CHAPTER 1.

MODERN AND TRADITIONAL INSTRUMENTS OF SMES PROJECTS FINANCING

SME BONDS IN EUROPEAN COUNTRIES AS A NEW APPROACH TO FINANCING

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Nowadays a lot of new financial instruments for SMEs innovation projects are getting more popular in the business environment. A great number of them are traditional like credit loans at the same time we can observe the appearance of innovative ones. Variable set of financial instruments generalized on fig.1. This classification is giving by Organiztion of Economic Cooperation and Development (OECD). As we can see from the fig.1 the classification is based on risk approach.

For further research it is needed to clarify these definitions. Firstly, *asset based finance* is the method of assigning structured turnaround capital and term loans, disbursement of debit portfolio, stocks, machines, funds, and / or real estate. This type of finding is suitable for SMEs beginners, refinancing existing loans, growth financing, mergers and acquisitions.

Secondly, alternatives debt is a form of debt relief and are currently referred to as debt restructuring or tolerance. Debt restructuring allows SME to reconcile the terms of payment, terms and payment schedules to allow the recipient to get a better chance of returning the primitive principal. By weakening the part of the pressure of accrued interest, as well as reducing the amount paid for each lot, the creditor protects himself from the debtor who is at risk of his payments, and thus increases the probability of satisfaction of the primary debt. Alternative debt can also be used for lower interest rates. Accepting an existing debt and / or reviewing its condition, or paying a principal amount at the expense of funds received from new sources of financing, the developer corporation may reduce its costs of financing below the amount incurred as a result of the original contract. The corporation may issue callable bonds for s restructuring in the future. The debt from these bonds can be called up as necessary, and then replaced by a new, lower interest rate [2].

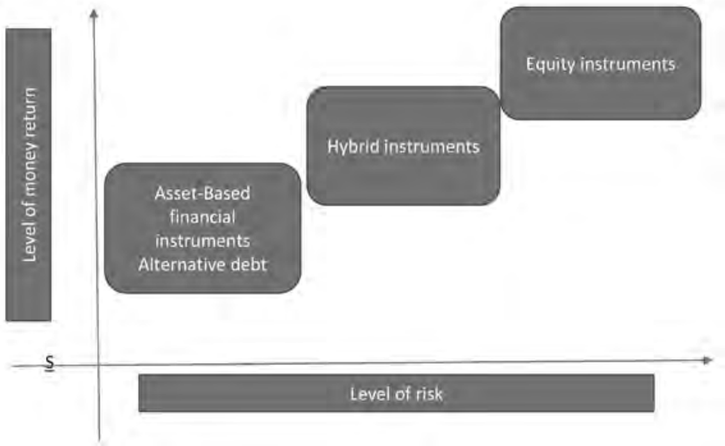

Fig. 1. Groups of financial instruments for SME innovation project*
**Source: Based on [1]*

Thirdly, "hybrid instruments are the key tools in shaping a holding firm's tax policy appears to be merited" [3].

Fourthly, equity investments provide a critical capital base for a company or project to grow its operations, access other sources of finance, and reduce investment risks faced by other project/company investors, especially debt investors who are repaid before equity investors [4].

From within each group there are other specific instruments. In the table 1 below the types of financial instruments are described within each group.

Table 1

Types of alternative SME financing*

ASSET-BASED FINANCING	
Asset-based lending	A business loan secured by collateral (assets). The asset-based loan, or line of credit, is secured by inventory, accounts receivable, equipment, and/or other balance-sheet assets.
Factoring	A financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount
Purchase order financing	A funding option for businesses that need cash to fill single or multiple customer orders.
Warehouse Receipt	A receipt used in futures markets to guarantee the quantity and quality of a particular commodity being stored within an approved facility
Leasing	A contract outlining the terms under which one party agrees to rent property owned by another party.
ALTERNATIVE DEBT	
Corporative bonds	A corporate bond is a debt security issued by a corporation and sold to investors
Securitized debt instruments	the products of securitization, which in turn is the process of passing debts onto entities that in turn break them into bonds and sell them.
Covered bonds	are debt securities issued by a bank or mortgage institution and collateralised against a pool of assets that, in case of failure of the issuer, can cover claims at any point of time. They are subject to specific legislation to protect bond holders.
Private placement is	a capital raising event that involves the sale of securities to a relatively small number of select investors. Investors involved in private placements can include large banks, mutual funds, insurance companies and pension funds.
Crowdfunding (debt)	Debt based crowdfunding encompasses several different types of crowd based lending. These include mini-bonds, peer-to-peer lending (sometimes known as 'peer-2-peer'

	or ‘P2P’ lending) and invoice financing. Essentially, a large amount of retail investors (the crowd) lend money through a platform to a business or individual. In removing many of the middlemen that would be involved if the transaction happened through a bank, debt based crowdfunding can keep the costs down for borrowers while giving the lenders improved rates of return.
“HYBRID INSTRUMENTS”	
Subordinated loans/ bonds	A loan or security that ranks below other loans and securities with regard to claims on a company’s assets or earnings.
Silent Participations	financing method an investor (so called silent partner) participates in the commercial business of another person by providing a capital deposit and in return receiving a participation in the profits of the company
Participating loans	a special form of a loan. 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. The participating loan differs from a silent participation particularly by the fact that the lender does not hold a stake or share in the company. He cannot influence the company’s business and does not participate in the company’s losses.
Profit participation rights	are purely contractual participations in a company with which the investor participates as well in profits as in losses of the company. The owner of the profit participation right is not a shareholder of the company and he is usually not entitled to membership rights. This means that he has no voting right in the company’s shareholders’ meeting and no right to attend these meetings.
Convertible bonds	a type of debt security that can be converted into a predetermined amount of the underlying company’s equity at certain times during the bond’s life, usually at the discretion of the bondholder.
Bonds with Warrants	a bond with an attached warrant, the warrant gives you the right to buy a certain number of fixed-price shares of the stock of the company that issues the bond. You are not

	obligated to purchase the stock, and the price specified on the warrant may be different from the price at which the stock is trading on the day you buy your bonds.
Mezzanine finance	A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full.
EQUITY INSTRUMENTS	
Private equity	capital that is not noted on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity. Institutional and retail investors provide the capital for private equity, and the capital can be utilized to fund new technology, make acquisitions, expand working capital, and to bolster and solidify a balance sheet.
Venture capital	inancing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from well-off investors, investment banksand any other financial institutions. However, it does not always take just a monetary form; it can be provided in the form of technical or managerial expertise.
Business angels	An angel investor is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.
Specialized platform for public listing of sme	SME-focused equity platforms have been established across the globe, offering an alternative to main listing boards on national stock exchanges.
Crowdfunding (equity)	is the process whereby people (i.e. the 'crowd') invest in an early-stage unlisted company (a company that is not listed on a stock market) in exchange for shares in that company. A shareholder has partial ownership of a company and stands to profit should the company do well. The opposite is also true, so if the company fails investors can lose some, or all, of their investment.

Sources: [5], [6], [7], [8], [9], [10], [11] As we can see, there is a large set of alternative instruments of SMEs. Lately such financial instruments as bonds play a crucial role for SME development all over the world.

The SME bond is an agreement between the company and the investor that the investor will provide to the company with the amount of money that the company will return to the investor at the end of the agreed maturity. The «face value» of the SME bonds is the principal that the company has committed to pay to the investor and serves as a basis for calculating the interest payable on the bonds. The price of the question is the same; generally coincides with face value (unless otherwise indicated).

While the SME is borrowing money of investor, the company will pay interest to investors during the life of the bond. The amount of interest payable on each SME Bond is equal to the value multiplied by the interest rate agreed and paid monthly or quarterly.

SME bonds can be considered part of a diversified investment plan. In a balanced portfolio, bonds for SMEs can offer a higher fixed rate than equities and savings accounts that fluctuate with market conditions and interest rates [12].

There are different bonds. The main of them could be devided into SME Bonds for Growth and SME Bonds for acquisition (see table 2).

Table 2

Deference between into SME Bonds for Growth and SME Bonds for acquisition*

SME Bonds for Growth	SME Bonds for acquisition
A new source of financing on the debt capital SME side. The Basel III regulatory banking measures have placed a squeeze on lending, and already impacting on SME's seeking finance globally.	Seller could offer SME Bonds as Vendor finance for franchises, management buyouts or acquisition. Suit most industries like logistics, energy, automotive and consumer sectors.
As a result growing companies continue to source alternative capital sources and a SME Bond is private finance that fills the gap.	SME Bonds are ideal as funding alternatives for companies too small to tap into the Corporate Bond market and want to invest in a self-sustaining cash-generating asset.

SME Bonds for Growth	SME Bonds for acquisition
SME Bonds funding for acquisition finance or refinancing of expiring debt. Well known brand name have the advantage when placing bonds backed by a balanced financing structure.	The SME Bond rate is negotiated around the terms of the acquisition or buy-out and converted to equity or refinanced. Can use company assets as security.

Source: [12]

The main reason is that SMEs have witnessed traditional sources of funding dry up since the 2007 — 2013 financial crisis and are seeking financing through alternative methods such as peer-to-peer loans, securities based crowdfunding, Enterprise Investment Schemes and mini-bonds. Roughly 7% of SMEs seek financing from private equity and the remaining 1% from other parts of the markets. As the market matures new instruments such as SME Bonds have the potential to reshape the financial landscape; offering growth opportunities with less risk to investors. The frameworks being established are creating retail enabled investments as low as £1000, giving average income worker the opportunity to take a stake in companies that are enhancing the future. The market is ripe for market makers, issuers and investors seeking to create long — term market value and jobs. With banks coming under increasing pressure to comply with Basel III, lending has become restricted to a select few. The capital market needs initiatives such as SME Bonds to provide leverage to the stifled economy [13]

Other advantage is that for SME there is no need to be afraid of bank's rejection in getting loan. Other reason is that very often SME doesn't have enough money to purchase an established business. Next one is that SME wishes legal structure with legal documents. Then, it is possible to use SME Bonds for negotiations flexible terms with the seller. After, SME can also use such instrument for trading history for lending approval. In practice SME bonds are used for a combination of growth financing and refinancing.

All these incentives belong to internal ones. We can also reveal external inducements, among them are:

– private investors always search attractive investment projects. Very often SMEs play role of providers of innovations. It is cheaper for both investors and SMEs to get their goals without any intermediary (bank, investment funds). That is why equity capital is still high demanded in comparison with other sources of finance.

– SME bonds are transparent financial instrument for investor who is ready to invest in SME projects. This can be achieved by creating special purpose vehicle (SPV) that will issue the bonds,

– Banking lending has shorter periods then financing with bonds,

– Banking lendig is related to the rules of Basel III, rather other investors (private and institution) do not.

There are different platforms — private placement — for listing SMEs' bonds. The most popular is euronext.com — the Pan-European marketplace. This platform allows to SMEs from Netherlands, Portugal, France, Belgium to be listed on. The aim of this platform is to serve the real economy by bringing together buyers and sellers in venues that are transparent, efficient and reliable. On this platform companies from different sectors (Investment Services, Specialty Chemicals, Biotechnology, Electronic Equipment, Business Training&Employment Agencies, Personal Products, Industrial Machinery, Medical Equipment, Furnishings, Software, Renewable Energy Equipment, Exploration&Production etc) of economics successfully have already listed. And as we can see most of them represent innovation SMEs. It means that high-tech companies also can use not only tradition financial instruments. By listing on Euronext SMEs make their bonds tradable and accessible for wide circle of different investors. This creates a myriad of benefits for them: increased brand awareness, easier access to investors in subsequent issues or a stock exchange listing, and the possibility of an exit for the director-majority shareholder [14]. In the table 3 we can see selected examples of SME bond issues:

Table 3

Some bonds issues for SMEs at Euronext exchange*

Name of SMEs	Place of issue	Date of issue	Amount, €	Rate of bond, %	Maturnity, years	Listed or non-listed
Brisa Concessao	LISBON, Portugal Euronext	June 2016	120 milions	EUR+0.024%	6	Non-listed issuer

Name of SMEs	Place of issue	Date of issue	Amount, €	Rate of bond, %	Maturnity, years	Listed or non-listed
The Navigator Cmpany	LISBON, Portugal Euronext	March 2016	200 milions	EUR+0.019%	7 years	Listed issuer
Lusiaves Group	LISBON, Portugal Euronext	February 2016	25 milions	EUR+1.06%	10 years	Non-listed issuer
My stic Invest, SGPS, S.A.	LISBON, Portugal Euronext	February 2016	20 milions	EUR+3.7%	7 years	Non-listed issuer
Belfius	BRUSSELS, Belgium Euronext	January 2016	25 milions	1.5%	23 years	Listed issuer
OrPEA	BRUSSELS, Belgium Euronext	December 2015	50 milions	2.51%	7 years	Non-listed issuer
Vrije Universiteit Brusseles	BRUSSELS, Belgium Euronext	October 2015	21 milions	1.65%	20 years	Non-listed issuer
Econocom	BRUSSELS, Belgium Euronext	June 2015	€46m	2.4%	6 years	Listed issuer

**Formed by author, using sources: [15]*

Obviously, that SME bonds are cheaper than banking lending. Interest rate of EUR according to Global rates service [16] for 2017 is -0,18%, while ECB interest rate is 0%. It easy to assume that this typeof financing getting more and more popular next years.

Nevertheless, not for all SMEs bonds can be suitable for future placement on specialized platforms. As Dutch consultants state, SME bonds are appropriate for companies with: a grounded financing need of a minimum of 2.5 million euros; nteresting and sufficient current assets as collateral for the bond issue; proven business model and track record with sufficient cash to pay the bond coupon.

Notwithstanding the low-level price of coupons, it is need to say that issue of SME bonds is not very easy process. There are several phases in it (see Fig. 2):

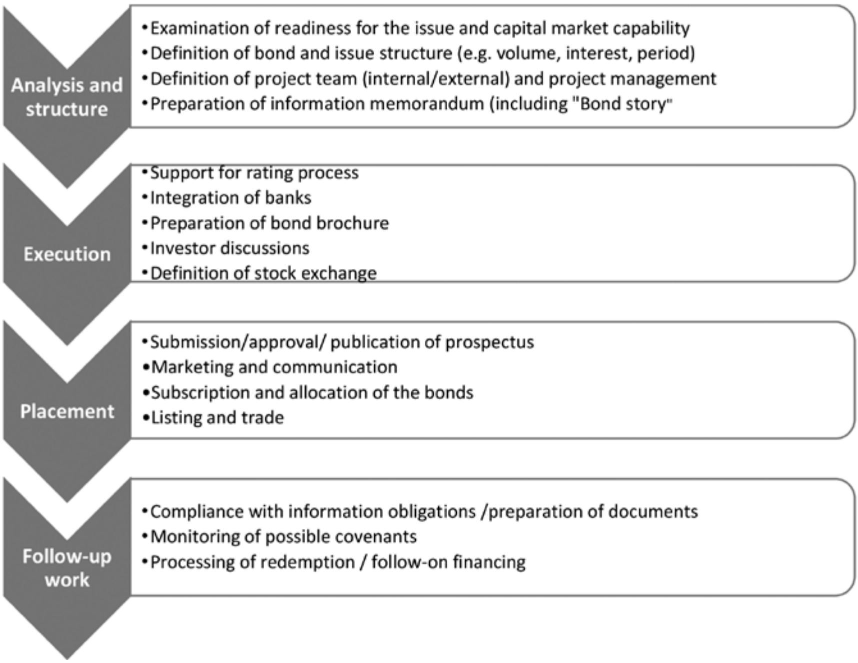

Fig. 2. The phases of SME bonds issue*
**Designed by author using surces[17]*

Very often SME address to consulting firms which have the experience in issuing SME bonds and know it procedure. From one hand, it economie the tome, from other it adds the value to the cost of financing. Due to this, mid companies are the target auditory of issuing bonds.

SME bonds market in some European countries has been developing since 2010. For instance, in Germany SMEs can use bond for financing of their activity (see fig. 3)

There were issued SME bonds on 194 milions Euro. Total defaults are 30. Average coupon rate is 7.25%.

German SME bond market has both positive and negative experience. Outstanding refinancing risks point to a serio us likelihood of further corporate defaults in the market. While all market participants are working on reestablishing the credibility of the German SME bonds market, it is important to incorporate the lessons learned from the past. Scope Ratings ("Scope") has analysed the reason for the high number of defaults and points out measures aimed at reducing them in future. The lessons learned can serve as guidance to other European markets, helping them to establish transparent and credible bonds markets in their respective country.

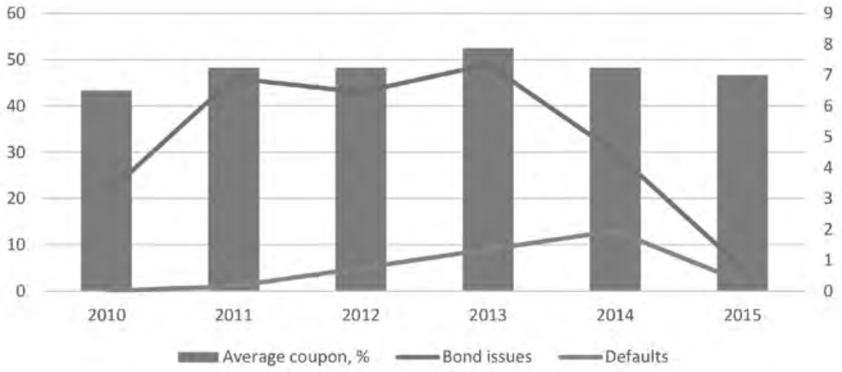

Fig. 3. German SME bond market in Fig.s*

**Calculated using sources [18]*

Eclectic reasons for high default rate Scope [18] sees diverse reasons for the high default rate in the German SME bond market, namely: structural problems in a particular industry with strong debt issuance activity, such as the renewable energy market; fraud allegations; • financing of unduly risky investments with proceeds of bonds issuance; lack of strict financial covenants limiting the ability of creditor-friendly debt protection measures. Often the SME bond market was seen as the last resort of financing for weaker debt issuers. This trend was further accelerated by the expansive monetary policy of the European Central Bank, catalysing the provision of capital through private placements or the traditional banking system. The average credit ratings assigned at issuance indicated a low investment-grade or high non-investment grade credit quality of the segment, while the actual default rate suggests an average credit quality of mid sub-investment-grade in this market. Lessons learned Some market participants have drawn their conclusions and have adjusted to these circumstances. For instance: debt advisors are examining new issuances with more scrutiny, which has led to several cancellations of new bond issues, issuers are offering improved creditors protection by means of provision of tangible collateral or stricter covenants; bond exchanges have heightened transparency requirements for a listing; rating agencies have adapted rating methodologies with a more focussed approach on future cash flow generation and liquidity; investors are conducting more thorough reviews on their investments, recognising the need for in-depth credit analysis of an international standard; issuers are pursuing other financing options with alternative financial instruments such as private debt placements or the issuance of hybrid bonds.

Considering crucial role of SME at Europian countries and accounting for problems wich face investors and SMEs, there were developed additions to MIFID II provides for a new category of market to facilitate: access to capital for SMEs; and the further development of specialist markets that aim to cater for the needs of smaller and medium-sized issuers. Currently, SME growth markets, growth markets or junior markets are usually operated under MiFID as multilateral trading facilities (MTFs). For example, in the UK, AIM is an MTF and not a regulated market under MiFID. MiFID II envisages that the creation within the MTF category of a new sub-category of SME growth market and the registration of those markets should: raise their visibility and profile; and aid the development of common regulatory standards in the EU for those markets. MiFID II recites that attention should be focused on how future regulation should further foster and promote the use of that market so as to make it attractive for investors, and provide a lessening of administrative burdens and further incentives for SMEs to access capital markets through SME growth markets [19].

As we can see, the approaches to SME financing are getting changes. Some traditional resourses of finance have been losing their popularity sharply. Instead of them, modern types of financingis getting very popular nowadays. Among them are SME bonds. SME bonds are used mostly in Great Britain, France, Germany, Portugal, Nitherlands, Belgium. SME bonds are realized with assistans of SPV and can be traded on special place market. From recent times MIFID II has included rules for SME bonds on growth markets. For sure, these measures will have favouriable impact on SME development. It is worth to notice, that this will contribute for the development of export and innovation potential of SMEs. In general, it can facilitate the enters on new markets, spreading purchasing power, increasing working places etc.

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