1. Basic information

1.1 CRIS Number: 2003-004-995-03-09

1.2 Title: Support to Innovative SMEs (SISME)

1.3 Sector: Economic and Social Cohesion (ECOSOC)

1.4 Location: Slovakia

2. Objectives

2.1 Overall objective:

- To restructure the Slovak production sector towards the knowledge-based economy and to increase its productivity.
- To foster the sustainable development of the SMEs sector and to improve its competitiveness on EU market through innovations.

2.2 Project purpose:

To increase availability of financial sources for innovative companies through establishment of sustainable venture capital investment scheme.

2.3 Accession Partnership and NPAA priority

Accession Partnership (AP)

"Continue enterprise restructuring and promote private sector development …" 

National Plan for the Adoption of the Acquis (NPAA)

Increasing Slovakia's competitiveness and strengthening less developed regions through investment, mainly into small and medium-sized businesses, human resource development, infrastructure and the environment.

Medium-term priorities (chapter 16 of the NPAA)

To strengthen the position and stimulate the growth of SMEs in key manufacturing sectors

2.4 Contribution to the National Development Plan (NDP)

The activities supported under the Support to Innovative SMEs will contribute specifically to the following targets identified as priorities for economic development in the draft NDP from 10.12.2002:
NDP Priority 1: Increase of competitive industrial production and services, development of domestic growth potential – covered by SOP Economic Development. Under SOP the following priority will be addressed:

- Priority 1: The development of competitiveness

Specifically, it will contribute to the measure 1.2: Support of innovative development, transfer science and technology knowledge and continuous education in the framework of adaptation processes in the business sector.

3 Description

3.1 Background and justification

The Slovak government adopted the planning and programming of the use of assistance from structural funds for regions eligible for assistance under Objective 1 through the Community Support Framework (CSF) through resolution no. 133/2002 on 13th February 2002. The number of regional operational programmes (ROP) was reduced to 1 and sectoral operational programmes (SOP) to 5 in accordance with EC recommendations. By the Governmental Resolution No. 678/2002 the Department for foreign assistance and European Community programmes at the Ministry of Economy will be appointed to perform the function of management authority for SOP Economic Development.

At its session on 20th February 2002, the government adopted the division at the level of NUTS II regions. On the basis of Statistical Office measure no. 75 of 4th March 1998, agreed with EUROSTAT, the Slovak territory is divided as follows: the Bratislava region, Western Slovakia, Central Slovakia, and Eastern Slovakia. Following the government resolution no. 317/2002 on 27th March 2002 the structural fund support under Objective 1 (EC Regulation 1260/1999) will be provided for all NUTS II regions except Bratislava region, which is eligible for structural fund assistance under Objectives 2 and 3. Consequently the Single Programming Documents (SPD) will be elaborated for NUTS II Bratislava Objective 2 and NUTS II - Bratislava Objective 3.

Taking into account the EC recommendations, the government approved, by the resolution No. 617/2002 of 5 June 2002, the establishment of a single payment authority for structural funds at the Ministry of Finance. The spending centres will be created on the line ministries budgetary departments. One of them will be located at the Ministry of Economy for channelling of the funds within SOP Economic Development.

The SOP Economic Development was re-drafted in mid-November 2002. It specifies the means how to achieve mid-term economic goals.

The competitiveness of the Slovak industry is weakened by the low level of R&D and innovative activities of companies. Since the early 90's, the number of researchers felt from 60.5 thousand to 22.3 thousand and investments for R&D felt from 4.4% GDP to about 1%. Innovations are dependent not only on the R&D outputs but also on the lack of capital in enterprises. There are only 2% high-tech enterprises, 23% with medium-high technology and 48% companies are classified as low-tech. Based on those facts, the SOP sets the following goals for the period of 2004-2006:

- Industry should maintain the permanent growth of production, added value, productivity, and decrease the gap in the competitiveness with EU countries.
• Growth trends should be accompanied by the fundamental structural changes, diminishing regional disparities and respecting environmental standards.

The goal of increasing competitiveness can be specified as:
• Development of entrepreneurial activities with a high share of added value
• Using highly qualified work force and increasing its quality
• Maintain the sustainable growth of productivity
• To increase the efficiency of production through innovations, technology transfer, and efficient exploitation of raw material and energy resources.

Based on SWOT analysis of the Slovak economy, the first priority for the years 2004-2006 is the growth of power and competitiveness of industry and tourism and other related sectors and mobilising all factors increasing their competitiveness. R&D should contribute to this goal by increasing innovation activities and increasing the number of high-tech companies.

Slovakia’s GDP is less than 50% of the average per capita GDP of EU member States, thus emphasizing the need for industry to increase its added value content, classically, by enhancing the value of output and decreasing the cost of inputs.

The importance of industry within the national economy should be counted by reference to 1998 when industry accounted for 26.7% of GDP, 30.2% of total employment and approximately 80% of total Slovak exports. However, the report also highlighted that a large proportion of the exports by indigenous firms comprised low value, low margin sub-contract and semi-processed products plus non-sophisticated consumer goods. It concluded that production finalisation is lagging far behind. This situation holds obvious adverse consequences not only in lack of capability to develop export trade but also in withstanding open competition in industrial products on the home market.

It has also been identified that Slovak industrial enterprises do not appreciate the value of innovation in increasing quality and competitiveness. In the past, as evidenced by numerous studies (e.g. OECD reports on innovation), manufacturing industry in member states lagged significantly behind the USA in industrial innovation, a situation that prompted special response measures being introduced by the EC. There is cogent evidence (see reports prepared by the Institute for Public Affairs ‘A survey of the Economic Elite’s Opinions on Topical Issues Concerning the Slovak Republic’ and the interim evaluation reports conducted by EMS in November 2001 of SME related projects under the Phare programme), that Slovakia suffers an innovation deficit relative to Western Europe which engenders serious national competitiveness weaknesses.

As outlined in a report prepared by NADSME and the Euro Info Centre (2002), ‘Readiness of SMEs to Slovakia’s accession to the EU’, Slovak SMEs generally, are rightly expecting rapidly increasing competition on the domestic market and recognize a need for increasing product and service quality and more effective utilization of human resources. These needs require new technologies, equipment and training and therefore, require investment. Access to such funding, through loans, R & D subsidies, grants and seed and venture funds is essential to accelerate the development and adaptation process.

Larger industrial companies have cited an improved legal system and tax incentives to support innovation but also, as with SMEs, the need to have more accessible and affordable financial mechanisms (Institute for Public Affairs).
Innovation is an important factor in SMEs competitiveness. Therefore, NADSME in cooperation with the Statistical Office analyzed recently the situation in this respect in Slovakia. Based on the representative survey from November 2002, almost 60% of small and medium-sized companies made some innovations in their products, services or technologies in the last three years. About 50% of them used in-house innovations. About 50% of innovative companies used for innovations more than 10% of their turnover. However, what is characteristic for current situation is that 90% of innovative companies used predominantly their own financial resources and only 20% had an access to bank loans. These results imply that there is a good potential for innovations but the dominant barrier for innovation activities is the lack of any form of capital.

Support of Innovative SMEs is designed to contribute to goals set in SOP. It is considered as continuation of the Phare 2002 Industry Development Grant Scheme. The project will focus on enterprises which can significantly enhance commercial performance through a) new product development or the redesign of existing products, and/or b) improving production processes, so that these innovations will result in increased sales values and/or decreased production costs to the point where the enterprises can withstand open international competition. Technology acquisition by means of inward licensing of products or process technology which allow of similar benefits will be included within the scope of the project as well as training for the successful management of innovation and accreditation of internationally recognized quality standards – always provided that these activities have not previously been grant aided. Product and process development activities will be centred within each enterprise so that development strategies will be realistically based having regard to the enterprise’s particular strengths and weaknesses in terms of its existing production, commercial and financial configuration. External expertise in the form of expert advice or technical test resources may be recruited but it must be related to a brief that is specific to the enterprise itself. This approach also supports the adoption of a sustained in-house innovative development culture.

There is a variety of funding options available under Pre-accession assistance to support private sector activity. These include loan and credit schemes and guarantee funds. All these require the participation of financial institutions in the delivery of the project, and, therefore, require a further set of performance criteria to be followed. In addition, these schemes require repayment and, as such, constitute a continuing liability entailing cash flow from the enterprises for their duration. Furthermore, financial institutions are adverse to funding Research and Development (R & D) activities in enterprises since, these activities do not afford any loan collateral. Even in enterprises where there is surplus cash flow, product or process innovation is not regarded as a priority activity, or it is perceived as inherently complex and risky. Against this background, grants have the primary advantage of being both a source of funding and a means for minimising associated risk. As such, they constitute an important incentive to the participation of industrial enterprises in the Support of Innovative SMEs. Using the grant scheme mechanism, as set out in this fiche, will therefore ensure a higher level of take up of the available funds than if the other mechanisms were used. Marketing activities and grant activities will demonstrate the positive economic benefits of investment in innovation and this encourages industry to adopt R & D as an investment function in its own right.

The importance of creating venture capital financing opportunity for innovative companies is evident from an economic impact study conducted by WEFA. It revealed that 4.3 million new jobs were created by US companies originally backed by venture capital. Those companies generated $736 billion in revenues in the year 2000. According to the study,
venture capital-backed companies represented 3.3% of the nation's total jobs and 7.4% of Gross Domestic Product in 2000.

The realization of this Support of Innovative SMEs needs the creation of the venture capital fund because most of relevant projects will need further financing, predominantly by risk capital. There will be several options, either venture capital investment into fast growing company or a loan under favourable conditions or a mixture of both. Loan facilities with these purposes already exist (e.g. Support Loan Scheme).

The support process will be in two steps. The best projects for innovations and implementation of research results and patents will be supported by grants up to 45% of the eligible costs except for the Bratislava region (Objective2) with the upper limit of 50% grant support. The projects that fulfil all planned goals will be eligible for venture capital or debt funding. This two-step procedure will decrease venture capital risks. This is necessary for the introduction of venture capital funds in Slovakia where there is no such financial facility available to cover potential needs.

Integral part of this process will be the creation of Business Angels Network (BAN). BAN will consist from two databases. The first one will include projects, which are looking for equity financing, and the second one will include private investors. The project database will be common for institutional venture capital financing as well as for BAN. Each project performing successfully in grand scheme can be submitted to this database for equity financing. Projects from the Industry Development Grant Scheme under Phare 2002 are also eligible. History of companies during the grant phase will give a basis for better assessment of company performance for equity investment decisions. They will have chance to be selected either for institutional venture capital financing or for financing by informal investors who will be enlisted in the BAN database. This will help to develop also informal equity financing. Informal investors will be sought in cooperation with similar networks in neighbouring countries (Austria, Czech Republic, Hungary, Germany and Italy). In addition to gaining the still missing forms of innovation financing, this will help to access European market by Slovak innovative companies and to integrate innovation effort in the regional scale.

The promotion campaign for the utilization of existing resources for innovation will be performed through seminars, workshops, and media.

At the regional level, awareness activities will be carried out and support will be provided to the applicants during the design and implementation phases of the scheme, through the networks of Chamber of Commerce, Business and Innovation Centres (BICs) and Regional Advisory and Information Centres (RAICs). There are 13 RAICs and 5 BICs that were established with Phare support during the period 1992 - 2001. Like NADSME, these centres have significant experience in international projects and their involvement will help to strengthen their existing relationships with local businesses and develop new relationships. There is at least one RAIC in each NUTS III region.

The Support of Innovative SMEs is open to all enterprises operating in the manufacturing sector. However, data from the Statistics Office of the SR show that over 99% of all registered companies in Slovakia employ less than 249 workers, i.e. they fall within the SME employment classification. A total of only 590 registered companies in 2001 are classified as large. While a distinction is not made in the data between manufacturing and non-manufacturing companies – nor is information available of the number of enterprises that
may have ceased trading – there remains a high probability that SMEs will dominate take up under the scheme.

Information is available on the number of manufacturing companies with more than 10 employees and this is 3656 according to the Statistical Yearbook 2002. Given the co-financing requirement and the need to satisfy technical and financial capacity criteria, it is expected that applicants will mainly come from this group.

3.2 Linked activities

The MOE, MOCRD and NADSME are currently involved in the design and delivery of a number of related projects. The Support of Innovative SMEs is designed to complement the measures for support of SMEs introduced so far in the area of competitiveness and innovation. The most related projects are:

Project 2002/000-43000 Industry Development Grant Scheme aimed at increasing of the value added content of Slovak industry through enhanced product offerings and process technologies.
This project, specifically grant scheme part is an extension of the FM02 Industry Development Grant Scheme (IDGS).

QUALITY – the Programme for Quality Management System is funded through the State budget and aims to improve quality of goods and services in Slovakia through the development of advisory and educational services and lowering costs of the certification process. The Support of Innovative SMEs also aims to enhance quality standards but specifically within the manufacturing sector and only when part of a wider project – e.g. linked to the development of a new product.

Technology transfer – this project managed by NADSME provides grants to SMEs to develop progressive technologies in the production sector. Support of Innovative SMEs will build on the experience and lessons learned in the implementation of this project. Successful organisations under this scheme will be eligible to participate in the project but not for the same project activity for which they have already received funding.

Project SR0009.02 Financial support schemes for SMEs in least developed regions in Eastern Slovakia is aimed at improvement of access to domestic capital for SMEs in priority regions (NUTS II Slovakia-East). The part of the project is devoted to high-risk investments focussing on innovative and young enterprises with a growth potential over the medium-term. The fund operator is the Seed Capital Company. The target group are enterprises acting in the production, crafts and active tourism field.

Project SR0107.01 – Development of the Institutional Framework and Administrative Capacity for Programming and Implementation of Structural Funds. The project is focused on the provision of assistance in increasing the skills and capacity of the coordinating bodies of the state administration to assume the future managing authorities for structural funds.

Grant Scheme for the Support of Competitiveness managed by Sario agency and financed from the state budget. The programme provides support for the increasing of effectiveness of business activities and production and for strengthening the position on the market both locally and internationally.
There have been a number of lessons learned during these projects that are detailed in section 3.5.

3.3 Results

The process of making off a mechanism for venture capital investment involves a set of tasks to be realised both in the area of institutional building and investment.

The two results are foreseen within the implementation of the project:

Result 1: The pool of innovative enterprises capable for venture capital operation established

Output 1 – Investment support to individual innovation projects

The specific results of the grant-funded initiatives will only be realized at the time of selection. The scheme will support a range of innovation projects that will increase the competitiveness of the grant holders’ enterprises. Supported projects will:

- Increase output values and enhance production processes within industrial enterprises
- Improve quality standards and enhance marketability of products/services
- Improve managements’ capabilities within the enterprises
- Create conditions within and without enterprises for continuous development of innovative development strategies
- Promote regional development by increasing the stock of available institutional incentive measures that can promote more balanced growth
- Creation of new jobs with higher stability and increased skills levels of employees

The individual results of each initiative will be measured through monitoring and evaluation visits carried out by BIC and RAIC personnel and through the submission of progress reports by the grant holders. Initiatives will be measured against the targets set out in the application form and, latterly, included in their contract with NADSME. The progress reports will include a comparison of actual results against targets and explanations for any variances. Longer-term targets will be expressed in terms of levels and phasing of investment and projected effects over a stipulated, but not immediate, period on sales values, gross and net profits, employment levels and market off-take.

Given the limited funding available, it is not expected that the grant scheme will have a major immediate impact on Slovak industry as a whole. However, by ensuring that the selection process brings forward those enterprises that are best positioned to benefit from innovation, the effect of the investment will be optimised. This outcome will not only result in substantial benefits to those enterprises but also, through effective dissemination of the impact (e.g. enhanced medium and long term profitability and new contracts), will serve as models for progressive companies within the entire industrial sector. This should encourage and trigger further innovative development.

The overall results of the Support of Innovative SMEs will be measured against targets set in the logical framework attached as Annex 1 to this document. Progress against these targets will be presented at quarterly progress review meetings that will be held in line with the reporting schedule. These meetings will discuss key issues and recommendations and will
involve the NADSME and the MOE Departments. Six monthly Project Monitoring Committee meetings will be held for the same purpose.

**Output 2 – Improved skills within the industrial enterprises in accessing EU funds.**

It is anticipated that, if it is marketed effectively to its target audience, the Support of Innovative SMEs should attract around 500 applications for both components. Support will be available to all applicants during the design phase from the Chamber of Commerce, RAICs and BICs through formal Project Design Training. The application form and evaluation of bids will follow procedures and regulations outlined in the PRAG and will, therefore, be broadly consistent with the procedures set for accessing future EU funds. All applicants, successful or unsuccessful, will have increased capacity to access future regional development funds.

This will be measured by assessing the percentage of applicant companies meeting the eligibility criteria. These percentages will be assessed over a number of calls for proposals – should they be required. The success of applicants in accessing other EU funds will also be assessed through surveying a sample of successful and unsuccessful applicants.

**Output 3 – Improved planning and project management skills within the successful industrial enterprises**

All grant holders will be supported by a range of mechanisms to improve their skills in areas such as financial planning and accounting, quality and performance management, business planning and marketing. This output also refers to the effective use of external agencies in the delivery of specialized functions, particularly in smaller organisations.

This output will be measured by assessment of each project in terms of activities completed on schedule; % of budget spent and quality of technical and financial reporting.

**Output 4 – the positive effects of the project disseminated to other relevant organizations.**

It is important that the dissemination of project benefits is achieved at two levels. Firstly, to promote the results of the completed initiatives to Slovak industrial and financial institutions in order to foster an environment and business culture which recognizes the importance of innovation and the need to invest in it. Secondly, to inform other national and regional bodies involved in the management of SF type instruments of the results of the overall project so that lessons learned from the implementation of the Support of Innovative SMEs can be incorporated into the design and management of future schemes.

**Result 2: Pilot project for a risk capital financial institution realised**

This represents the institution-building component with the following tangible outputs to be expected:

**Output 1 – establishing a venture capital fund**

Most innovative companies are growing in a speed set by the capability and level of self-financing (internal capital). It becomes more and more evident, however, that this is not enough to meet the present needs for many companies. Fiercer competition in consequence of globalisation, rapid technological development, shorter product cycles, innovation requirements etc, put pressure on the companies to increase and speed up their development
investments. It becomes increasingly difficult, however, to keep the costs for this within the frame of self-financing. Therefore companies need capital from external sources.

SMEs can finance growth with retained earnings and external debt, such as bank loans. However, for many rapidly growing enterprises, particularly in the high tech sectors, venture capital is the preferable alternative. Such enterprises lack tangible assets and cash flow. At the same time, they are attractive to investors because of their potential for high growth and profits.

Financing of growth enterprises is not merely a question of supply and demand for funding, but a co-operation between the entrepreneur and the investor. This should be taken into account when planning funding strategies for a growing company. For example, in situations where markets are growing fast, rapid growth might be the only opportunity for a company to survive. In this situation entrepreneurs need back up, good connections and business knowledge in order to take the right decisions. This kind of expertise must be required from a management team of a venture capital fund.

The institutional venture capital fund should concentrate on expansion (or development) financing, provided for the growth and expansion of an established company (predominantly those who received Phare grant and whose performance has been already tested and monitored), which is breaking even, or trading profitably. Capital may be used to finance increased production capacity, market or product development and/or to provide additional working capital.

Output 2 – establishing a Business Angels Network

The level of participation of a VC-operator in a company can range from taking the role as a “sleeping” partner to that of a majority owner. To increase diversity of provided venture capital, in addition to the institutional venture capital fund, it is necessary to establish a system of business angels who specialise their private investments in certain sectors of activity (e.g. biotechnology, information technology) and/or in certain stages of a company’s life cycle.

Informal investors will be sought in cooperation with similar networks in neighbouring countries (Austria, Czech Republic, Hungary, Germany and Italy). In addition to gaining the still missing forms of innovation financing, this will help to access European market by Slovak innovative companies and to integrate innovation effort in the regional scale. A technical assistance for these forms of financing is desirable.

Target recipients and TA outputs are summarized as follows:

<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Impact / Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>VC operator(s)</td>
<td>Increased capacity to manage the venture capital investment skills developed in negotiation, marketing, management and administration, including promotion to applicants, handling media</td>
</tr>
<tr>
<td>Advisors</td>
<td>Skills developed and experience in supporting applicants in project design and assessment of business plans</td>
</tr>
<tr>
<td>Applicants</td>
<td>Experience and skills in project design</td>
</tr>
<tr>
<td>Grant holders</td>
<td>Experience and skills in project design and implementation.</td>
</tr>
</tbody>
</table>
Results will be measured by:

- formal institutional assessment of central and regional organizations involved in the management of the venture capital scheme, including EU audit and verification processes; and
- report questionnaires and interviews of applicants and grant holders to assess quality of support from the above and the resulting improvements relative to targets.

The MOE will use the above information to review progress against SOP Economic Development priorities. The progress being made against specific priorities and the review of best practice will assist the MOE to prepare additional programmes for funding under ERDF.

3.4 Activities

The activities to be completed under the project can similarly be divided to meet the objectives of the main components set out in 3.3 above.

The first component will support projects that focus on the development of tangible products and productive capacity and quality, developing activities to facilitate Research and Development and raising awareness of the positive impact of innovation. The second component will focus on increasing availability of specific financing tools (risk capital) for specific needs of fast growing industrial enterprises.

Result 1

1. Grant scheme implementation

The purpose of the grant scheme will be to increase the share of sophisticated production in the total volume of Slovak production; to increase management effectiveness; to increase industrial productivity and to raise awareness within industry of the positive benefits in investing in training and innovation.

The purpose of this component will be to fund the design and development of a wide range of innovative products and processes with the intent of increasing output added value; increasing industrial productivity and reducing overall costs.

Aiding the accreditation to internationally recognised quality standards is an integral part of this component. In study after study, it has consistently emerged that quality (and reliability of delivery) are more important to purchasing decisions. Consequently, it is important that, in any innovation programme, promotion of the attainment of an internationally recognized quality standard is an imperative. The following measures will be supported by the grant scheme:

- Development of new products in-factory as additions to, or replacement of, existing product lines but with higher added value content. Support will be available for new product search activity (e.g. by attendance at conferences and fairs) as well as for training in innovation processes
- Upgrading production technology (including the application of computerised systems) with the effect of increasing production efficiencies and lowering unit costs
• Production of prototypes to ensure compatibility of innovation with equipment and other resource capabilities as well as for market testing

• Testing of new product or processes by certified institutions to ensure compliance with standards and specifications

• Identifying and drawing on technical expertise and resources, both domestic and international, necessary to introduce new technology and products within existing product configuration, typically, the costs of designers, legal experts and experts in intellectual property acquisition.

• Major upgrading of existing product range to yield higher added value through higher unit revenues and/or lower unit costs

• Acquisition of new products and/or processes through the purchase of rights by way of a product licence or a know-how agreement.

• Knowledge enhancement – participation in international projects and professional activities, specifically relating to industrial innovation, including international conferences, product licensing fairs, trade shows and other forums for new product search or refinement of new product concepts.

• Organisation of fairs and exhibitions to promote the positive benefits of investing in innovation.

• Networks and working groups established for representatives of industry and R & D institutions (including higher and further education) in IDGS Phare 2002 in order to develop long term links will be strengthened by joining of new grant applicants.

Detailed specification of supported measures will be included in Guidelines for this grant scheme based on specific experience from the implementation of IDGS Phare 2002.

A total of 2.7 MEUR will be available to support this component. Grant sizes will range from 10,000 - 50,000 Euro and the project duration will be 12 month maximally. In order to address the SOP priority to enhance those industries using domestic resources, the development of added value projects inter alia in the wood processing, glass, building products and magnesite product sectors will be considered during the project assessment phase. The total grant fund available is 2.7 M Euro from Phare. It is expected that at least 1 MEUR will be co-financed by grant holders. On the assumption that the average grant awarded will be 30,000 Euro, a total of 90 individual grant contracts will be involved.

The potential beneficiaries of this component are industrial enterprises. Enterprises, which have all the necessary expertise in-house, are able to bid on their own. Enterprises which do not have all the necessary expertise in-house can submit proposals in partnership with other organisations as required e.g. with R & D institutions. In all cases however, the lead body must be the industrial enterprise. Such partnerships will help to develop long-term relationships and ensure that progress is aligned with industrial as opposed to research-based priorities. The role of each project partner should be clearly set.
2. Management of the Grant Scheme

The activities will follow the processes stipulated in the PRAG. The following documents will be developed:

- Grant scheme application form – applicant and assessment friendly
- Guidelines to Applicants – providing information and advice to assist applicants in the design process
- Operational Manual – providing information and advice to those involved in the management of the grants scheme

These documents have been developed for the Industry Development Grant Scheme under Phare 2002 through consultation with, and participation of, relevant national and regional organizations. It is important however that these documents are updated nearer the call for proposals. Key data such as deadlines, contact details and financial allocations will need to be inserted but the documents, as a whole, should be reviewed to assess whether any changes can be made to improve the efficiency of the Support of Innovative SMEs.

Following approval of the final documentation by the Project Monitoring Committee, the grant scheme will be launched and publicized using national and regional media - print and electronic. Support will be provided to applicants during the design of their applications through the national networks of Chamber of Commerce, RAICs and BICs. Formal ‘Information Days’ will be held to convey key details and selection criteria. These will also provide a forum for potential applicants to settle queries and to determine their eligibility. Once eligibility has been determined, Project Design Training seminars will be run in each region for enterprises with an appropriate project. Such activities will be particularly important in those regions with less experience in the development of EC applications.

In addition to such formal events, the RAICs and BICs will be available to provide one-on-one support as required by applicants. Again, it will be particularly important that such support is available to regions with a lower capacity for producing applications of the necessary quantity and quality. BIC and RAIC personnel in these regions in particular will need to be pro-active in ensuring that applicants receive the necessary advice.

Evaluation Committees and teams of Assessors will be established for each of the grant scheme components. These will be separate to the Project Monitoring Committee. The Support of Innovative SMEs Monitoring Committee will be responsible for approving the Assessors and Evaluation Committee members and the criteria to be used in the selection of applications. NADSME should, where possible, draw on qualified personnel who have completed the evaluation of projects under previous Phare assistance programmes. The feasibility of using the same assessors, as for Phare 2002 grant scheme should also be examined. The evaluation process will follow PRAG procedures.

Once evaluation has been completed, the focus of activity will move to the provision of support to grant holders and the financial management of the grant scheme, including reporting to the National Fund (Ministry of Finance), Monitoring Committees, and to the EC Delegation.

For the Grant Scheme management, there will be 0.03 M Euro available from the state budget. In addition 0.05 M Euro for contracting assessors on individual basis will be provided by Phare 2003 with the use of the same mechanism as in IDGS Phare 2002.
3. Monitoring

Monitoring of individual projects will be carried out by Chamber of Commerce, BIC and RAIC staff and through completion of progress reports by the grant holders. Formal monitoring visits will be held approximately three times for each contract. The exact number will depend on duration and complexity of the project and will be set out in a monitoring schedule attached to their contract with the Contracting Authority (NADSME). The monitors will be supported by a centrally based team of Monitoring Advisers who will ensure that monitoring is being carried out consistently across regions; provide on-the-spot support to BIC/RAIC staff in carrying out their monitoring inputs; address areas of weakness and provide specialist advice in a particular sector. This team will therefore consist of individuals from NADSME and the MOE and from experts from other Ministries depending on the nature of the successful projects. For instance, an expert from the MCRD would be appointed for any projects in the building sector.

In addition to the formal visits, grant holders will also be able to call on the BICs/RAICs to discuss other issues as they arise – e.g. preparation of grant payment submissions and completion of technical reports. Project progress will be assessed against the projected results in the individual applications. Where common problems are being experienced by grant holders, limited specific training and workshops will also be provided as needs are identified.

These individual assessments will be incorporated into an overall analysis of the Support of Innovative SMEs against the targets set out in the project terms of reference and those set in the logical framework attached as Annex 1 to this document. Key concerns and issues arising during this process will be included in the TA reports and will be discussed at Support of Innovative SMEs Monitoring Committee meetings.

For the Grant Scheme monitoring, there will be 0.05 M Euro available from Phare for subcontracting Chamber of Commerce, RAICs/BICs with the use of the same mechanism as in IDGS Phare 2002. They already received training within Phare 2002 grant scheme and gained experience for grant scheme promotion, assistance to applicants and project monitoring during the IDGS program, will be subcontracted for those activities also in this programme. This is the most effective way how to deliver high quality services without an additional training.

4. Evaluation

A final evaluation of each grant contract will be completed and approved by NADSME in order to release the final payment (subject to the invoice meeting the financial requirements of the MOE). Positive project results should be disseminated. Given that the impact of many projects will not be realised for 2 – 3 years, it is important that monitoring of the projects continues in the medium term, through the Chamber of Commerce, BICs and RAICs. This should include a formal sample survey after 12 months of overall project completion.

5. Marketing

A Support of Innovative SMEs marketing strategy will be developed prior to the launch of the first call for proposals. The strategy will be made up of three distinct phases:

- Promotion of the scheme to ensure that all potential applicants are fully aware of the scheme and have information necessary to submit eligible applications;
• Generation of positive media coverage during implementation so that the impact of individual projects is demonstrated to others; and
• Dissemination of the overall results on a national and regional scale (see Output 3)

The strategy should identify the most appropriate means of accessing the target groups at each phase, as set out in this fiche. The means should include electronic and other media forms and utilise regional and national media. It is important that the strategy takes advantage of existing networks to disseminate information, such as the Union of Employers, Union of Entrepreneurs and Chambers of Commerce. The strategy should also include mechanisms for ensuring that eligible applicants in regions with less experience in the preparation of such proposals are aware of the project and understand the preparation and selection process.

A range of marketing materials should be prepared including leaflets, posters and signage. An interactive project web-site should also be developed, attached to the Ministry of Economy site. The web-site should include application documents; up-coming project activities and information on positive results of grant schemes to date. It should also be linked to other relevant sites such as NADSME, Chamber of Commerce and individual BICs and RAICs.

On completion of the individual grants, appropriate events will be organised to disseminate best practice and achievements. Such events may include a final conference and an inter-Ministerial workshop on grant management.

For the Grant Scheme marketing, there will be 0.03 M Euro available from Phare for contracting PR agency.

**Result 2**

1. **Investment support to venture capital**

There is a general need to increase the availability of specific financing tools for supporting innovation activities within industrial enterprises.

The Venture Capital investment process will generally proceed along the following lines:

1. **First contact**
   - A letter to the VC-operator enclosing the Executive Summary from the Business Plan.
2. **Interview**
   - Key members of the team should be present and ready to discuss their roles.
3. **Examination of the Business Plan**
   - The VC-operator may now examine the Business Plan more carefully - especially the financial projections, the cash flow forecasts and the potential returns.
4. **Due diligence**
   - The Venture Capital fund managers may now proceed to make a complete evaluation of the Plan.
5. **Valuing the opportunity and Investment**
   - An offer may be made to the company. The details of the investment will be embodied in a legal document called the Shareholders' Agreement.
The decision making body will be Investment Committee (IC) which will have 7 members with the voting rights. The members of the IC will be selected from the representatives of the commercial banks, universities, associations of the entrepreneurs, NADSME and relevant ministries.

Venture capital can be used to develop new products and technologies, to expand working capital, or to strengthen a company’s balance sheet.

The exit possibilities are:

- The company is sold to the company owner,
- Initial Public offering (IPO), the company is listed in a stock exchange;
- The company is sold to another company,
- A part of the company is sold to another venture capital investor;

The investments made by the venture capital funds must not serve to replace the obligations, commitments and engagements of existing long term financiers of the SME, nor should they be used to merely refinance the company's debts.

The new capital should be used for:
- extending the existing operations;
- developing new activities;
- introducing new methods or systems of production, based on innovative technology or products.

To qualify as innovative technology projects, investments made under this action should comply with at least one of the following criteria:

a.) Projects, which represent or lead to market application of RTD results, obtained through participation in European Community or national research programmes. This can help to overcome barriers for Slovak SMEs to participate in 6th Framework Programme.

b.) Projects, which show a high degree of innovative technology in product, service or process. This is shown by at least one of the following:
- the establishment of intellectual property rights, owned by the company or obtained under a licensing agreement;
- recognition of the innovative character by a national authority, either by award or subvention, or other certification;
- recognition as a key technology under a national technology foresight exercise;
- any other convincing demonstration of the innovative character of the project, acceptable to the commission.

These elements must constitute more than 50% of the innovative project to be supported.

c.) The projects successfully finished under Result 1 that fulfilled all planned goals will be eligible for venture capital or debt funding. This two-step procedure will decrease venture capital risks. This is necessary for the development of venture capital market.

The Seed Capital Company can implement the pilot project for this venture capital fund. Its experience including its expansion into deprived Slovak regions is a guarantee for successful implementation of this pilot project. The fund will be used on a revolving basis.
A total of 1.1 M Euro is available to support this pilot project from the state budget. This is also a co-financing from the state budget for the whole project.

2. Preparation of business plan for a venture capital operator

The activity will comprise the elaboration of longer-term strategy and operational manual for the institution entitled to manage the venture capital scheme. The comparative analysis of different contemporary models of venture capital support used within EU will be followed by identification of best possible solution for the Slovak Republic, including the way of territorial channelling of the funds and monitoring of the impact reached by the investments provided. This will be followed by the definition of the internal procedures and preparation of the operational manual for the VC operator. The part of this activity will be the training needs analysis and corresponding training delivered to staff of VC operator

3. Establishment of Business Angels Network

With reference to point 3 the conditions for operation of Business Angels will be prepared. This will need to create a database of prospective business projects, which will be assessed and offered to potential investors either from Slovak database or Business Angels Networks abroad. Project assessment will be carried out by the panel of assessors. TA will include training of assessors to guarantee security for innovative projects as well as to provide trustable data for investors. A virtual market place will be created by placing these databases on internet. It allows new and innovative firms to address business angels as well as institutional investors. In this way transparency is increased in a marketplace that includes both formal and informal sources of investment, through a system that is fast, easy to use and low-cost. This database will give investors an opportunity to network innovative companies and allows capital mobility.

Technical Assistance (TA) will be contracted for activities 2 and 3. They will have responsibility for the following specific tasks:

A breakdown of the TA inputs for activity 2:
- The development of strategy for equity investments in innovative small and medium enterprises;
- The preparation of procedures and manual for assessing companies for equity investments;
- To create list of conditions for decision process in equity financing;
- Training for project evaluators;
- Training for investment committee members;
- Participation in quarterly review meetings and six-monthly Monitoring Committee meetings, including joint presentations with MOE/NADSME staff on project progress;
- Technical support to the Secretariat in the organisation of the six-monthly Monitoring Committee meetings;
- Participation in project evaluation process as an observer;

A breakdown of the TA inputs for activity 3:
- Defining requirements for Business Angels Network and preparation of its concept;
- Defining system for collecting investment projects, their evaluation, counselling, and presentation to investors (database system);
- Procedures for searching private investors;
• Establishing contacts with similar networks in neighbour countries and negotiating conditions for presenting projects of Slovak companies to foreign investors;
• Launching the database system and assessing its functionality;
• Participation in quarterly review meetings and six-monthly Monitoring Committee meetings, including joint presentations with MOE/NADSME staff on project progress;
• Technical support to the Secretariat in the organisation of the six-monthly Monitoring Committee meetings;
• Participation in project evaluation process as an observer;

The TA contract for these activities is expected in the amount of 210 000 Euro from Phare. It envisages 3 experts (6 months) and 1 short-term expert (3 month) for launching and assessing the database system functionality.

Based on these inputs another TA contract will be expected for the creation of projects and investors database in the amount of 50 000 Euro.

3.5 Lessons learned

From previous experience within other organizations that have managed loan and grant schemes - MOE (Tourism Section), SARIO and NADSME - the key learning points are:

3.5.1 Applicants require further technical and administrative support in the preparation of their projects in accordance with the requirements of the particular scheme. For SARIO (Phase 1) 68% of applicants failed to meet the administrative criteria set for the scheme. Such assistance for Support of Innovative SMEs applicants will be provided by the BICs and RAICs, who are already experienced in EC, and other, grant schemes. The accessibility of these centres to applicants across the country will be essential in ensuring that the support structures meet the demands of applicants. It will therefore be important that the personnel at the BICs and RAICs receive formal training in supporting applicants under this particular scheme and that they receive technical support from the MOE to ensure that advice is consistent and accurate across Slovakia.

3.5.2 Linked to the above is the negative feedback from some applicants concerning the marketing of schemes. In particular, applicants have criticised the lack of clarity concerning project eligibility criteria. For the Support of Innovative SMEs, the marketing materials will explicitly state the organizations and activities that are eligible to receive support. These materials will be part of a structured marketing strategy utilising MOE web-site and the national and regional media. Sessions will also be delivered to potential applicants in their region and these will afford an opportunity for applicants to determine their own eligibility.

3.5.3 Greater impact could also be achieved through the provision of formal support to applicants during project start up and during implementation. This will be completed through the monitoring process and through the distribution of regular ‘Guidelines’ on aspects of project management and planning, which are identified during the monitoring.

3.5.4 Project applicants generally over-budgeted. As a result, funds were returned to the Contracting Authority. In most cases, such over-budgeting was identified (at least by the Contracting Authorities) towards the end of projects and outside the contracting period. Such funds were therefore wasted. Training in project design and project implementation should help to overcome this but, equally, it will be important that the projects under the grant scheme are initiated on time so that any under spends can be identified during 2005.
4 Institutional Framework

The recipient of the project is the Ministry of Economy (MOE) as the designated Managing Authority for SOP Economic Development.

NADSME will be the implementing agency for result 1. NADSME is responsible for administration of support programmes for SMEs in Slovakia and has large experience with EU assistance programmes. A Support of Innovative SMEs Monitoring Committee will also be established to review the work under the project and approve key documents.

The duties of the NADSME will be defined in a Memorandum of Understanding (MOU) between the NADSME and the MOE. These duties will include the supervision of the grant process, grant awards, supervision of awards, payments, maintaining records and approving technical reports, establishing a Monitoring Committee, identifying and nominating central and regional staff.

The implementation institution for result 2 of the project will be Seed Capital Company, Ltd. Seed Capital Company, Ltd. (SCC) was established on December 13, 1994, by the National Agency for Development of Small and Medium Enterprises. SCC manages financial support programme with high-risk investments financed from PHARE sources (Financing Memorandum 1993, 1995, 1997, 1999). Under this programme is SCC looking for innovative enterprises with growth potential over the intermediate term. Activities of the SCC cover the whole territory of the Slovakia. In order to increase the direct capital investments SCC close co-operate with network of Regional Advisory and Information Centres, Business Innovation Centres and with Regional Office of the SCC in Banská Bystrica.

5 Detailed budget

<table>
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<th>Phare support (MEUR)</th>
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* Slovak government co-financing
*) In line with the Slovak Government’s decision dated 9 February 2000, all Phare funded projects including an investment component must be co-financed from the State Budget. The co-financing will be ensured through the 2004 State budget.
6. Implementation arrangements

6.1 Implementing Agency
PAO. Mr. Juraj Majtan, Director-General
National Agency for Development of Small and Medium Enterprises (NADSME)
Prievozska 30
821 05 Bratislava
Phone: +421 2 5341 7328
Fax: +421 2 5341 7339

6.2 Twinning – not applicable

6.3 Non-standard aspects

Although the total grant programme exceeds 2 MEUR, the individual grant size is below 100,000 EUR. The scheme will therefore be organised as a local calls for proposals according to Section 6.2.1 of the PRAG.

Available grants range from 10,000 - 50,000 EUR. This is below the minimum value set out in the Phare programming guide 2003. This range has been set in order to ensure there are a sufficient number of grants available to test the administrative and management procedures within the relevant institutions.

The grant scheme in this project is an extension of IDGS Phare 2002. Therefore, the TA contract for monitoring the grant scheme will be provided to the Regional Chambers of Slovak Trade and Industry Chamber and RAICs/BICs with the use of the same mechanism as in IDGS Phare 2002, in order to utilise already gained training and experience.

Similar arguments hold for providing contract for VC Fund to SCC.

6.4 Contracts:
• GS in the amount of 3.6 MEUR (including the Slovak government co-financing)
• Service contract for management - 0.03 MEUR (financed by SK government)
• Service contracts for monitoring – 0.05 MEUR
• Service contracts with assessors – 0.05 MEUR
• Service contract for marketing – 0.03 MEUR
• MoU with SCC on the investment to VC – 1.1 MEUR (fully financed by the Slovak government)
• Service contract for business plans – 0.22 MEUR
• Service contract for BAN database – 0.05 MEUR

7 Implementation schedule

7.1 Call for proposals should be launched according to the following schedule:

First call – June 2004
Second call – September 2004
Third call – November 2004
Fourth call – January 2005 if required
7.2 Start of project activity - first contract is expected to be signed in September 2004.

7.3 Project completion - last payment is expected to be made in October 2006

8 Equal opportunity

The grant scheme will be open to industry in general. No discrimination will be made between organizations with all applications being assessed objectively against the criteria set out in the Guidelines for Applicants. There will be an opportunity for the Evaluation Committee to review the applications and, in particular, to ensure that no duplication of funding occurs.

9 Environment

No environmental impact study has been undertaken for the project during the preparation of the project fiche. The grant scheme is designed to encourage and support a wide range of projects, the impact of which will only be known once they have been selected. It will, however, be a requirement of each individual application that they provide information on environmental impact.

10 Rates of return

A key criterion for the selection of projects is the forecasted and assessed growth in gross and net margins, as detailed in application forms. Progress in accordance with these forecasts will be the acid test of project success. However, the phasing of returns is important. The initial stages of innovation will impact negatively on the overall rate of return (because costs are being incurred on the development activities) but the return then tends to increase steeply as the commercialisation phase gathers momentum (due to increased revenue inflows).

Result 2 is not so readily quantifiable but we expect usual rates of returns as for other venture capital investments. All returns will be reinvested.

11 Investment criteria

11.1 Catalytic effect. The funding represented by the grants as well as equity investment would not be available to industry from conventional banking or investment sources. Because of the delay in pay back during the development and testing phases, industry generally has been reluctant to fund innovation solely from its own resources. The substantial returns that should accrue from the commercialisation stage render the grants as valuable leverage in R&D funding. The success of the scheme will also tend to induce participants to fund continuing innovation from own resources and have the demonstration effect of encouraging other enterprises within the industrial sector to adopt R&D programmes as an effective development strategy.

11.2 Co-financing. A minimum of 50% co-financing will be required from all applicants registered in the Bratislava region. A minimum of 25% co-financing will be required from applicants registered in other regions.

11.3 Additionally. Funding for innovation is not available from existing financial institutions.
11.4 Project readiness and size. All required documentation for design and implementation of the scheme is scheduled to be available by end May 2004.

11.5 Sustainability. The scheme represents a response to a national development priority and is assured of Ministerial and Government commitment. The results from the scheme will be readily quantifiable. Project models are available from similar schemes undertaken in Member States that evidence sustainability compliance.

11.6 Compliance with State Aid provisions. The grant scheme will be designed to conform fully to the regulations and guidelines of the Commission. Guidelines for Applicants will be designed in accordance with the format set out in the PRAG. The Guidelines will clarify eligible activities for support, administrative, financial and technical criteria against which applications will be assessed and will provide applicants with information on how to complete the necessary documentary submissions. All applications will be checked to comply with State Aid provisions.

11.7 Contribution to National Development Plan. Section 2.2 provides a detailed description of the areas of the NDP to which the project will contribute, in particular as a measure to respond effectively to the priority need of enhancing industrial competitiveness.

12 Conditionality and sequencing

- EDIS in place
- National co-financing timely available for venture capital
ANNEXES TO PROJECT FICHE

Annex A – Logical framework matrix
Annex B – Detailed implementation chart
Annex C – Cumulative Contracting and disbursement schedule
Annex D – Summary of project survey
<table>
<thead>
<tr>
<th>LOGFRAME PLANNING MATRIX FOR PROJECT</th>
<th>Programme name and number: 2003-004-995-03-09</th>
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<td>Contracting period expires: 30.11.2005  Disbursement period expires: 30.11.06</td>
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<td><strong>Total budget</strong>: 5.13 MEUR  <strong>Phare budget</strong>: 3.10 MEUR</td>
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<tr>
<td><strong>Overall objective</strong></td>
<td><strong>Objectively verifiable indicators</strong></td>
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<tr>
<td>To restructure the Slovak production sector towards the knowledge-based economy. To increase its productivity.  To foster the sustainable development of the SMEs sector and to improve its competitiveness on EU market through innovations.</td>
<td>Added value in ERDF supported industries  Enhanced turnover and performance of Slovak companies by 2006</td>
</tr>
<tr>
<td><strong>Project purpose</strong></td>
<td><strong>Objectively verifiable indicators</strong></td>
</tr>
<tr>
<td>To increase availability of financial sources for innovative companies through establishment of sustainable venture capital investment scheme.</td>
<td>Full budget utilisation  30 investments in innovation companies  Increased awareness of MOE/EU activities.</td>
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<tr>
<td><strong>Results</strong></td>
<td><strong>Objectively verifiable indicators</strong></td>
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<tr>
<td>1. The pool of innovative enterprises capable for venture capital operation established  • Investment support to individual innovation projects  • Improved skills within the industrial enterprises in accessing EU funds.  • Improved planning and project management skills within the successful industrial enterprises  • the positive effects of the project disseminated to other relevant organizations.</td>
<td>90 new products, technologies and services developed or existing range upgraded  300 eligible grant applications received  150 eligible applications for equity financing</td>
</tr>
<tr>
<td>Activities</td>
<td>Means</td>
</tr>
<tr>
<td>------------</td>
<td>-------</td>
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<tr>
<td>Result 1</td>
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<td>• Supporting innovative projects by grants</td>
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<td>• Management of the grant scheme</td>
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<td>• Monitoring of individual projects</td>
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<td>• Evaluation of each granted project</td>
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<td>• Marketing the grant scheme to reach the target group</td>
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<td>• Investment support to venture capital</td>
<td>Technical Assistance for VC</td>
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<td>• Preparation of business plan and operation procedures for venture capital operator</td>
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<tr>
<td>• Strategies for financing innovations</td>
<td>Contract for investment support</td>
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<tr>
<td>• Establishment of Business Angels Network</td>
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<tr>
<td>• Operating BAN database</td>
<td>Technical assistance for creating internet based database</td>
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<tr>
<td>• Establishing a panel of assessors</td>
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<td>• Training in project evaluation</td>
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<td>Quarterly review meetings and 6-monthly Monitoring Committee meetings.</td>
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**Preconditions**

- EDIS in place
- National co-financing available
## Annex 2

### CUMULATIVE CONTRACTING AND DISBURSEMENT SCHEDULE (MEUR)

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**DETAILED IMPLEMENTATION CHART**

Support to innovative SMEs (SISME)

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<tr>
<td>Business angels</td>
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Executive Summary on SISME applicants

1. It is anticipated that there will be finances available to support around 90 projects under Result 1 – grant scheme. Under similar schemes funded by the EU in member and applicant states it has been necessary to receive 4 applications for every successful project. A number of applications will be non-compliant and/or ineligible and will be disqualified during the first stages of the evaluation. There should be sufficient remaining after this to allow a meaningful technical evaluation process to be completed. Using this 1 in 4 ratio as a guide, it is forecasted that the scheme will need to attract 360 applications under grant scheme.

Information is available on the number of manufacturing companies with more than 10 employees and this is 3656 according to the Statistical Yearbook 2002. Given the co-financing requirement and the need to satisfy technical and financial capacity criteria, it is expected that applicants will mainly come from this group.

Innovation is an important factor in SMEs competitiveness. Therefore, NADSME in cooperation with the Statistical Office analysed recently the situation in this respect in Slovakia. Based on the representative survey from November 2002, almost 60% of small and medium-sized companies made some innovations in their products, services or technologies in the last three years. About 50% of them used in-house innovations. About 50% of innovative companies used for innovations more than 10% of their turnover. However, what is characteristic for current situation is that 90% of innovative companies used predominantly their own financial resources and only 20% had an access to bank loans. These results imply that there is a good potential for innovations but the dominant barrier for innovation activities is the lack of any form of capital.

It is anticipated that the majority of eligible applicants will be enterprises employing in excess of 10 employees. Enterprises with fewer employees than this will struggle to find the necessary co-financing and demonstrate sufficient implementation capacity. On the basis of there being 3,600 Slovakian industrial enterprises with more than 10 employees, the estimation of 10% interested companies, would give a predicted total of 360 applicants for grant scheme.

It should be highlighted that eligibility of applicants will not be determined by the number of employees. However, promotion materials will need to emphasise the capacity necessary to implement such projects so that applications are confined as far as possible to enterprises, which have a realistic chance of meeting the selection criteria for management experience.

2. All applicants for equity financing can come from the above group and also from the Phare 2002 Industry Development Grant Scheme. This is at least 180 eligible applicants, who will compete for about 16 investments in the average amount of 100,000 Euro.