Europe needs more equity capital to generate economic growth, reveals AFME’s report *Bridging the growth gap*

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A shortage of risk capital and under-developed capital markets are holding back growth in Europe, according to a new study comparing financing for business in Europe with the US.

The report by the Association for Financial Markets in Europe (AFME), "*Bridging the growth gap: Investor views on European and US capital markets and how they drive investment and economic growth*", co-written with The Boston Consulting Group (BCG), shows that Europe has a significantly smaller pool of investable assets than the similar sized US economy. But the real problem is the fragmented nature of European markets and the lack of equity finance.

The AFME report draws on a survey of global investors holding around €9tn assets under management and provides a unique, in-depth analysis of how capital markets in Europe and the US compare, and how these differences may have contributed to the wide disparity in growth rates since the financial crisis.

**Key findings on Europe's capital markets compared to the US**

- Survey participants identified **three factors that are holding back investments**: 65% cited **market fragmentation**, i.e. lack of information and understanding of differences across markets, 60% cited **discrepancies in rules** and 40% cited the **macro outlook**.

- **Europe has a smaller pot of funding** with approximately €30tn available for investment compared with €49tn in the US even though GDP is roughly similar at €17tn each.

- **Europe has significantly less listed equity capital**, with €10tn invested in listed equities compared to €19tn in the US.

- **Europe delivers a larger pot of financing to SMEs** than the US, with approximately €2.0tn in outstanding stock compared to €1.2tn in the US. **However, the majority of EU financing is bank lending** (€1.4tn vs €0.5tn).

- **Sources of equity funding for SMEs are underdeveloped in Europe**. By comparison, small SMEs, start-ups and entrepreneurs in the US benefit from more diverse financing sources which provide a significantly larger proportion of funding than in Europe:
  - US private equity and venture capital funds had €488bn to invest in 2013 vs only €245bn in Europe
  - In the US 33% of SME financing is provided by private persons’ wealth vs 9% in Europe

- **Europe’s savings market structures are less geared to equity investing**. The US retirement system, which is largely funded by savings, provides €14.9tn in investible assets, compared to €4.3tn in Europe.

- **Allocation of investments toward equities is also lower in Europe** than in the US, with only 37% of funds managed by pension funds and fund managers invested in equities, compared to 53% in the US.

- **In Europe the private sector is providing more infrastructure financing than governments** (€260tn vs €159tn in 2013), compared to the US (€115tn vs €182tn), but there is still an overall infrastructure funding gap. To solve this, surveyed investors believe **government support should be channelled towards greenfield and brownfield projects that would not be viable without it**.
Simon Lewis, Chief Executive of AFME, said: “Under-sized capital markets are limiting growth in Europe, but more important is the lack of risk capital. This is a particular problem for SMEs, where the lack of equity is preventing the development of the entrepreneurial ecosystems that nurture growth sectors such as technology, communications and energy.”

Clare Francis, Head of Global Corporate Banking at Lloyds Bank, said: “Market fragmentation and the different rules and regulations across Europe are holding back the flow of investment capital. We have actively listened to end user needs and acted upon policy-maker concerns about growth.

“The report estimates there is €1.2tn of SME financing in the US compared to €2tn across Europe. Despite this higher overall European funding level for SMEs in Europe there is a lack of European alternative financing opportunities and a different risk culture. Europe has a smaller pool of funding available for investment than the US even though its economy is a similar size. It’s only by understanding and articulating these differences that we can work with the European authorities to achieve growth and shape and develop the detailed proposals needed for Capital Markets Union.”

Philippe Morel, Global Leader of Capital Markets at The Boston Consulting Group, said: “There are two particularly interesting dynamics at play which became clear during our conversations with institutional investors. The fragmentation in Europe is off-putting: working with 28 individual countries is burdensome in comparison to investment in the United States where one legal and regulatory system applies. Secondly, there is a strong sense amongst the investor community that there is less of an appetite for risk in Europe, and as such, alternatives to bank lending are not as readily available for SMEs in Europe when compared to the US.”

Key actions

- **Reduce capital markets fragmentation.** This is the main reason preventing investments in Europe, according to the interviewees. This should be addressed by the implementation of specific Capital Markets Union targets for equity capitalisation as well as the percentage of funding provided by capital markets instruments.

- **Help promote a responsible equity risk culture** for all types of equity raising by increasing SME supply and demand for equity – important for the development of entrepreneurship, start-ups and growth expansion.

- **Facilitate private investment in long-term infrastructure projects** by reducing political and regulatory risk and disincentives, and focus government support on projects that would not be viable without it.

- **Raise the profile and use of Private Placements for loans and bonds**, a well-established market in the US.

Industry initiatives

AFME will in the next few weeks publish two practical guides for SMEs and participants in infrastructure financings to actively promote broader understanding of financial markets for borrowers, investors, and other stakeholders by:

- Improving the chances of SMEs across Europe to achieve success with loan applications and bond and equity issues.

- Helping infrastructure issuers more easily tap various types of funding, including bank, private placement and public project bond financing, and support the European Fund for Strategic Investments (EFSI) Juncker plan. This guide is co-produced with the International Capital Market Association, ICMA.

To support the development of a Pan-European Private Placement (PEPP) market, AFME supported a guide which was released on 11 February by the PEPP Working Group, a cross-industry group led by ICMA. The PEPP Market Guide is available [here](https://www.afme.eu).

**Bridging the growth gap** is available [here](https://www.afme.eu).

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About the Association for Financial Markets in Europe
AFME promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website, www.afme.eu
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