

# MARF: Alternative sources of funding for SMEs in the Portuguese market

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## Abstract

The aim of this study is to examine the main features of Portuguese SMEs, with a special focus on the funding sources they use. The main goal is to evaluate the need to use alternative funding sources, with an emphasis on the fixed-income market. We start by identifying the different types of funding mostly used by companies, finding that bank credit, in all its forms, is the most common. However, considering EU and national regulations, economic cycles and also bank institutions' organizational structure, we conclude that companies are trying to diversify their sources of funding, as a way of managing their liabilities. It can be assumed that there is a direct relation between the companies' need for debt capital and alternative sources of funding. That is, there is a need to use a fixed-income market, as opposed to the more traditional sources of funding.

## Keywords:

Alternative funding, Portuguese SMEs, Banking credit, Fixed income.


## JEL classification:

G11, G12, G24.

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# MARF:

## Fuentes de financiación alternativas para las pequeñas y medianas empresas en el Mercado portugués

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### Resumen

El objetivo de este estudio es examinar las principales características de las pequeñas y medianas empresas portuguesas, prestando especial atención a las fuentes de financiación que utilizan. El principal objetivo es evaluar la necesidad de utilización de fuentes de financiación alternativas, poniendo el énfasis en el mercado de renta fija. Primeramente se identifican las diferentes formas de financiación más utilizadas, infiriéndose que el crédito bancario, en todas sus formas, resulta ser la más importante. Sin embargo, considerando tanto la regulación nacional como la europea, los ciclos económicos y la estructura organizativa de las instituciones bancarias, se concluye que las empresas objeto de estudio tratan de diversificar sus fuentes de financiación, como una forma de administrar su pasivo. Se puede suponer una relación directa entre la necesidad de recursos ajenos de las empresas y fuentes alternativas de financiación. Lo mismo se puede decir de la necesidad de utilizar el mercado de renta fija, como algo opuesto a las fuentes de financiación tradicionales..

### Palabras clave:

Financiación alternativa, pequeñas y medianas empresas portuguesas, crédito bancario, renta fija.

## ■ 1. The evolution of credit in Portugal

Historically speaking, the evolution of credit in Portugal has been closely related to political and regulatory frameworks and it is tightly connected to the banking industry, which has been the main source of funding.

Till the revolution of 1974, which marked the beginning of Portuguese democracy, all the financial institutions had their foundation in private equity (except for Caixa Geral de Depósitos). Banco de Portugal itself followed the same model. With the arrival of democracy, all the financial institutions became nationalized.

In 1976, a new legal framework was established, which made the prior nationalizations irreversible and prohibited any private fund-raising initiative. This action led to mergers, which changed the financial scenery in Portugal: the bigger institutions took over the smaller ones.

For example, there were the cases of Banco Intercontinental Português, which was taken over by Banco Pinto & Sotto Mayor, and Banco Português do Atlântico, which has taken over Banco Fernandes Magalhães and Banco do Algarve.

Till the beginning of the 80s, the Portuguese banking system was almost exclusively built on nationalized institutions, which held 95% of the market share. The exceptions were foreign entities with ongoing operations in the Portuguese market, such as Banco do Brasil, Credit Franco-Portugais (owned by Credit Lyonnais) and Bank of London & South America (owned by Lloyds Bank).

The finance and banking activity was heavily regulated with respect to the types of interest rates, the amount of credit granted, the opening of new branches/desks and also the creation of new institutions. Against this backdrop, the competitiveness of the entire sector declined.

Moreover, in 1984 there was an opening up of the banking activity to private equity due to an amendment to the Portuguese Constitution and to the issuance of Decree-Law No. 406/83 of 16th November and Decree-Law No. 51/84 of 11th February. This new regulatory framework allowed the creation of new private institutions on nationalized institutions, as well as the arrival of several foreign institutions such as Barclays, Banque National de Paris, and Citibank, among others.

Table 1 clearly reveals the doubling of national and foreign banking institutions in Portugal in a decade.

● **Table 1. Number of institutions in the Portuguese Banking System**

	National	Foreign	Total
1986	17	9	26
1990	20	13	33
1995	30	15	45
1996	31	19	50
1997	35	20	55
1998	33	24	57
1999	34	25	59
2000	29	29	58
2001	30	27	57
2002	32	28	60

SOURCE: ASSOCIAÇÃO PORTUGUESA DE BANCOS, INFORMATIVE NEWSLETTER FROM JUNE 2015 AND ANNUAL REPORT FROM BANCO DE PORTUGAL.

After unlocking private initiatives, the prevailing trend in the second half of the 80s was the urge to consolidate and regulate the Portuguese Banking System as the result of the integration of Portugal in the European Union.

At the same time, the integration of the country in the EU has enhanced economic growth, especially in terms of families' purchasing power and the professionalization of the corporate structure.

This context has created the ideal background for the expansion of the financial institutions, while strengthening their solvency and developing the complexity of their operations.

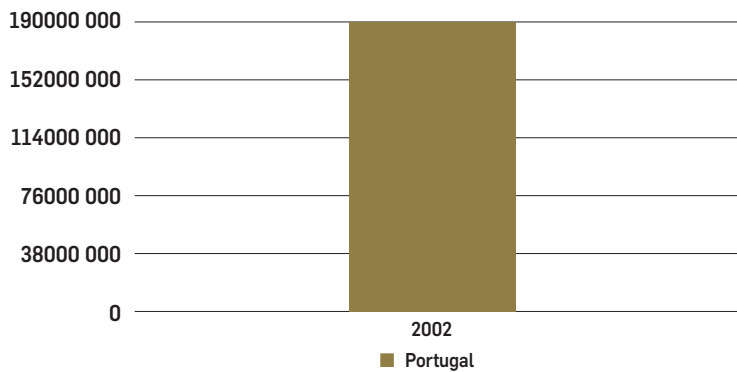
The inputs of the Portuguese financial market, as well as the need and obligation to apply the European Union regulations, resulted in Decree-Law no. 298/92 of 31st December 1992, which was the highlight of the regulation of the banking system in Portugal.

Just as the other Central European Banks, Banco de Portugal, in its role as a regulatory structure, assumed greater responsibility as a supervisor of the behaviour of the banking institutions and as a risk management entity. Furthermore, it took on the indirect supervision of the amount of available capital, imposing minimums for banking institutions' net capital and promoting free market transactions. Additionally, it abolished the existing limits on the amount of credit granted and also the interest rates previously established by law.

In the 90s, this led to an exponential increase in the amount of credit granted, in volume and in all its forms, followed by a strong stimulation of corporate search for funding. Between 1992 and 2002, the annual growth rate of credit was 22.4%, and the total volume of credit granted in 2002 was 190,000 million euros. There was an evolution in the amount of credit granted to individuals, in which represented 15.8% of GDP in 1992 rising to 64.4% in 2002, especially in housing credit.

Regarding the credit granted to the corporate market, it rose from 45% of GDP in 1991 to 90% in 2002.

**Figure 1. Credit granted in Portugal during 2002**



SOURCE: INE

In conclusion, we can say that, in little over a decade, the credit market dramatically changed in Portugal, though remained entirely held by the banking industry. It evolved from a restrictive approach in terms of its representativeness and the level of credit granted, to a wider one with major levels of indebtedness.

Despite the slowing of the Portuguese economy since 2004, reflected in a decrease in domestic consumption (a result of over-indebtedness of the economic agents), investment and public expenditure, the banking sector has presented signs of growth. As opposed to the local economy in general, the banking industry has been increasing its assets by boosting the credit granted to clients and all its other services. The expansion of the offered services allowed banks to increase their margins with the income of extra fees, reducing exposure to margins between funding and credit granted.

Over a five-year period (from 2004 to 2009), there was a growth of 67% in the amount of credit granted, and a 44% rise in fund-raising, as we can see in Table 2.

The integration of Portugal in the European Union allowed the Portuguese banking industry to achieve almost unlimited debt to foreign institutions, with extremely low

interest rates. This helped the country to perform beyond its potential. The assets of the five major banking institutions operating in Portugal totalled almost 3 billion euros in 2007. (Figure 2)

**Table 2. Evolution of the leverage of the Portuguese Banking System (in millions of euros)**

	2004	2005	2006	2007	2008	2009
Credit	177,943	196,014	225,740	255,531	289,476	296,560
Clients assets	130,497	136,186	148,479	162,375	183,767	187,569
Transformation Ratio	136%	144%	152%	157%	158%	158%

SOURCE: BANCO DE PORTUGAL

**Figure 2. Assets of the five major banking institutions (in millions of euros)**



In 2007, the subprime crisis first reached European countries (sovereign deficit crisis) and later hit the most indebted financial institutions, affecting the entire Portuguese banking industry in 2011. The financial statements of the institutions revealed funding of projects that proved to be less profitable than expected and which became the source of major problems, mainly in construction and housing.

Regarding housing credit, the operations proved to provide little return on investment as a result of the credit provision on low interest rates for very long terms. The rate of fund-raising did not match that of credit provision, which explains the leverage growth from 136% in 2004 to 158% in 2009 (Table 2). The banking institutions were obliged to make allocations on provisions, which made it impossible to surpass the 2007 level of assets. From 2010, due to the sovereign deficit crisis, there was a phenomenon similar to a black hole in which financial markets closed their doors to several countries, including Portugal.

After 2011, the Portuguese economy had external help. Banking institutions started a process of leverage reduction, under pressure to strengthen their capital structure. However, the institutions could not count on the major assets previously acquired once they had already been distributed to shareholders. The consequence was a decrease in credit provision.

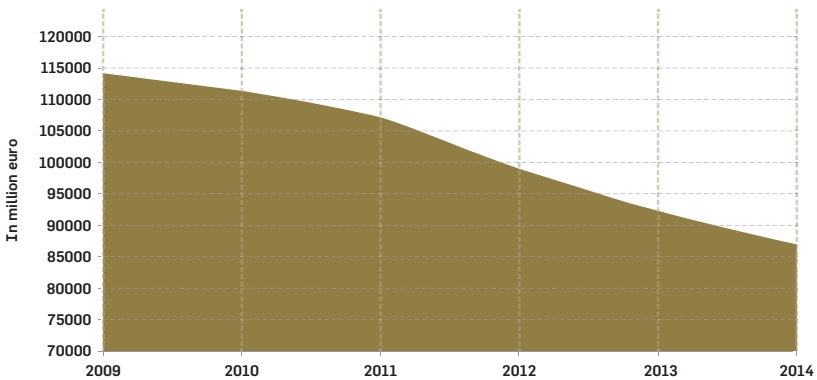
The presence of the IMF in Portugal brought a new reorganization of the banking system: closed branches, layoffs, mergers and complex managements. The IMF provided

78 billion euros, of which 12 billion was targeted to the “recapitalization” of the national banking industry. This ensured that between 9 and 10% of those invested funds would have an effective impact on this sector of the economy sector.

Figure 3 presents the evolution of credit granted to companies from 2009 to 2014. Over this five-year period, it fell by 27 billion euros, with 2012 proving the most critical moment, registering a decrease of 8.3 billion euros.

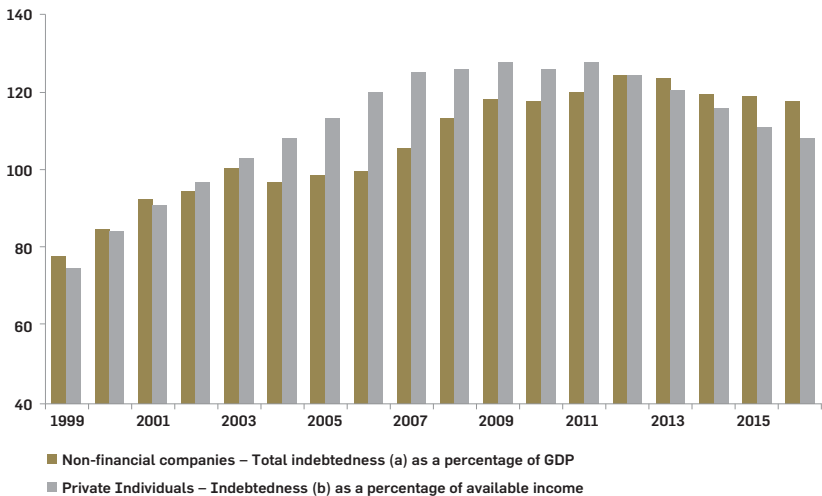
**Figure 3. Credit granted to non-financial corporations (NFCs)**

Past Due Ratio (in %):	4.2	4.6	7.0	10.6	13.4	15.0
Rate of Change (in %):	.	-1.5	-3.2	-6.8	-5.5	-4.9



SOURCE: BANCO DE PORTUGAL – 17TH RELEVANT STANDARD COMMITTEE OF ECONOMIC STATISTICS – MARCH 2015

**Figure 4. Indebtedness of the private non-financial sector**



a) Includes credit granted to non-financial companies by other institutional sectors; commercial paper and bonds issued by non-financial companies held by other sectors and commercial credit received from other sectors.  
 b) Financial debt is the sum of the received credit and debt securities issued by the sector.

SOURCE: INE AND BANCO DE PORTUGAL

In recent years, a slight recovery can be detected, driven by the restored confidence of foreign agents in the Portuguese economy.

Figure 4 shows that the total debt of companies (bank credit granted, loans provided by different institutional departments, commercial paper, bonds) as a percentage of GDP grew till 2011, and that there was a slight turning point with a small growth in the last year.

## ■ 2. Portuguese corporate structure with a special focus on SMEs

In 2004, there were over one million companies in Portugal, only 30% of which had an effective impact on the economy. The remaining 70% were sole proprietorships. Table 3 presents, in numbers, the main variables representing the Portuguese corporate structure. SMEs represent 99% of that structure and are responsible for about 60% of company turnover.

● Table 3. Description of the corporate structure in 2014

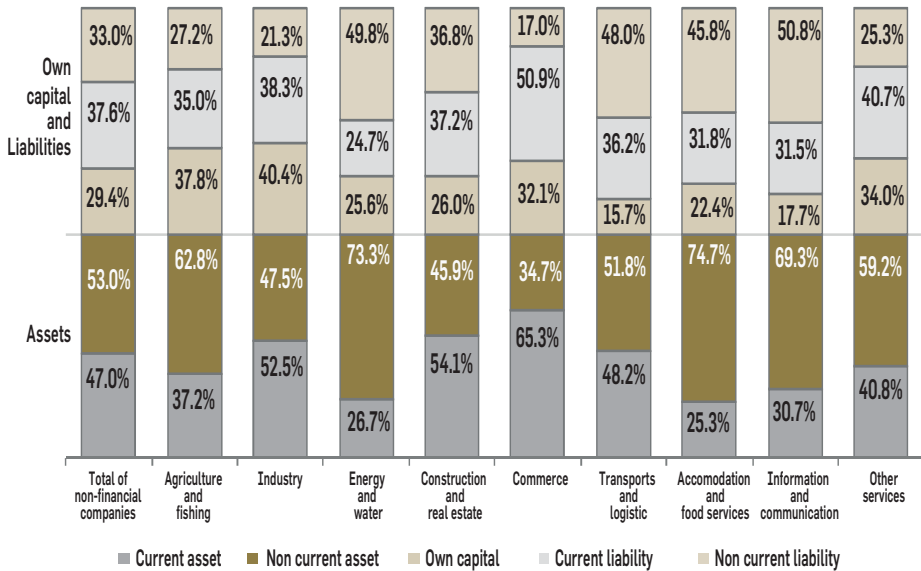
	Companies		Employees		Business Volume		GVA		Expenses		Gross Operating Surplus	
	2014	Rate of change 13-14	2014	Rate of change 13-14	2014	Rate of change 13-14	2014	Rate of change 13-14	2014	Rate of change 13-14	2014	Rate of change 13-14
	Nº	%	Nº	%	10 <sup>9</sup> Euros	%	10 <sup>9</sup> Euros	%	10 <sup>9</sup> Euros	%	10 <sup>9</sup> Euros	%
Total of Non-financial companies	1 127 317	2.7	3 445 226	2.1	322 637	1.7	75 825	4.0	44 559	2.0	31 695	7.2
Legal Form												
Sole Proprietorship Companies	764 902	3.1	850 994	1.9	14 203	-0.7	5 822	3.8	1 181	-1.2	4 819	5.1
Companies	362 415	1.9	2 594 232	2.2	308 434	1.8	70 003	4.0	43 379	2.1	26 876	7.6
Dimension												
Large Companies	973	1.7	680 915	3.5	131 364	0.5	28 175	2.9	14 554	2.2	13 422	3.5
SMEs	1 126 344	2.7	2 764 311	1.8	191 273	2.5	47 650	4.6	30 005	2.0	18 272	10.1
Activity Sector												
Agriculture and Fishing	128 765	19.3	185 038	15.0	5 925	6.8	1 401	15.4	809	6.9	1 045	17.1
Industry	67 303	-0.4	659 983	2.0	81 538	1.4	17 856	4.1	10 880	3.4	6 959	5.7
Energy and Water	2 193	2.0	38 599	-0.7	24 821	0.3	5 897	2.5	939	-7.7	4 908	4.4
Construction and real estate	107 405	-2.0	341 159	-3.4	22 141	-4.7	6 602	-3.7	4 451	-2.9	1 873	-3.8
Commerce	221 846	-2.1	719 005	-0.6	119 579	2.4	14 787	5.4	9 645	1.5	4 979	14.6
Transports and Logistic	21 876	-2.3	150 874	2.1	17 861	1.9	6 092	3.8	3 473	1.5	2 639	5.8
Accommodation and food services	84 122	2.3	273 338	2.9	9 190	9.1	3 431	8.4	2 384	4.1	1 029	21.7
Information and Communication	14 834	2.3	85 508	3.3	11 334	-2.7	4 913	0.2	2 420	-3.8	2 449	4.3
Other services	478 973	3.1	991 722	4.0	30 250	4.3	14 846	6.3	9 558	5.5	5 814	7.5

SOURCE: INE AND SCIE



On the other hand, Figure 5 allows us to analyse Portuguese companies' capital structure. Generally speaking, companies present a diversified funding structure (33% own capital, 37.6% long-term debt and 29.4% short-term debt), which allows a 53% funding of fixed assets and 47% of floating capital. Industry and commerce are the least capitalized sectors.

■ **Figure 5. Statement structure by activity sector (2014)**



SOURCE: INE – EMPRESAS EM PORTUGAL 2014

The following figures demonstrate in greater detail the features of the corporate structure, with special emphasis on private companies, which, as mentioned above, are the ones with an effective impact on the economy.

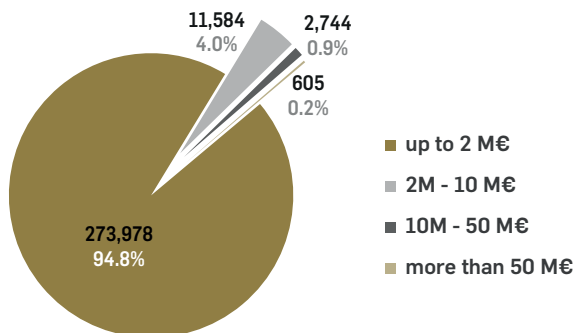
Data refer to 2014, and are based on the information on all the companies that have paid taxes (excluding the banking and insurance sector).

Thus, this study is focused on 288,911 private companies, and uses established ranks of revenue that allow us to differentiate between micro companies, SMEs and large companies.

### Number of companies

From a total of 288,911 companies, 94.8% are micro companies (with an annual revenue of less than 2 million euros), 4% are companies with a revenue of between 2 and 10 million euros, 0.9% are companies with a revenue of between 10 and 50 million euros, and 605 or 0.2% report a revenue of over 50 million euros.

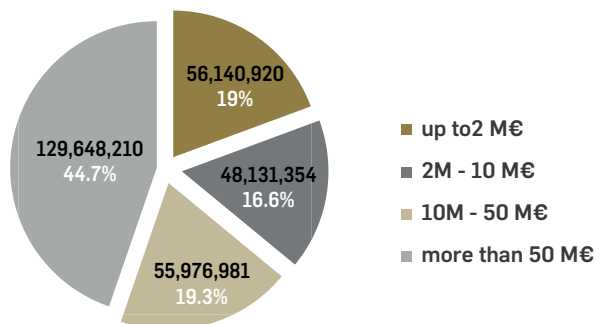
■ **Figure 6. Distribution of SMEs by size**



### Revenue

In 2014, total revenue was about 290 billion euros, with 45% being generated by 605 companies. On the other hand, the companies with a revenue of between 2 and 50 million euros (4.9% of the companies) were responsible for 36% of total revenue.

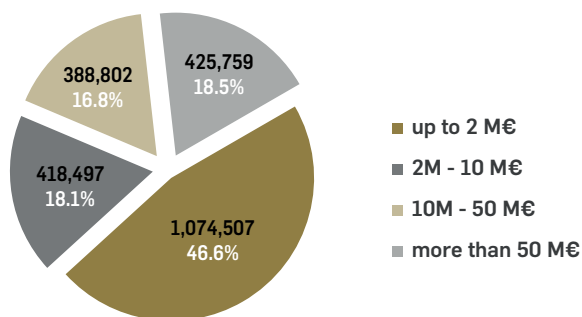
■ **Figure 7. Distribution of SMEs by total revenue**



### Employees

The companies ranking lower for revenue, rely on 47% human labour, while higher-ranked companies show 18% human labour in each sector.

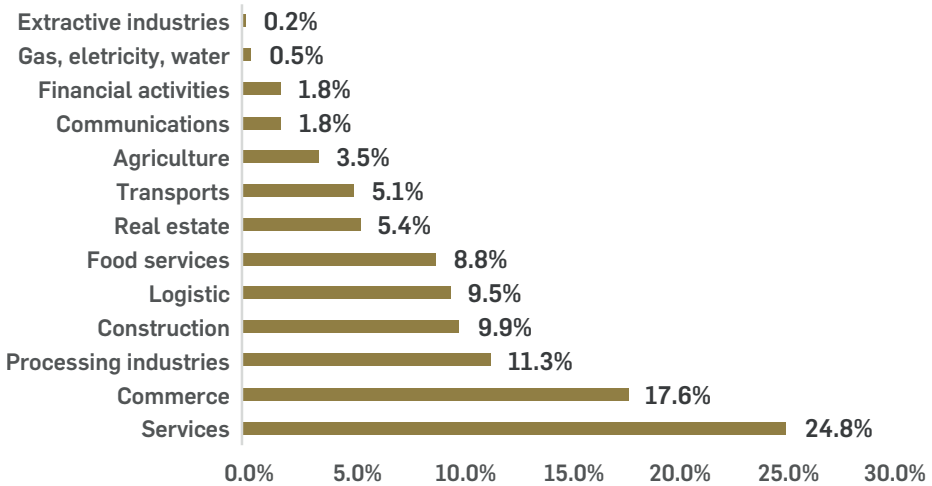
■ **Figure 8. Distribution of SME's by number of employees**



## Activity sector

The biggest share of revenue belongs to the services sector (25%) and to the processing industry (almost 18%).

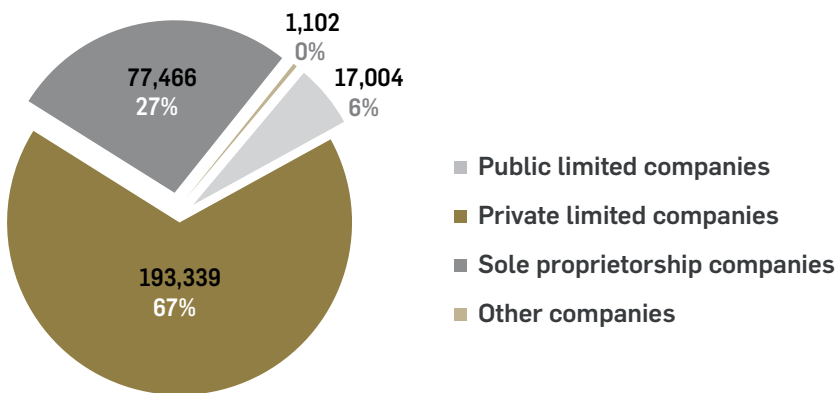
■ **Figure 9. Distribution of SMEs by activity sector**



## Legal Status

Limited Companies represent 67% of the total share and sole proprietorship, 27%.

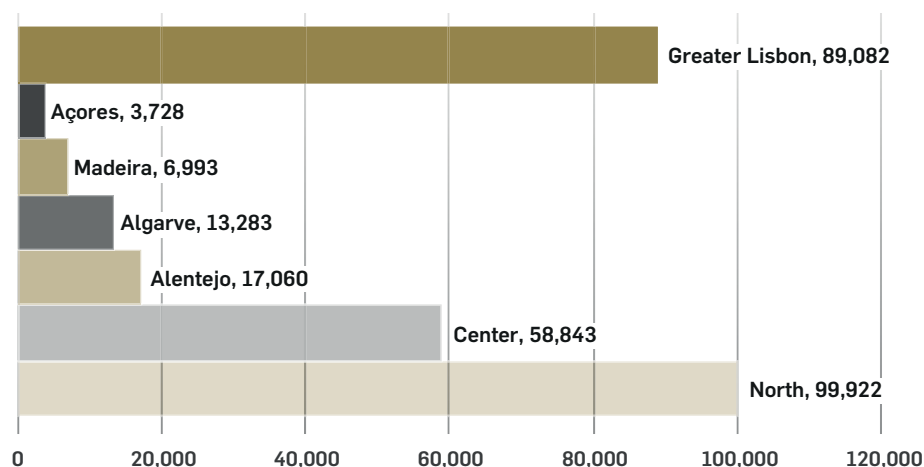
■ **Figure 10. Distribution of SMEs by legal status**



## Geographic area

65% of the companies are concentrated in the country's major cities. However, the centre of the country also plays an important role in this matter.

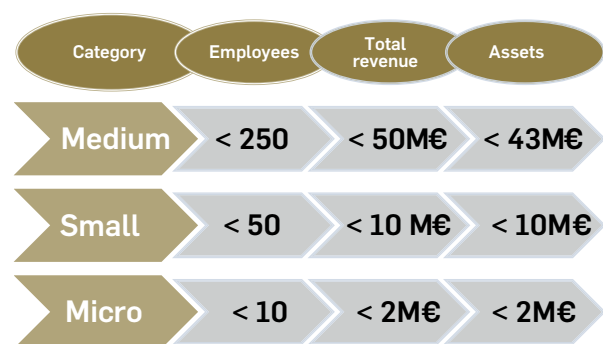
**Figure 11. Distribution of SMEs by geographical area**



Once we have analysed the typology of the companies operating in Portugal, it is necessary to define what SME means.

The concept of SME embraces a wide range of companies with distinctive features. Among the criteria that define SME, the European definition is widely used in Portugal and corresponds to Decree-Law No. 372/2007 of 6th November 2007. It was updated in early 2005 according to the guidelines set out in 2003/351/CE of 6th May 2003. According to these guidelines, we use the term SME to refer to companies that present the following features:

**Figure 12. Definition of SME**



Applying this concept to the Portuguese situation, it can be seen that in 2014:

- There were 273,978 micro companies, whose turnover was about 56 billion euros
- There were 11,584 small companies, whose turnover was about 48 billion euros.
- There were 2,744 medium-sized companies, whose turnover was about 55 billion euros.

We can thus highlight some of the distinctive qualitative features of Portuguese SMEs:

- The associate/shareholder plays the role of manager.
- They depend on one or several key persons, who are vital to the future success of the company. This key person is usually the owner of the SME.
- The hierarchy and organization are simple, with little or no delegation of responsibilities.
- Most are not listed companies.
- Generally, the ability to negotiate with banks, suppliers and larger clients is restricted.
- They lack public and audited information. Medium companies are obliged to audit their balance sheets. However, failure to comply with this requirement is not sanctioned, so many SMEs choose not to comply.
- Their area of influence is mainly regional or national, but due to economic globalization many of them are planning to branch out internationally.

On the one hand, the concept of SME includes micro and small companies, where there is no delegation of responsibilities. On the other hand, it also includes medium companies, in which this system proves to be ineffective, making it vital to develop a more professionalized structure.

### ■ 3. Credit structure of SMEs in Portugal and its evolution

As seen above, the Portuguese economy depends on the economic future of SMEs, which is why it is necessary to guarantee a well-balanced structure of funding.

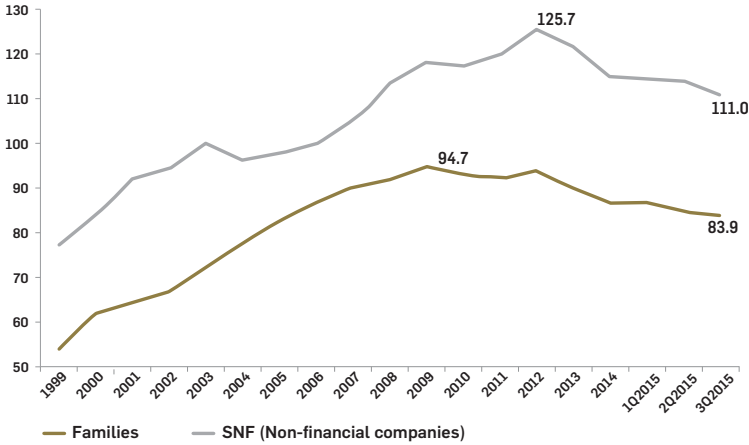
It is thus important to analyse which funding structure is widely used and its impact on company assets and country GDP. To that end, we highlight the following issues:

#### **a) Companies' global indebtedness as a percentage of GDP and by debt instruments**

Figures 13 and 14 show that there is a high level of indebtedness and a strong tendency to seek bank credit as opposed to alternative debt instruments, such as bonds, stocks, etc.

In 2000, the indebtedness of non-financial companies was 83.9% of GDP and by 2015 it had increased to 111%. Nevertheless, bank credit represented 85.7% of total indebtedness as a percentage of GDP in 2015, while alternative instruments represented 20%.

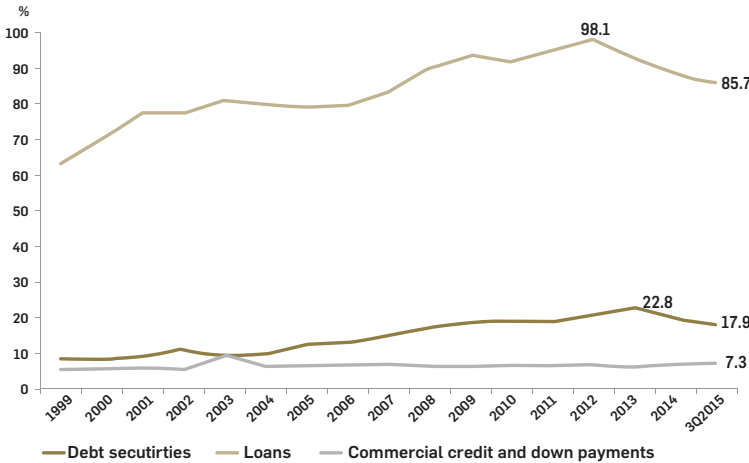
**Figure 13. Debt as a percentage of GDP**



Note: NFC indebtedness (National Financial Accounts – Financial Assets) = debt securities (F3) + Loans (F4) + Commercial credit and down payments – consolidated values

SOURCE: BANCO DE PORTUGAL, FIGURE EXTRACTED FROM PAINEL DE ENDIVIDAMENTO – GABINETE DE ESTUDOS DO MINISTÉRIO DA ECONOMIA.

**Figure 14. Indebtedness of non-financial companies by alternative instruments**



Note: national financial accounts - financial assets, consolidated values

SOURCE: BANCO DE PORTUGAL, FIGURE EXTRACTED FROM PAINEL DE ENDIVIDAMENTO – GABINETE DE ESTUDOS DO MINISTÉRIO DA ECONOMIA.

**b) Weight of the different types of funding as a percentage of total assets**

After observing the chart above, we can conclude that the structure of funding in percentage of assets follows the same pattern, whereby banks assume the main role in the structure of funding. From 2009 to 2014, this kind of service has dropped 0.1% for SMEs, but it has reported a 3.1% growth for large companies. We can also observe that during crisis periods, there is not a tendency to reduce the use of bank services.

● **Table 4. Structure of funding in % of total assets**

Structure of funding	SME's							Large companies						
	2009	2010	2011	2012	2013	2014	2009-14	2009	2010	2011	2012	2013	2014	2009-14
Shares	27.3	27.9	26.9	26.7	28.4	30.9	3.6	32.7	36.6	35.7	34.8	33.4	31.9	-0.8
Bank credit granted	37.8	40.0	40.4	41.9	40	37.7	-0.1	35.9	35.4	38.0	39.1	39.1	39.0	3.1
Commercial credit	12.4	12.4	12.2	11.7	11.5	10.9	-1.5	10.9	11.5	11.2	10.4	9.9	10.4	-0.5
Others types of funding	22.5	19.7	20.5	19.7	20.1	20.5	-2.0	20.6	16.6	15.1	15.7	17.6	18.8	-1.8

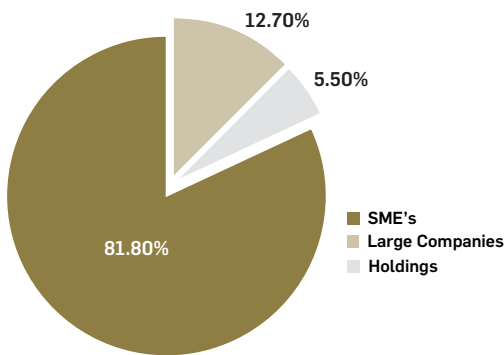
SOURCE: BANCO DE PORTUGAL, FIGURE EXTRACTED FROM PAINEL DE ENDIVIDAMENTO – GABINETE DE ESTUDOS DO MINISTÉRIO DA ECONOMIA.

From the table, it can be concluded that, on the one hand, the negative variation in credit was offset by the strengthening of equity in the case of SMEs.

On the other hand, we see the opposite pattern for large companies. As such, concerning the structure of funding, we can conclude that there were no significant differences between SMEs and large companies in 2014.

Figure 15 presents the distribution of the stock of credit consumed in 2015. SMEs accounted for 81.8%, large companies 12.7%, and holdings 5.5%. Once again, we can conclude that the highest share of the consumed credit was held by SMEs in the banking market.

■ **Figure 15. Structure of banking credit stock (2015) in terms of dimension**

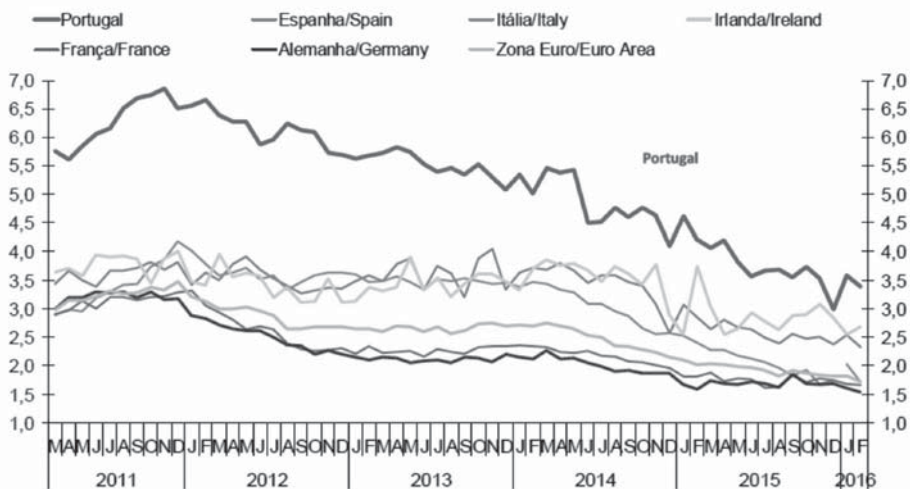


SOURCE: BANCO DE PORTUGAL, FIGURE EXTRACTED FROM PAINEL DE ENDIVIDAMENTO – GABINETE DE ESTUDOS DO MINISTÉRIO DA ECONOMIA.

### c) Patterns in the types of interest on bank loans

Figure 16 depicts the evolution of different types of interest rates in the Eurozone, with a focus on specific countries. Since 2011, there has been a downward trend overall. In Portugal, the types of interest rates are higher due to the country's associated risk.

■ **Figure 16. Types of interest rates on new loans to non-financial corporations (%)**



**d) Impact of the funding on companies’ performance**

We can come to a conclusion about the way companies have reacted to the sovereign and banking deficit crisis by comparing some financial indicators for 2013 and 2014.

● **Table 5. Financial indicators for the different types of companies**

	Micro		Small		Medium		Large	
	2013	2014	2013	2014	2013	2014	2013	2014
<b>Liquidity</b>								
General liquidity (1)	126.9	125.6	127.9	135.4	126	133	102	106
Reduced liquidity (2)	70.32	73.11	96.08	102.7	101.5	106.5	86.9	89.8
<b>Financial structure</b>								
Financial autonomy	25.74	26.52	29.2	32.01	30.77	31.46	32.5	30.6
Indebtedness rate	388.5	377	342.4	312.5	325	317.9	308	327
General sustainability	34.67	36.1	41.25	47.07	44.45	45.9	48	44.1
<b>Funding</b>								
Financial debt ratio	0.64	0.52	0.29	0.22	0.27	0.22	0.23	0.25
Return on equity	-4.75	-3.85	1.49	5.85	3.49	7.3	7.37	3.79
Return on assets	1.76	1.94	5.35	6.68	6.42	7.62	7.99	7.15
Return on sales	4.72	5.5	6.48	7.67	8.12	9.25	9.3	8.56

(1) The general liquidity ratio measures the company’s ability to pay its short-term debt and it is calculated using the following formula:  $\text{general liquidity ratio} = \text{current assets} / \text{current liabilities}$ .

(2) The reduced liquidity ratio measures the company’s ability to pay its short-term debt using liquid assets, but in a more demanding way than the general liquidity ratio, assuming that the stock can be hard to convert into immediate liquidity or for the value identified in the balance sheet. It is calculated using the following formula:  $\text{Reduced liquidity ratio} = (\text{current assets} - \text{stock}) / \text{Current liability}$ .

SOURCE: BANCO DE PORTUGAL



These ratios confirm capitalization effort made by SMEs, which led to an increase in their return on equity and on assets. Large corporations, on the other hand, have not made an equivalent effort.

No matter how important the loans are in the funding structure of the SMEs, there is a fundamental need to find alternative instruments that increase their financial capacity and ensure a balanced, sustainable and differentiated growth. It is especially vital during a crisis, when along with reduced credit provision, SMEs face excessively high interest rates.

#### ■ 4. Alternative sources of funding used

In Portugal, statistical data show that alternative sources of funding represent 20% of the different types of funding. This kind of funding is an asset not only to the issuer but also to the investor, as we can see below:



This way of funding used to be associated with large corporations; nowadays, however, it is an option open to SMEs, and it takes different forms.

We describe below the alternatives most commonly used in Portugal.

##### 1. Collaborative funding - Crowdfunding

This is a way of funding a corporation or its projects by which it is possible to raise funds from one or more individual investors, after registering on electronic platforms available online.

There are four kinds of crowdfunding:

- a) Donation – the financed entity receives a donation and in return may or may not compensate in kind.
- b) Reward – in exchange, the financed entity is obliged to provide the service or the financed item as compensation.
- c) Equity – the financed entity gives investors small equity, distribution of dividends. In order to grow the business, the entity endorses a part of equity to a group of investors.
- d) Debt – the investor receives an interest payment, with the rate established when the contribution is made, working as an alternative to bank credit.

In Table 6 we discuss the advantages and disadvantages for each kind.

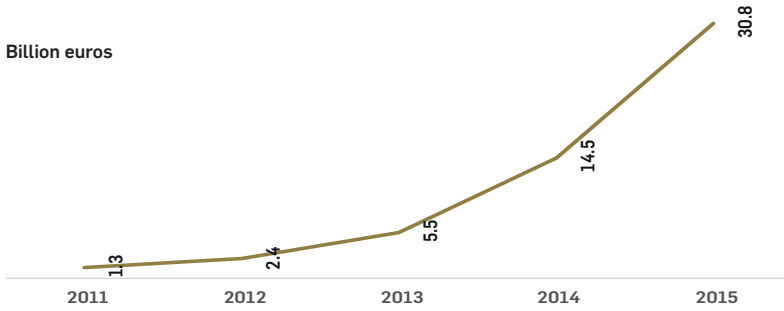
● **Table 6. Advantages and disadvantages of the kinds of crowdfunding**

	ADVANTAGES	DISADVANTAGES
Donations	<ul style="list-style-type: none"> <li>•Transparency</li> <li>•No intermediaries</li> <li>•Company owner maintains equity</li> <li>•Simple process without compensation</li> </ul>	<ul style="list-style-type: none"> <li>•Harder to differentiate among projects</li> <li>•The return on the investment is smaller</li> </ul>
Reward	<ul style="list-style-type: none"> <li>•Customer retention with products and services</li> <li>•No repayment on invested contribution</li> <li>•Allows the entity to receive feedback on the product/service and its quality</li> <li>•Retention of equity by the company owner</li> </ul>	<ul style="list-style-type: none"> <li>•Obligation to compensate the investor</li> <li>•Not appropriate with complex products or projects</li> <li>•Most appropriate for product or goods producers</li> </ul>
Equity	<ul style="list-style-type: none"> <li>•Wide range of small investors</li> <li>•Product and services companies oriented</li> <li>•Allows companies to access a wide range of investors through electronic platforms</li> <li>•Allows return to the investor</li> <li>•Increase in company's own equity</li> </ul>	<ul style="list-style-type: none"> <li>•The Company Balance Sheet presentation is required.</li> <li>•Investors focus on companies with a high growth potential.</li> <li>•All the decision making is on the company</li> </ul>
Debt	<ul style="list-style-type: none"> <li>•Available to the general public</li> <li>•Allows return to the investor on the invested contribution</li> <li>•Simplified access to an investor network</li> <li>•Flexibility as to the type of interest rate</li> <li>•absence of systemic risk</li> </ul>	<ul style="list-style-type: none"> <li>•Demand for repayment on the acquired debt.</li> <li>•Portugal has a small market</li> <li>•Investors focus on companies with a high growth potential</li> </ul>

Globally speaking, crowdfunding raised 14.5 billion euros in 2014 (which represents a 167% growth compared to 2013).

However, the Portuguese market does not represent a significant share of the total, with the amount collected being less than 5 million euros.

■ **Figure 17. Total raised through crowdfunding (2011- 2015)**



SOURCE: EQUITISE, DELOITTE AND PIPER ALDERMAN (2015)

## II – Risk Capital funds

In exchange for a share of their own funds, SMEs are financed by risk capital funds. The aim is to help the company to appreciate, which will then be sold with a higher return rate. As such, risk capital funds are aimed at start-ups or companies in expansion. Generally, these funds are made up of institutional investors and focus on companies with the capacity to achieve high growth.

The main advantages and disadvantages of this kind of funding are:

### ADVANTAGES

- Private investors contribute with specialized technical consultancy
- Strong supervision and risk capital follow-up preventing deviation from the main goal.
- Attractive to high-risk investors
- Institutional investors enhance the company's reputation.
- Does not involve the company's indebtedness

### DISADVANTAGES

- New members in the company's administration
- Private investors with power to decide
- Slow process
- Loss of confidentiality
- Aimed at projects between 3 and 5 years.

## III – Business Angels

Business Angels are instruments that are often mistaken for risk capital. Nevertheless, the fact that such instruments are assured by a private investor changes the philosophy of the investment. Moreover, it is known as a medium-term investment, rather than being intended as short sell, which is a characteristic of risk capital, although the final aim is the same (selling for the highest possible profit).

The investor assumes all the business risks, since the project/product has not yet been tested in the market place, and brings their “know-how” to the business.

The main advantages and disadvantages of this kind of funding are:

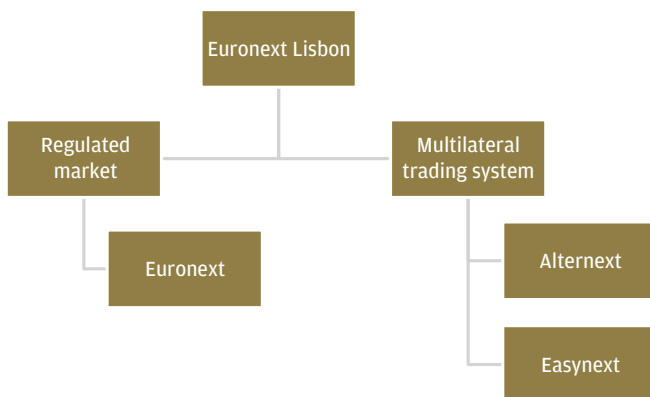
ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"> <li>• High proximity to the business owner</li> <li>• Contributes with specific know-how and business network</li> <li>• Faster decision making</li> <li>• Implies the capitalization of the company.</li> </ul>	<ul style="list-style-type: none"> <li>• Hard to find the right business angel to suit the needs of the business owner</li> <li>• Type of investment best suited to start ups</li> </ul>

According to the report “Evaluation of the EU Member States’ Business Angel Markets and Policies” of October 2012, the global amount invested by business angels in Portugal was 2.06 million euros (in Spain the amount collected was 8.16 million euros) with an average investment value of 121,000 euros (Spain: 182,197 euros).

#### IV. Capital market

Originally intended for large companies, the capital market started to become more significant for SMEs as an alternative to bank credit. The stock market effort to reach SMEs allows solutions with more flexible characteristics, costs and demands.

In Portugal, the stock exchange is divided into three segments: Euronext, Easynext and Alternext.



Euronext is a well-developed market aimed at larger companies. The other two trading facilities are simpler and better adapted to smaller companies.

**Euronext** is the stock market’s largest group and the one with greatest liquidity in the world. On a daily basis, over 100 billion euros are traded in Euronext, including stocks, bonds, commercial paper and derivatives products. In Europe, Euronext combines the Paris, Amsterdam, Brussels and Portuguese stock markets.

It is the most developed market and it is open to companies, which are better prepared to face its demands and investors. The minimum amount of capital placed is 25% with an initial minimum of 5 million euros.

Companies must ensure transparent management and adherence to government policies. Moreover, they are obliged to regularly provide information to the market related to:

- Audited balance sheets from the preceding three years
- Compliance with international accounting standards
- Information and ongoing projects that may have impact on share value
- Shareholders holding more than 2% of share capital
- Negotiation of share capital by the administration members
- Release of quarterly reports
- Changes in the members of administration

In May 2016, the stock market capitalization of the Euronext Lisbon reached 231.16 billion euros.

The bonds segment has registered a monthly 2.9% growth, reaching 113.26 billion euros, while the share segment has fallen by 2.4% to 114.33 billion euros.

**NYSE Alternext** is the platform created to offer SMEs simpler access to the stock exchange than through Euronext. At the same time, it offers the investors the required financial transparency.

The target of this stock market is companies with sustainable business and seeking alternative sources of funding, either by issuing shares or debt. It is a stock market open to companies with a minimum of three shareholders willing to place 2.5 million euros.

NYSE Alternext can be accessed in two different ways:

- I. Initial public offering (Shareholding participation or issuing and incrementing new stock/capital). The total value of the IPO must be superior to 2.5 million euros.
- II. Private placement, in which the company will have to perform a capital increment, of at least 5 million euros, and it must be placed between 5 or more different investors.

To perform an IPO, the company must choose a listing advisor in order to prepare and advise its entry into the stock exchange.

Moreover, in order to meet investors' expectations related to transparency and financial and economic information, companies are obliged to regularly provide information to the market related to:

- Audited annual balance sheets, with an analysis of business evolution prepared by company managers.
- Non-audited balance sheets every six months
- Every piece of information that may have an impact or influence on share pricing.
- Acquisition of amounts of own capital that exceed certain limits (50% and 95% of own capital)
- Calling of General Meetings
- Dividend Distribution

In 2013, in Europe, there were 180 companies listed in Alternext, with an average stock market capitalization of 35 million euros. In Portugal, there are only two listed companies in Alternext: ISA and Nexponor.

Intelligent Sensing Anywhere (ISA) was the first Portuguese company to enter Alternext in June 2012. It is a Portuguese company established in the centre of Portugal dedicated to providing technological solutions to the energy sector. Its initial IPO was of 1.5 million shares. The operation was concluded with the placement of 520,626 new shares at a value of €5/share, representing a total placement of 2.6 million euros. The total added value to the capital of the company was 7.5 million euros.

Company	ISA
Type of company	Public Limited Company
Business sector	Technology
Revenue	3,200,000
Own capital	1,600,000
Total assets	4,300,000
No. of employees	47

In 2013, the real estate fund Nexponor's IPO took place, raising a total amount of 65.2 million euros, corresponding to 94% of the offering. Specifically, 13,049,240 shares were bought at a value of €5 each.

**Easynext** is the most flexible market segment, targeted at smaller companies. It was created in 1991 and was named Mercado Sem Cotações, before changing its name to Easynext in 2009. It is a multilateral trading facility, including shares, bonds, warrants and certificates.

A total of 2,074 securities from 23 companies were listed. Of those, 12 were shares from the following companies: Conduril, Transinsul, Copam, Sipan, Sopragol, Sonagi, S.C. Braga, Oli Irmão, Fitor, Fenalu, Curia and LithoFormas.

According to the information issued by Euronext Lisbon, in that same year, 663 million euros were traded, representing a 96% increase over the previous year. Of this total, 1.4 million euros was in shares. By the end of 2013, the German Company HQ LifeCorporation was listed in this market.

This segment may represent a first exposure to the stock exchange because the requirements are more flexible than those for Alternext and Euronext. It only requires audited Balance Sheets from the previous two years.

● **Table 7. Some data from the Portuguese companies listed in this market for the year 2015**

Company	Conduril	Oliveira e Irmão	Sonagi SGPS, SA	Copam	Litho Formas
Type of Company	Public Limited Company	Public Limited Company	Public Limited Company	Public Limited Company	Public Limited Company
Business Sector	Construction	Production of plastic material for construction	Construction and real estate	Food Services	Graphic Design
Revenue	197,000,000	46,000,000	10,500,000	30,300,000	6,100,000
Own capital	10,000,000	10,000,000	10,000,000	5,000,000	2,500,000
Total assets	494,000,000	57,600,000	101,400,000	15,300,000	6,400,000
Number of employees	2700	370	26	109	n.a.

Recently, in May 2013, the Euronext group launched Enternext, an initiative aimed at the development and promotion of the stock exchange for SMEs.

It is important to note that any company that wants access to the stock exchange may choose between Euronext and Alternext. However, if its market capitalization is less than 1 billion euros, it will automatically benefit from the advisory services of Enternext. Its mission is to create a close and trusting relationship with listed companies, advising them about the best ways to benefit from the market instruments (shares and bonds), as well as with non-listed companies as a demonstration of the advantages that this alternative funding instrument offers.

It is aimed at companies with a market capitalization of less than 1 billion euros and it includes 750 companies that are listed in the regulated market Euronext and also in the alternative facility Alternext.

Working as an alternative instrument of funding, the stock exchange also allows SMEs to build up capital, either by issuing shares or by issuing bonds (debt), giving them the possibility of reaching a large number of national and international investors.

ADVANTAGES
<ul style="list-style-type: none"> <li>• Capital build up, either by issuing shares (own capital) or by issuing bonds (debt)</li> <li>• Improved internal management</li> <li>• Access to a large number of National and International investors</li> <li>• The investor has a guaranteed return when investing in bonds</li> </ul>

DISADVANTAGES
<ul style="list-style-type: none"> <li>• Administrative fees and costs</li> <li>• Bigger exposure and necessity of transparency</li> <li>• Bigger dispersion of shares with the increment of shareholders</li> </ul>

According to statistical data reported by the Portuguese Stock Market facility in 2014, non-financial companies issued 12 bond loans (in 2013 only 6 were issued). Half of these are non-listed companies, which means an increase in the performance of the capital market.

**Figure 18. Issuing of bonds in 2014**

COMPANIES	DATE OF ISSUE	AMOUNT	TERM	RATE
SEMAPA	17-04-2014	150,000,000	5 years	Eur6M+3,25%
FUTEBOL CLUBE DO PORTO	06-06-2014	20,000,000	3 years	6,75%
JOSÉ DE MELLO SAÚDE	04-08-2014	50,000,000	5 years	Eur6M+3,875%
NOS	01-10-2014	100,000,000	5 years and 6 months	Eur6M+2,5%
MEDIA CAPITAL	14-10-2014	75,000,000	5 years	Eur6M+4%
SONAE CAPITAL	21-10-2014	42,500,000	5 years	Eur6M+4%
<b>EASYNEXT</b>				
CELBI	30-04-2014	80,000,000	5 years	Eur6M+3,65%
BIAL	14-07-2014	50,000,000	5 years	Eur6M+3,875%
AUTO SUECO	14-08-2014	25,000,000	4 years	Eur6M+3%
COLEP	22-10-2014	45,000,000	3 years	Eur6M+2,95%
IMPRESA	13-11-2014	30,000,000	4 years	Eur6M+4%
PESTANA	27-11-2014	65,000,000	6 years	Eur6M+3,5%

SOURCE: CMVM, A BOLSA PORTUGUESA – FACTOS E NÚMEROS, 2014

Whether regarding the Euronext market, or the more flexible Alternext and Easynext, the few companies that made use of this kind of markets were not SMEs.

Even though these sources of alternative funding are not widely used, it is shown that SMEs rely on them, but not on the capital market. As such, we can conclude that the costs involved, the criteria for access or simply the lack of information on how to access these markets are deterring SMEs from using these sources of alternative funding.

