An Evaluation of Phare SME Programmes

Czech Republic

Final Report

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The report is based on fieldwork and the position as at December 1998

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Table of Contents

Introduction 1

1 Main features of SME developments in Country 2

1.1 Macro economic and political context
1.2 Growth and development of SMEs
1.3 Key issues facing SME development
1.4 Financial Market
1.5 Legal and Regulatory Issues effecting finance for SMEs
1.6 Institutional Development
1.7 Representation and lobby network
1.8 The Business Development Agency (ARP)
1.9 Regional Advisory and Information Centres (RPICs)
Business and Innovation Centres (EICs)
1.10 Research and Development Support: TECHNOS and PARK
1.11 The Czech Moravian Guarantee and Development Bank

2 The Phare programme for SME Development 19

2.1 Introduction
2.2 Phare's Financial Programmes for SMEs
2.3 Activities of other donors
2.4 Phare support for institutional development
2.5 Activities of other donors

3 Evaluation of Phare Financial Programmes 24

3.1 Logical framework: main criteria for assessment
3.2 Project selection and methodology of evaluation
3.3 Achievements of the equity programme
Relevance
Efficiency and effectiveness
Impact
Sustainability
3.4 Comments on other Financial Programmes

4 Evaluation of Institutional Programmes 34

4.1 Introduction
4.2 Evaluation of Phare support to the National Agency
4.3 Evaluation of Phare support for the Business Innovation Centres

5 Conclusions and Recommendations 46

5.1 Financial programmes: future options and priorities
5.2 Institutional programmes: future options and priorities

APPENDICES

A1	**Employment share by sector and size**	**48**
A2	**Firms by size class and employment**	**49**
A3	**Background note on evaluation methodology**	**50**
B	**Log frame: Phare Financial Programmes for SMEs**	**53**
C	**Log Frame: Phare support for a National Agency**	**56**
D	**Log Frame: Phare support to Business Innovation Centres**	**57**
E	**Conversion rate of local currency to Euro over time**	**68**

Introduction

This is one of a series of ten Phare SME Country Evaluation Reports, which examines the contribution of Phare's SME programmes in the context of macro economic and SME developments in the country since the transition process began. This is part of the horizontal evaluation of the Phare's SME programmes being undertaken for the Evaluation Unit by an RDH/LDK consortium of three EU specialists supported by local consultants in each country. This country evaluation report was prepared by **Jean-Jacques KUDELA** with **Alena ZEMPLINEROVA**, Senior Researcher to the Centre For Economic Research and Graduate Education by the Charles IV University in Prague, based on a preparatory work during June-August 98 and a three week evaluation mission in December 1998.

The Country Evaluation Report follows a common format. The first chapter sets out the main features of SME development in the context of key changes in the economy and the political make up of Czech Republic since 1991. The chapter includes sections on the financial environment and institutional developments effecting SMEs. The second chapter summarises Phare's SME programmes and the work of other donors, and then reviews the appropriateness of the overall design of Phare's SME programme in the context of the country's priorities.

The formal evaluation of the financial and the institutional programmes are set out in chapters three and four respectively, based on a standard evaluation methodology and logical frameworks that are included in appendices A to E. Particular projects were selected, and detailed interviews were carried out with a small sample of intermediate and final beneficiaries in selected areas. The results of each evaluation are set out in a common format covering relevance, efficiency, effectiveness, impact and sustainability, together with a discussion of key issues and future priorities. The conclusions and recommendations arising from the evaluation are set out in chapter five.

Chapter 1 Main features of SME developments in Country

1.1 Macro economic and political context:

A separate, independent Czech Republic came into being on Jan. 1, 1993, when the federal union founded in 1918 with Slovakia was peacefully dissolved.

The new republic began its first year of existence without Slovakia with the hope that, having left behind what it saw as a burden, it would be able to integrate into Europe at a very early stage. Indeed, the prime minister, Vaclav Klaus, hinted that the Czech Republic might be able to join the European Community (EC) within a few years, The conservative coalition was largely united on a policy of rapid movement toward the creation of a market through privatisation and, of course, integration into Europe.

The Czech Republic had inherited a fully industrialised economy from communism, but it was seriously obsolete in many branches. Launching a re-equipment programme would require massive inputs of capital; many uneconomic factories would have to be closed and resulting unemployment dealt with. When viewed from this perspective, the low level of unemployment indicated that serious reform of the economy had still to begin. In the interim the Czech Republic was ready to exploit its great natural advantage in tourism--the attractiveness of Prague--and to switch to a service-based economy.

Restructuring seemed to be a move that Klaus was not ready to contemplate, despite his high-profile free-market and monetarist rhetoric.

In the May-June 1996 elections, the three political parties supporting Klaus won only 99 of the 200 parliamentary seats. By late March 1997, however, Klaus's minority government had gained a parliamentary majority, thanks to the support from two deputies who had been expelled from the opposition the Czech Social Democratic Party (CSSD).

On April 16 the government announced a package of austerity measures to address the rising trade, budget deficits and growing public-sector wages. Most controversial was the introduction of a 20% import deposit tax, (cancelled in August following criticism from the EU). With opinion polls showing a steady fall in the public's confidence in the government, the President, Vaclav Havel, called for the Cabinet's resignation.

The economic crisis reached a climax in the last two weeks of May when the Czech National Bank put up interest rates and spent approximately $3 billion to defend the koruna, which was under continual pressure from speculators. On May 26 the bank abolished the 15% trading band in which the exchange rate was allowed to fluctuate. The next day the koruna lost 10% of its value against the dollar. Seven years of currency stability ended.

The chairmen of the three ruling coalition parties announced radical measures aimed at resolving the economic crisis, and Klaus was forced to admit to economic policy errors. Klaus resigned on November 30. Two weeks later Havel appointed a non-party figure, National Bank Director Josef Tosovsky, to form a caretaker government.

For the Czech Republic, 1997 was a year of foreign policy success and economic disappointment. It was the year the country "returned to Europe," being offered membership in NATO and being invited to start membership talks with the European Union (EU). These long-awaited developments, however, were overshadowed by the economic and political crisis that emerged in the spring. Although Prime Minister Vaclav Klaus had claimed, as early as January 1994, that the Czech economic transition was over, in the first months of 1997 it became obvious that much work remained. Many problems were caused by the government's failure to ensure adequate firm restructuring and to create transparent financial market regulations. The Cabinet's delay in dealing with health care, energy, transportation, education, and housing reform was also criticised.

TABLE 1.1: MACRO ECONOMIC INDICATORS

Czech Republic	1990	1991	1992	1993	1994	1995	1996	1997	1998*
Real GDP Growth Rate (%)	-1.2	-14.2	-6.4	-0.9	2.6	4.8	4.8	5.0	-2.7
Current Account Balance (% GDP)	-3.4	1.3	-1.7	1.6	-2.2	-2.9	-8.3	-6.5	-1.9
General Government BD (% GDP)	n/a	n/a	-1.0	1.4	0.5	-0.8	-0.6	0.1	-2.2
Gross Foreign Debt (% GDP)	20.20	33.04	27.08	29.37	29.67	35.14	28.80	22.47	N/a
Real-effective Exchange rate (1994=100)	83.26	77.12	79.46	94.83	100.00	103.90	110.01	n/a	N/a
Real Deposit Interest Rate (avg.)	-5.96	-29.44	-2.60	-9.25	-0.51	1.71	2.77	-1.01	N/a
Real Lending Interest Rate (avg.)	n/a	n/a	n/a	-5.57	2.78	3.39	3.42	6.87	N/a
Inflation Rate (CPI. avg.)	9.6	56.6	11.1	20.8	10.1	9.1	8.8	8.6	10.7
Registered unemployed % *	N/a	N/a	N/a	N/a	3.8	4.1	3.5	7.5	8.2
Currency exchange CZK/Euro				34.18	34.22	34.72	34.42	35.95	N/a

Source: IMF tables and European Commission DG2 (for items indicated by *)

1.2 Growth and development of SMEs

Contrary to Hungary, Poland or GDR, where the small business sector survived even during the command economy[1], the SME sector was liquidated completely in the Czech Republic. Since 1989, when the Czech Republic embarked on the road to a market economy, conditions for the development of small and medium enterprises have become more favourable. The number of firms in the whole economy increased from several thousand in 1989 to more than one million in 1992, the majority being small firms. Since then the number of firms has continued to grow, although more slowly, reaching 1.5 million by 1996. In the Czech Republic more than 50% of the active enterprises today were established before 1993. In September 1995 no more than 50% of the enterprises had been in existence for more than 3 years.

TABLE 1.2: BIRTHS AND DEATHS OF SELF EMPLOYED AND LEGAL ENTITIES

Rate of formation	1992	1993	1994[2]	1995	1996	1997
Self employed registered	1.034.942	1.133.510	964.597	1.124.662	1.247.615	nk
Net increase	**Nk**	**98.568**	**(168.913)**	**160.065**	**122.953**	**nk**
Legal Entities: registered	83.695	116.706	153.937	196.434	233.162	nk
Net increase	**Nk**	**33.011**	**37.231**	**42.497**	**36.728**	**nk**

Source: Czech statistical yearbook,

The register is updated every month on the basis of data from company registers (administered by Register Court according to the regional division), trade licensing offices (administered by local authorities) and statistical sources (regular recording and surveying administered by CSO). The problem with the BR is that it does not remove units, which do not operate any longer. **Thus new start-ups are recorded but old units, which have ceased to trade, are not removed from the business register.**

Legal entities include individual entrepreneurs who are registered by the Commercial Register as legal person and business companies. Business companies and partnerships include general commercial partnerships, limited liability companies, limited partnerships, limited companies (before 1993) and joint-stock companies. Self employed persons include private entrepreneurs who are in business based on the Trades Licensing Act, self-employed farmers and people carrying out other business activities governed by special regulations.

[1] It is estimated that a mere 1% of people including those in agriculture that had been employed in private sector in 1989 in the former Czechoslovakia.

[2] The reason for considerable decrease in the number of the units as compared to the previous period is the completed re-registration of entrepreneurs in compliance with the Trades Licensing Act.

The SME sector grew through new start-ups, restitutions, small-scale privatisation and the division of big state enterprises into smaller units. The old monopoly structure provided numerous niches and opportunities for SME sector activities. There were underdeveloped industries with great potential for growth in the economy.

According to computations and adaptations of existing official figures in relation to the PECO PANEL findings, there were 846 765 firms operating in the whole economy (including the primary and financial sector, both legal units as well as individuals) by the end of 1995.[3] Out of the total number of firms that were active in the Czech economy by the end of 1995, almost 838,000 were small enterprises. Small enterprises (enterprises up to 49 people) employed 2,037,000 people. There were 7,100 medium sized enterprises in the economy, which employed 1,190,000 people and 1,700 firms large firms employing more than 784,000 people. In the European Union, SMEs employ two thirds of the workforce, which is a similar proportion to the Czech Republic.

TABLE 1.3: FIRMS BY SIZE, 1995

Number of employees	% of total employment in Czech Republic	% of total employment in European Union	CR	EU
	Share on total number of firms		share on the total work force	
0-49 (small)	98.96	98.82	40.65	50.51
50-249 (medium	0.84	0.97	23.74	15.85
250 and more (large)	0.20	0.22	35.61	33.64
Total	847,000.	16,040,000	5,011,000	99,585,000

Source: Business Register, CSO, Panel 1995: Evaluation of the Quality of Business Register and Major Characteristics Entrepreneurs in the Czech Republic, CSO publication No 27 01-96, Time Series of Basic Indicators of the Labour Statistics 1948-1995, CSO publication No 09 04-96, own computations. EU figures: EIM Small Business Research and Consulting; adapted from Eurostat/DG XXIII, Enterprises in Europe, Fourth report, Brussels/Luxembourg, 1996 in The European Observatory for SMEs, ENSR, fourth Annual Report 1996, p. 49

TABLE 1.4: DENSITY OF ENTERPRISES

	Czech Republic	Central and Eastern European Countries	European Union
Enterprises /1.000 Inhabitants	68.4	31.0	42.8
Active population	112.7	64.9	95.0
Non-farming active population	127.4	83.0	112.6

Source: Eurostat (PECO panel).

The significance of SMEs varies widely from sector to sector in the economy. As might be expected, SMEs are most prevalent in trade, services, tourism, construction and other labour intensive industries. Small enterprises began to play an important role in education and health care as well. In certain manufacturing industries, SMEs role is important.

If small enterprises are arranged horizontally (see table A1 in the annexes), i.e. within each sector, the following conclusions can be drawn: small enterprises provide 72% of employment in trade and repairs and 75% in hotels and catering. Small businesses provide more than half of employment in wood and wood products, real estate and related businesses and other personal services. Small businesses represent up to 24% of employment in manufacturing

[3] The usual source of the number of operating firms is the Business Register. As confirmed by Panel 1995, BR provides distorted information on firm numbers. According to the findings of Panel 1995 out of all registered firms more than one third were not operating by the end of 1995 (compare Panel 1995). Out of 1.32 million registered firms by the end of 1995 almost half a million firms (475,000) were registered but not operating. The following reasons for not operating have been identified: about 23% registered entrepreneurs/firms never started operating, 20% interrupted and 57% closed down the firm during the last five years. As there is no legal obligation to cancel registration once the firm stops operating, the BR does not depict realistically the number of active firms

Table A2 in the annexes provides further data on the distribution of small firms across particular sectors. Out of total number of small enterprises in the economy more than 263,000 are operating in the trade sector, 136,000 in real estate and related activities and 93,000 in construction. The high number of small businesses in the real estate sector is related to the restitution of houses, hotels, pensions and shops to the original owners (or their heirs); those premises are often being rented. Similar patterns of distribution of small businesses across sectors are obtained if the share of small enterprises in the total work force employed by small businesses is taken as the criterion.

Out of the total number of units registered by BR by the end of 1995 (1.31 mil. units), 196,434 were legal units and 1,124,662 individual entrepreneurs not registered in the Commercial Register (incorporated) and Free Lancers

The figures below summarise the share of the SME sector in the Czech Economy in 1996. The proportion of SMEs ratio was 99.6%, their output share was 55.7% and added value was 60.6%. SMEs employed 60% of the workforce and accounted for nearly 55% of exports and 68% of imports.

1.3 Key issues facing SME development

The creation of new enterprises has considerably slowed down in the past years. Access to credit was quick and easy in the first years after the Velvet Revolution. Different factors explain the reserved attitude of the banks today.

The banking crisis in 1995-96 was – among other reasons – a consequence of the lack of technicality in crediting companies. The main reason today seems to be poor legal protection of the creditor. It takes too much time to get authorisation from a judge to sell collateral, and outside of big cities the value of real estate is low.

TABLE 1.5 SOME KEY BARRIERS FACING SME DEVELOPMENT

Main barriers	Commentary
1. Lack of access to credit for SME development	*Access to bank credit, particularly by start-ups and young growing enterprises with a limited track record and collateral, has become more difficult since 1996.*
2. Insufficient financial support from Authorities for small firms	*SMEs - especially start ups – expect financial assistance on the national and regional level to fill the gap not covered by the banks.*
3. Bureaucracy	*In many instances, civil servants whose role is not clear*
4. Insufficient trust between contractors	*The existing legislation protects the debtor against the creditor.*

Sources: Entrepreneurs, Chambers of Commerce

After the banking crisis in 1996, the Czech National Bank (CNB) increased the regular level of collateral and gave 3 years to the banks to solve the question of the attached real assets. Otherwise they would have to include within their balance sheet a provision for bad debts up to 100% of doubtful credit. As a consequence, the banks drastically reduced the outstanding credits to SMEs and turned towards the provision of consumer credits.

The crisis beginning in the real estate market reduced the banks trust in the value of old or new collateral and their willingness to credit SMEs, in particular start ups. To that may be added a growing interest of western banks in the Czech financial markets, with the threat of mergers and acquisitions for Czech banks.

Because of all the reasons given, the development of SMEs is not one of the major concerns of the banks today.

1.4 Financial market

In the year 1997 the growth of CZK distributed credits to the business sector was significantly slowed down by 6.5 points to 1.6% against 1996.

TABLE 1.6 FLOWS OF CREDITS AND DEPOSITS

ECU billions	1993	1994	1995	1996	1997
TOTAL CREDITS	20.52.	24.03.	26.79.	30.07	31.77
Foreign exchange credits	0.84.	1.34.	3.00.	4.06.	6.06.
CZK credits	19.69.	22.70.	23.79	26.02.	25.69.
CZK credits to private sector	10.33.	13.17.	15.87.	18.51.	18.24.
CZK credits to the private sector (% of total CZK credits)	52.50%.	58.00%.	66.70%.	71.10%.	71.00%.
CZK credits to SMEs	1.35.	1.79.	1.91.	1.90.	1.55.
CZK credits to SME (% of total CZK credits)	**13.10%.**	**13.60%.**	**12.00%.**	**10.30%.**	**8.50%.**
TOTAL DEPOSITS	20.88.	24.58	28.77.	30.80	32.71
Foreign exchange deposits	1.91.	2.04.	2.85.	2.88.	4.72.
CZK deposits	20.02.	22.55.	25.92.	27.91.	27.98
CZK deposits of the private sector	4.39.	5.60.	6.64.	7.55.	6.59.
CZK deposits of the private sector (% of total CZK deposits)	21.90%.	24.90%.	25.60%.	27.00%.	23.50%.
CZK deposits of the SMEs	0.73.	0.98.	0.99.	1.09.	1.12.
CZK deposits of the SMEs (% of total CZK deposits)	**3.70%.**	**4.30%.**	**3.80%.**	**3.90%.**	**4.00%.**

Source: CNB, in billions, end of period balance

According to the CNB, the amount of domestic credit issued was a decisive factor detrmining money supply growth in 1997. An absolute increase in domestic credits of CZK 108 billion (ECU 3.09 billion) meant a decline in the growth rate against 1996, in nominal terms by 0,3 points to 10,5 % and in real terms by 1,6 points to 4,5%. The uneven development throughout the year was affected by changes in the business sector's demand for credits.

In April the government adopted measures to correct economic policy (restricting government expenditures, slowing down wage increases in the state-owned institutions…). New adverse data on economic development (decline in industrial production and construction) were published in May. The worsening relationships amongst the government coalition parties and a general identification of weak spots in some newly developing markets increased the worries of the investors. The CZK came under pressure from domestic and foreign investors (as occurred in some Southeast Asian countries).

The CNB cancelled the existing exchange rate and, on May 27th introduced a new system based on a floating rate for the CZK orientated to the DEM. Subsequently, the CZK was depreciated by around 10% against central parity

The CNB adopted a restrictive monetary policy in order to fight the external imbalance and internal inflationary factors. The monetary policy was focused on dampening excessive domestic demand (to reduce the level of imports) and defending the CZK during the crisis of confidence in May amongst foreign and domestic investors.

The demand for cheaper foreign currency credits continued. A decline in more expensive koruna credits was partly compensated by higher drawing on foreign currency credits with lower interest rates from domestic banks; however drawing on these credits also dropped in the second half of the year.

In 1997 more than 4/5 of the increase in credit to businesses was drawn in foreign currency whilst the proportion of credit to SMEs fell by 2.1 points to 8,5%.

The volume of classified credits (excluding banks under administration) rose by 4.8% in 1997. This increase was significantly lower than that of standard credits whose volume grew by 15.1% against the end of 1996. The more rapid growth in standard loans led to a gradual decrease in the proportion of classified credits in the overall credit portfolio.

The continuing high proportion of classified credits in bank portfolios is, to a large extent, connected to the low level of credit write-offs against created provisions and reserves. Their volume at the end of 1997 was 8.2% more than at the end of the previous year; they cover about 55% of the potential losses from the credit portfolio. The remaining part is covered by collateral.

During 1997 the number of banks decreased by five. At the end of the year, fifty banks were operating in the Czech Republic. Taking into account the ongoing merging operations, liquidations and reorganisations in the banking sector, only 40 are still active.

No new entity was granted a banking license during 1997; the number of banks with a licence dropped by four as a result of the revoking of three licences (EKOAGROBANKA, BANKA SKALA, and EVROBANKA) which were taken over by UNION BANKA as well as the bankruptcy of REALITBANKA. Administration continued in four banks: COOP BANKA, PODNIKATELSKA BANKA, VELKOMORAVSKA BANKA and AGROBANKA. Altogether eleven small banks failed during the past years.

Five large banks, in which the state still keeps a large ownership stake, dominate the banking sector, as illustrated in the market share analysis based on figures at the end of 1995.

TABLE 1.7 LARGEST BANKS AS AT 31/12/95

		Deposits	**Deposits**	**Loans**	**Loans**
	Number of branches	**Amount**	**Market share (%)**	**Amount**	**Market share (%)**
CESKA SPORITELNA	1,864	294.7	31.0	119.3	18.6
KOMERCNI BANKA	350	228.8	24.1	245.8	28.1
INVESTICNI A POSTOVNI BANKA	3,650	105.7	11.1	119.9	13.7
CESKSLOVENSKA OBCHODNI BANKA	40	69.2	7.3	58.6	6.7
AGROBANKA	346	47.4	5.0	37.9	4.3
Total		*745.8*	*78.5*	*581.5*	*66.4*
Czech Banking Sector Total		*949.3*	*100.0*	*875.6*	*100.0*

Source: EVCA, European Venture Capital Association

The five largest banks have a share of the credit market of around 70%. The rank occupied by the banks in the PHARE Financial Programme for SMEs is not known.

The structure of the ownership of the banks can be described as following:

30% state
19% domestic financial institutions (investment funds, insurance companies)
16% domestic non-financial institutions
7% domestic banks
4% municipalities
2% domestic physical persons
22% others incl. foreign owners

TABLE 1.8 STRUCTURE OF THE BANKING SECTOR BY SEPTEMBER 1995

Total bank (57*)	Market share	Savings	Credits
Large banks (5)	66.7	79.2	67.2
Small banks (21)	11.0	11.3	13.2
Foreign banks (12)	8.7	5.4	6.4
Branch offices (10)	5.0	1.7	4.4
Specialised (9)	8.7	2.4	8.8
Total on the market	100 %	100 %	100%

Source: Czech National Bank

Emphasis has been placed on increasing the efficiency of banking activities by means of closing inefficient branches, reducing the number of employees and cutting operating costs. Between 1996 and 1997, the number of branches were reduced 679 to 2,472, and the number of employees was reduced by 4.4% to 57,082.

Interest Rates

During 1997, year-on-year, inflation rose from 8.5% o 10% due to increases in regulated prices, the devaluation of the CZK and a growth in wages and material costs.

TABLE 1.9 EVOLUTION OF THE INFLATION 1992-1997

	1992	1993	1994	1995	1996	1997
Inflation Rate	11.1	20.8	10.0	9.1	8.8	8.5

Source: CNB

In mid-May interest rates increased sharply when the CZK weakened seriously. After removing the fluctuation band for the CZK exchange rate, the interest rate level gradually declined in June; however uncertainty on the market persisted and was confirmed by the continuation of relatively wide spreads. The CNB gradually lowered its basic rates and non-resident access to the domestic market was opened.

TABLE 1.10 COMMERCIAL BANK INTEREST RATES

	1992	1993	1994	1995	1996	1997
DISCOUNT RATE	**9.5**	**8.0**	**8.5**	**9.5**	**10.5**	**13.0**
LOMBARD RATE	14.0	11.5	11.5	12.5	14.0	23.0
Average rates on credits to private sector	**13.6**	**14.6**	**13.5**	**13.3**	**13.1**	**14.5**
Short term	15.0	15.6	12.7	12.5	12.4	14.1
Medium term	15.4	15.9	14.5	14.2	13.5	14.1
Long term	10.4	10.4	11.2	11.5	11.8	14.6
Average rates to private sector ***on newly granted credits***		**16.1**	**14.6**	**13.4**	**13.8**	**17.0**
Short term		14.0	13.3	12.9	13.6	16.5
Medium term		16.7	14.8	14.2	14.3	17.0
Long term		14.5	14.2	13.3	12.5	16.0

Source: CNB, data by December each year

In general the commercial banks were reluctant to lend to SMEs because transaction costs tend to be independent of the size of the loan, so that the cost of making small business loans is relatively high.

State owned enterprises and large firms are the primary influence on the level and utilisation funds in the money market. They have, in many cases, preferential access to credit and government subsidies. Some large enterprises are still being helped by the banks, which continue to provide them with credit to keep them operating despite their insolvency and inefficiency.

These statistics confirm reports from the Regional Agencies about the severe lack of credit for SMEs in the last two years. It is in this context that the Phare and other special credit lines should be viewed.

As in most other countries, the primary source of funding for SMEs has been the owners' funds, family and friends and trade credit. Before the implementation of the first PHARE financial program, several Banks did develop lending programmes for small firms; but because credit appraisal procedures for small firm lending were not well developed, they incurred losses. New appraisal techniques have progressively been introduced, but loans to small firms have become progressively more difficult to obtain after the bank crisis and with the ongoing real estate crisis.

There are clear signs of crowding out, due to the combined effect of large number of non performing loans to state enterprises, and increased lending to the government. In this situation, banks have tended to allocate the reduced level of credit to large enterprises and the utilities (encouraged by the Government and pressure from large enterprises faced with serious cash flow problems) rather than to the small firm sector, where they perceive the risks to be higher.

The table below summarises our assessment on the current availability of fund to SMEs:

TABLE 1.11: AVAILABILITY OF MARKET BASED SOURCES OF FINANCE BY SMES (EXCLUDING DONOR-SUPPORTED SOURCES)

	Start ups and micro firms (1-9 people)	Small enterprise (10-24 people) less than 3 years old	Small enterprise over three years old	Medium sized enterprise
Short term funds	Never	Occasionally	Possible	Possible
Long term funds	Never	Never	Possible	Possible
Guarantee	Never	Never	Occasionally	Possible
Leasing	Exceptional	Occasionally	Possible	Possible
Equity capital	Exceptional project	Occasionally	Occasionally	Occasionally

Source: Consultant's assessment

Whilst availability is the major problem, there are other reasons why accessing bank credit has become progressively more difficult for SMEs:

TABLE 1.12: PRIMARY REASONS FOR FINANCIAL PROBLEMS

Reason	Commentary
Lack of track record	Enterprises without an established relationship with their bank are less likely to be able to secure a credit. Start ups and enterprises under two years of age are especially vulnerable
Level of collateral	Normally collateral of at least 130-160% of the loan is regarded as essential. Banks are reluctant to accept family goods (apartments, cars…). The real estate crisis worsens the situation. .
Interest rate	'Market' interest rates can only generally be afforded by trading companies requiring short-term loans. When a long term credit is used for an investment project, small enterprises (particularly start ups) have great difficulty until sales have been fully established
More profitable deals elsewhere: lack of competition	Banks prefer currently to develop the consumer credit market
Lack of credit management skills	Banks loan appraisal and credit management skills and procedures have improved in the last three years. This is generally not a major limitation.

Source: consultant's assessment based on feedback from banks and entrepreneurs

Equity and Venture Funds

In the Czech Republic (CR) there is not a developed market for venture capital corresponding to the scale of the country. By the end of 1995 there were USD 200 million (MECU 152) of venture capital funds under management available for investment in the CR, although much of this total is comprised of regional funds targeted at all Central and East European countries. By 1998, this had grown to 13 funds with ECU 480 u nder management. The Czech American Enterprise Fund (supported by USAID) was the earliest and most active venture capital fund in the CR, with investment activity dating back to early1991.

There are now at least 13 venture capital funds with management companies resident in CR, who together employ around 54 executives (an investment portfolio of around CZK 320: ECU 9.0 million per executive). A total of 62 investments have been made totalling ECU 55 million (average investment: CZK 32 m: ECU 890,000). Thus only 12% has been invested to date, of which only 1% has gone to firms at an early stage (ECU 3.4 million), and 2% for high tech firms (ECU 7.8 million). In terms of the number of projects, 35% involved the manufacture of industrial goods, 17% the manufacture of consumer goods, 10% IT related businesses, 8% commercial services, 8% retail and wholesale trade, 7% leisure and tourism, 5% construction and 12% others.

Most of these firms will not consider equity investments below ECU 1 million. Only two of them are aimed at small firms, Regional Business Fund (RPF) based in Ostrava and the Venture Capital Fund (FRK) in Prague.

In addition Kapital was set up as Government founded fund to provide venture finance. It is administered by the CMGDB. Apart from this fund, the main sources of funding are from external non-Czech investors. This is due to a lack of enabling legislation, which would permit the largest group of potential investors (domestic banks, domestic insurance companies etc) to participate in a venture fund. At present there are no legally recognised commercial structures suitable for venture capital investments. The tax law makes no provision for favourable treatment of capital gains, venture capital sources or otherwise.

In addition, there is a high level of competition from commercial banks for good quality projects. Rather than be complementary to an active venture capital industry, the uneven development of the Czech Banking industry has served to inhibit if not undermine the successful development of the Czech venture capital industry.

Another problem is that exit strategies are problematic because the stock market is not well developed.

Co-operative banks

Co-operative savings banks are restricted under the law from being able to provide loans and credits to businesses. However, a credit may be provided to a co-operative bank member, but this is limited to a short term loan (up to 6 months) maximum amount of CZK 400,000 (ECU 11,126). Although the co-operative bank representatives consider the risks as minimal, a triple guarantee is required. Loans are only provided to those co-operative members who are on friendly terms with their bank representatives and provide good information about the purpose of the loan demanded.

1.5 Legal and Regulatory Issues effecting Finance for SMEs

TABLE 1.13: REGULATORY AND LEGAL ISSUES AFFECTING FINANCE FOR SMES

Area	Commentary
Transparency	Connections still play a significant part in deciding whether an enterprise should receive a credit. In general, most large firms are better connected than small enterprises, unless the owner manager had previously occupied an influential position in a large enterprise. Banks are protected as the banking act provides for confidentiality to be maintained between the bank and its clients.
Accounting systems and requirements	Current legislation requires the same format for all types of commercial enterprise (except banks, insurance & not-for-profit organisations. Many otherwise sophisticated entrepreneurs view financial reporting as a statistical activity driven by the requirements of the tax office, rather than a management tool or a vehicle for informing investors about the company's progress (banks, venture capital funds…). The rules on auditing adopted were drafted to be compatible with the IAS (International Auditing Standards) but the domestic auditing profession is considered to be in its infancy.
Corporate income tax	There is a trend to reduce the general rate of corporate income tax, fallen from 45% in 1993 to 39% in 1997. The maximum rate band for personal income has been reduced from 47% in 1993 to 40% in 1997
Banking services	With the exception of deposit taking (covered under the civil code) all other services are covered under the Commercial Code.
Bankruptcy arrangements	The procedures are far too long and too favourable to the debtor.
Collateral	The recovery of physical assets pledged as collateral for bank loans is proving to be very slow: typically up to two years. Banks are reluctant to accept the family house as collateral due to problems of recovery and resale. This is a serious problem for entrepreneurs with few other assets. There is a project to allow the creditor to sell collateral without the formal authorisation of the debtor.

1.6 Institutional Developments

Between 1993 and 1996 the Ministry of Economy was in charge of setting up SME policy, its organisation and the implementation. In November 1996 the Ministry of Economy was abolished and its role concerning SME policy has been taken over by the new Ministry of Industry and Trade. (MIT)

Ministry of Industry and Trade: this is the central public administration body responsible for small and medium sized enterprise affairs. The Ministry has a special Department for Support of SMEs (1+10 persons),. They are analysing the situation in the SMEs sector. Once a year they provide the government with a report. MIT supports also high technologies through TECHNOS and PARK programmes. They also support and monitor the performance of Business Develpoment Agency (see below).

Also other departments within this Ministry develop policies and instruments which directly concern SMEs, like export promotion programmes, the Export Support Fund, and innovation and R&D programmes, fairs and exhibitions. In addition the Ministry has close links with other semi autonmomoous bodies such as CzechTrade and CzechInvest who provide services to SMEs, though the main focus of these bodies is overseas trade and forreign investment, respectively.

There are also other Ministries involved in supporting SMEs, although the instruments implemented are not specifically targeted at or used solely by SMEs. The main institutions in this respect are:

Ministry of Agriculture: it supports small primary production agricultural enterprises in the form of grants and returnable aid from the state budget. The main programmes are related to agricultural enterprise modernisation, informational and advisory services and land management.

The state also participated in supporting the Farming and Forestry Guarantee Fund, which provides guarantees for loans and subsidies covering interest payments.

Ministry of Labour and Social Affairs: provides financial contributions for the creation of new jobs within the framework of the active employment policy. Programmes are organised through a network of labour offices to support the mobility of labour, reduce local unemployment and create job opportunities for the long term unemployed and minorities groups.

Ministry of Regional Development (MMR): created in November 1996 (2 persons) the Ministry takes the lead on regional policy – including regional support for private enterprises, housing policy, the development of housing resources, leasing of residential and non residential facilities, zoning, building regulations, investment policies and tourism. In fact its responsibility for SMEs policy issues is not clearly set out; supporting SME sector is a lower priority for the MMR than fighting unemployment with traditional means. There needs to be an agreement with the MIT about division of programmes and budget.

There are formal and informal communication lines for co-operation between ministries concerning activities affecting SMEs. The official procedure is that documents have to be circulated among ministries before they are delivered to the government.

The Ministry of Industry and Trade has good relations with representative organisations of SMEs. These organisations provide the Ministry with information concerning the main problems and needs of SMEs and discuss possibilities to solve those problems.

There are also quarterly meetings between the Ministry of Industry and Trade and representatives of the main employers' associations. At lower hierarchical level meetings take place twice a month.

TABLE 1.14: INSTITUTIONS, POLICIES, LAWS AND REGULATIONS IMPACTING ON SMES

Area	Summary	Impact on SME Sector
Institutional development	Czech Moravian Guarantee and Development Bank set up 03/92 Ministry of Industry and Trade set up in 1992 and took over responsibilty for SMEs in 1996 Ministry of Regional Development set up 11/96	- Its primary role is guaranteeing a portion of loans made by commercial banks to SMEs and servicing as a financial body charged with administering various governmental financial assistance and subsidy programmes targeted toward SME sector. - Definition of a specific SME policy
Government funding for SME sector	The main funding goes through the CMGDB	CMGDB in MECU 1993 = 31.21 / 1994 = 40.63 1995 = 47.18 / 1996 = 37.59 / 1997 = 34.77
Other SME related legislation	Act on Accounting introduced in Jan 1992	New chart of accounts
Regional policy developments	11/1996 Law specifying the scope of powers of the MMR 12/1996 Creation of the Centre for Regional Development. (CRD)	The CRD initiates the development of economic activities in the regions through direct and indirect forms of support.
Commercial legislation:	Trade Licensing Act 455/1991 (TLA) Amendment to the TLA SME Support Act 299/1992. New legislation is being introduced to bring the definetion of SMEs into line with EU	- This act regulates the conditions for carrying out a trade (minimum age, legal competence, character, and specific licenses…) and classifies the types of trades. - The 1992 Act Defined a SME as a an enterprise up to 500 employee. But government support is limited to firms which conform to EU definition
Tax laws and regulations	New taxation system set up 01/93	- Introduction of VAT (22% today) - New rates for social security and health care 47% of which 35% for the employer

1.7 Representation and lobby network

SME interests are represented through a number of bodies and associations.

Chambers of Commerce: the Economic Chamber of the Czech Republic (ECCR) became the legal successor to the Czechoslovak Chamber of Commerce and Industry in 1994 after the Czech Parliament passed a law ratifying the merger of the Czechoslovak Chamber of Commerce and the Economic Chamber of the Czech Republic. Actually, when Czechoslovakia split into two separate countries in 1992 the chamber institutions became independent and the Economic Chamber of Czech Republic was established.

The merger made it the only chamber-type institution in the CR in the non-agricultural field. Founded by law, the ECCR plays the role of official intermediary with the government, proposing improvements for the business sector. Membership is not obligatory for the enterprises and the ECCR does not want it, although there are governmental trends in this direction.

The ECCR employs a staff of 70 people and has an annual turnover of CZK 140 million without any subsidy. The membership fees represent only 0,7%. The ECCR has got its own real estate patrimony, which insures a source of regular and autonomous income. Other sources of income are training seminars and the marketing of a database about the bad debtors (the CNB does not have a centralised programme to do it).

The ECCR defends the interests of all types of enterprises, not specifically the SME sector. The ECCR copes with the CMGDB and the EGAP (Export Guarantee and Insurance Co-operation) on a basis of agreements for distributing and marketing information to their members.

Beside the ECCR there is a network of about 100 Local Chambers (one per district). Each is juridically independent and non-governmental. Membership is voluntary. The Chambers provide a wide range of classical services to small, medium-sized and large enterprises: information on legislation, trade fairs and exhibitions, counselling on import-export, customs tariffs, licensing and legal counselling, organising trade missions…etc.

The ECCR and the “District” Chambers are considered positively by their members, although –as elsewhere – they are criticised for representing rather more the interests of the big companies than the interests of medium-sized enterprises.

Association of Entrepreneurs of the Czech Republic: founded in 1989 by a group of private businessmen. It acts as an employers’ union for SMEs. The association provides advice to its members but its major activity is lobbying on behalf of its members and establishing business contacts between and for its members.

Confederation of Industry of the Czech Republic: the Confederation unites employers and entrepreneurs in the field of industry and transportation. Established in 1990 the Confederation consists of 28 collective and 160 individual members and represents 1,650 companies with 1 million employees.

The Confederation mainly represents the larger traditional companies in industry and transport. The aims are classical: protecting entrepreneurial and managerial interests of its members during negotiations/dialogue with the Parliament, the Government, the Trade Unions, the Political Parties…etc, public relations to the general public and with foreign partners.

Association for Innovative Enterprises: the Association was set up to support the development of innovative enterprising (new technologies, products and services) in the CR. Its activities include providing information, establishing networks, offering advice. They also have links with the Government and public agencies to secure support for the development of innovative enterprises and lobbying them to improve legal and logistic environment.

Association for Small Entrepreneurs: an employer association of private entrepreneurs and SMEs. It is a voluntary lobbying organisation aimed at creating better conditions for the development of all forms of entrepreneurial activity. The Association participates in the preparation of legislative texts related to the entrepreneurial activity.

1.8 The Business Development Agency (BDA)

The Business Development Agency, BDA (ARP in Czech, Agentura pro Rozvoj Podnikani) was created as a semi-autonomous institution in 1995 by merging the department within the Minsitry of Economy engaged in managing the Phare programme with the former semi autonomous agency repsponsible for managing the German bilateral aid programme for SMEs. The aim was to create a single institution engaged in SME develpoment which combined practical experience with the management of procedures focused on the introduction of nation-wide and regional projects for support to SMEs.

The BDA has been operating under the auspices of the expanded Ministry of Industry and Trade (MIT), who also appoint the Director, since the Ministry of Economy was abolished in November 1996. Legally the BDA is an independent so-called non-governmental contributing organisation and at the same time it partly relies on government and PHARE funding, but also secures some income through consulting services. The BDA reports to the MIT operating within the framework of the Law governing SMEs support (n°299/1992).

The BDA acts as the PMU for the PHARE SME programmes and is also responsible for providing policy advice and information to the MIT. It also undertakes the economic evaluation of the PHARE TECHNOS Financial Scheme (see below).

An Advisory Board including representatives of entrepreneurial organisations guides the activities of the ARP. The ARP has a local staff of 17 persons in four departments:

- Financial Schemes
- Support of Innovative and Growing Business
- Consulting
- Co-operation and Training

The support of the BDA is focused on three areas: services for entrepreneurs, financial schemes and support to SME institutions and has carried a variety of activities in support of SME development:

- Direct advisory, information and education services for SMEs as well as support for consulting and other services beneficial to the enterprise sector, in particular for innovative enterprises.
- Implementation of educational programmes in order to increase professional qualifications and skills of business advisors;
- Organisation of seminars to promote SME development.
- Analysis of the entrepreneurial environment in the CR and proposals for its improvement,
- Facilitating access to and implementing SME assistance programmes, co-operation with foreign SME agencies and institutions.
- Initiation and active participation in new projects supporting SME development, including promotion, preparation and implementation of programmes.

The BDA operates through the network of Regional Advisory and Information Centres (RPICs) and Business and Innovation Centres (BICs) which are the main delivers of publicly supported services for entrepreneurs (see section 1.9 below).

Funds are made available for the development of the information network of the Chamber of Commerce and its district offices. The BDA also supports the activity of the Association of Innovation Enterprises and training projects run by the Association of Industry and Transport.

The other main area of activity of the BDA is financial schemes. It works closely with the Czech Moravian Guarantee Bank (see section 1.11 below) in the administration of the SME funding programmes inlcuding the government's SME loan guarantee scheme and Technos loan scheme, both of which are inlcude Phare contributions.

1.9 Regional Advisory and Information Centres (RAICs/RPICs) Business and Innovation Centres (BICs) Euro Info Centres (EICs)

Regional Advisory and Information Centres (R PICs)

The RPICs were set up and partially funded under the PHARE Programme. Five R PICs were set up on a pilot basis was created from 1991. This was extended through a process of public tenders in a further 19 regions. Another 7 RPICs were chosen at the end of 1996 in order to extend both the services and coverage. Over the period co-operation with 5 RPICs ceased for different reasons. There are thus a total of 21 RPICs now in operation, covering about 90% of the country.

The RPICs are in effect private consulting firms. Due to the different type of organisations, size of companies and differing capabilities they are very diverse in their objectives. Since 1992 a number of satellite RPICS have been set up to serve particular areas, acting as an integral part of their parent RPIC or as a separate centre on the basis of a contract with the "parent".

The RPICs provide the following services to entrepreneurs:

- Consultations on general business problems, information on SME and other government support schemes
- Specialist consultations which are mainly in the field of procedures for establishing a company; elaboration of financial plans for applying for credits; and consultations on accounting and taxation issues.
- Elaboration of business plans (BP) mainly related to bank credit applications and implementation projects.
- Training of entrepreneurs (mostly in regions where no other active educational institutions and companies offer training services)

Phare has contributed towards the development of services of RPICs. Currently Phare funds enable entrepreneurs to get access to business support services on a 'free of charge' or subsidised basis. General consultations to entrepreneurs are 100% subsidised and the specialist consultations and BP elaboration are subsidised by 40% with an annual limit of the PHARE contribution for services per entrepreneur of CZK 25,000. (ECU 695). There is a 45% subsidy for the training of entrepreneurs.

RPICs are also involved in developing local networks for supporting SMEs and they co-operate with district authorities, regional employment agencies, district Chambers of Commerce and other local and regional bodies. Services provided by RPICs to regional bodies are also eligible for a 45% contribution.

Finally, a number of RPICs take part in the organisation of bilateral co-operation to develop tourism. Data bases have been set up with information on local enterprises.

Business Innovation Centres (BICs)

A network of five BICs has been set up with PHARE support, to develop innovative firms and encourage technology transfer and spin-out activities. The BICs are part of the European Business Network (EBN).

The main activity of the BICs is the establishment and operation of incubators, providing space and common business support services for new SMEs where the focus is on innovation, technology transfer and practical utilisation of research and development. BICs offer a range of other services including office services, lease of computer equipment, meeting facilities…etc.

The main professional services of the BICs include patent advice, exploration of technical facts, name research, assessment of the patent status of a product, searching for validity of protective documents and filling applications for registering of inventions and other industrial property such as industrial design and trade marks.

Consulting services of the BICs to entrepreneurs receive the same Phare support as RPICs for the provision of business support to SMEs in their area. Enterprises established in an incubator centre can get a subsidy as a contribution to the rent and service costs. These subsidies are higher for an innovative enterprise than for a normal enterprise. For a normal enterprise the subsidy is decreased over a three-year period from 25%, 20% and 15% respectively. For innovative enterprises a decreasing scale is applied over a four-year period at 50%, 40%, 30% and 15% respectively.

Institutional Network

A Network of BICs and RPICs, independent of the BDA was formally set up in 1996, but during 1997 very little in terms of actual results has been achieved. This is due essentially to a lack of interest and participation by the centres. PHARE support has ensured the continued financial sustainability of both networks (RPICs and BICs).

EURO Info Centres

PHARE has supported the creation of EU Information Co-operation Centres in order to improve access to and the quality of information about EU business. The Prague EIC was established within the National Information Centre, but in 1996 moved to the BDA, as the sole official contact point for the European commission in the country. A network of 6 branches were set up between 1994 and 1998.

Other services to entrepreneurs include funds to support exhibitors at trade fairs, export support services and provision of business information. Support to exhibitors at trade fairs is eligible for enterprises up to 150 employees and the subsidy was 40-60% of the exhibition cost. The export services also provide support for the participation of Czech enterprises in Europartenariat events and for participation of enterprises in border area exhibitions organised by district Chambers of Commerce.

1.10 Research and development Support: TECHNOS and PARK

The Ministry of Trade and Industry has introduced a programme to support projects in R&D, but the level of participation by SMEs has been limited. In 1996, within industrial research and development programme, 117 projects were supported at a cost of CZK 442 millions (ECU 12.8 million); only 11 projects involved SMEs, which received CZK 42 million (ECU 1.22 million).

Two special programmes have been designed to provide R & D support for SMEs: TECHNOS and PARK. These programmes are designed and implemented directly through the MIT. Applications are collected through a tender procedure. There is an independent committee, which selects projects to be funded.

Technos:

Technos was designed by the Czech government in 1994. It has recently been approved that the PHARE programme will also participate in the funding of the Technos Programme. The PHARE Technos Fund was prepared with the technical support from the BDA and an EU advisor, and disbursement started in early 1998 (see section 2.2 below).

Park

The programme is initiated and realised through the MIT. The objective is to contribute to the creation of the innovative structures. The programme supports the establishment, exploitation and development of science and technology parks, to foster the start up and growth of innovative, technology based firms. The Park programme focuses on projects involving the setting up of new centres or extending existing technology centres.

The main criteria include the quality of the proposed project, a clearly defined ownership structure of the centre as an incubator, the extent of links with R&D departments, the provision of education and training in the fields of innovation and entrepreneurship, and the ability of the team to realise the project. It is possible to receive up to 50% of the project cost with a maximum of CZK 5 m (ECU 185,000). The projects must be realised within 2 years. Proposal are tendered in a similar way as for the TECHNOS programme.

1.11 The Czech Moravian Guarantee and Development Bank (CMGDB)

The Czech Moravian Guarantee and Development Bank (CMGDB/CMZRB) was founded in January 1992 with the aim of managing financial programmes to support SMEs. The Government approves the conditions for providing state subsidies to CMZRB for realising particular programmes. The bank draws on funds from the state budget. Using these contributions, the CMZRB guarantees some credit operations of commercial banks, which provide loans to SMEs.

The most significant shareholder of the CMZRB is the Ministry of Trade and Industry with 49%. Major banks own the rest of the shares: Ceska Sporitelna (Savings Bank, 13%), Komercni Banka (13%), Investicni a Postovni Banka (12,66%), Agrobanka (10,66), Ceskoslovenska Obchodni Banka (1,68%).

The composition of shareholders makes it possible for the Guarantee Bank to combine the adoption of a market focus necessary for its activities within the banking sector, with the implementation of specific policy measures set by state institutions.

The Bank has a full banking licence, and a limited foreign exchange licence (keeping foreign exchange accounts for individuals, legal entities and foreign exchange deposits with licensed banks in the Czech Republic). The Bank delivers its services through five branches in Prague, Brno, Plzen, Ostrava and Hradec Kralove. Its primary business activity is the provision of guarantees for a part of the loan principal made by commercial banks to SMEs. It also serves as a fiduciary institution charged with administering various governmental financial assistance and subsidy programmes targeted towards SMEs.

For 1997, the following programmes were available through CMZRB for support to SMEs:

- Main programmes: Guarantee, Start, Development and Credit
- Supplementary programmes: Region, Regeneration and Special

The essential objective of the assistance is to improve access to capital for SMEs by using state funds to share in the business risk. The volume of funds available from the state budget limits the realisation of the programme. The duration of the programmes is not fixed. The main eligibility criteria for participating include: being registered in the CR as a sole trader or legal entity, meeting employment limits set by each programme, the realisation of a concrete and clearly formulated project…etc.

Since the programmes were launched in 1992, about 7600 firms have been supported at a cost of about CZK 5,7 billion (ECU 165 million).

In 1996 CMZRB received more than 1500 applications and provided support to 1345 projects. About 85% of all applicants were satisfied. 51% of all projects were submitted by individuals, 47% by legal units and 1.4% others (coops, associations). 92% of the projects supported were to small enterprises with less than 25 employees. In terms of regions, the greatest contributions went to North Monrovia (Ostrava region) - 38% and South Moravia 21% whilst Prague received the least. As in previous years most of the guarantees were provided businesses in trade, industry, property and healthcare. A total of 6700 new jobs will be created by supported new projects, of which 222 are for disabled and disadvantaged people.

Guarantee

There are essentially two types of guarantee in place:

- Guarantees to commercial banks for loans
- Guarantees to leasing companies for leasing contracts

In 1995, the nature of the guarantee was modified to reduce the Bank's exposure to losses. Prior to 1995, the Bank guaranteed crediting banks with the total value of the outstanding instalment repayment. This had a negative influence on the Bank's cash flows due to the difficulties of realising the collateral.

Since 1995, a different type of guarantee has been involved whereby crediting banks only receive a percentage guarantee on the outstanding instalment repayments. The responsibility for the administration and realisation of collateral has been shifted to the crediting bank. It has improved the bank's cash flows but reduced the volume of newly issued guarantees. The banks utilised the experience of the German and Austrian guarantee banks and institutions in the design of the new guarantee product.

In 1996: 189 guarantees were made. The total amount guaranteed was CZK 400.2 million (ECU 11.62 million), i.e. in average CZK 2.12 million (ECU 61,592) per guarantee. This resulted in loans amounting to CZK 1.2 billion (ECU 33.38 million) being made by the banks.

Start

The programme provides an interest rate subsidy for start ups and micro businesses. The participation in the Start programme enables combination with other programmes (Guarantee, Region, Regeneration, and Special). In 1996, 1136 contributions were provided, at a cost of CZK 547.7 million (ECU 15.91 million), i.e. in average CZK 480,000 (ECU 13,945) per enterprise.

Development and Credit (Rozvoj)

This is another interest subsidy scheme. In 1996 1286 contributions to interest payments were made, totalling CZK 884 Million (ECU 25.68 million), i.e. CZK 680,000 (ECU 19,755) per project

Region (Region)

The objective of Region is to encourage the start up and growth of SMEs in those regions suffering from major restructuring of industries, unemployment, and poverty. In 1996, the scheme had supported 414 projects totalling CZK 468 million (ECU 13.62 million)

Regeneration (Regenerace)

The objective of Regeneration is to assist the development of SMEs in urban areas. In 1996, 153 projects had been supported.

Chapter 2 Phare Programmes for SME Development

2.1 Introduction

Phare assistance to SMEs started in 1991 with an allocation of ECU 20 million under the CS-9106 SME Programme. This programme was directed at both the Czech and Slovak Republics but administered at the the Federal level. Programme implementation started within the Ministries of Labour and Social Affairs but later, it was transferred to the Ministry of Economy.

The 1991 Financing Memorandum allocated ECU 6.24 million for a loan scheme and ECU 2 million for a guarantee scheme covering small loans. Agreements with the banks selected to run the schemes came into effect in September 1992. By the time of the signature of FM '93, ECU 1 million had been lent, and guarantees totalling ECU 0.75 million had been made. At the start the disbursement was slow, but it improved with time.

In the PHARE Financing Memorandum of 1993 (duration from June 1994 to the end of 1996), ECU 12.36 million was allocated to support the SME sector (CZ-9302.01). A significant part of the programme was devoted to the design and implementation of financial support schemes for SMEs.

The allocation of Phare funds for SME development is summarised in Table 2.1 below:

TABLE 2.1: ORIGINAL PHARE ALLOCATIONS TO SME DEVELOPMENT

Programme Components	1991	1992	1993	1996	1997	Total
	CS9106 (1)	CZ9202-2(2)	CZ 9302-01	CZ 9603(2)	CZ 9705(3)	
Institutional, training, TA and central services	.86		2.92			3.78
RPICs/BICs	2.73		3.32		0.50	6.55
Loan	6.24					6.24
Loan (Technos)			3.50			3.50
Loan Guarantee	2.00					2.00
Equity scheme	0.82	10.20	2.37			13.39
Regional development fund				5.00		5.00
TA to Equity	0.08		0.25			0.33
Total	12.73	10.20	12.36	5.00	0.50	40.79

Note: in addition there are a number of other programmes which have provided support to SMEs, such as the Exporters Support Fund (contribution of EUR 1.54 from CZ 9302 and EUR 0.35 from CZ 9705)
(1) After the split up of the country MECU 20 allocated by CS-9106 were divided between CR and SLOVAKIA
(2) Only includes the regional investment fund component in Ostrava
(3) CZ9705 (ECU 11 million) includes a number of private sector components. Within the business support elements (ECU 3 million) there is also funds for exports and foreign investment promotion. Data based on the financial memorandum.

Out of a total of ECU 498 million allocated by Phare for all programmes in the Czech Republic up to the end of 1997, ECU 41 million went exclusively towards SME related activities. In addition there were a number of other programmes such as export promotion and management training, which also benefited SMEs.

2.2 Phare Financial Programmes for SMEs

75% of the SME programme (ECU 30.46 million) was allocated to the design and implementation of financial support schemes for SMEs. At the end of 1997, the EU Delegation in Prague set up a memorandum of understanding regarding the ownership and reuse of the various funds allocated to the loan and guarantee schemes, totalling ECU 11.77 million. Both parties agreed that whilst the funds formally are repaid to the Business Development Agency (capital+ interest - management costs - losses) who is responsible for performance monitoring of the loan schemes, the Ministry of Industry and Trade will be responsible for their reuse within agreed parameters laid down by the European Commission. This could include co-financing future EU programmes, but that new proposals had to relate to the accession and the adaptation of businesses to the pressures arising from the Single Market. The main projects in which Phare provided assistance are summarised below**:**

Guarantee Programmes (allocation: 2 MECU)

Under CS-9106, funds were allocated towards the provision of loan guarantees to banks making loans to SMEs. The loan guarantee programme is run by the Czech Moravian Guarantee and Development Bank. The project is summarised in the table below:

TABLE 2.2: SUMMARY OF INPUTS AND OUTPUTS OF THE GUARANTEE PROJECT

Type and size of funds, date set up, partners	Terms of funds available	Uptake: criteria and number of clients etc
ECU 2 m in the 1991 programme allocated to the Czech Moravian Guarantee and Development Bank Arrangements with 8 banks and chambers of commerce and consultancy firms to issues application forms Owner of the fund: Agency for Support of SMEs At the end of 2000, the deposit in the Guarantee Bank + interest is free to be withdrawn and used for other schemes	Maximum guarantee: CZK 10 million (ECU 290,000) Level of collateral required for the remainder of the loan: 40-70% Target firms: production, construction, crafts and services	First guarantee in 1993 Number of applications: 140 Number of guarantee: 40 Value of guarantees made : CZK 154 million (ECU 4.5 million) Multiplier ratio: 2.2 Average length of guarantee: 4 years

Small Loan Schemes (allocation: 6.24 MECU)

A total of EUR 6.24 million was allocated to the provision of small loans to SMEs. The scheme has been administered by three banks: Bohemia, Agrobanka and Moravia Banka. The objective of the Small Loan Scheme was to assist SMEs to raise sufficient capital to start up and/or improve their businesses on affordable terms, and encouraging participating banks to lend to small private enterprises.

TABLE 2.3: SUMMARY OF INPUTS AND OUTPUTS OF THE SME LOAN PROJECT

Type and size of funds, date set up	Terms of funds available	Uptake: criteria and number of clients
Agrobanka: ECU 1.44 million Banka Bohemia: ECU 1 million ECU 2 million Moravia Banka: ECU 1.8 million	Maximum loan: CZK 1 million (ECU 29,000) The first programme with Banka Bohemia was limited to CZK 300,000 (ECU 8,700) Terms: maximum 3 years Criteria: SMEs with less than 100 people (one loan programme was limited to SMEs with less than 25 people) Interest rate to intermediary banks: Discount rate -2-3% Interest rate: Discount rate + 2%	**Agrobanka:** Loans: 9.94-9.97 No of loans: 64 Loans made: CZK 57.9 million (ECU 1.67million Level of disbursement 120% Bad debts: 4 **Banka Bohemia** Loans: 3.93-12.94 Applications: 663 No of loans: 376 Loans made: CZK 111.6 m (ECU 3.2 m) Level of disbursement: 115% Average loan size: CZK 188,000 (ECU 5,400) and CZK 514,000 (ECU 14,800) Level of disbursement 85% Number of potential bad debts: nk **Moravia Banka** Loans: 4.95-12.97 No of loans: 54 Length of loan: 2.2 years Loans made: CZK 52.1m (ECU 1.5 m) Level of disbursement 85%

Venture Capital (allocation: 13.39 m ECU)

Two venture funds have been supported by PHARE: the Risk Capital Fund established in 1995 in Prague and the Regional Venture Capital Fund established in Ostrava. Both funds are in the formal ownership of the Foundation for Regional Development. Both funds are designed to fill an equity funding gap due to the reluctance of private venture funds to invest less that around ECU 1 million, a figure that is too large for most small enterprises.

The Risk Capital Fund (Fond Rizikoveho Kapitalu, FRK) was founded by Regional Development Foundation with an initial capitalisation of ECU 3.19 million provided by PHARE as a source of equity funds for small private business in their early stages of growth. The FRK seeks innovative original companies with proven technical scope, growth potential and need for further financing. The FRK offers such companies equity financing often accompanied by unsecured loans in one or more phases. The investment may vary from ECU 80-220,000. The fund expects to realise its investment objectives over a period of five to seven years.

The Regional Venture Capital Fund (Regionalni Podnikatelski Fond, RPF) was launched in mid-1994 in the region of Ostrava. The RPF seeks to invest in companies in the region offering the prospect of an attractive return on investment, with particular emphasis on businesses, which address an international market. The RPF is focused on small and medium size business, which have clear market differentiation. The investment may vary between CZK 5-100 million (from EUR 1-1.5 million). RPF considers any sector, with the exception of retail and farming.

TABLE 2.4 INPUT OUTPUTS OF THE EQUITY PROGRAMME

Parameter	Risk Capital Fund (FRK) Fond Rizikoveho Kapitalu	Regional Venture Capital Fund (RPF) Regionalni Podnikatelski Fond
Funds	FM: CS-9106 & CZ9302. Funded on the base of a contract with ARP-Foundation for Regional Development (FRD) 3.2 million including operating costs TA in 94-95 (6 months) : ECU 0,6 millionMECU	10.2 million
Investees	SMEs, industrial companies, financial services excluded	SMEs with a clear market differentiation
Investment details	Target IRR : 30% Target time of holding an investment : 7 y Up to CZK 10 Million (ECU 80-220,000)	Target IRR: 25% Target time of holding : 5-7 years ECU 1 – 1.5 million
Statutes & Ownership	Date of foundation : 1995 Fund located in PRAGUE Limited Company Owner : FRD	Date of foundation: 1994 Fund located in OSTRAVA Owner: FRD
Number of applications Number of investments made	Approx. 300 app. Received since the beginning. 14 inv. approved by the Board in 9 firms, 11 completed at the end of 1998. No collateral demanded	Approx. 450 app. Received since the beginning 15 inv. Completed by 1997.
Total volume of investments	Investments: CZK 50.3 million (ECU 1.5 million) Average investment: CZK 5.6 million (ECU 124,000)	Over CZK 275 million (ECU 7.9 million)
Duration of fund	Indefinite life period. Funds are recycled. No remuneration agreement with ARP nor the FRD	
Exits	1 exit (850,000 CZK / ECU 23,643) in 1997 with a 93% IRR on 15 months 1 exit planned in 1997	
Losses	1 bankruptcy (1.M CZK / ECU 27,816)	Not known

Programme PHARE Technos (allocation 3.5 MECU)

The PHARE Technos Fund is managed by the BDA and uses the CMGDB as the financial intermediary, The scheme is implemented in co-operation with the national network of RPICs, which undertake an initial evaluation and monitor individual business projects submitted by SMEs within the programme. The target is to encourage the growth of the high technology sector and increase the level of technology in SMEs.

Preference is given to businesses in biotechnology, new materials, and information systems. Agriculture and the primary sector are excluded. Both individuals and legal entities are eligible up to a maximum of 250 employees. There is a wide set of criteria, which have to be fulfilled in order to acquire support. The scheme aims to provide non-interest loans repayable over a seven year period covering up to 50% of the total research and development costs not exceeding CZK 5 million (ECU 185,000). There is a grace period up to 4 years, before repayment is required. Under CZ-9302.01, 27 technology based projects have been supported.

TABLE 2.5: SUMMARY OF INPUTS AND OUTPUTS OF TECHNOS LOAN PROJECT

Type and size of funds, date set up, partners	Terms of funds available	Uptake: criteria and number of clients etc
ECU 3.5 million from FM 1993 funds transferred in Dec 1996 to the Czech Moravian Guarantee Bank	Max loan: CZK 5 million (ECU 185,000) Terms: maximum 7 years (3 years grace period) Criteria: SMEs with less than 250 people Focus on new materials, IT and biotechnology projects	Loans: 2.98 Applications: 102 No of loans: 27 Loans made: CZK 118.9 million (ECU 3.4million Average size of loan: CZK 4.4 million (ECU 162,000) Av length of loan: 4 years Level of disbursement 98% Bad debts: 4

2.3 Activities of other donors

Loans:

The EBRD established Central Europe “Agency Lines” with the Dutch ING Bank and the French Société Génrale to finance medium sized enterprises in Eastern and Central European Countries.

The Agency Lines lend primarily to established medium sized private enterprises and firms in the process of privatisation. Project sponsors or enterprises are required to provide a minimum of 25% of project costs and the portion provided by the EBRD should not exceed 35% of the total project costs. The principal amount of loans disbursed through the Agency Lines is between ECU 100,000 and ECU 10 million.

Venture Capital:

EBRD invested ECU 7 million in the CZECH VENTURE PARTNERS (CVP). Founded in 1997, CVP is a joint venture between Baring Private Equity Partners (BPEP) the international private equity arm of the ING Group (ECU 7 million), Czeskoslvenka Obchodni Banka (ECU 7 million) and the Netherlands Development Finance (ECU 4 million). The fund is orientated towards the provision of development capital to well established medium sized businesses, generally privatised firms.

2.4 Phare support for institutional development

The objective of Phare’s institutional programmes has been to improve the environment for SME development by focusing on the legal and regulatory environment and providing SMEs with better access to information, advice, and training.

This has involved supporting the development of new institutions to service the needs of the SME sector, including the establishment and development of the Business Development Agency (BDA) to co-ordinate this work, and the setting up of a network of Regional Advice and Information Centres (RAICs/RPICs) and BICs, providing services to start ups and small firms.

Since the start of the programme, a total of ECU 10.3 million has been allocated to institutional development, of which a total of ECU 6.55 million has been allocated to the provision of free and subsidised business support services through the network of RPICs and BICs, and ECU 3.78 million to fund EU experts, contribute towards the costs of running the BDA, the provision of central training for RPIC and BIC staff, and policy work with the Chambers, the Associations and the Ministry.

TABLE 2.2 PHARE CONTRIBUTION TO THE RUNNING COSTS OF ARP

(ECU)	1996	1997	1998
Total Cost	253,098	279,584	309,014
State Budget Contribution	132,435	135,798	138,320
%Phare Contribution	39.5%	26.8%	16.2%
Total Contribution	100,000 (1)	75,000 (1)	50,000 (2)

Source memorandum of understanding between EUC and the ARP 14/12/96; OMAS Report 02/98

(1) paid out of the FM CZ-9302 (2) forecasting.

Regional Advisory and Information Centres (RAICs/RPICs)

Phare has contributed to the RPICs set-up costs (including office equipment). Phare has also contributed towards the operating costs of the RPICs on a pro-rata basis. Funding can also be obtained for the provision of services delivered by the RPICs. The advisory services for entrepreneurs (initial consultations, training seminars, further consultation, and preparation of business plans) are subsidised by Phare in accordance with the Phare agreement. Since 1995, Phare has funded an average of 40% of the costs of advisory services and training provided by the centres.

Business Innovation Centres

These organisations concentrate on the development of the innovative enterprises, by providing space services, consultation and training to SMEs, both within the incubators and in the local area. Individual BICs, whilst focusing on the same key areas, have slightly different priorities. The Brno BIC, for instance, concentrates its activities on technical fields and science while the Ostrava BIC has a wider focus and seeks to assist businesses from a larger number of areas.

2.5 Activities of other donors

Germany

Since 1996 there has been continued support from the German Ministry of Economy through the company Protrade. 33 small exhibitors have been supported at a cost of ECU 65,000. Through the DGM, funds have been provided for professional training of staff in the RPICs.

United Kingdom

The UK Know-How Fund has made contributions to the work of the BDA and selected RPICs.

United States of America

Czech American Fund (American Senate foundation of $50 m) was set up in the early 90's to provide equity and loan funds for SMEs. The fund was closed in 1996.

Chapter 3 Evaluation of Phare Financial Programmes

3.1 Logical framework: main criteria for assessment

The Logical Framework (LF) approach has become the de facto European Commission standard for project design, monitoring and evaluation. Five criteria are used for evaluating programmes, relevance, efficiency, effectiveness, impact and sustainability. These terms and the general approach are summarised in appendix A 3.

Using this approach, a log frame for financial programmes has been drawn up to identify the anticipated inputs, outputs and objectives of financial programmes. The table also includes a set of key questions. The subsequent fieldwork focused on assembling evidence to help answer these questions.

3.2 Project selection and methodology of evaluation

Sample

The Regional Venture Capital Fund (Regionalni Podnikatelski Fond, RPF) was selected for detailed evaluation, as it was the first Equity Fund started by PHARE in the CR. It has been running now for about five years and has one of the longest experiences in venture capital in the Czech Republic. Additional information is provided about the Regional Venture Capital Fund in Ostrava, the only regional capital fund in the Czech Republic.

Relevance: to what extent has the programme clear objectives?
to what extent does the design address them in an optimal way, and should changes be made to the design of the programme?
Efficiency: is the rate of investment and the selection of applicants appropriate?
Effectiveness: in what ways has the programme improved the performance of these firms, and were these firms the most appropriate for the programme?
Impact: to what extent has the programme altered investing policies?
Sustainability: what financial and management arrangements have been made for the Programme to continue?

3.3 Achievements of the Equity Programme

Information about the inputs and outputs of the two funds are summarised in table 2.4 above. Additional information was sought but unfortunately we did not receive any answers from the CVP/RPF to a number of outstanding questions. Below is a summary of the investment portfolio of the FRK equity fund.

Table 3.1: List of the client portfolio of the FRK equity fund

Company name And age (if known)	FRK share	Form of investment	Date of investment	Sector and activity	Size CZK million and current status
APOLON, joint stock co.	48%	Equity share, preference shares, unsecured loan	Aug.-Nov.1996	Software information and reservation system for travel industry	5.0 m Written off
STASPO, Ltd	45%	ditto	1996	Construction insulating technology	3.7 m 'Living dead'
MOBALPA,Ltd.	-	convertible loan	April-May 1996	Design and delivery of furniture	0.83 m Investment sold
NASIT, Ltd. 2-3 years old	38%	equity share, unsecured loan	Aug.-Sep.1997	Developing and implementing information software	9.0 m Investment OK
KELI,Ltd 2-3 years old.	35%	equity share, silent partner's share	Nov.-Dec 1997	Construction of local cable TV network	8.0 m
TIP, Ltd. Start up	45%	equity share and unsecured loan	Dec 97-March 98	Production of patented mini-tractor	7.0 m
ODLIT,Ltd. Start up	-	convertible unsecured loan	Sept.1997	Centrifugal casting	1.28 m
ECOdate,Ltd Start up	80%	equity share, silent partner	January 1998	Regional information system	6.0 m
TOP Select ,Ltd.	NK	equity share and subordinated loan	March 1998	Developing and operating of equipment for virtual reality	2.0 m Good prospects
TOTAL		**9 enterprises**			**CZK 50.28 m**

More detailed information about the investee companies of the RPF programme in Ostrava:

Table 3.2: List of client portfolio of the RPF fund in Ostrava

Company	Activity	RTF share-holding	% of port-folio	Investment CZK million /ECU + follow up investment required	Stage of development
Keravit sro	Ceramics, over 1,400 heat and chemical resistant products for steel and chemical plants. Set up a subsidiary with Italian partner	49	12.3	27.9/800,000	MBO
Mineral/ Slezske Izolacni Zavody as	Production of slate floors, roofs and insulation for export	49	6.1	13.8/400,000	MBO
Beskyd as	Potato storage, trading and processing; prepacked fresh vegetable and dressings. JV set up with US company	29	8.4	19.1/550,000 + CZK15 m	Development
Ekol Gas sro	Network of LPG filling stations. Increased from 4 to 8 gas stations	49	4.6	10.4/300,000	Start up
Talpa-RPF sro	Automated equipment for installation of underground pipes and cables + services to construction industry in geomorphology and hydrology	49	4.6	10.4/300,000 + CZK10-20 m	Development

[4] There were allocated according to the official documents MECU 18.39. We have fund a use of MECU 13.2

Company	Activity	RTF share-holding	% of port-folio	Investment CZK million /ECU + follow up investment required	Stage of development
Mada - Pack sro	Trade in packaging materials, now set up its own production plant and trading subsidiary in Slovakia	45	3.1	7.0/200,000 + CZK 5-10 m	Development
RTF sro	Wood processing ceased due to failure to implement business plan. Closed.	100	4.8	10.9/315,000	Rescue
Steeltile sro	Switch to production of steel coated roofing tiles	49	12.2	27.7/800,000	Development
Atrei-Izotherm as	Superstructure for breweries + cooling and freezing vehicles	49	3.1	7.1/215,000 + CZK 3-5 m	Development
Dehtochema as	A JV producing heavy asphalt insulation materials for roofs	25	4.6	10.4/300,000	Start up
VUP	Privatisation of company in high technology knitted materials for medical implants, vascular prostheses and bullet proof vests etc	49	12.7	28.8/835,000	MBO
Voicetronics sro	Development and marketing of software and hardware for voice recognition technology	40	4.6	10.4/300,000 + CZK 5 m	Start up
Dr Krol spol sro	Instant food production e.g. creams, soups sauces and bread with exports to Hungary and EU	0	0	0/ + CZK 6-8 m	Development
Laurin	Research and production of industrial detergents and anticorrosion protection products for Czech market	49	10.0	22.7/660,000 + CZK 3-5 m	Development
Belgrade sro	Development and production of ride on garden mowers for US and EU markets	40	7.5	17.0/490,000	Development /MBO
Total as at 31.12.96	**15 investments**		**100%**	**224/ 6.50 m + CZK 32-68 m**	

Table 3.3: Number of Enquiries for RTF (as at end of 1996)

By region		By stage of development		By industrial sector	
Ostrava	142	Expansion	331	Industry	326
Vesting	24	Joint venture	8	Construction	29
Brutal	36	MBO/MBI	37	Banking and consultancy	2
Frydek-Mistek	26	Privatisation	17	Transport and distribution	5
Karvina	14	Rescue	4	Trading	27
Novy Jicin	34	Start up	197	Tourism	26
Opava	41			Services	137
Other	83			Others	42

Relevance

Did the Equity Programme meet the needs of the country?

The Czech Republic is considered as the most promising market in Central Europe for venture capital according to the European Venture Capital Association (EVCA).

The possible market is shown in “State of Small Business in the Czech Republic 1997”:

- Around 67% of entrepreneurs expressed a need for further financial resources
- As far as the type of resources is concerned, 10% of entrepreneurs would prefer an equity investment by another investor
- Around 4% of entrepreneurs expressed the view that some form of support should be provided to the investor to encourage them to take a stake in their firm.

The Czech equity market for SMEs is still very undeveloped, although interest and potential demand for equity is rapidly rising. There has been a significant inflow of funds aimed at later stage investments. Currently there are at least 9 funds dedicated to CR with more than ECU 200 million under management, seeking deals in the Czech Republic and other East and Central European countries.

The aim of the Czech government in 1994, when they founded the RPF, was to stimulate the development of SMEs by introducing venture capital as an instrument of corporate finance. With Phare's support, two venture capital funds were set up working on a full commercial basis. The first was designed to provide long term investment finance for unquoted companies, with a particular focus on the North Moravia and Upper Silesia region. The other, based in Prague, was to invest in start ups and smaller companies where the investment size was significantly smaller.

Nonetheless, reflecting of the sector's early stage of development in the Czech Republic, in 1995 most of the funds under management had some participation from government or quasi-governmental institutions. Since that date there has been a substantial increase in the availability of larger amounts of equity funding for the further development of established enterprises and management buy outs. There has been a significant gap in the provision of smaller amounts of venture funding for start ups and young enterprises without an established track record.

Since many private institutional investors have developed a preference for investing on a cross-regional basis rather than through the traditional vehicle of country specific funds, it is expected that government related institutions will continue to play an important role in channelling much needed investment capital into specific regions and/or industry sectors within the CR.

Most venture capital investment in the CR falls into two categories: expansion capital provided by foreign run venture funds for established companies, and newly formed with foreign corporate participation. Financing of start-ups and small firms requiring smaller amounts of capital cannot be economically provided by private funds, due to the high costs of management relative to the fund size, and the lack of managerial track record of the enterprises requiring capital. Without the participation of the public sector to subsidise the management costs, funds targeted at small companies are not a financially viable proposition.

In addition there is another reason for the lack of venture capital in the country: sources of funding for venture capital investment in the CR are limited to international (i.e., non-Czech) investors. At the present there are no legally recognised commercial structures in the CR, which are suitable for venture capital investment. As a result most of the venture capital funds operating in the CR are organised as offshore investment companies or limited partnerships, managed by foreign domiciled funds managers. Given the almost exclusively foreign sources of venture capital, the VC Funds in the CR have a foreign orientation.

Funders that make an equity investment in return for a minority shareholding in the firm, expect to secure their return on the investment by selling their shareholding at some future date at a considerable premium. This clearly depends on the availability of willing buyers, either through an initial public offering on the stock market, selling their minority stake to another investor or selling the whole business. In the Czech Republic, the scope for floating on the stock market is still very limited. The possibility of a take-over depends on the nature of the business, the availability of potential partners and the willingness of the majority stake holders to agree to being bought out.

There are no government-funded programmes specifically aimed at the improvement of the environment for venture capital. According to the Czech Venture Capital Association (CVCA) the Czech government believes that sound economic and political management are the most powerful incentives that a government can give to industry in order to promote growth.

Under such conditions, there is no doubt that the PHARE sponsored funds, RPF and FRK addressed a funding gap and have played a demonstration role in orientating enterprises to the notion of raasing funds by selling equity to a venture partner.

To what extent was the design appropriate?

In both cases the funds were well designed. The FRK was deliberately started on a pilot basis with limited funds. The size of each investment (ECU 80-200,000) was deliberately kept low and a flexible approach has been adopted with respect to the nature of the investment. Whilst a guide of a 25% IRR was set, the fund has paid more attention to the business opportunity, and the capacity of the management to exploit the opportunity. Considerable flexible was allowed for in the selection of projects, with only limited restrictions placed on the sectors or stage of development of the enterprises.

In Ostrava, the size of the fund was deliberately set to be larger to provide it with the scope for supporting more mature projects requiring larger amounts of equity funding. Otherwise, a flexible approach was also adopted to the selection of projects. An important feature of the fund has been its integration within a broader regional development programme for an area facing substantial restructuring and layoffs. In particular is has worked closely with the local Business Innovation Centre, established to support technology based enterprises (see section 4), and other local agencies engaged in restructuring the regional economy.

In both cases experienced experts, who had had hands on experience of setting up and running funds were used. In both cases the consultants have maintained contact with the fund; in one case the person stayed on in Ostrava as the fund manager providing stability and continuity to get it thoroughly established. This input is reflected in the performance of the fund.

Despite the difficulty of utilising Phare funds to invest in a venture fund, a satisfactory solution was found.

Should Phare resources have been utilised?

The setting up of a fund offering small amounts of venture funds targeted at small firms requires access to grant resources to cover the high management costs and be able to absorb the higher risks associated with start ups and early stage funding. Even in the EU countries, the available of these sort of funds has depended on government intervention. This pioneering role is wholly appropriate for Phare, which is the only organisation with the resources able to offer technical assistance, grant support to cover management costs and a source of funds which does not require impossibly high internal rates of return to be earned to enable the fund to be sustainable.

Efficiency

People managing the funds are enthusiastic and imaginative. The TA provided (about 80.000 ECU for the FRK) permitted not just to transfer knowledge, drawing on bet practice developed in western Europe, but also enable the new funds to be integrated into the network of European venture funds.

The Equity programme met its targeted clients. Both funds ended up investing in a mix of start ups and expansion situations and MBOs. The decision to centre the RPF outside Prague in Ostrava has led to the attraction of a high proportion of manufacturing opportunities, some of which have been from successful trading companies who recognise the benefits of investing in new manufacturing plant. Both funds have also attracted a few technology based firms.

In terms of the rate of disbursement, both funds have been successful . The number of applicants has been high – about 700. The RPF is over-invested; normally funds are 70% to 80% invested, RPF 110%. Rates of disbursement have been encouragingly high, and the losses to date appear to have been in line with the experience of other western funds. In the case of RPF, with the overall level of demand from promising projects, there was a strong case for continued funding beyond 1996 to maintain the momentum. This would also have enabled the fund to spread its management costs over a larger number of deals.

In the same way FRK 1997 annual report notes that the deal flow volume is probably close to its maximum level. To be simple : the PHARE funds have been well utilised, but there is not enough money in comparison with the demand.

At this stage, with only one exit from each fund, it is very difficult to review the overall performance of the fund so that a meaningful assessment can be made of the subsidy involved. The 1995 and 1996 accounts for RPF provide some indication of the negative cash flow that is being financed by Phare. In 1995, the operating costs and salaries amounting to CZK 22 million (ECU 640,000) were partially covered from fees and dividend income (CZK 2.3 million) and interest on the capital (18,1 m), resulting in a trading loss of CZK 3 million (ECU 86,000). In 1996, operating costs were cut back to CZK 15,000 covered by fees and dividend income of CZK 15.6 million and interest on capital of CZK 400, resulting in a loss of CZK 3.8 million (ECU 110,000). These figures are relatively small in relation to the overall sums invested. The operating performance will depend crucially on the number and profitability of the star performers in relation to the number of investments that will need to be written off. Currently the signs in both funds are very promising.

In the case of FRK, the operating costs were low, representing less than 5% (3% in FRK) of the capital invested in the fund (FRK: ECU 3.2 million invested, less than ECU 0.5 million spent on operating costs in 5 years). Due to the low quality of financial information the level of OC should be much higher. Venture capital managers are required to do a lot by themselves; this process tends to prolong the due diligence process. Thanks to the technical assistance received and the enthusiastic attitude of the (young) executive, RPF and FRK saved money, which should logically be devoted to external auditors and experts.

Were the firms being invested the most appropriate?

Venture capitalists have reported a total of 70 investments in the Czech Republic by the end of 1998, 14 of which were start-ups.

However, most of the investment funds will only consider making investments to established companies in excess of ECU 1-2 million. Also the existing stock market will hardly serve as source of equity under 1 MECU. Only a few funds supported by the public sector, such as the two Phare supported funds FRK and PRK, are able to meet the needs of SMEs requiring equity funds of less than ECU 1 million. By 1997, PRF had invested in three start ups and the FRK financed three start-ups and two early stage companies.

The mix of firms in terms of sector and activity was very good. In several instances the investments were in manufacturing enterprises focusing on businesses with sales to EU countries, an example of EU funding being used to strengthen the Czech economy ahead of Accession and the Single Market.

In conclusion, despite the number of applicants it is not easy to find small firms with ambition, the management capacity to succeed, and innovative products being marketed effectively. The venture funds must be satisfied with acceptable projects, even if the applicants are not start ups, true beginners or small firms.

Furthermore, because of the rarity of “good projects”, the funds have to compete with banks. Given the lack of developed infrastructure for successful early stage venture capital investing, most venture managers investing in the CR are oriented towards later stage investments – expansion capital, management buy-outs/buy-ins and join venture projects. Seed and start-up investments are perceived as too risky to be viable as an investment strategy for private sector investment funds.

Effectiveness

It is a bit early to judge the performances of the funds. Only one exit was realised with a very high IRR (93%) by the FRK; RPF plans one more in 1999.

In November 1997 FRK sold its stake in the AB MOBALPA s.r.o. and realised a value of 218% of the investment made in 1996 (CZK 0,98 million). The company is engaged in the design, sales and installation of an exclusive range of kitchen and bathroom furniture in partnership with the French manufacturer MOBALPA Cuisines. AB MOBALPA s.r.o was an example of a start-up financed by a convertible loan. Turnover increased quickly. In the second half of 1996 AB MOBALPA s.r.o opened a store in Prague and achieved a turnover of CZK 2.2 million. In 1997 the management expected to increase turnover to CZK 10 million: in fact this was reached by June. The founder of the company offered to buy back FRK's convertible option on the loan.

In the same year (1997) the balance sheet of the FRK registered one bankruptcy. APOLON a.s.

As previosly indicated, it is too early to judge performances of the funds. The stakes in the invested companies (investees) are evaluated for the value of the amount invested. The exits will show the real benefit or loss. The most realistic exit route seems to be via a sale to a strategic partner rather than a listing on the Czech Stock Exchange.

In terms of the performance of the companies, the evidence from the RPF suggests that without access to additional equity together with the disciplines and hands on involvement of the venture fund executives, several of the companies would not have been able to make the level of investment to improve the design and production of the product and develop new markets both in the Czech and Slovak Republics and in the EU. Without access to equity capital, the growth and overall competitive position of these firms would have been retarded.

Impact

The most significant impact has been the development of two small funds which are seen to be operating successfully in a different market to the more traditional development capital funds being established by western banks and venture fund managers. In the case of the RPF, the fund management arrangements are being reorganised. A joint venture has been set up with EBRD and ING to act as the fund manager of both the RPF and other funds which they hope to help establish, using a combination of public and private sector capital. Because of the promising track record being built up by the RPF, it is now in a position to seek additional investment funds from EBRD and the private sector. Neither of these developments would have happened had the two pilot projects not been successful.

Both funds have been very active in marketing and promotion through newspapers, regional television and adverts, seminars and building up a network of organisations such as banks, accountants, lawyers and business advisers, to explain the role and availability of venture capital and how it is being used to support firms with growth potential. Despite efforts of the FRK and RPF public awareness of venture capital remains low.

Many entrepreneurs view venture capital as a lender of last resort, to be approached only when all other avenues for funding are unsuccessful. Furthermore, equity is viewed as a sort of long-term capital, which only has to be "paid back" when the company is successful. The perspective of equity as a form of ownership-securitisation in a company is now better understood.

RPF has played an active part in formation of the Czech Venture Capital Association founded in 1995 to promote the development of a venture capital industry. The association provides education and training for members and represents the interests of its members in discussions with authorities. There are today 12 members represented in the association.

PHARE equity programmes has contributed substantially to the development of the skills required by venture fund managers and increased the awareness of public servants in ministries concerned. The PHARE programmes also developed a new “Czech School” for Czech venture capital executives.

The RPF was designed as a pilot project for the Czech Republic. The results of RPF’s operations have contributed as a model to the development of similar projects in Poland, Slovakia and Hungary.

Sustainability

The RPF and FRK seem to be sustainable. They have developed a proper network and they are beginning to receive dividends and fees from their investees. This income is modest at present and is not sufficient to cover all operating costs; this is quite normal in the early years of all venture funds. A part of the initial funding was set aside for this purpose.

The RPF and FRK collaborate with the BICs and RPICs, but their professional culture is different; in the experince of the venture capital executives, most of the BICs and RPICs are “friendly” towards enterprises but not sufficiently commercial or profit orientated. In general they lack the skills and experience to provide the help that these firms need to enable them to put together a project which fully addresses the business issues which will be raised by venture funders.

There is a little ambiguity. The RPF utilises the network of its shareholder, the CSOB (Ceskoslovenska Obchodni Banka). However, the first competitor for a venture capital fund is not another venture fund, but banks. Before the banking crisis, banks distributed credits easily. Today the banks are quite willing to extend generous terms to good quality companies. For publicly traded companies, acquiring shares of its borrowers is viewed as a tool for building a symbiotic relationship between the bank and its key clients.

Conclusions

The demand for equity capital in the CR appears to be higher than the supply of investment, though the major constraint for venture funders is to attract an adequate supply of fundable deals. The two specialised funds (RPF and FRK) engaged in early stage investment represent - according to the CVCA – less than 5% of the capital available for investment.

In spite the fact that the market is not very large, the Venture Funds cannot meet the needs of all the possible projects, because of a lack of money and insufficient staff.

A key factor for the success of both venture funds was the choice of management. In the case of the RPF, the long term adviser, a person with substantial experience of equity funding, stayed on in the role of Chief Executive of the fund. This provided long term stability and continuity during which other executives in the fund have been able to build up their level of experience. This is in contrast to many Phare projects where the EU experts only stay for perhaps 18 months to two years, after which a new set of advisers may be sent, often with a different orientation and philosophy, or the local team is left to manage the programme with only limited access to outside assistance.

A serious obstacle preventing the development of the venture capital industry relates to the legal difficulties of setting up a fund within the Czech Republic. There are too many legal obstacles to the development of the venture capital funds. The tax implications have yet to be addressed if funds are to attract capital from local investors.

The successful development of the public stock markets serves as the single most important external factor impacting on the future of the venture capital industry. Unfortunately, the public markets have still a long way to go before they serve as a viable vehicle for venture capital firms seeking to manage a successful exit. This is a question of volume of trade and of observance of transparency rules.

TABLE 3.4 SUMMARY EVALUATION OF THE PHARE VENTURE CAPITAL FUNDS

Evaluation Measure	Comment	Rating
Relevance to government policy	The government is not very convinced about the potential help, which could be provided by the venture capital to the SME sector. Relative lethargic attitude.	3
Relevance of the design	Appropriated design specially oriented to small firms and start ups with insufficient means	4
Efficiency	Target reached. Fund over-invested (110%)	4
Effectiveness	Good support to small firms; hands on attitude	4
Impact	Very good pedagogical impact (developing skills for VC fund managers and the awareness of public servants in ministries concerned).	3
Sustainability	Sustainable; too early to judge profitability and sustainability.	3
Total	A technical success in an unfavourable legal environment	3.5

3.4 Comments on other Financial Programmes

Both internal and public research reveal, that the other schemes like TECHNOS and guarantee schemes are popular with SMEs and appear to be fully utilised. However in the long term, they cannot solve the problem of the under-capitalisation of growing private businesses. This has often been demonstrated by bank executives and economic researchers as well as by government departments.

Small loans

The success of the scheme was limited by the events affecting the commercial banks involved. We met the banks in Prague and Ostrava. The Bohemia Bank went bankrupt in 1995 and the operations was taken over by the Business Development Agency. The scheme is no longer effective today as the money is not being recycled and no additional funds have been made available.

The Agrobanka was the only bank where the loan scheme was targeted at enterprises in 6 poor districts with a high level of unemployment. Founded in 1990, this bank was the first private financial institution. At the beginning it focused on the rural economy; the bank has since rapidly enlarged its range of activities. In 1997 GE (General Electric) bought the best part of the bank. Concerning the Phare Small Loan Scheme, the bad projects (11 out of 69) were transferred to a special bank set up to hold ‘bad loans’. The Agrobanka executives in the local branches regretted the disappearance of this Loan scheme; there is still a need for credit, which is not being satisfied.

TABLE 3.5 SMALL LOAN SCHEMES

Participating bank	Numbers of clients	Budget	Losses (%)
Bohemia Bank	376	3 MECU	14%
Agro Bank	64	1,4 MECU	8%
Bank of Moravia	69	1,8 MECU	1%

Source: as of July 97, OMAS Report (02/98)

According to some of the RPICs the Bank of Moravia did not use the Phare loan scheme very effectively, and did not achieve the expected impact on the development of the SME sector. "The lending scheme seems to have been overly cautious as indicated by an extremely low ratio of non performing loans (2%). Although this caution has prevented a loss of public funds, it also means that the targeted group of SMEs has not received the expected financial support". We do not fully agree with this assumption made in the OMAS Report. The scheme is no longer of interest to the bank from the financial perspective.

The money allocated through the BDA to commercial banks was lent to them for a 4 years period and at an interest rate of 9%. The mechanism was interesting so long as the intervention rate of the Central Bank was higher and the deposits in the Central Bank redistributed. In the event of losses, the BDA covers 6O% and the banks are responsible for 40% of the bad debt. The Agency monitors the scheme on the basis of quarterly reports from the banks.

Flood scheme

This scheme, financed using Phare money, was initiated by the BDA and can be considered as a success. In July 1997, disastrous floods affected the population living in Moravia and East Bohemia. The floods, the worst of the century, caused at least 47 deaths and an estimated CZK 50 billion in damage. Thousands of firms in these regions were effected including a large number of SMEs with limited access to credit even before the disaster.

A plan was quickly developed involving the reallocation of money from the advisory scheme (CZK 10 million / ECU 0,3 million) and unutilised funds from the Loan Scheme amounting to CZK 80 million (ECU 2.2 million), including the Phare SME credit line placed with the Bohemia Bank. A total of 126 loans amounting to ECU 1.2 million were rapidly disbursed through the network of RPICs and the BICs.

The design and the process were practical and easy to understand:
- maximum size of loan: 500,000 CZK (ECU 13,908)
- maximum duration of loan: 2 years
- target firms: up to 50 employees
- goal: recover the fixed assets and strengthen the current assets
- financing on the base of a project drawn with the RPIC/BIC assistance

Chapter 4 Evaluation of Institutional Programmes

4.1 Introduction

Two programmes have been included for evaluation. These cover:

- The setting up and development of the Business Development Agency (BDA)
- The provision of business support services by the Business Incubators

Log frames and input output tables have been prepared for each programme, from which a sample of projects has been selected for evaluation. The results of the each evaluation are set out in the sections below.

4.2 Evaluation of Phare support to the Business Development Agency

The following evaluation is based on documentation and interviews. The quality of the evaluation depended upon the support of the representatives of the BDA. Whilst it was possible to gather good information on the loan and venture capital schemes, the evaluation of the institutional programmes (RPIC and BIC network, SME policy), was less successful due to the cool reception that we were given. Regrettably, the questions regarding their day-to-day management (finance, relationship with the Ministries) were answered evasively. They explained that their reluctance was because they have repeatedly had to provide answers to the same questions put by different sets of EU experts sent by the Commission. We were therefore obliged to concentrate on documentation.

Objectives and logical framework

The Ministry of Economy established the Small Business Development Agency (BDA) in September 1993 as a semi autonomous body to adminsiter the German bilateral SME programmes, whilst a department withoin the Minsitry adminstered the Phare SME programmes. In the summer of 1995, this department respsonsible for the Phare programme was merged with the BDA to concentrate all SME support within a single orgasniation. Since November 1996, the BDA has been operating under the auspices of the Ministry of Industry and Trade (MIT), following the trasnfer of SME s functions from the Ministry of Economy. A Logical Framework with key questions to be considered during the evaluation is set out in Appendix D.

Inputs and outputs

Since the transfer, Phare has provided technical support in the design and setting up of the BDA, as well as on-going funds for running costs, under a cost sharing agreement with the MIT (see section 2.4, table 2.2). Phare has also provided financial support and technical assistance for specific projects.

The BDA now acts as a PMU for the Phare SME Programme. It is also responsible for providing policy advice and information to the MIT as well as for the management of the economic assessment of projects submitted for funding under the Technos scheme.

The work of BDA is organised in four departments:
- Financial schemes
- Support of innovative and growing businesses
- Consulting

[5] In 1996 and 1997 paid out of the FM CZ-9302. For 1998, forecasting in February 1998

- Co-operation and training.

In 1996-7, the BDA carried out a range of surveys to determine the performance of support organisations and provide information for policy discussions on the following topics:
- Effect of joining the single EU market on SMEs in the Czech Republic
- Information needs of SMEs
- The need for an observatory to assess SME performance

Relevance

To what extent did the programme fit the needs and policies of the country?

Before the creation of the BDA, SME support was very fragmented. The Phare programme brought money and gave a direction to SME support including the creation of a Business Centre network, and the setting up of a centre to support export development.

Was the design appropriate?

Legally, the BDA was set up as an independent so-called "non-governmental contributing organisation". The BDA relies on government and Phare funding, as well as income through consulting services and report to the MIT. Plans for the setting up of the Business Development Agency were drawn up by EU Experts who commented on the lack of interest or involvement of the Czech counterparts. The passive involvement and lack of commitment of the Ministry has inhibited the BDA being more effective. A consequence was that initially only limited funding was provided by the Ministry of Economy to cover the basic running costs of the BDA.

The objectives and strategy pursued by the BDA in the Czech Republic is similar to those adopted by National Agencies in other Central and Eastern European countries:

- Direct advisory, information and education services for SMEs
- Implementation of educational programmes for business advisors
- Organisation of seminaries to promote SME development
- Analysis of the entrepreneurial environment and proposals for its improvement
- Facilitating access to and implementation of SME assistance programmes
- Acting as the PMU for SME programmes
- Initiation and active participation in new projects supporting SME development (promotion, preparation and implementation of programmes).

Was this an appropriate programme for Phare?

Having been the largest and most active external source of funds for the SME development, and having taken the lead in creating the RPIC and BIC network, it was wholly appropriate for Phare to take the lead in encouraging the setting up of a National Agency to improve the co-ordination of the various SME programmes in place, and at the same time begin the process of encouraging the Ministry to introduce effective SME policies, backed up with spending commitments.

Phare played an essential role. At the start it was almost the sole source of funds for SME support programmes. It is only since 1998, that 50% of the money received by the RPICs has been coming from the Czech State Budget.

It is generally believed that without external support, such a structured and comprehensive approach would not have been taken. No other donor had the resources or the flexibility to develop such a broadly based support programme. Having established a clear structure and programmes, it has enabled other foreign donors to participate within an integrated framework avoiding overlap and duplication.

From the outset, Phare adopted a holistic view towards the design of programmes for SMEs, playing a more active role in policy-making than usual.

Efficiency

Since most of Phare's support has involved the provision of funds to cover operating costs (rather than the transfer of know-how), efficiency is not easy to consider. The main beneficiaries have been the staff in the BDA and the network, who have built up a substantial body of experience as a result of the funding provided by Phare. Part of the reason for the relatively low efficiency of the BDA is that it would appear that the Ministry or the Advisory Board has not provided it with a clear set of goals and objectives, a reflection of the lack of clear long term policies and aims for supporting the growth of the SME sector.

It has not been possible to consider the relative value or cost effectiveness of each of the services provided by the BDA.

Staff
Until the beginning of 1996 the BDA activities were slowed down by shortage of personal. The BDA has a local staff of 17 working in the four departments mentioned.

The staff seemed to be well motivated and generally appeared to have a good understanding of their subject. However, arguments between its senior management team unfortunately limits the motivation and efficiency of the staff. There was an atmosphere of permanent hostility. Regrettably, the mentality of the people involved in the BDA were too administrative, and staff had only a limited experience of the real issues facing SME development. The BDA is not profit oriented, and is run by civil servants who do not perceive reality in the same way as entrepreneurs. Unfortunately some of the people in charge considered a lot of information concerning the economy as being confidential.

BDA's relationships with the RPICs and the BICs is poor; as a result the contribution of the BDA to improving the quality of services offered by the network has been limited.

Whilst some of the short comings within the BDA are widely recognised, little or no action had been taken at the time of our field work to address these concerns, even though the MIT and the Union of Chamber of Commerce are both on the BDA Supervisory Board. Concerns have been expressed by the Delgation on a number of occasions. Eventually, (after the fieldwork for this evaluation was completed), we understood that the Director of the BDA was replaced. There stil remains much to do to improve the quality of its services.

Effectiveness

In a few years, the BDA has helped to complete the development of a network of 24 RPICs covering 70% of the territory (despite the fact that some RPICs have more reality on paper than in life).

The role and activity of the BDA are strongly criticised by the RPICs. The violent tensions within the BDA inhibit efficient co-operation. The RPICs tolerate the BDA. For them, the BDA is just an official organ for channelling money to them. They prefer to work together through the NARP (national organisation of RPICs). Because of a lack of resources, the NARP has only limited added value.

Towards the SMEs the effectiveness of the BDA is controversial. Its effectiveness can only be approached by considering the value ascribed by SMEs to the RPIC network. As a result of interviewing 1,700 SMEs it has appeared that:
- 1,505 (88%) of the SMEs included in the surveys have never used RPICs as source of information
- 1,680 (99%) of them have never resorted to the services of the BICs

- 1,679 (99%) of them have never contacted the EU Information Centre.

This represents a very low level of awareness and penetration of the RPIC network, reflecting at the same time the low profile of the BDA.

Impact (spill over effects)

The impact of the BDA is no less controversial than its effectiveness. The BDA is perceived by other organisations as an extension of the Department of the Ministry of Economy. In fact, the BDA undertakes a lot of studies and surveys for the government. It also prepares documents, which will be the basis for new laws proposed by the government. In other terms, the BDA does not play the independent role expected by the non-governmental entities, such as the Chamber of Commerce and the Entrepreneurs Associations.

The Ministries are aware of many of the SME specific issues, but despite the efforts of the BDA, few measures are taken.

Sustainability

According to the General Manager, the BDA annual budget is around CZK 7 m (ECU 200,000). CZK 5 million comes from the State Budget and Phare, and the remaining CZK 2 million must be earned through the sale of services. Phare’s money may not be used for salaries. This presents a conflict for the BDA, which is both expected to be a national agency engaged in strategic work and the provide value added services to the network of RPICs and BICs. It also needs to earn commercial income by providing business support services; this brings it into conflict with other members of the network.

In 1998 the BDA stopped receiving any more money from Phare; the Memoranda 1 & 2 came to an end. New priorities must be set up between the BDA and the relevant Ministries.

There is no clear solution to the problem. On the financial side, the BDA is nearly self-sustainable as an entity: the BDA is able to pay salaries and operating costs from the income it receives for managing these funds. Nevertheless, the BDA does not seem able (or willing) to put forward proposals for the management of the projects by playing a more active role.

Conclusions

TABLE 4.2 SUMMARY EVALUATION OF THE BUSINESS DEVELOPMENT AGENCY

Evaluation Measure	Comment	Rating
Relevance to government policy	The role and the place of the BDA in the governmental SME support policy has not been clarified sufficiently by the Ministry despite the prompting of the Delagation.	1.5
Relevance of the design	Too many changes in the Czech Ministries concerned by the SME question. The BDA is in perpetual gestation.	1
Efficiency	Realises surveys for the government, provides services to medium and large firms to generate consultancy income. Acts as Phare PMU...	1.5
Effectiveness	Ignored by the SMEs and avoided by the Business Centres.	1
Impact	No measurable impact	1
Sustainability	Sustainable so far; the State Budget will replace Phare funding	2.5
Total	A quasi-governmental entity with a limited proper identity and a very limited impact on the SME support policy.	1.25

The BDA has not established itself as a major actor in the development of SME support policies. The BDA is stuck in a supporting role. The role played by the BDA is not really clear, either to the RPICs or to the SME support organisations.

The BDA has not established itself as the spokesperson of the SME interests, neither with the Ministries nor SME Centres. This is the main reason why it is not recognised or respected by the RPICs or SMEs.

The BDA has not established itself as the obligatory intermediary between the beneficiaries of Phare assistance and the Phare administration. Phare has continued to deal directly with the RPICs and the BICs. The BDA has only been an implementer of Phare projects, and has not taken many initiatives. This is one of the reasons why the BDA is only considered as "the" PMU by the beneficiaries, not as a responsible interlocutor.

4.3 Evaluation of Phare support for the Business Innovation Centres

Objective, logical framework, project selection and methodology

The second programme evaluated within the institutional area covers Phare's support for the establishment and running of BICs. The main objective of these centres has been to increase the rate of formation, growth and survival of SMEs focusing on innovation for industry or services to industry by providing information, advice and training on an affordable basis. A Logical Framework with key evaluation questions has been developed for the Centres (see Appendix D).

It was planned to evaluate the Ostrava BIC as it is also the location of the Regional Venture Fund evaluated in section 3 above. The region of Ostrava (see below) encounters serious problems in restructuring its main activity (mining). The creation of SMEs is vital in order to diversify the local economy and provide news jobs to former mineworkers. The region of North Moravia and Silesia is going through the same difficulties encountered by the French Lorraine since the end of the 70's. There are contacts between the two regions in the ECOs framework.

Unfortunately it was not possible for us to meet companies receiving assistance from the BIC and simultaneously loans from a regional bank participating to the Phare Loan Scheme.

The region of OSTRAVA

Ostrava, is the capital of Severomoravský *kraj* (region), eastern Czech Republic. It lies between the Ostravice and Oder rivers above their confluence at the southern edge of the Upper Silesian coalfield. Ostrava is the third largest city in the CR with a population of 323,870 inhabitants. The region of North Moravia and Silesia represents a total area of 5.555 km² (7% of the total country area) with a total population of 1.3 mn (12.5% of the total number of inhabitants in the country). The region represents 20% of total GDP of the Czech Republic. The city was founded about 1267 as a fortified town. Ostrava is surrounded by a rich black-coal basin that has made it a centre of heavy industry, with a long tradition dating from 1830, when the first blast furnace was built at the Vítkovice ironworks. Some of the coal pits extend into the city limits, and their derricks are common features of the skyline.

The conurbation of Greater Ostrava occupies an area of about 700 km². The region receives a steady influx of workers, and many housing estates and new towns, such as Poruba and Havírov, have been built there. Most planned development is east of the Ostravice River, in Slezská ("Silesian") Ostrava. Settlements west of the Ostravice are in Moravská ("Moravian") Ostrava. The population of the region is employed predominantly in mining (at Ostrava, Karviná, Orlová) and in metalworking (at Vítkovice, Kuncice, Trinec). Manufacturing also include mining machinery at Opava, railway cars at Studénka, and automobiles at Koprivnice. Coal mining also supports chemical (ammonia and nitrate fertilisers) and power industries. The Technical University of Mining and Metallurgy of Ostrava (founded in 1716) is located there.

A Technology Innovation Centre (TIC) was established in Ostrava-Vitkovice in early 1994 by a group of entities interested in restructuring the industry in Ostrava and supporting emerging SMEs in the region. The founders were the Moravia Bank, the Vitkovice integrated iron and steel plant and the Municipality of Ostrava.

In 1996 the TIC was transformed into the present BIC and joined the EBN Network. The BIC has got satellites in the cities of Koprivnice and Frydek-Mistek. The Ostrava BIC is among the five existing BICs (Brno, Plzen, two established in Prague) the oldest and the only one not to have been created by the Government.

The current activities include the following:
- Research and evaluation of emerging businesses
- Assistance and support to business innovation activities
- Business incubator (practical material help to new innovating CIEs)
- Support to SMEs to develop exports and joint venture relationships with enterprises in the EU

Inputs: funding and technical assistance

The Vutkovice plant in the centre of Ostrava-Vutkovice has hosted the BIC since its beginning. In addition to office premises, there are 10,000 m² available for the "incubating activities".

The 1991 Financial Memorandum planned ECU 754,000 for the BIC Network; the 1992 Financial Memorandum allocated a further ECU 843,000. We have no breakdown by type of support or by BIC. Nevertheless, for the year 1996, the Ostrava BIC received ECU 49,400 for three-quarters through the BDA, i.e. ECU 16,466 per quarter. This represented 19% of the total amount allocated to the BIC Network by Phare in 1996.

TABLE 4.3 BIC OSTRAVA - PHARE FUNDING IN 1996-1997

In 000 ECU	Planned support for 1996	Real support in 1996	+/-	Planned support for 1997	Real support in 1997	+/-	1996- 1997 support evolution
Consulting services	8.95	7.76	*-1.19*	16.55	17.76	*1.21*	*+ 229%*
Incubator support	19.90	19.55	*-0.35*	0.04	40.08	*40.05*	*+ 204%*
Training & Seminars	0.64	0.61	*-0.03*	3.37	1.53	*-1.83*	*+ 252%*
Services to regional organs	1.74	3.14	*1.39*	7.99	2.56	*-5.43*	*82%*
Membership fees (EBN)& training of BIC staff	8.63	4.85	*-3.78*	7.45	20.11	*12.67*	*+ 414%*
Purchase of software and documentation	0.46	1.74	*1.28*	1.99	1.61	*-0.38*	*92%*
Audit	1.05	1.10	*0.06*	1.50	1.34	*-0.16*	*+ 121%*
New Equipment	7.82	6.10	*-1.71*	7.47	6.56	*-0.90*	*+ 107%*
Total of PHARE Support	49.18	**44.86**	*-4.32*	46.35	**91.57**	*45.22*	*+ 204%*

Source: BIC Ostrava and consultant's assessment

In 1997, 80% of the amounts indicated above were allocated to BIC in Ostrava, 10% to the satellite in Frydek-Mystek and 10% to the satellite in Koprivnice.

TABLE 4.4 LEVEL OF SUBSIDY TO THE BIC FROM PHARE BY ITEM

Support	Max amount includingVAT	Phare subsidy
Subsidised Services to enterprises		
First contact	CZK 400/hour	100%
Specialised consulting	CZK 500/hour	40%
Business plans	CZK 400/hour	40%
Assistance to firms "being incubated" (rent, transport, logistic)	According to the market price 1st year 2nd year 3rd year 4th year	 25%+50% 20%+40% 15%+30% 00%+15%
Training		45%
Special clients		
Services to regional structures	CZK 500/hour	45%

Support	Max amount includingVAT	Phare subsidy
Enhancement of the BIC		
Membership fees (EBN) in international structures		100%
Seminars , fairs, exhibitions		50%
Actions and consulting from the PMU & EU Delegation		100%
Purchase of software & documentation		40%
Audit of the Phare contribution		100%
New equipment		100%

Source: BDA. Note: The level of subsidy from PHARE is the same for a BIC as for an RPIC.

Outputs

Table 4.5 summarises the services delivered to all clients whether or not they are housed in the Innovation Centre. Table 4.6 summarises the activity levels in the Innovation Centre only.

TABLE 4.5 BASIC SERVICES DELIVERED BY THE BIC OSTRAVA (ALL CLIENTS)

	1996	1997
Initial contact	120	297
Specialised consultations	55	48
Business Plans	10	14
Training	9	6
Assistance to start-ups	7	9
Assistance in new work opportunities	42	88

TABLE 4.6 BRIEF ANALYSIS OF ACTIVITIES WITHIN THE OSTRAVA BIC

	1995	1996	1997	1998
Number of companies in BIC	24	33	44	48
Number of innovative companies	16	22	28	39
New jobs created	217	267	302	377
Office space Technology adjusted facilities	6,000 m² 3,500 m²			
Number of firms vacating the BIC	4	7	7	4

Source: Ostrava BIC

Relevance

To what extent does the project address a real gap in the provision of information, advice and training for SMEs?

The BIC is the only semi-public structure in the region whose purpose is to exploit the existing technological know-how of executives and workers of former big plants. The BIC activity is closely linked to the restructuring of coal mining, the steel industry, engineering and chemistry industries. The large industrial firms must reduce staff numbers and subcontract a part of their former production activity. In Ostrava 60,000 lay-off are foreseen in the coming months. The start up and growth of small firms helps to reduce unemployment and create sub-contractors.

This explains why the BIC supports innovative manufacture in the processing of metals, insulation, wood and paper tools, and devices for environmental protection. Another direction is to support the development of services and consulting businesses in such areas as information technology, quality assurance and quality management as well as in production technologies. The third area of activity is to encourage SMEs engaged in R&D, the supply of technologies such as hydraulics, transportation systems, environmental constructions, steel structures, machinery & equipment, and technologies for measurement, control and automation.

To what extent was the design appropriate?

The initiative is based on reusing redundant property to provide small flexible space for start-ups and growing companies. To reduce their operating costs, common business services are provided together with access to on site business advice.

One concern expressed by one of the local consultants was that the design is much more targeted to SMEs creation in general and does not take into account the particularities of the restructuring of large companies. In this sense, it may be more significant for the region to transform, for instance, departments of large companies into autonomous economic and legal entities than to encourage the foundation of firms in areas of tourism or ecology. In practice both approaches are relevant, to build on the local strengths of the region whilst at the same time attracting new sectors to the area, to make it less dependent on the heavy industry.

Suitability of current BIC legal structure?

The BIC was converted to a joint stock company in 1996. Since then, several new shareholders have joined the BIC including the Czech Venture Capital Fund, the BDA, and OKD (a mining company). In the same period one member, the Chamber of Commerce, left.

The main reason why the staff agreed in 1996 to the change of structure was the opportunity to get technical assistance, in the form of management training for people who were previously engineers. This was an opportunity for the BIC to improve its quality in consulting and to enlarge its activity area out of the pure technical support to innovative business.

Efficiency

The efficiency of the Ostrava BIC is recognised by the BDA and Phare. Because of the good results being achieved, the Ostrava BIC has received more funds than other BICs. For the year 1997, the BIC received ECU 91,570 (see table 4.3), which represents 25.5% of the total allocated to the BIC Network (5 BICs) by Phare in 1997. The average annual donation in 1996 from Phare to a BIC was ECU 52,438 and ECU 71,691 in 1997.[7]

[7] There may be possible distortions because of the exchange rate CZK/ECU utilised by the different actors. See annex E for the rates we have utilised.

The following table shows how effective the Ostrava BIC is in comparison to other BICs in the Czech Republic.

TABLE 4.7 CZECH BUSINESS INNOVATION CENTRES: ACTIVITY IN 1997

	New clients	Advising	Business plan	Credits	Start-ups	Firms being in incubator		Seminars	Participants	Advising regional organs
						Number of firms	Number of workers			
Brno	282	25	42	10	9	29	113	36	84	1
Plzen	90	15	6	3	8	17	70	7	230	2
Ostrava	**279**	**69**	**14**	**4**	**27**	**72**	**468**	**4**	**71**	**3**
ÈVUT Praha	98	289	5	0	4	27	143	1	5	1
TC AV ÈRPraha	78	26	1	2	1	11	51	27	328	3
Total	**827**	**424**	**68**	**19**	**49**	**156**	**845**	**75**	**718**	**10**

Source: BDA from information obtained from the BICs

The Ostrava BIC (together with the BIC in Brno) are the most active in terms of clients served and new companies established. The Centre is less orientated to teaching (seminars) and more active in assisting start-ups. The BIC offers space, technical facilities (faxing, phoning, internet access) and consulting. A positive feature is the number of firms being in the incubator. According to the data provided by the Incubator, the breakdown of clients is as follows:

TABLE 4.8 PROFESSIONAL ORIENTATION OF THE CLIENTS (1995-1998)

	1995		1996		1997		1998	
R&D	5	*20.8*	8	*24.2*	13	*29.5*	17	*35.4*
Processing	11	*45.8*	14	*42.4*	16	*36.4*	13	*27.2*
Services	7	*29.2*	10	*30.3*	9	*20.5*	12	*25.1*
Commercial	1	*4.2*	1	*3,1*	6	*13.6*	5	*10.5*
Total	***24***	***100%***	***33***	***100%***	***44***	***100%***	***48***	***100%***

Source: Ostrava BIC

Most clients are engaged in production processes. The proportion of enterprises engaged in R&D activities has been steadily increasing, so that by 1998 had become the most important activity in the BIC. Nevertheless, the companies supported by the Ostrava BIC are not as innovative in terms new technology, new process and new market as firms in the Brno BIC.

The main purpose of the BIC is to recycle/re-qualify people from old fashioned big plants. Basically any start up company with a viable business idea and reasonable prospects can be included. All the start-ups recorded have not been accommodated in the Incubator; similarly all the firms in the BIC have not been pure start-ups.

The subsidised rents and business services in the Incubator itself were granted to 23 innovative firms (out of 72). The level of subsidy varies between 5 and 40% depending on the duration of the stay in the Incubator (see table 4.4 above) and the kind of activity the firms have.

Staff and incentives

The range and uptake of consulting services has increased substantially during the last three years (1995-1998). There are now seven full-time employees (eight soon) plus external advisors on a contract basis. The BIC includes teams of specific external consultants on demand. With the creation of an experts' database the BIC exploits its network better. There is a strong demand for ISO specialists.

The basic salary amounts CZK 15,000 (ECU 430 per month), which is rather modest. The salary represents 40% of the regular income of each employee. The second part of his income depends on the activity of the BIC. Other BICs offer a basic salary of CZK 40,000 (ECU 1,160) with no performance related element.

However, access to training particularly from abroad is regarded as more important to BIC staff than the level of salary. Thus the training budget was multiplied by 4 during the period 1996-97 (see the table 4.3). This is linked to the fact that the executives are former engineers and not pure financial managers, seeing themselves as "hands on" advisors.

Effectiveness

One indicator of success is the number of work places created[8]. The BIC accounts for 377 new jobs, which was substantially more than any other BIC (table 4.9). Not all of the companies in the BIC's portfolio were successful and some have left the BIC (22 since 1995), though some may be trading from another location.

TABLE 4.9 FIRMS IN THE BUSINESS INCUBATORS AND JOBS CREATED (1998)

Czech BICs	Firms hosted in the incubator	Total number of employees	Innovative firms in the incubator	New jobs created in the innovative firms
Ostrava	72	468	47	377
Brno	29	113	21	87
Plzen	17	70	15	65
CVUT Praha	27	143	16	97
TCAVCR Praha	11	51	9	38
Total	**156**	**845**	**108**	**664**

Source: BDA

Interviews were carried out with tenants and staff in the BIC. These are summarised in table 4.10 below:

TABLE 4.10 SUMMARY OF REVIEW OF FIRMS ADVISED BY THE OSTRAVA BIC

Firm	Activity	Services provided	Assessment	Number of employees	Effective rating
Co A	Production of spare parts for machine tools. Production of equipment from metal sheets Founded in 1995	Cheap rent. Seeking JV partners Access to training	We saved time and energy finding everything we needed at the same place. We could afford advice at market price, but wouldn't have reached the same level of profitability	7 full time	3
Co B	Plastic products Founded in 1992	Seek information about new technology Drawing up a business plan	We appreciate the mix of technical facilities and management advice. We could not find such conditions elsewhere.	5 full time 3 part time	4
Co C	Production of saddles and bags. Founded in 1995. Sales doubled since establishment	Advice for establishment (legal, taxation, marketing). Drawing up a business plan Preparing an application for credit.	We wouldn't be able to find such help at such price. We highly appreciate the follow up provided by the BIC.	21 full time	3.5

[8] This point is controversial. Another source totalled for 1997 a number of 118 new jobs created thanks to Ostrava BIC

Firm	Activity	Services provided	Assessment	Number of employees	Effective rating
Co D	Production of engines. Founded in 1993. Sales multiplied by 1.7 since 1994.	Space and technical facilities. Training (computer) Marketing Search for partners	We have increased our sales thanks a better marketing. We couldn't be profitable with a higher rent for the premises. The BIC is our only access to information about the western market and potentials partners.	15 full time 1 part time	4
4 firms					3.6

Impact (spill over effects from wider objectives)

To what extent has it strengthened the SME lobby locally?

The SME lobby is well represented in the region by private associations and the existing RPIC. Furthermore because of the difficulties experienced by the region, the authorities and the politicians are aware of the opportunities offered by the creation of SMEs. This is not a question of awareness but a question of means (money).

Are private sector services precluded from developing because of the Phare support to the BIC?

The BIC activities do not compete with services offered by the growing number of private consultancies. This is because most young firms cannot afford the services of private consulting companies, the BIC offers a range of common business services not offered by private firms e.g. reception, trasnsport, computing and faxing.

Furthermore, the BIC is able to exploit a rich network of qualified experts in different technological fields; the BIC is able to offer full teams able to support full time companies.

The private consulting companies and the BIC are not in the same market segment. The BIC co-operates locally with the local RPIC in a friendly way.

Sustainability

The basic idea of the BIC is its potential to be fully self-financing, through the recycling of rental income to cover staff and overhead costs. The staff were aware from the beginning that Phare help would not last for ever. According to the BIC staff, the BIC is self-sustainable. We have not sufficient evidence to confirm this point, but we have no reason not to believe the BIC representatives, who pointed out that the BIC was founded and run for about 2 years without any Phare or Budget funding.

However, the Ostrava BIC is stuck in a dilemma: it can either work with the more prosperous firms able to pay for the BICs services or pursue its main mission of support start up; but this is dependent on government funding.

Conclusions

Unlike many Business Centres we have encountered during this survey, the Ostrava BIC plays its role in an unbureaucratic way. The team is very proud of its acheivements since the beginning.

The people of the Ostrava BIC are very jealous of their autonomy, yet they feel they are not suported sufficiently “by Prague”.

However there is some overlap and duplication with the RPIC in Ostrava, except that that the RPIC does not have any "incubating activity".

Nevertheless, we agree with the February 98 OMAS Report assessing that "the Ostrava BIC left the impression of having reached the standards of a European version of Business Development Centre". This opinion was also shared by the Dutch audit made when the BIC applied to join the EBN Network.

TABLE 4.10 SUMMARY EVALUATION OF THE BUSINESS INNOVATION CENTRES

Evaluation Measure	Comment	Rating
Relevance to government policy	No active support from the government. Phare is committed for everything	2
Relevance of the design	Appropriate design specially oriented to start-ups with innovative projects. In fact, the system is able to support every start-up technologically oriented	2.5
Efficiency	Target reached. Numerous firms incubating	4
Effectiveness	Good support to very small firms and start-ups	3.6
Impact	No clear impact. No awareness of the specificity of those SMEs. No support from local authorities (with a few exceptions as in Ostrava).	1.5
Sustainability	Phare funding stops, no state funding, not enough commercial oriented in many places. Centres will not be very sustainable without public support.	1.5
Total	Useful centres playing an irreplaceable role in the local economy.	2.5

Phare support to BICs and to innovative entrepreneurs is highly appreciated. Phare action is considered as consistent and well structured. The Phare BICs do what the other SME support structures do not undertake.

Other BICs exist outside of the Phare BIC network, but their action is not considered as significant. "The total number of business incubators, as well as the number of national programmes for the support of SMEs, may indicate the false conclusion that there are almost no problems in the area of support of small innovative business in (CR)[9] (...). The main difference between a real business incubator and other multi-tenant facilities is in the service area. Most of the facilities claiming to be business incubators simply offer space and - because telephone, fax and some basic office equipment are available - they are described as 'incubators'. In these cases, the relationship between the facility owner and small companies resembles that between landlord and tenants and there is no assistance with management, marketing and financing".

In 1996 the total Phare contribution to the BIC network was ECU 262,192; the RPIC network received about the double for the same period (ECU 485,260). In 1997 the amounts were respectively ECU 358,457 and ECU 785,425. If we consider that there are 16 RPICs[10] and only 5 BICs, it seems that the BIC network is privileged. In 1997 the average donation for a RPIC was ECU 34,149 and ECU 71,691 for a BIC.

The BICs, while focusing on the same key areas, have slightly different priorities (development of the innovative enterprises). Fees for consultancy services represent a serious problem for start-ups usually short of working capital; in comparison to "normal" start-ups, innovative companies have to face additional problems (R&D, patenting, licences and official authorisations) that make the assistance provided by a BIC as being relevant and justified.

This is maybe why BIC are less profit-oriented than RPICs and also why the BICs are relatively better funded. The RPICs are expected to generate additional income through commercial activities if they are to survive.

[9] "Support of small innovative business in the Czech Republic", Karel Klusacek (Industry & Higher Education, Feb.97)
[10] In addition there were 7 founded in 1997.

Chapter 5 Conclusions and Recommendations

Despite the measures taken by the government since 1995, the Czech SME sector remains underdeveloped in comparison with western market economies.

The restricted access to credit is a severe constraint for the private sector. This is no longer due to a lack of liquidity in the banking system as in the early years of transition. Now it is due to a fear of bad loans and a credit policy, which is oriented towards large firms.

Venture capital for financing start-ups is still undeveloped and restricted by an inadequate legal framework.

The Phare financial programmes have not generated any "propagation effect" or "explosion of credits". The money allocated does not appear to be been recylced the banks have remained reluctant to increase their level of lending to the SME sector, despite the potential competition from foreign banks in the Czech Republic.

Whilst the RPICs have provided inforamtion and advise to over 10,000 small firms there is still much to be done in this field. In general, according to different sources (CMGB, BIC Ostrava, and Association of Entrepreneurs), the existing support systems for SMEs have a very low penetration and uptake rate: only 1% to 3% of the SMEs in the country appear to access the RPIC/BIC network. Whilst it would appear that penetration levels seem to be lower than in some other CEECs, the low proprtion of SMEs making use of these services remains a common problem facing all small firm advsiory services, whether in both Eastern and Western Europe.

5.1 Financial programmes: future options and priorities

Concerning the financial schemes, we suggest:

1) *The Development of seed capital financing procedures.*

This could complete the action of the Venture Capital companies. It would be the first stage for an SME before being able to attract an investment from a VC Fund or before receiving long-term financing from banks. At this first stage, the SMEs are not attractive to VC Funds and they are too risky for the banks. We understand that this issue has been taken up by the Delegation with the Ministry of Industry and Trade, but the Ministry have not regarded it as a priority.

2) *Diversify the public financing schemes*

At the same time, the public financing scheme (state funded or EU funded) needs to be diversified:

- taking into account the need for working capital
- reducing the criterion to below 100 employees
- create/reinforce a non commercial banking structure in order to deliver credits and/or guarantees (not in the same structure) to SMEs through the RPIC network and in co-operation with the commercial banks[11]

[11] We are very surprised that Phare did not use the Post office network and the savings banks as the first distributors of loans. They are people used to deal with money, even if they do not have any commercial bank experience. They cover the whole territory and they know very well their customers. We know, that such a proposal will be considered as "heretical" by Western bankers Our field experience with bankers in so-called emerging countries shows that the credit officers (at the beginning of technical support programmes) are not really more experienced than postmen.

- decentralise decision making about credits

To some extent this is being addressed through the non-banking small loan scheme whicih is being implmented by the BDA in co-operatoin with the RPICs.

3) Improve the legal framework for venture capital

The demand is high from both the investors' side and the potential investees. The Czech Republic has not lost the reputation it had of being a progressive and serious country before the World War II. Technically, it is necessary to:

- organise the exit routes (access to listing, share of profits and losses and reinvestment)
- necessity to improve the laws (suppress the restrictions)
- develop guarantee schemes for Venture Capital as in Germany

5.2 Institutional programmes: future options and priorities

Concerning the institutional programme, we propose:

1) More autonomy for the BDA

There is an urgent need to clarify the role of the BDA in the system. The common feeling is that the BDA works more for the government than for the SME sector. It is absolutely necessary to increase the political independence of the BDA rather than their financial independence. We recommend that the BDA should move out of Ministry buildings to free themseleves from direct influence, and hire more young people from business schools

2) *Specific credit line for Business Centres*

We suggest a specific credit line for each RPIC/BIC with a 0% interest rate in addition to the necessary state subsidies for the running of the RPICs and BICs. If the business centres are to be treated like private companies: they must be self-sustainable. A private company growing fast is often short of money, although the debtor portfolio increases. Currently the business centres must wait a long time before clients are able to pay for the services that they receive. Phare and state subsidies often come too late. A 0% credit (or reimbursable subsidy) could finance the need of working capital of the business centres and help them provide better services to SMEs.

3) *Increase and speed up the funding for Business Centres*

Start-ups lack financial resources. BICs have to wait up to 12 months to receive payment for their services. Therefore, Phare support in this area is vital for dynamic young companies to gain access to these services during the start-up phase. The Business Centres are not credited fast enough by the supporting entities. We are not convinced that the self-sustainability criterion is necessary to guarantee the future of the Business Centres. The RPICs would prefer a permanent subsidy of 50% on a contractual basis. The RPICs are worried about the sustainability of SME support system after the end of the Phare financial support. This will depend on the prioity attached by government towards utilising the future structural funds to support RPICs and SME develpoment.

Technically, it is feasible to establish a joint venture between a commercial bank and a branch of the Post or the National Savings Bank. It makes it easier to privatise this entity or to develop this entity as a full licensed bank in the future.

ANNEX A1

Table A1: Employment share per sector by size and size dominance in 1995

Sector	0-49 employees	50-249 employees	250 and more employees	Total
Agriculture	33	***44***	23	100
Extraction energy	1	2	***97***	100
Other Extraction	15	36	***49***	100
Food, drink, tobacco	23	35	***42***	100
Textile, clothing	26	21	***53***	100
Leather	13	21	***66***	100
Timber and timber products	***57***	22	21	100
Paper, publishing	30	26	***44***	100
Cokes, petrol	2	0	***98***	100
Chemical products	11	16	***73***	100
Rubber, plastics	22	21	***57***	100
Other non-metallic	18	23	***59***	100
Basic metals	31	21	***48***	100
Machinery, equipment	11	20	***69***	100
Electric, optic equipment	28	18	***54***	100
Transport equipment	4	10	***86***	100
Other industry	32	28	***40***	100
Utilities	5	18	***77***	100
Construction	***49***	26	25	100
Trade	***72***	14	14	100
Hotels, restaurants	***75***	16	9	100
Transport	37	15	***48***	100
Financial services	31	18	***51***	100
Real estate, business services	***61***	22	17	100
Public administration	22	37	***41***	100
Education	36	***49***	15	100
Health, social services	29	19	***52***	100
Other personal services	***56***	28	16	100

Annex A2

Table A2: Firms by size class and employment across sectors, 1995 (%)

	0-49 employees	50-249 employees	250<employees	Total
AGRICULTURE.FOREST.FISH	5.10	11.70	3.97	6.26
MINING OF ENERG.MATERIAL	0.02	0.14	3.75	1.38
MINING OF OTHER MATERIAL	0.16	0.68	0.61	0.45
FOOD PRODUCTS AND TABACCO	1.93	4.96	4.04	3.40
TEXTILES AND CLOTHES	2.13	2.93	5.00	3.34
LEATHER PRODUCTS	0.25	0.64	1.38	0.75
WOOD AND WOOD PRODUCTS	2.12	1.39	0.87	1.50
PAPER AND PUBLISHING	0.98	1.42	1.62	1.31
COKE, PETROLEUM, NUCLEAR	0.01	0.00	0.36	0.13
CHEMICAL PRODUCTS	0.22	0.57	1.69	0.83
RUBBER AND PLASTICS	0.46	0.73	1.36	0.84
OTHER NON-METALIC PROD.	0.77	1.76	2.95	1.78
BASIC METALS AND PRODUCTS	3.45	4.00	6.22	4.56
MACHINERY AND EQUIPMENT	1.09	3.29	7.69	3.96
ELECTR. AND OPTIC EQUIPM.	1.97	2.19	4.31	2.85
TRANSPORT EQUIPMENT	0.15	0.71	3.85	1.60
OTHER INDUSTRY, RECYCLING	1.54	2.31	2.25	1.98
ELECTRIC., GAS AND WATER	0.21	1.41	3.94	1.82
CONSTRUCTION	10.87	9.86	6.24	8.98
TRADE, REPAIR	26.48	8.60	5.99	14.94
HOTELS AND RESTAURANTS	5.25	1.85	0.73	2.83
TRANSPORT AND COMMUNIC.	6.43	4.64	9.47	7.09
FINANCIAL INTERMEDIATION	1.31	1.25	2.43	1.69
REAL ESTATE AND BUSINESS	11.69	7.00	3.79	7.76
PUBLIC ADMINISTRATION	1.73	5.09	3.68	3.23
EDUCATION	5.75	13.09	2.73	6.42
HEALTH AND SOCIAL WORK	3.71	4.17	7.69	5.24
OTHER PERSONAL SERVICES	4.23	3.63	1.39	3.08
HOUSEHOLDS & EXTRATER.	0.01	0.00	0.00	0.00
Total	100.00	100.00	100.00	100.00

Source: Business Register, Panel 1995: Evaluation of the Quality of Business Register and Major Characteristics Entrepreneurs in the Czech Republic, CSO publication No 27 01-96, Time Series of Basic Indicators of the Labour Statistics 1948-1995, CSO publication No 09 04-96, Alena ZEMPLINEROVA's computations.

Appendix A3
Evaluation methodology and approach
The Logical Framework approach

The Logical Framework (LF) approach has become the *de facto* EU standard for project design, monitoring and evaluation. It is now widely used throughout most of the EU's domestic and external aid programmes. The LF is simply a method of classifying a chronological series of events in a project. It distinguishes between various stages in the production process that leads to the achievement of the objectives: preparation and design, delivery of inputs, activities, delivery of outputs, achievement of immediate and wider objectives, sustainability of achievements over time. One of the main advantages of the LF is that is forces the project designer - and the evaluator - to define these events and make their occurrence verifiable by means of a set of objective indicators and assumptions. This facilitates monitoring of implementation arrangements and evaluation of achievements. In fact, a general set of evaluation criteria can be readily derived from the 'project logic' reflected in the LF, as shown in table A3.

The central point in the classification of events is the ***outputs*** of projects. Outputs are the final deliverables, the point at which the responsibility of the project management stops. In the case of institutional reform projects, outputs usually consist of trained human resources and proposals for legal, regulatory and organisational reform. Implementation of the reforms is usually not the responsibility of a project team; it is up to owners and decision-makers in the beneficiary institution to do so. Some projects may include support in the implementation phase, but final responsibility for implementation can never be attributed to an external consultant or expert.

Outputs are generated by means of ***inputs***, which are used in activities. The Phare programme mainly delivers technical assistance inputs. In some cases, complementary equipment deliveries may also be included. Financial and physical investment inputs are, so far; rather limited under the Phare programme, although they may be important for some projects.

The ***efficiency*** criterion evaluates the transformation of inputs into outputs, both in quantitative (where feasible) and qualitative terms. These relate to such issues as the rate of disbursement, the number of people/organisation, who have received the input (finance or know how) in relation to the public sector costs involved.

Once outputs have been delivered, they should contribute to the achievement of project objectives. Standard LF's identify objectives at two levels: immediate and wider objectives. More levels can be inserted where useful. Objectives should be formulated within reasonable 'distance' from the outputs. If not, too many noise factors will come in between and verification of the correlation between outputs and objectives becomes impossible.

Effectiveness assesses the extent to which outputs contribute to immediate objectives. Thus for financial projects or technical assistance (in terms of advice, training or information provision) to what extent did the support result in improved performance of the organisation that received the benefit?

Impact assesses the extent to which outputs contribute to wider objectives. In what measurable ways did the improvements in the recipients' performance result in wider; spill over effects, such as providing a demonstration effect, raising awareness.

The ***sustainability*** criterion assesses the extent to which this impact is sustainable over a longer time horizon, particularly when Phare technical or financial assistance has come to an end.

Table A3: Logical Framework and derived Evaluation Criteria

Project Logic:	Evaluation criteria:	Indicators for institution building/reform projects:
Sustainable over time	**Sustainability**	Long-term viability factors
⇑		
Wider objectives	**Impact**	Spill over effects beyond the immediate recipients
⇑		
Immediate objectives	**Effectiveness**	Measurable changes in the recipient's performance as a result of the input
⇑		
Outputs	**Efficiency**	Amount of work undertaken, numbers of participants, and rate of disbursement in relation to the inputs
⇑		
Inputs		Time, effort and public sector cost of the inputs

Relevance Criterion

Apart from a project level evaluation, the LF methodology also allows for a programme or policy level approach, revolving around the *relevance* criterion. There are three aspects to relevance:

a) An assessment of the overall programme, including its project level components, with respect to the needs, policies and strategies of the country: *to what extent did the project meet the needs and priorities of the country?*
b) An assessment of the appropriateness of the programme and its projects: *to what extent was the design of the project appropriate?*
c) An assessment of PHARE's comparative advantage in carrying out this programme: *should Phare be engaged in this work?*

Using these principals, logical frameworks have been constructed for each type of project being assessed: financial programmes, the provision of policy advice, support for the development of National Agencies, and the provision of business support services through Business Support Centres and through Business Innovation Centres. In each case the logical framework has been reconstructed to define the project, its inputs, outputs, immediate objectives and wider objectives. Against each evaluation criteria, the log frame sets out the key questions to be considered, verifiable indicators that should be used and the sources of information according to the summary table below:

Table A4: Standard Log frame table used for the Evaluation

Objectives	Evaluation Questions	Verifiable indicators	Sources of information
Description of the project			
Inputs		**Indicator**	**Sources of information**
Outputs	**Efficiency of programme**	**Indicator**	**Sources of information**
Immediate results	**Effectiveness (on performance)**	**Indicator**	**Sources of information**
Wider objectives	**Impact (spill over effects)**	**Indicator**	**Sources of information**
Relevance and design		**Indicators**	**Sources of information**
To what extent did the programme fit into the needs and policies of the country?			
To what extent was the design appropriate?			
Was this an appropriate project for Phare?			
Sustainability	**Indicators**		**Sources of information**

Appendix B

Log Frame: Phare Financial Programmes for SMEs

Objectives	Evaluation Questions	Verifiable indicators	Sources of information
Description of the project			
Access to external sources of finance by SMEs, including - Grants - Micro loans - Small loans (generally on a longer term basis) - Guarantees for loans - Equity funds			
Inputs		**Indicator**	**Sources of information**
Phare cash contribution and terms of lending Co financing by Bank or Government Technical assistance to enhance credit management skills Possible involvement of Business Support Agencies in assisting clients to prepare business plans or provide a monitoring service to the bank		Standard input table summarising the conditions of the loan Inventory of alternative sources of finance	Bank records Country Reports
Outputs	**Efficiency of financial programme**	**Indicator**	**Sources of information**
Finance to SMEs	Level of subsidy Appraisal process: how well did the selection of enterprises conform to the project design?	Comparison of revenues and all costs	Input-output table + interview with the bank
Immediate results	**Effectiveness (on enterprise performance)**	**Indicator**	**Sources of information**
Improved economic performance of SMEs	Has the investment led to an improvement in the performance of firms receiving finance? Did the improved performance justify the use of subsidised credit?	Increases in investment, employment, outputs and profits.	Interviews with selected firms, inspection of loan files and feedback from credit officers

	Were the firms receiving funds the most appropriate?	Target market for fund The level of demand List of applications and selection process. Could the firms have received funds from other sources? Why did they seek funds from this source? What if they had not managed to obtain finance?	Bank data and interviews with enterprises
Wider objectives	**Impact (spill over effects)**	**Indicator**	**Sources of information**
Improved access to external finance by SMEs	Learning and demonstration effects within the firms receiving finance	How has their attitude towards finance changed as a result of having to negotiate and repay a loan?	Questions to firms, their advisers and the credit officer
	Learning and demonstration effects leading to changes in lending policies of bank (and other banks)	More active lending/co funding by bank and government	Questions to banks on their lending policy
	Lower transaction costs in bank	More professional approach to credit management	Questions to banks on whether their credit management has improved, and reduced spreads now being sought
	Larger client base for the bank (through lowering risks and demonstrating creditworthiness etc)	Greater access of clients to market based finance?	Questions to bank (how many Phare clients become clients of the bank)
	What effect did the programme have on the market (volume and price) for financial services to SMEs?	Did it increase competitiveness or distort the market	Questions to the banks and managers of other financial programmes
	Has this project contributed to a greater understanding in Government, agencies, and small firms about the role of financial for SMEs?	Improved understanding of the critical issues	Interviews with Ministry, Foundation, and Banks
	Has this project led to the government, donors and banks introducing more effective financial programmes?	Introduction of better designed financial programmes	Review the design of most recent financial programmes

Relevance and design	Indicators	Sources of information
To what extent did the programme fit into the needs and policies of the country? • how relevant is the project to the needs of the country? • to what extent was the project at variance with other government policies (particularly in relation to the provision of subsidised finance to a small number of enterprises)? • to what extent does the project address a real funding gap? • to what extent did the provision of finance 'crowd out' other sources, and to what extent was it additional?	Country analysis Country analysis Country analysis	Questions to banks, and Ministry ditto ditto
To what extent was the design appropriate? • choice of instrument, • target group of enterprises • risk profile of project • timing of delivery • choice of institution and terms of the agreement • ownership rights of the Phare sourced funds • pricing and other conditions to the end client: is the implied subsidy justified • potential role of co-financing from government or financial institution	Consultants assessment ditto ditto ditto ditto ditto ditto ditto	Country report Country report Questions to bank Country report Input output table Questions to bank, Ministry and delegation Input output table Input output tables and questions to bank and Ministry
Was this an appropriate project for Phare? • what other options should have been considered to improve the flow of finance to SMEs? • what were the opportunity costs of the project from Phare's point of view • to what extent has there been overlap and duplication with other donors	Assessment by consultants ditto Country analysis	Country report

Sustainability	Indicators	Sources of information
Financial sustainability of programme	Positive internal rate of return, net of donor and government support If not, what rate is the fund being depleted, how long will it survive?	Bank data on the financial performance of the programme
Clear and satisfactory arrangements for the ownership and management of the programme to continue to fulfil its original aims and objectives following the 'exit' of Phare	Is it clear who owns and is responsible for the money donated by Phare to the programme? Is there a clear decision making structure for the management of the fund	Interviews with bank and Ministry Review the legal agreement for the fund and changes that have been made
Soundness of the management of the fund without further technical assistance	Competence of the team managing the fund	Interviews with the Bank

Appendix C
Log Frame: Phare support for a National Agency

Objectives	Evaluation criteria	Verifiable indicators	Sources of information
Project description			
The establishment of a national level co-ordinating and promotional body for SME development, which is also meant to liaise with, and support, the network of LEAs also established with Phare support.			
Inputs			
TA, Phare financial contribution for running costs, leveraged co-financing arrangement with government.			
Outputs	**Efficiency questions**	**Indicator**	**Sources of information**
Providing support to government, NGOs, and others engaged in SME development; Provision of support for LEA network; co-ordinating international assistance.	Level of subsidy included in the programmes	Total cost of the support.	PMU, FMs.
Immediate objectives	**Effectiveness**	**Indicator**	**Sources of information**
To improve the operation of institutions involved in SME development, including network	Performance (visibility, strategic role, implementation) of individual institutions supported by The National Agency improved; performance of network as a whole improved	change in performance of those institutions receiving The National Agency support (before and after; with and without); performance of network (sustainability)	PMU, The National Agency, interview programme of institutions having received The National Agency support.
Wider objectives	**Impact**	**Indicator**	**Sources of information**
To improve the overall climate for SME development in the country.	Existing SME support infrastructure improves; economy considered more "SME friendly"; growth of private sector support.	Number of SME development programmes and institutions now on offer thanks to The National Agency; number of supportive government measures/laws/acts introduced thanks to The National Agency; quantity and quality of relations with network.	The National Agency, LEAs, ministries
	Relevance	**Indicator**	**Sources of information**
	Does the National Agency fill a recognised gap in the SME support infrastructure.	Level of national provision of business support services co-ordination; number and extent of activity contacts with other institutions, including LEAs	The National Agency; government departments; LEAs.
	Sustainability	**Indicator**	**Sources of information**
	Will the National Agency retain its original objectives; who is going to accept long term responsibility for it.	Changes in original objectives and target client group; plans for alternative funding.	The National Agency, government departments.

Appendix D
Log Frame: Support for the establishment of Business Innovation Centres

Objectives	Evaluation criteria	Verifiable indicators	Sources of information
Project description			
Establishment of a network of Business Innovation Centres to stimulate technology and innovation-based new businesses.			
Inputs			
PHARE financial contribution, leveraged co-financing arrangement with government, TA to support centres, local contributions..			
Outputs	**Efficiency questions**	**Indicator**	**Sources of information**
New businesses established	Level of subsidy included in the programmes	Total cost of the support to the BIC, including per client	The BIC.
Immediate objectives	**Effectiveness**	**Indicator**	**Sources of information**
To improve the rate of technology and innovation development and take-up in new small businesses	Performance of SMEs supported by BIC; number of new technologies adapted/adopted/developed;	Improved performance of those SMEs resident in BIC; number of graduates from BIC; access to finance of BIC supported SMEs	BIC, interview programme of local entrepreneurs resident in BIC.
Wider objectives	**Impact**	**Indicator**	**Sources of information**
To improve the flow in the technology chain in the country/region – from pioneering, development, commercialisation, introduction and success.	number of links established in the chain	Aggregate effect of SMEs supported, greater amount of financial support to SMEs, changes in capacity of private sector business advisory services,	BAC, central Agency (if exists), survey of private sector business advisory capacity,
	Relevance	**Indicator**	**Sources of information**
	Does the BIC fill a gap in the service provision, does the BIC duplicate private sector or University services, are private sector services precluded from developing because of the PHARE support to the BIC, is the BIC willing to support high risk SMEs	Level of private sector provision of BIC-type services, price of BIC services compared to market price, the number of SMEs supported which would have been willing and able to access private sector or University support, BIC client portfolio.	BIC, interview survey of BIC residents.
	Sustainability	**Indicator**	**Sources of information**
	Will the BIC retain its original objectives or become simply an industrial park; who is going to accept long term responsibility for the BIC after Phares departure.	Changes in original objectives and range of residents; total rental income as a percentage of total income (current and planned); plans for alternative funding and ownership changes (eg. privatisation, management buy-out)	BIC, BIC partners (eg. University), profile of residents.

Appendix E

Standard Currency Rates
for use in converting local currencies to Euros

LOCAL CURRENCY RATES PER EURO

	Unit	1990	1991	1992	1993	1994	1995	1996	1997
$/Euro	$	1.273	1.2405	1.2968	1.1723	1.1886	1.3081	1.2680	1.1341
Bulgaria	Lev	2.79	22.07	30.27	32.05	64.34	87.86	225.6	1907
Czech R	*CZK*				*34.18*	*34.21*	*34.72*	*34.42*	*35.95*
Estonia	EEK			16.74	15.50	15.44	15.00	15.26	15.74
Hungary	Forint	80.46	92.77	102.4	107.8	125.0	164.4	193.5	211.8
Latvia	LVL			0.954	0.791	0.666	0.691	0.699	0.659
Lithuania	Lita			2.30	5.09	4.73	5.23	5.07	4.54
Poland	Zloty	1.152	1.312	1.767	2.124	2.701	3.172	3.429	3.719
Romania	Lei	28.55	94.76	399.3	891.0	1967	2660	3911	8128
Slovakia	SLK				36.07	38.08	38.87	38.87	38.12
Slovenia	Tolar		34.20	105.4	132.7	153.1	155.0	171.6	181.1

Source: IMF International Financial Statistics Yearbook 1998

Note: Figures are the average annual dollar exchange rate in each country, divided by the average dollar:euro rate
No figures quoted for Czechoslavakia prior to 1993.