channelling of funds to the European economy backbone (Source: EIF).

To pursue its equity activities, EIF invests its own funds as well as resources managed on behalf of mandators. These are deployed through various programmes including the EIB Risk Capital Resources (RCR) mandate and the EC COSME Equity Facility for Growth (EFG), which is part of the new "Single EU Equity Financial Instrument" (s. below). The new EIB Group Risk Enhancement Mandate (EREM) extends, inter alia, the offer of funding instruments to the actors in the social economy, notably social sector intermediaries such as social investment funds that are supporting social enterprises.

On the European level, the new "Single EU Equity Financial Instrument" supports European enterprises' growth, research and innovation from the early stage, including seed, up to the expansion and growth stages. This instrument is financially supported by "Horizon 2020" and the "Programme for the Competitiveness of Enterprises and SMEs" (COSME). Moreover, private equity instruments can be supported under regional and local mandates (see EIF, 2014, and the EIF website).

5 SME guarantees and SME Securitisation in Europe

5.1 SME guarantees

In the area of access to finance for SMEs, a market imperfection/failure is not only present during a deep recession or a financial crisis, but also on an on-going basis as a fundamental structural issue (see OECD, 2014b, for a recent overview of market failures in SME lending and mitigation techniques). There are several reasons for this. One of them is the disproportionality between the extent, and hence the cost, to assess a relatively small company's application for finance and the potential revenue. Whereas the credit assessment contains a certain fixed cost element (i.e. independent of the size of the finance requested), the revenue is, inter alia, dependent on the amount. The aforementioned issue is even reinforced by the asymmetric information (in the case of debt: information gap between lender and borrower – and the availability (and quality) of information about smaller enterprises is typically even worse than for the bigger companies), combined with uncertainty, which causes agency problems that affect debt providers´ behaviour (see Akerlof, 1970 and Arrow, 1985).[39] This results in an insufficient supply credit (an analogue argumentation is valid for equity financing) for SMEs.

Information asymmetries exist to a less degree if a strong relationship between lender and borrower has been established which makes the borrower well aware of what information needs to be provided, including the extent of collaterals required (support in this regard is also given by third parties like, for instance, chambers and guarantee societies), and that enable the lender to know well not only the hard but also the soft facts of the borrower. Thus, through due diligence/lenders' examination (screening), and by a firm's ability to signal its credit worthiness (incl. an institutional assessment or rating by an independent agency and the provision of collateral, also in form of a guarantee), information asymmetries can be reduced. However, this means that new or young firms, with a lack of collateral and, by definition, without a track record, are the ones with the greatest degree of difficulty in accessing debt capital. These financing obstacles can also negatively affect productivity in the economy.

Guarantee mechanisms, "whereby should the borrower default the guarantor compensates a pre-defined share of the outstanding loan" (OECD, 2014b), are a commonly used response to these kinds of market failures, as guarantees reduce the risk of lenders and favour the provision of financing to viable businesses that are constrained in their access to finance. Credit guarantee schemes "are used widely across economies as important tools to ease financial constraints for SMEs and start-ups" (OECD, 2013), and in order to alleviate market failures in SME financing. Moreover, loan guarantee programs expanded substantially in the years 2007-2011, as a government policy response to the financial crisis. In addition, "new elements were added to some of these programmes, such as reduced red tape and more rapid provision (i.e. 'express guarantees' [in Belgium]), and new instruments were created outside traditional guarantee programmes" (OECD, 2014b). Therefore, loan guarantee programs continue to be "the most widely used instrument at goverments' disposal to ease SME access to finance" (OECD, 2015).

[39] Agency theory/the principal-agent approach is often applied in economic literature for analysing relationships between lenders and borrowers (e.g. contract design, selection process, credit constraints, etc.)

Referring to the countries in Central, Eastern and South-Eastern Europe (CESEE), the Working Group on Credit Guarantee Schemes (CGSs) in CESEE, established under the European Bank Coordination Initiative (Vienna Initiative 2) undertook in 2014 an analysis of the role of SME Credit Guarantee Schemes in the respective region (VIWGCGS, 2014). The findings and conclusions are in line with other studies (e.g. OECD, 2013 and 2014) and emphasize the importance of and the strong demand for SME CGSs in the region. Moreover, best practices for the design and operational characteristics of schemes have been identified that can be generalised as well for other parts of Europe.[40]

Market information concerning CGS in Europe is gathered by AECM, the European Association of Mutual Guarantee Societies.[41] These data covers SME guarantees and counter-guarantees provided by AECM members (in the case of counter-guarantees, the – typically public – counter-guarantor takes over the risk from the guarantor, up to a predefined share of the guarantee. See Kraemer-Eis, Lang and Gvetadze, 2013a, and OECD, 2013). In the following we provide information about the countries with at least one AECM member to show the state and development of this important market segment.

Market size

Key figures, based on *outstanding guarantees* on SME loan portfolios in 2013[42], are presented in Table 3 (see further below for a discussion of AECM figures for the first half-year 2014). In terms of total amounts of guarantee and counter-guarantee activities, the core countries are Italy (EUR 32.9bn), France (EUR 16.5bn), Germany (EUR 5.8bn), and Spain (EUR 4.7bn). Italy also has the highest total *number* of outstanding guarantees (781,635), followed by: France (596,660), Turkey (283,231), Poland (150,314), Portugal (80,892) and Spain (73,200).

[40] In the context of this work, a sub-project concerning measuring the economic additionality of CGSs has been performed, using a specific guarantee programme (MAP, Multi Annual Programme for Enterprise and Entrepreneurship) that has been financed by the European Commission and implemented by the EIF. This sub-project found, inter alia, positive effects on the number of employees (at the level of the companies, benefitting from the guarantees), as well as positive effects on the total factor productivity. This sub-project will be presented in detail in a forthcoming joint working paper of the European Commission and EIF.

[41] We would like to thank our colleagues from AECM for their support. AECM has currently 42 members in 20 EU Member States, Bosnia and Herzegovina, Kyrgyzstan, Montenegro, Russia, and Turkey. EU countries without an AECM member are Cyprus, Denmark, Finland, Ireland, Malta, Slovakia, Sweden and the UK, even if guarantee activities exist. In the AECM member countries, the AECM members cover all or almost all SME guarantee activity. Some AECM members are national associations or networks and thus have their own member organisations. AECM has purely private, mutual, public, and public-private mixed members. In 2013, AECM members had a volume of outstanding guarantees in portfolio of EUR 77bn and 2.2mn active guarantees. Source: AECM.

[42] For data availability reasons, AECM statistics include the business figures of the largest Italian AECM member with a time lag of one year. For the same reason, 2012 figures were used for AECM members from Greece, Luxembourg, and Poland and for one Slovenian member. No 2013 data was included for some smaller Belgian AECM members. These disclaimers apply as well for the diagrams and tables presented throughout this chapter.

Table 3: Outstanding guarantees and counter-guarantees[43] on SME[44] loan portfolios[45] and resulting average guarantee size in 2013[42] by country

Country	guarantee and counter-guarantee			guarantee activity			counter-guarantee activity		
	Volume [k EUR]	Number	Average guarantee size [k EUR]	Volume [k EUR]	Number	Average guarantee size [k EUR]	Volume [k EUR]	Number	Average guarantee size [EUR]
Austria	373,336	5,759	64.8	373,336	5,759	64.8			
Belgium	737,780	9,643	76.5	712,409	8,002	89.0	25,371	1,641	15.5
Bulgaria	30,028	1,041	28.8	28,944	1,023	28.3	1,084	18	60.2
Czech Rep.	661,039	6,060	109.1	661,039	6,060	109.1			
Croatia	149,356	1,384	107.9	149,356	1,384	107.9			
Estonia	102,300	1,366	74.9	102,300	1,366	74.9			
France	16,548,860	596,660	27.7	15,748,860	587,960	26.8	800,000	8,700	92.0
Germany	5,794,999	48,431	119.7	5,794,999	48,431	119.7			
Greece	585,298	23,374	25.0	585,298	23,374	25.0			
Hungary	1,327,863	42,045	31.6	1,281,953	41,706	30.7	45,910	339	135.4
Italy	32,915,057	781,635	42.1	20,276,000	658,380	30.8	12,639,057	123,255	102.5
Latvia	86,104	386	223.1	86,104	386	223.1			
Lithuania	192,799	3,711	52.0	102,222	2,314	44.2	90,577	1,397	64.8
Luxembourg	1,563	61	25.6	1,563	61	25.6			
Netherlands	2,166,000	19,830	109.2	2,166,000	19,830	109.2			
Poland	1,540,905	*	*	1,540,905	*	*			
Portugal	3,039,368	80,892	37.6	3,039,368	80,892	37.6			
Romania	1,623,948	36,737	44.2	1,369,233	29,955	45.7	254,715	6,782	37.6
Russia	265,706	1,812	146.6	265,706	1,812	146.6			
Spain	4,704,049	73,200	64.3	4,704,049	73,200	64.3			
Slovenia	194,195	1,841	105.5	193,705	1,781	108.8	490	60	8.2
Turkey	3,911,411	283,231	13.8	3,911,411	283,231	13.8			
Total	*76,951,964*	*2,169,413*	*35.5*	*63,094,760*	*2,027,221*	*31.1*	*13,857,204*	*142,192*	*97.5*

**For Poland, the number of guarantees and the average guarantee size are available for one AECM member only. For this member, AECM statistics report a number of guarantees of 150,314 and an average guarantee size of EUR 0.5k. Most recent figures for all Polish AECM members are from 2011, when the average guarantee size amounted to EUR 6.8k.*

General Note: Missing values mean that the AECM member(s) in the respective country has (have) no counter-guarantee activities, according to AECM information.

Source: AECM (provisional figures)

Compared to the value of economic activity, guarantees are relatively important (measured by the volume of outstanding guarantees in portfolio as a percentage of GDP) in Italy (2.1%), Portugal (1.8%), Hungary (1.4%), and Romania (1.1%), as shown in Figure 30.[46] According to the OECD (2013), guarantees are particularly relevant "in those countries where a network of local or sectoral guarantee institutions is well established".

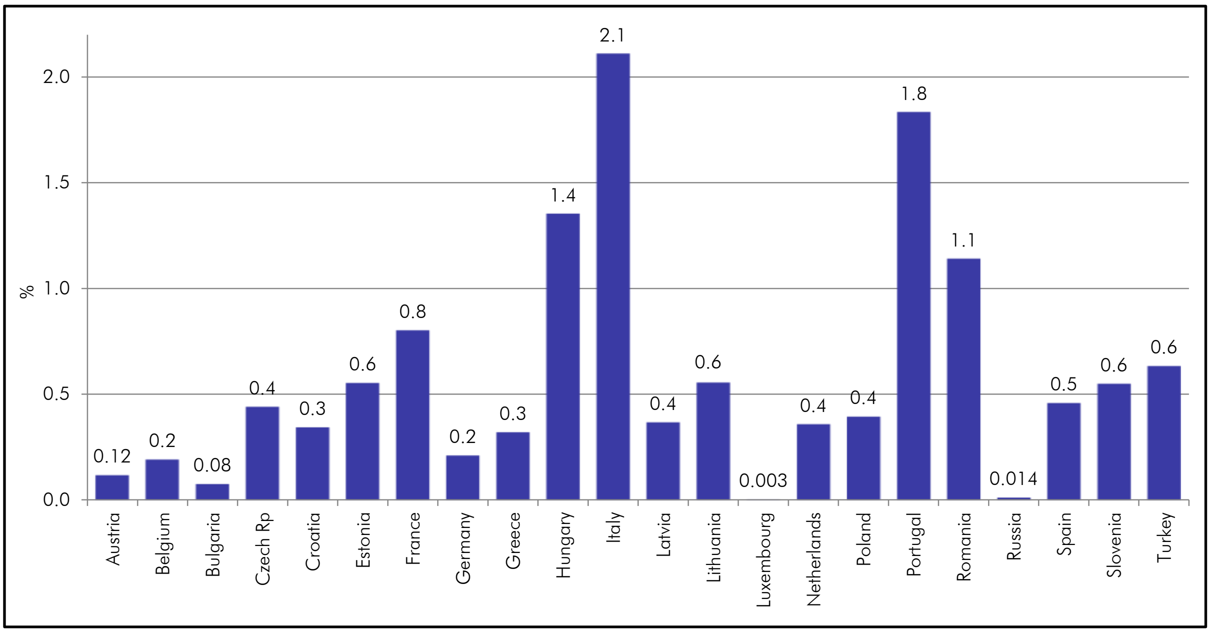
[43]In Romania and Slovenia, some AECM members provide counter-guarantees to other AECM members; in these cases, the summing-up of guarantee and counter-guarantee activities leads to a double-counting of the underlying guaranteed loans. However, for consistency of the data shown in the table, these were not cleaned accordingly.

[44]In the case of France, the counter-guarantee data include co-guarantees. These can also cover non-SME related areas such as regional infrastructure and municipality financing.

[45]In the case of some AECM members, guarantees or counter-guarantees cover *portfolios* of loans or guarantees; however, in most cases, they cover *single/individual* loans/guarantees.

[46]Here and in the following, all figures include guarantee, counter- and co-guarantee activities.

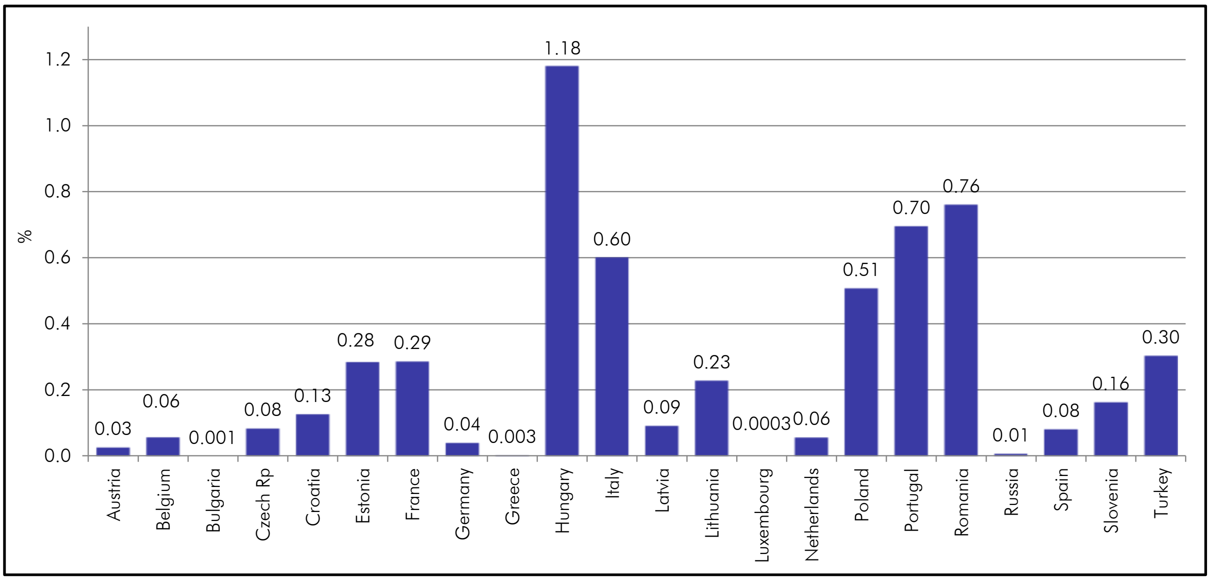
Figure 30: Volumes of outstanding guarantees in portfolio scaled by GDP, 2013 data



Source: AECM (provisional figures).

The guarantee activity in 2013 was strongest, related to GDP, in Hungary, Romania, Portugal, Italy and Poland (see Figure 31).

Figure 31: Volumes of guarantees granted in 2013 scaled by GDP



Source: AECM (provisional figures).

Market activity

Guarantees outstanding

Changes in the volumes of guarantees outstanding

In 2013, according to the preliminary AECM data, the total *volume of outstanding guarantees in portfolio*, decreased by 0.7%, compared to the previous year.[47] Within the EU, the largest decreases were recorded in Bulgaria (–47.7%), the Czech Republic (–22.8%), Spain (–14.9%) and the Netherlands (–11.6%). Only five countries exhibited a positive growth rate, of which the strongest one was recorded for one Polish AECM member (+295.3%), following the launch of a new guarantee product. Other increases were reported for Lithuania (+11.2%), Turkey (+9.3%), France (+3.4%) and Portugal (+2.4%).

At the same time, the *number of outstanding guarantees* reported by AECM increased by 3.8%. Within the EU, by far the largest increase was recorded in France (+31.0%), followed by Portugal (+12.4%) and the Czech Republic (+11.2%). The most substantial decreases were reported for Romania (–38.7%) and Bulgaria (–36.7%). For the Czech Republic, the decrease in the guarantee volume (in EUR) with a parallel increase in the number of outstanding guarantees can to a large extent be explained by the devaluation of the Czech Koruna between end-2012 and end-2013.

The observed decrease in values, with a parallel increase in the number of guarantees, is reflected in the development of the *average guarantee sizes*, for which the AECM statistics show an increase from EUR 34.1k in 2008 to EUR 40.2k in 2011, while the value dropped backed again in 2012 (to EUR 37.4k), i.e. towards the average size reached in prior years. In 2013, the average guarantee size has further decreased to EUR 35.8k.

These developments can be explained by an increase of guarantees with smaller amounts, due to smaller underlying loan sizes because of lower investments, as well as of short-term guarantees (i.e. working capital loan guarantees, which have in general smaller amounts, and bridge-financing guarantees, e.g. for the extension of an already provided guarantee). Short-term guarantees generally (for the AECM members) cover less than 12 months. Moreover, according to AECM, their members are currently faced with growing requests to increase the guarantee duration of already incurred guarantee commitments, because of SMEs' financing constraints, which lead to requests to reschedule loan repayments. These reschedulings of SME loan repayments and of the related guarantee commitments often imply lower guarantee values.

Guarantees provided per year

The volume of *new guarantees provided per year* was reported to be at the level of EUR 25.7bn in 2013 (EUR 23.3bn of guarantee activity plus EUR 2.4bn of counter-guarantee activity). For those AECM members that consistently reported data for 2012 and 2013, the volume of new

[47] Those AECM members, for which 2013 data has not yet been reported in the AECM statistics, were not included in the calculation of the growth rate.

guarantees (including counter-guarantees) increased by 2.0%.[48] No further explanation is reported as to why the stock of guarantees fell in 2013, while the new business increased. A possible reason could be that the value of guarantees that reached the end of maturity in the course of 2013 was higher than the value of the new guarantees issued.

As for the developments in new guarantee business *by country* (for those countries for which 2012 and 2013 data is reported in the AECM statistics), the largest value increases of new guarantees granted per year were recorded for the Poland (+914.3%), the Czech Republic (+68.1%), Lithuania (+34.9%), Portugal (+33.0%), Slovenia (+13.9%) and Austria (+6.8%). Due to their relatively large business size, the increases in France (+2.7%) and Germany (+2.4%) also contributed strongly to the overall growth in the European guarantee business. The largest decreases were observed in Bulgaria (–97.9%), the Netherlands (–29.2%), Turkey (–24.0%), Romania (–18.2%) and Spain (–13.4%). The large drop in activity that was recorded in Bulgaria is due to the termination of one major guarantee product (a newly developed product was started only this year). In addition, setbacks in demand and cuts in the budgets allocated to purely public guarantee schemes led to decreases in guarantee activity in some countries.

In terms of *numbers*, 681,347 new guarantees were issued in the course of 2013. For those AECM members that consistently reported data for 2012 and 2013, the number of new guarantees issued increased by 20.9% compared to the previous year. This seemed to reflect a bottoming out of the negative trend after strong falls in the number of new guarantees in 2010 and 2011.

The total number of *new SME[49] beneficiaries* in portfolio stood at 154.7k in 2013, for the subsample of the AECM members that provided this information.

According to the most recent AECM data for the *first half-year of 2014*, but only based on a subset of AECM members,[50] the *total amount* of *new* guarantees has slightly increased (+1.0%), compared to the same period one year before, while the *number* of *new* guarantees has remained rather stable (+0.1%). In some countries, in particular in Bulgaria and Poland, remarkable increases in the new guarantee business have been observed, due to the launch of new guarantee product lines.

<u>*Drivers of the developments in guarantee business*</u>

The developments in SMEs guarantee transactions are, on the one hand, caused by special items in particular countries, while on the other, they seem to mirror the specific macro- and micro-economic situation in the different economies. Those countries that suffer relatively strongly from the current sovereign debt crisis and experience weak economic growth – or even a fall in economic activity – also show poor developments in guarantee transactions. This seems to be

[48]Those AECM members, for which 2013 data is not yet reported in the AECM statistics, were not included in the calculation of the growth rate.

[49]Number of SMEs (in case of rural guarantees including farmers) related to the new amount of guarantees (including counter- and co-guarantees, and including guarantees for agricultural businesses) or new number of SME partners of mutual societies per year.

[50]The AECM (2014) Scoreboard for the first half year of 2014 covers the data of 23 AECM members, as currently not all members "are able to provide their figures on a semester basis".

driven by both demand *and* supply side factors. In times of the weak growth of economic output, SMEs business, investments, the related need for finance, and, hence, their implied demand for guarantees – are all low. At the same time, tightening restrictions on public budgets and high financial risk perceptions are weighing quite heavily on guarantee supply. Consequently, public support on the European level, as typically provided through the EIF, could improve the situation, if only on the supply side. In some countries, e.g. Germany, the weak development of guarantees has also been explained by relatively favourable financing conditions, and so lesser need for guarantees, following the large increases in guarantee demand observed during the crisis years of 2009-10 (VDB, 2012). Hence, in some countries, the downturn in guarantee business mirrors a development towards the levels prevalent before the crisis.

EIF's role and recent developments

In order to alleviate problems experienced by SMEs in accessing finance, EIF is playing an important counter-cyclical role. Through a wide range of financial intermediaries, such as banks, leasing companies, guarantee funds, mutual guarantee institutions, promotional banks, and other financial intermediaries, EIF can effectively provide both financing to SMEs and guarantees for SME financing. Apart from EIF guarantees for securitised SME financing instruments (see chapter 5.2), EIF offers guarantees/counter-guarantees for portfolios of micro-credits, SME loans or leases.

As a result of EIF's recognised expertise in the SME guarantee market, EIF manages several mandates on behalf of the EIB, the European Commission (EC) and national and regional Managing Authorities. Among the EC mandates, the EIF manages the Loan Guarantee Facility (LGF) under the Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) and the InnovFin SME Guarantee Facility under Horizon 2020. Both facilities are windows of the Single EU Debt Financial Instrument, which is financially supported by COSME and Horizon 2020 in order to support growth, research and innovation of European enterprises.

Through COSME LGF, EIF offers guarantees and counter-guarantees, including securitisation of SME debt finance portfolios, to selected financial intermediaries (e.g. guarantee institutions, banks, leasing companies, loan/debt funds[51] etc.) to help them provide more loans and leases to SMEs. By sharing the risk, COSME guarantees allow the financial intermediaries to expand the range of SMEs they can finance, facilitating access to debt finance for many SMEs which might be having difficulties in accessing the traditional banking system. LGF is a successor to the SME Guarantee Facility (SMEG), successfully implemented by EIF, on behalf of the EC, under the Competitiveness and Innovation Framework Programme (CIP) in the period 2007-2013.[52] Until mid-2014, more than 346,000 SMEs were supported under CIP SMEG, and 70 agreements with 54 intermediaries were signed in 24 countries. The loan amount that CIP SMEG has so far generated for SMEs was in the order of EUR 17.8bn.

[51] See Box 7 below for more information on institutional non-bank lending and the role of Debt Funds.
[52] Source: EIF. For more information on the COSME LGF see http://www.eif.org/what_we_do/guarantees/single_eu_debt_instrument/cosme-loan-facility-growth/index.htm. For more information on the CIP SMEG see http://www.eif.org/what_we_do/guarantees/cip_portfolio_guarantees/index.htm.

The InnovFin SME Guarantee Facility is part of "InnovFin – EU Finance for Innovators", an initiative launched by the EC and the EIB Group in the framework of Horizon 2020. EIF, acting as the implementing body, covers a portion of the losses incurred by the financial intermediaries on loans, leases and guarantees between are provided under the InnovFin SME Guarantee Facility. In this way, the EU and EIF allow the provision of more debt financing to research-based and innovative SMEs and small mid-caps (up to 499 employees). The InnovFin SME Guarantee Facility builds on the success of the Risk Sharing Instrument (RSI), developed under FP7, the 7th EU Framework Programme for Research and Technological Development (2007-2013), managed and implemented by EIF. The RSI Facility for Innovative and Research oriented SMEs and small Mid-Caps had been launched in 2011. It was an EIF/EIB/European Commission joint pilot guarantee scheme that aimed at improving access to debt finance for innovative SMEs and small mid-caps. RSI complemented the scope of the Risk Sharing Finance Facility (RSFF), which has been managed by the EIB and has mainly addressed large corporates. RSI proved that it could address current market needs and was speedily introduced to financial intermediaries with absorption and deployment to SMEs following swiftly. As of September 2014, 40 operations (including 4 increases) with 36 different intermediaries in 18 countries had been signed, totalling EUR 1.6bn, which enables SME financing of up to EUR 3.3bn.

Moreover, EIF continues to deploy its financial products in order to catalyse European Structural and Investment Funds. In doing so, EIF capitalises on its experience with JEREMIE (Joint European Resources for Micro to Medium Enterprises), a joint initiative developed by the European Commission in co-operation with the EIB Group and other financial institutions to enhance cohesion across the EU in the 2007-2013 programming period. JEREMIE was developed with a view to enabling SME financing in countries less supported by "traditional" EIF products, namely risk-sharing loans and portfolio guarantee instruments under JEREMIE[53]. Under the JEREMIE First Loss Portfolio Guarantee (FLPG), EIF has covered part of the credit risk relating to a new portfolio of loans and/or leases granted by a financial intermediary to SMEs. Moreover, EIF has further implemented risk-sharing loan products, the Portfolio Risk Sharing Loan (PRSL), and the Funded Risk Sharing Product (FRSP), whereby EIF has provided funding to banks for the financing of new portfolios of SME loans (such loans to be co-financed by the financial institutions), and has shared part of the credit risk related to the portfolios. As at November 2014, the impact, based on these products, is about to reach a total SME portfolio originated of almost EUR 1.8bn.

Looking forward, EIF has been entrusted with a dedicated EIB Group Risk Enhancement Mandate (EREM; we had given a more detailed overview in Kraemer-Eis, Lang, and Gvetadze, 2014), which will encourage further SME lending in the EU. EREM is a facility of up to EUR 6bn (EUR 4bn from EIB supplemented by EUR 2bn from EIF) that will back, inter alia, additional guarantees to be issued by EIF over the next seven years. In box 7 further below, we give information on a very specific window under EREM, which is meant to support "debt funds" through equity and guarantee solutions.

[53] The JEREMIE initiative offered EU Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds to finance SMEs by means of equity, loans or guarantees, through a revolving Holding Fund acting as an umbrella fund. A JEREMIE Holding Fund could provide to selected financial intermediaries SME-focused financial instruments, including guarantees, co-guarantees and counter-guarantees, equity guarantees, (micro) loans, export-credit insurance, securitisation, venture capital, Business Angel Matching Funds and investments in Technology Transfer funds. For more information see: http://www.eif.org/what_we_do/resources/jeremie/index.htm

In general, it is the objective to increase coherence and consistency of the instruments. While EREM are more to be seen as a special measure to fight the crisis, the EU level instruments are mainly meant to mitigate the structural weaknesses in SME lending.

Another instrument to alleviate the impact of the crisis on SME lending is under discussion: the *EU SME Initiative*. Its objective is to achieve an increase in the volume of lending to SMEs. The concept of this initiative derives from the experiences of the existing programmes. Its overall aim is to combine the resources available from the EU (COSME and Horizon 2020), the EIB Group (EIB and EIF), third parties and the Member States (European Structural and Investment Funds, ESIF) to achieve rapid and significant impact. First implementation is expected in Spain and Malta. Moreover, a *Cultural and Creative Sectors guarantee facility* (under the Creative Europe Programme) is under development for roll-out in 2016.

For this and further information on EIF's activities, see EIF (2014), and the EIF website (www.eif.org).

Box 7: Institutional non-bank lending and the role of Debt Funds

Against the background of the need for alternative or additional financing channels for SMEs, EIF Research & Market Analysis has recently issued the EIF Working Paper "Institutional non-bank lending and the role of Debt Funds", which analyses this market segment in more detail (see Kraemer-Eis, 2014, available at http://www.eif.org/news_centre/research/index.htm). In order to keep a focused scope, the topic of non-bank lending refers to non-bank institutions (e.g. insurance companies, pension funds, private equity funds) and not to the – also growing – segment of non-institutional lending (i.e. crowdfinancing).

The paper presents the concept of Debt Funds, and the split between Diversified Funds and Selective Funds is introduced. It gives a range of examples for Debt Funds and related initiatives to enhance the (SME) financing via non-bank sources, private initiatives as well as publicly supported initiatives – covering the two groups, mentioned before. Moreover, the paper presents the emerging market segment of the so-called SME bonds (which forms itself the basis for SME bond funds (as well classified as Debt Funds).

The dynamic in this market segment shows that its importance is growing, and increasing volumes in non-bank lending appear to be a trend. So far, only the minority of existing Debt Funds focus on EIF's core final beneficiaries - SMEs and smaller mid-caps. Most of them are targeting the bigger category of companies (bigger mid-caps to large caps) and/or mezzanine instruments. Moreover, initiatives take place so far only in a limited number of countries. Against this background, and the fact that there is a need to strengthen alternative financing channels, the participation of EIF in developing such an emerging market for the smaller segment of companies - learning from its past experience with non-granular portfolio guarantee transactions - appears to be straightforward.

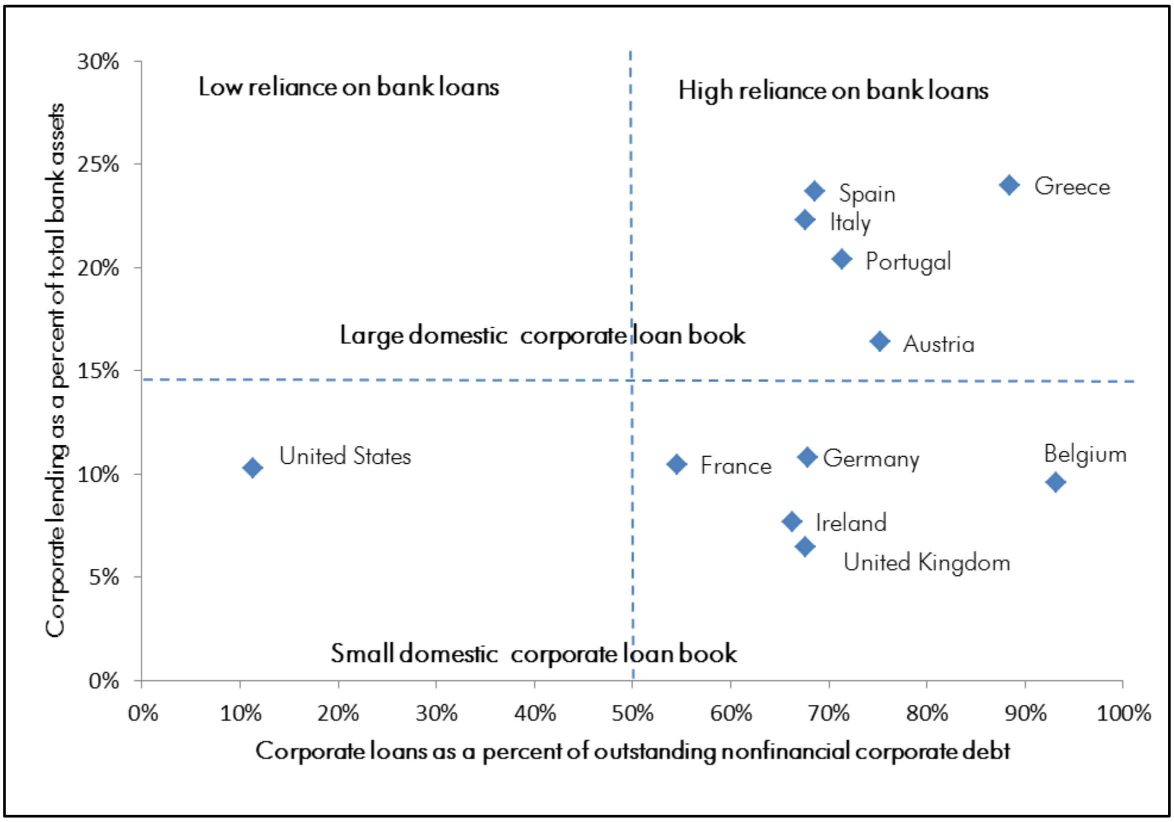
In this context and in particular in the framework of the EIB Group Risk Enhancement Mandate (EREM), EIF is in the process of implementing financing instruments (equity and guarantees solutions) in order to support the development of the Debt Funds market segment.

(Sources: EIF and Kraemer-Eis, 2014.)

5.2 SME Securitisation[54]

European SMEs depend very much on bank financing (see Figure 32). ECB president Mario Draghi mentioned in an often quoted statement that "in the United States 80% of credit intermediation goes via the capital markets. […] In the European situation it is the other way round. 80% of financial intermediation goes through the banking system" (Draghi, 2013).

Figure 32: Reliance on bank financing by non-financial corporations (in %)



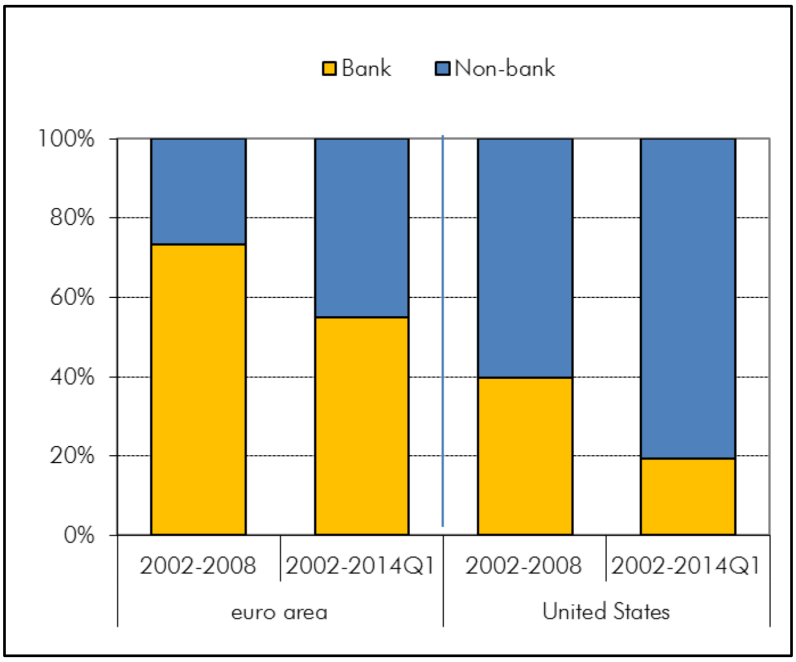
Source: IMF (2012), based on data from ECB, Eurostat, Federal Reserve, Halver analytics.

As outlined in more detail in Kraemer-Eis (2014), this ratio is moving towards more capital market action: Cour-Thimann and Winkler (2013) state that external financing of the non-financial corporate sector (financing other than retained earnings) is dominated by bank financing (in the euro area), see Figure 33. However, as the authors point out, this split refers to the stock - in terms of flows the figures fluctuate significantly; in particular as the corporate sector can to some extent substitute bank lending with other sources of finance. However, this possibility exists for SMEs only to a very limited extent. Bank lending started declining at the beginning of the crisis, and continues to do so, but part of the decline in bank funding was offset by an increase in capital market funding (see Figure 33): debt securities issued by corporations (but also quoted shares issued) increased. But again, "such substitution is primarily possible for large corporations; it is less so for small and medium-sized firms, which constitute the bulk of employment and activity in the euro area" (Cour-Thimann and Winkler, 2013).

[54] This chapter benefitted from contributions from George Passaris, head of EIF's securitisation division.

Moreover, banks in peripheral countries are facing the highest deleveraging pressure and at the same time are looking to recapitalise and strengthen their balance sheets in light of the recent stress tests – typically these banks have large corporate and SME loan portfolios (IMF, 2012). Moreover, banks are less willing to supply loans to SMEs due to the difficulties involved in securitising these loans. Hence, SMEs are more affected by changes in bank lending related to bank deleveraging than other firms.

Figure 33: Funding of non-financial corporations in the euro area and the United States (shares in accumulated debt transactions)



Source: Based on Cour-Thimann and Winkler (2013), with updated data from Eurostat, ECB, Federal Reserve System.

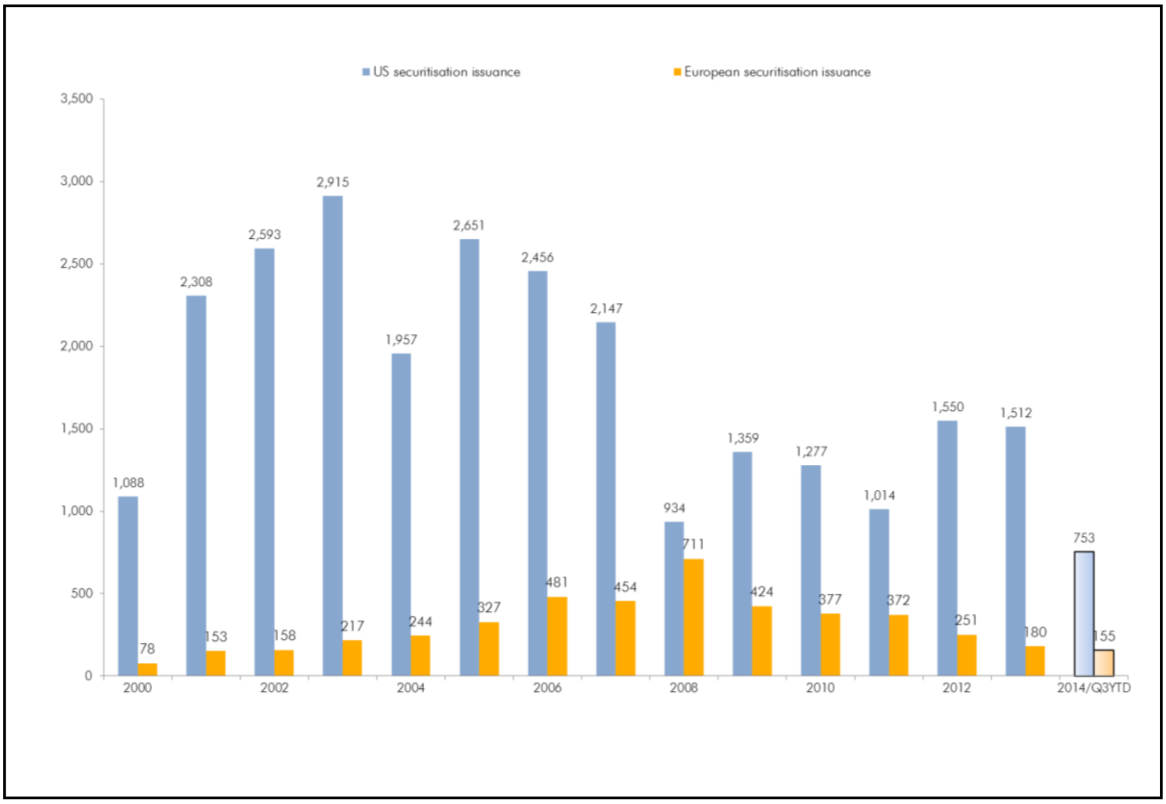
Against this background, a well-functioning securitisation market could be a way to easing supply problems by helping banks diversify their funding and achieve capital relief (see for details e.g. Kraemer-Eis, Passaris and Tappi (2013), IMF (2014a), ECB and BoE (2014), or EIB (2014)). Euro area banks are holding a large stock of relatively illiquid loans that could be transformed into liquid assets through securitisation (IMF, 2014a). SMESec can provide indirect access to the capital market for SMEs – making SME loans "liquid". However, as we will see later, SME securitisation (SMESec)[55] placed with investors currently represents only a very small portion of the total placed Asset Backed Securities (ABS) issuance and there is for the time being only a very limited primary market.

[55]The term SME Securitisation (SMESec) comprises transactions based on SME loans, leases, etc. It is important not only to look at banks/lending when analysing SMESec, but equally at leasing companies, which form part of the securitisation market. Given that bank financing is and will be less available for leasing companies post-crisis, it can be expected that SMESec will be particularly relevant in the leasing area. For more information on the importance of leasing for SMEs finance, see Kraemer-Eis and Lang (2014a).

5.2.1 Market activity[56]

The European securitisation market had grown steadily from the beginning of the previous decade until the outbreak of the crisis. However, the European market is much smaller than its US peer (see Figure 34).

Figure 34: Securitisation issuance Europe versus US (annual issuance 2000 - 2014, bn EUR)



Source: Based on Wehinger and Nassr (2014) data from AFME/SIFMA

During the crisis, issuance remained initially at high levels (compared to pre-crisis values) in Europe, but these volumes were almost exclusively driven by the eligibility of ABS as collateral for ECB liquidity operations; then the overall market activity decreased to the 2003/2004 levels due to regulatory uncertainties[57] and tighter euro system collateral rules.[58] Also the large volumes of synthetic SMESec transactions, that were evidenced pre-2007 on SME portfolios dominated

[56]If not flagged otherwise, the data source is AFME, the Association for Financial Markets in Europe (i.e. AFME, 2014).

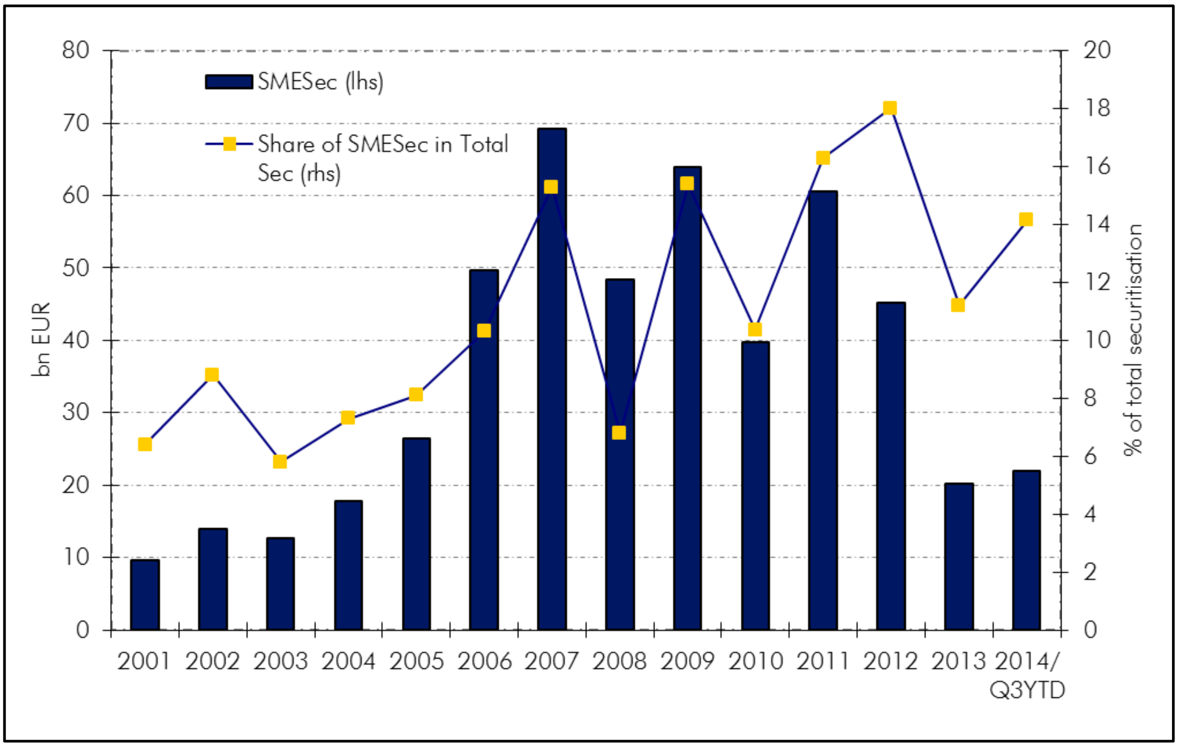
[57]There are many ongoing regulatory work streams, potentially affecting the securitisation market (with impact on originators and investors) – we could even speak of a regulatory wave. The most prominent ones are the proposed Basel (III) securitisation framework, as well as the Solvency II treatment, proposed by the European Insurance and Occupational Pension Authority (EIOPA). In October, the European Commission published the respective Delegated Acts under the EU capital requirements framework (http://eur-lex.europa.eu/ LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF) and the Solvency II regime (http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2/delegated/141010-delegated-act-solvency-2_en.pdf), providing further details on the treatment of securitisation. For a discussion of regulatory reforms, see e.g. EBA (2014) or Wehinger and Nassr (2014).

[58]The ECB's asset repurchase or "repo" facility allows (among other assets) Asset Backed Securities to be used as collateral for funding.

primarily by German SMEs on the back of KfW's PROMISE program, virtually disappeared. Rating downgrades, based on revised rating agency criteria (i.e. counterparty and country ceiling criteria, without grandfathering), on downgrades of counterparties involved in the transactions, and on negative credit trends, contributed to the overall negative market sentiment.

The most active markets in the first three quarters of 2014 in terms of *overall securitisation issuance* were France (market share: 29%), UK (19%), the Netherlands (13%), Italy (9%) and Germany (9%). *SMESec issuance* is still suffering from the crisis, however the issued volume of SME deals in the first three quarters 2014 was already slightly higher than the overall volume in 2013 (see Figure 35). The market share of SMESec rose (with some volatility) from 6% in 2001 to 18% (of total yearly issuance) in 2012, the highest value ever registered in Europe. This, however, came about due to the base effect, as the overall activity went down (while SMESec activity decreased slightly less). In Q1-Q3 2014, the share of SMESec was 14%.

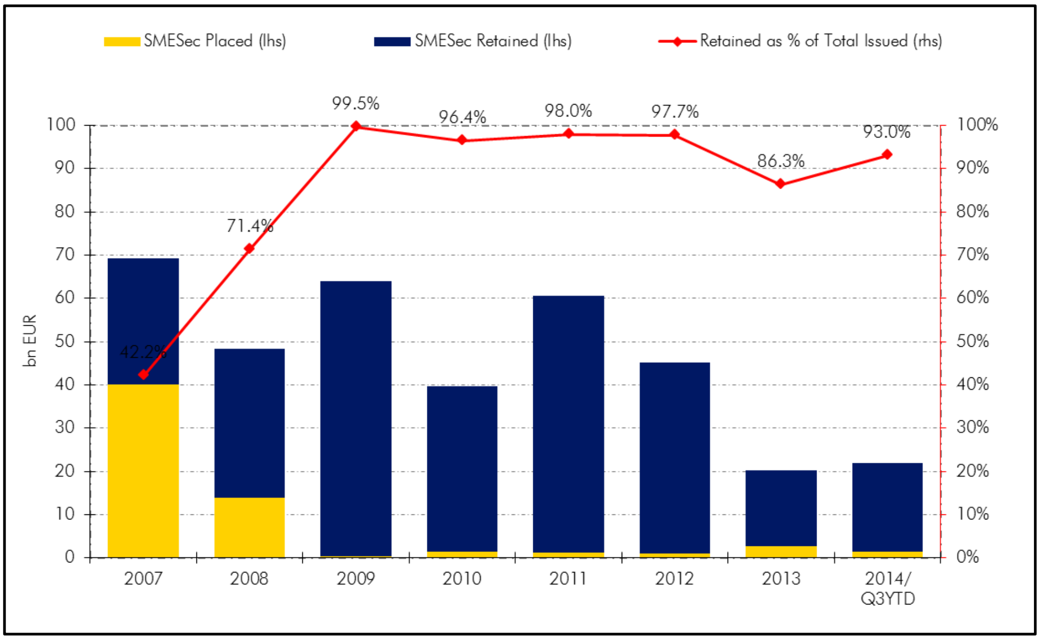
Figure 35: SMESec issuance in Europe (volume and share of total securitisation, bn EUR and %)



Source: EIF, based on data from AFME and own calculation

The SME related issuance in Q1-Q3 2014 occurred only in the Netherlands (42%), Italy (20%), Belgium (19%), Spain (11%) and Portugal (8%). As already mentioned, it is important to note that only a very small fraction of the issuance has been placed with investors (see Figure 36): the nature of the SMESec market changed from a developing market (pre-crisis, with most transactions placed in the primary market) to a purely retained/ECB repo-driven market during the crisis (with almost no placement on the primary market). This shift led to liquidity drying up and originators accepting higher all-in costs as, in addition to the credit enhancement, the repos envisage considerable haircuts to the face value of the notes.

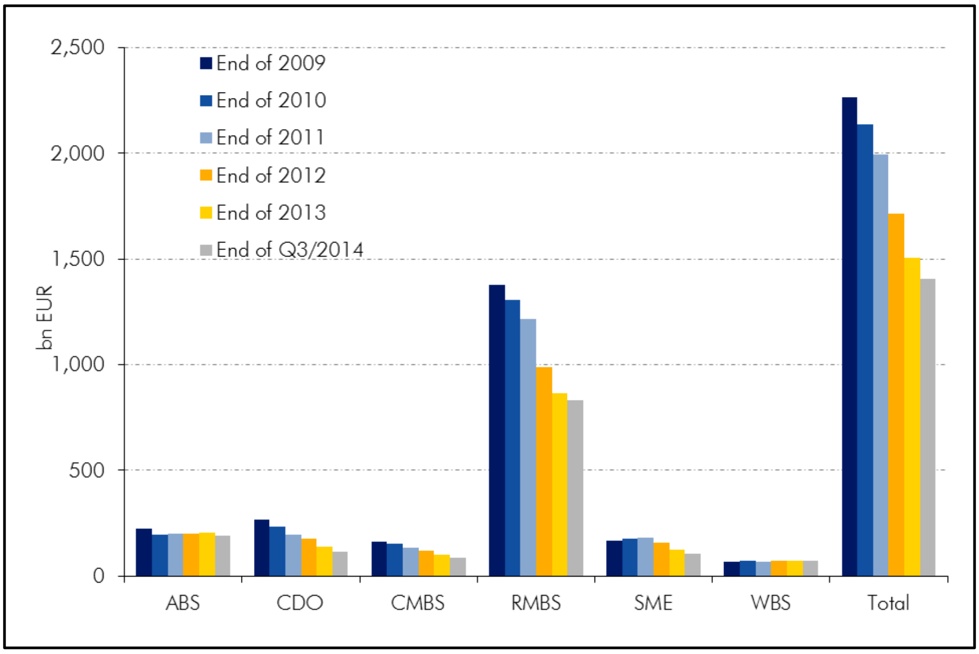
Figure 36: European SMESec by retention (bn EUR and %)



Source: EIF, based on Wehinger/Nassr (2014) and updated data

Due to low new activity levels, the volume of *outstanding securitisation transactions* (see Figure 37) is on a downward trend (negative net supply). Compared to the end of 2013, until end of Q3/2014, the total outstanding decreased by another 7%. Since the end of 2011, the volume of outstanding SMESec transaction decreased by 43%, from EUR 182bn to EUR 159bn (end of 2012), to EUR 104.6bn (end of Q3/2014)).

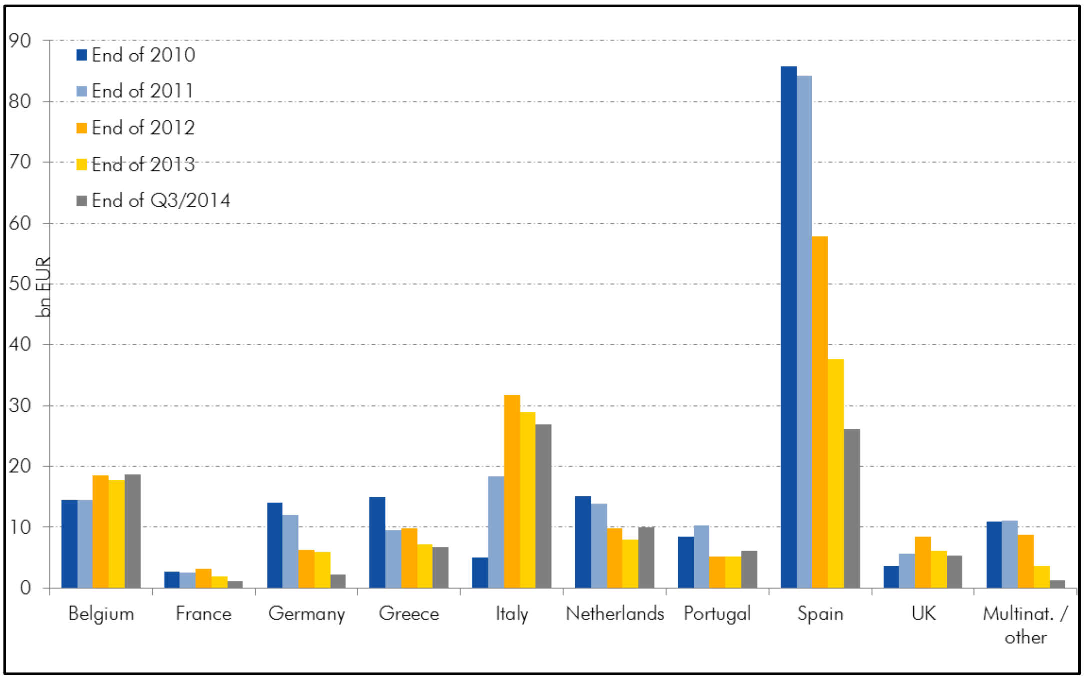
Figure 37: European outstanding securitisation transactions by collateral (bn EUR)



Source: EIF, based on data from AFME

If SMESec volumes per end of Q3/2014 (EUR 104.6bn) are broken down by country (see Figure 38), the Spanish (25.7%) and Italian (25%) markets together count around half of the overall outstanding, followed by Belgium (18.7%), and Greece (6.7%).

Figure 38: European SMESec outstanding volume by country (bn EUR)



Source: EIF, based on data from AFME

5.2.2 SMESec performance trends

Despite the financial and sovereign crisis, the European securitisation market in general has performed relatively well with comparatively low default rates.[59] The low losses are not only based on the typically high granularity, diversification and seasoning of these transactions, but also on the structural features (such as large credit enhancement) that helped counterbalance the negative effects of the deteriorating European economy (i.e. increased SME default rates).

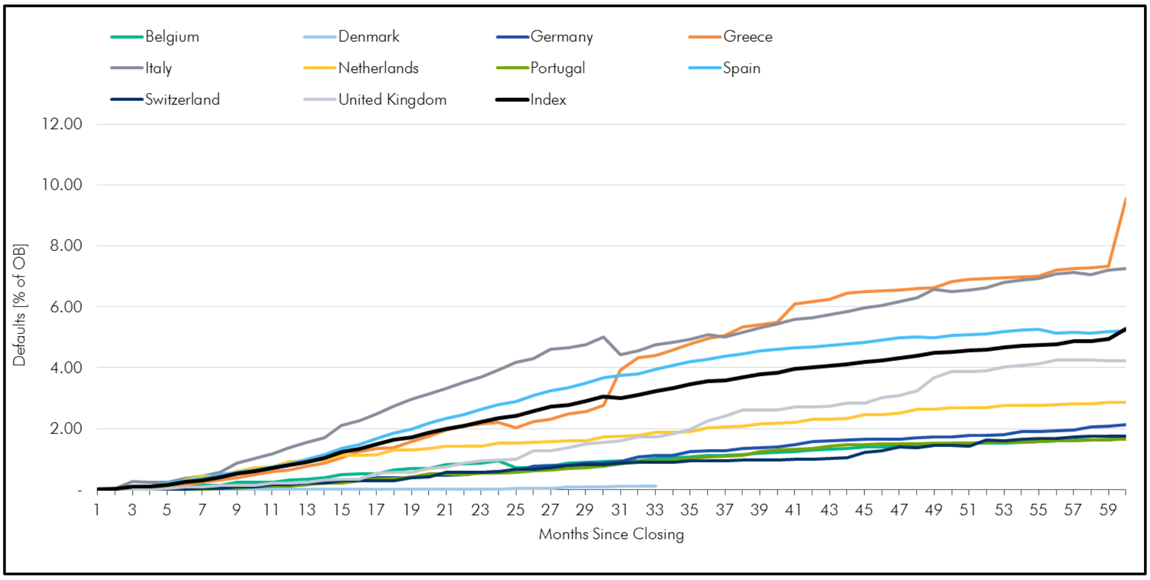
The track record of SMESec in Europe is relatively short: the market started only towards the end of the 1990s – at the time, this segment was relatively unknown to investors and rating agencies (based on the novelty of the applied tools, but as well based on the heterogeneity of SMEs/SME loans), and the technique of securitisation was also new to most of the originators – and many banks were not in a position to securitise SME loans (as a simple example: the originators' IT infrastructure has to be able to cover securitisation transactions). As a consequence - on the one hand - before the crisis started, the overall SMESec volumes were small compared to the overall securitisation market – and the market had not had much time to develop. On the other hand, the uncertainty was one of the reasons for the relative conservative structures in the general SMESec segment – and this led to good SMESec performance in Europe, i.e. compared to other segments of the securitisation market (and i.e. compared to the US).

According to Standard & Poor's (2014), only 1.58% of European Structured Finance notes (rated by Standard & Poor's) outstanding in mid-2007 had defaulted by mid-2014. The cumulative default rate for SMESec transactions was at 0.55% – for comparison: the cumulative default rate

[59]With some exceptions, i.e. the non-granular hybrid transactions (German Mezzanine CDOs). For more details see Kraemer-Eis, Passaris and Tappi (2013).

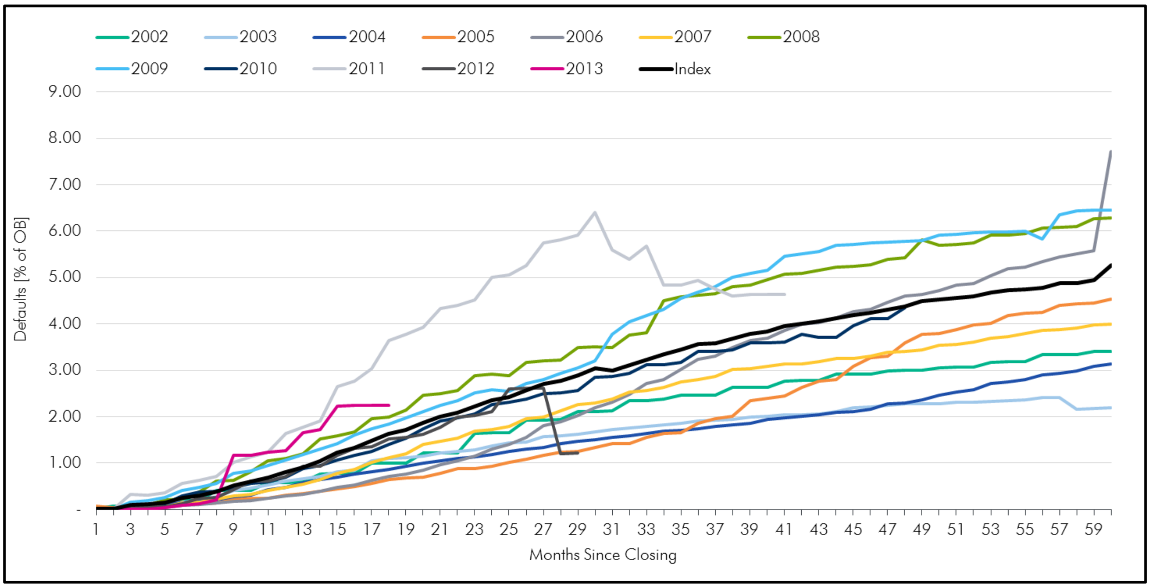
for US Structured Finance notes was at 19.3%, the one for CDO of ABS was at 41.08%.[60] Figures 39 and 40 below show the cumulative credit events or defaults on original balance by country and by vintage (of the SME transactions in the EMEA region rated by Moody's).

Figure 39: EMEA ABS SME loan and lease cumulative credit events or defaults on original balance (seasoning by country)



Source: Moody's (2014)

Figure 40: EMEA ABS SME loan and lease cumulative credit events or defaults on original balance (seasoning by vintage)[61]



Source: Moody's (2014)

[60]See also EBA (2014) for an analysis of historical credit performance of the securitisation market.

[61]Terminated transactions are included in the index calculation. Moody's believes that this information must be included for an accurate representation of trends over time. Additionally, Moody's notes show that vintage seasoning charts might move unexpectedly for the last few data points, because transactions start at different points in time within a vintage and, hence, some transactions may be more seasoned than others. The index includes only the transactions rated by Moody's.

As explained in more detail in the related EIF working papers, the SMESec market has also been hit by a wave of downgrades due to weaker (crisis-driven) performance effects in the underlying portfolios, as well as the rating methodology changes. Typically, AAA tranches show strong rating stability, but during the crisis also AAA and AA tranches migrated downward. This was mostly driven by downgrades of the respective country/sovereign ratings, and the limitation by the country ceilings, or they may be driven by downgrades of (not replaced) counterparties (whose rating is in turn affected by the respective sovereign ratings).

The rating transition data shows that the downgrade pressure for SME transactions persists across all tranche levels. The example below (Figure 41) shows the rating migration of SME Collateralised Loan Obligation (CLO) transactions (rated by Fitch, migration since transaction closing). For example, of all the tranches that have initially been rated AAA, 49% (by number[62]) have paid in full (pif), 10% are still AAA, 16% moved down to AA etc. Meanwhile, there has been very limited upgrading, but no tranche was upgraded to AAA.

Figure 41: Fitch European SMEs Rating Transition Matrix (October 2014)[63]

% of tranches		Current rating									
		PIF	AAAsf	AAsf	Asf	BBBsf	BBsf	Bsf	CCCsf	CCsf	Csf
Initial Ratings	AAAsf	49%	10%	16%	14%	8%	2%	1%	0%	0%	0%
	AAsf	14%	0%	43%	11%	5%	11%	11%	3%	0%	3%
	Asf	4%	0%	22%	35%	9%	13%	11%	2%	2%	2%
	BBBsf	5%	0%	0%	5%	14%	16%	11%	23%	20%	7%
	BBsf	5%	0%	0%	5%	0%	29%	14%	10%	33%	5%
	Bsf	0%	0%	0%	0%	20%	40%	0%	0%	40%	0%
	CCCsf	0%	0%	0%	0%	0%	0%	0%	20%	30%	50%
	CCsf	0%	0%	0%	0%	0%	0%	0%	0%	40%	60%
	Csf	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%

Source: Fitch (2014)

5.2.3 Prospects

There are many advantages of SMESec – for banks, for investors, and – most importantly - for the SMEs (see for a detailed discussion Kraemer-Eis et al, 2010, or Wehinger and Nassr, 2014). At first sight, the advantages are mainly for banks and investors, but these benefits can channel through to a positive effect on SME's access to finance and hence to the SMEs themselves. A recovery and development of the primary securitisation markets could play a role in unlocking credit supply and economic recovery. However, this will only be to the benefit of SMEs if the freed-up capital / fresh liquidity is going to be used to finance the real economy (i.e. for new SME lending) and not for such purposes as regulatory arbitrage.

[62]Relative to the number of tranches in a given initial rating category.
[63]The addition sf indicates a rating for structured finance transactions.

A compelling case could be made for public assistance to enhance access to finance for SMEs (market failure based on information asymmetries, high transaction costs, and spill-overs – exacerbated by the credit crunch in many economies associated with the financial crisis), and for supporting the SMESec European market (for details, see Kraemer-Eis, Passaris and Tappi, 2013). If public support could contribute to the re-emergence of the primary European SME securitisation market, it could be an important element to enhance access to finance for SMEs in Europe. In this context, not only does the supplied volume matter, but the positive signalling effect, triggered by the public involvement and support, could be equally important.

In the event that framework conditions for securitisation improve, there is also significant potential for SMESec transactions. Altomonte and Bussoli (2014) estimate a potential securitisation volume of EUR 325bn of SME ABS – spread mainly over the main markets Spain (19%), France, Germany (17% each), Italy (14%), Portugal (7%), Ireland (6%) and the rest of Europe (22%). Their estimate is based on the current outstanding loan volumes, adjusted by several "haircuts" based on different eligibility parameters,

What could be done to revitalise the securitisation market? A first important step towards restoring investors' confidence in European ABS is to remove misalignment of interests and information asymmetries between originators and investors, including greater transparency to ensure the accurate pricing of credit risks. This also includes the harmonisation of information and framework conditions (e.g. regarding credit quality information, national insolvency frameworks, etc.). Several financial regulations, and a number of public and private sector initiatives in the EU, have been recently implemented to address this concern. However, there are a number of remaining structural roadblocks that should be addressed. In this context, it is crucial that public development banks, the European Commission and European agencies engage in a close dialogue with regulators, both in response to public consultations as well as on a bilateral basis to ensure that the regulatory framework is based on a holistic view, and that it is consistent with the quality of the assets it applies to.

Transparency should be a prerequisite for any structured transactions. Hence, a particular focus should be put on the promotion of simple structures and well-identified, transparent underlying asset pools with predictable performance ("high-quality securitisation", HQS) to revitalise the securitisation market – and such a definition should include SMESec transactions. In our previous ESBFO, we outlined what high quality SMESec could look like.[64]

Also the Ecofin Council meeting of 9 December 2014 (Ecofin, 2014) highlighted the importance of revitalising the market for simple and transparent securitisations, including those products suitable for SMEs, based on a dedicated European securitisation framework, addressing the inherent risks associated with securitisations, and encouraged the Commission to develop such a framework by summer 2015.

[64]See in this context as well the currently ongoing EBA consultation concerning simple standard and transparent securitisation (EBA, 2014).

Current disclosure and bankruptcy laws across Europe create a non-level playing field. Although it is acknowledged that significant efforts are required for the standardisation of reporting and improvement of data availability, these efforts must continue unhindered. Moreover, the spreading of best market practice and knowledge about SMESec among (potential) market participants is important to develop this market; here, public support can play a significant role as well.

The European Council (2013a), (2013b) conclusions of June and October 2013 required an increase of the credit-enhancing capacity of the EIF with the purpose of supporting the impaired financing of European SMEs; the reaction was the capital increase of the EIF together with an EIB Group initiative named EIB Group Risk Enhancement Mandate (EREM). The EREM is an initiative that the EIB Group has launched recently to contribute to the revitalisation of the securitisation market and aims to further enhance access to finance for SMEs and small midcaps by providing, inter alia, a range of targeted capital market instruments, including various forms of ABS credit enhancement. Under the umbrella of these instruments, the EIB Group can provide credit enhancement for senior and mezzanine tranches of securitisation backed by SME loans, including guarantees. Under this initiative, a total of EUR 4bn from EIB supplemented by EUR 2bn from EIF could be deployed. EREM will enable raising the credit enhancement capacities of the EIF; it will leverage on its catalogue of existing products, systems and procedures. An important element is the ABS credit enhancement window that allows EIF to increase its capacity as credit enhancer of ABS tranches, both in terms of larger ticket size and broader scope in each individual SME securitisation. This can be seen as important additional contribution by the EIB Group to a revitalisation of the European SMESec market.

In October this year, the ECB (2014a) announced operational details of its ABS purchase programme (ABS PP, see Box 8). The overall objective is to enhance the transmission of the monetary policy, support the provision of credit to the euro area economy and, as a result, to provide further monetary policy accommodation. The ECB's support of the ABS market in general, and the SMESec market in particular, is a positive step. The ABS PP can play an important role as a buyer, and by driving investors into mezzanine tranches (Bank of America/Merrill Lynch, 2014b). However, to date, the revealed details remain vague, and in particular the eligibility criteria for guaranteed mezzanine tranches have not yet been disclosed. Hence, at this stage, it is not possible to judge the overall impact of these measures on the revival of a sustainable SMESec market, and in particular on the involvement of the EIB Group, but constructive discussions between the Group and the ECB are underway. With regard to the latter, some market participants expressed expectations, for example Bank of America/Merrill Lynch (2014a) „[O]ne multilateral agency in Europe which has the mandate and capacity is the EIF in conjunction with the EIB. They have the financial resources, qualifications and experience to do that", or Credit Suisse (2014) „We think the EIF is the obvious institution given its expertise in the area […]".

Box 8: Summary of the ECB's ABS PP

On the 04.09.2014, the ECB (Draghi, 2014) announced to purchase "a broad portfolio of simple and transparent ABS [...]. This reflects the role of the ABS market in facilitating new credit flows to the economy [...].

On the 02.10.2014, the ECB announced operational details of its purchase programme

Overall objectives:

- enhanced transmission of the monetary policy
- support the provision of credit to the euro area economy and,
- as a result, to provide further monetary policy accommodation

ABS purchase criteria:

- linked to the repo eligibility
- cover retained and investor-placed bonds, new issues and secondary transactions
- focus on simple and transparent ABS
- purchase of senior and guaranteed mezzanine tranches of ABSs
- programme will start in Q4/2014 and last for at least 2 years

The eligible ABS purchase transactions will be conducted via executing asset managers, on explicit instructions from, and on behalf of, the Eurosystem, which will undertake price checks and due diligence prior to approving the transactions. The appointed companies are Amundi and Amundi Intermédiation, Deutsche Asset & Wealth Management International, ING Investment Management, and State Street Global Advisors (ECB, 2014c).

The ABS PP will be executed in two phases (Bank of America/Merrill Lynch, 2014b):

- initially, by ECB in a centralised manner, and
- after this first phase, by the Eurosystem Central Banks in a decentralised manner
- in accordance with the subsequent decision to that effect by the Governing Council.

The programme entered into force on the day following its publication on the ECB website (publication: 20.11.2014) and started with the purchase of Dutch residential mortgage-backed securities (RMBS). For details of the ABS PP see as well ECB (2014d).

6 Microfinance market

6.1 Microfinance business environment

"Microcredit is generally recognised […] as an effective financing channel for job creation and social inclusion, which can attenuate the adverse effects of the current financial crisis while contributing to entrepreneurship and economic growth in the EU" (European Commission, 2012b). In Europe, microfinance consists mainly of micro-loans (less than EUR 25,000) tailored to micro-enterprises (92% 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. In order to prepare for a further analysis of this topic, it is helpful to start with some definitions (see Box 9):

Box 9: What is "micro"?

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

A **microfinance institution (MFI)** is an organisation/financial intermediary that provides microfinance services. There is a wide spectrum of different MFI business models in Europe.
Microcredit in general 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: (1) an economic impact, as it allows the creation of income generating activities, and (2) a social impact, as it contributes to the financial inclusion and, thus, to the social inclusion of individuals.

Microfinance, as a general term, is traditionally defined as 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). However, more and more often, the definition is used in a wider sense, also to include financial services to existing microenterprises. This wider concept is used in the present text and in order to achieve a pragmatic approach, we follow a segmentation, following a differentiation introduced by EMN (2012):

- *Microenterprise lending* = microlending to existing enterprises. Organisations that implement the lending model of microenterprise lending tend to focus on the upper end market of microfinance, providing loans to bankable or nearly bankable microenterprises that have difficulties accessing loans up to 25,000 EUR from commercial banks due to risk aversion or lacking liabilities. The average volume of the provided loans is markedly higher than in the model of social inclusion lending, meant to support the start or stabilisation of microenterprises with a growth perspective. The maximum loan sizes go up to 25,000 EUR (or even higher in some cases).
- *Social inclusion lending* = lending to self-employed individuals that are excluded from banking services, due to their socioeconomic status of being socially excluded or (long term) unemployed and/or belonging to financially excluded population groups like ethnic minorities or young people. The average loan sizes are relatively low, meant to support basic income creating activities.

EIF has published two working papers so far that specifically cover the European microfinance market (see Kraemer-Eis and Conforti, 2009 and Bruhn-Leon, Eriksson and Kraemer-Eis, 2012). In these studies, EIF found that there are wide spectra of final beneficiaries and financial intermediaries, and concluded that there is no common microfinance business model in Europe – on the contrary, the market is highly fragmented and diverse, but with a trend towards efficiency, professionalisation, and self- sustainability. In the following sections we briefly explain important elements of the demand and supply-side perspectives, as well as their combination.

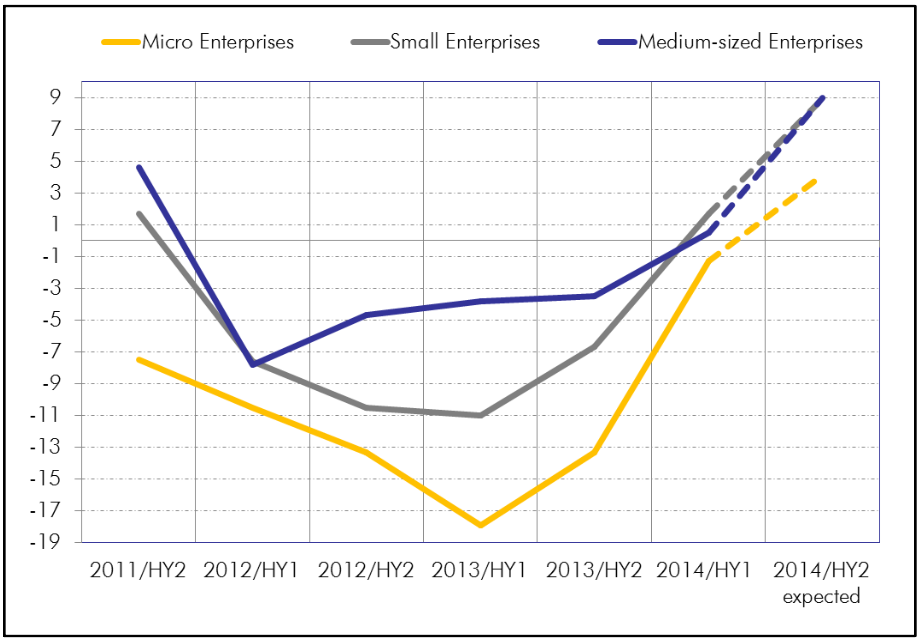
6.2 Overall situation and demand-side perspectives

Standardised, regularly available indicators to explain market developments for microfinance in Europe do not exist yet, or refer to Central-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 microenterprises.

6.2.1 Business environment and access to finance of microenterprises

The UEAPME EU Craft and SME Barometer (see UEAPME Study Unit, 2014) shows that, on balance, only microenterprises estimated their overall situation deteriorated while other SMEs estimated their overall situation improved in the first half of 2014 (see Figure 42).

Figure 42: Overall situation of European micro-firms compared to other enterprise size classes

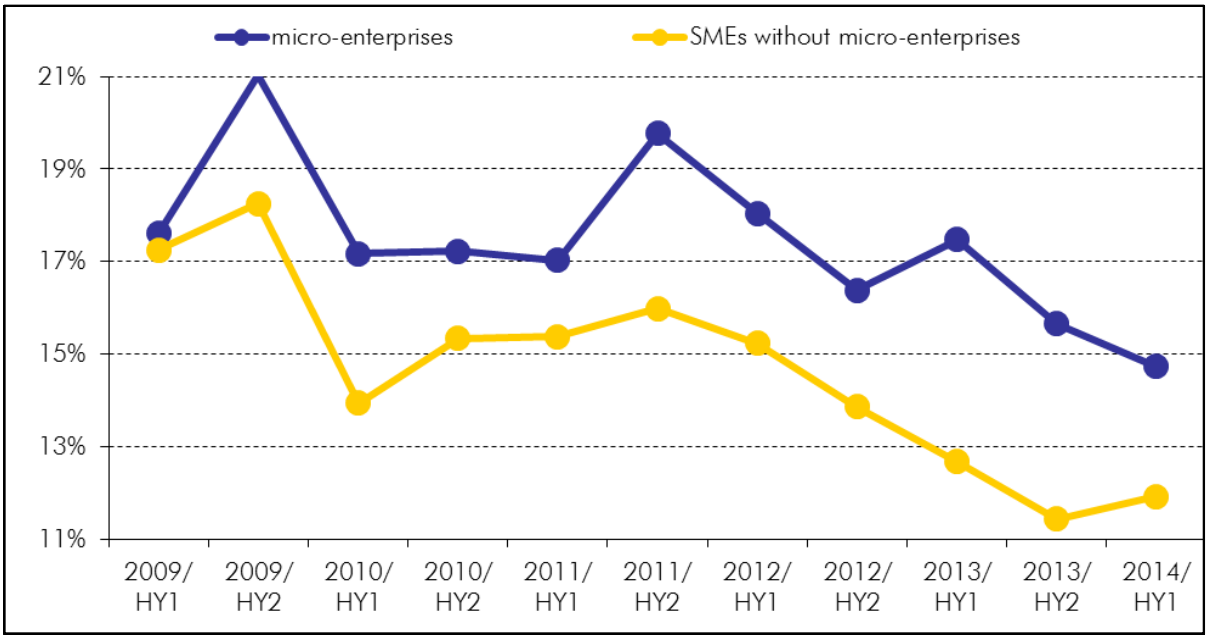


Source: UEAPME Study Unit (2014)

However, expectations for the first half of 2014 were exceeded by realised outcomes. Moreover, microenterprises, on balance, expect positive changes in their business situation in the second half of 2014 for the first time since a long time (+4.1% compared to (-10.5%) in the first half of 2014). Similar results were reported for the survey questions on turnover, employment, and orders in the first half of 2014. According to the overall picture, micro, small and medium-sized enterprises are slowly converging on similar overall situation levels, however, microenterprises will continue facing more difficulties than other SMEs.

According to the data from the latest ECB survey on the access to finance of enterprises in the euro area (ECB, 2014f), the share of enterprises which see access to finance as their most pressing problem is larger among microenterprises than among other SMEs. Microenterprises reported "access to finance" as the second of their most pressing problems (while it is in the sixth place of the "most pressing problems" for small, medium and large enterprises), (Figure 43). "Finding customers" stayed the most frequently mentioned concern. The ECB (2014f) also reported a rise in bank loan rejection rates for micro and small enterprises, and a drop for medium-sized ones. The rejection rate is still the highest for micro firms (18%), compared to 12% for small firms and 5% for medium-sized firms.

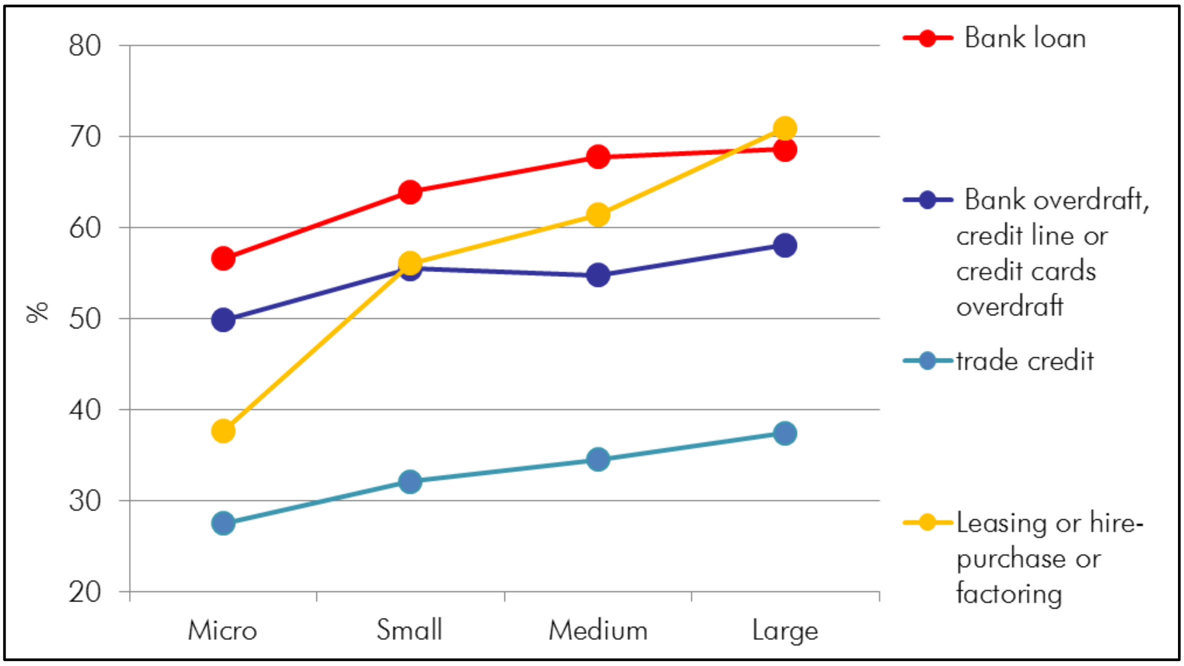
Figure 43: Share of enterprises reporting access to finance as their most pressing problem



Source: EIF, based on data from ECB (2014f), Statistical Data Warehouse

Difficult access to finance, in particular to bank loans, might be one key reason why microenterprises in Europe use bank loans and other external financing sources considerably less than other SME size classes, however micro enterprises, on balance, reported increased needs for bank loans. Figure 44 shows that, with the exception of "bank overdraft, credit line or credit cards overdraft", the usage of different financing sources on average typically increases with the size of the SME (ECB, 2014f).

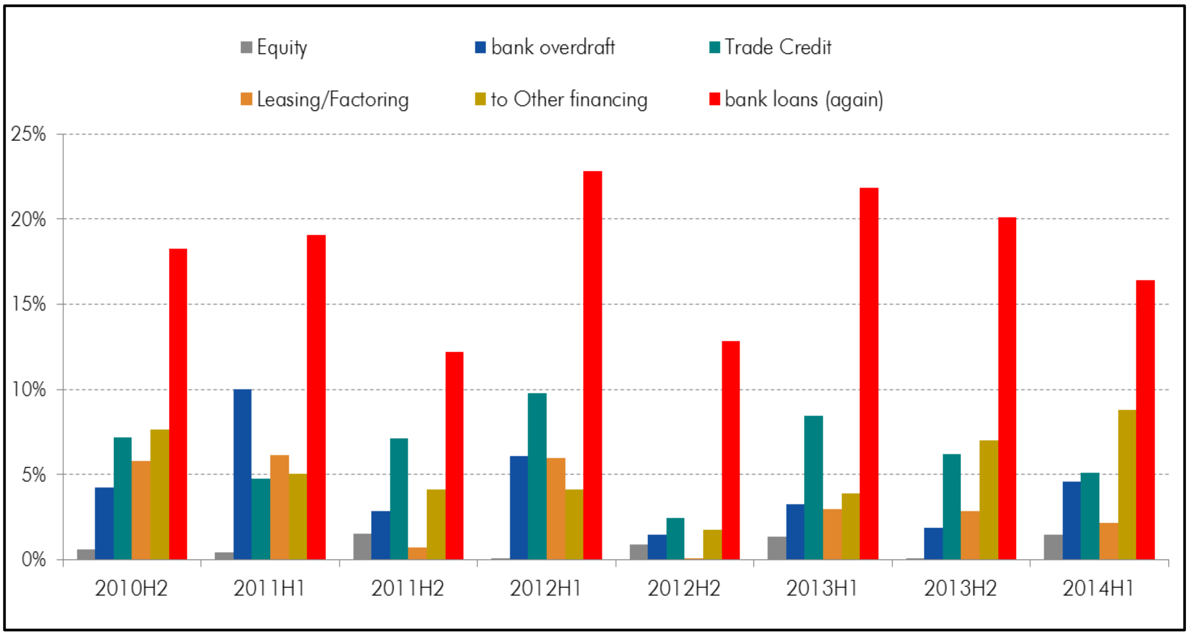
Figure 44: Different financing sources relevant for enterprises (by enterprise size class)



Source: EIF, based on ECB (2014f) data.

Moreover, microenterprises often use bank loans, despite their bad experience in the recent past. Figure 45 presents the usage of different financing sources for a certain survey round, given that the microenterprises have been rejected or refused, or were discouraged to apply for a bank loan in the previous survey round.[65]

Figure 45: Switching from bank loans to different financing sources relevant for enterprises



Source: EIF, based on ECB (2014f) data.

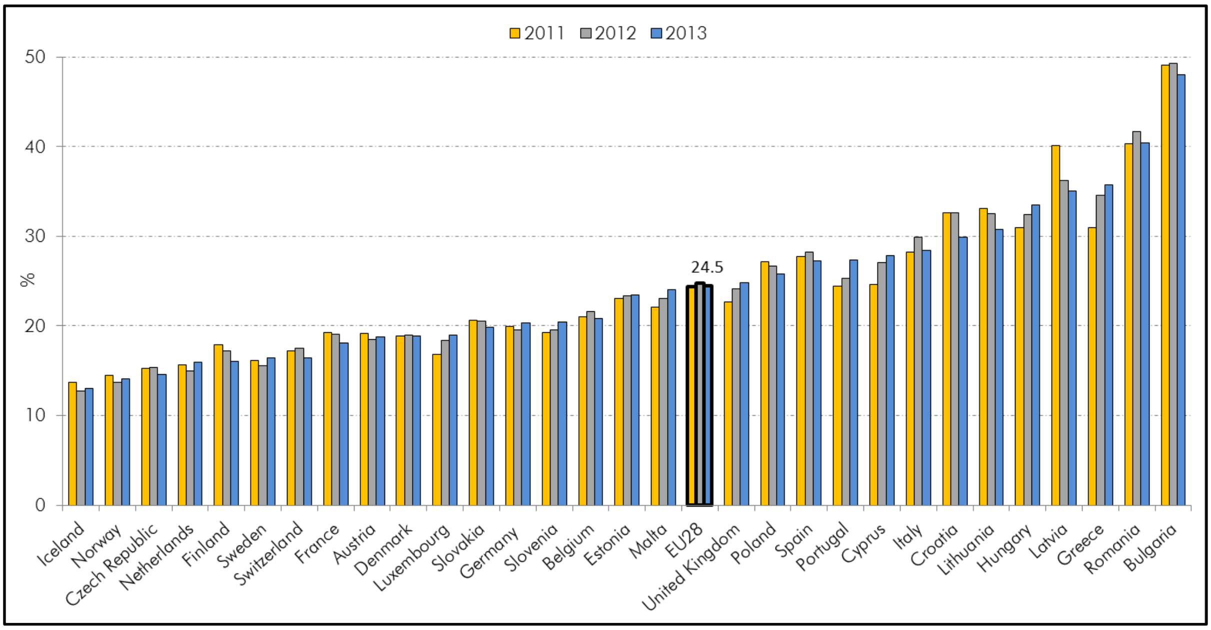
[65] The usage of different financing sources is based on SAFE questions nr. 4 and 5 (whether a firm uses or considers using a financing source and/or whether its need for that financing source has increased in the last six months). Relevant questions among different survey rounds have been harmonized accordingly.

Despite the increased needs for bank loans, the percentage of micro enterprises not applying for a loan due to fear of rejection (discouraged borrowers) increased. Discouragement is often related to higher costs charged by banks on smaller loans (Ferrando, 2014). Moreover, among the micro-enterprises which applied for loans, 4.5% refused to take them because the cost was too high (ECB, 2014f).

6.2.2 Potential business creators

In order to assess the likelihood of achieving the Europe 2020 poverty/social inclusion target, Eurostat has provided an indicator called "people at risk of poverty or social exclusion".[66] Figure 46 depicts the headline indicator, corresponding to the sum of persons who are at risk of poverty after social transfers, or severely materially deprived, or living in households with very low work intensity (i.e. a combination of the three sub-indicators).[67] When comparing 2013 to 2012 and 2011, the situation became worse in many countries. Within the EU, the highest risks of poverty or social exclusion are recorded in Bulgaria, Romania, Greece and Latvia. The countries on the right-hand side of the diagram include some of the relatively new entrants to the EU and those countries that have suffered the most from the impact of the current sovereign-debt crisis, i.e. Greece, Italy, Cyprus, Portugal and Spain.

Figure 46: People at risk of poverty or social exclusion (percentage of total population)



Source: EIF, based on data from Eurostat.

[66] 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

[67] 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) worked 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

People at risk of poverty are considered to be potential business creators. A decision to start a business often arises out of necessity, but considerations regarding the availability of the necessary finance or the dissatisfaction in current work situation also play an important role. The majority of entrepreneurs start businesses to improve their situation (OECD, 2014a). According to the Eurobarometer Survey on Entrepreneurship (European Commission, 2012a), in most countries of the EU, the majority of self-employed people found dissatisfaction with their previous work very important in their decision to start a business.

6.3 Supply side

As outlined in previous versions of our papers, the European microfinance market is still young and heterogeneous due to the diversity of legal frameworks, institutional environments and microfinance providers in European countries. In addition to commercial banks that target microenterprises as within their general SME lending activity, the spectrum of European microcredit developers includes many profit-oriented and non-profit associations: microfinance associations, credit unions, cooperatives, Community Development Financial Institutions (CDFIs), non-bank financial institutions, government bodies, religious institutions and Non-Governmental Organisations (NGOs).

The EMN survey[68] results show that MBFSs and NGOs or foundations constitute more than half of all institutions surveyed. MFIs finance their activities mainly with equity and grants. Funding sources range from regional and national to EU level initiatives. The EMN (2014) survey showed a high diversity with regard to targeted social groups and societal policy goals. Two thirds of all surveyed MFIs reported that they included social impact in their mission, followed by job creation (58%), social (56%) and financial inclusion (50%). 85% of the surveyed MFIs reported that they include at least one dedicated employment goal as part of their mission. In 2013, a minimum of 121,270 microenterprises and start-ups were estimated to have been supported by the surveyed organisations which resulted in an impact on at least 250,000 jobs throughout Europe.

According to the EMN survey, the microcredit provision in Europe showed a positive trend, in terms of the overall total value and the number of microloans. More precisely, the surveyed European microfinance institutions (MFIs) disbursed a total of 207,335 microloans with a total volume EUR 1.26bn in 2013 (compared to 122,370 microloans disbursed with a volume of EUR 872m in 2011). Compared to the survey data from 2011, this shows an increase of 45% in the total value of microloans and 69% of the number of loans in 2013 reported by the surveyed MFIs. The average loan size also increased to EUR 9,234 in 2013 from EUR 7,129 in 2011 and reached a similar level compared to 2009 (EUR 9,641).

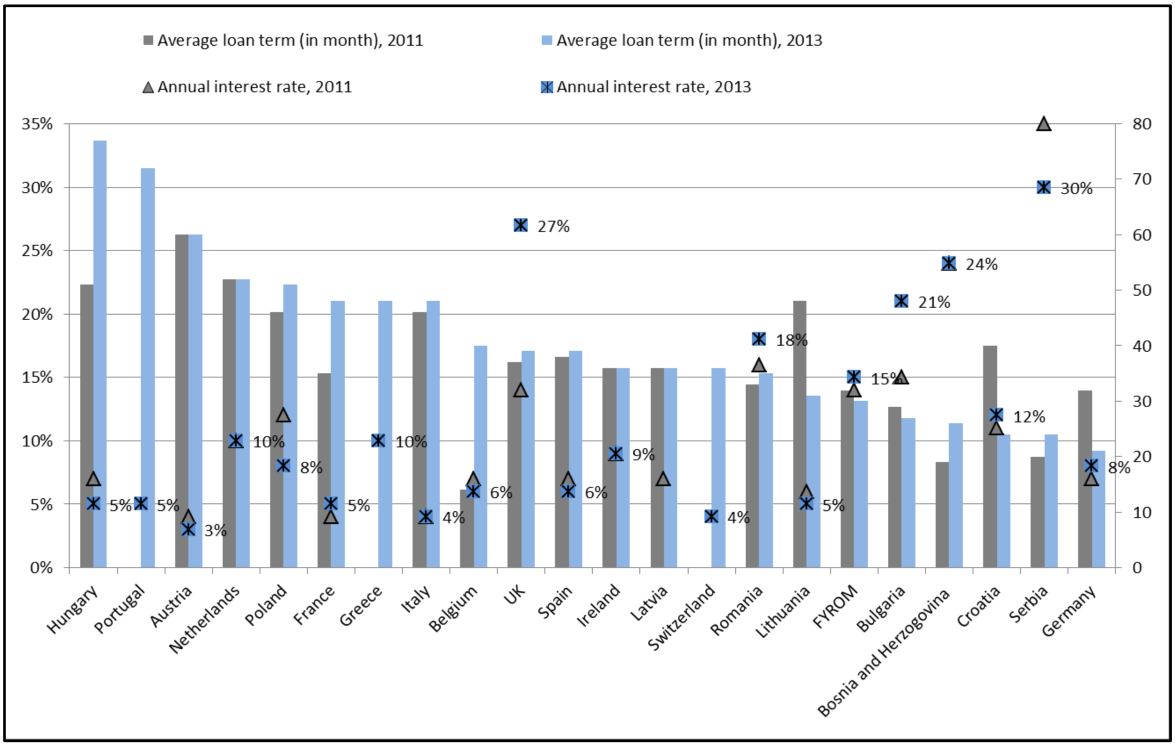
Despite the recent positive trends reported by the EMN-member MFIs, the overall situation in microcredit provision in Europe remains complex. Microfinance institutions have been affected by

[68] The new edition of European Microfinance Network (EMN)'s Overview of the microcredit sector in the European Union for the period 2012-2013 (EMN) has published in 2014. This new report is based on a survey among 150 MFIs in 24 countries. 447 MFIs have been contacted, 150 contributed data, which equals an overall response rate of 34%. The survey has been supported by EIF.

the adverse macro-economic conditions during the global financial and economic crisis, generally through significantly higher bad debt rates among their clients, and in some cases through increased difficulties in accessing external sources of funding. With ongoing problems in the banking sector, the target groups for microfinance are faced with tightening credit supply by mainstream banks due to their higher risk aversion and increasing need to de-leverage their balance sheets. In an increasingly risk-averse environment of credit allocation, lending might be allocated away from small and young firms as they are more risky than their larger peers. This refers by nature in particular to the segment of microfinance.

In addition to the diversity of institutional environments and microfinance providers, the characteristics of microloans are much diversified across countries. According to EMN (2014), the average interest rate among the surveyed microfinance providers was 10% in 2013 (11% in 2011), but ranging from 5% in France, Italy, Austria and Switzerland, to 27% in the UK, and even higher in non-EU Balkan states (figure 47).

Figure 47: Microcredit conditions in Europe



Source: Based on data from EMN (2014)

The differences in average interest rates are typically related to differences in the legal framework, MFI business models, pricing policies, refinancing cost, cost structure and the level of subsidies. Without usury laws or interest rate ceilings in place, the interest rate usually decreases in the loan size (EMN, 2012, 2014). Micro-loans are usually offered with a special focus on social inclusion. Higher interest rates ("high" compared to "standard" lending business) for micro-loans typically reflect the non-subsidised, cost-covering business models (often MFIs in the central-eastern part of the EU), while the lower interest rates are reflecting higher prevalence of social microfinance, corporate social responsibility initiatives, and MFIs with subsidised, partly grant-dependent business models (often in the western part of the EU). Typically, for-profit-institutions charge higher interest rates (cost coverage) and grant larger loans (economies of scale). However, it is important to note that a profit orientation is not inconsistent with a socially oriented investment strategy. In fact, the micro-loan business model, if operated on sustainable terms in the long run, inherently requires relatively high interest rates on the microloans (Bruhn-Leon, Eriksson and Kraemer-Eis, 2012).

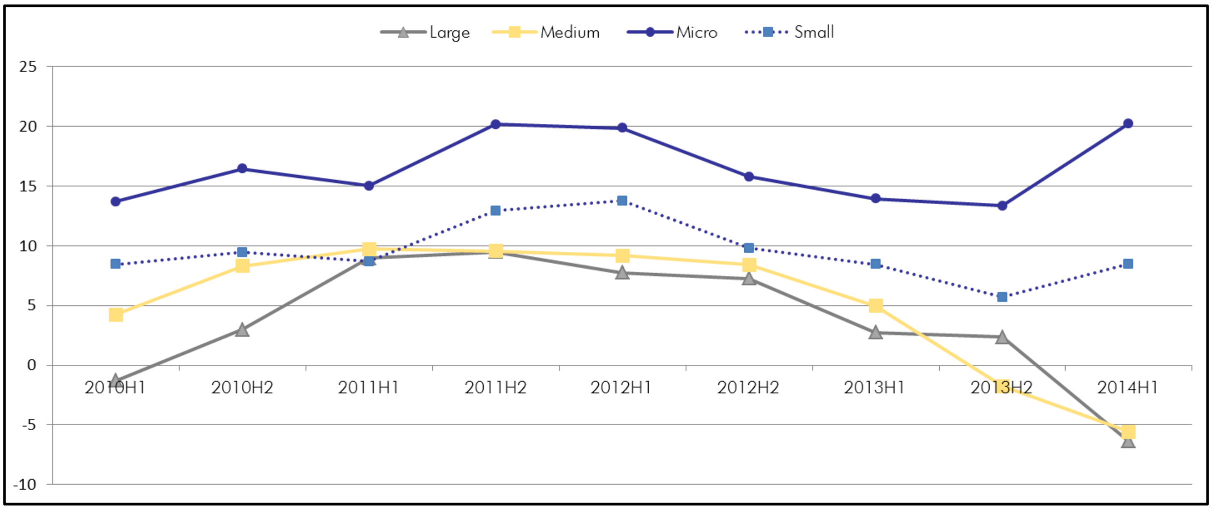
Similarly, the spread of average loan durations varies across countries. Long loan terms can be found in Hungary (77 months), Portugal (72) and Austria (60 months). Typically, shorter loan terms are observed in countries with high average interest rates and low average loan volumes, with the exception of Germany, mainly in Balkan states.

6.4 Is there a financing gap?

When looking at the business climate of microenterprises, even in a thriving economy, these smallest firms often have trouble in obtaining finance. Uncertainty and asymmetric information between the demand side (entrepreneur) and the supply side (financial institution) often create a perpetual structural difficulty for micro- as well as small and medium-sized enterprises. Without a track record or a long standing relationship with a financier, constrained by limited capital or collateral, the young and small companies seldom have an easy time finding the funds they need to grow. In times of crisis, like today, microfinance clients, be it as an enterprise or a self-employed, typically find capital even harder to obtain.

Proportionally more micro-enterprises perceive an increased gap in external financing than small or medium-sized enterprises (see Figure 48). Moreover, the external financing gap for microfinance increased to 20% (from +13% in the previous survey period); see ECB (2014f).

Figure 48: Perceived change in the external financing gap (by firm size)



Source: EIF, based on ECB (2014f), Statistical Data Warehouse

The poor access to finance creates barriers not only for existing microenterprises or self-employed people, but also for unemployed people who intend to become self-employed or create an enterprise. "People starting businesses from unemployment face the same principal barriers to business start-up as other entrepreneurs – lack of finances, lack of human capital and lack of social capital" (OECD, 2014c).

Concerning the demand for *microenterprise* lending and i.e. the high relevance of microfinance for start-ups and existing small enterprises, there is to our knowledge no recent EU-wide study available. However, many studies refer to the SME finance gap in Europe (e.g. Kraemer-Eis and Lang (2014b) for an overview). If we consider the importance of microenterprises in Europe, it can be assumed that a significant portion of this gap refers to microenterprises – and if banks continue to reduce their exposure to risky and small scale loans in the context of the ongoing deleveraging and adjustment processes, this situation is expected to further worsen.

6.5 Microfinance prospects

Difficulties in access to finance are particularly pronounced for micro-enterprises and other target groups of micro-finance. Despite the recent positive trends that the EMN member-MFIs reported, the overall situation in microcredit provision in Europe remains complex. Microfinance institutions have been affected by the adverse macro-economic conditions during the global financial and economic crisis, generally through significantly higher bad debt rates among their clients and in some cases through increased difficulties in accessing external sources of funding. With ongoing problems in the banking sector, the target groups for microfinance are faced with tightening credit supply by mainstream banks due to their higher risk aversion and increasing need to de-leverage their balance sheets. In an increasingly risk-averse environment of credit allocation, lending might be allocated away from small and young firms as they are more risky than their larger peers. This refers by nature in particular to the segment of microfinance.

Microfinance could be an important contribution to overcome the effects of the crisis for some specific groups and in particular to support inclusive growth. However, the perspectives of the sector with regard to growth and self-sufficiency are limited, if microfinance providers do not have access to stable funding.

Moreover, with regard to future trends, MFIs expect less public support in the coming years, due to public budget restrictions.The MFIs have prepared to develop more efficient and lean processes, and to reduce the costs for the provision of microloans and to look for additional funding sources. Besides MFIs, other financing channels for microfinance include crowdfunding and crowdlending platforms, digital lending clubs, mobile payment solutions (EMN, 2014). Against the background of the current difficult framework conditions, support on a European level has become even more important – via funding, guarantees and technical assistance to a broad range of financial intermediaries, from small non-bank financial institutions to well-established microfinance banks – in order to make microfinance a fully-fledged segment of the European financial sector.

We discussed the rationale for public support in the microfinance area in one of our previous working papers (i.e. in Bruhn-Leon, Eriksson and Kraemer-Eis, 2012), and explained the chosen approach for the Progress Microfinance mandate as support on European level; in the current market environment this support is even more important. The intervention logic is based on the market structure and its significant diversity. It seeks to maximise outreach through a flexible investment approach in terms of eligible types of investments and types of financial intermediaries. The key target group are non-bank MFIs, but the range of financial intermediaries is extended also to banks with good outreach to microfinance clients, such as cooperative banks or micro-banks.

With regard to EIF's main activities in the field of microfinance, the Progress Microfinance Fund (see Bruhn-Leon, Eriksson and Kraemer-Eis, 2012, for more information) aims at easing access to finance for micro-enterprises and the self-employed, including typical groups with difficulties in accessing the traditional banking system, such as women, youngsters, people belonging to a minority group or with a disability, etc.

Through the implementation of Progress Microfinance we receive regular updates from financial intermediaries regarding the demand for microcredit throughout the EU-28. Progress Microfinance now covers 20 countries with two additional countries (Estonia and Hungary) likely to be added in early 2015. The highest outreach to final beneficiaries at a single intermediary across Progress Microfinance was registered in The Netherlands, Romania and France. Out of total estimated new micro credits facilitated under Progress Microfinance of EUR 250m as end-September 2014, these three countries represent almost 50% of the aggregate microloan volumes. Over time, the microloan volume in Spain is expected to increase significantly.

The general trend continues to suggest that non-bank MFIs have been the most active lenders over the first four years of Progress Microfinance, as their main focus is micro-lending, unlike banks. Moreover, many non-bank MFIs have made use of the flexibility under Progress Microfinance to provide funding and risk coverage denominated in local currency.

7 Concluding remarks

Although there are some signs of improvements, as shown above, the imbalances between the EU Member States are still significant. A large fraction of SMEs continues to face major problems with access to finance, and there are, in particular, significant differences from country to country in such fields as, for example, debt financing.

Against this broad backdrop, it is evident that public support continues to play a crucial role in enhancing access to finance for SMEs. However, as outlined in detail in our previous ESBFO, it is important "how" this support is provided: support mechanisms have to be designed in a way that they catalyse other sources of finance to the benefit of SMEs. The decision to finance a company should be made by market-oriented professionals who make investment decisions on a business basis. This is also in line with the OECD (2014b) argument that "[p]ublic financial institutions have an important role in fostering co-participation of the private sector in the lending markets through managing guarantees and in encouraging new public-private collaboration in equity instruments." This is the investment approach of the EIF – the core competency is to select financial intermediaries who in turn know their individual markets best. Indeed, the existing support measures have facilitated SME survival, development and success in many countries of the EU, and – equally importantly – some new public support initiatives have been started, and several others are under preparation. In all these efforts, EIF's goal is not just to provide capital or guarantees: it is also to help spreading best market practice, encourage collaboration and network building, and the creation of a sustainable financing eco-system to the benefit of SMEs, entrepreneurship, and innovation.

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. In doing so, EIF aims at leveraging its market assistance and seizing market opportunities in all areas of the equity eco-system which are relevant to the sustainable development of the industry. EIF has increased – as the key catalytic investor in European venture and growth capital funds – its counter-cyclical role in providing financing solutions to boost entrepreneurship and innovation. In the coming years, EIF will continue to act as a cornerstone investor across the spectrum of Technology Transfer through Venture Capital to the Lower Mid-Market and mezzanine financing. This also includes the launch and extension of new/pilot initiatives, such as the European Angels Fund, partnerships with corporate investors, or a Social Impact Accelerator - a first step in the EIB Group's strategy to pioneer the impact investing space and to respond to the wider EU policy aim of establishing a sustainable funding market for social entrepreneurship in Europe.

In the areas of *credit guarantees* and *securitisations*, EIF cooperates with a wide range of financial intermediaries. They include: banks, leasing companies, guarantee funds, mutual guarantee institutions, promotional banks, and other financial institutions that provide financing or financing guarantees to SMEs. Given that SMEs have no direct access to the capital markets, banks are typically the most important source of external SME finance. Hence, funding limitations of banks have direct impact on SME lending capacity. For loans to SMEs, a standardised, highly transparent and quality-controlled securitisation market could transform these illiquid loans into an asset class with adequate market liquidity – this can also broaden the transmission mechanism of monetary policy, while providing a lasting intermediation market for this segment (Brunnermeier and Sannikov, 2014).

There are several initiatives to revive the SME securitisation market. However, there is currently significant uncertainty concerning the future regulatory treatments of securitisations. In our understanding, a holistic view has to be taken, and the impact of the "regulatory wave" duly analysed not to stall the market revival, but to frame its development in an economically reasonable way. In this context, the introduction of a properly defined concept of "high quality securitisation" can add substantial information and such a definition should include SMESec transactions. The ECB's Asset Backed Purchase Programme started only recently. At this stage, it is still impossible to judge the overall impact of these measures on the revival of a sustainable SMESec market, and in particular the involvement of the EIB Group, i.e. as the eligibility criteria for guaranteed mezzanine tranches have not been disclosed yet. Constructive discussions between the EIB Group and the ECB are underway.

Finally, *microfinance* is an important contribution to overcoming the effects of the crisis, and in particular to supporting inclusive growth. 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. Moreover, EIF intends to sustain its support of microcredit, social investments, and participation in the increasing number of social finance institutions that are being established in the EU Member States.

Additional support for European enterprises might be available in 2015 under the new "Investment Plan for Europe". On November 26, 2014, the European Commission has launched this plan, under which the EIB Group and the European Commission are working together to mobilise EUR 315bn of investment in strategic infrastructure and companies. The Investment Plan for Europe should catalyse private sector investment and create growth and jobs for a more competitive Europe. An essential part of the Investment Plan put forward is to set up a new European Fund for Strategic Investments (EFSI). This would be a dedicated fund, managed and hosted by the EIB and jointly funded by the European Union and the EIB. Initial funding of EUR 21bn should result in total investment in strategic projects of at least EUR 315bn over the period 2015-2017 thanks to the Fund's potential to mobilise private investment. Funding would be channelled to viable projects with a real added value for the European social market economy, from a wide range of sectors, including, inter alia, "investments boosting employment, in particular through SME funding and measures for youth employment" (source: EIB website).

According to the related European Commission (2014f) communication, the EFSI "will support risk finance for SMEs and mic-cap companies across Europe, relying on the European Investment Fund […] for the operational implementation. This should help them overcome capital shortages by providing higher amounts of direct equity, as well as additional guarantees for high-quality securitisation of SME loans. This is an effective way to kick-start job creation and growth, including the recruitment of young people. The EIF is highly experienced in these kinds of activities. The European Fund for Strategic Investments should thus serve to scale up the activities of the EIF and, in doing so, create new channels for NPBs [i.e. National Promotional Banks] to develop their own activities in this area. This will come on top of existing activities for SMEs initiated by programmes such as COSME and Horizon 2020, which will notably already provide significant sources of funding in 2015."

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).
- **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.
- **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 organisation 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. For the avoidance of doubts: IRR means the financial IRR and not the economic IRR, i.e. it does not account for any externalities.
- **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 New Company'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

- **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 (e.g. 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.
- **Collateralized loan obligations** (CLOs) are a form of securitisation where payments from multiple middle sized and large business loans are pooled together and passed on to different classes of owners in various tranches.
- **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
- ABS PP: Asset Backed Securities Purchase Programme
- AECM: European Association of Mutual Guarantee Societies
- AFME: Association for financial markets in Europe
- AIFMD: Alternative Investment Fund Managers Directive
- BA: Business Angel
- BAN: Business Angels Network
- BCI: Business Climate Indicator
- BLS: Bank Lending Survey
- BMWi: Bundesministerium für Wirtschaft und Technologie
- BoE: Bank of Enland
- bn: billion
- bp: basis point(s)
- CDO: Collateralized Debt Obligation
- CESEE (countries): (countries in) Central, Eastern and South-Eastern Europe
- CGAP: Consultative Group to Assist the Poor
- CGS: Credit Guarantee Scheme
- CIP: Competitiveness and Innovation Framework Programme
- CLN: Credit Linked Note
- CLO: Collateralized Loan Obligation
- COM: European Commission (also: EC)
- CoriP: Corporate Innovation Platform
- COSME: Programme for the Competitiveness of enterprises and SMEs (COSME) 2014-2020
- CRD: Capital Requirements Directive
- CRR: Capital Requirements Regulation
- CVC: Corporate Venture Capital
- EAF: European Angels Fund
- EBAN: European Business Angels Network
- EMN: European Microfinance Network
- EC: European Commission (also: COM)
- ECB: European Central Bank
- EFG: Equity Facility for Growth
- EFSI: European Fund for Strategic Investments
- EIB: European Investment Bank
- EIF: European Investment Fund
- EMEA: Europe, Middle East, and Africa
- EMN: European Microfinance Network
- EREM: EIB Group Risk Enhancement Mandate
- ESBFO: European Small Business Finance Outlook
- ESI: Economic Sentiment Indicator
- ESIF: EU Structural and Investment Fund
- EU: European Union
- EU27: the 27 EU Member States
- EU28: the 28 EU Member States
- EUR: Euro
- EuVECA: European Venture Capital Fund Regulation
- EVCA: European Private Equity & Venture Capital Association
- FLPG: First Loss Portfolio Guarantee
- FRSP: Funded Risk Sharing Product
- FYROM: Former Yugoslav Republic of Macedonia
- GDP: Gross Domestic Product
- GP: General Partner

- HICP: Harmonised index of consumer prices
- HM / HMT: HM Treasury is the UK government's economic and finance ministry
- HQS: High quality securitisation
- HY: Half Year
- IMF: International Monetary Fund
- IPO: Initial Public Offering
- IRR: Internal Rate of Return
- k: thousand
- JEREMIE: Joint European Resources for Micro to Medium Enterprises
- LBO: Leveraged buy out
- LFA: Förderbank Bayern
- LGF: Loan Guarantee Facility
- LP: Limited Partner
- m: million
- MDD: Mezzanine Dachfonds für Deutschland
- MFG: Mezzanine Facility for Growth
- MFI (in the context of ECB): Monetary Financial Institutions
- MFI (in the context of microfinance): Microfinance Institution
- NFC: Non-financial corporation
- NGO: Non-Governmental Organisation
- NPB: National Promotional Bank
- NPL: Non-performing loan
- NRW. The development bank of North Rhine-Westphalia.
- OECD: Organisation for Economic Co-Operation and Development
- PCS: Prime Collateral Securities
- pif: paid in full
- PE: Private Equity
- PFB: Public Funding Body
- PRSL: Portfolio Risk Sharing Loan
- Q: Quarter
- RCR: Risk Capital Resources
- RMA: Research and Market Analysis
- RMBS: Residential mortgage backed securities
- RSFF: Risk Sharing Finance Facility
- RSI: Risk-Sharing Instrument for Innovative and Research oriented SMEs and small Mid-Caps
- SAFE: Survey on the Access to Finance of Enterprises
- SDW: Statistical Data Warehouse
- sf: Structured Finance
- SIA: Social Impact Accelerator
- SME: Small and medium sized enterprise
- SMEG: SME Guarantee Facility
- SMESec: SME Securitisation (comprising transactions based on SME loans, leases etc.)
- SPV: Special Purpose Vehicle
- TMT: Technology, Media, Telecom
- TT: Technology transfer
- TTFF: Technology Transfer Finance Facility
- UEAPME: European Association of Craft, Small and Medium-sized Enterprises
- UK: United Kingdom
- US: United States
- VC: Venture Capital
- VDB: Verband Deutscher Bürgschaftsbanken e.V.
- WBS: Whole Business Securitisation

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