EFA GROUP

FUNDING THE SME GAP

Creating Opportunities for Businesses and Investors

By Gerry Afentakis

Head of Strategic Development, EFA Group

www.efa-group.net

September 2017

EXECUTIVE SUMMARY

In virtually every economy in the world, small and medium enterprises (SMEs) serve as the engines of growth

While the World Bank estimates SMEs contribute to more than 50% of jobs and account for over 35% of GDP in many emerging markets[1], SMEs globally identify “lack of financial resources”[1] as the number one impediment to sustaining or growing their businesses.

Furthermore, the trend is getting worse with SMEs being increasingly underserved by financial institutions.

This has created a need for alternative sources of capital to fill the funding gap. Businesses are turning to non-bank financiers, such as funds, to supplement their access to capital.

For investors, this is good news. With the proper execution, providing liquidity to robust SME businesses via direct-lending vehicles not only generates outperforming and uncorrelated return, but contributes to the growth of these corporates and their respective economies as a whole.

Content

FACTORS CONTRIBUTING TO THE FUNDING GAP

Unmet demand for trade finance estimated at over USD1.6 Trillion

Banks' Appetite

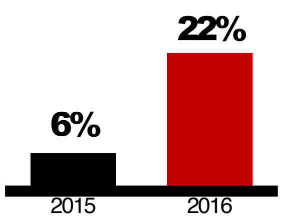
In the United Kingdom, recent Bank of England statistics show that lending to Britain's SMEs by the largest UK banks contracted by £536 million from December 2016 to January 2017[2]. This financing gap is also reflected in the latest global survey in trade finance by the International Chamber of Commerce where 255 banks from 98 countries identified that there is presently more demand than supply for trade finance, with current unmet demand estimated at over USD1.6 trillion. 46% of the same respondents also admitted to favoring multinational and large corporates as their highest priority clients[3].

Regulatory Pressure

Banks, the traditional providers of capital, are facing mounting regulatory and compliance pressure which is leading them to cut back on otherwise healthy lending activity. For example, the new International Financial Reporting Standard (IFRS) set to be implemented in January 2018 will require financial institutions to make higher loan-loss provisions on receivables and loans. This will likely translate to an increased 'cost-of-risk' resulting in some client segments or parts of the banks' business becoming less profitable. Banks can accordingly be expected to take a more cautious stance in their loan portfolios, further exacerbating the funding gap for SMEs.

Global Dynamics

While this trend is certainly a global one, selected regions and countries experience their own dynamics.



SMEs having difficulty coping with the cost of financing

In Singapore, the percentage of SMEs with financing issues rose to 22%, an increase from 14% the previous year. The number of SMEs having difficulty coping with the cost of financing has also leapt from 6% to 22%[4].

> "In India, strong mid-tier companies selling services and technology to international customers, have seen their ability to grow stymied by the working capital bottlenecks of long-payment cycles and an exclusion from the mainstream financial system or other credit providers,"
>
> ***Rohit Goyal****, Deputy Head of Receivables and Supply Chain Finance at EFA Group*

Razvan Mondoca, Regional Head of Structured Trade and Commodity Finance at EFA Group reports, "In Turkey, the ability to raise working capital finance from banks is contingent on the borrowers' asset base, and particularly their real estate holdings. Without robust fixed asset collateral, many healthy and growing SMEs are excluded from fully realizing their competitive advantage as they just can't access the capital they need."

The same is true in the commodity sector. Since the global financial crisis and more recent European banking crisis, global banks have contracted their commodity finance business, choosing to shave their exposures to small and medium sized corporates in favour of the larger global commodity firms.

NON-BANK FINANCIAL INSTITUTIONS FILLING THE GAP

Unburdened by the same regulatory and balance sheet issues, the financing gap is being increasingly filled by non-bank financiers with origination, structuring and credit capabilities on par with conventional lenders. Via commodity trade finance, receivable and supply chain financing, senior loan syndications, repo transactions, and long-term asset-backed lending, non-banking financial institutions have the agility and skill set to allocate to varying financing requirements across geographies.

Speed of execution has become another pertinent factor. Xavier de Nazelle, Head of Corporate and Asset-Based Finance for EFA Group recalls a borrower in the mining and processing sector who was working with their bank to finance the purchase of a dredger.

“There was a tight timeline to complete this purchase. But as the deadline approached it became clearer the bank was not going to be able to fund the transaction. With just a month left to complete the purchase, the borrower approached us to seek financing for the acquisition, and we saw the opportunity to provide capital for the acquisition of a quality asset within a very robust collateral and security structure of our making. We also understood the time-sensitivities involved and with the borrower’s transparency, fluid sharing of information, and professionalism, we were able to complete the due diligence and approval process swiftly to provide the financing they needed on time.”

The next few years will likely see a trend of alternative financiers leveraging their specialized expertise and transforming themselves into providers of capital across the credit spectrum.

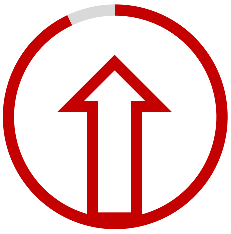
By building on their internal infrastructure and taking the right opportunities that arise from the banks’ withdrawal or inability to support businesses, such alternative providers of capital can enable the growth of SMEs when they need it most.

THE OPPORTUNITY FOR INVESTORS

Simultaneously investors are also acknowledging the private debt opportunity and putting their capital to work

$595bn

Assets under management in the private debt industry have quadrupled since 2006, reaching USD595 billion as at June 2016. As of February 2017, there were 286 private debt funds in market, of which 129 were focused on direct lending[5].



93%

A resounding 93% of investors surveyed felt that their private debt investments met or exceeded their expectations in 2016.

60%

Almost 60% of existing investors plan to commit more capital to the asset class this year[5].

Private debt, in particular direct lending strategies, have been consistently yielding market-neutral returns that have been unaffected by the macroeconomic environment of the day or volatility of other asset classes. For pension funds, insurance companies and other institutional investors seeking long-term, stable and consistent return this makes for an attractive investment opportunity.

Underlying everything is the premise that providing liquidity to strong, growing, well-managed yet capital-starved mid-sized companies generates outperforming and uncorrelated returns to allocators of this asset class.

At the same time, this gives the opportunity for investors to contribute not only to the growth of these corporates, but also to the economies in which they reside.

CONTACT

To find out more about the private debt opportunity, reach out to the Investor Relations team at:

investor.relations@efa-group.net

REFERENCES

[1] **World Bank Group,** *What's Happening In the Missing Middle: Lessons from Financing SMEs*, 2017
[2] **www.altfi.com,** *A Quiet Crash in Big Bank Lending?*, 2017
[3] **International Chamber of Commerce,** *2017 Rethinking Trade & Finance*, 2017
[4] **DP Information Group,** *2016 SME Development Survey*, 2016
[5] **Preqin,** *2017 Preqin Global Private Debt Report*, 2017

© EFA Group, September 2017. All rights reserved.