

The background of the entire page is a vibrant green, featuring a microscopic view of water droplets and plant stems. The stems are dark green and radiate from a central point on the left side, creating a fan-like pattern. The water droplets are of various sizes, some appearing as large, clear spheres with highlights, while others are smaller and more numerous, creating a textured, bubbly effect. The overall composition is dynamic and organic, suggesting themes of nature, science, and growth.

# ALLEN & OVERY

## Funding European business: Harnessing alternatives

November 2015



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*The vital role alternative finance plays in funding European business has been reinforced in this year's research.*

## Introduction

### The aspiration is to create a pan-European private placement market to match that of the U.S.

That corporates have successfully harnessed the power of alternative finance there can be no doubt. The vital role it plays in funding European business highlighted in our 2014 report “Funding European Business: What’s the alternative?” has been reinforced in this year’s research.

While firmly established in the funding mix for European corporates, the alternative finance market remains fragmented. It lacks the standardisation required to build a critical mass, yet critical mass will not be achieved without standardisation – leaving the market with a chicken and egg conundrum.

The regulatory framework is being finalised. The European Commission has outlined a commitment to promoting innovative forms of business financing such as private placements in its Capital Markets Union action plan. The launch of standardised private placement documentation and release of a guide to best practice have provided crucial building blocks to help make this market more uniform. Our research shows four in five investors are now aware of these documents and that they are being used with increasing frequency in deals across markets. No one could have expected all deals in the market to use this format only 10 months after launch. But it is clear more work must be done to educate players about these structures in order to achieve a deeper pool of European capital for the benefit of everyone.

With their entrenched relationships and vast distribution networks, banks and indeed law firms have a crucial role to play in educating market participants about alternative finance. Only when all the various groups work together will this transformation take place.

Investors are another crucial community. That is why this year, to supplement the views of corporates, we sought the input of investors on who they fund, in what form and what their expectations are for the future.

Our research into the state of alternative finance in Europe shows that a truly pan-European market remains a work in progress. But the desire and ambition to make this happen is clearly there for both corporates and investors.

# Alternative finance: a European profile

We assessed the use of alternative finance across six markets looking at corporate funding and investor behaviour



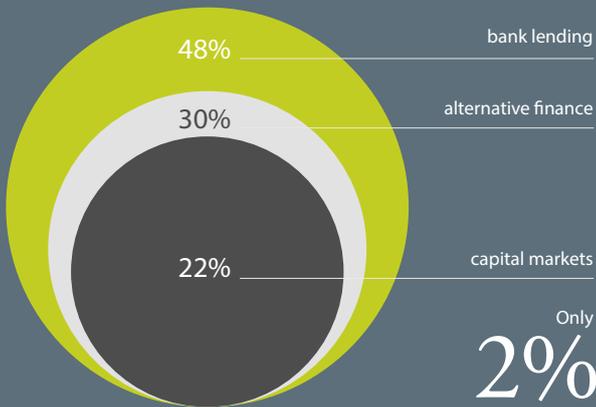
## Six key insights

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### Sharing the load

Bank lending is top, but it isn't the only source of funding. Corporates are making use of a diverse funding mix

Breakdown of funding sources:



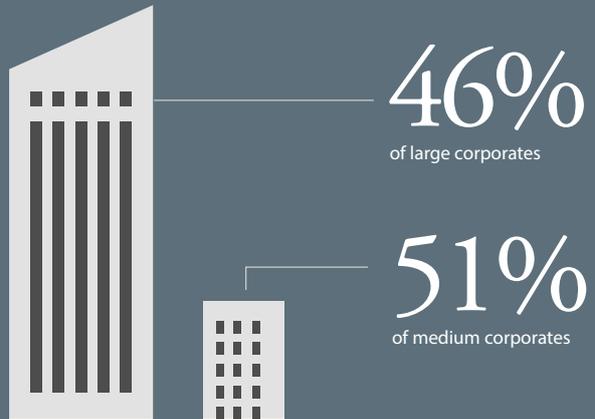
Only 2% of corporates get 100% of their funding from one source

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### On the up

Nearly half (48%) of corporates expect their use of alternative finance to increase over the next five years

Expected increase of alternative finance by size:

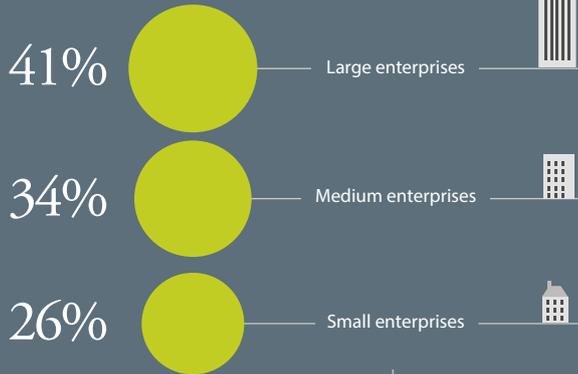


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## A bigger boost



Investors are more likely to provide alternative finance to large corporates, on average allocating their funding as follows:



France is the only country where investors offer more alternative finance to small corporates than large and medium



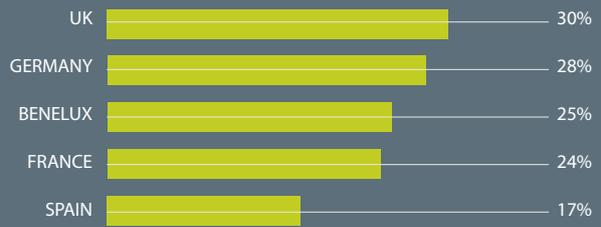
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## Domestic leads



Corporates are most likely to use domestic providers for alternative finance but international providers are part of the mix

Alternative finance is mainly sourced from providers in:



# lin5

Italian corporates use global providers rather than domestic providers

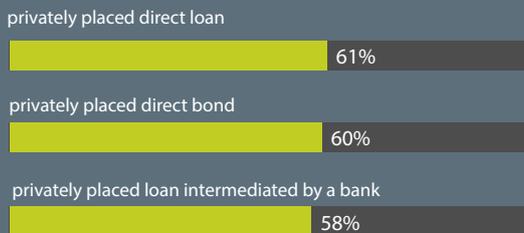
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## Spoilt for choice

A wide variety of alternative finance is available, but investors and corporates are product agnostic



Top forms provided by investors:



6

## Building awareness

Over three quarters of corporates and investors are aware of the pan-European Corporate Private Placement Market Guide and standardised documentation



Although there are signs of the pan-European private placement market developing, education is needed to increase use of standardised documentation and build a critical mass. The market is approaching a tipping point: it just needs a push



## Methodology

This research has been conducted by YouGov plc mainly using telephone interviews with 368 respondents, both corporate and investor, in six European markets: France, Germany, Italy, Spain, the UK and Benelux.

Corporate respondents were split evenly between medium and large companies and across all major commercial sectors excluding financial services. Respondents all have substantial decision-making input over their company's funding arrangements.

Investor respondents were split between organisations including private debt funds, asset managers, hedge funds,

insurance companies, family offices, pension funds, peer-to-peer and crowdfunding platforms and others. Respondents all have substantial decision-making input over their organisation's provision of funding.

YouGov plc makes every effort to provide representative information. All results are based on a sample and are therefore subject to statistical errors normally associated with sample-based information.

Fieldwork was undertaken between 21 September 2015 and 6 October 2015. Percentages may not always add up to 100% due to roundings.

# The survey results

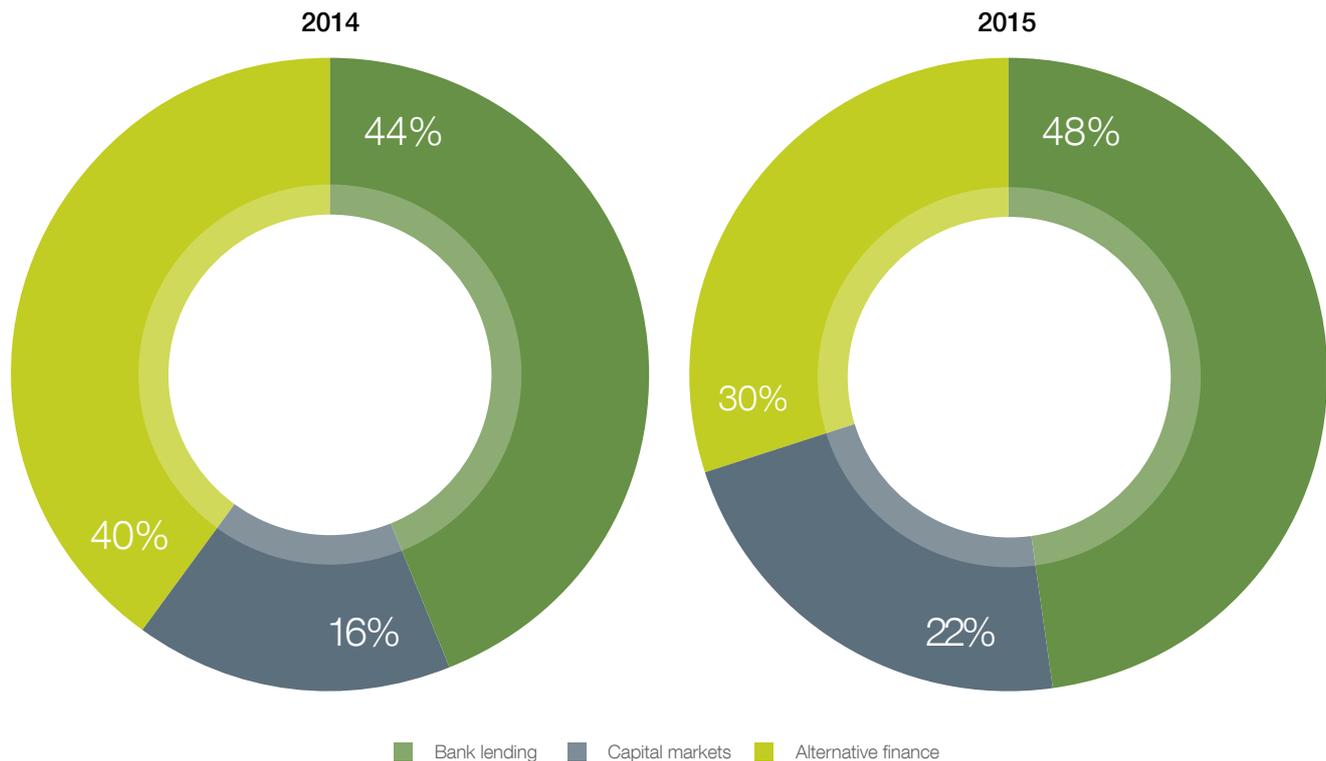
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*Despite an increase in bank lending and capital markets activity alternative finance performed robustly in 2015, proving it is an important component of the corporate funding mix.*

# How important is alternative funding in Europe?

## IT REMAINS A VITAL PART OF THE CORPORATE FUNDING MIX

**Question asked of corporates:** Please indicate the extent to which you use each of the following sources of funding as a per cent of your total funding?



Last year's report "Funding European Business: What's the alternative?" indicated widespread confidence that use of alternative finance would increase. The European Central Bank (ECB)'s aggressive supply of liquidity to banks through a EUR60 billion a month asset purchase programme has meant this increase failed to materialise. Nevertheless alternative finance has maintained a strong market share.

Overall, corporates indicated that 30% of their funding was sourced from alternative finance in 2015, compared to 40% the year before. The funding share of capital markets rose from 16% to 22% and bank lending increased by four percentage points to make up 48% of the funding mix.

Larger corporates showed a steeper decrease in use of alternative finance, from 40% to 26%. Mid-market firms reported stable use, with a third of their funding continuing to come from alternative finance, indicating the extent to which this market appeals to mid-caps.

Two nations reported significant drops in use of alternative finance: the UK and Italy. The case of Italy requires nuanced interpretation. Two years ago the Italian market completed a liberalisation of alternative finance: a rush of deals followed, and this year's apparently lacklustre performance is merely a regression to the mean. Other indicators, such as corporates' expectations for the next five years, show Italians are overwhelmingly enthusiastic about the future of alternative finance.

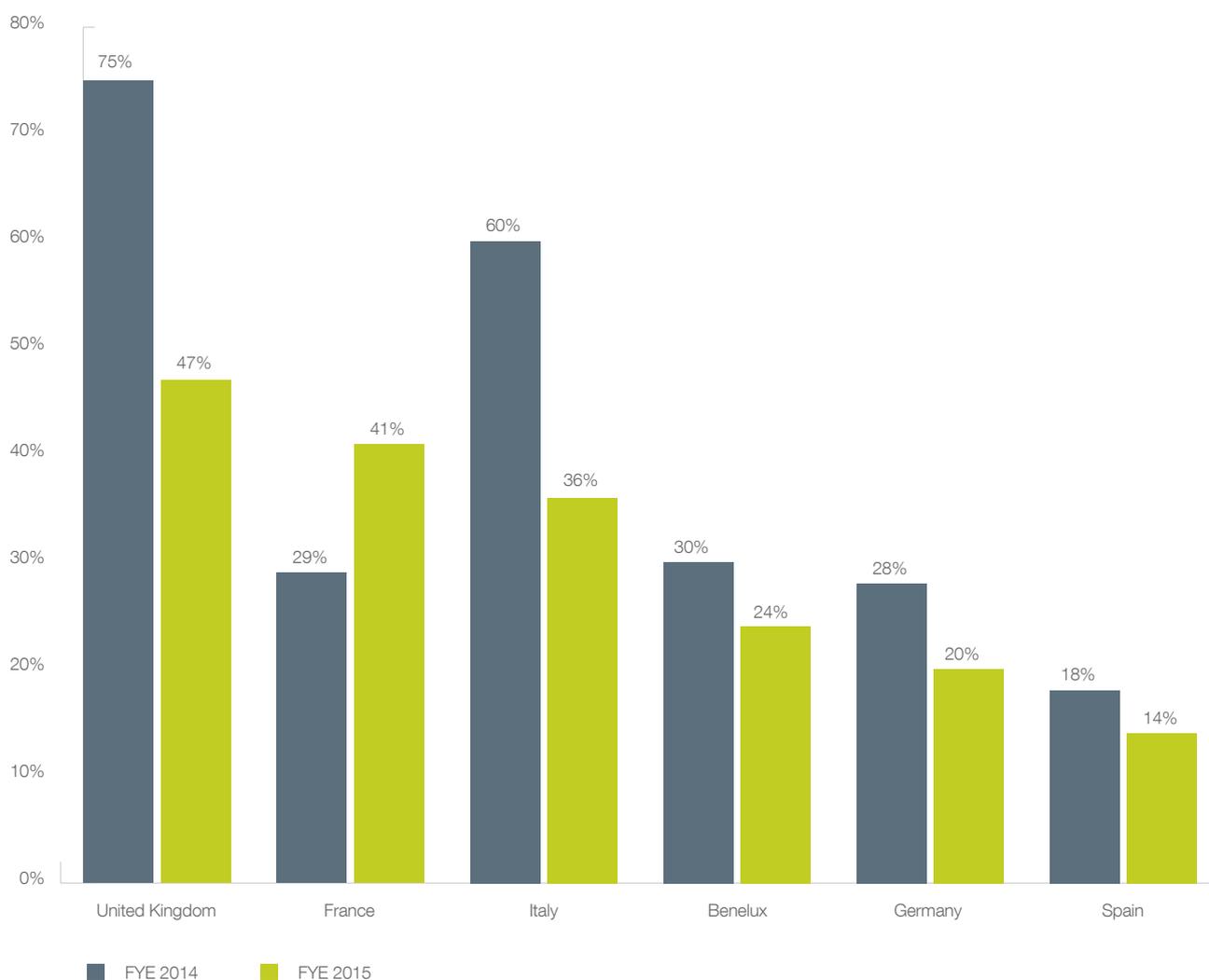
France enjoyed strong growth in alternative finance. In 2013 French regulations changed to allow insurance companies to invest 5% of assets in alternative finance. The impact of this rule is visible as funding rose sharply in 2015.

Germany is a unique story. The German banking system, with Sparkassen, Volksbanken and Landesbanken, is exceptionally diverse. German banks are currently awash with liquidity following the ECB's quantitative easing. Mittelstand corporates are in a borrowers' market. They have little need for alternative finance, and this situation is reflected throughout the survey.

# Use of alternative finance by country

## NATIONAL VARIATIONS IN USE EXIST

**Question asked of corporates:** Please indicate the extent to which you use alternative finance as a per cent of your total funding?

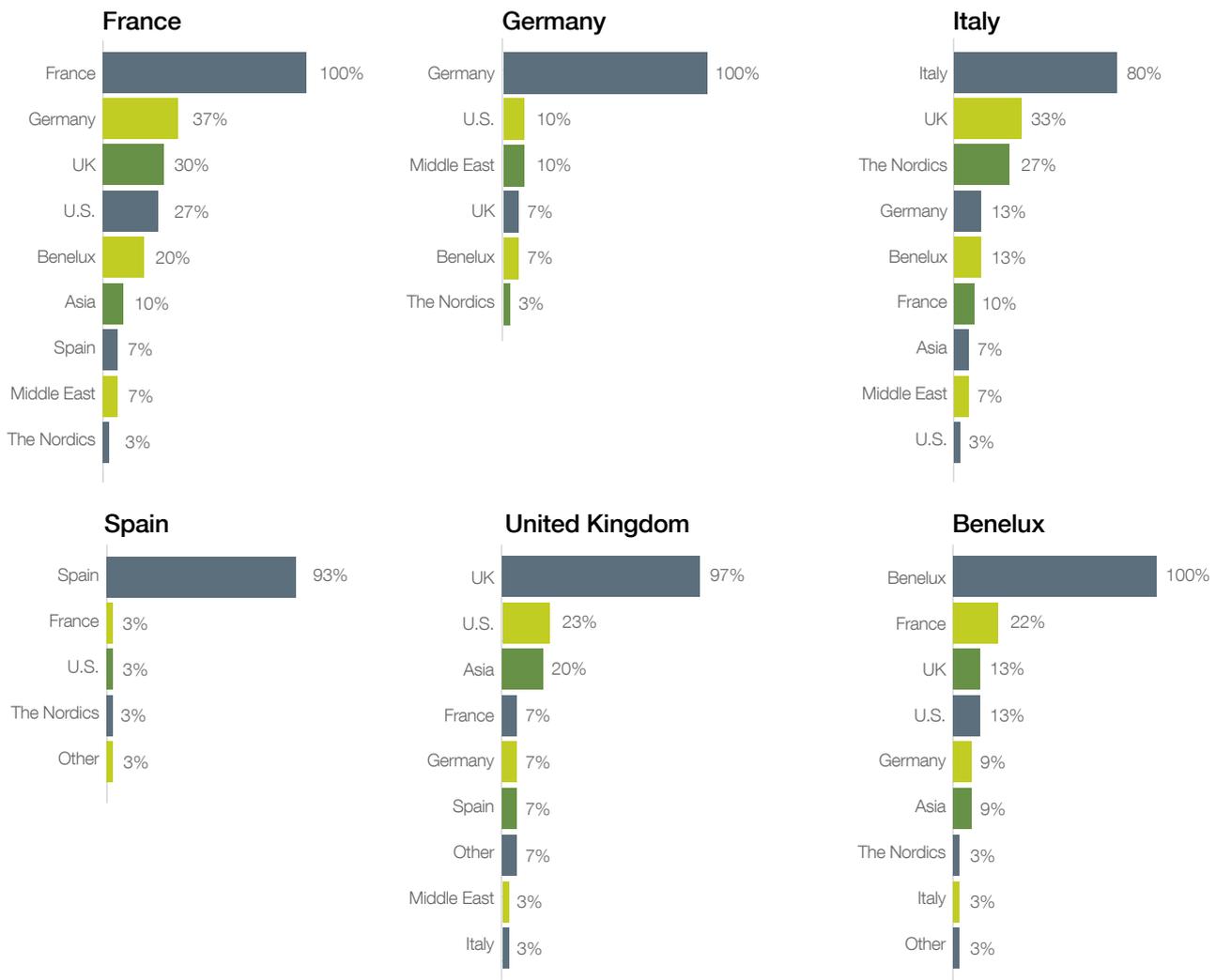


*The ECB's aggressive supply of liquidity to banks through a EUR60 billion a month asset purchase programme meant an increase in use of alternative finance failed to materialise. Nevertheless, alternative finance has maintained a strong market share.*

# Where are alternative finance providers based?

## NATIONAL BORDERS CONTINUE TO BE SIGNIFICANT

Question asked of corporates: *Where are your alternative finance providers based?*



When a truly pan-European market is functioning we'll see investors searching continent-wide for the best deals. Corporates will have a wide selection of international investors to choose from. This research shows a borderless Europe is emerging, but not yet fully fledged.

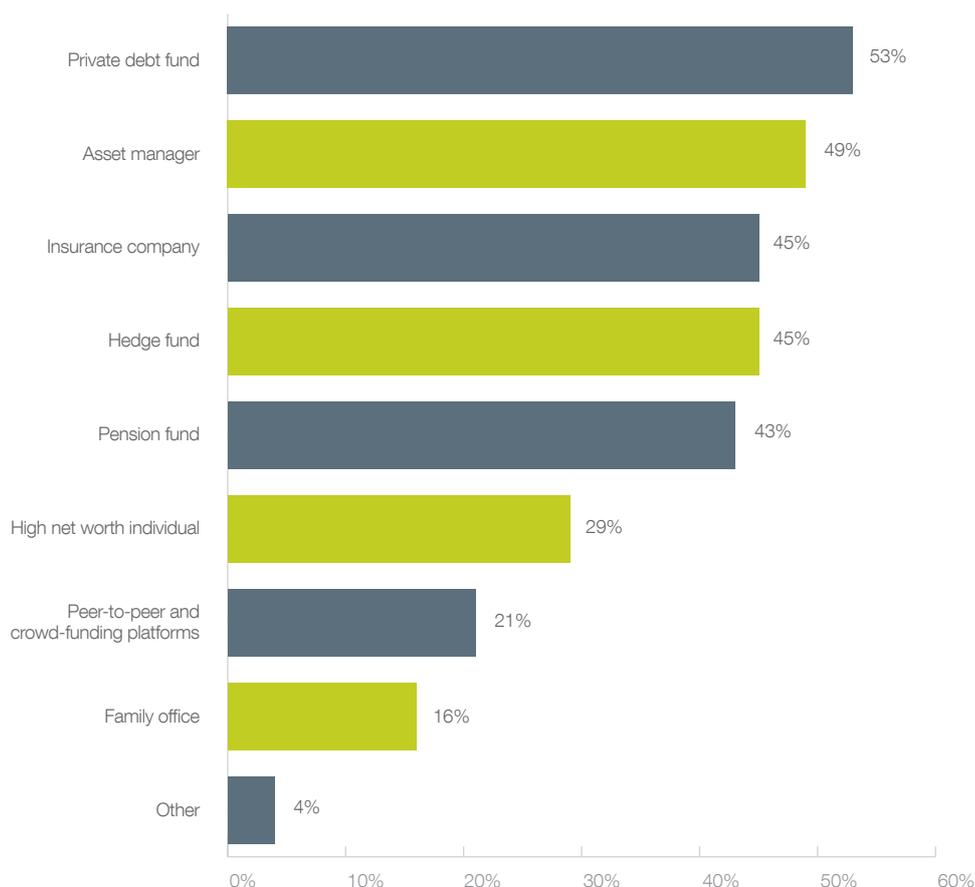
National borders continue to be significant. On the whole, Spanish corporates use Spanish investors, British corporates stick to British investors, and Benelux corporates keep to Benelux investors. Although there is cross-border activity, it is telling that British corporates are more than twice as likely to use U.S. based providers as their German counterparts (23% compared with 10%). Only 3% of Spanish corporates receive investment from alternative finance providers based in France.

However, this situation has the potential to change fast. The first reason is that cross-border deals are commonplace, if not yet the norm. A quarter of corporates in Italy make use of alternative finance provided by Nordic investors, showing the attraction of deep pools of capital, such as those from Nordic sovereign wealth and pension funds. Around a third of corporates in France use alternative finance from either German or British investors. These indicate the market is opening. Furthermore, word of mouth plays a big role in alternative finance; a deal by an international investor can draw in affiliated investors for future deals. A market like France is already host to a cosmopolitan spectrum of investors and the process of drawing in further investors from other nations is under-way.

# Which organisations are providing this funding?

## A BROAD RANGE OF PLAYERS ARE ACTIVE IN THIS MARKET

**Question asked of corporates:** Which of the following types of alternative finance providers do you currently use? Here we are talking about the end investor, not bank intermediaries.



What sort of investors are engaging in alternative finance? The research reveals a broad range of players ranging from hedge funds and pension funds to insurers and asset managers.

Drilling down beyond the headline data reveals some interesting national variations.

In Benelux the insurers dominate the market, yet in Italy they are a rarity. Asset managers are prominent in the UK, yet are used by fewer than one in ten corporates in Spain. French entrepreneurs and family offices are highly active in alternative finance; in Spain, rarely. The situation in France is unique in Europe as French investors report that the funding available for alternative finance is three times more likely to be allocated to small firms rather than large corporates.

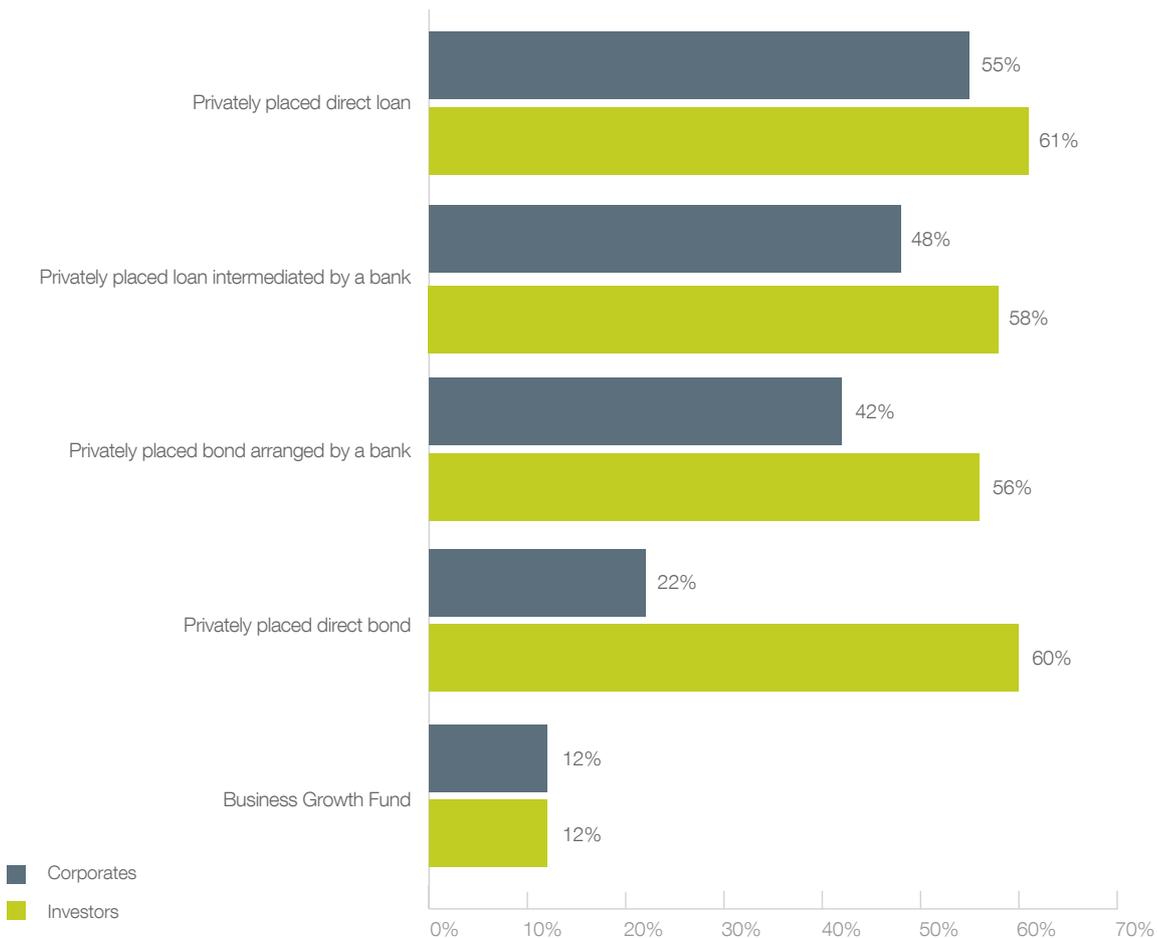
In France and Benelux it is common for high net worth individuals (HNWIs) to provide funds for alternative finance. Two-thirds of corporates polled in Benelux sourced funds from HNWIs, and 33% of French corporates did the same. Family offices were used by a fifth of corporates in these two countries. In other nations the story is very different. In Spain HNWIs are rare in the market, with only 3% of corporates striking deals with these individuals. Why? Awareness and marketing are a key factor. French HNWIs have been active in alternative finance for a while. Investing in the sector is a normal part of an investment portfolio strategy. Corporates and banks know they can approach HNWIs and family offices and receive a considered response.

# What form does this funding currently take?

**PRIVATELY PLACED LOANS AND BONDS ARE MOST COMMONLY USED**

**Question asked of corporates:** Which of the following forms of alternative finance do you currently use?

**Question asked of investors:** When providing alternative funding to large, medium or small enterprises, what form does this currently take?



Current market practice shows that corporates’ use of alternative finance and what is provided by investors, primarily centres on either bonds or loans. What would they prefer? The research provides a clear answer: there is no preference for bonds or loans. Nor is there any marked preference for direct borrowing over bank facilitated deals, although actual deal activity reflects the pivotal role banks can play in arranging alternative finance.

Current deal activity reflects confidence with all forms of funding. Loans are narrowly more common than bonds. When corporates use bonds, they are twice as likely to be arranged by a bank than placed directly, although there’s nothing problematic about any

form of funding. There is a strong sense of product agnosticism. For example, only 4% of corporates regard privately placed direct bonds as unfavourable.

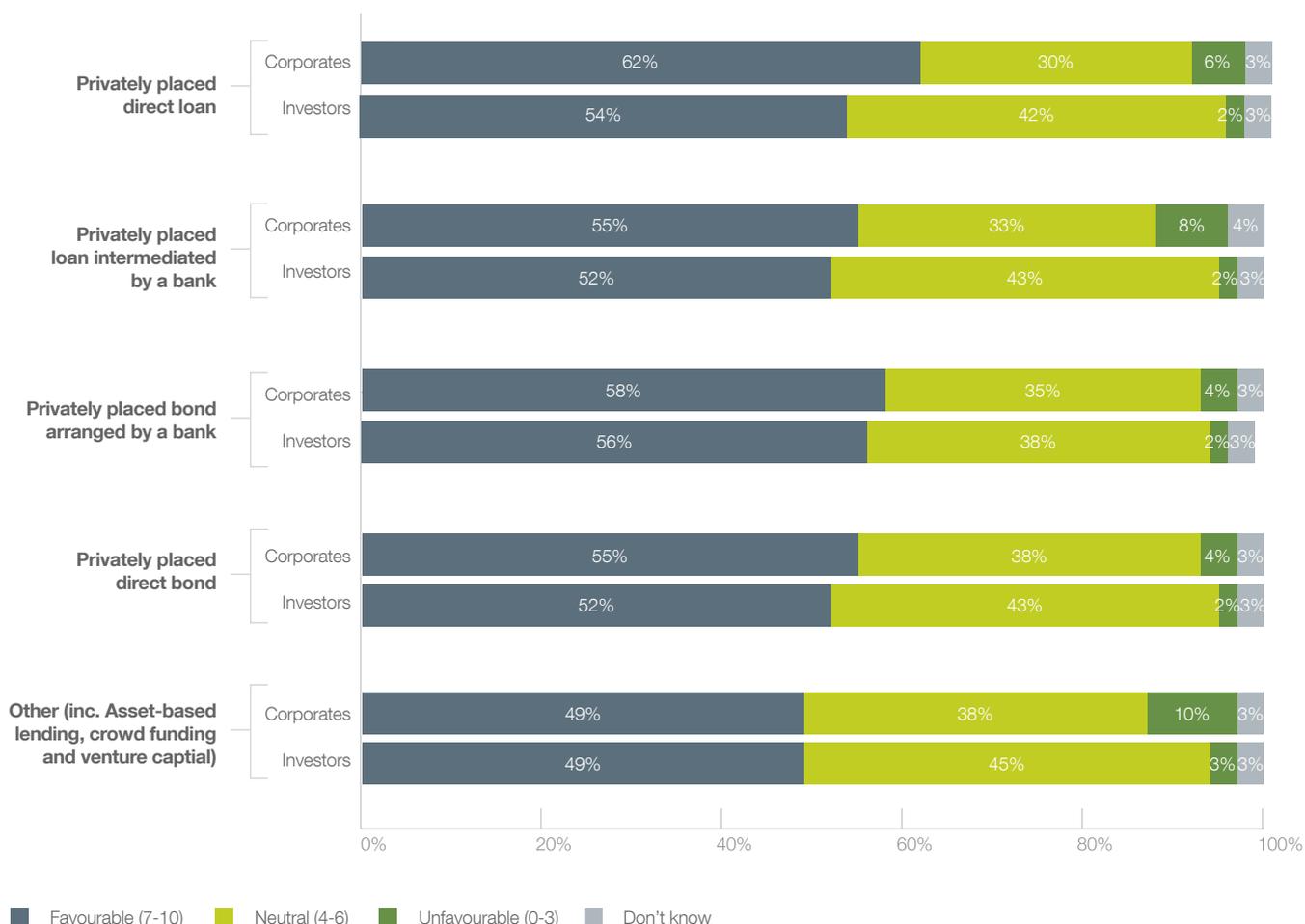
Investors are equally likely to be using direct or intermediated loans or bonds. When it comes to their preferences, they are again, just as agnostic as the corporates seeking their funding.

These responses appear to reinforce the role standardisation could play in the alternative finance market. Both corporates and investors currently seem content to take whatever they can get. If standardisation is embraced it could play a pivotal role in harnessing the potential of alternative finance across Europe.

# What would the market prefer to use?

## LEVELS OF FAVOURABILITY ARE BROADLY THE SAME FOR EACH PRODUCT

**Question asked of corporates and investors:** *How favourable would you say you are, in general, towards each of these forms of alternative finance?*



A quick look at national preferences reinforces this insight: again, corporates are agnostic with regard to funding forms, even if there is a national tendency towards a particular structure. In France 90% of corporates make use of privately placed loans intermediated by a bank, making it the default format. Privately placed direct bonds are less used, with only 23% of French corporates taking advantage of this format. Yet the research shows French corporates are content to work with all forms. Only 3% are unfavourable to the less-frequently used form of privately placed direct bonds.

Investors in the UK use the most diverse spread of alternative finance, with two-thirds (67%) providing their funding through private equity and venture capital, another 40% have used asset-based lending, while around third have used business growth funds and private or intermediated loans. German investors have also embraced a wide range of different forms of alternative finance, while Italian and Spanish investors exclusively use private or intermediated loans and bonds. Benelux are similar with just small amount of private equity funding (3%) outside the main loans and bonds while France is a bit more developed using business growth funds, private equity and venture capital in equal measure (7% for each) with a smattering of trade finance (3%).

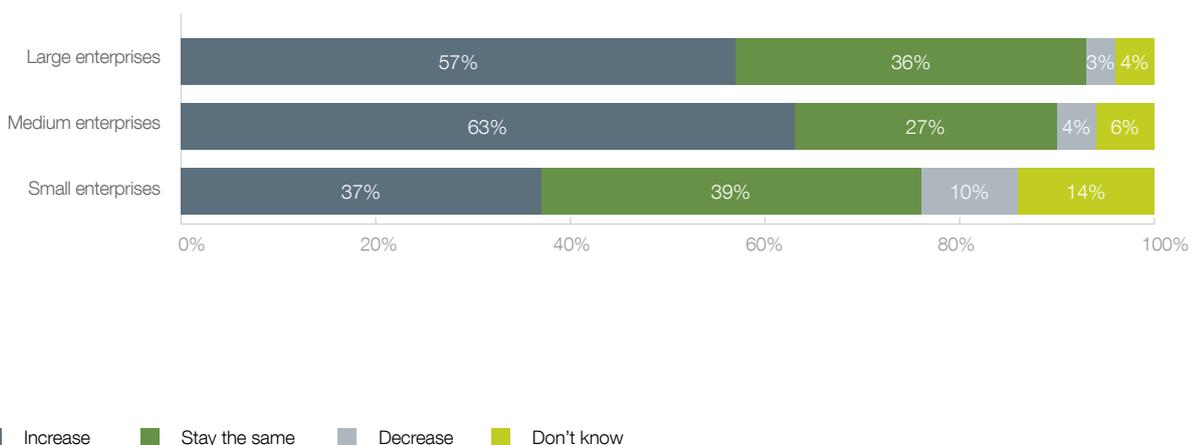
# Who are investors funding?

## LARGE ENTERPRISES BENEFIT THE MOST – FOR NOW

**Question asked of investors:** Over the past 12 months, what proportion of your total funding available for alternative finance was allocated to large/medium/small enterprises?



**Question asked of investors:** Over the next five years is the amount that you fund large, medium and small businesses likely to increase, decrease or stay the same?



Alternative finance remains primarily the domain of large enterprises. Investors report that large enterprises win 41% of funding, medium size enterprises 34% and small enterprises 26%.

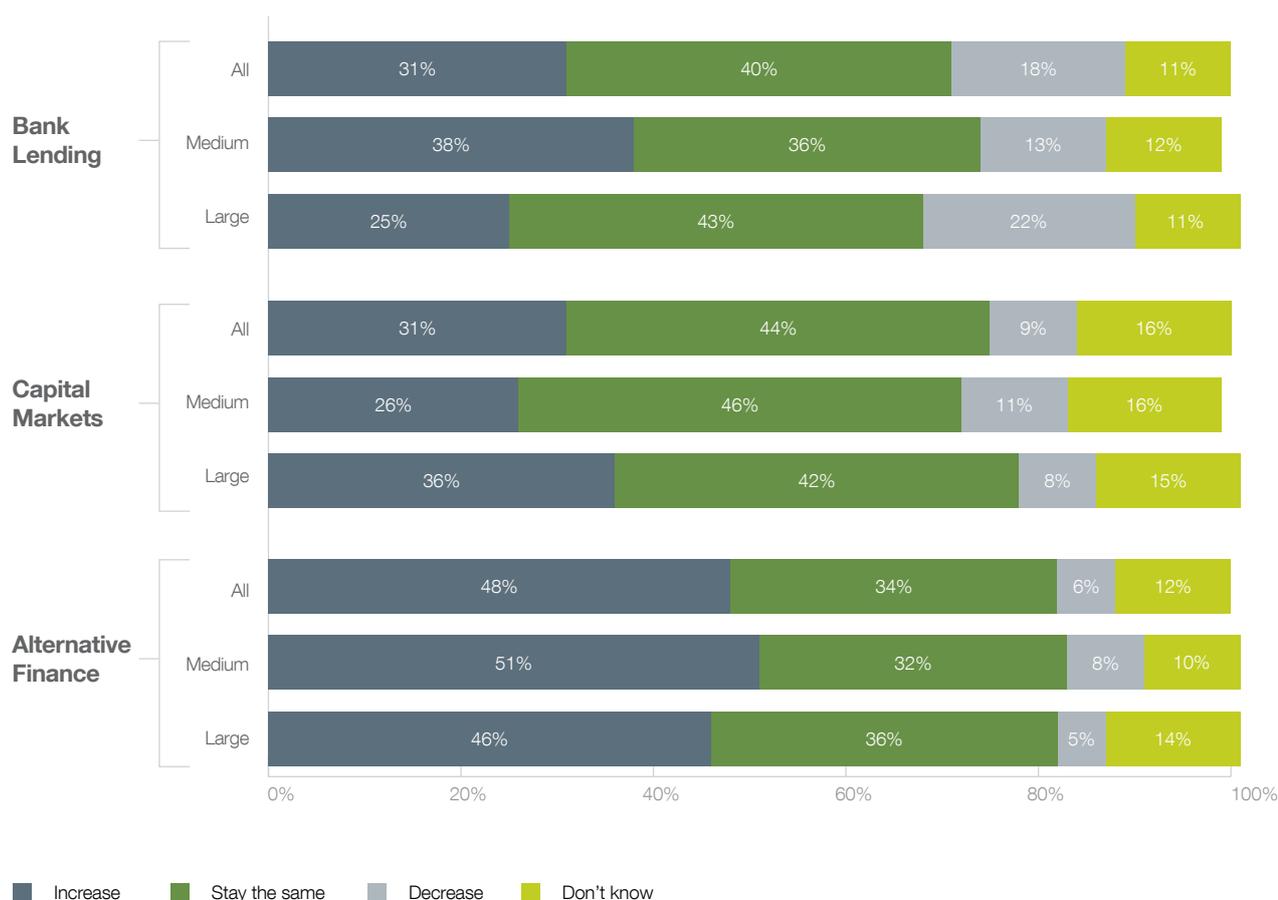
Looking to the future, corporates of all sizes are forecast to enjoy healthy increases in funding. A majority of investors, 57%, say they expect to increase provision to large firms, with only 3% expecting a decrease. Mid-sized firms will gain even more – with 63% of investors forecasting an increase, and just 4% predicting a decrease. It is encouraging to note that small firms will gain too. Over a third of investors (37%) foresee an increase in funding to small firms, versus 10% expecting a decrease.

German and French investors’ expectations to increase funding to small firms outstrip the expected increases to larger corporates. Spanish investors show confidence for increased provision to corporates of all sizes: 87% of investors expect to increase funding to large firms, 77% to increase funding to medium-sized firms, and 57% to increase funding to small firms. In Benelux, 91% of investors expect to increase funding to mid-sized corporates and 3% expect a decrease. These figures show continent wide investor confidence in funding growth for corporates of all sizes.

# What do corporates expect to use?

**ALMOST HALF OF CORPORATES (48%) EXPECT THEIR USE OF ALTERNATIVE FINANCE TO INCREASE**

**Question asked of corporates:** *Do you expect your use of bank lending/capital markets/alternative finance to increase, decrease or stay the same over the next five years?*



The underlying sense from the research is that we are approaching a tipping point where a uniform standard could be embraced, harnessing the disparate pools of capital dispersed across the continent.

Almost half of corporates expect their use of alternative finance to increase over the next five years, compared to 6% who believe this will decrease. This outstrips corporates' expectations of using bank lending or capital markets.

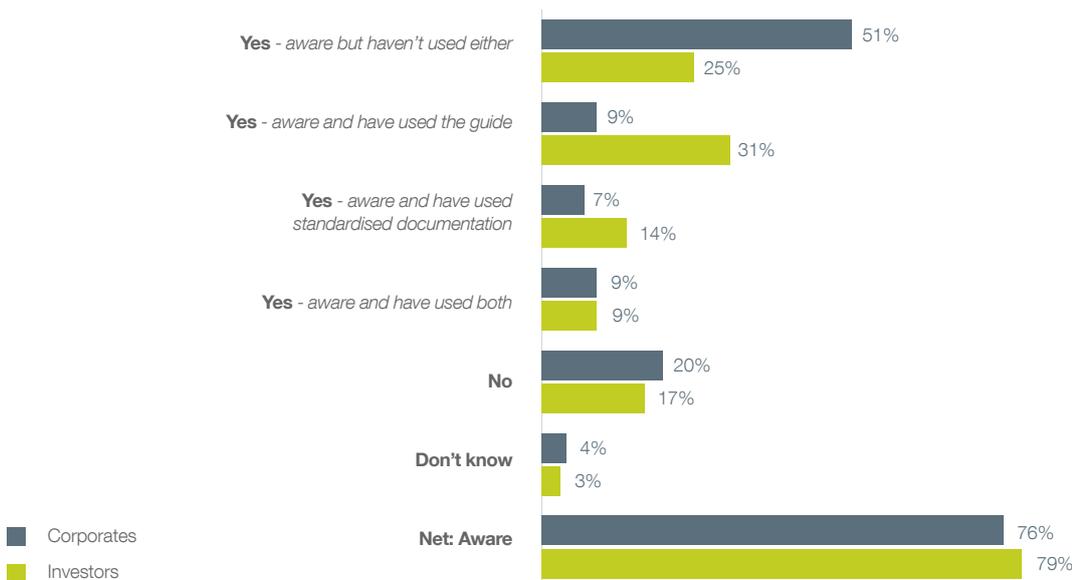
The findings suggest that Italy and Benelux will be booming markets. A remarkable 87% of Italian corporates expect to increase their use of alternative finance in the next five years, and 74% of those in Benelux envision a similar increase.

In the UK, the research illustrates corporates' sombre forecasts for future lending. Almost half of UK corporates (47%) expect their use of bank lending to decrease in the next five years, with just 6% expecting it to grow. Naturally, corporates will look for other routes to raise funds. Half expect their use of alternative finance to grow, and 22% will be increasing their use of capital markets.

# Standardisation and awareness of market initiatives

## BORROWERS ARE AWARE OF INITIATIVES BUT INVESTORS HAVE QUICKLY EMBRACED STANDARDISATION

**Question asked of corporates and investors:** *Are you aware of the launch of the pan-European corporate private placement market guide and standardised loan and bond transaction documentation?*



Awareness of recent market initiatives is an important piece of the puzzle. Early in 2015 the International Capital Market Association (ICMA)'s Pan-European Private Placement Working Group, of which Allen & Overy was a part, produced a guide to best practice, the Pan-European Corporate Private Placement Market Guide. This was accompanied by complementary standard documentation from both the Loan Market Association (LMA) and ICMA.

Our research demonstrates a rapid rise in awareness. Overall, 76% of corporates and 79% of investors are aware of the guide and documentation. Italy and Benelux are even further engaged: 97% of corporates are aware of both, as are 100% of investors.

Use, naturally, is still gathering traction. Overall, only 9% of corporates and 9% of investors have used both the guide and documentation. Italy leads the way, with 27% of corporates and investors using both. The laggards? In Benelux, France, Spain and Germany none of the survey respondents from the investor community had used both.

Germany is likely to be the last to follow. Banks are offering loans on exceptional terms – often barely breaking even. If corporates want to use alternative finance, they use the well-entrenched *Schuldscheine* agreements. Awareness of the harmonised guide and documentation is low: 63% of German corporates admitted to not having heard of either. No investors or corporates polled have used both. If liquidity tightens, or regulators take bold action, this may change.

Despite Germany as an outlier, these figures underline the progress made by the LMA and ICMA. The European Private Placement Association (EUPPA) has also played a key role in bringing the investor community together to share information and work towards the development of industry standards.

As banks and law firms educate investors and corporates, use of the guide and documentation will rise. Flexibility is also important, as Italy has proven. Italy is enjoying strong growth in alternative finance by adopting the guide and documentation. The Italian model is to use both as templates, introducing additions and revisions to meet specific needs; an approach which is clearly working well.

Some resistance is coming from borrowers. Anecdotally, some corporates report feeling that the guidance and documentation favour the investor. They prefer to stick to the established loan agreements they are familiar with. If a harmonised market is to emerge, these objections will need to be proven groundless.

On the whole, the prospects for alternative finance are bright across Europe. If all parties can work together to better educate borrowers, the prospect of a thriving market will become a reality.

We are making progress to reach that goal, but there is more work to do.



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## GLOBAL PRESENCE

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