



OECD SME and Entrepreneurship Papers No. 2

Alternative Financing
Instruments for SMEs
and Entrepreneurs: The
Case of Mezzanine Finance

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<https://dx.doi.org/10.1787/3709429e-en>

Unclassified

CFE/SME(2012)9/FINAL

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

08-Feb-2013

English - Or. English

CENTRE FOR ENTREPRENEURSHIP, SMEs AND LOCAL DEVELOPMENT

Alternative Financing Instruments for SMEs and Entrepreneurs: the Case of Mezzanine Finance

Final Report

This document contains the final report on "Alternative Financing Instruments for SMEs and Entrepreneurs: the Case of Mezzanine Finance". The report is part of the WPSMEE Programme of Work and Budget for 2011-2012 in the area of SME and entrepreneurship financing. This report has been declassified under the written procedure.

The report was prepared by John Thompson, CFE consultant, and the Secretariat.

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JT03334358

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ABSTRACT

OECD governments have long assigned a high priority to improving conditions for access to finance for new, innovative and fast-growing SMEs and established firms pursuing expansion.

This report analyses the potential and challenges of mezzanine finance for addressing diverse financing needs of SMEs and entrepreneurs, highlighting the advantages and costs in relation to other financing techniques. It is the first in a broader series of studies to map and analyse the full range of financing instruments for SMEs alternative to traditional bank credit. It describes the types of SMEs – or stages in their life cycle – for which mezzanine finance is best suited and the ways in which it is used to finance SMEs, comments on the evolution of mezzanine finance in the wake of the financial crisis, and analyses policy approaches to support its broader use.

JEL codes: G20, G23, G28, G32

Keywords: SME Finance, Financial Crisis, Mezzanine Finance, Growth Finance, Public Programmes

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EXECUTIVE SUMMARY

OECD governments have long assigned a high priority to improving conditions for access to finance for new, innovative and fast-growing SMEs and established firms pursuing expansion. Traditional financing techniques, based mainly upon debt and guarantees, have only limited capability for such dynamic firms. Furthermore, capital gaps also exist for companies seeking to effect important transitions in their activities, such as ownership and control changes, as well as for SMEs seeking to de-leverage and improve capital structures. This report discusses the limitations of debt financing and introduces the range of non-bank financing instruments available to SMEs and entrepreneurs, proposing an in-depth focus on the technique of mezzanine finance. This has proven effective in supplying “growth capital” for precisely the above mentioned purposes in some OECD countries and has potential for wider usage. Moreover, in the post-2007 environment of tight bank credit, the authorities of many OECD countries are considering measures to promote the wider use of this technique to enable SMEs to have adequate financing in appropriate forms.

This report analyses the potential and challenges of mezzanine finance for addressing diverse financing needs of SMEs and entrepreneurs, highlighting the advantages and costs in relation to other financing techniques. It is the first in a broader series of studies to map and analyse the full range of financing instruments for SMEs alternative to traditional bank credit. It describes the types of SMEs – or stages in their life cycle – for which mezzanine is best suited and the ways in which it is used to finance SMEs, while considering the possibilities for the public sector to support its broader use. The main sources of information for the report are 1) publicly available information; 2) interviews with market participants, officials involved in mezzanine programmes and independent analysts; and 3) replies by country officials to the *OECD Questionnaire on Seed, Early and Later Stage Finance*¹.

“Mezzanine finance” is a generic term for financing techniques that incorporate elements of debt and equity in a single investment vehicle. A typical mezzanine facility combines several financing instruments of varying degrees of risk and return, such as subordinated debt, profit participation certificates and equity warrants. It differs from “straight debt” finance, in that it implies greater sharing of risk and reward between the user of capital and the investor. However, the risk and the expected return are lower than for “pure” equity. In the event of bankruptcy, mezzanine investors have lower rankings than other creditors, but higher rankings than “pure” equity investors. Inasmuch as recourse to mezzanine finance requires the firm to pay interest, mezzanine finance is most relevant in a later (expansion) phase of the firm, usually when a firm with positive cash flow is approaching a turning point in its development. For companies looking for an injection of capital to grow an already successful business without giving up control, mezzanine financing can be an appropriate solution.

¹ The Questionnaire was developed in collaboration with the OECD Economic Policy Committee and the OECD Committee on Industry, Innovation and Entrepreneurship.

Mezzanine finance complements rather than replaces other forms of finance. Mezzanine finance is considered equivalent to an increase in equity by banks and other traditional lenders, offering greater scope for additional straight debt. Similarly, mezzanine finance can be used in conjunction with various forms of equity finance, such as private equity, venture capital, business angels, or listing on an exchange or similar trading platform.

There is a well-developed “commercial” market in mezzanine finance that has functioned for more than two decades with minimal public involvement. Commercial mezzanine finance takes place only in the private capital market, which is restricted to professional and institutional investors. Investors include high net worth individuals, family offices, insurance companies and savings and loan associations, pension funds, hedge funds, and banks with specialised mezzanine subsidiaries. Generally, mezzanine investors hold positions for relatively long periods. Unlike venture capitalists and business angels, the mezzanine financier holds only a small part of a company’s equity and does not seek to participate actively in the running of the company.

The largest share of commercial mezzanine finance is extended to larger companies, usually as part of a leveraged buy-out (LBO). However operations of this kind are not considered in this report.

Policy makers in some countries and in international organisations have sought to encourage the use of mezzanine finance, due to its potential to provide finance efficiently to key categories of SMEs. The traditional market for commercial mezzanine finance has been upper-tier SMEs, with high credit ratings and demand for funds above EUR 2 million. With the support of public programmes, it has become increasingly possible to offer mezzanine products to SMEs with lower credit ratings and smaller funding needs. Public intervention can take two forms: i) participation in the commercial mezzanine market by public entities (national or sub-national development funds; international organisations, etc.), which create investment funds targeted to certain categories of SMEs and award mandates to private investment specialists, who in turn invest in targeted companies; and ii) direct public financing to SMEs under programmes managed by public financial institutions or development banks.

Commercial mezzanine finance, with or without the use of official funds, has tended to converge toward a uniform global pattern based upon market practice. As an example of public provision of funds for commercial mezzanine facilities, the Report presents the case of the Mezzanine Facility for Growth of the European Investment Fund.

In cases where a public agency supplies mezzanine finance directly, the specific pattern of has tended to be shaped by the laws, institutions and policies of the jurisdiction in which it operates. Public mezzanine programmes usually provide for the public entity to offer subordinated debt with some share in the “upside” of the investment, but tend to avoid equity-like instruments. The report provides case studies of direct public mezzanine finance schemes in Austria, Canada, Czech Republic, Estonia, France, Germany, the United Kingdom and the United States.

The utilisation of mezzanine finance has followed divergent patterns in the aftermath of the post-2007 financial crisis. The market contracted in commercial mezzanine finance, as did the demand for officially backed mezzanine finance in many countries where the technique was well established. In other countries where private lenders were in retreat, recourse to officially supported mezzanine credit appears to have grown as governments stepped in to fill the void. The early evidence suggests these have helped SMEs weather the crisis and represent a potentially useful addition to the range of financing vehicles available to SMEs.

With a few exceptions, utilisation has been recovering in countries where it was well established and has remained strong in countries where it was introduced in the crisis.

It should be emphasised that this report does not suggest that mezzanine finance represents a definitive solution to the financing problems of SMEs. Many SMEs are not well-suited for this form of finance and most firms using mezzanine finance will continue to need traditional debt and equity finance. Traditional bank credit, based mainly upon debt and official guarantees, is well suited to established low-risk companies, but has only limited applicability to firms seeking growth capital. Venture capital is relevant for start-ups, technology-based companies and those with exceptionally high growth prospects, but such companies only constitute a tiny, albeit critical, part of all SMEs. An effective financial system is one that can supply financial resources to a broad range of companies in varying circumstances. On balance, the early evidence suggests that mezzanine finance can be an important part of the continuum of financing options that together constitute an efficient financial system.

At present, the ability to assess the full potential of mezzanine finance for SMEs and entrepreneurs, and the effectiveness of public institutions in providing these facilities, is hampered by the lack of data on commercial mezzanine finance, in terms of financing volume, number and type of firms, as well as data on public investment funds in OECD countries and international organisations. This report provides a significant amount of information about official programmes to mezzanine finance directly to SMEs. However, it would be desirable to deepen understanding of the functioning of programmes in some countries, through more precise statistical data on the size of programmes and beneficiaries, and to collect information on existing programmes in a broader range of OECD and non-OECD economies. To help fill these gaps more extensive analysis and policy dialogue involving key players, such as official agencies that actively provide mezzanine finance, industry associations, private financial institutions and international financial institutions, should be encouraged.

GLOSSARY OF KEY TERMS²

Business Angel

A private investor who provides both finance and business expertise to an *investee* company in exchange for ownership equity. Business Angels typically participate at an early stage of a firm's life. Business Angels are considered to be informal investors who, unlike venture capitalists, typically do not manage the pooled money of others through a professionally-managed fund. However, angel investors are increasingly organising themselves into angel networks or angel groups to share research and pool their own investment capital.

Business Angel Network

A BAN is an organisation whose aim is to facilitate the matching of entrepreneurs (looking for financing) with business angels.

Buy-and-hold investors

An investor who buys and holds assets for a long period of time, regardless of fluctuations in the market. An investor who employs a buy-and-hold strategy may actively select assets, but once in a position, is not concerned with short-term price movements and technical indicators.

Buy-Out

A buyout is a transaction in which private equity capital is used to acquire a private or public company from the current shareholders. After buyout, the purchased firm usually becomes a private company. For the OECD Guidelines on Measuring Access to Finance, *Private Equity* is divided into two distinct and separate components, namely *Risk Capital* and *Buyout*. Buyouts include a number of specific types of investments, including management buyout (MBO), management buy-in (MBI), institutional buyout (IBO) and leveraged buyout (LBO).

Buyout Fund

A Private Equity fund whose strategy is to acquire other businesses.

² The glossary draws from the 2009 report by the OECD Working Party on SMEs and Entrepreneurship on "Financing High Growth and Innovative Start-Ups and SMEs: Data and Measurement Issues," for terms covered in that report. For other terms and further information, see EVCA (European Venture Capital Association) website www.evca.eu/toolbox/glossary.aspx and EBAN (European Business Angel Network) website www.eban.org/resource-center/glossary.

Common shares/stock

In a public company, the stock which is traded between investors on various exchanges. Owners of common or ordinary shares are typically entitled to vote on the selection of directors and other important issues. They may also receive dividends on their holdings, but common shares do not guarantee a return on the investment. If a company is liquidated, the owners of bonds and preferred stock are paid before the holders of common shares.

Common shares/stock equivalent

Debt and/or quasi-equity type securities capable of subscription, exchange or conversion into the company's common stock (ordinary shares). In calculating dilution, earnings per share, etc., the number of ordinary shares is often adjusted to reflect conversion of common stock equivalents.

Deal Flow

The total number of investment opportunities available to a Venture Capital firm.

Debt Financing

This is capital provided to a firm with an obligation that it be paid back. It includes a wide variety of financing such as loans from individuals, banks, or other financial institutions; selling bonds, notes or other debt instruments; and other forms of credit such as leasing or credit cards. The lender gains no equity position in the firm and the borrower's obligation is to repay the debt, usually with interest.

Development Capital

See *Expansion Capital*

Due Diligence

Process of evaluation of a project by a potential investor based on material facts. For private equity professionals, due diligence can apply either narrowly to the process of verifying the data presented in a business plan/sales memorandum, or broadly to complete the investigation and analytical process that precedes a commitment to invest. The purpose is to determine the attractiveness, risks and issues regarding a transaction with a potential investee company. Due diligence should enable fund managers to realise an effective decision process and optimise the deal terms.

Early Stage

This is a general term applied to all the stages prior to the *expansion stage*. Thus, it includes the pre-seed, seed and start-up stages of a business. While a firm may enter the expansion

phase at an earlier date, the early stage is usually considered to be the first 3 to 5 years of the firm's life. Firms with a growth objective normally require financing during this stage.

Early-Stage Fund

Venture capital funds focused on investing in companies in the early part of their lives, prior to the *Expansion Stage*.

Equity

Ownership interest in a company, represented by the shares issued to investors.

Equity Financing

This refers to all financial resources that are provided to firms in return for an ownership interest. Equity investors have no guarantee that any specific amount of money will be returned. Rather, their return on investment will be determined by the success of the firm. They may sell their shares in the firm, if a market exists or they may get a share of the proceeds if the firm is sold. The large category of equity finance is sub-divided into *Public Equity* and *Private Equity*.

Equity-related debt

Convertible debt or bonds with equity warrant are a type of bond that the holder can convert into shares of the company or cash of equal value, at an agreed-upon price and up to a specified expiration date.

Exit Stage

This is the stage at which Venture Capital, Business Angel or other private equity investors liquidate their holdings in a *portfolio company*. Methods of exiting an investment include: trade sale, sale by public offering (including *IPO*), write-offs, sale to another equity investor or sale to a financial institution.

Expansion Capital

Financing provided for the growth and expansion of a company, which may or may not be operating profitably. The capital may be used to fund market or product development, finance increased production capacity or provide additional working capital. Also called *Development Capital*.

Expansion Stage

During this stage, the firm is producing and selling products or services but it is seeking to expand output of products and/or services and to increase revenues. Usually, at this stage, operating revenues are not sufficient to fund the expansion and thus the firm seeks financing through formal and informal risk capital and/or debt. Normally a firm is in operation for 3 years before the expansion stage.

Family Office

A family office is an office that provides services to one (i.e. Single-family office) or several families (i.e. Multi-family office). Services can range from investment management and advice, accounting, tax and financial advice to educational planning or concierge services.

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.

Grace Period

The period in a term loan when no principal repayments are made. Thus, in a 5 year term loan with 2 years grace, principal repayments begin in the third year.

High Growth Enterprise

All enterprises with average annualised growth in employees greater than 20% per annum over a three year period and with 10 or more employees in the beginning of the observation period.

Initial public Offering (IPO)

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.

IPO candidate

A company that is suitable for an IPO.

Innovative firm

A firm that has introduced a product, process, marketing or organizational innovation, according to definitions of the Oslo Manual.

Investee Company

The company or entity into which an equity investment is made, whether from a Venture Capital fund, a Business Angel or other informal capital. Also known as *Portfolio Company*.

Late Stage

Late or Later Stage is a term used loosely by different organisations to refer to various types of investing in mature firms including spin-outs of operating divisions, expansion, turnaround, replacement capital and buyout.

Leveraged Buy-Out (LBO)

An acquisition of a company (or single assets like a real estate), where the purchase is financed through a combination of equity and debt and in which the cash flows or assets of the target are used to secure and repay the debt. A significant share of the equity of the company is replaced by debt, which usually has a lower cost of capital than the equity. The Principal vehicle for LBOs is the LBO association, which is organized as a private investment partnership. The general partners organise the buyout and also monitor management. The limited partners, typically institutional investors (insurance companies, pension funds and money management funds), provide most of the equity capital. The limited partners along with banks provide most of the debt financing, which typically constitutes 80-90% of the deal.

Limited Partner

An investor in a limited partnership (*i.e.* mezzanine, venture or private equity fund).

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.

Long Term Debt Financing

Long Term Debt Financing usually applies to assets a business is purchasing, such as equipment, buildings, land, or machinery. With long term debt financing, the scheduled repayment of the loan and the estimated useful life of the assets extends over more than one year.

Mezzanine finance

A combination of debt and equity financing. The investor in a mezzanine facility accepts more risk than a provider of a senior loan and normally receives a higher return. Common forms of mezzanine finance include subordinated loans, participating loans, and equity-related mezzanine instruments such as convertible bonds and bonds with warrants. A

mezzanine facility usually contains more than one of these instruments. Mezzanine finance is often used as expansion capital.

Participating loan

A special form of loan, by which the investor receives a payment linked to the profits or turnover of the company in which the investment is made. Fixed interest payments can be also included in the contract.

Payment in Kind (PIK)

A feature of a security permitting the issuer to pay dividends or interest in the form of additional securities of the same class, i.e. a financial instrument that pays interest or dividends to investors of bonds, notes or preferred stock with additional debt or equity instead of cash.

Portfolio Company

See *Investee Company*.

Preferred shares/stock

Shares which have preference over ordinary shares, including priority in receipt of dividends and upon liquidation. In some cases these shares also have redemption rights, preferential voting rights, and rights of conversion into ordinary shares. Venture capitalists generally make investments in the form of convertible preference shares.

Pre-Seed Stage

The earliest stage in the development of a business idea. At this stage, an idea is born and a business plan may be in development but no concrete steps have been taken to set up a business. The term pre-seed is often associated with efforts to commercialise research.

Private Equity

This is capital provided to private companies, whose shares are not freely tradable in any public stock market, in return for ownership equity. The term applies to provision of equity capital across the entire cycle from seed financing to buyouts. Thus, Private Equity is used both for early and expansion stage financing of young, developing firms and for *Buyout* of mature firms. For the OECD Guidelines on Measuring Access to Finance, the proposed classification breaks the full range of Private Equity investment into two major sub-components: *Risk Capital* and *Buyout*.

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.

Public Equity

This refers to equity investments made in companies whose shares are quoted in some form of stock exchange. Normally, public equity investors make hands-off purchases of shares in these listed companies. The investors are not involved in providing advice or otherwise assisting the owners or managers in the development of the firm.

Risk Capital

This is private equity capital provided by investors to firms in pre-seed, seed, start-up and expansion stages. It includes investments from both formal (Venture Capital) and informal (Business Angels or individuals) sources, but does not include any debt finance. While there is some inconsistency in the use of the term Private Equity between different organisations in different countries, for the OECD Guidelines on Measuring Access to Finance, *Risk Capital* and *Buyout* are considered to be two separate and distinct components of *Private Equity*.

Security

Enforceable claim or lien created by a security agreement, or by the operation of law, that secures the fulfillment of a pledge. A lender or obligee has a security interest in the collateral provided by a borrower or obligor to guaranty timely payment of a debt or performance of an obligation. An asset pledged to guarantee the repayment of a loan, satisfaction of an obligation, or in compliance of an agreement. Security gives a lender or obligee a legal right of access to the pledged asset and to take their possession and title in case of default for a foreclosure sale.

Seed Stage

A development phase when founders require financing to conduct research, develop products and explore market potential. This is prior to *start-up* and also prior to entry into entrepreneurship. The future business entity is beginning to take shape but founders have not yet established commercial operations.

Seed stage finance

Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.

Short Term Debt Financing

Short Term Debt Financing applies to money needed for the day-to-day operations of the business, such as purchasing inventory, supplies, or paying the wages of employees. Short term financing is referred to as an operating loan or short term loan because scheduled repayment takes place in less than one year. A line of credit is an example of short term debt financing.

Sophisticated investor

An investor recognised by a third party as someone who is sufficiently knowledgeable to understand the risks involved with investing in an unquoted company. The individual has already made previous investments and has a long history of investing in a range of financial instruments.

Start-Up

This discrete event is synonymous with the enterprise birth. This is the point at which the firm becomes an operating enterprise.

Start-up Stage

While the start-up or birth of a firm takes place at a point in time or during a limited period of time, the start-up stage is considered to cover a period in the early-stage life of a firm. During this stage, the firm has begun operations and is paying salaries but product development work may still be under way and sales and revenues may be zero. In the start-up stage, a firm often requires capital for activities such as product development and initial marketing. The start-up stage begins with the *enterprise birth* and extends through to the start of the expansion stage. As such, there is no universally-accepted period of time associated with the start-up stage.

Subordinated debt

Loans or bonds in which the lender agrees that senior or secured creditors will be fully paid before any interest or principal is paid.

Turnaround Stage

This stage describes a situation where an established firm requires capital to address a temporary situation of financial or operational distress. The intervention of turnaround financing aims to overcome difficulties and re-establish prosperity. Turnaround is considered to be beyond the expansion stage.

Venture Capital

This is equity capital provided through formal, organised professionally-managed funds to co-finance, with the founder or entrepreneur, an *Early Stage* or *Expansion Stage* venture. Offsetting the high risk the investor takes is the expectation of higher than average return on the investment. The Venture Capitalists supply not only financing but also expertise in the form of domain knowledge, business contacts and strategic advice. Venture Capital is a subset of private equity.

Venture Capital Fund

This is generally a private partnerships or closely-held corporation that pools money from private and public pension funds, endowment funds, foundations, corporations and wealthy

individuals, to provide equity investment for young, rapidly growing companies that have the potential to develop into significant economic contributors.

Warrants

Type of security usually issued together with a loan, a bond or preferred stock. Warrants are also known as stock-purchase warrants or subscription warrants, and allow an investor to buy ordinary shares at a pre-determined price.

Young Innovative Firms

Definitions can vary across countries by age, size and sector. A number of countries have “Young Innovative Company” schemes to help young and innovative firms overcome the challenging early years of existence by extending tax credits in various forms or reducing other costs or reporting requirements.

1. Introduction

1.1. Rationale and objectives of the study

The work conducted by the OECD Working Party on SMEs and Entrepreneurship (WPSMEE) in 2009-2010 concluded that in many countries, the range of financing instruments for SMEs is excessively narrow (OECD, 2010a). In particular, newer, innovative and fast growing companies face considerable difficulties in obtaining finance. More generally, the dilemma of financing dynamic companies identified in the 2006 OECD study on *The SME Finance Gap: Theory and Evidence* remains largely unresolved in many countries.

Firms with established business models, as well as those with low to moderate growth prospects, typically seek financing through bank credit, asset-based financing (leasing, factoring etc.), and official loans and guarantees. However, such traditional financing techniques based mainly upon debt and risk mitigation through guarantees, are of only limited applicability in the financing of certain kinds of SMEs, due to their peculiar risk profiles (OECD, 2011). These include: a) firms with high growth potential but newer business models, especially those utilising new technology; b) established firms seeking capital for expansion into new domestic or international markets; and c) firms seeking to effect other important transitions in their activities, such as ownership and control changes. The “financing gap” that affects these businesses is an important issue for a sustainable recovery and long-term economic growth, since these companies are often at the forefront in job creation, in the application of new technologies and in the development of new business models (OECD, 2010c).

While alternatives to traditional debt finance are particularly important for start-ups, high-growth and innovative SMEs, the development of alternative funding techniques may be relevant to the broader population of SMEs, which are often over-reliant on debt instruments. The thin capitalisation and excessive “leverage” (excessive reliance on debt financing compared to equity) impose costs, as loans to companies that already have considerable amounts of debt tend to have higher interest rates, and increase the risk of financial distress and bankruptcy.

The long-standing need to strengthen capital structures and to decrease dependence on borrowing has now become more urgent as many firms were obliged to increase leverage in order to survive the crisis, and banks in many OECD countries have been contracting their balance sheets in order to meet more rigorous prudential rules. Indeed, the problem of over-leveraging may have been exacerbated by the policy responses to the 2008-09 financial crisis, as the emergency stabilisation programmes tended to focus on mechanisms that enable firms to increase their debt, while funding from other sources (i.e. business angels, venture capital) became scarcer (OECD, 2012).

Recognising that “financing gaps” exist for certain categories of SMEs and that excessive leverage may increase financial distress, in its 2011-2012 Programme of Work, the WPSMEE agreed to investigate alternative financing techniques for SMEs, in which investors, entrepreneurs and government develop innovative ways to distribute risks and rewards in fast growing and/or newer companies.

The present study builds on recent WPSMEE work on high growth firms, which examined business growth factors and government levers to foster the creation of high growth companies (OECD, 2010b). It also complements recent and on-going OECD studies on equity finance to boost firm creation and growth, which explore the role of venture capital and business angels in particular (OECD, 2011). On-going work in the OECD is examining the relationship between business dynamics and equity finance, to identify relevant policy levers for strengthening equity finance for new and innovative firms. This is the case of the project on seed and early stage finance jointly developed by the OECD Economic Policy Committee and the OECD Committee on Industry, Innovation and Entrepreneurship.

The present WPSMEE study is the first step in addressing the need to improve understanding about the full-range of non-bank financing instruments available for SMEs and entrepreneurs. It is part of a broader exercise to map the full range of financing instruments for SMEs. In particular, it reviews the spectrum of alternative financing instruments (AFTs) available to high growth and innovative firms and develops a focus on *mezzanine finance*. This hybrid technique, which forms a bridge between traditional straight debt and pure equity, is applicable to a broader range of SMEs than other AFTs, such as venture capital or special exchanges for SMEs, but it has received considerably less attention. Analysis of mezzanine finance is complementary to the studies on equity finance mentioned above.

There has long been a market in commercial mezzanine finance that functions according to market principles with limited government intervention. In recent years, policy makers in several countries have experimented with mezzanine finance schemes. In fact, a significant share of activity in mezzanine finance for SMEs involves the provision of capital by public institutions, such as national and regional development funds, development banks or SME support agencies and international organisations. While these institutions are usually required to comply with financially sound management models, their objectives go beyond profitability and include considerations such as reaching under-served market sectors or developing local markets. The present report illustrates different models of mezzanine provision through public support programmes in selected countries, and aims to contribute to an improved understanding of this financing mode and of the opportunities for policy action in this area.

In particular, the present report:

1. provides an overview of the financing instruments available to SMEs over their life cycle, commenting on the shortcomings of certain instruments for specific categories of firms;
2. illustrates the characteristics of mezzanine finance instruments, their advantages and costs in relation to other techniques and the opportunities they offer to certain types of firms, including high growth and innovative SMEs;
3. analyses what governments are currently doing to support the use of AFTs, providing examples of mezzanine facilities developed or supported by public institutions. The report investigates two main types of public support:
 - a) official institutions that form investment funds, which are managed as commercial mezzanine finance facilities, according to a model that is similar across countries;
 - b) official agencies that supply funds or extend guarantees directly to SMEs, under programmes that differ significantly among countries;
4. comments on the evolution of mezzanine finance during the global financial crisis and the scope for its wider use in financing SMEs.

1.2. Methodology

The study has been developed using:

- i) Secondary sources, including analytical work and public reports;
- ii) Interviews with experts and practitioners in public and private institutions that are active in mezzanine finance;
- iii) Information on public policies collected through the “OECD Questionnaire on Seed, Early and Later Stage Finance”, submitted to officials from member countries in May 2012, as part of the joint OECD Economic Policy Committee and the OECD Committee on Industry, Innovation and Entrepreneurship project on business dynamics and equity finance. The questionnaire covers seed and early stage venture capital, and includes a section on mezzanine finance³.

Literature and official reports, as well as contacts with participants in mezzanine finance, have already produced a fairly large body of information concerning the procedures and techniques of *commercial mezzanine finance*, i.e. those operations where the intermediaries are private financial institutions operating as profit seeking entities. The practices and techniques of commercial mezzanine finance have evolved through market practice and are rather standard in all countries. At the same time, there is a dearth of reliable statistical data on the size of the markets in commercial mezzanine finance particularly on the use of commercial mezzanine finance by SMEs.

Similarly, quantitative data about the size and development of official mezzanine finance are still fragmented. The information contained in this report, collected through the Questionnaire submitted to member countries and interviews to officials involved in mezzanine programme, represents a first step towards monitoring public provision of mezzanine finance and providing some initial estimates of the size of national programmes.

2. Financing SMEs: The spectrum of financing instruments

Ensuring that SME have access to finance is crucial for their growth opportunities and for the long-term prospects of the economy as a whole. The financing hurdle to firm creation and SME survival and growth has long been recognised (e.g. OECD, 2006). Overcoming this hurdle has become prominent in the policy agenda of governments in the aftermath of the global economic and financial crisis, which has brought about a deterioration of financing conditions for start-ups and small businesses (OECD, 2012).

The crisis has also made more evident the vulnerability, in many countries, of an over-leveraged SME sector, which is largely dependent on debt finance for its working capital needs, as well as for long-term investment and growth. In many countries, problems in accessing finance in suitable forms are especially acute for start-ups, fast-growing companies and high-technology firms, which are ill-served by traditional debt instruments (OECD, 2006).

The present section discusses the main types of external finance available to SMEs and identifies challenges that might lead to financing gaps, particularly for certain categories of SMEs or those at specific stages in the firm’s life cycle. The section discusses debt financing and the typical risk mitigation techniques that have developed to overcome market failures. It then highlights the limited applicability of these traditional techniques for companies with high growth prospects or undergoing changes in products, processes, business model or proprietary structure. The section introduces other external forms of finance,

³ See Annex 1 for the full questionnaire and Annex 2 for the follow-up questionnaire on mezzanine finance.

“alternative financing techniques” (hereafter AFTs), including equity and equity-like instruments. Finally, the section presents some key shortcomings of equity finance and discusses how mezzanine finance can address existing gaps in finance to SMEs.

2.1. SME lending: market failures and mitigation techniques

The most common source of financing for most SMEs is banks or similar depositary institutions (e.g. savings banks or cooperative banks). Generally, this financing comes in the form of overdrafts, term loans or through the use of credit cards. Traditional debt financing represents an unconditional claim on the borrower, who must pay a specified amount of interest to creditors at fixed intervals, regardless of the financial condition of the borrower. The interest rate may be fixed or adjusted periodically according to a reference rate. Moreover, bank claims have high priority in cases of bankruptcy.

The popularity of traditional debt finance lies partly in the fact that it is one of the least expensive forms of external finance.⁴ It generates moderate returns for the lender and is therefore appropriate for low risk businesses which generate stable cash flows. Furthermore, in OECD, countries since the 1980s, as large corporations and local authorities have been moving away from the banking system and borrowing on more favourable terms in the capital market, banks have been encouraged to enhance their capacity to reach potential borrowers. One of the responses of major banks has been to target the “middle market”, i.e. retail banking and SME lending, a trend that the financial crisis has partly reversed (Griggs, 2012).

At the same time, specific constraints may limit lending to SMEs. Box 1 details the main problems that lenders face in granting credit to SMEs. In addition, lending to SMEs, which generally involves small loan volumes (under EUR 1 million), can imply relatively high unit costs for banks, as the administrative costs associated with the evaluation of the borrower’s creditworthiness are typically fixed.

Financial institutions have developed several methods to mitigate the incidence of these challenges in SME lending. The main objective is to alter the risk-sharing mechanism in order to align incentives between lender and borrower. The most common ways for bankers to oblige lenders to share risk are through a) requests for high equity contributions by prospective borrowers; and b) requirements for collateral. In either case the borrowers suffer a loss if the enterprise fails and the loss of the lender will be diminished. Other commonly used methods to manage SME credit risk include:

- *Loan covenants:* A loan covenant is a condition imposed by the lender with which the borrower must comply in order to adhere to the terms in the loan agreement. Common loan covenants include the following: 1) Hazard Insurance / Content Insurance under which the borrower is required to keep insurance coverage on the plant / equipment or inventory in order to safeguard against the catastrophic loss of collateral; 2) Key-man life insurance, which insures the life of the indispensable owner or manager without whom the company could not continue. The lender usually gets an assignment of the policy; 3) Requirements for payment of taxes / fees / licenses whereby the borrower agrees to keep those expenses up to date. In fact, failure to pay would result in the assets of the company being encumbered by a lien (i.e. legal claim on property) from the government, which would take precedence to the one from the bank; 4) Provision of financial information on the borrower and guarantor, whereby the borrower agrees to submit financial statements for the continuing assessment by the bank. Financial statements are usually submitted yearly, while account receivable can be required every month. Furthermore, via loan covenants the borrower might be prevented from taking specific actions, without prior approval, such as: change in management or merger, demanding more loans, or distributing dividends.

⁴ Additionally, debt payments are in many countries tax deductible.

- *Credit guarantee schemes (CGS)*: CGS reduce the risk associated with SME lending: should the borrower default CGS compensate a pre-defined share of the outstanding loan. CGSs are widespread in developed and developing countries alike and recent evidence shows that they have been extensively used as a policy instrument to soften the adverse impact of the 2008-09 financial and economic crisis on SMEs' access to finance (OECD, 2010a, 2012, 2013). Importantly, guarantee institutions generally require that firms produce regular information and accept monitoring by outside parties⁵.
- *Relationship lending*: Banks active in the SME sector often supplement statement-based lending with qualitative information about the entrepreneur and the firm's business strategy, gathered through long-term relationships with the owners/ managers of the company as well as with other members of the local community (Berger and Udell, 2002). In several OECD countries there exist well developed networks of community-based financial institutions (savings banks, cooperative banks, credit unions etc.), which maintain close relations with local SMEs. Relationship lending depends to a substantial degree on soft (i.e. non-quantifiable) information about the borrower. However, soft information generally takes significant time to accumulate and is not easily observed, verified, or communicated to others. Therefore, it has limited application to firms that seek to attract new sources of capital to finance expansion.
- *Credit scoring*: Since the 1990s, the adoption of small business credit scoring (SBCS), which involves analysing large amounts of historical data on borrowers, has been found to have a positive impact on SME lending, as it allows reduction in costs and time of granting a loan, greater consistency of credit evaluation and focus on difficult cases or large loan requests (DeYoung et al., 2010). The scoring method was first adopted in consumer lending, based on the large amounts of data readily available for banks on the performance of consumer credits and on the characteristics of borrowers. In the 1990s, banks, especially in the United States, began to use SBCS on a large scale, often while continuing relationship lending and statement-based analysis. Recognising that it is very difficult to separate the finances of the firm from those of its owner(s), SBCS analyses data about the owner of the firm (as if the owner were applying for a consumer loan) and combine it with relatively limited data about the firm itself, using statistical methods to predict future credit performance. The "hard" information is primarily personal consumer data (e.g. income, net worth, available credit, prior delinquencies, and prior bankruptcy) obtained from consumer credit bureaus, data on the business collected by the financial institution (e.g. financial ratios, such as profitability and leverage and past credit problems), and in some cases information on the firm from commercial consumer credit agencies. Thus, SBCS depends on a strong information infrastructure, particularly on credit bureaus, as the data needed to manage credits on a statistical basis may be available only to large banks (UNCTAD, 2001; Berger and Udell, 2006).

⁵ See OECD (2012), "SME and Entrepreneurship Financing: The role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises".

Box 7. Structural problems in SME lending

In any financial system, prospective financiers (banks, investors, or suppliers of asset-based finance) must have some means to gauge the risk of a given entity and to balance that risk against the potential reward. The financier must also monitor the entity in order to determine whether it is acting in accord with the initial contract and to have some means to oblige the entity to respect the terms of the contract. For numerous reasons, assessment and monitoring are more problematic for SMEs than for larger firms.

First, *asymmetric information* is a more serious problem in SMEs than in larger firms. The entrepreneur has better access than the financier to information concerning the operation of the business and has considerable leeway in sharing such information with outsiders. Hence it may be difficult for the outside provider of financing to determine whether the entrepreneur is making bad decisions or whether the outsider is unable to understand the business adequately.

SMEs are more informationally opaque and financially less well-structured than larger companies. In a competitive market, banks usually make credit decisions based upon the financial statements (balance sheet and income statement) of the company. However, for statement-based credit to operate: 1) the borrower must produce informative financial statements (ideally, audited statements prepared by a reputable accounting firm in accord with high accounting standards); and 2) the financial information must show the borrower to be in a strong financial condition. SMEs often do not produce audited financial statements that yield credible financial information and have no obligation to make public disclosure of their financial reports, although they are generally obliged to produce them and make them available to relevant authorities upon request. Furthermore, in smaller enterprises the line of demarcation between the finances of the owner(s) and those of the business is usually blurred. Unlike established public companies, which are expected to observe standards of corporate governance with clearly defined roles for shareholders, managers and stakeholders, SMEs tend to reflect the idiosyncrasies of their owners and their informal relationships with stakeholders.

The principal/agent problem, which is inherent in all financing operations, is particularly acute in the case of SMEs. Once financing is received, the entrepreneur may use funds in ways other than those for which it was intended. An entrepreneur might undertake excessively risky projects since all of the “upside” of the project belongs to the entrepreneur while a banker would prefer a less risky operation, even if profitability is less than under the riskier alternative. This problem is more serious in smaller firms than in larger firms because of the blurring of the line between the firm and the entrepreneur and because of information asymmetries. Additionally, a large firm wishing to undertake a comparatively risky activity could select a different technique with appropriate formulas for sharing risk and reward, such as equity issuance, but the range of choice available to small firms is usually narrower.

The implications of asymmetries in information are made more severe by the large heterogeneity in the SME sector. SMEs are characterized by wider variance of profitability and growth than larger enterprises, and exhibit greater year-to-year volatility in earnings. Empirical studies show that SMEs have a much lower probability of survival than larger firms, with the risk of failure permeating all aspects of their activity and financing. As such, other things being equal financiers can reduce their risk by dealing with larger and longer established firms.

Source: Evans (1987); Storey (1995); OECD (2006).

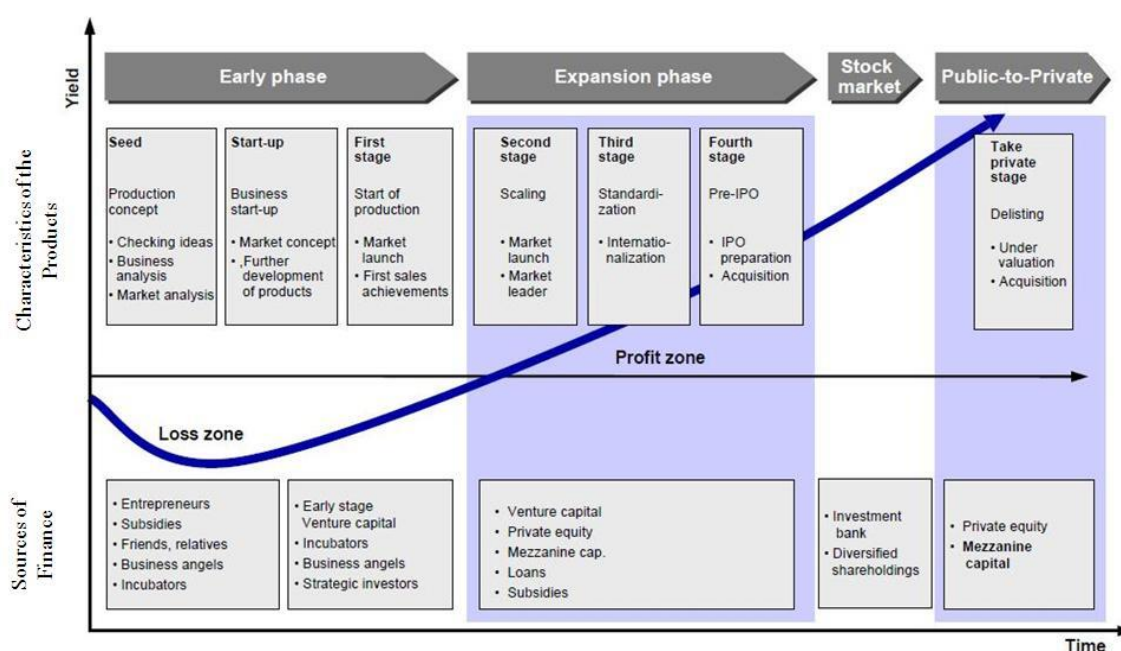
2.2. Limitations of debt financing over the business life cycle

While it is the most commonly used form of external finance for SMEs, straight debt financing poses challenges to firms and may be ill-suited at specific stages in the firm life cycle. In the first place, there are limits in the sustainability of the financial leverage, usually defined as ratio of the sum of short and long term debt over total equity. Highly leveraged firms find it increasingly difficult to obtain further credits (OECD, 2006). This tendency has been exacerbated by the financial crisis, as many firms’ financial positions have weakened and banks generally have tightened credit standards (OECD, 2012).

Moreover, situations may exist in which debt financing does not adequately match financial needs of firms. While debt finance is suitable for working capital needs, it is less appropriate to provide funds required for long-term development and for expansion into activities that entail higher risk and rewards. The reason is that traditional “straight” debt generates only moderate returns for lenders. An entrepreneur seeking to enter an untried segment of the market accepts increased risk in expectation of higher reward. The banker by contrast has only limited interest in seeing the company achieve exceptionally high rates of return, but would be severely disadvantaged if the company were unable to pay its debts. Therefore, as a rule, lenders will prefer borrowers with low risk, even if this means rejecting borrowers with projects that have high potential returns. The problem facing the entrepreneur in a firm with high potential is to find capital in a form that matches his/her own risk/return profile.

Figure 1 provides an overview of firms’ differing financing needs over their life cycle. At early stages in the life cycle, firms typically exhibit unstable or negative cash flows and are short of collateral. Hence, the risks associated with an investment in start-ups or young firms are typically high, implying that investors demand higher returns. The risk profile of the new or young business also depends on its business model and technological characteristics. Firms experimenting with technical innovation or unproven business models usually have negative cash flows in the first stages and uncertain prospects, which make debt financing ill-suited. The required risk capital generally comes in the form of funding from relatives and friends, early stage venture capital or angel investment (IKB, 2003; OECD, 2011).

Figure 1. Financing Tools and the Life Cycle of the Firm



Source: IKB (2003).

When entering a mature or expansion phase, the firm might satisfy financing needs through internal cash flow and bank loans. At that stage, it might turn to the capital markets for funding through a public listing and bond issues. When public, the firm may be “taken private” through a buy-out.

However, SMEs may face financing constraints even in the “profit zone”, especially when entering new market segments, effecting changes in capital structure and/or aspiring to sustained growth (OECD, 2010b). The so-called *growth capital* encompasses funding which allows firms to expand operations, for

example by developing new products or moving into new markets. Growth capital typically involves intermediate levels of risk; investors therefore accept lower levels of return than in the case of high risk capital, such as pure equity.

Improving financial conditions for high growth SMEs (HGSMEs)⁶ has become a key policy priority in several countries. While their share varies across countries and industries, they have been identified as key drivers of innovation and overall economic growth. However, their financing poses specific challenges. Substantial amounts of funds might be needed to finance projects with high growth prospects, while the associated profit patterns are often difficult to forecast. The financing constraints can be especially severe in the case of start-ups or small businesses that rely on intangibles in their business model, as these are highly firm-specific and difficult to use as collateral in traditional debt relations (OECD, 2010b).

While there are serious limitations on the capacity of banks to finance these kinds of SMEs, banks are not entirely absent from the process of providing risk capital. They may provide some part of the funding for expansion or transformation through term loans⁷, especially for purchases of capital goods and if the loan is secured. Additionally, with the use of mezzanine finance, which affords lenders protection similar to that of equity, banks may be willing to provide more financing in the form of senior loans.

2.3. Alternative financing techniques

The purpose of this section is to provide an overview of the range of possible financing instruments that are available to the SME, alternative to ‘straight’ debt, and to place mezzanine finance within that range. Table 1 categorises Alternative Financing Techniques (AFTs) into four groups, characterised by differing degrees of risk and return. As one progresses to the right in the table the degree of risk and the expected return rise. In this section, each category of AFT will be considered. It should be noted that the first two categories of AFT are basically suited to low risk / low return SMEs, rather than for faster growing companies.

The first category of AFTs is asset-based finance. In this case, a firm obtains cash, based not on its own credit standing, but on the value of a particular asset generated in the course of its business. Two of the most commonly used techniques of asset-based finance are *factoring* and *leasing*.

In the case of *factoring*, a company sells a receivable from a party with a good credit rating to a factoring company at a discount. For instance, an SME might manufacture and sell goods to a recognised retailer with an established credit rating with payment due in specified time. As a result, the SME acquires a trade-related claim on the retailer that can be used to obtain working capital by selling the asset (the trade receivable) to a factoring company. The factoring company is not concerned with the credit standing of the SME. Rather, it will be willing to advance funds if it has confidence in the credit of the firm upon which it has a claim, in this case, the retailer.

Another common form of asset-based finance is *leasing*. In this case an SME may need capital equipment, but banks would not be willing to lend funds to purchase the equipment due to the company’s credit rating. With leasing, the financial leasing company purchases the piece of equipment and retains ownership, but allows the SME to use the equipment under a leasing contract while receiving lease payments. The lease payments will be close to the leasing company’s cost of borrowing the funds plus a credit risk spread. In case the company does not make the lease payments, the leasing company takes possession of the asset.

⁶ The OECD Eurostat Manual on Business Demography Statistics defines “high growth firms” as those enterprises with an average annualised growth rate of more than 20% per annum over a three years period and with ten or more employees at the beginning of the observation period (OECD, 2010b).

⁷ A term loan typically contains a specified repayment schedule and maturity between one and ten years.

What all techniques of asset-based finance have in common is that they allow the SME to overcome problems of poor creditworthiness or financial opacity by offering the provider of funds an asset that is independent of its own credit standing. Although these techniques may be useful to enlarge access to finance for SMEs in emerging markets, where bank finance is less developed, they are for the most part already widely used in OECD countries. Furthermore, with the exception of leasing, most of these techniques are a close substitute for short-term working capital and thus have little capacity to narrow the “growth capital gap.”

The next category of AFTs illustrated in Table 1 consists of alternative debt instruments, such as *corporate bonds*, when issued by SMEs, and *securitised* debt, in which investors in the capital markets, rather than banks, provide the financing for SMEs. Few SMEs have succeeded in issuing *corporate bonds*, because of difficulties that small privately held companies have in meeting investor protection regulations and the high relative cost of bond issuance for small companies⁸.

Securitisation of SME debt takes place when cash flows from assets are transferred to a specialised company that uses cash flow from the assets to support a fixed income security⁹ that is sold to investors (Thompson, 1995). In the case of a SME loan securitisation, the originating bank or similar entity sells SME loans to a specialised company. The specialised company creates a new security backed by the payments of SMEs, which is sold to investors. The investor accepts the risk of non-payment by the SMEs in the portfolio and receives payments of interest and principal. Thus the financing of the SME is transferred from the banking system to the capital market.

One basic characteristic of these instruments is that, like bank loans, they represent an unconditional claim on the borrower, who must pay a specified amount of interest to creditors at fixed intervals, regardless of the financial condition of the company. They also have high priority in cases of bankruptcy. The interest rate may be fixed or adjusted periodically according to a reference rate.

However, neither corporate bonds nor securitisation is widely used by SMEs at this time. In this sense, these techniques, which are on the border between traditional finance and AFTs, can only be described as ‘innovative’ since they are not widely used by SMEs. It will require effort by private entities and/or the public authorities to create an environment in which it is possible to develop instruments that are suitable for sale to investors and use such instruments on a sizeable scale.

⁸ Total costs of issuing an SME bond are nearly as high as those for issuing by a large company.

⁹ An Asset-Backed Security (ABS).

Table 1. Alternative Financing Techniques

Low Risk/ Return	Low Risk/ Return	Medium Risk/ Return	High Low Risk/ Return
Asset-Based Finance	Alternative Debt	“Hybrid” Instruments	Equity Instruments
<ul style="list-style-type: none"> • Factoring • Leasing • Purchase Order Finance • Warehouse Receipts 	<ul style="list-style-type: none"> • Corporate Bonds • Securitised Debt 	<ul style="list-style-type: none"> • Subordinated Loans/Bonds • Silent Participations • Participating Loans • Profit Participation Rights • Convertible Bonds • Bonds with Warrants • Mezzanine Finance 	<ul style="list-style-type: none"> • Private Equity • Venture Capital • Business Angels • Specialised Platforms for Public Listing of SMEs • Equity Derivatives

Two further considerations that limit the applicability of these techniques for SMEs should be kept in mind. First, these techniques are likely to be accessible only to the best rated SMEs. Second, these instruments do not address the problem of excessive SME reliance on debt or provide an improved capital structure for the firm.

Despite the factors that limit the applicability of corporate bond issuance and securitisation by SMEs, there may still be some justification to consider public efforts to encourage their utilisation for SME financing. If these instruments are structured so as to make issuance possible by SMEs, they might enlarge the range of financing instruments available to them, offering alternatives to traditional bank-based finance. Furthermore, it is arguable that since the onset of financial crisis in 2007-2008, banks in many OECD countries are retrenching their lending to reasonably creditworthy SMEs, in other words that the market in SME financing has not been functioning normally. In those circumstances, it would be justifiable to consider exploring the use of these techniques¹⁰.

The basic techniques above illustrated concern the financing of low-risk SMEs. The following paragraphs consider techniques that are better suited to higher risk / higher return activities. In Table 1, these techniques fall under two broad headings 1) hybrid techniques and 2) equity techniques.

A common feature of hybrid techniques and equity is that the investor accepts more risk and expects a higher return than with the other techniques outlined above. These instruments have the potential to overcome the problems of asymmetry of risk and reward that characterise bank credits. As mentioned above, the risk/reward characteristics of bank credits induce bankers to avoid risk even at the cost of forgoing high rewards. By providing an alternative risk-reward structure that enables an investor to accept more risk in exchange for a higher return, hybrid techniques and equity have the capacity to produce a better alignment of the interests of the SME and the provider of finance.

Equity instruments, which represent shares of the company, are found at the right end of the risk/return spectrum. Equity investors take the highest risk, in that they are paid only after senior creditors and investors in hybrid instruments have received all payments. However, equity investors are entitled to all residual profits of the company. This category also includes equity derivatives, such as futures, options and warrants. At the same time, it is the most expensive form of finance, and it usually obliges the owners of the firm to share control with outsiders. Equity is not considered at length in this report, except where necessary to distinguish between equity and hybrid techniques. Rather the report focuses on hybrid techniques, particularly mezzanine finance, which lies in the middle of the risk-reward continuum.

¹⁰ For a discussion of the potential of securitisation to support SME access to finance see Kraemer-Eis, Schaber and Tappi (2010).

2.4. Hybrid instruments

In the middle of the risk/return continuum, from “pure” debt to “pure” equity, there is a range of financing instruments that can be characterised as “hybrid instruments”, in that they have some features of debt and equity. These techniques differ from straight debt finance, in so far as they imply greater sharing of risk and reward between the user of capital and the supplier of capital (the investor). The investor in a hybrid instrument accepts more risk than a provider of a senior loan and expects a higher return, which implies a higher financing cost for the firm. However, the risk and the expected return are lower than in the case of equity, which thus implies the cost of financing for the enterprise is lower. In the event of insolvency, where the firm is unable to meet all its contractual obligations, investors in mezzanine finance have lower rankings than other creditors, but higher ranking than investors in “pure” equity capital.

Because hybrid finance is better able to distribute risk and reward with investors than straight debt finance, it is often a suitable form of finance for SMEs seeking expansion, but also seeking lower financing costs and less loss of control than occurs in an equity transaction.

Some of the most commonly used hybrid instruments are:

- a. Subordinated debt (loans or bonds) in which the lender agrees that senior or secured creditors will be fully paid before any interest or principal is paid;
- b. Equity-related debt (convertible debt or bonds with warrants) in which the investor receives (in addition to interest) a payment linked to the share price of the company in which the investment is made. Holders of convertible bonds or bonds with warrants have the right to acquire shares or other equity instruments of the company instead of accepting repayment of the bond. This right is exercisable for a defined period and at a predetermined conversion or subscription rate. The effect of the exercise of the conversion right by bondholders is to convert debt into equity. The difference between a convertible bond and a bond with warrants is that, in the latter case, the warrants (subscription rights) are separate from the bond and can therefore be traded separately;
- c. Profit or earnings participation mechanisms in which the investor is compensated by a share of future earnings of the company, subject to the risk that earnings may not reach the required threshold.

Some of these hybrid instruments (e.g. subordinated debt, convertible bonds or equity derivatives) can be used as “stand alone” investment instruments, and some may be offered in public capital markets. However, nearly all hybrid instruments that are publicly offered involve larger companies.

3. Mezzanine finance

Given its relevance as a source of growth capital for SMEs, this report focuses on one particular kind of hybrid instrument, mezzanine finance. There is no universally accepted definition of the term. However, as generally understood by market participants and as used in this report, mezzanine finance is a technique that combines two or more investment instruments within a facility that is sold as a single entity to investors.

This section details the characteristics of mezzanine finance and the types of firms for which these instruments are a suitable form of finance. It describes the investment instruments that may be included in mezzanine facilities. It notes that mezzanine finance takes place only in private capital markets, which are restricted to professional and institutional investors, and describes the modalities of mezzanine finance, such as legal forms of vehicles and functioning of investment funds.

3.1. Instruments for mezzanine finance

A mezzanine facility typically includes several financing instruments (tranches) of varying degrees of risk and return. The exact mix of instruments in a specific facility can be tailored to suit the risk/reward preferences of the SME and the investors. To the extent that the facility has a large share of fixed rate current pay assets, it will tend to have a low but steady yield. Yield can be enhanced by increasing the proportion of higher risk assets in the facility or by delaying payments until later stages of the operation. The more risk assumed by the investor, the more the investor attempts to capture the "upside" of the investment.

A simple mezzanine facility contains: i) one or more categories of subordinated debt; ii) a tranche in which the investor receives a "success fee," i.e. a share of the firm's earnings or profits and/or; iii) an equity-related tranche in which an investor receives a payment whose value is contingent upon a rise in the value of the company, usually reflected in the company's share price. The latter tranche is often called the "equity kicker". The following paragraphs illustrate in more detail the main components of mezzanine facilities.

i) *Subordinated debt* instruments are the most common instrument of mezzanine financing. Subordinated loans (sometimes called junior debt) are unsecured loans where the lender's claim for repayment in the event of bankruptcy ranks behind that of providers of senior debt but ahead of equity investors. The subordinated debt tranche is usually at a specific rate of interest and is independent of the state of the company's finance. The provider of financing is entitled to this payment under all conditions, subject only to the condition that senior debt holders must be paid in full before any payment is made to subordinated debt holders. Principal is usually repaid in "bullet" form, i.e. at the end of the loan. In some cases, the facility may provide for payment in kind (PIK) in which both interest and principal are paid at the loan's maturity. A PIK tranche generally carries a higher interest rate than one where interest is paid throughout the course of the loan.

ii) *Sales or turnover participation rights* provide the investor receives with a payment based upon the performance of the company, in terms of revenue, turnover, or earnings¹¹. This payment can also take the form of PIK. Participating loans are loans whose remuneration is contingent upon the results of the business (profit, financial position, share price etc.), rather than being fixed. There exist two typologies: a) a profit-sharing loan, for which the remuneration (interest) may vary; b) a participating loan for which the "capital repayment" may vary. In both cases, the lender receives a participation in the profits or turnover of the company in return for the provision of capital. This participation can be confined to the purpose for which the loan was provided or pertain to the whole business of the company. Additionally, fixed interest payments can be included in the contract. On the other hand, participating loans do not share losses. In the event of bankruptcy, providers of participating loans share in the results of the liquidation in the same way as other loan creditors.

iii) *Profit participation rights* are equity investments that entitle the holder to rights over the company's assets (e.g. participation in profits or in the surplus on liquidation, subscription for new stock), but not to the right to be consulted on business decisions. The owner of the profit participation right is not a shareholder of the company and is not entitled to ownership rights. This means that he has no voting right in the company's shareholders' meeting and no right to attend these meetings. Profit participation rights are not defined by law and can therefore to a large extent

¹¹ Earnings is frequently represented by EBITDA, i.e. income before interest, taxes, depreciation and amortization have been subtracted; an indicator of a company's profitability that is watched by investors.

be negotiated and designed to suit the parties. They can be designed to resemble borrowed capital by contractually agreeing on minimum interest payments which are independent of the company's profits. Profit participation rights can also resemble equity capital if they grant the right to participate in the company's profits and/or liquidation proceeds. Profit participation rights can be issued by all kinds of companies. Profit participation rights can be issued as securities called profit participation certificates.

iv) "*Silent*" participation is closer in legal form to an equity investment than subordinated or participating loans. In this form of financing one or more persons take an equity stake in a company, but without assuming any liability to the company's creditors. The typical "silent" participation affects only the company's internal affairs and is not apparent to outside observers. The details of participation in profits or losses, involvement in the company's management, supervision and information rights, etc. can be structured flexibly. A major feature of this type of financing is that the silent investor participates in losses. However, it is possible to remove this feature partially or completely. Moreover, in addition to the silent partner's right to monitor the company's business, the silent partner can be granted rights to be informed and to participate in the company's decision making.

v) *Equity "kickers"*. Finally, the investor can be compensated by receiving a payment that reflects the increased value of the company enabled by mezzanine finance. The most common equity kickers are warrants which give the holder the right to purchase a specific number of shares at a predetermined price. The value of the warrant is the difference between the price at which a share of the company can be purchased by exercising the warrant (the strike price) and the market price. The value of this instrument can be determined by market process where the company is publicly traded or is sold to an outside investor through a merger or acquisition (M&A). In cases where no such basis for pricing the equity interest is available, the value of the equity warrant is determined using a valuation technique specified in the contract.

3.2. Mezzanine finance versus equity investment

Figure 1 shows the various forms of finance used by SMEs as they progress throughout the life cycle of the firm. Mezzanine finance is most frequently used in a later (expansion) phase of the firm, after the company has attained profitability, and typically when a firm with positive cash flow is approaching a turning point in its development. Recourse to mezzanine finance implies an obligation for the firm to pay interest promptly and eventually to make additional payments linked to the performance of the company. The investor expects these payments to be made from the firm's cash flow.

Mezzanine finance can be contrasted to venture capital finance¹², where the investor is willing to provide financing to firms with negative cash flow while demanding higher rates of return in exchange. In fact, venture capital finance is often undertaken with the assumption that the firm will not achieve positive cash flow for a certain time and will thus require several rounds of financing. In addition, the providers of venture capital expect to play an active role in guiding the development of the company and conflicts between the founding entrepreneur and equity investors over control are fairly common. Venture capitalists are willing to accept a relatively high rate of failure and search intensively for companies that will attain extraordinarily high rates of return in order to boost average returns.

There may be a small number of cases in which mezzanine finance can be useful when the firm is approaching the expansion stage but still has negative cash flow. If investors are convinced that there is a reasonable likelihood the firm will achieve sufficiently strong cash flow relatively quickly, they may be

¹² Most of these remarks also apply to business angels.

willing to accept comparatively small interest payment early in the life of the mezzanine facility with a larger share of the pay-out taking the forms of success fees, PIK or equity-related instruments where payment is made later in the project.

With mezzanine financing, the financiers will do all they can to ensure that debts are repaid, but seek to invest and to exit without acquiring control. Not only do mezzanine financiers not retain an equity interest in the company, except in the event of a default, but also they generally do not want an interest in the company and do not seek to participate in its management. According to Credit Suisse (2006), mezzanine investors generally do not wish to acquire more than 3-5% of the equity of any company in their portfolio. However, in return for the lower ranking and unsecured nature of mezzanine capital, investors require detailed and prompt information on the economic progress of the business, and usually define specific financial indicators, or covenants, which the company must observe. For the investee companies – especially SMEs – this gives rise to increased requirements as regards accounting, oversight, and information policies. It also requires intensive monitoring on the part of mezzanine investors.

Table 2 provides a summary comparison between mezzanine finance and other financing techniques commonly used by SMEs. The table illustrates the positioning of mezzanine in the middle of the continuum along several dimensions, including terms, interest costs and total expected returns. To round out the comparison, this table does not include asset-based finance, for asset-backed finance effectively removes the credit standing of the user of finance from consideration. In cases where the firm cannot pay, the supplier of finance simply receives payment from the originator of the trade receivable (in factoring) or retakes possession of this asset (in leasing).

Table 2. Comparison of mezzanine finance and other financing techniques

	Senior debt	Mezzanine	Equity
Economic perspective	Debt	Equity	Equity
Legal perspective	Debt	Debt	Equity
Ranking	Senior	Contractually subordinated	Junior
Taxation	Debt interest deductible	Debt interest deductible	Tax on capital
Covenants	Comprehensive restrictions	Tracks senior, but looser	None
Security	Yes -1 st ranking	Yes -2 nd ranking	No
Investor's involvement in management	No direct involvement	Moderate involvement; board seats	Direct involvement
Purpose	Contractually specified	Not specified	Not specified
Term	4-5 years	5-10 years	Open ended
Interest Costs	Cost of funds + 255-350 basis points	150-300 basis points above senior	None
Repayment	Amortizing from cash flow	Bullet* upon exit or at maturity	None
Warrants	None	Almost always	None
Total Expected Return	5-13%	13-25%	>25%

* The payment for the principal is not made over the life of the loan, but rather as a lump-sum payment at exit or maturity

Source: adapted from Credit Suisse (2006).

3.3. Relevance of mezzanine financing for SMEs

Mezzanine financing offers a particularly appealing form of financing for owners of privately held companies that are not suitable for public listing and/or do not want the dilution of control that would accompany equity finance, either through a public listing or a private sale (including venture capital). It is widely understood that a privately held company cannot achieve the same sort of fluid capital flow as a publicly held company, but mezzanine financing offers a way to deal with the need for increased capital without going public or relinquishing control.

Furthermore, the presence of a mezzanine finance facility, as well as the support from a financial institution offering mezzanine finance, may favour increased access to debt financing. In fact, most debt incurred through mezzanine facilities will be classified as “subordinated debt”, thus it will be considered equivalent to an increase in equity by banks and other traditional borrowers. The more favourable ratio of equity to debt can lead to an improvement in the firm’s credit rating, implying more favourable loan conditions and greater scope for raising additional debt capital.

Banks often look more favourably on companies that are backed by institutional investors such as mezzanine lenders and may extend more credit under more attractive terms as a result of their reputation and their expected increased involvement with the company. Furthermore, mezzanine lenders can help entrepreneurs to diversify their banking relationships, thus acting as a source of reserve capital and reducing dependence on any one lender (Silbernagel and Vaitkunas, 2010).

Returns on mezzanine finance are higher than those on senior debt but lower than those on equity. Mezzanine investors generally target a 15 - 25 % IRR (internal rate of return) compared to more than 25% for equity investors (EC, 2007; Silbernagel and Vaitkunas, 2010). To the extent that a company can obtain mezzanine financing, it can therefore lower total financing costs with respect to equity. While mezzanine debt is more expensive than bank debt, it is not as rigid. Generally, mezzanine shares the same covenant package as bank debt, but terms are more flexible. For instance, if the maximum permitted leverage on a bank deal is three and a half times, a mezzanine facility would accept leverage ratio of four or five (Silbernagel and Vaitkunas, 2010). The ability of highly leveraged smaller companies to attract senior debt for expansion or other major operations is generally limited, especially for non-traditional transactions and special situations. As a result of reduced senior debt levels initially, the use of mezzanine capital is more relevant in such circumstances.

To obtain mezzanine finance, however, SMEs have to fulfil strict criteria; namely, they must have a sound track record, stable cash-flows and an experienced management team. Firms are also required to have sound financial and business information reporting capabilities, allowing the providers of mezzanine finance to evaluate and monitor their key risks and success drivers (EC, 2007).

3.4. Types of firms suitable for mezzanine finance

Mezzanine capital is a suitable form of finance for SMEs with a strong cash position and a moderate growth profile. However, it is not intended to be a permanent feature of the capital structure of any firm. Rather, it is applied at certain defined points in the business life cycle, in order to assist the firm in effecting certain transitions in its development.

In particular, mezzanine capital can serve SMEs when the risks and opportunities of the business are increasing, but they have insufficient equity backing, and, for this same reason, face difficulties in accessing debt capital (Credit Suisse, 2006).

The traditional market for mezzanine finance has been upper-tier SMEs, with high rating (BBB+ or above) and demand for funds above EUR 2 million, although in recent years, some financial institutions,

particularly public financial institutions, have started to extend mezzanine finance to SMEs below the upper tier and with smaller funding needs. For SMEs in this segment, which normally have to rely on regular loans or equity to meet their funding requirements, the opening up of the mezzanine market to smaller and lower rated borrowers enables broader choice, more tailor-made financing and better conditions for negotiation on the terms for new senior debts and equity (EC, 2007).

In general, an important precondition for raising mezzanine capital is that the earning power and market position of the business should be well established and stable. A company must demonstrate an established track record in its industry, show a profit or at the very least post no loss, and have a strong business plan for the future. Qualitative factors, such as the track record and capabilities of the management, play important parts in the investment decision. As a result, established businesses with stable, healthy cash flows and the prospect of long-term positive business development are the primary candidates for mezzanine financing. For businesses looking for a quick injection of capital to grow an already successful business, without giving up control, mezzanine financing can also be an appropriate solution.

There is no single instrument or technique that can satisfy the diversified needs of every high growth SMEs in every situation. In order for the capital market to meet the needs of enterprises most effectively, it is desirable to have a broad range of instruments so that firms and investors can choose the technique best adapted to the company in particular cases. The following paragraphs underline instances in which mezzanine finance can fit the SME's financing needs.

Young high-growth companies

A young high growth company that has used venture capital in earlier phases of growth might decide that it is more advantageous to use mezzanine finance for expansion capital rather than to seek additional funding from venture capital. Since mezzanine finance is cheaper than equity finance, it results in lower financing costs and also diminishes the dilution of control for founding entrepreneurs that typically accompanies venture capital financing.

Established companies with emerging growth opportunities

A large share of high growth SMEs in OECD countries are not fast growing recent "start-ups" that advanced through the early phases of growth speedily, but established companies that discover new markets segments and thereby achieve substantial gains in output and employment. There is considerable evidence that growth opportunities can be exploited by firms of various ages, in various sectors of the economy and in various geographic regions (OECD, 2010b). Firms with these characteristics can be good candidates for mezzanine finance.

An immediate benefit of mezzanine is that the company obtains the funds necessary to go ahead with promising business projects (e.g. expansion) in cases where the funding requirement exceeds what can be obtained using traditional debt financing. Some of these firms may not have the right profile in terms of sector or region to attract venture capital finance, or the projected rate of return, though comparatively high, may not be sufficiently high to attract venture capital.

Companies undergoing transitions and restructuring

Mezzanine capital can be used in effecting a wide range of transitions, particularly given the fact that the purpose is not specified in the financing agreement. The transition may occur when an existing owner of a company decides that he/she no longer wishes to manage the business and cannot find a successor who will purchase the business in its current condition. Mezzanine finance can help to effect the transformation from a closely held family run business into a transparent company with professional management. The plan may ultimately call for sale to existing managers or to an outside management group. The plan may

also envisage an increase in equity (and “cash-out” for the entrepreneur). Mezzanine finance can also support spinoffs of parts of the business.

Strengthening of capital structures

Mezzanine finance can address the financing constraints encountered by SMEs that are excessively leveraged, particularly closely owned and/ or family companies, and can enable companies to reduce leverage. In the past, thinly capitalised firms have been able to maintain access to debt financing based upon the entrepreneur’s strong relationships with banks. Following the 2008-2009 financial crisis, many companies were obliged to increase reliance on bank loans and /or official guarantees, and therefore will need to improve their capital structures (OECD, 2010a). At the same time, banks are becoming more wary about exposure to thinly capitalised companies and may demand higher equity as a precondition for continued lending. In the longer run mezzanine can be a bridge to equity finance, either because: i) the company increases equity through retained earnings or ii) at the end of the period for which mezzanine is utilised the company is recapitalised either through a sale to strategic investors or through an initial public offering (IPO).

Leveraged Buy-Outs (LBOs)

Mezzanine finance is often used in conjunction with leveraged buy-outs (LBOs). In fact in most countries, the bulk of mezzanine transactions occur in the buy-out market. These operations mostly involve larger companies and will not be considered at length in this report.

4. Government support to mezzanine finance

The rationale for government intervention in the market for mezzanine finance relates to the existence of a financing gap (or market failure) in certain parts of the SME finance market, meaning that SMEs that are apparently creditworthy and have reasonable economic prospects cannot obtain funding in the market. The “growth capital” segment of the market is more problematic than the one concerning established SMEs with strong cash flows or those buttressed by guarantees and collateral. Substantial amounts of funds might be needed to finance projects with high growth prospects, while the associated profit patterns are often difficult to forecast (OECD, 2010b).

As indicated in Section 2, techniques in which investors and SMEs can share risk more equitably than under bank credits are most relevant to high-growth SMEs, meaning that equity and mezzanine finance both would help fill in gaps in the financing continuum. While both of these techniques are highly pertinent to growth SMEs, SMEs often have difficulty accessing the capital market without official support.

Table 3 illustrates the forms that government support may take in this market. These can be classified into three categories:

1. The government can create funds that invest in mezzanine finance for SMEs. In many OECD countries, governments have formed special investment funds that invest alongside private investors in SMEs. Some of these funds may only invest in mezzanine vehicles, while many have flexible investment mandates that permit them to invest in a broader range of assets such as equity or mezzanine. There are two main ways in which public entities invest in SMEs through funds:
 - a simple fund structure in which the public entity joins other public and private entities and provides resources (equity, debt or mezzanine) to SMEs; or

- a fund of funds structure, in which the public entity allocates funding to several funds that provide financing to SMEs.
2. Direct funding to SMEs can be provided by a special agency, (e.g. an SME support agency or development bank) under a specific programme. Typically, these programmes contain some mix of subordinated loans with a mechanism for participation in the sales, earnings or profits of the company, when performance is good. Alternatively, the official agency may provide guarantees while private institutions offer the facility.
 3. The government can support mezzanine financing from private investment companies by providing them funding at highly attractive terms. This modality of government support to mezzanine finance development is observed specifically in the United States, but may provide insights for other countries. Under the Small Business Investment Company (SBIC) mechanism, a government agency, the US Small Business Administration (SBA), issues debt and makes funding available to SBICs. These are privately owned and managed investment companies that provide funding (in equity or mezzanine form) to SMEs. The SBA is a senior creditor of the SBIC and receives interest regardless of the performance of the companies in the SBIC's portfolio. The SBA does not sponsor a fund that makes investment in SMEs, nor does it provide direct funding to any. Instead, government support takes the form of funding at highly attractive terms.

All of these mechanisms require private funds to complement public funding, and all require SMEs to pass various tests of financial viability in order to qualify for official support.

Table 3. Typology of public schemes to provide mezzanine finance to SMEs

Indirect Investment via Funds	Direct Provision of Finance to Companies	Funding of private investment companies at attractive terms (US SBIC Model)
<p>a) Fund of Funds Structure</p> <ul style="list-style-type: none"> • Public Investor <ul style="list-style-type: none"> – Establishes Investment Policy; – Selects Funds; – Co-Invests in Fund with other public and private investors; – Provides funding to Fund. • Fund <ul style="list-style-type: none"> – Selects SME for Investment. <p>b) Simple Fund Structure</p> <ul style="list-style-type: none"> • Public Investor <ul style="list-style-type: none"> – Establishes Investment Policy – Joins other public and private investors to form fund • Fund <ul style="list-style-type: none"> – Selects SME for Investment 	<p><i>Government Entity</i></p> <ul style="list-style-type: none"> • Designs Product • Sets Criteria for Eligibility • Provides Funding Directly to SME via Loans or Guarantees 	<p><i>Government Entity</i></p> <ul style="list-style-type: none"> • Sets criteria for eligibility • Provides Funding on Favourable terms to private companies specialised in SME investment. <p><i>Private investment company</i></p> <ul style="list-style-type: none"> • Selects SME for investment.

The following section describes these modalities of government participation in more detail. As some of these forms imply that public funding is channelled through the commercial market, the main characteristics of commercial mezzanine finance are presented first.

4.1. Investment through commercial mezzanine finance

4.1.1. Modalities

Commercial mezzanine finance means investments that are undertaken by private specialists in mezzanine finance operating as profit-making companies and using techniques that have evolved through market practice. As will be explained below, investors may be private or public.

A commercial mezzanine investment usually takes the legal form of a private investment partnership, a vehicle that is restricted to a limited number of sophisticated investors (Limited Partners – LPs) each of whom must commit a substantial sum¹³. The investment is organised by General Partners (GPs) who are professionals in management of mezzanine investments. The GPs contribute their skills in identifying good companies and guiding them through the mezzanine cycle. The tasks of the GPs are 1) to assemble and raise funds from a group of investors; 2) to identify a group of suitable companies in which the investments are made; 3) to monitor the performance of the companies; 4) to receive payments from the companies while distributing payments to investors; and 5) to liquidate the fund at the end of its mandate.

The GPs operate through a mezzanine fund which has a pre-determined life (usually 7-10 years). During its life, the fund has very limited liquidity and investors are expected to remain invested through the life of the fund. Normally, in its early years, the fund will have large shares of assets in cash as investible projects are sought. During the middle years of the fund life, assets are usually fully invested.

The GPs in a mezzanine arrangement spend a moderate amount of time in overseeing the companies in their portfolio. Typically, they will seek to have seats on the boards of directors of the companies and to be informed of major developments affecting the companies in which they invest. Mezzanine finance usually has covenants restricting the activities of the companies although their covenants tend to be less rigorous than those of commercial banks. Due to the need to monitor companies actively, mezzanine funds usually only hold a limited number of companies in their portfolios, with 20-30 companies being the average.

Mezzanine investors expect to realise value by exiting in the later stages of the investment. Most commercial mezzanine investments are taken out either through a change-of-control sale or recapitalization of the company. Some mezzanine providers may look to invest in companies that represent strong IPO candidates. In some cases, the company may be sold to strategic investors. More frequently, the mezzanine capital provider is bought out by the initial owner through a recapitalisation with inexpensive senior debt, through the accumulated profits generated by the business or through an acquisition of the company by a competitor.

Toward the end of the fund's life, earnings will flow into the fund and investors will receive cash. At the end of its life, the fund is wound up and all investors receive a share of the earnings of the fund. In contrast to most bank loans, debt normally is in "bullet" form with all repayment of principal at the end of the loan. The GPs receive fees for all assets under management (usually about 2%), as well as a share of the profits of the investment.

Mezzanine finance takes place only in the private capital markets (see Box 2). These investors often operate through private investment partnerships in which participation is restricted to a relatively small number of large investors. They are not publicly listed and are not subject to full transparency and disclosure rules set by securities regulators.

¹³ The same legal form is frequently used for other private capital market operations, such as hedge funds and venture capital.

Box 8. Private versus Public Capital Markets

A public market operation is one that is offered to the general investing public (institutional and retail investors) and that is subject to the full range of disclosure requirements as other regulations imposed by securities regulators. The public capital markets are of limited relevance to SMEs of any kind. Most SMEs cannot meet transparency and disclosure standards through public channels imposed by securities regulators. Many owners of SMEs do not wish to share information and control with outside parties. Similarly, norms of corporate governance for large public companies, which mandate a strict delineation of roles for company management, boards of directors and outside investors, are not applicable, where entrepreneurs, investors and managers must work together and exchange information in ways that are not appropriate for large publicly listed companies. Thus, while some attributes of capital market finance indicate that the markets have potential to finance high growth SMEs; these firms require special adaptations of investment instruments to their own circumstances.

In addition to the public markets, a private capital market exists, although the size and relative importance of the private capital markets differs considerably among OECD countries. This market is characterized by lesser formal disclosure requirements and a generally smaller degree of official regulation and formalized investor protection than the public markets. In most cases this markets is not open to the broad investing public, but is rather restricted to professional, institutional or sophisticated investors. Venture capital, as well as mezzanine finance, takes place in private capital markets. The private capital markets are often used by large companies, which can select between public and private capital markets. By contrast, SMEs must obtain funding almost entirely through the private markets.

Nevertheless, SMEs can be listed and traded on public markets by way of special exchanges and comparable trading platforms for SMEs. For example, the alternative Investment Market (AIM) in the United Kingdom is designed to facilitate public listing by smaller companies. Disclosure requirements and trading regulations are specially calibrated to the needs of SMEs. Even in this case, SMEs that are listed on specialised exchanges are usually subjected to less rigorous disclosure requirements than large companies, and other investor protection rules are usually applied more flexibly, in recognition of the special difficulties of SMEs in complying with rules in public markets. However, the SMEs that qualify for listing on such exchanges tend to be the most advanced SMEs, i.e. those that are closest to being able to access the public markets.

In the period 2004-2007, banks in Germany and, to a lesser degree in Austria and Switzerland, experimented with an alternative method to private investment partnership, using asset securitisation as a technique for extending mezzanine finance to SMEs. However, due to large losses in the underlying portfolios and to a less receptive mood in capital markets for securitised assets since the crisis, no new activity in this market segment has been undertaken since 2007 (Box 3).

Box 9. The experience with securitised mezzanine finance (2004-2007)

In 2004, the Capital Efficiency Group together with HypoVereinsbank (HVB) initiated the first German securitisation of subordinated loans and profit participation agreements to German SMEs (in this case the enterprises could have up to 500 employees). Several other large German banks as well as a few foreign institutions launched similar operations. Through 2007, around 500 mezzanine loans to some 450 medium-sized companies were securitised with a total volume of bonds issued reaching more than EUR 4.4 billion (Beissenhirtz, 2011).

The structure of this facility was based upon that of collateralised debt obligations (CDO). The individual mezzanine loans were bundled into a portfolio. The cash flows from this portfolio of assets supported the securitised transaction. Under this mechanism the organisers, led by the originating bank, create a special purpose vehicle (SPV), a legal entity whose only purpose is to support a securitisation operation. Usually, the SPV cooperates with one or more German banks who select candidates for inclusion in the facility. The SPV extends loans and other financing (mainly profit participation certificates) to the SMEs and funds itself by issuing bonds. Besides, other financial experts may be engaged in the process. A trustee has the role of safeguarding the interests of investors buying bonds issued by the SPV. Rating agencies assign the ratings to issued bonds. Other financial advisors may help in the screening of obligors and in the monitoring of the transaction. In some transactions, a recovery manager is designated to sell off distressed loans or to restructure the obligor companies so as to improve the value of distressed loans.

In this form of securitisation of mezzanine loans, the SPV obtains the funds for the loans by issuing bonds. These bonds have the same maturity as the underlying loans. Hence the securitisation is not exposed to liquidity risks. Several tranches of bonds are issued. This portfolio is then sub-divided into different default probability tranches, and each of the tranches is rated by the big international rating agencies. Usually, these tranches are strictly subordinated, i.e. a tranche suffers from default losses only if all subordinated tranches are completely exhausted by default losses. The most subordinated tranche, which first absorbs all default losses up to its par value, is the First Loss Position (FLP). It is non-rated and also called equity tranche or junior tranche. In a typical loan securitisation transaction, the FLP absorbs more than two thirds of the expected default loss of the underlying loan portfolio (Franke, Herrmann and Weber, 2007). The most senior tranches are sold to individual and institutional investors, while the junior tranches are held by the originating banks and closely related entities. In other words, the risk and reward are concentrated in the originator and closely related parties.

The borrowing companies undergo a rigorous screening process before being selected for the portfolio. They should have an investment grade rating, generate an annual turnover of more than EUR 50 million and have capital needs of at least EUR 1 million. Relatively large loan volumes (EUR 1-18 million) are a feature of mezzanine transactions, with small enterprises largely absent.

The number of loans in these facilities is relatively small so that the loan portfolios are not well diversified, making them more vulnerable to adverse market developments. In contrast, securitisations of SME standard loan portfolios are more granular (often more than 200 loans) and characterised by small average loan volumes, mostly between EUR 200 000 and EUR 1.5 million (HVB Corporate & Markets, 2005). Furthermore, the volume of a standard SME loan securitisation usually exceeds EUR 1 billion, substantially more than middle market securitisations.

In a typical middle market transaction, the underlying mezzanine loans have a seven-year bullet maturity without any call provision. The claims are generally unsecured.

The terms of these facilities were fairly attractive from the borrowers' standpoint. In these transactions, borrowers' pay a fixed interest coupon plus a stepwise profit dependent-component of respectively 1% and 2%. For example, one of the portfolio companies in a securitised mezzanine facility for EUR 15 million, stated in its annual report that it paid a fixed interest rate of 7.5% as long as the adjusted net income of the same year is less than EUR 45 million, 8.5% if it is between EUR 45 and EUR 55 million and 9.5% if it is above EUR 55 million. In some transactions, the company must pay an additional interest if it does not provide annual statements in time.

These rates are far below comparable rates on transactions using the limited investment partnership structure, where the investor normally expects a return of 13% and 16% (Dentz, 2006). This cost differential remains substantial even when the enterprises must pay profit-related premiums and/or a surcharge for interest deferral.

The issuance of securitised mezzanine products of this kind effectively ceased with the crisis of 2007, partly because investors became wary of exotic securitised investment instruments in the wake of the sub-prime crisis. In addition, the poor subsequent performance of these facilities has discouraged new issues. Defaults were considerably higher than projected. Because of the subordinated nature of these claims and the absence of collateral, losses were

heavy in case of default. Additionally, the limited monitoring and control rights of the portfolio managers to interact with the corporate (i.e. limited covenants, no right to force the management of the borrower to act in a certain way) combined with an inability to sell the asset (no liquidity in the underlying asset). Apparently, originators tended to securitise some of their weaker credits, since the risk was passed on to investors.

On balance, the experience with this kind of operation suggests that it cannot be a model for future use of mezzanine finance for SMEs without fundamental modifications.

Source: Beissenhirtz (2011); Franke, Herrmann and Weber (2007); Dentz (2006); HVB Corporate & Markets (2005).

4.1.2. Investors

Private investors

As mentioned above, mezzanine investment usually takes place through a limited investment partnership in which professional managers are the general partners (GPs) who contribute expertise in the management of mezzanine investment, while the limited partners (LPs) are entities with funds to invest. When investment in mezzanine funds began in the United States in the 1980s, the main investors (LPs) were insurance companies and savings and loan associations. At present, the investor base has widened to include investors such as high net worth individuals, family offices, pension funds, hedge funds, leveraged public funds, as well as banks that have established specialised mezzanine subsidiaries.

Traditionally, mezzanine lenders are “buy-and-hold” investors, meaning that they tend to hold positions for relatively long periods as opposed to investors who trade frequently. They are generally focused on cash-flow lending. These investors usually try to obtain high rates of return for an extended period of time, while using various profit or turnover participation rights as well as equity participation to enhance total return. Unlike assets such as traded equity, high-yield debt, and interest rates which exhibit volatility in the face of changing economic and financial conditions, commercial mezzanine finance tends to have consistent and stable yields. Even as rates on traditional credits have tended to decline with the fall of interest rates since 2007, the coupon rate on mezzanine notes and expected returns of mezzanine investments have remained relatively steady (Silbernagel and Vaitkunas, 2010).

There is only limited possibility for smaller (i.e. retail) investors to invest in SMEs in any form, including mezzanine. One mechanism by which smaller investors can invest in SMEs is through specialised collective investment schemes (CIS), which receive the savings of smaller investors and purchase assets that are traded in private markets. Some OECD countries have authorised the creation of special investment vehicles in which retail investors can purchase shares of special CIS that invest in SMEs through instruments such as mezzanine finance, venture capital funds and unlisted equities. Indeed, in some countries the authorities have decided to grant preferential tax treatment to these specialised CIS. For example in France a special investment vehicle, the *Fonds Commun de Placement en Innovation* (FCPI), has been created to facilitate investment in companies that are certified as innovative under criteria established by OSEO, the state-owned financial institution that facilitates SMEs’ access to long-term capital. Investment in FCPIs is tax deductible and capital gains on investment on FCPIs held for a specified period are tax free.

Public investors

In addition to the funds provided by private investors, who are mainly interested in profit, funds may also be provided by official entities. These may award investment mandates to commercial mezzanine specialists under the assumption that private investment specialists are better able than government

officials to identify promising candidates for mezzanine finance and to interact with such companies at varying stages of their growth cycle.

Public suppliers of mezzanine capital include national and sub-national governments as well as regional institutions. Public investors usually operate through investment funds in which a sum of money is assigned to various professional asset managers who are the general partners. As explained in Section 3.2, public investment in funds can take the form of simple funds structures or fund of funds structures.

There are some investment funds that are required to place funds in mezzanine products. Examples include the EIF's Mezzanine Facility for Growth (see Box 5) and the recently formed Mezzanine Dachfonds for Germany (see Section 5).

In addition to funds that are specifically dedicated to mezzanine finance, there exist many public funds whose mandates are flexible enough to permit investment in mezzanine finance, as well as in other instruments such as loans, venture capital or other forms of equity. For example, in *Denmark*, Dansk Vækstkapital, established in 2011 through an agreement between the Danish government, the pension industry association Forsikring & Pension (F&P), the Federation of Danish Investment Associations, LD and ATP, operates as a fund of funds. According to its investment mandate, it would be permitted to invest in funds which supply mezzanine capital to small and medium-sized companies. However, Dansk Vækstkapital has not yet invested in mezzanine. In the *United Kingdom*, the Capital for Enterprise Fund (CfEF), fully owned by the UK government, supports viable businesses that have exhausted their borrowing capacity with banks in amounts ranging from GBP 200 000 to GBP 2 million. The fund is authorised to invest in mezzanine or equity. In *Sweden*, Industrifonden and Fouriertransform are public early stage venture capital providers that also deal with mezzanine finance. *Ireland* has a number of other public investment funds which may invest in mezzanine finance along with other forms of financing such as venture capital. These include the Innovation Fund Ireland Scheme and the domestic Seed and Venture Capital Schemes. In the *United States*, there are no funds of this kind on the federal level, but some states have development funds that invest in mezzanine and equity.

Funds are made available to GPs who invest them in portfolios of qualifying companies as they would invest funds obtained from private sources. Public money is invested under general guidelines such as a requirement that a stipulated share of instruments must be invested in companies producing alternative energy or those with sales of a comparatively small amount. In *France*, the long-term French Investment Program (*France Investissement*) of CDC Entreprises provides an example of a comprehensive programme of investment in mezzanine finance by the public authorities through privately managed funds (Box 4).

In addition, amongst the funds for investment in small companies provided by international organisations, such as the EU, the EIF, and the ADB the EBRD and the IFC, some are dedicated mezzanine funds. At European level, the financial instruments of the Competitiveness and Innovation Framework Programme (2007-2013) offer the possibility of mezzanine type financing through one of the windows of its SME Guarantee Facility (the 'Equity Guarantee Window'), and the European Regional Development Fund provides the opportunity for Member States/Regions to finance similar instruments. The EU often invests directly with regional (i.e. sub national) funds in member countries. Box 5 illustrates the example of the European Investment Fund (EIF)'s Mezzanine Facility for Growth.

Box 10. Investment Funds for SMEs: The Case of *CDC Enterprise* in France

The *Caisse des Dépôts et Consignations* (CDC) is a French State-owned financial Institution, founded in 1816, whose consolidated assets amounted to EUR 270 billion in 2010. CDC is under the “supervision and guarantee” of the French parliament and its mandate includes long-term investments through a network of operating subsidiaries.

CDC Entreprises, founded in 1994, is a wholly owned subsidiary of CDC, whose principal line of business is private equity funds' management (both funds of funds and direct funds) focused on SMEs with high value technologies and expansion strategies. It manages investments in SMEs on behalf of the *Fonds Stratégique d'Investissement* (FSI), a state investment fund, but also for the CDC and other public and private institutions. As an investment management institution, *CDC Entreprises* is approved and regulated by the French capital market supervisor (Autorité des Marchés Financiers – AMF).

The general purpose of *CDC Entreprises* is to stimulate development and ensure sustainability of the private equity market without disrupting or artificially supporting the market. As of September 2012, it had assets of EUR 7.8 billion under management. Since its inception, it has invested in more than 5 500 SMEs. Its present portfolio is composed of 3 000 French SMEs with 190 000 employees. Indeed, it is estimated that half all SMEs in France that receive equity financing are directly or indirectly financed by *CDC Entreprises*.

During the post 2007 crisis, *CDC Entreprises* continued to invest in new companies and to re-invest in existing ones. However, the volume of funds actually invested remained flat. Beginning in 2009, the volume of investment outlays has been rising sharply. In 2011, EUR 1.25 billion was invested in 844 SMEs of which EUR 881 million in 422 new businesses (*primo investments*). This represented a 12% rise from the preceding year and was a historic high.

CDC Entreprises targets a ‘sustainable’ long-term Internal Rate of Return (IRR). This means that, while a competitive market based rate of return is sought, it takes other considerations into account when making asset allocation decisions, such as general market development, funding of key sectors and providing resources for under-served market segments. *CDC Entreprises* invests through both direct funds and funds of funds structures. It is *CDC Entreprises* policy to invest only alongside private investors. *CDC Entreprises* never takes more than 50% of any fund or company, except in very specific segments (i.e. in the case of seed capital, *CDC Entreprises* can take up to 90% of a fund capital). As of 2012, it worked with 257 partner funds.

While *CDC Entreprises* began with a focus on venture capital and other forms of equity, it has a flexible mandate and thus provides financing in other forms as appropriate. Its funds generally have sufficient flexibility to invest in the form of financing that best suits the needs of the SME, subject to compatibility with the general investment objectives of *CDC Entreprises*. In general, the use of hybrid products, including mezzanine, has been rising over time.

Some 70-75 % of *CDC Entreprises*' total EUR 7.8 billion in assets is invested through fund of funds structures. There are 9 funds of funds centred on investment in French SMEs. These funds of funds invested in 231 funds, both sectoral and generalist (a limited number of funds invest outside of France). In its fund of fund structures *CDC Entreprises* acts as a General Partner with major French and international financial institutions, non-financial business and the French State as Limited Partners (LPs). No attempt is made to assess individual companies. Instead, the selection process centres on the selection of fund managers. Meetings are held with prospective partners who are domestic firms with fund management expertise, as well as a few international firms. The prospective fund manager initiates the process by making a proposal to form a fund with a stipulated investment policy and indicating the sums that will be raised from other private and public investors. Selection criteria for GPs that will manage individual funds include the attractiveness of proposed fund on the basis of financial projections and discussions with fund management team, the investment strategy, proposed terms and conditions of the fund and the professional qualifications and record of the team. The main categories of investors (LPs) are insurance company's family offices, banks and industrial companies. *CDC Entreprises* monitors the performance of funds in its portfolio by receiving regular reports, which are discussed by Advisory Board. Monitoring concerns the fund performance, which is however closely linked with the performance of companies financed through the fund.

Venture capital and expansion capital are the two main areas covered by the fund of funds. In the case of venture capital, all stages are covered (i.e. seed, early and later stage) and the minimum target investment size for a fund has risen over time, approaching EUR 50 million. While the activity is mainly focused on equity investments, some mezzanine and other hybrid techniques are used. In expansion finance debt, mezzanine and other techniques are used along with equity. Investment strategy for expansion includes: a) pure expansion capital (via minority investment in equity); b) mezzanine; c) turn-around finance; and d) degree buy outs, to a limited extent.

CDC Entreprises also makes direct investments through 11 funds, in which it partners with other investors. Direct funds under management include EUR 710 million in general venture capital funds and EUR 360 million in dedicated expansion and mezzanine funds. These funds operate throughout the country and in all sectors. There are some specialised funds for industries such as 1) cultural, media and fashion sectors 2) the health industry 3) the timber industry 4) the digital industry and 5) environmental technologies. There are also regional funds that focus on certain localities and have wide industry coverage using various techniques.

In the case of direct funds, *CDC Entreprises* is directly involved in discussions with individual companies and in the selection of companies that receive funding. It also engages in direct monitoring of the companies. It may be represented on the boards of companies in which it invests, with different positions, including that of observer or member of Strategic Committee.

In a recent development, *CDC Entreprises* received EUR 510 million in funding from the FSI, which is earmarked for investment in mezzanine-like instruments. These assets are invested through a fund called OC+. The investment policy of this fund is to fill the gap between medium term credit and equity funding. It is targeted to established companies, especially family controlled companies that seek expansion capital without opening their capital structures to outside parties. Borrowings are from EUR 0.5 million and EUR 7 million. Companies selected for investment issue of convertible bonds with share subscription warrants attached with a maturity of 5 to 7 years. The bonds consist of a 5% annual interest rate and of a 7% Payment In Kind (PIK) rate. At the end of the period, the company has the option of permitting the investor to exchange the bonds (integrating the PIK) for equity or to make cash payment of equivalent amounts. Warrants let *CDC Entreprises* participates in the business's growth during the investment period. These warrants give entitlement to acquire shares at a price set at the time of making the investment.

Source: *CDC Entreprises* (2012)

Discussions with practitioners reveal that in some countries, especially those with relatively underdeveloped capital markets, public investors are predominant. The public investor often has motivations other than profit when investing, such as to make financing available to companies for which a financing gap has been identified and/or to familiarise market participants with new financing techniques. Public investors receive the same treatment as other limited partners. If public investors invest with private investors they will all receive the same return. If public investors are the dominant investors, they may accept lower returns in exchange for selection of companies that meet other criteria.

4.1.3. Data on use of commercial mezzanine finance by SMEs

The information in this section was obtained from public sources and direct contacts with market participants. Although this has produced a reasonably complete picture of the techniques used in mezzanine finance and the major participants in the markets, there is a significant lack of information concerning the volume of commercial mezzanine finance for SMEs.

As far as is known, there is no accepted source of data on the use of commercial mezzanine finance by SMEs. A certain amount of data is sold by private vendors. However, the definitions of mezzanine finance differ across countries and there may be a problem in separating mezzanine finance used by SMEs from those used by larger companies where the market is dominated by LBOs. In addition, not all mezzanine finance is registered. The extent of silent participations, for instance, is difficult to measure (EC, 2007).

Box 11. European Investment Fund (EIF) - Mezzanine Facility for Growth

The EIF is the European Investment Bank (EIB) Group's specialist provider of SME risk finance across Europe. It plays a crucial role throughout the value chain of enterprise creation, from the firm's earliest stages to mid and later-stages. While EIF's equity instruments aim to improve the availability of risk capital for high-growth and innovative SMEs, EIF also targets the debt requirements of SMEs by providing guarantees and credit enhancement thus improving the lending capacity of financial intermediaries to benefit SMEs.

As a pioneering investor in European venture and growth capital, EIF has built a strong track record. Its equity activity is based on the experience it has developed through its diversified portfolio of fund investments, being a reference investor with measurable catalytic effect. A key priority is to help the establishment of a well-functioning, liquid venture and growth capital market that attracts a wide range of private sector investors, and to contribute to the sustainability of investments.

In 2009, the EIF began to offer mezzanine finance, by launching a fund with a dedicated mezzanine mandate, the Mezzanine Facility for Growth (MFG). This is a EUR 1 billion 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 a new but real 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.

In 2011, EIF committed a total of EUR 236 million in six hybrid debt-equity funds, spreading its contribution between two first-time teams composed of experienced professionals and four established teams raising new funds. Five of the funds backed by EIF in 2010 and 2009 made further closings in 2011, demonstrating EIF's catalytic role in allowing first closings and in generating new investors' interest which amounted to EUR 1.2 billion. In 2012, 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) was established. MDD is a EUR 200 million 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).

Source: European Investment Fund.

4.2. Public programmes to provide direct mezzanine finance

The preceding section described the situation of commercial mezzanine finance as it has evolved among private market participants, including those cases in which a public body supplies capital but delegates' responsibility for the actual investment of that capital to private asset managers. Funds of this kind are most likely to be used by larger SMEs and by those with relatively high credit ratings.

However, even if official programmes to provide financing through investment funds are successful, they would still leave substantial numbers of economically and financially viable SMEs with a financing gap. For example, at the Fifth Round Table between bankers and SMEs, organised by the European Commission in 2006-07, it was estimated that the commercial mezzanine market can accommodate operations of EUR 2 million or higher with ratings of BBB+ or better, whereas medium sized operations (EUR 1- 2 million) or smaller operations (less than EUR 1 million) require more direct participation by an official body (EU, 2007).

As a result, many governments have decided to take additional steps to expand access to finance by developing programmes under which financing can be made available to other SMEs using risk sharing and compensation techniques that are similar to those used in commercial market mezzanine. Regionally operating and promotional banks had been trying to introduce this product in a number of countries. In section 5, examples from Member countries are presented.

Also, a Network of Financial Institutions for SMEs (NEFI), which brings together promotional institutions from several EU countries, has become active in this field. Financial institutions in this range often operate in concert with Business Angel networks. This work is often combined with mentoring of smaller and newer companies.

4.2.1. Structure of programmes

On the basis of publicly available information and selected contacts with SME finance agencies, some basic characteristics of programmes to support mezzanine finance to SMEs can be discerned. Essentially, in contrast to straight loans and guarantees provided under traditional public financing programmes, these schemes are designed to provide financing for growth and for other situations of transition (e.g. internationalisation, recapitalisation or transmission), similarly to commercial mezzanine finance. They tend to operate under the principles that the official partner should mitigate the risk to private suppliers of capital while sharing in the rewards if the company attains above average growth.

Unlike commercial mezzanine finance which has tended to converge toward a uniform global pattern, in the case of public participation, the specific pattern of mezzanine finance has tended to be guided by the laws, institutions and policies of the jurisdiction in which it operates. These operations are less standardised than fully private market operations and depend upon the decisions that each country has made regarding the best way to structure its own programmes.

Rather than investing in a portfolio of companies as was the case with funds, these schemes usually involve one particular company, which receives direct funding from the official financing agency. An alternative model is for the official agency to maintain a programme of guarantees where actual funding comes from a private institution (in most cases a bank). Official agencies that promote SME development have tended to work with individual financial institutions such as private banks, whereas commercial mezzanine facilities tend to group investors into funds where all investors share the earnings equally. In direct financing schemes, the official agencies are sometimes more willing to accept different tranches than private participants. Official agencies will often accept the riskier subordinate tranches, while the bank provides a senior tranche¹⁴. These programmes usually stipulate conditions that the SME must meet in order to receive funding and set the terms of a typical contract, including the term length of the facility and the interest rate.

The official financing agency will usually insist that a private financier participate in the operation, either through a bank loan or an equity investment. Facilities supported by official agencies to promote SME finance sometimes contain “straight” or senior debt tranches where subordinated loans will only be granted where the company raises a significant amount of funding from banks. Subordinated loans are typically part of the facilities offered under these programmes. These loans are usually at fixed rate over a base rate, with the premium rising along with the credit risk of the company. The rate is higher than those provided by official agencies on senior credits or guarantees but is usually less than rates charged by commercial mezzanine finance. In some cases, the interest rate is linked to the credit standing of the company. Some of these subordinated loans amortise over the life of the loan with a grace period offered or may be in bullet form, i.e. with payment at the end of the loan. These facilities often provide for guarantees both on the debt and equity portions of the funding.

Most public mezzanine programmes avoid equity-like instruments such as convertible debt or debt with warrants and instead favour silent partnerships or “success fees” under which the agency receives a share of the profit or turnover of the company but does not acquire an active equity stake in the company. In fact, these facilities generally entitle the agency to receive information about the state of the company, but no

¹⁴ See the case of Oseo in France (Section 5).

right to take part in decisions of the company. The Business Development Bank of Canada (BCD) would appear to be one exception, as it is rather flexible in its readiness to accept equity-like positions (see Section 5). Usually these facilities enable the official agency to obtain additional compensation if the company is successful. Thus, in France, under the Development Contract (DC) scheme, OSEO receives some compensation in the form of a share in the firm's turnover above a specified threshold.

As Table 4 illustrates, countries with government programmes of direct provision of mezzanine finance to SMEs include Austria, Canada, the Czech Republic, Estonia, France Germany and Spain. Reportedly, Poland is developing such a programme under the auspices of the Bank for National Economy (BGH). The new Business Bank in the United Kingdom may include a programme of this kind. In Belgium, there are three regional programmes for Flanders, Wallonia and the Brussels region.

4.2.2. Data on public programmes for direct mezzanine finance for SMEs

In general there are even less publicly available data on officially supported mezzanine finance than on commercial mezzanine finance. The information supplied through the OECD Questionnaire to Member countries (Annexes 1 and 2) has provided essential evidence on some countries and represents a first step for developing an accurate monitoring framework of mezzanine finance provided to SMEs under public schemes.

Table 4. Mezzanine finance programmes in selected OECD countries

Country	Agency	Name of Programme	Target group	Type of mezzanine product	Guarantee	Mezzanine investment range	Duration of mezzanine investment	Rights of mezzanine investor	Private co-financing (debt or equity) required	Official Contribution (straight debt, subordinated debt, guarantee, equity)	Official participation in "upside"	Evaluated
Austria	Austria Wirtschaftsservice		SMEs	Subordinated Loan	Yes 70% of own funds	Up to EUR 2.5 million	3-10 years	Information rights	Yes			No
Belgium: Wallonia	Sowalfin	Subordinated loan programmes	SME according the European definition located in the Walloon Region not in financial difficulties (also European definition)	Subordinated Loan		Max 40% of the funding of a specific project Min EUR 25,000, max. EUR 350,000 per project Max outstanding amount per company: EUR 500,000	Same term as the bank loan with a maximum of 10 years (+ 2 years max franchise if the bank also gives a franchise)	No presence at the board	Private co-financing of min 60% of the project	Subordinated Loan		No
Belgium: Flanders	Participatie Maatschappij Vlaanderen. (PMV)	Groeimezzanine, Participatiemaatschappij Vlaanderen (PMV), sub-national Innovatiemezzanine; Participatiemaatschappij Vlaanderen (PMV), sub-national	Groeimezzanine, SMEs and larger companies; older than 6 years Innovatiemezzanine: Innovative start-ups (those who got a subsidy from the government agency for Innovation by Science and Technology (IWT) for an SME innovation project or an R&D business project)			Groeimezzanine: between EUR 500 000 and EUR 5 million Innovatiemezzanine: max. either EUR 1 million or 80% of total project cost minus received subsidies, whichever is smallest	Groeimezzanine: 10 years maximum (on average 7 years) Innovatiemezzanine: 6 years	Information Rights Possibly Board seats (as an observer in general)	Groeimezzanine: co-financing of at least 20% of mezzanine amount required Innovatiemezzanine: subsidy from IWT granted	Subordinated debt	(Occasionally) warrants, right of first refusal and conversion rights; depending on deal structure and type of company; Innovatiemezzanine: Right of first refusal and conversion right	No
Belgium: Brussels region	SRIB regional Investment Company for Brussels		SMEs	Unsecured and convertible loans	No		3-7 years	information rights, board seats in some cases	Yes	Straight or convertible debt	In some cases	No
Canada	Business Development Bank of Canada (BDC)			Subordinate Financing		Between USD 250,000 and USD 10 million	3-7 years	Information Rights or Board seats representation or observer status	Yes	flexible	Yes	No. In progress: 10-year legislative review of BDC

Country	Agency	Name of Programme	Target group	Type of mezzanine product	Guarantee	Mezzanine investment range	Duration of mezzanine investment	Rights of mezzanine investor	Private co-financing (debt or equity) required	Official Contribution (straight debt, subordinated debt, guarantee, equity)	Official participation in "upside"	Evaluated
Czech Republic	Czech Moravian Guarantee & Development Bank Progress		SMEs and larger companies	Subordinated Loan		Up to EUR 750,000	9 years maximum	Information rights			No	No
Denmark	Vækstfonden (State investment fund)	Ansvarlige lån (subordinated loan product to SMEs)	SMEs (according to EU definition)	Subordinated Loan			6-8 years		Matching fund: minimum 100% (including new financing from banks)			No
Estonia	Kredex		SMEs and larger companies	Subordinated Loan & Silent Partnership		EUR 64,000- EUR 1.1 million	3-10 years	Information rights	No	Subordinated Debt	Yes, success fee	
France	OSEO	Contrat de Developpement Participatif			Yes	EUR 40,000 EUR 3 million	7 years	Information rights	Bank loan or equity investment		Yes, share in turnover	No
	France Investissements											No
Germany	KfW	KfW Entrepreneur Loan	Established SMEs and self-employed professionals	Subordinate debt + senior loan	100% of subordinated loan	Turnover, ≤ EUR 50 million	10 years (7 years grace)			Guarantee of subordinated loan		No
	KfW	ERP Capital for Start-Ups	start-ups, young enterprises	Subordinate debt	100 %		15 years (7 years grace)		Equity	Guarantee of subordinated loan by bank		No
	KfW	ERP Innovation Programme	Established SMEs and self-employed professionals	Subordinate debt + senior loan	100% of subordinated loan	Turnover, < EUR 125 million (exceptionally EUR 500 million)	10 years (7 years grace)			Guarantee of subordinated loan		Yes
	European Investment Fund	Mezzanine Dachfonds for Germany Facility (EUR 200 million)	SMEs	Fund of Funds For mezzanine Silent Partnership		Turnover, ≤ EUR 500 million	7 years					No
	Regional Profit Participation Funds (20)	- MBGs (SME-oriented equity funds)	Start-ups+ Established companies	Silent partnerships	Yes 50% of risk covered	Turnover, negligible to EUR 75 million				Counter Guarantee		No

Country	Agency	Name of Programme	Target group	Type of mezzanine product	Guarantee	Mezzanine investment range	Duration of mezzanine investment	Rights of mezzanine investor	Private co-financing (debt or equity) required	Official Contribution (straight debt, subordinated debt, guarantee, equity)	Official participation in "upside"	Evaluated
Ireland	Innovation Fund Ireland Scheme and Seed and Venture Capital Schemes			Funds of Funds: may invest in mezzanine and other instruments								No
Norway	Innovation Norway	National innovation loans, Innovation Norway, national Regional innovation loans, Innovation Norway										No
Poland	BGW			Programme under Development								No
Spain	Empresa Nacional de Innovación (ENISA)	Línea de Préstamos Participativos para: - empresas de base tecnológica - pymes - jóvenes emprendedores	SME	Subordinated Loan	No	EUR 75000- EUR 1.5 million	9 years (up to 7 years grace)					Yes
Sweden												No
United Kingdom	BIS			Programme under Development								No
	Capital for Enterprise Fund (CfEL).			GBP1.2bn fund for SME investment. With private contributions total assets include. GBP 4 billion Partly invested in mezzanine								No
	BIS	Santander Breakthrough;	SMEs, via bank	Pure subordinated debt, repayment PIK	No		3-5 years	Senior debt holder, No seat	Yes	Straight debt	No	No
	BIS	Business Finance Partnership	SMEs, via non-bank lenders		No		Mixed	Mixed	Yes	Straight debt	Parri-passu	No

Country	Agency	Name of Programme	Target group	Type of mezzanine product	Guarantee	Mezzanine investment range	Duration of mezzanine investment	Rights of mezzanine investor	Private co-financing (debt or equity) required	Official Contribution (straight debt, subordinated debt, guarantee, equity)	Official participation in "upside"	Evaluated
United States	Small Business Administration (SBA)	Small Business Investment Corporation (SBIC)	Taxable income < million Net worth < USD18 million	SBIC		2-3 times private contributions		Information Rights Board seats		Senior loan	No	No

Source: OECD Questionnaire to Member Countries on Seed, Early and Later Stage Finance (2012).

5. Public support programmes in selected countries

5.1. Austria: AWS¹⁵

The Austrian public promotion agency AWS (Austria Wirtschaftsservice) provides guarantees for mezzanine products within its facility called Guarantees for Mezzanine Investments (“Garantien für beihilfenfreie Mezzaninfinanzierungen”). Eligibility is restricted to SMEs located in Austria, independent of their legal form and sector of activity. Similarly, the project to be financed with the mezzanine investment has to be realized within the country. In order to be eligible for the program, firms have to apply before December 2013. Eligible investors include banks and individual investors.

The guaranteed mezzanine product can be used for either investment or acquisition purposes. Investment projects include those related to the modernisation or capacity expansion of the firm as well as plans to enhance research and development. As for acquisition purposes, only expenses related to the acquisition of firms in Austria, rather than the purchase of shares, will be supported. On the other hand, the guarantee cannot be used to finance working capital needs. Only projects which have not yet started are eligible.

A maximum of 50% of the mezzanine investment volume can be guaranteed; the maturity of the mezzanine investment must be between 5 and 10 years. The guaranteed amount cannot exceed 7.5 EUR million apart from justified exceptions. Administrative fees are structured as follows: 0.5% of the guarantee amount for the first EUR 2.5 million, and 0.3% for the remaining guarantee volume. The guarantee fee in turn depends on the credit rating of the SME; the minimum fee is 0.6% of the guarantee amount. Finally, 0.2% of the guarantee volume has to be paid for the guarantee commitment.

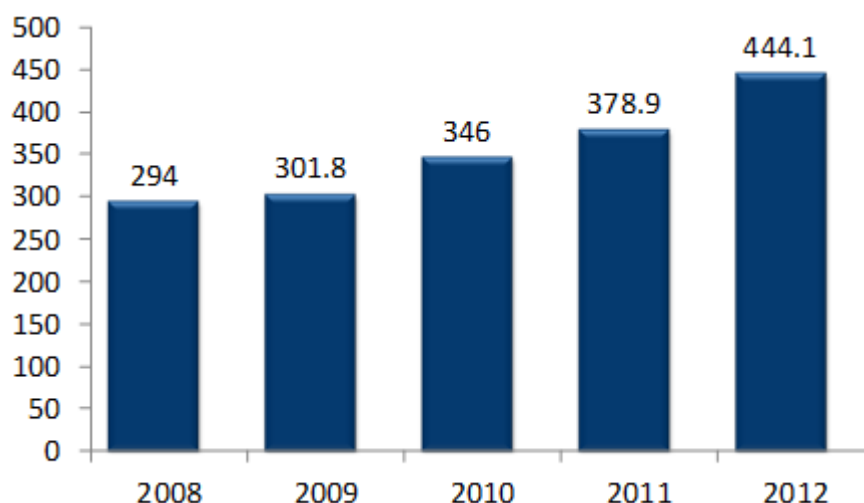
Currently, AWS is evaluating several applications from Austrian SMEs. So far, one mezzanine guarantee has been granted. The programme has a provision for the evaluation of operations; the government has established a list of criteria according to which the performance of the guarantee program will be evaluated. Specifically, a survey will capture information on several fundamental characteristics of the supported firm (sector of operation, location, firm size, size of the mezzanine investment). Moreover, the performance will be assessed taking into account the growth of the supported firm (measured in terms of both employees and turnover) and whether the additional funds provided by the guaranteed mezzanine have resulted in further investment or accelerated the realisation of the project. Each participating firm is obliged to provide the corresponding information.

5.2. Canada: Business Development Bank of Canada (BDC)¹⁶

The Business Development Bank of Canada (BDC) is a Crown corporation, with a mission of facilitating SME access to finance in areas where a market gap is present and private markets do not appear inclined to become active. BDC has been active in mezzanine finance for 10 years and the activity has proven to be profitable. The mezzanine finance represents a relatively small share of total BDC activity, but is nonetheless significant in certain sectors. As in other countries, mezzanine credits contracted at the beginning of the crisis in 2007 and remained flat through 2009, but rebounded in 2010-2011 (Figure 2). Mezzanine finance declined initially as a share of total BDC outstanding, but its share subsequently rebounded.

15 Source: Aws (2012) Garantien für barrierefreie Mezzaninefinanzierung, available at www.awsg.at/Content.Node/files/kurzinfo/Inland-Mezzaninfinanzierungen.pdf

16 Source: BDCs' financial statements and reports.

Figure 2. BDC's subordinated debt portfolio (USD000), 2008 – 2012

Source: BDC, Financial Statements, 2006-2011.

Compared with public agencies in other countries, the BDC enjoys great flexibility in structuring facilities to fit the situations of its clients. The size of financing facilities range from CAD 250 000 to CAD 10 million. The BDC can provide all of the financing on its own, but more frequently it partners with private financiers, especially the chartered banks. The programmes are operated by small teams, through regional offices across the country. The teams operate separately from those offering debt-based products.

A typical BDC mezzanine facility contains a subordinated loan which provides a stipulated rate of return as well as other facilities that provide additional income linked to the performance of the company. Additional income can take the form of a) royalties on sales or EBITDA¹⁷; b) interest based on enhanced value of the company; c) equity warrants; or d) other factors that can be negotiated with the client. The BDC's targeted rate of return for mezzanine (including interest and participation in "upside") is 15-17%.

The maturity of the subordinated loan can be from three to seven years. Grace periods are also subject to negotiations, and the BDC can negotiate contracts under which payments are all postponed until the end of the facility or under which the obligor makes regular monthly payments. An agreement that allows borrowers more flexibility in repayment to reflect their cash flow situation is possible.

Three basic purposes for which BDC provides mezzanine finance are 1) acquisition; 2) growth; and 3) working capital. The BDC does not generally provide mezzanine finance to early stage companies, preferring to work with established companies with a strong market position. Some of the main characteristics of companies considered "bankable" are detailed in Box 6.

In order to be considered for mezzanine/subordinated debt financing, an applicant should expect to provide the lender with a detailed business plan, including a comprehensive description of the company's market and the opportunities with which it is confronted. This should be supplemented by audited financial statements of historical results (or at least a review of engagement reports with an

¹⁷ Earnings Before Interest, Taxes, Depreciation and Amortization.

audit on major balance sheet items), as well as a copy of the company's strategic plan. In some instances, a technology assessment conducted by a qualified third party may be required.

Box 12. Mezzanine finance by the Business Development Bank of Canada: Criteria for the selection of firms

A strong management team with vision. BDC looks first for a strong, committed management team that possesses continuity. Some necessary components include a clear mission and vision for the organization and evidence of strategic planning. Furthermore companies should have sound financial and business information reporting capabilities, allowing the providers of mezzanine/subordinated debt finance to monitor their key risks and success drivers.

Financial soundness. The company must be financially healthy with a strong track record of at least two or three years. This is measured by the historical cash-flows and earnings of the business and its abilities to meet needs and obligations to date, otherwise known as its cash-flow coverage. Further indicators are the proposed level of debt relative to overall equity, working capital ratios, margins of safety (break-even sales relative to forecast sales) and the cash conversion cycle.

Supportive private financial institution with operating line of credit in place. Other important considerations are the level of support from major operating lenders and the ability to raise additional capital when necessary. The facility must be supported by BDC's in-house credit specialists and relationship managers.

Industry strength poses the most challenges for lenders because of the level of due diligence that is involved in this area. They must assure themselves that there is a market for the product based on an analysis of market demand, competition and the business's ability to continue to bring the product to market. Additionally, returns on assets and gross margins relative to industry averages are considered as well as barriers to entry and key competitive advantages possessed by the applicant.

Source: BDC.

The BDC generally prefers to offer mezzanine finance to mature companies with positive cash flows, but will occasionally look at early stage and companies that have not yet achieved positive cash flows, but whose prospects of attaining a positive position during the life of the facility seem reasonable. The BDC will consider offering mezzanine finance to high-tech companies if the firms have already reached a fairly advanced stage.

5.3. Czech Republic: Czech-Moravian Guarantee and Development Bank¹⁸

In the Czech Republic, PROGRESS is the main scheme to provide mezzanine financing to SMEs. The scheme is administered by the Czech-Moravian Guarantee and Development Bank (ČMRZB Bank), which was established in January 1992 as a specialised banking institution, on the initiative of the Ministry of Economy in cooperation with major Czech banks. ČMRZB Bank's activities have been primarily focused on providing support to SMEs within programmes of assistance launched by the Government of the Czech Republic, although, in recent years, it has also become active in housing and infrastructure finance. Indeed, the ČMRZB Bank is the only promotional bank in the Czech Republic entrusted with the administration of funds disbursed within the programmes of assistance launched by the Government to encourage the development of SMEs and entrepreneurship using financial resources from national or EU funds. These programmes aim to ease access to financial capital by SMEs and to enable them to share their business risks, while reducing their project costs. For this purpose, the support instruments used consist mainly of guarantees, preferential loans and financial subsidies.

¹⁸ www.cmzrb.cz; <http://erawatch.jrc.ec.europa.eu>; AECM (2010).

The PROGRESS programme started in 2005 and was initially funded only from the state budget. In 2007, the PROGRESS facility was transferred into the EU Operational Programme Enterprise and Innovation 2007-2013, funded from EU Structural Funds. The total allocation envisaged for this PROGRESS facility is EUR 160 million. Of this, 60% is provided by public sources and 40% from the ČMRZB Bank's own resources. Of total public funding, 85% comes from EU structural funds with the remainder from the national budget. However, in 2012, the programme was temporarily suspended due to unresolved issues in negotiations with the EU.

The PROGRESS facility provides subordinated loans to SMEs (i.e. enterprises with less than 250 employees) anywhere in the Czech Republic, except in the Capital city (Prague). The size of the loan may be as high as CZK 20 million (EUR 750 000). These loans are extended at a fixed interest rate of 3% with a maturity of up to nine years and a three-year grace period. These loans do not provide for any participation by the lender in the "upside" of the investment.

During 2007-2008, the ČMRZB Bank often required that funding through the PROGRESS facility be accompanied by a bank loan, a leasing agreement or an equity investment of an amount no less than that of the PROGRESS subordinated loan. This condition is no longer enforced. However, in most cases, additional financing from other sources is usually sought, since in general the amount of the PROGRESS loan is fairly small.

Table 5 shows the expansion of the PROGRESS Loan Programme over 2005-2011. The highest volume of new subordinated loans was reached in the year 2011. The majority of loans were issued for investment projects in manufacturing and production of energy from renewable sources.

Table 5. Czech Republic: Development of PROGRESS Loan Programme 2005-2011

Year	2005	2006	2007	2008	2009	2010	2011
Number of new PROGRESS loans	161	63	89	33	34	89	130
CZK million							
Amount committed under PROGRESS loans	1137	527	793	235	201	625	1085
Amount outstanding under PROGRESS loans	558	1215	1622	2258	2503	2892	3189
EUR million							
Amount committed under PROGRESS loans	44.1	20.4	30.7	9.1	7.8	24.2	42.1
Amount outstanding under PROGRESS loans	21.6	47.1	62.9	87.5	97.0	112.1	123.6

Source: Czech-Moravian Guarantee and Development Bank.

5.4. Estonia: KredEx

Foundation KredEx (KredEx), the official institution in Estonia responsible for export credits and loan guarantees, manages a programme of mezzanine finance. This programme is not restricted to SMEs, but is available to enterprises with equity capital of at least EUR 64 000. KredEx is expected to cover all expenses for the operation of the programme (including credit losses) from its earnings.

In order to be eligible for the programme, the enterprise must be entered in the commercial register of the Republic of Estonia. It must be sustainable and solvent with no arrears on debts. The members of the management board and the owners must be trustworthy, competent and of high reputation.

Certain economic activities may not be financed from the programme including:

- primary production (agriculture, fishery and aquaculture and forestry);
- armaments, coal and tobacco industries;

- steel sector and synthetic fibres;
- capital equipment for road transportation of goods;
- working capital for retail and wholesale trade;
- real estate projects for hiring-out and sales purposes;
- projects for export-related activity in cases where the company receives a state aid for that purpose.

The main component of mezzanine finance under the KredEx programme is a subordinated loan. The loan is aimed at providing the company with capital for development or expansion in order to enable the company: a) to invest in capital assets with the purpose of making the core business more efficient or of enabling the company to launch a new or significantly improved product; b) to implement an improved production process, delivery method or an operation supporting production, the goal of which is an increase in the quality of the product, efficiency, flexibility, environment saving or safety of the above described supporting operation or; c) to make significant changes in its business practice, work organisation or marketing. The loan can be made for other investments which will support at a forecast growth of turnover of 20% per annum for at least three years.

The amount of the loan may be from EUR 64 000 to EUR 1 100 000 but not more than the enterprise's equity capital. The term of the loan generally is for three to five years but not more than 10 years. The loan may have a grace period of up to three years but not more than seven years.

The interest rates charged on loans depend upon the age of the firm and the share of exports in the firm's turnover. The interest rate for an enterprise that has been active for at least three years, and whose export turnover in the last or current economic year was not less than 20% of the total turnover (including the turnover of subsidiaries of the company that are located abroad), starts from 10% (fixed interest rate 7.5% + success fee ranging from 2.5% to 5%). The interest rate for enterprises whose export turnover in the last or current economic year was less than 20% of their total turnover starts from 11% (fixed interest rate 7.5% + success fee ranging from 3.5% to 7%). Only fixed interest rate for the whole loan period can also be applied to that target group. The success fee depends on the risk category of the enterprise and is calculated from five times EBITDA at the end of the loan period. However, the success fee has a cap feature in which the fixed interest component plus the success fee cannot exceed the amount that would have been earned if the loan had carried an interest rate of 15% during the loan period.

Utilisation of the subordinated loans programme has fluctuated in line with company cash flows and the banks' willingness to finance companies projects (see Table 6). Demand for these loans surged when banks tightened credit during the initial phases of financial crisis in 2009-2010. In 2011-2012, Estonian companies cash flows have strengthened again and banks have become less restrictive in their lending. It is KredEx policy that KredEx should never compete with private market, and should only intervene when there is a market failure.

Table 6. Estonia's KredEx Subordinated Loan, 2008-2012

Subordinated loan	2008	2009	2010	2011	2012 I h.y.
Loan amount <i>EUR Thousands</i>	511,239	13,421,446	3,304,232	500,823	0
Number of companies	1	27	9	4	0

Source: KredEx.

5.5. France: OSEO¹⁹

OSEO is the French publicly-owned entity that is responsible for facilitating access of SMEs to long-term capital. The agency has a strong regional focus and maintains close contact with client firms. It operates and maintains close links with other major players in the SME finance sector, such as local governments, chambers of commerce, industry and professional associations, financial institutions, mutual guarantee societies, venture capitalists and business angel networks. Some 1 000 of its 1 700 employees work outside headquarters in regional offices. OSEO has elaborated strict internal procedures for credit review and only extends financing to firms that are believed to be financially viable.

Although some programmes to enable SMEs to maintain access to working capital have been introduced since the start of the 2008-09 financial crisis and thus were partly designed to help SMEs weather the crisis, the basic mission of OSEO is to support SMEs' access to riskier forms of financing at critical points in their development, as well as to foster innovation by SMEs. The critical points in the life of the enterprise are defined as: a) the founding of the enterprise; b) the expansion (growth) phase; c) transmission (change of ownership or control); and d) internationalisation.

In order to accomplish this mission, OSEO has developed a range of financing techniques that can be characterised as "mezzanine", in as much as they contain elements of debt and equity financing and also allocate risk and reward in ways that differ from straight debt finance and equity finance. These facilities have some characteristics of straight debt, guarantees and equity, as well as mezzanine.

In the wake of the crisis and with the government urging public sector entities to step up efforts to expand financing for SMEs, OSEO decided to review its line of products to determine whether there was scope to develop new products to fill the SME financing gap. OSEO argues that several of these techniques have proven decisive in helping SMEs weather the crisis since 2007, when balance sheets came under pressure and access to other forms of finance, such as bank loans and commercial mezzanine finance, has become more problematic.

¹⁹ Source: OSEO's reports and evaluations at www.oseo.fr, interview with OSEO official.

In OSEO's view, there is a mismatch between the kinds of finance that SMEs are seeking and the kinds that the market is willing to offer. As is the case in most countries, many SMEs that have the opportunity or the necessity of making basic transitions, hesitate to rely solely on external equity, which would lead to dilution of ownership and control of the firm. According to OSEO, only about one fourth of French SMEs, of which a large share is closely associated with their founding entrepreneurs and/or is family owned, would be open to enlarged equity participation by outside investors. Furthermore, the returns on many operations are not high enough to qualify for equity finance. In fact, the French private equity and commercial mezzanine markets are oriented toward buy-outs. Straight bank financing, which would have been difficult for such companies even before the crisis, has become now harder to obtain.

One of the mezzanine products that OSEO has recently used extensively to help SMEs obtain capital for growth and/or to strengthen their capital structures is the Development Contract or DC (*Contrat de Développement Participatif*), which was introduced in October 2009 in response to growing difficulties of French medium-sized firms in obtaining market-based financing.

In order to qualify for a DC, the firm must be more than three years old with less than 5 000 employees²⁰. OSEO will only participate in operations that are supported by the local authorities. Therefore, in order to be eligible, the company must undertake an investment program. The bank loan will cover capital goods and material purchases while the DC can be used to cover intangible expenses such as outlays to meet environmental norms, for acquisition of other companies, IT expenses, training and recruitment of personnel, foreign expansion, advertising and marketing.

The amount that OSEO will contribute is limited by the capital contribution of the shareholders. A further requirement is that the firm must obtain bank funding that is at least twice as large as the OSEO contribution loan or an increase in equity (from existing or new shareholders) of an amount at least equal to the OSEO contribution. In some cases, an additional requirement for approval is that an insurance policy covering key owners or executives must be purchased. In cases where the DC is accompanied by a bank loan, OSEO can provide a guarantee of up to 70% for the loan, from OSEO's own guarantee funds or from a regional guarantee fund. In any case, the size of the DC is limited as a multiple of the shareholders equity and can range from EUR 300 000 to EUR 3 million.

The main component in the DC is a subordinated loan of seven years maturity with two years grace (i.e. no principal repayments are made for the first two years). The interest rate may be fixed or variable and is set according to the risk rating assigned by the Banque de France. Thus a well rated company would pay a spread of 266 basis points over Euribor for the variable rate subordinated loan while a firm in the lowest rating category that is eligible for this facility would incur a spread of 606 basis points. OSEO receives additional compensation in the form of a share (usually about 5%) of the increase in firm turnover following the loan. OSEO's risk is limited by a public guarantee fund which covers 80% of the risk, plus a 5% deposit by the company.

Since its launch in 2009, utilisation of DCs has grown rapidly. From December 2009 to December 2011, EUR 1.1 billion have been granted under the scheme to 1 076 firms, allowing them to raise EUR 5.5 billion of investment funding from other sources. Although companies with up to 5 000 employees have taken advantage of the programme, some 76% of DCs have been to firms with 249 or fewer employees. DCs of EUR1 million or less account for about 70% of the total, measured by the amount of the Contract. About 80% of the firms involved have been in industry, services and trade. Most

²⁰ This figure is well in excess of the 250 employee limit that defines medium sized enterprises in the EU. Hence, this instrument extends beyond the narrow definition of SME finance.

industrial companies are involved in manufacturing intermediate goods, while many service-oriented firms are in the category of business services rather than consumer services.

About one third of all users of the DC are characterised as financially strong and with relatively few downside risks, while 54% show some signs of vulnerability or fragility but are still financially sound. On balance, the firms that utilise DCs are mature and relatively concentrated in traditional activities rather than high technology sectors. However, about 44% of enterprises are characterised as being in a process of innovation. Also, some 36% of enterprises are characterised as significant exporters, with foreign sales accounting for at least 5% of total sales. Since it responds to the needs of companies that are not always well served by existing market arrangements, the DC represents a potentially useful addition to the range of financing vehicles available to SMEs.

As Table 7 shows, although the DC was only introduced in late 2009, by the end of 2010, funding under the DC programme were already more than 40% of total funding of mezzanine-like programs administered by OSEO.

Table 7. OSEO: Contrats de Développement, 2008-2010

Contrat	2008		2009		2010	
	Number	EUR (k)	Number	EUR (k)	Number	EUR (k)
CDE Classique	484	27 780	484	32 365	488	38 730
CDE Creation	172	7 297	201	8 435	191	7 761
CDE Transmission	817	117 249	1 076	160 698	1 314	208 898
CDE Innovation	1 802	299 681	2 261	353 691	2 375	310 515
CDE International	97	24 047	230	51 751	276	54 914
Contrat de Développement Participatif	-	-	2	1 800	553	541 283
TOTAL	3 372	476 054	4 254	608 740	5 197	1 162 101

Source: OSEO.

5.6. Germany: Mezzanine finance schemes

The German Ministry of Economics and Technology has recognised the importance of mezzanine capital for financing SMEs. Thus, in cooperation with KfW Bankengruppe, Germany's state-owned development bank, several programmes have been developed to fill the SMEs "growth capital gap".

In 2004, KfW launched the promotional programme "Unternehmerkapital" (Entrepreneur Capital), which was designed to cover the entire life cycle of small and medium-sized enterprises, and which adapted mezzanine products (previously used mostly by larger companies) to meet the needs of middle-tier SMEs. Subsequently, "Unternehmerkapital" was divided into two different programmes: i)– KfW Entrepreneur Loan – Subordinated Loan; and ii) ERP Capital for Start-Ups, in which KfW provides start-ups, young enterprises, established SMEs and self-employed professionals with subordinate financing at favourable terms ('debt mezzanine') in a highly standardised form. ERP

Capital for Start-Ups aims at start-ups and young enterprises, whereas KfW Entrepreneur Loan subordinated capital focuses on established SMEs. ERP Capital for Start-Ups is composed only of subordinated loans, while Entrepreneur Loans must always be accompanied by a senior bank loan.

The loan offered under KfW Entrepreneur Loan subordinated capital consists of two tranches of equal size, provided through an on-lending bank: i) a classic senior debt, in which the risk is carried by the bank; and ii) a subordinated loan that is 100% carried by KfW. Different interest rates apply depending on the risk rating of the enterprise being financed. This ensures that each borrower pays a risk premium that reflects his/her statistical default risk. In consequence, entrepreneurs with a good credit standing will benefit from low interest rates, while weaker companies are still offered access to capital but at risk-adjusted interest rates.

Under ERP Capital for Start-Ups, the margin is the same for all borrowers - because the enterprises have no history upon which to judge an individual default risk - and only a single subordinated loan tranche is made. The programme intends to leverage the founders own resources up to 50% of the total amount of the investment (KfW, 2012).

In addition to these instruments, since 1996, KfW has administered the ERP Innovation Programme, which is currently composed of: Part I - financing of market-oriented R&D (i.e. applied research and technological development); and Part II: funding of expenditures for market introduction of innovations (both goods and services), including fixed investment for innovation activities in firms. Part II is addressed to SMEs only, whereas, for Part I, typically firms should have an annual turnover of less than €125m, except if the innovation to be funded is new for Germany. In the latter case, firms with an annual turnover of up to EUR 500 million are also eligible. In 2011, the commitments within the programme amounted to EUR 1 309 million.

The ERP Innovation Programme offers SMEs, through their house bank, a loan which typically consists of two tranches: a classical senior bank loan (though offering below market-rate interest rates) and a subordinate loan (50 to 60 percent of the total loan, depending on the size of the firm's annual turnover), for which no collateral is needed. There are special low interest rates for very small firms. Repayment of the loan typically starts after two years for the senior bank loan tranche, and after seven years for the subordinated loan tranche.

Between 2005-2010, 2 171 firms were supported via the ERP Innovation programme, almost 75% of them being SMEs. Among SMEs, firms with less than 10 employees account for about 7% of all supported enterprises, while the corresponding figure for small firms is 24%. In turn, 40% of supported firms have between 50 and 29 employees. The overall investment volume of EUR reaches 4.3 billion within the 5 year period, corresponding to an average credit volume per supported firm of EUR 1.2 million (Ramboll, 2011).

In order to assess the effectiveness of the ERP Innovation programme, in 2010, firms which have received funding from the programme during 2005-2009 (i.e. 1556 companies) were asked to state the effect of the support. According to the survey results (N=177), 45% of the interviewed SMEs indicate that they started to innovate due to the KfW support, while 10% expanded their innovation activity. The share of SMEs which have brought forward their innovation projects is 22%, while roughly 20% indicated that the support of the KfW has had no effect on their innovation activities (Ramboll, 2011).

In addition to the above-mentioned programmes, there exist approximately 20 regional "Mittelständische Beteiligungsgesellschaften – MBGs" (SME-oriented equity funds) supporting SMEs with mezzanine capital. Normally, MBGs are active as typical silent partners in small and medium-sized enterprises or with entrepreneurs. The majority of MBGs shareholders are private or semi-public

(Chambers of Commerce and Crafts, private and public banks, insurances). Existing for up to 40 years, MBGs normally invest in a range of EUR 50 000 - EUR 2.5 million into start-up companies with negligible turnover to as high as EUR 75 million annual turnover. All 20 MBGs benefit from public counter-guarantees – without fees – covering approximately 50% of the risk. In 2011 MBGs invested about EUR 200 million in SMEs.

5.7. United Kingdom: Proposals for the expanded use of mezzanine finance

Over the past few years, awareness has been growing among policy makers in the United Kingdom that there may be a serious malfunctioning in the market for growth capital. This problem may have become more serious after the onset of the financial crisis in late 2007.

As the problems of financing smaller enterprises became more acute after 2007, several reports recommended that the government develop new programmes focused on reducing the SME growth financing gap. As detailed below, several of the policy recommendations included enlarged use of mezzanine finance, and both the Government and private banks have taken action in this area.

In November 2009, a report on “The Provision of Growth Capital to UK Small and Medium Sized Enterprises” (the Rowlands Review) was issued by a Panel of industry experts convened at the invitation of the Department for Business, Innovation and Skills (BIS). Among its major conclusions (‘High Level Options for Intervention’) the Review identified mezzanine finance as especially relevant to the needs of growth companies inasmuch as it combined elements of both debt and equity: *‘A gap continues to exist for companies looking for between GBP 2m and GBP 10m in growth capital. Neither bank lending nor equity investors are likely to fill this gap in the foreseeable future. A mezzanine product would be best suited to fill this gap. It would help address demand side aversion to pure equity, and provide a return above regular bank lending at a level of risk lower than for venture capital or private equity. A well-structured intervention could attract capital to this risk/return profile’*.²¹

In 2011, the Government launched a major fund to support private-sector employment in areas heavily dependent on public sector spending and invited private sector participants to bid for government funds to support the accelerated development of sustainable private sector employment. Among the many bidders putting forth suggestions was Santander, which requested support for its mezzanine finance programme. The government agreed to add GBP50 million of funding to the GBP 150 million from Santander, to support its “Breakthrough” programme.

Under the Breakthrough programme, Santander provides subordinated debt, with repayment on a combination of recurring and bullet repayment. The Santander facility does not entail representation of mezzanine investors on the board of the company and has no provisions for participation in the upside. Santander is seeking deals in the range of GBP 400 000 - GBP 1 million for 3-5 year terms, targeting firms with records of sustained growth and prospects of accelerated growth. It is too early to assess how well the programme is being received at this time.

In 2011, noting the reliance of businesses on banks as a source of debt finance, the Government pledged to help businesses raise funds from non-bank sources by making available an initial GBP 1.2 billion through a Business Finance Partnership. The partnership initially focused on co-investment with the private sector through loan funds, which lent directly to mid-sized businesses in the UK, but

²¹ Rowlands (2009), “The Provision of Growth Capital to UK Small and Medium Sized Enterprises”, p. 26, available at www.bis.gov.uk/files/file53698.pdf

also included the first known co-investment in a peer-to-peer lending platform by Government. The first awards of Business Finance Partnership funds to bidders were announced in late 2012.

In March 2012, another industry panel (the “Industry-Led Working Group on Alternative Debt Markets”, led by Tim Breedon, then Chair of Legal and General) issued a report on ‘Boosting Finance Options for Business’. It noted that mezzanine finance was used very infrequently in the United Kingdom and suggested that the government should take steps to promote wider use of this technique.

On 24 September 2012, the Government took the first steps in implementing the recommendations of the Breedon Report by announcing the creation of a government-backed Business Bank, backed by new Government funding of GBP1 billion. Details of the activities would be released over the coming months. Since development of mezzanine finance was one of the major recommendations of inquiries undertaken in the past three years, the new institution is likely to explore possibilities to encourage wider use of this technique.

5.8. United States: The SBIC programme²²

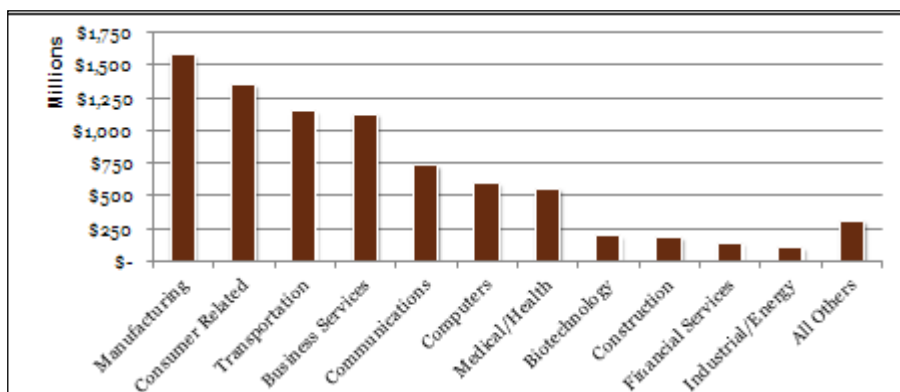
The SBIC programme, administered by the US Small Business Administration (SBA), was created in 1958 to bridge the gap between entrepreneurs’ need for capital and traditional sources of financing. SBICs are privately owned and managed investment funds, licensed and regulated by SBA, that use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses. No tax dollars are appropriated to fund SBIC debentures.

Since their inception in 1958, SBICs have provided more than USD 60 billion of funding to over 100 000 SMEs. Some well-known companies that received financing from SBICs include Apple Computers, FedEx, Callaway Golf and Outback Steakhouses. SBICs can invest in venture capital, but the majority of their investments are mezzanine financings.

Investing through SBICs (i.e. funds) takes place under a mechanism in which the General Partners in a firm specialised in SME finance organise a fund with capital provided by a group of investors, who are the Limited Partners in the SBIC. The licensing procedures for a new SBIC can last from as little as 6-8 months to more than 18 months from the initial application to formal licensing. Fund managers must demonstrate their professional competence and capability to execute the business strategy based upon the capital raised. SBICs are required to be audited annually, while the SBA examines funds for adherence to programme requirements.

SBIC investments are not concentrated in any particular region of the country and are widely distributed among sectors (Figure 3).

²² Source: US SBA website (www.sba.gov), secondary sources, interviews with mezzanine finance experts and practitioners in the United States.

Figure 3. SBICs: Distribution of Debenture Portfolio by Sector, 2007-2011

Source: SBA.

The SBIC programme is funded by a combination of public and private capital. Capital is contributed essentially by private investors, while the SBA leverages that contribution on a two to one match (funds may obtain up to three times private capital although most only obtain two times private capital). There was some slowing of activity immediately after the 2007-2008 crisis, but activity has recovered strongly since that time. Total financings to small businesses by SBA's SBIC debenture programme grew to a 54-year record high of USD 2.95 billion in 2012, 14 % more than in 2011. As of 30 September 2012, the SBA had USD 8.8 billion in outstanding leverage or leverage commitments to 301 funds. Total private and public funds committed under the SBIC programme amounted to about USD 18 billion at that time.

The maximum amount of leverage that an SBIC may obtain is either 300% of the SBIC's private capital or USD 150 million, whichever is smallest, with investments in affiliated funds in a group limited to USD 225 million. The SBA's contribution takes the form of senior debt (debentures) of the SBIC. SBA debentures are 10-year unsecured debt instruments on which interest only is repaid semi-annually. All principal is paid at maturity, but the borrower is free to prepay without penalties at all times. SBICs are free to distribute profits to its LPs at any time. The cost of borrowing from the SBA is based upon the 10-year US Treasury rate plus a spread, usually of about 60-80 basis points. In September 2012, the Trust Certificate Coupon Rate was less than 2.25% annual rate. The SBA imposes some additional fees on borrowers, but the total cost of borrowing from the SBA under the programme is currently about 4% annually.

Legally, the fund must have at least USD 5 million in committed private capital, but as a practical matter USD 15 million or more is generally needed to launch a viable fund. Investors in the funds may be foreign or domestic individuals or institutions. The investors usually are high net worth individuals, family offices, banks, pension funds, endowments and insurance companies. No single investor, or group of related investors, may represent more than 70% of private capital and at least 30% of private capital must come from investors unrelated to management. Investors representing 10% of private capital must be disclosed, and those representing 30% of private capital must submit additional background information. SBICs usually charge investors management fees of 2% per annum plus 20% of the profits.

SBICs are required to invest in small businesses. Small businesses are defined as companies with a total net worth of less than USD18 million and average taxable net income of less than USD 6 million for the two last fiscal years. At least 25% of an SBIC's funds must be invested in smaller businesses

that have total net worth of less than USD 6 million and average taxable net income of less than USD 2 million for the two last fiscal years. The SBA has capped interest rates at 19% for straight loans and 14% for facilities with equity features. Generally, investment by SBICs in financial institutions, most real estate projects, single purpose projects, foreign businesses, and “passive businesses” are prohibited.

In order to be successful, SBICs need to have a significant deal flow. Most companies are referred to SBICs by intermediaries, such as investment banks, accountants and lawyers. The investment banks operating in this market sector are smaller institutions than the well-known larger institutions that deal with large corporations. They often consist of a handful of professionals, and have a locally based clientele. Another source of referrals is from other SBICs who invite the firm to share part of the financing in order to achieve better risk diversification.²³

The characteristics of companies for which SBICs seek to invest are similar to those in all mezzanine transitions. Specifically, the SBIC looks for companies with positive cash flows, a good management team, an established market position and sound business plan. They are seeking companies that are approaching major turning points in their development (expansion, acquisition of other companies, transfer of ownership, change in capital structure) rather than providing on-going financing.

Proposals for financing are scrutinised by the SBIC’s management. In general, only a very small share (generally less than 5%) of applications are eventually accepted. All investment decisions are made by the SBIC; the SBA does not participate in these decisions.

The remuneration structures that an SBIC reaches with a company in its portfolio are rather flexible, but most agreements provide for some mix of on-going cash payment of interest on the subordinated loans, a payment in kind (PIK) tranche under which interest payments are deferred until the maturity of the subordinated loan and equity warrants. The pricing of the warrants is normally straightforward when the SBIC exits through a trade sale or a public listing. However, if no such transfer take place, the terms under which the warrants are exercised must be specified in the agreement.

²³ For discussion of the operation of SBICs from a practitioner’s viewpoint, see Goodman (2011) and Rubak and Yudkoff (2011).

Table 8. United States' SBIC Debenture Pools: Treasury Rate and Trust Certificate Rate, 2001 -2012

Pricing Date	Date of Sale	Treasury Rate	Spread Above Treasury	Trust Certificate Coupon Rate
20/09/2001	26/09/2001	4.71%	1.18%	5.89%
18/03/2002	27/03/2002	5.31%	1.03%	6.34%
20/09/2002	25/09/2002	3.78%	0.89%	4.67%
19/03/2003	26/03/2003	3.94%	0.69%	4.63%
16/09/2003	24/09/2003	4.29%	0.59%	4.88%
17/03/2004	24/03/2004	3.68%	0.46%	4.12%
15/09/2004	22/09/2004	4.17%	0.52%	4.68%
15/03/2005	23/03/2005	4.54%	0.50%	5.04%
20/09/2005	28/09/2005	4.27%	0.67%	4.94%
15/03/2006	22/03/2006	4.73%	0.80%	5.52%
20/09/2006	27/09/2006	4.72%	0.82%	5.54%
20/03/2007	28/03/2007	4.54%	0.83%	5.38%
18/09/2007	26/09/2007	4.49%	1.04%	5.53%
18/03/2008	26/03/2008	3.39%	2.08%	5.47%
18/09/2008	24/09/2008	3.45%	2.27%	5.73%
18/03/2009	25/03/2009	2.94%	1.68%	4.62%
16/09/2009	23/09/2009	3.47%	0.77%	4.23%
17/03/2010	24/03/2010	3.64%	0.47%	4.11%
15/09/2010	22/09/2010	2.67%	0.55%	3.22%
22/03/2011	29/03/2011	3.34%	0.74%	4.08%
12/09/2011	21/09/2011	1.95%	0.92%	2.88%
14/03/2012	21/03/2012	2.26%	0.50%	2.77%
11/09/2012	19/09/2012	1.70%	0.55%	2.25%

Source: SBA.

6. Mezzanine finance and the crisis

While the scarcity of reliable statistical data makes any analysis tentative, it is possible to make general assessments of the impact of the crisis on the mezzanine finance market. It appears that the commercial market for SME mezzanine finance, which has been functioning in the United States since the 1980s and grew steadily in Europe between the late 1990s and 2005, contracted considerably after the onset of the crisis in 2007. To some degree, this reflects the fact that SMEs reacted to the crisis partly by postponing investments, which in turn led to diminished demand for mezzanine and other forms of long-term financing. This market has yet to recover its full pre-2007 dimensions, but it is still active. By contrast, the market in securitised mezzanine financing for SMEs, which had gained some traction in Germany and neighbouring countries, ceased operating after 2007, and no resumption can be detected.

Somewhat different patterns can be observed in the case of officially supported direct mezzanine credit. In cases where the programme was well established before 2007 (e.g. Canada), some contraction was discernible immediately after the crisis, as SMEs retrenched in the face of declining demand and investors became visibly more cautious. There has, however, been a subsequent recovery, and these programmes seem to be on track for further growth. A similar pattern can be detected in the United States, which uses the SBIC model. In cases where measures were introduced in response to the crisis, utilisation has remained high, as governments have stepped in to fill the gap at a time when

private banks' credit offerings were contracting. An example in this regard is the OSEO DC programme, which was launched in 2009 as a part of the anti-crisis package and has quickly grown into OSEO's largest mezzanine product. A third pattern can be observed in Estonia, where the programme, which was already in place before the crisis, was heavily used as bank credit contracted. However, in Estonia, banks recovered relatively quickly and firms were subsequently able to satisfy credit needs. As a consequence, the utilisation of mezzanine facilities fell.

On balance, mezzanine finance is probably not the ideal instrument to combat a contraction in private financial activity stemming from a massive loss of confidence such as occurred in 2007-2009. Since mezzanine almost always requires the private sector to share risk, it has limited capacity to sustain flows of financing when private investors are determined to cut back on their exposure. In such circumstances, techniques such as official guarantees, where the public sector takes on risk that the private sector is no longer willing to assume, may be more effective as an anti-crisis tool.

However, in cases where the withdrawal of private funding has eased but private investors still hesitate to take new risks, mezzanine can be a highly relevant tool for exiting the crisis. Because it has characteristics that help investors recognise new growth opportunities, partly through innovative risk sharing techniques, mezzanine has the potential to encourage new private funding and to direct investment to those firms with the best growth prospects.

Recent policy initiatives by several governments suggest that many OECD governments recognise this potential. For instance, France and Germany, among other countries, are providing substantial support to a revival of activity in the commercial mezzanine sector, by raising contributions to official investment funds, thus encouraging private investors to increase investment in SMEs. The authorities in the United Kingdom also appear to have concluded that the crisis revealed a serious gap in the range of financing instruments for SMEs, and that official action to fill in gaps along the spectrum of instruments available to SMEs is in order.

7. Conclusions and next steps

Mezzanine finance has considerable potential to respond to two critical problems in SME finance:

- *First*, mezzanine finance can play an important role widening the range of financing vehicles available to SMEs. The “expansion” phase of the firm financing cycle, where mezzanine is most commonly used, has been identified as one where market failure is common. This is not to say that mezzanine is the best solution to the scarcity of growth capital at all times, but that it is highly relevant solution when used by certain firms in specific situations. While mezzanine finance is less suited than venture capital to financing high technology start-ups and guiding them through successive phases of the growth cycle, it is more effective in meeting the needs of established companies seeking to grow and those seeking to effect major transformations. An efficient financial system needs to have a range of instruments adapted to different needs.
- *Second*, mezzanine finance may be especially relevant at the present juncture in global finance, since it enables companies to improve their capital structure and lessen their vulnerability in times of stress. This can be particularly useful when SMEs have been highly leveraged and dependent upon close relationships with banks. Given the present need in many countries to de-leverage, mezzanine may have the potential to help SMEs to improve the quality of their balance sheets and help them to move into the next phase of expansion. In countries where SMEs could obtain adequate growth capital from banks in the past, but

where banks are seeking to contract balance sheets, it will be important to broaden the range of financing options for SMEs.

One salient fact about the market in mezzanine finance is its uneven development across OECD countries. It seems difficult to ascribe differences in use of mezzanine to obvious factors such as the state of development of the economy or the institutional structure of the financial system. Even countries at similar levels of development and with similar financial structures appear to have vastly different levels of usage of mezzanine.

Based upon the information submitted by country officials through the *OECD Questionnaire on Seed, Early and Later Stage Finance*, follow-up contacts with Members and interviews with experts and practitioners, it appears that less than half of OECD Members have programmes to support the use of mezzanine finance for SMEs. In many OECD countries, there are few mezzanine facilities in place and many SMEs – as well as officials responsible for SME finance – are not familiar with the product.

At the same time, in countries where mezzanine finance programmes have developed or been strengthened in recent years, the responsible institutions and the private firms that use these facilities to support their investments express a positive assessment about the effectiveness of these schemes in reaching SMEs in need of capital that the private markets have neglected. Similarly, SME associations, such as UEAPME (European Craft and SME Association), argue that mezzanine finance is particularly well suited to the situation of SMEs in times of growth and transition, and that European governments and EU institutions should seek to expand programmes to enable firms to increase utilisation of this technique²⁴.

On balance, 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. Also, the use of mezzanine finance instruments requires a certain level of financial skills on the side of entrepreneurs and SME managers, who often lack awareness and capabilities to understand and access a wider range of financial options than traditional debt. In order for this form of finance to be used more widely, efforts will have to be made to familiarise potential users with the capacity of mezzanine to address their problems.

Once again it bears repeating that this report does not suggest that mezzanine finance represents a definitive solution to the financing of SMEs. Many SMEs are not well-suited for this form of finance, and most firms using mezzanine finance will continue to need traditional debt and equity finance. Traditional bank credit, based mainly upon debt and official guarantees, is well suited to established low-risk companies, but has only limited applicability to firms seeking growth capital. Venture capital is relevant for start-ups, technology-based companies and those with exceptionally high growth prospects, but such companies only constitute a tiny, albeit critical, part of all SMEs. An effective financial system is one that can supply financial resources to a broad range of companies in varying circumstances and where the demand from these companies is also differentiated by circumstances and needs. On balance, the early evidence suggests that mezzanine finance can be an important part of the continuum of financing options that together constitute an efficient financial system, and can represent an effective technique for firms in certain specific conditions.

Looking ahead

This study has provided extensive information about the functioning of the market in mezzanine finance, along with evidence on policy programmes in this area. However, the ability to fully assess

²⁴ See UEAPME Position Paper on The Next Generation of European SME Finance Programmes, available at www.ueapme.com/IMG/pdf/110222_CIP_SMEfinance_final.pdf.

the potential of mezzanine finance for SME development, and its implications for policy, is limited by a lack of information on the size of the commercial market, in terms of volume, number and type of SMEs. Only limited information exists on the amount of public funding provided through both commercial vehicles and public financial institutions. Furthermore, the lack of evidence on the performance of SMEs using this type of finance limits the scope for assessment.

This study can be viewed as a first step in the analysis of alternative financing techniques (AFTs) for SMEs and entrepreneurs. The tentative conclusion that appears to be emerging from this preliminary evidence is that mezzanine finance has been an effective tool in broadening the access of SMEs to finance in some countries and under some conditions and that it has potential for significantly wider usage. On this basis, the WPSMEE may wish to consider further investigation in this area, in particular to expand country coverage and to improve the factual and statistical data base. This would entail efforts to obtain better statistical data about the commercial mezzanine market. Further research would also be needed to improve understanding about the demand side of this market, in order to identify drivers and barriers to SMEs' access and use of mezzanine tools and, possibly, current gaps that may require policy responses.

The WPSMEE may also wish to take a more active role in raising awareness of the potential of mezzanine finance for SMEs and in promoting assessment of existing programmes, by disseminating information about mezzanine finance and engaging in dialogue with private and public market participants, as well as with SMEs representatives and associations.

In future work, the WPSMEE will address other AFTs, such as specialised exchanges for SMEs or private equity financing for SMEs, through an exercise to map the full range of financial instruments available to SMEs, as a complement to studies and monitoring of SME debt financing. For example, in view of the apparent problems that the banking systems of many OECD countries are now experiencing in providing traditional credit-based finance to SMEs, it may be advisable to explore the use of capital market and institutional investors to finance SMEs. In this regard, the WPSMEE could examine the potential of techniques such as the corporate bond market and securitisation to respond to SMEs' demand for finance.

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ANNEX 1. THE OECD DRAFT QUESTIONNAIRE ON SEED, EARLY AND LATER STAGE FINANCE

The aim of the questionnaire

The purpose of this questionnaire is to obtain information on a number of policy factors including (but not limited to): the tax treatment of angel, venture capital and mezzanine funding, direct government involvement in seed, early stage and mezzanine finance (*e.g.* direct equity investments, co-investment programs and fund of funds), the rules affecting the types of investors which may carry out these investments (*e.g.* high net worth individuals, pensions funds, insurance companies and other institutional investors), and the regulatory framework. The questionnaire does not cover policy factors or performance indicators for which the OECD already has access to data from other sources. This data will be combined with information resulting from the questionnaire for cross-country empirical analysis.

The structure of the questionnaire

The questionnaire is divided into three main parts. The first part covers policy instruments targeted to promote seed and early stage equity investment in high growth firms and sectors. It also includes a section on mezzanine finance. The second section focuses on the regulatory issues which might impact investment in seed and early stage equity finance, as well as mezzanine finance. The third section focuses on broader policies to develop the entrepreneurial ecosystem which impact investment in seed, early and later stage finance.

The questionnaire is the first step in a two-stage process. In the first step, countries are requested to provide general information about their policies in responding to this questionnaire. In the second step, more detailed questions on the design of different policies will be requested directly to the contact persons responsible for different programmes. This two-stage process is intended to reduce the burden on member countries and enhance the efficiency of the process.

The detailed sections of the questionnaire are as follows:

Section 1: Financial instruments (supply side)

- Grants, loans and guarantee schemes
- Fiscal/tax incentives
- Equity funds
- Mezzanine finance

Section 2: Regulatory and Administrative Environment

- Institutional investors
- Funds and individual investors

Section 3: Policies to Develop the Entrepreneurial Ecosystem (demand side)

- Human capital
- Social capital/networks

General instructions

Each country should identify a contact person(s) who can collect the appropriate information and responses from colleagues responsible for seed, early stage and mezzanine financing programmes for questionnaire.

If possible, answers should be entered electronically directly into the Word document (doing so will facilitate the treatment of responses by the Secretariat). The Yes/No answers can be entered by clicking on the appropriate box, while questions that require a written response (for example, numerical responses) can be entered in the appropriate field. The questionnaire word document can then be returned to the Secretariat by e-mail. Please feel free to provide additional responses or comments in a separate document.

Answers should accurately reflect the current policies and regulatory settings at the time of response, or as recently as possible. Please do not anticipate any future policy or regulatory actions. Please tick the appropriate box or provide the data requested for each question.

The questions refer to regulations or policies issued or accepted by the national government. Federal countries are invited to base their answers on federal level. If possible, information on institutions prevailing in the most representative sub-national entities or a subset of regions that may characterise best each country's institutional settings should also be reported in a separate response. Alternatively, if a country chooses, it may complete the questionnaire for two or more federal entities if sufficient differences exist for the concerned policies. Whatever alternative is chosen, please indicate briefly which sub-national entity your answers reference.

OECD Contact:

Please identify a contact person(s) for the questionnaire within your country and send his/her details to Karen Wilson in the Directorate for Science, Technology and Industry. She can also answer questions you or your colleagues might have about the content of the questionnaire, either by email or phone Tel: (+ 33 1) 45 24 17 55. Please ensure your answers are returned to the OECD no later than 15 June 2012, by email to Karen.wilson@oecd.org

COUNTRY: _____
 CONTACT PERSON: _____
 TITLE AND/OR DEPARTMENT: _____
 EMAIL: _____
 PHONE: _____
 CURRENCY USED IN QUESTIONNAIRE: _____

SECTION 1: Financial Instruments

This section looks at specific policies and programmes aimed at facilitating the supply of seed and early stage financing as well as mezzanine finance. These include direct and indirect financing instruments.

This section is divided into four parts:

1.1 Grants, loans and guarantee schemes

1.2 Fiscal/tax incentives

1.2.1 Young Innovative Company schemes

1.2.2 Tax incentives on investment ("front-end")

1.2.3 Tax incentives on capital gains or losses ("back-end")

1.3 Equity funds

1.3.1 Public funds

1.3.2 Fund of funds

1.3.3 Public/private co-investment funds

1.4 Mezzanine finance

1.1 Grants, loans and guarantee schemes

a) Does your country have grant, loans and/or guarantee schemes?

☐ YES

☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

☐ Ceased during the past 5 years

☐ Decreased

☐ Remained unchanged

☐ Increased

☐ Introduced during the past 5 years

c) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

d) Have there been evaluations of these programmes?

☐ YES

☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.2 Fiscal/tax incentives

1.2.1 Young Innovative Company (YIC) Schemes

a) Does your country have special tax incentive schemes for qualified “young innovative firms”?

☐ YES

☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

☐ Ceased during the past 5 years

☐ Decreased

☐ Remained unchanged

☐ Increased

☐ Introduced during the past 5 years

c) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

d) Have there been evaluations of these programmes?

☐ YES

☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.2.2 Tax incentives on investment (“front-end”)

a) Does your country have income tax incentives for investment in seed and early stage firms by venture capital firms, angel groups or individual angel investors?

- ☐ YES
☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

c) Does your country have income tax incentives for later stage investments in firms?

- ☐ YES
☐ NO

d) If yes, do mezzanine investments qualify for such incentives?

- ☐ YES
☐ NO

e) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

f) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

g) Have there been evaluations of these programmes?

- ☐ YES
☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.2.3 Tax incentives on capital gains (“back-end”)

a) Does your country have “back-end” incentives which provide capital gains tax relief on profits from realized investments in seed or early stage firms (roll overs of investments or carry forward of capital gains)?

- ☐ YES
☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

c) Does your country have “back-end” incentives which provide capital gains tax relief on profits from realized from later stage investments?

- ☐ YES
☐ NO

d) If yes, do investments through mezzanine capital qualify for such incentives?

- ☐ YES
☐ NO

e) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

f) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

g) Have there been evaluations of these programmes?

- ☐ YES
☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.3 Equity funds

1.3.1 Public funds

a) Does your government support seed and early stage firms through public equity funds?
(100% government funds or fully government sponsored venture capital funds investing in seed and early stage firms?)

- ☐ YES
☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

c) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

d) Have there been evaluations of these programmes?

- ☐ YES
☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.3.2 Fund of funds

a) Does your government support seed and early stage firms through the public fund of funds (pooled investment funds to invest in intermediaries such as venture capital firms)?

- ☐ YES
☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

c) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

d) Have there been evaluations of these programmes?

- ☐ YES
☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.3.3 Public/private co-investment funds

a) Does your government support seed and early stage firms through public/private co-investment equity funds?

- ☐ YES
☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

c) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

d) Have there been evaluations of these programmes?

- ☐ YES
☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

1.3 Mezzanine finance

a) Does your government support the use of mezzanine finance by SMEs with guarantees or provision of funds?

☐ YES

☐ NO

b) What is the estimated annual amount of public mezzanine finance provided to SMEs in your country? (please provide source of data or a link to the relevant documents): _____

c) In general, how has government support for these programmes changed in the past 5 years?

☐ Ceased during the past 5 years

☐ Decreased

☐ Remained unchanged

☐ Increased

☐ Introduced during the past 5 years

d) Please specify the main programmes (by size of the budget) in this area:

		Programme 1	Programme 2
Name of the programme		Name: _____	Name: _____
Name of the agency responsible for the administration of the programme		Name: _____	Name: _____
Contact person		Name: _____	Name: _____
Is the programme managed at the national or sub-national level (please check below):			
- National	<input type="checkbox"/>		
- Sub-national	<input type="checkbox"/>		

If more than two programmes please list the names of the others: _____

e) Have there been evaluations of these programmes by the executing authority, other public bodies or outside parties?

☐ YES

☐ NO

Please provide a link to the relevant documents, if possible, or attach with the completed questionnaire: _____

SECTION 2: Regulatory & Administrative Environment

This section looks at the regulatory and administrative environment for seed, early stage and mezzanine financing. Note that in this area, existing indicators will be drawn upon from other sources. Also, further information on exit markets will be gathered.

This section is divided into two parts:

2.1 Institutional investors

2.1.1 Restrictions on investments in private equity

2.1.2 Restrictions on cross-border or foreign investments

2.2 Funds and individual investors

2.2.1 Cross-border investment barriers

2.2.2 Securities legislation

2.1 Institutional Investors

2.1.1 Restrictions on investments in the private equity

a) Are there legal restrictions on institutional investors in your country in terms of investing in alternative assets, private equity (of which venture capital and mezzanine financing is a part) or unlisted companies?

Please indicate the answers for each type of investor:

	Yes	No	If no, are investments in foreign VCs allowed?
Banks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pension funds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Insurance companies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Government agencies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate investors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Endowment funds (university and foundation)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Family or private offices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

b) In general, how have these changed in the past 5 years?

- ☐ Ceased during the past 5 years
- ☐ Decreased
- ☐ Remained unchanged
- ☐ Increased
- ☐ Introduced during the past 5 years

c) Has there been any assessment of the effect of these restrictions on investment?

- ☐ YES
- ☐ NO

2.2 Funds/investors (VCs, angels)

a) Which legal structures apply for venture capital firms in your country?

Limited liability partnerships

- ☐ YES
☐ NO

Tax flow through (taxes are levied on each investor, not on the fund/partnership structure)

- ☐ YES
☐ NO

b) Does regulation allow investment in collective investment schemes (mutual funds, unit trust etc.) that provide mezzanine facilities?

- ☐ YES
☐ NO

2.2.1 Cross-border investment barriers**a) Are there legal restrictions on venture capital firms in terms of investing abroad?**

Please indicate for each type of venture capital firm:

	Yes	No
Private venture capital firms headquartered within the country	<input type="checkbox"/>	<input type="checkbox"/>
Public/private venture capital firms headquartered within the country	<input type="checkbox"/>	<input type="checkbox"/>
Public venture capital firms within the country	<input type="checkbox"/>	<input type="checkbox"/>
Foreign venture capital firms investing in your country	<input type="checkbox"/>	<input type="checkbox"/>

b) In general, how have these changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

c) Are there restrictions on angel investors investing across borders?

Please indicate for each type of angel investor (groups or individuals):

	Yes	No
Angel groups, networks or syndicates within the country	<input type="checkbox"/>	<input type="checkbox"/>
Foreign angel groups, networks or syndicates investing in your country	<input type="checkbox"/>	<input type="checkbox"/>
Individual angel investors in your country	<input type="checkbox"/>	<input type="checkbox"/>
Foreign individual angel investors investing in your country	<input type="checkbox"/>	<input type="checkbox"/>

d) In general, how have these changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

e) Are there government policies or programmes focused on attracting experienced investors (angel investors and/or venture capitalists) from abroad?

	Yes	No
Foreign venture capital firms	<input type="checkbox"/>	<input type="checkbox"/>
Foreign angel groups or syndicates	<input type="checkbox"/>	<input type="checkbox"/>
Individual angel investors from abroad	<input type="checkbox"/>	<input type="checkbox"/>

f) If yes, what types of incentives are provided? (check all that apply)

- ☐ Public matching/co-investment funds
☐ Tax incentives
☐ Facilitating access to networks (local investors and companies)

Please list the name of the programme and a link to further information about it, if possible:

g) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

2.2.2 Securities legislation

a) Does securities legislation in any of the following areas limit private investment from seed and early stage investors?

	No	Yes
Rules for "qualified" investors	<input type="checkbox"/>	<input type="checkbox"/>
Solicitation and advertising of investment opportunities	<input type="checkbox"/>	<input type="checkbox"/>
Restrictions on alternative investment pools	<input type="checkbox"/>	<input type="checkbox"/>
International accounting/financial directives	<input type="checkbox"/>	<input type="checkbox"/>
Other (please state): _____	<input type="checkbox"/>	<input type="checkbox"/>

SECTION 3: Policies to Develop the Entrepreneurial Ecosystem

This section looks at specific policies and programmes aimed at facilitating the parts of the entrepreneurship ecosystem related to seed, early and later stage financing.

This section is divided into two parts:

3.1 Human capital

3.1.1 Investor readiness (entrepreneurs)

3.1.2 Investor training (institutional, VC, angel)

3.2 Social capital

3.2.1 Facilitating connections between entrepreneurs and investors (BANs, incubators/accelerators, etc.)

3.1 Human capital

3.1.1 Investor readiness (entrepreneurs)

a) Are there government policies or programmes focused on educating entrepreneurs about sources of financing?

- ☐ YES
☐ NO

b) Are there government policies or programmes which help entrepreneurs develop their business plans and prepare for approaching investors (investor readiness programmes)?

- ☐ YES
☐ NO

c) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

3.1.2 Investor training (institutional, VC, angel)

a) Are there government policies or programmes focused on strengthening the professional capability of investors in terms of risk capital investing?

For institutional investors:

(Pension funds, banks, insurance companies, endowment funds, family offices, etc. to help them design, manage and control portfolios of venture capital/private equity funds)

- ☐ YES
☐ NO

For venture capital firms:

(Training about the due diligence process, valuation of companies, pricing and structuring of deals, legal aspects, intellectual property rights, divestments, fund raising/investor relations, etc.)

- ☐ YES
☐ NO

For angel investors:

(Training about the due diligence process, valuation of companies, pricing and structuring of deals, legal aspects, intellectual property rights, divestments, etc.)

- ☐ YES
☐ NO

b) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

3.2 Social capital/networks**3.2.1 Facilitating connections between entrepreneurs and investors** (business angel networks, incubators, accelerators, etc.)**a) Are there policies or programmes to strengthen collaborative networks between seed and early stage firms and investors?**

- ☐ YES
☐ NO

b) If yes, have these been in the form of? (check all that apply)

- ☐ Incubators
☐ Accelerators
☐ Business Angel Networks
☐ Matchmaking programmes

What is the name of the program and in which year was it launched? Please provide a link to further information if possible _____

What is the estimated annual budget of each? _____

c) In general, how has government support for these programmes changed in the past 5 years?

- ☐ Ceased during the past 5 years
☐ Decreased
☐ Remained unchanged
☐ Increased
☐ Introduced during the past 5 years

END

ANNEX 2. OECD QUESTIONNAIRE: FOLLOW UP ON MEZZANINE FINANCE FOR COUNTRIES WITH MEZZANINE PROGRAMMES

In the table below, please specify the name and details for your programme in this area (If more than one programme, please fill in multiple charts.)

	Yes	If yes, amount where noted	No
Background on the specific programme:			
Name of the Programme		Name: _____	
Name of the agency responsible for the administration of the programme		Name: _____	
Is the programme managed at the national or sub-national level? Please check below			
- National	<input type="checkbox"/>		<input type="checkbox"/>
- Sub-national	<input type="checkbox"/>		<input type="checkbox"/>
Year launched		Year: _____	
What is the current total amount of public funding available for this programme?		Amount: _____	
- Of that amount, how much has been committed to date?		Amount: _____	
Does the programme use funds raised in the market as well as public funds?	<input type="checkbox"/>		<input type="checkbox"/>
Does the public investment cover all the tranches of the mezzanine facilities? If no, please specify the tranches covered.	<input type="checkbox"/>		<input type="checkbox"/>
-Subordinated debt	<input type="checkbox"/>		<input type="checkbox"/>
-Equity	<input type="checkbox"/>		<input type="checkbox"/>
-Other (please specify)	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
What is the typical duration of the investment?		Years: _____	
Criteria for firms to qualify:			
Are there requirements in terms the following? (Please check all that apply)			
-Revenues	<input type="checkbox"/>	Amount: _____	<input type="checkbox"/>
-Gross assets	<input type="checkbox"/>	Amount: _____	<input type="checkbox"/>
-Number of employees	<input type="checkbox"/>	Number: _____	<input type="checkbox"/>
-Age	<input type="checkbox"/>	Years: _____	<input type="checkbox"/>
-Stage in the life cycle of the firm	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
Is there a certification requirement for the firm?	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
- If yes, what bodies make such certification?		Specify: _____	
Is the programme restricted to firms in a particular sector?	<input type="checkbox"/>	Sector: _____	<input type="checkbox"/>
Are specific technical or business qualifications of owner/entrepreneur of the firm required?	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
Is the willingness of the owner /entrepreneur to share information and control with outside investors a requirement? How is this determined?	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
Are there requirements in terms of the capital structure of firm?			
-Transparency of ownership and control	<input type="checkbox"/>		<input type="checkbox"/>
-Leverage	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>

-Other characteristics	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
Are there specific cash flow requirements?	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>
What the requirements in terms of the growth prospects for the firm?		Specify: _____	
Is matching funding required from private institutions and investors? If so, please specify percentage.	<input type="checkbox"/>	Percentage: _____	<input type="checkbox"/>
Is there a minimum financial contribution required by the owner/entrepreneur in terms of percentage?	<input type="checkbox"/>	Percentage: _____	<input type="checkbox"/>
Are links with research or entrepreneurship support networks required?	<input type="checkbox"/>		<input type="checkbox"/>
Are there other criteria not specified here?	<input type="checkbox"/>	Specify: _____	<input type="checkbox"/>

Have there been evaluations of these programmes by the executing authority, other public bodies or outside parties?

- ☐ Yes
☐ No

Please provide a link to the relevant documents (annual reports, evaluations, brochures, etc) if possible, or attach with the complete questionnaire

