SME FINANCING: THE ROLE OF ALTERNATIVE INSTRUMENTS

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Outline

- Recent trends in SME financing
- The role of finance instruments other than straight debt
- Challenges and policy responses for the wider uptake of alternative sources of finance for SMEs
Recent trends in SME financing

- Annual flagship publication that aims to improve the evidence base on SME finance
- Data on debt, credit costs and conditions, asset-based financing, VC investments, and the financial health of SMEs
- Information on policies and programmes
- 43 participating countries
- Official data from ministries, central banks, statistical offices, sector organisations
- Network of experts
Credit conditions have been improving

Interest rates charged to SMEs 2013 (blue) and 2016 (orange)

Other indicators also point to improvements in credit conditions:
- **Loan rejection data**
- **Demand-side surveys** (number of SMEs stating access to finance as a major problem)
- **Supply-side surveys** (with senior loan officials)

Yet new loans to SMEs have declined in many countries

New loans to SMEs

data: year-on-year growth rate (%) between 2015 and 2016, adjusted for inflation

SMEs are reducing their dependence on short-term lending

The share of short-term SME loans as a proportion of all SME loans

As a percentage

Outline

- Recent trends in SME financing

- The role of finance instruments other than straight debt

- Challenges and policy responses for the wider uptake of alternative sources of finance for SMEs
There is a broad range of alternative instruments with potential to finance SMEs.

<table>
<thead>
<tr>
<th>Low Risk/Return</th>
<th>Low Risk/Return</th>
<th>Medium Risk/Return</th>
<th>High Risk/Return</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset-Based Finance</strong></td>
<td><strong>Alternative Debt</strong></td>
<td><strong>“Hybrid” Instruments</strong></td>
<td><strong>Equity Instruments</strong></td>
</tr>
<tr>
<td>• Asset-based lending</td>
<td>• Corporate Bonds</td>
<td>• Subordinated Loans/Bonds</td>
<td>• Private Equity</td>
</tr>
<tr>
<td>• Factoring</td>
<td>• Securitised Debt</td>
<td>• Silent Participations</td>
<td>• Venture Capital</td>
</tr>
<tr>
<td>• Purchase Order Finance</td>
<td>• Covered Bonds</td>
<td>• Participating Loans</td>
<td>• Business Angels</td>
</tr>
<tr>
<td>• Warehouse Receipts</td>
<td>• Private Placements</td>
<td>• Profit Participation Rights</td>
<td>• Specialised Platforms for Public Listing of SMEs</td>
</tr>
<tr>
<td>• Leasing</td>
<td>• Crowdfunding (debt)</td>
<td>• Convertible Bonds</td>
<td>• Crowdfunding (equity)</td>
</tr>
</tbody>
</table>

Sources of finance other than straight debt are becoming more widely used.

New production in leasing and hire purchases
year-on-year growth rate (%) adjusted for inflation

Factoring volumes, VC investments and online alternative finance instruments were also up in 2016.

Private equity and debt markets are expanding, including in Europe

**Private equity (USD billion)**

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<thead>
<tr>
<th></th>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>80</td>
<td>87</td>
<td>95</td>
<td>176</td>
<td>189</td>
<td>168</td>
<td>199</td>
</tr>
<tr>
<td>Europe</td>
<td>40</td>
<td>44</td>
<td>64</td>
<td>86</td>
<td>77</td>
<td>70</td>
<td>116</td>
</tr>
<tr>
<td>Asia</td>
<td>36</td>
<td>54</td>
<td>42</td>
<td>37</td>
<td>58</td>
<td>37</td>
<td>40</td>
</tr>
<tr>
<td>Rest of world</td>
<td>16</td>
<td>17</td>
<td>18</td>
<td>12</td>
<td>15</td>
<td>12</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>172</td>
<td>202</td>
<td>219</td>
<td>311</td>
<td>339</td>
<td>287</td>
<td>364</td>
</tr>
<tr>
<td>Global un-invested capital (&quot;dry powder&quot;)</td>
<td>622</td>
<td>601</td>
<td>565</td>
<td>666</td>
<td>695</td>
<td>752</td>
<td>869</td>
</tr>
</tbody>
</table>

**Private debt (USD billion)**

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>31</td>
<td>36</td>
<td>37</td>
<td>47</td>
<td>54</td>
</tr>
<tr>
<td>Europe</td>
<td>13</td>
<td>18</td>
<td>18</td>
<td>23</td>
<td>31</td>
</tr>
<tr>
<td>Asia</td>
<td>3</td>
<td>8</td>
<td>1</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>47</td>
<td>62</td>
<td>56</td>
<td>73</td>
<td>90</td>
</tr>
</tbody>
</table>

Source: Prequin in Thompson and Boschmans (forthcoming), OECD SME and Entrepreneurship Papers
Online alternative financing instruments are rising fast, often from a low basis.

Total volume of alternative finance raised through digital platforms, selected countries and regions, in billion USD

Crypto-assets and ICOs are gaining prominence, but the future is uncertain.

Source: IMF, Global Financial Stability Report April 2018: A Bumpy Road Ahead April 2018
Outline

- Recent trends in SME financing
- The role of finance instruments other than straight debt
- Challenges and policy responses for the wider uptake of alternative sources of finance for SMEs
Challenges persist to the wider take-up of these instruments by SMEs

<table>
<thead>
<tr>
<th>POLICY OBSTACLE</th>
<th>MAIN AREA OF CONSTRANTS</th>
<th>POTENTIAL POLICY ACTION</th>
<th>STRUCTURAL MEASURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demand-side</td>
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</tbody>
</table>
| Lack of awareness, negative perceptions and inability to access alternatives to bank finance | • Consider a national strategy to foster financial literacy, ideally with a specific focus on SMEs  
• Develop financial education programmes for entrepreneurs and would-be entrepreneurs, including through incubators  
• Develop investor-readiness programmes | • Address the fragmentation of SME financial markets |
| Lack of financial skills and vision | • Enhance SME financial skills and strategic vision by offering advisory services to improve accounting, financial management and overall business development  
• Complement the provision of financial support to SMEs with non-financial elements such as counselling and monitoring | • Improve the liquidity and scale of markets (thin markets problem) |
| Disadvantageous tax treatment of equity instruments | • Encourage tax neutral regulation  
• Support a range of financing instruments for SMEs, e.g. via tax deductibility for innovative start-ups that participate in entrepreneurship trainings or in incubator programmes | • Help to develop an SME finance ecosystem |
| Opacity of the SME market | • Improve transparency and provide targeted information, e.g. by credit registries or bureaus for SMEs and rating services going beyond collateral and historical financial information  
• Identify SME financing needs and gaps and improve the evidence base | • Create links and matchmaking services between (potential) investors, entrepreneurs and large companies |
| Supply-side     |                         |                         |                     |
| Regulatory ambiguity or barriers to entry in the SME market | • Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection | • Monitor and evaluate public policies in this area |
| Limited exit options | • Lower the costs of IPOs  
• Introduce measures that reduce the length of time between investing and exiting  
• Considering the needs of equity investors when designing regulation |                     |

G20/OECD High-Level Principles on SME Financing

1. Identify SME financing needs and gaps and improve the evidence base.
2. Strengthen SME access to traditional bank financing.
3. **Enable SMEs to access diverse non-traditional financing instruments and channels.**
4. Promote financial inclusion for SMEs and ease access to formal financial services, including for informal firms.
5. Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection.
6. Improve transparency in SME finance markets.
7. Enhance SME financial skills and strategic vision.
8. Adopt principles of risk sharing for publicly supported SME finance instruments.
9. Encourage timely payments in commercial transactions and public procurement.
10. Design public programmes for SME finance which ensure additionality, cost effectiveness and user-friendliness.
Common and other approaches

– Tax incentives to encourage investments in SMEs – large variations in the level of the tax incentive and in eligibility criteria
– Information programmes to increase SME awareness and understanding of various financing options, through seminars and/or brochures/websites
– Promotion of factoring of electronically recorded monetary claims and supply-chain finance electronic platforms
– Accelerators or incubators to improve SMEs’ investor-readiness
– Adapted requirements for issuing debt or listing
– Provision of equity funding either directly through public financial institutions or indirectly through funds (private equity or venture capital funds, business angels)
– Framework in place mostly for equity crowdfunding, with limitations for both the issuer and the investor

Innovative approaches

– Services matching SMEs with finance providers and investors
Regulatory issues influence the development of online alternative finance instruments.

How to balance consumer/investor protection and financial stability with financial innovation?

- Development of dedicated regulatory framework more suitable to (equity) crowdfunding activities, with adapted due diligence and information requirements, restrictions, prospectus and registration exemptions.

- Regulatory sandboxes to regulate and supervise Fintech activities.
The regulatory landscape on ICOs is fragmented

- ICOs banned
- Moderate regulation
- Guidelines issued
Areas for further research

• More harmonised data and evidence on trends in alternative instruments, also in combination with traditional instruments
• Classification and a clear terminology on crypto-assets
• The potential of these instruments to address SME finance gaps
• The drivers and determinants of take-up of different financial instruments by SMEs
• Options for regulatory and supervisory approaches
• Innovative policy options to stimulate these markets
THANK YOU!

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