



# Small and Medium Enterprises

## Jumpstarting the jobs engine in Luxembourg and Europe

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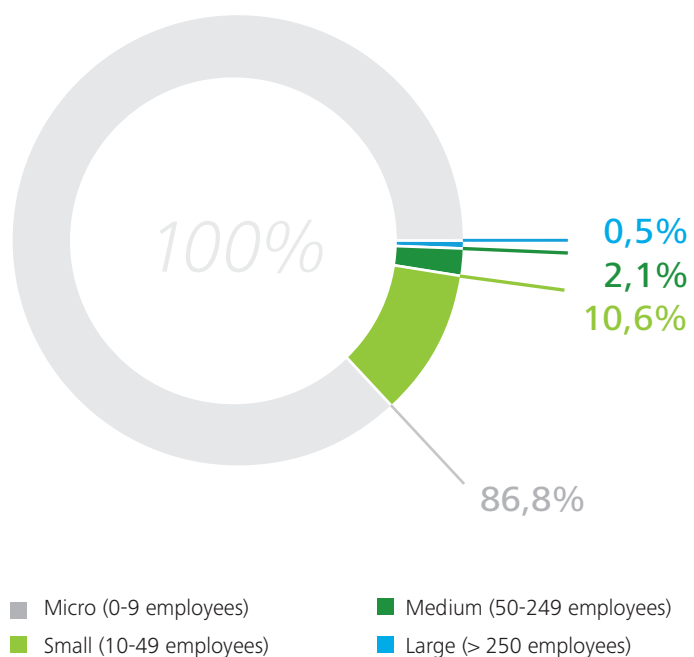
## Small and Medium Enterprises (SMEs) are a large and increasingly significant economic and employment contributor in Luxembourg and Europe.

In Europe, SMEs are an essential part of the economy and account for the vast majority of businesses in the EU. SMEs also represent a key pillar of the economy in Luxembourg, with over 99 percent of companies classified as SMEs, with less than 250 employees (Figure 1).

However, SMEs are not only relevant in terms of number of companies they are also a key economic driver in terms of GDP, value added, and employment. In fact, according to the Small Business Act (SBA) assessment of Luxembourg in 2013, the majority of private employment and value added in the country is generated by SMEs, accounting for 67 percent of employment generated in the private sector and 68 percent of the value added.

These contributions are higher in Luxembourg than in Europe as a whole and underline the particular importance of SMEs in Luxembourg.

Figure 1: Distribution of companies by size in Luxembourg



Source: Eurostat

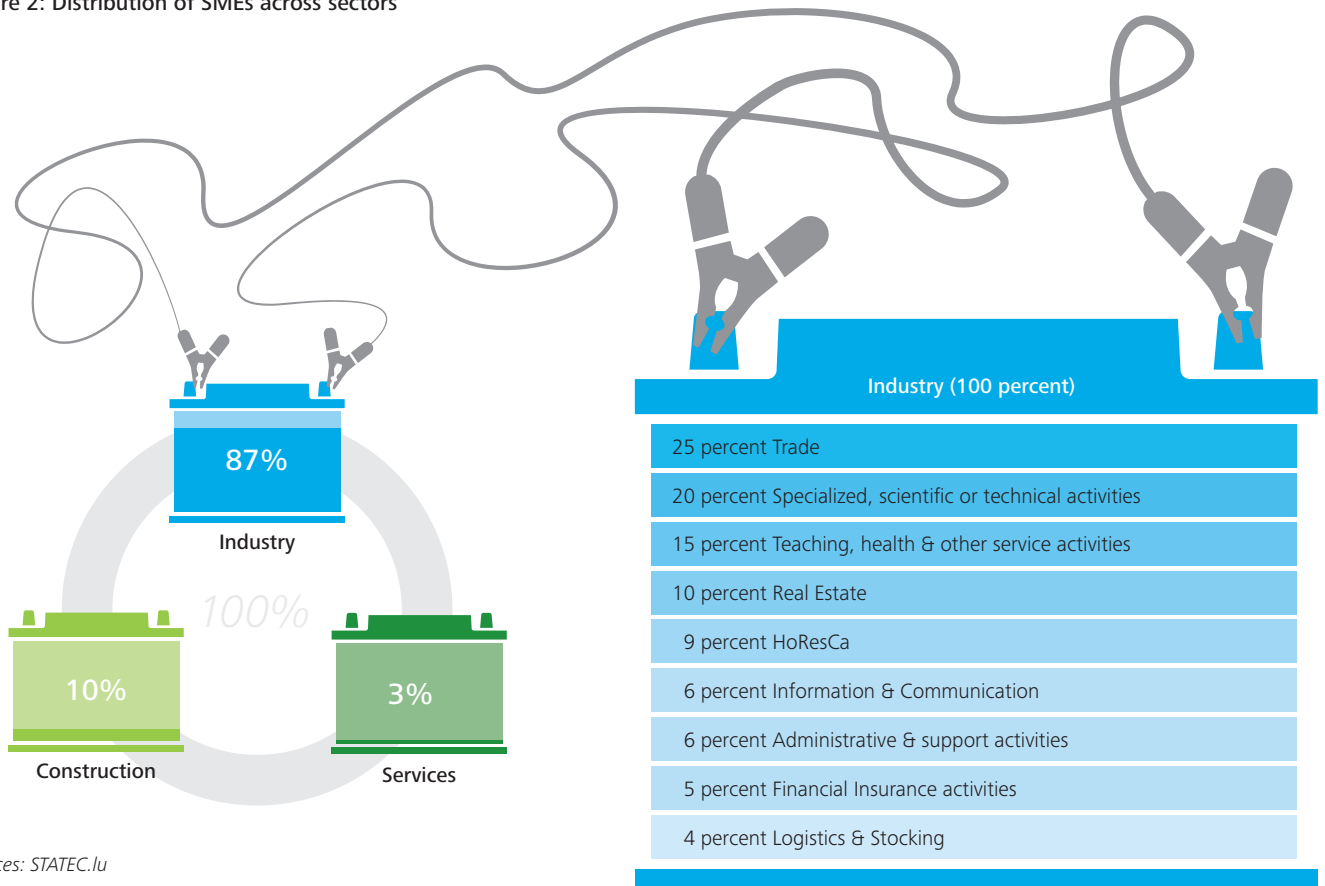
In terms of employment, according to the OECD, SMEs were responsible for 85 percent of new jobs created in Europe between 2002 and 2010. The smallest SMEs (known as micro-enterprises, with fewer than 9 employees) accounted for over half of such job creation in Luxembourg and Europe. This makes SMEs—and particularly micro enterprises—an essential instrument in addressing unemployment challenges.

Furthermore, recent trends suggest that the relative contribution of SMEs is likely to continue to increase. In fact, the value added generated by SMEs increased by approximately 4 percent between 2008 and 2013, while the value added generated by larger companies decreased by 8 percent during the same period. Forecasts made by the European Commission indicate that the value added generated by SMEs will increase in the years to come.

**Luxembourg’s SMEs span a variety of sectors and can play a key role in economic diversification**

The Luxembourg SME landscape includes industry-focused, construction, and tertiary sector activities. The majority (87 percent) of SMEs are active in the tertiary sector, spanning a variety of sub-sectors from trade, scientific and technical activities, teaching, health and other services, real estate, and catering and hospitality. This broad distribution underlines the role that SMEs can play in diversifying the Luxembourg economy and reducing dependence on the financial sector, a key priority of the government, and one of the recommendations formulated by the OECD in its 2015 Economic Survey. The presence of SMEs in innovative and technological sectors also underlines their key role in creating new sources of prosperity for the country in these growing sub-sectors.

Figure 2: Distribution of SMEs across sectors



Sources: STATEC.lu

**Access to financing is one of the key strategic considerations for SMEs and can be a major obstacle to their development**

In the current economic environment, SMEs face a number of challenges on a day-to-day basis, such as finding clients and developing their business, managing costs, recruiting and retaining employees, and complying with regulation. Alongside these daily challenges, the issue of accessing financing stands out as one of the major issues faced by companies in Luxembourg and Europe.

Due to their small size and relatively lower degree of financial sophistication, SMEs tend to have limited access to funding from capital markets and instead rely on bank loans to finance their investments. In recent years, access to bank loans has become more difficult for SMEs and, in addition, lending rates have become less favorable.

One of the factors that have aggravated the difficulty of accessing financing for SMEs is the financial crisis. Destabilized by systemic losses, many European financial institutions have reduced their exposure to riskier parts of their portfolios, which often include loans to SMEs. In addition, new regulation aimed at increasing bank stability have increased running costs and capital requirements for lenders, creating further pressure on risky assets.

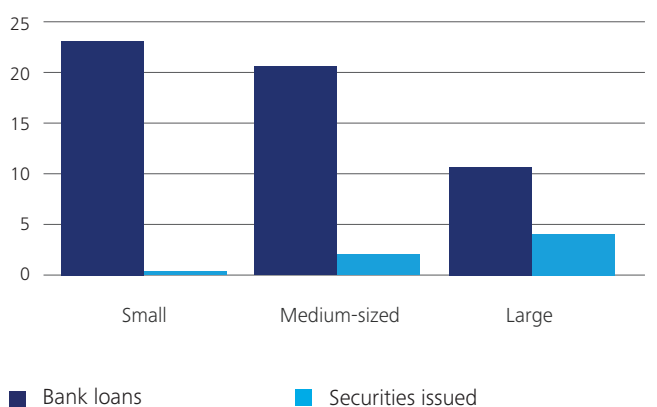
Systemic monetary measures from the ECB and other European institutions have so far not had a significant impact on reversing this trend in favor of easier lending for SMEs. Furthermore, the high lending rates faced by SMEs can be attributed to banks' funding costs, which continue to be high despite accommodative monetary programs.

**Figure 3: Most pressing problems for SMEs in the euro area (% , 2013-H2)**



Sources: SAFE, Deutsche Bank Research

**Figure 4: Limited market funding for SMEs (% of balance sheet)**



Countries covered are Austria, Belgium, France, Germany, Italy, Portugal, Spain and the Netherlands. Securities issued include bonds and other securities issued.

Sources: BACH, Deutsche Bank Research



Access to financing is also a major issue in Luxembourg, though the country's SMEs fare somewhat better than in other countries, in part due to the country's financial solidity in comparison with Southern European peers for instance. According to the recent Small Business Act (SBA) assessment, Luxembourg outperforms the EU-28 average on several dimensions.

In particular, the low relative costs for smaller loans (less than €1 million) compared with larger loans ratio is notable and is lower in Luxembourg vs the European average. In spite of this, Luxembourg SMEs still face significant issues in obtaining financing through banks. The typical issues for local SMEs include bank requirements for loan guarantees and collateral, and the cost of bank loans.

Given these hurdles and the strategic importance of SMEs for the economy, it remains crucial for Luxembourg to address the issue of financing as a means to promoting SME development.



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**The Luxembourg government has developed a number of financing tools and aids available to SMEs**

Upon analysis, the Luxembourg financing toolbox appears to be quite rich. However, we note that awareness of the policies available today may not be sufficient among the companies that need them.

Figure 5: Financing tools and aids available to SMEs

	Seed	Start-up	Early growth	Sustained growth	Equity	Loan	Aids
Luxembourg	<b>SNCI</b>					⚡	
	• Equipment loans					⚡	
	• Start-up Loans					⚡	
	• Direct loan for R&D and Innovation					⚡	
	• Loan for Innovative enterprises					⚡	
	• Financing of foreign investments					⚡	
	• Equity loans					⚡	
	<b>CD-PME (Subsidiary of SNCI)</b>				⚡	⚡	
	• Participation				⚡		
	• Subscription to convertible bonds					⚡	
	<b>Luxembourg Future Fund</b>				⚡		
	• Co-investment fund				⚡		
• Business angels & Family offices fund				⚡			
• Risk capital				⚡			
<b>Government aids</b>						⚡	
• Aid to creation/takeover of company for job-seeker						⚡	
• Investment aid for craft or commercial SMEs						⚡	
• Investment aid for SMEs in the industrial or services sector						⚡	
• Aid for first time company creation or takeover						⚡	
• Export aids for promotion, shows and training						⚡	
• Aid for consultancy services for craft or commercial SMEs						⚡	
• Aid for first participation at a trade fair/exhibition						⚡	
• Aid for food safety measures						⚡	
• Environmental aid for craft and commercial businesses						⚡	
• Financial assistance for R&D projects and innovation initiatives						⚡	
<b>Tax incentives</b>						⚡	
• Tax deductability of intellectual property						⚡	
• Tax deductability of interest						⚡	
Europe	<b>Guarantee Schemes</b>					⚡	
	• InnovFin					⚡	
	• FEIS (Juncker Plan)					⚡	
	<b>Horizon 2020</b>						⚡
	• SME Instrument						⚡
	• Calls for proposals linked to R&D and Innovation						⚡
	<b>COSME</b>				⚡	⚡	
	• Investments in private venture capital funds				⚡		
	• Business angels & Family offices fund					⚡	
	<b>LIFE</b>				⚡	⚡	
• Natural Capital Financing Facility				⚡	⚡		
• Private Finance for Energy Efficiency				⚡			

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## A number of private initiatives complement public initiatives to facilitate access to financing

The cost, the application criteria and the procedures surrounding these financing tools may be too narrow or complex to be used to their full potential. We also note, perhaps as a result thereof, that aids available in Luxembourg tend to benefit larger, more established companies, and be less easily accessible for smaller SMEs.

Figure 5 summarizes the public policies that have been put in place by the Luxembourg government or by European institutions in Luxembourg so far by type and across different stages of company development.

The *Société Nationale de Crédit et d'Investissement* (SNCI) provides SMEs in Luxembourg with targeted loans covering the numerous financing needs of an SME throughout its lifecycle, from the start-up phase to the sustainable growth phase. Through its subsidiary CD-PME, the SNCI can subscribe convertible bonds and it can also provide equity to SMEs during the early and sustained growth phases, either through its subsidiary CD-PME or through its participations in financial intermediaries.

The Luxembourg Future Fund (LFF), launched in April 2015, is a significant enhancement of public policy regarding the provision of equity to SMEs in Luxembourg. The SNCI and the EIF will co-invest €150 million<sup>1</sup>, in innovative high-tech European companies throughout the different stages of their growth using the LFF.

InnovFin guarantees and the FEIS (also called the Juncker Plan) address the issue of a lack in collateral and guarantees, by providing guarantees and counter guarantees to selected financial intermediaries in order to allow them to give loans to SMEs. In Luxembourg, this has translated into €110 million in additional loans for SMEs at ING bank and BIL.

Lastly, a number of European programs can provide equity or loans to SMEs. In the context of the Competitiveness of Enterprises and Small and Medium Enterprises (COSME), the European Commission provides €4 billion to private venture capital funds to encourage investment in SMEs.

Other programs, such as LIFE (Financial Instrument for the Environment) provide equity for SMEs active in certain target segments (e.g., renewable energy). Public policy to improve access to equity and debt financing is complemented by a number of financial aids targeted at SMEs. The Luxembourg government provides a range of specific aid targeted at SMEs (e.g., aid to support innovation or exports). In the context of Horizon 2020, SMEs can further benefit from aid such as the SME instrument, which provides financial support for start-ups and growing SMEs.

Besides purely financial help, SMEs also receive non-financial support. Particularly, assistance regarding the writing of business plans and finding of financing has recently been supported by public initiatives. The most prominent example is that of Luxinnovation, which represents a point of contact for SMEs, providing advice on possible sources of funding, business plan writing, or on the promotion of new technologies. 123gosocial follows a similar concept, providing coaching to social entrepreneurs.

SMEs will receive further assistance through “business-check.lu”—an online self-assessment tool for SMEs of the Ministry of the Economy—which was launched in July 2015. While the aforementioned examples lay their focus on innovation and start-ups, this tool will be of particular benefit to established companies.

Luxembourg is also home to a number of public incubators. The "Technoport" and the "House of BioHealth", "neobuild", "nyuko", and "ecostart" are incubators benefitting from public sources of funding, intended to encourage start-ups in technology and BioHealth.

A number of private initiatives complement public initiatives to facilitate access to financing. Private initiatives provide both financing as well as non-financial help to SMEs in Luxembourg.

Besides financing from banks, a number of private initiatives offering seed and venture capital for start-ups exist. A notable example is the Luxembourg Business Angel Network (LBAN). For more mature SMEs, a number of private equity funds provide funding.

In addition to financial help, private initiatives and public-private partnerships also provide non-financial support. Examples include "123-go" or "seed 4 start", which help start-ups to write business plans, to meet potential investors, and to connect with other entrepreneurs. Furthermore, a number of private incubators and accelerators, such as "the Greenhouse" or "luxfuturelab", combine financial and non-financial support.

**Moving forward by looking at best practices abroad: increased transparency and new alternative financing sources such as crowdfunding and securitization should be considered**

While already developed, we believe Luxembourg's SME financing can and should continue to draw inspiration from best practices observed in other countries. Firstly, we suggest that the existing funding options could be communicated more broadly to improve awareness among target recipients. Conditions of access to these tools could also be simplified to facilitate application procedures and generally make the available measures more accessible to even the smallest companies.

For example, both France and Germany have set up umbrella organizations consolidating their various existing programs. In Germany, KfW Group is the leading institution providing long-term investment and working capital loans to SMEs. France, similarly, created the "Banque Publique d'Investissement" in December 2012 - following the example of KfW - combining the activities of Oséo, CDC (*Caisse des dépôts et consignations*) Entreprises, FSI (*Fonds stratégique d'investissement*) and *Fonds Stratégique d'Investissement Régions*.

Secondly, we suggest that a number of alternative financing mechanisms could be introduced in Luxembourg, not only with the government playing a sponsorship role but also with potentially increased private sector participation.





For example, possible alternative initiatives for consideration in Luxembourg include the following:

- *The Q-Credit program in the Netherlands*: a public-private partnership that provides small bank loans to micro-enterprises, under a guarantee provided by the EIF
- *The Arkimedes program in Belgium*: a program structured around fiscal incentives to mobilize private capital in favor of local SMEs
- *The FTPYME program in Spain*: an SME loan securitization scheme, with loan securities issued and guaranteed in part by the Spanish government

Best Practice	Q-credits - Providing microcredit
Country	Netherlands
Description	<ul style="list-style-type: none"> <li>• Public-private partnership offers financing and coaching to micro-SMEs</li> <li>• Funding from the Dutch Ministries</li> <li>• Guarantees from the EIF provides for over €20 million of loans</li> <li>• Loans are provided by private partners, such as Rabobank, ING or ABN Amro</li> </ul>
Result	5,000 loans amounting to €16,288 on average between 2008 and 2013
Implication for Luxembourg	The Dutch case study shows that a government-backed micro-credit scheme in partnership with private actors can significantly increase available loans for micro-enterprises and companies in the seed phase

Best Practice	Arkimedes - Crowdfunding
Country	Belgium
Description	<ul style="list-style-type: none"> <li>• Public initiative launched in 2005</li> <li>• Fiscal incentives to mobilize private capital of individuals to match private venture capital (doubling VC with limited costs for the government)</li> <li>• Specialized in fund of fund investments in PE and VC funds. The fund invests less than €15 million (US\$18.77 million) per transaction</li> </ul>
Result	<ul style="list-style-type: none"> <li>• Following the success of the first ARKImedes-Fonds nv fund launched in 2005 with €111.1 million under management, a second fund was launched in 2010 with €100 million under management</li> <li>• 22 funds have been financed under this program since its implementation</li> </ul>
Implication for Luxembourg	The implementation of this initiative has allowed the number of start-ups financed by the selected funds to be significantly increased

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## In the context of Horizon 2020, SMEs can further benefit from aid such as the SME instrument, which provides financial support for start-ups and growing SMEs

<b>Best Practice</b>	<b>Asset Securitization Fund for SMEs (FTPYME)</b>
<b>Country</b>	Spain
<b>Description</b>	<ul style="list-style-type: none"><li>• Government guarantees on securitization funds</li><li>• The Spanish government guarantees 80 percent of issued securities rated AA or Aa (or higher) through the Public Treasury</li></ul>
<b>Result</b>	<ul style="list-style-type: none"><li>• €50,640.4 million have been issued making it possible to reinvest more than €40,512.3 million in new loans for SMEs since 2010</li><li>• The total state backing used for these issues came to €15,495.2 million</li></ul>
<b>Implication for Luxembourg</b>	This guarantee program provided liquidity to private banks, which in turn significantly increased their outstanding loans

Considering Luxembourg's strengths as an international financial center, new initiatives in the field of securitization, for example, could be considered. This avenue may be a way for Luxembourg to build on its strengths and develop new innovative securitization schemes, leveraging local fund expertise, building on the presence of many international banks as potential issuers, and potentially tapping into the private wealth managed by Luxembourg private banks and ripe for innovative investment. In parallel, a review of the legal securitization framework and the possibility of issuing government guarantees in relation with SME loan securities could also be explored.

### Conclusion

SMEs are a large and increasingly important economic and employment contributor in Luxembourg and Europe as a whole. Access to financing is critical for these companies and a lack thereof can be an obstacle to their development, as well as a hindrance to job creation and economic growth. To support SME financing, Luxembourg should build on its current toolbox and ensure broader awareness and adoption of existing measures, as well as explore new alternative financing tools that could benefit local SMEs and help diversify the Luxembourg economy. For this, the private sector, financial institutions and others (i.e., industrial groups, private investors) should be more actively engaged in SME financing support.