

FINANCIAL MANAGEMENT

FROM ANGEL TO ZEBRA

Fourth edition

RUDY AERNOUDT

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Rudy Aernoudt

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PREFACE

The funding gap which entrepreneurs encounter is often attributed to the lack of supply. In reality lenders (banks) and investors (business angels, venture capital funds) do have funds. The problem lies in their unwillingness to make these funds available to entrepreneurs. This, in turn, is attributed to information asymmetries. Although it is true that suppliers can never know as much about the entrepreneur as the entrepreneur knows about him- or herself, it can be suggested that part of the information gap can be bridged through a better understanding of each party's goals.

This information gap results in a 'dialogue of the deaf' which leads to the frequent failure of enterprises to obtain the most appropriate form of financing. Either they do not obtain sufficient funds, or the conditions in terms of cost, form of financing or guarantees are not optimal. This is not only a significant obstacle to starting a business; it is also one of the biggest obstacles which prevent firms from scaling-up. It is also a major cause of bankruptcies. Indeed, inappropriate financing, combined with inadequate financial management skills, are the biggest cause of bankruptcy whereas surviving a crisis is closely related to optimal financing.

Financing is therefore not simply about raising sufficient cash. It is also about determining what is the optimal financing for the business at that particular stage in its development.

The clear implication is that a basic knowledge of finance and financial management is crucial for any entrepreneur. This is even more true in the aftermath of the economic crisis, in which good financial management was essential for the survival of companies. International banking regulations, also known as the Basel Accords, also require entrepreneurs to have a sound understanding of finances. But the financial management 'tomes' that an entrepreneur might consult are aimed at specialists in financial management and are typically dominated by theory and complex mathematical formulas. They are of little value in assisting an entrepreneur in his or her daily management role, or for students wanting to acquire basic and practical knowledge of financial management.

This book therefore fills an important gap. In contrast to the rather academic approach taken by other authors, Professor Aernoudt opts for an approach based on practice, with cases and exercises to enhance understanding of various theoretical approaches. The author differentiates between various types of enterprises and financiers. Hence the title of this book: *Financial Management. From Angel to Zebra*. He is eminently qualified for this task. As a former credit manager at an international major bank, he has experience of the bank side of corporate financing at close quarters. In addition, he has also advised many companies in determining their most appropriate form of financing. He has also been the chief financial officer (CFO) in a non-governmental organisation and a spin-off of MIT. And as a professor of Corporate Finance, he strives to impart this practical experience to his students. This book provides a vehicle through which he can share this knowledge with financial officers of small and medium-sized enterprises to guide them through financial management and, amongst other things, assist them in their negotiations with various financiers.

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CHAPTER 1

THE FINANCING LANDSCAPE

“You can make a lot more money by smart investment decisions than by smart financing decisions.”¹

Financing is all about the free interplay of market forces. The parties on the demand side are companies. However, companies are very diverse. A small start-up company does not have the same financing requirements as a long-established, internationally operating business. However, the parties on the supply side are diverse as well. A bank, for instance, will need to be approached entirely differently from a venture capital fund. In order to optimise the interplay of supply and demand and achieve the best possible financing, and financing terms, a good understanding of the company’s needs, on the one hand, and the different suppliers, on the other, is essential. Moreover, there are also a very wide variety of financing products available. First, we take a look at the product, before examining the entrepreneurial landscape, the banking scene and the world of the venture capitalists.

1.1. NOT ALL MONEY IS THE SAME

Companies tend to express their financing needs in terms of a sum of money. Their needs, however, are not only for a certain amount, but may also relate to the form, the time limit and the arrangements of the financing. It therefore seems useful, first of all, to present an overview of the advantages and disadvantages of the various financing arrangements. Every form of financing has its advantages and disadvantages, so it is important to find the optimal solution.

Indeed, not all money is the same, and too often managers concentrate on whether or not they will receive the funds, instead of focussing on the arrangements, and the form of financing they require. The source of financing is the decisive factor in this respect.

1. R.A. BREALEY and S.C. MYERS, *Principles of Corporate Finance*, New York, McGraw-Hill Books, 1988, p. 142.

After all, a subsidy granted by the government does not need to be repaid, unlike a bank loan. Repayment is also not required if a venture capitalist provides the financing, as he becomes the co-owner of the company. The same goes for a professional private investor (a business angel). This is not the case, however, for funds obtained through a family member, for instance, who may want to financially support a start-up.

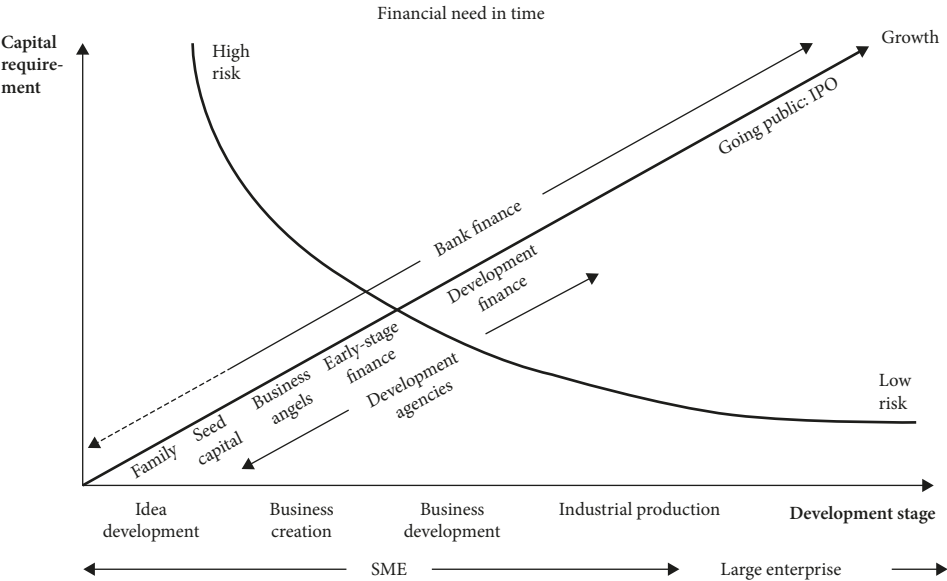
By and large, we can distinguish between five sources of financing. The table below offers an initial overview.

Table 1: Advantages and disadvantages of different sources of financing.

Source of finance	Advantages	Disadvantages
Friends, family and “fools”	– easy to find – patient	– limited added value – limited funds
Government grants	– free – patient	– bureaucratic – slow – difficult to locate
Banks	– relatively cheap – rather fast	– unpredictable behaviour – require guarantees – impatient
Business angels	– fast – unbureaucratic – understand business	– funds relatively limited – sometimes a rather unsystematic investment policy – agenda not always foreseeable
Formal venture capital	– sufficient funds – added value is easy to determine – clear agenda	– relatively slow – high expectations – difficult to obtain – exit-driven

Most instruments of equity financing focus on companies at a certain stage of development, or in a certain sector, whereas loans tend to be used by existing companies or small start-ups with a preference for the traditional sector. The various instruments are thus complementary. Before going into further detail about each of the instruments, we will try to illustrate how they are connected to each other.

Figure 1: The relationship between the source of financing and the stage of investment.



1.2. THE ENTREPRENEURIAL LANDSCAPE

Just as financing is a broad concept, one should consider that not all enterprises are the same, and that a tailor-made approach is needed. The financial needs of a start-up sandwich bar are not comparable to those of a start-up in the biotech sector. Therefore, not only the development stage, but also the characteristics of the company, determine the nature and the volume of its financial needs. We can summarise the different kind of enterprises in the table below, based on the metaphor of “creatures”.²

2. The concept of the “gazelle” is based on research, in the late eighties, by David Birch, who concluded that “mice”, but especially “gazelles”, were more important for the maintenance and creation of jobs than “elephants”: D. BIRCH, *Job Creation in America: How Our Smallest Companies Put the Most People to Work*, New York, 1987.

Table 2: Typology of companies.

	What?	Major Obstacle	Comments
Mice	Small companies but having little growth potential	Red tape Lack of finance (banks, love money, crowdfunding)	Important for self-employment and supplementary employment
Elephants	Big companies struggling to remain competitive; often offshore their businesses	Labour cost Red tape Trade unions Disruptive innovators	Important for job maintenance Outsourcing of parts of their activities, and investing abroad, is crucial for survival
Zombies	Can't pay their interest with operational profits	Finance (bank) Market Innovation	Need to do a turnaround or liquidate (the sooner the better)
Gazelles	Companies with a huge growth potential	Finance (scale-up money) Qualified labour Fragmented markets	These 5% of the companies account for 80% of newly created jobs
Unicorns	A non-quoted start-up worth 1 billion dollars	Finance (scale-up money) Fragmented markets	It is estimated (in data from 2023 ³) that there are 600 unicorns worldwide, most of them in the digital economy
Zebras	Sustainable and responsible business models	Need for sustainable ventures	Value-driven. Considered as very important for the next few decades

The importance of small to medium-sized enterprises (SMEs) is undisputed. The 25 million European SMEs account for 66 per cent of private employment. The comparable figure for the United States is “only” 44 per cent, and in corporatist Japan it is 33 per cent. Therefore, Europe is an SME region par excellence. Additionally, we have the elephants. High salary and energy costs obliged them to move part of their operations outside Europe. But times have changed, and reshoring should be considered. Fast-growing companies, such as gazelles and unicorns, are responsible for around 80 per cent of job creation. They have huge financial needs and need to find money very fast. Then we have the zombies. In Europe, the zombies represent 10 per cent of companies in Spain and Belgium, the two countries with the highest level of zombies. They lead to misallocation of human and financial resources, as they use up to 20 per cent of financial resources.⁴

3. <https://growbylittle.com/2023/04/01/unicorn-startups/>.

4. OECD, *The Walking Dead?, Zombie Firms and Productivity Performance in OECD Countries*, Economics department working paper no. 1372, 2017.

It is worthwhile noting that their outstanding credits are mostly with less creditworthy financial institutions.⁵

At the other end of the spectrum, we see the zebras. Unicorns and their financiers are out for quick profits. Their short-term profit-making are often more important than ethical, social and environmental considerations. Zebras, on the other hand, reject this dual thinking: for them, entrepreneurship is both the pursuit of profit and the social responsibility; it is, therefore, both white and black. Therefore, zebras also need sustainable financing techniques.

Money for sale

The banking landscape in Europe is very well developed and the financial markets are highly liquid. The venture capital industry is very volatile, but has grown enormously in the last few decades, and the volume of invested venture capital has been increasing by 20–30 per cent each year. However, most studies show that many companies still regard access to lines of credit as problematic, and that access to finance remains a major obstacle to the start up and development of a company. In the case of start-up businesses, empirical studies are unanimous: a lack of financial resources is the reason why many good projects do not see the light of day.

Especially fast-growing companies regard access to finance as one of the most important obstacles to further growth. A survey of the 500 fastest-growing companies in Europe, the so-called top 500, has found that three obstacles impede further growth: the level of taxation, the bureaucracy of public services and the lack of finance.

A survey of 50,000 small and medium-sized enterprises looked into barriers to further growth. Seven obstacles were found to be the most important. Three related to financing: the lack of finance, the cost of finance and the enterprises' lack of their own resources. Forty per cent of the companies surveyed mentioned the issue of financing as the main obstacle to growth. Other obstacles included lack of trained staff, lack of market opportunities and insufficient innovation. In the most-recent yearly *Survey on the access to finance of enterprises* (SAFE), 82 per cent of SMEs in the European Union considered bank financing as the most relevant form of financing, albeit by expressing systematically their pessimism on the availability of bank finance.⁶

5. OECD, *Breaking the shackles: zombie firms, weak banks and depressed restructuring in Europe*, Economics department working paper no. 1433, 2017.

6. EUROPEAN COMMISSION, *Survey on the access to finance of enterprises (SAFE)*, Brussels 2023.

This unanimity among the various surveys in no way means that all companies are confronted by the problem of financing to the same extent. Relying once more on the survey carried out in Europe, the table below indicates, in addition to the percentage of companies that regard the financial barrier as the main obstacle, the percentage of companies that have access to bank credit, and whether the banks require personal guarantees, or business guarantees based on the company's assets, for that purpose.

Table 3: Importance of the financial barrier in accordance with the development stage and type of company.⁷

Company type:	Early stage	Limited growers	Very innovative	Growing
Financing as major obstacle	22%	8%	16%	19%
Bank loans	40%	40%	47%	50%
Bank guarantees	33%	37%	44%	48%
Personal guarantees	25%	26%	36%	39%
Guarantees on fixed assets	4%	5%	5%	7%

Start-ups and fast growers appear to suffer more as a result of financial barriers than limited growers. Half of fast growers have access to bank credit, and 80 per cent of entrepreneurs report that they have had to put in their personal assets as a guarantee in order to secure the line of credit. This includes both personal security and collateral security, for instance on the immovable property of the manager. Empirical research in the United Kingdom has shown that “high-performance start-ups” are confronted with major financial bottlenecks in their first two years.⁸ Their financing requirements are particularly large because of their initial negative cash flow.

Innovative companies are also confronted with the problem of financing, although to a lesser extent. Limited growers, on the other hand, do not have such a major need for credit, and thus do not experience the problem of obtaining financing to such an extent. Nevertheless, 40 per cent of such companies have access to bank credit, and here, too, in two out of three cases the bank is not satisfied with mere collateral security.

In start-up companies too, 40 per cent have access to bank credit, although here the credit squeeze is perceived as the major obstacle in almost three times the number of companies. On the basis of these statistics, we may conclude that 60 per cent of companies, whether

7. *European Yearly Observatory for SMEs, European Commission, Brussels.*

8. A. BURKE, et al., “What Determines The Level Of Informal Venture Finance Investment? Market Clearing Forces And Gender Effects,” *Small Business Economics, Springer*, vol. 42(3), pages 467–484, March, 2014.

forced or otherwise, start up without using bank credit. They use their own funds, love money, business angels or crowdfunding.

Of course, all these figures need to be interpreted with caution. Nevertheless, we can conclude from these surveys that a lack of financing is still a major barrier to starting up a company, and that this barrier is severely felt by fast growers and innovative companies in particular. Moreover, because of the fact that banks systematically require personal securities, the principle of limited liability of various types of companies is, at least partly, put at risk.

1.3. CREDIT CULTURE

It is no wonder that banks are often perceived quite negatively. They are too expensive, and take too many securities and too few risks. This was the conclusion of SME organisations, following the first roundtable of companies and banks organised by the European Commission.⁹

Despite the criticism that banks attract, they remain the most popular financiers. There are various reasons for this:

1. They are relatively cheap, especially in comparison with venture capital or capital markets.
2. They do not, or rarely, intervene in business policy, at least only to the extent that the agreed due dates are observed.
3. They do not demand a seat on the board of directors, nor a share of the equity.
4. They are more easily accessible to SMEs than other forms of financing.

They remain by far the most popular external financiers. In the European Union, half of all companies have obtained cash credit, and almost as many have access to bank credit. In the United States as well, bank financing is the most important external source of financing.¹⁰

European companies encounter particular difficulties in attracting long-term credit. After all, for short-term credit, banks are very demanding in terms of guarantees, and many commercial operations are self-securing. The ratio between long-term credit and total

9. EUROPEAN COMMISSION, Roundtable banks – companies, first report, Brussels 1999.

10. See, e.g. study by L.H. MEYER, “The present and future roles of banks in small business finance”, *Journal of Banking & Finance*, 22, 2004, 1109–16.

appropriations is called the “confidence ratio”. To what extent do banks put their trust in companies? A very large difference can be seen between the United States and Europe. We will compare the average financial structure of an American company with a company in Europe. In so doing, we take the equity capital and short-term and long-term credit to equal 100. Note that these averages, of course, hide the differences between the various countries and companies.

Table 4: Comparison of European and American financial structures.¹¹

(as % of balance sheet total)	US	EU
Equity capital	46	32
Long-term loan capital	28	17
Permanent funds	74	49
Short-term credit	26	51

Table 4 shows that European companies rely on banks for short-term credit almost twice as much as American companies do. The different balance sheet structure in Europe in comparison with the United States also means that the impact of the revision of capital requirements of banks will be felt more in Europe. Every change with regard to capital requirements can have a higher impact on European companies than on those in the United States. Bank financing in the European Union is, on average, 50 per cent of the total debt financing, whereas this figure is 34 per cent in the United States.¹² The outstanding bank debt of companies in the European Union, therefore, exceeds that of those in the United States threefold.¹³ This indicates that US companies can appeal more to the financial markets for their debt financing, including by issuing bonds. An additional element is that, in the United States, the spectrum between equity and debt – the so-called “mezzanine financing” – is used much more than in Europe.

This phenomenon is called “the confidence gap” by academics. Because of companies’ lack of their own resources, banks in Europe prefer granting short-term credit, usually bound by specific self-liquidating transactions, or classic cash credit. This confidence gap can, in turn, at least partially be explained by the equity gap of the equity culture: since the equity culture is much more developed in the United States than in Europe, the equity capital is

11. R. AERNOUDT, “European policy towards venture capital: myth or reality?,” *Venture Capital, an International Journal of Entrepreneurial Finance*, vol. 1, no. 1, 1999.

12. EUROPEAN CENTRAL BANK, *Survey on the Access to Finance of Enterprises in the Euro area*, Frankfurt 2022.

13. D. VALIANTE, *Europe’s Untapped Capital market, Rethinking integration after the great financial crisis*, Brussels, CEPS ECMI, 2016.

ceteris paribus higher in the United States than in Europe. This equity culture refers both to capital markets and to private formal and informal venture capital.

Bank loyalty

In Europe, banks are, therefore, of greater importance for financial intermediation than they are in the United States. And although the capital markets are also developing strongly in Europe, credit financing remains more important. Another way of looking at this is to compare the market capitalisation of listed companies with bank financing. This ratio is below one for all European countries, while the ratio of market capitalisation to bank financing in the United States is above two. This puts European companies in a position of dependence on the bank.

Undercapitalisation is especially significant for SMEs. The equity compared to the balance sheet total – or, in other words, the ratio of financial autonomy – is 28 per cent for European companies with a turnover of less than 7 million euros, and 36 per cent for companies with a turnover of more than 40 million euros.¹⁴

The financial independence of Belgian SMEs is 35 per cent, compared with 41 per cent for large companies. These averages again conceal the fact that more than 15 per cent of Belgian companies have a negative equity, which means that the losses carried over exceed the initially used capital. Due to their weaker structure, SMEs are more likely to use cash credit, which significantly increases the cost of financing. A survey among Flemish entrepreneurs confirms the importance of cash credit: 30 per cent of the SMEs had taken out cash credit in the year concerned, despite the fact that the overdraft rate was particularly high.¹⁵ Half of the companies that took out overdrafts last year paid an interest rate of 8 per cent or higher. A fifth of the companies even paid a rate higher than 10 per cent, and that at a time when the interest on the financial markets was very low, or even negative.

Because the volume and duration of loans tend to be insufficient, it is in the interest of companies, and especially SMEs, to build stable relationship with their banks. In fact, a personal relationship increases the chance of obtaining a line of credit, as many studies show.¹⁶

14. THE EUROPEAN OBSERVATORY FOR SMEs, Sixth Report, Brussels, 2001. These average figures are based on the figures of seven countries.

15. FOD ECONOMIE, *Access to finance: an international comparison*, Brussels, 2022.

16. E.g. B. PRAET, “Basle II: What does it mean and what is the impact” in R. AERNOUDT *et al.*, *Belgian Yearbook on Corporate Finance*, Intersentia, Antwerp 2004, pp. 35–53.

Therefore, we also note that many SMEs have a relationship with only one bank. In Germany and Austria, for example, where undercapitalisation for companies with a turnover of less than 7 million euros is huge (the average ratio of equity to the balance sheet total is 14 per cent), companies tend to have a very close relationship with one banker (the so-called *Hausbanksystem*). No less than 78 per cent of Belgian SMEs declare that they work with only one principal bank.

Market failure

One could argue, referring to the equilibrium rates, that the financing gap is due to price conditions whereby the amount of financing demanded exceeds the amount being supplied. However, peculiarities of finance explain the existence of a financing gap without price distortions, because financiers may decline to supply funds for a variety of reasons. Some issues of primary importance include the complications arising from asymmetric information, such as moral hazard and adverse selection. Stiglitz and Weiss¹⁷ conclude that there are no competitive forces in action to increase the interest rate in order to bring demand and supply together. A market-clearing equilibrated pricing mechanism is, hence, not an efficient instrument to cope with the financing gap. On the contrary, if, for instance, a bank agreed a higher interest rate, its expected return would decrease, due to informational asymmetries. First, an adverse selection effect would be introduced, as a higher interest rate attracts higher-risk borrowers, while lower-risk borrowers drop out. Secondly, borrowers who receive a loan will prefer higher-risk projects to low-risk projects. By driving out lower-risk borrowers, high interest rates may lead to a riskier loan portfolio, thus setting in motion a process of adverse credit selection. Thirdly, this would increase the capital requirements imposed by the Basel Regulations, and hence the higher interest would not necessarily lead to higher profit margins. For all these reasons, bankers have an incentive to engage in credit rationing, and to allocate credits to very creditworthy borrowers. Consequently, bankers do not provide or extend the full amount of credit demanded, even when the borrower is willing to pay higher rates. On the demand side, potential borrowers do not apply for a bank loan, because they fear their applications would be rejected. Studies show that, amongst those discouraged borrowers, only 20 per cent have a high likelihood of being rejected should they apply.¹⁸

17. J.E. STIGLITZ and A. WEISS, "Credit rationing in markets with imperfect information", *The American Economic Review*: vol. 71(3): 393–410 (1981).

18. A. FERRANDO AND K. MULIER, *The Real Effects of Credit Constraints: Evidence from Discouraged*, 2017.

1.4. THE BANKING LANDSCAPE

It should be clear by now that banks will continue to play a major role in financing. Let us therefore have a closer look at the banking landscape.

The concentration of the banking sector is very volatile. It can be measured by the Herfindahl index (HHI), referring to the concentration of banking business (based on total assets). The HHI is obtained by summing the squares of the market shares of all the credit institutions in the banking sector. An HHI value below 1,000 corresponds to a low concentration of the total banking assets, a value between 1,000 and 1,800 refers to a moderate concentration, and a value above 1,800 to a high concentration. According to the American competition authorities, which, in contrast with the European ones, tend to emphasise structures and behaviour, a Herfindhal index that exceeds 1,800 is regarded as an indication of a (too) strong concentration. In less concentrated markets (with an index between 1,000 and 1,800) an increase in the index is only considered critical if it raises the index by at least 10.

As an illustration, in Belgium the HHI doubled over 13 years, from 971 in 1995 to 1,894 in 2008, before falling again to 1,320 in 2021. This illustrates that the banking sector was highly concentrated, in 2008, just before the outbreak of the financial crisis, which does not mean that there was a lack of competition. The number of major banks had fallen from nine in 1995 to just five in 2008, as a result of merger & acquisition operations. The financial crisis led to a normal concentration once again, especially as a number of large banks had to close down part of their activities, in order to qualify for state aid.

For those who have not yet had enough of indexes, the reverse Herfindhal index calculates the equivalent number. This is the hypothetical number of banks of equal size that would lead to the same outcome as the calculated HHI based on reality, and therefore on banks of different sizes. Thus, the equivalent figure corresponding to an HHI of 1,320 would be 7.5 ($1/0.1320$). This means that the Belgian credit market is as concentrated as it would be were only seven banks of equal size active. This figure can be put into perspective if we compare it with the actual number of banks, which is 101 if we rely on the banks recognised by the Financial Services and Markets Authority (FSMA), or 317 if we take the complete database of banks active in Belgium into account. In the Netherlands, the concentration level is even higher, with an HHI of 2,143; the five largest banks provide more than 80 per cent of all loans. At the other end of the spectrum is Germany, with an HHI of only 289, or almost ten times less than that of the Netherlands.¹⁹

19. EU, *Structural Indicators for the EU Banking Sector, 2023 (updated yearly)*.

The economic crisis of 2008/09 has, indeed, profoundly changed the entire banking environment. The sector was shaken right down to its foundations. Many banks have only survived with the benefit of massive government support. Supervision and regulation were intensified. But a “run on the bank”, often based on a lack of trust in the bank and its management, can still put a bank on its knees within a couple of days. In 2023, *Crédit Suisse*, one of the major Swiss banks, could only be saved after a takeover by *UBS*, orchestrated by the government. Fifteen years earlier, the same happened to *Fortis*, which could only be saved by being sold to the *BNP Group*. In both cases, the banks were sold for prices far below their capitalisation value before the run on the bank.²⁰

And although the banks have undergone a great deal of mutation over recent decades, they still face significant challenges. The main challenges are the phenomenon of globalisation, the emerging trend of fragmentation, the impact of information technology, and the Basel Accords. These factors have given the sector a totally new look.

Globalisation of the economy forces commercially oriented banks to increase their shareholder value. Credit to enterprises has to be as profitable as all other activities, such as asset management. Regarding lending to enterprises, and especially to SMEs, the risk and relatively high administrative costs involved in lending are reasons why lending is not, a priori, the most profitable banking activity. Consequently, certain commercial banks have withdrawn from lending to SMEs, which certain niche players might embrace as an opportunity.

Belgian and French banks, in particular, had to undertake a catching-up operation, since the margins achieved on credits at the end of last century – particularly because of internal competitive pressure – were half the European average.²¹ The margins are calculated as the difference between the implicit interest which is received, and that which is payable on interest-bearing assets and liabilities. Now that Belgian and French banks have caught up, the margins have increased steadily ever since.²² One of the reasons for this is, obviously, that Belgian and French banks have adapted their margins to those in neighbouring countries. But the Basel Framework has undoubtedly played a role in this too.

In the wake of globalisation, the fragmentation of the European banking landscape has prompted major players to strengthen their positions through mergers and acquisitions. After the first stage in which such operations took place, particularly on a national scale,

20. R. AERNOUDT, “Op naar een volgende bankencrisis (the next banking crisis in view?)”, *FD-Magazine*, March 2023.

21. See Annual Analysis Intelligence Unit.

22. See V. BAUGNET and M. HRADSKY, “Vorming van de debetrentetarieven van de Belgische banken”, *Tijdschrift NBB*, 2004, III, p. 50.

these operations are becoming increasingly transnational. In order to improve their competitive position in this context, and to optimise the synergistic effects of the merger or acquisition, these new entities need to reduce costs. This usually involves redundancies and a gradual reduction in the number of offices. Banks cannot offer such advice on every street corner. Besides, even after the large reduction in the number of bank branches, partly as a result of mergers, there is still one bank branch for every 6,000 Belgians.²³ Of other European countries, only Germany and Italy have a higher branch density. Further reductions are therefore required, and will gradually take place. As a consequence, companies may find it difficult to continue to have personal contact with their branch or account manager.

The process of bank branch closures has been accelerated by the information, telecommunication and technology age, which not only makes self-service possible, but also leads to enforced competition. Traditional banks face increasing competition from direct banking services on the Internet (online). These online banks use efficient ICT links and do not need an extensive network of branches, if they need branches at all. It goes without saying that this is cost-effective, and that banks have no other option but to be responsive to the waves caused by the Web.

Finally, in order to compel banks to engage in sound risk management, banks are restricted and subject to reserve requirements by the Basel Committee. These Basel Accords aim to prevent banks from having too many outstanding loans in relation to their equity, thereby risking serious problems when certain loans are not repaid. However, the Basel regulations were not able to prevent the banking crisis. Therefore, Basel II was supplemented with additional requirements, reflected in the Basel III and IV regulations.

1.5. THE LANDSCAPE OF VENTURE CAPITAL

Just as you do not go to the butcher for bread, you do not go to the banker for the financing of a project that is very risky, in the start-up phase and has no guarantees. Gazelles and unicorns, especially in their first years, cannot go to the bank for financing, and have to resort instead to risk capital.

23. Belgische Vereniging der Banken, “Structuur van de Belgische bankensector in 2024”, 2025.

Venture capital, also called equity financing, includes financing through the stock exchange, through formal risk capitalists (venture capital), or through private investors (business angels). We make a distinction between public equity (stock market financing) and private equity (venture capital, business angels). There is also an intermediate form that we call “mezzanine”, and which is located between equity financing and credit financing.

After bank credit, capital markets are the most important source of financing. Table 4 above shows that bank credit is twice as important a source of financing as capital markets.

Within Europe, major differences can be seen. We can note a strong correlation between countries with a private equity culture and countries where capital markets are important. In the United Kingdom, for example, which still represents approximately half of the venture capital market in Europe, bank credit exceeds capital markets as a source of financing only to a limited extent (10 per cent). In Germany, however, bank credit is used eight times more often than capital markets, as a source of financing. This correlation is of course logical, as we have seen that venture capitalists are themselves often at the very root of first exchange quotations. Besides, countries with an open-minded attitude towards external equity are also open-minded with respect to exchange quotations as well as venture capital.

The venture capital market is growing, but at a macroeconomic level such growth remains rather marginal. Formal venture capital represents less than one per cent of gross domestic product. The European Private Equity and Venture Capitalist Association (InvestEurope) publishes an annual volume with very detailed figures. These figures show that, however big the growth of these funds has been in recent decades, it nevertheless remains a limited phenomenon. Each year, only 5,000 start-up businesses (out of the 1.6 million new enterprises in Europe each year) obtain venture capital. The total number of companies obtaining an annual venture capital injection is approximately 10,000. How is this possible when so many funds are available on the capital market?

Obviously not all enterprises qualify for venture capital. It is estimated that, each year, 150,000 enterprises qualify for venture capital, and are also open to it.²⁴ The difference between enterprises that theoretically qualify for venture capital, and those who effectively obtain it, can be seen as an estimate of the equity gap.

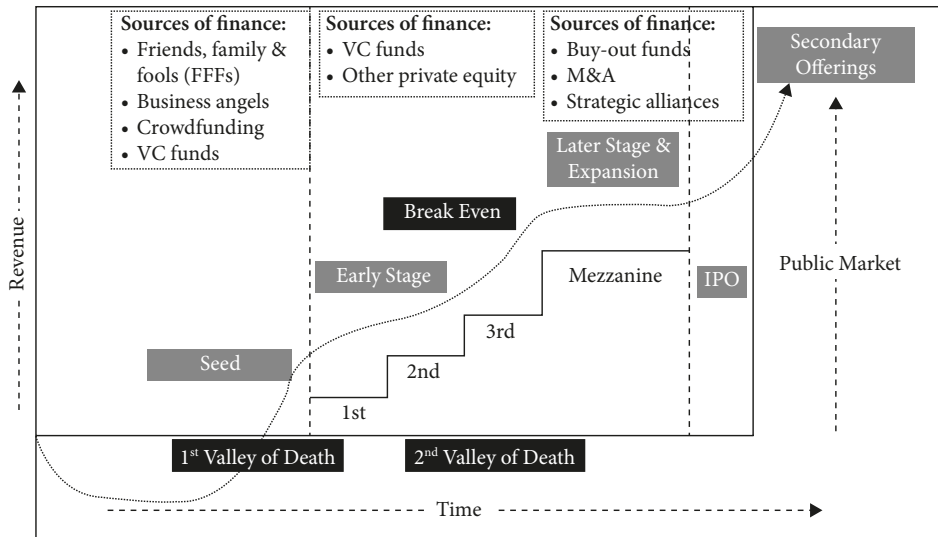
24. BANNOCK CONSULTING, *Innovative instruments for raising equity*, Report for the European commission, Brussels, 2001.

Classically, a distinction is made between the small equity gap and the scale-up gap:

- The *small equity gap* refers to start-up companies having difficulties in accessing risk capital in order to cover their first losses. This gap concerns relatively small amounts, usually between 250,000 and 1.5 million euros.
- The *scale-up gap* refers to companies that experience difficulties when they are in an expansion and internationalisation phase, looking for financing to grow rapidly. This mainly concerns gazelles and unicorns. To achieve this, they are looking for sums of an average of 15 to 25 million euros: amounts that are difficult to find in Europe, despite the highly liquid financial markets.²⁵

Many companies are confronted with a lack of funds in an early phase (the small equity gap), or in an expansion phase (the scale-up gap), and this can mean the end of the company: we call this the “valley of death”.

Figure 2: The equity gaps.



25. R. AERNOUDI, Executive Forum: The Scale-Up gap: how to address it”, *Venture Capital*, (2007) 19(4), 361–72.

Where smaller amounts and start-ups are involved, business angels, seed funds or equity funding can help. But for large amounts, these are not the right partners. With equity, however, we also have to take into account that the market consists of supply and demand. However, many entrepreneurs are not willing to open their capital. They prefer the bank that will leave them alone if they are correctly repaid. Where a high return can be expected, albeit with a calculated risk being taken, the venture capital sector will be prepared to invest. When the risk is rather low, and the repayment capacity rather stable, banks will, perhaps provided that there are sufficient guarantees, help the enterprise to access finance. When the risk is high and the return below average, neither banks nor venture capitalists will be interested in the company. Nevertheless, such companies also contribute to economic growth and create employment, and have to find alternative financing.

Finally, a word about gender. More than men, female entrepreneurs anticipate a credit refusal, which means they have less access to bank loans. The venture capital world remains a male bastion. While 30 per cent of all companies are female-led, they receive only 2 per cent of the venture capital invested. However, the return from female-led companies is higher, and the credit reimbursement rate is better. Thus, paradoxically, female-founded companies are better investments, but get less funding, smaller loans, and pay higher interest than those founded by their male counterparts.²⁶ Is this an example of inefficient capital markets or, rather, a case of implicit discrimination?²⁷

The conclusion to all this is that financial management is a complex socio-economic and cultural story, but is essential for all companies. And this story is the main theme of what follows.

26. R. AERNOUDT, "The paradox: female-founded companies are better investments, but get less funding, smaller loans and pay higher interest than their male counterparts" in L. JACOBS, *Women in Tech*, Kalmthout, Pelckmans, 2023.

27. R. AERNOUDT and A. DE SAN JOSÉ, "A gender financing gap: fake news or evidence?", *Executive Forum, Venture Capital*, vol. 2, pp. 127–34 (2020).