European Small Business Finance Outlook

June 2013

Helmut Kraemer-Eis

Frank Lang

Salome Gvetadze

Working Paper 2013/18

EIF Research & Market Analysis

Helmut Kraemer-Eis heads EIF's Research & Market Analysis.

Contact: h.kraemer-eis@eif.org
Tel.: +352 248581 394

Frank Lang is Senior Manager in EIF's Research & Market Analysis team.

Contact: f.lang@eif.org
Tel.: +352 248581 278

Salome Gvetadze is consultant to EIF's Research & Market Analysis team.

Contact: s.gvetadze@eif.org
Tel.: +352 248581 360

Editor

Helmut Kraemer-Eis, Head of EIF's Research & Market Analysis

Contact:

European Investment Fund
15, avenue J.F. Kennedy, L-2968 Luxembourg
Tel.: +352 248581 394
http://www.eif.org/news_centre/research/index.htm

Luxembourg, June 2013

Disclaimer:

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 December 2012.

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, we briefly highlight important aspects of microfinance in Europe.

In previous ESBFO versions we touched the topic of SME guarantees only briefly. From now on, in addition to our already 'traditional' analysis of the SMESec market, we include a specific section on SME guarantees in order to reflect the importance of this area for SME finance in Europe.

Market Environment:

- Since the publication of the last ESBFO in December last year, Europe's sluggish and uneven economic performance continued and there are a number of downside risks.
- Top issues are still the concerns surrounding the large funding requirements of sovereigns and banks.
- The overall business environment of European SMEs further deteriorated and the imbalances between the EU Member States are significant.
- The ECB bank lending survey shows that, on balance, the reporting euro area banks have further tightened their credit standards to non-financial corporations; the overall net tightening has been applied more to SMEs than to large firms.
- Using small loans as a proxy for the financing cost of SMEs, this elevated divergence "may point to some degree of discrimination by banks against small firms" (ECB, 2012b) as a consequence of a supposed divergence in firm-specific risks, in particular in the countries most affected by the deepened sovereign debt crisis.
- The relatively difficult access to finance conditions for SMEs in those countries which are suffering the most from the sovereign debt crisis is particularly worrying, as SMEs account for relatively large shares of gross value added in these countries.
- According to the ECB's latest "survey on the access to finance of SMEs in the euro area", access to finance remained the second most pressing problem for euro area SMEs. Moreover, it appears to be still a more severe concern for SMEs than for large firms.

Private equity:

- Following the deep crash in 2008/2009, private equity (PE) investment had partially rebounded in the years 2010 and 2011. However, the recovery suffered a setback in 2012. EVCA figures show that private equity and venture investments recorded a significant downturn which was at least partially due to the very difficult general economic environment.

---

[1] This paper benefited from comments by many EIF colleagues for which we are very grateful. All errors are of the authors.

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

- Some of the gap left by the fall in venture capital (VC) investment has been filled by increased business angel activity; their proximity to the market has been beneficial during this difficult period.
- According to EVCA preliminary figures, also total private equity and venture fundraising decreased substantially in 2012. Alongside the developments of private equity fundraising and investment activity, also divestments have fallen considerably.
- Investors' currently cautious sentiment towards VC is shown in the shift in the investor base which has been going on during the past years. According to EVCA figures, government agencies - continuing to support the market counter-cyclically - accounted for almost 40% of total VC fundraising in 2012.
- VC performance, although still disappointing, has slightly improved. EIF is observing an increasing number of early-stage companies which show an unprecedented pattern of growth and good potential to positively impact the funds' performance.

SME Guarantees / Securitisation:

- Credit guarantees are used widely across economies as important tools to ease financial constraints for SMEs and in order to alleviate market failures in SME financing.
- Recent developments in SME guarantee activity seem to mirror the economic situation in the different countries. In times of weak business and investment activity, the need for finance and demand for guarantees are low. At the same time, tightening restrictions on public budgets and high financial risk perceptions are weighing on guarantee supply.
- In these times, public support coming from the European level can improve at least the situation on the supply side.
- In the SME securitisation market originators continue to mainly retain newly issued deals in order to create liquidity buffers and to use the assets as collateral with central banks.
- Despite the financial and sovereign crisis, the European securitization market in general performed so far relatively well; also the SME segment shows low default rates.
- The re-emergence of the European SME securitisation market would be an important element to enhance access to finance for SMEs in Europe. Recent positive statements, initiatives, and proposals concerning this market segment (e.g. by the ECB and the EC) give reason to be more optimistic than last year for SMESec.

Microfinance:

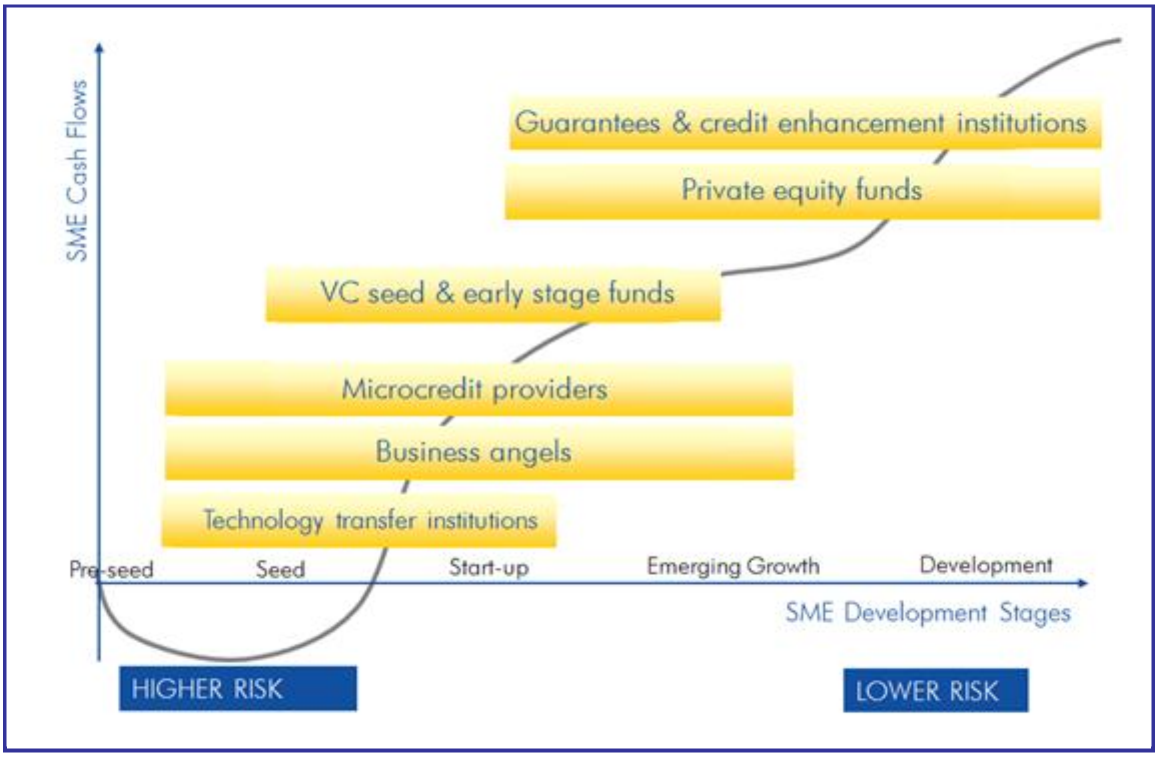
- The results of the latest EMN survey show that over the past years the European microfinance sector as a whole was growing in terms of the number of loans disbursed.
- The microfinance market in Europe in general shows trends towards efficiency, professionalization, and self-sustainability, but needs access to stable funding.
- The impact of the on-going crisis on the availability of microfinance is a central issue of the sector. In times of crisis, like today, microfinance clients, be it as an enterprise or a self-employed, typically find capital even harder to obtain; not to mention the additional challenges faced by certain vulnerable groups such as ethnic minorities or female entrepreneurs.
- Microfinance is an important contribution to overcome the effects of the crisis and in particular to support inclusive growth.

Table of contents

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). It is an update of the ESBFO December 2012.

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

In previous ESBFO versions we touched the topic of SME guarantees only briefly. From now on, in addition to our already 'traditional' analysis of the SMESec market, we include a specific section on SME guarantees in order to reflect the importance of this area for SME finance in Europe.

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

2 Economic environment

Since the publication of the previous ESBFO in December last year, the global economic outlook has slightly weakened. The European Commission (EC) recently forecasted a stabilisation of global growth rates at 3.0% in 2012 and 3.1% in 2013. Global growth is expected to increase again to 3.8% in 2014. However, compared to the EC's previous projections (made in December 2012) these forecasts have been decreased by 0.2 and 0.1 percentage points for the years 2013 and 2014 respectively (European Commission, 2013d).

Emerging market economies continued to be the main drivers of world output growth. However, impacts of the global slowdown on individual economies have been different, resulting in diverse growth performances of countries. Emerging markets that are closely connected to the EU economy experienced significant slowdown of their economies (particularly CIS countries). On the other hand, the Asian economy continued to expand. Among non-EU advanced countries, the US and Japan remained on a steady recovery path. Policy actions taken by central banks and governments are still supportive for global economic growth. The divergence between growth in advanced and emerging economies is expected to persist. Specifically, the EC has not changed its forecasts for the growth in advanced economies (+1.1% for 2013 and +2.1% for 2014) and slightly reduced it for emerging and developing economies (to +5.2% for 2013 and +5.6% for 2014).

The European Commission has also updated its projections for the European Union (EU), expecting negative (–0.1%) growth for 2013 and a modest recovery (+1.4%) for 2014 (see table 1). For 2013 and 2014, the labour market conditions in the EU are expected to hit a double-digit unemployment rate. However, private consumption and public consumption, both, are expected to moderately expand. As in the last two years, net exports remain the most powerful growth driver in 2013. For 2014, domestic demand is expected to step in as the main contributor to growth (European Commission, 2013d).

Table 1: Main features of the European Commission spring 2013 forecast for the EU

(Real annual percentage change unless otherwise stated)				Spring 2013 forecast		
	2009	2010	2011	2012	2013	2014
GDP	-4.3	2.1	1.6	-0.3	-0.1	1.4
Private consumption	-1.5	1.1	0.1	-0.7	0.4	1.0
Public consumption	2.2	0.7	-0.2	0.1	0.2	0.4
Total investment	-13.0	0.0	1.4	-2.8	-1.7	2.6
Employment	-1.9	-0.5	0.2	-0.3	-0.4	0.4
Unemployment rate (a)	9.0	9.7	9.7	10.5	11.1	11.1
Inflation (b)	1.0	2.1	3.1	2.6	1.8	1.7
Government balance (% GDP)	-6.9	-6.5	-4.4	-4.0	-3.4	-3.2
Government debt (% GDP)	74.6	80.2	83.1	86.9	89.8	90.6
Adjusted current-account balance (% GDP)	-0.7	-0.5	-0.2	0.5	1.2	1.4
Contribution to change in GDP						
Private and Public Consumption	-0.4	0.9	0.0	-0.4	-0.2	0.7
Investment and Inventories	-3.8	0.8	0.6	-1.0	-0.5	0.5
Net exports	-0.1	0.5	1.0	1.1	0.6	0.3

(a) Percentage of the labour force.

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

Source: European Commission (2013d)

3 Small business environment

3.1 SME business climate

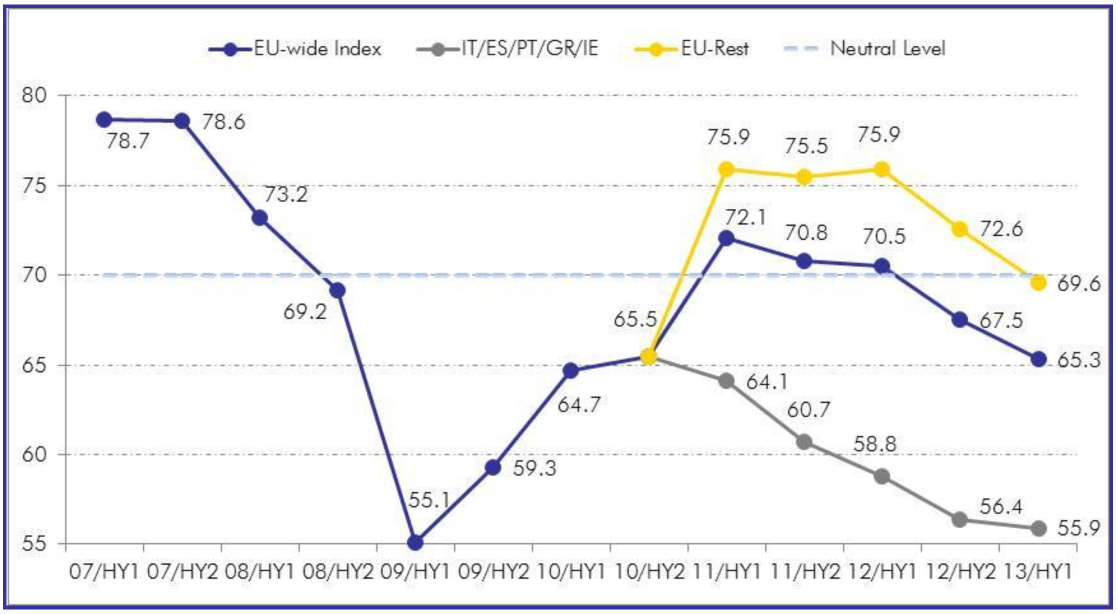
According to the UEAPME SME Business Climate Index, the overall business environment of European SMEs deteriorated for the fourth time in a row. The index for the first half-year of 2013 declined by 2.2 percentage points compared to the second half-year of 2012. The index continued to stand below its neutral level of 70%.

The imbalances between the EU Member States that were first identified in the beginning of 2011 are still significant. In fact, in those countries that were hardest hit by the sovereign debt crisis, SMEs have not found their way out of contraction as SMEs in the rest of the EU seem to have done since the end of 2010. To the contrary, the reported Business Climate Index for the country group Italy, Spain, Portugal, Greece, and Ireland is again at the levels of early 2009, showing a clear lack of confidence among SMEs concerning the current and upcoming developments. As a result, two diverse country groups can be observed within Europe reflected by a gap in the Business Climate between them amounting to 13.7 percentage points as depicted in figure 2. However, the Climate index for the "rest of the EU" also became a contributor to the low EU-wide index, as it dropped slightly below the 70% neutral level for the first time since the beginning of 2011 (UEAPME Study Unit, 2013).

Figure 3 shows the balance of "positive minus negative" answers reported by European SMEs, regarding 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 first half-year 2013. During the second half-year of 2012, all economic indicators have turned negative. All results were in line with what SMEs expected half a year earlier.

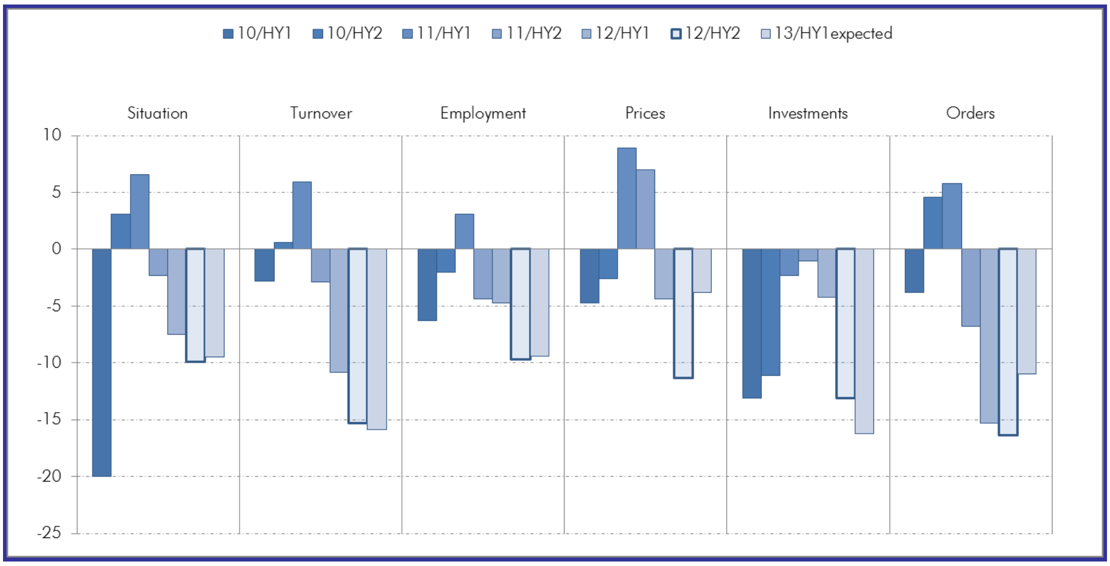
Specifically, in the first half of 2013, turnover, orders and employment were on balance expected to fall by 15.9%, 11.0% and 9.4% respectively, corresponding to the macroeconomic forecasts. Moreover, expectations for investments are on balance even worse (-16.2%), driven by the uncertain business environment and the difficult situation in lending that SMEs keep facing. Lastly, SMEs, in line with previous survey rounds, continue to expect lower prices (however, only with a balance of -3.8%). A modest upward change in the expectations of orders (-11.0% compared to -16.4% in the previous semester) might be perceived as a first sign of an economic recovery (UEAPME Study Unit, 2013).

Figure 2: SME Business Climate Index[4]



Source: Based on UEAPME Study Unit (2013)

Figure 3: Main Results of the EU Craft and SME Barometer 2012/HY2[5]



Source: Based on UEAPME Study Unit (2013)

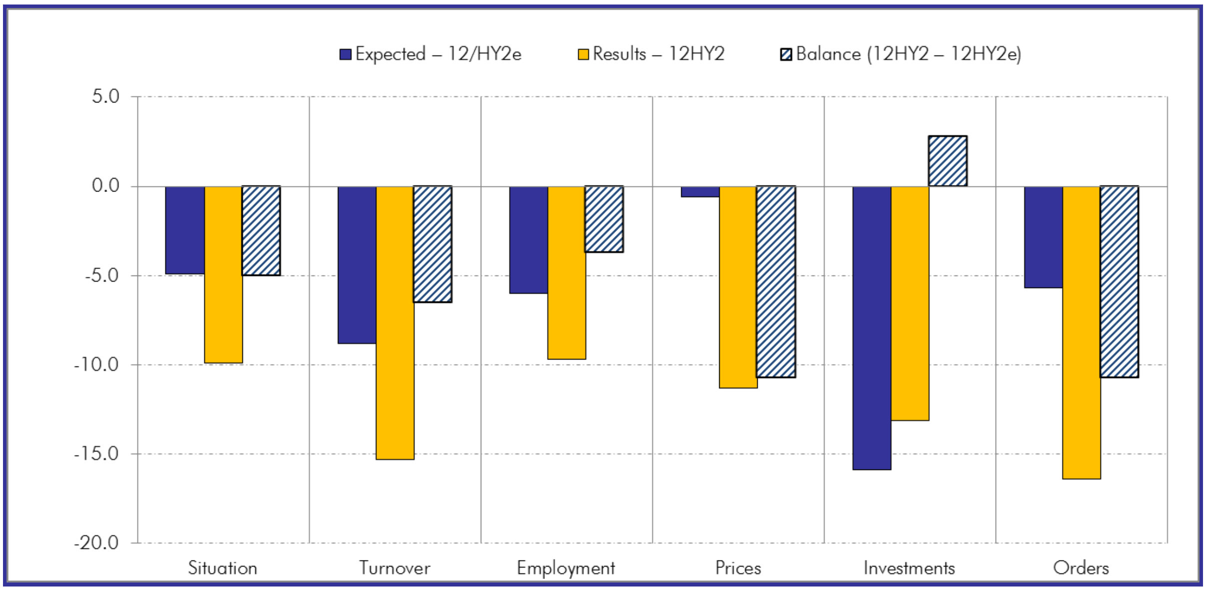
---

[4] 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.

[5] The EU Craft and SME barometer builds on surveys that are conducted by UEAPME member organisations. The 2013/H1 results are based on about 30,000 answers collected between December 2012 and February 2013. The balanced figures mentioned in the text show the difference between positive and negative answers, with national results weighted by employment figures. The surveyed categories include overall situation, turnover, employment, prices, investment, and orders. For details see UEAPME Study Unit (2013).

The balance between expectations and final results for the second half of 2012 is depicted in figure 4. The most remarkable difference was observed for prices for which the balance of expectations (-0.6%) contrasts significantly with the balance of actual results reported (-11.3%). The negative balance was caused by the strong effect of the downward pressure on SMEs sales prices. A negative balance was also observed for investments for which the balance (-13.1%) reached the level registered back in 2010 (UEAPME, 2013).

Figure 4: Expectations of SMEs and real outcome for 2012/HY2



Source: Based on UEAPME Study Unit (2013)

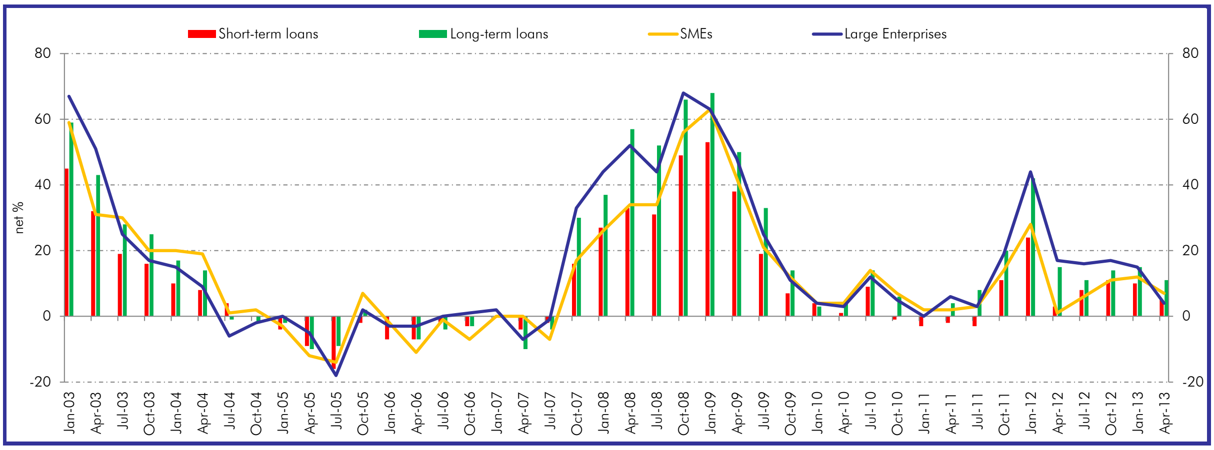
The results are widely confirmed by the recent Eurochambres (2013) Economic Survey[6]: According to this study business confidence fell for a second consecutive year in the EU and is now at the lowest level since the first wave of this survey in 1993. For the first time in ten years, Eurozone members are on average significantly less optimistic about *domestic* sales than non-Eurozone countries. "This highlights the impact of the Eurozone crisis and the short-term effects of the response measures on the purchasing dynamic of a number of Eurozone countries." In line with this statement, the *export* expectations do not differ so much between Euro- and non-Euro countries. Despite the currently very weak business sentiment, the positive results of some sub-indicators lead Eurochambres to the opinion that "the economic downturn is set to bottom out." However, "businesses clearly see little sign of any swift recovery and the overall sentiment is that 2013 is set to be another very tough year." Among the crisis countries in the Euro area, "Portuguese businesses are more confident after three years of growing pessimism, Italian confidence is stabilising, while Spain's is falling, although not at an all-time low. […] Cypriot and Slovakian businesses are the least confident."

[6] The Eurochambres Economic Survey is conducted since 1993. The 2013 results were gathered by national Chambers of Commerce and Industry from 53,000 businesses in 26 countries, mostly EU Member States and selected non-EU countries. For details on the methodology see Eurochambres (2013).

3.2 Bank lending activity

The current status of bank lending has been analysed in the ECB's latest Bank Lending Survey (BLS, see ECB, 2013c)[7]: On balance, the reporting euro area banks have further tightened their credit standards to non-financial corporations (NFCs). However, the survey reports a slight decrease in the *additional* net tightening[8]; a net 7% of banks reported a tightening in Q1/2013 (compared to 13% in the previous quarter). As shown in figure 5, the overall net tightening of credit standards has been applied more to SMEs than to large firms. The decline in net tightening of standards for SME loans (from 12% in Q4/2012 to 7%) was less pronounced than for large enterprises (from 15% in Q4/2012 to 4%). The BLS examines the net tightening of credit standards also with respect to the loan maturity and it declined for both, loans with longer maturities as well as for short-term loans.

Figure 5: Changes in credit standards applied to the approval of loans or credit lines to enterprises (SMEs versus large enterprises)



Source: Based on data from ECB (2013c)

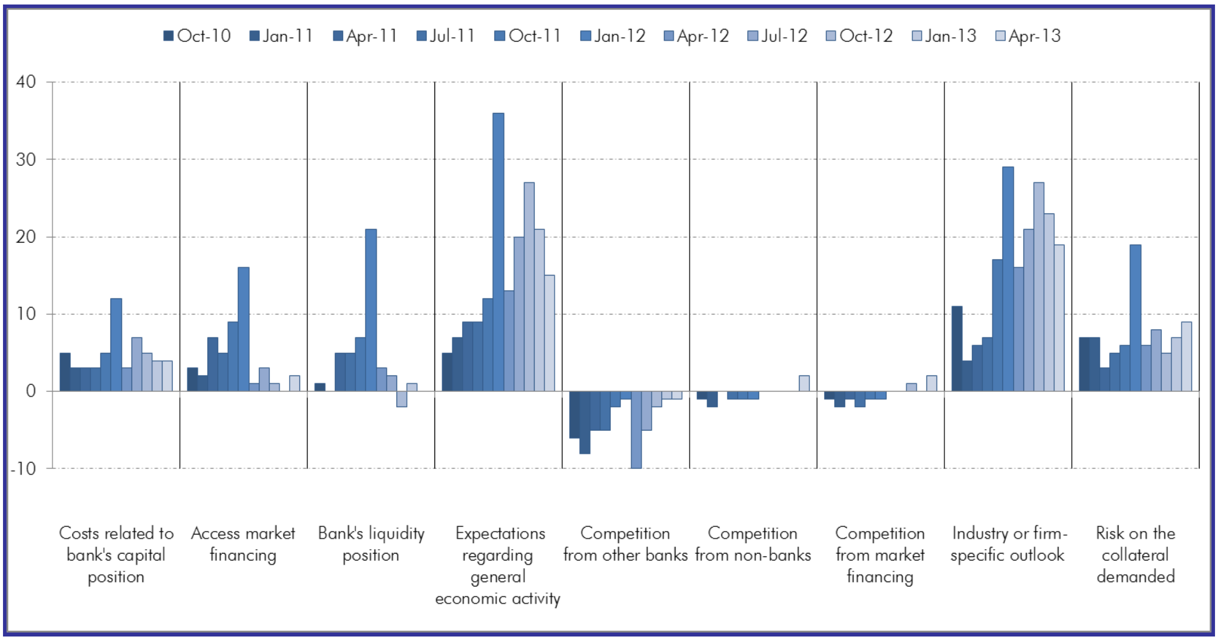
In Q1/2013, in net terms and as far as SMEs are concerned, the factors that were most and increasingly mentioned by banks as having contributed to tighter credit standards were the expectations concerning the industry (or firm) specific outlook and the expectation regarding the general economic outlook. In contrast, banks liquidity position and competition from other banks were on balance reported as having taken away some tightening pressure from credit standards (see figure 6).

According to the reporting banks, the decline of net *demand* for loans to NFCs was broadly unchanged in Q1/2013 (-24% compared to -26% in Q4/2012), mainly driven by the substantial negative impact of fixed investment on the financing needs of firms. Concerning the projections for Q2/2013, banks mainly expect a stable net tightening in credit standards (for large firms and SMEs). Moreover, they expect a less negative net decline in demand (for all categories of loans).

[7] This survey was conducted on 135 euro area banks and reports changes during the first quarter of 2013 (Q1/2013) and expectations of changes in the second quarter of 2013 (Q2/2013).

[8] Text and diagram refer to *net* percentages of banks contributing to tightening standards (difference between the sum of the percentages of banks responding "tightened considerably" and "tightened somewhat" and the sum of the percentages of banks responding "eased somewhat" and "eased considerably").

Figure 6: Factors contributing to tightening credit standards for SMEs[9]



Source: Based on data from ECB (2013c)

Box 1: Creditless Recovery?

This text box is based on Darvas (2013) and Abiad et al. (2012).

Access to finance and investment are crucial factors to foster economic activities, for growth and to recover from recessions. However, despite the importance of bank credits, some countries managed to recover from recessions without credit growth. From annual data for 135 countries since 1960, 428 recoveries were found of which 82 were creditless.

Before the crisis, credit supply was not limited in most European countries, but at the end of 2011 the stock of loans stopped growing or even decreased in some countries. Therefore, the evidences of creditless recoveries provoked a debate on whether European economies could expect to grow without credit stock growth.

Creditless recoveries can be characterized by significant GDP growth rates. However, growth rates are on average very different between low and high income countries. The data for creditless recoveries showed that the average yearly real GDP growth during the first three years after the trough was much higher in middle-income countries than in high income countries (4.7% versus 3.2%). These differences are partially related to economies' dependence on bank loans. High-income countries typically depend strongly on bank loans. Therefore limited credit supply can have more severe consequences than in lower income countries if they are more independent from bank credits.

[9] 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.

Box 1 continued:

Industries and firms may recover without loan growth when they easily find alternative financing:

(i) After deep recession they could exploit idle capacities.

(ii) Liquidity is restored by discontinuing investment.

(iii) Exporting firms are financed by increased trade revenues. This may happen, when external demand increases and firms produce goods that are highly tradable or when the real exchange rate depreciates and it fosters exports.

Access to finance is crucial in particular for SMEs. They depend heavily on bank financing and the issuance of debt securities or bonds is usually not an option for them. Therefore, they are hit harder by limited credit supply. SMEs are a significant part of the total number of European firms and they strongly contribute to economic growth and employment. Recoveries heavily depend on countries' composition of firms and how those firms reacted on the recent credit crunch. Moreover, different from the US, it is more difficult for firms in Europe to substitute bank loans with debt securities. Since the most European countries strongly depend on bank loans, credit constraints can be particularly disruptive for European economic growth.

Despite the existence of creditless recoveries, growth rates are higher in recoveries without imitations in credit growth. Therefore, European policy makers should try to revitalise impaired financial intermediation as this will likely stimulate economic activity and lead to higher growth.

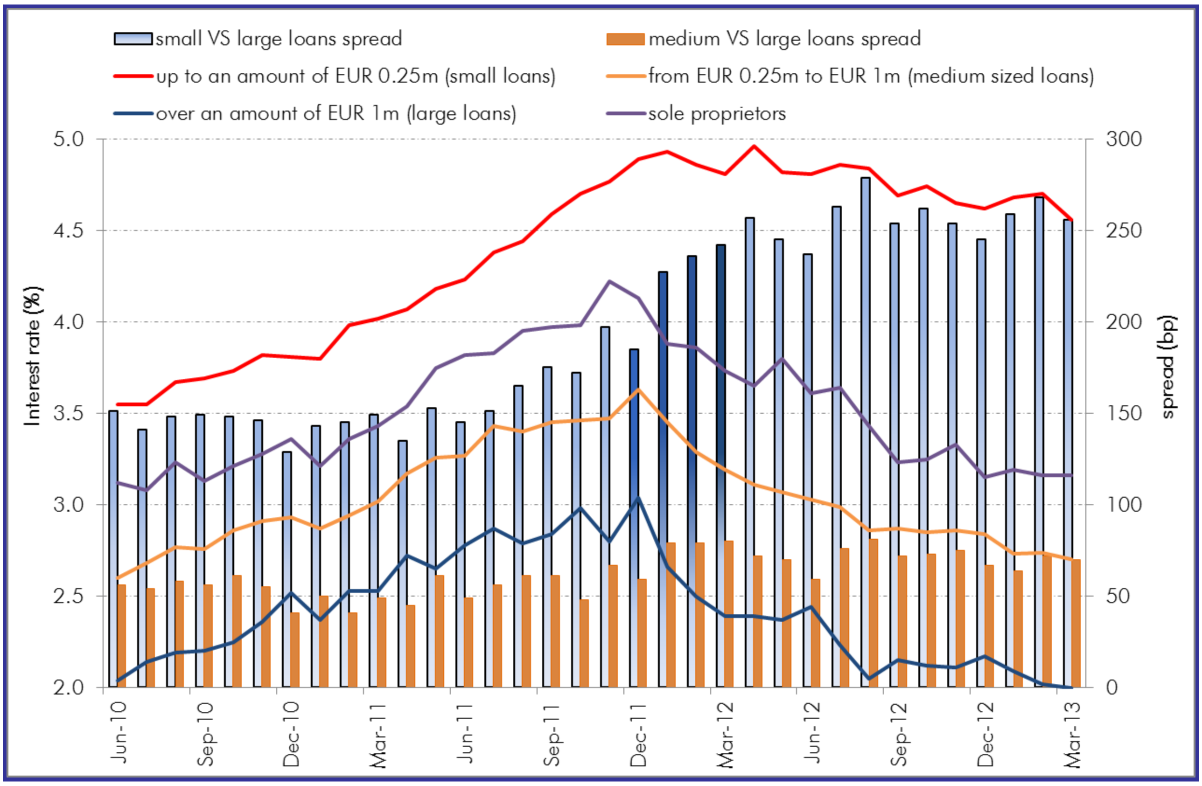
3.3 ECB interest rate statistics

The monetary financial institutions interest rate statistics, 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 to euro area non-financial corporations up to EUR 1m is divided into two sub-categories, one includes loans up to and including EUR 0.25m and another loans over EUR 0.25m and up to EUR 1m. Based on the assumption that the average size of new loans for SMEs is smaller than the typical loan size for large enterprises (Huerga et al., 2012), this categorisation enables us to have a closer look at the financing cost of SMEs.

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 62 basis points (bp) for the period June 2010 to March 2013 (see figure 7). In contrast, the interest rate spread between loans up to an amount of 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 has shown an increasing trend until August 2012 when it reached a record high of 279bp. Since then, the spread has been rather stable at an average level of 257bp.

Using small loans as a proxy for the financing cost of SMEs, this elevated divergence "may point to some degree of discrimination by banks against small firms" (ECB, 2012b) as a consequence of a supposed divergence in firm-specific risks, in particular in the countries most affected by the deepened sovereign debt crisis. This can be explained partially by the fact that smaller enterprises are more dependent on their domestic banking sectors where they face more adverse conditions compared with larger enterprises that are more flexible to benefit from global financial markets (ECB, 2012a). In addition to that, loans to sole proprietors (small-scale unincorporated businesses and self-employed persons) were granted with an interest rate between that of small and medium sized loans for the whole examined period.

Figure 7: Evolution of monetary financial institutions interest rates on new loans to non-financial corporations[10]



Sources: Based on Huerga et al. (2012), ECB (2013a) and own calculations

The relatively difficult access to finance conditions for SMEs in those countries which are suffering the most from the sovereign debt crisis is particularly worrying, as SMEs account for relatively large shares of gross value added in these countries, as was pointed out in a recent Morgan Stanley Research (2013) paper. The study concludes that it is in particular the "highly SME-dependent economies that face the greatest challenges – or an SME squeeze".

[10] 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.

According to the ECB executive board member Benoît Cœuré, "such credit tightening currently appears to be very severe for SMEs […] because SMEs are often unable to switch from bank credit to other sources of external finance. […] Difficulties in borrowing, which influence not only their day-to-day activities, but also their ability to grow, may then easily transform liquidity constraints into solvency risk." As the substitution of bank loans by trade credit, leasing or factoring is "strictly related to the business activity of companies and in recessions their buffer role might be limited by the reduction in the exchange of goods and services" (Cœuré, 2013), additional public policy support measures, such as guarantees or investments in venture capital, which help to alleviate SMEs' collateral and equity shortages might prove valuable to improve SMEs' access to finance and to reduce the cost of financing. In addition, supranational support measures to SMEs "could be enhanced" such as "traditional instruments […] related to the European Investment Bank (EIB) lending to SMEs and the European Investment Fund's (EIF) actions in the ABS market designed to revive investors' interest and confidence, by facilitating large and liquid transactions" (Cœuré, 2013). In addition, improvements in regulatory framework conditions can facilitate SMEs' access to finance, as well as current initiatives to revive SME securitisation (see chapter 5). "A reopening of the ABS market may be one way of enhancing funding conditions for SMEs", as ECB executive board member Peter Praet (2013) recently stated.

For these reasons, the ECB "Governing Council decided to start consultations with other European institutions on initiatives to promote a functioning market for asset-backed securities collateralised by loans to non-financial corporations" (Draghi and Constâncio, 2013). In particular, discussions are currently taking place with the EIB Group (see chapter 5 "SME guarantees and SME Securitisation" for more information).

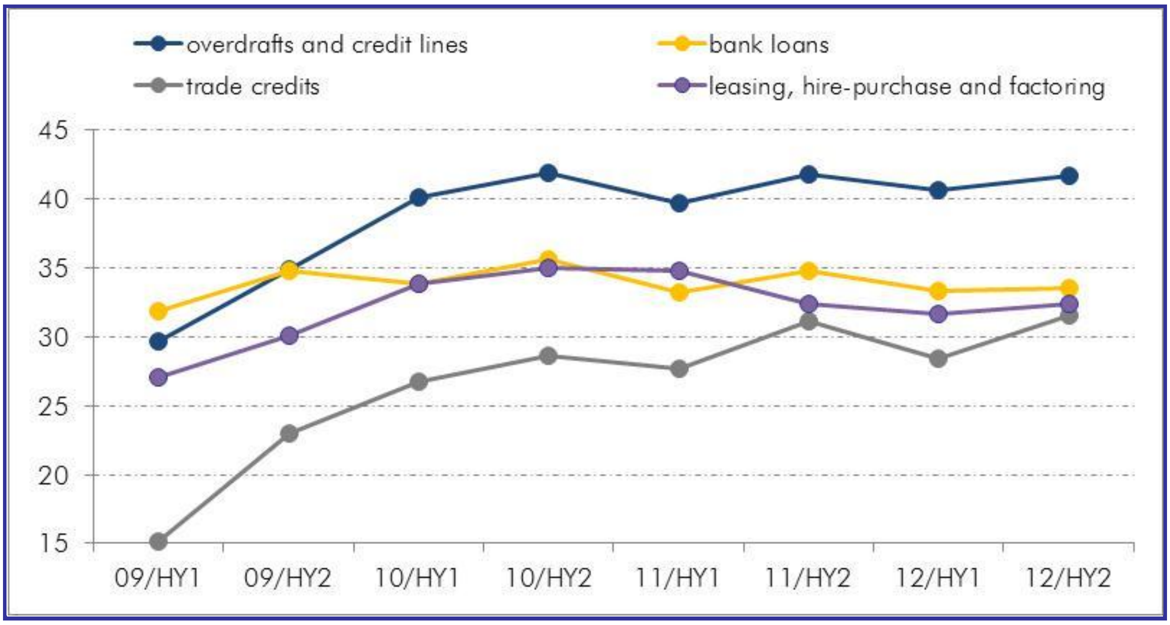
3.4 Access to finance

According to the ECB's "survey on the access to finance of SMEs in the euro area", covering October 2012 to March 2013 (ECB, 2013b), access to finance remained the second most pressing problem for euro area SMEs. Moreover, it appears to be still a more severe concern for SMEs than for large firms. Compared to the previous survey wave, the percentage of companies mentioning access to finance as their most pressing problem decreased for SMEs as well as for large firms, while "finding customers" stayed the most frequently mentioned concern. Unsurprisingly, the divergence across countries was large. "On the high side, 38% of the SMEs in Greece, 25% in Spain, 24% in Ireland and 21% in Portugal mentioned 'Access to finance' as the most pressing problem, compared to 8% of the SMEs in Germany and Austria on the low side" (ECB, 2013b).

Compared to the previous ECB survey (covering the period April to September 2012), there has been a slight increase in the percentage of SMEs having used debt financing through its most popular forms overdrafts and credit lines, bank loans and trade credits, leasing, hire-purchase or factoring. Traditional bank financing (overdrafts, credit lines, bank loans) remained the most important external funding source (see figure 8).

Figure 8: Sources of external financing of euro area SMEs

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

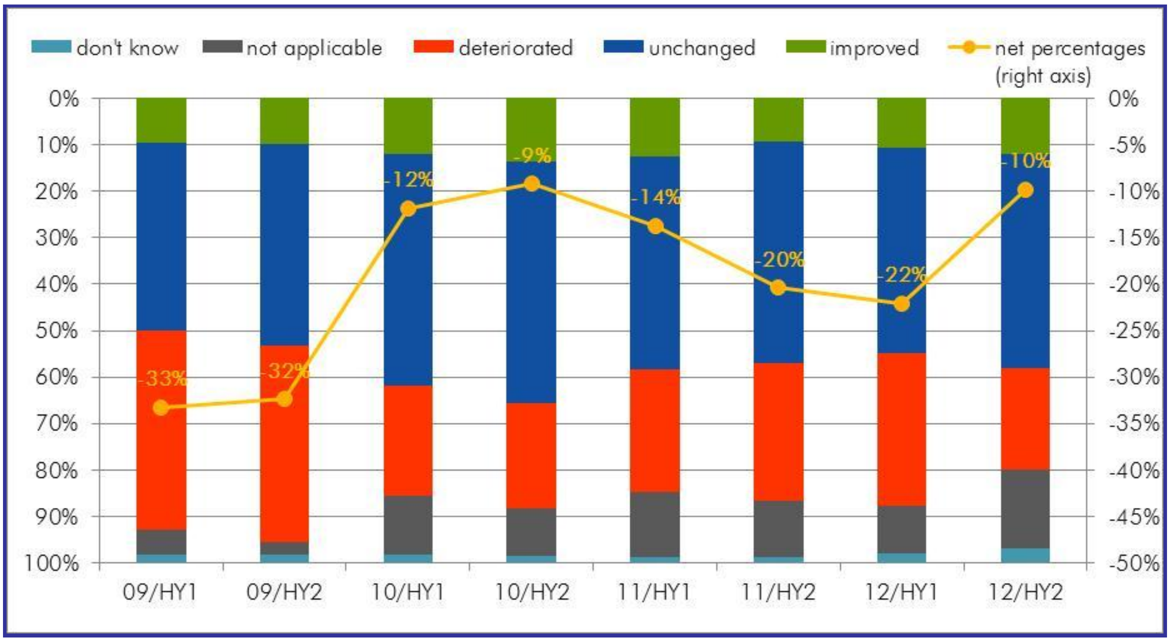


Source: Based on ECB (2013b) Statistical Warehouse Data

During the reference period, compared to the previous survey, the net percentage[11] of SMEs reporting a higher *need* for bank loans decreased for the second time in a row. At the same time, the net percentage of SMEs that perceived a deteriorated *availablity* of bank loans declined significantly and for the first time since two years (see figure 9).

Figure 9: Change in the availability of bank loans for euro area SMEs

(over the preceding 6 months; % of respondents)



Source: Based on ECB (2013b) Statistical Warehouse Data

[11] "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).

Moreover, SMEs also reported, on balance, a considerably smaller deterioration in the availability of bank overdrafts and trade credits. The overall picture of a less deteriorated availability of external financing “reflects the improvement in financial market confidence over the last few months and in banks’ funding conditions, helped by the ECB’s non-standard monetary policy measures” (ECB, 2013b). This improved (or less troubled) picture was reported from the majority of the euro area member states, with the most pronounced changes in Italy, Ireland, Greece and Spain. However, the *levels* of the reported net deterioration in bank loan availability was still high for several euro area members, in particular in Greece (-40%) and Portugal (-42%). Germany (+7%) was the only country where SMEs reported, on balance, an improvement in the availability of bank loans.

According to the responses of surveyed SMEs, the main factor which negatively impacted the availability of external financing was the general economic outlook. In addition, SMEs mentioned, on balance, some deterioration in banks’ willingness to lend and in their firm-specific outlook as factors weighing on the availability of external financing.

The net percentage of SMEs reporting an increase in interest rates dropped for the third time in a row to a level of 17% (from 27%). The net shares of SMEs which observed increases in costs of financing other than interest rates (46%) and in collateral requirements (35%) slightly decreased as well, albeit at high levels. The somewhat less pronounced tightening in terms and conditions of bank loans possibly reflect a slightly improved funding situation of banks and the slight moderation in average bank lending rates on small loans (see chapter 3.3) over the reference period (ECB, 2013b).

When looking at actual applications for external financing, 24% of SMEs applied for a bank loan between October 2012 and March 2013. The main reason for SMEs not to apply for a bank loan was the availability of sufficient internal funds (see also box 2). The success rates of actual loan applications by SMEs improved somewhat compared to the previous survey. Nevertheless, SMEs continued to report a higher rejection rate than large firms.

Looking ahead, Euro area SMEs expect on balance only a small further deterioration of access to bank loans and bank overdrafts, and broadly unchanged internal funds for the period from April to September 2013. Despite some improvements in net expectations, SMEs in Greece, France, and Portugal still showed the most pessimistic outlook for their future access on bank loans.

In contrast, SMEs in Germany expected, on balance, an improvement in access to bank loans. According to a recent survey by the Association of German Chambers of Commerce and Industry, it is in particular those enterprises which have positive business expectations and/or a high willingness to invest that express higher concern about future access to finance. Obviously, companies that expect growing order inflow and higher financing needs fear restrictions in financing over the coming months (DIHK, 2013a, and DIHK, 2013b).

Box 2: Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard

The OECD published recently its Second Edition of *Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard* (OECD, 2013a)[12] 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 25 OECD and non-OECD countries and examines 13 core indicators of debt, equity and general market conditions, complemented by a review of government policy measures.

The report confirms our view that, based on 2011 data, SMEs' access to debt and equity finance and the conditions at which they were granted – varied significantly across countries. SME lending conditions deteriorated in most countries, particularly as a result of higher interest rates and greater demand for collateral by banks. This was also generally accompanied by modest or no growth in credit volumes, with the exception of a few countries. These diverging performances can be traced to the different degrees to which countries were hit by the crisis and their subsequent recovery in 2009 and 2010.

On the whole, the analysis summarizes that finance for SMEs remained tight but appeared to stabilize in 2011 and early 2012. However, there are strong indications that the sovereign debt crisis in several European countries will lead to further deterioration in bank lending in 2013. In a number of countries, where the crisis resulted in a high level of bankruptcies and left many SMEs in a weaker financial condition, reversing the severe post-2007 job losses in SMEs will be particularly challenging.

3.5 Insolvencies

The current economic developments will also lead to growing insolvencies. Recently, Euler Hermes (2013) updated the predicted increase in global business insolvencies in 2012 to an even slightly more pessimistic level. For 2012 the Euler Hermes Global Insolvency Index[13], which analyses changes in business insolvencies across the world, forecasts an increase (+3%) for the second year in a row, following consecutive years of improvement (reduction in insolvencies of –6% in 2010, –4% in 2011, but increased insolvencies of +1% in 2012).

Concerning the euro area, the Insolvency Index reported an increase in bankruptcies by +16% in 2011 and the projection for 2013 has been recently updated by Euler Hermes to a more pessimistic level of +21% (compared to +11% projected in October 2012). For 2014 the Insolvency Index is expected to decrease to +7%. At the same time, the regional disparities have significantly increased as indicated by figure 10.

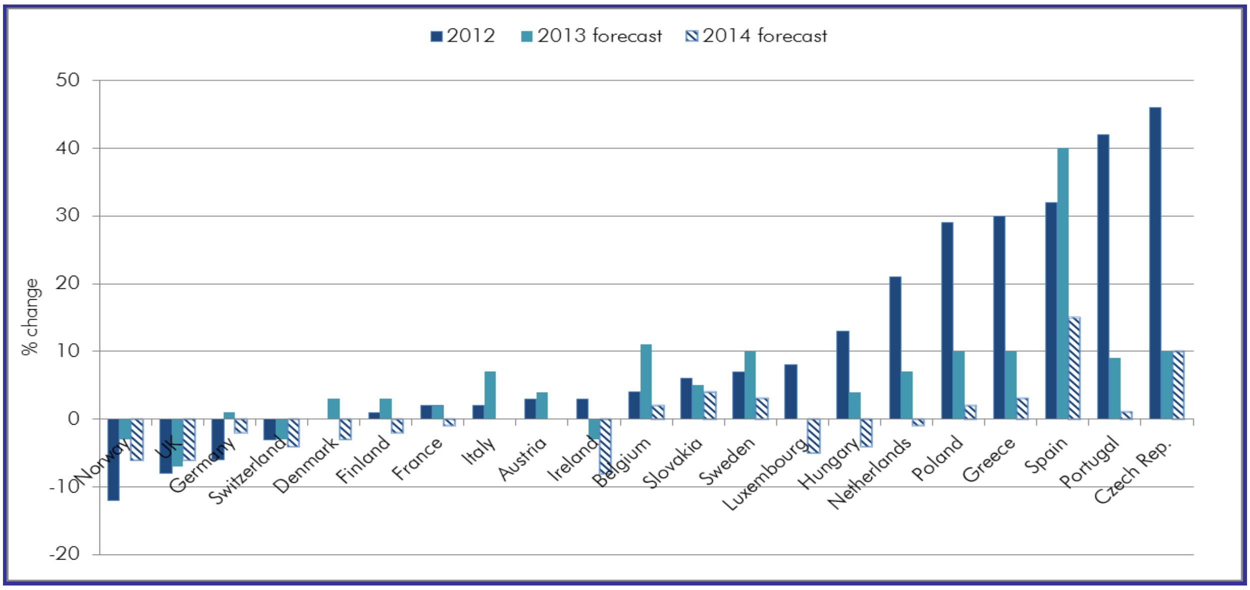
[12] EIF closely cooperates with the OECD on this project and other projects related to SME finance.

[13] For each country, an insolvency index is calculated, using a basis of 2000=100. Global Insolvency Index (GII) is the weighted sum of the national indices. Each country is weighted according to its share of the total GDP (at current exchange rates) of the countries included in the study, which account for more than 85% of world GDP at current exchange rates for 2011 (Euler Hermes, 2013).

In 2012, the insolvency indexes increased at a record speed of +42% in Portugal, +32% in Spain, and +30% in Greece, while a few central and Eastern European countries also recorded double-digit increases (Czech Republic+46%, Poland +29% and Romania +31%). On the other hand, the most significant falls in European insolvency indexes were recorded in Norway (-12%), the UK (-8%) and Germany (-6%).

For 2013, insolvencies in some European periphery countries are expected to worsen, e.g. in Spain (+40%); however, the downward pressure in Greece (+10%) and Portugal (+9%) is expected to fade (Euler Hermes, 2013).

Figure 10: Rate of change in insolvency, 2011-2013

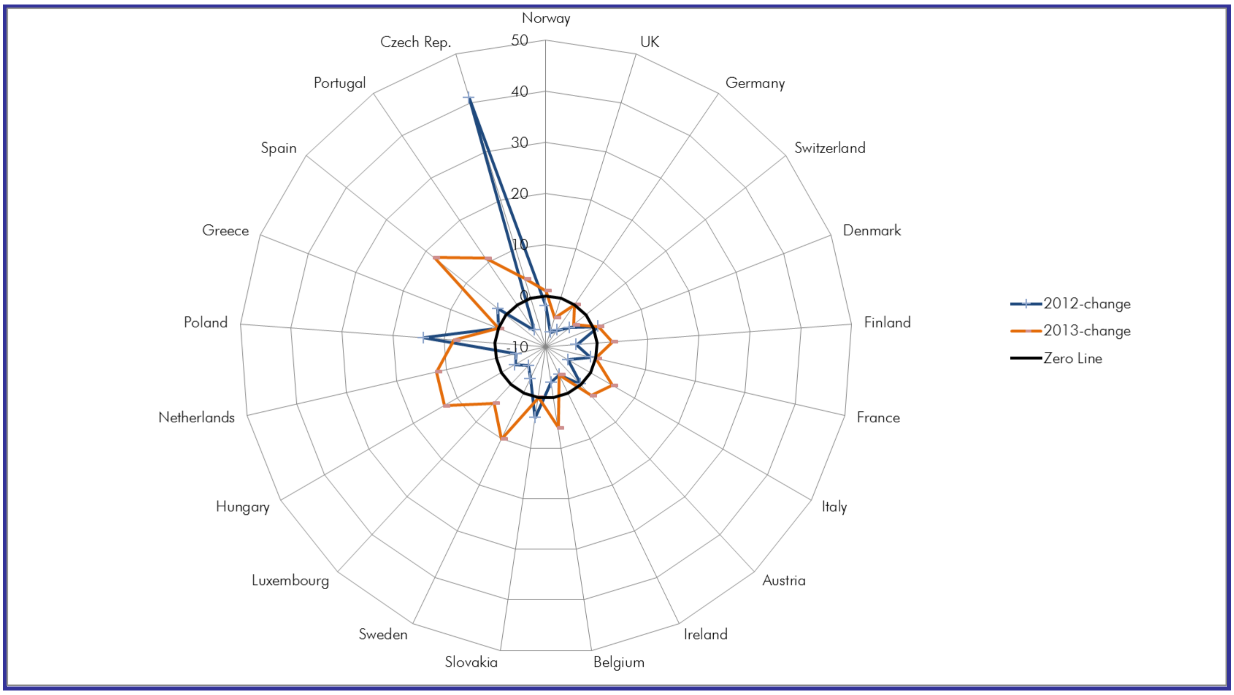


Source: Based on Euler Hermes (2013)

For some countries, the Insolvency Index for 2012 varies significantly from the projections made 6 months earlier and reported in previous versions of our ESBFO. On top of that, the updated forecast for 2013 also shows important deviations from the forecast for 2013 reported in the previous Euler Hermes Insolvency Indexes, reflecting the deteriorating economic environment (see figure 11).

For example, Portugal: In 2012, the actual change of insolvencies was +42% which was much better than the projection reported in the previous Insolvency Index (negative rate of change, hence: blue spot inside the zero line), while the new projection made now for 2013, was 9% worse than the previous projection made for 2013 six months earlier (positive rate of change, hence: orange spot outside the zero line); please see also footnote 13.

Figure 11: Insolvency Index – gap of current and previous projections per country[14]



Source: EIF, based on data from Euler Hermes Global Insolvency Index 2012 and 2013

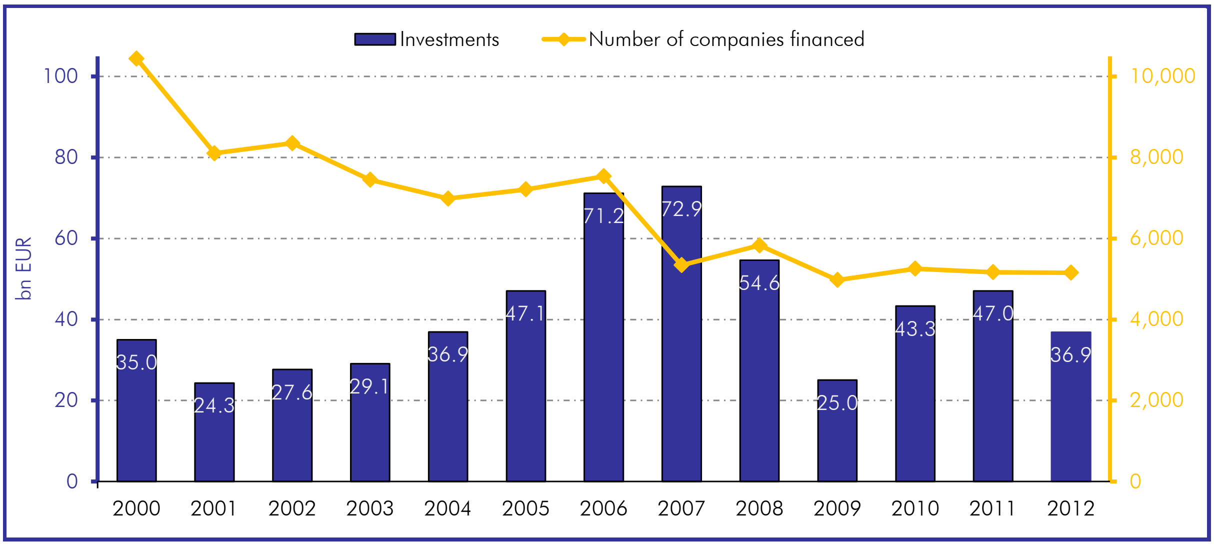
[14] The gap is calculated as following: For 2013 the gap is the difference of the current projection of Insolvency Index per country and the previous projection (reported 6 months earlier in ESBFO 2/2012). For 2012 the gap is the difference of the actual level of Insolvency Index per country and the projection made 6 months earlier (as reported in ESBFO 1/2012). The spots of the graph that are out of the black circle – zero line (positive) represent a deterioration of the forecast in percentage points (more insolvencies). The negative points (inside the black circle) show an improved situation in terms of business insolvencies.

4 European private equity market

4.1 Investment activity

Following the deep crash in 2008/2009, European private equity (PE) investment had partially rebounded in the years 2010 and 2011. However, the recovery suffered a setback in 2012. According to EVCA[15] figures, total PE investment amounts slumped by 22%, compared to the year before, to a level of EUR 36.9bn.[16] Nevertheless, total PE investment is still well above the 2009 crisis low (see figure 12). The number of companies which benefited from PE investment in 2012 remained almost constant at a level of around 5,150. The negative trend which was observed until 2009 seems to have bottomed out. However, while the number of companies supported by *growth* or *buyout* investments increased by 6% to 1,925 in 2012 the number of *venture* backed companies slightly decreased by 1.4% to 2,923.

Figure 12: Investment activity by private equity firms located in Europe[17]



Source: Based on data from EVCA

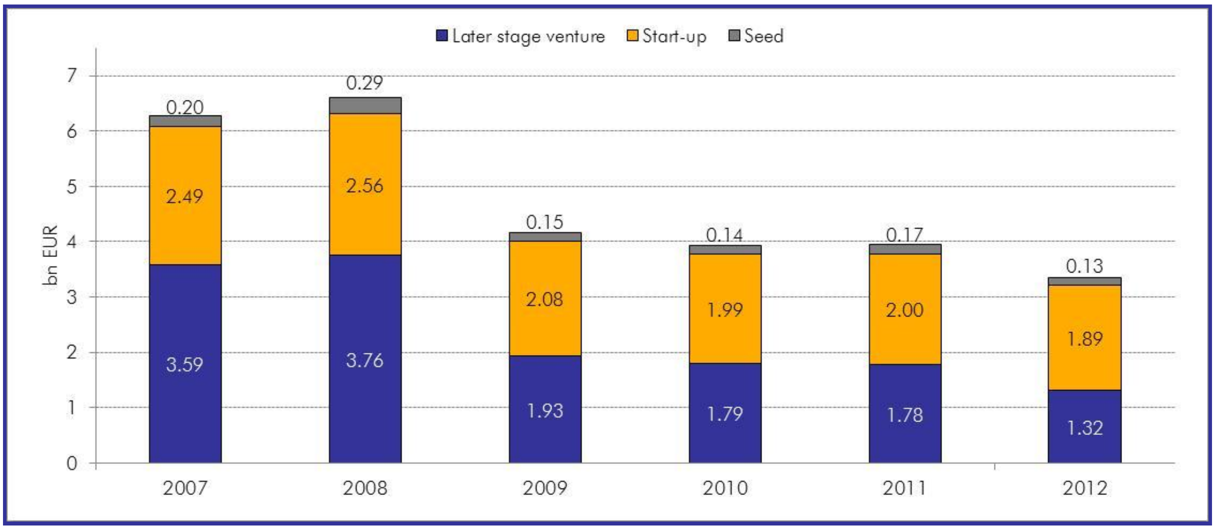
In terms of amounts invested, all private equity market segments have recorded a weak year (please note that the market segment business angels is not included in PE or VC statistics; as business angel financing is important for the financing of SMEs and innovation we present more information in Box 3). In the buyout sector, which forms the largest part of the market, investment activity decreased by 21% to EUR 28.2bn, but also growth capital investments showed remarkable weakness (-27%). Venture capital investment dropped by 15% to EUR 3.3bn. According to the EVCA figures, all VC stages declined in 2012 (see figure 13), however, later stage venture investments showed the strongest downturn (-26% to EUR 1.3bn). These developments are at least partially driven by the severe general economic downturn to which private equity – and in particular the buyout sector being the biggest segment of the market – is exposed to a relatively large extent.

15 We would like to thank our colleagues from the EVCA research team for their support.

16 The EVCA figures mentioned in this chapter show investment activity by PE firms located in Europe ("industry approach" or "office approach").

17 All investment figures are equity value, i.e. excluding leverage.

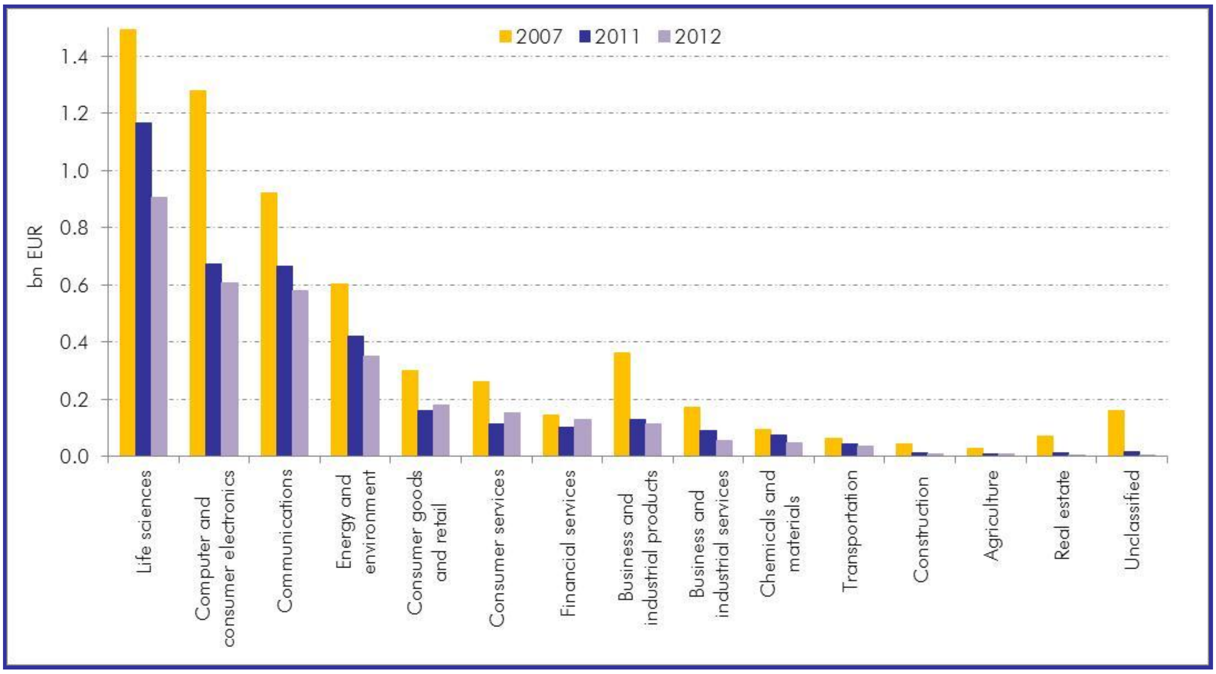
Figure 13: Venture Capital investment activity evolution in Europe



Source: Based on data from EVCA

The recent developments in venture investment by sector are shown in figure 14. Despite recent decreases in almost all areas, the relative importance of sectors shows certain stability over time. Life sciences, computer/consumer electronics, communications, and energy/environment remain the most relevant industries for venture investment. The *share* of life science in total VC investment activity has even increased from 25% in 2007 to 28% in 2012. The relative importance of the communications sector increased from 15% to 18%.

Figure 14: Venture investment in Europe by sector, 2012 and 2011 vs. 2007[18]



Source: Based on data from EVCA

[18]Figures 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.[19]

Business Angels differ from VC funds, who primarily invest third parties' funds (e.g. Institutional Investors'), in that typically Angel-financed companies are in earlier stage of their development compared to the VC-backed ones. Moreover, Business Angel Investments are usually short term with median holding period of approximately six years. The past three years have seen an increase in Business Angel Investments in early-stage high-growth companies as VC funds have migrated to less risky later-stage investments. Business Angels offer a number of advantages compared to VC funds:

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

There are potential difficulties in measuring the size of the 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 (a recent study states that the invisible part of the market is up to 7 times greater than the visible part (CSES, 2012)). 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. According to the European Business Angel Network (EBAN), the number of angel investors active both within networks and independently (individually or in syndicates) is estimated at around 75k in Europe. CSES (2012) estimates a total number of 170k to 240k business angels for the EU27 (visible and invisible market) - compared to, according to the Center of Venture Research (2013), approx. 268k active investors in the United States. In terms of overall investment by Business Angels, the same study estimates the annual amount invested by Business Angels (visible and invisible market) to be in the area of EUR 4 to 5bn in the EU27; and regarding the size of their funding, it is estimated that Business Angels provide on average around EUR 100k to 200k per deal, with individual angel investments varying significantly (CSES, 2012, based on 2010 data and related estimations).

In the traditional venture segment "business angels of all kinds are displacing VCs", as (e.g. internet-related) technology has become cheaper and more easily accessible, so that related investment sizes can be smaller. This change in the composition of venture-type investors in companies has led Go4Venture Advisers (2012) to the conclusion that "venture financing and venture capital fund activity cannot be seen as one and the same any longer" (Go4Venture Advisers, 2012).

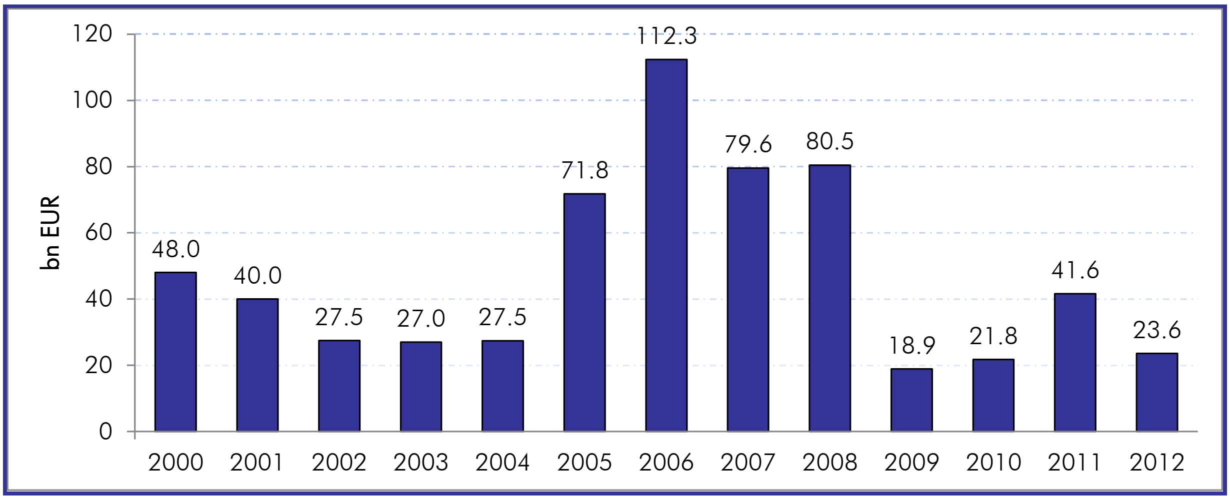
[19] For a general description of Business Angel financing please refer to Kraemer-Eis and Schillo (2011) and to OECD (2011).

4.2 Fundraising activity

Total PE fundraising substantially decreased in 2012. EVCA figures report a 43% drop (compared to the year before) in funds raised by private equity firms located in Europe to EUR 23.6bn (see figure 15).[20] With this amount, total PE fundraising is almost back to its minimum levels reached during the crisis years 2009 and 2010.

Fundraising decreased over all stages of the European private equity market, except for the early-stage venture segment. The largest negative contribution came from the buyout sector where fundraising is reported to have fallen by EUR 10.4bn. In addition, growth capital fundraising decreased by 91% to a level of only EUR 413m.

Figure 15: Funds raised by private equity firms located in Europe

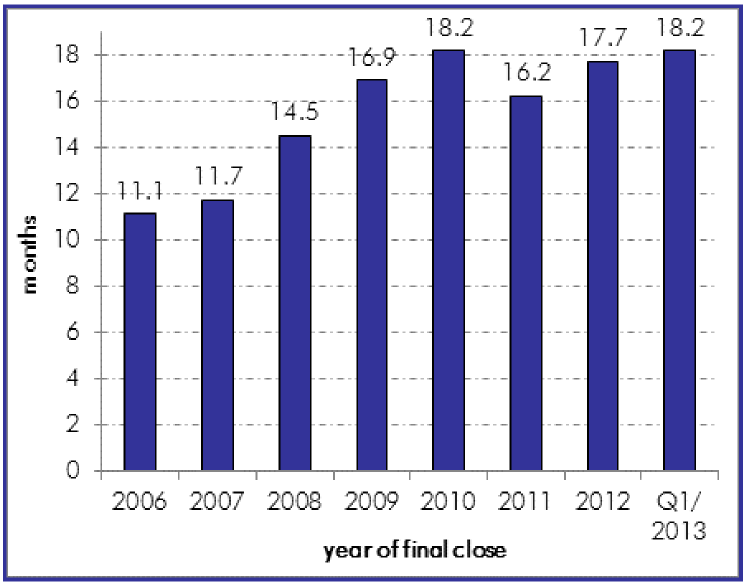


Source: Based on data from EVCA

The difficult fundraising environment is also reflected by Preqin (2013) global figures which show that the average time to close a fund increased considerably from 16.2 months in 2011 to 17.7 months in 2012, and to 18.2 months in Q1/2013 (see figure 16). Before the crisis, these numbers were much lower (11.1 and 11.7 in 2006 and 2007, respectively).

[20]Figures show fundraising activity (incremental amounts raised during the year) by private equity firms located in Europe ("industry approach" or "office approach").

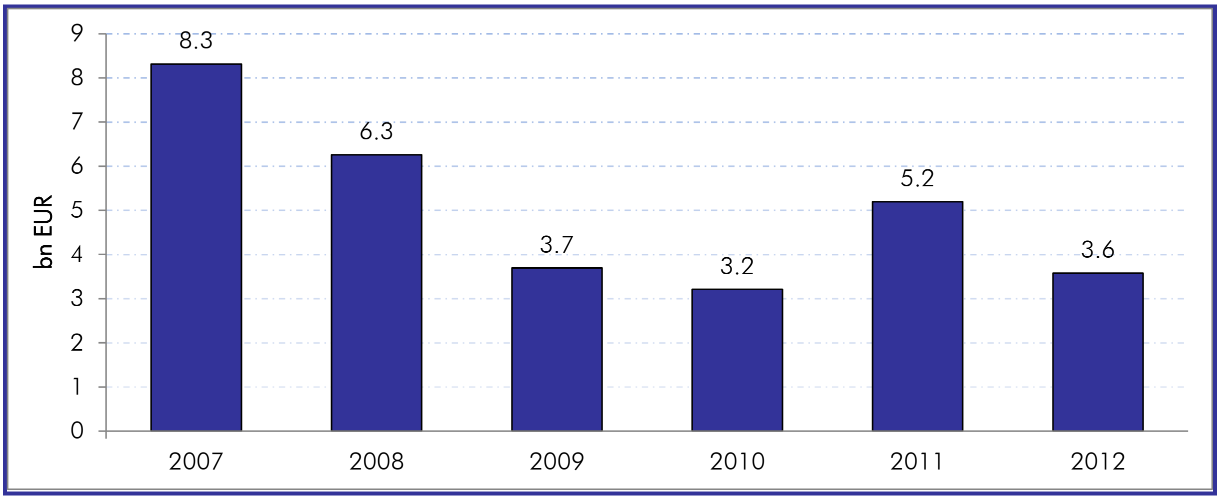
Figure 16: Average time taken for funds to achieve a final close



Source: Preqin (2013)

Moreover, the positive rebound in European *venture capital* fundraising which was recorded in 2011 did not continue in 2012. According to EVCA data, European VC fundraising decreased by 31%, compared to the year before, to a level of EUR 3.6bn, which means a fall-back to the levels of the crisis years 2010 and 2011 (see figure 17). According to EVCA (2013b), "Europe's venture capitalists face a funding shortage, with some areas particularly affected, such as hardware and life sciences."[21]

Figure 17: Funds raised by VC firms located in Europe

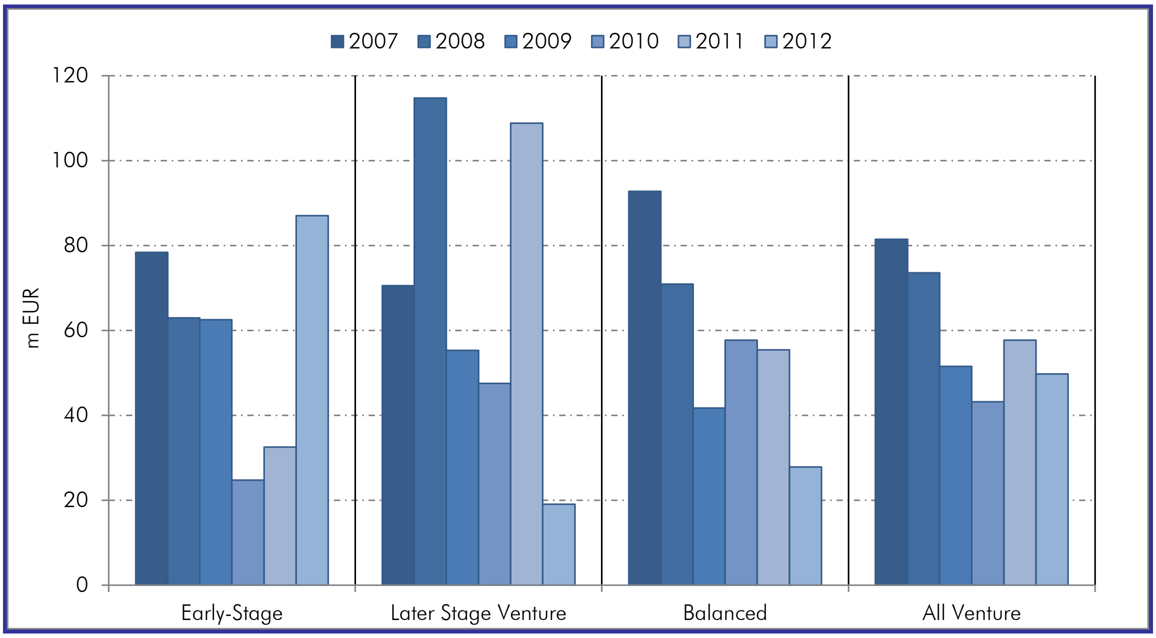


Source: Based on data from EVCA

[21] EVCA (2013b) illustrates this statement by the following example: "'Capital supply for hardware-related businesses has severely deteriorated over the last few quarters,' says Christian Reitberger, general partner at Wellington Partners. Wellington Partners' latest life sciences fund – its fourth – has taken two years to reach a first close at EUR 70m. While it remains confident of overshooting its EUR 120m final close target, so much time on the road is an unhelpful distraction from sourcing and building great companies."

The current downward trend in the industry is also reflected in fund sizes: EVCA figures indicate a fall of the average VC fund size to EUR 50m (see figure 18), based on a number of 30 fund closings. Given evidence in previous studies that indicates that small fund size is one of the reasons for poor European VC performance (Kelly, 2011), this may be an additional cause for concern.

Figure 18: Average VC fund size (based on final closings)

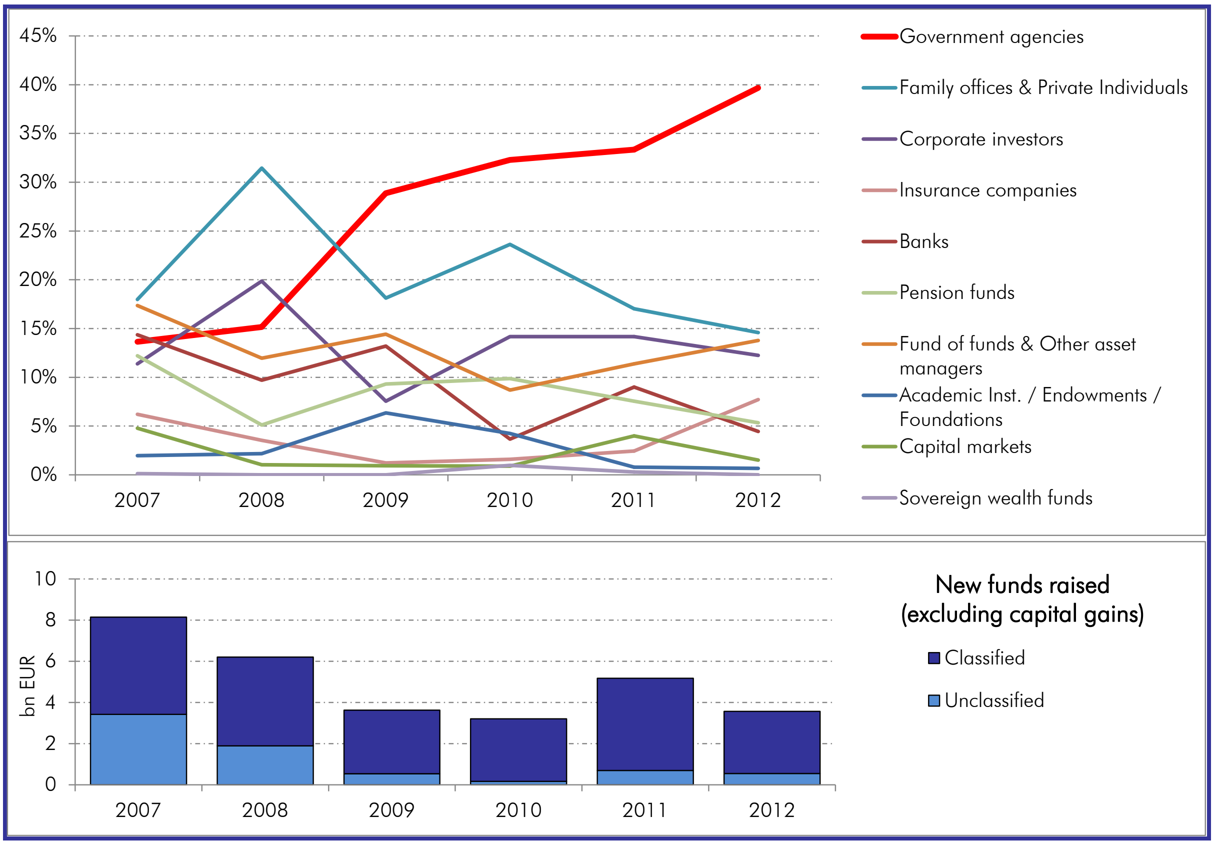


Source: Based on data from EVCA

Another sign of investors' currently cautious sentiment towards venture capital is the shift in the investor base which has been going on during the past years (see figure 19). According to EVCA figures, government agencies accounted for almost 40% of total investors into venture capital funds in 2012.[22] However, even if this share is unsatisfyingly high for the long term, it is noteworthy that government agencies continue to play their role and support the market in a counter-cyclical way, in particular in a year which showed a significant deterioration of the economic environment. Moreover, according to EIF market insight the importance of alternative investors (e.g. corporates) is expected to increase. This is also reflected in early indicators as described in chapter 4.5 on PE prospects.

[22]It has to be considered that the figures with regard to the investor base are highly volatile for short time periods and have to be carefully interpreted. (For example: according to EVCA data, the reported share of government agencies in VC fundraising was 57% in HY1/2011 and came down to 34% with the inclusion of HY2/2011.) Moreover, it has to be considered that, for the calculation of the percentages, a) the underlying amounts of funds raised have changed significantly (as shown in the diagram) and b) that the amounts that could for technical reasons not be classified have been deducted (extrapolation).

Figure 19: Investor base: Share of government agencies in VC fundraising



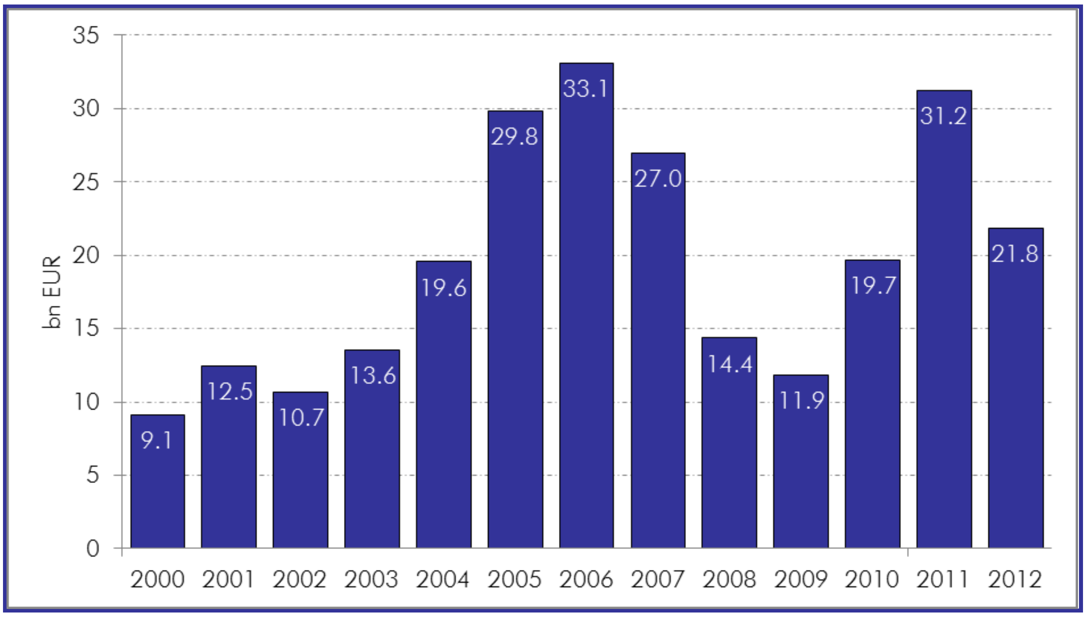
Source: Based on data from EVCA

4.3 Divestment activity

Alongside the developments of PE fundraising and investment activity, also divestments fell considerably in the last year. In 2012, total divestments in Europe amounted to EUR 21.8bn which was 30% below the value reached one year before (see figure 20). According to EVCA figures, the downturn was more pronounced for the buyout/growth stage (-28%) than for venture capital (-20%). Despite the recent market weakness, total PE divestment amounts still strongly exceeded the levels of the crisis years 2008 to 2010. However, venture exits are even below those levels which were reached during the worst years of the market.

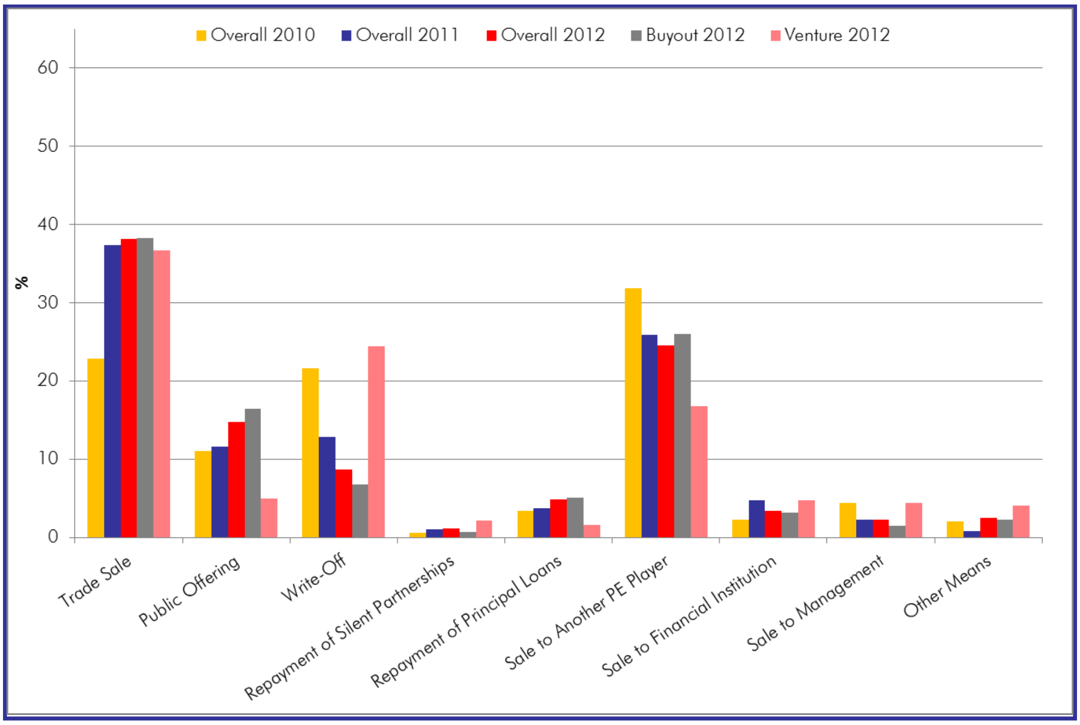
The relative importance of write-offs as a form of divestment has continued to decline in 2012 (see figure 21). Trade sales are still the most popular form of divestment. Together with sales to another private equity house they are accounting for almost two-thirds of total exit value. However, while write-offs made up only 7% of all buyout stage divestment amounts, they accounted for 24% in the venture part of the market, which is the largest share since the beginning of EVCA's records in 2007.

Figure 20: Divestments by private equity firms located in Europe



Source: Based on data from EVCA

Figure 21: Divestment routes (shares)[23]



Source: Based on data from EVCA

In the venture part of the market, the relative importance of public offerings decreased significantly in 2012. When looking back over a longer term, a recent study conducted by Axelson and Martinovic (2013) found that for the US and Europe, the "probability of an exit via an IPO (initial public offering) has gone down significantly over the last decade, while the time to IPO has gone

[23]Shares based on amounts at cost divested. Market approach, due to data availability.

up – in contrast, the probability of exit via trade sale and the average time to trade sale do not change much over time." See box 4 for more details.

The effects noted above seem to be "quite uniform across different European countries". However, "there is some evidence of difference in performance across European countries, with the UK performing the best and Germany and the Benelux countries performing the worst." However, Germany performs "extremely well when we look at IPOs only, perhaps related to the Neue Markt."

Box 4: "European Venture Capital: Myths and Facts"

The London School of Economics (LSE) researchers Ulf Axelson and Milan Martinovic (2013) recently published the paper "European Venture Capital: Myths and Facts", which was supported by the British Private Equity & Venture Capital Association (BVCA). They analyse and compare the determinants of successful exits in European and US VC transactions, using a Dow Jones VentureSource dataset of 12,315 European and 23,483 US companies that received VC investments between 1980 (1995 for Europe) and 2011.

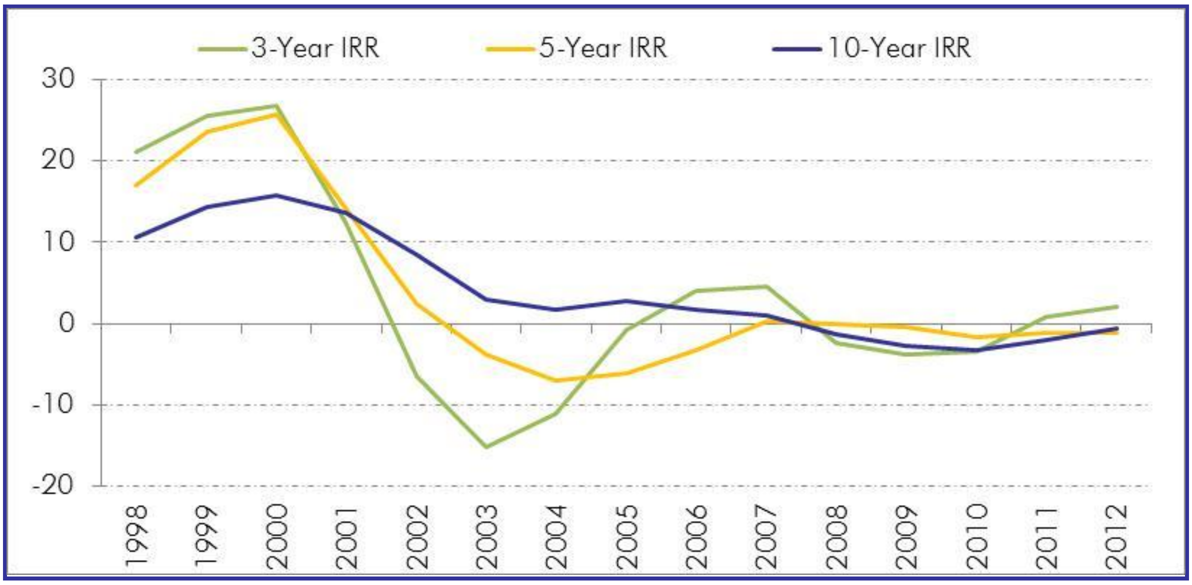
At first glance, US VC deals seem to have better performed (in terms of the share of successful exits, either in the form of an IPO or a trade sale, in all companies having received VC investments) than their European counterparts. Among the US firms in the dataset, 38.8% had a successful exit over the entire period, compared to 25.3% in Europe. However, when comparing success rates between investments done in the same year, the difference between these rates narrows. Moreover, the difference completely disappears, if "successful exit" is defined only as an IPO (and comparing US and European IPO exits from the same vintage year). In contrast, for trade sales, the probability of a successful exit is about eight percentage points lower for Europe than for the US. Thus, according to Axelson and Martinovic (2013), the difference in overall success rates between Europe and the US can be explained by a lower probability of trade sales in Europe.

"Venture success has the same determinants in both Europe and US, with more experienced entrepreneurs and venture capitalists being associated with higher probabilities of exit." "Having a VC represented on the board, having a VC that is specialized in the industry of the firm, using preferred shares, and syndicating deals are all features related to better performance, and […] these variables have the same effect in the US and Europe." "The fact that repeat entrepreneurs are less common in Europe and that European VCs lag US VCs in experience explains the remaining difference in performance." Moreover, "differences in industry composition or stage of investment between the US and Europe explain none of the difference in success rates." Also, "contrary to perceived wisdom", Axelson and Martinovic (2013) find "no evidence of a stigma of failure for entrepreneurs in Europe". The chance that a previously unsuccessful entrepreneur gets financing for a new venture is "at least as high" in Europe as it is in the US. Thus, even if a stigma of failure might exist in the society as a whole, it seems to not exist among entrepreneurs or investors. To conclude, important factors for Europe lagging behind in venture success seem to be relatively self-evident, as Europe has developed its venture sector later than the US, and Europe has less repeat (or "serial") entrepreneurs.

4.4 Performance trends

According to EVCA and Thomson Reuters data, European venture capital performance has slightly improved. The 3 year rolling horizon Internal Rate of Return (IRR) increased for the third year in a row and amounted to 2.0% in 2012. This is good news in particular when taking into account the long period of negative returns during the years 2008 to 2010. However, when looking at longer term performance figures, the picture is less bright (see figure 22). The rolling horizon IRRs for the 5 year (-1.1%) and the 10 year (-0.5%) periods are reported to be still in the negative area. Nevertheless, in 2011 and 2012 European VC performance improved for all three mentioned rolling horizons periods.

Figure 22: Rolling Horizon IRR European Venture Capital (in %)

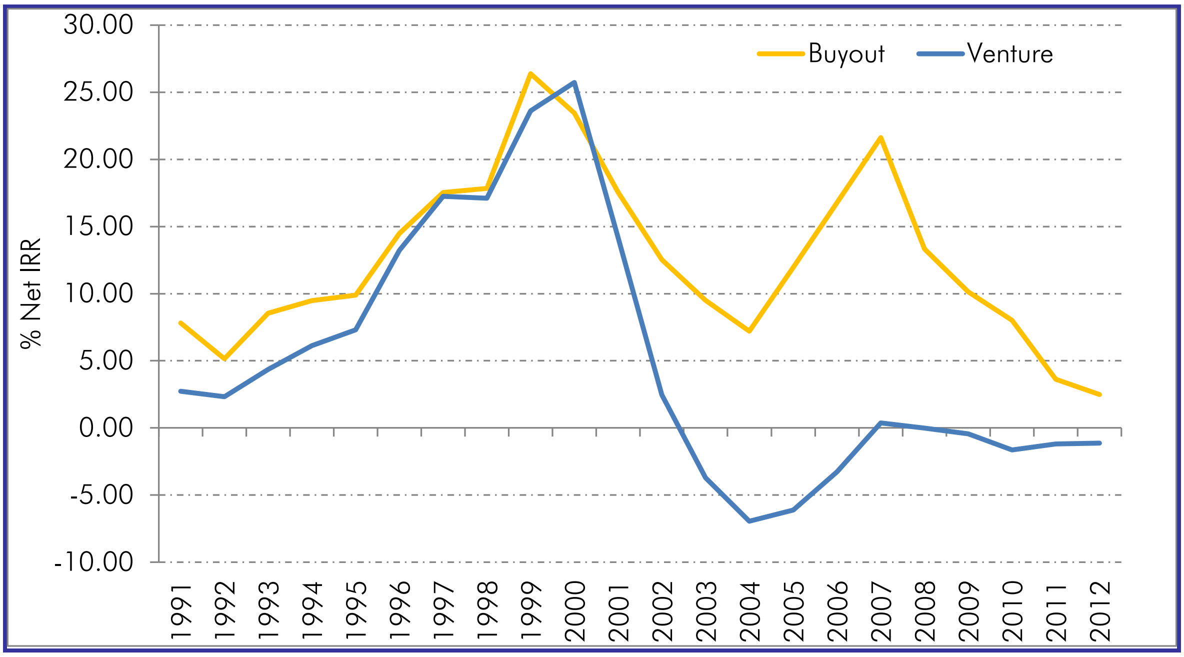


Source: Based on data from EVCA and Thomson Reuters

However, VC performance in Europe is still far below the returns reported for the private equity industry as a whole which also includes the buyout and the mezzanine segment of the market. For the 5-year rolling horizon IRR, figure 23 shows that the relatively good performance of the buyout sector compared to venture capital in Europe holds true also when looking to the past, in particular to the last decade. However, the IRR figures for the buyout and the venture sector are converging.

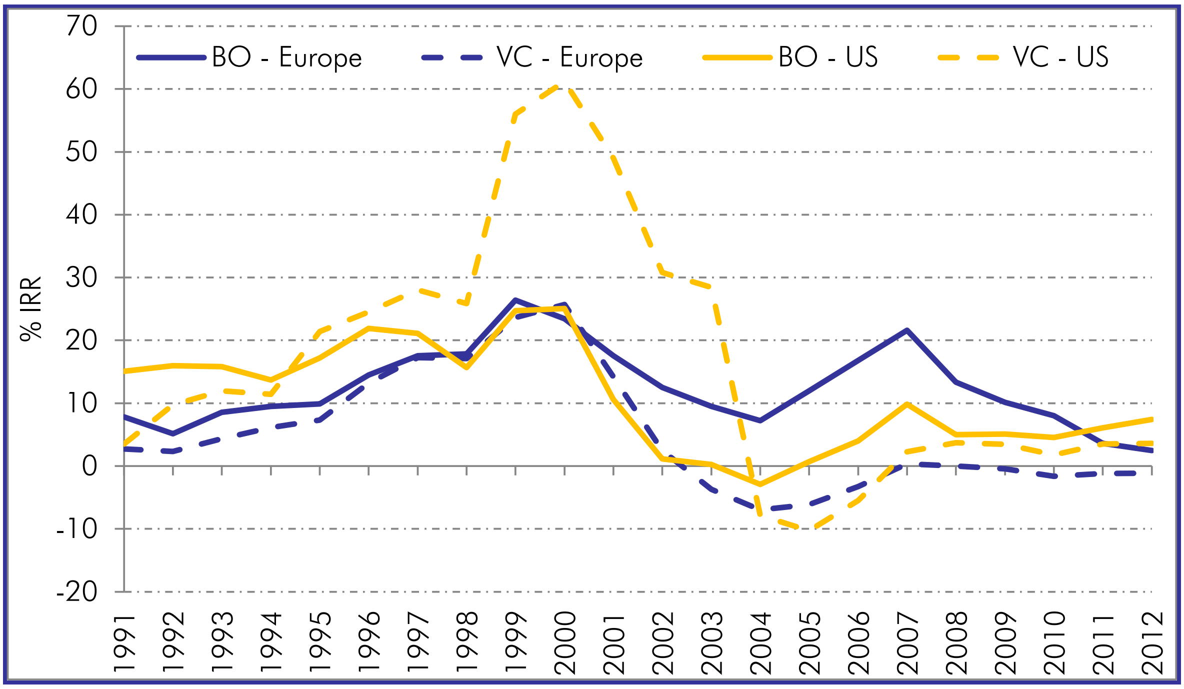
From a geographical point of view, the European picture looks relatively brighter for the buyout sector than for the venture capital part of it. Figure 24 shows that buyout performance (measured as rolling five-year horizon IRR) in Europe was better than in the US between 1998 and 2010 (2000 being the only exception). However, in the last two years the US buyout sector picked up, and 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, its European counterpart performed slightly better.

Figure 23: Five-year horizon rolling net IRRs for European venture and buyout funds



Source: Based on data from EVCA and Thomson Reuters

Figure 24: Five-year horizon rolling IRRs for Europe and the US



Source: Based on data from EVCA and Thomson Reuters

4.5 Prospects

The current economic situation and various regulatory initiatives continue to make the private equity environment very challenging. As regards financial regulation, on the one hand, the Alternative Investment Fund Managers Directive (AIFMD), the European Venture Capital Fund Regulation, and the European Social Entrepreneurship Funds Regulation aim at creating an improved EU-wide regulatory framework and facilitating fundraising across all EU Member States for funds investing into SMEs and social businesses. However, on the other hand, AIFMD "may not only reduce the number of new funds investing into SMEs […] but will also increase the burden of administration and reporting for SMEs held by such funds and could also imply an increase in the cost of capital for such SMEs" (ESMA, 2012). Moreover, Solvency II and CRD IV "will make it more difficult for insurance companies and banks to indirectly invest into SMEs via private equity and venture capital funds" (ESMA, 2012). According to the same source, "the balance between costs, restrictive application and benefits remains to be seen."

In addition, the current market environment is hampering the fundraising perspectives. Many PE firms fear that current economic developments will negatively impact their portfolio companies. "Growth inhibits returns and diminishes capital reserves for new investments, while institutional investors re-allocate and cautiously manage their liabilities, complicating fundraising for all parties involved" (Tappe, 2012). In this environment, fund managers' track records are becoming increasingly important. According to Preqin (2013), "many LPs are choosing to invest in funds raised by more established managers". Preqin figures show that first-time funds, closed in the first quarter of 2013, raised a total of only USD 4.2bn (EUR 3.2bn[24]) worldwide, compared to the peak of USD 31.6bn (EUR 20.3bn) reached in the second quarter of 2008. In 2012, on average[25] 9% of the total capital raised went to new funds. In the three years before, new funds had raised an average proportion of 15% of total capital raised worldwide. In Q1/ 2013, this proportion dropped to a low of 6%.

Many VCs have at least partially turned to investments in companies with substantial revenues, i.e. to the growth equity market segment, "and it is the growth equity part which is sustaining the market rather than the venture end" (Go4Venture Advisers, 2013b). The market changes are not only driven by changes in supply but also by challenges on the demand side. The difficult exit market "has resulted in a large pool of VC-backed companies seeking further investment. As a result approximately half of the 'venture' activity […] is essentially late-stage companies" (Go4Venture Advisers, 2012).

The structural challenges in the European VC market, the currently difficult fundraising environment, and the risk-averse market sentiment obviously create access to funding problems in particular for new funds. This supports the view that public backing is especially needed for this market segment. Looking forward, some confidence can be taken from the results of "Preqin's interviews with private equity investors in December 2012" according to which half of the

[24] We calculated the EUR values based on the average quarterly ECB reference exchange rates of USD/EUR 1.32 (2013/Q1) and USD/EUR 1.56 (2008/Q2).

[25] This and the following average figures are calculated as an unweighted average of quarterly Preqin data.

interviewed LPs intend to "consider committing to first-time funds or those managed by spin-off teams in the following 12 months" (Preqin, 2013).

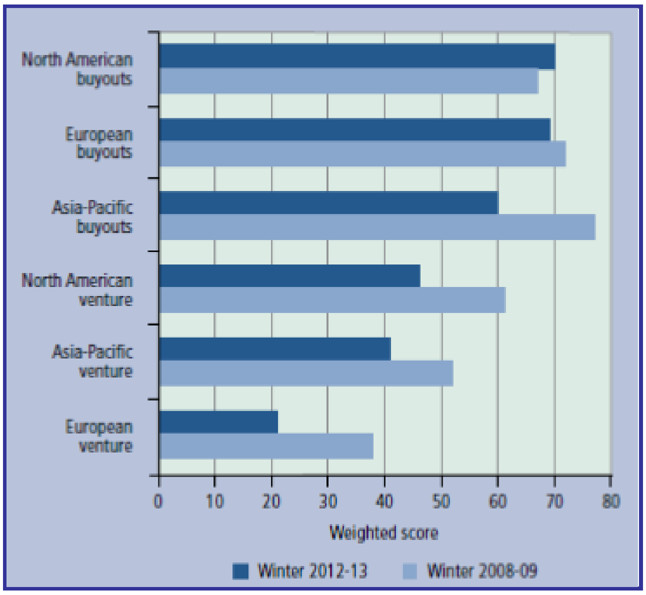
The in general difficult fundraising environment is also highlighted by the recent Coller Capital (2012b) survey: "Almost two thirds of investors report that their due diligence on potential fund commitments has been more intensive since the financial crisis. Significant proportions of LPs in all regions of the world say they have made fewer commitments as a result: half (48%) of Asia-Pacific LPs; 29% of North American LPs; and 19% of European LPs." The deteriorated fundraising situation leaves room for other investor types to step into the PE market, in particular in Europe where institutional investors' capital has become even scarcer than in other world regions (Tappe, 2012).

In this context, EIF – as reference catalytic investor in European venture and growth capital funds – has increased its counter-cyclical role in providing financing solutions to boost entrepreneurship and innovation. In the coming years, EIF will continue to cornerstone across the spectrum of Technology Transfer through Venture Capital to the Lower Mid-Market and mezzanine financing (see box 5 for more information concerning "mezzanine"). This also includes the launch and extension of new and pilot initiatives - such as the European Angels Fund (EAF, a co-investment fund to provide equity to Business Angels, launched in March 2012 in Germany; it is in the process of being extended to Spain, Austria, and other European countries in view of a future pan-European coverage)[26] or such as partnerships with corporate investors which is structured as a Corporate Innovation Platform (CoriP)[27] in order to establish collaboration between fund managers, strategic investors and portfolio companies.

With regard to *performance*, the medium term perspective remains uncertain as the difficult general economic and financial environment will also strain the performance of private equity – in all of its segments. Nevertheless, in a recent survey (Coller Capital, 2012a), 77% of Limited Partner investors (LPs) expected net annual returns of 11% or more from their European buyout portfolios, and more than 30% from European venture portfolios. Moreover, "two thirds of LPs believe that there are not enough high-quality venture firms in Europe". Compared to the outcome of the same survey conducted before the crisis, LPs' views on the best investment opportunities worsened for VC[28] in general, and for Europe in particular (see figure 25).

[26] EIF provides more information on the European Angels Fund (EAF) here: http://www.eif.org/what_we_do/equity/eaf/index.htm
[27] EIF provides more information on the Corporate Innovation Platform (CoriP) here: http://www.eif.org/what_we_do/equity/corip/index.htm.
[28] Note that the definition of "venture capital" used in the cited survey is not necessarily the same as the definition used in other parts of this publication.

Figure 25: LPs' views of the best investment areas over the following 12 months



Source: Coller Capital (2012a).

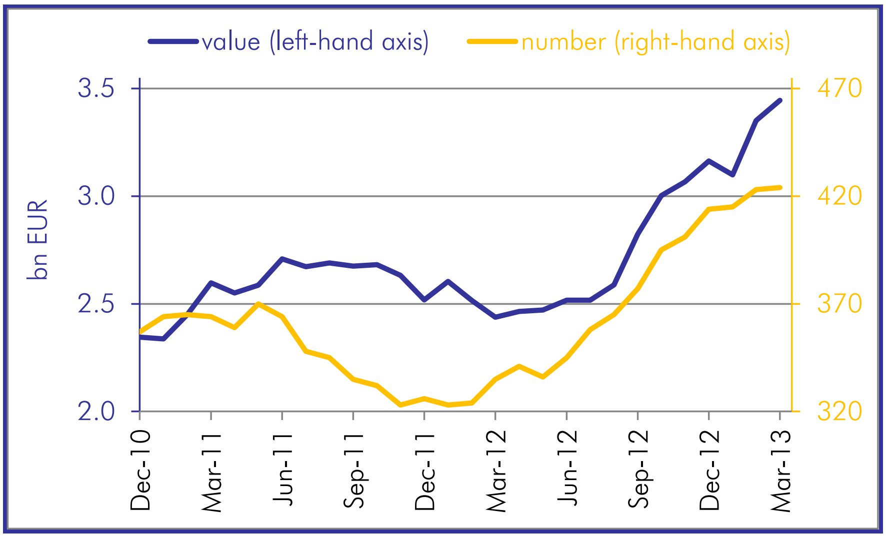
However, a crisis is also a source of opportunities in PE as valuations are decreasing and acquisitions can be completed at more favourable prices. Moreover, the outcome of the on-going fund selection process in the market might not only be negative (in terms of fewer investors), but may also result in a more efficient investor base. "'The clear out of venture capital firms was inevitable and in many ways desirable. The European venture capital industry is much stronger in 2012 than it was in 2000,' says John Holloway, director at the European Investment Fund. 'There has been a Darwinian evolution in Europe: those teams that have been able to raise capital really are the best.'" (EVCA, 2013b).

The reasoning behind is similar to the one presented in box 4 above, namely that, relative to its US counterpart, lack of experience in the young European VC industry has been a key source of its relatively weak performance figures. "'When looking back at past results, investors need to look at the reasons for this – particularly inexperience among VCs and entrepreneurs in the early days," says Uli Fricke, managing general partner at Triangle Venture Capital Group. "Those reasons are no longer there […]" (EVCA, 2013b). Moreover, according to EIF market insight there is an increasing number of budding companies in the early-stage segment which show an unprecedented pattern of growth. Should this trend continue, the potential return of these companies would have a significant positive impact on the performance of the financing funds. As a consequence, the medium term perspective of the European Venture Capital market would be more positive than the backward looking statistics reveal.

Positive news comes as well from Go4Venture Advisers' early indicator, the European Tech Headline Investment Transactions Index[29]; it has recorded strong increases since summer 2012 (see figure 26) and "a record number of funds [...] announced their fund-raising, both financial and corporate investors". However, much of this investment activity "is growth equity as much as venture per se" (Go4Venture Advisers, 2013a).

Interestingly, US investors are an important part of some recent success stories in fundraising. According to EVCA (2013a) data, 25% of the amounts invested into PE funds with a European focus came from North America in 2012, compared to 20% in 2011. North American investors' share increased also in the venture segment of the market, from 1.6% in 2011 to 4.5% in 2012. According to Go4Venture Advisers (2013a), "it's rather ironic that US LPs seem to have more belief in European venture than European LPs themselves. In many ways this is a vote of confidence in a pan-European approach to venture investing."

Figure 26: European Tech Headline Investment Transactions (12-month rolling horizon)



Source: EIF calculations, based on Go4Venture Advisers data.

[29] Go4Venture Advisers' European Tech Headline Investment 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 more information on definition and methodology see Go4Venture Advisers' (2013c).

Box 5: Mezzanine finance market

OECD 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 may have potential that is at least equal to these better known forms of finance" (OECD, 2013c). In fact, many SMEs have demand for (mezzanine-) capital to finance their expansion, which is often not met by capital markets' supply or by banks, especially in the present period of the financial crisis. During the financial crisis, there was not only a sharp retrenchment in the availability of pure debt and pure equity capital, but also the mezzanine market suffered. Moreover, the mezzanine finance for smaller companies and in small amounts is not yet sufficiently developed in Europe.

In 2009, the EIF began to support this market and began to offer mezzanine finance, by launching a fund with a dedicated mezzanine mandate, the Mezzanine Facility for Growth (MFG). MFG is a EUR 1bn fund of funds mandate granted by the EIB to the EIF to be invested in hybrid Debt /Equity funds throughout Europe, with a view to playing a catalytic role in this market segment. This tailor-made solution is meeting market demand and provides financing to support entrepreneurs who are endeavouring to keep control of their companies as the company expands or to companies which need complex reorganisation of their capital structures. Mezzanine also caters for later stage technology companies which have reached breakeven but do not yet have access to standard funding. It can be tailored to meet the specific financing requirements of these companies and in the current market situation, where bank lending remains limited, it is well adapted to long-term financing. EIF is usually involved early in the launch process of mezzanine funds, taking a significant participation at first closing. These Mezzanine Funds typically offer hybrid debt/equity products to their portfolio.

In 2012 EIF substantially increased the total volume invested under MFG, with a total of EUR 320m committed to eight hybrid debt/equity funds, a 50% increase over the volumes achieved in 2011. EIF's investments catalysed over EUR 1.3bn of commitments and in most cases EIF's investment was vital for the successful closing of these mezzanine funds. Projects were supported for the first time in countries such as Italy and Spain, where new funding possibilities are much needed by SMEs. In 2013, EIF is continuing to play a critical role in stimulating the development of this market.

Under the umbrella of the MFG mandate, which covers EU 27, in 2012, the "Mezzanine Dachfonds für Deutschland" (Mezzanine fund-of fund for Germany, MDD) has been established. MDD is a EUR 200m fund-of-fund, targeting hybrid debt/equity fund investments in Germany. MDD is funded by EIF (under the MFG mandate), 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).

5 SME guarantees and SME Securitisation in Europe

In our previous versions of the ESBFO we touched the topic of SME guarantees only briefly. From now on, in addition to our already 'traditional' analysis of the SME securitisation (SMESec) market, we include specific sections on SME guarantees in order to reflect the importance of this area for SME finance in Europe.

5.1 SME guarantees

Credit guarantee schemes "are used widely across economies as important tools to ease financial constraints for SMEs and start-ups" (OECD, 2013b) and in order to alleviate market failures in SME financing. 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. The reasons for a market failure relate to insufficient supply of capital (debt or equity) and inadequacies on the demand side. This market failure is mainly based on asymmetric information (in the case of debt: information gap between lender and borrower), combined with uncertainty, which causes agency problems that affect debt providers´ behaviour (see Akerlof, 1970 and Arrow, 1985).[30]

Information asymmetries can be reduced via three ways: a strong relationship between lender and borrower, 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 or a guarantee). However, this means that new or young firms, with a lack of collateral and by definition without track record, are the ones with the greatest degree of difficulty accessing debt capital (Equinox, 2002). Indeed, a Eurostat survey found that "insufficient collateral or guarantee" was most frequently mentioned by banks as the reason for partially or fully unsuccessful loan applications in 2010 (Ushilova and Schmiemann, 2011).[31] This was in particular true for high-growth enterprises and the so-called "gazelles" (young high growth enterprises).[32] These financing obstacles can also negatively affect productivity in the economy. Against the background of the on-going economic crisis and sources of firm financing possibly becoming scarce this problem is even more relevant today (ECB, 2013c).

Guarantee mechanisms 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 (OECD, 2013b).

---

[30] Agency theory/the principal-agent approach is often applied in economics literature for the analysis of relationships between lenders and borrowers (e.g. contract design, selection processes, credit constraints, etc.).

[31] The survey was a one-off exercise conducted in consultation with the users of Eurostat's business statistics, the OECD, the ECB, and the EIF. The aim was to shed light on the consequences of the financial crisis by comparing data for 2007 (considered as a reference point before the crisis) and 2010 (at the time of the survey conduct considered as the end of the crisis, at least for some EU Member States). An outlook for the years 2011-13 is also contained. The survey was conducted among 25,000 enterprises which had between 10 and 249 employees in all EU countries with the exception of Austria, the Czech Republic, Estonia, Hungary, Portugal, Romania, and Slovenia. For more detailed information on the data source please see http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics.

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

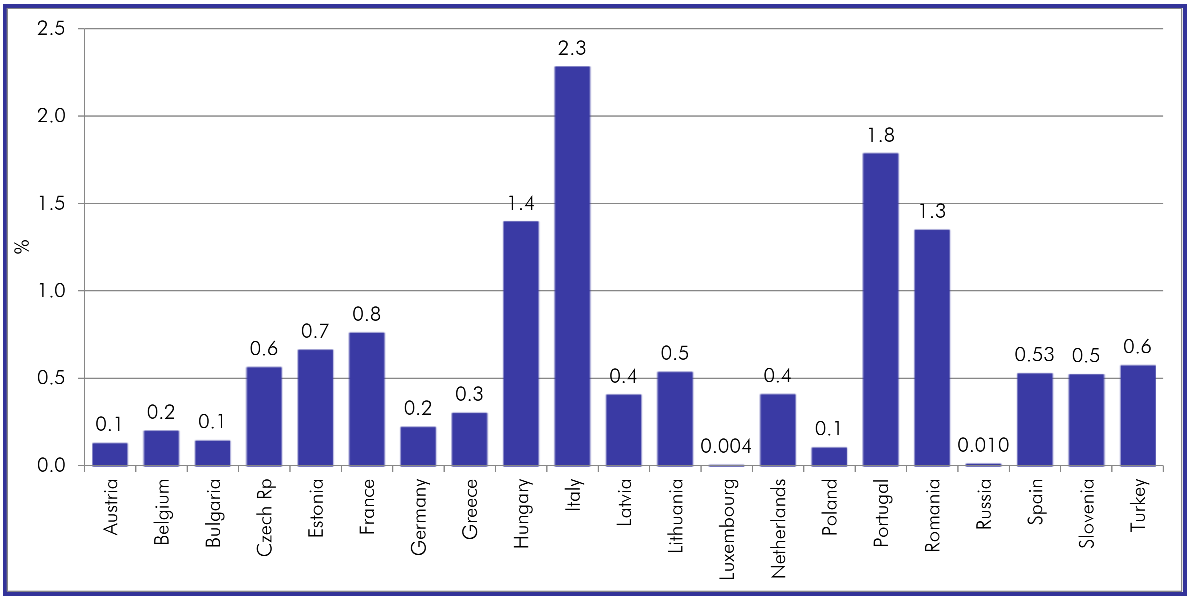
Market size

Data on the provision of guarantees to the benefit of SMEs in Europe is scarce. Some market information is gathered by AECM, the European Association of Mutual Guarantee Societies.[33] These data covers SME guarantees provided by AECM members. In the following we provide information about the countries with at least one AECM member in order to start to show the state and development of this important market segment.

In terms of total *volume* of outstanding guarantees, the core countries are Italy, France, Germany, and Spain (see table 2), while the total *number* of outstanding guarantees is highest in Italy (866,237 in 2011)[34], France (449,450 in 2012), Turkey (264,118 in 2012), Poland (150,314 in 2012), Portugal (71,968 in 2012), and Spain (80,077 in 2012). Within the EU, the *average size* per outstanding guarantee is largest in Latvia (EUR 227k in 2012), the Czech Republic (EUR 157k), Slovenia (142k), Germany (120k), and the Netherlands (119k). In contrast, France (34k) and Italy (41k in 2011), the two leading countries in terms of total number and value of guarantees, have relatively small average guarantee sizes in portfolio.

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 (2.3%), Portugal (1.8%), Hungary (1.4%), and Romania (1.3%), as is shown in figure 27. According to the OECD (2013b), guarantees are particularly relevant "in those countries where a network of local or sectoral guarantee institutions is well established".

Figure 27: Volumes of outstanding guarantees in portfolio scaled by GDP, 2012 data



Source: AECM (provisional figures).

[33] We would like to thank our colleagues from AECM for their support. AECM has currently 40 members in 20 EU Member States, Montenegro, Russia, and Turkey. EU countries without an AECM member are Cyprus, Denmark, Finland, Ireland, Malta, 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. Source: AECM.

[34] For data availability reasons, AECM statistics include Italian members' business figures with a time lag of one year. This is also true for the diagrams and tables presented throughout this chapter.

Table 2: Total volume (m EUR) of outstanding guarantees in portfolio by country[35]

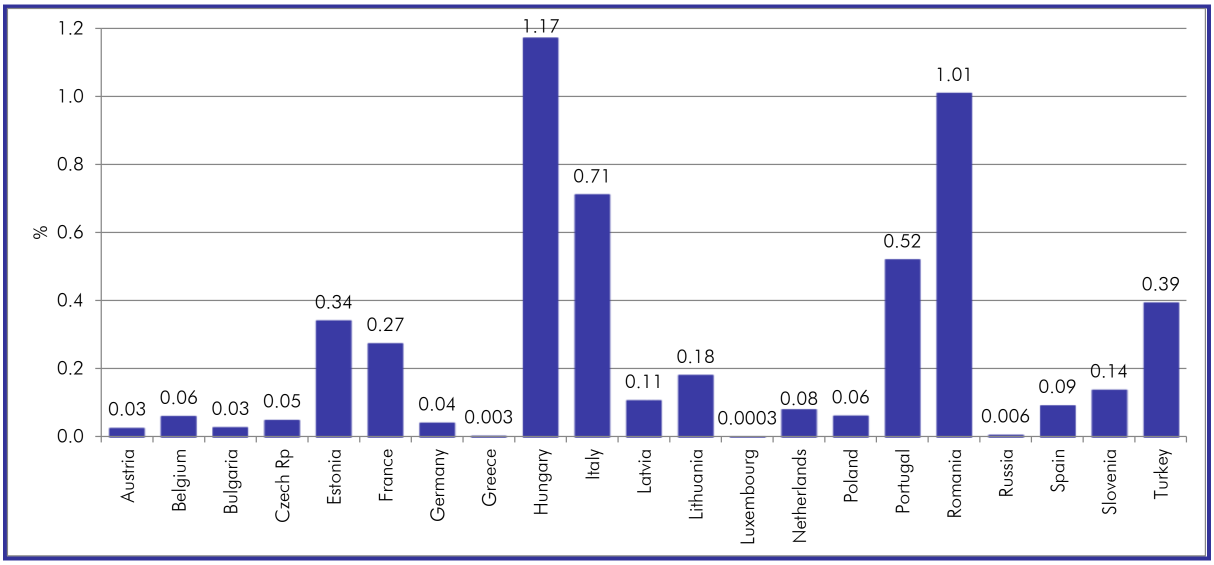
Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 (provisional)
Austria	433.4	473.9	417.1	418.9	422.9	489.3	416.3	425.5	426.2	481.0	454.9	416.9	396.3
Belgium	53.1	48.0	122.5	123.8	125.4	113.3	296.9	320.0	357.6	492.7	612.6	719.0	747.3
Bulgaria											31.6	60.6	56.0
Czech Rp	163.9	205.0	226.8	292.0	307.3	363.0	423.0	451.0	530.5	701.4	943.7	829.4	855.9
Estonia	3.1	5.3	13.7	17.2	21.4	27.6	34.4	41.3	42.2	68.3	98.3	103.0	111.6
Finland	470.0	549.0	685.5	758.5	851.2								
France	6,104.7	6,404.1	6,701.0	6,744.5	7,079.1	7,294.2	8,797.9	9,575.5	9,421.9	13,354.8	16,067.3	16,385.1	15,441.8
Germany	4,952.2	5,102.6	5,112.7	5,040.7	5,038.1	5,135.7	5,199.3	5,301.0	5,401.0	5,586.1	5,063.4	5,911.0	5,836.3
Greece	0.0	0.0	0.0	0.0	0.0	22.7	33.2	83.4	134.8	3,498.0	2,532.5	1,327.4	585.3
Hungary	406.3	519.2	617.0	612.1	981.2	1,092.3	1,205.7	1,481.9	1,580.0	1,706.9	1,575.3	1,356.0	1,388.6
Italy	14,326.8	16,761.4	19,168.5	19,634.7	21,858.0	26,957.7	25,619.3	29,518.1	28,963.2	32,083.3	33,094.3	32,818.4	35,682.4
Latvia								18.5	42.4	42.4	85.6	89.9	88.7
Lithuania	44.8	48.0	47.9	66.1	56.8	93.5	125.3	163.2	190.6	220.2	216.9	204.8	173.5
Luxembourg												2.1	1.6
Netherlands											2,230.5	2,567.8	2,449.3
Poland										442.3	385.5	484.8	392.1
Portugal	75.7	96.4	99.7	126.5	141.9	206.2	345.7	465.0	898.0	2,749.0	3,762.0	3,240.0	2,968.5
Romania		6.6	13.1	35.5	48.9	82.8	231.4	360.9	450.2	709.8	916.3	1,431.3	1,768.1
Russia													268.3
Spain	1,909.2	2,209.8	2,468.3	2,829.3	3,307.5	3,945.1	4,826.4	5,638.3	5,938.8	6,524.3	6,533.9	6,200.3	5,527.6
Slovakia		51.4	87.1	57.1	62.7	80.9	108.0	128.1	140.1	208.4	196.4	204.9	
Slovenia						4.2	3.0	14.2	30.7	100.5	156.2	226.9	186.1
Sweden							1.1	4.2	4.6				
Turkey	250.8	185.9	107.2	511.7	682.7	1,297.2	1,428.5	1,593.7	1,494.6	1,980.0	2,121.5	2,878.1	3,578.6
TOTAL	29,193.9	32,666.6	35,888.1	37,268.4	40,985.2	47,205.7	49,095.4	55,584.1	56,047.3	70,949.5	77,078.5	77,457.7	78,503.7

Source: AECM.

[35]Missing values are either due to data unavailability or an AECM membership in the particular country and year did not exist.

The country rankings, shown above, are broadly in line with the guarantee activity in 2011 and 2012 which was strongest (related to GDP) in Hungary, Romania, and Italy (see figure 28 for 2012 data).

Figure 28: Volumes of guarantees granted in 2012 scaled by GDP



Source: AECM (provisional figures).

Recent activity

In 2012, according to preliminary AECM data, the total *volume* of outstanding guarantees in portfolio amounted to EUR 78.5bn.[36] The volume of *new guarantees granted per year* was reported to be at a level of EUR 26.1bn. For those AECM members that consistently reported data for the last two years the volume of outstanding guarantee business decreased by 4.2% compared to 2011.[37] In line with this development, the volume of new guarantees decreased by 6.0%.

At the same time, the total *number of outstanding guarantees* in portfolio of AECM members was at a record level of 2.1m in 2012, when 636,000 *new guarantees* were issued. For those AECM members that consistently reported data for the last two years, the number of outstanding guarantees increased by 10.0% compared to the year before, and the number of new guarantees by 3.5%. This seems to reflect some bottoming out of the negative trend after two years of strong falls in the number of new guarantees in 2010 and 2011.

[36]In order to allow for comparisons with the previous year, the figures presented here were adjusted by AECM for counter-guarantee activities of members which reported such activities for the first time in 2012. Without these adjustments, the total volume of outstanding guarantees amounted to EUR 78.6bn in 2012 and the volume of new guarantees granted in 2012 was at a level of EUR 26.2bn.

[37]In order to report reasonable growth rates, three forms of adjustment of AECM statistics were conducted. However, these modifications led to only minor changes in growth rates:

- The figures were adjusted by AECM for counter-guarantee activities of members which reported such activities for the first time in 2012. However, this led to a relatively small total adjustment of EUR 0.1bn for both the volume of outstanding guarantees and the volume of new guarantees granted in 2012.
- In addition, we deducted the business figures of Italian AECM members, as these are included in AECM statistics with a time-lag of one year.
- In addition, we deducted the data for countries from which AECM members did not report business figures for one of the two years 2011 and 2012.

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 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 37.9k), i.e. towards the average size reached in prior years. According to AECM, the recent developments could be explained by an increase of guarantees with smaller amounts, as well as of short term guarantees (i.e. working capital loan guarantees and bridge financing guarantees, which have in general smaller amounts). Short term guarantees generally (for AECM members) cover less than 12 months.

As regards developments by country (for which 2011 and 2012 data is available), strongest increases in the value of new guarantees granted per year were recorded for the Czech Republic (+19.3%), Portugal (+19.0%), Romania (+13.2%), Estonia (+10.6%), Hungary (+7.7%), Austria (+5.2%), and Turkey (+3.6%). The strongest decreases were observed in Greece (-84.1%), Luxembourg (-82.7%), and Bulgaria (-70.4%). Moreover, several countries with large guarantee activities (in absolute terms) recorded substantial slumps in new business in 2012, e.g. France (-7.2%), Spain (-24.6%), Germany (-5.1%), and the Netherlands (-46.6%). In some countries (e.g. Bulgaria and Greece), cuts in the budgets allocated to these purely public guarantee schemes led to the strong decreases in guarantee activity. For Luxembourg, small absolute changes already imply strong relative variations, due to the low size of the scheme.

The *ratio* of new business to outstanding business decreased significantly over the last two years. For the *number* of guarantees, the share decreased from 37.8% in 2010 to 32.5% in 2011 and to 30.7% in 2012. For the *volume* of guarantees, the share decreased from 40.0% in 2010 to 36.7% in 2011 and to 33.2% in 2012.

The recent developments in SME guarantee activity generally seem to mirror the economic situation in the different countries. Those countries suffering relatively strongly from the current sovereign debt crisis and experiencing weak economic growth or even a fall in economic activity, see poor developments in guarantee activity. This seems to be driven by both demand *and* supply side factors. In times of weak economic output growth, SME business activity, investment, the related need for finance and hence implied demand for guarantees are low. At the same time, tightening restrictions on public budgets and high financial risk perceptions (ECB, 2013d) are weighing on guarantee supply. In these times, public support coming from the European level can improve at least the situation on the supply side. In some countries such as Germany, the recent slowdown in guarantee activity can also be explained by a relatively positive development in financing conditions and less need for guarantees, following the strong increases in guarantee demand that were observed during the crisis years 2009/10 (VDB, 2012).

EIF activity and recent developments

In order to alleviate the difficulty for SMEs in accessing finance, EIF is playing a counter-cyclical role: via a wide range of financial intermediaries, such as banks, leasing companies, guarantee funds, mutual guarantee institutions, promotional banks or any other financial institution, it provides financing to SMEs, or guarantees for SME financing. Besides 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 part of its mandate activity, EIF manages the SME Guarantee Facility (SMEG) under the Competitiveness and Innovation Framework Programme (CIP) on behalf of the European Commission (EC). Under this facility, losses are covered using the EC budgetary resources specifically allocated. Moreover, EIF continues to deploy its financial products in order to catalyse EU structural funds 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[38]. Under the JEREMIE First Loss Portfolio Guarantee (FLPG), EIF covers part of the credit risk relating to a new portfolio of loans and/or leases granted by a financial intermediary to SMEs. Moreover, EIF further implemented a risk sharing loan product, the Funded Risk Sharing Product (FRSP), whereby EIF provides funding to banks for the financing of new portfolios of SME loans (such loans to be co-financed by the financial institutions) and shares part of the credit risk relating to the portfolios.

In addition, EIF launched the Risk-Sharing Instrument for Innovative and Research oriented SMEs and small Mid-Caps (RSI) Facility in 2011. RSI is an EIF/EIB/European Commission joint pilot guarantee scheme that aims at improving access to debt finance for innovative SMEs and small mid-caps (enterprises with fewer than 500 employees) in support of research, development and innovation projects. RSI complements the scope of the existing Risk Sharing Finance Facility (RSFF), which is managed by the EIB and mainly addresses large corporates and mid-caps. Under RSI, EIF issues guarantees and counter-guarantees to selected financial intermediaries in order to allow them to provide loans, financial leases and loan guarantees. Serving as a basis for the EU 2014-2020 programming period, RSI complements the existing EU SME support schemes.

At the end of 2012, the EIF guarantees loan portfolio totalled over EUR 4.7bn in more than 250 transactions, positioning it as a major European SME guarantees actor and a leading micro-finance guarantor.

---

[38] JEREMIE stands for Joint European Resources for Micro to medium sized Enterprises. The initiative, developed in cooperation with the European Commission, offers 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 can 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 please visit: http://www.eif.org/what_we_do/jeremie/index.htm

5.2 SME Securitisation (SMESec)

5.2.1 SMESec market activity[39]

The European Structured Finance[40] market had grown steadily from the beginning of the decade until the outbreak of the crisis. During the crisis, issuance remained at high levels, but these volumes were almost exclusively driven by the eligibility of Asset Backed Securities (ABS) as collateral for ECB liquidity operations. In 2009 and 2010 the overall market activity decreased to pre-crisis levels (after having peaked in 2008) due to regulatory uncertainties and tighter Euro system collateral rules.[41] Rating downgrades, based on negative credit trends and revised rating agency criteria, contributed to the negative market sentiment. However, despite the crisis, the European securitisation market in general performed relatively well with comparably low default rates (see chapter 5.2.2).[42]

SME Securitisation (SMESec), as important element of the financing of SMEs in Europe, is still suffering from the economic and financial crisis. The near-collapse of the European structured finance market, in tandem with the other markets around the globe more generally, has profoundly affected the status and outlook of SMESec and unfortunately the situation has only slightly improved since our previous report. It is still the case that originators mainly retained newly issued deals in order to create liquidity buffers and to use the assets as collateral with central banks for re-financing purposes. At this point in time we can still not talk about a functioning primary market.

As a consequence, overall securitization activity was high during the crisis (but this mainly reflects retained transactions), with a peak in 2008 (EUR 711bn) and since then a continuous decrease. In 2012 the *issuance* in Europe went down significantly (-36%), from EUR 372bn in 2011 to EUR 238bn (for comparison: a level like in 2004). The most active markets in terms of issuance were the UK (market share in 2012: 27%), Italy (24%) and the Netherlands (20%). The overall reduction in collateral production is mainly based on a reduced issuance of Residential Mortgage Backed Securities (RMBS), i.e. UK Prime RMBS – reason for this development is the availability of the "funding for lending scheme" (since August 2012 until January 2014) that allows potential RMBS originators cheaper refinancing via the Bank of England (DZ Bank, 2013).[43]

[39]If not flagged otherwise, the data source is AFME, the Association for Financial Markets in Europe, 2013.

[40]The reader can find a securitisation glossary in Annex 2. The term SME Securitisation (SMESec) comprises transactions based on SME loans, leases, etc. For background information with regard to the importance of SMESec see Kraemer-Eis, Schaber and Tappi (2010).

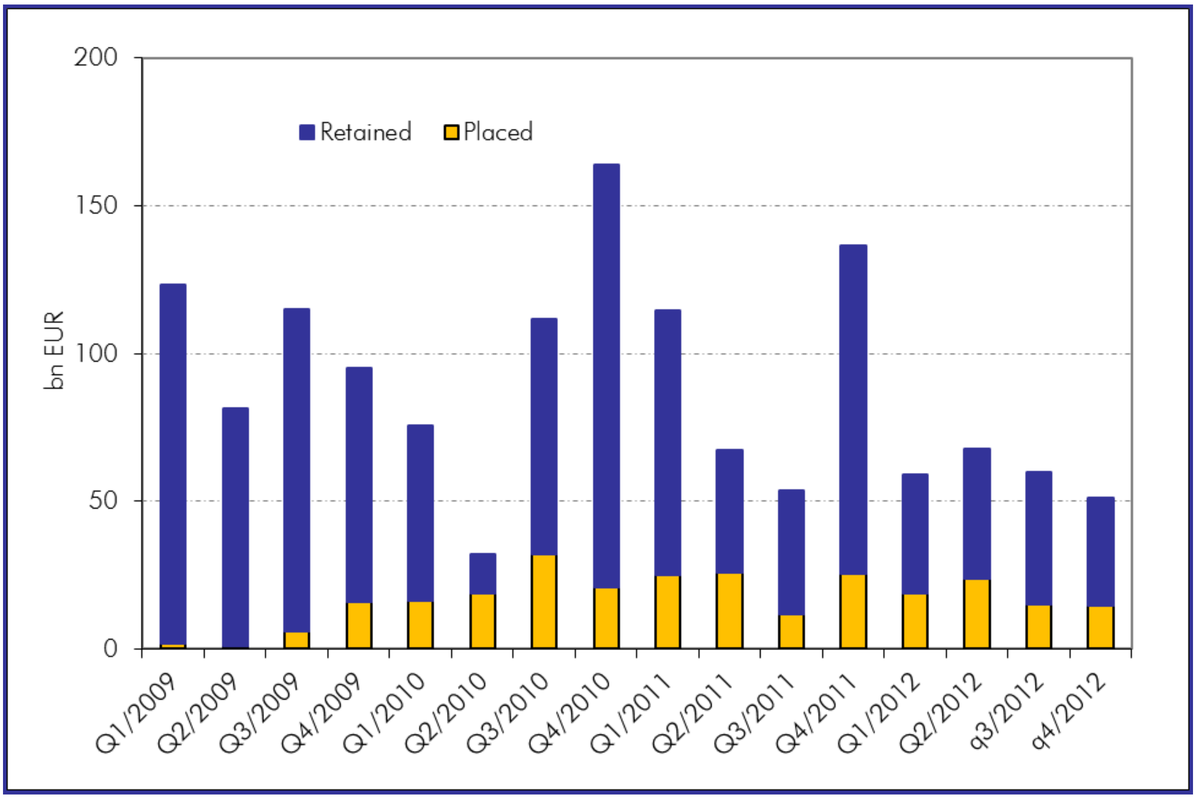
[41]The ECB's asset repurchase or "repo" facility allows (among other assets) Asset Backed Securities to be used as collateral for funding.

[42]Please note that, due to structural protections available to transactions, weakening portfolio performance does not necessarily result in downgrades or even defaults of transactions.

[43]FLS aims at reducing the costs of banks' funding in exchange for commitments to lend more (to mortgagors and companies); originally it was foreseen to stop the scheme in January 2014 but recently the Bank of England and HM Treasury announced an extension until end of January 2015. The scheme will now also be extended to non-bank lenders like financial leasing, factoring and mortgage and housing credit corporations, which were originally excluded from the scheme. Moreover, SME lending is further incentivized, with a higher multiple being included for SME lending (UniCredit, 2013). It can be expected that the FLS will keep the UK securitisation issuance on lower levels.

For the full year 2012, the retention (see figure 29) was at around 70% (2011: 76%). At first sight, the reduced retention rate looks encouraging, but this is only in relative terms as the overall issued amounts went down (see also figure 30) and the amounts placed with investors went down by almost 18% (2011: EUR 88.3bn, 2012: EUR 72.2bn).

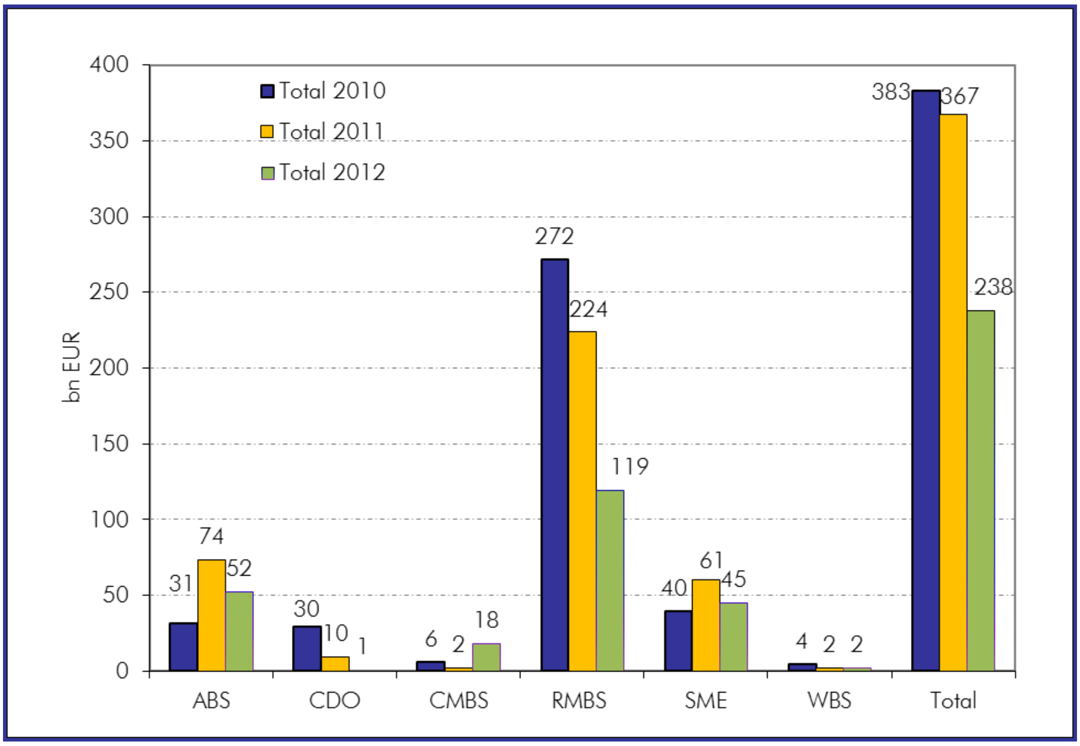
Figure 29: European securitisation issuance by retention (bn EUR)



Source: Based on data from AFME (2013)

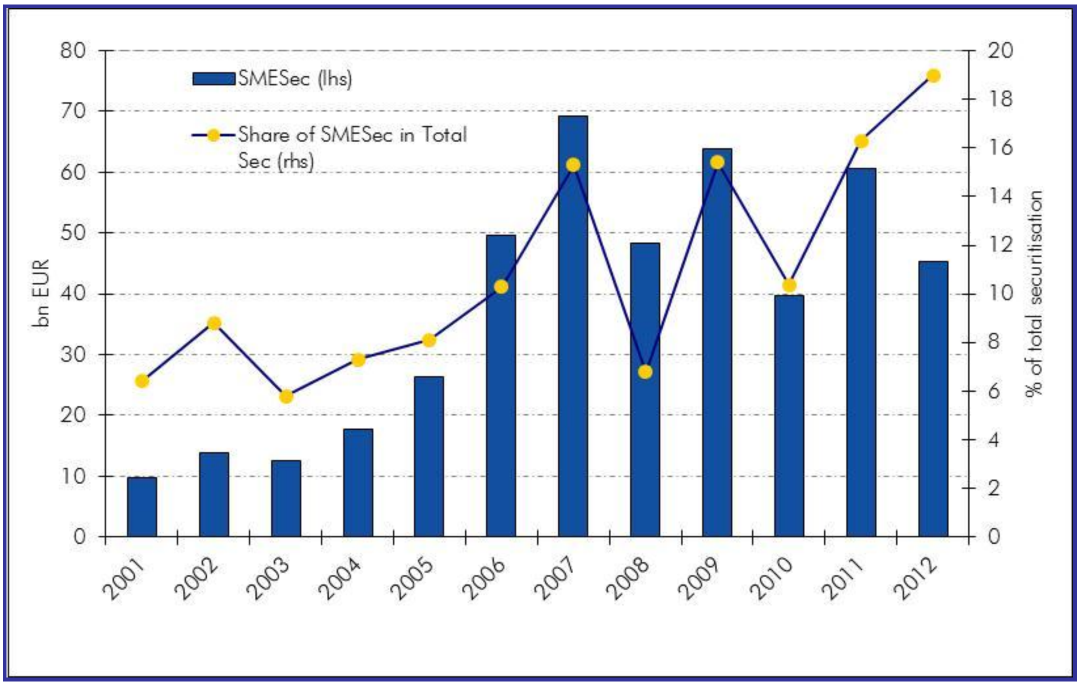
Given the dominance of the securitisation of RMBS, SMESec remained a relatively limited but important segment of the European structured finance market (see figure 30). The market share of SMESec was consistently between 6% and 16% of total yearly issuance during the decade before 2012. In 2012, it further increased to almost 19%, the highest value ever registered in Europe – but this came due to the base effect, as the overall activity went down (see figure 31); moreover, only a small fraction of the issuance has been placed with investors. The main issuance activity was in Italy (44%) and Spain (42%).

Figure 30: European Securitisation Issuance by collateral (bn EUR)[44]



Source: Based on data from AFME (2013)

Figure 31: SMESec volumes in Europe and share of SMESec in total securitisation



Source: Own calculation, based on data from AFME and KfW

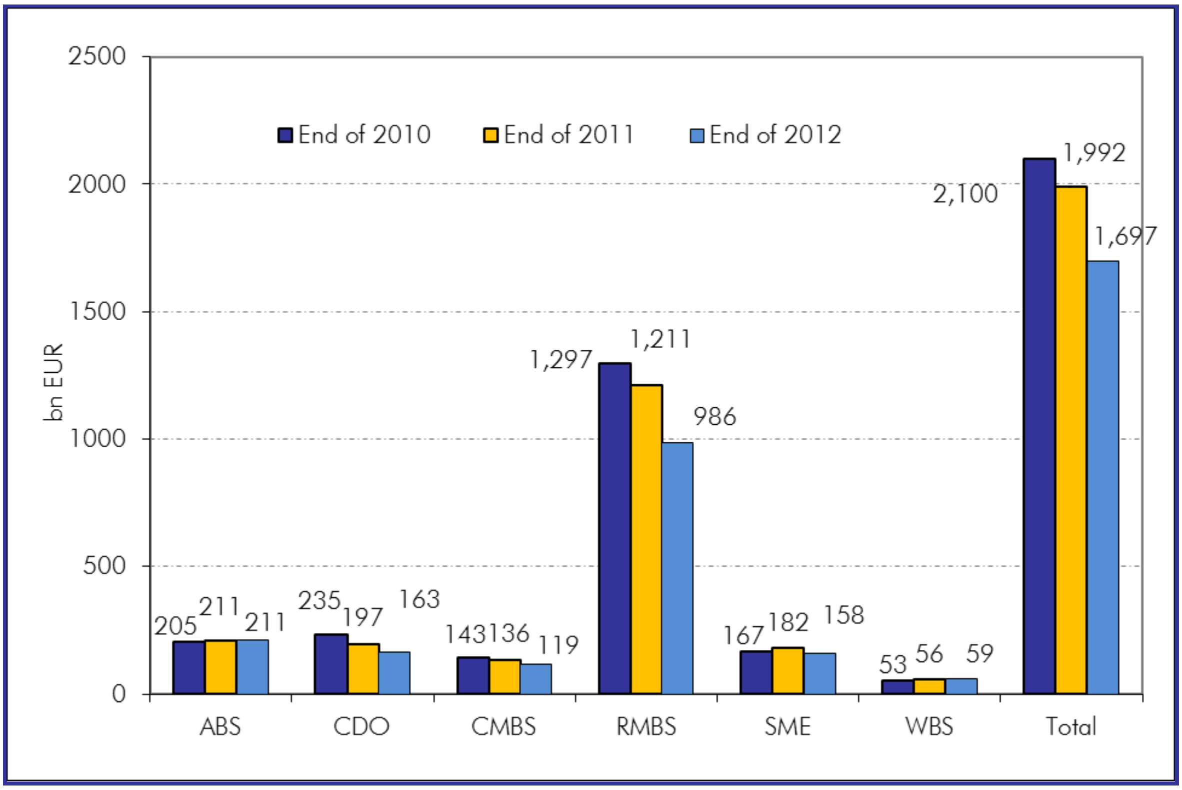
[44]AFME definitions: European ABS issuance includes auto, credit card, leases, loans, receivables and other. European CDO issuance numbers only include issuance denominated in a European currency regardless of the country of collateral. A substantial percentage of CDOs are backed by multi-jurisdictional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

According to an analysis by DZ Bank (DZ Bank, 2013), the main investors in publicly placed European securitisations were funds (49%) and banks (39%) from the UK (40%), France (12%), and Germany (12%).

With regard to the *outstanding transactions*, compared to end of 2011, the total outstanding decreased by 15% from EUR 1,992bn to EUR 1,696bn (see figure 32). The regional distribution of the outstanding is similar to the distribution of the total issuance and remained almost unchanged to the past: in terms of volumes UK ranks first (28% of the EUR 1.696bn), followed by the Netherlands (17%), Spain (12%) and Italy (12%).

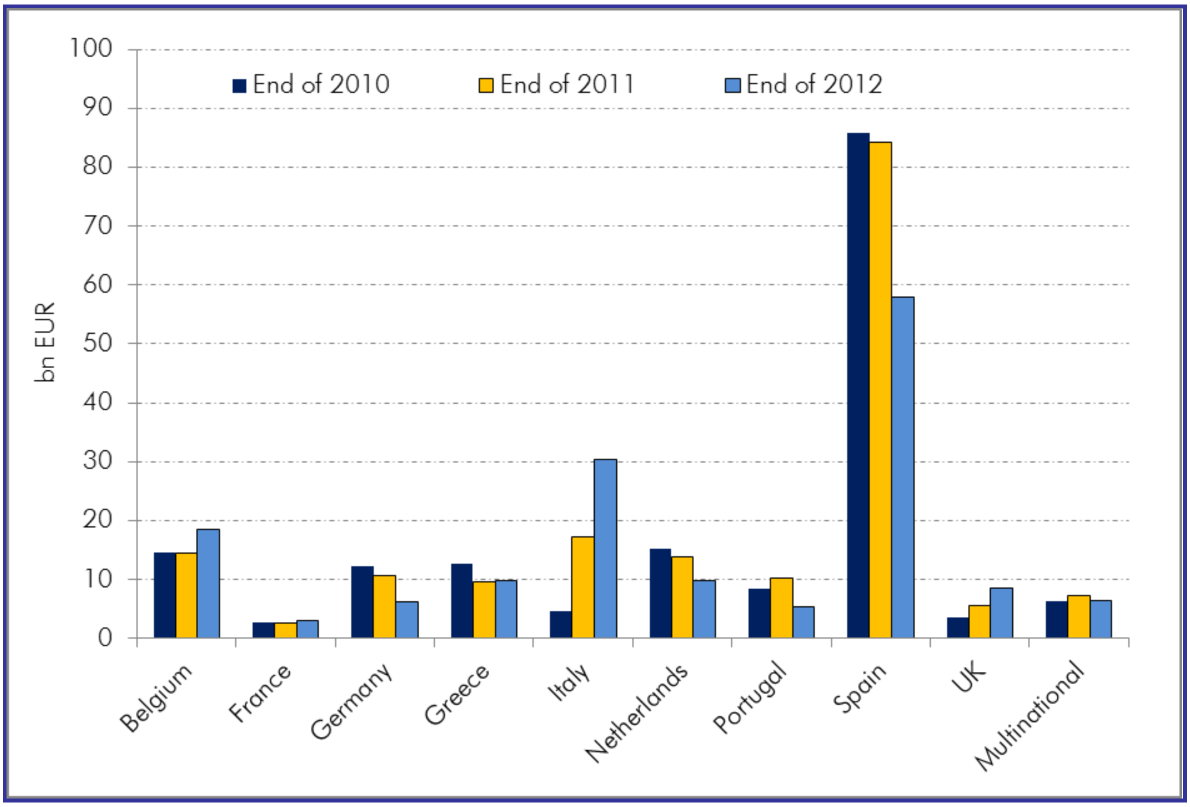
Since end of 2011, outstanding SMESec decreased by more than 13% (from EUR 181bn to EUR 158bn). If we break down the EUR 164bn of outstanding SMESec by country, the significance of the Spanish market becomes obvious. The regional market distribution for SMESec did not change much since end of 2011 (see figure 33), with the exception of a reduction in Spain and an increase in Italy.

Figure 32: European outstanding securitisation transactions (by collateral, bn EUR)



Source: Based on data from AFME (2013)

Figure 33: European SMESec outstanding by country (bn EUR)



Source: Based on data from AFME (2013)

5.2.2 SMESec performance trends

Despite the financial and sovereign crisis, the European securitization market in general performed so far relatively well.[45] The low losses are not only based on the typically high granularity/diversification of these transactions, but also on structural features that helped to counterbalance negative effects of the deteriorating European economy (i.e. increased SME default rates). As shown above, the track record of SMESec in Europe is relatively short; the market started only towards the end of the 1990's – at the time, this segment was unknown to investors and rating agencies, and the technique of securitisation was also new to most of the originators. The related uncertainty was one of the reasons for conservative structures in the general SMESec segment.[46]

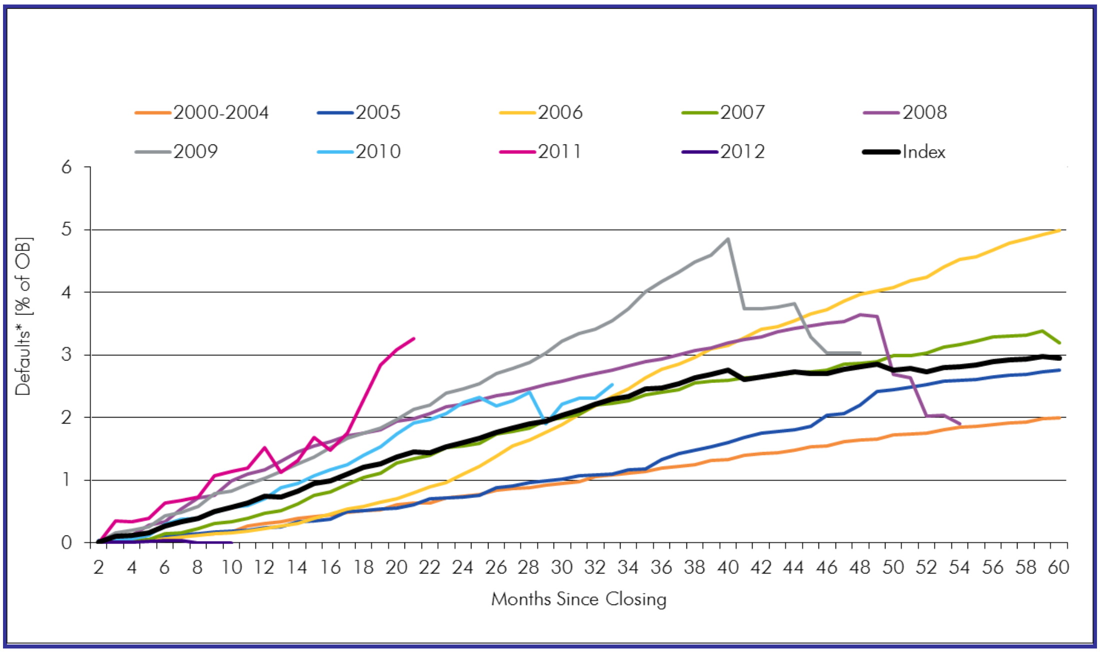
[45] 2012-data shows that, according to the rating agency Standard & Poor's, the European structured finance default rate since beginning of the crisis (mid-2007) is low: only 1.1% of European structured finance securities outstanding in mid-2007 have defaulted; this default rate is well below the one of US pendants (14.8%). For the SME segment, the rating agency registered defaults (weighted by notional value at issuance rather than by number of tranches) of 0.23% (Standard & Poor's, 2012).

[46] In the years running up to the crisis there were first signs also in Europe of a drift away from key principles and main success factors for SMESec – i.e. granular portfolios and transparent structures – for example in the form of hybrid transactions (i.e. the so-called German Mezzanine CDOs) with non-granular portfolios, larger (mid-cap) borrowers and non-aligned incentive structures. The generally poor performance of these transactions provides lessons for the future of SMESec.

We mentioned earlier the tightening of credit conditions for SMEs; although this development has a direct negative impact on the SMEs it has indirectly a positive effect for new loan vintages, and hence the quality of newly securitised portfolios, as banks have become more risk averse. However, the sovereign crisis and weak macroeconomic fundamentals in many European countries had also negative effects on SME transactions and it is expected that the credit quality of existing portfolios in stressed markets will further deteriorate – the performance of SME portfolios is typically dependent on GDP growth trends.

Moreover, many counterparties in SME related transactions will continue to suffer from the on-going stress in the European banking system.[47] In fact, latest data shows that the performance of SME ABS deteriorated. For example, in the SMESec transactions rated by Moody's (in the EMEA[48] region), the 90-360 day delinquency rate rose to 4.91% in December 2012 from 2.13% in December 2011, predominantly reflecting the weakness in markets such as Portugal, Spain, and Italy. However, a small number of badly performing transactions are mainly responsible for the weakness in these markets (Moodys, 2013b). Figure 34 depicts cumulative credit events (or defaults) on original balance by vintage for the EMEA region (transactions analysed by Moody's). It shows a relatively constant development over time for most vintage years.

Figure 34: EMEA SME ABS cumulative credit events or defaults on original balance (seasoning by vintage)[49]



Source: Moody's (2013a)

---

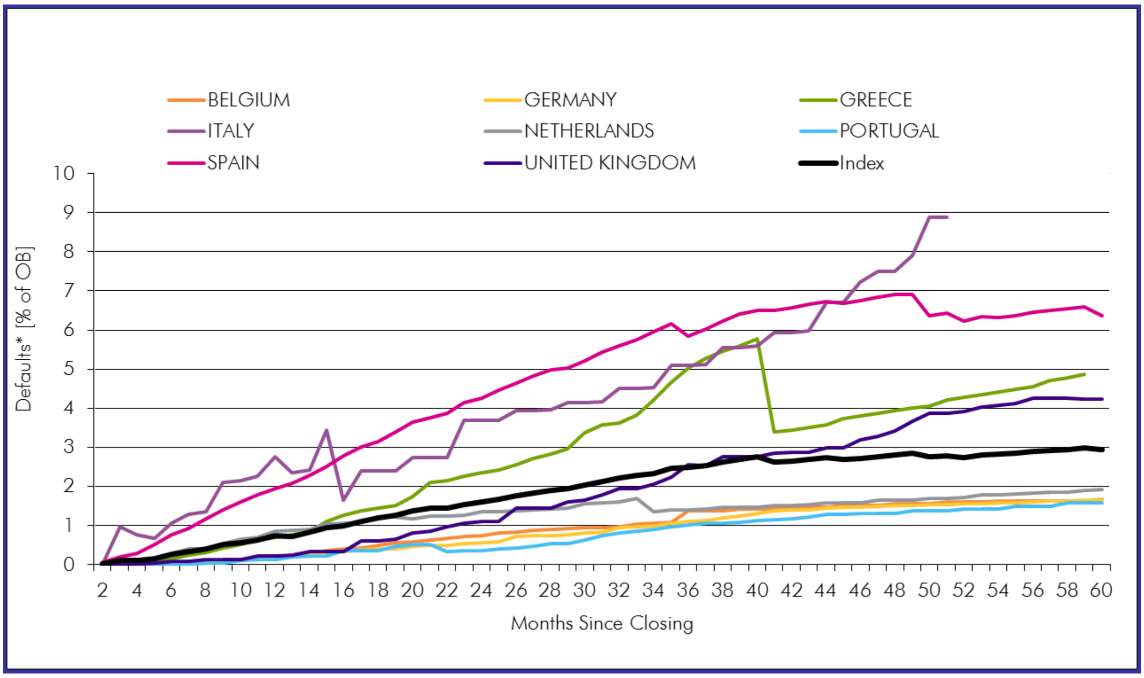
[47]We discussed the impacts of the sovereign crisis on securitisation transactions in more detail in our ESBFO in December 2012: http://www.eif.org/news_centre/publications/eif_wp_2011_12.pdf.

[48]The "EMEA region" includes Europe, Middle East, and Africa; with regard to Structured Finance most of the transactions in this region are in Europe.

[49]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 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 transaction rated by Moody's.

However, the performance differs from country to country (see figure 35). Moody's e.g. reports that the recent performance of EMEA SME ABS transactions showed weak trends in Greece and Italy and stable trends in most of the other jurisdictions.

Figure 35: EMEA SME ABS cumulative credit events or defaults on original balance (seasoning by country)



Source: Moody's (2013a)

Due to various reasons and as explained in more detail in our previous reports, also the SMESec market has been hit by a wave of downgrades. Typically, AAA tranches show strong rating stability, but today also AAA and AA tranches migrate downward, often driven by downgrades of the respective country/sovereign ratings and the limitation by the country ceilings (Fitch, 2013b).

The rating transition data shows that the downgrade pressure for SME transactions was across all tranche levels. The following example (table 3) shows the tranche rating migration since transaction closing of the SME Collateralized Loan Obligation (CLO) transactions that have been rated by Fitch. For example: of all tranches that have initially been rated AAA, 31% (by number) have paid in full (pif), only 12% are still AAA, 23% moved to AA etc.

Table 3: Fitch European SMEs Rating Transition Matrix (April 2013) [50]

% of tranches		Current rating									
		PIF	AAAsf	AAsf	Asf	BBBsf	BBsf	Bsf	CCCsf	CCsf	Csf
Initial Ratings	AAAsf	31%	12%	23%	21%	9%	3%	0%	1%	0%	0%
	AAsf	15%	0%	29%	12%	12%	9%	15%	6%	3%	0%
	Asf	6%	0%	10%	44%	10%	10%	13%	2%	2%	2%
	BBBsf	6%	0%	0%	6%	6%	27%	10%	25%	14%	6%
	BBsf	4%	0%	0%	0%	8%	19%	19%	15%	23%	12%
	Bsf	0%	0%	0%	0%	0%	57%	14%	0%	0%	29%
	CCCsf	0%	0%	0%	0%	0%	0%	0%	10%	30%	60%
	CCsf	0%	0%	0%	0%	0%	0%	0%	0%	40%	60%
	Csf	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%

Source: Fitch (2013c)

5.2.3 SMESec prospects

The pressure on European banks to deleverage continues, and banks have to raise fresh capital or to reduce their balance sheets in order to anticipate and fulfil future Basel III rules. One possible reaction is to downsize lending activities; another direction could be to use securitisation as tool: a recovery of the securitisation markets could play a role in unlocking credit supply and economic recovery.

As mentioned above, in the current market, securitisation is virtually only funding driven: the most senior tranche is either placed or - more frequently - retained and used as collateral for ECB loans. Despite some promising first attempts to revive this asset class, the primary SME market - both in terms of number of transactions and volumes placed with market investors - is still expected to remain well below pre-crisis levels for some time and the image of securitisation is still damaged (with related negative impact on the image of SMESec as well[51]), i.e. due to the understandably bad reputation of the US sub-prime products and the unfortunate negative association of the European structured finance markets with its US peers, despite the fact that the former performed substantially better than the latter. However, more and more often the important role of securitisation in financing and in particular SMESec is publicly voiced again, inter alia by the European Commission (e.g. European Commission, 2013a; European Commission, 2013b) or the Group of Thirty (The Group of Thirty, 2013).

Also the ECB has repeatedly stressed the importance of SMESec and also raises the point to reconsider the appropriateness of regulatory capital requirements for ABS (i.e. Solvency II) in order to revitalize SME funding (see Cœuré, 2013). ECB Board Member Jörg Assmussen, speaking about supporting ABS markets, said on the 08th May 2013: "[We] have an open mind to look at all things we can do within our mandate, and this relates to how can the market for asset-backed

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

[51] The contagion effects for SMESec have been discussed in more details in our Working Paper 2010/7: http://www.eif.org/news_centre/research/index.htm (Kraemer-Eis, Schaber and Tappi, 2010).

securities, especially backed by SME loans, be revived in Europe, of course under strict supervision."

EIF is trying to stimulate the market having participated in transactions, including from a number of lower rated EU countries that are currently facing more challenges accessing the public markets; one concrete example to provide capital relief is represented by the second loss protection transactions recently closed by EIF under the European Commission's Competitiveness and Innovation (CIP) Programme (see box 6). Due to the challenges that the SME ABS market has been facing since the crisis, financial institutions have been seeking alternative means of funding SME loans. Commerzbanks' issuance of a structured SME covered bond has attracted quite a lot of coverage and renewed the discussion of the participation of SME loans in the covered bond space, although this is a topic of hot debate at the moment. EIF has been following with keen interest those developments and is engaged in a dialogue with a number of parties to evaluate the potential involvement in future transactions. One market where EIF has actually been active in the SME covered bond space is Turkey, which is the only country where bank bonds backed by SME receivables are covered by the national covered bond legislation, although we understand that similar discussions are taking place in Italy and Austria. These transactions can help to support SME financing via funding advantages for the originating banks, and it might well be that in many countries legislators are going to introduce covered bonds legal frameworks. EIF would welcome the further development of this segment, participated in one real SME covered bond in Turkey, and is working on some other transactions of this kind.

There have also been a couple of additional initiatives that aim to remove current hurdles in the market and help reigniting issuance and return to more normal conditions; among which we should mention the development of the European Data Warehouse that will deal with investor's complaints about the lack of transparency and standardisation of ABS data, as well as the Prime Collateralised Securities (PCS) initiative which represents an industry-led project that is looking to create a sustainable securitisation market with standardised criteria based on simplicity, quality and transparency. The EIB Group has been actively involved from the inception in these two initiatives as far as SMESec is concerned.

Another element to restart the market is an initiative by the EIB Group (EIB and EIF) to increase its involvement in ABS, combining EIB purchases of senior tranches of SME-backed ABS notes with EIF guarantees for other tranches of the same ABS, making them more attractive to market purchasers. This facility for SMEs will enhance EIB Group's external effectiveness in the priority area of SME lending and better use complementarities of EIB and EIF in the ABS domain. EIB Group's involvement is expected to encourage originators to initiate the launching of further new ABS transactions by facilitating deal execution through increased underwriting capacity and provision of credit enhancement to third party investors.

As mentioned above, in the past few weeks there have been a number of comments from policy makers and the ECB about current discussions and potential initiatives in connection to the SME markets and securitisation. There are various task forces that are actively looking at ways of providing credit to the real economy especially for those countries who are suffering the most from the crisis. The EIB Group is in constant exchange with interested parties and welcomes all initiatives that can generate a catalytic effect to enhance access to finance for SMEs in the EU countries. As an EU institution we will pursue the objectives and directives of the EU, always in line with best banking standards and practices.

Our outlook remains "reluctant": in general, driven by secured funding needs, more originators are expected to return to the market (especially from Spain and Italy, but also other countries), however, for the time being and as explained above, the majority of these transactions will be for ECB placement and structured in line with the respective eligibility repo-criteria to minimise the funding costs of the originators. This situation is expected to continue, also for SME transactions. However, against the background of a low yield environment, investors are progressively looking at the securitisation markets, also at SME transactions. Moreover, ECB support can lead to improving investor confidence and increased willingness to take SMESec risks.

A continuation of the gradual recovery of the European Structured Finance market is expected. However, this will not only depend on the development of market fundamentals and the enhancement of investors' confidence but also strongly on the direct and indirect impact from regulatory priorities. Hence, future/potential regulatory treatments of SMESec have to be duly analysed. Based on the current Basel 3 framework, banks' capital against securitisations will have to increase significantly. Bank of America/Merrill Lynch estimates that European banks must increase their capital against securitisation bond holdings by (depending on the approach used) EUR 23bn to EUR 47bn (Bank of America/Merrill Lynch, 2013). Investors will only return in volume if they regain trust in the quality of the transactions and if there is satisfactory secondary market liquidity. Originators will return if transactions are economically feasible. For both, a stable and reliable regulatory framework is a key precondition as well.

Box 6: Second loss protection from the CIP Securitization Window

EIF has signed in March this year the first two transactions under the so called *CIP Securitisation Window* with UniCredit Italy on two portfolios originated by UniCredit Italy together with, respectively, Federconfidi and Federascomfidi, two Italian mutual guarantee associations (federation of Confidi).

Under the securitisation window, EIF provides, in the context of both cash and synthetic SME securitisation transactions, EU Guarantees on tranches with low layers of credit enhancement. The objective is to facilitate access to capital markets for unrated or low rated institutions, such as smaller banks and to find alternative solutions to allow financial intermediaries to circulate funding in the SME market. The aim of the CIP Securitisation product is to generate additional financing for SMEs, hence it combines an unconditional and irrevocable guarantee on an existing portfolio of loans at a market level guarantee fee with a separate undertaking to build up a new portfolio of SME loans (under a separate additional portfolio agreement). In exchange for the EU Guarantee, originators undertake to create a new portfolio of SME financing during an agreed period (known as the *additional portfolio*). The required size and composition of this portfolio depends on the size and the seniority of the EU Guarantee. The Additional Portfolio must contain medium- or long-term financing to SMEs. In case the targeted volume of the additional portfolio is not achieved, a commitment fee would become due, while the guarantee on the securitisation transaction would remain in place.

Box 6 continued:

Thanks to EIF's intervention taking second loss risk alongside a first loss tranche taken by the Confidi, UniCredit as well as the participating Confidi have reduced the respective capital requirements. This is particularly important during the current transition period as many Confidi decided to be regulated as a bank. In addition, UniCredit can free up its credit lines of the participating Confidi thanks to the transaction and therefore increase the volume of new loans with the same Confidi.

The transactions refer to two granular portfolios of loans originated by UniCredit and partially guaranteed by Confidis. While the Confidis cover the first loss piece, EIF guarantees the second loss piece. As required under the CIP securitisation window, UniCredit and, respectively, Federconfidi and Federascomfidi commit to increase the loan volume granted by UniCredit and guaranteed by the Confidi by a multiple of approximately 15 times the amount of capital released by the transaction.

The transactions present the unique feature of aiming at strengthening the Italian mutual guarantee system, in a period where SMEs suffer most from the lack of bank financing and the Confidi's guarantee capacity has been eroded by the deteriorating credit quality of their guarantee portfolios.

In detail, transactions under the CIP Securitisation Window combine an unconditional and irrevocable guarantee on an existing portfolio of loans at a market level guarantee fee with a separate undertaking to build up a new portfolio of SME loans (under a separate additional portfolio agreement). The deal structure can be replicated in other parts of Europe and also scaled up to help stimulating SME lending.

6 Microfinance

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." This statement, given in a recent European Commission (2012) report, reflects the common idea to combine social and economic objectives in microfinance. This attractive combination has made microfinance an important tool to reach EU policy objectives.

One part of the Europe 2020 strategy[52] is the initiative "European platform against poverty and social exclusion" which sets out actions to reach the EU target of reducing poverty and social exclusion by at least 20 million people by 2020. Although combating poverty and social exclusion is mainly the responsibility of national governments, the EU can play a coordinating role for example by making funding available. One key action is the "better use of EU funds to support social inclusion and combat discrimination" including improvements in the use of microcredits (e.g. via the JASMINE initiative and PROGRESS financial instruments).[53]

In order to assess the achievement of the Europe 2020 poverty/social inclusion target, Eurostat measures the indicator "people at risk of poverty or social exclusion".[54] Figure 36 depicts the headline indicator, corresponding to the sum of persons who are at risk of poverty or severely materially deprived or living in households with very low work intensity (i.e. a combination of the three sub-indicators).[55] In Eastern Europe, the incidence of poverty or social exclusion is the greatest, although the difference between the EU15 and EU27 figure is relatively small. When comparing 2011 to 2010 and 2009, the situation became worse in most of the countries. Within the EU, the highest risks of poverty or social exclusion are recorded for Bulgaria, Latvia and Romania; in general countries on the right-hand side of the diagram are countries from Eastern Europe as well as from those countries which have suffered most from the impacts of the current

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

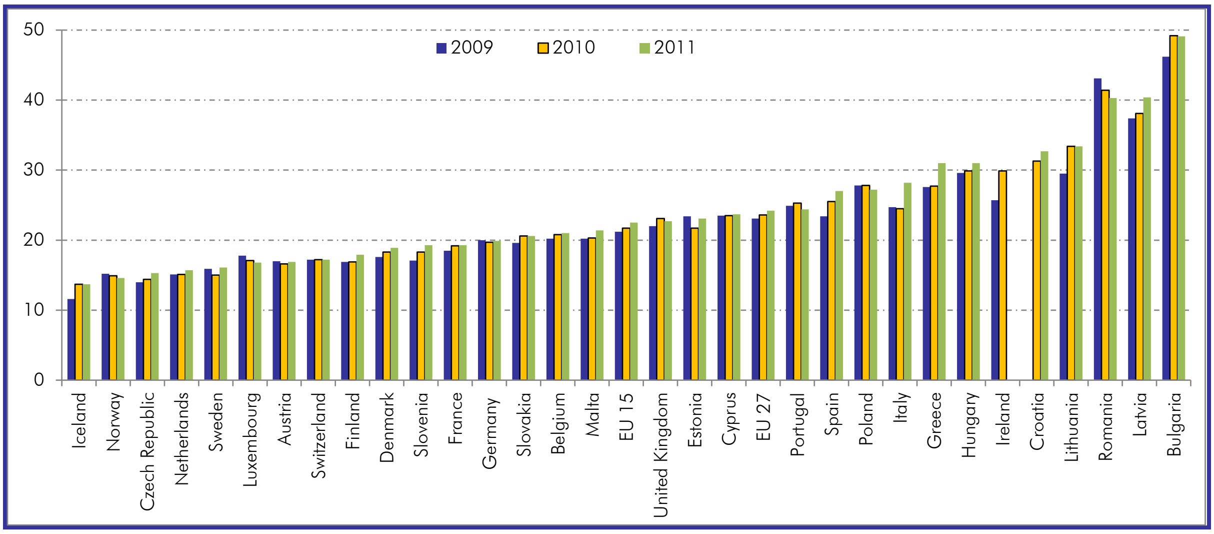
[53] For more information on Europe 2020's social inclusion/poverty initiatives and actions please see http://ec.europa.eu/social/main.jsp?catId=961&langId=en and http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2010:1564:FIN:EN:PDF, p. 8. For information on JASMINE, the European PROGRESS Microfinance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

[54] The indicator is a union of the three sub-indicators "People living in households with very low work intensity", "People at-risk-of-poverty after social transfers", "Severely materially deprived people" 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

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

sovereign debt crises in recent years (Ireland, Greece, Italy, Spain, Portugal, and Cyprus). This is even more worrying as a significant part of the recent fiscal consolidation efforts weighed on social protection expenditure. Moreover, according to the European Commission (2013c), "the reduction of social spending was much stronger than in past recessions".

Figure 36: People at risk of poverty or social exclusion (percentage of total population)



Source: Based on data from Eurostat

As regards East European EU member states, their relatively poor performance in social welfare indicators, combined with low bank penetration rates, is one reason for the significant market for microfinance (i.e. commercial microfinance) in this region.

6.2 Microfinance market

Microfinance in Europe 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 (see also box 7). Throughout the EU, 99% of all start-ups are micro or small enterprises and one third of those were launched by unemployed people.

As outlined in previous versions of our papers[56] the European microfinance market is still a young and heterogeneous sector, due to the diversity of legal frameworks, institutional environments and microfinance providers in European countries. In addition to commercial banks, that target microenterprises as a part of 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 Organizations (NGOs) or Foundations.

[56] E.g. previous version of our ESBFO or our papers specifically referring to microfinance; see http://www.eif.org/news_centre/research/index.htm

Box 7: What is "micro"?

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

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

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.

NGOs and Foundations together have the highest share among the institutional types (22% in 2011) according to the new edition of European Microfinance Network (EMN)'s *Overview of the microcredit sector in the European Union for the period 2010-2011* (Bendig et al., 2012[57]). This is the latest issue of EMN's overview of the European microfinance sector, which is conducted every second year. As the data availability for microfinance in Europe is still very limited, this study contributes significantly to the improvement of the situation. This report is based on a survey among 154 MFIs in 32 countries[58], and it has been supported by the EIF.

Many of the surveyed organizations are very small and provide less than 10 loans per year. The total number of loans provided by the surveyed MFIs is 204,080, equivalent to an amount of EUR 1,047m. The average number of loans per MFI is significantly higher in Eastern Europe than in Western Europe (2,390 versus 1,226). Within the EU, the largest numbers of loans disbursed in 2011 were reported by MFIs active in Spain[59] (36,188), France (28,690), and Poland (23,732), while the total portfolio value of loans disbursed per country was largest in Spain[59] (EUR 232m), Germany (EUR 188m), and France (EUR 165m). The total outstanding microcredit portfolio was largest in Spain, France, and Finland. The highest average loan sizes were reported for Lithuania[60], Belgium (EUR 19,349), and Finland[60]. In general but with the exception of Lithuania[60], the average loan sizes in Eastern EU Member States are significantly lower than in Western European countries.

The conditions for microloans are much diversified across countries. According to Bendig et al. (2012), the average interest rate among the surveyed microfinance providers was 11% in 2011, but ranging from 4% in France, Italy and Austria, to 16% in Romania, and even higher in non-EU

[57] The report is dated December 27, 2012 and was published on February 11, 2013.

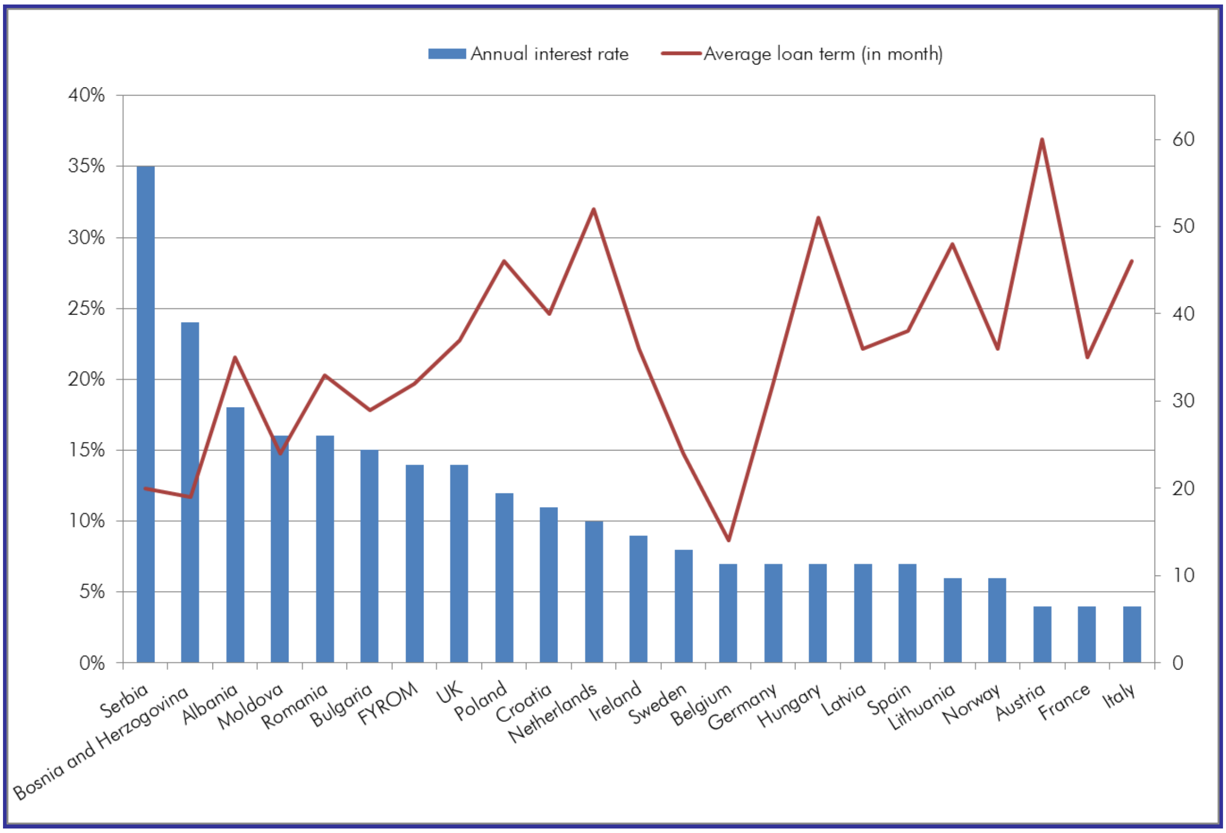
[58] 376 MFIs in 32 countries (of which 22 are EU Member States) have been contacted, 154 MFIs in 25 countries (18 EU Member States) contributed data. The geographical distribution of organizations that participated in the survey shows an overrepresentation of institutions from Western Europe. Out of the 154 organizations, only 56 (37%) are from Eastern Europe (Bendig et al., 2012).

[59] According to Bendig et al. (2012), "the number of microloans issued in Spain is particularly related to the activities of one banking institution."

[60] Only one institution. No detailed country figures provided in Bendig et al. (2012).

Balkan states. The differences in average interest rates are typically related to differences in the legal framework, MFI business models, pricing policies, refinancing cost, and the level of subsidies. Without usury laws or interest rate ceilings in place, the interest rate usually decreases in the loan size. Similarly, the spread of average loan durations varies across countries. Long loan terms can be found in Austria (60 months), the Netherlands (52 months), and Hungary (51 months). Typically, shorter loan terms are observed in countries with high average interest rates and low average loan volumes (see figure 37).

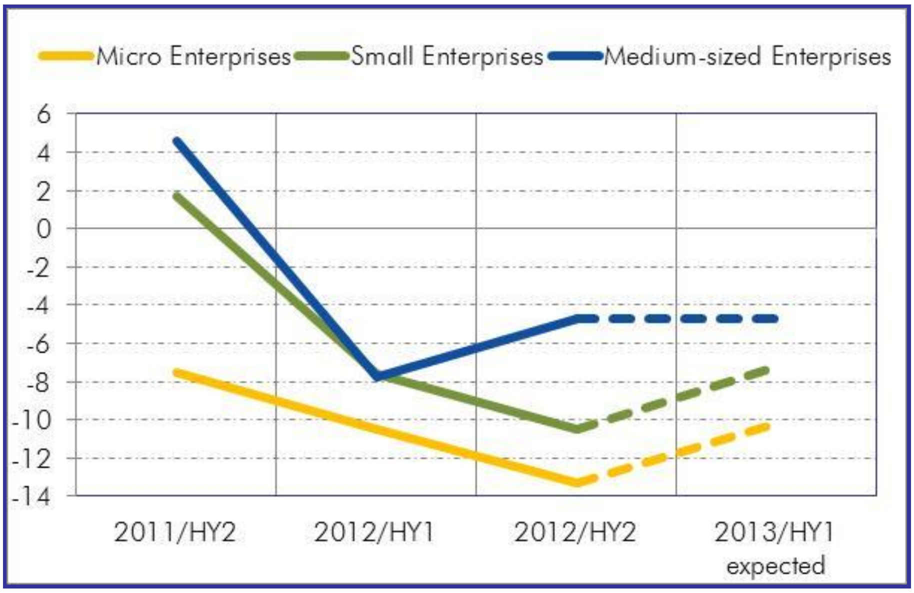
Figure 37: Microcredit conditions in Europe



Source: Based on Bendig et al. (2012)

When looking at the business climate of micro-enterprises, the EU Craft and SME barometer shows that micro-enterprises on balance estimated their overall situation less favourable than other SMEs in the second half of 2012 (see figure 38). However, micro-enterprises on balance expected some improvement of their business situation for the first half of 2013. Similar results were reported for the survey questions on turnover, employment and orders in the second half of 2012. All in all, the figures reveal stronger difficulties for micro-enterprises than for other SMEs.

Figure 38: Overall situation of European micro-firms compared to other enterprise size classes



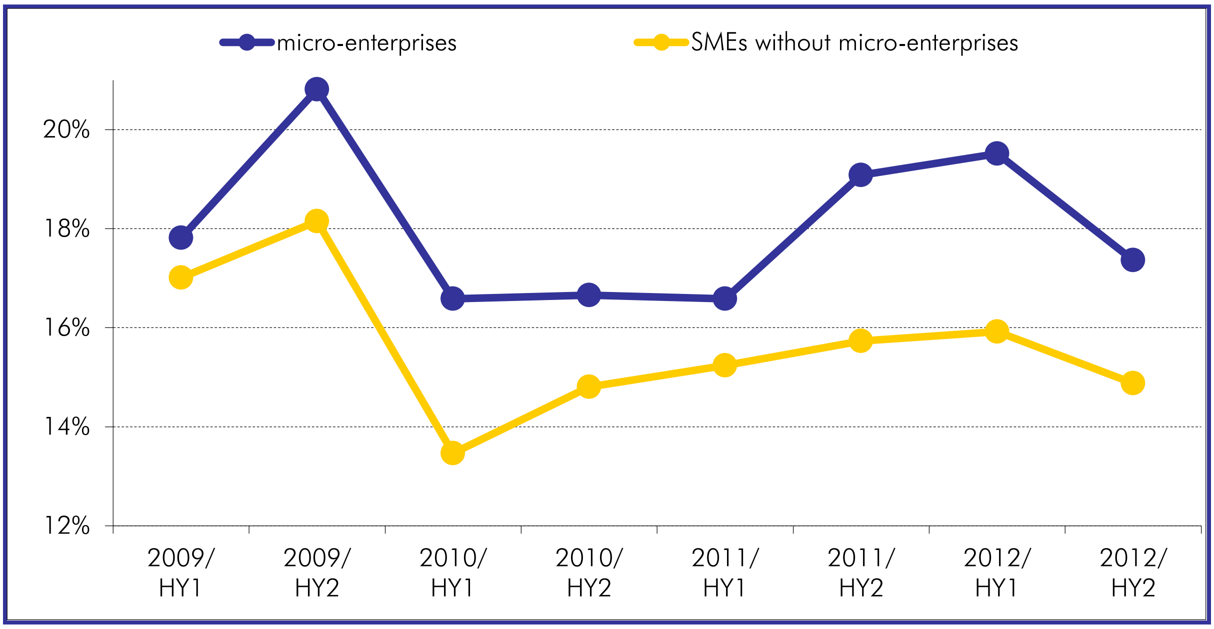
Source: Based on UEAPME Study Unit (2013)

According to the data from the latest ECB survey on the access to finance of SMEs in the euro area (ECB, 2013b), the share of enterprises which see access to finance as their most pressing problem is larger among micro-enterprises than among other SMEs. Micro-enterprises reported "access to finance" second most frequently as their most pressing problem (while it is in the third place of "most pressing problems" among small enterprises, the fourth place among medium-sized ones, and the fifth place among large enterprises).

Compared to the previous survey wave, the percentage of companies mentioning access to finance as their most pressing problem decreased (see figure 39) for all enterprise size classes, while "finding customers" stayed the most frequently mentioned concern. In line with this development, the ECB (2013b) also stated a decrease in bank loan rejection rates for all enterprise size classes. However, the rejection rate is still the highest for micro firms (18%), compared to 6% for small firms and 7% for medium-sized firms.

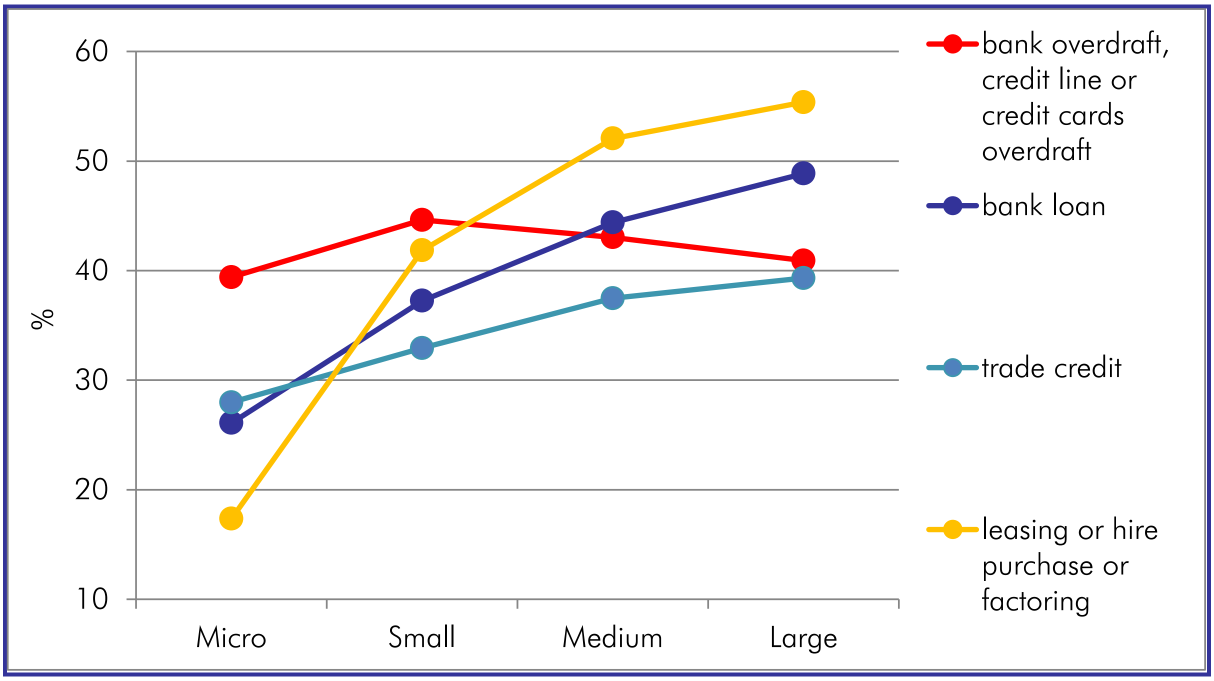
Difficult access to finance, in particular to bank loans, might be one key reason why micro-enterprises in Europe use bank loans and other external financing sources considerably less than other SME size classes. Figure 40 shows that, with the exception of "bank overdraft, credit line or credit cards overdraft", the usage of different financing sources on average typically increases with the size of the SME. Nevertheless, despite all unfavourable conditions faced by micro-enterprises, in 2011 the number of loans increased by 45% and the total volume by 5% compared to 2009 (Bendig et al., 2012).

Figure 39: Share of enterprises reporting access to finance as their most pressing problem



Source: Based on ECB (2013b) Statistical Warehouse Data

Figure 40: Enterprises having used different financing sources (by enterprise size class)
over the preceding 6 months (October 2012 to March 2013); percentage of respondents



Source: Based on ECB (2013b) data

6.3 Microfinance prospects

The impact of the on-going crisis on the availability of microfinance is a central issue of the sector. In times of crisis, like today, microfinance clients, be it as an enterprise or a self-employed, typically find capital even harder to obtain; not to mention the additional challenges faced by certain vulnerable groups such as ethnic minorities or female entrepreneurs. If commercial banks reduce their lending to the "typical" microfinance clients this provides as well an opportunity for non-bank MFIs to strengthen their position in the market.

On the demand side, the increased levels of unemployment in many European countries, especially in those most affected by the sovereign debt crises, might increase as well the demand for microfinance – from the perspective of social inclusion lending but as well from the viewpoint of enterprise lending. It can be expected that especially many young people will try to start self-employment (Bendig et al., 2012).

We mentioned that there is no common microfinance business model in Europe and the microfinance market is immature and fragmented – but there is a trend towards efficiency, professionalization, and self-sustainability. However, without the access to stable funding, the prospects of the sector with regard to growth and self-sufficiency are limited. According to the EMN survey, i.e. based on the qualitative interviews with the MFIs, the general public support for the microfinance sector is expected to decline in the coming years, due to budget restrictions and high deficits at national and regional level (Bendig et al., 2012).

We discussed the rationale for public support in the microfinance area in one of our previous working papers[61] 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.

Through the implementation of Progress Microfinance we receive regular updates from financial intermediaries regarding the demand for microcredit throughout EU27. Progress Microfinance now covers 16 countries with the largest projected microcredit volumes in the Netherlands, France and Romania. Non-bank MFIs have been the most active lenders in the initial phase of Progress Microfinance. As of end-September 2012 more than 70% of the actual microcredit volume achieved had been originated by non-bank MFIs. In terms of outreach at micro-borrower level, a mobilised volume of more than EUR 100m is expected to be reached over the next months compared to an overall target of EUR 500m by 2020.

Based upon the most recent social reporting under Progress Microfinance (as of end-September 2012) one can observe a noteworthy outreach of 30% to the unemployed and inactive across the overall facility. Also, many of the micro-borrowers are to be considered as start-ups, indicatively around 80% of all total micro borrower financed so far.

[61]See i.e. Bruhn-Leon, Eriksson and Kraemer-Eis (2012).

7 Concluding remarks

Europe's sluggish and uneven economic performance continues and there are a number of downside risks. Top issues are still the concerns surrounding the large funding requirements of sovereigns and banks. Fiscal consolidation in many advanced economies is important to ensure future growth, however it is also a burden for economic growth prospects in the short term. Moreover, as shown above, the overall business environment of European SMEs further deteriorated and the imbalances between the EU Member States are significant.

In this context, public support is very important to play a catalytic role and to enhance access to finance for SMEs. Only recently, the European Commission, the EIB and the EIF published a joint report on their activities and initiatives to facilitate access to finance for SMEs (EIB Group and European Commission, 2013).

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

In the areas of *credit guarantees* and *securitisations*, EIF cooperates with a wide range of financial intermediaries such as banks, leasing companies, guarantee funds, mutual guarantee institutions, promotional banks or any other financial institution providing financing to SMEs, or guarantees for SME financing. Credit guarantees are used widely across economies as important tools to ease financial constraints for SMEs and in order to alleviate market failures in SME financing (OECD, 2013b) and EIF sees strong demand for its portfolio guarantee solutions. Against the background that SMEs have no direct access to the capital markets, banks are the most important source of external SME finance and hence banks' limitations have a direct impact on SME lending capacity. Thus, securitisation or similar techniques such as e.g. SME covered bonds are important in order to access the capital markets and allow mitigating the inherent illiquidity of SME portfolios. The re-emergence of the European SME securitisation market would be an important element to enhance access to finance for SMEs in Europe.[62] Recent positive statements, initiatives, and proposals concerning this market segment (e.g. by the ECB and the EC) give reason to be more optimistic than last year for SMESec.

[62] It is important not only to look at banks when analysing SMESec but equally to leasing companies and trade receivables financing which form part of the SME securitisation market. We expect in particular leasing companies to play a larger role in the market for SME finance as banks will at least partially retreat. Given that bank financing is and will be less available for leasing companies post crisis, we expect that SME securitisation will be particularly relevant in the leasing area. See for more information on the importance of leasing for SMEs finance: Kraemer-Eis and Lang (2012).

Concerning *microfinance*, the results of the latest EMN survey show that over the past years the European microfinance sector as a whole was growing in terms of the number of loans disbursed. However, without the access to stable funding, the perspectives of the sector with regard to growth and self-sufficiency are limited. Commercial banks in Europe are expected to further reduce their lending to financially excluded people, small start-ups and microenterprises. Moreover, the general public support for microfinance provision is expected to decline in the coming years. Therefore, the MFIs prepare to react to this with developing more efficient and lean processes, by reducing the costs for the provision of microloans and looking for additional sources for funding (Bendig et al, 2012). Microfinance is an important contribution to overcome the effects of the crisis and in particular to support 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.

ANNEX

Annex 1: Private Equity Glossary

(selection, from EVCA)

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

- **Fundraising:** The process in which venture capitalists themselves raise money to create an investment fund. These funds are raised from private, corporate or institutional investors, who make commitments to the fund which will be invested by the general partner.
- **General Partner:** A partner in a private equity management company who has unlimited personal liability for the debts and obligations of the limited partnership and the right to participate in its management.
- **General Partner's commitment:** Fund managers typically invest their personal capital right alongside their investors capital, which often works to instil a higher level of confidence in the fund. The limited partners look for a meaningful general partner investment of 1% to 3% of the fund.
- **Generalist fund:** Funds with either a stated focus of investing in all stages of private equity investment, or funds with a broad area of investment activity.
- **Holding period:** The length of time an investment remains in a portfolio. Can also mean the length of time an investment must be held in order to qualify for Capital Gains Tax benefits.
- **Horizon IRR:** The Horizon IRR allows for an indication of performance trends in the industry. It uses the fund's net asset value at the beginning of the period as an initial cash outflow and the Residual Value at the end of the period as the terminal cash flow. The IRR is calculated using those values plus any cash actually received into or paid by the fund from or to investors in the defined time period (i.e. horizon).
- **Hurdle rate:** A return ceiling that a private equity fund management company needs to return to the fund's investors in addition to the repayment of their initial commitment, before fund managers become entitled to carried interest payments from the fund.
- **Inception:** The starting point at which IRR calculations for a fund are calculated; the vintage year or date of first capital drawdown.
- **Institutional investor:** An organization such as a bank, investment company, mutual fund, insurance company, pension fund or endowment fund, which professionally invest, substantial assets in international capital markets.
- **Internal rate of return (IRR):** The IRR is the interim net return earned by investors (Limited Partners), from the fund from inception to a stated date. The IRR is calculated as an annualised effective compounded rate of return using monthly cash flows to and from investors, together with the Residual Value as a terminal cash flow to investors. The IRR is therefore net, i.e. after deduction of all fees and carried interest. In cases of captive or semi-captive investment vehicles without fees or carried interest, the IRR is adjusted to create a synthetic net return using assumed fees and carried interest.
- **IPO (Initial public offering):** The sale or distribution of a company's shares to the public for the first time. An IPO of the investee company's shares is one the ways in which a private equity fund can exit from an investment.
- **Later stage:** Expansion, replacement capital and buyout stages of investment.
- **Leverage buyout (LBO):** A buyout in which the 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

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

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

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

  (iii) Third party credit enhancement (EIF or monoline insurers).
- **Credit Linked Notes (CLN):** A security issued by an SPV (or directly from the balance-sheet of the originator) credit-linked to the default risk of an underlying portfolio of assets. Usually used in synthetic securitisations for the mezzanine tranches of a transaction.
- **Collateralized loan obligations** (CLOs) are a form of securitization 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
- AECM: European Association of Mutual Guarantee Societies
- AFME: Association for financial markets in Europe
- AIFMD: Alternative Investment Fund Managers Directive
- BLS: Bank Lending Survey
- BMWi: Bundesministerium für Wirtschaft und Technologie
- bp: basis point(s)
- BVCA: British Private Equity & Venture Capital Association
- CDFIs: Community Development Financial Institutions
- CDO: Collateralized Debt Obligation
- CGAP: Consultative Group to Assist the Poor
- CIP: Competitiveness and Innovation Framework Programme
- CIS: Commonwealth of Independent States (former Soviet Union)
- CLN: Credit Linked Note
- CLO: Collateralized Loan Obligation
- CMBS: Commercial Mortgage Backed Securities
- CoriP: Corporate Innovation Platform
- CRD: Capital Requirements Directive
- DIHK: Deutscher Industrie- und Handelskammertag
- EAF: European Angels Fund
- EBAN: European Business Angels Network
- EC: European Commission
- ECB: European Central Bank
- EIB: European Investment Bank
- EIF: European Investment Fund
- EMEA: Europe, Middle East, and Africa
- EMN: European Microfinance Network
- ESBFO: European Small Business Finance Outlook
- ESMA: European Securities and Market Authority
- EU: European Union
- EU15: the 15 countries which formed the EU until April 30, 2004
- EU27: the 27 EU Member States
- EVCA: European Private Equity & Venture Capital Association
- FLS: Funding for Lending Scheme
- FLPG: First Loss Portfolio Guarantee
- FRSP: Funded Risk Sharing Product
- FYROM: Former Yugoslav Republic of Macedonia
- GDP: Gross Domestic Product
- GII: Global Insolvency Index
- GP: General Partner
- IPO: Initial Public Offering
- IRR: Internal Rate of Return
- JASMINE: Joint Action to Support Microfinance Institutions in Europe
- JEREMIE: Joint European Resources for Micro to Medium Enterprises
- KfW: Kreditanstalt für Wiederaufbau
- LBO: Leveraged buy out
- LFA: Förderbank Bayern
- LP: Limited Partner
- LSE: The London School of Economics and Political Science

- MDD: Mezzanine Dachfonds für Deutschland
- MFG: Mezzanine Facility for Growth
- MFI (in the context of microfinance): Microfinance Institution
- MFI (in the context of ECB): Monetary Financial Institutions
- NFC: Non-financial corporation
- NGO: Non-Governmental Organisation
- OB: Original Balance
- OECD: Organisation for Economic Co-Operation and Development
- PE: Private Equity
- RMBS: Residential Mortgage Backed Securities
- RSFF: Risk Sharing Finance Facility
- RSI: Risk-Sharing Instrument for Innovative and Research oriented SMEs and small Mid-Caps
- 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
- UEAPME: European Association of Craft, Small and Medium-sized Enterprises
- US: United States (of America)
- VC: Venture Capital
- VDB: Verband Deutscher Bürgschaftsbanken e.V.
- WBS: Whole Business Securitisation

References

- Abiad, A., Dell'Ariccia, G., and Bin Li, G. (2012). What Have We Learned about Creditless Recoveries? In: Gerlach, S., Gnan, E., Ulbrich, J. (eds.). The ESRB at 1. SUERF – The European Money and Finance Forum. Vienna 2012. SUERF Study 2012/4. Pp. 115-129. http://www.suerf.org/download/studies/study20124.pdf
- AFME (2013). Securitisation data report Q4:2012. 22.03.2013. http://www.afme.eu/Documents/Statistics-and-Reports.aspx
- Akerlof, G. A. (1970). The Market for "Lemons": Quality Uncertainty and the Market Mechanism. In: Quarterly Journal of Economics, Vol. 84, No. 3, pp. 488–500.
- Arrow, K. J. (1985). The Economics of Agency. In: J. W. Pratt und R. J. Zeckhauser, Principals and Agents: The Structure of Business, Boston, pp. 37–51.
- Axelson, U. and Martinovic, M. (2013). European Venture Capital: Myths and Facts. BVCA and Dow Jones. http://admin.bvca.co.uk/library/documents/European_MandF_Report_21Jan13.pdf
- Bank of America/Merrill Lynch (2013). Killing me softly, Basel? European Structured Finance. 28.02.2013.
- Bendig, M., Unterberg, M., and Sarpong, B. (2012). Overview of the Microcredit Sector in the European Union 2010-2011. 27.12.2012. European Microfinance Network (EMN). http://www.european-microfinance.org/data/file/overview2010-2011-final.pdf
- Bruhn-Leon, B., Eriksson, P.-E. and Kraemer-Eis, H. (2012). Progress for Microfinance in Europe. EIF Working Paper 2012/13. January 2012. http://www.eif.org/news_centre/publications/eif_wp_2012_13_microfinance.pdf
- Center of Venture Research (2013). The angel investor market in 2012: a moderate recovery continues. 25.04.2013. http://paulcollege.unh.edu/sites/default/files/2012_analysis_report.pdf
- Cœuré, B. (2013). SME financing, market innovation and regulation. Speech at the Eurofi High Level Seminar organised in association with the Irish Presidency of the Council of the EU. 11.04.2013. http://www.ecb.europa.eu/press/key/date/2013/html/sp130411.en.html
- Coller Capital (2012a). Global Private Equity Barometer. Winter 2012-13. 10.12.2012. http://www.collercapital.com/Uploaded/Documents//News/Coller_Capital_Global_Private_Equity_Barometer_Winter_2012-13.pdf
- Coller Capital (2012b). Global Private Equity Barometer. Winter 2012-13. News release. 10.12.2012. http://www.collercapital.com/News/2012/Coller-Capital-Global-Private-Equity-Barometer-Winter-2012-13.aspx
- CSES (2012). Evaluation of EU Member States' Business Angel Markets and Policies. Final Report. October 2012. http://ec.europa.eu/enterprise/dg/files/ba-rep_en.pdf
- Darvas, Z. (2013). Can Europe recover without credit? Bruegel Policy Contribution. Issue 2013/03. February 2013. http://www.bruegel.org/download/parent/770-can-europe-recover-without-credit/file/1645-can-europe-recover-without-credit/
- DIHK (2013a). Finanzierung: Mittelstand entspannt, Risiken am Horizont. Sonderauswertung der DIHK-Konjunkturumfrage „Wirtschaftslage und Erwartungen" zu Jahresbeginn 2013. http://www.dihk.de/themenfelder/gruendung-foerderung/unternehmensfinanzierung/umfragen-und-prognosen/umfragen-zur-unternehmensfinanzierung/sonderauswertung-mittelstandsfinanzierung-02-2013.pdf
- DIHK (2013b). The Economic Situation and Expectations for 2013. Results of a survey conducted by the Association of German Chambers of Commerce and Industry (DIHK). February 2013. http://www.dihk.de/ressourcen/downloads/dihk-konjunkturumfrage-02-2013-engl.pdf
- Draghi, M. and Constâncio, V. (2013). Introductory statement to the press conference (with Q&A). Bratislava, 02.05.2013. http://www.ecb.europa.eu/press/pressconf/2013/html/is130502.en.html
- DZ Bank (2013). ABS & Structured Credits. Rückblick 2012/Ausblick 2013. 22.02.2013.

- ECB (2013a). Euro area MFI interest rate statistics: February 2013. Press release. 05.04.2013. http://www.ecb.eu/press/pr/stats/mfi/html/index.en.html
- ECB (2013b). Survey on the access to finance of SMEs in the Euro area. October 2012 to March 2013. 26.04.2013. http://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html
- ECB (2013c). The Euro Area Bank Lending Survey. 1st quarter of 2013. April 2013. http://www.ecb.int/stats/money/surveys/lend/html/index.en.html
- ECB (2013d). Monthly Bulletin. May 2013. http://www.ecb.europa.eu/pub/pdf/mobu/mb201305en.pdf
- ECB (2012a). Monthly Bulletin. August 2012. http://www.ecb.europa.eu/pub/pdf/mobu/mb201208en.pdf
- ECB (2012b). Monthly Bulletin. March 2012. http://www.ecb.int/pub/pdf/mobu/mb201203en.pdf
- EIB Group and European Commission (2013). Supporting small and medium-sized enterprises in 2012. A joint report of the European Commission and the European Investment Bank Group. 02.05.2013. http://www.eif.org/news_centre/publications/joint_report_EIBGroup_EC_SMEs_access_to_finance.htm
- Equinox (2002). Gaps in SME financing: An analytical framework. February 2002.
- ESMA (2012). Securities and Markets Stakeholder Group – Report on Helping Small and Medium Sized Companies Access Funding. ESMA/2012/SMSG/59. 12.10.2012. http://www.esma.europa.eu/system/files/2012-smsg-59.pdf
- Euler Hermes (2013). Macroeconomic, Risk and Insolvency Outlook Economic Outlook no. 1193. 16.04.2013
- Eurochambres (2013). Economic Survey 2013. http://www.eurochambres.eu/content/default.asp?PAGEID=1&DocID=4895
- European Commission (2013a). Green Paper. Long-term financing of the European economy. COM(2013) 150/2. March 2013. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013DC0150:EN:NOT
- European Commission (2013b). Long-term financing of the European economy. Commission Staff Working Document. SWD(2013) 76. March 2013. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013SC0076:EN:NOT
- European Commission (2013c). EU Employment and Social Situation. Quarterly Review. March 2013. http://ec.europa.eu/social/BlobServlet?docId=9924&langId=en
- European Commission (2013d). European Economic Forecast. Spring 2013. Commission staff working document. http://ec.europa.eu/economy_finance/eu/forecasts/2013_spring_forecast_en.htm
- European Commission (2012). Report from the Commission to the European Parliament and the Council on the application of Directive 2006/48/EC to microcredit. COM(2012) 769 final. 18.12.2012. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0769:FIN:EN:PDF
- EVCA (2013a). 2012 Pan-European Private Equity and Venture Capital Activity. Activity Data on Fundraising, Investments and Divestments.
- EVCA (2013b). Smart Choice: The case for investing in European venture capital. http://www.evca.eu/publications/VC_report_interactive.pdf?dm_i=1GLS,1ELP1,827W1J,4RUU2,1
- Fitch (2013a). SME CLO Performance Highlights. Special Report. 01.03.2013.
- Fitch (2013b). Global Structured Finance 2012 transition and default study. Special Report. 15.03.2013.
- Fitch (2013c). SME CLO Compare. Update on SME CLO issuance. 02.04.2013.

- Go4Venture Advisers (2013a). Go4Venture Advisers' European Venture & Growth Equity Market Monthly Bulletin. February 2013. http://www.go4venture.com/content/HTI/2013/2013_02_Go4Bulletin.pdf
- Go4Venture Advisers (2013b). Go4Venture Advisers' European Venture & Growth Equity Market Monthly Bulletin. January 2013. http://www.go4venture.com/content/HTI/2013/2013_01_Go4Bulletin.pdf
- Go4Venture Advisers (2013c). Go4Venture Advisers' European Venture & Growth Equity Market Monthly Bulletin – Methodology. http://www.go4venture.com/content/HTI/G4V_Bulletin_Methodology_2013.pdf
- Go4Venture Advisers (2012). Monthly European TMT Private Investments and M&A Transactions Bulletin – December 2012. http://www.go4venture.com/content/HTI/2012/2012_12_Go4Bulletin.pdf
- Huerga, J., Puigvert, J. and Rodriguez, C. (2012). Enhancements on ECB MFI Interest Rate Statistics. In: *OECD - The Statistics Newsletter*. Issue No. 55. March 2012. http://www.oecd.org/dataoecd/26/34/49803839.pdf
- Kelly, R. (2011). The performance and prospects of European Venture Capital. *EIF Working Paper 2011/009*. May 2011. http://www.eif.org/news_centre/publications/EIF_Working_Paper_2011_009.htm
- Kraemer-Eis, H. and Conforti, A. (2009). Microfinance in Europe. A market overview. *EIF Working Paper 2009/001*. November 2009. http://www.eif.org/news_centre/research/EIF_WP_2009_001_Microfinance.pdf
- Kraemer-Eis, H. and Lang, F. (2012). The importance of leasing for SME finance. *EIF Working Paper 2012/015*. August 2012. http://www.eif.org/news_centre/research/index.htm
- Kraemer-Eis, H., Lang, F. and Gvetadze, S. (2012). European Small Business Finance Outlook December 2012. *EIF Working Paper 2012/016*. December 2012. http://www.eif.org/news_centre/publications/EIF_Working_Paper_2012_16.htm
- Kraemer-Eis, H., Schaber, M. and Tappi, A. (2010). SME loan securitisation. An important tool to support European SME lending. *EIF Working Paper 2010/007*. October 2010. http://www.eif.org/news_centre/publications/eif-wp_2010_007_smesec.pdf
- Kraemer-Eis, H. and Schillo, M. (2011). Business Angels in Germany - EIF's initiative to support the non-institutional financing market. *EIF Working Paper 2011/011*. November 2011. http://www.eif.org/news_centre/publications/eif_wp_2011_011_Business_Angels_in_Germany.pdf
- Moody's (2013a). EMEA ABS SME Indices. December 2012. 07.03.2013
- Moody's (2013b). Announcement – Moody's EMEA ABS SME performance deteriorated further in December 2012. 07.03.2013.
- Morgan Stanley Research (2013). European Loans & Deposits Tracker: What can the ECB do to boost SME financing and ease fragmentation? 30.04.2013.
- OECD (2011). Financing high-growth firms. The role of angel investors. December 2011.
- OECD (2013a). OECD Scoreboard: Financing SMEs and Entrepreneurs 2013. 21.05.2013.
- OECD (2013b). SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises. Final Report. CFE/SME(2012)1/FINAL. Unclassified. 30.01.2013.
- OECD (2013c). Alternative financing instruments for SMEs and entrepreneurs: the case of mezzanine finance. 08.02.2013.
- Praet, P. (2013). Transition of the financial system in the wake of the financial crisis. Speech at the 8th annual European Market Liquidity Conference of the Association of Financial Markets in Europe. 13.02.2013. http://www.ecb.europa.eu/press/key/date/2013/html/sp130213.en.html

- Preqin (2013). The Preqin Quarterly Update: Private Equity. Q1, 2013. http://www.preqin.com/docs/quarterly/PE/Preqin_Quarterly_Private_Equity_Update_Q1_2013.pdf
- Standard & Poor's (2012). Transition study: Five years on, the European structured finance cumulative default rate is only 1.1%. 23.08.2011.
- Standard & Poor's (2013). Global structured finance default study 1978 – 2012: a defining moment for credit performance stability. 30.03.2013.
- The Group of Thirty (2013). Long-term Finance and Economic Growth. Working Group on Long-term Finance. March 2013. http://www.group30.org/images/PDF/Long-term_Finance_hi-res.pdf
- Tappe, A. (2012). "Report indicates tough times for PE ahead". Unquote. 16.11.2012. http://www.unquote.com/unquote/analysis/2225384/report-indicates-tough-times-for-pe-ahead
- UEAPME (2013). UEAPME Newsflash. Issue No. 214. 19.04.2013. http://www.ueapme.com/IMG/pdf/130419_news.pdf
- UEAPME Study Unit (2013). The EU Craft and SME Barometer 2013/H1. March 2013. http://www.ueapme.com/spip.php?rubrique120
- UniCredit (2013). Securitisation Market Watch. Credit Research. 29.04.2013.
- Ushilova, E. and Schmiemann, M. (2011). Access to finance statistics. Data from September 2011. From Eurostat Statistics Explained. October 2011. http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics
- VDB (2012). Stabilität für den Mittelstand. Die deutschen Bürgschaftsbanken 2011. Verbandsbericht. http://www.vdb-info.de/media/file/1919.VDB_Verbandsbericht_2011.pdf

About …

… the European Investment Fund

The European Investment Fund (EIF) is the European body specialised in small and medium sized enterprise (SME) risk financing. The EIF is part of the European Investment Bank group and has a unique combination of public and private shareholders. It is owned by the EIB (62.1%), the European Union - through the European Commission (30%) and a number (25 from 16 countries) of public and private financial institutions (7.9%).

EIF's central mission is to support Europe's SMEs by helping them to access finance. EIF primarily designs and develops venture capital and guarantees instruments which specifically target this market segment. In this role, EIF fosters EU objectives in support of innovation, research and development, entrepreneurship, growth, and employment.

The EIF total net commitments to venture capital and private equity funds amounted to over EUR 6.9bn at end 2012. With investments in over 430 funds, the EIF is the leading player in European venture capital due to the scale and the scope of its investments, especially in the high-tech and early-stage segments. The EIF commitment in guarantees totaled over EUR 4.8bn in close to 255 operations at end 2012, positioning it as a major European SME loan guarantees actor and a leading micro-finance guarantor.

… EIF's Research & Market Analysis

Research & Market Analysis (RMA) supports EIF's strategic decision-making, product development and mandate management processes through applied research and market analyses. RMA works as internal advisor, participates in international fora and maintains liaison with many organisations and institutions.

… this Working Paper series

The EIF Working Papers are designed to make available to a wider readership selected topics and studies in relation to EIF´s business. The Working Papers are edited by EIF´s Research & Market Analysis and are typically authored or co-authored by EIF staff. The Working Papers are usually available only in English and distributed only in electronic form (pdf).

EIF Working Papers

2009/001 *Microfinance in Europe – A market overview.*
November 2009.

2009/002 *Financing Technology Transfer.*
December 2009.

2010/003 *Private Equity Market in Europe – Rise of a new cycle or tail of the recession?*
February 2010.

2010/004 *Private Equity and Venture Capital Indicators – A research of EU27 Private Equity and Venture Capital Markets.* April 2010.

2010/005 *Private Equity Market Outlook.*
May 2010.

2010/006 *Drivers of Private Equity Investment activity. Are Buyout and Venture investors really so different?* August 2010

2010/007 *SME Loan Securitisation – an important tool to support European SME lending.* October 2010.

2010/008 *Impact of Legislation on Credit Risk – How different are the U.K. and Germany?* November 2010.

2011/009 *The performance and prospects of European Venture Capital.*
May 2011.

2011/010 *European Small Business Finance Outlook 1/2011.*
June 2011.

2011/011 *Business Angels in Germany. EIF's initiative to support the non-institutional financing market.* November 2011.

2011/012 *European Small Business Finance Outlook 2/2011.*
December 2011.

2012/013 *Progress for microfinance in Europe.*
January 2012.

2012/014 *European Small Business Finance Outlook.*
May 2012.

2012/015 *The importance of leasing for SME finance.*
August 2012.

2012/016 *European Small Business Finance Outlook.*
December 2012.

2013/017 *Forecasting distress in European SME portfolios.*
May 2013.

2013/018 *European Small Business Finance Outlook.*
June 2013.