



Universidad
Zaragoza

Trabajo Fin de Grado

Alternative ways of financing SMEs
Formas alternativas de financiación de las PYMES

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Curso 2019-2020



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Abstract

This paper includes the outcomes of the work around issues related to the alternative methods to finance SMEs. Given the difficulty of obtaining finance for SMEs, this work outlines different alternatives of getting money from investors, not only from banks - traditional ways of financing, as it was mainly in the past, before FinTech revolution.

The purpose of this dissertation is to understand why SMEs, but mainly start-ups, are looking for alternative financing options when starting and expanding their businesses. The final objective is to understand which are the main success factors for the increase in new ways of financing SMEs.

The very beginning of this work deals with a definition of alternative financing and SMEs. Then there is an outline of Alternative financing ecosystem in Europe where the reader can find an information about the volume of alternative funding and Alternative finance market allocation in Europe. Since start-ups are a significant part of SMEs, the paper holds more information values about Start-ups alternative financing, i.e. start-up accelerators. From the point of view of the investors, success factors of these companies are the next point which can help reader to understand measurable parts of business and their importance when looking for additional finances in an alternative way. Then the work deals with success factors of alternative financing itself. In order to highlight the reasons for the increase in popularity of new ways of financing for start-ups and SMEs, two case studies are analysed.

To sum up all the information briefly, this dissertation helps people to understand not only what are the success for the increase in new ways of financing for SMEs, but also the way the alternative financing works and how does the evolution of this market of new financing means looks like.

1. Introduction

1.1. Interest in the subject

In the present difficult times, SMEs have many problems due to the future economic crisis, if it has not started yet. Due to the present Covid-19 global pandemic, all of the Small and Medium Size enterprises want some financial liquidity to be able to survive in their respective markets. Through these complications, a concern for the several means to finance is emerging.

Financing SMEs is, nowadays, one of the most challenging subjects, because of the existing problems regarding it. These problems affected especially people with low wages or young people who could not find a job despite having a good resume. But now many vulnerable groups have appeared, like those who are related to in the sector of hospitality and catering or tourism (the most affected by ERTE¹ in our country), as well as many companies in danger of closure. The current fact does not mean that these problems didn't exist before/ previously, but the current situation is just a mere reflection of the policies carried out in the last few years, triggered by a dreadful global pandemic.

In any case, it is necessary to go deeper into the subject, not relying solely on our judgement. We can not only assess the situation of SMEs regarding financing, but also to design solutions for them, so they can positively affect our current situation.

There has to be other ways of getting liquidity, otherwise these new companies will not thrive well. And if a sector of large corporations and banks are not able to help SMEs, there must be a diversification of portfolio which can do so. And at this point is where alternative financing become important, since it is a type or financing that operates independently from the bank, as well as with different consequences.

1.2. Methodology

In order to address the issue, it will be introduced the importance of SMEs for Europe and our country, as well as the problem of the banking sector in terms of financing. Later, an analysis of the volume of alternative financing will be made, making use of the data provided by University of Cambridge. It should be noted that this University has a department of

¹ An ERTE is a Spanish legal concept that implies the suspension of the work contract for a limited period of time. When the term ends, the work contract resumes on the same terms, and the enterprise cannot fire a worker affected by this legal term.

alternative finance, and every year they perform investigations about this financing, which are totally for public use.

After introducing the transaction volumes around the world focused on China. Europe and Spain will be also analysed, both the volume and the most important models. A brief comparison will be made between them. It will be exposed the importance of start-ups, as well as the problems they find to get financing; these types of companies are elementary since they could make the most use of alternative ways of financing.

Even though it was not intended, one point will be dedicated to new financing trends, in particular ICO credits and loans. It is important to analyse it because it could be the key point for the conclusion, given that it involves a much less risky way of financing.

Before the conclusions, it will be introduced a case study: a Spanish SME based in Zaragoza, SMS Ibérica S.L., and Warby Parker, a company founded in 2010 based in New York City (USA). Due to their different ways of financing and different environments, comparing both companies seems interesting for this paper.

Finally, it will be exposed some conclusions about the work.

2. The importance of the SMEs from an economic perspective

For the common reader, a widespread thought lied on the importance of the great enterprises in the European Countries could exist, probably because most of the ordinary business entities are the great ones. However, sometimes we are not aware of the vast number of enterprises in our countries and, in terms of SMEs, in 2016² there were 24.7 million.

The concept of SME has been defined the European Commission in the Recommendation 2003/361, whose main factors are staff headcount, and turnover or balance sheet total³. The breakdown of the concept is shown in the table below.

Table 1: definition criteria for SMEs defined by European Commission

Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

Source: European Commission

Small and Medium Size enterprises have been decisive in employment creation (in Spain, 74%⁴ of the total employment was created thanks to them) and in the economic subsistence of the European Union Countries. In Spain, this kind of businesses represent almost 100%⁵ of the total of the enterprises, which is very similar to European rate which ascended to 99.8%⁶ in 2016, this rate included United Kingdom. Thanks to these data, we can assert that European countries are very dependents on SMEs, based on the added value created for them,

²Small and medium-sized enterprises: an overview, Eurostat, European Commission, updated to 11 November 2019, retrieved on 15 April 2020, available in <https://ec.europa.eu/eurostat/en/web/products-eurostat-news/-/EDN-20191125-1>

³ What is an SME?, European Commission, retrieved on 15 April 2020, available in https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_es

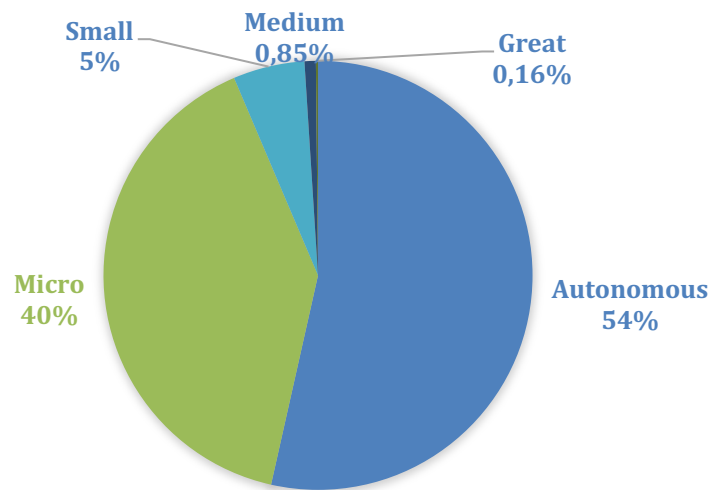
⁴ La economía española es una de las más dependientes de toda Europa, Cepyme News, updated to 30 January 2018, retrieved on 15 April 2020, available in <https://cepymenews.es/la-economia-espanola-una-las-mas-dependientes-las-pymes-toda-europa>

⁵ Cifras PYME enero 2020; Ministerio de Industria, Comercio y Turismo; Gobierno de España; updated to February 2020, retrieved on 15 April 2020, available in <http://www.ipyme.org/Publicaciones/CifrasPYME-enero2020.pdf>

⁶ Small and medium-sized enterprises: an overview, Eurostat, European Commission, updated to 11 November 2019, retrieved on 15 April 2020, available in <https://ec.europa.eu/eurostat/en/web/products-eurostat-news/-/EDN-20191125-1>

which comes to to 65% of the Spanish Gross Domestic Product in our country⁷. However, it is, sometimes, difficult to obtain external financing, due to the low negotiating power that have such enterprises.

Graph 1: percentage of enterprises in Spain by size



Source: Own Elaboration from Ministerio de Trabajo, Migraciones y Seguridad Social⁸

Added to the difficulty in obtaining financing, this huge network of companies is mostly formed by micro-enterprises (in Spain represents the 93%), among are included self-employed workers. The big deal of this entrepreneurial form is the lack of technological development which involves a limitation to productivity and economic growth⁹.

Even so, the countries are aware of the importance of these companies within the business network and currently, due to the global pandemic, they are trying to save these enterprises through sources of funding which, at first sight, seem very profitable. These sources will be subsequently introduced and studied.

⁷ La PYME española y el reto del crecimiento, El Confidencial, retrieved on 15 April 2020, available in <https://datos.elconfidencial.com/sage-6/>

⁸ Cifras PYME enero 2020; Ministerio de Industria, Comercio y Turismo; Gobierno de España; updated to February 2020, retrieved on 15 April 2020, available in <http://www.ipyme.org/Publicaciones/CifrasPYME-enero2020.pdf>

⁹ SÁNCHEZ MARÍN, G. (et. al.), 2018, *Análisis estratégico para el desarrollo de la PYME en España: digitalización y responsabilidad social*, Diego Marín, Murcia, available in <https://www.cepyme.es/wp-content/uploads/2018/11/informe-FAEDPYME-Espana-2018.pdf>

3. The issue of bank financing

3.1. The years after 2008 crisis

The financial crisis of 2008 marked a turning point in the financial marketplace. Before this historical fact, banking policy was focused on increasing the level of indebtedness by emitting short -and long- term bank loans and credits without any control. This, along with other reasons, were the onset of the housing market bubble¹⁰.

Since that moment, a period of loss of confidence between SMEs and financial institutions began. The difficulty in getting financial products was expanded over time, due to the increasing of bureaucratic red tape, the control of the financial information, the increase in defaults and rising costs of external financing. We can assert that, until the last years of the second decade of the current century, SMEs had many obstacles to preserve their financial equilibrium. In order to compare the ecosystem around the crisis with the last few years, many surveys exist. In particular, I shall use two: the first study was performed from 2009 to 2011¹¹, while the second one from 2016 to 2018¹².

On the one hand, at the beginning of the crisis, SMEs tried to get external financing (78.30% of these businesses), but this fact started to decrease (in 2011 it was only 67.75%), which might be owing to the rise in commissions and fixed expenses (67.68% experimented a rise in this matter), larger quantity of personal guarantees (which was becoming greater from 2009 to 2011), and higher interest rate (61.60% of the SMEs experimented a rise in interest rate in 2009).

In other words, due to the limits imposed by banking market, there were less motivation to select this way of financing. This implies that Small and Medium-size businesses had to look for other sources of financing such as internal financial or those that will be exposed in this dissertation. In order to clarify the data remarked above this paragraph, the percentages are

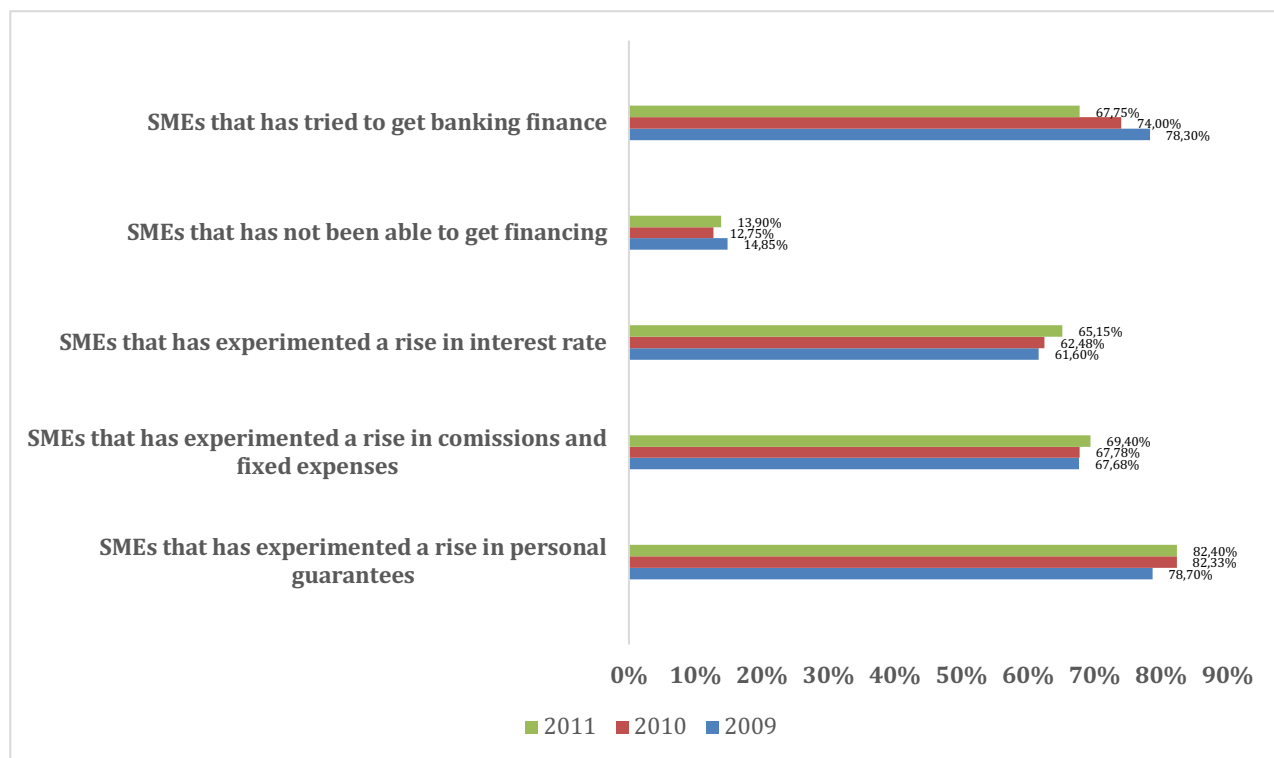
¹⁰ MAUDOS, J., «El impacto de la crisis en el sistema bancario español» (2012), *Cuadernos de información económica*, nº 226, 156

¹¹ Encuesta sobre el acceso de las pymes a la financiación ajena, Consejo Superior de Cámaras, 2011, retrieved on 17 April 2020, available in <https://www.camarabilbao.com/ccb/contenidos.downloadatt.action?id=8048397>

¹² VIII Informe sobre la financiación de la pyme en España, CESGAR Sociedades de Garantía Recíproca, 2019, retrieved on 17 April 2020, available in <http://www.cesgar.es/wp-content/uploads/2019/04/VIII-Informe-financiación-de-la-pyme.-Resultados-2018-1.pdf>

shown in the graphic 2, using an arithmetic average per year instead of dividing them by quarters.

Graph 2: survey to SMEs about bank financing issues from 2008 to 2011



Source: Own elaboration from Consejo Superior de Cámaras, “Encuesta sobre el acceso de las pymes a la financiación ajena”, 2011¹³

3.2. Years before the imminent new crisis

On the other hand, referring to the period between 2016 and 2018, bank financing, in all its various products and services, were the favorite way of financing for SMEs. In 2018, the 20.6% of the Small and Medium-size businesses used bank loans, 28.2% bank discount and 37.6% commercial line of credit; this last one was the most expanded.

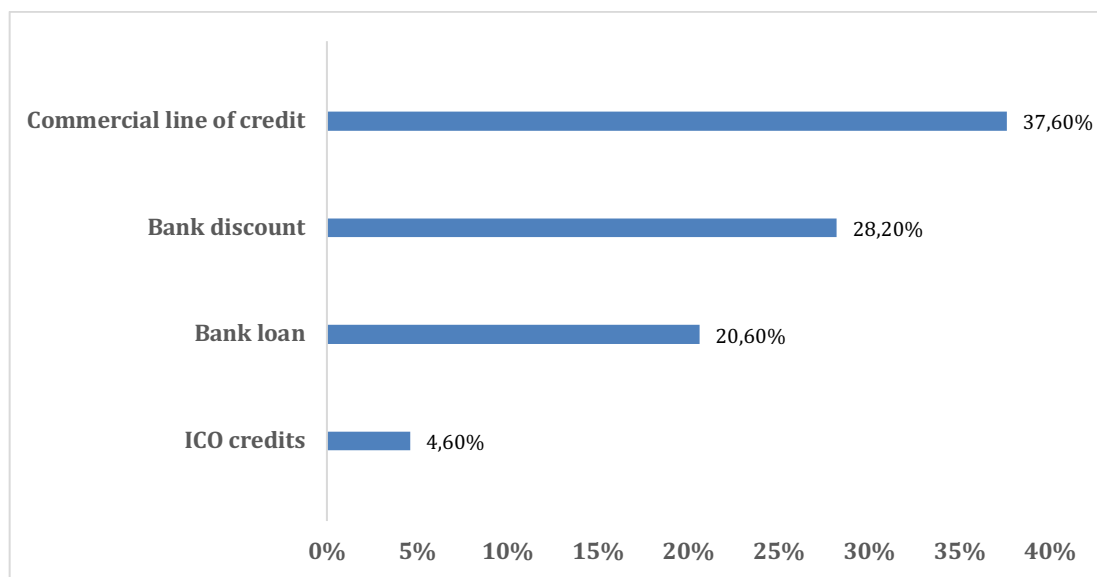
In reference to the cause of the need of funds, it can say that it is the main problem of this period due to the destination of the funding was for lack of liquidity, which means that most of SMEs were unable to cope with their current liabilities. Among all SMEs, only 36.7% used the funding to invest in productive equipment.

¹³ Encuesta sobre el acceso de las pymes a la financiación ajena, Consejo Superior de Cámaras, 2011, retrieved on 17 April 2020, available in <https://www.camarabilbao.com/ccb/contenidos.downloadatt.action?id=8048397>

Compared to the previous survey, in 2018, 65.4% of this type of businesses did not have obstacles to obtain financing. In addition, this increase is due to the minor importance of interest rate and the decrease in the need of personal guarantees. In this point, it is possible that the change of trend in the graphic not be because of a decline in interest rate or more flexible guarantees requested, but come accompanied by a change of mind by companies after many years operating with financial institutions.

Still, the truth is that bank financing was the main way of financing, whereas crowdfunding and crowdlending were insignificant (about 0,2% of the total), and ICO credits represented 4,6%. This last alternative will be studied later. The graphics 3 and 4 shows the data in a more visual way.

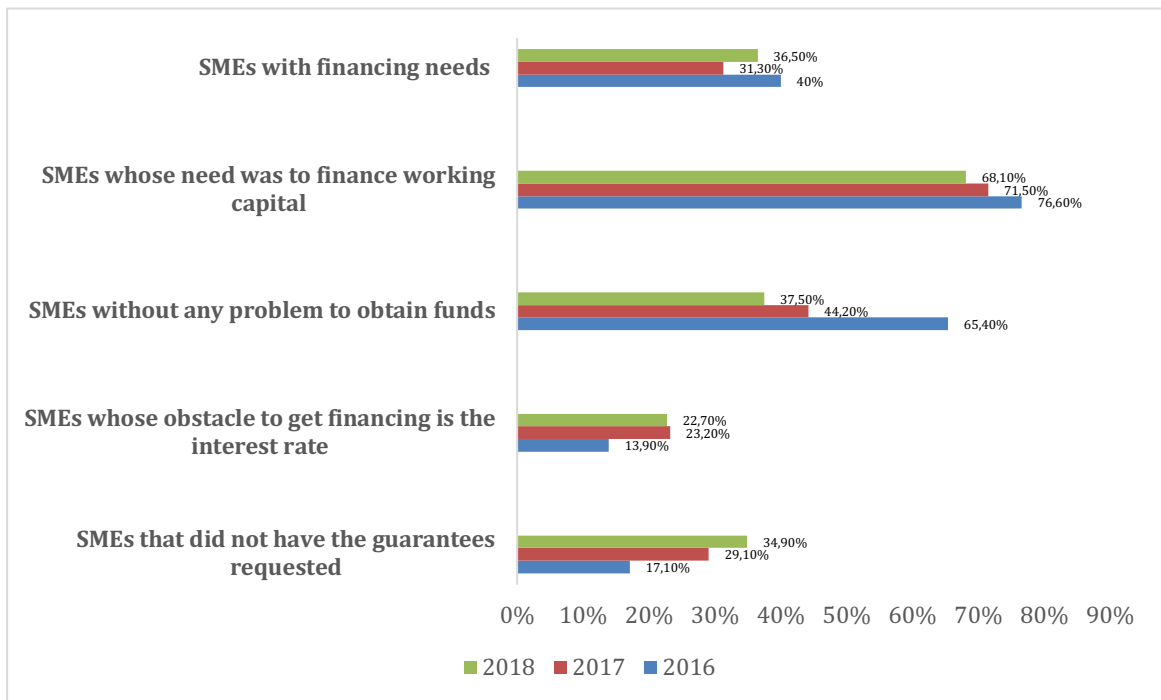
Graph 3: ways of financing used for Spanish SMEs in 2018 (percentage of the total which used a type on financing)



Source: Own elaboration from CESGAR “VIII Informe sobre la financiación de la pyme en España”¹⁴

¹⁴ VIII Informe sobre la financiación de la pyme en España, CESGAR Sociedades de Garantía Recíproca, 2019, retrieved on 17 April 2020, available in <http://www.cesgar.es/wp-content/uploads/2019/04/VIII-Informe-financiación-de-la-pyme.-Resultados-2018-1.pdf>

Graph 4: general aspects of financing SMEs from 2016 to 2018



Source: Own elaboration from CESGAR “Encuesta sobre la situación de las pymes en relación con la financiación ajena”¹⁵

¹⁵ VIII Informe sobre la financiación de la pyme en España, CESGAR Sociedades de Garantía Recíproca, 2019, retrieved on 17 April 2020, available in <http://www.cesgar.es/wp-content/uploads/2019/04/VIII-Informe-financiación-de-la-pyme.-Resultados-2018-1.pdf>

4. Alternative finance: meaning and ecosystem

4.1. Alternative finance meaning

The definition of this term refers to forms of finance that are outside the institutional finance system of banks and capital markets. A relatively new phenomenon that was made possible by digitization and, above all, by the emergence of the fintech sector¹⁶. It was partly affected by financial crisis in 2008, when a lot of people mistrusted in a bank, so the new ways of financing have arisen.

These alternative ways of financing are mainly processed through online markets which are reward-based crowdfunding, equity crowdfunding, revenue-based financing, online lenders, peer-to-peer consumer and business lending, and invoice trading third party payment platforms.

Alternative finance differs from traditional finance through the use of technology-enabled 'disintermediation'¹⁷. This leads to a reduction in the use of intermediaries between investors and recipients of funds in the case of SMEs. The main models of alternative financing (in terms of market share) are showed in table 2.

¹⁶SHENGLIN, B., et. al., The Future of Finance is Emerging: New Hubs, New Landscapes; University of Cambridge, 2018, retrieved on March 2019, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2018-ccaf-global-fintech-hub-report-eng.pdf

¹⁷ J. RUBINTON, B., Crowdfunding: Disintermediated Investment Banking, McGill University, April 11 2011, retrieved on March 2019, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1807204

Table 2: main ways of alternative financing in 2016 in terms of market share in Europe

AlternativeFinanceModel	Definition	2016	Market Share
P2P ConsumerLending	Individuals or institutional funders provide a loan to a consumer borrower.	€ 696.81m	33.8%
P2P Business Lending	Individuals or institutional funders provide a loan to a business borrower.	€ 349.96m	17.0%
Invoice Trading	Individuals or institutional funders purchase invoices or receivable notes from a business at a discount.	€ 251.87m	12.2%
Equity-based Crowdfunding	Individuals or institutional funders purchase equity issued by a company.	€ 218.64m	10.6%
Reward-based Crowdfunding	Backers provide finance to individuals, projects or companies in exchange for non-monetary rewards or products.	€ 190.76m	9.2%
Real Estate Crowdfunding	Individuals or institutional funders provide equity or subordinated-debt financing for real estate.	€ 109.45m	5.3%
P2P PropertyLending	Individuals or institutional funders provide a loan secured against a property to a consumer or business borrower.	€ 95.15m	4.6%

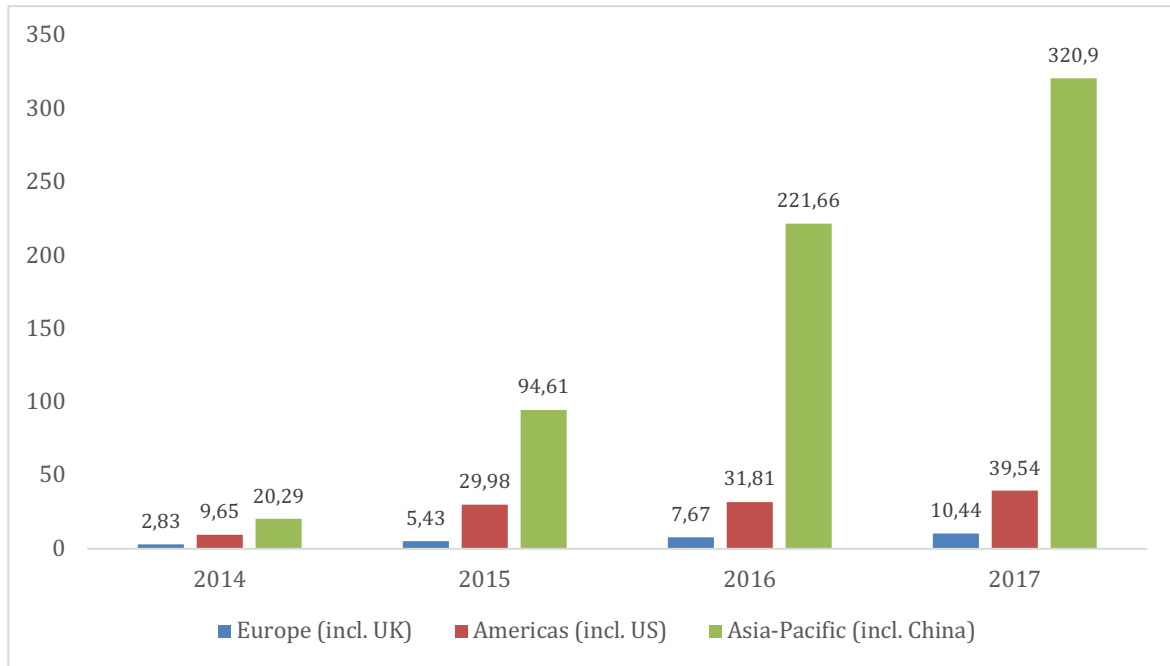
Source: Cambridge University¹⁸

4.2. Alternative financing ecosystem around the world

In Europe, the use of alternative financing is not as expanded as in other geographical areas. There has been a constant growth in terms of volume of transactions since 2013, but is incomparable with the growth of Asia, continent where this type of financing is more usual. Only in Asia there are more alternative agreements than in all the rest of the world. In America (included USA) between 2015 and 2016 the increase has been less pronounced than other years, especially 2014-2015. The data is shown in the figure below.

¹⁸ ZIEGLER, T. et. al., The 3rd European Alternative Finance Industry Report, University of Cambridge, 2018, retrieved on March 2019, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2018-ccaf-exp-horizons.pdf

Graph 5: Regional Online Alternative Finance Market Volumes 2014-2017 (bn €)



Source: Own Elaboration from Cambridge University¹⁹

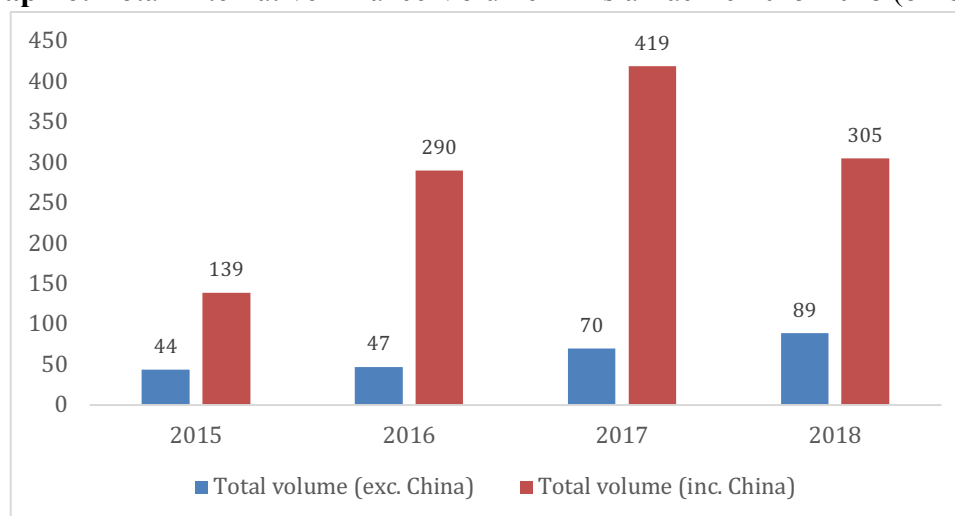
As we can see, this trend started to be used in 2014, a few years after the crisis. It is a proven fact that, in terms of volume, no geographical area can be compared with Asia-Pacific, whose volume is growing up since that year.

In this financial ecosystem, Europe and America are far below Asia-Pacific, nevertheless what is most striking is the difference related to percentage increments. But it is necessary to notice that the reason of this wide difference is the impact of China in alternative financing markets being the country where this method is more widespread, with an abysmal difference.

Graphically, the significance in the geographical region Asia-Pacific can be seen in the graph below:

¹⁹ ZIEGLER, T., et. al., Shifting Paradigms: the 4th European Alternative Finance Benchmarking report, University of Cambridge, 2019, retrieved on April 2020, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-05-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

Graph 6: Total Alternative Finance Volume in Asia-Pacific 2015-2018 (bn USD)



Source: Own Elaboration from Cambridge University²⁰

This means that China is the country that makes the difference in alternative financing models. But it is noteworthy that, in 2018, the importance of China noticeably dropped, as well as the volume of these transactions, while other countries in this geographical area increased the alternative ways of financing.

May this be the beginning of a recession in this sector in China, while other countries like USA and United Kingdom continue growing in transaction volume. However, it is strange that China, one of the most economic powers around the world, start to spot using these ways of financing. So, judging the fact that it is one of the most advanced countries in terms of financial technology, it is possible that other new way of financing is emerging.

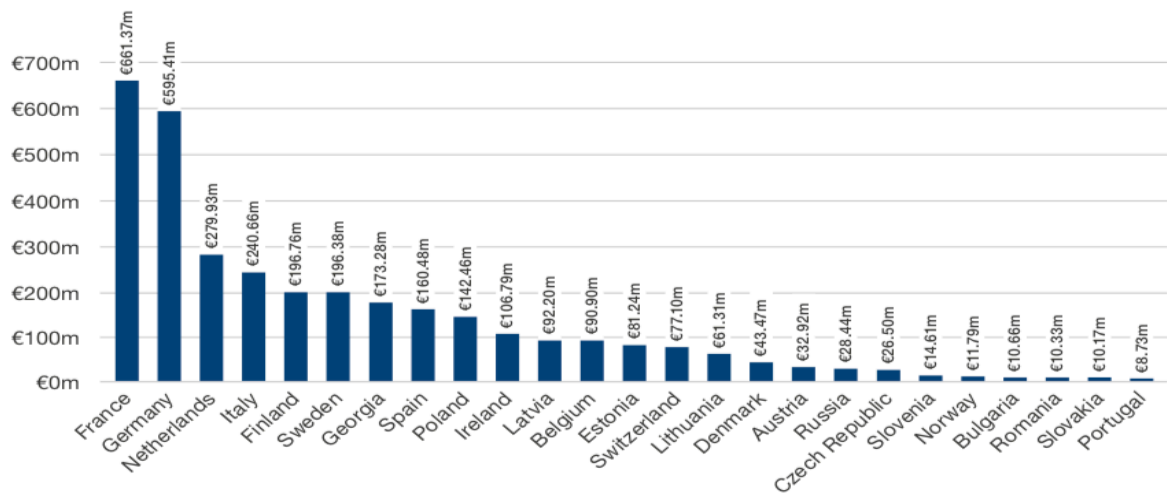
4.3. Alternative financing ecosystem in Europe

It is important to highlight that in Europe the volume of transactions of this type among countries is not equitable. The top of the volume-driving countries is chaired by United Kingdom by far of the rest, with an amount of 5,608€M. UK is followed by France (444M€), Germany (322M€), The Netherlands (194€M), Finland (194€M) and Spain (131M€). Nevertheless, in relative and considered per capita, France, Germany and The Netherlands are

²⁰ ZIEGLER, T., et. al., The Global Alternative Finance Market Benchmarking Report, University of Cambridge, April 2020, retrieved on 15 May 2020, available in <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/the-global-alternative-finance-market-benchmarking-report/>

not so important, but that are Estonia, Latvia and Georgia the countries that replace them²¹. In other words, there are countries with low transaction volume where people make greater investments in alternative financing.

Graph 7: Online Alternative Finance Volume by Country 2017 (€million; Exc. UK)



Source: University of Cambridge²²

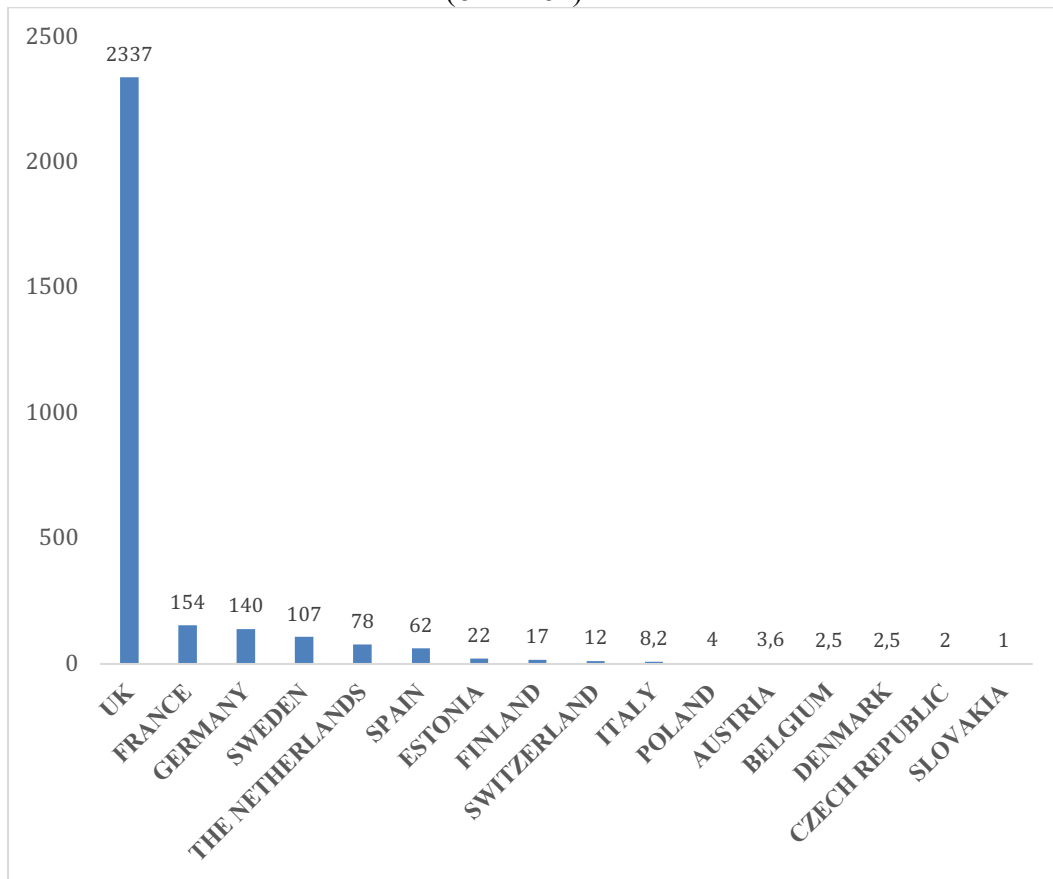
According to University of Cambridge reports (there are several papers each year) the finance market of the alternative financing has been growing permanently on a year-to-year basis during the examined period across the whole European Union area (including UK). The average growth rate of alternative financing is 146%, highlighting the sector's growth pace. Alternative ways of financing are becoming more popular and more readily accessible to the public. Furthermore, the author of Forbes article, David Prosser (2018), states: «*The number of countries in Europe with meaningful alternative finance activity is growing*». He has made this statement after reviewing the 2015 UK benchmark report. In addition, the number reached €7.7 billion in 2016 (the most recent period for which the data was available) what approves the

²¹ ZIEGLER, T., et. al., Shifting Paradigms: the 4th European Alternative Finance Benchmarking report, University of Cambridge, 2019, retrieved on April 2020, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-05-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

²² ZIEGLER, T., et. al., Shifting Paradigms: the 4th European Alternative Finance Benchmarking report, University of Cambridge, 2019, retrieved on April 2020, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-05-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

growth tendency of the alternative finance market. The distribution of those numbers is represented below:

Graph 8: volumes of alternative finance transactions by European countries on 2014 (€ million)



Source: Own Elaboration from University of Cambridge²³

The graph 8 shows that the biggest share of the alternative finance market in Europe belonged to the United Kingdom with a result of €2337 million in 2014. The list was followed by France (€154 million), Germany (€140 million), Sweden (€107 million), the Netherlands (€78 million), and other countries.

Currently, the ranking of countries has changed as it is shown in graph 8, in which UK is excluded. France is at the top of transactions volume with €661.37 million, followed by

²³ WARDROP, R., et. al., Moving Mainstream: The European Alternative Finance Benchmarking Report, University of Cambridge, February 2015, retrieved on March 2019, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2015-uk-alternative-finance-benchmarking-report.pdf

Germany (€595.41 million), The Netherlands (€279.93 million), Italy (€240.66 million), Finland (€196.76 million), Sweden (€196.38 million), Georgia (€173.28 million) and Spain (€160.48 million). This means that Spain has falls from fifth place to eighth in only three years. Thank to this comparison, it is plausible the extremely fast growth of this market, so it is assumed its importance role in the upcoming years. it will play an important role in the next few years.

Comparing both graphs above, most of the countries have tripled their volumes, while countries like Spain has been overcome by several countries like Italy or Georgia. It is true the quick evolution that alternative financing has suffered, unless it arises another type of financing more striking and beneficial, the growth curve does not seem to start a recession.

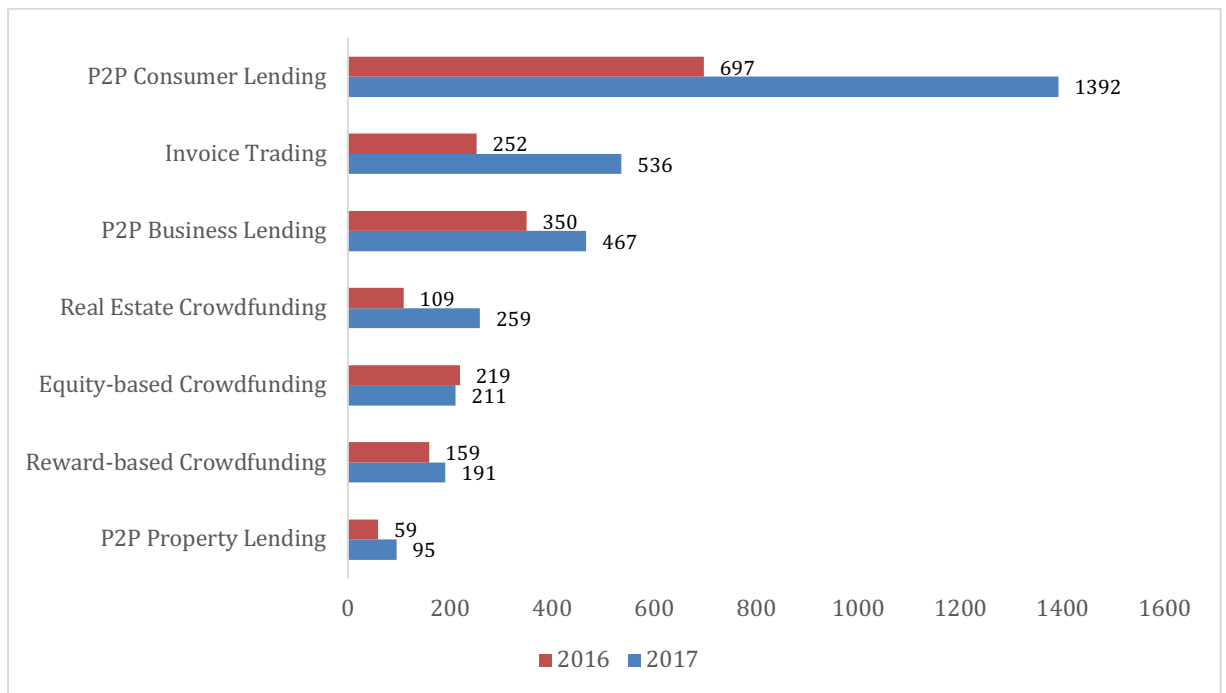
Moreover, it is important to assess the allocation of money among the different types of alternative financing. Due to the same benchmarking report, the biggest and most significant part of the alternative market takes Peer-to-Peer Consumer Lending. And the following places belong to Invoice Trading, P2P Business Lending and Real Estate Crowdfunding²⁴.

P2P Consumer Lending, the most important alternative financing model, reached a volume of €1,392 million in 2017 which represents an increase of 100% with 2016 (€697 million). Invoice Trading has achieved the second position in volume with a total of €536 million in 2017. The third is P2P Business Lending, with a total of €467 million. It can be stated that alternative ways of financing are more common for consumers than for businesses. Even so, the positive increase of models such as Invoice Trading, proves that these models are more and more important for companies.

The full list with the necessary numbers in 2016 is presented below in graph 9. It is only included the most important ways.

²⁴ ZIEGLER, T., et. al., Shifting Paradigms: the 4th European Alternative Finance Benchmarking report, University of Cambridge, 2019, retrieved on April 2020, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-05-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

Graph 9: Alternative finance market allocation in Europe (2016-2017)



Source: University of Cambridge

According to Forbes (2018), the services from alternative finance have helped to raise significant sums for the Small and Medium Enterprises, providing €1.14 billion (where debt types including peer-to-peer business lending made for 67% of business finance, while equity-based types made 27%) to more than 14,000 businesses across Europe²⁵, that shows the importance of alternative finance for Small and Medium Enterprises in Europe.

4.4. The difference between Europe and Spain

At the beginning, in Europe P2P Consumer Lending was more common than P2P Business Lending, which demonstrated the prevalent use of alternative financing for consumers, rather than business. In the case of Spain, data were totally contrary, meaning that the alternative finance ecosystem was business-focused activities²⁶. To emphasize this position,

²⁵ PROSSER, D., Europe's Alternative Finance Sector Accelerates, updated to January 26, 2018, retrieved on April 27, 2020, available in <https://www.forbes.com/sites/davidprosser/2018/01/26/europes-alternative-finance-sector-accelerates/#33d3fb183d96>

²⁶ ZIEGLER, T. et. al., The 3rd European Alternative Finance Industry Report, University of Cambridge, 2018, retrieved on March 2019, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2018-ccaf-exp-horizons.pdf

the volume of P2P Consumer Lending was totally insignificant with an amount of 2M€. And what it is more, there was any increase between 2015-2016.

In connection with total volume of transactions, it can be stated that, in relative terms, this method to obtain funds were more important for SMEs in Spain than in other countries of Europe where money was invested to obtain a profit through a platform of crowdlending for costumers.

Moreover, in Spain, Invoice Trading was also growing market. On one hand, as it is showed in graph 10, it is clear that people were investing larger sums of money in invoice discounting or factoring (in 2017, the volume of Invoice Trading is double that the previous year). On the other hand, SMEs were using these ways to get finance, especially to raise their current ratio, which is the most important problem due to their necessity of working capital. It is extremely important to highlight the necessity of positive cash flow in these companies. As a general rule, because of the low negotiating power with regard to their suppliers and clients, the pay period is less than days sales outstanding (this term refers to effective collection), so it is possible to have lack of liquidity.

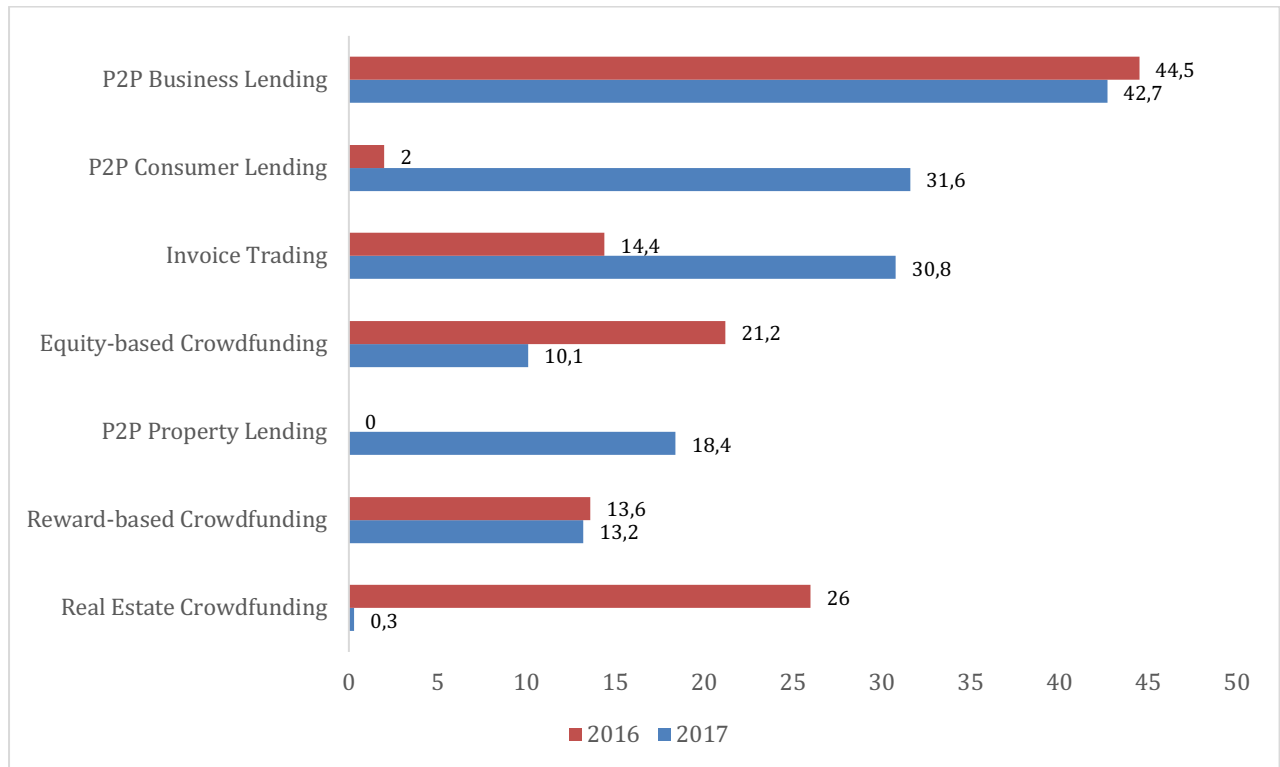
As it is showed in graph 4, SMEs find more problems in 2018 than in 2017 or 2016, which states that there is a need which has to be covered. And that is the point where alternative ways of financing comes in. It can be also seen the more the years increase, the greater the volume of transactions is, which does nothing but affirm the boom of alternative finance against bank financing.

However, in 2017 the financial ecosystem has changed. P2P Consumer Lending has experimented an extraordinary growth, resembling the European model, which could be a reflection of the ease with which everyone can access to this type of funds (which is different from the same being granted). It also has to warn that the volume of P2P Business Lending in 2017 might not be real, due to the fact that platform Comunitate.com shut down, so the data of this platform are not accumulated²⁷. In practical terms, crowdfunding loans are the most

²⁷ ZIEGLER, T., et. al., Shifting Paradigms: the 4th European Alternative Finance Benchmarking report, University of Cambridge, 2019, retrieved on April 2020, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-05-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

important in Spain (the sum of P2P Business Lending and P2P Consumer Lending), and it may be higher than what graph 10 shows. Finally, it is important to name Real Estate Crowdfunding and P2P Property Lending; for example, Spain has always been a country with a great real estate tradition, this sector is growing again²⁸ and the effect is seen in the graph.

Graph 10: Total Alternative Finance Volume by Model in Spain 2016-2017 (in millions of €)



Source: Own Elaboration from University of Cambridge²⁹

²⁸ Crowdfunding in Spain 2018, Annual Report, updated to 2019, retrieved on April 23, 2020, available on https://www.universocrowdfunding.com/wp-content/uploads/UC_Informe-anual-del-Crowdfunding-ES-EN-2018_XX92-FO2P-XZA1-32IK.pdf

²⁹ ZIEGLER, T., et. al., Shifting Paradigms: the 4th European Alternative Finance Benchmarking report, University of Cambridge, 2019, retrieved on April 2020, available in https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-05-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

5. Alternative financing for SMEs and Start-ups

The level of alternative finance market for Small and Medium Enterprises in Europe is growing, as it has seen on the previous chapter. There is a segment of SMEs that appeals to alternative financing more often than the other segments, and this segment belongs to start-ups.

A start-up is a concept that has appeared relatively recently in the financial world. It widely represents a young company that has just begun to develop and its size is small. According to the author of Forbes articles, a start-up is a company that works to solve a problem with some kind of solution on the market where the solution is not obvious and success is not guaranteed³⁰. The difference between SME and start-up is that start-ups are defined as “temporary organisation that is searching for repeatable and scalable business model”³¹, so the difference lies on the main reason for its creation and the vision of its creators.

The aim of start-ups is growing through disruptive innovations; nevertheless, due to their high degree of uncertainty, getting funding from traditional financing sources becomes harder for them³².

5.1. Risks associated with start-ups

In the past few years, risk management in companies has been gaining importance, especially due to the situation of widespread uncertainty that the world is experiencing. This situation is accentuated particularly in a start-up, for evident reasons: there is no validated business model, an insufficient number of customers, no financial buffer nor stable cash flows.

Regular company faces a diversity of risks, in this paper two of them will be explained for their importance related to start-ups:

- Market risk
- Liquidity risk

³⁰ ROBEHMED, S., What Is A Startup?, Forbes, updated to December 16, 2013, retrieved on March, 2020, available in <https://www.forbes.com/sites/natalierobehmed/2013/12/16/what-is-a-startup/#5d80bd9b4044>

³¹ BLANK, S., What’s a Startup? First Principles, updated to January 25, 2010, retrieved on May 2020, available in <https://steveblank.com/2010/01/25/whats-a-startup-first-principles/>

³² What is the Difference Between a Start-up and a SME, Bajaj Finserv, retrieved on March, 2019, available in <https://www.bajajfinserv.in/insights/what-is-difference-between-a-start-up-and-an-sme>

First of all, when a company faces liquidity risk, it is unable to meet the short-term liabilities, due to this fact, the SMEs assets sometimes are not suitable to work as collateral. Talking about liquidity risk it is reliable to mention the operational risk. This kind of risk is undertaken by companies who try to attempt to operate in unknown or new markets; for this reason, it is an issue which most of the start-ups faces at the beginning of their existence. The question that any company should ask themselves to overcome general operational risk is: Is there a mismatch between supply and demand of the new product/service the company is offering?

Market risk, also known as systematic risk, is the possibility of losing an investment due to market fluctuations. It encloses different risk economic factors such as inflation, interest rate and currency risks.

Start-ups and SMEs are especially vulnerable, as they have a reduced enterprise size and a concentrated asset base, so a slight change in any of the risk components might have dangerous consequences.

Although risk mitigation is achievable through by getting help from outside of the organisation and proper internal control, in the case of financial institutions they will still be reluctant to provide financing, which means it is difficult getting help for a bank. Nonetheless, it is necessary to mention that the core activity of banks has never been to finance start-ups, as their lines of action tend to be more conservative and risk averse.

Basically, the risks that were described above are the main reason for banks not to invest in start-ups. They are considered too risky; hence, the probability of start-up being financed by a financial institution is basically non-existing. However, general risks are not the only cause of denial, as banks and financial institutions always act under a low risk profile.

In professional business, if the company does not have at least one year of work experience in its profession, it is common for banks to deny funding. In the same way, if the owner/owners do not have enough expertise or an experienced management team, a lender would not feel comfortable with such a company. And finally, the last reason for credit rejection would be the lack of a stable customer base. This is, basically, the main problems start-ups or SMEs can find to get funds.

It is compulsory for start-ups to be aware of the importance of risk mitigation and risk management. Research by (Hirth & Chelsey, 2017)³³ concluded that effective risk management is supported by five pillars: Governance and culture, Strategy and Objective-setting, Performance, Review and Revision and Information, Communication and Reporting. The compliance with these risk management criteria will aid a start-up to understand the risk taken and will possibly have a more stable future. Potential investors are interested in the risk level of the company, to assess the worthiness of their investment.

5.2. Contrast between traditional lending and alternative financing opportunities

Nowadays, there are many different financing options instead of bank financing. In Spain, in order to have a bank loan, there are requirements that tend to make it difficult, especially when we are talking about SMEs. For instance, bank requirements for a private investment in Spain require the insured person to sign a life insurance in which the beneficiary is the bank, pay the notary or give a personal endorsement guarantee to cover insolvencies. The barriers and bureaucratic processes involved in asking for a formal credit to a financial institution tend to be lengthy and tedious.

In this scenario, we could name other more recent financing vehicles, such as crowdlending, venture capital or business angels, giving an overview of the most important differences between them and straight debt or bank loans. Online alternative finance channels have become an increasingly important conduct for SME financing in the UK. According to Zhang et al., (2018)³⁴ in 2017, £4.2 billion of business funding, which is 68% of the total market volume for alternative finance, was raised via online platforms and channelled to start-ups and SMEs across the country.

Firstly, we must emphasize that crowdfunding is the most extended way of financing in these days, as well as it is having the major growth. There is an upward trend that alternative investment opportunities have been experiencing in Europe. United Kingdom has the most prominent alternative financing market in the European Union, with a market volume in 2017

³³ HIRTH, R. & CHELSEY, D., Enterprise Risk Management: Integrating with Strategy and Performance, June 2017, retrieved on March 2019, available in <https://www.coso.org/Documents/2017-COSO-ERM-Integrating-with-Strategy-and-Performance-Executive-Summary.pdf>

³⁴ZHANG, B., et. al., The 5th UK Alternative Finance Industry Report, University of Cambridge, November 2018, retrieved on March 2019, available in <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/5th-uk-alternative-finance-industry-report/#.XtQC8S8rxQI>

of 6.19 billion³⁵. As one of the pioneers in popularizing alternative financial opportunities among European Countries, the market has matured, and the rapid growth of earlier years has slowed down. Nevertheless, 2017 marked the seventh consecutive year of substantive market growth for the UK alternative finance industry, with the online alternative finance market growing.

With crowdlending, a form of crowdfunding, it is typically easier to negotiate the interest rate, the maturities and the necessity or not of a personal guarantee or collateral than with bank lending. Transparency is another issue; a company that want to engage in crowdlending will have to publish a lot of ‘confidential’ information on the platform to be able to attract investors. Also, in case of financial problems at the company, the news will spread very quickly.

Venture Capital has become a suitable alternative for start-ups and small companies funding. It is composed of investors that provide financing to recently established companies that are forecasted to have a substantial growth potential in the long run. Venture Capital usually comes from specialized investment funds or wealthy investors looking for a valuable endowment.

When analysing the funding stages of a start-up through Venture Capital, it is important to emphasize the process and what each funding stage comprises. Early stage funding (Series A&B) have a capital investment ranging from \$1 million to \$6 million, depending on the development degree of the start-up. These operations are usually led by venture capital funds. The growth stage includes both the C series and subsequent rounds, incorporating the mezzanine capital rounds, a hybrid financing instrument unusual among start-ups that is halfway between debt and capital, and the combination of these stages create a bridge to IPO or another exit strategy. Exit strategies might include an IPO, or M&A with another company.

The last one, Business Angels, is a kind of finance where individuals invest both their expertise and money into small businesses to help them grow and achieve success in return for shares in the company. On a high level, they are focused on early stage companies with high growth potential and scalable business model, with a strong chance of good returns.

³⁵ ZHANG, B., et. al., The 5th UK Alternative Finance Industry Report, University of Cambridge, November 2018, retrieved on March 2019, available in <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/5th-uk-alternative-finance-industry-report/#.XtQC8S8rxQI>

The most important is that they bring not only investment to the company but also provide business and finance experience, contacts and access to potential customers. Business Angels are the most compelling source of investment in primary stage and high-risk companies, allowing for funding and training skills. A bank would never be able to provide these additional benefits to a start-up as they do not have the ‘entrepreneurial skills’ and network.

5.3. Start-up accelerators as a new funding mean

In Spain, there are a lot of options available to finance start-ups. The most popular alternative financing routes include business angels or angel investors, crowdfunding and business accelerators or business shuttles. Spain is a country of entrepreneurs and multinational companies, which in the last years have decided to strategically collaborate and create a more competitive and diverse business ecosystem.

A start-up accelerator program is an intensive business and personal development program which supports a small team of founders, usually with a business idea of their own³⁶. In Spain, there are two programs among the “Best start-up accelerator program in Europe”³⁷ (a research done by CB insights), which are SeedRocket and Startupbootcamp Internet of Things and Big Data Barcelona. Both of them support startups in their early stage providing access to mentors, partners and investors. In the case of SeedRocket, what creates more value are synergies that can be created by working several companies simultaneously in the same place³⁸, meanwhile Startupbootcamp is specialized in technology industry and can provide networks of contacts³⁹.

There are several accelerator programs which are created by great enterprises. Mercadona and BBVA are two of the biggest Spanish companies, highly recognized globally and nationally. The creation of a business accelerator for wholesome and innovative ideas benefits both players, establishing a win-win situation.

³⁶ GOPAK, A., Best startup accelerator programs in Europe, January 30, 2020, retrieved on April 27, 2020, available in <https://www.alphagamma.eu/entrepreneurship/best-startup-accelerator-programs-europe/>

³⁷ GOPAK, A., Best startup accelerator programs in Europe, January 30, 2020, retrieved on April 27, 2020, available in <https://www.alphagamma.eu/entrepreneurship/best-startup-accelerator-programs-europe/>

³⁸ Aceleradora de Empresas SeedRocket - ¿En qué consiste la etapa de aceleración?, SeedRocket, retrieved on April 27, 2020, available in <https://www.seedrocket.com/aceleradora/aceleradora-como-funciona/>

³⁹ About us, Startupbootcamp, retrieved on April 27, 2020, available in <https://www.startupbootcamp.org/about-us/>

Programa Lanzadera (Mercadona) is an accelerator and incubator of privately-owned companies promoted by Juan Roig, the founder and president of the supermarket chain. This initiative was created to support entrepreneurial leaders in the creation of competent companies that create value and implement a solid business model based on productive work, effort and leadership. Following that mission, Lanzadera looks for restless, ambitious entrepreneurs, with an innovative business plan or project, and the initiative provides them with the necessary training, economic and structural resources to get their idea forward.

BBVA Momentum is an initiative created by BBVA. It is based on a five-month program that provides training, strategic support, potential access to funding, networking and visibility, among others. The goal of the initiative is to give access to young companies to competitive markets, allow them to scale-up their business and make a positive impact on society. It aims to promote and extend the activity and impact of social enterprises, which have as a priority the creation of social and environmental value, but which also generate economic value. Hence, the focus of this initiative is the creation of social enterprises. Social entrepreneurs must develop their projects in areas unattended by public entities and by the market. Their projects propose new answers and perspectives to social and environmental problems contributing to the establishment of more sustainable societies where social, environmental and economic aspects are harmonized and are non-exclusive.

In addition to this, not only great enterprises, but public administrations have tried to make use of accelerators. In March two years ago, Spain launched the world's first government run crowdfunding platform in the Basque Country⁴⁰. It is thanks to the increasing popularity of crowdfunding that is reaching important figures: in 2018, it is estimated that the amount raised by this option could reach almost 8,000 million euros worldwide. According to the OECD (2018), this option has a strong potential to grow and reduce the financing gap of SMEs, especially younger entities that have medium or high credit risk.

⁴⁰ Crowdfunding Bizkaia, la primera plataforma online de financiación participativa de una administración pública; Bizkaia crowdfunding, updated to March 3, 2019, retrieved on March, 2019, available in <https://blog.crowdfundingbizkaia.com/actualidad/plataforma-online-financiacion-participativa-administracion-publica/>

5.4. Success factors of SMEs and start-ups from the point of view of the investors

5.4.1.SMEs

In Europe, there are about 20 million small and medium-sized enterprises, and the success of all of them is affected by the success key factors which differ to some extent from country to country. When it comes to financing, all these factors could be considered opportunities, as financing of new or small business can be a key factor for a survival - like a line dividing and imaginary area of bankruptcy and thriving of SMEs.

Before asking any subjects for their money we have to realize that our existing financial state or future trends can define our success in getting additional finances. We can say that it is:

- Profit of your company

When a company is specialized in selling products or services, it might serve as a benchmark for investors to know how profitable the company is. To optimize accounting systems, product portfolios could be separated to understand the individual profitability of each product line. The use of KPIs is useful when applying for funding, as it gives investors a broader and quantitative overview of the company.

- Small business benchmarks

These are key financial ratios drawn from information provided by businesses through activity statements and tax returns. They are competitiveness indicators which can help you understand how you are doing among other similar businesses. It has to be recognized that benchmark ratios can be applied to the business in order to get better ratio values - based on real data of course.

- Costs and overheads

Efficient management of costs and overheads can be very tricky for inexperienced management of new companies, but it can distinguish companies with no future from those who will do well. Poor cost management is an important cause for bankruptcy amongst SMEs. Often the focus

lies too much on generating sales. There are many ways to manage this issue of company finances and here is a recommendation to apply at least one of that ways.

- **Cashflow**

Speeding up incoming payments can be a great way how to improve cash-flow. It includes defining terms of trade, sending correct invoices on time and applying an active debt collection practice. At this point, proper management of incoming and outgoing payments will help a company to meet its obligations

5.4.2. Start-ups

Due to the start-up is a new creation business, the most normal situation is that it does not exist financial statements or, otherwise they exist but do not contribute anything to the financial evaluation. It has to remember that, in the early years of a company, the most typical situation is to present losses, commonly when using a new technology in an uncertain market (which means, among other things, higher profitability in case of success). For this reason, potential investors attend to other subjective variables⁴¹ to decide if it is a good option or not to invest.

Before referring to the main keys to invest on these new enterprises, it is essential to differentiate between two stages:

- Seed: probably one of the most important steps in the life cycle of a start-up. In this stage, the project become in a reality, and the only objective is to develop the idea with the help of iteration and professionals as well as experts of the sector⁴². It is important to mention that, in this stage, Business Angels are more interested in investing given the higher profitability in case of project success. At this moment, the start-up needs a little investment to start trading. However, it is very difficult to stablish the product on the market, so only a few percentages of start-ups are able to advance to the next stage. This phenomenon is known as “Valley of Death”.

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⁴¹ Las principales métricas que debes tener en cuenta antes de invertir en una “startup”, The Crowd Angel, updated to August 2, 2017, retrieved on April 12, 2020, available in <http://blog.thecrowdangel.com/blog/las-principales-metricas-debes-cuenta-invertir-una-startup/>

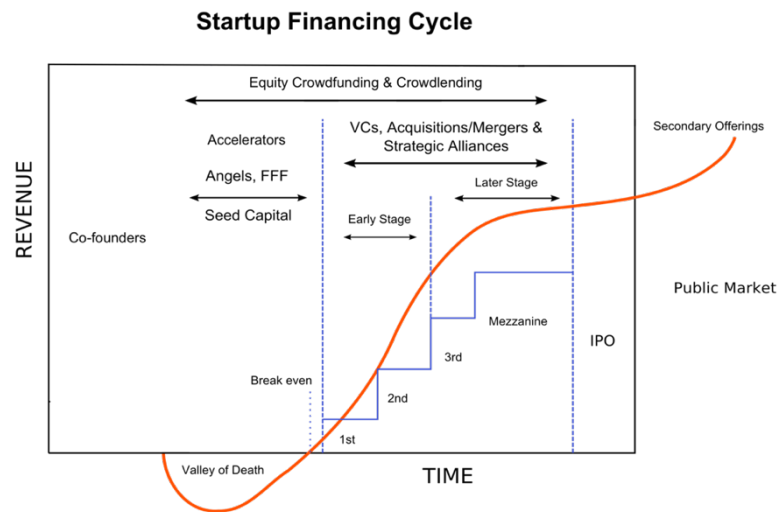
⁴² Las 5 etapas de una startup, explicadas con detalle, Abanca Innova, updated to April 12, 2018, retrieved on April 21 2020, available in <http://abancainnova.com/es/opinion/las-5-fases-una-startup-explicadas-detalle/>

- Early Stage: it is the stage in which the first metrics emerge. At this moment, thanks to the users/customers feedback, the start-up is able to develop their product through an iterative process. With the help of several key figures, start-ups may attempt to bring new fresh funds from Venture Capitals. Venture Capitals, as are more risk averse than Angel Business, focus their decision on objective data, for instance unit margin for each product, net income of the previous year or the growing in the market. The most important in this stage is getting a great amount of financing to consolidate in the current market as well as subsequently expand the company in order to continue growing and avoid stagnation⁴³.

In both stages, crowdlending and equity-crowdfunding are two of the most important ways to get financial funds. It could be said that, unlike Business Angels and Venture Capitals, there are no differences between stages in these alternative ways of financing. The only difference lies in the interest rate and the operation of each of them, being more risky equity-crowdfunding because part of the net assets is obtained⁴⁴.

The start-ups life cycle is shown in the graph below:

Graph 11: Start-up Financing Cycle



Source: Wikipedia⁴⁵

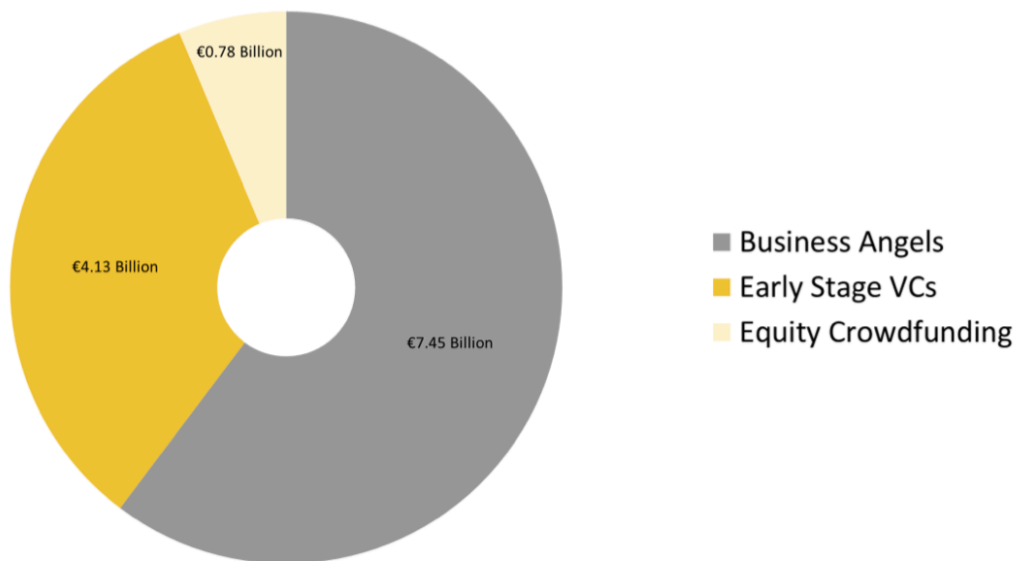
⁴³ Las 5 etapas de una startup, explicadas con detalle, Abanca Innova, updated to April 12, 2018, retrieved on April 21, 2020, available in <http://abancainnova.com/es/opinion/las-5-fases-una-startup-explicadas-detalle/>

⁴⁴ ¿Qué es el Equity Crowdfunding?, JL Casajuana Abogados, retrieved on April 21, 2020, available in <http://www.jlcasajuanaabogados.com/asesoria-legal-startups/que-es-el-equity-crowdfunding/>

⁴⁵ Startup Company, Wikipedia, updated on May 31, 2020, retrieved on May 15, 2020, available in https://en.wikipedia.org/wiki/Startup_company#/media/File:Startup_Financing_Cycle.png

In order to know the transaction volume of these kinds of financing, graph 12 is attached. In 2018, only in Europe it was invested 12'3 billion €, being Business Capitals the most representative investors, followed by Venture Capitals and, in last place, Equity Crowdfunding.

Graph 12: Early Stage Investment Market in Europe, 2018



Source: EBAN from European Commission⁴⁶

After having explained the main differences between a start-up and SMEs, it is necessary to mention some of the factors influencing investor decision-making⁴⁷:

- Who is in charge of the project

When someone invests in a start-up, he is betting on a person or a team. Many times, having a good idea it is not enough, but it is necessary to meet the people who are going to lead it (professional trajectory, success stories, character and temperament, etc.). Investors may be

⁴⁶Statistics Compendium European Early Stage Market Statistics 2018, EBAN, updated to 2019, retrieved on May 15, 2020, available in <http://eban.img.musvc1.net/static/90357/documenti/ConsoleDocuments/Statistics%202018%20Compendium%20-%20FINAL.pdf>

⁴⁷Statistics Compendium European Early Stage Market Statistics 2018, EBAN, updated to 2019, retrieved on May 15, 2020, available in <http://eban.img.musvc1.net/static/90357/documenti/ConsoleDocuments/Statistics%202018%20Compendium%20-%20FINAL.pdf>

interested in knowing the project by its creator, so the one in charge has to explain the project, and this is the best way to know his ambition.

Sometimes, it is very important knowing the staff opinion, using feedback as a form of knowledge. This is the most important factor in the criteria of a Business Angel⁴⁸.

- **Growth potential**

At this point, the investors focus on the potential of the product in the market. It is important to conduct a competitor analysis and what is more, is crucial knowing the market and their customers, as well as the existing technology. Linked to this idea, the start-up must be able to do a smart use of technology, a fresh perspective of what already exists in the market. Putting these ideas together, the start-up can have the ability to scale and sustain in the long term, making use of a good business plan.

- **Idea/concept**

Sometimes, the idea itself is so innovative and creative that is the only necessary thing to attract the attention of the investors. In these times, due to the great technological development, entirely new ideas may emerge without requiring large amounts of innovation, which means using current technology in other sectors.

There is another possibility to cover the market and gain a sustainable competitive advantage. This possibility lies in the creation of a new disruptive technology, which means the old ones are out of date, leading to total success in the market.

In any case, in addition to an excellent idea or concept, it is necessary having the other criteria.

- **Quality of the business plan**

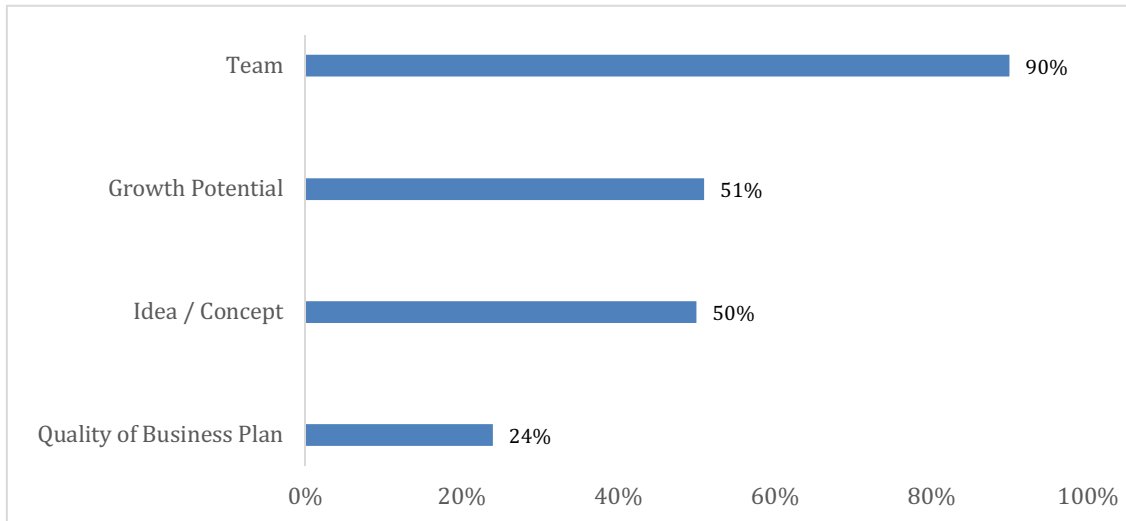
The business plan is the company's roadmap, the paper in which the objectives, values, principles and ambitions are broken down. It is here where the founder and his team answer questions like how they are going to develop the start-up, how is going to be the product, which

⁴⁸Statistics Compendium European Early Stage Market Statistics 2018, EBAN, updated to 2019, retrieved on May 15, 2020, available in <http://eban.img.musvc1.net/static/90357/documenti/ConsoleDocuments/Statistics%202018%20Compendium%20-%20FINAL.pdf>

technology they are going to use, which target market is the product going to be focused on, etc. That is, at this point the founder reflects what he wants to do and how he wants to do it.

Thanks to the European Commission, it is possible to know how these factors influence investor's decision and it is shown in the graph below:

Graph 13: Decisive factors to start an investment



Source: Own Elaboration from EBAN⁴⁹

The team is the most important factors to invest, which means investors focus their attention on personal skills, values, teamwork or leadership. The individual who is in charge has got the pressure to lead the way to success, and that is what creates added value to external funders. This characteristic represents nearly 90% of the importance declared for this kind of investor.

Growth potential, as well as the idea, it is not so significant, approximately 50%. This depends on the market where the business is going to operate, that is to say, it is an external risk. Finally, the quality of the business plan only represents a 25%.

⁴⁹Statistics Compendium European Early Stage Market Statistics 2018, EBAN, updated to 2019, retrieved on May 15, 2020, available in <http://eban.img.musvc1.net/static/90357/documenti/ConsoleDocuments/Statistics%202018%20Compendium%20-%20FINAL.pdf>

It is concluded that it is more important the internal risks than external risks. The potential of a SME or start-up was born from the union of the team, and it is critical to the success of a new company.

5.5. Why do start-ups choose new funding over traditional bank loans? The success factors of alternative financing.

A start-up requires some kind of initial investment in order to start and effectively develop its business. Each start-up is looking for different ways of funding itself. And we already know, that in order to do so, most of them rely on alternative financing methods. Previously, it was mentioned that the European alternative funding ecosystem has been constantly increasing its share on the year-to-year basis. Now, we'll try to answer the research question: "What are the success factors for the increase in new ways of financing for SMEs?"

There might be indefinite reasons why; however, the most important ones will be listed and described onwards.

Alternative financing opportunities like Venture Capital, Business Angels and crowdfunding do not only provide the company with sufficient funding to start their operations, but allow the start-ups to raise awareness and have a greater visibility in the market. For instance, a functioning crowdfunding campaign is a suitable way to introduce a start-up's general mission and objectives to the market, as it is a free and simple approach to reach many channels.

Another success factor for the alternative ways of financing is the level of the interest rate that is being charged to the start-up. The interest rate in alternative financing is considered to be lower than for the traditional bank loans. For sure, the rate differences also depend on the types of the investment, regulations, and the country where the start-up is based in.

Research in the field of peer-to-peer lending has been carried out to be able to compare the results with rates provided by banks. To be more precise, the UK P2P platform named Zopa and the UK biggest bank named Hongkong and Shanghai Banking Corporation (HSBC) have been used for that purpose.

The Zopa platform offers the peer-to-peer loans of maximum amount of 25,000 pounds for a company. In 2019, the interest rate varied between 3.3% to 3.5% depending on the loan

amount. For example, the APR (annual percentage rate) for the maximum amount with the repayment period of five years is 3.5%⁵⁰. And the APR for the personal loan of the same amount under the same conditions is 6.7% borrowed by HSBC⁵¹.

In reference to Spain, the interest rate varies regarding loan risk, especially on crowdlending platforms. For that reason, due to the fact that it is totally impossible to know this percentage, the table below shows the average interest rate for each entity. The comparison is between the two most important banks in Spain, and two of the most renowned crowdlending platforms.

Table 3: Average interest rate of loans (updated to 2020)

LENDER	INTEREST RATE
Banco Santander ⁵²	6,75%
BBVA ⁵³	5,55%
MytripleA ⁵⁴	3,76%
YounitedCredit ⁵⁵	5,75%

Source: Own Elaboration from Banco Santander, BBVA, MytripleA and HelpMyCash

In terms of interest rate, start-ups might choose to fund their companies through new instruments, as the interest rate aspect is beneficial or, in the worst case, very similar to bank loans.

Concerns the differences in requirements related to traditional and alternative ways of financing. In major cases, for start-ups it is harder to follow and fulfill the requirements of the bank. For instance, in the most countries the requirements for taking a bank loan are following:

- A company has to have a good credit score;

⁵⁰Debt consolidation loans – See rates & apply, Zopa, updated to 2020, retrieved on March, 2019, available in <https://www.zopa.com/loans>

⁵¹(“Personal Loans | Personal Loan Calculator, HSBC UK, updated to 2020, retrieved on March, 2019, available in <https://www.hsbc.co.uk/loans/products/personal/>

⁵² Préstamo Profesional 1|2|3, Banco Santander, updated to 2020, retrieved on May, 2020, available in <https://www.bancosantander.es/es/empresas/financiacion/anticipo-facturas-financiacion-dia-a-dia/prestamo-profesional>

⁵³ Préstamos Online Negocios, BBVA, updated to 2020, retrieved on May 28, 2020, available in <https://www.bbva.es/empresas/productos/financiacion/prestamo-para-negocios.html>

⁵⁴ Préstamos para Empresas y Negocios Españoles, MytripleA, updated to December, 2019, retrieved on May 28, 2020, available in <https://www.mytriplea.com/financiacion-empresas/prestamos/>

⁵⁵Préstamo P2P Younited Credit, HelpMyCash, updated to May 28, 2020, retrieved on May 29, 2020, available in <https://www.helpmycash.com/creditos/younited-credit/prestamo-p2p-younited-credit/>

- To qualify for a small business loan, the company should have at least one-year business history;
- The company should make at least \$50,000 revenue a year;
- The total income should be at least 1.25 times higher than the total expense;
- The company should have some collateral to apply for a bank loan;
- The company should specify, how exactly does it plan to use the money it asks.

As an alternative for the bank loan, crowdfunding requirements could be taken as an example of alternative finance demands. The following requisites are retrieved from the Czech crowdfunding platform named HitHit.cz:

- Register on the platform and describe the idea of the start-up using the tips provided on the web page of the platform;
- Give as much information about the start-up itself as possible;
- Set a target time to get a funding and set the amount that the company will ask⁵⁶.

Comparing both criteria, it is important to emphasize that crowdfunding focuses in more qualitative and subjective aspects, giving less importance to repayment abilities. A start up might find it easier to comply with crowdfunding requisites.

The other advantage of alternative financing is the time frame from applying to receiving funding. The time that the company takes to prepare all the mandatory documents and feedback is about 60 to 90 days⁵⁷. Moreover, bureaucratic processes when applying for credit tend to be lengthy and tedious. While in the case of crowdfunding or peer-to-peer lending, time depends mostly on the company itself. In general, it takes around 2 to 3 days to gather all the information that the platforms require. Furthermore, the time for collection money period varies. It depends on such factors as the attractiveness of the idea, the reward level (or the level of the interest rate), customers' preferences, and many other factors. Mostly it is about 30 to 45 days.

The time speed of the process of granting the money through alternative ways of financing is the other successor that might have caused the increase in popularity of the alternative ways of financing.

⁵⁶ HitHit, How does it work, retrieved on March 2020, available in <https://www.hithit.com/en/article/howHithitWorks>

⁵⁷BALLE, L., How Long Does It Take to Get an SBA Loan?, Chron, retrieved on March, 2020, available in <https://smallbusiness.chron.com/long-sba-loan-17359.html>

5.6. Alternative financing trends for start-ups

Bank-company relationships are still very common, but not long ago, it was usual to have a lifelong relationship with only one bank. Today, SMEs and especially, micro-enterprises agree to have relationships with more banks, in average up to three. Corporations or bigger enterprises tend to be related to a higher number of financial institutions⁵⁸. According to Fielding and Fleming (2016) banks can handle only 7% of products digitally from end to end⁵⁹.

The establishment of new digital banks and decentralized marketplaces incentives SMEs and start-ups to try their product offerings. Revolut, N26 and BNNext⁶⁰ are examples of digital banks that offer financial instruments apart from digital banking, such as loans, mortgages, and financial advice. Banks must make investments in digital lending more effective if they want to avoid a substantial decline in profits.

According to Forbes magazine, the innovation strategies of the greatest Spanish banks are focused on Fintech. The objective is that most financial products (such as personal loans, credit lines, mortgages) are contracted by computer application as well as decrease the use of branches. BBVA, for example, offers 92% of his products online and it can be contracted with just one click⁶¹.

As a rule,, financial institutions refused to collaborate with FinTechs. But, in the last few years, banks collaborate with Fintech companies and try to create a personalized experience through the delegation of specific actions. According to PwC,⁶² banking and payments industries offer palpable examples of FinTechs changing the financial sector by offering new solutions that are visibly disturbing traditional players

⁵⁸ WEHINGER, G. & KAOUSAR NASSR, I. (2015), "Unlocking SME finance through market-based debt: Securitisation, private placements and bonds, *OECD Journal: Financial Market Trends*, vol. 2014, issue 2, 89-190

⁵⁹ FLEMING, R. & FIELDING, J., How Banks Can Accelerate Digital Lending, Forbes, updated to March 2, 2016, retrieved on March, 2019, available in <https://www.forbes.com/sites/baininsights/2016/03/02/how-banks-can-accelerate-digital-lending/>

⁶⁰ GARAUS, N., ¿Qué bancos "fintech" operan en España actualmente?, HelpMyCash, updated to July 1, 2019, retrieved on 23 May, 2020, available in <https://www.helpmycash.com/blog/que-bancos-fintech-operan-en-espana-actualmente/>

⁶¹ TOCA, G., Las estrategias de innovación de los grandes bancos españoles, Forbes, updated to April 20, 2018, retrieved on 23 May, 2020, available in <https://forbes.es/empresas/41970/las-estrategias-de-innovacion-de-los-grandes-bancos-espanoles/>

⁶² Beyond automated advice: How FinTech is shaping asset & wealth management, PwC, updated to 2016, retrieved on March, 2019, available in <https://www.pwc.com/gx/en/financial-services/pdf/fin-tech-asset-and-wealth-management.pdf>

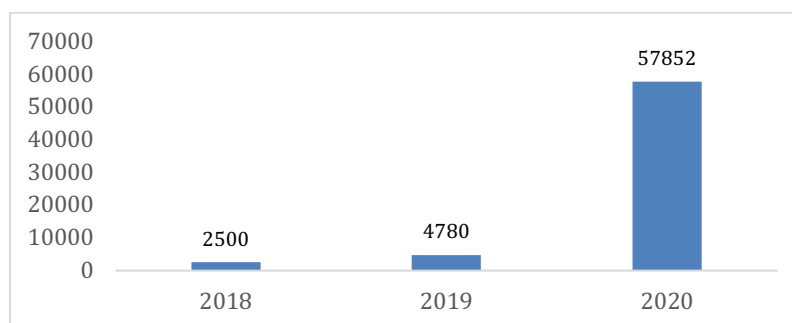
6. The current funding in Spain: an unprecedented situation

It is a fact that the current health crisis because of Covid-19 virus, which affects the world equally, is changing the way of financing SMEs. Governments have acted in response to the need of liquidity surrounding SMEs and the self-employed.

For example, in Spain, the government has allocated 57.852 million euros to ICO loans in the current year, most of them to help the entities previously named⁶³. This kind of loans exists years ago, but its use was not widespread. In 2018 the total of financing issue was 2.500 million euros⁶⁴, meanwhile in 2019 the volume was of 4.780 million euros, which means a 92% percentage increase⁶⁵.

However, as we can notice for the measures taken by the Spanish government since the beginning of the crisis, , this way of financing has increased a lot, specifically beyond twelve times the previous volume. This is not surprising according to the special measures declared in March, but it is clear that there will be an impact in the volume of alternative financing used for SMEs. In this case, regarding chart 11 data, there is more volume than P2P Business Lending.

Graph 14: volume of ICO loans in Spain (in million €)



Source: Own Elaboration from Instituto de Crédito Oficial

⁶³El ICO moviliza 57.852 millones de financiación para autónomos y empresas en 462-600 operaciones avaladas, Europa Press, updated to May 26, 2020, retrieved on May 27, 2020, available in <https://www.europapress.es/economia/finanzas-00340/noticia-ico-moviliza-57852-millones-financiacion-autonomos-empresas-462600-operaciones-avaladas-20200526114812.html>

⁶⁴El ICO mejora las condiciones de las Líneas ICO 2019 para adaptarse a las necesidades de financiación de empresas, pymes y autónomos; Gobierno de España, Instituto de Crédito Oficial, updated to February 2, 2019, retrieved on May 20, 2020, available in <https://www.ico.es/web/ico/notas-de-prensa/-/blogs/l-ico-mejora-las-condiciones-de-las-lineas-ico-2019-para-adaptarse-a-las-necesidades-de-financiacion-de-empresas-pymes-y-autonomos>

⁶⁵El ICO otorgó más de 4.780 millones de euros para financiar la actividad de autónomos y empresas españolas a través de sus líneas en 2019; Gobierno de España, Instituto de Crédito Oficial, updated to January 9, 2020, retrieved on May 20, 2020, available in <https://www.ico.es/web/ico/notas-de-prensa/-/blogs/el-ico-otorgo-mas-de-4-780-millones-de-euros-para-financiar-la-actividad-de-autonomos-y-empresas-espanolas-a-traves-de-sus-lineas-en-2019>

The good reception of these funds is based on four extremes:

- All ICO loans have a Governmental guarantee, although not for the whole. For SMEs and self-employed, this guarantee covers a 80% of the principal of the loan (not commissions or interests). In the case of non-SME companies, this guarantee covers a 70% of the same concept⁶⁶.
- These loans have a grace year, which means that the first year only pays the interest but not the principal.
- The maximum term of the loan is five years.
- Finally, the interest rate is the lowest in the whole market. In April, for SMEs it was 1'5% more or less, and for self-employed 2'5%⁶⁷.

Obviously, the most important aspect of these financing is the little risk involved for both the company and the bank. In case of non-payment, the bank would just have to face the 20% of which the company responds. For that reason, it is totally understandable that companies want to get into debt through this way.

However, it is worrying how quickly many loans have been accepted, which could be a sign that they have been granted complacently, increasing the risk of the State and, what is more, increasing debt levels in case of defaults.

Finally, what should happen in the context of the pandemic in which we find ourselves after two months in which the economy works halfway, is the slump in alternative funding levels in comparison to the levels of the ICO lines.

⁶⁶ Líneas Avales Covid-19, Gobierno de España, Instituto de Crédito Oficial, 2020, retrieved on May 20, 2020, available in <https://www.ico.es/web/ico/linea-avales>

⁶⁷ ALBA, C., Los autónomos reclaman que el ICO limite el tipo de interés del crédito avalado de la banca, El Español, updated to April 7, 2020, retrieved on 20 May, 2020, available in https://www.elespanol.com/invertia/empresas/banca/20200407/autonomos-reclaman-ico-limite-interes-credito-avalado/480453306_0.html

7. A case study of success and practical problems

In order to highlight the reasons for the increase in popularity of new ways of financing for start-ups and SMEs, we will analyse two case studies. The companies selected are SMS Ibérica S.L (SME) and Warby Parker (start-up), the first is an example of how traditional debt financing might slow down company growth, and the second represents a success case of a start-up company that thanks to venture capital had the chance to develop at persistent rates.

7.1. SMS Ibérica, S.L.

SMS Ibérica, S.L. is a Spanish limited liability company founded in 2014 in Cuarte de Huerva, Zaragoza. The object of the company is double: the making of false metal ceilings as well as ventilated facades, and the buying and selling of second-hand vehicles. The information used is thanks to the administrator of the enterprise who has given its consent, providing the annual accounts.

The net amount of turnover of SMS Iberica S.L. is €1.13 million⁶⁸. The first thing that stands out is the higher banking debt in the short term (€88,480) compared with the long term (€38,333). The company might face a liquidity problem in the short term, as their current ratio is 1.15. (Current assets: €194,900; Current Liabilities: €168,300).

The debt ratio is healthy: 1.6, but the issue is that the majority of equity is comprised of not distributed profit. To explain what the problem is, it is necessary to mention that total profit comes from both objects of the company, and buying and selling second-hand vehicles do not make use of banking finance, so it is very difficult to determine which is the real debt rate in any of them. Also, the banking finance debt rate is 0.9169 due to the banking loans represent the 57% of the total liabilities.

As a clarification, it can be said that 2019 annual account are not presented yet, so updated data are not available. What can be said is that, in these circumstances the company has taken ICO loans instead of bank loans. This fact would entail a higher long-term debt ratio.

⁶⁸ Appendix II

Other relevant information is the net positive profit, which amounts to 79,146.66€ and covers a 6.94% of the total net amount of turnover. Information broken down by business area is not available.

7.2. Warby Parker Ltd.

Warby Parker Ltd. began as a start-up company founded by three business school classmates, and has become a \$1 billion company. It was founded in 2010 around the goal of allowing everyone to be able to own fashionable sunglasses at an affordable price. As a private limited company, accounts are not public.

Warby Parker has funded its company almost entirely through venture capital. They have passed through the A, B, C and D funding series, and as of March 2018, they were looking into Series E funding for a worth of \$75 million⁶⁹. The first debt financing stage took place on October 2010, when the company was created and amounted to \$500 thousand dollars.

The company relied on hybrid funding, with aspects of traditional debt financing at their beginnings. After this first stage, the company completely relied on venture capital. Overall, Warby Parker has notched more than \$200 million in funding since its beginning, today, it is valued at \$1.2 billion⁷⁰. Rowe Price and General Catalyst are two examples of investment management firms dedicated to funding technological start-ups, and have been present in some of the funding stages that Warby Parker has undergone.

7.3. Main differences

The comparison between these two companies enriches our premise of why small companies might prefer new ways of funding, as they have proven to have quicker and more efficient results, which are also accompanied by success factors previously mentioned.

⁶⁹ Appendix I

⁷⁰ J. DE LA MERCED, M., Warby Parker, the Eyewear Seller, Raises \$75 Million, New York Times, updated to March 27, 2018, retrieved on March 2019, available in <https://www.nytimes.com/2018/03/14/business/dealbook/warby-parker-fundraising.html>

In order to understand the differences between these SMEs, it is crucial to know in which market they work.

In the case of SMS Ibérica, S.L., it only works with other companies (B2B), which means the product is not intended for ultimate consumers, but for other firms as clients. The impact is that an industrial company has the possibility to pay later, compared to the final customer, who pays at the time of the purchase. This situation might cause a need for funding in the short term because of uneven cash-flows. Also, it is important to stress that the construction sector is a mature market that does not give a lot of opportunities to turn into a big company, as there are many foreign enterprises trying to enter the European construction market, which means there are some threats that can reduce the growth due to market saturation. Further, in the construction sector it is very difficult to negotiate collection conditions due to the low negotiating power of the suppliers that depend on when the developer pays. All this implies that it is complicated that there are excess funds to invest.

Compared with the previous one, Warby Parker is a direct sunglass seller to the final customer, so they have a high level of cash rotation caused by the minimization of fixed cost and variable cost, so it is probable that they do not need finance in the short term. This implies that they can focus their funds on investing or expanding the business.

As can be seen, when we talk about financing, the sector is totally important. Warby Parker has used Venture Capitals, while SMS Ibérica, S.L. is totally financed by bank loans. With respect to sunglasses, the model of glasses can be changed, the colour, the material or even the production process. But the construction sector is different: changing the production process is very costly, normally it works upon order and the material is sold to a company, so the negotiation is more difficult. For these reasons, the sunglasses market is much more attractive than the construction industry in terms of investment.

8. Conclusion

In the first place, alternative finance data are published two years later (the most recent data are from two years ago), so the data of the current year is not known, which is an added difficulty.

It is believed that banking finance is the best way to raise money in a short period of time. However, nowadays, as banks are not as secure as they used to be before the 2008 crisis, there is an uncertain ecosystem due to their risk minimization concerns, opening the path to new types of funding.

Through research obtained, it is a suitable option for SMEs and start-ups to benefit from new funding ways. Currently, investors are looking for investments with increased profitability, and are not particularly concerned about the level of risk. Being part of an investment turns the SME into a more sophisticated corporation with the ability to absorb experience and know how.

Nevertheless, private investors are only going to consider investing into a small business if they believe that the return is going to be substantial. In the start-up ecosystem, risk and return tend to be proportional. The research paper highlights that being an entrepreneur in an emerging market tends to be more profitable than mature and saturated markets, where competition is already established and new entrants face high barriers to entry.

However, this year could be a recession in terms on investment due to the pandemic crisis. The risk is very high and forecasts show an increase in unemployment, and more importantly a considerable decrease in GDP. For these reasons, businesses could try to be cautious and risk averse, preparing for an uncertain future.

As far as I am concerned, without mentioning the current year, in the future is totally sure that these transactions are going to increase thanks to technological investments which will entail a financial change of mind. Banks, which are gradually offering other products, may stop having the majority of the market share in terms of financing businesses (this does not mean that they lose their leadership) if they find a more profitable business area, and the alternative ways would increase their presence.

The possible raising of transactions can be explained referring to Asian countries, which have had a strong economic growth thanks to alternative financing. And that is because they

have bet for the using of technology and the creation of successful fintech start-ups. This could mean that in Europe there is a financial market that it is not being exploited. The problem may be the emerging of a new financial market without fully exploited this one, which means to be behind technological development.

In addition, with alternative finance the investor is able to diversify the investment, which is an important advantage. The investor is who decide how he wants to spread the risk. This is very important because makes the investment on Small and Medium Enterprises more tempting, while banks assume total risk.

To sum up, the last question is: In which markets would an investor be willing to invest his funds? - All markets are attractive, and there is no definite conclusion about where to invest, but if the right decision is chosen, the likelihood of success may be exponentially elevated. And this because there are sectors which life cycle are beginning, especially technological markets. But these industries are totally unpredictable due to the rapid development of technology, so the investor will decide on the basis of their own criteria. Their criteria are commonly based on business idea, but success is by no means guaranteed. In any case, one of the crucial factors is to be disruptive, seeking innovative ideas. And this is the main problem: the higher the risk the greater the profit.

Finally, in my opinion, alternative financing is an essential source of finance for start-ups, but not for SMEs that have operated several years in the market. These enterprises are settled on the market, and their growth potential is less than a new creation business. For that reason, start-ups are much more profitable.

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10. Graphs and tables

TABLES

Table 1: definition criteria for SMEs defined by European Commission

Table 2: main ways of alternative financing in 2016 in terms of market share in Europe

Table 3: Average interest rate of loans (updated to 2020)

GRAPHS:

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Graph 2: survey to SMEs about bank financing issues from 2008 to 2011

Graph 3: ways of financing used for Spanish SMEs in 2018 (percentage of the total which used a type on financing)

Graph 4: general aspects of financing SMEs from 2016 to 2018

Graph 5: Regional Online Alternative Finance Market Volumes 2014-2017 (bn €)

Graph 6: Total Alternative Finance Volume in Asia-Pacific 2015-2018 (bn USD)

Graph 7: Online Alternative Finance Volume by Country 2017 (€million; Exc. UK)

Graph 8: volumes of alternative finance transactions by European countries on 2014 (€ million)

Graph 9: Alternative finance market allocation in Europe (2016-2017)

Graph 10: Total Alternative Finance Volume by Model in Spain 2016-2017 (in millions of €)

Graph 11: Start-up Financing Cycle

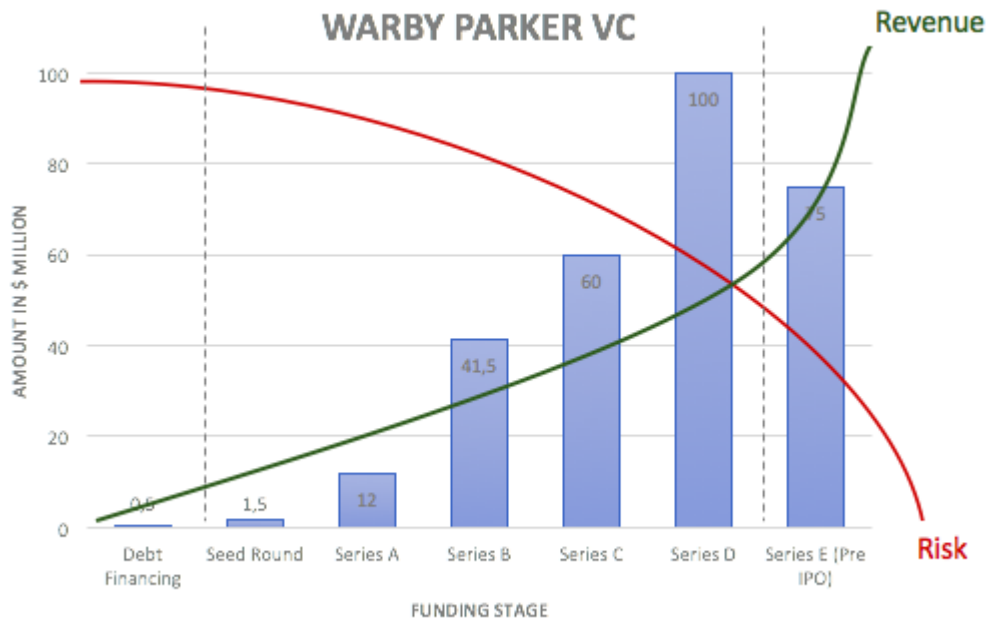
Graph 12: Early Stage Investment Market in Europe, 2018

Graph 13: Decisive factors to start an investment

Graph 14: volume of ICO loans in Spain (in million €)

11. Appendix

Appendix I



Balance de situación de PYMES

	Dic 2018	Dic 2017
PATRIMONIO NETO Y PASIVO		
C) PASIVO CORRIENTE	168.309,31	226.180,99
I. Provisiones a corto plazo	0,00	0,00
II. Deudas a corto plazo	95.615,39	97.336,05
1. Deudas con entidades de crédito	88.483,36	96.710,90
2. Acreedores por arrendamiento financiero	0,00	0,00
3. Otras deudas a corto plazo	7.132,03	625,15
III. Deudas con empresas del grupo y asociadas a corto plazo	0,00	0,00
IV. Acreedores comerciales y otras cuentas a pagar	72.693,92	128.844,94
1. Proveedores	35.502,66	42.766,18
a) Proveedores a largo plazo	0,00	0,00
b) Proveedores a corto plazo	35.502,66	42.766,18
2. Otros acreedores	37.191,26	86.078,76
V. Periodificaciones a corto plazo	0,00	0,00
VI. Deuda con características especiales a corto plazo	0,00	0,00
TOTAL PATRIMONIO NETO Y PASIVO (A + B + C)	359.165,22	355.214,91

Balance de situación de PYMES

	Dic 2018	Dic 2017
PATRIMONIO NETO Y PASIVO		
A) PATRIMONIO NETO	138.307,83	59.161,17
A-1) Fondos propios	138.307,83	59.161,17
I. Capital	3.100,00	3.100,00
1. Capital suscrito	3.100,00	3.100,00
2. (Capital no exigido)	0,00	0,00
II. Prima de emisión	0,00	0,00
III. Reservas	31.075,86	31.075,86
1. Reserva de capitalización	0,00	0,00
2. Otras reservas	31.075,86	31.075,86
IV. (Acciones y participaciones en patrimonio propias)	0,00	0,00
V. Resultados de ejercicios anteriores	0,00	0,00
VI. Otras aportaciones de socios	0,00	0,00
VII. Resultado del ejercicio	104.131,97	24.985,31
1. Resultado contabilizado (129)	24.985,31	0,00
2. Resultado sin contabilizar	79.146,66	24.985,31
VIII. (Dividendo a cuenta)	0,00	0,00
A-2) Ajustes en patrimonio neto	0,00	0,00
A-3) Subvenciones, donaciones y legados recibidos	0,00	0,00
B) PASIVO NO CORRIENTE	52.548,08	69.872,75
I. Provisiones a largo plazo	0,00	0,00
II. Deudas a largo plazo	52.548,08	69.872,75
1. Deudas con entidades de crédito	38.333,78	52.085,94
2. Acreedores por arrendamiento financiero	-186,56	1.535,95
3. Otras deudas a largo plazo	14.400,86	16.250,86
III. Deudas con empresas del grupo y asociadas a largo plazo	0,00	0,00
IV. Pasivos por impuesto diferido	0,00	0,00
V. Periodificaciones a largo plazo	0,00	0,00
VI. Acreedores comerciales no corrientes	0,00	0,00
VII. Deuda con características especiales a largo plazo	0,00	0,00

Cuenta de pérdidas y ganancias de PYMES

	Ene-Dic 2018	Ene-Dic 2017
1. Importe neto de la cifra de negocios	1.139.784,06	803.119,89
2. Variación de existencias de productos terminados y en curso de fabricación	0,00	0,00
3. Trabajos realizados por la empresa para su activo	0,00	0,00
4. Aprovisionamientos	-641.684,98	-463.715,50
5. Otros ingresos de explotación	0,00	0,00
6. Gastos de personal	-115.481,76	-100.817,22
7. Otros gastos de explotación	-305.415,84	-160.161,51
8. Amortización del Inmovilizado	0,00	-39.369,13
9. Imputación de subvenciones de inmovilizado no financiero y otras	0,00	0,00
10. Excesos de provisiones	0,00	0,00
11. Deterioro y resultado por enajenaciones del inmovilizado	0,00	1.432,00
12. Otros resultados	1.794,78	-354,38
A) RESULTADO DE LA EXPLOTACION (1+2+3+4+5+6+7+8+9+10+11+12)	78.996,26	40.134,15
13. Ingresos financieros	5.979,70	1.499,40
a) Imputación de subvenciones, donaciones y legados de carácter financiero	0,00	0,00
b) Otros ingresos financieros	5.979,70	1.499,40
14. Gastos financieros	-5.829,30	-8.201,68
15. Variación de valor razonable en instrumentos financieros	0,00	0,00
16. Diferencias de cambio	0,00	0,00
17. Deterioro y resultado por enajenaciones de instrumentos financieros	0,00	0,00
18. Otros ingresos y gastos de carácter financiero	0,00	0,00
a) Incorporación al activo de gastos financieros	0,00	0,00
b) Ingresos financieros derivados de convenios de acreedores	0,00	0,00
c) Resto de ingresos y gastos	0,00	0,00
B) RESULTADO FINANCIERO (13+14+15+16+17+18)	150,40	-6.702,28
C) RESULTADO ANTES DE IMPUESTOS (A+B)	79.146,66	33.431,87
19. Impuestos sobre beneficios	0,00	-8.446,56
D) RESULTADO DEL EJERCICIO (C+19)	79.146,66	24.985,31

