



SME financing in Europe

Banks and capital market alternatives



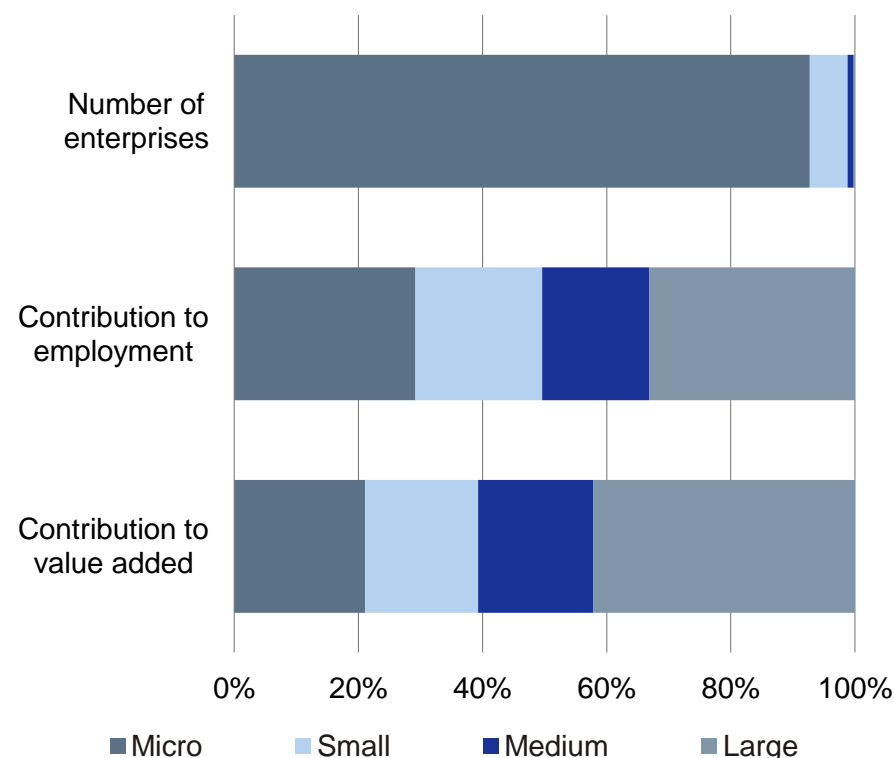
SMEs are the backbone of the EU economy



- There are around 5 SMEs for every km² of land surface in the EU (around 22,3 m. SMEs in total)
- SMEs employ almost 90 million people (two-thirds of total private sector employment)
- Between 2009-2014 SMEs accounted for 85% of new jobs created
- They generate 58% of private sector value added
- In 2014, SMEs' value added grew by 3% and employment by 1%

SMEs are central to the EU economy

as of 2014



Sources: EC, Deutsche Bank Research



Agenda



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SMEs and banks

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Indirect capital market alternatives

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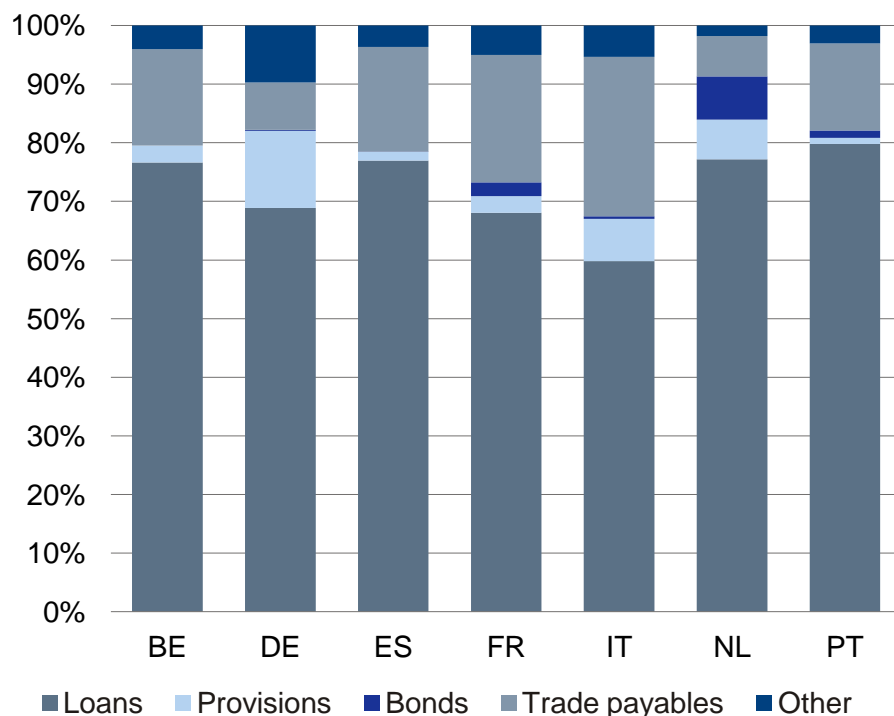
Direct capital market alternatives

Banks are central partners for SMEs, so are SMEs for banks



Loans make up the lion's share of SMEs' balance sheets

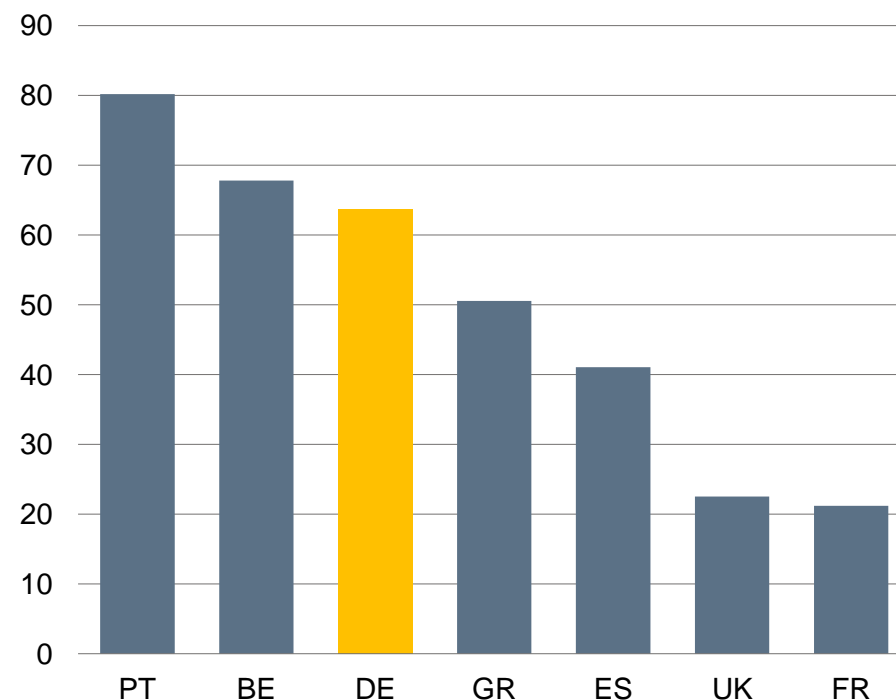
% of liabilities



Sources: Banque de France, Deutsche Bank Research

Share of SME lending in banks' total business lending

%



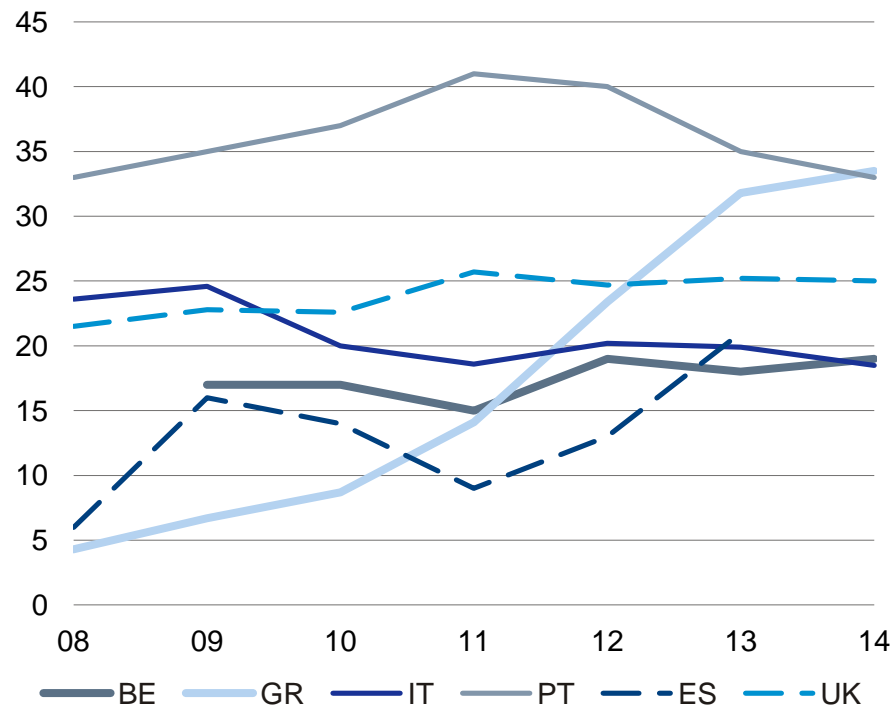
Sources: OECD, Bundesbank, Deutsche Bank Research

Yet, financial crisis has hit both hard. SMEs experience cash flow problems and higher failures...



SMEs' payment delays and ...

average number of days delayed*

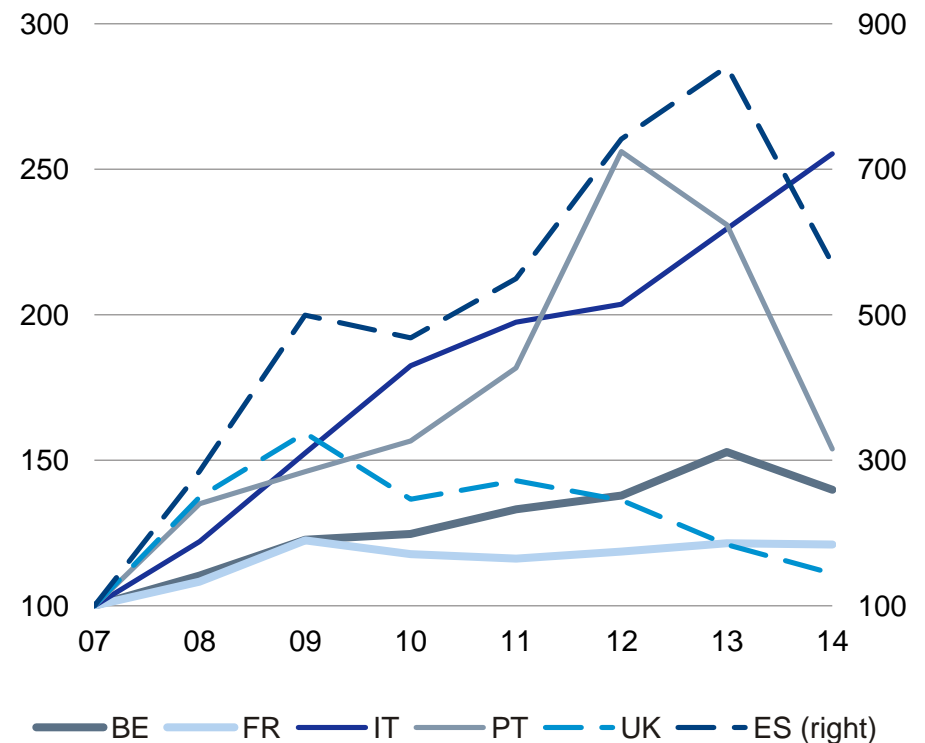


*beyond the contract period for delayed Business-to-Business loans.

Sources: OECD, Deutsche Bank Research

... failures on the rise in the periphery

2007=100



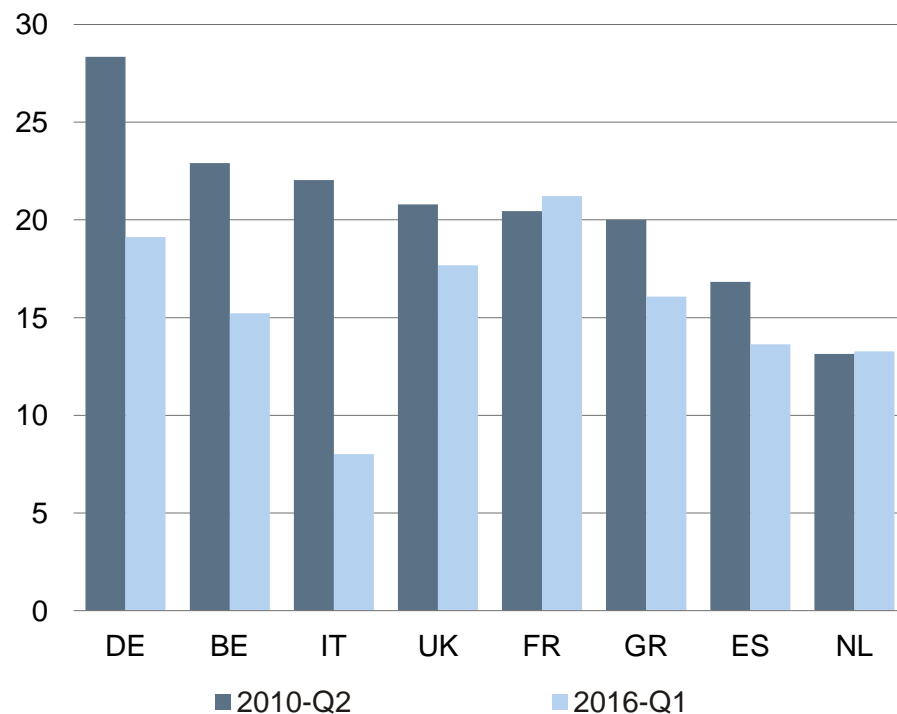
Sources: OECD, Deutsche Bank Research

...while banks are building up capital



European banks' leverage ratio came down significantly

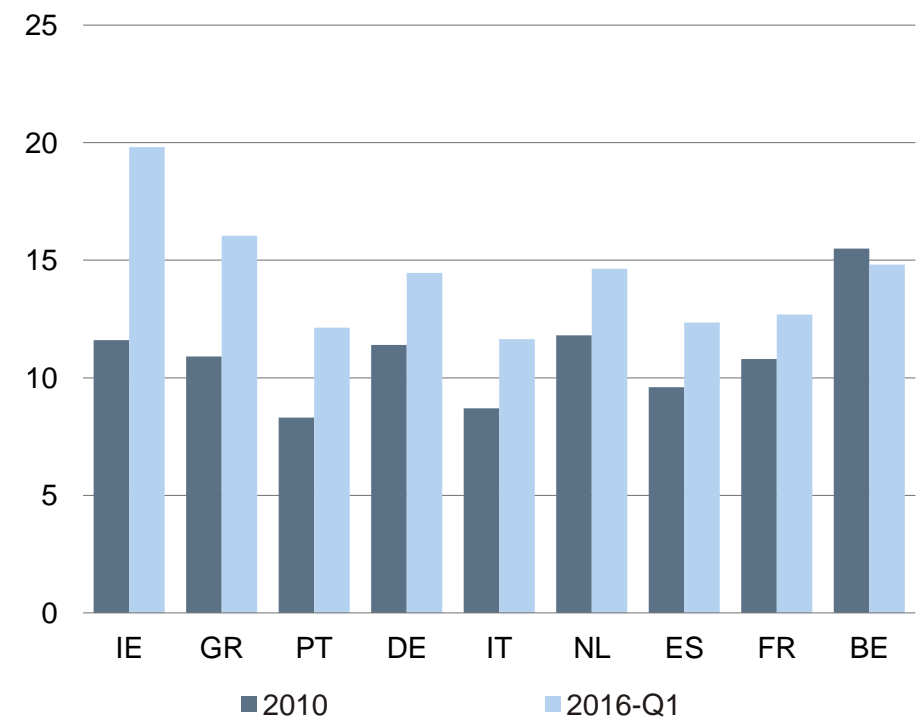
Total assets / equity capital



Sources: ECB, Deutsche Bank Research

European banks are building up capital

Common equity Tier-1 ratio in %



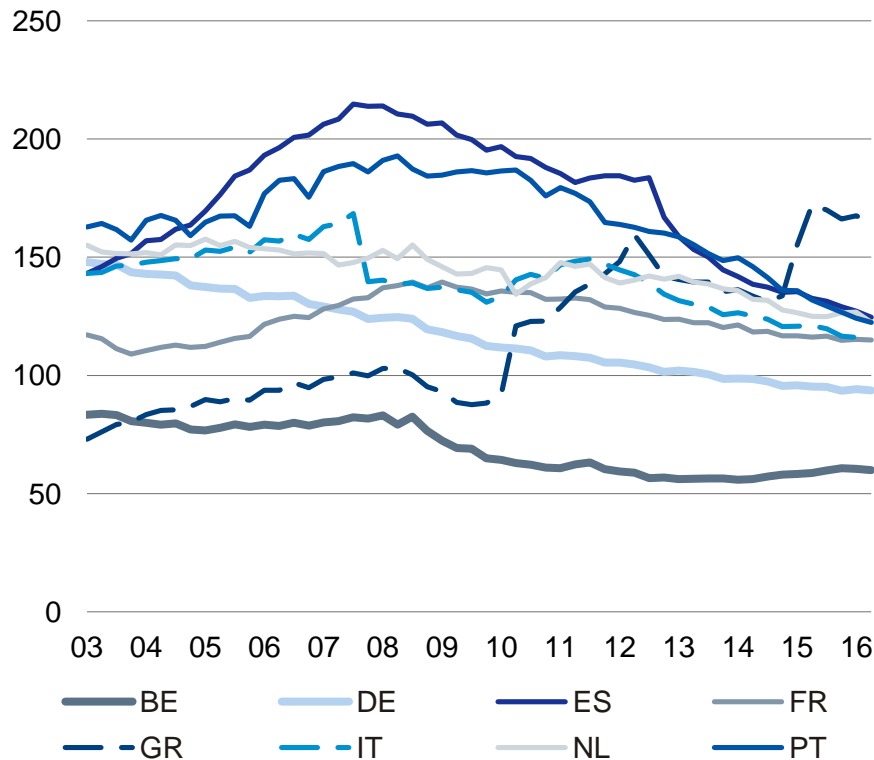
Sources: ECB, Deutsche Bank Research

... they deleverage and hesitate to take on additional risk



Loan-to-deposit ratios

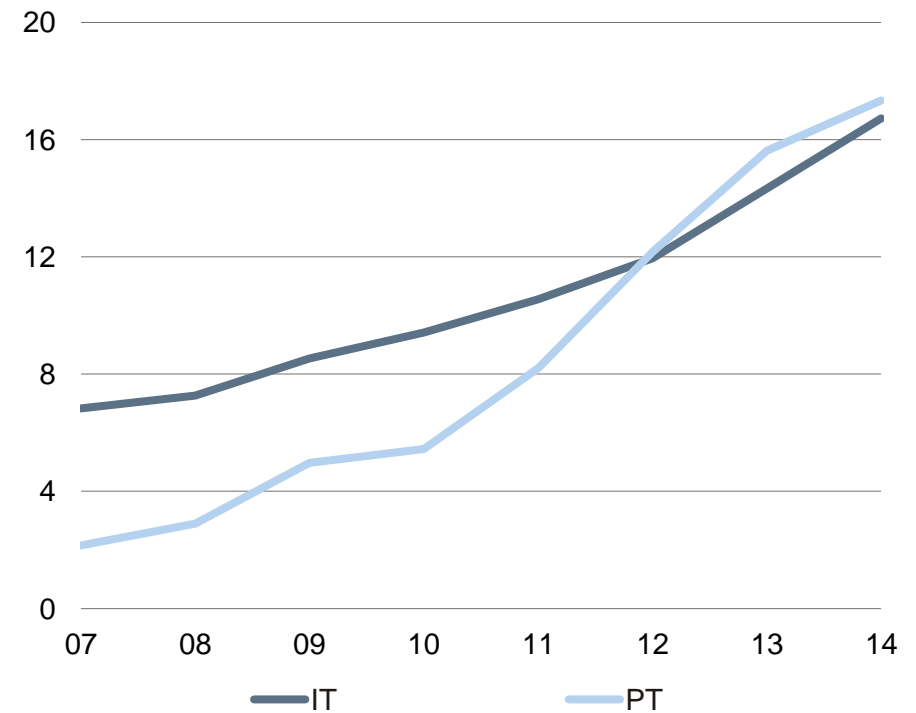
%, business with private sector



Sources: ECB, Deutsche Bank Research

SME NPLs surge in euro area periphery

SME NPLs as a percentage of total SME loans

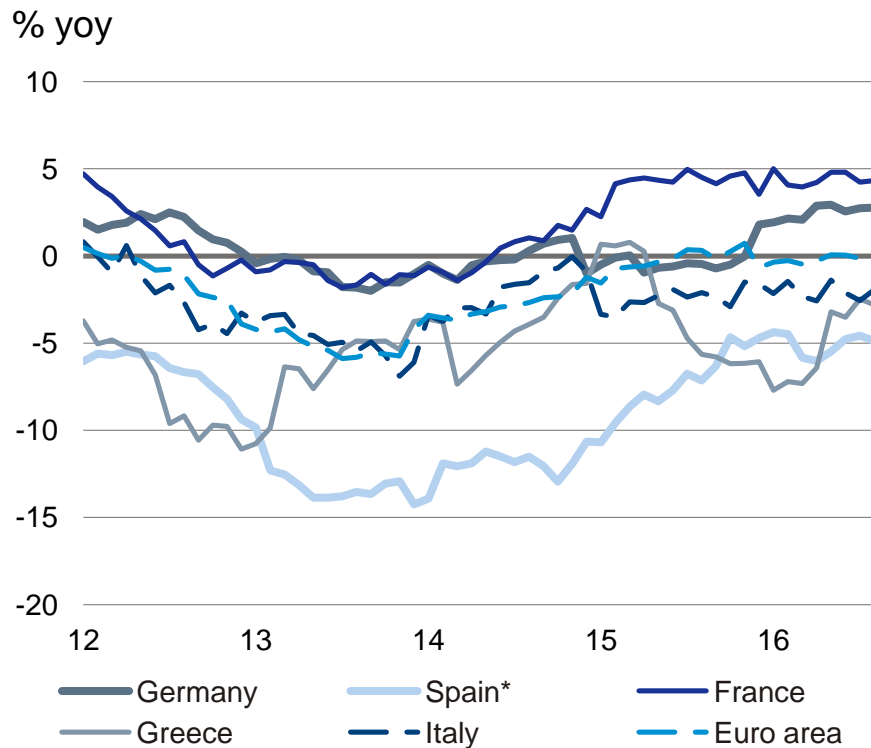


Sources: OECD, Deutsche Bank Research

Lending growth thus remains constrained, despite lending rates coming down remarkably



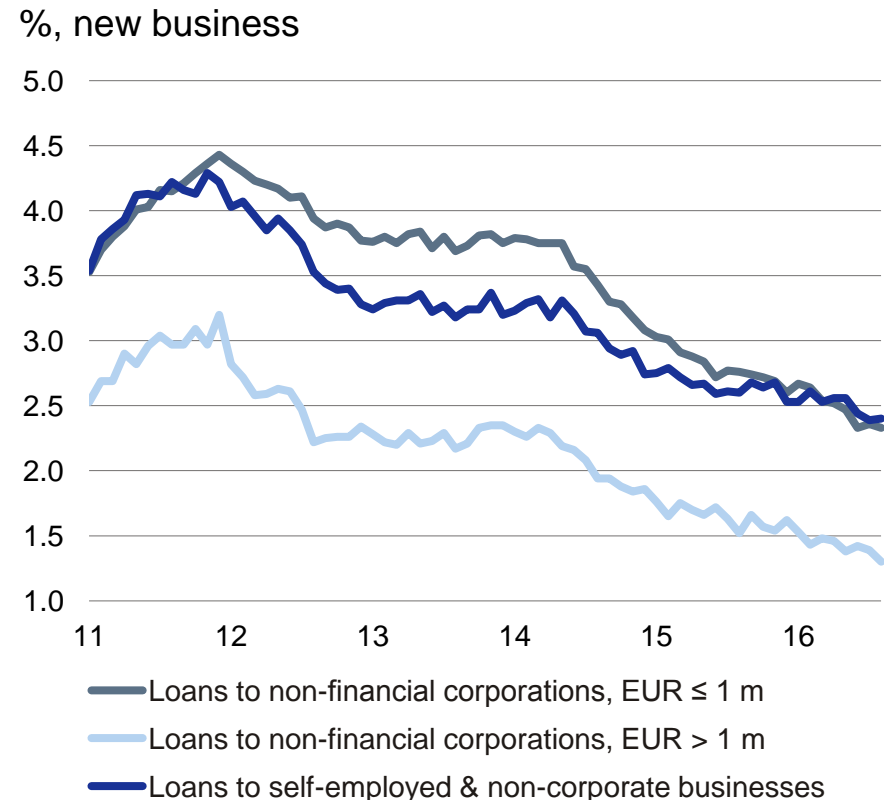
Lending to the private sector in individual countries



* adjusted for a statistical reclassification in December 2012.

Sources: ECB, Deutsche Bank Research

Corporate lending rates in the euro area, by loan size



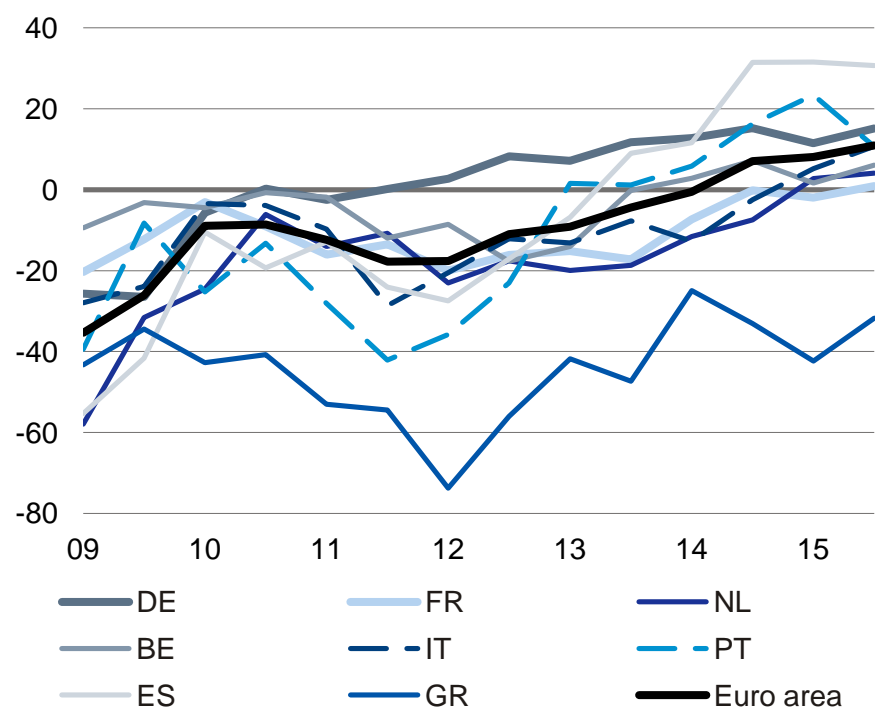
Source: ECB

During the sovereign debt crisis, bank loan availability for SMEs decreased especially in the euro area South



SMEs reporting deterioration in bank loan availability

net percentage*



*increased minus decreased responses

Sources: ECB, Deutsche Bank Research

- Bank loan availability has deteriorated for many SMEs due to
 - bank deleveraging and tighter lending criteria
 - rough macro environment

Can capital market financing be an alternative for SMEs?



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Direct capital market alternatives

SMEs' organisational features and high issuance costs limit their use of public capital markets

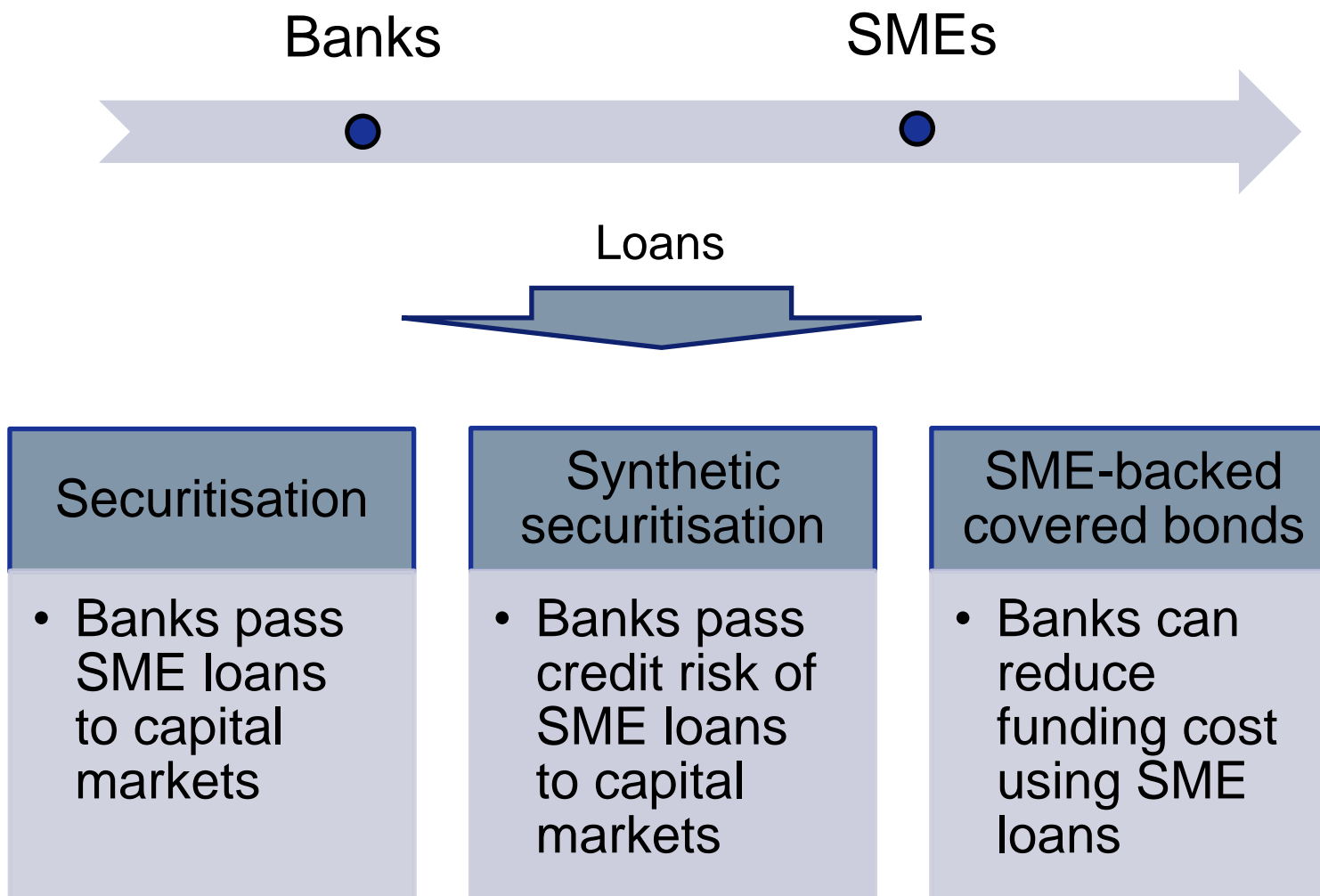


SMEs' survey responses for not accessing capital markets	in % (2012)
Family owned structures and fear of losing control of the company	20
Costs and fulfilment of regulatory requirements during and after an IPO	20
Lack of familiarity with capital markets	15
Shortage of skilled personnel	10
Issuance price, that is the discount applied by the market to the "true" price, is not considered to be fair	10
Self assessment that the company is too small and stock markets are only for large issuers	10
Lack of liquidity in the secondary market	10
Lack of investors and uncertainties about the success of the offering after paying the initial costs of the IPO	5
Sources: OICU-IOSCO, Deutsche Bank Research	



Bank lending will remain central for SME financing...

...therefore measures are necessary that **indirectly** link SMEs to capital markets via banks

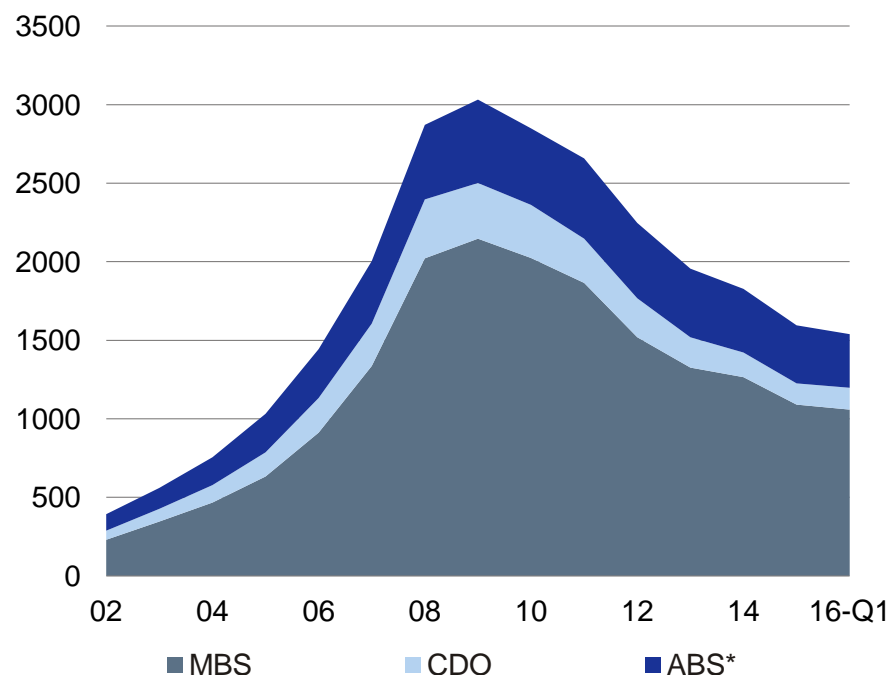


Securitisation market has the potential to bridge the gap between SMEs' funding needs and bank loan availability



Decline of the securitisation market in Europe

Outstanding amounts in USD bn



*includes SME ABS

Sources: SIFMA, Deutsche Bank Research

- Securitisation outstanding came down significantly in Europe:
 - USD 1.5 tr in 2016, down from USD 2.9 tr in 2008
 - ABS that includes SME loans USD 341 bn in 2016, down from USD 531 bn in 2009
- However, quality of EU securitisation market is robust
 - in 2015, structured finance default rates in total in the US 7x larger than in Europe
- Properly regulated securitisation market would help lending to pick up in general

Policy makers recognise the need for revival of the securitisation market in Europe



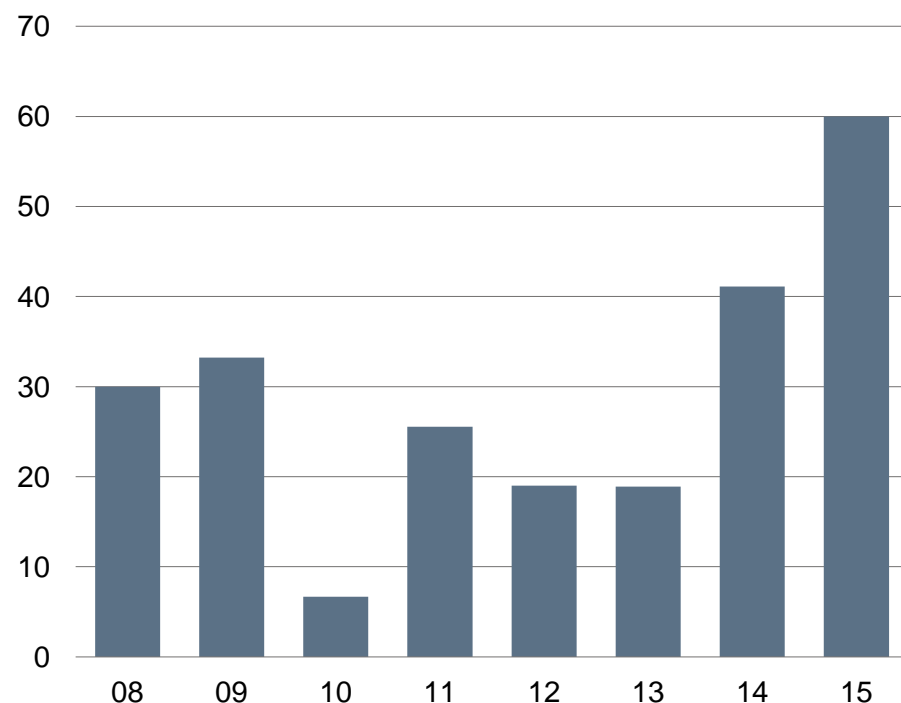
- Two legislative proposals by the European Commission that aim to
 - develop EU-wide framework for simple, transparent and standardised (STS) securitisations
 - amend the Capital Requirements Regulation to make the capital treatment of STS securitisations more attractive for banks and investment firms
- Both measures aim at true-sale securitisation market
 - But SME loans in general are difficult to pack and sell at the capital markets as they are tailor-made and by and large lack a rating
- Synthetic securitisation could address the rating problem
 - Synthetic securitisation refers to securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator institution (Definition as per Article 242(11) of the CRR).

Synthetic securitisation could foster SME lending



Synthetic securitisation issuance in Europe

EUR bn



Sources: EBA, Deutsche Bank Research

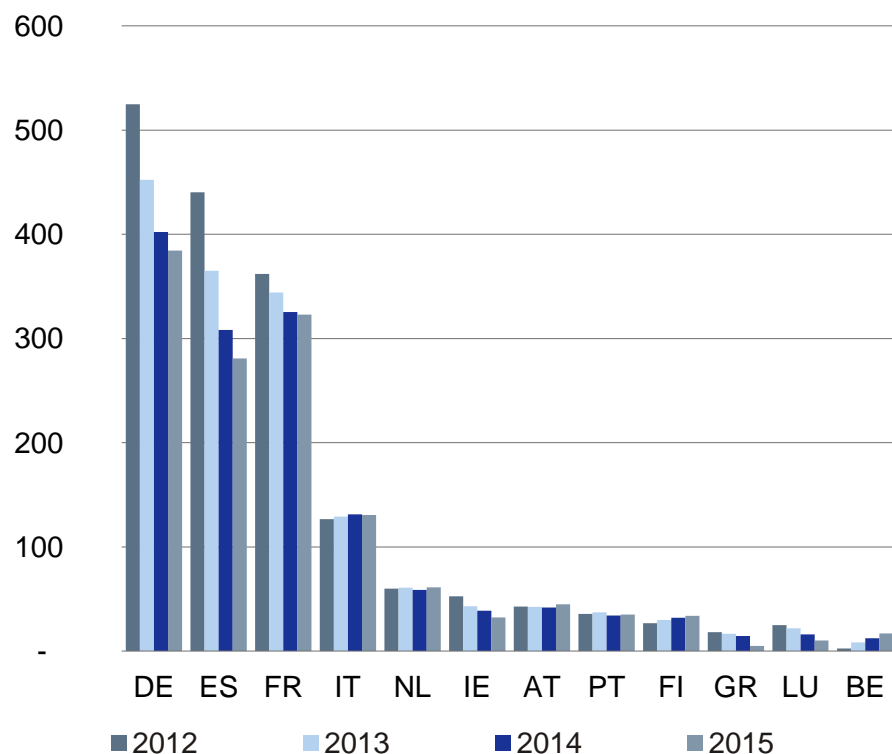
- Synthetic securitisation enables banks to hedge exposures that can not be hedged via true sale securitisation, such as
 - revolving credit facilities, SME loans and trade finance
- Synthetic securitisation has been recovering from the crisis
- Market went OTC in recent years with almost all issuance becoming bilateral

SME-backed covered bonds offer lucrative features to revive lending to SMEs, too



Covered bond outstanding volumes

EUR bn



Sources: European Covered Bond Council, Deutsche Bank

Issuing bank

- Lower funding cost
- But no capital relief

SME-backed covered bond

- Backed by SME loan pool

Bond holder

- Low-risk investment due to dual recourse
- But low yields

Yet statutory shortcomings and adverse market dynamics create impediments



Agenda



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SMEs and banks

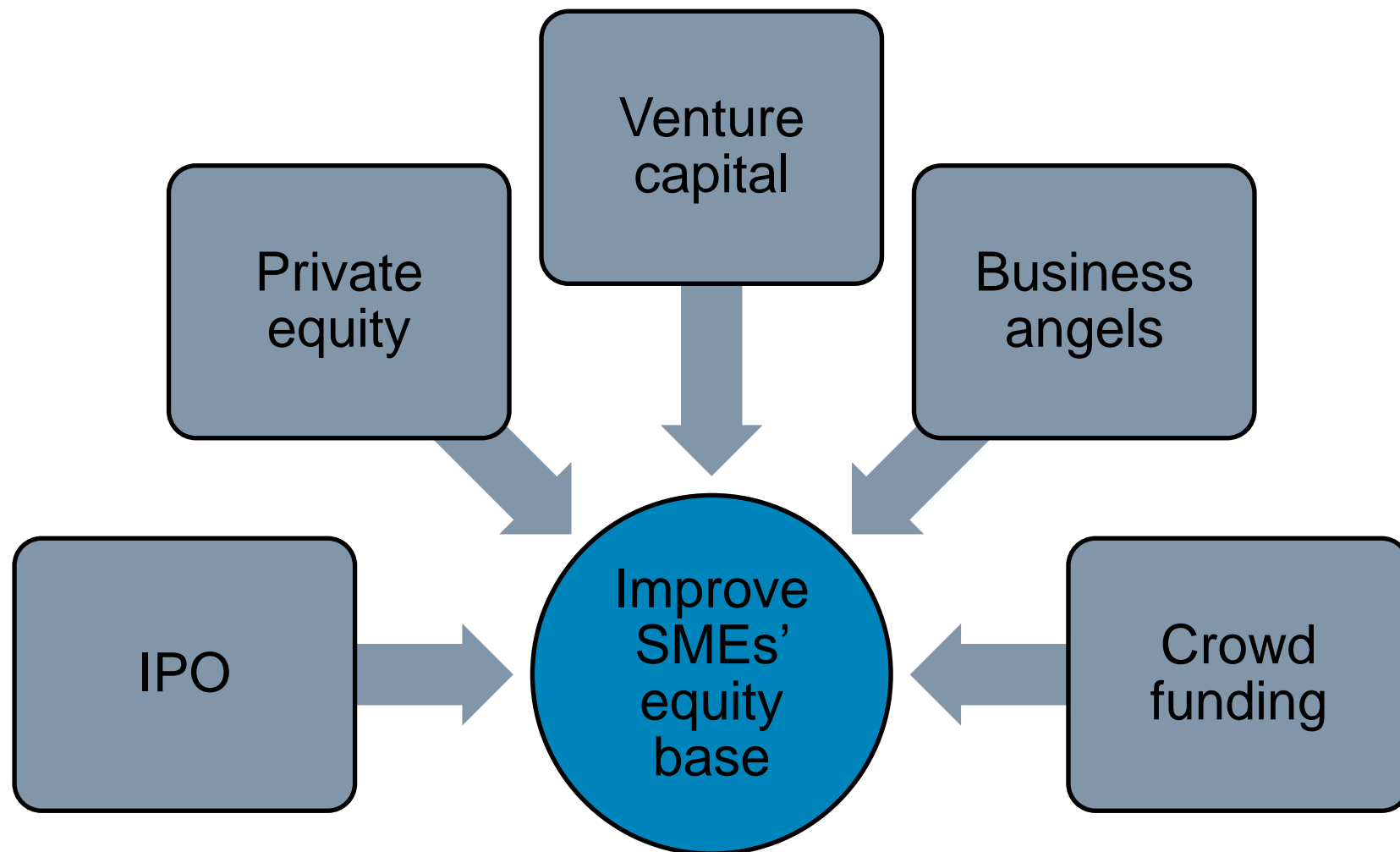
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Indirect capital market alternatives

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Direct capital market alternatives

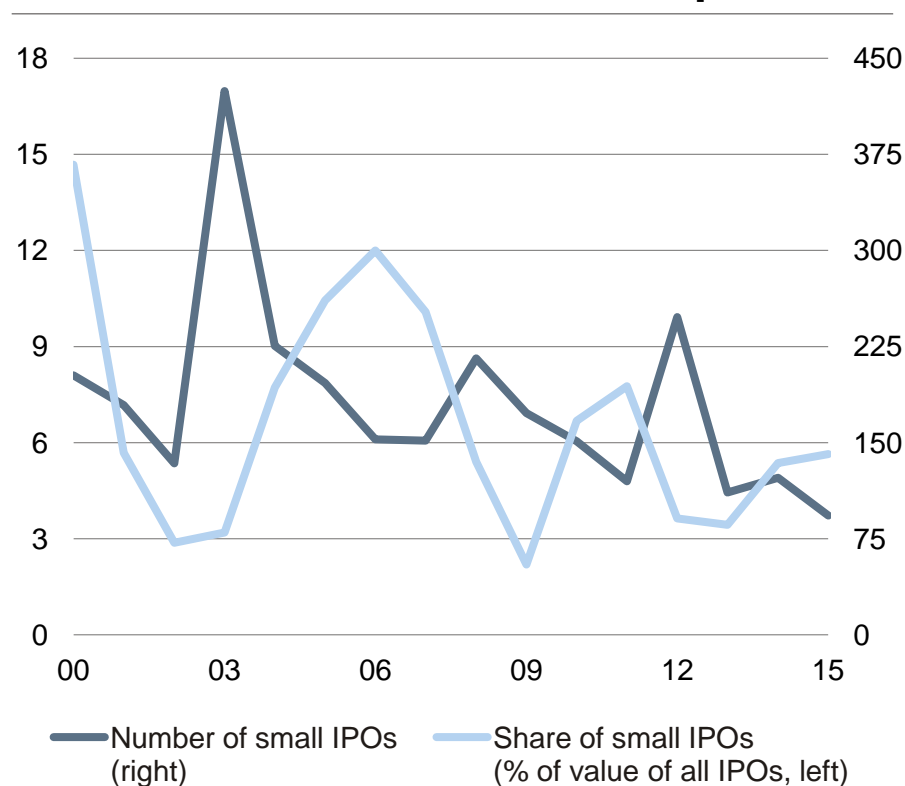
Direct equity injections into SMEs can provide necessary funding and strengthen capital structure



IPOs may help larger SMEs in particular but associated costs create a bottleneck



Decline in small IPOs* in Europe



* IPOs with a volume of less than EUR 50 m.

Sources: Dealogic, Deutsche Bank Research

— Cost of IPOs

- Initial costs
- Underwriting discount
- Exchange listing fees
- Legal, accounting and printing costs
- Road show expenses

— Ongoing costs

- External reporting costs
- Investor relations maintenance costs

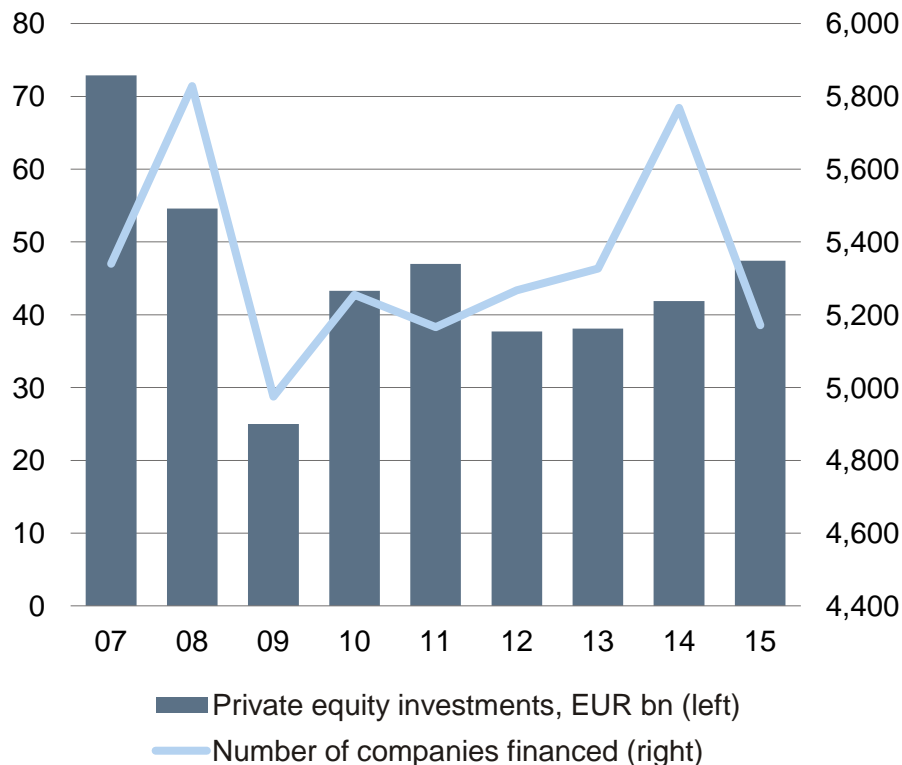
— “SME growth markets” of MiFID II

- Simplified disclosure regime
- ➔ reduce administrative burdens for issuers
- raise visibility and profile of SME stocks

Private equity suited for mid-size firms: Around 85% of European private equity investments are into SMEs



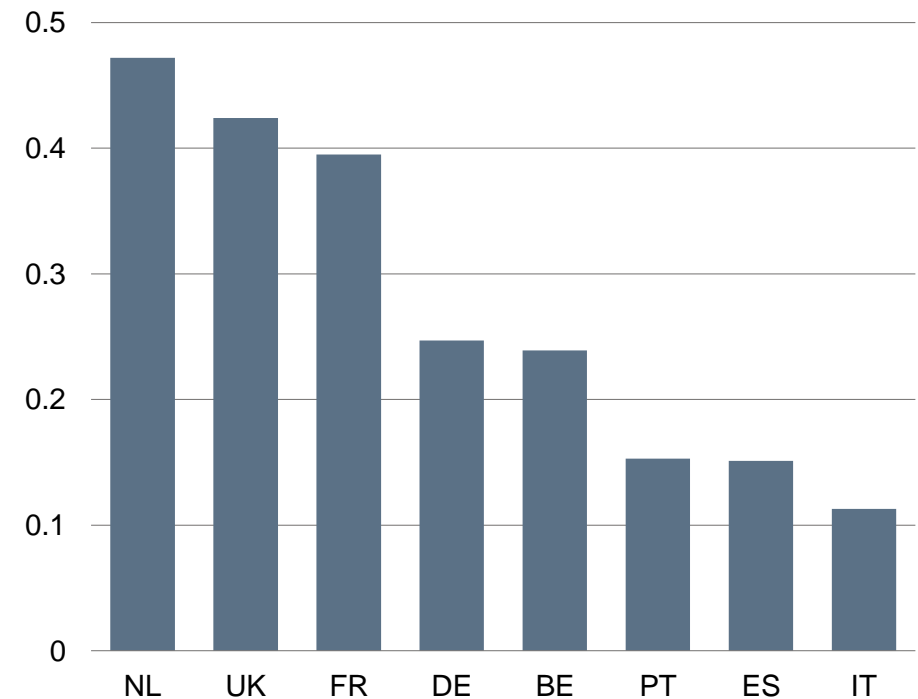
Private equity investments in Europe stagnate



Sources: EIF, Deutsche Bank Research

Private equity investments in individual countries

as a percentage of GDP, 2014



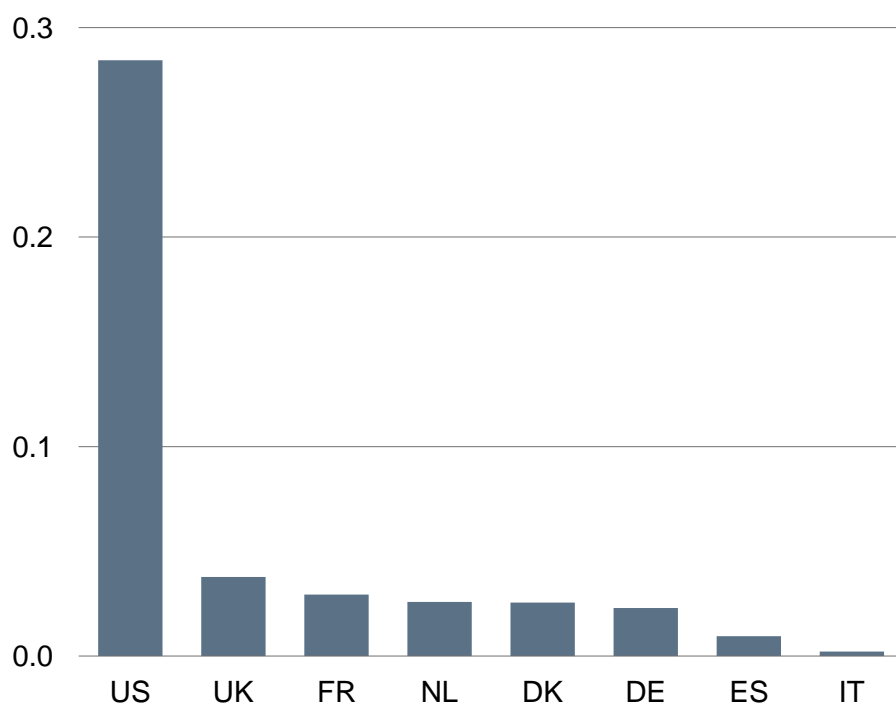
Sources: EC, Deutsche Bank Research

Venture capital investments essential to support young innovative SMEs



Venture capital investments in the US and in individual EU countries

as a percentage of GDP, 2014



Sources: OECD, Deutsche Bank Research

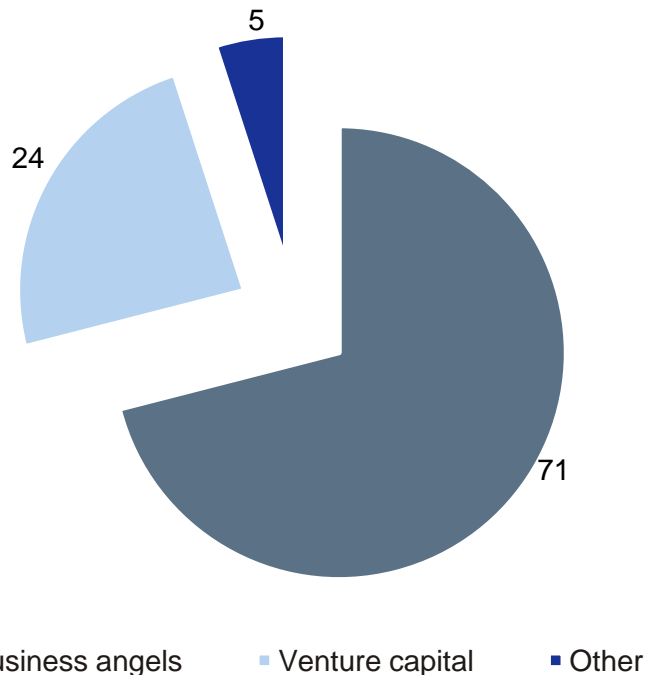
- Venture capital investments (to all firms) in the euro area lagging far behind in an international comparison
- In 2014, VC investments totalled
 - EUR 26 bn (0.28% of GDP) in the US
 - EUR 0.6 bn in Germany
 - In southern countries such as Italy and Spain volumes were almost negligible
- A more active participation by institutional investors such as pension funds, insurance companies is necessary.

Business angels may partly make up for the lack of venture capital funds



Business angels have potential in financing youngest SMEs

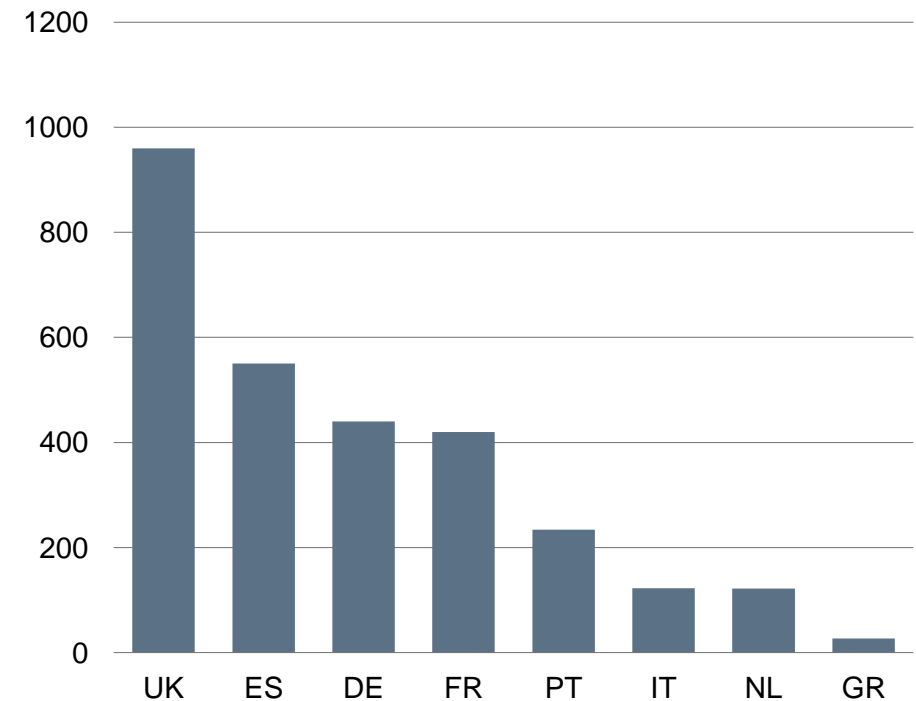
% of investments in European SMEs in their earliest years, 2015



Sources: EIF, Deutsche Bank Research

Business angel investments by country

EUR m, 2015

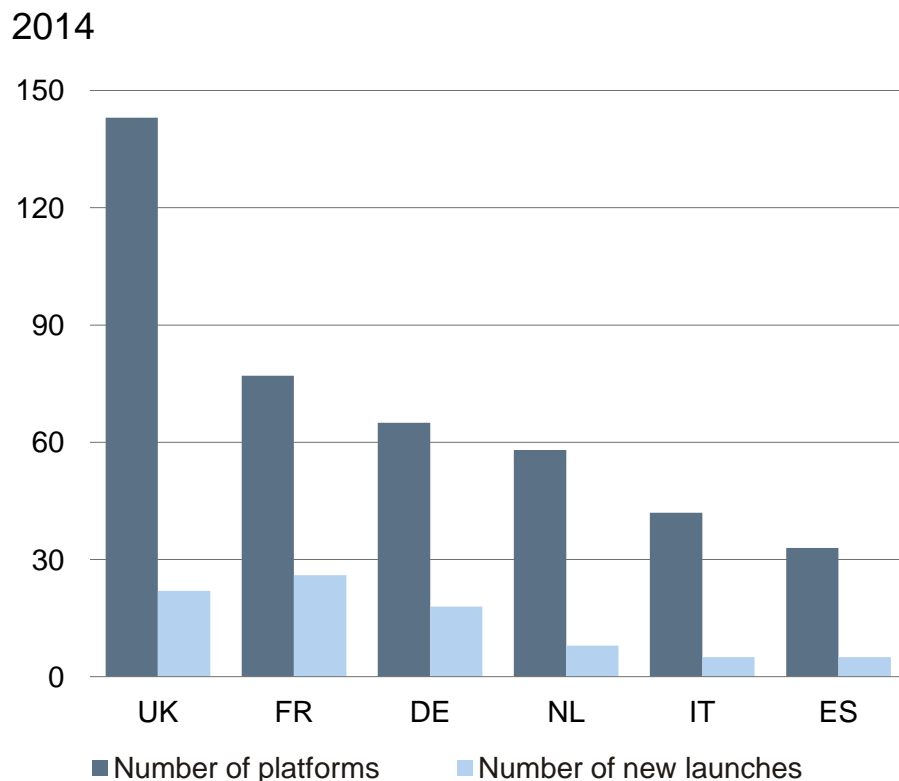


Sources: EIF, Deutsche Bank Research

Crowd funding can provide financing to SMEs and innovative firms in their earliest years



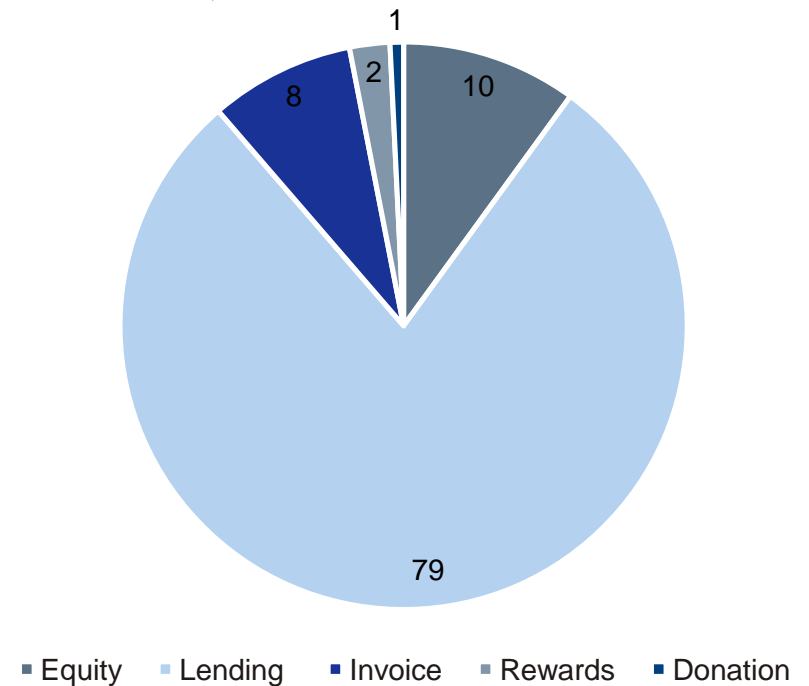
Crowd funding platforms across Europe



Sources: EC, Deutsche Bank Research

Crowd funding is largely about lending

in % of EU total, 2015



Donation includes donations and community shares.
Lending includes loans, bonds and debentures.

Sources: EC, Deutsche Bank Research

Concluding remarks



- SMEs and their financing have pivotal importance for the real economy and sustainable growth after the crisis
- Bank lending will continue to play a central role in SME financing
- That said, indirect and direct capital market alternatives can improve SMEs' access to finance
- Especially the revival of true-sale securitisation market is vital for indirect capital market funding of SMEs. Synthetic securitisation and SME-backed covered bonds could foster SME lending, too
- SMEs' equity base should be strengthened as well. Measures that reduce issuance costs would probably trigger more small IPOs. Increased private equity, venture capital and business angels investments may improve SMEs' access to finance, too

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