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The importance of leasing for SME finance

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The importance of leasing for SME finance

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Working Paper 2012/15
EIF Research & Market Analysis

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Abstract

It is well known that Micro and Small and Medium sized Enterprises (SMEs) are the backbone of the economy. Most of these companies use external financing sources like debt and equity capital to finance their activities. However, in general, in the area of SMEs' access to finance, there are market imperfections - not only in times of crisis, but on an on-going basis as a fundamental structural issue, based on uncertainty and asymmetric information between the demand side (entrepreneur) and the supply side (financial intermediary).

SMEs' access to finance is often a topic of economic or financial literature. In this context, the access to debt capital and even more often the access to Venture Capital is analysed. Research on the use and role of alternative forms of finance is however rather scarce.

Various surveys on access to finance show that bank loans and overdrafts are the most widespread debt financing methods for SMEs, but that alternative sources like leasing and factoring have also a high relevance. This paper puts a spotlight on the importance of leasing as integral part of the tool-set for SME finance, also against the background of market weaknesses for SME lending. It explains the mechanics and logic of SME leasing and provides latest available market information.

Furthermore, the paper explains in the form of three case studies how SME leasing can be supported via credit enhancement techniques. These examples, taken from recent EIF business cases, cover very different markets and products: a securitisation transaction in Germany, a loan guarantee in France, and a structured portfolio guarantee in Lithuania.[1]

JEL Classification Numbers: G01, G10, G14, G20, G21, G23, G24

Keywords: Leasing, Lending, Small and Medium sized Enterprise

[1] This paper benefited from comments by/contributions from Jacqueline Mills and Jurgita Bucyte (Leaseurope) and Athanasios Kyriakopoulos. We would also like to thank several EIF colleagues for useful discussions and comments. All errors are of the authors.

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1 Introduction

The ability of SMEs to access finance is important for funding business investment, ensuring businesses reach their growth potential, and for facilitating new business start-ups; a lack of finance can constrain cash flow and hamper businesses' survival prospects (BIS, 2012). Typically, SMEs are not able to raise money directly in the capital markets and are therefore - with regard to external sources - mainly dependent on traditional bank financing, which is itself limited by constraints due to banks' refinancing capacity, their risk appetite and capital adequacy.

Many parameters are currently impacting the lending behavior of European banks, among them are the ongoing sovereign crisis, upcoming adjustments of the regulatory framework, and an (if at all) only fragile economic recovery. Banks respond to the difficult market environment with deleveraging, building up liquidity, paring down risk assets and tightening of credit standards.

Bank funding markets have only partially re-opened and the pressure on European banks remains. Although the need for deleveraging does not necessarily imply lower credit to the private sector, the evidence suggests that it contributes to a tighter credit supply. Specifically, the IMF (2012b) expects that the need for reduction of the banks' balance sheet size will reduce the outstanding credit supply in the euro area by 1.7%. On top of that, deleveraging is also expected to reduce growth in the euro area, according to the IMF (2012a) by 1% this year.

According to the ECB (2012a), credit conditions for SMEs are on balance still tightening and access to finance has remained the second most pressing problem for euro area SMEs (ECB, 2012b). Moreover, access to finance appears to be still a more severe concern for SMEs than for large firms.

An important element of SME finance is not directly provided by banks through traditional loans but rather by leasing or factoring companies. Various surveys on access to finance show that bank loans and overdrafts are the most widespread debt financing tools for SMEs, but also that alternative sources like leasing and factoring are of high relevance. In many countries, leasing is used particularly by fast-growing SMEs, especially those in Belgium, Finland, Ireland and Spain (Ayadi, 2009).[2] The concept of leasing is based on the assumption that profits are generated by the lessee through the use of assets, rather than from the ownership (Fletcher et. al., 2005). Different to a loan there is no cash made available from a finance company to the client, but only an asset.

The intention of this paper is to enhance the awareness of leasing (and its importance) as additional financing technique for SMEs that expands the access to short- and medium-term financing for capital equipment.

[2] According to Eurostat data, the country with the highest share of high-growth companies which intend to use leasing in the near future is Slovakia. See Ushilova and Schmiemann (2011) for a description of the underlying data source.

2 Leasing and the motivation to lease

2.1 What is leasing?

Leasing is a possibility for SMEs to expand their access to short- and medium-term financing. From an economic perspective, leasing can be defined as "a contract between two parties where one party (the lessor) provides an asset for usage to another party (the lessee) for a specified period of time, in return for specified payments" (Fletcher et. al., 2005). This is also reflected in accounting-related definitions: According to the Accounting Standard IAS 17 "a *lease* is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time" (see e.g. European Commission, 2012).

Leasing is referred to as asset based financing. As lessors retain ownership of the assets they lease throughout the life of the contract, these leased assets are therefore an inherent form of collateral in such contracts (compared to traditional bank lending which will either be unsecured or make use of different types of collateral and typically not physical assets such as equipment which are inherent in leases). Conventional bank lending focuses on the loan repayment by the borrower from two sources: a primary source, the cash flow generation, and a secondary source, credit enhancements and collateral (if any). Leasing is focused on the lessee's ability to generate cash flows from the business operations to service the lease payments (Gallardo, 1997), as the lessor retains legal ownership of the asset. Hence, leasing separates the legal ownership of an asset from its economic use. Ownership of the asset may or may not pass to the customer at the end of the lease contract. Contracts, where legal ownership of the asset passes directly to the customer at the start of the agreement, are not considered to be leases.

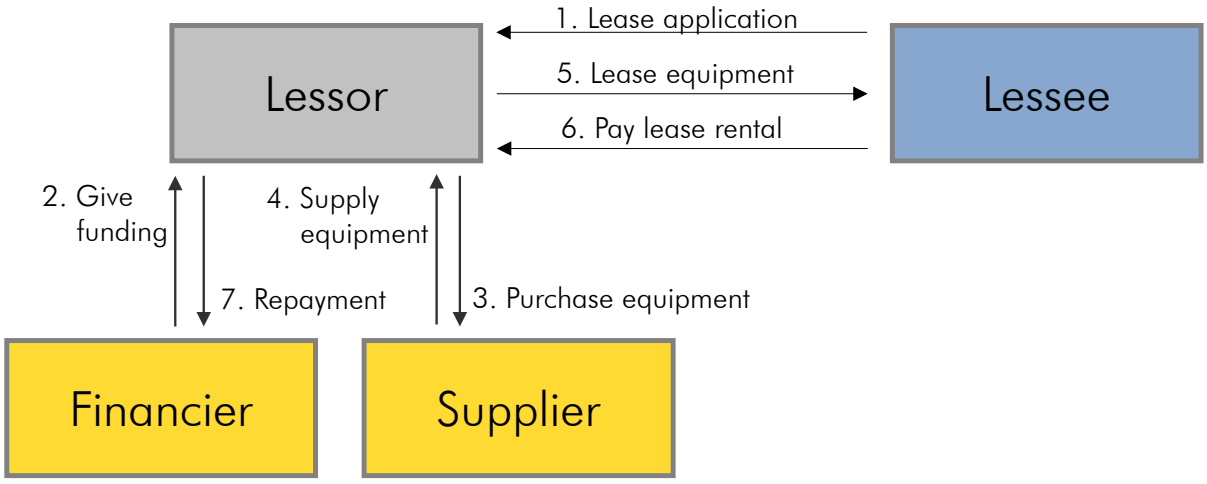
Based on contractual arrangements, the lessee is allowed to use an asset which is owned by the lessor; the lessee pays specified periodic rentals (see *figure 1*). The lessor relies on the lessee's ability to generate sufficient cash flows to pay the lease rentals (rather than to rely on the lessee's other assets or track record/credit history). Leasing enables also borrowers with limited track record / credit histories and collateral to access the use of capital equipment, often even in cases where they would not qualify for traditional commercial bank lending (Gallardo, 1997; Berger and Udell, 2005).

Box 1: Finance lease versus operating lease

In a "finance lease", typically substantially all the risks and rewards of ownership of the asset are transferred to the lessee (while the lessor remains owner).[3] In comparison, an "operating lease" is essentially a rental contract for the temporary use of an asset by the lessee. Typically, the risks associated with the ownership of the asset (e.g. maintenance and insurance responsibilities) remain with the lessor (Fletcher et. al., 2005).

[3] In the example of a full payout finance lease, payments made during the term of the leasing arrangement amortize the lessor' costs of purchasing the assets (however, often there are residual values). The payments also cover the lessor's funding costs (and a profit margin).

Figure 1: The leasing mechanisms



Source: Based on Izumi (2006)

Organisationally and technically, leasing companies have to be able to assess the value of the physical assets being leased in order to sell on the secondary market, or lease again the assets that have not been eventually purchased by their customers (Moutot et al, 2007).

Box 2: Leasing, hire purchase and factoring

In many statistics, leasing is combined with hire-purchase and factoring. The term *hire-purchase* covers different types of contracts from country to country. In some cases, hire purchase involves the transfer of ownership of the asset at the end of the contract, either automatically or through the exercise of a purchase option. These types of hire purchase contracts are therefore leases (i.e. in the UK, Germany, Poland and the Netherlands). However, in cases where ownership transfers at the beginning of the contract, these types of contracts are closer to an instalment credit contract than a lease. *Factoring* is typically an arrangement under which a financial intermediary (the factor) collects the debts of its client in return for a service charge in the form of discount or rebate (or to describe it the other way round: the company sells its receivables to the factor at a discount). The factor eliminates the company's risk of bad debts by taking over the responsibility of book debts due to the client.

2.2 Determinants of choice and market imperfections

Before we analyse recent *empirical evidence and survey results* in chapter 3, we have a look at what *academic literature* tells us about leasing. Simply speaking, the economic rationale for the decision between leasing and purchasing is, whether the cost of ownership and operation is higher or lower than the lease rate offered by the lessor (Slotty, 2009). Originally, finance literature assumed that mainly tax-related incentives lead to the decision of buying or leasing and that the real operating cash flows associated with leasing or buying are invariant to the contracts

chosen.[4] However the tax-argument is too single sided and cannot alone explain the strong position of leasing in many markets (Chemmanur and Yan, 2000). Also non-monetary items have to be considered, i.e. the fact that leasing contracts are flexible towards customer needs (Slotty, 2009), like the variety of contractual provisions (option to cancel the lease before maturity of contract, possibility to renew for additional periods, option to buy the asset at termination, etc.) (Chemmanur and Yan, 2000). Lease payments by the client can also be tailored to the cash flow generation pattern of the lessee.[5] However, in contrast to the purchase of an asset, leasing also means that certain expenses are due over a longer period (fixed component in P&L) without ownership of the asset.

Up-front cash down-payments (or required security deposits) in a lease contract are typically lower than the equity component in conventional bank financing (Gallardo, 1997). One of the advantages of leasing over traditional lending is the fact that a lessee can finance up to 100% of the purchase price of an asset and no additional collateral/security is needed - collateral for the transaction is provided by the asset itself. Moreover, the leased goods might be of higher quality than purchased goods – because of the distribution of payments the lessee might be able or willing to lease more expensive goods (Hendel and Lizzeri, 1998). Lasfer and Levis (1998) have found (based on a data set from the UK) that the reasons for using leasing depend on the size of the company and that in small firms the leasing decision is driven more by growth opportunities than by taxation considerations, the latter being one of the main reasons that larger companies chose leasing. The results also show that leasing allows smaller companies to survive, as small less profitable companies are more likely to lease than cash generating firms. As we show later, recent empirical evidence for Europe suggests that there is not *one* dominant reason for the choice of leasing, but leasing is attractive for SMEs in many diverse circumstances for different reasons.

Leasing is often seen as substitute for medium to long term credit, but the answer to the question whether leasing and debt are substitutes or complements[6] is not trivial and has in financial literature not resulted in a clear conclusion (see e.g. Severin and Filareto-Deghaye, 2007 for a discussion). In traditional corporate finance the decision of buying versus leasing is mostly discussed in the context of the Modigliani and Miller (1958) world of perfect capital markets (where in general the capital structure is irrelevant for the determination of the firm value). But in real financial markets, there are market imperfections. In the area of access to finance for SMEs, a market imperfection/failure is not only present during a deep recession or a financial crisis but

[4] We do not go into the details of taxation here. Tax aspects are for example: periodic lease rental payments as combination of interest related financing costs and payments against principal can be booked by the lessee as business expenses - to shield against tax liabilities on income. Moreover, if the tax rate of the lessor is higher than the one of the lessee, the tax saving (from deducting the depreciation of the asset) can be transferred to the lessee (smaller leasing payments) or can be split between the parties in order to achieve an optimal sharing of tax benefits (Slotty, 2009; Berger and Udell, 2005; Gallardo, 1997).

[5] We focus here on the access to finance of and advantages for the lessee and not on the ones of the lessor (e.g. the possibility for the lessor to exploit economies of scale by buying assets in bulk, an advantage which can then be passed on to the lessee in the form of lower rental payments (see e.g. Slotty, 2009)).

[6] A substitute good, in contrast to a complementary good, is a good with a positive cross elasticity of demand. This means a good's demand is increased when the price of another good is increased. Conversely, the demand for a good is decreased when the price of another good is decreased. See for an introduction e.g. http://en.wikipedia.org/wiki/Substitute_good

also on an on-going basis as a fundamental structural issue. The reasons for a market failure relate to insufficient supply of capital (debt or equity) and inadequacies on the demand side. This market failure is mainly based on asymmetric information (in the case of debt: information gap between lender and borrower), combined with uncertainty, which causes agency problems that affect debt providers´ behaviour (see Akerlof, 1970 and Arrow, 1985).[7]

Information asymmetries can be reduced via three ways: a firm's ability to signal its credit worthiness (incl. an institutional assessment or rating by an independent agency and the provision of collateral), a strong relationship between lender and borrower, and through due diligence/lenders' examination (screening). However, this means on the other hand that new or young firms, with a lack of collateral and by definition without track record, are the ones with the greatest degree of difficulty accessing debt capital (Equinox, 2002). Indeed, according to a recent Eurostat survey, "insufficient collateral or guarantee" was the reason for partially or fully unsuccessful loan applications in 2010 which was most frequently mentioned by banks (Ushilova and Schmiemann, 2011).[8] This was in particular true for high-growth enterprises and the so-called "gazelles" (young high growth enterprises).[9] These financing obstacles can also negatively affect productivity in the economy. Against the background of the on-going economic crisis and sources of firm financing possibly becoming scarcer this problem is even more relevant today (ECB, 2012a).

Sharpe & Nguyen (1995) found that low-rated firms with poor estimated credit quality (and resulting high costs of external financing) show higher volumes of leasing than highly-rated companies since they can reduce their financing costs by means of leasing. Yan (2002) examined the impact of asymmetric information, agency costs and taxes on the substitutability of leases and debt and concluded that they are more likely to be used as substitutes by firms facing more severe asymmetric information and agency problems. Also Slotty (2009) analysed whether enterprises (i.e. SMEs), for which the problem of information asymmetries are severe, lease a greater share of their assets. The analysis concluded that the "descriptive and empirical evidence seems to support the theory that firms which are more likely to suffer from problems of asymmetric information have a greater exigency to leasing". Moreover, Chigurupati and Hegde (2010) concluded that lessee firms with higher information asymmetry rely more on lease financing; furthermore they stress that leasing mitigates underinvestment problems by enabling capital expenditures and reducing the sensitivity of investment expenditures to availability of internal funds. In financial literature, leasing is sometimes even labelled as the last financing resort (Severin and Filareto-Deghaye, 2007).

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

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

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

Hence, leasing is an alternative mechanism to facilitate access to finance; it enables the use of capital equipment in particular for new/young enterprises without credit track record and with limited possibilities to provide collateral. This refers especially to situations of (from the bankers' perspective rational[10] but) de facto unjustified credit rationing: the real creditworthiness of the SME can be better than the perceived quality (i.e. if a financial institution's decision to lend is based on collateral and track record, rather than the economic viability of the business (BIS, 2012)). Consequently, leasing is also a tool to mitigate market weaknesses in SME lending. That this is the case is also shown by the fact that there is no adverse selection process (adverse selection would mean that by trend the companies with the highest (real) credit risk would lease because they do not receive the respective loans). Adverse selection would result in high default rates in the leasing business. However, one could also argue that these rates are low in particular among SMEs, because the leased equipment is typically too important to the lessees' operations to lose it by defaulting on lease payments. Empirical results show indeed that leasing exposures are associated with relatively low risk compared to other forms of financing (see for example Schmit, 2005, and De Laurentis and Mattei, 2009). "The presence of physical collaterals no doubt contributes very largely to this reduced risk profile" (Schmit, 2005).[11]

Overall, academic literature underlines the advantages of leasing as an additional financing form for enterprises. Leasing is an alternative mechanism to facilitate access to finance, even more in the current market environment (e.g. current efforts to change financial market regulations, in particular Basel III liquidity provisions, might hamper long-term SME loan financing (e.g. ACCA, 2012)). Leasing can serve as a helpful financing tool for SMEs which provides financing close to the investment periods of the leased assets. Public support of this instrument can help to mitigate market weaknesses and to enhance the access to finance for SMEs.[12]

[10] Stiglitz and Weiss (1981) argued that under certain circumstances credit rationing can be rational for banks; this can be particularly true in the case of SME financing (OECD, 2006).

[11] However, even if "[s]ome authors suggest that leasing companies benefit from lower LGDs than banks because of their better understanding of the secondary markets and the assets themselves" (Schmit and Stuyck, 2002), this statement is not unambiguously confirmed by some other empirical studies. Hartmann-Wendels and Honal (2010) find that LGDs seem to depend significantly on the type of the leased asset (and so does the result of a comparison with bank loan LGDs). Nevertheless, "assets with relatively stable market values (for example real estate or machinery) and assets traded on liquid secondary markets (vehicles) benefit from lower LGDs" (Hartmann-Wendels and Honal, 2010). Moreover, several papers find a relatively low dependency of leasing LGDs on macroeconomic conditions (e.g. Schmit and Stuyck, 2002, and Laurent and Schmit, 2005). However, Hartmann-Wendels and Honal (2010) show that the type of the leased asset also influences the impacts of macroeconomic conditions on LGDs. They find particularly high cyclical LGD variability for vehicle leases, again possibly due to the rather developed secondary market which enables demand and supply to quickly react to changes in the economic situation.

[12] This argument is even stronger in areas with insufficient bankruptcy rights as leasing offers a higher security than a collateralized loan due to the lessor's retained ownership of the asset. In case of bankruptcy it will be easier for the lessor to regain control of his asset than for a secured creditor to demand his security interest in the collateral (Kirchler and Haiss, 2008).

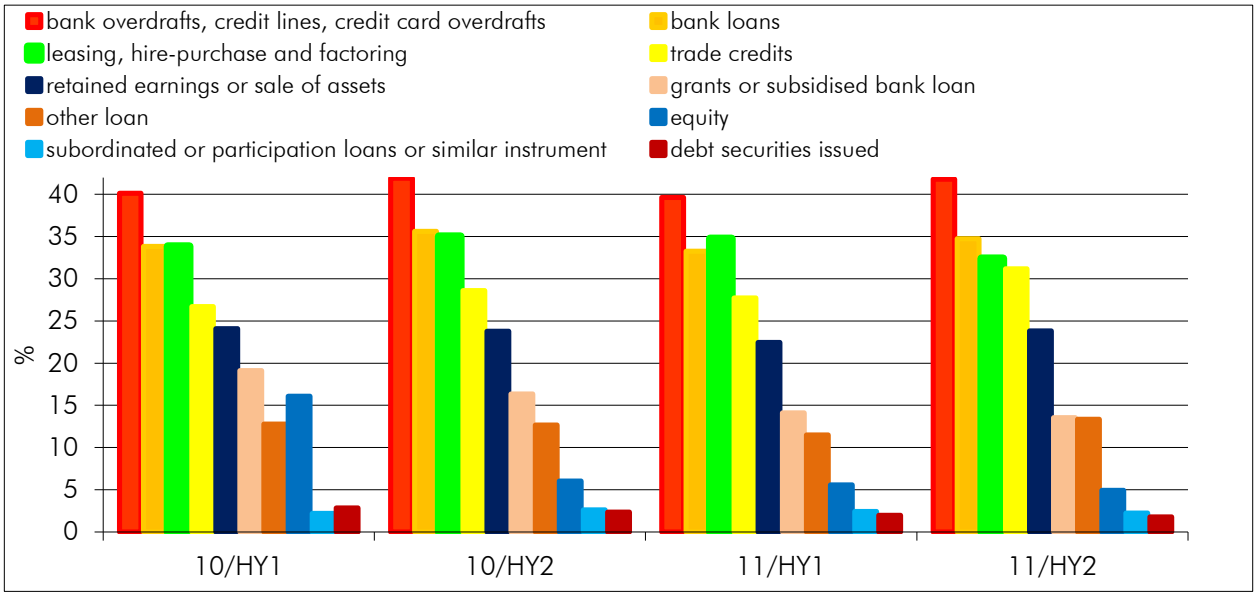
3 Leasing as integral part of the financing tool set for SMEs

3.1 To what extent do SMEs use leasing?

SMEs finance themselves to a great extent by internal sources, both from the business owner and through retained profit. Many SMEs also use external sources of finance, informal sources (such as family and friends, and some types of business angel investment) and formal sources, such as bank loans, leasing, trade credits, factoring and more "formal" Venture Capital, which is important for a select group of high potential SMEs (EIM, 2009). Nevertheless, as mentioned above, SMEs have usually more difficulties in accessing external financing than large enterprises.

This general picture is confirmed by recent *empirical evidence*. According to the ECB's "survey on the access to finance of SMEs in the Euro area", covering October 2011 to March 2012 (ECB, 2012b), access to finance remained the second most pressing problem for Euro area SMEs, and it appears to be a more severe concern for SMEs than for large firms. However, the most pressing problem for SMEs was still "finding customers". Compared to the previous ECB survey (covering the period April to September 2011), the composition of external sources of finance changed. While the ECB data does not isolate leasing products specifically, the importance of "leasing, hire-purchase and factoring" taken together[13] decreased somewhat. Nevertheless, it is the third most important financing source of SMEs, preceded by "bank overdrafts, credit lines and credit card overdrafts" and "bank loans" (see *figure 2*).

Figure 2: Sources of external financing of Euro area SMEs
(over the preceding six months; percentage of respondents)



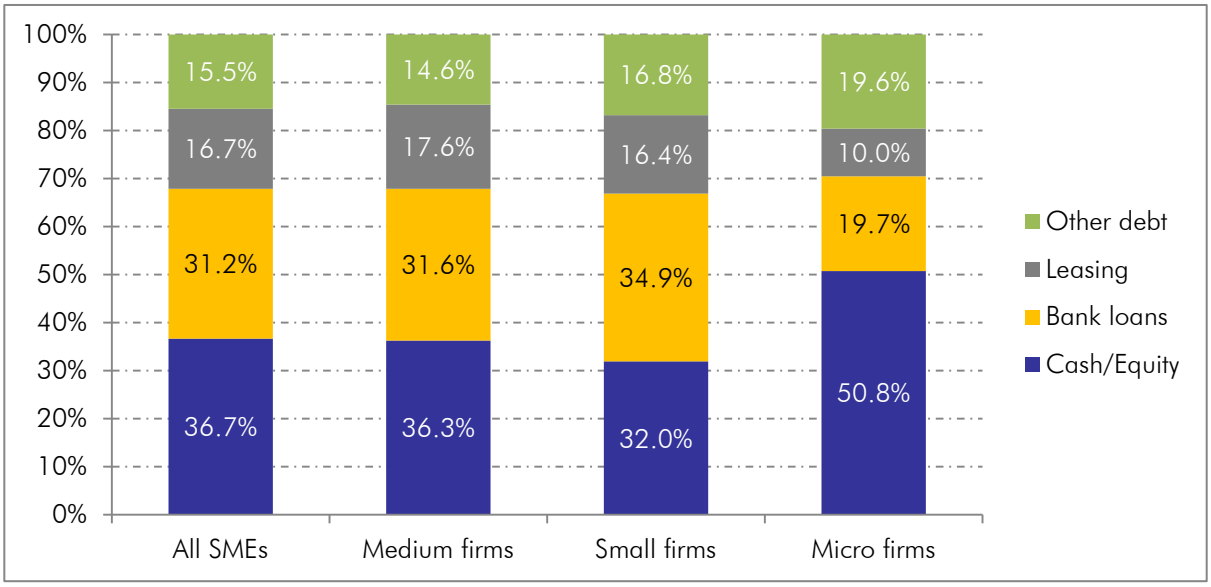
Source: ECB (2012b)

[13]For the ECB survey, leasing is grouped together with factoring, which is also a form of asset based lending. Leasing is based on physical assets while factoring is based on receivables. According to Oxford Economics (2011), only 13% of European SMEs' used factoring for funding of investments in 2010 while 40% of SMEs used leasing. A recent Eurostat survey showed similar results regarding the relative importance of leasing versus factoring for SME finance (OECD, 2012): According to Eurostat, in 2010, 55% of all surveyed enterprises which were looking for finance used leasing and 16% used factoring.

The relatively high importance of leasing for the external financing of SMEs is confirmed by the recent study "The Use of Leasing Amongst European SMEs" which was prepared by Oxford Economics (2011) for Leaseurope, the European Federation of Leasing Company Associations.[14] In 2010, according to the survey, leasing was the most popular source of external financing, which was used by 40% of the surveyed SMEs in 2010.[15] The second most important external financing source was bank loans of more than 3 years.[16]

However, even if a large number of SMEs uses leasing, the share of investment financed by leasing (16.7%) is actually smaller than the share of SMEs which used leasing as a financing tool, as depicted in *figure 3*. Bank loans (all maturities taken together plus other forms of bank loans) are used to finance a larger part of SMEs' investments (31.2%).

Figure 3: SMEs' Fixed Asset Investment financed by different sources in 2010, by size class



Source: Oxford Economics (2011)

[14]The report is based on a survey about the use of leasing conducted amongst almost 3,000 SMEs across eight EU Member States and nine industrial sectors in July 2011. The eight countries (France, Germany, Italy, Netherlands, Poland, Sweden, Spain and the UK) represent 78% of new leasing volumes in 2010. The split of firms across countries, sectors and size classes was intended to correspond to the industrial structure of the SME sector in each of these countries (based on Eurostat data). The authors consider the study as giving a representative picture for each country and for each industry included in the sample as well as for Europe as a whole.

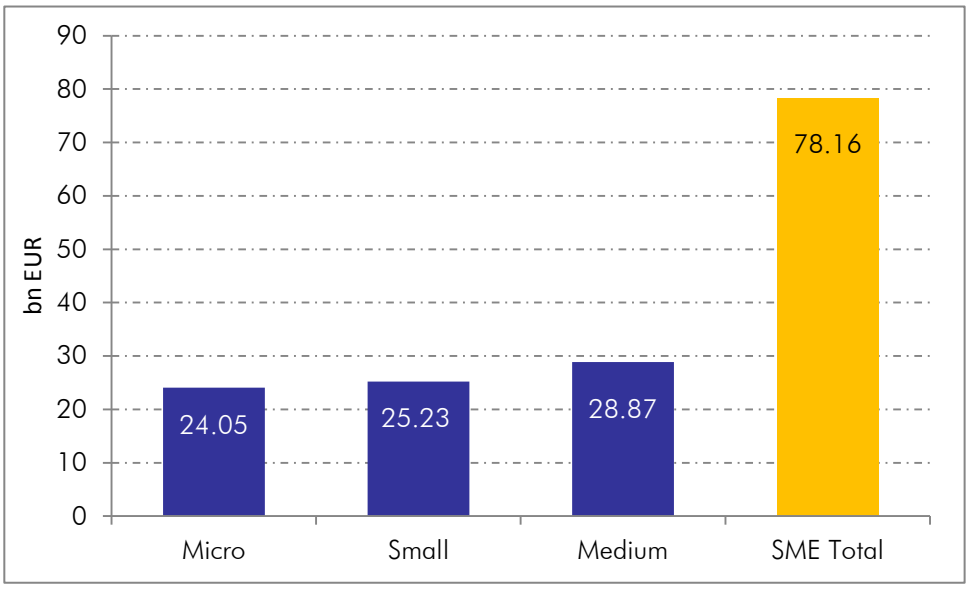
[15]Differences in the Oxford Economics (2011) and the ECB (2012b) survey results could be attributed to different survey samples/country base and definitions of the financing categories included. However, the main findings concerning the relative importance of leasing are similar.

[16]With regard to duration, according to the report, this financing source (bank loans of more than 3 years) is seen as the form of bank finance which is most comparable to leasing.

However, when looking only at those SMEs that actually used leasing in 2010, the share of investment financed by leasing is much higher (32.4%) and exceeds the shares of investment financed by bank loans (30.1%) or by any other financing source. Thus, for SMEs which decide to lease an asset, this instrument becomes on average the most important part of their financing tool set.

Scaling up the figures from the eight country sample, Oxford Economics (2011) estimates the SME leasing volume for the whole EU to EUR 100bn for 2010 which corresponds to 52% of total leasing to businesses. The share of each of the three size-classes (micro, small and medium sized enterprises) was roughly equal for the eight countries in the sample (see *figure 4*).

Figure 4: Estimated new SME leasing volumes in 2010[17]



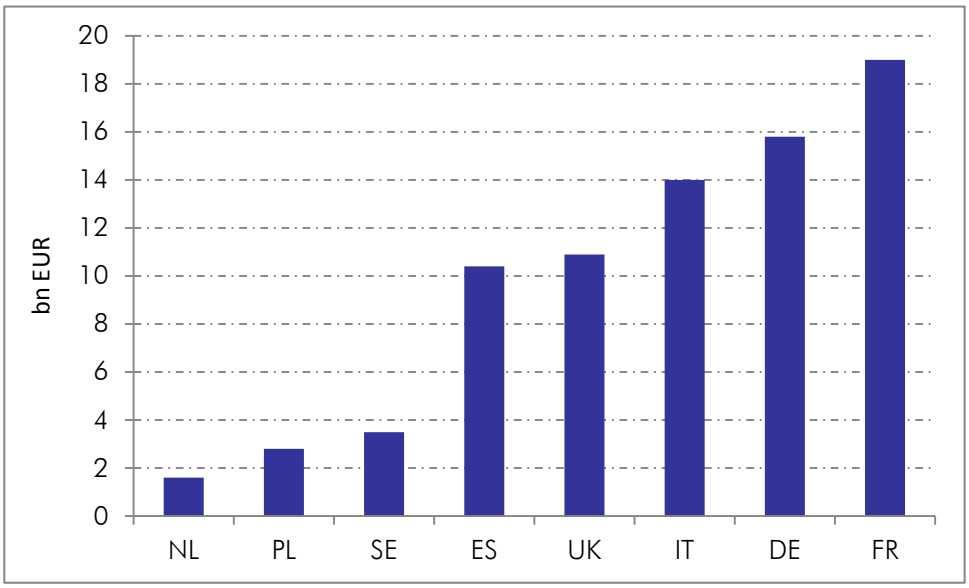
Source: Oxford Economics (2011)

However, as depicted in *figure 5*, the estimated total new SME leasing volumes show remarkable differences across countries. France held the leading position in 2010 with an estimated new SME leasing volume of EUR 19.0 bn. In contrast, SME leasing plays a smaller role in the Netherlands.[18]

[17]Estimated new SME leasing volumes in 2010 for the eight countries in the sample (France, Germany, Italy, Netherlands, Poland, Sweden, Spain and the UK). Estimated new SME leasing volumes for each country are calculated by multiplying the penetration rate estimate from the sample of firms with the estimate of investment (gross fixed capital formation) by SMEs. For more details see Oxford Economics (2011).

[18]The share of estimated new SME leasing volumes of nominal GDP is highest in Sweden, Spain and France, and lowest in the Netherlands. However, the sample size in the Oxford Economic study is small for some countries (e.g. the Netherlands). Hence, results should be interpreted with care when being examined at national level.

Figure 5: Estimated new SME leasing volumes by country in 2010



Source: Oxford Economics (2011)

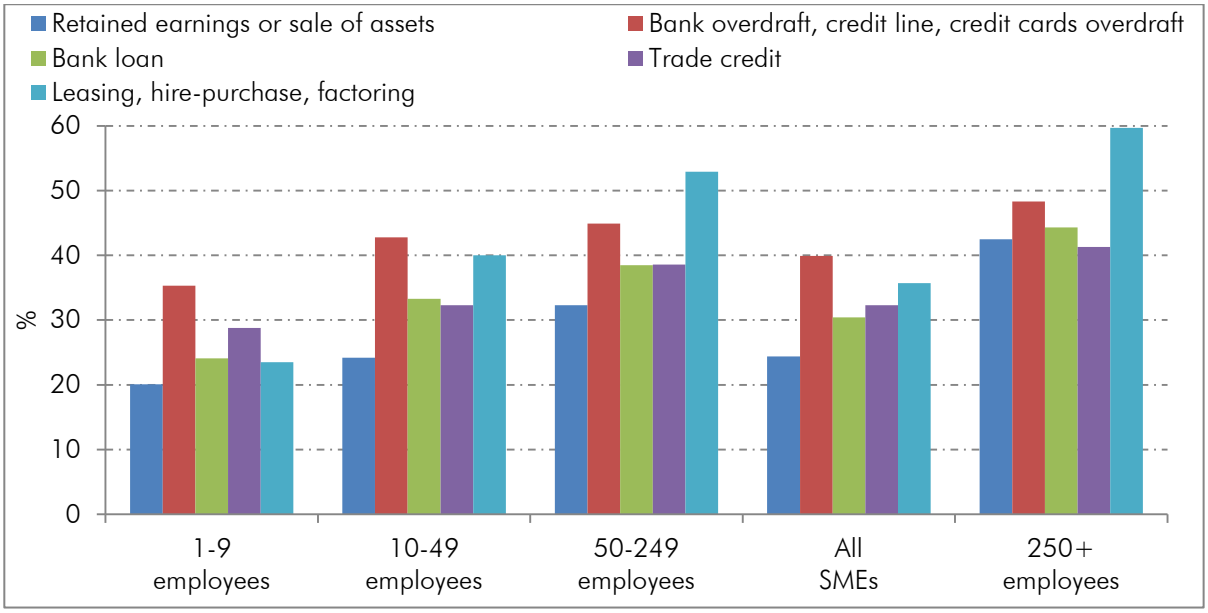
3.2 What kind of SMEs use leasing?

When looking at different enterprise size classes in the EU, the use of external financing on average increases with company size (see *figure 6*); the same applies to leasing (including hire-purchase and factoring). In particular, micro-enterprises seem to lag behind. Of SMEs with one to nine employees, only 24% used leasing as a funding source, compared to 53% of businesses with 50 to 249 employees and 60% of large enterprises (with 250 or more employees). According to the European Commission (2011a)[19], there was also a difference by turnover: While approximately half of the companies with a turnover greater than EUR 2m made use of leasing, hire-purchase or factoring, only 27% of SMEs with a smaller turnover used this type of financing. SMEs in the industry sector were more likely than those in other sectors to have used this source – 44% had done so, while those in the trade sector were least likely (31%).

[19] The EC and the ECB decided in 2008 to collaborate on a survey on the access to finance of SMEs in the European Union. The survey covers micro, small, medium-sized and large firms and provides evidence on the financing conditions faced by SMEs compared with those of large firms. Part of the survey is run by the ECB every six months to assess the latest developments of the financing conditions of firms in the euro area. The more comprehensive part of the "Survey on the Access to Finance of Small and Medium-sized Enterprises" (SAFE), covering all EU countries and other countries participating in the Entrepreneurship and Innovation Programme of the Competitiveness and Innovation Framework Programme (CIP) is run by the EC and the ECB every two years.

Figure 6: EU Enterprises having used different financing sources (by enterprise size class)

(over the preceding six months; percentage of respondents; survey conducted from Aug. to Oct. 2011)

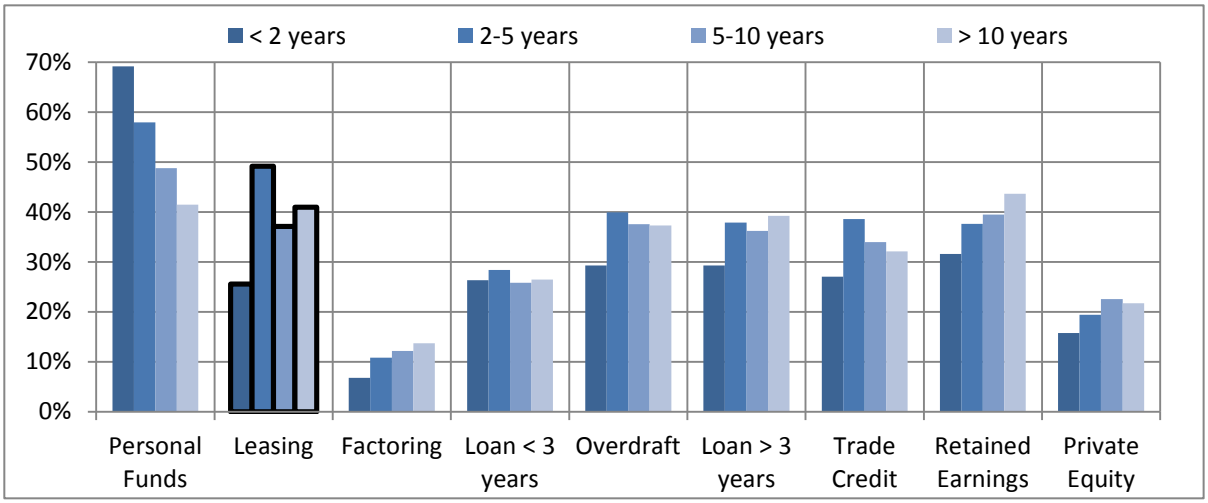


Source: European Commission (2011c)

The results are broadly in line with the findings of Oxford Economics (2011): Broken down by size classes, 28% of micro enterprises used leasing, 42% of small firms, and 53% of medium sized firms. Moreover, also the share of investment which is financed by leasing (so-called penetration rate) increases on average with the size of the SME. Penetration-rates for micro-enterprises (10%) are smaller than for small (16.4%) or medium-sized firms (17.6%).

While it is generally difficult for young firms to access external financing sources, SMEs' access to leasing seems to develop quicker than the access to other sources of external financing as depicted in *figure 7*. According to the Oxford Economics (2011) survey, the relative importance of leasing was highest for relatively young enterprises aged between two and five years.

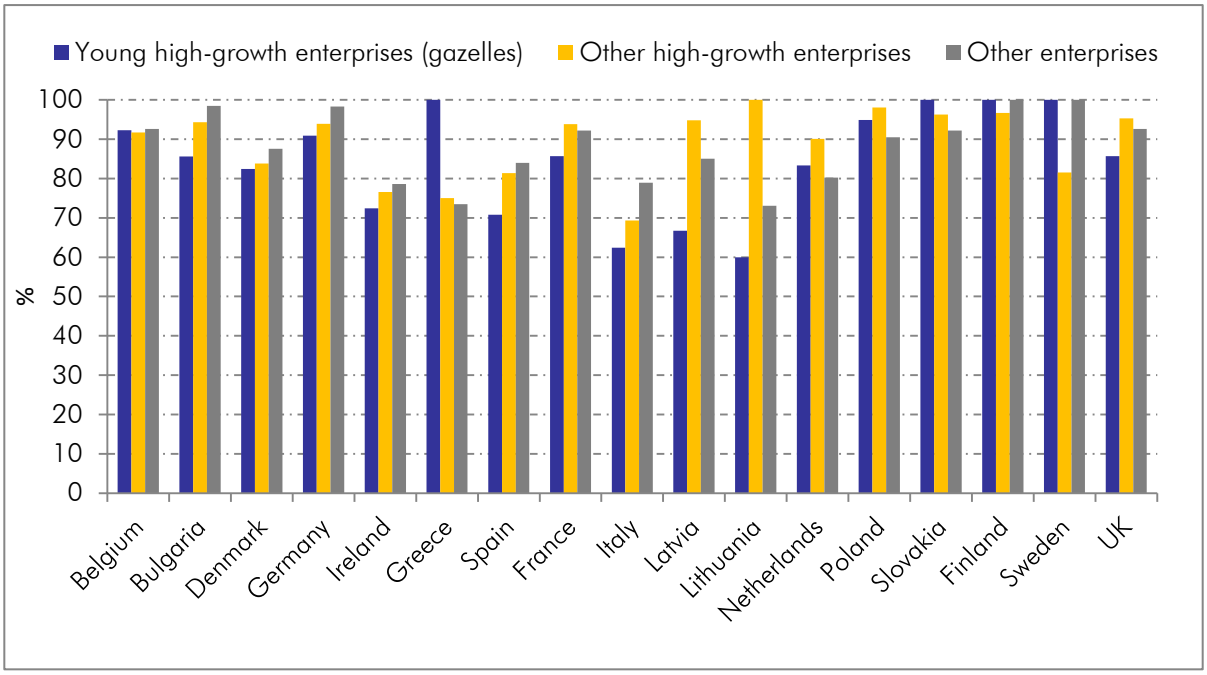
Figure 7: Use of financing source by SME age class in 2010



Source: Oxford Economics (2011)

The advantage of leasing for young SMEs and other enterprises that are considered to bear comparably high credit risk is also shown by relatively low rejection rates. Despite an increase from 2007 to 2010, leasing remained the financing source with the lowest rate of unsuccessful applications. Moreover, the success rates in obtaining leasing finance are relatively similar between the so called gazelles, i.e. the young high-growth enterprises, and all SMEs. For other forms of finance (e.g. bank overdrafts or credit lines) gazelles show considerably lower approval rates than other enterprises in most countries. Thus, the OECD (2012) concludes that "[l]easing is the form of finance that appears to be equally suitable for enterprises with different growth characteristics, with approval rates relatively similar in most countries."

Figure 8: Success rates in obtaining leasing in 2010



Source: OECD (2012) and Eurostat

3.3 A closer look at differences by country

When looking at country level, large differences in the use of leasing appear (see *table 1*). In the latest period (August to October 2011) for which the European Commission (2011a,b) survey was conducted, 35.7% of SMEs used leasing, hire-purchase or factoring in the whole EU. However, while more than half of all SMEs made use of these instruments in Estonia, Sweden and Germany, only a relatively small fraction of SMEs used these financing sources in Cyprus, Malta, and Greece.

Table 1: SMEs having used leasing, hire-purchase or factoring in different countries

(over the preceding six months; percentage of respondents, survey conducted from Aug. to Oct. 2011)

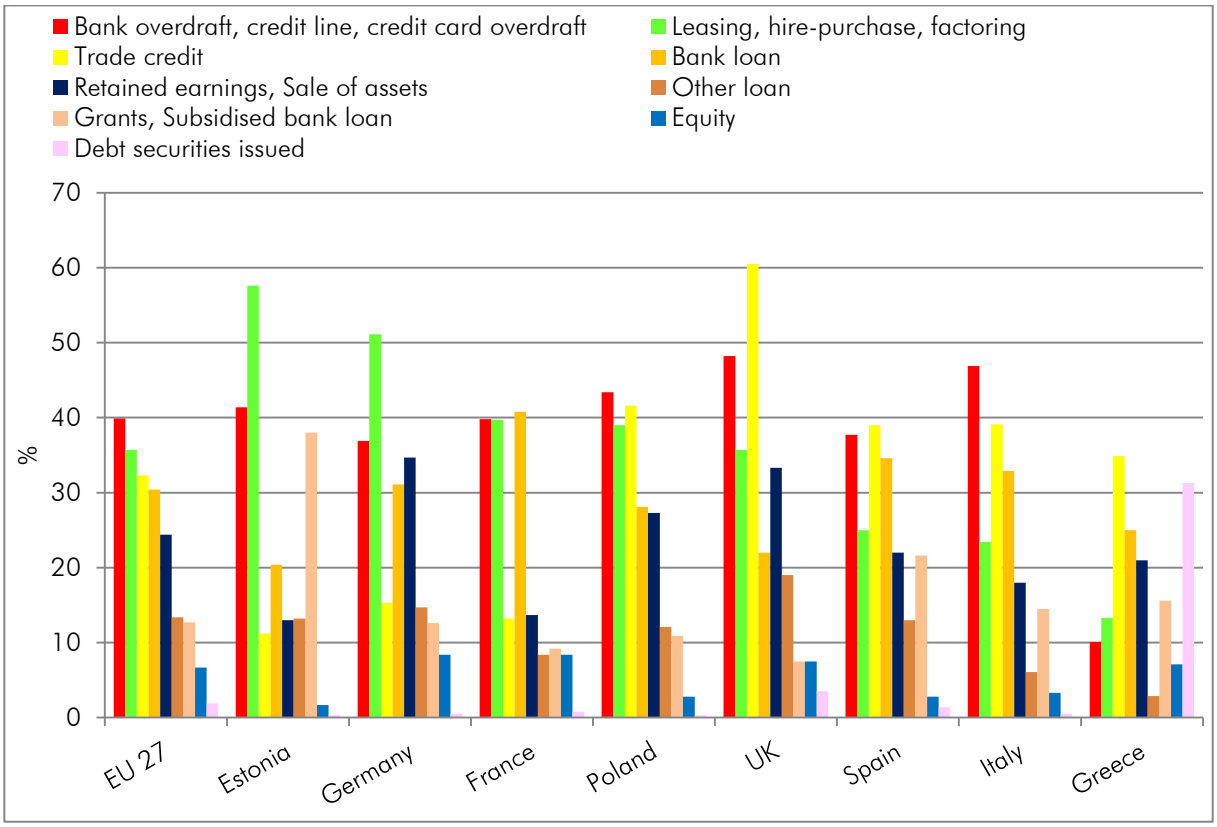
EU 27	35.7						
Estonia	57.6	Denmark	41.2	Romania	36.3	Italy	23.4
Sweden	55.4	Czech Republic	40.1	UK	35.7	Belgium	20.9
Germany	51.1	France	39.7	Hungary	35.0	Luxembourg	20.8
Latvia	47.4	Poland	39.0	Ireland	31.1	Cyprus	17.5
Slovakia	45.7	Slovenia	38.1	Portugal	28.1	Malta	14.6
Austria	45.1	Lithuania	38.0	Spain	25.0	Greece	13.3
Finland	42.9	Netherlands	37.2	Bulgaria	23.6		
Non-EU countries							
Croatia	38.1	Serbia	22.5	Liechtenstein	18.2	Albania	1.7
Norway	35.2	Iceland	22.0	FYROM	14.3	Israel	0.9
Switzerland	30.2	Turkey	19.1	Montenegro	11.6		

Source: European Commission (2011b)

Moreover, the category leasing (including hire-purchase and factoring) was the second most frequently cited source of external financing in the EU (following the category bank overdraft, credit line or credit cards overdraft). However, the leasing category was the most frequently used external financing source in Estonia, Sweden, Germany, Latvia, Austria, the Czech Republic, Slovenia, Lithuania, and Hungary. As shown in *figure 9*, leasing, hire-purchase and factoring was somewhat less important for SMEs in other large EU Member States.

Figure 9: SMEs having used different financing sources (EU and selected Member States)

(over the preceding six months; percentage of respondents, survey conducted from Aug. to Oct. 2011)



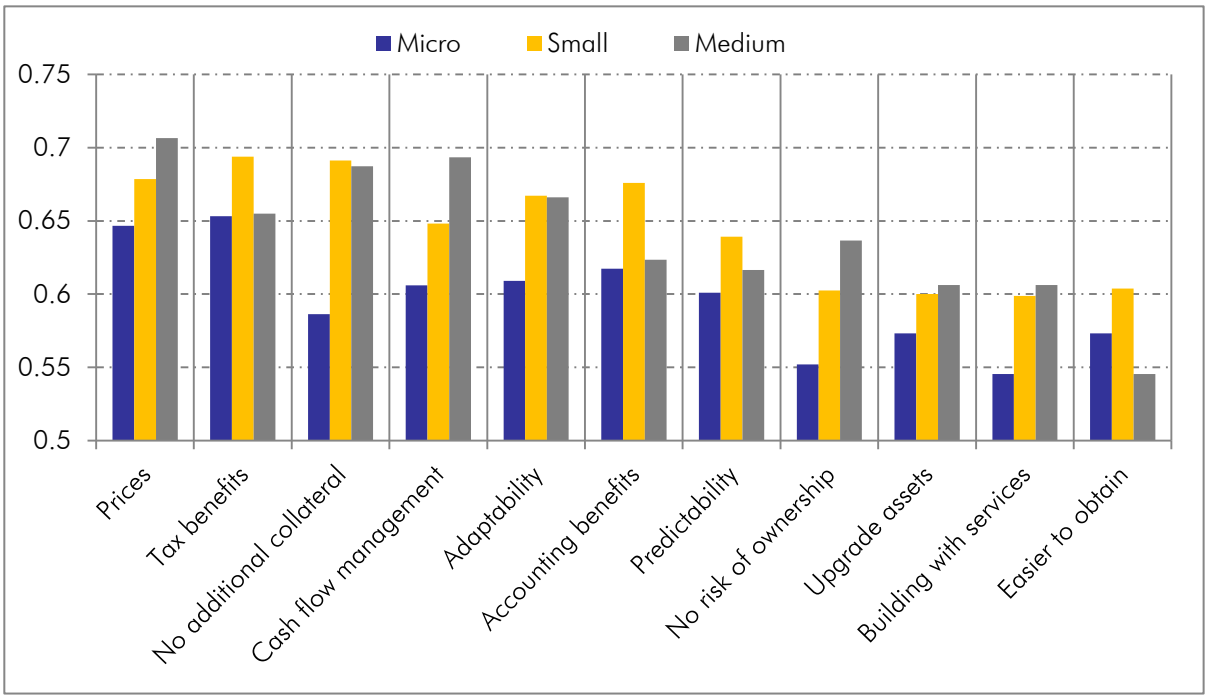
Source: European Commission (2011b)

3.4 Why and how do SMEs use leasing?

SMEs' reasons to use leasing

According to recent survey results (Oxford Economics, 2011), SMEs on average have a variety of reasons for their decision to lease an asset (see *figure 10*). However, the main reason seems to be price considerations (price of leasing relative to other financing forms). The importance of different reasons for using leasing becomes clearer when looking at different SME size classes. For example, medium-sized enterprises seem to lease due to price considerations, better cash flow management and the absence of the need to provide collateral. In contrast, micro-enterprises stated tax benefits next to price considerations as main reasons to use leasing. Interestingly, the absence of collateral requirements seems to be less important for micro-enterprises than for small or medium-sized firms.

Figure 10: SMEs' reasons to use leasing
(0=not at all important, 1=very important)



Source: Oxford Economics (2011)

Reasons for leasing vary more over countries than over sectors. According to Oxford Economics (2011) this could be due to different tax and regulatory environments. For instance, collateral considerations were most important in France and Italy, while tax benefits were mainly stated in the UK.

In a survey conducted by the EBRD Evaluation Department (2011), the reason for leasing with which most respondents (80%) agreed was that business had grown due to using leased

equipment. The second most important reason (77% agreement rate) was that it was "quicker to obtain lease finance" for SMEs.[20]

Participants of the Oxford Economics (2011) survey were also asked why they *did not use leasing or – in the case of leasing users – why they did not use leasing to a larger* extent. The two main reasons were the preference to own the assets outright and a better price in case of an asset purchase than in case of a lease. However, as stated above, price considerations can also lead to a positive decision to lease, depending on the circumstances of the financing project.

The choice of a particular financing source can also depend on the specific investment type, e.g. on the asset which is financed. As shown in *table 2*, SMEs lease a broad range of assets. However, vehicles of various types account by far for the biggest share.

Table 2: Share of SMEs which leased different asset types, by country

	FR	DE	IT	NL	PL	ES	SE	UK	All eight countries
Agricultural and construction equipment	8.0%	0.9%	4.4%	1.0%	4.3%	2.7%	2.4%	3.9%	**3.7%**
Mechanical handling equipment, e.g forklift	13.8%	7.8%	11.6%	3.9%	6.7%	4.9%	4.4%	10.0%	**8.6%**
Production equipment	20.7%	14.4%	8.7%	1.9%	9.0%	4.0%	6.3%	24.7%	**12.5%**
Other machinery and industrial equipment	20.0%	13.1%	11.3%	2.9%	20.0%	8.9%	5.9%	36.2%	**16.3%**
IT and communications equiment	25.1%	15.1%	8.9%	4.9%	26.7%	8.4%	10.2%	19.4%	**15.5%**
Office printers & photocopiers	19.6%	15.8%	12.0%	3.9%	17.7%	4.7%	15.6%	13.3%	**13.1%**
Other equipment & furniture	17.3%	7.3%	6.4%	2.4%	8.3%	4.0%	4.4%	23.1%	**10.2%**
Medical equipment	2.0%	0.7%	1.8%	0.5%	0.0%	0.9%	0.5%	1.7%	**1.1%**
Renewable energy equipment, e.g. solar panels	2.9%	1.6%	0.9%	0.0%	1.3%	0.7%	2.0%	6.8%	**2.2%**
Passenger cars and commercial vehicles<3.5 tonnes	23.6%	24.9%	18.4%	13.6%	38.0%	9.6%	12.2%	14.4%	**19.4%**
Commercial vehicles>3.5 tonnes	15.8%	7.8%	8.2%	5.3%	5.3%	6.0%	10.2%	18.1%	**10.1%**
Other vehicles, e.g. bus	5.8%	4.7%	2.4%	3.4%	2.3%	2.2%	7.3%	11.6%	**5.1%**

Source: Oxford Economics (2011)

[20]The authors of the study state that the sample of lessees surveyed "seemed representative across six of the EU or EU candidate countries", i.e. for Bulgaria, Hungary, Slovenia, Romania, Bosnia and Croatia (EBRD Evaluation Department, 2011, p. 18).

SME leasing channels

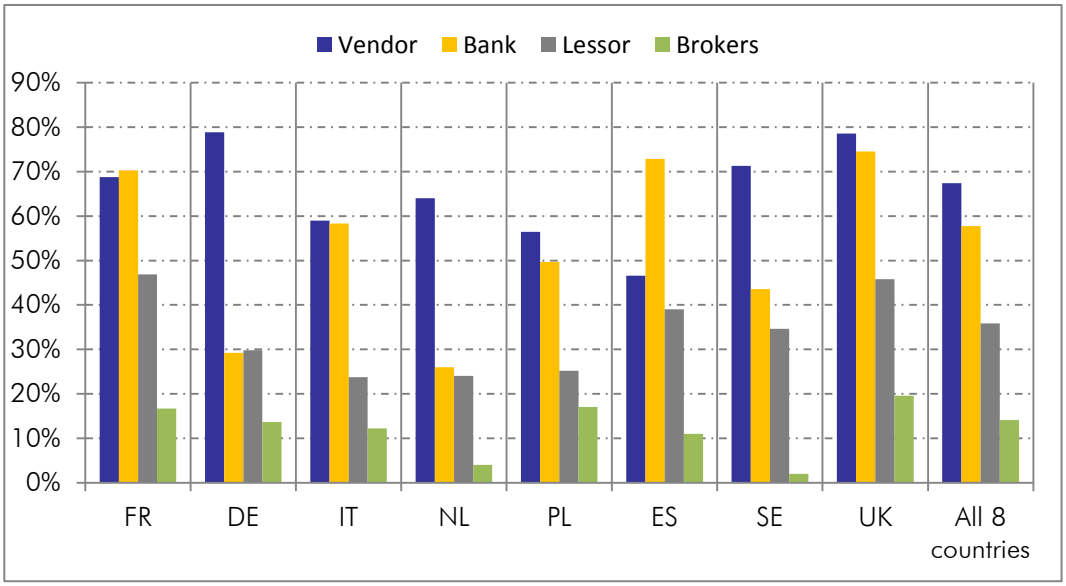
The main channels through which an SME can lease goods are the vendor channel and the customer channel (Oxford Economics, 2011, see *box 3*). The importance of the vendor channel is obvious. According to Oxford Economics (2011), 67% of European lessees use this channel, compared to 58% using the banking channel and 36% for the direct sales network of lessors. *Figure 11* shows the differences in distribution channels used in various European countries. For example, 79% of SMEs accessed leasing through the vendor channel in Germany and the UK in contrast to 47% in Spain where the banking sector was the main distribution channel. However, for each country the shares sum up to more than 100% which shows that many SMEs used more than one leasing channel.

Box 3: Vendor and customer channels

In the *vendor channel*, the SME leases an asset at its point of sale, i.e. at the same time as selecting the equipment from a manufacturer or dealer, it also selects to finance the asset. In such cases, the financing can be provided directly to the end customer by the manufacturer or dealer,[21] or the manufacturer/dealer may have an agreement in place with a 3rd party leasing company who provides the lease to the end customer.

The *customer channel* involves initiating contact between the lessee and the provider of the lease in a number of ways, e.g. through the bank branch of the customer (in the case of bank owned leasing companies who distribute their leasing products through the banking network), directly through the sales network of a lessor or through a broker which may provide a range of financial services, including leasing.

Figure 11: Share of lessees using different leasing channels by country in 2010



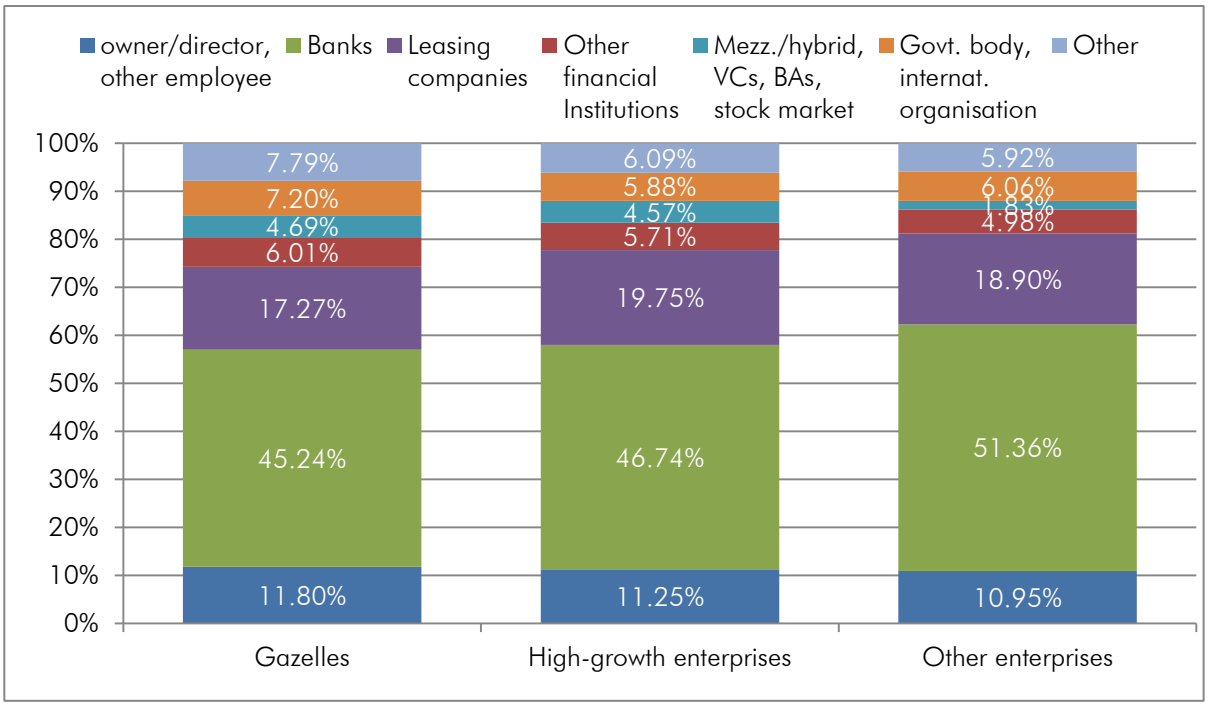
Source: Oxford Economics (2011)

[21] Manufacturer or dealer owned leasing companies are known as captive leasing companies.

3.5 Will the importance of SME leasing change?

All in all, and despite the differences between enterprise size classes and among countries, the recent surveys on access to finance show the high relevance of leasing for SMEs. This is also confirmed by recent Eurostat findings. In October 2011, Eurostat published results from a survey on access to finance for SMEs in the EU (Ushilova and Schmiemann, 2011).[22] According to this study, more than half of the surveyed SMEs did not seek any external finance in 2007 and 2010. However, the financing needs were expected to grow for the period 2011-13. Loans were still the most desired financing type and the need was expected to increase, including a plus of 10 percentage points for "gazelles" and other high-growth enterprises. For all types of enterprises, banks were expected to stay the most important financing source of the surveyed SMEs. Leasing companies were expected to be in the second position among all enterprise groups (see *figure 12*). However, these figures do not necessarily reveal the full importance of the leasing product for SMEs as leases can be distributed by banks together with loan products (see above).

Figure 12: Envisaged finance sources between 2011 and 2013



Source: Own calculations based on Eurostat data

The recent survey results, described in this chapter, prove the high relevance of leasing for SME finance. This was also the outcome of our literature survey in chapter 2. Moreover, leasing can also help firms lacking sufficient collateral to access financing. Thus, leasing is a particularly important tool for new/young enterprises including the so called "gazelles" (OECD, 2012). The recent Eurostat survey shows no major change in SMEs' expectations regarding the future importance of leasing. Thus, in the following chapter, we will have a closer look at EIF's support for leasing as an integral part of the current and future financing tool set of SMEs.

[22] See footnote 8 for details with regard to this survey.

4 Case studies

Generally speaking, EIF support is intended to mitigate market inefficiencies or weaknesses with regard to SMEs' access to finance. As shown above, SMEs which would otherwise have difficulties to access financing (at least partially due to market failure) can benefit from leasing. However, in the current financial and regulatory environment, also the leasing companies themselves have distorted access to (re-)financing.

The problems are different depending on the ownership model of the leasing companies. According to Leaseurope and KPMG (2012), 50% of European leasing companies were bank related, 18% captives, and 32% independent in 2010.[23] However, in terms of shares of new volumes "90% of the European leasing market is in the hands of bank owned leasing companies" (Mignerey, 2012). Moreover, "whether bank owned, captive or independent, European leasing companies heavily rely on the banking sector to fund their operations" (Mignerey, 2012).

In the current financial and economic crisis, several banks have reduced or fully abandoned the refinancing of leasing companies, as described in *box 4*. According to Mignerey (2012), the decision of some parent banks to downgrade leasing to the status of a "non-core" business was "simple to understand: leasing did not bring what banks needed, i.e. deposits; leasing required what banks were lacking, i.e. capital and liquidity". As we will show below, EIF's support instruments can help to mitigate some of these negative developments.

Box 4: Leasing companies and the financial crisis – results from a German Survey

During the financial crisis, the leasing market has been particularly affected by the worsening of refinancing conditions for leasing companies. According to a survey among German leasing companies (Hartmann-Wendels and Pytlik, 2010), leasing companies which are independent from banks and manufacturers were hit the most. Moreover, several banks have reduced or fully abandoned the refinancing of leasing companies, due to scarcity of banks' own resources, regulatory requirements, or management decisions to stronger concentrate on core business activities (Hartmann-Wendels and Pytlik, 2010, Hartmann-Wendels, 2010, and Mignerey, 2012). According to Hartmann-Wendels and Pytlik (2010), a significant reduction of active refinancing partners was reported by leasing companies, in particular by smaller ones. Moreover, collateral requirements have considerably increased.

These developments are different from past recessions, when leasing companies were "only" hit by reduced overall investment activities which could often be compensated by an increase in leasing penetration rates (Hartmann-Wendels and Pytlik, 2010). This time, the deterioration in the access to refinancing came on top.

The financial crisis has not only affected banks and their leasing affiliates. In fact, as mentioned in *box 4*, independent leasing companies were hit the most by the worsening of the refinancing conditions. Moreover, a significant reduction of active refinancing partners was reported in particular by smaller leasing companies. Many independent leasing companies are also hit by

[23]Percentage of European leasing companies according to shareholder type.

structural problems such as a low equity base or a lack of specialisation which often leads to relatively low residual values of the leased assets in their balance sheets. Thus, EIF support can also be helpful for smaller viable independent leasing companies that are suffering from structural weaknesses and negative cyclical developments.

Some vendor owned leasing companies follow a way which brings them closer to become quasi banks supported by strong cash flows of their parent companies. However, this can only to some extent compensate for the negative developments which affect other ownership models.

Thus, EIF support can mitigate the current market distortions, thereby enabling the financing of new leases to SMEs and contributing to enhance their access to long-term financing. The following sections provide a closer look at the character of EIF support and at three concrete case studies.[24]

The EIF is the European Investment Bank (EIB) Group's specialist provider of risk financing for entrepreneurship and innovation across Europe, delivering a full spectrum of financing solutions through financial intermediaries (i.e. equity instruments, guarantee and credit enhancement instruments, as well as microfinance). In general, the EIF focuses on the whole range of micro to medium-sized enterprises, starting from the pre-seed, seed-, and startup-phase (technology transfer, business angel financing, microfinance, early stage VC) to the growth and development segment (formal VC funds, mezzanine funds, portfolio guarantees).

With regard to portfolio guarantees, the EIF cooperates with a wide range of financial intermediaries such as commercial banks, leasing companies, guarantee funds, mutual guarantee institutions, counter-guarantee institutions, promotional banks or any other financial institution providing financing to SMEs, or guarantees for SME financing. The guarantee instruments consist of two main products supporting access to finance for SMEs; both instruments are also applied to support lease finance:

1. Credit Enhancement/Securitisation - *Guarantees for securitised SME financing instruments:*
EIF is recognised as Europe's leading provider of triple A-rated credit enhancement in SME securitisations, benefitting from Multilateral Development Bank status, which enables financial institutions to apply a 0% risk-weighting to assets, guaranteed by EIF. Typically, EIF guarantees certain tranches of notes (senior and/or mezzanine tranches) issued through a SME securitisation transaction. Lease receivables are eligible assets for this type of transactions and we provide below a case study of a transaction in Germany.

[24]These case studies are very recent examples; EIF supports the leasing market since many years and in different types of transactions/business lines: e.g. in the area of microfinance as micro-leasing transactions, or in the field of Venture Leasing as hybrid of traditional leasing and VC. In the latter case the lessor leases equipment to early-stage companies and typically receives in addition to the lease payments upside potential (e.g. via warrants) as compensation for the high risk taken.

2. Guarantees/counter-guarantees for portfolios of micro-credits[25], SME loans or leases - *Management of programmes of the European Commission/national and regional Managing Authorities:*

EIF manages several mandates on behalf of the European Commission or of national and regional Managing Authorities. Also these guarantees can support lease finance; we provide two case studies as examples. The first one is conducted under the JEREMIE[26] initiative: a leasing transaction in Lithuania. The second one is a loan guarantee under the CIP Programme.[27]

IKB Leasing 2012, Germany

Before we introduce this securitisation transaction we briefly analyse the importance of leasing for SMEs in Germany (see *box 5*).

Box 5: Leasing in Germany

Leasing is a very important source of financing for German SMEs. According to KfW, 85% of the clients in the German leasing market are SMEs (KfW, 2011b). The overall leasing market (new lease totals, all enterprise sizes) showed a continuous increase from 2003 to 2007/2008 (from EUR 46bn to EUR 54.9/54.4bn) but went down by more than 20% to values of EUR 41.9bn and EUR 43.6bn during the crisis years 2009/2010. The KfW enterprise survey (KfW, 2011a) shows that leasing is among the most important sources of financing on position 3 (preceded by internal financing and bank loans).

[25] Micro-credit is defined by the European Commission as a loan or lease under EUR 25,000 to support the development of self-employment and micro-enterprises. A micro-enterprise is any enterprise with fewer than 10 employees and a turnover under EUR 2m (as defined in the Commission Recommendation 2003/361/EC of 6 May 2003, as amended).

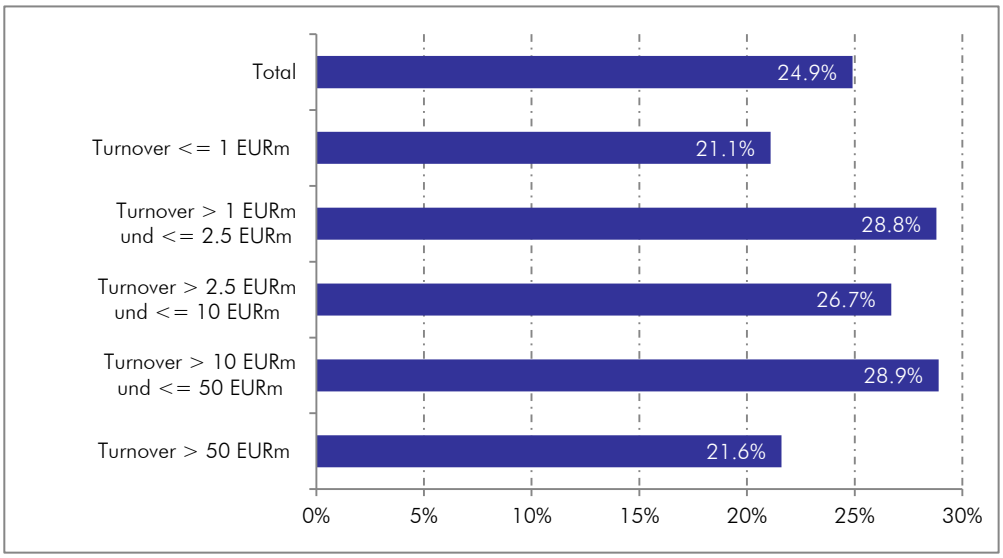
[26] JEREMIE stands for Joint European Resources for Micro to medium sized Enterprises. The initiative, developed in cooperation with the European Commission, offers EU Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds to finance SMEs by means of equity, loans or guarantees, through a revolving Holding Fund acting as an umbrella fund. A JEREMIE Holding Fund can provide to selected financial intermediaries SME-focused financial instruments including guarantees, co-guarantees and counter-guarantees, equity guarantees, (micro) loans, export-credit insurance, securitisation, venture capital, Business Angel Matching Funds and investments in Technology Transfer funds. For more information please visit: http://www.eif.org/what_we_do/jeremie/index.htm

[27] The Competitiveness and Innovation Framework Programme (CIP) which is funded by the European Union aims at SMEs mainly by supporting enhanced access to finance. On behalf of the European Commission, the EIF manages the CIP high growth and innovative SME facility (GIF) and the SME guarantee facility (SMEG). The GIF facility provides risk capital for innovative SMEs in their early stages and to SMEs with high growth potential in their expansion phase. The SMEG facility provides capped guarantees to financial intermediaries in order to partially cover portfolios of financing to SMEs. SMEG comprises four "windows" (business lines): loan guarantees, micro-credit guarantees, equity guarantees, and securitisation guarantees. For more information please see the CIP website provided by the European Commission, http://ec.europa.eu/cip/, and the EIF website on SMEG: http://www.eif.org/what_we_do/guarantees/cip_portfolio_guarantees/index.htm

Box 5 continued:

25% of the surveyed enterprises mention leasing as important source of financing (see *figure 13*). The correlation between enterprise size, industry and the importance of leasing seems to be somewhat different from the one shown in chapter 3. However, in this case, it is an analysis with different questions and turnover classes and a look at Germany only. For companies with an annual turnover between EUR 1m and EUR 50m leasing is more important than for smaller companies (turnover below EUR 1m) and for bigger enterprises. The highest importance of leasing can be found in the service sector – this is not a surprise as especially this sector uses typical leasing assets like cars and office equipment. The lowest degree of importance can be found in the retail business.

Figure 13: Share of companies that consider leasing as important financing source, by turnover



Source: KfW (2011b)

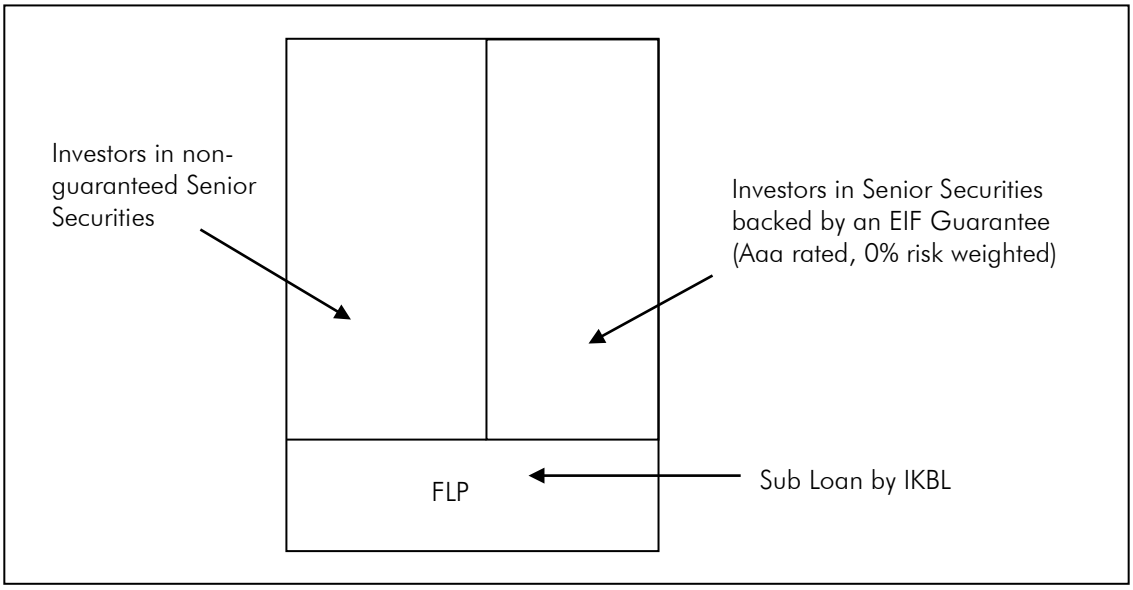
Leasing and trade receivables have been used widely as collateral in pre-crisis securitisations, often through Asset-Backed Commercial Paper programs (ABCP). Independent leasing and factoring companies have previously been depended on bank finance (often secured) but availability of this finance has been reduced during the crisis. Main reasons are capital constraints, liquidity issues and operational risks in smaller leasing companies which in total have led to lower availability of financing for leasing companies and in any case to significantly higher refinancing costs (see chapter 2). Securitisation can effectively provide an additional important funding source for these non-bank finance providers.[28]

We now turn to a concrete example, the securitization transaction IKB Leasing 2012, with IKB Leasing GmbH (IKBL) as originator. This operation has been signed in August 2012 and allows a strategic SME leasing provider to attract funding at competitive terms which will in turn support future SME leasing activity. EIF's involvement in the transaction allows the placement of the transaction with investors and enables the originator to diversify its funding sources.

[28]For a more detailed introduction to SME loan securitisation please refer to Kraemer-Eis, Schaber and Tappi (2010).

The transaction is a so called true sale, static transaction in respect of a portfolio of leases to mainly SMEs (more than 4,000 lease contracts granted to more than 2,000 enterprises). True sale means that there is the separation of the portfolio risk from the risk of the originator, i.e. there is a non-recourse assignment of assets from the originator to the issuer, a special purpose vehicle.[29] "Static" indicates that there is an initial portfolio selection and that amortising assets will not be replaced (i.e. no replenishment). The structure has 2 tranches (see *figure 14*), the senior tranche and a subordinated position (first loss piece, FLP), the latter will be retained by IKBL. The senior tranche will be divided into several sub-tranches; all these classes are going to benefit from the credit enhancement of the FLP (in form of a sub loan provided by IKBL). EIF will guarantee one or more of these senior tranches. The overall portfolio volume amounts to EUR 232.5m, of which EIF guarantees EUR 85m.

Figure 14: Basic structure of the securitisation structure



Source: EIF

EIF acts as anchor investor in the transaction, primarily due to its ability to attract other investors to participate in the transaction. EIF achieves a multiplier effect by pooling other investors' resources to the transaction. Moreover, EIF was actively involved in the structuring of the transaction and the optimization of its economics.

In general, securitisation transactions based on SME loans and/or leases can play an important role in contributing to the indirect access of SMEs to the capital markets. The revitalization and further development of this market after the financial crisis is pivotal for the future growth of SME financing. We expect in particular leasing companies to play a larger role in the market for SME finance as banks will at least partially retreat. Given that bank financing is and will be less available for leasing companies post crisis, securitisation will be particularly relevant in the leasing area, as funding source for more established market players.

[29]To be contrasted with synthetic securitisations where only the underlying credit risk is transferred.

With the second and the third example we turn to traditional guarantee products:

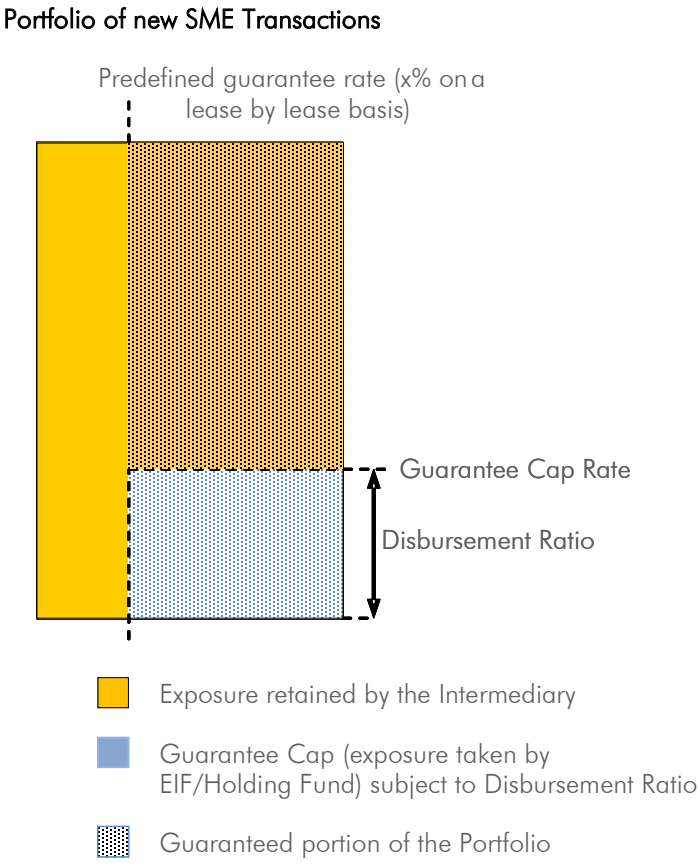
UniCredit Leasing Lithuania

In the framework of the JEREMIE implementation in Lithuania, EIF launched a Call for Expression of Interest with a view to supporting lease financing to SMEs through its First Loss Portfolio Guarantee ("FLPG"). The FLPG provides credit risk protection in the form of a capped portfolio first loss guarantee covering new SME leases.

The operations of UniCredit Leasing Group in the Baltic States are managed through a Latvia based subsidiary, SIA UniCredit Leasing. It has expanded into Lithuania since mid-2011 by establishing its branch in Lithuania. SMEs represent a key target segment for SIA UniCredit Leasing, comprising about 85% of its total lease portfolio.

Technically speaking, the first loss portfolio capped guarantee provides credit risk coverage on a lease by lease basis, for the creation of a lease portfolio. The guarantee cap is determined in order to cover both, expected and unexpected, loss of the lease portfolio. The overall maximum portfolio volume will amount to EUR 30m.

Figure 15: Basic structure of a First Loss Portfolio Guarantee



Source: EIF

This transaction has been signed in June 2012 and is the first guarantee to support SME leasing under the JEREMIE mandates. The FLPG product allows UniCredit Leasing to offer lease finance to SMEs by substantially reducing down payment requirements. It will also offer leases at lower margins. The combination of both of these measures represents a significant benefit to SMEs, especially at a time when SMEs are clearly facing substantially tighter financing conditions. The JEREMIE Holding Fund will thus support a leasing company with a firm strategy to increase its financing activity in the SME segment.

GE Capital Equipement Finance, France

As a third case study we show a recent example of a French transaction under the SMEG facility of the CIP programme. This programme is available under an open call and aims at enhancing access to finance for SMEs. The guarantee covers part of the expected loss (i.e. not also the unexpected loss as the FLPG guarantee does) of a portfolio of new SME leases/loans and is free of charge while requiring the intermediary to take additional SME risk.

GE Capital Equipement Finance was founded to finance its business customers with leasing products. Within the GE Group it belongs to its division specialized in financial services: GE Capital. The main activity of GE Capital Equipement Finance (GECEF) is to buy and lease to its customers (companies of all types) long-lifetime tangible assets.

More than 80% of GECEF's customers are SMEs being lessee companies with less than 250 employees (of which almost 40% have less than 10 employees). GECEF covers under the guarantee agreement its SME and micro-enterprise leases with the purpose of investment financing to these companies.

Thanks to the CIP guarantee, GECEF offers financing solutions to risk categories which were hitherto not approved, and therefore cover new leasing volumes to SMEs and micro-enterprises.

The transaction provides a shared, capped first loss (= expected loss) guarantee to GECEF which is financed from the CIP mandate – this means that the originator and EIF (via the CIP mandate) share the first loss up to a pre-defined amount (the so-called guarantee cap amount as maximum liability for the EU budget). The transaction covers a maximum portfolio of new lease transactions in an amount of EUR 140m to the benefit of SMEs and micro-enterprises in France.

Figure 16: Deal structure

Source: EIF

5 Concluding remarks

The intention of this paper was to enhance the awareness of leasing (and its importance) as additional financing technique for SMEs that expands the access to short- and medium-term financing for capital equipment. We described the relevance of leasing for SMEs and explained the drivers and mechanisms. Leasing is an alternative instrument to facilitate access to finance; it enables in particular new/young enterprises (including the so called "gazelles") without credit track record and limited possibilities to provide collateral the use of capital equipment. As such, it also mitigates market weaknesses of SME lending.

As shown, SMEs expect leasing to stay of high relevance as integral part of their financing tool set. However, the supply side has come under extraordinary pressure in the current economic and financial crisis. Thus, public support not only helps to enhance the access to finance for SMEs in general, but also to counteract the severe impact of the financial crisis on refinancing conditions and the implied consequences for investment and growth.

With three case studies we showed, how SME leasing can be supported in an efficient way. These examples covered very different markets and products: We introduced a securitisation transaction in Germany as example. Properly applied, securitisation can enhance access to finance for SMEs - and it is a replicable tool for SME support that provides a multiplier effect. In addition to complementing private sector money, the participation of an institution like the EIF in these transactions can "crowd-in" private resources via its positive signalling effect. With two other examples we presented guarantee transactions in France and Lithuania with significant benefits for the SMEs with regard to improved financing conditions. The leverage and efficient use of public resources which is implied in all described cases is especially important against the background of high public debt burden in many key countries and will serve to substitute for the expensive crisis-driven support measures, which have typically had lower leverage. Moreover, efficient public support will not only help to mitigate the impacts of the crisis but also to counteract market imperfections and weaknesses in SMEs' access to finance which exist not only in times of crisis but on an on-going basis as a fundamental structural issue.

ANNEX

List of acronyms

- ABCP: Asset Backed Commercial Paper
- ACCA: Association of Chartered Certified Accountants
- BIS: Bank for International Settlements
- CIP: Competitiveness and Innovation Framework Programme
- EBRD: European Bank for Reconstruction and Development
- EC: European Commission
- ECB: European Central Bank
- EIB: European Investment Bank
- EIF: European Investment Fund
- EU: European Union
- FLP: First Loss Piece
- FLPG: First Loss Portfolio Guarantee
- FYROM: Former Yugoslav Republic of Macedonia
- GIF: High Growth and Innovative SME Facility
- IAS: International Accounting Standard
- IFRS: International Financial Reporting Standards
- IMF: International Monetary Fund
- JEREMIE: Joint European Resources for Micro to medium Enterprises
- LGD: Loss Given Default
- OECD: Organisation for Economic Co-Operation and Development
- PD: Probability of Default
- P&L: Profit and Loss statement
- SAFE: Survey on the Access to Finance of SMEs
- SME: Small and medium sized enterprise
- SMEG: SME Guarantee Facility
- VC: Venture Capital

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… the European Investment Fund

The European Investment Fund (EIF) is the European body specialised in small and medium sized enterprise (SME) risk financing. The EIF is part of the European Investment Bank group and has a unique combination of public and private shareholders. It is owned by the EIB (61.9%), the European Union - through the European Commission (30%) and a number (25 from 16 countries) of public and private financial institutions (8.1%).

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

The EIF total net commitments to venture capital and private equity funds amounted to over EUR 5.4bn at end 2011. With investments in over 300 funds, the EIF is the leading player in European venture capital due to the scale and the scope of its investments, especially in the high-tech and early-stage segments. The EIF commitment in guarantees totalled over EUR 14.7bn in close to 160 operations at end 2011, positioning it as a major European SME loan guarantees actor and a leading micro-finance guarantor.

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