Executive Summaries of Evaluations Studies on SME Access to Finance in EU Member States/Regions carried out by EIF in the Context of the JEREMIE Initiative from 2006 to 2008

1 March 2009

This document summarizes evaluation studies carried out by EIF with the financial assistance of the European Union. The views expressed herein can in no way be taken to reflect the official opinion of the European Union.
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1 INTRODUCTION

On 11 October 2005, the JEREMIE initiative was launched by the European Commission (Directorate-General for Regional Policy) and the EIB Group at a ministerial meeting in Brussels to promote increased access to finance for the development of SMEs in the context of EU Structural Funds 2007-2013.

The initiative offers EU Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds to finance SMEs by means of equity, loans or guarantees, through contributions from operational programmes to revolving holding funds organising operations.

The JEREMIE holding funds can be managed either by the EIF or by other financial institutions, according to the EU Structural Funds legislation applicable (notably Article 44 of EC Regulation 1083/2006 and articles 43-46 of EC Regulation 1028/2006).

The Commission, in cooperation with the EIF, has decided in 2006 to offer to Member States or regions interested in JEREMIE, the possibility to have a JEREMIE evaluation study, offered free of charge to them, identifying gaps between supply and demand for financial products ensuring appropriate SME access to finance and proposing action to take to fill the gaps. The Commission /DG REGIO would finance 85% of the studies cost, and the EIF would finance the remaining 15%. The EIF would carry out the evaluation studies, upon request of interested Member states or regions.

Consequently, at the beginning of 2006, the EIF set up a JEREMIE team whose objectives was to carry out the JEREMIE evaluation studies. The EIF started assessing the demand and supply for financial engineering and to identify SME finance market failures in regions and Member States in the context of such JEREMIE evaluation studies, so-called “gap analyses”.

By end of 2008, the EIF finalised 53 national and regional evaluation studies through a standard evaluation methodology, in cooperation with respective national/regional Managing Authorities.

The standard evaluation methodology for these gap analyses was developed by the EIF in 2006, in cooperation and in agreement with DG REGIO in order to quantify existing supply of and potential demand for SME financing in individual EU Member States/regions, and to propose action to take. This methodology is described further below.

There are many complexities involved in the task of understanding the areas of market weaknesses or gaps in the access to finance to SMEs. The primary challenges lie in the context of data availability and the feasibility of measuring the gap between current supply and potential demand for financially engineered instruments. A methodological framework has been adopted to assess SMEs...

1 Joint European Resources for Small and Medium-sized Enterprises
2 European Investment Bank (www.eib.org) and European Investment Fund (www.eif.org)
3 Micro, small and medium-sized enterprises according to the EU definition recommended by the European Commission in 2003 (less than 250 employees, turnover of max. EUR 50m, a balance sheet total of max. EUR 43m)
4 European Investment Fund – EIB Group institution specialised on SME guarantee and equity financing
5 See list below
financing in any marketplace. The approach seeks to understand whether gaps or market weaknesses exist based upon the following principles:

- Demographic trends within the SME environment and in each market segment are used to estimate the future potential size of market space and potential demand;
- Supply sources are measured or estimated using the latest available statistical data from respective SME financing market sources such as EVCA and national data sources as appropriate;
- The trends and shifts in the supply are then reviewed together with the current levels of public support to identify evidence of market failures, gaps or absences;
- From this, proposals are made for generic financial engineering instruments that comply with the rules of JEREMIE and specifically target the identified market weaknesses or failures with the justification of the size of the funding based upon either a macro (top down) view of the market or the bottom-up, practical view of the instrument in question. These proposals are made on the basis of the EIF’s wide experience of guarantee and equity instruments across Europe and reflect the standards of best practice in the market;
- An estimation of the sensible ‘tranche approach’ is then given for the Holding Fund with proposed management structures and the total Holding Fund size, estimated for budgetary planning purposes.

This approach adopted follows a set of principles to understand whether gaps or market weaknesses exist in each segment of the SME market in each country. For example, the first market segment in the area of the ‘socially excluded population’ (microfinance), the method used is as follows: The latest available data for the section of the overall population regarded as ‘at risk of poverty’ is taken as the base population for the segment. Then using historical information for the number of people that have created an enterprise per 1,000 inhabitants, this percentage rate is applied to the segment population. This gives an overall estimate of the potential demand size in this segment.

For the three other groupings (micro, small and medium SMEs) overall statistics for each segment is presented with a review of factors affecting demand in each case. For these segments, an analysis of the trends in the provision of key sources of supply of finance is undertaken at macro-level before deeper analysis of the main elements of supply in each individual segment is undertaken to understand the key aspects of market weakness or failure that may exist.

From this point, practical proposals are made targeting identified weaknesses whilst respecting the aspects of financial engineering and self-sustainability at the core of the JEREMIE initiative. The proposals need to be viewed as a flexible portfolio of instruments that combine to address the weaknesses in the economy but may be varied according to the dynamics of the situation across a period.

Taking into account points mentioned above, the structure of the evaluation studies prepared by EIF for EU Member States/regions interested in the JEREMIE approach looks as follows:

- Executive summary;
• Background information, including characteristics of the economy and demographics, SME characteristics and environment, regional characteristics;

• Supply and demand analysis of existing and potential financial instruments for SMEs, market failures and recommendations;

• Next steps including recommendations of a portfolio of financial instruments in a JEREMIE holding fund and proposed actions to be taken.
The following table lists all JEREMIE evaluation studies carried out by EIF on request of the respective national/regional Managing Authorities in charge of EU Structural Funds implementation for 2007-2013, and finalised by 31 December 2008:

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The respective national/regional counterparts (i.e. Managing Authorities) have been contacted by DG REGIO and EIF to approve publication of the executive summaries of these 53 evaluation studies on the Commission’s website. By 28 February 2008, approvals have been received from 29 national/regional counterparts; the respective executive summaries are listed in chapter 3 of this report.

It should be noted that the executive summaries published in this document vary in terms of structure, size and content, given that they were prepared on the basis of the draft evaluation studies presented to the respective national/regional counterparts.
2 WHY JEREMIE?

The contribution that SMEs deliver to the EU economy is well documented. Across the EU, Member States appreciate this fact and have focused many policy initiatives at this sector. This is further recognised in a recent communication by the European Commission which states that ‘the partnership for growth and jobs depends on Europe’s SMEs achieving their potential, as they prove to be crucial in fostering the entrepreneurship, competition and innovation that leads to sustainable growth and development.’

Recent data shows that Europe needs to work on the availability of risk capital to SMEs with high growth potential. After a decrease from EUR 4.2 bn in 2001 as a result of the bursting of the technology bubble, European venture capital investment in early stage firms has stagnated at around EUR 2 bn. A recent survey has shown that 14 per cent of the 23 m SMEs registered in the European Union need better access to finance.

It is for these reasons that the Commission has launched in close cooperation with the EIF and the EIB the Joint European Resources for Micro to Medium Enterprises (JEREMIE), in the context of the renewed cohesion policy for the period 2007-2013 of the structural funds.

The future of European competitiveness depends on an integrated, open, and competitive financial market that covers risk capital and debt finance instruments and as part of the JEREMIE initiative, the European Investment Fund has been asked to evaluate the specific needs of each EU market to identify market failures and to propose a series of appropriate financially engineered instruments.

The JEREMIE initiative will combine contributions from operational programmes of the European Regional Development Fund (ERDF) and the European Social Fund (ESF) with loan capital and other sources of finance to support the creation and expansion of micro, small and medium-sized enterprises as part of EU regional policy. Using the concept of a ‘Holding Fund’ to organised operations, JEREMIE enables each Member State to support the development of business angels, technology transfer funds to link business, universities and research centres, and to improve the availability of micro-credits targeted at those who may not have access to commercial credit. Funding from instruments established through JEREMIE may also be combined with business support and institution-building measures financed by the Structural Funds.

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6 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. ‘Implementing the Community Lisbon Programme: Financing SME Growth – Adding European Value’ - Brussels, 29.6.2006 - COM(2006) 349 final
7 ‘SME Access to Finance’ Flash Eurobarometer survey, October 2005
8 The Competitiveness and Innovation Framework Programme (CIP) and the Joint European Resources for Micro to Medium Enterprises (JEREMIE) are complementary in nature and the European Investment Fund will be the key implementation institution ensuring that this is the case for each Member State.
9 To give just one example, for growth-seeking entrepreneurs, external financing becomes necessary when their initial funds have been exhausted. Knowledgeable private investors are critical for the launching of entrepreneurial businesses, but there is a serious and persistent lack of business angels and other seed investors in Europe. To illustrate, Business Angel investments in Europe are estimated to be less than 10% of those in the United States for a similarly-sized economy.
In previous periods, lack of knowledge and expertise in the financial sector and products, as well difficulties with the administrative processes have led to relatively low levels of Structural Funds utilisation regarding financial engineering for enterprises. The Commission expects that significant improvements can be made via the creation of JEREMIE Holding funds within the Member States or regions, and with full delegation to the appropriate Managing Authority to oversee the implementation of JEREMIE programmes aimed at delivering sustainable financially engineered instruments that improve access to finance for SMEs.

Importantly, operations under JEREMIE will be individually tailored to the needs of each Member State following on from the combined efforts of the EIF and the Member State to evaluate market failures and the appropriate remedies in the context of its Operational Programme. The proposed instruments will efficiently engage the private sector and seek to maximise the leverage effect.

The flexibility within the portfolio of JEREMIE instruments in each programme enables a full range of instruments varying from equity and quasi-equity to venture capital, loans or guarantees for the benefit of SMEs in the Member State. Furthermore, the portfolio of instruments used and financial commitments made is flexible enabling alterations in positional allocations to be made during the period.
3 EXECUTIVE SUMMARIES OF EVALUATION STUDIES

This chapter lists all executive summaries of final evaluation studies prepared by EIF in cooperation with respective national/regional Managing Authorities, for which the Managing Authorities have given their approval for publication of the executive summaries on the Commission’s website.

As outlined in chapter 1 of this report, the executive summaries published in this document vary in terms of structure, size and content, given that they were prepared on the basis of the respective draft evaluation studies presented to the respective national/regional counterparts.

3.1 Bulgaria (September 2007)

Statement of Position

This report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) in Bulgaria in the context of access to finance. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency and export potential. The measures are balanced as to their size and effect aiming at an efficient use of the EU Structural Funds allocated in the framework of the Operational Programme (OP) “Development of the Competitiveness of the Bulgarian Economy 2007-2013”.

Priority Axis 3 “Financial Resources for Developing Enterprises” aims at increased investment activity and entrepreneurship through the development of alternative financial sources for SMEs from the non-banking sector. The OP confirms a serious market failure in this area, as SMEs are an important actor for economic development and have serious problems in accessing finance.

The indicative financial framework for revolving financial instruments is currently set at EUR 200m (Community and National Public Funding) in relation to about EUR 1 bn total funding in the framework of the OP Competitiveness. In the context of EIF’s gap analysis of existing supply of and potential demand for financial instruments facilitating SME access to finance in the coming years, the following instruments have been identified as recommendations for establishment in the JEREMIE framework under a holding fund concept:

- **Guarantee Scheme for Micro Financing** amounting to EUR 80 m to be offered to eligible institutions (or banks) to onlend micro loans to needy people and socially excluded people for the purpose of creating SMEs;
- **Guarantee Scheme** amounting to EUR 100 m for SMEs offering four types of guarantees: guarantee for start-ups; guarantees for existing enterprises; guarantees for export loans and for innovative projects.
- **Support for Export-Oriented SMEs** amounting to EUR 50 m.

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Draft Version of June 2006
• Risk Capital Investment amounting to EUR 10 m for Venture Capital investments (Early Stage).
• Pilot Project in the field of Technology Transfer amounting to EUR 5 m.
• Risk Capital Investment amounting to EUR 5 m for creating a Fund to stimulate the creation and activities of Business Angels

Thus, a portfolio of a total amount of EUR 250 m is recommended to be set up through the means of the Structural Funds allocation for Bulgaria from 2007 on to help decreasing the market failures existing in the areas of SME access to finance.

The discussions on specifying the form of the proposed instruments and their sizes in the framework of a JEREMIE holding fund will be intensified during the preparation of the implementation phase. In this context, further consultations with market participants, banks and SME organizations will be undertaken to analyse more existing problems and the need for financial instruments in the market. The support of the financial and private sector is necessary to assure that there is no “shift from the private capital market” as a result of the proposed measures and that the private capital is entirely engaged in this process.

The process of specifying the measures may lead to changes in the proposals made when setting up the JEREMIE business plan or after the start of the implementation phase according to the JEREMIE counterparts' decisions.

Coordination of Recommended Actions

This assessment is focused on the understanding of the financing of the Bulgarian SME market and on determining the demand and supply financing levels of different market segments and other types of financing. The proposals are described in the next sections and they are to be considered as a portfolio of initiatives.

The main market players included in the analysis, which are recommended to participate in the future implementation of the programme are the government bodies involved in the implementation of the EU Structural Funds 2007-2013 and all potential financial intermediaries during JEREMIE implementation.

Strategic Priorities and Policies

The analysis and the measures proposed take into consideration the main guidelines in the National Strategy Reference Framework (NSRF) of the Bulgarian Government as well as the recommendations and requirements of the EU in this sphere. As defined in the OP Competitiveness, Bulgaria intends to focus its efforts in the following areas:

• Economic development based on knowledge and innovative activities;
• Increasing the efficiency of the enterprises and encouraging the development of the business environment;
• Financial instruments for enterprise development and entrepreneurship;
• Strengthening the international market positions of the Bulgarian economy.

The proposed measures should be seen and applied in this context and improve the access to financing, creating new financial instruments supporting SMEs, developing innovations and supporting SMEs in their business efforts.

Overview of SME Environment

In 2004, 238,51912 existed in Bulgaria of which 90% are micro enterprises13. SMEs play an important role in the economy of the country – they represent 79% of the employment, realise 75% of the turnover of enterprises and create 61% of the gross added value of the country. The regional differences are of particular importance showing a quicker development of the SMEs and of the economic environment in the large cities in comparison to the small towns, and of the urban districts compared to the rural ones.

In general, the SME finance environment in Bulgaria seems to benefit from improving lending conditions, stimulated - among others - by a booming property sector, but the banking sector is still quite timid in its lending to SMEs. Banks tend to ask a high level of (business and/or personal) collateral and start-ups and tech companies (high R&D spending, but no/little collateral) still find it very difficult to raise financing though banks.

Guarantee schemes are not sufficiently present and effective and the supply of equity instruments tends to increase only in the later stage/buyout market, whilst it is still completely absent at the seed/start-up level, and scarce for young companies needing to expand. Although the entrepreneurial culture is taking root, the SME segment as a whole seems to lack managerial experience and scientific research remains strongly academic.

In general, Bulgaria’s population migration is negative and this trend can be expected to worsen after EU accession as observed in other countries, e.g. Poland. This would hamper the creation of SMEs, mainly micro enterprises in Bulgaria, as potential entrepreneurs are increasingly leaving the country. Thus, programmes on entrepreneurial culture and creation of enterprises in Bulgaria are very important in all areas to decrease the effects of this development.

Major Market Failures and Proposed Instruments

This report assesses the existing supply and demand of financial engineering instruments supporting SMEs in Bulgaria and proposes instruments to decrease the gap given the proved market failure in this area. Existing public support measures supporting SME access to finance were assessed as far as possible; details are shown in chapter 4. The macroeconomic and SME environment are analysed in chapter 2.

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12 NSI 2004 figure without SMEs in Agriculture, Forestry and Fishery; all SMEs = 245,676
13 Defined as enterprises with 0-9 employees, see chapter 2.2.
as background information for the development of the financial engineering instruments.

The identified market failures and weaknesses of the Bulgarian SME financing market mainly lie in the area of SME financing by the commercial banks in particular segments (micro financing, guarantees) and in the underdevelopment of the venture capital investments and technology transfer activities. The total amount of the portfolio and the size of the separate measures are based on the current level and development dynamics of the financing of SMEs in Bulgaria and on the experience in the use of financial instruments in practice.

The proposed instruments might cover more than one market segment, as exact borders between the segments do not exist.

The proposed measures form the investment portfolio under the JEREMIE Programme focusing on:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Portfolio share</th>
<th>Million EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantees</td>
<td>40 %</td>
<td>100 m</td>
</tr>
<tr>
<td>Micro financing</td>
<td>32 %</td>
<td>80 m</td>
</tr>
<tr>
<td>Export support</td>
<td>20 %</td>
<td>50 m</td>
</tr>
<tr>
<td>Venture capital</td>
<td>4 %</td>
<td>10 m</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>2 %</td>
<td>5 m</td>
</tr>
<tr>
<td>Business Angels</td>
<td>2 %</td>
<td>5 m</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100 %</strong></td>
<td><strong>250 m</strong></td>
</tr>
</tbody>
</table>

EIF proposes to the Bulgarian national public authorities in charge to implement the recommendations made in this report with regard to the proposals to the Commission for the next planned period between 2007 and 2013. All proposed amounts will be reviewed and further examined in the context of the setting up of the JEREMIE business plan. EIF will strive to actively engage in the discussion all parties related to the issue to ensure that JEREMIE will raise substantial added value to the Bulgarian economy and will be applied successfully in partnership with participating institutions.

Main market failures arising from the gap analysis:

- The existing micro-financing schemes do not cover the potential demand of potential and existing micro enterprises; a financing gap of about EUR 110 m can be assumed during the coming years;
- SMEs mainly rely on financing by own means (70%) for starting-up a business;
- There is a strong need to encourage banks to build SME loan portfolios to decrease the market failure in debt-financing for SMEs in Bulgaria;
- Existing guarantee schemes have a limited effect on SMEs; a National Guarantee Fund does not exist in Bulgaria;
Leasing services developed rapidly in the last three years substituting to a certain decree the loans granted for machines, equipment and vehicles used for business; given the expected growth of leasing activities, a regional gap can be observed;

Venture capital is not well developed in Bulgaria; investors are mainly active in existing enterprises with good management and potential for development (enterprises with a turnover of up to BGN 50 m). Risk investments in start-ups are rare; there is no Venture Capital Association existing;

The Business Angels segment is still to be developed in Bulgaria. The legislative framework necessary for its establishment and operation as well as a Business Angels Network do not yet exist;

Factoring companies have limited activities, usually engaged in receivables against enterprises-trustworthy payers or, for example, state receivables. The financing offered by them is minor;

The National Innovation Fund provides subsidies for innovation projects but focuses on large enterprises rather than SMEs and does not concentrate on revolving financial instruments.

3.2 Cyprus (December 2007)

Statement of Position

This report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) in Cyprus in the context of access to finance. The measures are clearly in line with the broad guidelines set by the European Council to facilitate access to finance in order to achieve growth and job creation in the general framework of improving the attractiveness of regions, encouraging innovation, entrepreneurship and the growth of the knowledge economy and creating more and better jobs. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency.

The key proposals are as follows:

- **A National Guarantee Scheme** amounting to an indicative range of EUR 15 – 25 m for SMEs with sufficient sectoral and stage dispersion;

- **A Microfinance Scheme** could be set-up to be managed by a financial intermediary(ies) for direct lending to SMEs. Such a scheme would be used to “jump-start” the microfinance industry in Cyprus and could be at the range of EUR 5 m.

- A pilot allocation of approximately EUR 15 – 18 m for **Venture Capital** investing mostly in early stage / start-up and expansion stage companies.

- **Incubation Fund** for Incubatee Companies. A dedicated incubation fund indicatively in the range of EUR 10 – 15 m could invest in incubatee companies.
A Side-car type fund to co-invest with Business Angels could be developed. The size of such a fund should be discussed if and when such measures are to be implemented depending on the state of the market at the time.

All the measures above are sector independent except the proposal related to an Incubation Fund which has a definite technology focus.

Thus, an initial portfolio of specialised instruments amounting to a range of EUR 45 – 63 m is recommended to be set up through the means of the European Regional Development Fund (ERDF) allocation for Cyprus for the planning period 2007 – 2013 to alleviate those conditions that hamper the Cypriot SMEs access to finance.

It is evident that at this stage - the Preparation Phase, this non-exhaustive list of proposals is of indicative nature. The proposed capital allocation per instrument is subject to revision and the structure and operations of each instrument is yet to undergo a process of fine-tuning so as to improve possible synergies with existing market players. The discussions on specifying the form of the proposed instruments, their size and the selection of the most eligible institution for their implementation will continue during the finalisation of the JEREMIE evaluation report. It is important to build the entire portfolio of the JEREMIE Programme on a central level. Further consultations with market participants, banks and SME organisations will be undertaken during the finalisation of the proposed instruments so as to gauge the potential intermediaries’ opinions and interest regarding the proposed instruments.

Coordination of Recommended Actions

This initial assessment is focused on the understanding of the financing of the Cypriot SME market and on determining the demand and supply financing levels of different market segments and other types of financing. The proposals are described in the next sections and they are to be considered as a portfolio of initiatives.

Consultations with the main market players, public or private organisations and entities will take place so as to ensure the most efficient implementation of the initiatives and the optimal allocation of funds.

Strategic Priorities and Policies

The analysis and the measures proposed take into consideration the main guidelines in the National Strategy Reference Framework (NSRF) of the Cypriot Government as well as the recommendations and requirements of the EU in this sphere. NSFR defines the main national tasks and priorities as well as the most important challenges of the policy for economic development.

As defined in the National Reform Programme (NRP), Cyprus’ key priorities are:

- Improve the quality of public finances via a redirection of public expenditure;
• Increase the diversification of the economy towards higher value added activities via, mainly, an increased utilisation of the comparative advantages of the island;
• Promotion of R&D and innovation and facilitation of ICT diffusion;
• Structural reforms targeting at enhancing competition and improving the overall business climate;
• Upgrading of basic infrastructures;
• Further human capital development:
  o Enhancement of the links of the educational system to labour market needs
  o Development of a comprehensive national framework for lifelong learning
  o Continuous upgrading and adaptability of skills to labour market needs
• Further enhancement of the conditions of social cohesion;
• Ensuring environmental sustainability.

In addition, the analysis takes into consideration the Lisbon Strategy. The national measures towards the Lisbon strategy aim at creating a dynamic and competitive economy which will deliver high growth and living standards for the citizens of Cyprus. A healthy and stable macroeconomic environment underpinned by sound fiscal and monetary policies, is a prerequisite for the successful implementation of these reforms. Policies to enhance investment in physical and human capital, research and development, and the country’s infrastructures are essential.

The enhancement of productivity and of the competitiveness of the economy constitute core elements of the Programme which will help raise long-term growth, but will also make the transition and participation to the eurozone easier.

The proposed measures should be seen and applied in this context and improve the access to financing, creating new financial instruments supporting SMEs and developing innovations.

Overview of SME Environment

In order to better understand the Cypriot SMEs market environment it is worth taking into account the following considerations:
• The vast majority of enterprises are micro enterprises (approximately 94%14 are enterprises that have an annual turnover less than EUR 1 m and less than 10 employees).
• The main reason for an individual to plan to create a new enterprise is because of “necessity” (e.g. unemployment, very low salaries) and not because of the “opportunity”.

14 Cypriot Statistical Service.
• The majority of enterprises are involved in activities related to a final consumer (imports, restaurants, etc.) and not the production of high-quality innovative products and services.

• The fear of failure is the main reason for not proceeding to the creation of an enterprise. In addition, in Cyprus, women entrepreneurship is ‘difficult’ (social discouragement, absence of structures and lack of services especially for women with a family).

• The enterprises with a financial and commercial risk above the market average (e.g. enterprises under establishment, enterprises of the “new economy”, viable enterprises with liquidity problems etc.) as well as those that cannot offer sufficient collateral either cannot be financed by the financial system or in case they are financed, the cost and the collateral required are high.

For all those reasons, a large number of enterprises do not approach the banking and financial system, but they use sources of financing such as personal and friends and family funding and/or even personal loan to set up their enterprises.

In conclusion, the Cypriot SMEs have permanent needs for financing during their whole life cycle, which are not sufficiently covered by the existing financial system.

**Major Market Failures and Proposed Instruments**

This report assesses the existing supply and demand of financial engineering instruments supporting SMEs in Cyprus and proposes instruments to decrease the gap given the proven market failure in this area. The existing public support measures supporting SME access to finance were assessed as far as possible; details are shown in chapter 3.1 of this report. The macroeconomic and SME environment are analysed in chapter 2.4 as background information for the development of the financial engineering instruments.

The identified market failures and weaknesses of the Cypriot SME financing market mainly lie in the area of SME financing by the commercial banks in particular segments (micro financing, guarantees) and in the under-development of the venture capital investments and technology transfer / innovation development activities.
The proposed instruments might cover more than one market segment, as exact borders between the segments do not exist. The proposed measures form the investment portfolio under the JEREMIE Programme focusing on:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Approximate portfolio share</th>
<th>EUR m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantees</td>
<td>36.5%</td>
<td>15 - 25</td>
</tr>
<tr>
<td>Micro financing</td>
<td>9.5%</td>
<td>5</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>31.0%</td>
<td>15 - 18</td>
</tr>
<tr>
<td>Business Incubators</td>
<td>23.0%</td>
<td>10 - 15</td>
</tr>
<tr>
<td>Business Angels</td>
<td>N/A</td>
<td>TBD</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>45 - 63</strong></td>
</tr>
</tbody>
</table>

The EIF proposes to the Cypriot authorities in charge to implement the recommendations made in the Interim Report with regard to the proposals to the Commission for the next planned period between 2007 and 2013. All proposed amounts should be considered as indicative. A follow-up review is necessary, which will be finalised in the period of completing the assessment. EIF will strive to actively engage in the discussion all parties related to the issue to ensure that the JEREMIE initiative will raise added value to the Cypriot economy and will be applied successfully in partnership with the participating institutions.

A questionnaire and interview survey has been conducted on Cyprus SMEs active in various economic sectors. Based on data collected, the following inferences can be drawn concerning the financial needs of SMEs in Cyprus. The final results of the survey are presented in Appendix 6.6.

Main market failures arising from the gap analysis:

- The existing micro-financing schemes do not cover the potential demand of potential and existing micro enterprises;
- A quarter (approximately 25%) of Cypriot enterprises does not access the credit market (either by choice or due to inability/failure to obtain a loan) and thus resort to own resources or family and friends to satisfy their financing needs.
- High lending costs (primarily) and level of collateral (secondarily) are perceived to be the main discouraging factors for SMEs in accessing the financial system.
- Existing guarantee schemes have had a limited effect on SMEs; a Government Guarantee scheme was put in place for manufacturing companies in the past however it did not meet the expected targets;
- Venture capital is not well developed in Cyprus; private equity investors are mainly active in well established enterprises at later stages of development (late expansion, mezzanine financing, MBO/LBO and pre-IPO). Risk investments in start-ups are rare; there is no Venture Capital Association existing;
• The Business Angels segment is still to be developed in Cyprus. The legislative framework necessary for its establishment and operation as well as a formal Business Angels Network do not yet exist;

• Enterprises without collateral, “new economy” enterprises, women and immigrants have difficulty in accessing or are rejected by the banking system.

3.3 Denmark (June 2006)

Statement of Position

Through the process of research and evaluation required for the purposes of the creation of this ‘Interim Report’, the European Investment Fund (EIF) has reached the following initial conclusion.

'There is substantial benefit to be gained by Denmark from the implementation of a JEREMIE programme representing a financial commitment in the range of approximately €250 million across the next funding period for the purposes of improving SMEs access to finance with related support activities. The programme would need to adopt the appropriate portfolio of financial engineering instruments as identified in the report and would need to be implemented jointly with all relevant authorities, namely the National Agency for Enterprise and Construction (EBST) and Vaekstfonden (formerly known as the Danish Growth Fund) and organised in a way to maximise the involvement of the private sector and with the clear objective of being 'evergreen' in nature. For such a portfolio to be 'evergreen', it must be balanced in nature and not shift to overweight positions in any specific instrument. Additionally, the fund needs to retain a degree of flexibility to respond to dynamic market conditions. It is important to note that the estimated financial commitment figure given above relates to a portfolio of proposed financial engineering instruments that seek to address observed market failures, weaknesses or gaps within Denmark.

The key six investment proposals are as follows:

1. A guarantee instrument of up to €22.5 million to be made available to selected Microfinance institutions to deliver micro loans to the socially-excluded population in Denmark.

2. A guarantee instrument of up to €17.5 million to be made available to selected banks to deliver ‘Get Started’ (Kom-i-gang) Loans to first-time entrepreneurs.

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15 The term ‘evergreen’ refers to when the fund is receiving fees and returns on investments that are greater than any losses and costs involved.

16 There are two additional proposals explained in section 2.7 which are not investment-related.
3. Equity funding of up to €80 million to be made available to a new ‘Business Angel Matching Fund’ to co-invest in SMEs with selected Business Angels spread across all Danish regions.

4. Equity funding of up to €25 million to be made available to pilot and then expand a ‘Proof of Business Concept Fund’ acting as a technology transfer instrument to enable Denmark’s well-respected R&D centres to resolve known business issues for SMEs.

5. Equity funding of up to €62.5 million to be made available to kick-start three regional Seed Capital funds with private market participation of 75%.

6. Equity funding of up to €37.5 million to be made available to create 5 new regional Risk Capital funds in cooperation with the banking sector to invest in higher risk SMEs.’

During the full Evaluation period, the EIF will continue to work with the appropriate regional authorities to define the exact nature of these investments proposals and the most appropriate legal structures to adopt. It is important that the overall portfolio approach to JEREMIE is kept at a central level but with clear regional implementation implications. It is envisaged that the appropriate governance structure would include the formation of a ‘JEREMIE Fund Management Committee’ with representatives appointed by EBST and to include representatives from each of the Regional Development authorities.

In addition, further consultation of the proposals will need to be undertaken directly with market participants and selected SME industry entities to ensure the programme is realistic and operational in nature. Validation with private market participants is envisaged to ensure there is no ‘crowding out’ effect created by the proposals and to fully engage private market capital in the process. This process may lead to adjustments in the final proposals.

Coordination of Recommendation Actions

The initial evaluation has focused upon understanding the current market within Denmark and has sought to understand the levels of demand for finance across several market segments set against the trends in the provision of different finance types. The series of recommendations are therefore presented in the following section however, it is important that they are viewed as a portfolio of initiatives.

‘It is critical that these recommendations are viewed as a whole and not as a series of separated activities. The success of each element is dependent upon the coherent nature of the activities to ensure that the entire spectrum of SME-financing stages are adequately supported and that a continuum of support is provided throughout the distinct growth stages that SMEs face. Additionally, for the overall JEREMIE initiative to succeed in delivering a ‘revolving’ capability, the entire Holding Fund needs to be managed appropriately. The appointment of a qualified ‘managing institution’ is
required to ensure this is the case, with clear terms of engagement and objectives.’

The key market participants that have been involved in the initial analysis and need to be closely involved in any future implementation program include:

• The National Agency for Enterprise and Construction (EBST)
• Vaektsfonden
• The Six Regional Development entities within Denmark

Denmark’s Strategic priorities and policies

Furthermore, this analysis needs to be viewed within the context of the development of the Danish Government’s National Strategic Reference Framework. Several important and connected areas of focus are worthy of note. In particular, Denmark’s strategic reference framework constitutes the overarching framework for Denmark’s Structural Fund policy for the next funding period and the document identifies the most significant growth-related policy challenges and specifies a number of national goals, which the Structural Fund policy shall be instrumental in supporting to strengthen the EU’s overall competitiveness and employment.

The document indicates that Denmark’s policy will focus on four fields of action:

• Development of human resources;
• Innovation, knowledge sharing and knowledge building;
• Utilisation of new technology; and
• Establishing and developing new enterprises.

It is within this context that the proposals within this report need to be placed and ultimately implemented. The ‘four fields of action’ appear to be consistent with the focus of the proposals and their expected results. Denmark’s focus on the development of ‘growth enterprises’ is commendable and a logical extension of their recent policies on entrepreneurship. Growth-orientated SMEs are known to utilise these aspects in developing their businesses if appropriate sources of finance are available.

In 2004, Denmark had 227,236 SMEs that had fewer than 10 employees. In 2003, this number had been increased around 14,000 and the current and future annual net growth rates of between 5 and 8.5% are expected. This enterprise creation rate is one of the highest in the EU and whilst this is a positive factor, only a small proportion of these SMEs could be described as ‘growth enterprises’ or operating within high growth sectors. However, fatality rates of small businesses are high (up to 70% in the first 5 years) but given current trends Denmark should expect to see continued growth in this sector, possibly reaching 280,000 Micro SMEs by the year 2013.

Also connected to this process is the growing element of regional differences within Denmark that have been recognised as continuing throughout the previous period. The new regional structure to be implemented in Denmark from 2007 is an additional and relevant element in this evaluation process. All proposals within this report have been constructed from a national perspective but it is recognised that once
formed, the regional authorities will play the critical role in the final agreement and implementation of the proposals.

Overview of Recommendations – Denmark

The following two tables illustrate the initial conclusions of the evaluation.

The first table sets out an overview of the SME market segments (including the segment labelled ‘socially excluded individuals’) and the current macro-level data for each. The main aspects of supply of finance trends are also shown. Greater detail is provided within the sections of this report and the Appendices to support these conclusions.
Many aspects show a strengthening overall picture in terms of market demand and the evolution of the SME environment. Given current trends, it is estimated that by 2013, Denmark will have approximately 280,000 Micro SMEs based upon current birth and fatality rates\(^\text{18}\).

**Supply Side Projections**

Current trends within the major various sources of finance have been analysed with projections of future expected growth trends made across to the year 2013. Where possible, a full understanding of the levels of current public support of these finance types has been made where it exists and where it does not. For example, until now there is no evidence of public money being used to support or promote investments made by Business Angels\(^\text{19}\) or in support of the Leasing and Factoring sectors. Whilst there are known initiatives of delivering support to Debt finance providers, due to

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\(^{17}\) The definitions used are taken from ‘The new SME Definition – User Guide and model declaration’ published by the European Commission in May 2003 and accepted by the European Commission effective January 1st 2005.

\(^{18}\) A recent Global Entrepreneurship Monitor Report for 2005 showed Denmark to high the highest ‘new firm birth rate’ of the 35 countries reviewed showing an increase of 16.3% for 2003-2004.

\(^{19}\) Business Angels are wealthy individuals prepared to invest between €10,000 and €200,000 or even higher in a start-up, early-stage or developing firm. They often have managerial and/or technical experience to offer the management team as well as equity and debt finance and take a medium to long term investment horizon.
the limitation in available statistics, it is not possible to state the overall level of support for any given year.
Nevertheless, this type of analysis enables an understanding of the current and future levels of public support to each different source of finance. For example, in Denmark in 2005, the total amount of venture capital investments reached € 356.6 million of which 22.9% or € 81.7 million are estimated to be through public support. With an estimated future growth of 15% per annum (presently 28.7% in 2005), this would imply that by the year 2013, the total estimated venture capital investments in Denmark would reach € 1,090 million. If the relative level of public support is continued, it would imply a public investment program of € 249 million in the year 2013. The monetary size of the proposals included in this report bear such estimations in mind.

The second table shows an overview of the identified ‘Market Failures and Weaknesses’ within the Danish market. More detail on the evidence of Market Failures within Denmark is given in section 2.2.

Table 2 – Examples of Market Failure and related proposals

<table>
<thead>
<tr>
<th>Evidence of “Market Failures” in Denmark</th>
<th>Key JEREMIE Proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero or low provision of ‘Microfinance’ credit for SME creation to population at risk of poverty. Limited adoption of ‘Get Started Loans’.</td>
<td>Expansion of KfG loans via Banks to deliver 1,000 loans (averaging € 39,000 ) over period. JEREMIE Guarantee (to 50%). Targeted at regions.</td>
</tr>
<tr>
<td>Seed Capital investments in absolute and relative decline for 4 years (well below EU average).</td>
<td>JEREMIE funding for FoF equity into 3 Regional Seed Capital Funds (East, North &amp; West). Target of € 100m with 25% JEREMIE participation. East Fund 50% financed today.</td>
</tr>
<tr>
<td>Worsening regional disparities in equity investment via VC Funds &amp; Business Angels with clear concentration around Capital region.</td>
<td>New Business Angel Matching Fund using JEREMIE funding to 50%. 20 deals per year, 4 year revolving, split 50/50 with selected BA’s, spread across regions.</td>
</tr>
<tr>
<td>Relative to Peer Group (Swe, Fin, UK), poor record of Technology Transfer from R&amp;D centres or business use of R&amp;D expertise.</td>
<td>Proof of Business Fund Pilot using key R&amp;D centres to solve business issues. 3 – 5 projects in Year 1 (€5m). Phase 2 -&gt; 25% JEREMIE Funding of €80m Fund.</td>
</tr>
<tr>
<td>Reduced appetite by Banks to lend to higher risk SMEs due to costs, risks and assessment expertise.</td>
<td>Bank driven process to create 5 new Regional Risk Capital Funds targeting High Risk SMEs. JEREMIE to provide 25% of €30m regionally focused funds.</td>
</tr>
</tbody>
</table>

The total size of the portfolio and the individual size of the proposals are based on understanding the size and dynamics of the SME market in Denmark at present and on the known realities of instrument sizes from practical experience. The portfolio also reflects the acceptable size of ‘public money’ intervention in a market the size of Denmark and whilst this process is not an exact science, the proposed portfolio represents a lesser commitment of public money per annum than has been invested over the last few years.

These proposals need to be viewed as a portfolio as they address a number of issues across the various market segments in Denmark.
In some cases the proposed instruments actually cover more than one market segment which is to be expected as in reality the defined borders between segments do not exist in black and white. The amounts proposed should be considered as estimates only. Each of these proposals is explained in detail in section 2 of this report.

These proposals effectively combine to create a JEREMIE investment portfolio which can be viewed as concentrating on instruments areas in the following way:-

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Portfolio Split</th>
<th>Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance</td>
<td>9%</td>
<td>(€ 22.5 m)</td>
</tr>
<tr>
<td>Guarantees</td>
<td>7%</td>
<td>(€ 17.5 m)</td>
</tr>
<tr>
<td>Equity instruments</td>
<td>84%</td>
<td>(€ 210 m)</td>
</tr>
</tbody>
</table>

It is possible to argue that this view of the portfolio shows an imbalance towards equity instruments which in numerical terms is true. However, this report and the proposals within it reflect the Danish government policy towards building ‘growth enterprises’ as opposed to just creating SMEs. Hence the various equity instruments will focus on the potentially higher growth sectors and are seen as an extension to the shift in government policy towards this goal in recent years²⁰.

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²⁰ The potential impact of the imbalance of the portfolio will be explored in the full evaluation process.
Further Evaluation

During the full Evaluation period in the second half of 2006, more detailed research and validation of this proposal will be completed. This process will involve detailed discussions with ‘market participants’ in order to gain opinions on the impact of the proposals and to avoid the possible effect of ‘crowding-out’. Three separate additional elements of research are proposed:

1. A market consultation process should be undertaken by the EIF and Vaekstfonden in before the end of 2006 to ensure that the proposals do not create any negative effects and to maximise the ongoing private market support for the eventual JEREMIE activities (see section 2.8).

2. An additional element of research is to be undertaken to further understand the size of the ‘socially excluded individuals’ segment within Denmark that have a banking relationship but do not have the opportunity to obtain credit or loans for the purpose of creating an entrepreneurial activity. Whilst Denmark does have some experience of the ‘Iværksætterydelsen’ programme which is perceived to have not been successful, it would seem appropriate that the ‘Centre for Economic & Business Research’ in Copenhagen, the Aarhus Business School or the FORA research unit are all well placed entities to assist in this validation exercise.

3. As location is a key element in the decision of investment for Business Angels, a further piece of analysis to understand the actual geographic coverage of Denmark’s Business Angel community is required. It would seem appropriate that a combined effort between Vaekstfonden and the Danish Business Angels Network could complete this exercise.

The Full Evaluation Report (to be completed before the end of 2006) will provide further detail on the proposed recommendations, feedback from the market consultation exercise, confirmation of the amounts involved and a finalisation of the appropriate structures required. Furthermore, a view of the relative position of Denmark to other EU nations will be developed in the context of the overall JEREMIE initiative. Until this point, this interim report can only be regarded as indicative at this stage.

Conclusion

The European Investment Fund proposes to the Member State that it adopts the recommendations of this Interim Report in any proposals that it may need to provide to the Commission and in the planning for the next Funding period of 2007 to 2013. The EIF is committed to working closely with the Danish authorities to develop and implement the proposals made in this report.

All proposed figures are provided as indications only and further validation will be required and will be completed during the full evaluation period. However, based on the initial analysis, the European Investment Fund believes a structured programme of initiatives as explained in this report, under the JEREMIE umbrella, will contribute importantly to the development of the SME sectors in Denmark and strongly contribute towards Denmark achieving its goals in this area.
The EIF will proactively seek to engage in discussions with all appropriate parties to ensure that the JEREMIE initiative adds value to the Danish economy and is successfully implemented in partnership with the entities involved.
In addition, although out of the scope of the JEREMIE exercise, it is recommended that Vaekstfonden and the European Investment Fund share their experiences on how to manage guarantee instruments in order to find a more efficient process for Vaekstfonden. Vaekstfonden may benefit from the EIF's experience of managing a 'portfolio guarantees' product line utilising a capital base of over € 9.3 billion in partnership with over 165 financial intermediaries. Whilst both companies are active in this instrument area, the internal management processes and the nature of agreements with intermediaries are fundamentally different. Depending upon the outcome of such a 'best practice sharing' exercise, there may be scope for JEREMIE funding to be utilised in addressing any issues that arise.

3.4 Estonia (September 2007)

Statement of Position

This report recommends a number of complementary measures addressing the market failures identified in the evaluation of access to finance of micro, small and medium size enterprises (SMEs) in Estonia. These measures intend to propose an effective use of the EU Structural Funds allocated in the framework of the Operational Programme (OP) for 2007-2013 in view of supporting growth, innovation and employment.

The present Report has identified the following financial instruments that could be implemented in the period 2007-2013:

- Guarantee Scheme for Micro and start-up companies amounting to EUR 15m;
- Strengthening of the national Guarantee Scheme for an amount of EUR 20m;
- Strengthening the national Subordinated Loan programme for an amount of EUR 10m;
- A Pan-Baltic private equity fund with a minimum size of EUR 30m, with a public contribution from Estonia of EUR 5m;
- A Business Angels co-investment fund with an initial size of EUR 5m;
- A pre-seed technology transfer fund with a minimum size of EUR 15m.

Thus, instruments for a total amount of EUR 70 m are recommended.

Further consultations with market participants, banks and SME organisations are recommended to be undertaken during the implementation phase in order to assess whether the proposed instruments are considered as realistic and useful for the market. In this context, it is important to point out that the proposed measures are intended to catalyse private investments rather than crowding out private players.

This evaluation report was prepared by the EIF and is considered as final after presentation to the Managing Authority and incorporation of feedback received.
Subject to a positive decision by the government on the implementation of the JEREMIE initiative in cooperation with the EIF, further work is to be done to complete the evaluation and prepare for implementation. These tasks include the establishment of the legal framework, business planning and modelling of flows, organisational, governance and procedural issues.

Coordination of Recommended Actions

This initial assessment is focused on the understanding of the financing of the Estonian SME market and on determining the demand and supply financing levels of different market segments and other types of financing.

The main market players included in the initial analysis, which are recommended to participate in the future implementation of the programme are:

- Ministry of Economic Affairs;
- Estonia Enterprise;
- Kredex;
- Regional Development Centres;
- Banks;
- Associations of branch industries (Credit Unions).

Strategic Priorities and Policies

The analysis and the measures proposed in this report take into consideration the main guidelines in the Operational Programme of the Estonian Government as well as the recommendations and requirements of the EU in this area.

The new Estonian enterprise policy will be carried out according to a detailed 3-year action plan that outlines the specific development actions and the organisations responsible for their implementation. The development of the enterprise policy is coordinated by the Ministry of Economic Affairs and Communication.

The main areas of intervention are:

- Development of know-how and entrepreneurial skills;
- Investment support;
- Support for internationalisation;
- Improvement to the legal environment.

The financial engineering instruments recommended in this report should be seen and implemented in this context.

Overview of SME Environment

As of 1 January 2006, 73,926 companies were registered in Estonia. In terms of economic activity, trade (37% of total) and real estate companies (24% of total) lead the market.
The absolute majority (over 99%) of Estonian enterprises are micro enterprises with 1 to 9 employees. Overall the SME sector share of total private sector employment is approx. 77%.

<table>
<thead>
<tr>
<th>SMEs by number of employees</th>
<th>% of all SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>18%</td>
</tr>
<tr>
<td>1-9</td>
<td>63%</td>
</tr>
<tr>
<td>10-49</td>
<td>16%</td>
</tr>
<tr>
<td>50-249</td>
<td>3%</td>
</tr>
</tbody>
</table>

The main sectors in terms of value added are real estate (18.8%), manufacturing (16.8%), wholesale and retail trade (15.2%) and transport (12.1%). The main industries in manufacturing are traditional food and wood industry.

SMEs access to debt finance is relatively good and improving (e.g. the launch of a start-up loan programme in 2006 by Hansabank), while access to private equity is more difficult as there is a scarcity of private investment in the small national market.

Major Market Failures and Proposed Instruments

This report endeavours to assess the existing supply and demand of financial engineering instruments supporting SMEs in Estonia and proposes instruments to address the identified market failures. The macroeconomic and SME environment are analysed in chapter 2 as background information for the development of the financial engineering instruments. The existing public measures supporting SME access to finance are assessed in chapter 3 and 4 of this report.

The following market failures for SME financing were identified:

- The existing and planned start-up and micro-financing schemes do not cover the potential demand of potential and existing micro enterprises;
- Entrepreneurs mainly have to rely on financing by own means for starting-up a business;
- There is a strong need to encourage banks to build SME loan portfolios to decrease the lack of debt-financing for SMEs in Estonia;
- Existing guarantee schemes have limited resources and mainly rely on external support in order to continue their activity;
- The existing mezzanine finance schemes do not cover the potential market and the public mezzanine loan programme recently launched has

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insufficient funds available;

- Insufficient private equity investments in the pre-seed, seed and start-up segments;

- Gap of expansion investment for the smaller established companies needing capital to increase production capacity, working capital and capital for the further development of the product or market;

- Insufficient level of Business Angels activity.
In order to address these market gaps, a set of recommendations concerning the setting up of new, or strengthening of existing financial instruments has been made with the following allocation of resources:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Portfolio Share</th>
<th>Million EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantees</td>
<td>28.6%</td>
<td>20</td>
</tr>
<tr>
<td>Subordinated loan facility</td>
<td>14.3%</td>
<td>10</td>
</tr>
<tr>
<td>Micro and Start up finance</td>
<td>21%</td>
<td>15</td>
</tr>
<tr>
<td>Venture Capital - Pan-Baltic</td>
<td>7%</td>
<td>5</td>
</tr>
<tr>
<td>Business Angels</td>
<td>7%</td>
<td>5</td>
</tr>
<tr>
<td>Pre-seed tech. transfer fund</td>
<td>21%</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>70</td>
</tr>
</tbody>
</table>

The size of the proposed measures is based on the estimated absorption capacity of the market for each instrument, taking into consideration the nature of the instrument (VC funds, guarantees, co-investment funds, etc.) and the current and future levels of development of the market. It is important to point out that all proposed amounts should be considered as indicative, and that further analysis of the situation is needed in order to determine the feasibility of the proposed measures and to quantify the financial resources required.

EIF has started to actively engage all relevant parties in the discussion related to this issue to ensure that the initiative will raise added value to the Estonian economy and will be applied successfully in partnership with the participating institutions.

3.5 France

3.5.1 Basse-Normandie (November 2007)

Statement of Position

The report recommends a range of complementary measures to overcome the “market failures” enumerated in the access to finance report for the micro, small and medium size enterprises in Basse-Normandie (France). It identifies the most relevant focus for the JEREMIE holding fund taking into account the available supply of finance and the existing and potential demand to be covered. The directions to be set for the JEREMIE holding fund are largely determined by the available intermediaries’ ability to deliver funding adapted to the current and future needs of the SMEs. These measures are in line with the use of the structural funds allocated to the region Basse-Normandie as part of the Operational Programme 2007-2013 in order to promote growth, innovation and employment. EUR181.35m is devoted to the regional strategy for Basse-Normandie’s ERDF Operational Program 2007-2013. The recommended size of the JEREMIE Holding Fund in Basse-Normandie should range between EUR18 to 35m.
Discussions concerning the size and the types of instruments or the means of financing aimed at enhancing the capacity of intervention of the existing intermediaries will be continued at the beginning of the operational phase, within the steering committee and with the managing authority. At the national level, talks with the public institutions, the intermediaries’ network and the banks will progressively lead to the definition of the optimal means of operating in France. So far, the optimal structure seems to be of one or several “matching funds”\textsuperscript{22}. The JEREMIE program is designed to act as a catalyst for the existing types of financing, and to cooperate with the current intermediaries or operations.

The EIF has begun to engage an active dialogue with all the stakeholders, in order to ensure that the JEREMIE program will provide an important added value to Basse-Normandie’s regional economy and that it will be successfully set up in partnership with the institutions concerned.

Conclusions

The analysis of the existing supply and current and potential demands in Basse-Normandie leads to the identification of a series of gaps in the available financing possibilities granted to the micro, small and medium-sized enterprises in Basse-Normandie.

Examining the activity of the existing intermediaries has made possible the evaluation of the supply and the level of the existing demand matches the demand covered by the supply. The assessment of the potential demand is made through taking into account the activity of current financial intermediaries, characterizing the economic and social environment and its evolution.

The main market failures or gaps identified in the supply of funding for the regional micro, small and medium-sized enterprises are the following ones:

- The lack of available resources of microfinance funding, for economical and social microenterprises, able to face the existing demand and the forecasted increase in the creation of economic activity;
- The lack of funding for expansion capital on the low to medium level of intervention;
- The missing segment of seed capital for innovative projects start-ups;
- The shortage of regional guarantees for banking credits;
- The insufficient presence on the market of private investors or business angels.

In order to overcome these market failures and the future gaps between the supply of finance and the estimated needs of funding of the regional SMEs, the allocation of resources of the JEREMIE holding fund could be set up as follows:

<table>
<thead>
<tr>
<th>Financial instrument</th>
<th>Ventilation of the portfolio</th>
<th>EUR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microcredit</td>
<td>25%</td>
<td>5</td>
</tr>
</tbody>
</table>

\textsuperscript{22} The matching funds allow increasing the capacities of intervention of the intermediaries by co-financing projects usually financed exclusively by the intermediaries.
<table>
<thead>
<tr>
<th>Description</th>
<th>Percent</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed funding for innovative project start-ups</td>
<td>15%</td>
<td>3</td>
</tr>
<tr>
<td>Funding for strong potential SMEs (small amount)</td>
<td>5%</td>
<td>1</td>
</tr>
<tr>
<td>Banking credit guarantees</td>
<td>15%</td>
<td>3</td>
</tr>
<tr>
<td>Support to equity investment</td>
<td>35%</td>
<td>7</td>
</tr>
<tr>
<td>Business angels</td>
<td>5%</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100%</td>
<td>20 M€</td>
</tr>
</tbody>
</table>
Such an allocation of resources answers the need to create new instruments or reinforces the capacity of intervention of the existing instruments.

At this stage, development of new financial engineering tools remains only hypothetical. It will be the responsibility of the future holding fund manager to define the appropriate modality of support these segments of the funding of the microenterprises and SMEs. Close collaboration with the relevant partners, including national institutions such as OSEO and CDC, will be necessary.

The extent of the measures forecasted is based on the evaluation of the activity of the existing intermediaries and on their capacity to answer the existing and potential demand. The allocation of resources is indicative. Further analyses drawn with the intermediaries will lead to a more precise assessment of the sums proposed.

3.5.2 Champagne-Ardenne (December 2008)

Summary

The report recommends a range of complementary measures to overcome the “market failures” enumerated in the access to finance report for the micro, small and medium size enterprises in Champagne-Ardenne (France).

It identifies the most relevant directions for the JEREMIE program taking into account the available supply of finance and the existing and potential demand to be covered. The directions to be set for the JEREMIE holding fund are largely determined by the existing intermediaries’ ability to deliver funding adapted to the current and future needs of the SMEs.

These measures are in line with the use of the structural funds allocated to the region as part of the 2007-2013 Operational Programme designed to promote employment, competitiveness and growth in Champagne-Ardenne. EUR 185m is devoted to the regional strategy for Champagne-Ardenne’s ERDF Operational Program 2007-2013.23

The recommended size of the JEREMIE Holding Fund in Champagne-Ardenne should range between EUR 15.5m to 25.5m.

Discussions concerning the size and the types of instruments or the means of financing aimed at enhancing the capacity of intervention of the existing intermediaries will be continued at the beginning of the operational phase, within the steering committee and with the managing authority. At the national level, talks with the public institutions, the intermediaries’ network and the banks will progressively lead to the definition of the optimal means of operating in France. So far, the optimal structure seems to be of one or more “matching funds”24. In any case, the JEREMIE program is designed to act as a catalyst for the existing types of financing, and to cooperate with the current intermediaries or operations.

24 The matching funds allow increasing the capacities of intervention of the intermediaries by co-financing projects usually financed exclusively by the intermediaries.
Conclusions

The analysis of the existing supply as well as current and potential demand in Champagne-Ardenne has led to the identification of a series of financing possibilities granted to the micro, small and medium size enterprises.

The examination of the activity of the existing intermediaries has enabled supply estimates. The assessment of the potential demand has been established by taking into account the activity of current financial intermediaries, characterizing the economic and social environment and its evolution.

The existing supply for enterprises' access to finance in Champagne-Ardenne is strong and no substantial gap is to be noticed. Market segments in all stages of enterprise development seemed to be covered with the only likely exception being the seed stage enterprise financing. In light of current social and economic trends, future gaps between existing supply and potential demand are however likely to occur. The potential demand by SMEs for access to finance is increasing and unlikely to be matched by existing supply. Current trends have been identified as follow:

A gap in seed funding for innovative project enterprises has been observed, i.e. in forms of 'prêts d’honneur'. This market segment is of particular importance since it allows actors such as OSEO to be mobilised, the sources of which can be crucial in the process of enterprise development, as well as in re-directing enterprises towards other providers (i.e. Champagne-Ardenne Croissance).

Efforts made by local policymakers to develop policies favouring innovation indicate that the capital creation segment, including seed funding, could require immediate support beyond the existing one provided by CAC.

Beside enterprises' support, the trend towards increased enterprise creation is expected to boost demand from project holders on the other market segments. Improvements in the deal-flow responding to the varied market segments have been identified as follows:

Enterprise creation has increased for some years and is likely to further increase;

A potential catch up process in the service sector is likely to occur as shown by the recent trend of enterprise creation in the sector;

The stock of regional takeover is a future stake;

Self-employment is becoming a key issue in Champagne-Ardenne;

The objective of territorial cohesion shared by local partners brings enterprise creation at its core as a means to contribute balanced economic development.

JEREMIE is of crucial importance in answering the potential increased demand for SMEs to access finance in the region Champagne-Ardenne in the course of the period 2007-2013. JEREMIE responds to the current public policy concerns of supporting and developing enterprises through ERDF Operational Programs and its strategic objectives.
In order to overcome market limitations and to anticipate the likely gap between the supply of finance and the potential demand by local SMEs, the allocation of resources of the JEREMIE holding fund could be firstly set up as follows:

<table>
<thead>
<tr>
<th>Financial instrument</th>
<th>Breakdown portfolio</th>
<th>of the portfolio</th>
<th>EUR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microcredit</td>
<td>25%</td>
<td></td>
<td>3,75</td>
</tr>
<tr>
<td>Seed funding for innovative project start-ups</td>
<td>8%</td>
<td></td>
<td>1,25</td>
</tr>
<tr>
<td>Funding for high potential SMEs (small amount)</td>
<td>3%</td>
<td></td>
<td>0,5</td>
</tr>
<tr>
<td>Support to capital investment</td>
<td>33%</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>Banking guarantee</td>
<td>13%</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Business Angels</td>
<td>3%</td>
<td></td>
<td>0,5</td>
</tr>
<tr>
<td>Diversification of the Holding Fund</td>
<td>13%</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td></td>
<td><strong>15 M€</strong></td>
</tr>
</tbody>
</table>

Such an allocation of resources answers the need to create new instruments and reinforces the capacity of intervention of the existing instruments. The availability of ERDF via JEREMIE to local actors within a smooth and simplified framework provides additional support to their activity to bridge the expected gap between increasing demand and supply of finance on the various market segments.

At this stage, development of new financial engineering tools remains hypothetical. The responsibility to define the appropriate modality of support to these segments of microenterprises and SMEs funding remains to the future holding fund manager. Close collaboration with the relevant partners, including national institutions such as OSEO and CDC, will be necessary.

The extent of the measures forecasted is based on the evaluation of the activity of the existing intermediaries and on their capacity to answer the existing and potential demand. The allocation of resources is indicative. Further analyses drawn with the intermediaries will lead to a more precise assessment of the sums proposed.

The EIF has engaged in an active dialogue with relevant stakeholders. Nevertheless no particular interest has been identified at this stage in implementing JEREMIE in Champagne-Ardenne. This report however assumes its implementation.
3.5.3 Guyane (November 2007)

Statement of Position

The report recommends a range of complementary measures to overcome the “market failures” enumerated in the access to finance report for the micro, small and medium size enterprises in Guyane (France). It identifies the most relevant focus for the JEREMIE holding fund taking into account the available supply of finance and the existing and potential demand to be covered. The directions to be set for the JEREMIE holding fund are largely determined by the available intermediaries’ ability to deliver funding adapted to the current and future needs of the SMEs.

These measures are in line with the use of the structural funds allocated to the region Guyane as part of the Operational Programme 2007-2013 in order to enhance Guyane’s competitiveness and to accelerate the convergence of its economy within the European Union through improving growth and employment conditions. EUR 256.8 m is devoted to the regional strategy for Guyane’s ERDF Operational Program 2007-2013, plus EUR 48.3 m additional funds as Guyane is eligible for FEDERUP specific allocation. The recommended size of the JEREMIE holding Fund in Guyane should range between EUR 17m to 31m.

Discussions concerning the size and the types of instruments or the means of financing aimed at enhancing the capacity of intervention of the existing intermediaries will be continued at the beginning of the operational phase, within the steering committee and with the managing authority. At the national level, talks with the public institutions, the intermediaries’ network and the banks will progressively lead to the definition of the optimal means of operating in France. So far, the optimal structure seems to be of one or more “matching funds”. The JEREMIE program is designed to act as a catalyst for the existing types of financing, and to cooperate with the current intermediaries or operations.

The EIF has begun to engage an active dialogue with all the stakeholders, in order to ensure that the JEREMIE program will provide an important added value to Guyane’s regional economy and that it will be successfully set up in partnership with the institutions concerned.

Conclusions

The analysis of the existing supply and current and potential demands in Guyane leads to the identification of a series of gaps in the available financing possibilities granted to the micro, small and medium-sized enterprises in Guyane. Examining the activity of the existing intermediaries has made possible the evaluation of the supply. The assessment of the potential demand is made through taking into account the activity of current financial intermediaries, characterizing the economic and social environment and its evolution.

25 FEDERUP is a fund dedicated to the counterbalance specificities of the 7 ultraperipheric regions of the European Union.

26 The matching funds allow increasing the capacities of intervention of the intermediaries by co-financing projects usually financed exclusively by the intermediaries.
In order to overcome the barriers to the funding of the regional SMEs, the allocation of the resources of the JEREMIE holding fund could be set up as follows:

<table>
<thead>
<tr>
<th>Financial instruments</th>
<th>Ventilation of the portfolio</th>
<th>EUR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microcredit</td>
<td>8%</td>
<td>1.5</td>
</tr>
<tr>
<td>Seed funding for innovative project start-ups</td>
<td>3%</td>
<td>0.5</td>
</tr>
<tr>
<td>Equity investment</td>
<td>17%</td>
<td>3</td>
</tr>
<tr>
<td>Business angels</td>
<td>3%</td>
<td>0.5</td>
</tr>
<tr>
<td>Loans</td>
<td>44%</td>
<td>8</td>
</tr>
<tr>
<td>Banking guarantees</td>
<td>22%</td>
<td>4</td>
</tr>
<tr>
<td>Bridge financing on grants</td>
<td>3%</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>18 M€</strong></td>
</tr>
</tbody>
</table>

The allocation of resources above answers the need to create new instruments, such as bridge financing on grants, and to reinforce the capacity of intervention of the existing instruments.

At this stage, development of new financial engineering tools remains only hypothetical. It will be the responsibility of the future holding fund manager to define the appropriate modality of support these segments of the funding of the microenterprises and SMEs. Close collaboration with the relevant partners, including national institutions such as OSEO and CDC, will be necessary.

The extent of the measures forecasted is based on the evaluation of the activity of the existing intermediaries and on their capacity to answer the existing and potential demand. The allocation of resources is indicative. Further analyses drawn with the intermediaries will lead to a more precise assessment of the sums proposed.

### 3.5.4 Languedoc-Roussillon (November 2007)

**Statement of Position**

The report recommends a range of complementary measures to overcome the "market failures" enumerated in the access to finance report for the micro, small and medium size enterprises in Languedoc-Roussillon (France). It identifies the most relevant focus for the JEREMIE holding fund taking into account the available supply of finance and the existing and potential demand to be covered. The directions to be set for the JEREMIE holding fund are largely determined by the available intermediaries' ability to deliver funding adapted to the current and future needs of the SMEs. These measures are in line with the use of the structural funds allocated to the region Languedoc-Roussillon as part of the Operational Programme 2007-2013 in order to support growth, innovation and employment. EUR 270.4m is devoted to the regional strategy for Languedoc-Roussillon's ERDF Operational Program 2007-2013. The recommended size of the JEREMIE holding Fund in Languedoc-Roussillon should range between EUR 29m to 43m.
Discussions concerning the size and the types of instruments or the means of financing aimed at enhancing the capacity of intervention of the existing intermediaries will be continued at the beginning of the operational phase, within the steering committee and with the managing authority. At the national level, talks with the public institutions, the intermediaries’ network and the banks will progressively lead to the definition of the optimal means of operating in France. So far, the optimal structure seems to be of one or more “matching funds”\textsuperscript{27}. The JEREMIE program is designed to act as a catalyst for the existing types of financing, and to cooperate with the current intermediaries or operations.

The EIF has begun to engage an active dialogue with all the stakeholders, in order to ensure that the JEREMIE program will provide an important added value to Languedoc-Roussillon’s regional economy and that it will be successfully set up in partnership with the institutions concerned.

Conclusions

The analysis of the existing supply and current and potential demands in Languedoc-Roussillon leads to the identification of a series of gaps in the available financing possibilities granted to the micro, small and medium size enterprises in Languedoc-Roussillon. Examining the activity of the existing intermediaries has made possible the evaluation of the supply. The assessment of the potential demand is made through taking into account the activity of current financial intermediaries, characterizing the economic and social environment and its evolution.

The main market failures identified in the supply of finance for micro, small and medium-sized enterprises are:

- The funding through equity for the creation of enterprises. The local intermediaries tend to move further away from this area of financing to focus their private equity investment activity on growth and development of enterprises. This failure can be noticed both for the creation of generalist enterprises as well as for innovative project enterprises;

- Smaller funding, through “prêt d’honneur”, for small projects concerning the creation of generalist SMEs with good potential. Such financing, which theoretically ensures a link with small regional venture capital, does not exist in Languedoc-Roussillon and constitutes an important market gap.

On the basis of the identification of the market failures enumerated above, the JEREMIE program foresees the following interventions:

- The creation of an investment vehicle for equity or quasi equity called “RELAIS CROISSANCE” to support the emergence of a small supply of financing for high-potential SMEs.

- To support the financing of innovative start-ups by increasing the available resources in the segment of seed technological or innovative projects. An increased support to innovation is scheduled in the ERDF operational

\textsuperscript{27} The matching funds allow increasing the capacities of intervention of the intermediaries by co-financing projects usually financed exclusively by the intermediaries.
program, as requested by the local players, which will increase the deal-flow related to the creation of innovative enterprises.

- To bridge the market gap likely to appear in the microcredit market between the available supply of financing and the potential demand assessed. Taking into account the regional performance in enterprise creation, the existing takeover potential, the opportunity to enhance the creation of economic activity as a path to self-employment and territorial balance, JEREMIE’s support to the supply of microcredit shall lead to an important leverage effect on the supply of available funding for small-size regional enterprises.

In order to overcome these market failures and the future gaps between the supply of finance and the estimated funding needs of the regional SMEs, the allocation of resources of the JEREMIE holding fund could be set up as follows:

<table>
<thead>
<tr>
<th>Financial instruments</th>
<th>Breakdown of the portfolio</th>
<th>EUR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microcredit</td>
<td>27%</td>
<td>6,25</td>
</tr>
<tr>
<td>Seed funding for innovative project start-ups</td>
<td>17%</td>
<td>4</td>
</tr>
<tr>
<td>Funding for high potential SMEs (small amount)</td>
<td>3%</td>
<td>0,75</td>
</tr>
<tr>
<td>Creation of the “RELAIS CROISSANCE” vehicle</td>
<td>48%</td>
<td>11</td>
</tr>
<tr>
<td>Business Angels</td>
<td>4%</td>
<td>1</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100%</td>
<td>23 M€</td>
</tr>
</tbody>
</table>

Such an allocation of resources answers the need to create new instruments and reinforces the capacity of intervention of the existing instruments.

At this stage, development of new financial engineering tools remains only hypothetical. It will be the responsibility of the future holding fund manager to define the appropriate modality of support to these segments of microenterprises and SMEs funding. Close collaboration with the relevant partners, including national institutions such as OSEO and CDC, will be necessary.

The extent of the measures forecasted is based on the evaluation of the activity of the existing intermediaries and on their capacity to answer the existing and potential demand. The allocation of resources is indicative. Further analyses drawn with the intermediaries will lead to a more precise assessment of the sums proposed.

### 3.5.5 Lorraine (October 2007)

**Statement of Position**

The report recommends a range of complementary measures to overcome the “market failures” enumerated in the access to finance report for the micro, small and medium size enterprises in Lorraine (France).
It identifies the most relevant directions for the JEREMIE program taking into account the available supply of finance and the existing and potential demand to be covered. The directions to be set for the JEREMIE holding fund is largely determined by the existing intermediaries’ ability to deliver funding adapted to the current and future needs of the SMEs. These measures are in line with the use of the structural funds allocated to the region Lorraine as part of the Operational Programme 2007-2013 in order to support growth, employment and competitiveness in Lorraine. EUR 329m is devoted to the regional strategy for Lorraine’s ERDF Operational Program 2007-2013. The recommended size of the JEREMIE holding fund in Lorraine should range between EUR 18m to 30m.

Discussions concerning the size and the types of instruments or the means of financing aimed at enhancing the capacity of intervention of the existing intermediaries will be continued at the beginning of the operational phase, within the steering committee and with the managing authority. At the national level, talks with the public institutions, the intermediaries’ network and the banks will progressively lead to the definition of the optimal means of operating in France. So far, the optimal structure seems to be of one or more “matching funds”\textsuperscript{28}. In any case, the JEREMIE program is designed to act as a catalyst for the existing types of financing, and to cooperate with the current intermediaries or operations.

The EIF, in spite of an active dialogue with all the stakeholders of the project in order to guarantee that the JEREMIE initiative will provide a true added value to Lorraine’s economic environment, did not reach so far a consensus with the various partners to implement JEREMIE in Lorraine. Nevertheless, the present report has been drafted with the prospect of an effective implementation of the JEREMIE initiative in Lorraine.

Conclusions

The supply has been assessed through the analysis of the activity of the current intermediaries; the results obtained by the institutional working group\textsuperscript{29} gathered to prepare the JEREMIE study have been taken into account.

The effective demand matches the demand revealed by the supply; the assessment of the potential demand is made possible by taking into account the context that characterises the economic and social environment and its evolution.

The key steps identified in the supply of funding for regional micro, small and medium-sized enterprises are:

- Providing seed capital, particularly small amounts for projects emerging from the regional incubator, in order to initiate the innovation process;
- Concerning the banking guarantees plan, the difficulties faced by the regional small and medium-sized enterprises in their access to credit, and resorting to the banking guarantee, reinforce the need to activate the regional guarantee fund. Besides, the supply of guarantee to weak microentrepreneurs does not

\textsuperscript{28} The matching funds allow increasing the capacities of intervention of the intermediaries by co-financing projects usually financed exclusively by the intermediaries.

\textsuperscript{29} The institutional working group is composed of state agencies (Préfecture de région, DRIRE), the regional council, OSEO group, CDC and EIF.
seem to be available within the region, which is linked to the difficulty for the smallest enterprises in Lorraine to access banks;

- The supply of social microcredit is meant to meet an increasing demand given the evolution of the economic and social environment, and given the capacity of such a financial supply to provide funding to microenterprises, including those in the extreme start-up phase (whenever the available resources meant to cover this segment are sufficient);

- Concerning the economic part of microcredit, and the allocation of small amounts for high potential projects, an important potential demand shall lead to strengthening the current supply provided by the intermediaries. There is a strong potential in Lorraine not only for the general dynamics of enterprise creation/takeover but also more specifically for the progress of enterprises creation, notably in the service industry.
Regional equity investment raises a number of issues:

- The combined supply ILP-SADEPAR has been recently able to cover the supply of funding (50K€ to 1,5M€);
- The information gathered by the institutional working group shows that there may be a discontinuity in the range of intervention, the segment 150K€-300K€ seems indeed to be already covered in so far as the supply of equity funding is concerned, mainly by the European intermediary EUREFI.

Yet, EUREFI’s investment policy is mainly focused on cross-border groups, even if this requirement seems to have slightly changed due to there being a lack of applicants (data from EIF qualitative diagnosis).

Conditions under which regional SMEs in Lorraine may be granted equity funding for the creation, the development or the expansion in the medium segment (150-300 K€) are still to be assessed. The possibility of covering the business creation segment above 300 K€ is also considered, given the discontinuous investment policy of the intermediaries (focus on specific projects, on “priority” sectors...)

This seems to be especially important given that enterprises in Lorraine suffer from a serious under-capitalisation and that the innovative enterprises are facing difficulties in meeting the requirements of equity investors.

In order to overcome these potential failures in the supply of funding or to bridge the future gaps between the available supply and the estimated demand of funding of the regional SMEs, the allocation of the resources of the JEREMIE holding fund foreseen could be set up as follows:

<table>
<thead>
<tr>
<th>Financial instrument</th>
<th>Breakdown of the portfolio</th>
<th>EUR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microcredit</td>
<td>28%</td>
<td>5</td>
</tr>
<tr>
<td>Seed funding for innovative project start-ups</td>
<td>8%</td>
<td>1,5</td>
</tr>
<tr>
<td>Funding for high potential SMEs</td>
<td>3%</td>
<td>0,5</td>
</tr>
<tr>
<td>Support for equity investment</td>
<td>28%</td>
<td>5</td>
</tr>
<tr>
<td>Business Angels</td>
<td>3%</td>
<td>0,5</td>
</tr>
<tr>
<td>Guarantee</td>
<td>19%</td>
<td>3,5</td>
</tr>
<tr>
<td>Diversification</td>
<td>11%</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>18 M€</td>
</tr>
</tbody>
</table>

Such an allocation of resources answers the need to create new financial instruments, or to reinforce the capacity of the existing ones.

At this stage, development of new financial engineering tools remains only hypothetical. It will be the responsibility of the future holding fund manager to define the appropriate modality of support these segments of the funding of the microenterprises and SMEs. Close collaboration with the relevant partners, including national institutions such as OSEO and CDC, will be necessary.
The extent of the measures forecasted is based on the evaluation of the activity of the existing intermediaries and on their capacity to answer the existing and potential demand. The allocation of resources is indicative. Further analyses drawn with the intermediaries will lead to a more precise assessment of the sums proposed.

3.6 Greece (June 2007)

Statement of Position

This report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) in Greece in the context of access to finance. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency. The measures are clearly in line with the broad guidelines set by the European Council to facilitate access to finance in order to achieve growth and job creation in the general framework of improving the attractiveness of regions, encouraging innovation, entrepreneurship and the growth of the knowledge economy and creating more and better jobs.

The key six investment proposals are presented as follows (figures are indicative):

- A Micro Credit scheme up to EUR 100 million to be offered to eligible institutions (or banks) to onlend micro loans for the promotion of entrepreneurship;
- A Guarantee Scheme up to EUR 240 million for SMEs with sufficient regional, sectoral and stage dispersion;
- A Securitisation programme up to EUR 100 million to cover operations backed by SMEs loans, SMEs leases or pool of bonds issued by SMEs;
- Risk Capital Investment up to EUR 35 million for creating a Seed Fund.
- Risk Capital Investment up to EUR 15 million for creating a Fund to stimulate the creation and activities of Business Angels.
- Risk Capital Investment up to EUR 10 million for Intellectual Property Fund.

Thus, an initial portfolio of specialised instruments up to an indicative amount of EUR 500 million is recommended to be set up through the means of the Structural Funds allocation for Greece for the planning period 2007 – 2013 to alleviate those conditions that hamper the Greek SMEs access to finance.

It is evident that at this stage, this non-exhaustive list of proposals is of indicative nature. The proposed capital allocation per instrument is subject to revision and the structure and operations of each instrument is yet to undergo a process of fine-tuning so as to improve possible synergies with existing market players.

In the case that further consultations and/or research evidences the need for change, such alterations will be adopted for the optimal utilisation of allocated resources in order to maximise the positive impact on SME development.
The proposed measures have been conceived and formulated to be implemented on a national basis and without necessarily linking them to the Operational Programmes which at the time of this report were not finalised. The European Investment Fund reserves the right to introduce modifications or to withdraw any of these proposals if they are deemed incompatible with the limitations imposed by the nature of budgetary allocations.
Overview of SME environment

In 2005, 880,000 enterprises were registered in Greece of which 98% were small (employing less than 50 employees and having less than EUR 10m annual turnover), with the majority of enterprises being micro enterprises (approximately 95% are enterprises that have an annual turnover less than EUR 1m and less than 10 employees). Thus, SMEs in Greece play an important role in the economy of the country. More than half of the enterprises are located in the regions of Attiki and Central Macedonia exhibiting a high concentration in the urban areas of Athens and Thessaloniki, where half the population of Greece is concentrated.

The Greek market is dominated by SMEs that do not have sufficient financial data and thus face higher lending cost. About 1/3 of the enterprises do not have a loan, while a large number of special categories of enterprises (new enterprises, new economy enterprises etc.) find it difficult to access the financial system and a large number of existing enterprises is rejected from the banking system for various reasons. Notwithstanding that, it is expected that, for the future, more loans or other financial instruments will be used to address SMEs' financing needs. Lending costs are high especially for the micro enterprises. Taking into account that these enterprises amount to 95% of all Greek enterprises, this represents a challenge for the SMEs financing environment in Greece.

This partially explains the unwillingness of a significant percentage of entrepreneurs to resort to the financing system and, complemented by the rejected applications, the high number of SMEs (one third) that operate outside the financial system. Parallel to this, the venture capital market appears to be in its infancy and unable to really boost entrepreneurship at its early stage on a major scale.

Major market failures and proposed instruments

The purpose of this final report commissioned by the Directorate-General for Regional Policy of the European Commission is to evaluate the financing opportunities of SMEs in Greece, identify market failures and quantify the gap between the supply and demand for funds to promote entrepreneurship. Prior to that, an overview of the SME environment in Greece is presented that sets the analysis in its appropriate context.

Finally, the appendix section forms an integral part of this report presenting information concerning the SME environment, the related market research and the historic use of Structural Funds in detail.

Based on the results derived from the market research and the desk research, the existence of a financing gap is established in all activity sectors of small enterprises. This gap is present regardless of the business history of the enterprise, the size and maturity of the loan or the region the enterprise is established in. It also exists for special groups of debtors (immigrants, women entrepreneurs, social or non-profitable companies), enterprises with insufficient collateral according to bank requirements and economically viable enterprises with temporary liquidity problems enterprises listed in Tiresias (bank information system with bad credit related data) even if they have met all their obligations.
In order to address this gap, a portfolio of financial instruments is proposed in the framework of the JEREMIE programme (figures are indicative):

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Approximate portfolio share</th>
<th>EURm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro financing</td>
<td>20 %</td>
<td>100</td>
</tr>
<tr>
<td>Guarantees</td>
<td>48 %</td>
<td>240</td>
</tr>
<tr>
<td>Securitisation programme</td>
<td>20 %</td>
<td>100</td>
</tr>
<tr>
<td>Seed Fund</td>
<td>7 %</td>
<td>35</td>
</tr>
<tr>
<td>Business Angels</td>
<td>3 %</td>
<td>15</td>
</tr>
<tr>
<td>Intellectual property fund</td>
<td>2 %</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>100 %</td>
<td>500</td>
</tr>
</tbody>
</table>

The EIF proposes to the Greek authorities in charge to implement the recommendations made in this final report with regard to the proposals to the Commission for the next planned period between 2007 and 2013. The creation of a single fund will allow for the more efficient risk management and the optimal utilisation of the funds by shifting unused resources from an instrument to another if such a case arises.

The proposed measures have been conceived and formulated to be implemented on a national basis and without necessarily linking them to the Operational Programmes which at the time of this report were not finalised. The European Investment Fund reserves the right to introduce modifications or to withdraw any of these proposals if they are deemed incompatible with the limitations imposed by the nature of budgetary allocations.

Summary of main market failures arising from the gap analysis:

- Approximately one third of the Greek enterprises (more than 300,000) do not have access to credit and thus are forced to resort to own resources or family and friends to satisfy their financing needs.
- High lending costs and level of collateral are perceived to discourage SMEs from resorting to the financial system.
- High risk and lack of financial information are perceived to discourage the banks from granting loans to SMEs, especially start-ups.
- In numbers, only 8,000 new enterprises resort to the financial system on an annual basis whereas 40,000-50,000 new enterprises are established every year.
- Similarly, enterprises without collateral, “new economy” enterprises, women and immigrants have difficulty in accessing or are rejected by the banking system.
- Leasing and factoring are not sufficiently directed to micro and small SMEs.
- The private equity industry and especially the venture capital sector lags behind the rest of the VC industry at European Union level.
- There is a strong lack of awareness of the use of VC tools among entrepreneurs or potential entrepreneurs.
- The Business Angels network is nearly non-existent.
Consideration on the Methodology adopted

Further to both primary and secondary research, this report aims at analysing the gap between the demand for funds by Greek entrepreneurs and the supply of business funding by the existing financial system. The findings are used so as to arrive at proposals that constitute portfolio of initiatives.

The scope and objectives of this gap analysis report run tangent to a variety of elements for which primary research, alongside desk research, was necessary to confirm some of the findings of the desk research.

Primary research was conducted as follows:

• Concerning the equity industry, the primary research consisted of questionnaires that were sent in October 2006 to venture capital firms and incubators in Greece; followed-up with telephone discussions to obtain information on more qualitative aspects of the research.

• The research on the non-equity instruments and general attitudes consisted of a desk research and a market research. Due to the extensive coverage of the market research (the whole of the country), the market research was conducted by Credit Guarantee Fund for Small and Very Small Enterprises (TEMPME) in cooperation with the Centres for the Business and Technological Development (KETA), which operate in the 13 regions of Greece. The sample was drafted based on the stratified sampling approach, on such criteria as number of employees, annual turnover, years of operation etc. It was then up to each KETA to select randomly the actual SMEs of the region that would constitute the sample based on the guidelines received by TEMPME. The process was initiated in mid-June 2006 and replies were collected by September 2006.

3.7 Hungary (December 2007)

This report has been prepared in the framework of the JEREMIE Initiative by the European Investment Fund and the Hungarian Ministry of Economy and Transport.

Statement of Position

Based on the analysis of SME sources of finance, both on equity and debt side, a number of market failures have been identified. In light of these findings, establishment of a public support mechanism in a form of a revolving JEREMIE Holding Fund is recommended, with the total contribution up to EUR 720m. Such vehicle, operating at national level, should be managed by an independent institution allowing for attracting private resources as well as improving the efficiency of the existing support schemes.

Overview of Market Failures and Recommendations

In the framework of this evaluation study the existing supply and potential demand for financial engineering products targeting SMEs has been analysed. The currently operating public support schemes, outlined in Chapter 3, together with financing
offered to SMEs by the commercial sector were evaluated against the trends in the SME sector leading to the identification of market failures.
The main failures related to:

- limited supply of financing, both on the debt and equity side, to newly established enterprises
- low volume of credit offered to enterprises
- low provision of expansion capital in a form of equity
- lack of revolving support for technology transfer

Based on these findings JEREMIE recommends to concentrate public support to SMEs in a form of holding fund with the total allocation up to EUR 720m.

The potential split between support mechanisms, identified in this report, should be as follows:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance guarantee window</td>
<td>EUR 77m</td>
</tr>
<tr>
<td>Loan guarantee scheme for micro-enterprises</td>
<td>EUR 300m</td>
</tr>
<tr>
<td>SME portfolio guarantee window</td>
<td>EUR 175m</td>
</tr>
<tr>
<td>Factoring guarantee window</td>
<td>EUR 40m</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>EUR 120m</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>EUR 10m</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>EUR 722m</strong></td>
</tr>
</tbody>
</table>

3.8 Italy

3.8.1 National level (September 2007)

Statement of Position

The analysis carried out has shown that a financial gap does exist with reference to the following financial instruments:

- Risk capital
- Guarantees
- Loans

There appears to be a substantial shortage of financial resources for risk capital markedly affecting SMEs and start-ups (in particular knowledge-based ones), while for guarantees and loans it is not appropriate to refer to market failure since resources are not scarce but the characteristics of the Italian financial system often lead to a misallocation and sub-optimal use of resources.

The quantitative gap estimated by the analysis does not totally express the intensity of the market failure, since important gaps of a qualitative nature have to also be taken into account (referring especially to the behaviour of financial intermediaries), arising from asymmetric information, affecting the areas of microfinance, risk capital and innovative finance. So, on the whole, the concept of market insufficiency, rather than failure, seems to better suit the outcomes of the current analysis.
The observed gap is due to a number of different factors amongst which two are particularly relevant:

- the lack and/or shortage of an “emergence” of needs from those initiatives that could potentially benefit from the scheme: this especially concerns physical people and innovative/high-technological start-ups;
- the selection procedure implemented by the those providing the resources, in evaluating the applications for funding. The limitations of the set of tools adopted in evaluating the credit worthiness and the viability of projects represents real causes of “adverse selection” towards subjects with low visibility (physical people, especially if disadvantaged, and micro enterprises) or promoters of highly specialised entrepreneurial initiatives (knowledge-based and high-tech enterprises).

Conclusions

Following the results of the analyses, the potentially positive role of JEREMIE is envisaged to address the market insufficiencies impacting on the risk capital market, microfinance and guarantees.

- Risk capital funds for the early stage financing:
  - Fund for innovative start-ups, pre-seed tool: EUR 100m
  - Fund for innovative start-ups, sidecar fund: EUR 30m
- Guarantee fund for facilitating microfinance operations targeting subjects of the social economy: EUR 20m;
- Guarantee fund for micro and small enterprises: EUR 100m
- Entrepreneurial initiatives in early stage

State

The knowledge based start-ups phenomenon in Italy appears to be rather limited in size (although not that small). See below for details regarding academic spin-offs. There are at present 454 knowledge based enterprises born from universities. The average market capitalisation of these enterprises is around EUR 500,000. Only 10 out of the 300 Italian universities have the necessary rules and procedures for the creation of academic spin-off. These 10 universities generate roughly 60 enterprises per year.

Potential

With reference to the spin-off sector, assuming that all Italian universities prepare themselves appropriately to foster their creation and, envisaging a birth rate of 6 new enterprises per year per university, an estimate of roughly 1800 academic spin-offs...
off is obtained per year. On the assumption that one out of 20 can actually be considered suitable for investments with an average participation of around EUR 200K of risk capital, (minority quota compared to an average capital of EUR 500K), the hypothetical fund, covering all the early stage investments in academic spin-offs, could amount to EUR 75-100m (5 years as the average period for the investment).

Market Failure

Given the above, the availability of capital appears to be sufficient, (active funds amount to over EUR 200m – AIFI early stage, Ingenium, Principia, First, Sanpaolo, Sviluppoitalia, Fiditoscana, etc.)\textsuperscript{31}. In fact, up to now, no fund has been used up totally. The allocation of these resources does not seem to be efficient, at least as far as the objective of participating in the capital of knowledge-based start-ups enterprises. Often, more mature enterprises and with a lower risk profile are actually financed. The generalist nature of the funds that currently manage tools that should be used for early stage investments is one of the main causes of the above mentioned inefficient allocation, due to the ways the generalist fund reacts to the market information asymmetry that characterises this sector of intervention.

The majority of these funds have stemmed from public initiatives, with selection rules for the potential funds that have not favoured the establishment of specialised funds (managing entities with seed financing experience in knowledge-based start-ups that operate with a profit motive). Moreover, the regional bias of public intervention has hindered an optimal sizing of the funds from an economic-managerial standpoint. Quite often the overall size of the fund does not allow a market reward for a specialist management.

On the demand side, the policies of bringing the offer closer to the potential beneficiaries on a territorial basis has led to the fragmentation of the demand itself, thus preventing the fund managers from operating an adequate risk pool and from benefiting from economies of scale.

The analysis on the division of resources for financial engineering foreseen in the 2000-2006 planning period highlights that in the Objective 1 areas the measures that include tools dedicated to early stage operate with several drawbacks. This is due to difficulties, also systemic, in activating selection procedures for the specialised operator.

In absence of specialised operators, operating in line with profit-driven criteria and a risk-oriented mentality, further funds can hardly be translated into a greater ease of access to dedicated finance for knowledge-based start-ups.

Work hypothesis

The proposal for a JEREMIE initiative is predicated around co-investing in two inter-regional tools that, in a synergistic fashion, would act on:

\textsuperscript{31} Please refer to annex 1 for the description of the main funds active in Italy
• stimulating the emergence of the demand
• repositioning of the offer in favour of profit-driven specialised fund managers
Pre Seed Tool

The co-financing of a national seed fund is proposed for initiatives in the pre-seed phase (preliminary to the enterprise creation), in order to increase the deal flow of entrepreneurial projects that are “investor ready”. Such a fund can be estimated at around EUR 100m.

The pre-seed tool (of an evergreen type) would be aimed at granting convertible loans, for the co-financing of the development of entrepreneurial knowledge-based ideas, aiming at individuals and/or groups with objective of also promoting forms of capitalisation of knowledge (IP and ownership of technology).

Given the nature of the fund and its function, a high level of investment of public capital is deemed appropriate (even up to 90%) and, in line with the necessity to promote an entrepreneurial and risk-oriented culture, the opportunities for the management of such fund to be given to specialised managers is strongly recommended. A management fee should, moreover, be foreseen, (structured according to a fixed and a variable part) to reward, in addition to the costs inherent a typical management, at least the expenses of the scouting activity necessary to support the shift in attitude characterising the conversion from opportunity recognition to business shaping.

The selection criteria for the possible fund managers should favour not so much the presence of public members, but partnerships with foreign managers that can demonstrate a proven experience in knowledge-based early stage investments and in the consolidation phases of IP.

Besides, in order to always allow the remuneration of the so-called “conception risk”, part of the fund will be allocated to follow-on operations that will permit the fund to manage the dilution risk of its own holding once entrepreneurial initiatives have become investor ready. A more precise definition of the fund between the above-mentioned activities (soft-loans, capitalisation of knowledge and follow-on) is left for a further analysis.

A tool so devised will allow: i) on the one hand, the fostering of human capital, enhancement of an entrepreneurial attitude and the propensity to risk and to increase the quality and quantity of business proposals; ii) on the other hand, favour the establishment of specialised funds, also due to the added value arising from international partnerships.

Sidecar fund

It is considered important to promote the entry in the early stage sector of a further category of possible investors which in Italy, if not totally absent, is hidden. This category encompasses business angels, investors that bring capital as well as managerial competence. The efficiency of the tools of dedicated finance to knowledge-based start-ups would thus be improved, in the medium term, permitting
a move of generalist institutional investors towards phases of investment characterised by risk-returns combinations that make more sense.

To support the emergence of these “sponsors” the co-capitalisation of one or more sidecar funds is suggested, to cover the whole of Italy. These funds, usually set up by business angels belonging to a specific network and/or by other investors, are activated (more or less automatically, via mechanisms whose definition is beyond the present report) for co-investing in single operations undertaken by a business angels adhering to the fund. It is possible to envisage that private equity and/or venture capital organisations could take part in the management of the fund, to encourage forms of cooperation in networks and possible future operations.

The informal investors will thus be in the position to be involved, although indirectly, in a large number of operations in other sectors with risk pooling that, in absence of the fund, would have otherwise been impossible to undertake, given the low number of investments implemented and their diverse geographical allocation.

A side care fund of around EUR 20-25m (estimate based on projections of IBAN data from 2005-2006) would probably be justified.

The actual level of involvement of JEREMIE, of the co-investment levels in single operations and of the management modalities will need to be considered if the initiative is adopted.

Microfinance for the social economy

State

In the present report the word microfinance refers to a measure in favour of disadvantaged, or socially excluded, people (immigrants, women living below the poverty line or in risk) that could constitute a viable demand for finance, usually aiming at projects of self-employment or at small, labour-intensive, initiatives mainly directed at the provision of services to people. The latest ISTAT report on poverty (2005) estimates states that about 7.5 million people nowadays live in relative poverty in Italy.

Potential

Also due to the lack of regulations governing microfinance (and micro credit), data on the overall extent of the phenomenon is not available in Italy. An estimate of the potential demand has been carried out assuming that the people in working age, in a condition of relative poverty, are potential “entrepreneurs by necessity”. Overall, this could turn into a pool of roughly 60,000 new enterprises. It is estimated that these entrepreneurs subjects could absorb up to EUR 1,200m, thus providing a demand for guarantees of an equal amount. It is possible to estimate a hypothetical participation of risk capital in terms of EUR 300m.

Market failure
Given the difficulties in obtaining a real census of microfinance initiatives, also due to the scarce availability of data and the multiple definitions of the phenomenon, some significant experiences such as the ones from the Fondazione Risorsa Donna, or the measure of the Umbria Region allocating 300,000 Euro to measures for disadvantaged people, have been used as a basis.

These initiatives are usually administered by charitable bodies, non governmental organisations and bank foundations that provide funds to those otherwise excluded from the traditional sources of financial services and support. Such forms of intervention though operate with limited funds in specific geographical areas, in other words lacking any rational organisation. A rough estimate of the resources needed in Italy amount to about EUR 30m.
From the above analysis a peculiar characterisation of market failure is highlighted. The “weak” individuals in fact, faced with the probability of being denied the loan, do not even contact the traditional intermediaries. The shortage of funds and the impossibility, for the individuals, to provide adequate guarantees, make this type of customer unappealing, or not attractive at all, to the banks. As a confirmation of this phenomenon, a first informal investigation carried out in Umbria by the regional financial agency GEPAFIN, has highlighted how the banks operating in the area have only shown interest in micro-credit operations in cases where the regional financial agency commits itself to provide the necessary guarantees.

The market failure depends on the misalignment between the quality of the demand and the behaviour of the supply, especially as far as micro-credit is concerned. Micro-credit, in fact, by definition is the lending of small amounts of money, without any specific guarantees covering the risk. Nowadays these operations (transactions) are accomplished through intermediaries specialised in granting consumer credit (whose high market costs though have an even worse impact upon this underprivileged category) or through the banking system that applies to such operations standard credit scoring criteria (requiring guarantees). Further increasing the market failure is the poor profitability achieved by the non-specialised intermediaries in managing such financing.

Work hypothesis

The proposal for a JEREMIE intervention focuses in the co-investment in regional guarantees funds, the management of which should involve both the intermediaries administering the guarantee tools and the organisation typically dealing with such measures for social support (foundations, charitable bodies, etc.).

The granting of the guarantee would not however be automatic, but subject to a screening process by the former, supported by the latter.

Moreover, in addition to the JEREMIE intervention, on a local scale, other funds earmarked by the Regions for similar purposes could be used to contribute, with interest subsidies, in favour of such loan beneficiaries.

The aim of the initiative is to reduce the above illustrated misalignment through: i) stimulating an increase in demand, also as result of promotional activity; ii) an “on the job” training of the credit intermediaries that, also given an expanding demand, will be able to adopt those procedures which properly characterise micro-credit.

It is possible to hypothesise a JEREMIE fund of around to EUR 15-20m (estimated by applying to the national level the data derived from the initiative undertaken in the Umbria region).

The determination of the level of involvement for JEREMIE (in terms of co-investing in regional funds as well as providing advice) and of the procedures is left to further future studies, not relevant to the present analysis.
Guarantee fund for SMEs

State

The "banco-centric" character of the Italian financial system has gradually generated a sort of equilibrium between demand for and supply of loans.

It needs to be underlined that in such a system the market for loans turns out to be closely linked with the market for guarantees, also considering that the provision of guarantees (provided by the borrowers or third parties) has become a necessary condition for obtaining loans. The existence of this close connection has determined an expansion of the market for guarantees on credits, while it has left the area of guarantees supporting trading operations as a marginal activity.

The expansion of the market for guarantees on credits, mainly supporting short-term banking loans on traditional operations, has produced an inevitable side effect with the establishment of "guaranteeing non-specialist intermediaries"). The typical case is represented by the Italian system of Confidi, that (from 1956 to today) has developed into more than 1,000 separate entities, offering guarantees and support services to about 1 million Italian SMEs.

Confidi can rely upon a fund of guarantees estimated at around 11 billion euros based on a real financing amounting to EUR 1,4 billion\(^{32}\) (on average a multiplier close to 10). Given that the guarantees granted are estimated in 6300 Mln euro, it can be concluded that the funds are currently large and not entirely utilised.

Potential

Compared to the current offer of loans to SMEs, further significant increases are not deemed necessary. A partial modification of the situation could come about from the thorough application of Basel 2 regulations, with the introduction of more strict methodologies in evaluating the worthiness of credit and of the pricing systems linked to the degree of risk faced by the entrepreneurs.

For instance a group of smaller enterprises could be penalised, as underlined by a study of UNIONCAMERE, which indicates that 4-5% of enterprises are below the level of minimum reliability. On the basis of other studies\(^{33}\), the number of small enterprises that would be "excluded" by the banking system, by being considered as not totally reliable, can be estimated at around 10-15\%, following the establishment of standard evaluation procedures as foreseen in Basel 2.

Having determined that the loan market is basically in equilibrium, this does not imply that the guarantee market could not potentially grow further. The previously mentioned investigation by Unioncamere illustrates that 43\% of the smaller Italian enterprises recognises the relevance of guarantees in the dealing with financial intermediaries. It is thus reasonable to gauge the potential market for credit guarantees as roughly 50\% of loans granted to small enterprises (excluding the medium ones), with significant scope for growth, also considering that the funds available to the Confidi do not seem to be completely utilised.


\(^{33}\) During a seminar, the conclusion of a study carried out in Umbria few years ago reported that about 25\% of enterprises has experienced a 25\% reduction in banking loans as direct result of the application of the rules established within Basilea 2
It has to be noticed that such potential mainly concerns the granting of guarantees to bank loans; there is another market left – so far virtually unexamined – involving other types of guarantees relative to the covering of events and situations of a commercial and trading nature (bid bond, performance bond, etc.).

Attention is thus drawn to the enormous potentialities of strengthening the offer of guarantees in two specific areas:

- credit guarantees generally lent by Confidi, emphasising them as alternative financial tools;
- strengthening of the guarantee system on trading, mainly involving insurance initiatives.

Market failure

The analysis of the market failures affecting smaller enterprises focuses especially upon the gap emerging as a result of loans maturities and the role of guarantees. The two outcomes are largely associated and connected, but will be analysed, for analytical purposes, separately.

With regard to the loan maturity and type, the following market failures are singled out:

- enterprises, especially the smaller ones, largely turn to bank credit to fulfil their financial needs, given a structural undercapitalisation;
- mix of short-medium-long term loans, excessively unbalanced towards the short term, also considering investment needs;
- scarce use of alternative financial instruments, compared to the traditional ones, due to a marked standardisation driven by banks and a poor financial culture within smaller enterprise;
- methodological shortcomings in evaluating credit worthiness, particularly for innovative and knowledge-based enterprises, for small business unit (based around the entrepreneur) and, more generally, in cases where loans are requested for projects whose evaluation by banks is considered rather difficult (internationalization, purchase of intangible goods, participation in other enterprises, etc.)

As far as the nature of guarantees and guarantors over concerned, the following market failures have been identified:

- standardisation of guarantees granted by Confidi, mostly focused towards:
  - short term rather than medium-long term;
  - generic loans rather than tailored and targeted;
  - operations centred around traditional loans rather than hybrid loans (for instance participative loans);
• lack of experience, both technical and operational, of several Confidi in the execution of appropriate evaluation procedures of credit worthiness, mainly for knowledge-based and innovative enterprises;

• excessive fragmentation in the Confidi system, with consequent structural, financial, organizational and thus operational weaknesses;

• limited presence, in Italy, of intermediaries specialised in financial and insurance tools tailored for internationalisation, in particular: forfeiting, confirming, international factoring;

• reduced presence of insurance companies in the market for guarantees to small enterprises34.

Summarising, it can be stated that the low added-value of the loans made to small enterprises is, both the cause and effect of the scarce added-value of guarantees and guarantors: this is where the market failure, affecting the smaller Italian enterprises, occurs.

Work hypothesis

Taking into account the above analysis, a possible solution is to introduce tailored loans supported by innovative guarantees.

A JEREMIE initiative could be worthwhile with co-capitalisation of the guarantee funds (also at a supra-regional level, taking into account the classical division in North, Centre and South), managed by experienced intermediaries covering portfolios of customized credits. An estimate for the fund could be around EUR 100m. Such a measure would ensure operational efficiency for the intermediary as well as in attaining a significant level of tailored, viable, loans.

The benefits would be as follows:

• realignment of the capital structure, through a restructuring of the liabilities;

• the granting of guarantees supporting trading contracts for foreign operations;

• the negotiation of agreements for leasing and factoring operations;

• innovating, particularly in the following areas:
  o initial settlement and/or transfer of SMEs in areas with industrial districts or technological parks, managed along the most modern criteria;
  o support for the development of innovative processes and production, but also for the purchase of third party technologies;
  o encouragement of outsourcing as one of the most important and concrete forms of technological transfer;

34 A typical example is represented by SACE that, although stating a particular bias towards SMEs, it actually operates with the larger enterprises.
the creation of groups, networks, etc., especially of a trans-national nature;
• financial operations for internationalisation, appropriately tailored according to the needs of small enterprises, primarily in terms of:
  o covering of exchange-rate related risks, with the acquisition of specialised financial instruments (currency derivatives);
  o support for operations concerning penetration of foreign markets
• endorsing operations of recapitalisation

In order for such a fund to be effective in providing for a market shortage (hence encouraging access to tailored credit also from subjects up to now excluded) it is necessary for its management to be entrusted with specialised departments that would foresee, moreover, the involvement of the following operators:

• Streamlined Confidi network, through mergers and recapitalisation;
• export consortia, appropriately supported both technically and financially, in order to be able to operate as guarantors of the debts issued to small enterprises, for the acquisition – in particular, but not exclusively, abroad – of materials, know-how, etc. aimed at processes of innovation;
• new intermediaries that would involve, amongst others, insurance companies (both Italian and international).

3.8.2 Marche (June 2007)

Statement of Position

This evaluation report was prepared by the EIF and is considered as final after presentation to the regional Managing Authority and incorporation of feedback received. Subject to a positive decision by the Marche Regional Authorities on the implementation of the JEREMIE initiative in cooperation with the EIF, further work is to be done to complete the evaluation and prepare for implementation. These tasks could include the establishment of the legal framework, business planning and modelling of flow, organisational, governance and procedural issues.

This evaluation offers a comprehensive picture of how the financial system supports the regional production system in the Regione Marche.

94% of the industrial sector of the region is represented by micro enterprises, mainly concentrated in the manufacturing sector. Regione Marche’s financial system appears to be able to address some of the financial needs of businesses.

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35 SACE and SIMEST already exist but have a rather slow modes of operation, bureaucratic, so to be more better suited for medium and large enterprises.
36 It is the case for the Law 394/81, whose norms foresee the issuing, by the benefiting firm, of fidejussions for large amounts and long periods; many small firms are not able to obtain such fidejussions from banks and thus do not gain advantage from the benefits of the law, almost exclusively exploited by the larger enterprises.
Nonetheless, this evaluation study has identified areas for which the implementation of specific financial engineering instruments can play an important catalytic role, building on the constructive experience accumulated in the region.

In terms of findings, the evaluation study confirms that the financial system in the region is rather efficient, at least in the short-term: the main financial actors provide SMEs, including micro-enterprises, with the needed financial instruments. Nonetheless, the key player of the regional financial system remains the bank, which, as it is the case for the rest of Italy, is the main actor, able to offer a wide range of services to SMEs. Since the economic sustainability of SMEs is characterised by short-term debt versus long-term financing needs, the steady access to the banking credit line is indispensable for the sustainable growth of the SMEs.
The regional mutual guarantee schemes (Confidi) operating in Regione Marche, shows several similarities with the national system of guarantees. There are a relatively high number of mutual guarantee schemes operating in region with Artigiancredit Marche and Fidimpresa Marche acting as the main players. At this stage, not all the regional Confidi are sufficiently equipped to respond positively to the new challenges behind the entry into force of Basel II. In essence, on the one hand, the regional mutual guarantee schemes play an essential role in the regional economic system and, on the other hand, the entry into force of Basel II might be critical for the equilibrium of the system.

The private equity and venture capital industry does not constitute a significant reality within the regional financial system.

Based upon the findings expressed in this study a series of general recommendations is proposed aimed at improving SME access to finance. The recommendations are based on the possibility of creating a Holding Fund for Regione Marche by means of Structural Funds, mainly ERDF. Regione Marche recommendations mainly refer to the deployment of the following instruments:

- Microcredit, either by providing guarantees or by direct contribution of subordinated funds.
- Risk Capital, in particular with an investment focus on seed and early stage.
- Development of Mezzanine instruments, such as participating or subordinated loans.

In order to allow for a sustainable structure it is suggested the initial size of the Holding Fund should indicatively range between EUR 20 million and EUR 50 million.

3.9 Latvia (July 2007)

Statement of Position

This report recommends a portfolio of complementary measures addressing the market failures identified in the evaluation of access to finance of micro, small and medium size enterprises (SMEs) in Latvia. These measures intend to propose an effective use of the EU Structural Funds allocated in the framework of the Operational Programme (OP) for 2007-2013 in view of supporting growth, innovation and employment.

The Latvian “Entrepreneurship and Innovation” Operational Programme under NSRF for 2007-2013 has been approved by the European Commission on 27 November 2006. The amount of financing planned for this programme is EUR 874.9m, of which EUR 131.2m is Latvian public financing (15%). The part of the programme directly relating to financial engineering instruments is measure 2.2. “Access to finance”, with a planned public financing of EUR 166m.

The present Report has identified the following financial instruments that could be implemented in the period 2007-2013:

- Guarantee Scheme for Micro and start-up companies amounting to
EUR 20m;

• Social Micro finance pilot scheme amounting to EUR 1m for loans to socially excluded people for the purpose of starting an entrepreneurial activity;

• Strengthening of the national Guarantee Scheme for an amount of EUR 30m;

• Securitisation pilot programme for an amount of EUR 30m;

• Venture Capital Fund-of-Funds envisaging the creation of and investment in several VC funds throughout the period, for a total public funding of EUR 40m;

• Pan-Baltic private equity fund with a minimum size of EUR 30m, of which EUR 5m would be invested with Latvian public funds;

• Pilot Co-investment Fund for Business Angels of EUR 5m;

• Pre-seed/seed fund of EUR 15m providing start-ups with equity and debt financing.

These instruments amount to a total of EUR 146m, to which a reserve of EUR 24m should be added for reinforcing one or the other of these measures or for investing in any additional instrument that might emerge during the period. The total amount of public resources to be dedicated to financial engineering instruments in the next programming period is therefore estimated at EUR 170m.

Given the number and diversity of the proposed measures, which also include some pilot projects, it would be advisable to adopt the holding fund structure, as per article 44 of regulation 1083/2006. This would not only allow for the draw-down of all the funds up-front, but also for a high degree of flexibility, enabling the reallocation of resources from one instrument to the other in line with the changing market needs.

Further consultations with market participants, banks and SME organisations are recommended to be undertaken during the implementation phase in order to assess whether the proposed instruments are considered as realistic and useful for the market. In this context, it is important to point out that the proposed measures are intended to catalyse private investments rather than crowding out private players.

This evaluation report was prepared by the EIF and is considered as final after presentation to the Managing Authority and incorporation of feedback received.

Subject to a positive decision by the government on the implementation of the JEREMIE initiative in cooperation with the EIF, further work is to be done to complete the evaluation and prepare for implementation. These tasks include the establishment of the legal framework, business planning and modelling of flows, organisational, governance and procedural issues.
Coordination of Recommended Actions

This initial assessment is focused on the understanding of the financing of the Latvian SME market and on determining the demand and supply financing levels of different market segments and other types of financing.

The main market players included in the initial analysis are:

- Ministry of Economy and Ministry of Finance
- Latvian Guarantee Agency (LGA)
- Rural Development Fund (RDF)
- Latvian Investment and Development Agency (LIDA)
- Latvian Mortgage and Land Bank (LMLB)
- Banks and Credit Unions
- Associations of branch industries
- NGOs and institutions active in the social field.

Strategic Priorities and Policies

The analysis and the measures proposed take into consideration the main guidelines in the National Strategy Reference Framework (NSRF) of the Latvian Government as well as the recommendations and requirements of the EU in this sphere. This framework represents also the Policy Framework for Utilisation of the Structural Funds and covers a period of 5 years (2007-2011). NSFR defines the main national tasks and priorities as well as the most important challenges of the policy for economic development.

The three main priorities for the allocation of the European Regional Development Fund (ERDF) contributions for 2007-2013 in support of enterprises are:

- to provide informational and advisory support for the creation of new firms and business development, including support for market research and promotion of market outlets;
- to improve the availability of funding to enterprises and business start-ups;
- to provide direct financial assistance for business development, as well as support for the introduction and production of new, innovative products and technologies.

The recommended financial engineering instruments should be seen and implemented in this context.

Overview of SME Environment

The number of active SMEs in Latvia is around 55,000, with 43,500 micro enterprises (79%), 9,900 small (18%) and 2,000 medium enterprises (3%). Around 36,300 self-

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employed people and 13,800 farms and fisheries\(^\text{39}\) are active in the country. The number of new companies is increasing with a positive trend: 10,221 were created in 2004, 11,009 in 2005 and 13,500 were set up in 2006\(^\text{40}\).

The sector distribution of active SMEs in 2005 is:

<table>
<thead>
<tr>
<th>Sector</th>
<th>% of SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>11%</td>
</tr>
<tr>
<td>Construction</td>
<td>7%</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>38%</td>
</tr>
<tr>
<td>Transport</td>
<td>8%</td>
</tr>
<tr>
<td>Real estate</td>
<td>20%</td>
</tr>
<tr>
<td>Others</td>
<td>16%</td>
</tr>
</tbody>
</table>

Major Market Failures and Proposed Instruments

This report endeavours to assess the existing supply and demand of financial engineering instruments supporting SMEs in Latvia and proposes instruments to address the identified market failures. The macroeconomic and SME environment are analysed in chapter 2 as background information for the development of the financial engineering instruments. The existing support measures supporting SME access to finance are assessed in chapter 3 and 4 of this report.

The following failures of the Latvian SME financing market were identified:

- The existing start-up and micro-financing schemes do not entirely cover the demand of potential and existing micro enterprises;
- No social micro finance programme is available in Latvia;
- Existing guarantee schemes have insufficient resources and their market penetration is limited compared to potential market size;
- Entrepreneurs indicate lack of financing as the main obstacle to start-up a business;
- Banks should be encouraged to operate in the SME segment and to assume more risk;
- Insufficient private equity investments in the seed and start-up segments. First-time entrepreneurs have access to a number of programmes offering small grants, but largely lack equity products which offer adequate financing to support them through the critical first years of life;
- Gap of expansion investment for the smaller established companies needing capital to increase production capacity, working capital and capital for the further development of the product or market;
- Insufficient level of Business Angels activity.

\(^{39}\) Latvian Ministry of Economy biquarterly report on development of Latvian economy, July 2006 (data as of 2004). Self-employed, farms and fisheries are not counted into Latvian SME statistics, as opposed to other EU countries.

\(^{40}\) Lursoft electronic database of Latvian Enterprise Register [www.lursoft.lv](http://www.lursoft.lv)
In order to address these market gaps, a set of recommendations concerning the setting up of new, or strengthening of existing financial instruments has been made with the following allocation of resources:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Portfolio share</th>
<th>Million EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantees</td>
<td>17.6%</td>
<td>30</td>
</tr>
<tr>
<td>Guarantees: Micro and start-up</td>
<td>11.8%</td>
<td>20</td>
</tr>
<tr>
<td>Social micro finance</td>
<td>0.6%</td>
<td>1</td>
</tr>
<tr>
<td>Securitisation</td>
<td>17.6%</td>
<td>30</td>
</tr>
<tr>
<td>Venture capital - National</td>
<td>23.5%</td>
<td>40</td>
</tr>
<tr>
<td>Private Equity - Pan-Baltic</td>
<td>2.9%</td>
<td>5</td>
</tr>
<tr>
<td>Business Angels</td>
<td>2.9%</td>
<td>5</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>8.9%</td>
<td>15</td>
</tr>
<tr>
<td>Reserve fund</td>
<td>14.2%</td>
<td>24</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>170</strong></td>
</tr>
</tbody>
</table>

The size of the proposed measures is based on the estimated absorption capacity of the market for each instrument, taking into consideration the nature of the instrument (VC funds, guarantees, co-investment funds, etc.) and the current and future level of development of the market. It is important to point out that all proposed amounts should be considered as indicative, and that further analysis of the situation is needed in order to determine the feasibility of the proposed measures and to quantify the financial resources required.

EIF has started to actively engage the relevant parties in the discussion related to this issue to ensure that the initiative will raise added value to the Latvian economy and will be applied successfully in partnership with the participating institutions.

3.10 Lithuania (September 2007)

Statement of Position

This report recommends a portfolio of complementary measures addressing the market failures identified in the evaluation of access to finance of micro, small and medium sized enterprises (SMEs) in Lithuania. These measures intend to propose an effective use of the EU Structural Funds allocated in the framework of the Operational Programme (OP) for 2007-2013 in view of supporting growth, innovation and employment.

In its OP, Lithuania has reserved approximately EUR 122m for revolving SME financial instruments, i.e. 26% of the total expenditure of Priority 2 (Increasing Business Productivity and Improving Environment for Business), the remaining EUR 340m being earmarked for grants and subsidies.

The present Report has identified the following financial instruments that could be implemented in the period 2007-2013:

- Guarantee Scheme for Micro and start-up companies amounting to EUR 20m;
• Social Micro finance pilot scheme amounting to EUR 1m for loans to socially excluded people for the purpose of starting an entrepreneurial activity;
• Strengthening of the national Guarantee Scheme for an amount of EUR 20m;
• Securitisation pilot programme for an amount of EUR 30m;
• A Venture Capital Fund with a minimum size of EUR 20m, of which EUR 10m would be invested with public funds;
• A Pan-Baltic private equity fund with a minimum size of EUR 30m, of which EUR 5m would be invested with Lithuanian public funds;
• A Business Angels co-investment fund with an initial size of EUR 5m.
• A Pre-seed/seed Fund with a minimum size of EUR 15m (all public) for providing technology start-ups with both equity and debt type of financing.
• A reserve of EUR 20m to be kept for reinforcing one or the other of these measures or for investing in an additional instrument that might emerge during the period.

Thus, instruments for a total public funding of EUR 126m are recommended.

Further consultations with market participants, banks and SME organizations are recommended to be undertaken to find out more about existing problems and whether the proposed instruments are assessed as realistic and useful for the market. In this context, it is important to point out that the proposed measures are intended to catalyse private investments rather than crowding out private players.

This evaluation report was prepared by the EIF and is considered as final after presentation to the Managing Authority and incorporation of feedback received.

Subject to a positive decision by the government on the implementation of the JEREMIE initiative in cooperation with the EIF, further work is to be done to complete the evaluation and prepare for implementation. These tasks include the establishment of the legal framework, business planning and modelling of flows, organisational, governance and procedural issues.

Coordination of Recommended Actions

This assessment is focused on the understanding of the financing of the Lithuanian SME market and on determining the demand and supply financing levels of different market segments and other types of financing.

The main market players included in the initial analysis are:

- Ministry of Economics and Ministry of Finance
- INVEGA
- Banks
- Associations of branch industries (Credit Unions)
- NGOs and institutions active in the social field.
Strategic Priorities and Policies

The analysis and the measures proposed take into consideration the main guidelines in the National Strategy Reference Framework (NSRF) of the Lithuanian Government as well as the recommendations and requirements of the EU in this sphere. This framework represents also the Policy Framework for Utilisation of the Structural Funds at entering the EU on 1st of January 2007 and covers a period of 5 years (2007-2011). The NSFR defines the main national tasks and priorities as well as the most important challenges of the policy for economic development.

As defined in the OP Competitiveness, Lithuania should focus its efforts in the areas of:

- Economic development based on knowledge and innovative activities;
- Increasing the efficiency of enterprises and encouraging the development of the business environment;
- Financial engineering instruments for promoting entrepreneurship and enterprise development;
- Strengthening the international market position of the Lithuanian economy.

The recommended financial engineering instruments should be seen and implemented in this context.

Overview of SME Environment

The total number of SMEs in Lithuania in 2005 was 56,428, representing 99.4% of all active enterprises. This level has been stable over the 2001-2005 period.

The share of micro-enterprises (with up to 9 employees) in the total number of active enterprises has decreased from 80% in 2001 to 75% in 2005, whereas the share of small and medium-sized enterprises has respectively increased from 16% in 2001 to 20% in 2005 and from 3.7% in 2001 to 4.8% in 2005.
Number of SMEs by number of employees in 2001–2005

<table>
<thead>
<tr>
<th>No. of employees</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 9</td>
<td>45,133</td>
<td>44,059</td>
<td>42,474</td>
<td>42,385</td>
<td>42,341</td>
</tr>
<tr>
<td>10-49</td>
<td>9,001</td>
<td>9,098</td>
<td>9,901</td>
<td>11,011</td>
<td>11,394</td>
</tr>
<tr>
<td>50-249</td>
<td>2,080</td>
<td>2,095</td>
<td>2,214</td>
<td>2,450</td>
<td>2,694</td>
</tr>
<tr>
<td>Total</td>
<td>56,214</td>
<td>55,252</td>
<td>54,589</td>
<td>55,846</td>
<td>56,428</td>
</tr>
</tbody>
</table>

Source: Department of Statistics under the Government of the Republic of Lithuania

At the end of 2005, micro-enterprises accounted for 74.6% of the total number of enterprises and employed 15.6% of the total workforce. At the same time, 29.4% of the employees were working in medium-sized enterprises, but the comparative share of such enterprises accounted for only 4.7% of the total number of enterprises.

38.5% of all the SMEs operating in Lithuania are in the trade sector.

The number of SMEs in the services sector increased in the last two years (24.2% of all the SMEs in 2005). The main part of SMEs in this sector was operating in land transport and hotels and restaurants – respectively accounting for 31.2% and 19.6% of all the service provided by SMEs in 2005.

The share of SMEs operating in the industry sector was stable and accounted for 15.5% of the total number of SMEs in 2001–2005. The most important sub-sectors are woodware, food products and beverages. Company birth-rate has been stable over the 2000-2005 period.

Major Market Failures and Proposed Instruments

This report endeavours to assess the existing supply and demand of financial engineering instruments supporting SMEs in Lithuania and proposes a set of instruments to address the identified market failures. The macroeconomic and SME environment are analysed in chapter 2 as background information for the development of the financial engineering instruments. The existing public measures supporting SME access to finance are assessed in chapter 3 and 4 of this report.

The following market failures were identified:

- The existing start-up and micro-financing schemes do not cover the demand of potential and existing micro enterprises;
- Banks should be encouraged to build SME loan portfolios in order to increase the supply of debt-financing for SMEs in Lithuania;
- Existing guarantee schemes have limited resources and mainly rely on external support in order to continue their activity;
- Insufficient levels of risk capital investments, especially for the early stages (pre-seed, seed, start-up and early stage), partly due to the absence of local players (the law does not yet allow for the registration of VC funds in Lithuania). First-time entrepreneurs have access to a number of
programmes offering small grants, but largely lack equity products which offer adequate financing to support them through the critical first years of life.

- A gap exists for expansion investment for the smaller established companies needing capital to increase production capacity, working capital and capital for the further development of the product or market.

- Insufficient level of Business Angels activity. There is no legal base for this class of investors, and no Business Angels network has been established so far.

In order to address these market gaps, a set of recommendations concerning the setting up of new, or strengthening of existing financial instruments has been made with the following allocation of resources:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Portfolio share</th>
<th>Million EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantees</td>
<td>15.9%</td>
<td>20</td>
</tr>
<tr>
<td>Social micro financing</td>
<td>0.8%</td>
<td>1</td>
</tr>
<tr>
<td>Micro and Start-up finance</td>
<td>15.9%</td>
<td>20</td>
</tr>
<tr>
<td>Securitisation programme</td>
<td>23.8%</td>
<td>30</td>
</tr>
<tr>
<td>Venture capital - National</td>
<td>7.9%</td>
<td>10</td>
</tr>
<tr>
<td>Venture capital – Pan-Baltic</td>
<td>4.0%</td>
<td>5</td>
</tr>
<tr>
<td>Business Angels</td>
<td>4.0%</td>
<td>5</td>
</tr>
<tr>
<td>Technology Transfer (Pre-seed and Seed fund)</td>
<td>11.9%</td>
<td>15</td>
</tr>
<tr>
<td>Reserve</td>
<td>15.9%</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>126</strong></td>
</tr>
</tbody>
</table>

The size of the proposed measures is based on the estimated absorption capacity of the market for each instrument, taking into consideration the nature of the instrument (VC funds, guarantees, co-investment funds, etc.) and the current and future level of development of the market. It is important to point out that all proposed amounts should be considered as indicative, and that further analysis of the situation is needed in order to determine the feasibility of the proposed measures and to quantify the financial resources required.

3.11 Malta (September 2007)

Statement of Position

The European Commission has set itself important objectives in favour of SMEs to be carried out within 2013\(^{41}\). In particular, the following measures are particularly sought:

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\(^{41}\) The document reference at the European level is represented by the “Chart of small enterprises”. In Feira, in Portugal, the European Council as approved the “Chart2”, in which the role carried out by enterprises having less than 50 employees is highlighted, both in terms of employment, innovation
• EU financing
• Incentives for risk capital
• Financing for innovation
• Member States’ actions

The European Commission, moreover, encourages Member States to operate in the following directions:

• Realising induction programmes preparing to investments
• Fostering cooperation amongst local organisations, often fragmented
• Applying best practices in the policies specifically tailored at promoting risk capital
• Pursuing stable and long-lasting objectives in public policies concerning risk capital
• Evaluating the advantages of those programmes supporting innovative enterprises
• Studying the advantages of adopting hybrid instruments for SMEs financing
• Effectively utilising the JEREMIE process for carrying out products specifically conceived for SMEs

This report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) in Malta in the context of access to finance. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency. The measures are clearly in line with the broad guidelines set by the European Council to facilitate access to finance in order to achieve growth and job creation in the general framework of improving the attractiveness of regions, encouraging innovation, entrepreneurship and the growth of the knowledge economy and creating more and better jobs.

The key investment proposals are as follows:

• A Guarantee Scheme ranging between EUR 2m and EUR 5m;

• A Micro Credit scheme ranging between EUR 2m and EUR 5m to be offered to eligible institutions (or banks) to onlend micro loans for the promotion of entrepreneurship;

• Risk Capital Investment ranging between EUR 1m and EUR 5m for creating a Fund to stimulate the creation and activities of Business Angels.

Thus, an initial portfolio of specialised instruments ranging between EUR 5m and EUR 15m is recommended to be set up through the means of the Structural Funds allocation for Malta for the planning period 2007 – 2013 to alleviate those conditions that hamper Maltese SMEs access to finance.

It is evident that at this stage, the Preparation Phase, these non-exhaustive list of proposals, are of indicative nature. The proposed capital allocation per instrument is promotion and socioeconomic integration. It has become a pillar of the European Commission policy in favour of enterprises and a term of reference for the Member States.
subject to revision in accordance with the indications of National Authorities, which have indicated an initial contribution to the JEREMIE of about EUR 5m. In addition, the structure and operations of each instrument is yet to undergo a process of fine-tuning so as to improve possible synergies with existing market players.

In the case that further consultations and/or research evidences the need for change, such alterations will be adopted for the optimal utilisation of allocated resources in order to maximise the positive impact on SME development.
3.12 Poland

3.12.1 Dolnoslaskie (August 2008)

The report presents an analysis of the SMEs access to finance in Dolnoslaskie region. Based on the evaluation of macroeconomic situation in the Region as well as trends in the SME population, and contrasting them with the information on the supply of financial products, the following market failures have been identified:

### Market Failures - Summary

<table>
<thead>
<tr>
<th>Micro Finance</th>
<th>Debt Financing</th>
<th>Leasing &amp; Factoring</th>
<th>Venture Capital</th>
<th>Tech Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Limited activity of existing funds (EUR 6.2m outstanding loans)</td>
<td>- Increasing volumes of bank lending</td>
<td>- Only one well established guarantee fund present</td>
<td>- Low level of venture capital financing in GDP</td>
<td>- Low R&amp;D to GDP ratio</td>
</tr>
<tr>
<td>- Lack of start-up financing</td>
<td>- Low level of financial intermediation</td>
<td>- General move towards asset based lending</td>
<td>- Lack of early stage investments</td>
<td>- Poor technology transfer record</td>
</tr>
<tr>
<td>- Market potential estimated up to EUR 200m</td>
<td>- Unfavorable market situation and trends</td>
<td>- Leasing: strong growth does provide evidence of market failure</td>
<td>- Existing/foreign funds active mainly in buy-out sector</td>
<td>- No specialised vehicles existing</td>
</tr>
<tr>
<td></td>
<td>- Limited number of guarantee operations (260 p.a. vs. c.a. 130,000 SMEs)</td>
<td>- Factoring: low penetration level &amp; concentration on operations with recourse</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Although the public support schemes are already present in the debt finance area, they are not able to fully meet the potential demand. Moreover, no scheme providing micro finance to individuals coming out of disadvantaged groups appears to be in operation. In addition, vehicles fostering equity investments have not been so far active, especially at regional level.

As far as the activity of commercial operators is concerned, growing lending activity by the banking sector has been observed. However, the level of financial intermediation remains low when compared to more developed economies of the EU. On the equity side, majority of private equity/venture capital funds concentrate on buy-out transactions with virtually no deals being concluded in early stages.
Given these findings, implementation of a JEREMIE Holding Fund support scheme is recommended in order to foster the competitiveness of the SME sector. Given the allocation for JEREMIE Initiative in the Regional Operational Programme of the Dolnośląskie Region of EUR 39m, the following initial portfolio of financial engineering instruments is being proposed:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance</td>
<td>EUR 6m</td>
</tr>
<tr>
<td>Guarantee scheme for micro-enterprises</td>
<td>EUR 8m</td>
</tr>
<tr>
<td>SME portfolio guarantee window</td>
<td>EUR 10m</td>
</tr>
<tr>
<td>Factoring guarantee window (optional)</td>
<td>MA to decide</td>
</tr>
<tr>
<td>Risk Capital</td>
<td>EUR 10m</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>EUR 5m</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>EUR 39m</strong></td>
</tr>
</tbody>
</table>

The initial split between instruments in the Holding Fund has been made with the view of balancing the risk profile of underlying instruments. The proposed allocation shall be discussed with the Managing Authority during the implementation phase.

The allocation presented above shall be covered by the Structural Funds, together with national contribution, under the said Programme. The possibility of leveraging the Holding Fund by private resources/resources managed by the EIB or other IFIs shall be investigated during the implementation phase.

### 3.12.2 Eastern Poland (October 2008)

#### Statement of Position

This report presents an analysis of the SMEs access to finance in five Eastern Poland Regions (EPR): Warmińsko-Mazurskie, Podlaskie, Lubelskie, Podkarpackie, and Świętokrzyskie.

The evaluation of the macroeconomic situation in the EPR, including the trends in the SME population and business environment, and of the supply of financial products, has led to the identification of the following market failures and JEREMIE recommendations.

#### Major Market Failures and JEREMIE Recommendations

Public support schemes are already present in the EPR microfinance segment, but demand has been estimated to outstrip supply in the coming years. Although a growing lending activity by the banking sector has been observed, the level of financial intermediation remains low when compared to the more developed economies of the EU. On the equity side, the majority of private equity/venture capital funds concentrate on buy-out transactions with virtually no deals being concluded in early stages, and their operations in the EPR group can be considered minimal so far. A SWOT analysis of the EPR financial sector, included in Chapter 5, suggests a number of weaknesses in the system, and significant threats associated with the current financial credit crisis and economic slowdown.
In consideration of these findings, the implementation of a JEREMIE Holding Fund support scheme is recommended in order both to boost the competitiveness of the SME sector and to support and modernise the EPR financial sector. Given the total estimated gap range of PLN 1.3-3.5 (EUR 0.386-1.1) billion in the microfinance and external debt financing segments over the 2007-2013 period, the following initial portfolio of financial engineering instruments is being proposed:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance</td>
<td>EUR 20m</td>
</tr>
<tr>
<td>Guarantee scheme for micro-enterprises</td>
<td>EUR 10-15m</td>
</tr>
<tr>
<td>SME portfolio guarantee window</td>
<td>EUR 25-30m</td>
</tr>
<tr>
<td>Factoring guarantee window</td>
<td>MA to decide</td>
</tr>
<tr>
<td>Risk Capital</td>
<td>EUR 15-20m</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>MA to decide</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>Up to EUR 85m</td>
</tr>
</tbody>
</table>

The initial split between instruments in the Holding Fund has been made with a view to balancing the risk profile of the underlying instruments. The proposed allocation shall be discussed with the Managing Authority during the implementation phase.

The suggested allocation will be covered by the Structural Funds, together with a required national contribution. The possibility of leveraging the Holding Fund by private resources, and/or resources managed by the EIB or other IFIs, shall be investigated during the implementation phase. One of the most visible and positive short-term effects of the JEREMIE initiative could be the mobilisation of IFI capital to be made available to the EPR group. This would be especially important now in the context of the global credit crisis and the associated economic slowdown, which are beginning to affect Poland now, and will likely continue in the coming months.
3.12.3 Pomorskie (May 2008)

The following report presents an analysis of the SMEs access to finance in the Pomorskie Region. Based on the evaluation of macroeconomic situation in the Region as well as trends in the SME population, and contrasting them with the information on the supply of financial products, the following market failures have been identified:

### Market Failures - Summary

<table>
<thead>
<tr>
<th>Micro Finance</th>
<th>Debt Financing</th>
<th>Leasing &amp; Factoring</th>
<th>Venture Capital</th>
<th>Tech Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Limited activity of existing funds (400 loans p.a.)</td>
<td>- Increasing volumes of bank lending</td>
<td>- Substantial growth in both sectors (especially leasing)</td>
<td>- Low level of venture capital financing in GDP</td>
<td>- Low R&amp;D to GDP ratio</td>
</tr>
<tr>
<td>- Lack of start-up financing</td>
<td>- Low level of financial intermediation</td>
<td>- General move towards asset based lending</td>
<td>- Lack of early stage investments</td>
<td>- Poor technology transfer record</td>
</tr>
<tr>
<td>- Market potential estimated at EUR 150 - 200m</td>
<td>- Unfavorable market situation and trends</td>
<td>- Leasing: strong growth does provide evidence of market failure</td>
<td>- Existing/foreign funds active mainly in buy-out sector</td>
<td>- No specialised vehicles existing</td>
</tr>
<tr>
<td>- Market potential estimated at EUR 200m</td>
<td>- Limited number of guarantee operations (400 p.a. vs. over 100,000 SMEs)</td>
<td>- Factoring: low penetration level &amp; concentration on operations with recourse</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- High collateral requirement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Well established guarantee fund in Gdansk</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Whereas the public support schemes are already present in the debt finance area, though their operations are limited, vehicles fostering equity investments have not been so far active, especially at regional level. Moreover, no scheme providing micro finance to individuals coming out of disadvantaged groups appears to be in operation.

As far as the activity of commercial operators is concerned, growing lending activity by the banking sector has been observed. However, the level of financial intermediation remains low when compared to more developed economies of the EU. On the equity side, majority of private equity/venture capital funds concentrate on buy-out transactions with virtually no deals being concluded in early stages.

Given these findings, implementation of a JEREMIE Holding Fund support scheme is recommended in order to foster the competitiveness of the SME sector.
Given the allocation for JEREMIE Initiative in the Regional Operational Programme of the Pomorskie Region of EUR 42m, the following initial portfolio of financial engineering instruments is being proposed:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance</td>
<td>EUR 10m</td>
</tr>
<tr>
<td>Guarantee scheme for micro-enterprises</td>
<td>EUR 10m</td>
</tr>
<tr>
<td>SME portfolio guarantee window</td>
<td>EUR 10m</td>
</tr>
<tr>
<td>Factoring guarantee window (optional)</td>
<td>EUR 5m</td>
</tr>
<tr>
<td>Risk Capital</td>
<td>EUR 10m</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>EUR 7m</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>EUR 52m</strong></td>
</tr>
</tbody>
</table>

The initial split between instruments in the Holding Fund has been made with the view of balancing the risk profile of underlying instruments. The proposed allocation shall be discussed with the Managing Authority during the implementation phase.

The allocation presented above shall be covered by the Structural Funds, together with national contribution, under the said Programme. The possibility of leveraging the Holding Fund by private resources/resources managed by the EIB or other IFIs shall be investigated during the implementation phase.

It is for these reasons that the Commission has created two main EU instruments to promote entrepreneurship and innovation, and to improve SMEs’ access to finance, being the Competitiveness and Innovation Framework Programme (CIP) and the Joint European Resources for Micro to Medium Enterprises (JEREMIE) of the structural funds. The future of European competitiveness depends on an integrated, open, and competitive financial market that covers risk capital and debt finance instruments and as part of the JEREMIE initiative, the European Investment Fund has been asked to evaluate the specific needs of each EU market to identify market failures and to propose a series of appropriate financially engineered instruments.

The JEREMIE initiative will combine grants from the European Regional Development Fund (ERDF) and the European Social Fund (ESF) with loan capital and other sources of finance to support the creation and expansion of micro, small and medium-sized enterprises as part of EU regional policy. Using the concept of a ‘Holding Fund’, JEREMIE enables each Member State to support the development of business angels, technology transfer funds to link business, universities and research centres, and to improve the availability of micro-credits targeted at those who may not have access to commercial credit. Funding from instruments established through JEREMIE

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42 The Competitiveness and Innovation Framework Programme (CIP) and the Joint European Resources for Micro to Medium Enterprises (JEREMIE) are complementary in nature and the European Investment Fund will be the key implementation institution ensuring that this is the case for each Member State.

43 To give just one example, for growth-seeking entrepreneurs, external financing becomes necessary when their initial funds have been exhausted. Knowledgeable private investors are critical for the launching of entrepreneurial businesses, but there is a serious and persistent lack of business angels and other seed investors in Europe. To illustrate, Business Angel investments in Europe are estimated to be less than 10% of those in the United States for a similarly-sized economy.
may also be combined with business support and institution-building measures financed by the Structural Funds.
Improving the Processes; Increasing Delegation to the Local Authorities

In previous periods, difficulties with the administrative processes have led to sub-optimal levels of fund utilisation. Time-consuming processes have led in certain cases to significant levels of funds earmarked for SMEs, being left unused. Understanding the problems this causes, the Commission foresees that significant improvements can be made via the creation of JEREMIE Holding funds within the Member States and with full delegation to the appropriate Managing Authority to oversee the implementation of JEREMIE programmes aimed at delivering sustainable financially engineered instruments that improve access to finance for SMEs.

Importantly, each programme will be individually tailored to the needs of each Member State following on from the combined efforts of the EIF and the Member State to evaluate market failures and the appropriate remedies in the context of its Operational Programme. The proposed instruments will efficiently engage the private sector and seek to maximise the leverage effect.

The flexibility within the portfolio of JEREMIE instruments in each programme enables a full range of instruments varying from equity and quasi-equity to venture capital, loans or guarantees for the benefit of SMEs in the Member State. Furthermore, the portfolio of instruments used and financial commitments made is flexible enabling alterations in positional allocations to be made during the period.

3.13 Romania (June 2007)

The report for the Romania SME Financing Gap Assessment was prepared in the context of the JEREMIE initiative and commissioned by the European Commission Directorate General Regional Policy.

Integration within existing Strategic Priorities and Policies

The present report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) in Romania in the context of access to finance. The proposed measures aim to contribute to strengthening the competitiveness of Romanian SMEs and increasing their efficiency as well as their export potential. The measures are balanced as to their size and effect aiming at a more efficient use of the EU Structural Funds allocated in the framework of the Sectoral Operational Programme (SOP) “Increase of Economic Competitiveness” in the period 2007-2013.

Within the Competitiveness SOP, Priority Axis 1 “An Innovative Productive System”\(^4\), provides a key area of intervention called “Access to credit and financing instruments for SMEs”, which aims at increased investment activity and entrepreneurship through the development of existing and alternative financial sources for SMEs. The SOP confirms a serious market failure in this area, as SMEs are

\(^4\) Proposed allocation by Romanian authorities, as per draft plan at the end of 2006: c. EUR 2.2 bln of ERDF funds), of which c. EUR 690m to Priority Axis 1 and c. EUR 470m to Priority Axis 2.
an important actor for economic development and have serious problems in accessing finance. In Priority Axis 2 of the same SOP, supporting “Research, Technological Development and Innovation for Competitiveness”, a proposed key area of intervention emphasizes the importance of supporting high-tech micro-enterprises and spin-offs. The Regional Operational Programme also includes a Priority Axis aimed at “Strengthening the regional and local business environment”.

Main Findings and Recommendations

An analysis of supply vs. demand for financing by SMEs was performed, with the objective of identifying possible “gaps” in access to finance to SMEs – areas in which the amount of financing provided currently provided by the market is insufficient to meet potential demand, expressed or yet unexpressed.

The study has revealed that SMEs in general – and start-ups in particular - face a challenging environment for financing. As the main source of external financing (other than the means brought by the business founders themselves), bank loans remain hard to obtain for young SMEs and in any event, the benefit from guarantee schemes are only considered as a supplement to – and not a replacement for - the obligation to back the loan request with full collateral. Nevertheless, it is generally felt that a strengthening of the national guarantee system, associated with a cooperation with banking institutions active in the country could yield an improved access to finance for SMEs. On the lower end of the lending market, the vigorous demand for micro-lending could be better met through a combination of guarantee instruments and selected seed-financing of selected micro-finance institutions.

The supply of equity capital in the earlier stages of development of enterprises is also lacking, and here too, the state could play a role in making such a supply more broadly (and visibly) available, in cooperation with the national institutional and private financial players. Pilot schemes to promote investment by business angels and for improving the creation and realization of intellectual property should be considered – although both of these fields will require considerable “institutional building” in order to put in place conditions under which such schemes are more likely to be successful.

Public supply of capital cannot be the only response to gaps in the financing market. Indeed in many cases institutional, legal and fiscal reforms, as well as measures to improve the “finance-readiness” of SMEs can, for example, constitute key complementary remedies for such market imperfections. The set of financial measures suggested for deployment through the JEREMIE mechanism do not therefore aim to eliminate the financing gap, but do however have the ambition to significantly contribute to narrowing it.

We believe that the following portfolio of financial instruments for supporting SME access to finance could be successfully deployed in Romania through the JEREMIE mechanism, over the period 2007-2015:

- Debt financing/Guarantees: dedicating EUR 120-150m to strengthening the guarantee system in Romania, in cooperation with existing guarantee institutions;
• Micro-lending: Setting-up a micro-finance fund, with an endowment of at least EUR 40 m to invest in - or provide guarantees to - micro-lending schemes by banks and/or microfinance institutions;

• Venture capital: Deploy c. EUR 100 m to support 7-10 seed, early-stage and development capital funds and, possibly, a small experimental facility to co-invest along business angel networks;

• Technology transfer: setting-up pre-seed instruments amounting to EUR 30 m to finance the commercialisation of promising technology through two facilities:
  o Tech-transfer fund focused on pre-financing R&D through upfront investment in a patent in return for a partial assignments of IP rights - EUR 10-15m;
  o Tech-transfer fund providing pre-seed finance to 1000 innovative start-up loans in the period 2007-2013 - EUR 15m;

In conclusion, the report recommends a portfolio of a total amount of c. EUR 290-320 m to be set-up through the means of the ERDF allocation for Romania 2007-2013 in order to help the catching-up process and alleviate existing market failures, as documented in the present report through a gap-analysis analysing the existing supply and potential demand. All recommendations are backed by the analysis that can be found in the different sections of the report.

Summary of market failures and proposed initiatives:

<table>
<thead>
<tr>
<th>Observed market gap</th>
<th>Proposed instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt financing/guarantees</td>
<td>Reinforce the national guarantee system, through EUR 120-150m targeted injection to stimulate lending to SMEs.</td>
</tr>
<tr>
<td>Difficulties for SME to borrow, in particular if new or active in manufacturing.</td>
<td>Support of micro-finance institutions by deploying c. EUR 40m via direct funding or a specific guarantee instrument.</td>
</tr>
<tr>
<td>Gaining access to finance through the traditional banking system is challenging for many aspiring new/self-employed entrepreneurs.</td>
<td>Fund-of-fund of c. EUR 100m to support VC initiatives in the country.</td>
</tr>
<tr>
<td>Early-to -development stage VC is under-developed.</td>
<td>Creation of a EUR 30 facility to a support technology transfer scheme to stimulate the</td>
</tr>
<tr>
<td>intellectual property.</td>
<td>production of “monetisable” intellectual property and finance pre-seed R&amp;D projects with the potential to lead to a viable spinout business.</td>
</tr>
</tbody>
</table>

**Coordination and next steps**

On the basis of the results of the preparatory phase of the JEREMIE, Romanian authorities will evaluate the range and size of financial instruments and agreements for the JEREMIE intervention will be detailed and negotiated. A key element will be to establish an ongoing coordination between institutional stakeholders in order to prepare the implementation phase and facilitate communication among the EIF, EC and the Romanian Government.
Such coordination should involve, at least, the following institutions:

- National Agency for SME and Cooperation;
- National Authority for Scientific Research;
- Ministry of Public Finance;
- Ministry of Economy and Commerce;
- Ministry of European Integration (Regional Development);
- Employers & business associations
- European Commission – DG Regio & DG Enterprise
- European Investment Fund.

3.14 Slovakia (August 2007)

Statement of Position

The Slovak economy is experiencing strong growth, to which small and medium enterprises (SMEs) are a very important contributor, creating almost 50% of the added value and providing 70% of all jobs. However, a major part of them indicates having insufficient financing to grow, notwithstanding increased activities of commercial banks.

In the context of the JEREMIE initiative, the European Investment Fund (EIF) has analysed in this report the access to finance for SMEs in Slovakia and has identified major gaps between potential demand and existing supply in the main financial instruments facilitating access to finance for SMEs, hampering their creation and development. EIF can act as a catalyst in closing these gaps through its know-how in setting up adequate market-oriented instruments and attracting private lenders and risk capital providers in the framework of JEREMIE (see chapter 1.4).

The portfolio of financial instruments is to be set up in a Jeremie Holding Fund structure, providing an important opportunity to the Slovak government to lay the foundations for continued high economic growth, strong development and increased competitiveness compared with other European countries, in the coming years.

Major Market Failures & Recommended Actions

EIF has identified the following major market failures in the context of access to finance for SMEs in Slovakia justifying the use of public support measures according to EU State Aid rules:

- Low provision of micro finance for self-employment and start-ups;
- Low ratio of SME domestic credit and guarantee activities as percentage of GDP;
- Low factoring-to-GDP ratio compared to EU-25 average;

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the order in which the institutions are listed is purely random and should not be interpreted as a prioritization of one institution over another.
• Low VC activities compared to GDP and other Central European EU member states;
• Low R&D-GDP ratio, poor technology transfer record;
• No business angels network existing.
At this stage, in order to diminish or fill these financing gaps, the following revolving instruments are proposed to be set up in 2007-2013 in the JEREMIE framework:

- Micro Loan Guarantee Scheme targeting start up companies: EUR 180 m;
- Social Micro Loan Scheme: EUR 5 m;
- Portfolio Loan Guarantee Scheme to SMEs: EUR 110 m;
- Slovak Seed Capital Fund; Slovak Emerging Growth Fund, smaller investments in quality private VC fund initiatives: EUR 150 m;
- Factoring supporting scheme of EUR 50 m;
- Intellectual Property Fund: 10 m;
- Capacity-building and Pool Fund to stimulate investment readiness: EUR 5 m.

Details of the supply and demand analysis of each financial instrument evidencing these market failures and the JEREMIE proposals are given in chapter 3 of this report. Given the flexibility of the JEREMIE structure, these instruments can be further developed and adapted and new instruments can be introduced, in line with market developments in Slovakia in the coming years, in order to best correspond to the needs of the SMEs and thus strengthen the Slovakian economy.

**Strategic Priorities and Policies**

The Competitiveness Strategy for the Slovak Republic until 2010 (‘Lisbon Strategy’) aiming to strengthen economic competitiveness with more and better jobs and social cohesion, lists four priority development areas:

- Information society;
- Science, R&D, innovation;
- Business environment;
- Education and employment.

This has been reflected in the National Strategic Reference Framework 2007-2013 (total EU Structural Funds to be received more than EUR 11 bn), which includes Operational Programmes in the areas of:

- Information society (EUR 993 m);
- Research and Development (EUR 883 m);
- Competitiveness and Economic Growth (EUR 772 m);
- Employment and Social Inclusion (EUR 864 m);
- Environment (EUR 180 m);
- Bratislava region (EUR 87 m);

Apart from the more traditional areas for EU Structural Fund support such as transport, environment and regional (infrastructure) development,
3.15 Slovenia (September 2008)

Statement of Position

In the context of the JEREMIE initiative, the European Investment Fund (EIF) has conducted a draft evaluation on the access to finance situation for Micro, Small and Medium-sized Enterprises (SMEs) in Slovenia, being a key factor of growth and employment in Europe. It has identified major gaps between potential demand in the coming years and existing supply of main financial instruments facilitating access to finance for SMEs, hampering their creation and development. EIF can act as a catalyst in closing these gaps through its know-how in further analysing the market, setting up adequate market-oriented instruments and attracting private lenders and risk capital providers in the framework of JEREMIE (see chapter 1.4.).

This draft evaluation was presented to the Slovenian Government in May-June 2008. The portfolio of financial instruments proposed is recommended to be set up in a Jeremie Holding Fund structure, providing an important opportunity to the Slovenian Government to lay the foundations for continued high economic growth, strong development and increased competitiveness compared with other EU countries, in the coming years.

Major Market Failures & Recommended Actions

EIF has identified major market failures in access to finance for SMEs in Slovenia justifying the use of public support measures according to EU State Aid rules:

- Low provision of micro finance;
- Low provision of SME domestic credit and guarantee activities for further growth and expansion;
- Low VC activities compared to GDP and other Central European EU MS;
- Low existence of business angel networks.

At this stage, in order to diminish or fill these financing gaps, the following revolving instruments are proposed to be set up in the context of EU Structural Funds 2007-2013 via a JEREMIE Holding Fund structure:

- Portfolio Micro Loan Guarantee Scheme: € 19 mio
- Quasi equity/debt (mezzanine\(^46\), Subordinated Loan (equity enhancement guarantee) Agreement: € 175 mio
- Venture Capital:
  - Co-Financing investment: € 10 – 20 mio
  - Investment initiative for medium sized companies: € 40 mio
- Business Angels: Co-Financing investment + Start-up school: € 5 – 10 mio

\(^{46}\) Mezzanine: Convertibles, Subordinate Loans with equity link, Subordinated Loans with variable return, etc.
TOTAL: € 249 – 264 mio
Details of the supply and demand analysis of each financial instrument evidencing these market failures and the JEREMIE proposals are given in chapter 3 of this study. After a positive decision of the Slovenian Government on the implementation of JEREMIE in cooperation with EIF, in-depth discussions with key market players in the debt and equity sector are envisaged during the preparation of the implementation phase. Given the flexibility of the JEREMIE structure, these instruments can be further developed and adapted and new instruments can be introduced, in line with market developments in Slovenia in the coming years, in order to best correspond to the needs of the SMEs and thus strengthen the Slovenian economy.

Strategic Priorities and Policies

The competitive strategy for Slovenia until 2010 (‘Lisbon Strategy’) is aiming to achieve greater economic growth and higher employment. This has been reflected also in mobilising all the necessary funds on the national level – including the cohesion policy. In the EU financial perspective 2007-2013 in Slovenia there will be EUR 4.2 million available in the field of cohesion policy. According to Lisbon expenditure Slovenia will indicatively allocate more than 60% of all resources available. Slovenia will achieve this objective with the implementation of the following operational programmes:

- Operational Programme for Strengthening Regional Development Potentials for Period 2007 – 2013
  - Competitiveness and research excellence
    - Knowledge for development
    - Promotion of entrepreneurship
  - Economic development infrastructure
    - Economic-development-logistics centres,

- Operational Programme for Human Resources Development for the Period 2007-2013
  - Promoting entrepreneurship and adaptability
    - Experts and researchers for competitive enterprises,

- Operational Programme of the Environmental and Transport Infrastructure for the Period 2007-2013,
  - Cross-border operational programmes,
  - Trans-national operational programmes,
  - Inter-regional operational programme.

According to the Government Communication Office of the Republic of Slovenia the competitiveness of the entrepreneurial sector and its development is especially important in a small and open economy such as Slovenia. Through their innovative, dynamic and adaptable qualities they represent one of the key levers for economic growth as well as for increasing employment. Support will be needed for innovative SMEs with high growth potential operating with high value added.
3.16 Spain

3.16.1 Andalucía (June 2008)

Statement of Position

Over the last ten years, Andalusia has experienced a substantial economic growth resulting in higher production levels, job creation and a significant increase in the relative weight of services.

Microenterprise predominance in the region as well as total SME proportion are slightly higher than the average in Spain. Financial situation is somewhat weaker, with lower capitalisation levels and higher recourse to ST debt.

SME support policies in Andalusia depend on the “Consejería de Innovación, Ciencia y Empresa” of Junta de Andalucía, mainly through Agencia IDEA. The “Orden de Incentivos” is the legal document setting forth the account of financial instruments (mainly grants) to support entrepreneurial investment.

The supply of instruments to improve SME access to finance can be summarised as follows:

• Social Microcredit: in addition to the handful of initiatives from savings banks, the “Consejería de Empleo” and the “Consejería para la Igualdad y Bienestar Social” have promoted a programme in cooperation with La Caixa and Fundación Genus aiming at promoting self employment. Microloans can be provided up to a limit of EUR 15,000. There is no microcredit scheme for start-ups.

• Ordinary loans are available through the financial system. IDEA also offers access to EIB global loans. Moreover, interest rate reductions for SMEs are available under certain conditions.

• Currently three SGRs are active in Andalusia operating in differentiated subregions and each offering different conditions to the SMEs in their territory, i.e. Andalusian SMEs do not have access to the same conditions or instruments throughout the region. Two SGRs have already approved their merger and the third may follow. IDEA has signed a Framework Agreement with the SGRs establishing the conditions for cooperation and contributions from IDEA to their own funds (Fondo de Provisiones Técnicas).

• Availability of mezzanine finance is highly biased towards small, early stage investments as the only regional player, INVERCARIA, provides participating loans as part of their overall supply of early stage instruments. Larger investments, frequently related to R&D, do not find their match, as the only source of financing comes from CDTI and ENISA, whose activity in the region falls below its economic weight.
• Risk capital market is among the most dynamic in Spain, yet polarisation can be detected in that the supply for early stage comes almost exclusively from public resources while that for larger later stage and buyout operations comes from private funds. Thus intermediate investments for growth opportunities are limited due to lack of adequate financing. In 2005 IDEA and EIF have jointly promoted the launch of a public-private fund focused on the underserved expansion segment.
• The Campus programme, cofinanced with ERDF, has proved a powerful instrument to promote technology transfer from Universities for the creation of technology-based spinouts. Since the beginning of this programme Andalusia has progressed in Spain from the last position to the first in terms of spinout generated.

• Business Angels activity is hardly noticeable and with the exception of Malaga’s network are at an embryonic stage with but a local network in Malaga.

In this context, EIF recommends the creation of a JEREMIE Holding Fund for the progressive implementation of financial instruments as outlined below:

• Social Microcredit: dedicate EUR 5m in form of guarantees to support, reinforce and guarantee homogeneous conditions for microloans granted by savings banks to microenterprises throughout the regions. It is essential to count on microfinance institutions for the mentoring tasks.

• Microcredit scheme for start ups: proceed with the creation of a EUR 10-15m guarantee fund as approved by the Junta for backing a EUR 100-150m microcredit programme.

• Develop a regional securitisation platform dedicating EUR 20m to enhance risk profile for a EUR 80-100m SME bond portfolio held by an SPV that would in turn issue and sell securities in the capital markets in one or more tranches throughout the period.

• Participating loan programme: Initially it could be done as a pilot project for a total loan amount of around EUR 20m to assess market acceptance. Risk for financial intermediaries could be mitigated either with guarantees or with the provision of subordinated funds, if the programme is marketed via banks, or setting up an independent mezzanine fund.

• Create a Seed capital fund to continue INVERCRIA activity in the segment. Such fund could also be open to coinvestment with BA.

• Expansion risk capital: At present this segment is sufficiently served from the GED Sur fund. As this fund approaches its investment limits it would be convenient to be prepared for launching one or more generalist funds with similar characteristics. It is therefore advisable to continue monitoring the market.

• Special Tech transfer financing requirements can be met from the recommended seed capital fund, continuing with the existing programmes, benefiting from the technical expertise of Universities, OPIs and CTIs and INVERCRIA’s know how.

• Business Angels activity and network are still too underdeveloped to allow for the creation of a specific, market-driven instrument. Opening the possibility of coinvesting with seed capital fund seems a feasible solution for this market failure.
It is also important to insist in the convenience of a progressive reduction of direct grants replacing them with market-driven, revolving financial instruments, which offer more incentives both to SMEs and to financial intermediaries.
3.16.2 Asturias (December 2007)

The SME promotion and financing in the Principado de Asturias is managed through IDEPA, Instituto de Desarrollo Económico del Principado de Asturias, the regional development agency whose main objective is fostering the creation of new businesses, promoting productivity and competitiveness improvement among the existing enterprises, enticing international investment and facilitating internationalisation. For the implementation of its financing instruments for SMEs IDEPA leans on ASTURGAR, the regional SGR (Sociedad de Garantía Recíproca – mutual guarantee association), venture capital funds as well as on financial institutions. Moreover, IDEPA is in charge of the coordination of all the initiatives.

The current situation of financing instruments for SMEs in the region can be summarized as follows:

- There is a regional microcredit scheme originally addressed to start ups, which offers now a window for social microcredit;
- ASTURGAR’s activity in the last years has slowed down (2002 – 2005) in relation both to the amount of new guarantees and to the total outstanding amounts. The bulk of operations are of small size and the level of collateral required is still relatively high;
- Mezzanine finance is provided through public sector VC instruments (SRP, Sociedad Regional de Promoción). Supply seems relatively low, with EUR 3.6 m for 4 projects in 2006;
- Public risk capital prevails in the region both in terms of volumes and number of deals, with increasing activity in the last years albeit at a lower pace than the overall national risk capital market (due to the significant momentum acquired by Madrid and Catalonia, in particular in megadeals). In the Venture Capital segment the average size per deal has grown significantly over the 2004 – 2006 period;
- Business angels and technology transfer financing instruments are still at an embryonic stage in the region.

Based on the situation outlined above and on the analysis of supply and demand for SME funding, EIF would recommend to establish a JEREMIE Holding Fund of EUR 20 m for the 2007 – 2013 programming period that could be set up with a minimum size of EUR 10 m and grow to the maximum over the years in order to implement the following financial outlined below:

- Reinforce the existing microcredit programme through the provision of EUR 1.5-2 m for guarantees to allow the SGR aiming at a target 1 operation per 1,000 SMEs per annum;
- Provide guarantees for EUR 1 m for a regional social microcredit programme set up in cooperation with the SGR, microfinance institutions to provide mentoring services and financial intermediaries, in charge of agency tasks and sharing risk with the SGR.
• Reinforce ASTURGAR’s guarantee capacity by injecting EUR 2 m in its equity to allow it to expand its activity and give coverage to a wider range of financial instruments, such as participating loans, business transmission, leasing operations as well as to increase the amount limits per operation;
Set up a EUR 10 m mezzanine programme of participating loans differentiated from VC investments. Risk could be addressed either with guarantees worth EUR 3 m or contributing EUR 8 m subordinated funds and leveraging private senior funds to top up to EUR 10 m. As for the instrument’s architecture, considering SRP’s expertise in providing mezzanine finance, creating a specific fund with an independent management appears to be a suitable structure for Asturias;

- Invest EUR 5 m in a public-private multiregional generalist VC fund focused on the lower mid market. The size should be enough to allow for sustainability and capacity to attract a professional and independent management team (target size EUR 55 m);
- Create a EUR 5 m seed capital fund funded 100% with public resources;
- Create a EUR 3 m pilot Business Angels co-investment fund. The amount could be subsequently increased if sufficient demand develops.

3.16.3 Canarias (December 2007)

The ultraperipheral location of the Canary Islands, the insularity factors (double insularity in the case of minor islands) and the special fiscal regime have determined the singularity of the Canaries with regard to its economic situation, entrepreneurial tissue and related financing.

The economy of the Canary Islands has experienced notable growth over the past years, largely thanks to the fiscal policies aimed at fostering investment. Profits generated must be reinvested to enjoy attractive fiscal benefits. The substantial amounts of cash generated have been invested mainly in the tourist sector, real estate and building, whose profitability was boosted by the low capital cost. The incentive to invest in innovative projects with higher risk/profitability profiles has been thus limited.

SME supporting policies are not centralised. Instead, there are various public institutions and bodies taking part in such policies, which depend on the Consejería de Industria, Comercio y Nuevas Tecnologías and the Consejería de Economía y Hacienda. The SME situation with regard to access to finance in the Canaries can be summarized as follows:

- Substantial cash available from the RIC (Reserves for Investing in the Canaries);
- There is no public social microcredit scheme, but a handful of minor private initiatives, especially linked to the Savings banks. Demand for national microcredit lines (ICO) has been relatively high;
- Incentives for starting up businesses are grants, thus crowding out a possible microcredit scheme for start ups;
- Access to debt financing is subject the same type of collateral requirements found nationwide. SME financial position appears more sound than in the rest
of Spain thanks to tax levy on profit reinvestment, thus creditworthiness of established SMEs is relatively higher and financing requirements lower. On the other hand, this represents an additional barrier for start ups;
• The two existing SGRs (mutual guarantee associations) in the Canaries have experienced uneven geographical development due to lack of presence in minor islands. Both feel constrained by limited guarantee capacity and low limits per operation. The recently-passed Decree 1/2007 specific for the Canaries aims at easing the SGR's activity;

• Mezzanine instruments such as participating loans are practically non-existent;

• There is hardly a regional risk capital market. The regional government has expressed its will to promote its development. Moreover, a number of private initiatives are emerging for the creation of RC funds taking advantage of the possibility of RIC investment (see section 4.2.1). The main difficulty lies in the lack of viable projects for investment;

• Various public organisms are involved in the development of technology transfer, but it is still at an embryonic stage;

• A business angels network is currently being formalised. There is some angel investment activity.

Based on the situation outlined above and on the analysis of supply and demand for SME funding, EIF would recommend to establish a JEREMIE Holding Fund of EUR 40-50 m that could be set up with a minimum size of EUR 20 m and grow to the maximum over the years in order to implement the following financial outlined below:

• Pilot programme for federating the existing social microcredit initiatives dedicating EUR 2 to 4 m in form of guarantees. This could be combined with initiatives outside the scope of JEREMIE but with complementary objectives such as fostering microfinance institutions (IAS, social assistance institutions) for instance by providing formation for human resources. Social microcredit should be differentiated from microcredit for start up;

• Setting up a EUR 30 m microcredit programme for start ups through EUR 3 m in the form of portfolio guarantees. This should not be presented as an alternative to grants;

• Dedicate EUR 10 m for the development of a regional securitisation platform totalling EUR 50 to 60 m worth of SME loans or bonds directly issued by SMEs. This instrument would allow to funnel the cash available from the RIC to finance SME activity in the region under conditions similar to those obtained by large corporates in the capital markets;

• Set up a EUR 50 to 60 m participating loan facility for innovative enterprises or technology based firms either through the provision of EUR 10 m guarantees or by creating a specific fund through the contribution of EUR 20 m subordinated funds;
• Reinforce the SGRs' guarantee capacity to back the above-mentioned instruments, if the guarantees were to be funnelled through the SGRs, as well as an additional EUR 3 to 4 m to allow for geographic expansion (minor islands) and extension of product cover range, to include for instance loans for business transfer;
The risk capital market development’s first requirement is the deal flow. The region can benefit from significant and unique advantages to attract entrepreneurs from Europe, America and Asia: fiscal regime, geographic position (Africa off-shore, yet European territory). Setting up a generalist risk capital fund would complement such an attractive environment. It is key to select an adequate management team capable not only of selecting good projects, but also of attracting them to the islands. Such a fund should have a size between EUR 20 and 30 m, of which ERDF contribution could be EUR 5 m. The relatively small size could limit the attractiveness of the remuneration package for a highly skilled management team under the regular market conditions applied, hence thought should be given to alternatives for providing complementary remuneration;

- Setting up a EUR 3 m business angels co-investment fund, possibly leveraging RIC funds.

The potential impact of such a Holding Fund on SME access to finance and ultimately on the regional economy cannot be isolated from complementary measures and policies aimed at fostering innovation, economic diversification and value added enhancement. In this context, EIF would recommend to coordinate initiatives, consolidate and reinforce existing actors, gradually reduce direct grants and using funds instead in form of indirect support (technical assistance, infrastructures, formation, etc), thus complementing the availability of financial resources.

3.16.4 Cataluna (December 2007)

The Generalitat de Catalunya has presented a programme for the utilisation of EUR 50 m from its regional ERDF Operating Programme to create a Holding Fund under the JEREMIE initiative for the development of revolving financial instruments to address a number of perceived market imperfections and thus improve the SME access to finance in the region. The plan has been designed by Institut Català de Finances, regional public institution in charge of finance policies and HF for the JEREMIE initiative. After preliminary presentation of EIF’s conclusions the plan was slightly amended. It comprises the following initiatives:

- EUR 20 m guarantees for MLT (medium to long term) loans in favour of technology-based SMEs, SMEs with high growth potential and R&D and TT (technology transfer) projects;
- EUR 15 m for a Risk Capital fund-of-funds investing in early stage funds;
- EUR 12 m guarantees for a microfinance scheme for start ups;
- EUR 3 m for a Business Angels co-investment fund.
On the basis of the information and support provided by ICF and CIDEM\(^{47}\), EIF reviewed the programme and formulated general recommendations related to the overall programme, guidelines for structuring the schemes that reflect good practices as observed by EIF across international markets, main structuring options to consider in certain cases. In some cases, EIF suggested modifications that would, in its opinion, allow the scheme to more effectively reach its objectives:

- **General recommendations**:
  - Need to focus as much as possible the available resources on a limited number of schemes in order to maximise the market reach. Opportunities to gain scale of through inter-regional/cross-border initiatives and seeking additional financing resources have the potential to yield significant benefits and should thus be considered too;
  - It is essential that thought be given to the “whole offering” of connected financial instruments and services to SMEs;
  - The availability of these financing instruments initiatives should be adequately communicated to the market;
  - Delegation to financial intermediaries must be well thought-out and precisely executed & monitored; once such autonomy has been granted, it should not be subject to decisional interference.
  - Guarantee scheme: EIF recommends to implement the scheme, possibly increasing the resources;

- **Risk Capital scheme**: EIF perceives some risk of insufficient generation of “investable” funds that could cause infrautilisation of the funds within the programming period or reduced scope for “cherry-picking” the best funds. The recommendation therefore is to dedicate less resources and to simplify the investment structure, for example, through a co-investment fund rather than a fund of funds;

- **Microfinance scheme for start up**: EIF recommends to implement the scheme and to use portfolio guarantees to incentive the uptake of the facility and ensure agile procedures, i.e. all loans granted by a given financial institution that complies with established set of eligibility criteria are automatically covered by the guarantee;

- **Business Angels co-investment fund**: In EIF’s opinion, the situation of BA and BA networks in Catalonia provide an excellent environment for the development of such an instrument.

### 3.17 Sweden (January 2007)

**Statement of Position**

\(^{47}\) Centro de Innovación y Desarrollo Empresarial
This report recommends a portfolio of complementary measures adapted to address the observed market failures within financing arena for the problems of micro, small and medium size enterprises (SMEs) across Sweden. The report also looks in further detail into the special characteristics of the counties of Västernorrland and Jämtland in Mid-Sweden and Västra Götaland in the north. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency and export potential. The measures are balanced as to their size and effect aiming at a more efficient use of the EU Structural Funds and to act as a catalyst to promote private market financing. It is important to note that the proposed measures support and complement existing and proposed public policy measures and should be regarded as appropriate for all of Sweden.

This report is also intended to supplement the process of Operational Programme submission to the European Commission that is currently ongoing.

The analysis indicates that disparate market imperfections or failures can be addressed by utilising the new JEREMIE framework and the construction of a portfolio of financial instrument interventions combining to create a revolving structure. The proposed portfolio comprises targeted instruments totalling a financial commitment of EUR 537.5 million focused on supporting SMEs’ access to finance during the coming years. The report also proposes implementing a unique utilisation of support provided by the European Investment Bank as an additional capital provider in addition to Structural Funds and a National contribution. The indicative proposals within the JEREMIE framework are proposed as:

- Micro Finance Loan Scheme targeting potential entrepreneurs currently not in active employment amounting to EUR 25m to be offered via eligible national institutions (or banks) to ‘on-lend’ micro loans to the selected target groups for the purpose of creating SMEs;
- Portfolio Guarantee Schemes for Debt Finance amounting to EUR 327.5m for SMEs offering three types of guarantees:
  - Guarantee scheme for start-ups; up to EUR 247.5m
  - Guarantee scheme for growth-oriented existing enterprises; up to EUR 80m
- Risk Capital Investment Fund of Funds amounting to EUR 100m for selected regional Venture Capital investments (Early Stage).
- Risk Capital Investment amounting to EUR 75m for creating a Matching Fund to stimulate the co-investment activities of Business Angels.
- In the area of Technology Transfer a consideration of the following factors is recommended.
  - Greater Capitalisation of University Holding companies
  - Consideration of the establishment of an ‘Intellectual Property Fund’ focussing on Technology Transfer opportunities possibly utilising the capital base of Innovationsbron, and
  - Full nationwide establishment of a TT network with appropriate resources offices
• There appears to be scope for a Pilot project to develop SMEs export volumes utilising a structured Export Credit facility.

No evidence of market failure in the areas of Leasing and Factoring were found and therefore no public policy proposals are included.

Thus, the portfolio totals an amount of EUR 537.5 million which is recommendation that may be set up through the provision of capital from three main sources. A proportion of the ERDF allocation for Sweden from 2007; a matching proportion provided by way of a national contribution; the possible additional capital provided by the new European Investment Bank Loan approach dedicated to supporting JEREMIE and the possible equity participation of significant private institutions within the Swedish market.

The discussions on specifying the form of the proposed instruments, their size and the selection of the most eligible institution for their implementation will continue during the finalisation of the JEREMIE evaluation report and the OP Competitiveness. It is important to build the entire portfolio of the JEREMIE Programme on a central level. Further consultations with market participants, banks and SME organizations are recommended to be undertaken during the finalisation of the report to analyse more about existing problems and whether the proposed instruments are assessed as realistic and useful for the market.
The support of the private business is necessary to assure that there is no “shift from the private capital market” (crowding out) as a result of the proposed measures and that the private capital is entirely engaged in this process. Within the evaluation a series of interviews was undertaken with over 40 people from around 20 companies and institutions directly involved in this sector. A summary of the results of those interviews is provided in Appendix 6.1 and further discussions with market players are recommended regarding the proposed measures that may lead to changes in the proposals initially made.

Major Market Failures and Proposed Instruments

This report assesses the existing supply and demand of financial engineering instruments supporting SMEs in two counties within Sweden and proposes instruments to decrease the gap given the proved market failure in this area. The existing public support measures supporting SME access to finance were assessed as far as possible; details are shown in chapter 4 of this report. The macroeconomic and SME environment are analysed in chapter 2 as background information for the development of the financial engineering instruments.

The identified market failures and weaknesses of the SME financing market mainly lie in the area of SME financing by the commercial banks in particular segments (micro financing, guarantees) and in the underdevelopment of the venture capital investments and technology transfer activities.

The total amount of the portfolio and the size of the separate measures are based on the current level and development dynamics of the financing of SMEs and on the experience in the use of financial instruments in practice.

The proposed instruments might cover more than one market segment, as exact borders between the segments do not exist. The proposed measures form the investment portfolio under the JEREMIE Programme with a balanced focus on financial engineering instruments illustrated in the following table:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Portfolio share</th>
<th>EUR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro finance</td>
<td>5 %</td>
<td>25 m</td>
</tr>
<tr>
<td>Guarantees (SME loans)</td>
<td>60 %</td>
<td>327.5 m</td>
</tr>
<tr>
<td>Venture capital</td>
<td>18 %</td>
<td>100 m</td>
</tr>
<tr>
<td>Business Angels</td>
<td>15 %</td>
<td>75 m</td>
</tr>
<tr>
<td>Export Credit Pilot facility</td>
<td>2 %</td>
<td>10 m</td>
</tr>
<tr>
<td>Total</td>
<td>100 %</td>
<td>537.5 m</td>
</tr>
</tbody>
</table>

The EIF proposes to the Swedish authorities in charge to implement the recommendations made in the Interim Report with regard to the proposals to the Commission for the next planned period between 2007 and 2013. All proposed amounts should be considered as indicative however they are regarded as

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48 One of the purposes of JEREMIE is to allow member States to flexibly allocate resources to instrument areas in the light of economic developments.
constituting a balanced portfolio of measures that could enable a Holding Fund to operate in a self-sustainable manner. A follow-up review is necessary, which will be finalized in the period of completing the assessment and could encompass wider proposals for the rest of Sweden. EIF will strive to actively engage in the discussion all parties related to the issue to ensure that the JEREMIE initiative will raise added value to the Swedish economy and will be applied successfully in partnership with the participating institutions.

Main market failures arising from the gap analysis:

- The very limited existing micro-financing schemes do not cover the potential demand of potential and existing micro enterprises; a significant financing gap appears to exist;
- Sweden continues to suffer from a lower than average business creation rate relative to close peers;
- There is a strong need to encourage banks to re-build SME loan portfolios to decrease the market failure in debt-financing for SMEs in Sweden following the legislation changes in 2004/5;
- Market failure appears to exist in both the provision of debt finance to start-up companies and to growth-oriented existing enterprises;
- In general, Venture capital is developing well in Sweden, however significantly large regional disparities exist across the regions;
- Multiple initiatives exist which may cause unintentional competition, inefficiency and wasted resources;
- The development of Business Angels networks continue but a coordinated national program is limited in nature and further potential exists;
- Sweden’s position as a leader in technology transfer is under threat with significant challenges yet to be fully addressed.

On a more positive note, there appears no evidence of market failure in the areas of growth areas of Leasing and Factoring and therefore no public policy proposals are included.

A summary table that displays the way that observed market failures are connected to each of the recommended proposals provides a useful overview for discussions purposes.
Market Failures & Key JEREMIE Proposals

<table>
<thead>
<tr>
<th>Evidence of Market Failures in Sweden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low provision of micro finance for self-employment opportunities</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Key JEREMIE Proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Targeted Micro Loan Scheme: EUR 25 m</td>
</tr>
<tr>
<td>Small Loan Guarantee Scheme targeting start-up companies: EUR 247.5 m</td>
</tr>
<tr>
<td>Portfolio Loan Guarantee Scheme targeting existing SMEs: EUR 80 m</td>
</tr>
<tr>
<td>Capital commitment of EUR 100 m but process / focus review needed</td>
</tr>
<tr>
<td>Business Angel Matching Fund EUR 75m</td>
</tr>
<tr>
<td>Capitalise Univ. Holding companies, consider IP Fund and full TT network</td>
</tr>
<tr>
<td>Create pilot initiative to boost SME exports, EUR 10 m</td>
</tr>
</tbody>
</table>

Note: No proposals for Leasing and Factoring as no market failure exists

Strategic Priorities and Policies

The analysis and the measures proposed take into consideration the main guidelines in the revised National Strategy Reference Framework (NSRF) produced by the new Swedish Government as well as the recommendations and requirements of the EU in this sphere. NSRF defines the main national tasks and priorities as well as the most important challenges of the policy for economic development and clearly states the importance of encouraging wider entrepreneurship across the Swedish economy. In addition, the possibility of utilising JEREMIE is highlighted on page 40.

For each of the 8 regions within Sweden, an ‘Operational programme’ has been recently submitted to the European Commission for review. An initial review of these also highlights the number of entrepreneurship-building activities and the utilisation of financial engineering mechanisms to achieve the goal.

In this context, this report is intended to illustrate the opportunity that JEREMIE offers to Sweden in terms of:

- Economic development based on knowledge and innovative activities;
- Increasing the efficiency of the enterprises and encouraging the development of the business environment;
- Financial instruments that target enterprise development and entrepreneurship;
- Strengthening the international market position of the Swedish economy.

The proposed measures should be seen and applied in this context and improve the access to financing, creating new financial instruments supporting SMEs, developing innovations and supporting SMEs in their wider developmental efforts.

Coordination of Recommended Actions
This initial assessment has been focused on the understanding of the financing issues within the SME market and on determining the market failures in the financing levels of different market segments. The main market players that have assisted in this process have included:

- NUTEK
- ALMI
- Norrlendsfonden
- Industrifonden
- Innovationsbron
- Swedish Venture Capital Association (SVCA)
- IFS
- KGF

Within Sweden, there are a significant number of state-owned or state-created institutions involved in the SME sector. Some, like the ones listed above, operate nationally with offices or branches across many regions of Sweden. However, in addition, it would appear that there is another series of institutions operating more regionally. Whilst this is partially understandable due to the geographic size of the country and the relatively autonomous nature of the regions, in terms of the provision of sources of finance and support to SMEs, such a numerate infrastructure could be considered to be sub-optimal. This can cause confusion in the understanding of the supporting infrastructure amongst SMEs and also unduly high administration costs relative to the amount of financial investment actually being received by entrepreneurs.
The Swedish authorities may well wish to consider this structural issue and its consequences during the next few years. The European Commission may also wish to assess whether such a structure is the optimal method for the effective utilisation of Structural Funds in the next funding cycle.

Whilst it is not the aim of this report to analytically investigate this subject further, however, careful consideration of the implications for the successful launch and implementation of a JEREMIE Holding Fund would need to be undertaken. It is important for a self-sustainable Holding Fund that investments be made via efficient mechanisms and via intermediaries with sufficient size and scope to manage the investment flow process with minimal administrative costs.

It is important to note that the European Investment Fund already operates certain financial engineering instruments via financial intermediary organisations within Sweden. JEREMIE is intended to be complimentary to the ongoing efforts of the EIF and specific areas of cooperation that deliver additional added-value can be envisaged.

3.18 UK

3.18.1 England (June 2007)

Statement of Position

This report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) across England in the context of addressing the continued market imperfections in the provision of access to finance. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency and export potential. The measures are balanced as to their size and effect aiming at a more efficient use of the EU Structural Funds.

This report builds upon and utilises a number of pieces of research undertaken by the SBS (Small Business Service), BVCA and other agencies and respected academics in this field. The report refers to documents published on this subject including the eleventh annual report ‘Finance for Small Firms (2004)’, written by the Bank of England and ‘EU Structural Funds programmes: 2007 - 2013’ by NSRF (National Strategic Reference Framework).

Using this research, the report is also intended to supplement the process of Operational Programme submission to the European Commission that is currently ongoing.49

The analysis indicates that disparate market imperfections or failures can be partly addressed by utilising the new JEREMIE framework and the construction of a portfolio of financial instrument interventions combined to create a revolving structure. The proposed portfolio comprises targeted instruments totalling a financial commitment in

49 Separate but similar reports have been compiled for Scotland and Wales. This report concerns England and the regions within England only.
the region of GBP 350 million focused on supporting SMEs’ access to finance during the coming years. The report also proposes the possibility of implementing a unique utilisation of support provided by the European Investment Bank as an additional capital provider in addition to Structural Funds and a National contribution.
The indicative proposals within the JEREMIE framework are proposed as:

- A Micro Financing Scheme amounting to GBP 30m to be offered via eligible institutions (or banks) to onlend micro loans to target groups for the purpose of starting micro-enterprises;
- A Portfolio Guarantee Scheme amounting to GBP 40m targeting Start-up SMEs via the banking networks
- A Portfolio Guarantee Scheme amounting to GBP 60m targeting existing SMEs with growth potential via the banking networks
- Risk Capital Investment Capital amounting to GBP 200m to fund existing Fund vehicles for early stage Venture Capital investments (GBP 175m) and Business Angels (GBP 25m).
- Capital allocation to continue Technology Transfer initiatives amounting to GBP 20m.

Thus, a portfolio of GBP 350 million is recommended to be set up through the provision of capital from three main sources. A proportion of the ERDF allocation for England from 2007; a matching proportion provided by way of a national contribution and potentially the additional capital provided by one or more of the new European Investment Bank Loan schemes dedicated to supporting JEREMIE.

The discussions on specifying the form of the proposed instruments, their size and the selection of the most eligible institution for their implementation will continue during the finalisation of the JEREMIE evaluation report and approval process for the Operational Programmes. It is important to consider the variety of forms of implementations that can be adopted for JEREMIE Holding Funds – including at a national level; at regional levels or where regions combine to create critical mass. Further consultations with market participants, banks and SME organizations are recommended to be undertaken during the finalisation of the report to analyse more about existing problems and whether the proposed instruments are assessed as realistic and useful for the market. The support of the private business is necessary to assure that there is no “shift from the private capital market” as a result of the proposed measures and that the private capital is fully engaged in this process. The process of specifying the measures may lead to changes in the proposals initially made.

Coordination of Recommended Actions

This initial assessment is focused on the understanding of the financing of the English SME market and on determining the demand and supply financing levels of different market segments and other types of financing. The proposals are described in the next sections and they are to be considered as a portfolio of initiatives.

The main market players included in the initial analysis, which are recommended to participate in the future implementation of the programme, are:

- DCLG (Department of Communities and Local Government);
• DTI (Department of Trade and Industry), now DBERR (Department of Business, Enterprise and Regulatory Reform);
• The RDAs (Regional Development Agencies);
• SBS (Small Business Service);
• The Key Banking Institutions and private market players.

Since 1997, the Government has therefore pursued a number of important initiatives to drive forward devolution. The Government has devolved substantial power to Scotland, Wales and Northern Ireland, and created the Greater London Authority and Regional Development Agencies (RDAs) in England, to ensure that all of the nations and regions have the opportunity to decide for themselves how best to work to reach their full potential.\(^5^0\)

In England, the RDAs have progressively been given more flexibility and are responsible for exploiting the indigenous strengths of each English region by reinforcing the five drivers of productivity; competition, enterprise, innovation, investment and skills.

The Government and Devolved Administrations recognise that effective partnership is critical for the success of future Programmes. Across the UK, Programmes will be expected to ensure appropriate liaison and coordination with Local Authorities, the higher and further education sector, the voluntary and community sector and the private sector. In England, Programmes will also be expected to build relationships with existing regional partnerships, such as Regional Skills Partnerships, strategic regional partnership, sub regional economic partnerships and local strategic partnerships. These partnerships should play a key role in identifying priorities for the Programmes.

The Government believes that the best way to overcome regional economic disparities is to allow each nation, region and locality the freedom and flexibility to exploit their indigenous sources of growth.

**Strategic Priorities and Policies**

The analysis and the measures proposed take into consideration the main guidelines in the National Strategic Reference Framework (NSRF) of the UK Government as well as the recommendations and requirements of the EU in this sphere. This framework represents also the Policy Framework for Utilization of the Structuring Funds on 1st of January 2007 and covers a period of 7 years (2007-2013). NSRF defines the main national tasks and priorities as well as the most important challenges of the policy for economic development.

This report is intended to illustrate the opportunity that JEREMIE offers to England in terms of:

• Economic development based on knowledge and innovative activities;

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• Increasing the efficiency of the enterprises and encouraging the development of the business environment;

• Financial instruments that target enterprise development and entrepreneurship;

• Strengthening the international market position of the English economy.

The proposed measures should be seen and applied in this context and improve the access to financing, creating new financial instruments supporting SMEs, supporting innovations and SMEs in their efforts to further develop the English economy.

The UK Government’s central economic objective is to raise the rate of sustainable growth and achieve rising prosperity and a better quality of life, with economic and employment opportunities for all. An essential element of that objective is to improve the economic performance of every part of the UK because unfulfilled economic potential in every nation, region and locality must be realised to increase the UK’s long-term growth rate.  

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Underlying this central economic objective, the Government is committed to:

- Raising the rate of UK productivity growth over the economic cycle, improving competitiveness and narrowing the gap with our major industrial competitors; and

- As part of the wider objective of full employment in every region, and taking account of the economic cycle, demonstrating progress on increasing the employment rate.

In England, the Government is committed to making sustainable improvements in the economic performance of all regions and over the long term reducing the persistent gap in growth rates between them. The Government, the Devolved Administrations and Gibraltar will continue to apply the principles of devolved and decentralised regional policy in the next cycle of Structural Funds Programmes.

The Structural Funds should promote investment in innovation, for example by facilitating private sector investment in R&D, improving the responsiveness of the UK’s research base, overcoming the barriers to the commercialisation of research and promoting the development of new products and services, operating with the UK support framework. The UK’s Structural Funds spending from 2007 to 2013 should make a major contribution to supporting enterprise.

Programmes should help create the framework for a thriving SME business sector, where firms can exploit the opportunities of a global economy, in order to drive productivity growth and generate new prosperity in disadvantaged areas.\(^5\)\(^2\)

At the same time, the Funds should help to stimulate a culture of entrepreneurship amongst new business start-ups, those running or owning existing businesses, the employed and social enterprises with the aim to optimise the conditions for the UK to be the best place in the world to start and grow a business.

Major Market Failures and Proposed Instruments

The Government, the Devolved Administrations and Gibraltar are committed to rigorous appraisal during the development of future Programmes, and ongoing evaluation of the impact of spending. One of the key principles for regional policy across the UK is that regional policy interventions can only be justified when they respond to a clear market failure. In many cases, the private sector will, for example, provide investment capital, develop new goods and services, and provide training, development and business support, without the need for state intervention. The Structural Funds should therefore only be used to finance these and other regional interventions in cases where free markets have genuinely failed to provide the goods or services by themselves, and where intervention is identified as being both necessary and capable of dealing with market failure.

This report assesses the existing supply and demand of financial engineering instruments supporting SMEs in England and proposes instruments to decrease the gap given the proved market failure in this area. The existing public support measures

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supporting SME access to finance were assessed as far as possible; details are shown in section 3 of this report. The macroeconomic and SME environment are analysed in section 2 as background information for the development of the financial engineering instruments.
The identified market failures and weaknesses of the England SME financing market mainly lie in the area of SME financing by the commercial banks in particular segments (micro financing, guarantees), in the underdevelopment of the Venture Capital investments, in technology transfer activities and certain regions export capability.

Main market failures arising from the gap analysis:

- The existing limited micro-financing schemes do not cover the potential demand of potential and existing micro enterprises. Significant further demand expected;
- The business creation ratio in certain regions within England is considerably lower relative to other UK regions and in general lower than the US;
- Whilst Venture Capital is relevant to a certain section of SMEs in significant growth sectors, it is not well developed in some regions with levels of investment well below UK averages and in actual decline in 2005;
- The Business Angels segment has further potential to be developed and further formalisation is required;
- England suffers from a poor record of R&D expenditure and a low level of cooperation between universities and the corporate sector hence limiting the potential for technology transfer activities relative to certain EU States;
- Export credit facilities for SMEs remains an area for possible further policy initiatives subject to further analysis.

In addition, within England there are significant regional disparities. These disparities are shown in detail in section 5 but can be summarised in the following way:

- Some regions display significantly lower business creation rates
- Venture Capital investment activity has declined in several regions
- Business Angels investment activity is underdeveloped in many regions
- Technology Transfer activities need to be further enhanced across all regions

As a result of this analysis process and discussions with the Managing Authority (DCLG and DTI), the European Investment Fund suggests that a continuation of the regional policy approach to this subject is appropriate, but that several lessons or practicalities need to taken into account.

This report proposes the types of financial instruments which could be utilised to address the continuing market failures but absolute sizes of capital are likely to be best determined at regional level.

The total amount of the portfolio and the size of the separate measures proposed in this report are made on a national level for England as a whole. They are based on the current level and development dynamics of the financing of SMEs in England and on the experience in the use of financial instruments in practice. If as expected, JEREMIE implementation is to be considered by each region within England, the
absolute figures proposed below would need to be adjusted appropriately. Hence these figures should only be regarded as a guideline.
The proposed measures form the investment portfolio under the JEREMIE Programme for England as a whole focusing on:

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Portfolio share</th>
<th>Million GBP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro financing</td>
<td>8.5 %</td>
<td>30 m</td>
</tr>
<tr>
<td>Guarantees (Start-ups)</td>
<td>11.5 %</td>
<td>40 m</td>
</tr>
<tr>
<td>Guarantees (Start-ups)</td>
<td>17 %</td>
<td>60 m</td>
</tr>
<tr>
<td>Risk Capital (VC &amp; BA)</td>
<td>57 %</td>
<td>200 m</td>
</tr>
<tr>
<td>Technology Transfer</td>
<td>6 %</td>
<td>20 m</td>
</tr>
<tr>
<td>Export Credit</td>
<td>Further analysis advisable</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100 %</strong></td>
<td><strong>350 m</strong></td>
</tr>
</tbody>
</table>

The EIF proposes to the English authorities to implement the recommendations made in the Interim Report with regard to the proposals to the Commission for the next Funding period between 2007 and 2013. All proposed amounts should be considered as indicative. A follow-up review is necessary, which will be finalized in the period of completing the assessment. EIF will strive to actively engage in the discussion all parties related to the issue to ensure that the JEREMIE initiative will raise added value to the English economy and will be applied successfully in partnership with the participating institutions.

### 3.18.2 Wales (May 2007)

**Statement of Position**

This report recommends a portfolio of complementary measures adapted to the problems of micro, small and medium size enterprises (SMEs) across Wales in the context of addressing the continued market imperfections in the provision of access to finance. The proposed measures will contribute to fostering the competitiveness of the SMEs and increasing their efficiency and export potential. The measures are balanced as to their size and effect aiming at a more efficient use of the EU Structural Funds.

This report builds upon and utilises a number of pieces of research undertaken by the SBS (Small Business Service), BVCA and other agencies and respected academics in this field. The report refers to documents published on this subject including the eleventh annual report ‘Finance for Small Firms (2004)’, written by the Bank of England and ‘EU Structural Funds programmes: 2007-2013’ by NSRF (National Strategic Reference Framework). In addition, this report uses data from an internal report for Finance Wales written by SQW Consultants entitled ‘Venture Capital and Loans Capacity Analysis’ (March 2007). In addition, the EIF has been allowed to use the Study of ‘ERDF Funded Venture Capital and Loan Funds in England Wales’ commissioned by DCLG and produced by Regeneris Consulting in February 2007.

Using this research, the report is also intended to supplement the process of Operational Programme submission to the European Commission that is currently ongoing.53

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53 Separate but similar reports have been compiled for Scotland and England. This report concerns Wales only.
The analysis indicates that disparate market imperfections or failures can be partly addressed by utilising the new JEREMIE framework and the construction of a portfolio of financial instrument interventions combined to create a revolving structure. The proposed portfolio comprises targeted instruments totalling a financial commitment in the region of GBP 150 million focused on supporting SMEs' access to finance during the coming years.
The report also proposes the possibility of implementing a unique utilisation of support provided by the European Investment Bank as an additional capital provider in addition to Structural Funds and a National contribution. The indicative proposals within the JEREMIE framework are proposed as:

- A Micro Financing Scheme amounting to GBP 5m to be offered via eligible institutions (or banks) to onlend micro loans to target groups for the purpose of starting micro-enterprises;
- A capital commitment of GBP 55 m to be assigned for the purpose of improving the provision of debt facilities to both Start-up SMEs and existing SMEs. It is envisaged that a Portfolio Guarantee Scheme could be structured via the banking network and work alongside a Direct Loan Scheme operated by a suitable intermediary;
- Risk Capital Investment Capital amounting to GBP 85m to further fund existing Fund vehicles for early stage Venture Capital investments (GBP 70m) and Business Angels (GBP 15m using a Matching Fund);
- Capital allocation to continue Technology Transfer initiatives amounting to GBP 10m.

Thus, a portfolio of GBP 155 million is recommended to be set up through the provision of capital from three main sources. A proportion of the ERDF allocation for Wales from 2007; a matching proportion provided by way of a national contribution and potentially the additional capital provided by one or more of the new European Investment Bank Loan schemes dedicated to supporting JEREMIE. Discussions with the EIB on this latter component have begun.

The discussions on specifying the form of the proposed instruments, their size and the selection of the most eligible institution for their implementation will continue during the finalisation of the JEREMIE evaluation report and approval process for the Operational Programmes. It is important to consider the variety of forms of implementations that can be adopted for JEREMIE Holding Funds – including at a national level; at regional levels or where regions combine to create critical mass. Further consultations with market participants, banks and SME organizations are recommended to be undertaken during the finalisation of the report to analyse more about existing problems and whether the proposed instruments are assessed as realistic and useful for the market. The support of the private business is necessary to assure that there is no “shift from the private capital market” as a result of the proposed measures and that the private capital is fully engaged in this process. The process of specifying the measures may lead to changes in the proposals initially made.

Coordination of Recommended Actions

This initial assessment is focused on the understanding of the financing of the Welsh SME market and on determining the demand and supply financing levels of different market segments and other types of financing. The proposals are
described in the next sections and they are to be considered as a portfolio of initiatives.

The main market players included in the initial analysis, which are recommended to participate in the future implementation of the programme, are:

- Welsh European Funding Office (as the Managing Authority);
- Finance Wales;
- The Key Banking institutions and private market players.

Since 1997, the UK Government has pursued a number of important initiatives to drive forward devolution. The Government has devolved substantial power to Scotland, Wales and Northern Ireland, and created the Greater London Authority and Regional Development Agencies (RDAs) in England, to ensure that all of the nations and regions have the opportunity to decide for themselves how best to work to reach their full potential.

The UK Government believes that the best way to overcome regional economic disparities is to allow each nation, region and locality the freedom and flexibility to exploit their indigenous sources of growth. In this sense, any decision upon implementing JEREMIE in Wales is with the Welsh Assembly Government supported by the opinion of Finance Wales.

Strategic Priorities and Policies

The analysis and the measures proposed take into consideration the main guidelines in the National Strategic Reference Framework (NSRF) of the UK Government and especially the Chapter for Wales, as well as the recommendations and requirements of the EU in this sphere. This framework represents also the Policy Framework for Utilization of the Structuring Funds on 1st of January 2007 and covers a period of 7 years (2007-2013). NSRF defines the main national tasks and priorities as well as the most important challenges of the policy for economic development.

This report is intended to illustrate the opportunity that JEREMIE offers to Wales in terms of:

- Economic development based on knowledge and innovative activities;
- Increasing the efficiency of the enterprises and encouraging the development of the business environment;
- Financial instruments that target enterprise development and entrepreneurship;
- Strengthening the international market position of the Welsh economy.

The proposed measures should be seen and applied in this context and improve the access to financing, creating new financial instruments or extending existing schemes supporting SMEs, supporting innovations and SMEs in their efforts to further develop the Welsh economy.

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54 UK National Strategic Reference Framework - DTI.
The UK Government’s central economic objective is to raise the rate of sustainable growth and achieve rising prosperity and a better quality of life, with economic and employment opportunities for all. An essential element of that objective is to improve the economic performance of every part of the UK because unfulfilled economic potential in every nation, region and locality must be realised to increase the UK’s long-term growth rate.\footnote{UK National Strategic Reference Framework – DTI.}

Underlying this central economic objective, the Government is committed to:

- Raising the rate of UK productivity growth over the economic cycle, improving competitiveness and narrowing the gap with our major industrial competitors; and

- As part of the wider objective of full employment in every region, and taking account of the economic cycle, demonstrating progress on increasing the employment rate.
In Wales, the NSRF states the Welsh Assembly Government’s strategy for spending its future Structural Funds allocations will reflect both the Community Strategic Guidelines and existing domestic policy priorities as set out in a number of key strategic documents for economic development.

The Welsh Assembly Government’s strategy for economic development, Wales: A Vibrant Economy\(^{56}\), is closely aligned with the Lisbon strategy for growth and jobs. It proposes four key priorities for economic development:

- to increase employment by supporting job creation and helping individuals to tackle barriers to labour market participation and the world of work;
- to invest in the regeneration of deprived communities and stimulate economic growth across Wales;
- to help businesses to grow and increase value-added per job and earnings, in particular by investing in infrastructure, attracting high added value economic activities, supporting sectors with strong potential, improving the skills base and helping businesses to become more competitive and;
- the need for all economic policies to support sustainable development, in particular by encouraging clean energy generation and resource efficiency.

The UK NSRF further states that Structural Funds should promote investment in innovation, for example by facilitating private sector investment in R&D, improving the responsiveness of the UK’s research base, overcoming the barriers to the commercialisation of research and promoting the development of new products and services, operating with the UK support framework. The UK’s Structural Funds spending from 2007 to 2013 should make a major contribution to supporting enterprise. Programmes should help create the framework for a thriving SME business sector, where firms can exploit the opportunities of a global economy, in order to drive productivity growth and generate new prosperity in disadvantaged areas.\(^{57}\)

At the same time, the Funds should help to stimulate a culture of entrepreneurship amongst new business start-ups, those running or owning existing businesses, the employed and social enterprises with the aim to optimise the conditions for the UK to be the best place in the world to start and grow a business.

For Wales, progress on the planning for Structural Funds has been significant. Wales is one of the first countries in Europe to reach agreement on its plans for using the European Regional Development Fund (ERDF) – a key part of the new Convergence programme 2007-2013.

The agreement was confirmed in a letter in March 2007 from European Commissioner Danuta Hubner in which she congratulated the Welsh Assembly Government on “a significant achievement”. She said “Wales has produced a strong programme, with well-justified objectives and priorities” and that the First Minister’s “expertise and experience in European matters and close personal involvement have been extremely important”. The ERDF Convergence programme will help to transform the West Wales and the Valleys region by investing in the

\(^{56}\) (www.wales.gov.uk/subtradeindustry/content/wave/wave-e.htm).

\(^{57}\) UK National Strategic Reference Framework - DTI.
knowledge economy, helping new and existing businesses to grow and develop, regenerating Wales' most deprived communities, tackling climate change and improving transport.

Details of the £825 million agreement for ERDF has been finalised and likely to be followed by an agreement on the European Social Fund (ESF) programme shortly. The EU funds will total over £1.4 billion and together with match funding from the public, private and voluntary sectors will enable the £3.2 billion programme to begin in the Summer.

Major Market Failures and Proposed Instruments

The Government, the Devolved Administrations and Gibraltar are committed to rigorous appraisal during the development of future Programmes, and ongoing evaluation of the impact of spending. One of the key principles for regional policy across the UK is that regional policy interventions can only be justified when they respond to a clear market failure. In many cases, the private sector will, for example, provide investment capital, develop new goods and services, and provide training, development and business support, without the need for state intervention. The Structural Funds should therefore only be used to finance these and other regional interventions in cases where free markets have genuinely failed to provide the goods or services by themselves, and where intervention is identified as being both necessary and capable of dealing with market failure.

This report for Wales assesses the existing supply and demand of financial engineering instruments supporting SMEs in Wales and proposes instruments to decrease the gap given the proved market failure in this area. The existing public support measures supporting SME access to finance were assessed as far as possible; details are shown in chapter 4 of this report. The macroeconomic and SME environment are analysed in chapter 2 as background information for the development of the financial engineering instruments.

The identified market failures and weaknesses of the Welsh SME financing market mainly lie in the area of SME financing by the commercial banks in particular segments (micro financing, guarantees), in the underdevelopment of the venture capital investments, in technology transfer activities and the export capability.

Main market failures arising from the gap analysis:

- The existing very limited micro-financing schemes do not cover the potential demand of potential and existing micro enterprises. Further demand should be expected to materialise;

- There is an over-reliance on 'grant mechanisms' in Wales which could be considered to be an impediment to more commercial funding processes and restricting the development of a risk capital culture;

- The business creation ratio in Wales is considerably lower relative to other UK regions and in the UK is in general lower than the US;
• Whilst venture capital is relevant to a certain section of SMEs in significant growth sectors, it is not well developed in Wales with levels of investment well below UK averages;

• The Business Angels segment has further potential to be developed and further formalisation and expansion is required;

• Wales and the UK suffers from a poor record of R&D expenditure and a low level of cooperation between universities and the corporate sector hence limiting the potential for technology transfer activities relative to certain EU States;

• Export credit facilities for SMEs is an area of apparent weakness for possible further policy initiatives subject to further analysis.

In addition, Wales displays significant regional disparities to other UK regions. These disparities are shown in detail in section 5 but can be summarised in the following way:

• Wales displays significantly lower business creation rates than most other areas in UK and within Wales there are also large differences;

• Economic and Entrepreneurial activity in Wales are below UK norms;

• BVCA data shows that early stage Venture Capital investment activity has proportionately declined in Wales and the trend continues. This is a opposite trend to overall UK trend;

• Average size of early stage investments in Wales is considerably below that of UK or Scotland norms;

• Wales has a significantly lower relative level of VC-backed companies compared to other UK regions and averages;

• Business Angels investment activity is underdeveloped despite the efforts of Xenos58 with the percentage of adult population involved in informal investment activity below UK norms;

• Grant dependency is a negative aspect particularly evident in Wales.

As a result of this analysis process and discussions with Finance Wales, the European Investment Fund suggests that the Welsh Assembly Government strongly considers the JEREMIE initiative as a vehicle to improve areas with market failure and relevant weakness.

This report proposes the types of financial instruments which could be utilised to address the continuing market failures but absolute sizes of capital are likely to be best determined through further discussion. Hence these figures should only be regarded as a guideline.

The proposed measures form the investment portfolio under the JEREMIE Programme for Wales as a whole focus on:

58 Xenos is the sole pan-Wales Business Angel Network in the principality run by Finance Wales.
Financial Instrument | Portfolio share | Million GBP  
---|---|---  
Micro financing | 3 % | 5 m  
Debt Facilities | 37 % | 55 m  
Risk Capital (VC & BA) | 53 % | 85 m  
Technology Transfer | 7 % | 10 m  
Export Credit | For further analysis |  
Total | 100 % | 155 m  

The EIF proposes to the Welsh authorities to implement the recommendations made in the Interim Report with regard to the proposals to the Commission for the next Funding period between 2007 and 2013. All proposed amounts should be considered as indicative. A follow-up review is necessary, which will be finalized in the period of completing the assessment. EIF will strive to actively engage in the discussion all parties related to the issue to ensure that the JEREMIE initiative will raise added value to the Welsh economy and be applied successfully in partnership with the participating institutions.

4. NEXT STEPS

DG REGIO and EIF intend to prepare an update of the report in the second half of 2009 taking into account further approvals for publication received from the other national/regional Managing Authorities, to be able to publish the other executive summaries of evaluation studies prepared.

Further information on the respective evaluation studies can be requested from the respective national/regional Managing Authorities.

A number of Managing Authorities decided during the evaluation phase to discuss further with the EIF on the possibilities of creating a JEREMIE holding fund, representing a portfolio of debt and equity financial instruments, as recommended in the context of the gap analyses prepared. Those discussions led to a number of 7 national/regional JEREMIE holding funds currently implemented by EIF. Obviously, in this context, the current financial and economic situation is taken into account when setting up JEREMIE financial instruments and publishing calls for expression of interest to financial intermediaries. For further information on JEREMIE implementation activities please consult the DG REGIO website [http://jeremie.europa.eu](http://jeremie.europa.eu) or the EIF website: [www.eif.org](http://www.eif.org)