



Funding sustainable economic growth

BNP Paribas Asset Management is launching a sustainable SME funding strategy to boost the economy and help investors escape the low yields offered by high-grade debt and fears of further sell-offs in listed equities.

These are uncertain times for investors. Bond yields are generally low and have been for a decade now, while there are concerns that geopolitical events could send further shocks through listed-equity markets.

Such conditions have sent pension schemes on a quest to find the returns needed to pay their members' benefits. This has brought illiquid sources of income into the spotlight, such as direct lending.

Not only could investors earn an illiquidity premium in the alternative debt markets, but such assets diversify portfolios as returns are often uncorrelated to listed bonds and equities.

This market has opened up as the role of banks in supplying capital to the financial system has diminished. Regulation that resulted from the financial crisis dictates that banks must hold more capital in reserve. This emphasis on stronger balance sheets has meant that some of the traditional avenues for riskier companies to raise capital have all but closed. This, along with technological advancements, has led to new entrants looking to meet demand.

Crowd-funding and FinTech platforms have arrived to finance smaller, micro companies, while banks, private equity firms and hedge funds are working with the larger entities. This has left small and

medium-sized (SME) companies, which generate between £2m and £50m in revenue, have less than 250 employees or have a £50m balance sheet, under-served.

So, institutions and asset managers have stepped in. Indeed, BNP Paribas Asset Management is launching a UK-focused debt fund to finance the many promising innovative and growth-orientated mid-tier businesses looking for capital.

BNP Paribas Asset Management UK SME Debt Fund 1, led by head of SME alternative financing Stéphane Blanchoz, intends to build a portfolio of up to 200 senior, unsecured fixed-rate loans of between £500,000 and £5m each. The aim is to

generate an annual net return for its investors above 6%.

SMALL COMPANIES, BIG IMPACT

There is a world of opportunity for investors who look beyond listed assets. Of all the businesses in the UK, 99%, or 5.5 million, are SMEs, which employ 60% of private sector workers, according to the British Business Bank. So funding such businesses is vital for economic growth.

This is impact investing. The aim is to fund companies that will generate an adequate risk-adjusted return while making a positive impact on the real economy.

BNP Paribas Asset Management's approach to funding mid-tier companies is to support growth by setting fair pricing and applying environmental, social and governance (ESG) principles to its lending decisions.

The asset manager steers clear of a borrower's strategy; instead it allows the client to retain control of their business, a point which it sees as crucial in building trust and ultimately driving a heightened performance.

To help improve the chances of this last point, BNP Paribas Asset Management believes in pricing its loans at a fair rate and not targeting maximum returns. There is no market from which to set a price, so the fund manager has to be the price-maker. It tries to be responsible here. It does, of course, want to be compensated for the risk taken, but charging companies an excessive rate for a loan is detrimental to the future of that business. The idea is to let borrowers re-invest any surplus profit in the future growth of the business.

It is all about responsible lending to help create a stable economy. A return to the days before greed took over, if you like.

This is part of BNP Paribas Asset Management's desire to act responsibly to its stakeholders; an attitude it wants to see in the companies it lends to. This is part of its ESG ethos, which is designed to cut risk on both sides of a deal.

ESG is at the heart of its investment decisions. It is bullish on such principles, such as high standards of transparency and governance, because they can give investors an early warning signal if there is a problem with, for example, a company's finances. The goal is to be a sustainable lender so that a borrower can repay the debt and still have funds to reinvest in the future of the business. If this happens, then BNP Paribas Asset Management UK SME Debt Fund 1 will be making a positive impact on the real economy.

TECH AND TEAM WORK

This is a new market for asset managers and so standardisation and automation of the approval and investment processes are ongoing themes. To this end, BNP Paribas Asset Management has partnered with SME credit specialist Caple, which has an online credit application system.

The asset manager is also working with big data specialists to build an online quantitative approval model to pre-screen loans and speed up the selection process. This is a much needed tool when considering how much data has to be digested before a loan decision is made.

The relationships that BNP Paribas Asset Management has built are creating the systems needed to make providing loans to mid-tier companies economically sustainable and keeping the business viable in the longer term.

With these loans offers by BNP Paribas Asset Management being unsecured, the due diligence focuses on cash-flow. It analyses the chances of a default by looking at the borrower's needs and how robust their finances are. It also puts covenants in the loan agreements, which remind the SME to monitor their cash-flows to make sure they

can repay the debt. They can be regularly tested, by giving a quarterly update on their cash-flow. The idea is to avoid a delay in interest repayments or, worse, a default.

So educating SMEs and having access to information are the two biggest challenges in this market. A deal is not as straightforward as simply signing a loan agreement with a finance director. Companies are used to dealing with bankers, so they are curious about who BNP Paribas Asset Management is and why it is offering to lend them the capital they need. This means that educating SMEs is part of the lending process.

The asset manager needs to understand the financial side of the business, which is not easy as many SMEs do not have a financial strategy. So this is part of the training that it gives an SME before agreeing to lend it any capital.

Access to information has always been challenge, but this is improving thanks to the technology that BNP Paribas Asset Management has employed.

Technology has revolutionised the way that information is collected and analysed thanks to companies putting their information onto digital platforms.

This is how BNP Paribas Asset Management intends to work with its partners. They will do their projection of a client's cash-flows to give it the information needed. This improves efficiency from the credit application stage to disbursement. The goal is to achieve this within five weeks, which is realistic thanks to the infrastructure that the asset manager has built.

If as an investor you are looking for predictable, diversified, stable and long-term cash-flows that could help to make a positive impact on the economy, then an SME debt fund could be a vehicle to consider.



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