1. **BASIC INFORMATION**

1.1 CRIS Number: 2003/004-643. Project 3

1.1. Title: SME Finance Facility in Cyprus

1.3 Sector: Small and Medium-sized Enterprises

1.4 Location: Cyprus

2. **OBJECTIVES**

2.1 **Overall Objective(s):**

To contribute to the economic development, the improvement of conditions for enterprise development, and the expansion of the financial sector in Cyprus.

2.2 **Project purpose:**

To provide sustainable access to longer-term financing to SMEs at market conditions in Cyprus.

2.3 **Accession Partnership and NPAA priority**

- **Accession Partnership (AP)**

  *Economic Criteria*

  Improve conditions for enterprise and development, with particular attention on sectoral diversification and small and medium-sized enterprises.

- **National Programme for the Adoption of the Acquis (NPAA)**

  The NPAA (Chapter 3.4.6(I) (a)) states the following:

  “The economy of Cyprus is dominated by small enterprises. Almost all enterprises (99.9%) employ less than 250 persons, whereas the overwhelming majority (95%) employ less than 10 persons.

  One of the primary objectives of the government development policy concerns the restructuring and modernisation of the economy in order to assist enterprises to meet the challenges of globalisation and accession to the European Union. To this end, various support schemes have been introduced in the different sectors of the economic activity. Although schemes do not generally distinguish between micro, small, medium or larger units, in view of the predominance of the SMEs in all sectors, size is one of the parameters which is taken into account in policy formulation.”

3. **DESCRIPTION**

3.1 **Background and justification**
The Financing problems of small and medium-sized enterprises (SMEs) in the candidate countries are becoming increasingly serious because of the rapid growth in the sector combined with the continued problems in relation to the provision of long-term finance to the sector.

Financing is often not available to SMEs because of lack of sufficient collateral or not available at longer-term maturity because of the allegedly higher risks of SMEs, making new projects particularly difficult to finance. Also, there is frequently a perception that the costs of administering small loans are disproportionately high, leading banks to concentrate their efforts on larger companies. Experience in most EU Member States shows that unless stimulated through focused schemes such as the SME Finance Facility, banks tend to focus on larger companies, thereby undermining the financing of SMEs and micro enterprises.

In April 1999, the European Commission launched the SME Finance Facility under the Phare Programme. The key objective of the SME Finance Facility for candidate countries is to induce local financial intermediaries and investment funds to develop their financing activities for SMEs. To achieve this objective, the SME Finance Facility provides the local financial intermediaries with incentives aimed at encouraging loans, leases and equity capital to SMEs.

From 2001 onwards, it was decided to extend the scope of the Facility to include all candidate countries, including Cyprus, and to provide funding for the operation of the Facility within the pre-accession assistance instrument applied to each candidate country in the context of the annual Pre-accession National Programme.

Within this framework, the present Project aims at extending to Cyprus the SME Finance Facility already active in other candidate countries to provide loans and financial leases to SMEs.

### 3.2 Linked activities
N/A

### 3.3 Results
The Project results can be summarised as follows:
- an increased level of long-term small loans/financial leases granted to Cypriot SMEs by local banks;
- an enhanced ability of the Cypriot banks to develop their financial services for SMEs;
- a growth of the national SME sector.

### 3.4 Activities:
Cyprus will participate in the SME Finance Facility in accordance with the rules and conditions to be specified in the Contribution Arrangement between the European Commission and CEB/KfW. The Project will be phased as follows:
- As a first step, the relevant authorities in Cyprus and the Council of Europe Development Bank (CEB), in co-operation with Kreditanstalt für Wiederaufbau (KfW), will identify the particular deficiencies of the SME financing in Cyprus in order to design the appropriate EU-funded incentives in favour of the financial intermediaries.
- In a second step, the Council of Europe Development Bank (CEB), in co-operation with Kreditanstalt für Wiederaufbau (KfW), will identify not more than three financial intermediaries which are eligible to act as Participating Banks (PB) in Cyprus under the SME Finance Facility. The selection of the Financial Intermediaries will be on the basis of the financial strength, branch networks and capacity to participate in and promote the Facility and its objectives. More specifically, the potential PBs need to have a strong SME orientation. They need to grant their loans according to sound banking principles and apply loan policies and procedures suitable for SME borrowers.

- CEB/KfW, who will be responsible for the selection of the PBs, will negotiate project agreements under which global credit lines will be provided to the PBs in combination with incentives financed by pre-accession funds. The global credit lines will be used by the PBs for granting longer-term sub-loans and financial leases at market interest rates to SMEs (sub-projects). The PBs will assume the credit/repayment risk of the final borrowers (SMEs).

- Incentives funded by this Project shall be used to induce the PBs to expand their lending and leasing operations to SMEs in order to overcome the deficiencies of SME financing in Cyprus. The main types of incentives provided are: Performance Fees, Guarantees, and Technical Assistance. Upon proposal of CEB/KfW and subject to approval by the competent Commission services, other appropriate incentives for the benefit of the PB may be paid.

4. INSTITUTIONAL FRAMEWORK

The CEB, in co-operation with KfW, will be entrusted with the implementation of this Project. The CEB will manage a special fund to which the pre-accession contribution will be transferred.

The Steering Committee will supervise the correct implementation of the Facility, including the Cyprus Project. The Steering Committee comprises representatives of the Commission and one representative of each International Financial Institution having signed Contribution Arrangements with the Commission.

Monitoring will be ensured by the Secretariat of the Facility.

Copies of the project proposals and reports will be made available to the Cypriot authorities involved in the Project.

5. DETAILED BUDGET

<table>
<thead>
<tr>
<th>Loan/Guarantee/Leasing Window</th>
<th>Investment</th>
<th>Institution Building</th>
<th>Total EU financing (=I+IB)</th>
<th>National co-financing</th>
<th>IFI at least</th>
<th>TOTAL at least</th>
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</thead>
<tbody>
<tr>
<td></td>
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<td>1.5</td>
<td></td>
<td></td>
<td>15</td>
<td>16.5</td>
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</table>
A management fee shall be paid to the CEB/KfW as 1.25% of each tranche transferred to the Special Fund and corresponding to a maximum amount of €18,750. The annual cost for auditing the Special Fund is included in the management fee.

The Commission shall not provide any additional amount to support the ordinary CEB/KfW cost resulting from the implementation of this Project, except where duly justified.

6. IMPLEMENTATION ARRANGEMENTS

The Commission shall allocate the additional contribution for the Cyprus Project in the already existing Special Fund created in the framework of the SME Finance Facility and managed by CEB. A particular account (Special Account) will be opened for Cyprus. Interest earned on the Special Account at CEB and amounts paid out from the Special Account and possibly recovered from projects shall be reinvested for the purposes of the SME Finance Facility in Cyprus.

Implementation will be delegated to CEB/KfW on the basis of a Contribution Arrangement with the European Commission. The Commission's supervision will be exercised throughout the duration of the Project, through the Steering Committee and through activities of monitoring and evaluation, various reports and audits.

The detailed procedures for implementation of the projects with the PBs shall be set out in the specific project agreements concluded between the PBs and CEB/KfW. These project agreements shall specify the terms and conditions applicable to the use of CEB/KfW and Fund resources.

The PBs will submit to KfW and the Government of Cyprus semi-annual progress reports containing all relevant information, using an agreed reporting format. Major indicators for monitoring and project evaluation are the number, average size and average maturity of the sub-loans, amounts disbursed, the average interest rates, sectors of activity as well as average figures of employees, annual turnover and total assets of the financed SMEs.

The EU contribution will be disbursed by CEB directly to the PBs after KfW’s confirmation of a request for disbursement submitted by the PBs.

6.1 Implementing Agency

The European Commission will entrust the CEB/KfW with the implementation of this programme under a Contribution Agreement to be signed, similar to the existing one for other candidate
countries. The management of the programme by the Commission will be subdelegated to DG Economic and Financial Affairs.

6.2 Twinning

N.A.

6.3 Non-standard aspects

The Project will be managed centrally by the European Commission.

6.4 Contracts

The EC will sign a Contribution Arrangement with CEB/KfW. A maximum of three project agreements shall be concluded between the PBs and CEB/KfW.

7. IMPLEMENTATION SCHEDULE

7.1 Start of tendering / call of proposals:

Start of Project activity: October 2003

7.2 Project completion: June 2012

8. EQUAL OPPORTUNITY

Article 28 of the constitution safeguards the right of all persons to equality before the law, the administration and justice and of equal protection thereof and treatment thereby. Any direct or indirect discrimination against any person on the ground, i.e. of sex, is prohibited. Furthermore, the prevailing legislation with respect to equality of treatment for men and women is partly in conformity with the *acquis communautaire*. Harmonised legislation is under preparation and full compliance with the *acquis communautaire* will be achieved gradually by 1/1/2003.


9. ENVIRONMENT

The PBs shall examine or at least be assured that the SMEs financed under the SME Finance Facility comply with national environmental and employee health laws and regulations.
10. **RATES OF RETURN**
N/A

11. **INVESTMENT CRITERIA**
N/A

12. **CONDITIONALITY AND SEQUENCING**
The components of the Project are inter-related and adopt a logical approach to design and implementation.

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ANNEXES
1. Logical framework matrix in standard format
2. Detailed implementation time chart in standard format
3. Contracting and disbursement schedule by quarter for full duration of programme
## LOGFRAME PLANNING MATRIX FOR

**PROJECT:** SME Finance Facility in Cyprus  
**Contracting period expires:** December 2004  
**Disbursement period expires:** December 2005  
**Total Budget:** 21.5 M€  
**EU contribution:** 1.5 M€

<table>
<thead>
<tr>
<th>Overall Objective</th>
<th>Objectively Verifiable Indicators</th>
<th>Sources of Verification</th>
</tr>
</thead>
</table>
| • To contribute to the economic development, the improvement of conditions for enterprise development and the expansion of the financial sector in Cyprus | • Growth of SME market share of Participating Financial Intermediaries (PFIs) versus non Participating Financial Institutions before, throughout and after the Programme  
• The evolution of the average size and maturity of SME loans/leases before, throughout and at the end of the Programme | • Pbs’ reports  
• Reports of the National Statistical Office  
• Reports of the Chamber of Commerce |

<table>
<thead>
<tr>
<th>Project Purpose</th>
<th>Objectively Verifiable Indicators</th>
<th>Sources of Verification</th>
<th>Assumptions</th>
</tr>
</thead>
</table>
| • To provide sustainable access to longer-term credit to SMEs at market conditions in Cyprus | • Average loan/lease size  
• Loan/lease maturity  
• Share of SME loan portfolio / total loan portfolio of PB | • Pbs’ reports | • No lending/leasing to SMEs with subsidised interest rates  
• SME lending/leasing in the long-term profitable for PBs |

<table>
<thead>
<tr>
<th>Results</th>
<th>Objectively Verifiable Indicators</th>
<th>Sources of Verification</th>
<th>Assumptions</th>
</tr>
</thead>
</table>
| • An increased level of long-term small loans/leases granted to Cypriot SMEs by local banks  
• An enhanced ability of the Cypriot banks to develop their financial services for SMEs  
• A growth of the national SME sector | • Number of SMEs which benefit from the Facility by the end of the Project  
• Amount of EU funds disbursed  
• Number of sub-projects financed | • Pbs’ reports  
• KfW’s reports | • Sufficient demand from SMEs  
• Efficient handling of the incentive schemes  
• Sufficient demand by SMEs |
### Activities
- Identification of eligible PBs in Cyprus
- Conclusion of project agreements with selected PBs
- Financing activities for SMEs

### Means
- 1.5 M€
- Project agreements with PBs and individual contracts with SMEs

### Assumptions
- Successful identification of Financial Intermediaries
- Smooth and timely approval procedures

### Preconditions
- Full commitment of all the services involved
- Budgets approved and available in time
## DETAILED TIME IMPLEMENTATION CHART FOR THE PROJECT

**Title:** SME Finance Facility in Cyprus

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<th>COMPONENT</th>
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<th>← ..2012</th>
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<td></td>
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<td></td>
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<tr>
<td></td>
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<td>I = Implementation</td>
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<td>X = Closure</td>
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ANNEX 3

CUMULATIVE CONTRACTING AND DISBURSEMENT SCHEDULE

Title: SME Finance Facility in Cyprus

<table>
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The above table is an approximation. The actual disbursements will depend on the demand of the projects financed under the Facility which have not yet been selected.