

Mezzanine Financing for SMEs

Mezzanine finance is a hybrid of debt and equity financing typically used to finance the expansion of existing businesses. It thus has features of both debt and equity. Mezzanine debt capital generally refers to that layer of financing between a company's senior debt and equity, filling the gap between the two. The most common form of mezzanine finance is the subordinated loan, which is subordinated in priority of repayment to senior debt, but senior in rank to common stock or equity. Providers of subordinated loans receive a fixed interest rate. Furthermore, mezzanine debt may take the form of convertible subordinated debt (debt that can be converted into equity) and private "mezzanine" securities (debt with warrants or preferred equity).

Mezzanine finance instruments have been gaining importance but remain little used compared to classic loan financing. Mezzanine finance products usually have several positive features for the borrowers as it is treated as equity on the company's balance sheet and thus results in an improved balance sheet structure and better access to additional standard bank financing in addition to the fact that the cost of mezzanine finance is lower than the cost of pure equity. For mezzanine finance providers, the return is higher than that of senior debt. Another important characteristic of mezzanine financing is that it can be structured flexibly in many different forms to provide tailor-made solutions for the specific financing needs of the company in question. To attract mezzanine financing, a company usually must demonstrate a track record in the industry with an established reputation and product, a history of profitability and a viable expansion plan for the business.

The development of the mezzanine market in Europe is mostly limited to the upper-tier SMEs (above €2 million financing needs) while in fact the middle- (less than €2 million financing) and low-tier SMEs (often less than € 250,000) together include the overwhelming majority of SMEs in Europe. So as to target this market gap for mezzanine financing, several initiatives and programs have been launched by financial institutions across Europe. For example in Germany, the KfW Bankengruppe, as a promotional institution, has already started this downsizing of investment amount limits through the "Capital for Work and Investment" scheme offering less than €2 million subordinated loans to established SMEs that have been operating for more than 5 years. Likewise, the NRW Bank has been recently developing a standardized mezzanine program for financing the SMEs' requirements of less than € 2 million in the German State of North Rhine-Westphalia.

In a broader range, the European Association of Mutual Guarantee Schemes (AECM) has reacted swiftly to the SMEs long-term financing needs through mezzanine products supplied by

the AECM member organizations as stand-alone mezzanine products, stand-alone guarantee products or both in combination with another, all featuring different characteristics:

Institution	Aws (Austria)	CMRZB (Czech)	KredEx (Estonia)	Oséo (France)	MGB & German Guarantee Banks
Product Type	Guarantee	Stand-alone product	Stand-alone product	Stand-alone guarantee or in combination with a mezzanine product	Mezzanine product with guarantee element
Type of mezzanine finance	Subordinated loans	Subordinated loans	Subordinated loans, silent partnership	Subordinated loans	Subordinated loans, silent partnership
Mezzanine Investment range	€ 0 – € 2.5 million	€ 0 - € 750,000	€ 64,000 - € 1,023,000	€ 40,000 - € 3 million	€ 50,000 - € 2.5 million
Guarantee Coverage rate	80% Max, 70% Avg.	—	—	80% Max, 70% Avg.	
Duration of mezzanine investment	3 – 10 years	Up to 9 years	3 to 10 years	7 years	7 – 10 years
Rights of mezzanine investor	No decisions rights, information and reporting rights	No decisions rights, information and reporting rights	No decisions rights, info. and reporting rights, convertibility option in case of difficulties	No decisions rights, information and reporting rights	Very limited decision rights, information and reporting rights.
Mezzanine Conditions	—	Annual flat interest rate: 3% Grace period of 3 years	Processing fee: 1% Annual variable interest rate: 9-18% Grace period: 3-7 years	Annual interest rate: 2.66% - 6.06% Grace period of 2 years	Processing fee of 1% Annual interest rate according to risk: 7 – 11%
Guarantee fees	Guarantee Processing fee: 0.5% Annual guarantee fee: 0.6% - 5%	—	—	Variable according to risk: 0.27% - 2.14%	—

- *Aws - Austria wirtschaftsservice*: a promotional institution that is publically owned and provides a guarantee instrument for mezzanine investments called “quasi equity guarantee” for investments both by individual private investors or banks.
- *CMRZB – Czech Moravian Guarantee & Development Bank*: provides a mezzanine loan product called PROGRESS.
- *KredEx – Credit & Export Guarantee Fund*: a publicly owned fund providing a mezzanine instrument using subordinated loans.
- *Oséo*: a publicly owned development agency offering a wide range of mezzanine finance.
- *MGB & German Guarantee Banks*: The Mittelstandische Beteiligungsgesellschaften (MGB), participation companies for SMEs, provide a mezzanine product for SMEs, which is in turn guaranteed by the German Guarantee Banks.

Done by: Rafiq T. Nasrallah