CMU and SMEs – structural power and the EU

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Abstract

For many the link between Capital Market Union and SME finance is a cynical ploy to sell financial markets to the citizens of the EU. In this paper we explore the relationship between the SME finance and European integration to illustrate a central structural relationship in the EU. Since the late 1960s significant volumes of capital controlled by the European institutions has been directed to SMEs through financial institutions. While this supported credit supply in peripheral economies it has also demonstrated the close relationship between financial institutions and the EU. In this context the CMU agenda describes a long-standing relationship between finance and enterprise that now supersedes the capital labour relationships traditionally associated with European capitalisms. In this context CMUs focus on SME securitization, and its reintroduction of subprime, private placements, and the unfair advantage this offers large investors, and the predatory private equity industry that dominates venture capitalism is a terrifying insight into the future of capitalism in Europe.

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Introduction

Capital Market Union (CMU) is a central policy platform for the Junker Commission. By deepening capital market integration it is proposed that the financial system will deliver cheaper funding to businesses through a more resilient financial system. As well as fixing the financial system, CMU will help realise Junker's ambitious 2014 strategy to fight economic recession by mobilising €315 billion of investment in the EU economy in three years within the heightened fiscal discipline of post crisis EMU. The political message is that the EU can make financial markets work for the citizens of the EU, by stimulating jobs and facilitating growth even in the precarious sectors of the EU economy. ECB surveys of SME finance needs collected between 2009-2014 have shown that while finance is the fifth most pressing issue faced, it is far more pressing in some economies ("access to finance most pressing issue": Greece 45% and Cyprus 32%) than others (EU28 13%) (ECB 2015: 144). For some, CMU has dedicated measures to assist SMEs access finance in peripheral economies to confirm that better working markets can deliver capital to marginalised economic groups. For others, including Commissioner Lord Hill responsible for CMU, the SME link was a narrative to help sell CMU (Quaglia 2016).

CMU promotes three key channels to improve the supply of finance to SMEs. The first of these is the promotion of SME asset backed securities (SME ABS) in debt markets. EU banks hold far higher amounts of SME debt than their US counterparts because they are less inclined to sell on the securitized SME debt to bond markets (Kaya 2014). This leaves them less able to comply with Basel III obligations and with less credit to pass on to SMEs. However securitization remains unpopular as a technique because it remains associated with the subprime mortgage crisis and SME ABS have remained unattractive since then. The second and third channels promote equity investment in the form of private placements and venture capital. Private placements allow companies to sell shares to a smaller group of interested investors without disclosing commercially the sensitive information required in a normal public offering. Popular in the USA, this initiative builds on attempts to establish a single EU prospectus for companies so that they can sell shares across national borders. Finally CMU also aims to promote venture capital (VC) supply across the EU. Risk capital is central to the EU2020 strategy of smart growth and a range of initiatives have been designed to increase the supply of funds to innovators (eg "Risk Sharing Finance Facility"). VC has however been dominated geographically by the UK and by the private equity industry indicating, for CMU policy makers, a market failure in need of correction.

In this paper we describe the history of EU agendas on SME finance to show how they have benefitted financial interests. In doing so the paper aims to show that rather than reflecting short term opportunism, the links between CMU and SME finance are another stage in the assertion of the structural power of finance in the EU. The link between SMEs and financial interests contributed initially to the shift in the EU from labour to financial rights (Peters 2011) but today they underline the asymmetry between popular and financial capitalism and between states with more or less developed financial systems.

The paper argues in the following way. First we identify the contemporary tensions between the EU institutions and SME representatives on the benefit of CMU to SMEs. Next we elaborate how EU SME finance contributed to the redefinition of labour since the relaunch of Europe in the 1980s. Beginning with the earliest subsidies to facilitate bank lending to SMEs in the 1970s we can see the extension of financial interests into new areas of activity from the 1990s onwards was supported through links to SME finance. The next sections demonstrate how CMU has extended financial capital influence in the EU in its proposals on securitization, private placements and venture capital. The conclusion reflects on the significance of these finding for CMU and the EU.

SME finance and Capital Market Union

The credit crunch that followed the 2008 financial crisis was seen to hit SMEs badly as "bank lending decisions inevitably became more selective, on the grounds of both banks' own balance sheet constraints and the rising default probabilities of borrowers." (CEU 2015:13). Certainly the withdrawal of paper money after the collapse of Lehman's led to considerable policy attention on SME credit access (BIS 2012; BoE 2013)[1]. More recent attention has focused on the additional cost that SMEs in peripheral economies paid for credit in comparison to those in core economies (ECB 2014).

While the idea of CMU has its origins in ECB chief Draghi, President Junker twice linked CMU to SME finance in his presentation of the 2014 Commission agenda to the EP (Junker 2014). The financial crisis and its effect on employment in the EU, the austerity packages delivered by the Troika on peripheral economies and the migration that has accompanied these events has put additional strain on the already taught relationship between the institutions of the EU and an increasingly Eurosceptic public. This Commission President, the first to enjoy the support of the European Parliament (EP) through its new *Spitzenkandidaten* process, was mandated to reassert the role of the Commission against the member states and to connect directly with the people (Dinan 2015). The EP has long been an advocate for supporting SMEs and the responsible Commissioner Lord Hill for CMU made a commitment to helping SMEs in his presentation of Commission's Green Paper on CMU:

> "Stronger capital markets would complement banks as a source of financing, and would: unlock more investment for all companies, especially SMEs, and for infrastructure projects; attract more investment into the EU from the rest of the world; and make the financial system more stable by opening up a wider range of funding sources." (CEU 2015a: 2)

In Commissioner Hill's words, the choice for CMU reflects the decision to "identify the barriers that are stopping capital from flowing and work out how to knock them down one by one" (CEU 2015 c). CMU therefore rejected the idea of an institutionally mediated "European" model of

[1] Subsequent literature on the impact of the crisis on SME access to finance has been far more nuanced by company size, demand, gender and innovativeness also influencing decisions(eg Cowling 2012, Lee et al 2015; Kremp 2011)

capitalism for one pursued through a free market. For SME finance this objective was framed through selective reference to the US market as a problem of information asymmetry.

> "The Commission will take forward measures to remove the barriers which stand between investors' money and investment opportunities, and overcome the obstacles which prevent businesses from reaching investors. The system for channelling those funds will be made as efficient as possible, both nationally and across borders." (CEU 2015 b:4)

The Commission linking of CMU to SMEs enjoyed wholehearted support from the official institutions of the EU. The CMU Action Plan was approved by the Council (Council 2015), received a confident majority of 80% in the EP and over 700 supportive comments to its February 2015 consultation (Votewatch 2015; CEU 2015 b). Leaders of the Party of European Socialists (PES) were supportive of the agenda including "the development of venture capital" while seeing CMU as a way of regulating shadow banking (PES 2015).

But behind the institutional conformity (and possible confusion) there were dissenting voices. Green MEP Matt Carthy observed in a letter to Commissioner Hill that:

> "The CMU goes against the lessons learned from the crisis by promoting the banking model that proved the most fragile and the financing channels that generated 'domino' effects" (Carthy 2015)

The lack of trust for securitization was evident in depressed demand for SME debt assets despite consistent attempts to raise their profile (Kraemer-Eis et al 2015). ETUC's Paris Manifesto is explicitly "opposed to financial-market-driven capitalism" (ETUC 2015) while Finance Watch argued that there were no guarantees that CMU would deliver employment (Finance Watch 2015). Perhaps most notably the constituencies that should have benefitted most from the CMU SME link appeared ambivalent. The European Savings and Retail Banking Group (ESBG), Federation of European Accountants (FEE) and European Association of Craft, Small and Medium-sized Enterprises (UEAPME) agreed a Common Position that observed:

> "Very few European SMEs are the high-tech start-ups and fast growing companies that will be attractive to capital market investors. 'Regular' SMEs cannot and will not get the financing they need from capital markets, whereas they are the backbone of the European economy" (ESBG et al 2015)

At a time when so much of the EU's regulatory activity has been focused on regulating financial markets and when key decisions about the management of the UK and national economies are being seen as unaccountable (eg Rittberger 2014), the link between CMU and SME finance presents an opportunity to explore the relationship between the EU as a political system and the

popular capitalism of the SME. But first we need to understand the context of SME policy and why and how the EU has in the past intervened to address SME finance.

SME FINANCE AND THE POLITICAL ECONOMY OF THE EU

The EU developed policies to explicitly support SMEs in the early 1980s, from when the SME has become a central constituent in the EU's policy making processes (Dannreuther 1999, 2006). But EEC policies started supporting SMEs through financial instruments from the late 1960s accompanying regional policy investments by the European Investment Bank (Pinder 1986). While SME policy and research had focused on national economies there had also …

> "… been international action to promote SME development through the provision of financial services. The prime mover internationally has been the Luxembourg-based European Investment bank (EIB)" (Pinder 1986: 171)

This pattern of supporting SMEs long preceded the more ideologically inspired 1980s with the free market agenda of the 1986 Single European Act, and Mitterand's 1983 "*tournant de la rigueur*" that marked the limits of state led reflation in Europe. The 1980s is often remembered as the decade in which ideologically driven market based reforms were ushered in by the EU (Majone 1996; Rhodes 1995). But at the same time the EIB was intervening quite significantly in some countries by offering subsidies to banks unable to borrow from international financial markets at viable rates (Pinder 1986). Rather than the EU pursuing a laissez faire liberalism of Adam Smith, the EU would be better interpreted as supporting member states in their pursuit of social morals and norms that embrace entrepreneurialism and self-reliance (Bonefeld 2015).

The need to balance the EEC's books limited the use of borrowing and lending operations but this was allowed in the pursuit of a specific Council objective (Moller 1981). One such was the "Ortoli facility" a form of global loan that used the EIB's credit rating in international currency markets to provide cheaper money to allowed small banks to borrow on the EIB's credit rating. These global loans increased from 10.8% of the EIBs total lending to 56% between 1969 and 1984 (Pinder 1986: 173). Developing as they did before Parliamentary scrutiny and I accordance to Treaty mandates, these activities were described as "extra-national" (Pinder 1979). The legacy of the technocratic origins of SME policy remains to this day as SMEs are still defined in relation to state aids derogations under EU competition policy. These definitions are designed to ensure that support for SMEs have no detrimental impact on the single market (Bennett 1983). They do not refer to any intrinsic characteristics or need of an SME.

So while the 1980s was a decade remembered for privatisation, the retreat of the state and the triumph of laissez faire, the EIB provided an EU sponsored mechanism to subsidise credit to the SME sector through banks and other financial intermediaries. Ideological battles, underpinned by the bipolarity of the Cold War, were expressed over the future of Europe as Thatcher's Bruges speech

advocated liberty over Delors Social Europe. Yet while the rhetoric of free trade and liberty fought against organised workers' interests protected under the Social Charter, the EIB intervened to promote European integration as self-employment through bank subsidies.

These overtly political attempts to reinstate the SME were matched by management literature that critiqued the post war reputation of the petit bourgeoisie as a dangerous and easily radicalised political constituency. Weiss argued that…

> "…the 'danger thesis' is so pervasive in the literature that it can be considered as part of the conventional wisdom" (Weiss 1986: 373, footnote 1)

and illustrated it with the following quote:

> "a good part of this self-employed lower-middle class is economically and socially 'reactionary' and, consequently, politically discontented. Hostile to the 'financial feudality', fearful of falling into a proletarian condition, they feel that neither liberalism nor socialism defends their interests. Incapable of understanding their own political Malthusianism, they find a scapegoat in the political system, the 'impotent parties and parliamentary system" (Dogan 1967 cited in Weiss 1986: 362)

An industry of SME research emerged from the 1980s onwards emphasising the SME as an employment creator (Birch 1979), as at the heart of a second industrial divide (Piore & Sabel 1986), as the motor of a new form of competition (Best). All challenged the idea that the petit bourgeoisie were less a source of danger than prosperity. While SMEs were officially recognised in the European Parliament's "European Year of the SME" in 1983, it was the introduction of the concept of competitiveness in the Commission's 1993 White paper on Competitiveness Growth and Employment that gave SMEs economic as well as political relevance. In highlighting the role of SMEs in innovation and employment generation, the White Paper placed SMEs at the heart of the EU's new strategic place in the post Cold War global world as an innovative economy capable of delivering participation and innovation to its new citizens. But most instructive of the White Paper was its identification of support for SMEs as focusing on the development of reforms that would benefit the retention of profits, transfer of ownership, access of investors to equity and investor protection of the SME. In stark contrast to traditional industrial policy objectives, in the White Paper promoting SMEs justified these radical reforms:

> "In some countries it will be necessary to adapt their tax systems, rights of succession and access to equity and to simplify intercompany credit regulations and practices" (CEC 1993:14).

As globalisation was seen to erode the capacity of states to deliver credible industrial policies, new schemes like the European Seed Capital Fund Scheme were established to support the supply of venture capital investment in new technology based firms (Murray 1998; Aernout 1999; Bottazzi & Da Rin 2003). The European Investment Fund, an offshoot of the EIB, was also established in 1994, issuing its first debt securities in 1996 and first venture capital operation in 1997 (EIF 2016). The dot.com technology bubble soon burst, but the commitment to EU SME policy remained and was aggressively promoted across a wide range of policy initiatives. While trade unions understood the constraints that EMU placed upon them they were too weak to oppose it and instead settled for the commitments to social justice embodied in the 1997 European Employment Strategy (Hermann & Hofbauer 2007). Yet the EES prioritised new firm formation and economic rights over social rights (Dannreuther 2006, 2016). The 2000 Lisbon Agenda and the SME Action Plan and SME Act again placed the SME at the heart of the EU's economic policy, just as the EU 2020 does today. With Eurozone member states subject to tight monetary restraints, and non-Eurozone countries complying with Broad Macro economic policy guidelines, self-employment policies offered cheap and versatile responses to social inequality.

As SMEs became more important so their access to finance also became a key policy concern. Much of this debate was influenced by Stiglitz & Weiss' (1981) presentation of credit rationing as a problem of asymmetric information and moral hazard. Specifically it asked: how could banks know if the project was any good or if the small business owner would not divert the loan to a different use? Larger banks were seen to invest in larger more transparent companies, while smaller banks were understood to develop deeper relationships with small firms to better understand the risks they are making (Berger & Black 2011; Berger & Udell 2002)[2]. It was the banks that made decentralised relation based decisions that were protected through the global loans in the 1990s and 2000s.

Less discussed were the implications of other policy agendas on the SME bank relationship. Yet European banks had to comply with regulatory (like Basel I-III) or political agendas (like EMU) that in turn influenced the banking system (Beck 2013). Under EMU the single market in financial services stimulated economies of scale and scope across the banking sector (Altunbas & Molyneux 1996; Cavallo, S & P.S. Rossi 2001). As a consequence banks shifted away from traditional lending and towards more lucrative transaction fee based incomes (Hartmann et al 2003) and foreign direct investment in Central and East European economies. These structural changes influenced the lending practices of banks to SMEs (Molyneux & Forbes 1995; Berger et al 2007) as foreign owned banks withdrew credit to SMEs in post crisis CEEC. Technological changes, and specifically the introduction of new credit scoring technologies, also gave a competitive advantage to larger banks which influenced their lending patterns (Berger & Frame 2007), a pattern also experienced in accession countries (Degryse et al 2012).

The consequence of framing the debate on SME finance through a perspective based on information asymmetries is that it again does not recognise any real characteristics or needs of the firm. The focus is instead on the contract and how it is "designed to induce the borrower to take actions which are in the interest of the bank" (Stiglitz & Weiss 1981:394). In a recent contribution to

[2] The debate on SME finance and banking structure is beyond the scope of this article.

an EUI analysis of the New Financial Architecture in the Eurozone, Pierre Schammo laments that the "'SME' is an umbrella term which lacks a single definition" (Schammo 2015). Not only is there "no single definition of SMEs" but the definition used for the Prospectus Directive differs to the one used under MiFID II which is in turn different to the one used by the World Bank and a range of others. Schammo concludes that "the range of businesses that are treated as 'SME' tends to be very broad. These businesses might often have little in common" (Schammo 2015:150-151).

This ambiguity is precisely the point of SME policy. Since its introduction into the lexicon of EU policy the "SME" has been a term defined and operationalised in relation to banking and financial interests. The petit bourgeoisie, once understood as reactionary and dangerous political constituency, was supported through subsidised banking, redefined in abstraction in relation to state aids and placed at the heart of the EU's new knowledge based political economy. A large critical literature now exists on the SME as a social construction (Jones& Spicer 2005; Ogbor 2000; Hyrsky 1999) and its use in political debates at the global, EU and local levels (Perren & Jennings 2004; Dannreuther& Perren 2013, WES 2015). This affects the credibility of SME policy:

> "The variability of definition of the term 'entrepreneur' leaves its meaning vulnerable to capture …, especially in relation to the intellectual … and political … priorities of the discussants." (Dannreuther 2007:379)

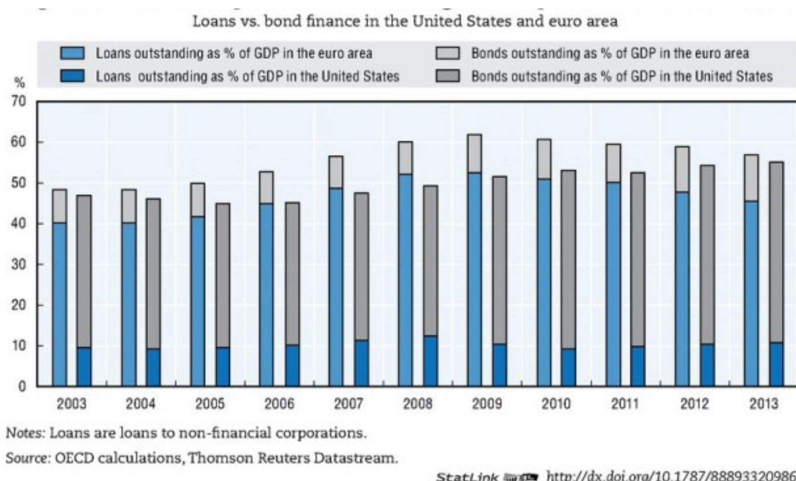
While SME research is inclined to be vulnerable to neo liberal assumptions (Parry 2015) the main danger is that the SME is an ill-defined concept, an "empty vessel" onto which policy elites can ascribe their interests to renegotiate the relationship state and society. Claims that SMEs deliver X employment, or generate X% GDP are therefore, in any Popperian sense, unfalsifiable. The following section demonstrates how the SME has been used to promote transaction fees through securitization, reduce transparency in investment decisions through private placements and further extend the influence of private equity through venture capital promotion. Each of these measures has been made in the name of improving SME finance while weakening the position of the smaller business in relation to investors.

Bank Capitalisation and SME securitization

> **"**STS (simple, transparent and standardized securitization). Nothing says "simple" like an acronym for a hitherto dangerous financial instrument …" (Heath 2015)

European SMEs are up to ten times more likely to rely on bank finance than their US counterparts [table 1].

Table 1: Banks vs Captial Market Financing Page (OECD 2015:160)



These smaller banks were thought to be better able to develop relationships with SMEs and to gather "soft information" that would compensate for the poor credit scores of SMEs (Berger & Udell 2004, 2002). The crisis revealed that many smaller banks in the periphery were less effective at making bad loans good than those in core economies (ECB 2014). In practice bank size was not of itself important in the delivery of finance to SMEs. Both large and small banks could benefit from using quantitative credit scoring and more qualitative relational banking techniques and the range of services offered by the bank could also beneficially affect lending putting larger banks in a stronger position (Fredriksson & Moro 2014).

Easing the flow of finance to SMEs through bank capitalisation was therefore not a simple issue. Indeed it was not clear that it finance was the most pressing issue for SMEs as many saw the lack of demand and finding customers as a far more important problem for them. Indeed the most recent ECB SAFE survey indicated that access to finance was the least important issue of five (SAFE 2015 :6). Since the crisis the demand for loans has decreased and recent reports even indicate improvements in SME access to finance.

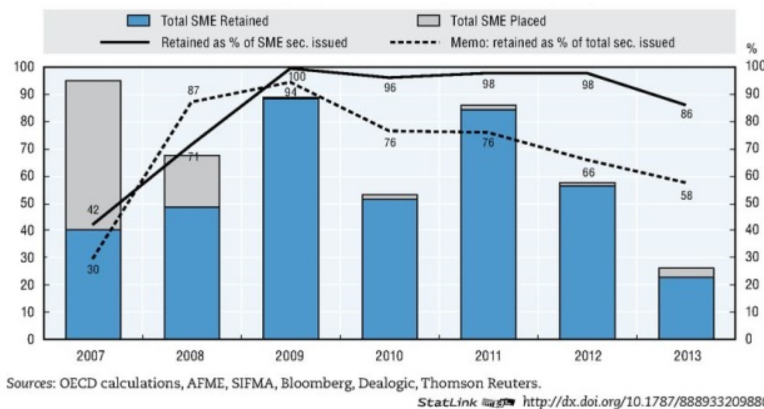
Yet under CMU SME finance remains a priority and the solution has been to promote the securitization of SME debt. A recent EIF working paper states:

> "A compelling case can be made for public assistance to enhance access to finance for SMEs (market failure based on information asymmetries, high transaction costs, and spill-overs – exacerbated by the recent credit crunch in many economies associated with the financial crisis), and for supporting the European SMESec market." (Kraemer-Eis et al 2015:4)

The aim of SME debt securitisation is to allow banks to lend more while complying with Basel III, increase competition between banks and to kick start the EU's economy using private rather than public investment. But rather than introducing greater safeguards to protect against these practices, often seen as the source of subprime crisis, the goal of stimulating SME ABS markets led the ECB to relax safeguards further. Specifically it has lowered SME ABS minimum rating requirements (in Dec 2011, June 2012, July 2013) lowered credit rating from 2xAAA to 2xAA in its Loan Level Data Transparency Initiative for ABS, reduced ABS (including SME ABS) "haircuts" (2xAA from 16% to 10, 2xBBB from 26 to 24%) and so allowed banks to borrow, and so lend on, more for the same collateral.

International regulators complained of poor transparency in fee structure, "incentive misalignment" and inadequate attention to risk origination (BIS 2011, Burne & Kuriloff 2015). The rules set out under the Commission's Securitization Regulation for STS ("simple, transparent and standardised") regime are clearer and intended to enable SMEs to issue their own asset backed securities, lower the cost of doing so and enable banks free up lending by offloading SME debt onto markets (CEU 2015d: 11-12). But the market for SME ABS was never vibrant before the crash, has failed to pick up and remains suppressed. Large numbers of SME ABS have been retained by banks rather than sold on [see table 2].

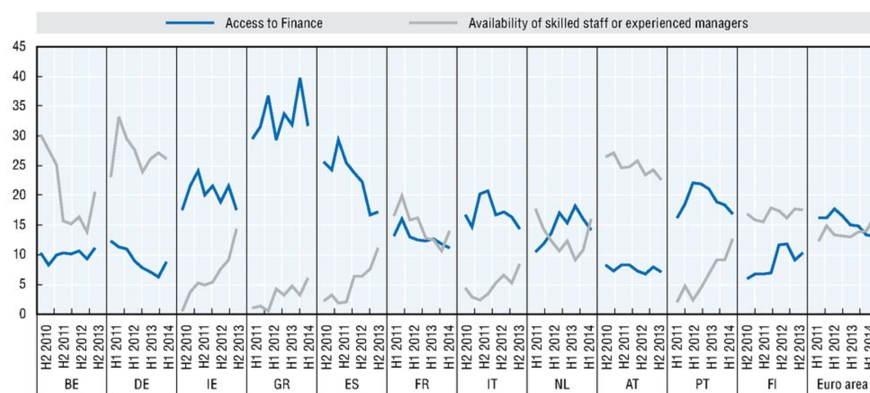
Table 2 : "Placed vs retained SME securitisation issuance in Europe in USD billion (l.h.s) and retained in percent of total (r.h.s.)" (OECD 2015: 163)



Sources: OECD calculations, AFME, SIFMA, Bloomberg, Dealogic, Thomson Reuters.
StatLink http://dx.doi.org/10.1787/888933209880

So although it was argued that CMU would increase liquidity of smaller European banks it does not seem that this has either happened or, given the better availability of credit to SMEs, even been that necessary [see table 3].

Table 3: "The Most Pressing problems faced by Euro area SMEs across euro area countries: percentage of respondents" (OECD 2015:159)



Notes:.Base: all SMEs. Figures refer to rounds four (October 2010-March 2011) to 11 (April-September 2014) of the survey.
Source: ECB, Survey on the access to finance of enterprises (November 2014).
StatLink http://dx.doi.org/10.1787/888933209855

Greater transparency may just reveal that poor performing banks were performing badly, reinforcing their high borrowing costs, especially as it has become clear that smaller banks originating the assets were not capable of turning around bad performing debts. Indeed feedback from the securitization industry has implied that the size of these transactions were not large enough to generate attractive fee income under existing regulatory regimes (Dietzsch, S & C.Terré 2015).

The demand for a securitization agenda has been far more clearly seen from sustained AFME lobbying and the Commission. Although SME ABS have been present since the 1990s it was Spain, Portugal and Germany, notably the KFW, which were most enthusiastic issuers of SME ABS in the pre-crisis period. AFME, the lobby group for financial markets in the EU, have a number of large bank members which prevail in the securitization industry. Their data and arguments are present throughout the Commission literature and thy have been effective at engaging and generating support from other EU institutions.

So while securitization may have the potential to increase lending to SMEs or give them cheaper alternatives to raising external debt, the lack of interest seems to be structural rather than cyclical. SME debt is expensive to monitor whether by a local bank manager or in assessing the risk of an SME ABS issued by an SME or inefficient bank. The main beneficiaries of the securitization market are those involved in the transactions and in the associated fees. These banks are disproportionately reflected on the board of AFME. All that has happened since the late 1960s is that the policies to support SME finance have moved away from providing subsidised credit to regional banks through global loans towards promoting greater transactions to benefit the larger banks capable of delivering SME ABS transactions. In both cases the chief beneficiaries have been banks.

Private placements and transparency

The previous section referred to the SME finance relation as a credit relation mediated through intermediary institutions. In this credit relation banks are protected as investors through their ability to enforce repayment through the courts or securing collateral from small firms and their assets. Eventually banks are also protected by lenders of last resorts such as central banks. In the next section we explore how CMU affects the raising of funds through the sale of equity either as a security in private placements or as ownership through a venture capital investment. Private Placements (PP) describes the issuing of debt directly to a limited number of usually institutional investors. They have become more popular since the financial crisis as investors seek diversification and long term returns (Campbell 2015). A private placement is different to a public placement, like an IPO (initial public offering), because although ownership of the company is still exchanged for investment, the opportunity to buy SME equity is restricted to a small group of individuals. PPs therefore avoid the expense and delay of complying with stock market regulations by placing more of the risk on the shoulders of the "accredited" or "sophisticated" investors.

The definitional criteria for a SME in the EU relate to quantifiable traits of the firm (turnover/balance sheet, employees, independence). But it is the legal form of the organisation that determines its relationship with investors. While limited liability protects the owner of the company from its creditors, the partitioning of assets protects the investor (Hansmaan & Kraakman 2005). The ways in which these assets are partitioned varies between the member states of the EU but are dominated by three traditions: the German GHMBH, the French SARL and the British private company (Drury 2005). It is precisely these differences that present some of the challenges for a CMU.

The USA currently has considerable advantage over the EU and national private placements markets as it has been an enduring feature of that economy since the 1933 Securities Act required that the issuance of all securities were registered. As this made the cost of issuing securities too expensive a special exemption was granted in subsequent legislation for private placements. Jurisprudence interpreted that this exemption would be granted only if those being offered the bonds did not need the normal investor protection provided by the Act. In the US these "accredited investors" are defined quantitatively as individuals with annual income exceeding $200,000 and a net worth in excess of $1 million (Sjostrom 2014).

Germany has a similar older practice of issuing certificates of indebtedness ("*Schuldschein*") that are easily transferrable by assignation rather than through property law like securities (Koller 2014). While these also allow middle sized companies to secure investment from institutional investors, these are not securities secured against assets but promises to pay. The *Schuldschein* market is unsurprisingly dominated by national investors and becoming less as attractive as German SMEs seek international investors. An estimated 126 private placements were invested in medium sized companies, making up around 20% of the total of private placements in Germany (Scope 2014:1). As investors have moved away from SME ABS in Germany mid-sized companies have increasingly looked to PPs to refinance making up an increased amount of the *Schuldshein* market (Scope 2014).

According to the 2012 Breedon report, UK issuers account for 1/5th of total PP issuances but these were predominantly directed to companies in the USA. A lack of ratings and requirements for pensions to invest against market indices, plus the cost of issuing in the UK has meant that the PP market was poorly developed in the UK (Breedon 2012). France has not had a tradition for private placements. However much of the work to promote a European wide PP market has been due to the leadership of French finance sector supported by the *Banque de France* and *Tresor* Although small the European Private placement market is now dominated by French investors and transactions (Dealogic 2015).

The US law firm Clifford Chance suggested that PP was the singular most important element of CMU for SME capital access because "in reality, early-stage capital-raising in the U.S. has been dominated by a single choice – the Private Placement Exemption." (Clifford Chance 2015:3). PPs offer a regulatory response to the long term investment needs of SMEs: in 2014, 85% of US PPs matured in 10 years (EY 2015:4). But this is a far more prevalent practice in the USA than the EU. 36% of investor transactions in 2014 were in EUROS (EY 2015:3) as European companies were "desperate to find alternatives to increasingly constrained, traditional bank lending at home" (Allan Overy 2013:28). Private placements have been seen as particularly important given the poor performance of SME ABS as an avenue for SME financing (Bryant & Vasagar 2015). The PP market is therefore already a global capital market with SMEs defined by French, German and English law already competing for investment against US companies.

Under CMU proposals the Commission has consulted on potential changes to the EU 2003 Prospectus Directive which allowed member states to set the terms of investor protection. The focus is on simplification of "the hundreds of pages of detailed information" often required in prospectuses while offering appropriate levels of investor protection (CEU 2015c). Unlike PPs in the US, European PPs do not need to obtain a credit score so have tended to be more attractive for the refinancing of company debt as it reaches maturity and shows a track record.

As well as stimulating the volume of finance access by SMEs through a Euro PP market, CMU also seeks to promote innovative methods of financing SMEs through the Prospectus Directive. Crowdsourcing has attracted significant interest in both academic practitioner and policy circles (PWC, FCA, CEU). While limiting the exposure of individual investor, crowdsourcing also embraces the "wisdom of the crowd" as an effective way of monitoring risks, potentially negating the need for intermediaries. In the USA the 2012 the JOBS (Jumpstarting Our Business Startups) Act added a new section to the Securities Act allowing crowd funding organisations like kick starter and institutional investors to benefit from PPEPs. These allow accredited investors would operate under looser regulatory controls than (known as "Big Boys"). The regulation of crowdsourcing is an important but contested policy issue. It has been argued that this introduces significant risk to individual investors and pushes crowd sourced funds towards "lemons" as institutional investors are better placed to pick up the best opportunities (Carpentier & Suret 2010). In the UK the FCA has placed clear qualitative guidance on who can be part of the crowd in crowd sourcing. This includes professional clients who are, for example, classified as corporate finance or venture capital contacts, certified as "sophisticated" or "high net worth", or "confirm that they will not invest more than 10% of their net investible assets in these products" (FCA 2014:7). Another proposal quotes Adam Smith to argue for greater regulatory freedoms, education and research (De Buysere et al 2012).

Interest in private placements is rising with over 300 delegates from 16 countries attending a conference on private placements in Europe in 2014. In part this is related to the institutional reforms that the CEC wants to see in the Prospect Directive. But the form of the debate has been closely structured around the US example rather than any EU member state. National models are likely to be too entrenched to adapt to more transparent prospectus as it is the interpretation of these risks that is also key. Thus the UK focus on the US market is indicative of a long standing City orientation away from investment in the SME sector. The December 2014 budget provided a significant boost to private placements in the UK by allowing an exemption to withholding taxes for private placements in the UK. Subsequently 6 pension funds and insurers released £9bn of investment. But rather than supporting SMEs this government sponsored investment was in the main committed to government infrastructure projects (Lokhandwala, T. 2014).

Attempts by the French financial markets to steal the agenda are unlikely to succeed because the key issue is less about creating a market dominated by national guidelines and more about communicating to investors that their investments will be safe. These different traditions are encapsulated in the legal variations of disclosure in the member states. But they also relate to the power relations in domestic financial markets. Thus the French state leads in support of their finance industry reflecting a long tradition of dirigisme. In the UK the FCA regulates access to crowd funding investments to a wealthy and well informed elite, thereby sustaining the revenue potential for financial services. The US offers fare more open opportunities to small investors but at the cost of competing with specialist heavily resourced institutional investors.

Venture Capital and Private Equity

Venture capital involves ceding control in exchange for investment and expertise. This is usually for a limited period in a firms growth so the venture capitalist can realise their return by selling their shares to a small caps market (like NASDAQ or AIM). Policies to promote venture capitalism are normally justified as providing high risk investments in new high technology companies seeking early stage investment while their technology has yet to prove its market (eg EIB 2001; Botazzi & Rin 2002). Again the US model is frequently referred to and the rationale for policy intervention made in terms of market failure, information asymmetry and competitiveness.

Policy however has tended to take the form of significant state involvement in the sector. Governments backed VC schemes were often unsuccessful as they distorted the market and the bureaucrats who ran them lacked the relevant skills. Most policy now takes a capital participation approach in either appointing venture capitalists to make the investments or investing directly into privately managed funds (Mason 2009). Other supply side initiatives have promoted informal VC through Business Angel Networks at national and EU levels. The EIB's European Investment Fund (EIF) works frequently with the EVCA (European Venture Capital Association) to develop schemes. The European Angels Fund (EAF) "provides significant financial support while granting a maximum amount of freedom to each Business Angel" (EIF 2015).

The market is heavily concentrated in the UK with 48% of new funds raised in 2014 and France with 16% (EVCA 2015)[3]. The obstacles to a broader EU market in VC are significant. In addition to finding investors, few SMEs are investment ready (Mason & Harrison) necessitating significant education and training for time starved entrepreneurs. VCs need mid cap markets, like EASDAQ, AIM and NASDAQ, to exit from their investment through an IPO or private sale. Finally securities regulations, like the Prospectus Directive, designed to protect "widows and orphans" impede the visibility of investment opportunities through a one size fits all prospectus (Mason 2009, EVCA 2015).

Government support for the VC industry in the UK has been shown to help companies in initial stages of their growth (Nightingale et al 2008). But the availability of data is limited making conclusions about the impact of political interventions costly and difficult to do (Mason 2009). When evaluations have been made of the performance of high growth new technology companies they have been found to be less like gazelles and more like muppets "marginal, undersized, poor performance enterprises" (Nightingale & Coad 2014).

Despite these problems, the VC sector benefits from significant state support. In the UK alone over £1.3billion was distributed to VC investors through tax breaks in venture capital trusts between 1995-2012 despite a lack of policy success in promoting high technology firms (Brown & Mawson 2015). Yet while the VC industry boomed in the UK, venture capital was regionally specific (Mason & Harison 2002) and studies that purported to find a link between employment growth and VC investment around Europe (Achleitner, Ann-Kristin and Kloeckner, Oliver, 2005) were funded by the EVCA. A credible recent study of government sponsored VC investments recently concluded that they "have no impact on invention and innovation" (Bertoni & Tykvova 2015:925). Indeed in 2014, £31.7m and the vast proportion (76%) of venture capital investment remained in management buy outs (EVCA 2015).

The most significant development in VC was less the new technology that it brought to market and more the growth of the Private Equity (PE) industry. PE is based on buying failing companies to restructure and sell on for profit. It is not a new practice (Toms et al 2015), but todays availability of debt allows PE investors to borrow multiples of their own assets in order to buy and restructure companies (Robertson 2009). It can also help explain the concentration of financial power in Europe since 2000 as 40% of PE deals were in Europe between 2000-2007 (Robertson 2009:550). PE used for buyouts is far more concentrated in its distribution of capital than VC. In 2014 59% (3380) of the number of companies invested in the EU by private equity were invested in by venture capitalists but for only 9% (€3.8m) of the total amount invested. For PE buyouts the numbers are 17% and 76% (€31.7m) (EVCA 2015).

Unlike VC, whose rationale at least is to take investment to the high risk economically peripheral innovation stage of the accumulation process, PE is relentlessly concentrated and

[3] Sweden holds 7% then Germany and Norway at 4% (ibid)

centralising in both its allocation of capital and distribution of wealth. PE buyouts typically occur in only three EU countries (UK, Fr, DE). Two out of every five investment in 2014 were made by a family or private firm, an increase from one in three the previous year (CMBOR 2015:7). While affected dramatically by the recession – European buy-out value dropped from €172.7 billion in 2007 to €20.5 billion in 2009– PE is increasing again and taking on more debt than ever (CMBOR 2015:5).

Support for PE is based on the assumption that it delivers the high growth associated with its pre-crash (1990-2007) era. It is argued that reorganising the relationship between finance and capital also benefits the general public good (Davis et al 2014; Paglia & Harjoto 2014). But the fact that private equity specifically rejects the public good is in the name – it exists for the private benefit of the investors (Morel & Clark 2010). The "take private" business model is based on agency based theories that assumes that the interests of company managers are at odds with those of the owners (Folkman et al 2007). Obligations to the rest of society – such as paying tax (Fleischer 2008) or employment (Bacon et al 2008, Boselie & Koene 2010, Rodrigues & Child 2010) or even their performance in relation to the rest of the economy (Phalippou & Gottschalg 2009) – are lost at the conceptual starting line of PE. Small wonder that the consequence of private equity is a pernicious and all encompassing focus on securing value for a small elite minority. As Froud and Willams observe:

> "The extraction of value is pure financial engineering because the operating business acquires liabilities in the form of debt equal to the sum of cash taken out. But the cash goes into the hands of elite private equity providers and fund managers, while the liabilities are passed on with the business" (Froud & Williams 2007: 415)

Conclusion - CMU and the extension of financial capitalism

There is nothing liberal in CMU. The Commission has long been understood to work with interested elites to cultivate integration by easing economic transactions. Distributing credit to the "SME backbone of the EU economy" by removing the impediments to capital market transactions across the EU conforms with a neo-functionalist analysis of European integration. AFME, a classic lobbying group following the power to Brussels crops up regularly in CEU documentation. It delivers advice on how to promote PPEP markets in the EU, UK and France, coordinates surveys on obstacles to growth in the EU Capital Markets and promotes ideas on SME ABS that feature in the EIB literature. But these are unequal not equal markets that are being created and appear more influenced by practices and interests in the US than European interests.

It could be argued that CMU is the reflection of the domestic interests of a small number of very powerful states. Certainly the UK and France appear regularly in relation to the risk capital agendas of private equity, private placements and venture capital. Germany also has an interest in the ABS markets, although in its own form. But again the story has far too much to do with US style investment protection regimes, ABS markets and VC traditions than that of any individual member

state. The UK has a weak PPEP market that is orientated to the USA, Germany has no real VC market share and PE is limited to buy outs in only three countries.

Finally the framing of CMU against a background of austerity could be argued to reveal how hegemonic neo liberal ideas have influenced the selection of choices in the EU. Rather than failing after the crisis period, these arguments have become stronger, with PE investors increasing their debt levels and a strong consensus across all the key political institutions of the EU. But while the agenda at the political level has remained unchanged in ways conducive to CMU, the social context is dramatically different. The EU has been suffering from a "constraining dissensus" for some decades (Hooghe & Marks 2009). The ideas of the CMU have not been sustained through the performance of liberal market orthodoxy, but through the naked exercise of power.

At first glance CMU presents a sensible solution to the desperate and apparently impracticable problem of delivering credit to SMEs in crisis ridden economies. The solutions seem the best that can be expected and in line with orthodox EU activity and theories. Yet the opaque definition of the SME has been instrumental in allowing financial capital to replace the wage labour relation with one of debtors and creditors. The policy resources designed to assist SMEs have been used to centralise economic control, polarise wealth, erode regulatory control and eradicate regulation and accountability. CMU make a play for all parts of European society on financial capital's terms, with little regard for the effect it will have on the rest of the European economy or the hostility that this might engender for the EU. It has little to do with SMEs and everything to do with power.

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