INTERVIEW

Financing the real economy

Francesca Fabrizi **meets** Stéphane Blanchoz**, Head of SME Alternative Financing at BNP Paribas Asset Management, to discuss how the firm is targeting an area of the SME space where sustainable funding solutions are currently limited**

Why are more institutional investors looking at the SME market space?

There is a strong need for diversification when dealing with fixed income investments. As we all know yields have been low for some time now, since 2008, and they are staying low. That's the main reason why investors are looking at this space.

Investors today are faced with going to the capital markets to find bonds, but there are a limited number of bonds for a limited number of companies. So, in order to directly finance the economy, investors need to think outside of the box and try to find other ways to access this market.

Why do you feel this area of the market is currently under-served?

It's an interesting story because investors have started diversifying their investments, going into the mid-market type of companies. If you go for private debt funds in general, however, you will end up investing in mid to large companies, usually large LBOs, sponsor-based, and while these may be called SMEs, they are not really SMEs at all. If you think about the financing of the economy it has been largely bank driven for as long as we can remember. Banks have been there and banks do provide financing. There are alternatives to banks for large companies, they can issue bonds, to tap the capital markets for example.

At the other end of the spectrum, very small companies have access to digital type lenders, such as crowd lending platforms. The average ticket size here is fairly small, around €100,000 on average, whereas, for the large private debt funds, nobody would do a ticket below €5 million.

So, there is a gap in relation to the real SMEs. Not the micro-SMEs, not the large companies, but the real SMEs who are struggling to get the financing they need. This part of the market, that we are targeting, is quite sizeable. By financing these SMEs we aim to provide innovative solutions to our investors. This will enable them to diversify their investments as well as benefit from good risk-adjusted returns, all whilst making a positive impact on the real economy. We will be providing financing alongside banks – we are not here to replace them. We are here to complement bank financing by doing something different.

There is a clear opportunity here and I'm often surprised when we start conversations with the SMEs on the origination side, while what we have to say is well received, there is still a lot of education to be done. A lot of training is needed to help them understand who we are as a lender. People are used to bankers whereas we work a bit differently. We act on behalf of investors. We want to look at cash-flows. We don't look that much at the security package because we want to act unsecured.

What role does technology and digital play in the SME market?

There has been a revolution when it comes to accessing information. There are several reasons why people originally went for mid to large companies. One is that you have access to information very easily for large corporates.

The second reason is that, if you analyse a company for, let's say, a €50 million ticket or for €500,000 ticket, it arguably requires the same amount of work. So, you're better off concentrating on large corporates, hence everybody is focusing on the same part of the market. Today, however, with new technology, you can have access to information in a much smoother, seamless way. Companies will input their information on digital platforms. This is how we plan to work with partners; they will do their cash-flow projections and provide the information we need.

So, it can be very efficient to get from the credit application stage to the disbursement – we strive to do this within a five-week period which isn't unrealistic.

Interest is growing, but this is a long-term strategy. You can't change the behaviour of SMEs overnight, as they are used to working with banks.

How are ESG principles relevant?

ESG has been a strong consideration from an investor point of view for some time now, and large corporates know about ESG – they know they have to measure their carbon imprint, for example. If you go down the scale however and talk to SMEs, things are different.

There are three reasons why I believe ESG is really important in this area. One, it can give you early warning signals. For example, if a company has a large turnover, or is filing its accounts late, are these early warning signals? So from a from a credit point of view, it's important.

Also, the simple fact that you ask questions is helpful. We have built a questionnaire for SMEs around their ESG principles – it's a proactive approach, something different, but it matters to us, it matters to our investors. Just by having this proactive approach makes a difference to SMEs. They understand that we care. It's not a marketing strategy.

The last point is that we, as investors, are lending to SMEs on an unsecured basis. There is no market as such, no capital market, no liquidity. We have to be price maker in a way. Our idea is not to say "we're taking a risk, so we want to benefit from the upside of the company, or take an equity kicker". We're not trying to rip the SME off. We're trying to be a responsible lender, act in a sustainable way when it comes to finding the right price that is compensating for the risk we are taking and that is enabling the company to repay the debt in a sustainable way.

So, it's all about cash-flow, it's about trying to scale this analysis and I do believe we are making an impact, we are making a difference. So ESG is not only at the heart of what we're looking at but at the heart of our own strategy.

What are the challenges when investing in an SME?

One challenge which I have mentioned is the access to information. This is getting better because we have tools that enable us to receive information. The second is the educational challenge – a lot of training is needed. Big companies or mid-sized companies are used to talking to investors, are used to having a financing strategy. When you talk to SMEs, they have a business. They don't want to spend too much time on the financing side but we need to understand it.

So, this communication aspect, the training about who we are, what we need to have from the SMEs for us to make a proposal, is challenging. It's something that takes time but it is the right approach because I am convinced that this will make a difference over time.

I'll give you an example. We have chosen to have covenants in our loans – I think it's very good practice. There is no liquidity but it reminds the SMEs they have a debt to be paid back. It's good practice for the SMEs to understand that they have things to monitor, so they can be sure they have enough cash-flow to pay the debt back.

If things go wrong, the simple fact that you ask the company what they are planning to do about this covenant breach makes a lot of difference.

What should institutional investors take away from all of this?

BNP Paribas Asset Management has a strong commitment to bringing differentiating solutions to their investors. We have gone from financing large corporates through European investments to providing the first European SME debt fund, to investing massively into a scalable framework to provide SMEs with proper financing and investors with differentiating solutions.

I'm really optimistic that this will work because of our commitment – this will take time to build. We need to educate people, we need to have access to information but the commitment from our firm to this development is really high. If it hasn't been done before, it's because it requires significant investment and you need to be committed to it and to have a vision which we have.

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