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delivering policy analysis on the  
performance of Cohesion policy 2007-2013  
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**Task 1: Financial engineering**

**Denmark**

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**A report to the European Commission  
Directorate-General Regional Policy**

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## List of abbreviations

- CIBIT Copenhagen International Business Information Technology Hub
- EEN Expert Evaluation Network
- FEI Financial Engineering Instrument
- OP Operational Programme
- PPPs Public-Private Partnerships
- VC Venture Capital

## Executive summary

This paper examines the use of Financial Engineering Instruments (FEIs) in Denmark.

Three instruments are supported by the ERDF. Two are examined in this paper.

One instrument is established as a venture capital fund and two are loan funds. All initiatives are established under the 'Regional Competitiveness and Employment Objective' as part of the Operational Programme (OP) 'Innovation and Knowledge'. Two FEIs were established in the current programme period, one dates back to 2004.

Three main arguments have been used to justify the use of the ERDF to support FEIs in Denmark: 1) regional-based FEIs enable initiatives to address regional challenges specifically, 2) FEIs can help to close 'the gap' in access to finance in the market (due to the current financial situation) for profitable SMEs, and 3) FEIs can be used to ensure the sustainability and effectiveness of ERDF appropriations.

A study of two FEIs shows that the authorities aim to ensure that FEIs meet programme targets in three ways: First, the two FEIs have clear and stringent requirements for enterprises seeking support, so that only projects that can actually help to meet the objectives of regional competitiveness and job creation are assured of funding. Secondly, both FEIs are organised with a Board of Directors with representatives from the regional authority to monitor their operation and from a private firm responsible for day-to-day management. Thirdly, the two FEIs are committed to achieving certain goals, e.g. the number of jobs created or maintained and the number of investments or loan granted. The goals and their achievement will be evaluated at the end of the programming period.

## 1. Use of financial engineering instruments

This section first explores the use of FEIs in Denmark. For purposes of the study, FEIs are defined as all means of financial support other than those which are non-refundable, such as grants or subsidies or the co-financing of infrastructure. Three Danish instruments co-financed by the ERDF comply with this definition. They are presented in the table below.

**Table 1: Financial engineering instruments**

Name <sup>1</sup>	<b>CIBIT (Copenhagen International Business Information Technology Hub)</b>	<b>The Fund CAT Invest Zealand</b>	<b>The Northern Jutland Loan Fund</b>
Region	Capital Area Region	Zealand Region	Northern Jutland Region
Budget (EUR million)	13.3	8.1	8.2
ERDF funding (EUR million)	3.3	4.0	4.1
Co-financing	EUR 3.3 million Capital Area Region (public), EUR 6.7 million The National Danish Investments Fund (Vækstfonden) (public)	EUR 4.0 million Zealand Region (public), EUR 1 million Danish Business Authority (public)	EUR 4.1 million Northern Jutland Region's Development fund (public)
Objective	Creation and development of new enterprises	Creation and development of new enterprises	Creation and development of new enterprises
Type	Loan Fund	Capital Fund	Loan Fund
Established	2009	2010	2004
Focus	Establish a fruitful environment for IT-based growth in Copenhagen in order to create jobs and businesses	To 'close the gap' in the existing capital market	Focus on the SMEs in the production, service, and tourism.

Source: New Insight A/S on the basis of the Danish Business Authority's data base and prof. Henrik Halkier

As shown in the table, two of the initiatives are categorised as loan funds and one as a Venture Capital fund (VC fund). All initiatives are co-financed under the 'Regional Competitiveness and Employment Objective' in the OP 'Innovation and Knowledge'. All three instruments are connected to the so-called "growth driver" 'Entrepreneurship'. Geographically, they cover three of the six regions in the country.

In total, the support by the ERDF amounts to EUR 10.8 million or 4.4% of the overall ERDF going to the OP 'Innovation and Knowledge' for this programming period, of just over EUR 245 million<sup>2</sup>.

Two of the three FEIs have been established in the current programme period. The CIBIT was established in 2009, the Fund Cat Invest Zealand in 2011 and the Northern Jutland Loan Fund in 2004. The number of initiatives supported so far is too small to indicate whether or not the use of FEIs is likely to increase in the future. However, the Danish Business Authority is assuming that it will be larger in the next programme period.

<sup>1</sup> New Insight A/S's own translation

<sup>2</sup> The total support to Denmark in the programme period 2007-2013 is EUR 254.8 million. 'Innovation and Knowledge' accounts for EUR 245.1 million and EUR 9.7 million to Technical Support. (Source: [http://ec.europa.eu/regional\\_policy/](http://ec.europa.eu/regional_policy/)).

## 2. Rationale for using financial engineering instruments

This section focuses on the arguments for using the ERDF to co-finance FEIs in Denmark. It is based on a review of documents relating to the establishment of FEIs and interviews with relevant authorities and fund managers. The arguments can be classified into three categories: 'special regional features', 'lack of venture capital' and 'effectiveness'. Finally, the costs of establishing FEIs are presented.

### **Special regional features**

As noted above, the FEIs have been established so as to take account of special regional needs and opportunities. In addition, some of the locally founded loan and VC funds are targeted on the sparsely populated areas of the country that have special needs.

### **Lack of venture capital**

A main argument for using FEIs relates to the current financial situation; the ERDF co-financed FEIs are considered an opportunity to 'close the financing gap' which exists in the private capital market.

Since the beginning of the global financial crisis, Danish enterprises - mainly SMEs - have had problems raising funds. This fact is seen by local authorities and local enterprises as an obstacle to creating growth and job opportunities in the various regions of Denmark. By establishing loan funds and venture capital funds co-financed by the ERDF local authorities hope to ease access to capital and thereby stimulate growth in their region. In the case of The Northern Jutland Loan Fund one major argument for establishing a loan fund has been the possibility of lending money at a low interest rate.

### **Effectiveness**

The last argument is in fact part of a series of arguments which can be put into the category of 'effectiveness.'

One major benefit compared with non-refundable grants is the possibility of re-using or recycling the money invested if investments turn out to be successful. Such a possibility is likely to motivate fund managers and local authorities to create portfolios which give a reasonable chance of achieving this and accordingly of establishing a sustainable fund.

Another perspective of FEIs is the possibility of Public-Private Partnerships (PPPs). It is an explicit goal to increase and improve cooperation between the public and private sectors in the various regions. Regional authorities also anticipated making use of the know-how of local businesses. Two of the FEIs have formalised this cooperation by involving both private and public representatives on their Boards of Directors.

The regional authorities seek to attract private investors to put money into the various enterprises supported by the fund. The main financing of the three funds comes from the EU Structural Funds and the Danish Government with private investors providing co-financing

### **Relative costs**

The main cost for the programme managers of FEIs is their administration. In addition, for funds co-financed by the ERDF, managers have to deal with what are regarded as complicated regulations relating to state aid. Some important issues in relation to compliance with state aid

rules, especially with regard to funds co-financed by both the ERDF and the Member State, remain unresolved.

A major obstacle to the expansion of FEIs for both public authorities and private investors is therefore a lack of knowledge and experience. None of the three FEIs has been evaluated so far and there is no formal knowledge sharing among the different actors and regions.

As indicated above, the main arguments for establishing an FEI co-financed by the ERDF are 1) to be able to take regional features and objectives into consideration (which is not the case for private funds), 2) the opportunity it gives for bringing venture capital into the region, and 3) to increase the effect of a given amount of support from the ERDF through recycling funding.

Moreover, co-financed FEIs can target businesses in their very early phases whereas private capital funds tend to target larger and more developed enterprises.

On the other hand, in some cases it can be more appropriate to use non-refundable grants to provide support. A Senior Consultant at the Danish Business Authority, Steen Frederiksen, pointed out that the FEIs are not suited for projects aimed at increasing employee competence or those not aimed at developing a concrete product.

### 3. The effectiveness of financial engineering instruments: selected examples

This section considers two specific FEI schemes.

#### 3.1: Case: Northern Jutland Loan Fund

The Northern Jutland Loan Fund is based in the region and provides loans primarily to SMEs located there. The purpose is to support regional businesses mainly in the early phases (pre-seed, seed, start-up and expansion phases) of development and only up to their seventh year, so stimulating innovation and job creation in the region. By targeting small businesses and entrepreneurs and focusing on regional growth and not profit making, the fund distinguishes itself from private capital funds.

**Table 2: Northern Jutland Loan Fund**

Established	2004 (2009)
Objective	Creation and development of new enterprises
Budget	EUR 8.2 million
ERDF support	EUR 4.1 million
Co-financing	Northern Jutland Region's Development fund
Organization	Politically elected Board of Directors and a professional management (administration + screening)

*Source: New Insight A/S on the basis of the Danish Business Authority's data base*

The fund was established in 2004 under the name 'Mål2-lånefonden and received support from the ERDF in the 2000-2006 programming period. It was reorganised in 2009 which was the year it received ERDF support for the current programming period. Some of the main changes made were to extend the scope of lending activities to the whole of the region instead of specific municipalities in the Northern part but to confine loans to entrepreneurs and development projects rather than supporting any investment in fixed assets.

The budget for the fund is EUR 8.2 million of which EUR 4.1 million comes from the ERDF

### Requirements for loan recipients

In order to ensure the achievement of the Operational Programme objective as well as sustainability, candidates for loans have to fulfil certain requirements.

First and foremost, they have to be an SME and to be able to demonstrate that the investment concerned is in new products or services and will have a positive influence on the development of the region.

Second, the fund can only grant loans of up to 50% of the capital needed. The SME has to raise the rest on the private financial market. This is intended to ensure that only projects with good prospects of success are supported.

### Organisation

The fund is managed by a Board of Directors. The Chairman is a representative from the Northern Jutland regional Government. Two members of the board represent regional businesses. One member represents one of the municipalities in the region and another, the local private capital market. The Board of Directors has the final say in the distribution of the funds.

The fund is managed on a day-to-day basis by a private company (LIVA Consult), which is a relatively new development. The company is responsible for administration and for the initial screening of applicants to ensure that the Board of Directors is not overburdened.

To ensure that the requirements for loan recipients are met, their business-and development plan is reviewed not only by the management of the loan fund but also by the regional authority (Northern Denmark Region/*Vækstforum Nordjylland*).

### Quality assurance

The loan fund and the Danish Business Authority have agreed on milestones and measures regarding outcomes, and these targets are included in the authorisation letter. The targets cover the effect of the loans extended on, in particular, the value added of the enterprises concerned, the number of new jobs created or maintained and the number of loans given. The targets are not evaluated until the end of the programming period, but twice a year the Board of Directors submits a progress report to the Danish Business Authority.

### 3.2: Case: The Fund CAT Invest Zealand

The second case, The Fund CAT Invest Zealand, is based in the Zealand Region and was established in 2010. It is a venture capital fund established as part of CAT Science Park (*Forskerparken CAT*), a privately-owned company, helping entrepreneurs and innovators to find the capital and the competences required to turn ideas into tangible products. CAT Science Park is a combination of government-backed pre-seed capital, science park and venture company.

The Fund CAT Invest Zealand can invest up to around EUR 0.8 million in a business concept.

**Table 3: The Fund CAT Invest Zealand**

Established	2010
Objective	Creation and development of new enterprises
Budget	EUR 9.1 million
ERDF support	EUR 4.0 million

Co-financed	Zealand Region and Danish Business Authority
Organization	Board of Directors and a professional management (administration and screening)

*Source: New Insight A/S on the basis of the Danish Business Authority's data base*

The budget for the fund is EUR 9.1 million and EUR 4.0 million comes from the ERDF, the rest coming from the Zealand Region. The fund managers strive to attract private money.

### **Who can get support and how**

The fund invests in SMEs which are located in Zealand, primarily those with a business concept at an early phase which involves a high degree of innovation and is aimed at achieving a significant market share. There should also be international market potential and the product should not be easy to copy. Usually, funding is extended in cooperation with other investors.

The Fund does not only provide capital for SMEs but also help for entrepreneurs with regard to many aspects of business development, such as by providing counselling and helping to establish strong management and good networks.

According to Head of Administration, Villy Vibholt, the main difference between the Fund CAT Invest Zealand and privately held capital funds, is the size of the enterprises the fund invests in, these being much smaller and younger than private venture capital funds would invest in, partly because of the risk involved and the length of time before returns are generated.

### **Organisation**

The fund has a Board of Directors in which the regional authority (Zealand Region) is represented. The fund managers screen the various applicants for loans, the screening process having five phases (identification and dissemination, screening, initial negotiation, due diligence, and final negotiation).

### **Quality assurance**

CAT Invest Zealand and the Danish Business Authority have agreed on goals for the fund and indicators regarding the outcome of their investments. These goals are included in the authorisation letter and cover the effect of the investment on much the same variables as for the North Jutland Loan Fund. As for the latter, the achievement of targets will not be evaluated until the end of the programming period, though twice a year the Board of Directors submits a progress report to the Danish Business Authority.

### **Effectiveness**

Meeting the programme target is pursued mainly through three measures: 1) The two FEIs have clear and stringent requirements for enterprises seeking support. In this way it is intended that only projects that can actually help fulfil the regional competitiveness and job creation objective are given support, 2) Both FEIs are organised in the same way - with a Board of Directors with representatives from the regional authority and a private firm undertaking the day-to-day management. This aim is to ensure that the fund is managed professionally but under the close monitoring of the regional authority, and 3) the two FEIs are committed to achieving specific regional objectives, the achievement of which will be evaluated at the end of the programming period.



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

It should be noted that only one of the FEIs described in this paper is more than three years old which means that while we have an impression of start-up problems, long-term problems are more difficult to identify.

There is one main obstacle when setting up an FEI under the ERDF which is the administrative cost. The regulations concerning state aid are complicated and some issues remain unsolved. While the regulations governing non-refundable grants are also complicated, since this kind of support has been used for a longer period, both public authorities and the private sector have more understanding of how to deal with the system.

The operational managers and the regional authorities have faced one very important issue: how to ensure that the FEI is seen as the recipient of ERDF support (and therefore the institution responsible in relation to the ERDF) and not the SMEs seeking funding. A main aim of setting up an FEI is to ease the access of SMEs to capita rather than to impose more regulations on them.

The administration of the funds has proved to be more demanding than expected, and for at least one FEI (the Northern Denmark Loan Fund) it has been necessary to hire a private firm to handle the day-to-day management.

#### **5. Evaluations of financial engineering instruments**

The three FEIs in Denmark were established over the period of 2009 to 2011 and so far no evaluations have been carried out. The Northern Denmark Loan Fund has been subject to an annual audit, which has so far been completed without comment.

#### **6. Concluding remarks**

The three FEIs in Denmark supported by the ERDF were established in order to overcome the damaging effect of shortage of venture capital available to SMEs in various parts of Denmark. The funds differ from private ones in their objectives.

The main disadvantage of using the ERDF in this way is the complex regulations concerning state aid and the lack of knowledge and experience in relation to FEIs. However, the two cases examined incorporate several elements with the specific aim of meeting overall Operational Programme targets, targets which are included explicitly in letters of authorisation. Nevertheless, there remains a need for in-depth evaluations of the schemes concerned in order better to be able to assess their effects in relation to overall regional development aims.

## References

### Books, articles, notes, etc.

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'Annual report 2008', by Mål2-lånefonden, 2009

'Strategic evaluation on Structural Fund program period 2007-2013', by Danish Business Authority

Minutes from meeting the 16<sup>th</sup> of September 2008 in 'The Monitoring Committee for Structural Funds program under the Regional competitiveness and employment Objective'.

### Homepages

The homepage of Northern Denmark Loan Fund: [www.nordjysklaanefond.dk](http://www.nordjysklaanefond.dk)

The homepage of The Fund CAT Invest Zealand: [www.catinvestzealand.dk/](http://www.catinvestzealand.dk/)

The Danish Business Authority's data base for projects supported by the ERDF: <http://www.ebst.dk/eustrukturfonde.dk>

### Interviews

Head of section at Danish Business Authority, Thomas Tandskov Dissing

Senior Consultant at Danish Business Authority, Steen Frederiksen

Head of Administration at The Fund CAT Invest Zealand, Villy Vibholt

Deputy Head of Section at Northern Jutland Region, Ulla Christensen