Expert evaluation network delivering policy analysis on the performance of Cohesion policy 2007-2013
Year 2 – 2012

Task 1: Financial engineering

Italy

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Ismeri Europa

A report to the European Commission
Directorate-General Regional Policy
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List of abbreviations

- CCR   Central Credit Register of the Bank of Italy
- CGF   Central Guarantee Funds
- DPS   Department of Development and Economic Cohesion
- EEN   Expert Evaluation Network
- EIB   European Investment Bank
- EIF   European Investment Fund
- ERDF  European Regional Development Fund
- FEI   Financial Engineering Instrument
- NOP   National Operational Programme
- OP    Operational Programme
- ReC   (National Operation Programme) Research and Competitiveness
- ROP   Regional Operational Programme
- VC    Venture Capital
**Executive summary**

In Italy, the use of Financial Engineering Instruments (FEIs) supported by the ERDF is extensive in the present programming period. Eighteen out of 21 regional operational programmes and 3 national operational programmes apply FEIs. These mostly concern enterprise support (4 based on the JEREMIE initiative) while FEIs for urban development (based on JESSICA) have been introduced by only three regions. Approximately EUR 2,434 million was effectively paid into these specific funds and as such was available in the market to support enterprises and urban development through repayable forms of financial assistance. The ERDF part of the resources committed to all funds amounted approximately to EUR 1,124 million, 5% of the total ERDF resources allocated in Italy in 2007-2013. The majority of existing FEIs are guarantee funds and to a more limited extent loan and Venture Capital (VC) initiatives. The effectiveness is satisfactory in the northern and central regions while is poor in the south, especially in the convergence areas.

Several kinds of obstacles/problems exist in using FEIs. These include: insufficient financing gap assessments carried out by managing authorities, bank procedural delays, uncertainties and constraints linked to the structural funds regulations, a lower investment propensity due to the economic recession, and crowding out effects (i.e. grants and FEIs with more generous selection criteria are preferred over ERDF funded schemes).

There is no specific evaluation on ERDF FEIs apart from an EIF gap assessments and a recent European Court of Auditors’ report which highlights the shortcomings which prevented a full use of the co-financed instruments. There are also some studies of the Bank of Italy which provide indirect evidence on the effectiveness as well as on deadweight and crowding out effects of ERDF FEIs: positive mitigating impact on the consequences of the credit crunch but also substitution effects (e.g. subsidised loan used instead of bank loans) and hence limited value added.
1. Use of financial engineering instruments

Most Italian Regional Operational Programmes (OPs) co-financed by the ERDF and relevant National OPs (NOP)\(^1\) apply these instruments in the form of guarantee, loan and equity funds for enterprises and, in very few cases, for urban development. In the Regional Employment and Competitiveness objective areas, 14 regions\(^2\) out of 17 have set up one or more FEI as part of their Regional OP (ROP) ERDF. All the 4 Convergence objective regions have also set up a fund in the context of their ROPs.

It is worth mentioning that in Italy there is a tradition of mutual or co-operative lending institutions working on a quasi-commercial basis. Six OPs (Abruzzi, Apulia, Lombardy, Piedmont, Tuscany and Veneto) support Confidi, as part of their financial engineering policy mix. These consortia, originated in the late 50ies from associations of producers, provide loan guarantees at a local level.

In 2007-2013 a greater attention was given to financial engineering than in 2000-2006, as advocated by the European Commission during the preparation of programmes. The main goal was to benefit from the multiplier effect that these instruments allow as compared to grants, to increase long term sustainability of public spending and also to introduce an alternative to non-specialised and non-refundable grants which have been strongly criticised for low effectiveness (e.g. investment aid schemes introduced by the law 488/92). In addition, the frequent use of FEIs was also influenced by the advantage that Managing Authorities have in relation to the \(n+2\) rule, since the resources conferred to a fund are considered certified expenditure, lessening the automatic de-commitment constraint.

On the basis of Department of Development and Economic Cohesion (DPS) data, as at 31 December 2011, there are 39\(^3\) FEIs co-financed by ERDF in Italy during the current programming period. The large majority of these are implemented without holding funds. Guarantee funds, including Confidi, prevail (19 out of 39; one based on the JEREMIE mechanism), followed by loan (12 funds; three based on the JEREMIE mechanism), equity (5 instruments) and urban development funds (3 regional funds based on the JESSICA mechanism).

A total of approximately EUR 2,434 million was effectively paid into these funds and as such was available in the market to support enterprises, urban development etc. through repayable forms of financial assistance. This, averaged over the 7 years of the programming period, is equivalent approximately to 7.4% of the total amount of public loans reported in the Central Credit Register (CCR) held at the Bank of Italy (i.e. EUR 4,700 million in 2007; equivalent to 12% of

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\(^1\) These are: the NOP Research and Competitiveness, the NOP Renewable Energy and Energy Efficiency and the NOP "Attrattori culturali, naturali e turismo".

\(^2\) Abruzzi, Basilicata, Emilia-Romagna, Friuli V. Giulia, Lazio, Liguria, Lombardy, Marche, Molise, Piedmont, Sardinia, Tuscany, Umbria and Veneto.

\(^3\) This number is significantly lower than the number of funds in the Commission report on FEIs implemented by Member States with ERDF contributions (59 in total). The difference can be explained by the fact that some instruments which are similar and have been implemented as part of the same programme (e.g. the NOP ReC "Fondini") are aggregated by the DPS and treated as a single instrument.
total state aid to firms). The ERDF resources amount approximately to EUR 1,124\(^4\) million and represent 5% of the total ERDF allocated in Italy in 2007-2013.

The use of FEIs does not seem to have been increased or reduced over the programming period in relation to what was initially planned, however due to the crisis the allocation to several funds was increased (e.g. additional EUR 400 million per year for the period 2012-2014 in the case of the Central Guarantee Funds (CGF)). Such increase in the endowment of instruments was not always financed with ERDF. The limited information available does not allow to provide a significant estimate.

**Table 1: Expenditure for FEIs by type and Cohesion objective**

<table>
<thead>
<tr>
<th>Type of FEI</th>
<th>No. of funds and resource endowment</th>
<th>Cohesion objective</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Competitiveness</td>
<td>Convergence</td>
</tr>
<tr>
<td>Guarantee</td>
<td>no. of FEIs</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>EUR million</td>
<td>400.3</td>
<td>374.5</td>
</tr>
<tr>
<td>Confidi</td>
<td>no. of FEIs</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>EUR million</td>
<td>102.2</td>
<td>51.5</td>
</tr>
<tr>
<td>Loan</td>
<td>no. of FEIs</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>EUR million</td>
<td>268.6</td>
<td>815.0</td>
</tr>
<tr>
<td>VC</td>
<td>no. of FEIs</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>EUR million</td>
<td>103.7</td>
<td>0.0</td>
</tr>
<tr>
<td>JESSICA</td>
<td>no. of FEIs</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>EUR million</td>
<td>70.0</td>
<td>248.1</td>
</tr>
<tr>
<td>Total</td>
<td>no. of FEIs</td>
<td>26</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>EUR million</td>
<td>944.8</td>
<td>1,489.1</td>
</tr>
</tbody>
</table>

*Source: DPS 2011*

According to the 2010 DPS Annual Report, approximately 60% of total resources have been employed in the Convergence regions and the remaining 40% in Regional Employment and Competitiveness areas. A very small share of resources have been mobilised in the Convergence areas (5%) while a high share of the existing funds are actually operational in the REC regions (95% of available resources)\(^5\).

Three regional holding funds for urban development have been set up (JESSICA Sicily, Campania and Sardinia), however, no specific fund has been put in place so far.

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\(^4\) Data on the actual ERDF share was not centrally available; this estimate was calculated on the basis of the average ERDF contribution rates applied by the different OPs which range from a minimum of 24.5% to a maximum of 50%.

\(^5\) Data on operativeness are taken from the 2010 DPS annual report and refer to end of December 2010.
2. Rationale for using financial engineering instruments

The most important reason given in OPs for the use of FEIs is credit rationing. This issue is particularly relevant in Italy given the very small average size of firms and the high incidence of financial costs and charges over the earnings before interest, taxes, depreciation and amortization. There is no data on the amount of loan requested but the ratio between uses of resources and GDP (particularly low in the South: 29% vs. 60% in the North-Centre) may give an indication of rationing.

The market failures underlying credit rationing which induce banks to offer a suboptimal amount of resources, and to borrow money only if an adequate amount of collateral is offered, are rarely mentioned explicitly in the OP strategy. It is worth noting that OPs were drafted before the outbreak of the economic crisis, and the policy makers’ push towards increasing the use of FEIs emerged later.

The structural features of the Italian economy and of the national/regional credit market which are considered to be at the root of rationing include:

- Scarcity development and fragmentation of the credit system (especially in the South):
  - Few intermediaries (in particular those operating in early stage of development of firms) and scarce diffusion of securitisation
  - Insufficient capacity to evaluate risky projects, while less relevant factors are taken into account (e.g. age, personal links etc.)
  - Small and not sufficiently diversified portfolios which prevent risky investments.
- Culture of entrepreneurship, oriented towards family business and retaining control at the expense of growth opportunities; unwilling to open to equity investments and relying almost exclusively on family capital. These features contribute to hinder the development of the equity market.

While these features are national, rationing is even more severe in the Southern regions where risk of default is higher, credit recovery needs on average a substantially longer time and the fragmentation of the market is more pronounced which translates into higher interest rates. All these issues can be somehow related to the well-known problems of information asymmetries such as adverse selection and moral hazard.

The advantage to treat allocation to funds as certified expenditure acted as an incentive for Managing Authorities but it is not explicitly declared, and it is not possible to understand to what extent this reason prevailed over strategic priorities in the decision making. It is certain that, in the decision to set up FEIs, the assessment of potential demand and hence the absorption capacity was often not clearly taken into account.

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6 As pointed out by the NOP Research and Competitiveness (ReC) in 2007.
7 Interest rates have been growing and the differential between Mezzogiorno and the rest of Italy increased significantly in 2011. For instance, the interest rate on short term loans was equal to 7.5% in December 2011 in the Mezzogiorno, a 0.6% increase compared to September. In the rest of the country, the interest rate was 5.9% in December (5.6 in the North-East, 5.7 in the North-West and 6.5 in the Centre), a 0.5% increase compared to September of the same year. The difference between Mezzogiorno and the Northern and Central areas was hence 1.6% at the end of 2011, while it was 1.4 in 2010. Overall, 0.4% of the differential is due to sector and firm size disparities and 1.2% to other factors such as higher risks.
Rationing of credit has become a more urgent issue to deal with following the 2008 credit crunch and the negative effects of the global economic crisis. As a consequence, loan denial became more frequent.

There are no particular reasons for using grants instead of FEIs in most policy areas with the exception of support to research whose results cannot be quickly commercialised and breakthrough innovation characterised by relevant spillover effects. While public provision of grant funding may be justified in supporting the development of early stage technology and innovation, where both the potential externalities and degree of risk are high, the existence of an effective VC market or the availability of VC schemes is also important. In fact there is an equity gap (private investors tend to abandon early stage in favour of more attractive activities in private equity deals) due to the divergence between private and social benefits associated with equity investment activities and this provides a rationale for hybrid VC schemes (i.e. schemes with a significant public participation).

The VC market both at early and later stages of SMEs’ growth is not adequately developed in Italy and in the Southern regions in particular where the small number of private equity investments coupled with their relatively high average size indicate that buy out and expansion are the most common operations.

The perceived benefits (by policy makers, programme managers) of using FEIs rather than grants in supporting enterprises, urban development, energy efficiency and renewable energies include the following:

- FEIs mitigate the negative effects of the credit crunch on firms economic performance and labour market (this is true especially for guarantee and loan funds).
- They allow a sustainable use of public resources in times of budgetary constraints: the possibility of using the same funds several times through various revolving cycles. This contributes to the impact of intervention which can be many times greater than grant assistance.
- They are characterised by a multiplier effect: additional resources allocated to the funds from national or regional budgets as well as from banks and other investors.
- They enable risk sharing between private and public actors; in particular national/interregional funds have more resources at their disposals and can create diversified risk portfolios from a territorial and sectoral point of view. This is relevant in the Italian context where the relatively high regional sector specialisation produces a high concentration of risks.
- They contribute to develop the credit market and the capacity of intermediaries and policy makers to effectively assist SMEs’ start-up and to evaluate potential beneficiaries not only on the basis of their solvability but rather on the assessment of the success of the investment and based on cash flow prospects. The input of know-how provided by

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8 Research and innovation are typically characterised by a high risk of failure which often makes private investment not profitable, furthermore there is a non-linear relationship between research investments and commercial gains and a significant time lag before these gains materialise; moreover, R&D may produce intangible results whose utility may be difficult to appraise ex ante; finally research and innovation may generate relevant spillovers which, being non excludible, reduce the business incentives to carry out R&D activities and determine a suboptimal level of investment. Hence the appropriateness of grants to support certain activities, especially R&D and pre-commercial development.
private sector participants as regards business start-up and support can be invaluable (this is true for VC funds while, in the case of guarantees, the fact that the public provides an insurance against the risk of default may induce banks not to carry out rigorous audits and to loosen links with firms).

- They diffuse innovative financing know-how among firms, also by carrying out complementary initiatives (scouting, training and tutoring etc.).

In most cases, the relative costs involved in using FEIs as opposed to grants are not properly assessed by policy makers. This would entail taking into account the management and administrative costs of the instruments but also the fact that in the case of FEIs public resources can be reused and there is an accumulation of interests generated and dividends paid to the funds. Managing Authorities often highlight the significant management fees involved in FEIs. However they also recognise that outsourcing the management of FEIs to external agents, as it is commonly done, may benefit from faster procedures and allows the public administrations to save on administrative and transactions costs of traditional grants.

As regards the time taken to set up the funds and make them operational, this seems to be much longer than in the case of grants in southern regions, due to a lack of expertise and capacity of both public administration and banks as well as to various delays (e.g. internal bank bureaucracy and delays in entering into agreements with beneficiaries). There is also a problem of low investment propensity due to a structurally weak business sector, worsened by the crisis, which is often not adequately considered during planning and causes the low operability of FEIs.

3. The effectiveness of financial engineering instruments: selected examples

General overview

If we consider the actual number of operations of FEIs in support of final beneficiaries, the outcomes do not seem encouraging on average. As mentioned the DPS 2010 annual report highlighted that only half of the set up funds, corresponding to approximately 60% of the available resources, are actually functioning.

Low “operativeness” concerns especially Convergence regions where only 5% of conferred resources have been used while in Regional Employment and Competitiveness areas, nearly 90% of resources have been actually utilised (e.g. guarantees issued). This lack of effectiveness in the Southern areas persists several months after the creation of a fund. This is the case of the National Guarantee Fund which gathered resources from the NOP Research and the NOP Energy as well as the FEIs activated as part of the ROP Sicily and the ROP Calabria.

Amongst the guarantee funds, which are the most commonly used FEIs, the best performance is registered in relation to Confidi. The “operativeness” of VC schemes is the lowest even though there are some good practices (e.g. Tuscany discussed below and Lombardy). On average, there

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9 To be noted that in the case of FEIs managed by the Holding Funds the implementation procedures were delayed. According to the officials consulted, some FEIs were seriously delayed by unclear EU regulations, contracting problems with European Investment Fund (EIF) and European Investment Bank (EIB), as well as EIF delays in the selection of intermediaries. In addition, management costs and fees were higher than the traditional reimbursable aids managed at regional level in the previous programming period 1994-1999 and 2000-2006.
seems to be a negative correlation between the complexity of FEIs and their effectiveness in Italy.

Finally it is worth mentioning the extremely poor performance of FEIs for urban development: only three JESSICA funds have been set up, in Campania, Sicily and Sardinia, but no intervention was actually implemented.

These findings highlight the importance of issues related to: the differences in the way Cohesion and private FEIs are operated; the influence policy makers can exert over the way funds are set up and allocated to final beneficiaries; eligibility criteria and criteria applied to assess performance of the instruments. The following paragraphs attempt to shed light on these issues on the basis of insights from selected examples.

Selected examples

In the current programming period, Tuscany applies a complete mix of FEIs (guarantee, loan and equity funds) during the current programming period to deal with credit rationing concerning different types of SMEs, from the more traditional ones (e.g. supporting existing firms which intend to carry out investments in crafts and manufacturing) to the highly innovative enterprises.

Toscana Innovazione is an equity fund which operates in the early stages of development (seed to start-up and expansion) of innovative SMEs and hence fills a financial gap which exists in the market because existing private VC funds consider it too risky and not enough profitable to undertake such investments. The fund is managed by SICI a company of savings management.

Beneficiaries are SMEs which operate in high tech sectors and/or are developing product or process innovation and propose projects with high growth potential and prospective profitability. The size of the fund is EUR 45 million and its duration is 12 years (from June 2008 to June 2020; the investment period is until June 2013). The regional contribution is 40% of total available resources, the remaining share is mainly from the bank foundations (53%) and other intermediaries (Fidi Toscana 4%, Sici et al. 3%).

Projects go through a selection process both scientific/technological and economic. The technical committee includes representatives of the Region and this is the main way the MA can influence the implementation of the instrument. Following the screening of 301 proposals, 15 projects have been currently approved with a total commitment of EUR 21.8 million (EUR 12.8 million already invested). According to both the regional officials and the VC intermediaries, the fund is important since it fills an existing gap in the market and the majority of the awarded investment projects would have not been started without Toscana Innovazione.

The objectives of Toscana Innovazione are in part different from other private VC funds. In the selection process a premium is given to projects on the basis of employment impacts, environmental innovation, gender equality and other social criteria. On the contrary, in the case of private funds only technical and economic criteria related to profitability are taken into account. It must be highlighted though that the difference in objectives is more formal than substantial meaning that the “social” assessment criteria are award (rather than selection) conditions and they count only when two or more projects receive the same technical and economic score.
Beside the equity instrument, the Region has set up a revolving fund, a guarantee fund and contributed to the capitalisation of Confidi. The revolving and guarantee funds are managed by Toscana Fidi. Beneficiaries are SMEs selected on the basis of target sectors and a credit score. There are no particular differences in objectives between these instruments and others privately managed apart from the particularly convenient conditions (e.g. a zero interest rate in the case of the revolving fund) which enabled the region to effectively tackle the consequences of the credit crunch.

Approximately 2,020 operations have been authorised (as per 12 February 2012), 37% concerning start-ups. Thanks to the guarantee funds 1,386 loans have been granted (EUR 228 million in total). A total of EUR 423.6 million of investments were mobilised.

Another illustrative example is the CGF which has been set up at the national level, following the law no. 662/96 (art. 2, comma 100, lettera a). It is administered by a Managing Committee (Comitato di Gestione) which includes representatives of the State/regional authorities (Ministry of Economic development, Ministry of Economy and Finance, regional administrations etc.) and various economic partners (e.g. Confindustria, Concommercio, Abi – the association of Italian banks). The Managing Committee is the instrument used to influence or exert control over the way that the funds are allocated. There is also a managing body (Gestore), Medio Credito Centrale, which carries out the preliminary examination of applications (istruttoria).

The CGF issues loan guarantees directly or counter-guarantees (of guarantees issued by Confidi and other funds). The Beneficiaries are SMEs working in all sectors except automotive industry, shipbuilding, agriculture and transport. The guarantee covers maximum 60% of the investment value (up to EUR 1.5 million for each SME); this percentage can be raised up to 80% in depressed areas located in the Mezzogiorno or characterised by a prevailing female participation (so called 107.3.a areas). Collateral cannot be requested on the share of investment guaranteed by the fund but personal guarantees are allowed. SMEs are assessed by means of an economic score based on the balance sheet of the last two years. Following this assessment the Committee takes the final decision on support.

A significant number of operations is carried out each year with national funding: approximately 55,000 operations were guaranteed in 2011 (+10% compared to 2010); the value of these operations exceeds EUR 8,400 million while the guaranteed amount is approximately EUR 4,400 million. The CGF generates a strong multiplier effect: for each Euro made available by the fund, a total of 16 are mobilised for SMEs on average. The total available resources (approx. EUR 1,000 million in 2010) have been increased (decreto "salva Italia" 201/2011) and EUR 400 million per year will be made available in the period 2012-2014. This will raise the total resource endowment to approximately EUR 2,200 million.

The fund gathers also resources from the NOP Research and Competitiveness and the NOP Energy which have not been utilised yet (see paragraph 4 on problems). The rate of default of the CGF is quite low: only 2% of beneficiaries.

In the convergence area, Sicily has introduces a mix of FEIs including supporting both business and urban development. EUR 60 million have been allocated to two loan funds (SMEs fund amounting to EUR 44 million, and micro-credit fund amounting to EUR 9 million) based on the JEREMIE mechanism. EUR 148 million have been allocated to two JESSICA instruments (multi-
sectoral fund and energy fund). According to the officials consulted, all Sicilian FEIs were seriously delayed by several shortcomings: unclear EU regulations, contracting problems with EIF due to language, reference law, EIB and EIF delays in the selection of intermediaries (which took more than 2 years) etc. In brief, the novelty of the instruments required much more time than expected to make them operational. The loan fund for SMEs started functioning in December 2011 and only one operation was carried out so far. The JESSICA energy became operational only since February 2012.

In conclusion, as in the Tuscany example, there are differences in objectives between private FEIs and hybrid schemes, including those used by Cohesion policy. In the first case only profitability and financial solidity/credit worthiness are considered when selecting projects/beneficiaries, while in the latter (Cohesion FEIs), development goals (e.g. employment prospects, gender equality) are also taken into account. These different objectives are particularly relevant, meaning that they have a stronger influence in the way funds are operated, especially in relation to equity/VC FEIs.

Managing authorities can exert some degree of control or influence over the way that the funds set up by financial engineering means are allocated. This happens through participation in technical selection or management committees (e.g. in the mentioned VC or CGF cases) or it is limited to the FEI tender specifications that require the managers of a fund to apply certain criteria and procedures for selecting beneficiaries and allocate resources. Criteria which need to be fulfilled by beneficiaries to receive support in most cases relate to sector of activity, geographical location (operating in a specific regional territory), maturity of firm (e.g. newly created in case of seed/early stage money), typology of investments for which support is sought (e.g. development of innovative products/process with high prospective profitability).

Assessing the performance of FEIs is difficult if at all possible in the South of Italy where there are still many instruments that have been set up but do not yet function. Anyway, traditional output and impact indicators are applied. There is not a specific set of key performance indicators agreed with the funds’ managers which would be ideally collected by the intermediaries and transferred to the policy maker. There is a large room for improving the appropriateness of the indicators and the monitoring/evaluation provisions from a policy perspective.

4. **Main problems in using financial engineering instruments**

The effectiveness of FEIs, as highlighted in the previous paragraphs, is very diverse across the Italian regions. In the South, the performance of FEIs is disappointing due to a mix of reasons including: limited capacity of the managing bodies which did not carry out appropriate financing gap assessments, crowding out effects (i.e. grants and FEIs with more generous selection criteria are preferred over ERDF funded schemes), bank procedural delays, uncertainties and constraints of the structural funds regulations etc. On the contrary, there are no major shortcomings in the Centre and the North of the country, even though some problems such as the uncertainty of EU regulations, the crowding out effects and, in general, the lower investment propensity caused by the economic recession concern also these regions.

The time that elapses between the creation of a FEI and when the funds actually reach final beneficiaries is sometimes too long in comparison with grants (even if there are more
obligations and steps involved in the set up and implementation of a non-refundable grant scheme). This is for instance the case of the resources allocated from the NOP Research, the NOP Energy and the NOP “Attrattori” to the CGF which are still “frozen”.

The long delays in selecting the managing bodies and signing agreements with the banks to implement actual finance operations may be caused by the lack of familiarity of the public administrations with FEIs and their capacity to adapt an existing scheme to the EU regulations, but also by the banks which do not define internal procedures in time and adjust their information systems appropriately\(^{10}\).

Delays in signing agreements with the banks have been aggravated by the crisis which constraints both firms’ and banks’ investments due to the lack of prospects and produces an increase in interest rates. Banks suffer not only because of the crisis but also due to the need for adapting their capital to the requirements of the European Bank Authority. This is done by increasing capital injections and reducing disbursements.

The weaknesses of the Structural Funds regulations (e.g. the insufficient provisions for revolving funds, the uncertain eligibility conditions of working capital) are certainly relevant for all regions, considering also the credit crunch. Only in February 2011, four years after the beginning of the programming period, the Commission issued a more comprehensive interpretative note on financial instruments. Nonetheless, some administrations still find it difficult to use ERDF to finance their financial engineering schemes: selection criteria are considered too tight and contribute to delay banking procedures; instruments which operate across different OP axes do not allow much flexibility and require modifying the financial plan of each axis if any change in the distribution of resources is done; the uncertainty as regards working capital eligibility has been clarified\(^{11}\) but more time for adaptation seems to be needed. These difficulties have hindered the use of Structural Funds especially in the regions where there is generous non-refundable support available (Convergence) or in FEIs’ markets (e.g. the market of guarantee funds) where there are national instruments characterised by much less stringent selection criteria. In both cases, ERDF FEIs are likely to have been crowded out.

Other problems which impacted on the effectiveness of FEIs and are mentioned by the interviewed officials include: the lack of financial culture coupled with a lack of communication campaigns; the low familiarity with FEIs (mostly in the South) is accompanied (in the entire country) by a lack of agents specialised in early stage financing, as well as by an insufficient number of agents capable of issuing advance payment guarantees (fideiussioni/surety) at convenient rates.

5. Evaluations of financial engineering instruments

Specific evaluations on the use of FEIs as part of Cohesion policy have not been carried out in Italy. Indirect evidence on the effectiveness as well as on deadweight and crowding out effects of ERDF FEIs can be extracted from some studies of the Bank of Italy. These analyse national

\(^{10}\) To be noted that in the case of the NOP Research the delayed enter into force of the functioning of the FEIs was due to the administrative burden of the fund manager processing selection and the terms and conditions of the Memorandum of Understanding. In addition, some technical blocks were discovered during the implementation phase.

\(^{11}\) The 2011 Commission’s interpretative note made clear that financing of working capital in early stages, or as part of the seed capital for new enterprises is acceptable.
financial engineering schemes either similar to those funded as part of Cohesion policy or which are in part funded by the Structural Funds. Other studies relevant to the Italian case have been carried out at the European level: the EIF financial gap analysis on the specific needs for FEIs at national level and in some Italian regions; and the European Court of Auditors’ report which, based on a sample of schemes, has highlighted the shortcoming in the Structural Funds regulations which prevented full effectiveness and efficiency of ERDF FEIs. In relation to JESSICA, several studies have been carried out to help determine how the initiative could be best implemented in specific territories. These studies are briefly discussed in the following paragraphs.

• The problems of deadweight and crowding out in relation to FEIs have been explored in some studies of the Bank of Italy. For example a 2011 paper (Carmignani and D’Ignazio) has demonstrated that, especially in the case of large firms and limited companies, subsidised lending is used as substitute for bank loans indicating that the effect of subsidised lending programmes in Italy has been modest (no significant finding for SMEs). A dataset with bank-firm information from 1998 to 2007 (drawing upon the Central Credit Register database on small and micro enterprises) was used. Other studies of the Bank of Italy (Bartiloro et al. 2012; Mistrulli et al. 2011) assess the impacts of some of the existing FEIs (e.g. CGF, Confidi) during the crisis and conclude that even though in general credit conditions have significantly deteriorated, the examined guarantee schemes managed to prevent a reduction in the flow of resources borrowed by SMEs, even in the period 2007-2010, and hence highlight the general efficacy of these instruments.

• Between 2006 and 2008, The EIF carried out 53 national and regional evaluation studies (gap analysis), through a standard evaluation methodology, in cooperation with respective national/regional Managing Authorities. The methodology was developed in cooperation and in agreement with DG REGIO to quantify existing supply of and potential demand for SME financing in individual EU Member States/regions, and to propose action to take. In Italy, one national and two regional assessments were completed in 2007 (Piedmont and Marche). This has identified market failures and potential for strengthening the mix and/or the size of existing instruments as well as introducing new ones based on the JEREMIE scheme. The analysis has shown that a financial gap exist especially in relation to risk capital affecting SMEs and knowledge based start-ups (e.g. insufficient pre-seed tools, sidecar/business angels), while in relation to guarantees and loans resources are not scarce but the features of the system often lead to a misallocation and sub-optimal use of resources (e.g. lack of appropriate guarantees for micro-credit, need for streamlining the Confidi network through mergers and recapitalisation).

• The recent report of the European Court of Auditors assessed the effectiveness and efficiency of a sample of FEIs co-financed by the ERDF during the 2000-2006 and the 2007-2013 programming period and reviewed the Commission and Member State’s management, monitoring and information systems. Most of the findings of this study are relevant to the Italian case and some specific examples concerning Italy are reported. In general, important shortcomings in the regulatory framework of the Structural Funds have hindered effectiveness of FEIs: there is a lack or inappropriateness of financing gap
assessment; there are significant delays before the funds reach SMEs compared with other programmes; finally, the Structural Funds regulations have been designed for grants and do not address the specificities of FEIs. For instance, the unclear eligibility conditions for working capital regulations while the fact that funds are not subjected to automatic de-commitments (coupled with incorrect gap assessments) produces at times unjustified allocations to the funds (e.g. the case of an oversized guarantee fund in Sardinia is mentioned).

* Finally, it is worth mentioning that several JESSICA preparatory evaluation studies\(^ {12} \), commissioned by the EIB, have been carried out in 2009 with the support of the JESSICA task force. These feasibility studies (concerning Liguria, Tuscany and Marche) highlight the potential benefits that the territories, where the existing initiatives are insufficient to satisfy the potential demand, can gain from implementing JESSICA.

### 6. Concluding remarks

The effectiveness of FEIs varies greatly in Italy, being satisfactory in the North and Centre, where they are standard practice, and very poor in the Southern regions, where financial engineering, especially equity, is still considered a highly innovative instrument. In these areas, the time that elapses from the allocation to a fund and the moment in which money is available on the market is often excessively long. This suggests not only that there is insufficient familiarity with FEIs but also that the actual demand and absorption capacity is not adequately taken into account when programming intervention. Therefore a need for adequate financial gap assessments in the regions is critical, especially at the beginning of a programming cycle.

Improving the Structural Funds regulatory framework is also a necessary condition to increase effectiveness since the shortcomings registered in the current period and mentioned in the paper are also linked directly or indirectly to insufficient provisions or uncertainties in the regulations. Removing the barriers which constrain the use and effectiveness of FEIs in the Cohesion policy framework is particularly urgent in the current historical phase, which is likely to continue for the next few years at least, in which there is an increasing credit rationing, and firms face higher credit costs as well as limits in the amounts that they can borrow.

It was emphasised that there are no specific evaluations of ERDF FEIs to help choose the most suitable policy mix with respect to enterprise support. The few studies available on the effectiveness of FEIs, and the evidence on the problems experienced in practice in using financial engineering at national and regional level, highlight substitution and crowding out effects: instruments with more generous selection criteria, when available, are preferred over ERDF funded schemes. A more robust body of evidence is necessary at an ex ante stage to make the right choices and, at an interim stage, to adapt them correctly. Agreeing on a set of common measurable and relevant outcome indicators is critical for evaluation and there is a substantial room for improvement in this respect.

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\(^ {12} \) See the list of studies on the Commission website: [http://ec.europa.eu/regional_policy/thefunds/instruments/jessica_evaluations_en.cfm#7](http://ec.europa.eu/regional_policy/thefunds/instruments/jessica_evaluations_en.cfm#7)
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