Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period

Enhancing the competitiveness of SME, including agriculture, microcredit and fisheries (Thematic objective 3)

Volume III

Please note that this version of the methodology reflects the current state of the Regulation as of March 2014.

The author reserves the right to update this document according to the evolution of the relevant regulatory framework.

Version 1.0 - March 2014

This study was commissioned by the EIB, co-financed by DG REGIO and assigned to the consortium led by PwC.”

‘Framework Agreement for the provision of technical assistance and advisory services, within the context of the JESSICA initiative
37th assignment contract No CC3912/PO62604’

Table of contents

Appendices

Glossary and definitions

AECM	European Mutual Guarantee Association
ABER	Block Exemption Regulation for agriculture
CAP	Common Agricultural Policy
CEB	Council of Europe Development Bank
CEI	Call for Expression of Interest
COCOF	Coordination Committee of the Funds as established under Article 143 of the CPR
Common Strategic Framework (CSF)	The framework which translates the objectives and targets of the EU strategy for smart, sustainable inclusive growth into key actions for the ESI Funds
COSME	Programme for the Competitiveness of Enterprises and SMEs
CP	Cohesion Policy
CPR	Common Provisions Regulation
de minimis	See below under 'State aid'
DG AGRI	Directorate General for Agriculture and Rural Development of the EC
DG REGIO	Directorate General for Regional and Urban Policy of the EC
EAFRD	European Agricultural Fund for Rural Development
EaSI	Employment and Social Innovation Programme
EC	European Commission ('the Commission')
EE/RE	Energy Efficiency and Renewable Energy
EEEF	European Energy Efficiency Fund
EIB	European Investment Bank
EIF	European Investment Fund
EMFF	European Maritime and Fisheries Fund
ERDF	European Regional Development Fund
ESF	European Social Fund
ESI Funds	European Structural and Investment Funds for the programming period 2014-2020. This includes: European Regional Development Fund (ERDF), Cohesion Fund (CF), European Social Fund (ESF), European Agricultural Fund for Rural Development (EAFRD), and European Maritime and Fisheries Fund (EMFF)
ESIF Policies	Policies making use of the ESI Funds
EU	European Union
EVCA	European Venture Capital Association
Ex-ante assessment	As in Article 37 (2) of the CPR. MS/MA are required to conduct ex-ante assessments before supporting financial instruments, including: rationale/additionality against existing market gaps and demand/supply, potential private sector involvement, target final recipients, products and indicators
Ex-ante evaluation	Ex-ante evaluation required for Programmes in line with Article 55 of the CPR
FADN	European farm accounting data network
Financial Engineering Instruments (FEI)	See below "Financial Instruments". In 2014-2020 reference will be made to 'Financial instruments' rather than Financial Engineering Instruments as referred to in the 2007-2013 legal framework.
Final recipient	Legal or natural person that receives financial support from a financial instrument as described in Article 2 (12) of the CPR

Financial Instruments (FIs)	As in Article 2 (11) of the CPR, the definition of financial instruments as laid down in the Financial Regulation[1] shall apply mutatis mutandis to ESI Funds, except where otherwise provided in the CPR. In this context, financial instruments means Union measures of financial support provided on a complementary basis from the budget to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants.
FI-TAP	Financial Instruments Technical Advisory Platform
FRR	Fair rate of return for entrepreneurial activities in a certain sector in a certain country
Focus Area	EAFRD proposes 6 priorities with 18 focus areas, between 2 and 5 for each priority
Fund of funds	Means a fund set up with the objective of contributing support from Programmes to several bodies implementing financial instruments. Where financial instruments are implemented through a fund of funds, the body implementing the fund of funds shall be considered the only beneficiary in the meaning of Article 2 (27) of the CPR.
Funding agreement	Contract governing the terms and conditions for contribution from Programmes to financial instruments. This shall be established between a MA and a FoF and between a FoF and financial instrument as described in Article 38 (7) of the CPR.
GAFMA	Guidelines for SME Access to Finance Market Assessments: a methodology developed by the EIF[2] to be used to prepare market assessments to identify market failures, suboptimal investment situations and investment needs related to the access to finance of micro-enterprises and SMEs
GBER	General Block Exemption Regulation
GDP	Gross Domestic Product
GGE	Gross grant equivalent (NPV consideration for State aid purposes)
GHG	Greenhouse gases
GVA	Gross Value Added
HA	Horizontal Assistance as foreseen in the proposed FI-TAP
IFI	International Financial Institution
JASMINE	Joint Action to Support Micro-finance Institutions in Europe
JEREMIE	Joint European Resources for Micro to Medium Enterprises
LGD	Loss Given Default (e.g. for a loan)
Managing Authority (MA)	Managing Authority, as defined in the Community Regulations regarding Structural Funds
MFF	Multi-annual Financial Framework of the EU (2007 – 2013, 2014-2020)
MFI	A microfinance institution (MFI) is an organisation that provides financial services targeted to a clientele poorer and more vulnerable than traditional bank clients. Note that this methodology focuses only on microcredit lending (loans < 25,000 EUR) to (future) entrepreneurs and micro-enterprises.
MRA	Multi-Region Assistance as foreseen in the proposed FI-TAP
MS	Member States

[1] Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).

2 The GAFMA is published as an EIF Working Paper by Krämer-Eis, H. and Lang, F. (2014).

NACE	Statistical Classification of Economic Activities in the European Community (in French: *Nomenclature statistique des activités économiques dans la Communauté européenne*)
NGO	Non-Governmental Organisation
NPV	Net present value (of a cash flow)
NUTS	Nomenclature of Territorial Units for Statistics
OECD	Organisation of Economic Co-operation and Development
Other Revolving Instruments	Defined in the context of these ToR to refer to funds which are similar to the FEI/FIs, for the eligible sectors, but which are not established under Title IV of the CPR
PD	Probability of Default (e.g. of a loan)
PPP	Public-private partnership
Programme	For the ERDF, this mean an 'Operational Programme' as referred to in Part Three or Part Four of the Common Provisions Regulation and in the EMFF Regulation, and 'Rural Development Programme' as referred to in the EAFRD Regulation as provided for in Article 2 (6) of the CPR
RDP	Rural Development Programme referred to in the EAFRD Regulation (document approved by the Commission comprising a set of measures which may be implemented by EAFRD or other financial instruments)
RDR	Regulation EU (No) 1305/2013 of the European Parliament and of the Council on support for rural development by the European Agricultural Fund for Rural Development (EAFRD)
Repayable finance	Defined in the context of these ToR to refer to either all, or a subset of, FEIs, FIs and other revolving instruments
SGEI	Service of General Economic Interest
SME	Small and medium-sized enterprises as per European Commission Recommendation 2003/361/EC
Specific Fund	A term used in the Summary Reports for 2011 and 2012. In the context of 'JESSICA type' of FEIs refers to an urban development fund (UDF); in the context of 'JEREMIE type' refers to loan, guarantee or equity/venture capital funds investing in enterprises.
State aid	'State aid' means aid falling under Article 107 (1) of the Treaty, which shall be deemed for the purposes of this Regulation, to also include *de minimis* aid within the meaning of Commission Regulation (EC) No 1407/213 of 18 December 2013 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid[3], Commission Regulation (EC) No 1408/2013 of 18 December 2013 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the sector of agricultural production[4] and Commission Regulation (EC) No 875/2007 of 24 July 2007 or its successor Regulation on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the fisheries sector and amending Regulation (EC) No 1860/2004[5]..
Structural Funds (SFs)	EU Structural Funds for the programming period 2007 – 2013 (ERDF and ESF)

[3] OJ L 379, 28.12.2006, p. 5.

[4] OJ L 337, 21.12.2007, p. 35.

[5] OJ L 193, 25.7.2007, p. 6.

Summary Report	Report published by DG REGIO in December 2012, on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds. Situation as at 31 December 2011. The follow-up report on 2012 was published in September 2013.
SWOT Analysis	Analysis of Strengths-Weaknesses-Opportunities-Threats
Technical support	Grants for technical support, which are combined with a financial instrument (FI) in a single operation are provided for the preparation of the prospective investment *(please refer to Article 37 (7) CPR and Article 37 (9) CPR)*.
TFEU	Treaty on the Functioning of the European Union
Thematic Objectives	Objectives supported by each ESI Fund in accordance with its mission to contribute to the Union strategy for smart, sustainable and inclusive growth (see Article 9 of the CPR)
Union priorities for rural development	For the EU rural development policy (EAFRD) 'Thematic Objectives' are translated into Union priorities for rural development as defined by Article 5 of Regulation EU (No) 1305/2013 (EAFRD). So, the term 'Thematic Objectives' will also cover the Union priorities for rural development.
Urban Regeneration / Development/ Transformation	A range of actions aimed at sustainable renewal, rehabilitation, redevelopment and/or development of city areas, which may include area-based and city-wide initiatives

Introduction

This methodology is intended as a **toolbox encompassing good practices and providing practical guidance to Managing Authorities (MAs)** in the preparation and the realisation of the ex-ante assessment of the financial instrument (FI) envisaged in the Programme(s), as required by Article 37 (2) of the Common Provisions Regulation (CPR).The ex-ante assessment process should also allow MAs to ensure that ESI Funds resources allocations to FIs are fully aligned with the objectives of ESI Funds and Programmes and are used in accordance with the principle of sound financial management (meaning in the most economic, efficient and effective way).[6]

This document constitutes Volume III of the ex-ante assessment methodology dedicated to Thematic Objective 3, notably: “Enhancing the competitiveness of SMEs, including agriculture, micro-credit and fisheries”. It aims to present specificities of this area to be taken into account for the ex-assessment of the FI, at proposing tools adapted to this area and at sharing good practices related to it.

It should be used in conjunction with Volume I – Ex-ante assessment methodology[7], as the common descriptions and tools of the General Methodology are not repeated in this volume. Therefore some paragraphs might be rather limited as long as there are no specificities related to this area.

It is important to note that significant interconnections exist between the research, technological development and innovation themes and entrepreneurship. In particular innovation is a major driver of start-up and SME competitiveness. As a result this specific methodology addresses topics and issues that are also discussed in Volume II: Strengthening research, technological development and innovation (Thematic Objective 1).

In order to facilitate the reading of this Volume the same structure as Volume I has been developed around the seven main groups of elements proposed in the Article 37 (2) of the CPR, namely:

a. Analysis of market failures, suboptimal investment situations and investment needs;
b. Assessment of the value added of the FI;
c. Estimate of additional public and private resources to be potentially raised by the FI;
d. Assessment of lessons learnt from similar instruments and ex-ante assessment carried out in the past;
e. Proposed investment strategy;
f. Specification of expected results;
g. Provisions allowing the ex-ante assessment to be reviewed and updated.

Additionally some specific methodological recommendations have been detailed for agriculture, micro-credit and fisheries in Chapters 10, 11 and 12.

The different elements of the ex-ante assessment can be performed in stages, as foreseen by Article 37 (3), and MAs are not obliged to strictly follow the order described in Article 37 (2).

As a result, the ex-ante assessment shall be conceived as an iterative process rather than as a strictly linear one. This means that MAs will most likely go back and forth when undertaking the ex-ante assessment and will have to ensure the coherence of the whole assessment before it is finalised.

---

6 Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Council Regulation (EC) No 1083/2006

7 *Ex-ante assessment methodology for Financial Instruments in the 2014 - 2020 programming period*, Volume I

Finally, please note that this methodological guidance encompasses five Volumes, namely:

- **Volume I** dedicated to the General Methodology covering all Thematic Objectives;
- **Volume II** dedicated to Thematic Objective 1, namely: “Strengthening research, technological development and innovation”;
- **Volume III** dedicated to Thematic Objective 3, notably: “Enhancing the competitiveness of SME, including agriculture, micro-credit and fisheries”;
- **Volume IV** dedicated to sectors related to Thematic Objective 4, notably: “Supporting the shift to low-carbon economy”;
- **Volume V** dedicated to “Integrated approaches to territorial development, including financial instruments for urban development”.

1 Financial Instruments: Overview

1.1 Rationale for the use of financial instruments for enhancing the competitiveness of SMEs

Small and Medium-sized Enterprises (SMEs) are frequently described as the backbone of the EU economy, as they represent more than 98% of all enterprises with some 20.7 million firms, of which 92% are firms with fewer than ten employees. According to estimates for 2012, SMEs accounted for approximately 67% of total employment and 58% of gross value added (GVA)[8] generated by the private, non-financial economy across Europe.[9]

When dealing with SMEs competitiveness is a crucial concept as it represents the advantage a firm obtains by lowering its costs, increasing productivity, improving the quality and differentiating its product or service offering, and by improving its marketing[10]. SMEs' competitiveness is closely linked to the following factors:

- Regulatory environment concerning SMEs;
- Cost and productivity of labour;
- Access to external sources of funding;
- Product ranges (high-level or low-cost);
- Innovation capacity;
- Cost of import of inputs, services and supplies, including energy;
- Export capacity and access to supply chains;
- Access to high quality human resources;
- Proximity to transport connections to reach suppliers and customers; and
- Overall business climate including corporate taxation.

Despite their importance and dynamism, SMEs are facing significant challenges in accessing finance since they are perceived as more risky than large companies by financial markets and investors. Moreover, in the area of access to finance for SMEs, economic literature often mentions structural market failures due to asymmetric information between lender and borrower and uncertainty.[11]

In addition, the competitiveness of SMEs has been severely affected by the recent financial crisis and the subsequent credit crunch. Despite the adoption and implementation of policies aiming to avoid financial markets collapses, growth and competitiveness policies are having a slower impact on the overall economic situation as the objectives of promoting growth and competitiveness and maintaining control of public spending are often conflicting.

Moreover, although hampered access to finance appears to be the main hurdle to SME development, other issues need to be addressed in order to enhance the competitiveness of SMEs in all industry sectors. These issues are particularly linked to the need for:

- Support services in enabling commercialisation of new products and services;

- Business services;

8 Ecorys (2012), EU SMEs in 2012: at the crossroads. Annual report on small and medium-sized enterprises in the EU, 2011/12, Report prepared for the European Commission.

9 This is a Eurostat classification that includes the sectors of industry, construction and distributive trades and services.

10 European Commission, Thematic guidance fiche No. 3 – Competitiveness of Small and Medium-sized Enterprises (SMEs), Version 1 22/04/2013

11 OECD (2006), The SME Financing Gap, Vol. 1, Theory and Evidence.

- Attraction and retention of talent and skills; and

- Internationalisation of economic activities of SMEs, for instance through joint research, outsourcing, relocations, mergers and acquisitions, technology transfer and so on.

It should however be highlighted that the challenges and opportunities facing SMEs across the EU-28 are not homogenous, but differ according to a number of variables such as size, industry, location etc. This methodological guidance represents a toolbox with which to approach the ex-ante assessment and proposed measures should be adapted to address the specificities of the SMEs targeted.

1.2 Rationale for financial instruments focusing on SMEs

Finding appropriate ways to finance the real economy and especially SMEs is a priority for the European Union.[12] In this regard, the European Union is working towards providing constructive solutions to empower the economy and boost sustainable, inclusive and smart growth. Since the early 1990s, policy recommendations at global, European and national level have urged that a coherent approach be taken to improve SMEs' access to finance, in particular equity finance.[13] In the 2007 – 2013 programming period, structural funds support to SMEs was provided via FIs in addition to grant finance. Based on DG REGIO's Summary Report 2012, FIs for enterprises were reported to have invested in approximately 34,000 SMEs, 16,000 micro-enterprises, and 62 large enterprises.[14]

The 2014-2020 programming period foresees an increased use of FI for all Thematic Objectives and across all sectors[15]. A number of FIs are foreseen to provide financing to SMEs with the objective of moving away from grant mechanisms towards FIs, namely revolving funds focused on productive investment that also allows for greater participation of the private sector. Furthermore, there is a wide interest in ensuring the strong commitment of the financial intermediaries in taking the role of bodies implementing FIs, in order to increase efficiency in the delivery of funds and leverage the amount of funds made available through private participation.

In the current economic situation financial intermediaries are constrained by the credit crunch and the need to apply strict risk management standards. This may increase the difficulties for SMEs to satisfy the conditions for access to finance. The ex-ante assessment needs to take this aspect into account in order to design the FI properly.

1.3 What are the options available to Managing Authorities

Please refer to the General Methodology for guidance on the options available to Managing Authorities.

---

12 Think Small First - A Small Business Act for Europe (COM(2008) 394 of 23.6.2008)

13 European Commission (2005), DG Enterprise and Industry: Best practices of public support for early-stage equity finance, Final report of the expert group, September 2005. http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=1202

14 European Commission, Summary of data on the progress made in financing and implementing financial engineering instruments reported by the MAs in accordance with Article 67(2) (j) of Council Regulation (EC) No 1083/2006. Programming period 2007-2013 (situation as at 31 December 2012)

15 European Commission, Factsheet - Financial Instruments in Cohesion Policy 2014-2020

2 Ex-ante assessment: preliminary considerations

2.1 Scope and value of the ex-ante assessment for financial instruments

Please refer to the General Methodology for guidance on the scope of the ex-ante assessment for FI.

2.2 Preliminary considerations

Please refer to the General Methodology for guidance on the preliminary considerations for ex-ante assessment for FI.

3 *Analysis of market failures, suboptimal investment situations and investment needs*

As there are significant similarities between the approach presented here and the one detailed in Volume II – Strengthening research, technological development and innovation (Thematic Objective 1), market assessments carried out for the same country or region and during a comparable timeframe for Thematic Objective 1 and 3 should not provide conflicting results.

3.1 *Identifying existing market problems*

As presented in the General Methodology[16], the demonstrated presence of market failures, suboptimal investment situations and unmet investment needs is an essential component to justify a public intervention. Following the identification of such events, the assessment of the extent to which additional investment is needed to reduce an identified financing gap is meant to be the trigger for the implementation of FIs.

The methodology presented below is based on the logic and the tools of the Guidelines for SME Access to Finance Market Assessments (GAFMA) developed by the European Investment Fund (EIF) [17]. This document focuses on market assessments to identify market failures, suboptimal investment situations and investment needs related to the access to finance of SMEs. Such methodology is consistent with the approach presented in the General Methodology Chapter 3.2 but also introduces SME-specific concepts.

As already stated in Chapter 1, this methodology provides a comprehensive toolbox that covers the activities required for a detailed analysis of market failures, designed to highlight a wide range of potential market failures that may occur. However MAs should bear in mind that, depending on the circumstances of their specific proposed FI, not all potential issues listed here may need to be covered in order to achieve compliance with Article 37 (2) (a) of the CPR. Readers may also consult an alternative approach to the structure of the market failure analysis which is presented in the GAFMA (e.g. to present existing SME financing instruments first, and then to turn to the market analysis).

The growth and competitiveness of SMEs require financing, especially at the early stages of their development.[18] Innovative companies and enterprises focusing on new technologies also need to consolidate their level of capitalisation. The level of resources that the company can rely on could have a direct impact on its capacity to access loans and hybrid finance (i.e. financial products that combine equity and debt characteristics such as mezzanine finance).

Despite their large number and dynamism, SMEs are facing significant challenges in accessing finance under normal market conditions. The key concept to be introduced in this framework is the notion of “financing gap”. According to the report published by the Commission in 2005[19], this refers to a situation where firms that would merit financing cannot get it due to market imperfections.[20] This situation is now exacerbated by the recent financial crisis and credit crunch. These difficulties related to access to finance may be directly addressed by a FI aimed to enhance SME competitiveness.

16 See: Ex-ante assessment methodology for Financial Instruments in the 2014 - 2020 programming period, Volume I.

17 The GAFMA is published as an EIF Working Paper by Krämer-Eis, H. and Lang, F. (2014).

18 Intitute of International Finance (2013) restoring financing and growth to europe’s SMEs

19 European Commission (2005), Best practices of public support for early stage equity finance, Final report.

20 For further details on the definition of financing gap please refer to the discussion in the EIF Guidelines for SME Access to Finance Market Assessments (GAFMA), chapter 2

However, while access to finance seems to be the principal hurdle to the development of SME, to enhance their competitiveness broader issues related to the business conditions may also need to be addressed. In other words the market failure is not exclusively related to the capacity of the market to ensure the equilibrium between demand and supply of various types of funding, but can be determined by a complex interaction of market weaknesses related to the general business environment.

It is important to clarify that this type of difficulty cannot be tackled directly by FIs. Nonetheless, they need to be considered when setting up a FI, since they may have an impact on the competitiveness of SMEs and they may also negatively impact the performance of FIs.

When such weaknesses are identified, the ex-ante assessment should envisage actions to mitigate their negative effect on the FI investment capacity.

Table 1 below provides a list of potential issues covering these two types of difficulties experienced by SMEs. MAs should identify which issues are relevant to their particular situation.

Table 1: Potential issues limiting SME competitiveness and main underlying causes

Hurdles faced by SMEs	Main causes
Poor business environment	• Limited availability of support and business services for SMEs; • Inefficient or uncertain management methods and governance structure; • Limited access to markets and clients; • Difficulties in complying with the relevant regulation and the related administrative burden; • Difficulties in attracting and retaining talent and skills; • Limited territorial attractiveness for foreign and private investments; • Difficulties in internationalising economic activities; • Lack of physical and financial infrastructure.
Limited access to finance	• Insufficient supply of adequate financial products; • Asymmetric information including principal/agent problems; • High transaction costs; • Insufficient capacity to provide collateral to SMEs; • Insufficient or unpredictable cash flow.

When analysing the presence of market failures, suboptimal investment situations and estimating unmet investment needs, the four methodological steps to be followed should be:

- Analysis of the economic context at the national or regional level;
- Analysis of the SME structure and characteristics (e.g. sector concentration, segmentation in terms of size of companies or clusters);
- Analysis of market failures/imperfections linked to the business environment in which SMEs are operating; and
- Analysis of the gap between supply and demand of financing for SMEs.

The following paragraphs present each of the four methodological steps as well as the tools that could be used to perform these analyses.

3.1.1 Analysis of the national or regional economic context

Key questions to address when completing the analysis of the economic context

1. What aspects of the economic environment are favourable and unfavourable to the development of SMEs?

Analysing the national and regional economic context is a first necessary step to understand the environment in which SMEs operate, before determining the existence of market failures and sub-optimal investment situations. It should be noted that this section represents a toolbox for the economic analysis step and should be adapted to the individual circumstances of each ex-ante assessment. In line with Chapter 2.2 of the General Methodology, this analysis of the economic context should also be consistent with analysis carried out for the Programme strategy.

Looking at the economic context is useful since SME competitiveness, as that of any other firm, is directly linked to, and influenced by the way the economy develops and by the economic policies, such as the economic growth, import and export dynamics, investment flows, taxation policy, level of public investment and performance of the financial market (e.g. situation of equity investment and credit allocation on the territory considered), as well as characteristics and qualification of the labour force, salary and income levels. Demographics elements are also important in order to understand the evolution of the population living in the country or region considered.

To begin with, GDP growth, jointly with the evolution of import and export, gives a measure of the size and evolution of the domestic market. When imports grow more slowly than the GDP, there is a new space for purchasing demand and reduced competition in the local market, providing local SMEs with new opportunities to increase both sale volume and profit. In addition, the contribution of the different sectors to the total GDP, and its evolution over time, allows identifying the fastest growing and most competitive sectors.

Following this, special attention may be paid to particularly innovative sectors so as to identify trends to be considered later on. This work may leverage the Smart Specialisation Strategies (S3) developed by MAs and the local consultation conducted to structure and implement the agreed-upon S3 policy.

3.1.2 Analysis of market weaknesses impacting the business environment

Key questions to address when analysing market weaknesses:

1. What are the various constraints limiting the development of SMEs?
2. In addition to issues linked to limited access to finance, what other factors have a negative impact on the overall business environment?
3. Are these factors due to contingent market conditions or do they imply structural market weaknesses?

In addition to the economic context, the competitiveness of SMEs can be influenced by other factors that exert a negative impact on the environment in which firms, including SMEs, operate. They can either be contingent and linked to the economic context at a particular moment in time (e.g. the reduction of demand due to the crisis) or constitute structural factors. While contingent factors are generally placed outside the control sphere of national and local authorities, structural factors need to be analysed as they may have an impact on the effectiveness of any FI to be put in place.

A non-exhaustive list of such factors determining these weaknesses are detailed in the following paragraphs. It should nevertheless be noted that not all the factors listed here may be relevant in every case, and MAs should adapt their analysis according to the individual circumstances of their ex-ante assessment.

Political stability influences the business environment, since it helps maintain the confidence of firms, national and foreign investors in the safety of their investments in the country or region. Therefore, the analysis of the market environment should consider the frequency and the regularity of changes in the strategic orientation of the government, the eventual political uncertainty due to election results and the reactions of the financial markets to these events.

The **legal and regulatory framework** establishes the rules within which all the financial institutions, FIs, and markets operate in a given country (including relevant EU Regulations and transposed EU directives). The procedures and legal requirements for entities operating in the financial services sector, the regulatory provisions for collection of receivables and default payment, the cost of regulation enforcement and the performance of the judicial system in dealing with business litigation are essential to determine sufficient confidence in the proper functioning of the market by the economic actors involved. The lack of a sound and effectively enforced legal and regulatory framework has a negative impact on the promotion of market development and competition, consumers and depositors' protection and ultimately market stability[21].

Linked to the lack of a sound legal and regulatory framework is the issue of **corruption,** or the abuse of public positions for private gains, which causes market inefficiencies, limits sound competition thus entailing significant costs. The causes of corruption are strictly dependant on the local context, in national policies, and political and social history. Nonetheless, corruption tends to flourish when institutions are weak and government policies generate rents.

Taxation policy, both corporate and personal income tax, has an impact of the growth of SMEs since it exerts a direct influence on their revenue and it is an important determinant of their investment decisions. Beyond the level of taxation, the clarity and stability of the tax regulation is essential to determine confidence and foster domestic and foreign investment.

[21] International Finance Corporation (2011), G-20 SME Finance Policy Guide,
http://www.ifc.org/wps/wcm/connect/f3ef82804a02db409b88fbd1a5d13d27/G20_Policy_Report.pdf?MOD=AJPERES

The level of **corporate indebtedness and insolvency** represents a frequently encountered obstacle to business and economic growth. High debt ratio also makes it more difficult for SMEs to meet their financing needs, due to the risk aversion of potential funding providers. This situation has been worsened by the effects of the crisis as banks are confronted to increased capital adequacy requirements.

Fragmentation of the supply chain and lack of coordination are additional causes of inefficiencies and costs, particularly production and transaction costs. The extent to which supply chains are fragmented varies across the sectors and depends on the number of actors operating on the market.

Innovation is an essential lever of growth for SMEs but it can be hindered by a set of factors, such as the lack of coordination between fundamental research and the needs of the productive sector, lack of cooperation between public and private research teams, insufficient policy initiatives and incentives for innovation, and/or a lack of interactions and coordination between key stakeholders in key innovative sectors for the country or region considered. Linked to the issue of insufficient investment in innovation are the complexity and the cost of protecting **intellectual property rights**. A well-functioning framework would remove the risk of rapid imitation, ensure the respect of ownership rights and play a crucial role in the diffusion of new technological advancements. In addition SMEs often lack sufficient in-house capacity and expertise to ensure the protection of their intellectual property rights.

Moreover, having **access to a qualified labour force at an affordable cost** is a key enabler of SME growth and influences their ability to attract foreign capital and investment. In this respect, it is important to analyse the average educational level and possible disparities across the territory. Bureaucracy, social security contribution and labour law constraints can increase the burden of direct and indirect labour cost for SMEs.

Finally, the **lack of infrastructure** (e.g. electricity, communication and transport networks) on a specific territory penalises the development of SMEs, since they have more difficulty to export, import and communicate with business partners, in comparison with companies in other territories.

Such weaknesses need to be investigated at the local level, but could also be highlighted by comparing the situation in the local market with other European countries or regions. A word of caution is however necessary since, while these comparisons can provide useful benchmarks, there is a risk of overlooking fundamental differences across the various countries and regions. That is why each country or region has to be considered independently so as to identify and analyse the specific needs of SMEs and their difficulties to access to finance. Comparisons and benchmarks with other countries or regions provide insights on the relative position of the territory under scope with regards to other territories. The gap analysis requires however to focus on the SMEs located on the territory.

This analysis should capitalise on the existing literature but should to be complemented by additional primary data collected through interviews and consultations.

3.1.3 Analysis of the SME structure and characteristics

Key questions to address when completing the analysis of the characteristics of SMEs

1. What types of SMEs operate under the geographical scope considered?
2. How have the SME structures and characteristics evolved during the last years and how are they likely to evolve in the near future?

Following the analysis of the economic context, the SME structure and characteristics have to be considered at the relevant geographical scope (national or regional) and detail:

- The stratification of SMEs in terms of company size (micro-enterprises, small and medium-sized companies);
- The stratification of SMEs by sectors; and
- The stratification of SMEs by geographical locality with a distribution by region.

This analysis could be enriched with the evolution over time of the SME structure and characteristics under consideration (historical analysis) and comparing it with other regions (or Member States) having similar characteristics.

This analysis consists of leveraging the existing literature (at EU, national and regional levels) to identify key information - including indicators relative to the SME structure and characteristics considered – to be monitored over time and in comparison with other regions. This literature analysis is meant to be completed with primary data collected through interviews and consultations.

3.2 Establishing the evidence of market failure and suboptimal investment situations

Once the characteristics of the national or regional economic environment, the structural market weaknesses and the characteristics of SMEs operating on the market have been analysed, financing gaps have to be identified through a comparison of supply and demand. This section presents the main factors that determine a mismatch between supply and demand of financing for SMEs. The components of supply and demand analyses are then presented in detail, in order to facilitate the launch of the ex-ante assessment. Finally, Chapter 3.3 provides a description of the suggested operational approach and the tools that could be used to perform these analyses.

3.2.1 Analysis of the gap between supply and demand for financing from SMEs

Key questions to address when performing the financing gap analysis

1. What is the structure of the financial sector (e.g. presence of commercial banks, MFIs, investment funds, venture capital, business angels) and to what extent does this structure impact the access to finance for SMEs?
2. What are the financial products that SMEs require that are under developed or not provided by the financing supply side?
3. What is the size of mismatch between the supply available to SMEs and the funding needs? (i.e. quantification of the financing gap, if possible)
4. What are the barriers (if any) limiting access to finance for SMEs?

As stated in the previous sections, limited access to finance is one of the main obstacles faced by SMEs in their growth and development. This situation has been worsened by the current financial and economic crisis. A public intervention with the use of FIs is one of the key tools to improve SMEs' access finance. The FIs to be developed and implemented have also to be considered within the overall portfolio of financial products that SMEs have at their disposal, including grants provided by European, national and local entities.

Among the frequently cited reasons behind the difficult access to finance is the **incomplete range of financial products and services** suited to the needs of SMEs[22] as well as **regulatory rigidities or gaps in the legal framework**[23]. As a consequence, SMEs may not be able to take full advantage of the available financing offer, because they cannot comply with the terms and conditions or because the eligibility rules do not ensure a broad coverage of their needs (e.g. SMEs have difficulties meeting the requirements for collateral to obtain a guarantee or do not have a sufficient regular cash flows to repay a loan and secure their financing).

Another reason behind SMEs' difficulties in accessing finance is related to **information asymmetries** that lenders (such as private and public banks or MFIs) have insufficient information on some bankable proposals and may therefore fail in providing sufficient funding to the SMEs that develop them[24]. Such proposals may, for instance, include new and technology-based products for which market intelligence may be limited. As a matter of fact, particularly at an early stage of product and firm development, entrepreneurs may be reluctant to provide full information to potential lenders, as maintaining confidentiality reduces the risk of competition[25]. In addition, there may be asymmetries related to location and sector. For example, owners of SMEs in rural environments may face difficulties with access to bank finance[26]. Another aspect related to asymmetric information is linked to knowledge and other externalities created by innovative SMEs. The failure to account for such social benefits resulting from the investment penalises innovative potential lenders.[27]

The difficulties SMEs experience in accessing finance are also linked to their own **weaknesses**. Compared to larger companies, some SMEs show a more volatile growth and earnings pattern, lower resilience to economic slowdown and average survival rate, a lack of sufficient collateral, as well as less efficient management methods and governance structure. In addition, they may be more focused on building their customer base and they may lack sufficient scale to hire dedicated finance professionals, leading to a general lack of awareness about alternatives to bank finance[28]. This situation is a particular concern for start-ups. As a result, commercial banks and other lenders may be reluctant to finance these young and very small SMEs, since the possibilities of high returns are often outweighed by a substantial risk of loss.

Eventually, **entrepreneurs' reputation issues** may also limit their possibilities of accessing adequate finance; considering that a reputation is often based on such factors as entrepreneur's age, gender, race, history, sector and geographical location[29]. Furthermore, reputation becomes a source of market failure when SME owners are prevented from applying for debt finance by their own, or others', unsuccessful experiences or by their perception that they will not have the information and good credit history that banks require. This situation is known as "discouraged borrower effect" and it may occur where entrepreneurs from certain groups, as for example ethnic minority entrepreneurs, women seeking to start-up businesses and immigrant groups, distrust bankers. The extent to which these issues may be overcome depends on the closeness of

[22] OECD (2006), Financing SMEs and entrepreneurs, Policy Brief, November 2006

[23] Stein, P., Goland, T., Schiff, R. (2010). Two trillion and counting. Assessing the credit gap for micro, small, and medium-size enterprises in the developing world. World Bank Group, International Finance Corporation (IFC) and McKinsey & Company. October 2010. http://mckinseyonsociety.com/downloads/reports/Economic-Development/Two_trillion_and_counting.pdf

[24] Stiglitz J.E. and Weiss A. (1981), Credit Rationing in Markets with Imperfect Information, *The American Economic Review,* Vol. 71, No. 3 (Jun., 1981), pp. 393-410

[25] Shane S. and Cable D. (2002), Network Ties, Reputation, and the Financing of New Ventures, Management Science, Vol. 48, Issue 3, March 2002

[26] OECD, 2008; Rural Policy Reviews: Scotland UK – Assessment and Recommendations, OECD, Paris.

[27] Grünfeld, L.A., Iversen, L.M., Grimsby, G. (2011). The need for government supported capital measures in the market for early stage risk capital in Norway. Menon Business Economics. Publication no. 18/2011. October 2011. http://menon.no/upload/2011/12/08/tidligfasekapital_rapport-nhdv3.pdf

[28] Breedon, T. et al. (2012): Boosting finance options for business. Taskforce to boost finance options for business. March 2012. http://www.bis.gov.uk/assets/biscore/enterprise/docs/b/12-668-boosting-finance-options-for-business.pdf

[29] Deakins D., Roth D., Baldock R., Whittam G., (2008): SMEs Acces to Finance: Is there still a debt finance gap? Institute for Small Business & Entrepreneurship

relationships between the financial institutions and these communities. These considerations are also particularly relevant in the ex-ante assessment of FIs aiming to cover social exclusion, such as microfinance instruments.

A further factor that should be taken into account during the ex-ante assessment may be the need to overcome a culture of “grant dependence”, especially in regions and countries where structural funds resources were widely used in previous programming periods to provide SMEs with grants. The legacy of this dependence on grants may result in some SMEs being unaware and/or unwilling to pursue non-grant forms of finance.

Based on these considerations, the gap analysis to be performed requires consideration of the two sides of the finance market:

- The demand side that is composed of the SMEs developing on the territory under scope.
- The supply side that is constituted by the organisations providing all kinds of financing to SMEs.

It should be noted that this analysis process should provide a snapshot of market conditions at the time of the ex-ante assessment and does not cover projections on future changes to market conditions throughout the programming period, nor the effect of the revolving funds in future cycles. Following Article 37 (2) (g), Chapter 9 of the General Methodology presents options on how to update or revise certain aspects of the ex-ante assessment if market conditions or investment trends evolve substantially during FI implementation (e.g. a substantial economic downturn).

The analyses of these two market sides are now presented in more detail over the following sub-sections. A good practice approach, as it is presented in the GAFMA, would be to conduct this market analysis (demand, supply, country/regional comparisons, findings) by financial product.

3.2.2 Demand analysis

Key questions to address when analysing the financing demand side:
1. What types of financial products do SMEs currently use in the country or the region?
2. What types of investments do SMEs seek financing for?
3. How much did the SMEs seek, and how much did they obtain in the past or more recently when looking for finance?
4. What difficulties do SMEs currently experience when looking for finance?
5. How much financing will the SME need in the near future?
6. Can these needs be met by the existing supply of financial products?

Building on the analysis of the economic context and the structure and characteristics of the SMEs, as well as on the results of the supply analysis, the **financial structure of the SMEs** should be investigated. The information that should be sought includes the level of capitalisation and the level of indebtedness and other forms of financing. The analysis should also include the use of alternative sources of finance such as owners’ financial resources and loans from friends and family, including grant schemes in order to get a comprehensive picture.

As a matter of fact, in some countries and regions, micro and small companies tend to rely on the owners’ resources and/or loans from family and friends to cover their needs rather than seeking bank loans or other financial products. This may be due to various reasons, such as a lack of suitable FI, in terms of financial product, terms and conditions, but also eligibility rules and timeframe for repayment. The perceived complexity of the funding application process and the (sometimes limited) experience with the banking sector, especially in peripheral areas, as well as the lack of awareness of the available financing supply are also to be considered (the General Methodology already provides a detailed description of the approach to estimate unrealised demand that applies also to microfinance).

The analysis should also focus on the **types of investments for which SMEs seek financing**, such as tangible assets (e.g. buildings and machinery) or intangible assets (e.g. technology, knowledge and human resources). This will give a detailed indication concerning the adequateness of the available supply to meet the needs of SMEs.

To estimate the level of financing needs of SMEs, two main pieces of information are needed: (1) the **expected number of SMEs in need of financing** during the period under consideration and (2) the **expected average amount needed per SME**. The product of these two variables provides an approximation of the demand for funding from SMEs over the period under consideration. This explains why the ex-ante assessment needs to consider elements on financing amounts sought, obtained and to be sought over the period under consideration by SMEs.

However collecting these elements may raise issues and estimating the two key variables is a major challenge. The required information is unlikely to be found directly and both quantitative and qualitative proxies may need to be used.

Finally, as far as possible, an assessment of bankable demand should be conducted. Indeed, the full potential demand should be corrected by removing the financing need that from an economic perspective are too risky for financial intermediaries. The demand analysis should only account for demand reflecting a real repayment possibility and exclude firm's demand that based on debt sustainability (companies' indebtedness levels/leverage ratios), the ability to service debt, or the return on equity would be rejected.[30] The calculation or estimation of the respective adjustments depend on data availability and has to be justified on a case by case basis.

3.2.3 Supply analysis

Key questions to address when analysing the financing supply side:
1. What are the financial and non-financial stakeholders providing finance to SMEs?
2. What are the financial products offered to SMEs?
3. How have the financial products proposed evolved over time?
4. Has the available supply been fully exploited in the past? If not, why?
5. Do the actors providing finance already use FIs proposed by public stakeholders?
6. What are the public resources that are available for SMEs (e.g. grants, revolving funds from 2007-2013 FEIs, support offered by MA from other existing revolving funds)?
7. Following this, has the available supply supported by FIs been fully used in the past? If not, why?

The supply analysis should provide a description of the actors involved in providing finance to SMEs with both public and private sources of finance. These actors may include:

- Financial institutions, such as commercial banks, public banks, development banks, leasing companies, micro-credit institutions, consumers lenders, business angels and private investment funds (such as venture capital);

- National and/or regional governments and their agencies; and

- International financial institutions, multilateral and bilateral donors, such as the EIB Group.

Each of these actors may provide SMEs with several financial products, as well as other forms of intervention, such as grants and technical support. The supply analysis needs to provide an inventory of the different products available, the terms and conditions applied to SMEs and the past use of these sources of finance in terms of volume.

---

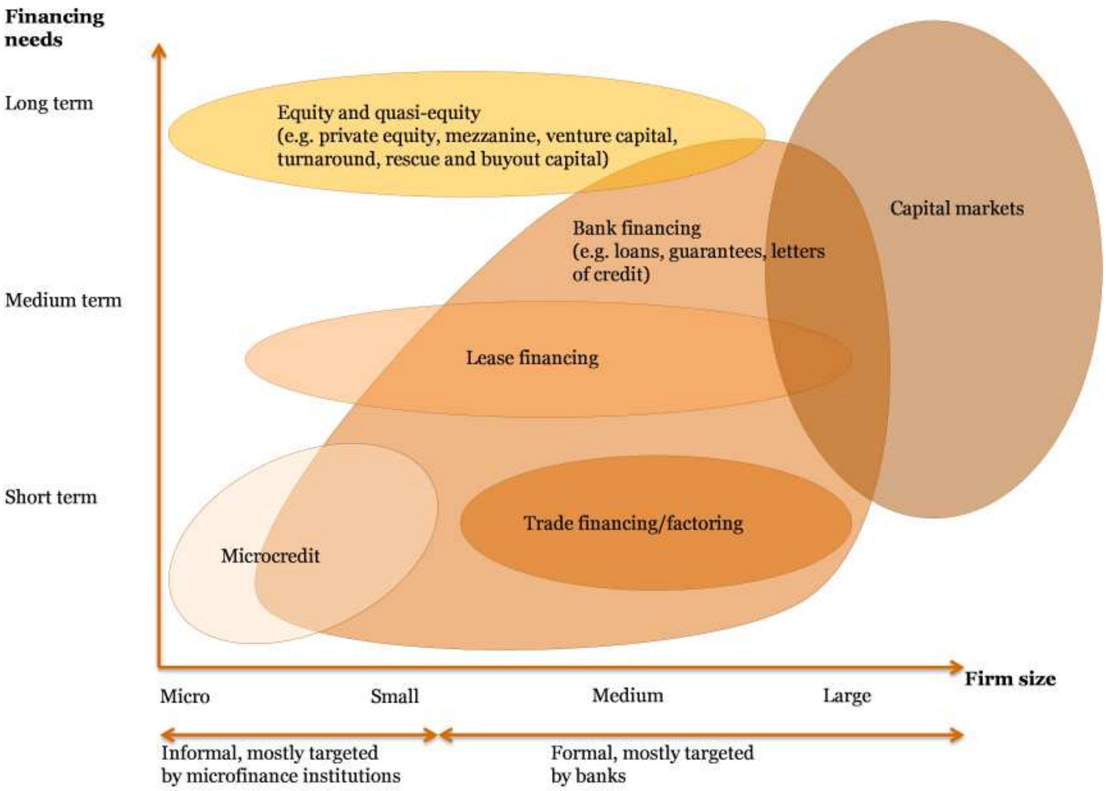
30 This concept has been taken from EIF's GAFMA

Institutional support schemes can provide SMEs with several financial products, including:

- Loans (e.g. short-term, medium-term and long-term loans), bank overdrafts, credit lines, asset-based loans;
- Microcredit;
- Lease financing;
- Trade financing/Factoring;
- Bank guarantees and letters of credit;
- Equity and quasi-equity (e.g. private equity, venture capital, mezzanine capital and growth capital);
- Technology transfer funds;
- Replacement, rescue, turnaround and buyout capital; and
- Grants.

These financial products address various SMEs' needs in terms of development and time horizon. These needs often depend on the size of the SME and its current stage of development.
A mapping of the main financial products with regards to the SMEs' needs and sizes is presented in Figure 1 below. It should be noted that grants could potentially cover the range of financing needs and firm sizes.

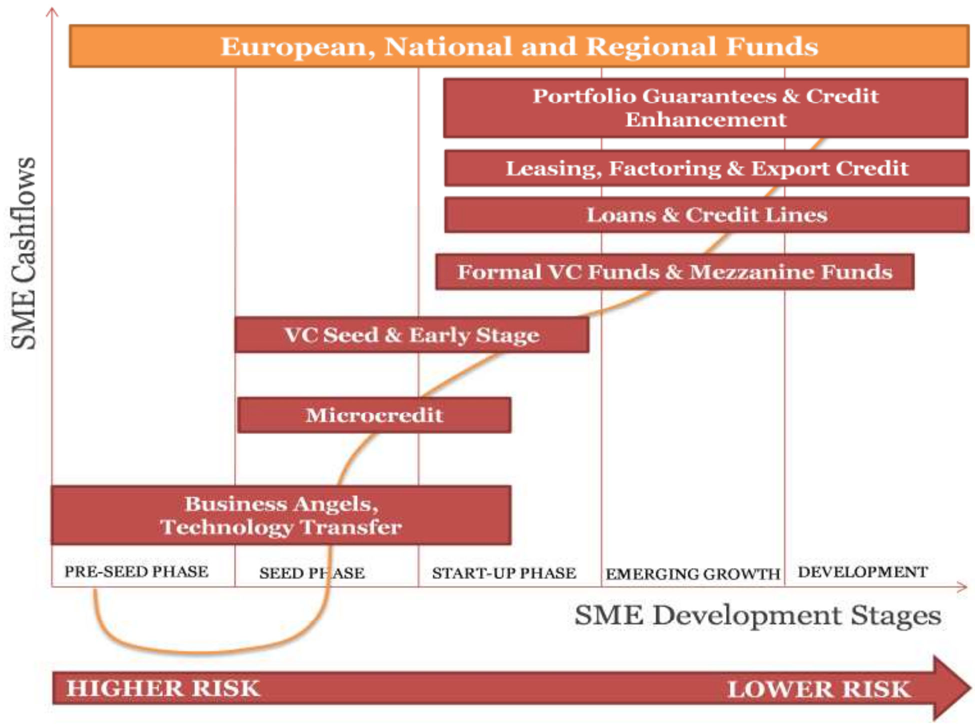
Figure 1: Conceptual map of non-grant financing options relative to SME size



Source: adapted from Stein, P., Goland, T., Schiff, R. (2010)

Figure 2 below displays another option that is to map the financial products with regards to the development stage of the SMEs. This approach is mentioned in the GAFMA and may be used as an alternative to the mapping according to the size of SMEs. Both approaches can deliver meaningful results in view of conducting an exhaustive supply analysis and the choice may be determined by the data availability constraints on each specific market.

Figure 2: Conceptual map of non-grant financing options relative to the SME development stage



Source: EIF's GAFMA

After having identified the existing sources of financing, it is important to identify and analyse the public support schemes developed at the European, national and regional levels. These support schemes may have been financed through Structural Funds during the previous programming periods (such as financial engineering instruments for enterprises), or through other public financial institutions at national and regional levels. [31]

It is important to recognise that in some MS/regions there may have been significant public intervention in the market to support SMEs through FEIs in the previous programming period. Therefore at the beginning of the 2014-2020 period, there may be existing revolving finance in MS/regions that will support SME sector (as it is explicitly required in the Regulation), either in the form of an FI or as a grant. Thus the assessment and analysis of "revolving funds" should be considered when determining the financing gap.

Despite the availability of financial products for SMEs, their terms and conditions as well as their eligibility rules may not be suitable for the SMEs operating in the country or region. This analysis is meant to assess whether the available supply of finance ensures adequate coverage of the SMEs' needs.

[31] As stated before, it should be taken in mind that the approach presented here, and in particular the structure of the analysis, is not the only good practice example. The GAFMA itself proposes a somewhat different "standard structure", e.g. to present existing SME financing instruments first, and then turn to the market analysis.

At this stage both supply and demand for financing for SMEs have been analysed and quantified to the extent possible. By comparing them, conclusions can be drawn on the presence of unmet demand for financing in terms of types of financial products and, where feasible, required amounts.

The analyses presented above imply the use of several tools and the triangulation of elements resulting from these tools. The tools and their practical use are detailed in the following paragraphs.

3.3 Operational tools

The analysis of market failures and sub-optimal investment situations aims to substantiate the rationale behind a public intervention and the introduction of FIs supported by ESI Funds.

As a consequence, the analyses detailed in the previous sections have to focus on:

- The economic context, the structure and the characteristics of SMEs, including the regulatory framework and an analysis of the barriers reducing the development and growth of SMEs;
- The demand for finance and the identification of the specific needs of SMEs on the territory, including an analysis of the existing FIs and products currently used by SMEs; and
- The supply of funding targeting SMEs.

This includes a focus on the performance of the different forms of public support, including existing FIs as well as grant schemes and subsidies provided to SMEs in the considered territory. [32]

In operational terms, different data sources both from the supply and demand sides have to be collected. A comprehensive research strategy needs to be adopted in order to gather all necessary data sources. These include secondary data resulting from desk research and literature review as well as primary data from interviews and online surveys.

The research strategy has three dimensions:

- Elements to be addressed: SMEs from different sizes and working in different sectors in the territory as well as the FIs available;
- Time period to be considered: the present time as the main focus with interest on previous years – including the pre-crisis period and the years following the financial crisis – as well as the near future (2-3 years) in the context of the programming period 2014-2020;[33] and
- Views and opinions of relevant stakeholders to obtain a comprehensive image of SMEs' needs for access to finance on the considered territory: i.e. opinions from the demand side, the supply side and policy-makers.

These elements then need to be triangulated and used in a mutually reinforcing way, since all of them can contribute to the estimation of financing gaps. This approach is consistent with previous

32 However, an ex-post evaluation is not part of the ex-ante assessment, but the analysis of the performance of existing public support has to be of a relatively limited nature.

33 2-3 years is suggested as the timeframe to give a meaningful analysis (i.e. >1 year), while it is unlikely SMEs would be able to accurately forecast more than 3 years into the future However, good practice examples of different approaches exist as well. See, for example, the financing gap assessment, based on a survey, in the "Survey on access to finance for cultural and creative sectors". http://ec.europa.eu/culture/key-documents/documents/access-to-finance-culture-and-creative-sector_en.pdf

methodologies[34] and implemented for various studies[35] in the view of identifying and, to the extent possible quantifying financing gaps for SMEs.
The main tools to be used to collect this information include:

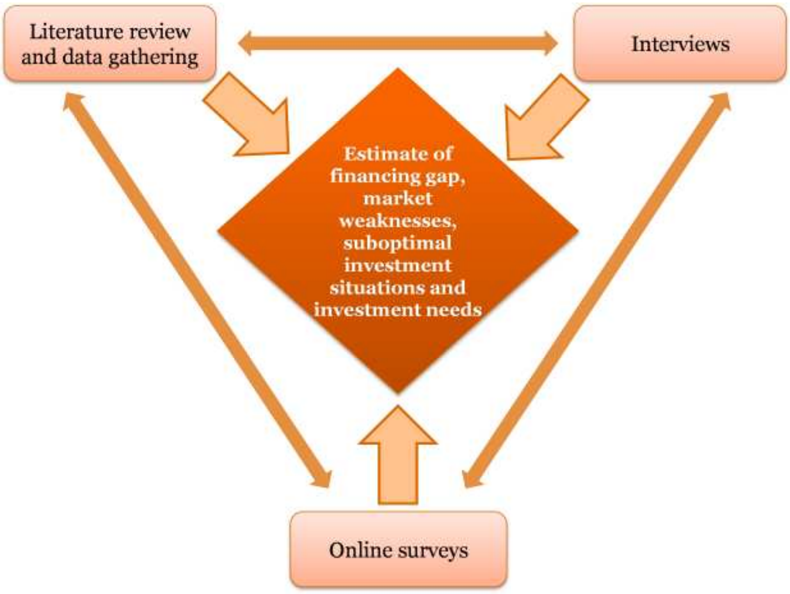
- Literature review with a focus on specific indicators and statistical data. This literature review also include the identification of lessons learnt from the implementation of public instruments (financial and non-financial) as well as elements on their performance, success and/or limitations;

- Face-to-face interviews with relevant stakeholders from the demand and supply sides, as well as with policy-makers; and

- Online surveys addressed to SMEs.

This triangulation process is illustrated in Figure 3 below.

Figure 3: Main tools to analyse financing gaps and market weaknesses



This multi-tool approach:

- Provides the demand and supply analyses with qualitative as well as quantitative information;

- Detects potential regional disparities on the territory in terms of access for finance market for SMEs, not necessary visible through one tool only (notably indicators which often provide only a national view of SMEs); and

- Identifies key success factors or blocking factors related to the implementation of existing FIs dedicated to SMEs on the territory.

Each tool is detailed in the following paragraphs.

34 See Guidelines for SME Access to Finance Market Assessments (GAFMA), section 3 "Tools". Please note that the GAFMA suggests the following tools: indicators, surveys/interviews, Peer-Group-Analysis. In this methodology the latter tool is included in the benchmarking of indicators.

35 PwC (2012), Risk Sharing Finance Facility (RSFF): New Ways to Finance Innovative Mid-Caps Growth Capital, report prepared for the European Investment Bank

EIF (2013), SME Access to Finance Market Assessment for Bulgaria

Tool 1-Literature review and data gathering

The **literature review** and the desk research are conducted to gather the existing secondary information on SME financing on the considered territory. More specifically this information helps to identify the:

- Quality and quantity of existing indicators and statistical data;
- Overall economic and political environment in the country or region;
- Regulatory environment affecting SMEs;
- Successes and limitations of the existing FIs;
- Policy priorities of the MAs (such as the Smart Specialisation Strategy); and
- Description of the financial products provided by the supply side and critical needs emerging from the demand side.

The literature review permits the sourcing of qualitative and quantitative indicators to be used to analyse the context and situation of SME financing in the country or region.

Indicators and statistical data are identified, reviewed and analysed so as to provide a quantitative analysis of both supply and demand and can be used to benchmark and compare the territory with other countries and regions in a similar situation.[36]

Quantitative indicators can be retrieved from official statistics and reports from EU institutions, Eurostat and national statistical offices, OECD, European Central Bank, National Central Banks and private sector organisations, such as European Mutual Guarantee Association (AECM) and European Venture Capital Association (EVCA) (or the entities at national level that form part of these European associations), national and/or regional banking associations as well as websites of financial institutions.

The literature review and identification of relevant indicators also permit the **comparison of indicators between countries and/or regions** having similar situations. The comparison of the structure and characteristics of SMEs in the considered territory with other regions (including the evolution of the use of financial products) helps to define good practices in terms of use of the financial product(s) and development of FIs. Such comparisons may also support the identification of financial intermediaries having previous experience with FIs in the same country and/or other regions of the same country. The main available sources that can be consulted in order to retrieve indicators and statistical data to be used during the assessment of financing supply and demand are provided in Appendix B.

Specific studies conducted at the regional and/or national levels also have to be taken into consideration.

[36] This benchmarking is similar to the Peer-Group-Analysis (PGA) approach mentioned in the GAFMA.

Box 1: National studies used for AFMA study on Bulgaria (EIF, 2014)

In addition to EU-wide studies, the AFMA study conducted in Bulgaria leveraged national documentation, including:

- Bulgarian Industrial Association (BIA) (2013), Indebtedness of the Bulgarian Non-Financial enterprises as of 31.12.2011;
- Bulgarian National Bank (2013), Macroeconomic Indicators: Leasing Companies;
- Cheresheva, M. (2013), Factoring market continues to expand on the Bulgarian financial services market. Enterprise.bg;
- National Statistics Institute (2010), Project „Access to Finance" - Results for Bulgaria;
- NOEMA (2012), Analysis of the Situation and Factors for Development of SMEs in Bulgaria: 2011-2012; and
- World Bank (2013), Bulgaria Reimbursable Advisory Services Program on Innovation.

The selection of indicators should take into account country- and market-specific considerations. In parallel, MAs are also encouraged to use indicators developed by the European Commission[37], the national and/or regional banking associations, as well as professional and business organisations.

Studies carried out by these stakeholders may provide precise indicators and enable **time series analysis** focused on the local environment. The analysis of the evolution of the structure and characteristics of SMEs as well as the historical use of various sources of finance are used to identify the local weaknesses of the market, and substantiate the development and implementation of FIs using ESI Funds.

In addition to comparisons with other countries/regions, the literature review identifies **lessons to be learnt from the past**. This step aims to:

- Become aware of the past experience in using FIs to bridge the financing gap for SMEs in the country or region;
- Identify the main successes of the past FIs (in terms of disbursement and coverage of SMEs' needs);
- Analyse if the absorption proved sufficient with respect to the available resources;
- Investigate potential margin for improvement (in terms of financial products to propose and/or support, and amounts to devote to each specific FI); and
- Understand if structural market weaknesses have been identified in the past and addressed successfully or not (including the use of FIs during the previous programming period).

The past use of available products is also to be included in the analysis and compared with the results of the demand analysis (developed in 3.2.2). If the available resources have not been fully used in the past despite evidence of unmet demand, this may signal potential shortcomings in the design or in the implementation of existing schemes.
The literature review is completed with stakeholder interviews and online surveys addressed to local SMEs.

---

[37] As an example, DG Enterprise and Industry provides links to EU policy documents, data and additional statistics from other sources than the European Commission related to the issue of access to finance of SMEs. This can be accessed on the website: http://ec.europa.eu/enterprise/policies/finance/index_en.htm

Tool 2-Interviews

Face to face interviews are conducted to develop the qualitative assessment of market failures and other market weaknesses. Relevant stakeholders need to be identified and grouped so as to cover the whole scope of the SMEs' access to finance topic in the country or region. Three groups of stakeholders are to be addressed:

a) Supply side stakeholders:

- Commercial and specialised banks;
- Development banks;
- MFIs;
- Venture capital institutions;
- Business angels;
- Business incubators and accelerators;
- Guarantee providers;
- Leasing and factoring companies;
- Insurance and public funds; and
- MA providing grants (both from 2007-2013 and 2014-2020 Programmes).

Trends and expected shifts in sources of supply (including intended changes in public support schemes) should be reviewed during the interviews to assess expected future supply. An example of an interview guide for supply-side stakeholders is presented in Appendix C.

b) Demand side stakeholders:

- Chambers of commerce;
- Leading professional associations;
- Cluster representatives (if existing);
- Specific district organisations; and
- Any other relevant organisation and public or private entities present on the territory.

c) Policy makers whose decisions may have an impact on SME competitiveness at the national and/or regional level. These interviews are meant to discuss the key focus points of future policies affecting SMEs and the sectors and/or areas of specific interest for the national and/or regional government; including initiatives to foster innovative trends (as developed in the Smart Specialisation Strategies).

Tool 3-Online survey

In addition to the literature review and stakeholder interviews, **online surveys** addressed to SMEs are an essential tool to be implemented. These online surveys are meant to provide additional qualitative and quantitative insights on the SME environment and SMEs' needs for finance in the future not available on existing databases (such as the ECB survey on the access to finance of SMEs in the euro area (SAFE). Indeed, ad hoc surveys provide all the flexibility required to investigate specific national and regional issues arisen in the literature review and analysis of aggregated statistical indicators.

Online surveys also support the quantification of financing needs by type of financial product and consequently help to define the future investment strategy for the FI. An example of a structure for an online survey is presented in Appendix D.

In operational terms the surveys should be designed to:

- Have a sample that is aligned with the overall SME population considered (in terms of size, sector and location);
- Propose a questionnaire that SMEs may promptly and easily answer and that include questions to be used both for qualitative and quantitative analyses; and
- Ensure a number of answers enabling an analysis that has appropriate statistical relevance.

A proposed approach to define a representative sample of SMEs in the country or region under consideration could take into account the following 3 dimensions:

- Sectors, using the NACE revision 2 classification;
- Location, using the NUTS2 regions; and
- Size of companies (micro, small, medium-sized) either based on the number of employees or turnover volume, using the most recent figures published by National Statistic Institutes.

To achieve a good representation, the size of the sample should cover a relevant percentage of the SME population in the country or region (e.g. 5% of the total SME population). The online survey should aim to achieve a minimum response rate (e.g. 1‰ of the total SME population).

The application of these tools allows a comprehensive picture to be constructed of the characteristics of the environment in which SMEs operate in the considered country or region, of the constraints and hurdles that limit the competitiveness of SMEs and of the gap existing between supply and demand for the different types of financing.

Based on this comprehensive picture, MAs can demonstrate the existence of a market failure and/or a suboptimal investment situation that justifies public intervention using ESIF resources. The following step of the ex-ante assessment involves the verification of the value added of the envisaged FI.

4 Assessment of the value added of the financial instrument

4.1 Analysing the dimensions of the value added for the envisaged financial instrument targeting SMEs

In the previous chapter we have presented the main methodological steps that need to be undertaken in order to demonstrate the presence of market failures, suboptimal investment situations, market weaknesses and financing gaps for SMEs operating in the concerned territory. The results of this analysis are the necessary starting point in order to justify a public intervention using ESIF resources, by means of an FI aiming to enhance the competitiveness of SMEs.

The General Methodology introduces the idea that, in most cases, the identified market failures and suboptimal investment situations can be addressed through several instruments, for instance through a grant scheme and through a revolving instrument. Based on the assumption that both of these options would achieve the primary objective of the FI (i.e. improving access to finance for SMEs), the ex-ante assessment needs to demonstrate that the chosen solution delivers the highest value added. It is therefore necessary to compare the value added of the alternative options according to both quantitative and qualitative criteria. The elements of the quantitative dimension of the value added of an FI are described in the General Methodology. These considerations are independent of the Thematic Objective specificities; therefore they will not be treated in this specific methodology.

On the other hand, a few specificities need to be highlighted as regards qualitative dimension, particularly as regards the direct and indirect economic benefits resulting from the implementation of an instrument targeting SMEs.

As stated in the previous chapter, increasing access to finance for SMEs is a key determinant of SME growth. This entails job creation in the country or region under consideration, which, in turn, produces an improvement in household revenue and consumption, thus entailing a positive effect on the overall economic situation.

In addition, higher household consumption means a larger domestic market for the products of all SMEs across sectors. This creates an incentive for new companies to enter the market and it increases competition, which is beneficial for consumers as it exerts a downward pressure on prices. Furthermore this pushes companies to improve their efficiency and productivity and to introduce process and product innovations, as a way to reduce their costs and to maintain or increase their market share.

A competitive SME environment also contributes to the attractiveness of the whole territory, resulting in more firms, both domestic and international, choosing to be present and to invest in the country or region. The geographic concentration of interconnected businesses, suppliers, and associated institutions in a particular field could eventually lead to the creation of clusters. As a result of the creation of such business concentration, a larger market for service providers will develop to address the newcomers' needs, for instance financial, fiscal, legal and real estate advisory services.

In line with the General Methodology, the ex-ante assessment should compare the ability of grants schemes and of FIs in achieving such benefits. Grants for SMEs have been widely used in the past and they have surely been successful in generating an increase in production, however the positive impact on productivity is less clear. [38] Previous studies have noted that the main effect of a grant is usually that enterprises increase the scale of their operations, the so-called "capital broadening",

---

[38] •European Commission (2012): What are counterfactual impact evaluations teaching us about enterprise and innovation support? Regional Focus series 02/2012

meaning that they increase their capital, employment and output.[39] However, efficiency gains and "capital deepening", meaning a better productivity of capital and therefore an increase in output using the same amount of input, are generally modest.

Both effects may be desirable, depending on the policy objectives to be pursued, for instance capital broadening is useful if the objective is to reduce unemployment, which may be desirable especially in times of economic crisis. However, capital deepening is crucial for long-term catch up by lagging regions, which is determined by increased productivity more than by increased production and employment.

Furthermore, although increasing production may be a positive impact, past experience shows that subsidising income-generating firms can entail unsustainable production levels (e.g. subsidies for agriculture), can increase pressure on natural resources to unsustainable levels (e.g. some subsidies in the fisheries and aquaculture sector) and can generate unfair competition by crowding out unsubsidised activities. In addition, there is a crowding-out effect with the allocation of the grant as firms have an incentive to reduce their own investment by replacing it with public money.[40]

The main difference between FIs and grants is the revolving nature of the former. While subsidies can achieve the primary objective of contributing to bridge the financing gap for SMEs and generate some of the economic benefits described above, the resources given to a firm cannot be recovered and recycled to other beneficiaries. Nevertheless, revolving finance requires that the investment itself must be generating revenues (i.e. a minimum level of cash flow at the final recipient level to reimburse the financing obtained). This means that investments supported by FI need to be a priori financially viable and more sustainable than in case of grants. While grants are not subject to the same requirements, they can be explicitly used to solve the difficulties of enterprises to pay interest (e.g. interest rates subsidies and guarantee fees subsidies).

Another added value of FIs is their pre-financing nature and their lower aid intensity. This contrasts with the use of grants whereby the enterprise has to first carry out investment with its own finance and is only reimbursed once the investment has been made (unless there is a national/regional pre-financing scheme offered).

It follows that FIs are not the solution for all SMEs. However, grants also have limitations. In the case of start-ups it can be argued that grants covering the investment costs can create a distortion in the risk perception of the entrepreneurs, which is not necessarily an objective per se. In fact such an approach does not target the main problem, which was access to finance in the first place (for example given by insufficient guarantees), while creating distortions and encouraging moral hazard.

It should be noted that there is flexibility in combining the two sources of financing. Indeed FIs, as described in Chapter 5 of this document, can still be complemented with grants and other forms of public intervention.

[39] Bondonio & Martini (2012), Counterfactual Impact Evaluation of Cohesion Policy: Impact, cost-effectiveness and additionality of investment subsidies in Italy, and European Commission (2012): What are counterfactual impact evaluations teaching us about enterprise and innovation support? Regional Focus series 02/2012

[40] European Commission (2012), What are counterfactual impact evaluations teaching us about enterprise and innovation support? Regional Focus series 02/2012

4.2 Assess the consistency with other forms of public intervention addressing the same market

As discussed in Chapter 3.2.3, it is important to recognise that in some MS/regions there may be on-going revolving funds set up in the previous programming period to support SME. Therefore added care should be taken to ensure the consistency between the support planned from the new FI to be implemented and the support offered by MAs from any existing revolving funds. Further guidance on the approach to the assessment of the consistency with other forms of public intervention is presented in the General Methodology.

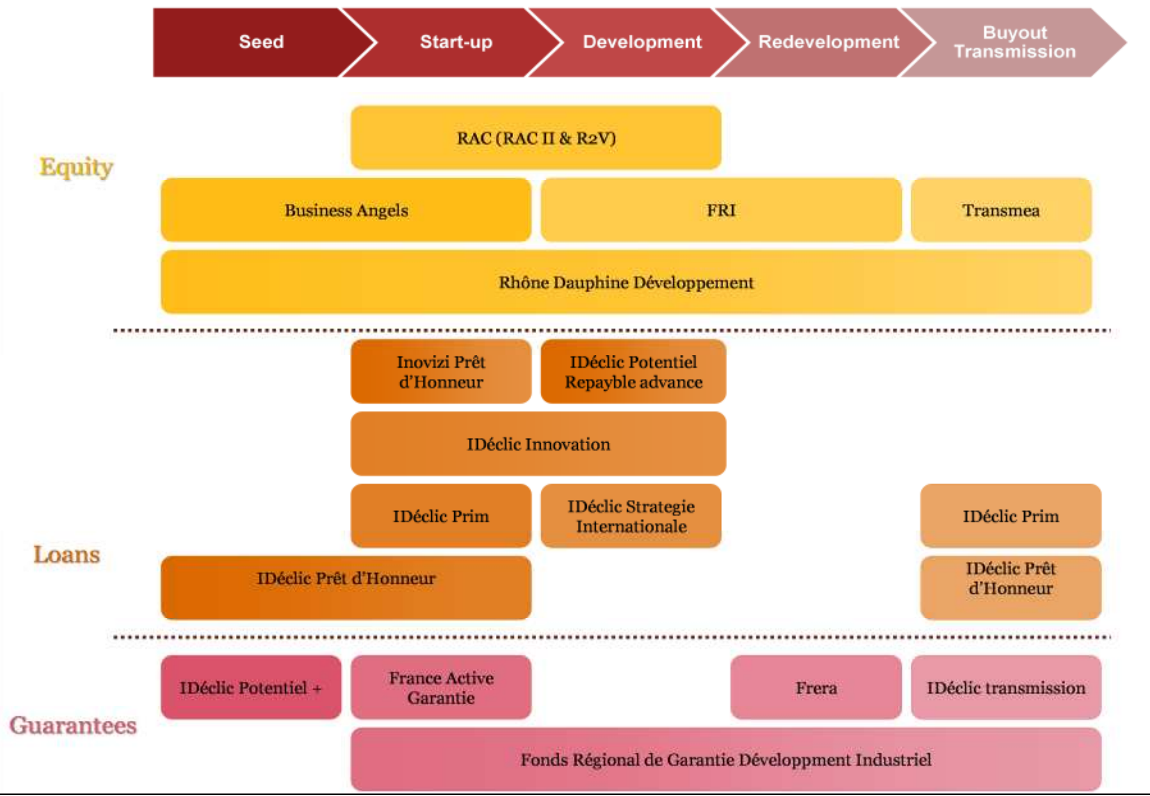
Box 2 provides an illustrative example of the different national and regional public financing resources supporting SME competitiveness. A mapping exercise such as the one presented in the example can be useful to avoid the risk of overlaps.

Box 2: Example of public financing instruments in Rhône-Alpes

In the access to finance market assessment of Rhône-Alpes[41], the analysis of the supply highlighted a significant presence of public financing instruments at regional level that do not use ESI Funds resources.

The investment strategy of the different instruments identified covers most of the segments of finance supplied in Rhône-Alpes. A mapping exercise such as the one presented below can provide a better understanding of the role of FIs in the region and building on local experience.

Market segment coverage and type of financial product offered by existing national public financing instruments in Rhône-Alpes[42]



41 EIF (2013), SME Access to Finance Market Assessment for Rhône-Alpes (ongoing)

42 PwC adaption of a Rhône-Alpes presentation : « *Présentation des dispositifs de la Région pour le financement des TPE/PME régionales* » (3 May 2013)

4.3 Identify possible State aid implications

The approach to the assessment of State aid implications of the envisaged FI is presented in detail in the General Methodology (Chapter 4.3). This chapter focuses exclusively on the specificities for FIs targeting SMEs.

In January 2014 a new set of State aid guidelines, the Risk Finance Guidelines[43], were adopted to specifically deal with risk finance measures related to SME support. These updated rules aim to enhance the incentives of private sector investors – including institutional investors – to invest and increase their funding activities in the area of SME financing. The Commission will apply the principles set out in these Guidelines to risk finance measures which do not satisfy all the conditions laid down in the General Block Exemption Regulation. The Member State concerned must notify the measures in accordance with Article 108 (3) of the Treaty and the Commission will carry out a substantive compatibility assessment as set out in Chapter 3 of these Guidelines.

However, Member States may also choose to design risk finance measures in such a way that the measures do not entail State aid under Article 107 (1) of the Treaty, for instance because they comply with the market economy operator test or because they fulfil the conditions of the applicable *de minimis* Regulation. Such cases do not need to be notified to the Commission.

The Risk Finance Guidelines should be seen together with the relevant rules contained in the draft General Block Exemption Regulation (GBER)[44]. The GBER exempts certain categories of aid from prior Commission scrutiny. For SMEs, the GBER sets the conditions whereby some aids may be granted if targeted at boosting competitiveness and creating jobs without the need for any notification to the Commission.[45] GBER is particularly important for SMEs since all 26 measures covered by such Regulation can be granted for SMEs, and some are even specially designed for them (aid for newly created small enterprises, SME Investment and employment aid and aid for small enterprises newly created by female entrepreneurs).

Of key importance to the potential application of FIs pursing TO3 is that these new risk finance rules have a substantially enlarged scope, covering a wider range of companies, irrespective of their location in assisted or non-assisted areas, including not only SMEs from seed/start up and expansion stages, but also SMEs at later growth stages, small midcaps (up to 499 employees) and innovative midcaps (up to 1500 employees and with R&D and innovation costs representing 10% of total operating costs). The proposed revisions to the GBER will also exempt risk finance measures of up to EUR 15 million from prior Commission scrutiny. This overall amount has to be seen as a one-off aid covering the full development cycle of the target SME (this represents a significant increase from the current maximum annual tranches of EUR 1.5 million in the current GBER).

A further possibility is that the gross grant equivalent (GGE) of the aid is compliant with the *de minimis* ceiling defined by the Regulation.[46] In practice loans with principal amount up to €1 m under conditions not causing GGE to exceed €200,000 over any period of three fiscal years (*de minimis* loan conditions) do not need to be notified.

De minimis guarantee conditions cover only newly originated loans, and the guaranteed part (max 80%) of the underlying loan shall not exceed €1.5 m under conditions not causing GGE exceed €200,000 (over any period of three fiscal years).
The State aid implications just described are already embedded in the proposed off-the-shelf structures for SMEs in order to streamline their roll-out. The approach described in the General Methodology with respect to the proposed off-the-shelf instruments, the proportionality to investment needs and measures to minimise market distortions also fully applies to SMEs.

43 Guidelines on State aid to promote risk finance investments (2014/C 19/04)

44 At the time of writing, an updated GBER was due to be adopted on 1 July 2014

45 Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88of the Treaty [to be updated]

46 Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid.

5 Additional public and private resources to be potentially raised by the financial instrument

After analysing market failures, sub-optimal investment situations and financing gaps for SMEs and assessing the added value of the envisaged FI, the ex-ante assessment shall concentrate on identifying the additional resources which could be raised by the FI. Moreover, the analysis should estimate the amount of their potential contribution and the level at which they intervene.

This will allow assessing to what extent the FI will be able to attract private and other public resources, thereby increasing the leverage effect and broadening the results achieved by ESI Fund resources.

5.1 Estimating additional public and private resources

The General Methodology provides a detailed analysis of the methodological steps required to obtain an estimate of additional resources. As a general rule, these additional resources can come from public sources at European, national, regional and local levels, as well as from private investors and financial institutions.

While the principles presented in the General Methodology still hold, it is useful to discuss more in detail which resources can be associated with the creation of an FI focused on SMEs.

5.1.1 Identification of the different potential sources

To begin with, it is necessary to **identify the main actors providing finance to SMEs, both public and private**, as well as the types of intervention they finance. These actors should have already been identified during the supply analysis performed as part of the market assessment (see Chapter 3.2.3). In addition, the extent to which FIs targeting SMEs have been set up and used in the past in the country or region under consideration, has also been investigated.

Against this background, it will be possible to have a fairly clear picture of where additional resources for the FI may come from. This will have an influence on the decision concerning the type of financial product and target beneficiaries to be selected. In this respect, a key issue is to avoid duplication of existing sources of finance for SMEs and foster complementarity of the new FI with the instruments already in place.

Secondly, as regards public resources, it is necessary to **check which other ESI Funds can finance SMEs** within the scope of the envisaged FI, since FIs can receive support from more than one ESI Fund, more than one Programme, and more than one priority axis or measure under the same Programme.

Support to SMEs competitiveness is a top priority for the EU, and this is reflected in the selected Thematic Objectives to be supported through ESI Funds resources. As a matter of fact, besides Thematic Objective 3, other Thematic Objectives have a close link to SMEs, and are addressed in the investment priorities of the different ESI Funds, as shown in Table 2 below.

Table 2: Investment priorities linked to SMEs in the different ESI Funds

ESI Fund	Thematic Objectives	Investment priorities linked to SMEs
ERDF[47]	T.O. 1	• Promoting business investment in innovation and research.
	T.O. 3	Enhancing the competitiveness of SMEs by: • Promoting entrepreneurship in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators; • Developing and implementing new business models for SMEs, in particular with regard to internationalisation; • Supporting the creation and the extension of advanced capacities for product and service development; • Supporting the capacity of SMEs to grow in regional, national and international markets, and to engage in innovation processes.
ESF[48]	T.O. 8	• Self-employment, entrepreneurship and business creation including innovative micro, small and medium sized enterprises; • Adaptation of workers, enterprises and entrepreneurs to change.
EAFRD[49]		• Fostering knowledge transfer and innovation in agriculture, forestry, and rural areas • Enhancing competitiveness of all types of agriculture in all regions and promoting innovative farm technologies and the sustainable management of forests; • Promoting food chain organisation, including processing and marketing of agricultural products, animal welfare and risk management in agriculture;, • Promoting social inclusion, poverty reduction and economic development in rural areas.
EMFF[50]		• Increasing employment and territorial cohesion; • Fostering innovative, competitive and knowledge based fisheries; • Fostering innovative, competitive and knowledge based aquaculture; • Promoting a sustainable and resource efficient aquaculture.

5.2 *Estimating the leverage of the envisaged financial instrument*

There are no sector specificities in terms of the concept of leverage therefore please refer to the General Methodology.

47 Investment priorities as reported in the Proposal for a Regulation of the European Parliament and of the Council on specific provisions concerning the European Regional Development Fund and the Investment for growth and jobs goal and repealing Regulation (EC) No 1080/2006, COM(2011) 614 final

48 Investment priorities as reported in the Proposal for a Regulation of the European Parliament and of the Council on specific provisions concerning the European Social Fund and repealing Council Regulation (EC) No 1081/2006, COM(2011) 607 final/2

49 Investment priorities as reported in the Proposal for a Regulation of the European Parliament and of the Council on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), COM(2011) 627 final/2

50 Investment priorities as reported in the Proposal for a Regulation of the European Parliament and of the Council on the European Maritime and Fisheries Fund [repealing Council Regulation (EC) No 1198/2006 and Council Regulation(EC) No 861/2006 and Council Regulation No XXX/2011 on integrated maritime policy, COM(2013) 245 final

5.3 Attracting additional private resources

In addition to other public resources, the FI should aim to attract additional private resources, in other words achieving leverage from EU resources and increase their impact. The General Methodology states that, in order to measure the ability of the FI to attract additional resources the following elements need to be looked at:

- Expected leverage and targeted private investors;
- Financial techniques to attract private investors (including preferential remuneration);
- Mechanisms to align private interests with the policy goals.

A possibility to attract additional private investment in SMEs is to **invest alongside investment funds focusing on SMEs**. Funded debt instruments, such as subordinated loans and risk-sharing loans appear to be particularly relevant in this context. Mezzanine funds, for instance, provide a hybrid of debt and equity financing typically used to finance the expansion of existing companies. Mezzanine financing is generally subordinated to debt provided by senior lenders, therefore it allows the SME to obtain additional loans from other sources such as banks and venture capital companies since it reduces the risks these lenders take when financing SMEs. According to the new guidelines in State aid to promote risk finance investments funded debt instruments are subject to minimum co-financing requirements in order to comply with State aid rules. This, in turn, has an impact on the maximum contribution from ESIF resources and therefore on the leverage achieved by the FI.

5.3.1 Preferential remuneration for private investors

Preferential remuneration for private investors is a very relevant topic for SMEs as a means of improving the risk and reward balance of private investors and thereby giving them incentives to finance SMEs, either through loans or equity investment.

The General Methodology provides a detailed analysis of the different types of preferential remuneration mechanisms that could be provided to private sector investors in order to encourage their participation to the FI.

6 *Lessons learnt*

The purpose of this chapter is to focus on lessons learnt as part of a continuous improvement principle. Article 37 (2) (d) states that the ex-ante assessment shall include an assessment of lessons learnt from similar instruments and ex-ante assessments carried out in the past.

6.1 *Gathering relevant information*

Please refer to the General Methodology for guidance on gathering relevant information.

6.2 *Identifying success factors and pitfalls of past experience*

Building upon the approach detailed in the General Methodology, it is important to gather information on the public and private support schemes available to SMEs in the country or region in question. Additional lessons learnt can be gathered from other territories and EU-level instruments focused on SMEs.

During the programming period 2007-2013, FEIs could be used in a limited number of sectors and "Enterprises, primarily SMEs" (Article 44a of Council Regulation No 1083/2006), was by far the sector where they were implemented the most. Consequently for Thematic Objective 3 there is a large pool of experience in using financing instruments.

While the review carried out for Chapter 3 was focused on elements necessary for the assessment of the financing gap, the focus should move now to information and/or data necessary to assess the key success factors and the main pitfalls that affect the performance of FIs (i.e. in terms of in terms of disbursement of OP resources or success in terms of returns on investments). It is recommended that before analysing any past and current experience, the analysis reconstitutes the considerations and assumptions used to design such instruments.

The first topics to be investigated are the **governance rules and FIs structure** used including the legal vehicles adopted and the role of implementing bodies, the final recipients and other stakeholders.

It is for example recognised that different experience exists with the use of holding funds. For example in Hungary one single Holding Fund has been used to contribute to over 180 specific funds supporting enterprises, while all the 38 German FEI are not related to any Holding Fund.[51]

Lessons learnt from the effectiveness of **investment strategies** are particularly relevant. The review should focus on the size of the target market, the appropriateness with the country/region specificities and the selected financial products.

As already highlighted, if a FEI for enterprises has previously been implemented in the country/region, either an ex-post evaluation or information on its performance should be sought. An initial source of information about FIs targeting enterprises is the Commission's report *Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds in the 2007-2013 programming period.*

According to this document, at the end of 2012 a total of 816 specific funds for enterprises were set up in 25 Member States. A high-level description of the typology of products provided is illustrated in Table 3 below.

[51] European Commission (2013), Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds (situation as at 31 December 2012)

Table 3: Implementation of FEI and typology of financial product offered in the programming period 2007-2013 (data as of 31 December 2012)

Member State	FEIs
Austria	2
Belgium	9
Bulgaria	5
Cyprus	4
Czech Republic	2
Germany	38
Denmark	4
Estonia	5
Greece	18
Spain	11
Finland	1
France	95
Hungary	185
Italy	84
Lithuania	28
Latvia	10
Malta	2
Netherlands	5
Poland	235
Portugal	46
Romania	3
Sweden	11
Slovenia	4
Slovakia	1
United Kingdom	56
Total	**864**

Guarantee Type of financial product	Equity /VCN of products offered	Other OP amounts disbursed EUR mln
Loans	38,501	1,985
Guarantees	96,989	1,467
Equity/Venture Capital	2,021	748
Other products	7,189	341
Total	**144,700**	**4,541**

While the investment strategies of private investment funds are usually not available for confidentiality issues, a preliminary data source of experience in shaping strategies to address identified market gaps are the outcome of previous ex-ante assessments.[52] Indeed these can provide a set of general recommendations concerning the setting up of new, or strengthening of existing FIs.

However, an analysis of concrete cases is essential to draw any lesson learnt. For example a regional FEI in Malta, considered quite small, is working effectively and, as reported by the relevant MA, is achieving the stated objectives.[53] It would be relevant to understand what helped them to avoid the problems related to dispersed projects and high overhead costs typical of funds unable to achieve a critical mass.

---

[52] The summary findings and conclusions of ex-ante assessments in relation to financial instruments shall be published within three months from their date of finalisation (Article 37 (2bis)). Before a bulk of practice exists MAs can consult - EIF (2009), 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 and 2008.

[53] Europecan Commission and EIB (2013) Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period

It follows that the analysis of the FI's **operations** is very important. The investigation should seek to identify the relevant processes, procedures and tools as well as indications on the past level of fees and lifecycle costs. Such information could be gathered from the experience of the local principle actors in the operations and in particular fund managers.

To draw conclusions on the **financial performance** of existing financing instruments, the ex-ante assessment should gather information to assess the cost-effectiveness (e.g. management fees per disbursement), the leverage effect achieved and returns on investments. Additional information to be gathered is the verification of the sound financial management by mean of audits and the capacity to achieve Programme objectives.

Lessons learnt can come also on the effectiveness of the **monitoring and control** system and suitability of key performance indicators. These elements will feed the specification of expected results (Chapter 8 of this methodology).

Once the investigation has highlighted what have been the key factors that allowed or impeded the full deployment of the potential value added of the instruments in the past, the ex-ante assessment should leverage on these learning and move to the preparation of a proposed investment strategy.

6.3 Applying lessons learnt to enhance the performance of the financial instrument

Please refer to the General Methodology for guidance on applying lessons learnt to enhance the performance of the FI.

7 Proposed investment strategy

At this stage of the ex-ante assessment, the market failure, suboptimal investment situations and financing gaps for SMEs to be addressed by the envisaged FI have been identified and quantified to the extent possible. In addition, the value added of the possible solutions to address them has been assessed. Subsequently, the additional potential public and private resources to be raised by the FI have been considered as well as the lessons learnt from the implementation of similar instruments in the past.

This process will have screen out some of the ways of addressing the issues limiting the competitiveness and growth of SMEs. The objective of the proposed investment strategy (PIS) is to start defining the operational framework of the FI, bearing in mind that the proper investment strategy will need to be defined in the set up phase, when the funding agreements are finalised.

7.1 Process to develop a proposed investment strategy

The General Methodology provides an explanation of the steps to be followed in order to develop a proposed investment strategy. These block of analysis, applicable to any FI regardless the Thematic Objective; include the description of the process to define scale and focus of the envisaged FI as well as its foreseen governance structure.

7.2 Defining the scale and focus of the financial instrument

The proposed investment strategy needs to describe the scale and focus of the envisaged FI as well as its foreseen governance structure.

When the ex-ante assessment reaches the stage of development of the proposed investment strategy, the characteristics of the financial products to be offered and final recipients to be targeted will appear as fairly straightforward. Indeed, since the analysis of market failures and suboptimal investment situations for SMEs focuses on access to finance, the identification of gaps in serving specific segments of the market will have a direct implication in terms of financial products to be provided by the FI. For example, acknowledging the shortage of venture capital in one region and assessing the size of such a shortage already gives an approximation of the size, scale and focus of the FI.

Developing the proposed investment strategy, therefore, means drawing conclusions from all the previous analyses and using their results to structure an FI that will be effectively able to address the market needs.

As such, the proposed investment strategy should include the following elements:

- **Summary of the conclusions** of the market failure, value added, potential co financing and lessons learnt analyses carried out so far. This will allow structuring the reasoning and demonstrating the rationale for the envisaged FI;
- **Target market**, i.e. the geographical scale at which the FI will be set up (national or regional);
- **Target final recipients**, i.e. the types of SMEs targeted in terms of sector, size and maturity;
- **Financial products** to be provided in order to respond to the identified needs of the final recipients;
- **Implementation option** chosen within the meaning of Article 38 CPR and the consequent governance implications for the setting up of the FI; and

- **Envisaged combination with grant support**, based on the conclusions regarding the appropriateness of blending with grants.

With regard to FIs focused on SMEs, the recommendation to define reasonably broad eligibility and selection criteria still holds. As discussed in the General Methodology, the investment strategy should not be excessively strict in the definition of the final recipients in order to facilitate absorption of the funds.

This is particularly true for SMEs because they cover broad category of potential final recipients. Indeed the definition of SME is applicable to very different companies in terms of sector and size[54]. Taking into account these important disparities, it could make sense for FIs to treat micro, small and medium enterprises as different potential target groups of final recipients, since their structural differences may require different approaches to effectively serve them in the supply of financing.

Nevertheless, since the issue of achieving critical mass is a pressing one for FIs targeting SMEs, the proposed investment strategy could pursue possible synergies in covering a broad spectrum of SMEs sizes and it should try to cover a broad range of product types across different industry sectors. It is important to stress that clear and straightforward eligibility rules simplify the work of bodies implementing FIs, and allow an easy audit of the activities of an FI.

7.3 Defining the governance structure of the financial instrument

7.3.1 Analyse different options for implementation arrangements

7.3.1.1 Choice of financial instrument implementation option

The General Methodology (Volume I) provides a thorough analysis of the different options available to MAs when setting up FIs. However, it is useful to provide an overview of how these options can be put into practice by a MA who chooses to establish an FI aimed to enhance the competitiveness of SMEs.

A further possibility is a contribution from ESI Funds to EU-level FIs. A number of them focus on SMEs in the programming period 2014-2020.

The most relevant is the **Programme for the Competitiveness of Enterprises and SMEs (COSME)**[55] which aims to:

- Facilitate access to finance for SMEs;
- Provide business support through the Enterprise Europe Network;
- Foster entrepreneurship and the framework conditions for the competitiveness of enterprises; and
- Encourage internalisation of SMEs.

An implementing option available to MAs interested in setting up FIs for SMEs is to allocate an ESI Fund contribution to FIs managed under the COSME Programme whereby the ESI Fund contribution would be invested in the MA's geographic area and for actions foreseen by their Programme.

[54] SMEs are defined as those enterpreses which employ fewer than 250 persons and have an annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million (see http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/)

[55] http://ec.europa.eu/cip/cosme

The FIs supported by COSME are the Equity Facility for Growth and the Loan Guarantee Facility. The **Equity Facility for Growth** (with an EU budget of €690 m) provides risk capital to SMEs in the expansion phase and stimulates the development of the European VC industry. In addition to growth-oriented SMEs this facility can contribute also to early-stage investments (to a maximum of 20% of the portfolio). The **Loan Guarantee Facility** (with an EU budget of €746 m) provides guarantees for loans (up to €150,000) to all types of SMEs. In addition the facility offers securitisation of SME debt finance portfolios.

Horizon 2020 is an EU-level FI aimed at securing Europe's global competitiveness.[56] Horizon 2020 has an integrated approach from different priorities towards SMEs and has the objective to invest 15% of its total budget in SMEs.

MAs can support innovative SMEs in the area and for actions foreseen by their Programme by allocating ESI Fund contributions to one of the FIs managed by Horizon 2020 investing in SMEs: the Equity Facility for Research and Innovation, and the RSI-II.

Within Horizon 2020, **RSI II**[57] is meant to provide guarantees for loans and leases to SMEs and mid-caps with focus on research and innovation activities.

The **Equity Facility for Research and Innovation** provides risk capital to innovative SMEs and small mid-caps in the early stages and (for a maximum of 20% of its total investment) growth stage investments.

Another EU-level FI relevant to SMEs is the Cultural and Creative Sector Guarantee Facility (under **Creative Europe)** which supports the EU cultural and creative sector.[58] MAs have the option to allocate resources to the Cultural and Creative Sectors Facility (with an EU expected budget of €120 m) that provides guarantees for loans to creative and cultural SMEs (with the target to guarantee around €700 m of lending).

In addition to EU-level FIs, MAs can entrust implementation of the FIs to entrusted entities (art 38(4) b). The advantage of this option is that it leverages on the existing know-how of bodies that could be already active in the target field. Concerning SMEs, it can be particularly relevant to take advantage of the past experience of bodies implementing FIs in 2007-2013 under Cohesion Policy (then called FEIs).

As discussed in Chapter 1 of the General Methodology, Managing Authorities have the possibility to invest in the capital of legal entities dedicated to implement FIs in line with the objectives of the ESI Funds and to directly implement the FI for loans and guarantees. However, no specificities for SMEs are foreseen for these implementation options.

7.3.1.2 Choice of FI type

The investment strategy should also clarify whether the FI is intended to adopt the structure of an off-the-shelf instrument or a tailor-made instrument to deliver the potential value added.

Further details on these predefined structures are available in the Standard terms and conditions for FIs, pursuant to Article 38(3) (a) of the CPR.[59]

---

[56] http://ec.europa.eu/research/horizon2020

[57] This Financial Instruments builds on the positive experience of the SMEs & Small Mid-caps Guarantee Facility (RIS) started in 2012 under the Seventh Framework Programme (FP7).

[58] http://ec.europa.eu/culture/media/creative-europe

[59] This section of the methodology will need to be updated following the publication of the Implementing Acts.

7.3.2 Envisaged combination with grants

In many regions across EU, the use of FIs to support SMEs is already widespread. Nevertheless, in some cases a mix of grant and FIs can better serve the objective of increasing the competitiveness of SMEs, or even be necessary in order to ensure the financial viability of the FI. The ex-ante assessment has to consider whether the combination of the FI with a grant element is appropriate. The grant element can take several forms:

- Direct investment grants (separate grant operation with distinct eligible expenditure);
- Technical support (part of FI operation and can be given only for the purpose of technical preparation of the prospective investment for the benefit of the final recipient); and
- Interest rate subsidies (Can be a separate grant operation (pure interest rate subsidy) or can be part of FI operation (subsidy combined within FI)).

Direct grants and technical support may be necessary to cover specific types of expenditures, for instance helping SMEs in preparing a business plan to seek finance from a venture capital fund, or in capacity building to develop in-house management skills.

For example, with respect to innovative SMEs (see Volume II), a subsidy can be useful to **fill a viability gap** and promote a capital investment that will deliver future increased competitiveness. This can be done, for instance, through a grant engineered to deliver soft loans (interest rate subsidy) and cheaper guarantee fees (guarantee fee subsidy). Another option is to directly replace part of the private financial contribution necessary for the investment by a public grant.

Indeed, in the case of new enterprises, the use of grants can be more relevant for its medium term success and sustainability then when it is used to **provide technical support**. For example grants can cover expenses necessary to address property rights issues (e.g. obtaining IPR) or used to pay the preparation of a sound business plan.

Another relevant option is to use grants to **provide capacity building** to SMEs. This could help them overcome their weaknesses in terms of inefficient management and governance structure, which as discussed in Chapter 3, can have a negative impact on the risk perception by potential lenders, thus limiting their access to finance. Training and coaching can also help **raise awareness of existing financing opportunities**, particularly for SMEs operating in sectors or regions where banking penetration is relatively weak.

On the other hand, interest rate subsidies and risk sharing instruments may be needed to provide **incentives to banks to extend their financing to SMEs**. These types of instruments are widely used. They are based on the idea that if financial intermediaries are provided favourable conditions they will be able to increase their lending to SMEs by requiring less collateral and charging lower interest rates.

Table 4 below presents two potential illustrative examples of FIs set up and combined with a subsidy/grant element.

Table 4: Potential examples of financial instruments encompassing a subsidy element

Financial Instrument	Final beneficiaries	Final recipients	Subsidy element	How does it work?
First loss portfolio guarantee	Credit institutions authorised to carry out business in the country or region of implementation of the FI	SMEs	Interest rate subsidy or Technical support subsidy	First loss portfolio guarantee scheme provides guarantees (backed by Structural funds) to selected financial intermediaries through a Holding Fund. The guarantee shall constitute a direct financial guarantee and shall cover losses (relating to unpaid principal and interest) incurred by the financial intermediary in respect of each defaulted eligible loan up to the cap amount of 70%. The financial intermediary retains a credit risk of 30% of the portfolio. Guarantee scheme should therefore boost the capacity of financial intermediaries to support SMEs. . Guarantee scheme could be combined with an interest rate subsidy (soft loan) that will give eligible SMEs increased access to finance and at lower cost. Alternatively guarantee scheme could be combined with technical support for the development of sound business plans for eligible SMEs.
Portfolio risk sharing loan (debt product)	Banks	SMEs	Technical support subsidy	Each loan extended under the initiative comprises 50% funding provided under the portfolio risk sharing loan (Structural funds contribution) at 0% interest rate. Remaining 50% funding is provided by the financial intermediary (bank) at market rate, thus decreasing by half the interest rate paid by SMEs. Grant element could be used to subsidise technical support e.g. for capacity building to develop in-house management expertise.

7.3.2.1 Critical issues with combining

The ex-ante assessment of a FI combined with a grant element must ensure compliance with Article 37 (7), (8), (9) of the CPR in addition to the relevant State aid Regulations, as already mentioned in Chapter 4.3. Moreover, despite the important role they can play in reaching the objectives and in delivering the benefits of an FI, grant elements can generate potential distortions, as already discussed in Chapter 4.

Without a careful coordination of the grant component and the FI, issues of **overlapping and duplication of support** given to final recipients can arise. For instance, the provision of grants to a SME should imply that the same SME does not receive support from a FI (in the form of soft loan) without a proper coordination of the two. FIs could play a stronger role in the coordination by collecting information on grant distribution.

For this reason, in case the envisaged FI encompasses a grant element, the ex-ante assessment should highlight how the risks of overlapping, duplication or distortive effects will be managed in an integrated way. To this end a mapping exercise similar to the one proposed in Chapter 4.2 can be a useful tool.

8 Specification of expected results consistent with the relevant Programme

8.1 Establishing and quantifying the expected results of the financial instrument

Once the proposed investment strategy has been developed based on the elements described in the previous chapter, an ex-ante assessment has to provide an indication of the expected results, and how and to what extent the FI is expected to contribute to the achievement of the specific objectives and results of the relevant priority or measure under which it has been established (i.e. its effectiveness).

The steps for defining the expected results of any FI are detailed in the Chapter 8 of the General Methodology. However, indicators to measure the performance of a FI aiming to strengthen the competitiveness of SMEs present some peculiarities that need to be addressed in this specific methodology.

As explained in Chapter 5, the competitiveness of SMEs is a shared objective, and it is mentioned in the specific funds Regulations of all the ESI Funds. This toolbox for establishing and quantifying the expected results of the FI presents several **result indicators** that focus on SMEs and have been developed for the investment priorities/focus areas of the ESI Funds. This list presents a comprehensive range of result indicators; however it is acknowledged that the individual circumstances of each ex-ante assessment (e.g. data collection constraints) may play a role in the selection of indicators by the financial intermediary/FoF or MA. Examples of possible result indicators specific to SMEs include:

- Number of business/university partnerships or number of innovation consortia;
- Start-up rates;
- Business survival rates;
- Employment creation or growth rates, either for the country or region, or for specific sectors;
- Productivity, e.g. as measured by Gross Value Added (GVA) per worker, for the target sector(s) or size class of enterprise;
- Measurable skills/technical competence levels in specific sectors;
- Export levels outside the Country and outside the EU (total or by sector);
- Community Innovation Survey indicators for the region;
- Number of patent applications per SME; and
- Number of registered trademarks or designs per SME.

The **output indicators** measure activities carried out by the FI in order to deliver the above outcomes/results. Some output indicators for FIs focusing on SMEs are listed below:

- Number of enterprises receiving financial support other than grants;
- Number of new SMEs supported;
- Private investment matching public support to SMEs; and
- Number of advertised job opportunities in supported SMEs.

Additional indicators will try to assess the operational efficiency of the FIs: the performance of the FI (in terms of disbursements of funds to SMEs, in terms of returns on investment). These indicators are not specific to FIs focused on SMEs and could be used for any FI, for instance credit losses (i.e. supplied financing that has become unrecoverable), management costs and leverage.

The setting up of a monitoring and reporting framework is necessary in order to ensure that potential difficulties in attaining the expected results are identified early on, so as to allow for adjustments and corrections before the end of the investment period. However, there seem to be no specificities concerning SMEs.

8.2 Specification of how the financial instrument will contribute to the strategic objective

Please refer to Chapter 8.2 of the General Methodology for guidance on the specification of how the FI will contribute to the strategic objective.

8.3 Monitoring and reporting

Please refer to Chapter 8.3 of the General Methodology for guidance on monitoring and reporting.

9 Provisions for the update and review of the ex-ante assessment methodology

The ex-ante assessment should be updated and reviewed every time it no longer represents the initial market conditions. This may happen throughout any phase of the FI life cycle.

No specificities to the general approach are foreseen under Thematic Objective 3 and the process described in Chapter 9 of the General Methodology should be applied to FIs focusing on SMEs including microcredit, agriculture and fisheries.

9.1 Result oriented approach

Please refer to the General Methodology for guidance on the result oriented approach.

10 Specificities for the ex-ante assessment of financial instruments focused on agriculture

The previous chapters have presented a methodology for the ex-ante assessment of FIs aimed at enhancing the competitiveness of SMEs, regardless of the economic sector in which they operate. This chapter takes into account the specificities of the 6 Union priorities for rural development and presents some unique characteristics for agricultural SMEs that deserve to be analysed separately as they impact the set up and the operation of an FI targeting them.

Articles 37 to 46 of the CPR apply to FIs established under all ESI Funds. However, in setting-up FIs under the EAFRD some peculiarities have to be considered, in particular:

- Consistency with the strategy of the Rural Development Programme (RDP):

  Each RDP is programmed on the basis of a clear strategic approach, including an assessment of the strengths, weaknesses, opportunities and threats, and taking into account the results of the needs assessment[60]. The strategy of the RDP therefore defines the priorities, objectives, targets and measures selected for achieving the goals. To be compliant with the strategy of the RDP, FIs have to be aligned with the needs related to the measures contributing to the FI. Compared to the SFs, the EAFRD intervention logic is to some extent more flexible. Each measure contributes to the achievement of the objectives of one or more focus areas under one or more of the Union Priorities for Rural Development (Rural Priorities). The Rural Priorities themselves translate the relevant Thematic Objectives of the CSF. For that, an FI which aims to support SMEs, which may be financed for example by measure "Farm and Business Development" (Article 19 of the RDR), can contribute e.g. to the achievement of the objectives of Rural Priority 2 (focus area 2a), 3 (focus area 3a) or 6 (focus area 6a), as this depends on the intervention logic of each single RDP.

- Consideration of EAFRD funds-specific rules:

  The RDR provides detailed information concerning the measures that might contribute to the budget of an FI. This includes for example measures-specific co financing rates and eligibility rules. As FIs are a form of support under specific measures, the measure-specific rules also apply to FIs. In addition the Horizontal Regulation on financing, managing and monitoring of the CAP applies to FIs under the EAFRD[61].

- Broader range of potential final recipients and sector specific State aid rules:

  The range of potential final recipients is broader than under the other ESI Funds, as RDPs might support SMEs in the industry and service sector in rural areas, as well as holdings in the agricultural and forestry sector, as shown in Figure 4 below. Due to this broader range of potential beneficiaries, the application of sector-specific State aid rules must be considered when establishing FIs.

- Different issues addressed:

  RDPs may support not only measures enhancing the competitiveness of the enterprises, but also support restructuring farms facing major structural problems, notably with a low degree of market participation or a need for diversification.[62]

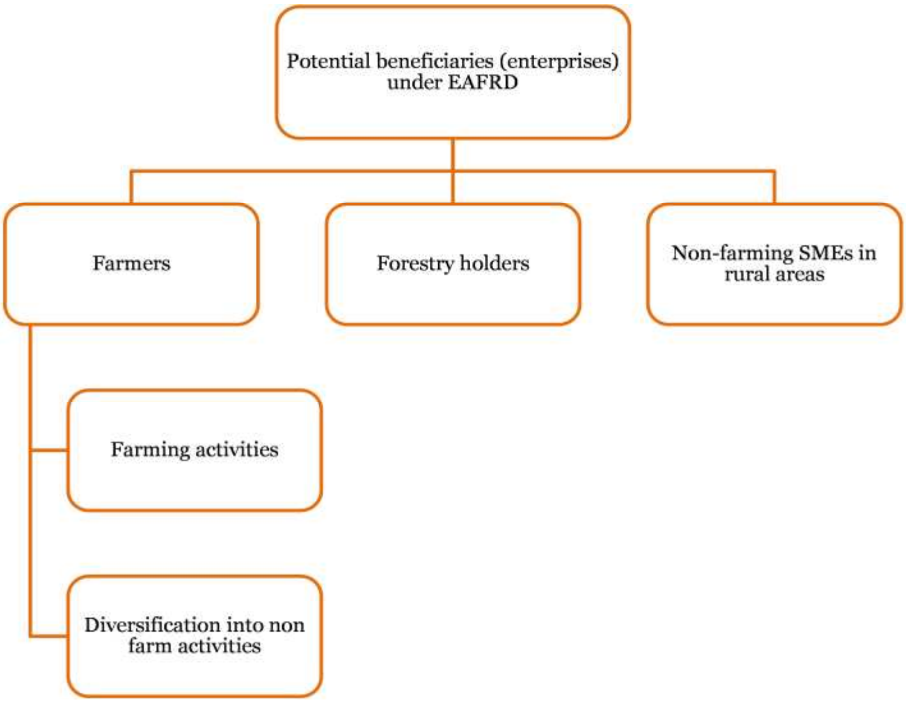
---

[60] Chapter 4 of the RDP; see European Commission: Draft Working Document - Content of a Rural Development Programme (Article 9, paragraph 1).

[61] See Regulation (EU) No 1306/2013 of the European Parliament and of the Council on the financing, management and monitoring of the common agricultural policy

[62] See DG AGRI 'Working paper: elements of the strategic programming for the period 2014 – 2020', link http://ec.europa.eu/regional_policy/conferences/sfc2014/doc/wp_prog.pdf

Figure 4: Range of potential recipients under the EAFRD



In the case of FIs aimed at supporting non-farming SMEs in rural areas, the methodology presented in Chapter 3 is applicable. This chapter will concentrate on the main differences when carrying out an ex-ante assessment for an FI using EAFRD resources to enhance the competitiveness of agricultural SMEs. The main focus will be on presenting a methodology to identify market failure in financing agricultural and diversification activities. In particular, a different methodology is required due to the lack of demand side data.

In addition to market failures that result in a restricted access to finance for SMEs, there can be other policy/society driven issues that might lead to suboptimal investment levels for agricultural SMEs.

For instance, the results of the SWOT analysis may indicate that there are more investments needed to create substantial effects on animal welfare (e.g. modernisation of farm buildings; Rural Priority 3) or to reduce the leaching of nutrients into groundwater or freshwater (e.g. investments in drag-hose systems; Rural Priority 4).[63] In such cases, FIs - as appropriate in combination with grants - can set incentives for a higher level of investment, and therefore can contribute to the achievement of the Rural Priorities in a more efficient way.

Concerning the methodology to analyse suboptimal investment situations, the MA should build on the results of the SWOT analysis of the RDP and the identification of the needs (consistency with RDP strategy). Appropriate tools for the quantification of the potential demand may include a literature review (e.g. publications of universities, local research institutes or sector research institutes), interviews with market experts (e.g. cooperative or local saving banks) or experiences with former promotional programs (e.g. within the framework of the 2007-2013 funding period).

63 The two examples provided here are not meant as an exhaustive list. Other examples could be the support of measures to improve water and energy efficiency or the support of young farmers to facilitate generational renewal.

10.1 Identifying and quantifying market failure in access to agricultural finance

10.1.1 General remarks

The recommended general structure of the approach for identification and quantification of market failure in agricultural access to finance follows the steps presented in Chapter 3, namely:

1. Analysis of the economic context at the national or regional level from an agriculture perspective;

2. Analysis of market weaknesses linked to the agricultural business environment;

3. Analysis of the farm structure (e.g. average farm size, agricultural income, sector concentration); and

4. Analysis of the gap between supply and demand of agricultural financing.

Steps 1 and 2 should provide relevant information about the economic environment, such as trends in Gross Value Added (GVA) and employment in agriculture, and the business related circumstances, such as the lack of rural infrastructure, which might have an impact on the access to finance for farmers. Step 3 should provide additional information concerning the structure of the agricultural sector in the envisaged region, which might give an indication of general problems in access to finance, due for instance to the lack of qualification and unfavourable age structure of farmers, poor agricultural income and small average farm size.

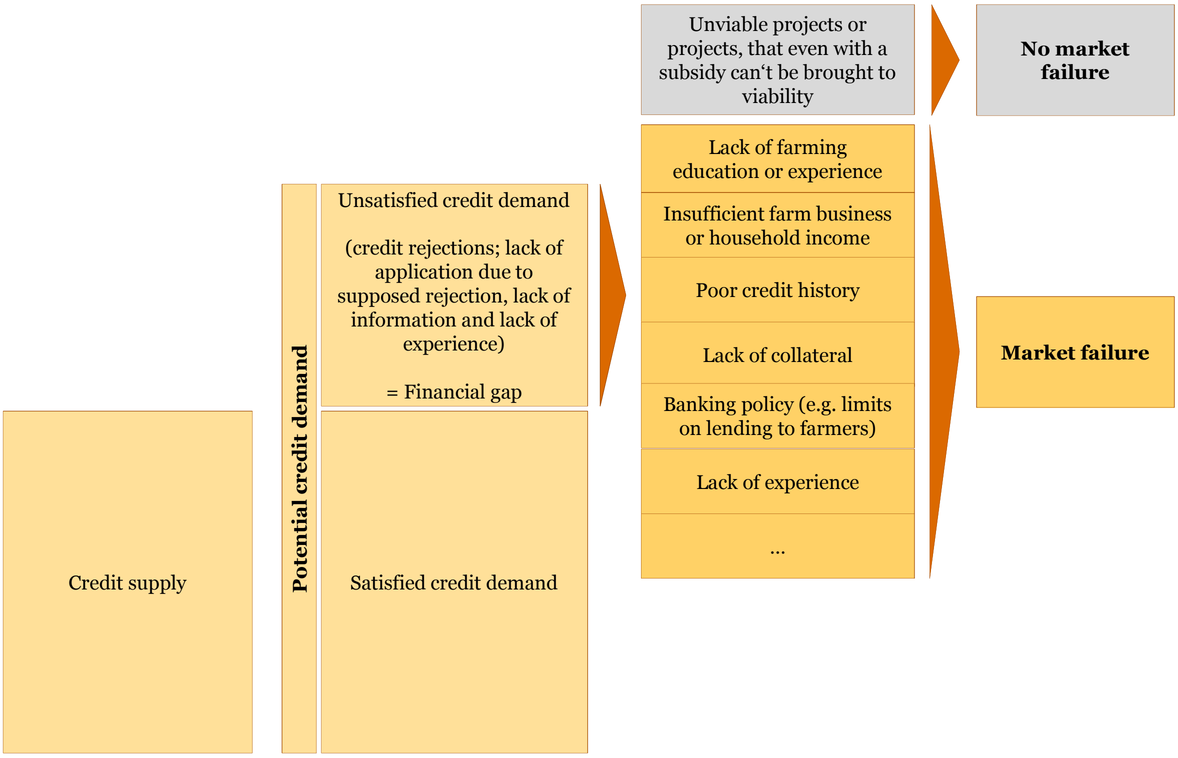
Steps 1 to 3 are important to get a clear picture of the agricultural sector and the needs for support through a dedicated FI. However, most of the research relating to steps 1 to 3 may have been already done during the preparation of the socio-economic and SWOT analysis for the RDP. If this is the case, the ex-ante assessment can build on the results of these previous analyses. Additional sources of information may be existing statistical databases such as Eurostat and National or Regional Statistics Offices, since most of the relevant indicators are part of the set of common indicators applying to RDP monitoring.

Step 4 will be the core of the analysis of market failure in access to finance for farm holdings. The recommended approach will be presented in detail in the following paragraph.

10.1.2 Description of the approach to address the financial gap

The operational approach provided below consists of an analysis of the supply of financing to and the demand for financing from farmers. The difference between supply and demand determines the financing gap, which could be closed, or at least reduced, with the implementation of the envisaged FI.

Figure 5: General approach to identify market failure in agricultural finance



Source: PwC

The derivation of the financial gap takes place in 3 steps.

1. **Supply side analysis**: through the definition of the volume of new lending to agricultural holdings per year;

2. **Demand side analysis**: through the estimation of the potential demand for financing by agricultural holdings; that is the volume of the realised and the unmet credit demand. In operational terms the scope is to estimate the percentage of unmet demand on total potential credit demand; and

3. **Gap analysis:** involves quantifying the financial gap by multiplying the volume of new lending per year (step 1) with the percentage of unmet demand on total potential credit demand (step 2), and analysing the reasons of loan rejections or refusals using the survey results (see Chapter 10.1.2.3).

The financial gap may result from a market failure (e.g. lack of collateral, banking policy) or from other causes, such as the lack of financial viability of the project applying for funding.

Subsequently, it is necessary to make an estimate of the expected trends of the financial gap in the future in order to quantify the total financial gap for the whole programming period 2014 to 2020.

The approach requires the use of various tools:

- Literature review concerning studies with regards to access to finance in the agricultural sector in the envisaged MS or region;
- Data review concerning the size of credit markets with respect to agriculture in the envisaged MS or region (e.g. national central banks, alternatively projection of funding volume on the basis of the European farm accounting data network (FADN)[64]);
- Data review concerning the structure of the agricultural sector in the envisaged MS or region (e.g. FADN, Farm Structure Survey);
- Face to face interviews or structured supply side survey (e.g. regional banks, agricultural promotional banks, agricultural co-operatives, chambers of agriculture, farmers associations, key actors of economic promotion), for checking the plausibility of the findings; and
- Demand side survey (agricultural holdings).

10.1.2.1 Supply side analysis

The objective of the supply-side analysis is to quantify the volume of funding available to agricultural SMEs in the envisaged MS or region. This may prove challenging due to **data availability constraints**.

Whenever possible, MAs should use statistical data, which in most cases is published or available on request from National Central Banks[65]. However, in most cases the only available information concerns the volume of loans outstanding to the agricultural sector, and therefore, the volume of new lending per year has to be estimated.

In cases where the statistical data on credit volume is only available for the whole primary sector[66], the ex-ante assessment should estimate the share of total credit volume allocated to the agricultural sector. If the FI is part of a regional RDP and there are no regional statistical credit data available, a regional break-down must be done. In such cases, MA should use representative proxies, for example the share of regional GVA in agriculture on national GVA in agriculture.

In addition to bank loans there are other financing sources for farm holdings, particularly agricultural leasing, farm co-operatives and family loans. In most cases, statistics concerning the volume of these additional financing sources will not be available and will need to be estimated based on the information provided by sectorial associations or organisations, such as agricultural co-operatives, chambers of agriculture or farmers associations.

Another valuable source of information to estimate the available financing for agricultural SMEs is the Farm Accountancy Data Network (FADN). The FADN collect every year financial data from a sample of agricultural holdings. The FADN is the only source of microeconomic data that is harmonised (i.e. the bookkeeping principles are the same in all countries).

However, the survey does not cover all the agricultural holdings, but only those which due to their size can be considered as commercial. Currently, the annual sample covers approximately 80,000 holdings. They represent a population of about 5,000,000 farms in the 25 Member States, which cover approximately 90% of the total utilized agricultural area (UAA) and account for about 90% of the total agricultural production of the Union. For the EU-27 the FADN represents about 6,400,000 farms.[67].

64 http://ec.europa.eu/agriculture/rica/

65 e.g. Banco de España: BOLETÍN ESTADÍSTICO; Deutsche Bundesbank: Monatsbericht; Bank of Lithuania (Lietuvos bankas): Structure of Loans by Economic Activities

66 agriculture, forestry and fishing

67 http://ec.europa.eu/agriculture/rica/concept_en.cfm

Box 3: Calculation of credit supply by using data of the Farm Accountancy Data Network

A MA plans to establish an EAFRD co-financed FI to support agricultural enterprises. Concerning the analysis of supply, agricultural credit data might be not available on request of National Central Bank. Alternatively, the MA can estimate the size of the agricultural credit market by using data from the FADN and Eurostat.

The FADN provides information on the average amount of loans per farm and the number of farms represented by the FADN. Given this information, the MA can make a projection of the total volume of loans to agricultural holdings. As mentioned above, FADN is representative only for agricultural holdings exceeding a certain minimum size.[68] An example of the calculation of the total volume of loans using FADN data is given below.

Standard Output	Number of farms represented (SYS02)*	Long and medium-term-loans (SE490)*	Short-term-loans (SE495)*	Total liabilities (SE485)*	Total volume of long and medium-term loans	Total volume of short-term loans	Total volume of liabilities
Size classes	Number	EUR per farm	EUR per farm	EUR per farm	M EUR	M EUR	M EUR
1	2	3	4	5=3+4	6=2·3	7=2·4	8=2·5
8 - 25 k€	14,740	27,634	1,009	28,643	407.3	14.9	422.2
25 - 50 k€	7,530	51,735	1,777	53,512	389.6	13.4	402.9
50 - 100 k€	8,590	84,464	4,157	88,621	725.5	35.7	761.3
100 - 500 k€	8,040	312,845	18,981	331,826	2,515.3	152.6	2,667.9
>500 k€	270	546,828	119,771	666,599	147.6	32.3	180.0
Total represented farms	**39,170**				**4,185.4**	**248.9**	**4,434.3**
Total net represented farms 1)	24,700	10000 2)	1000 2)	11,000	247.0	24.7	271.7
Total	**63,870**				**4,432**	**274**	**4,706**

* FADN code in brackets
1) Calculation of total number of farm holdings as reported by Eurostat less the number of farms represented in the sample
2) Estimation

However, the plausibility of the resulting data on credit volume should be discussed with market experts, in particular if the envisaged FI is to be established in a country or region in which very low levels of liabilities are observed, since this may be the result from different accounting practices, as liabilities could be included in farmers' private rather than farm accounts.

The MA could additionally make an estimate on the outstanding credit volume of small farms, which are not covered by the FADN.

In a first step, the MA could quantify the number of farms that are not represented by the FADN (see Footnote 1 in the table above). In a second step, the MA will have to make an estimate on the average volume of loans outstanding of such small farms. Here the MA has to consider, that the outstanding credit volume of very small farms is typically very small as well. As such it may be even significantly lower than it is for the smallest size class covered by the FADN. For getting a resilient indication, the estimated amount of the outstanding credit volume of very small farms should be discussed with market experts (e.g. banks, chambers of agriculture).[69]

Finally, the multiplication of the number of farms that are not represented by the FADN and the estimated outstanding credit volume of very small farms results to the total volume of liabilities of farms that are not represented by the FADN.

68 EUROPEAN COMMISSION - DIRECTORATE-GENERAL FOR AGRICULTURE AND RURAL DEVELOPMENT: EU farm economics 2012 based on FADN data, Annex 3: Threshold by Member State in 2009 (ESU: European size units)

69 Surveys could be considered as another tool.

A final consideration concerns the cases in which the envisaged FI focuses on very precise issues, such as investments in farm buildings to provide the appropriate space standards. In such cases, only part of the total credit supply is relevant for the supply-side analysis, as the total volume of credit includes support for a wide range of needs, such as machinery and equipment (including transport equipment) or agricultural land. As a result, the supply analysis for such FIs could focus on the share of gross fixed capital formation in different asset classes (e.g. agricultural products, machines and other equipment, transport equipment, farm buildings) on total gross fixed capital formation in agriculture[70] or the composition of assets as provided by the FADN[71].

Once the overall size of agricultural credit markets has been analysed and quantified based on available data and information, it is necessary to break down the gathered data to the volume of lending per year by estimating the remaining average term to maturity of the outstanding loans. This estimate should be based on the results of the supply side survey and/or face to face interviews with market experts.

Box 4: Estimate of the volume of lending per year

The estimated average credit period of investment loans in agriculture may be 10 years. Assuming, the overall volume of lending per year and the average credit period are constant over time, then the average term to maturity of investment loans is 5.5 years.[72] Taking into account the example presented in Box 3, the total amount of loans outstanding to agricultural holdings (€4.706 m) is aligned with a volume of lending per year of about €855 m (4.706 / 5.5).

10.1.2.2 Demand side analysis

As illustrated in Figure 6, the potential credit demand encompasses the volume of successful applications and the unmet credit demand, which may be due to loan application rejections, refused loan offers, for instance due to high costs, and missed applications due to "expected" rejections.

The volume of realised credit demand is identical to the credit supply. The volume of the unmet credit demand needs to be estimated. This can be done through demand-side surveys focusing on financing applications. As mentioned in Chapter 3, in cases of FIs addressing the needs of SMEs in the industry and service sector, MA can use the results of existing surveys. However, existing surveys typically exclude firms in the agriculture sector, therefore existing data is largely insufficient. If the existing data has an insufficient representation from the agriculture sector (as a percentage of the total versus the agriculture sector's representation of GDP in the region/country), a demand-side survey could be conducted.

A few research studies have focused on agricultural credit market restrictions in European countries[73]. However, the existing literature on access to finance for agricultural holdings in Europe is in comparison to the industry and service sector quite poor.

---

[70] Data available at Eurostat (aact_eaa01)

[71] Land, permanent crops & quotas (code SE446), buildings (code SE450), machinery (Code SE455), breeding livestock (SE460), http://ec.europa.eu/agriculture/rica

[72] The calculation is based on the formula: (n+1) / 2, where n is the average credit period. In the considering example this results to (10+1) / 2 = 5.5

[73] Factor Markets Working Paper 33: Agricultural Credit Markets Institutions - A comparison of Selected European Countries, 2003, http://www.ceps.be/book/agricultural-credit-market-institutions-comparison-selected-european-countries

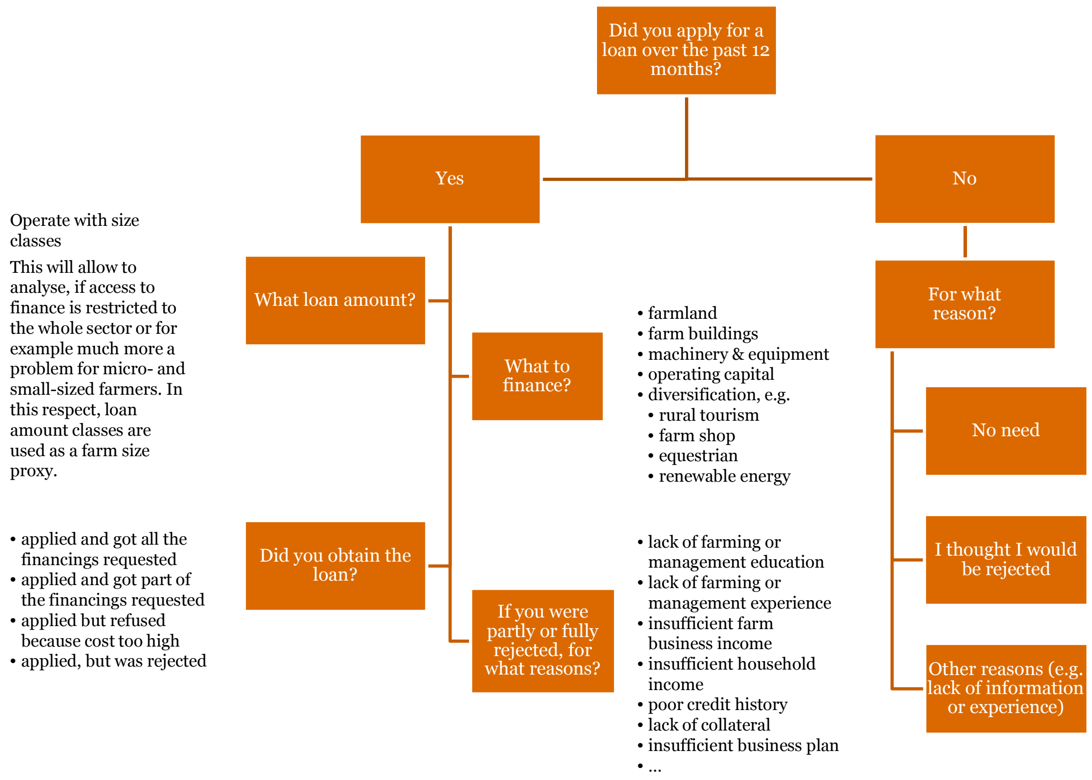
Petrick/Kloss: Exposure of EU Farmers to the Financial Crises, in: Choices - Magazine of food, farm and resource issues, 2nd Quarter 2013, http://www.choicesmagazine.org/choices-magazine/theme-articles/the-eurozone-crisis-and-its-implications-for-agriculture-in-selected-regions-of-the-world/exposure-of-eu-farmers-to-the-financial-crisis

European Network for Rural Development: Final Report on the ENRD Rural Entrepreneurship Thematic Initiative: Rural Finance, Final Version, 28th March, 2012, http://enrd.ec.europa.eu/themes/entrepreneurship/rural-finance/en/rural-finance_en.cfm

Nonetheless, there may be studies conducted at the national or regional level which provide an analysis of market failure in the agricultural credit market that could provide useful insights.

In cases where the available information is not sufficient to obtain a reliable estimate of the demand for financing for agricultural SMEs, a tailored demand-side survey can be developed and implemented. Figure 6 shows a possible structure of such a demand side survey.

Figure 6: Possible structure of a demand-side survey for agricultural SMEs



Source: PwC

The data collected using the structure of the survey will enable the analysis of the:

- Overall rejection rate; [74]
- Rejection rate with respect to different loan sizes, which can also provide useful information for the definition of the investment strategy (e.g. If there were reported high rejection rates only on small loan sizes, an FI could provide loans to small-sized farmers); and
- Rejection rate in respect of different investment needs (e.g. If there were reported high rejection rates for loans to cover the funding needs for diversification into non-agricultural issues, an FI addressing these special needs could be established to eliminate or reduce market failure).

The demand side survey structure could include question concerning the farmers' investment forecasts over the next 12 months compared to the current situation (decline / unchanged / increase). Additional questions could refer to the expected amount of farm's/farmer's financing needs and to the expected availability of financing over the next 12 months (will improve / unchanged / will deteriorate). Such information may be useful for estimating the financial gap in the future.

[74] This analysis will need to focus, as far as possible, only on bankable demand and exclude as much as possible rejections due to poor credit worthiness. Indeed, these are not related to market failure and do not require public intervention.

Box 5: Calculation of the unmet credit demand on the basis of the survey results (rounded to integers)

Loan Amount	Mean of loan amount class	Distribution of the sample	Fully rejected		Partly rejected (assumption: 50% of loan amount granted)			Applied, but refused due to bad conditions		Rejected/ refused loan amount	Weighted rejected/ refused loan amount	Weighted loan amount	Rejection rate per loan amount class[2]
Size classes	EUR	%	%	EUR	%	%	EUR	%	EUR	EUR	EUR	EUR	%
1	2	3	4	5=2·4	6	7=6·50	8=2·7	9	10=2·9	11=5+8+10	12=11·3	13=2·3	14=12/13
<10 k€	5,000	30%	20%	1,000	10%	5%	250	4%	200	1,450	435	1,500	29%
10 - 20 k€	15,000	25%	15%	2,250	12%	6%	900	5%	750	3,900	975	3,750	26%
20 - 50 k€	35,000	25%	10%	3,500	12%	6%	2,100	3%	1,050	6,650	1,663	8,750	19%
50 - 100 k€	75,000	15%	5%	3,750	10%	5%	3,750	3%	2,250	9,750	1,463	11,250	13%
100 - 250 k€	175,000	4%	2%	3,500	8%	4%	7,000	2%	3,500	14,000	560	7,000	8%
>250 k€	400,000[1]	1%	1%	4,000	5%	3%	10,000	1%	4,000	18,000	180	4,000	5%
Average over all classes											**5,257.0**	**36,250.0**	**15%**
Waiver of application due to an expected rejection													4%
Total													**19%**

1) Assumptions
2) Including refusals

Explanation

1	Loan amount	Defined loan amount classes in EUR
2	Mean loan amount per loan amount class	Arithmetic mean (average value) of the loan amount in the respective size class
3	Distribution of the sample	Share of reported loan applications (all rows sum up to 100%)
4	Fully rejected in %	Percentage of respondents, where the loan was fully rejected
5	Fully rejected in EUR	Volume rejected (average volume per loan)
6	Partly rejected in %	Percentage of respondents where the loan was partly rejected and 50% of the loan amount was contracted only
7	%	Transformed in equivalent full rejection percentage
8	Partly rejected EUR	Volume rejected (average volume per loan)
9	Applied, but refused due to bad conditions in %	Percentage of respondents where the loan was approved; however the client refused (e.g. interest rate too high, e.g. required collaterals not available)
10	Applied, but refused due to bad conditions in EUR	Volume refused (average volume per loan)
11	Rejected/refused loan amount in EUR	Gross unmet demand (fully rejected, partly rejected, refused by client)
12	Weighted rejected/refused loan amount in EUR	Gross unmet demand weighted with the share in the sample
13	Weighted loan amount in EUR	Average loan amount weighted with the share of respondents per loan amount class
14	Rejection rate including refusals per loan amount class	Rejection rate per loan amount class and as an average over all size classes

Taking into account that the rejection of a small loan has a smaller impact on the total volume of unmet credit demand than a large loan rejection, the average rejection rate over all loan amount classes is 14.6% (weighted average). Calculating the rejection rate instead by using the arithmetic mean would amount to a rejection rate of 22.3%. However, due to the higher rejection rates in smaller loan amount classes, this would result to an overestimation of the total unmet credit demand.
Finally it has to be considered that farmers could desist from a loan application due to the expectation of a rejection, as such cases are also part of the unmet credit demand.

In the example above, 4% of the respondents reported, that they didn't apply for a loan, because they expected a rejection. Thus, the unmet credit demand (in relative terms) is 18.6% of the total (potential) credit demand. In contrast, realised credit demand (or respectively credit supply) is 81.4% of total (potential) credit demand.

Again the plausibility of the reported rejection rates should be discussed with market experts. This is important as the perception of difficulties in access to finance might differ between the lender and the applicant.

10.1.2.3 GAP analysis

The financing gap can be calculated by multiplying the volume of new lending per year (step 1) with the percentage of unmet demand on total potential demand (step 2).

Box 6: Quantifying the financial gap

Assuming the volume of new lending to agriculture is EUR 855m (example given in Box 4), this is equal to 81% of the total (potential) credit demand (example given in Box 5). The total (potential) credit demand would be then EUR 1,055m.[75]

The financial gap would amount to EUR 200m (19% from EUR 1,055m).

Having identified the existence and the level of a financing gap, it is necessary to determine whether the gap is a result of market failure or other causes. As a result the ex-ante assessment should analyse the reasons of credit rejections or loan refusals as reported in the survey and assessed by market experts.

This analysis may lead to the result that a certain percentage (e.g. 25%) of rejected credit applications or refused loan offers are due to insufficient financial viability of the projects that cannot be tackled even with an appropriate subsidy. These situations cannot be considered as market failures. Thus the financial gap due to market failure reduces to 75% of the total financial gap. In terms of the example provided in Box 6 above, the financial gap due to market failure would amount to €150 m (75% of €200 m).

Additionally, the analysis of the reasons of loan rejections provides useful information concerning the appropriate proposed investment strategy for the FI. For example, if lack of collateral was reported as a major reason of credit rejections, a guarantee fund might be the right instrument to improve access to finance. In terms of low farm and/or household income, the MA can decide to provide interest rate rebates (as grants) or a combination of loans and grants.

Estimating the volume of the financial gap over time is important to define the right scale of an FI. For example the percentage of unmet credit demand may be currently high due to the economic and financial crisis, which brings along restrictions in credit supply. If it is expected that these restrictions will decline in the future, the financial gap will tend to decline as well. On the other hand, if the demand for loans is expected to increase in the future, for instance due to an existing investment delay, and the access to finance conditions for agricultural SMEs are expected to remain stable, the financing gap will tend to widen in the future.

As a result the gap analysis delivers an estimate of the financing gap due to market failure for the whole programming period 2014-2020.

[75] Calculation: 855 / 0,81

10.2 Assessment of the value added of the financial instrument

10.2.1 Value added

The approach to the assessment of the value added of the FI is presented in Chapter 4 of the General Methodology and complemented with regard to SMEs by Chapter 4 of this document. Related to FIs under the EAFRD, there is no specific methodological guidance.

10.2.2 State aid implications

With respect to State aid implications for FIs under the EAFRD different State aid rules apply, as already mentioned in Chapter 4 of the General Methodology.

In principle, state funding meeting the criteria of Article 107 (1) TFEU constitutes State aid. However, according to Art 109 TFEU, the Council may determine categories of aid that are exempt from the notification procedure set out in Article 108 (3) TFEU. With regards to FIs under the EAFRD, the ABER, GBER and the *de minimis* Regulation(s) are most relevant.

In the context of the Commission's State aid Modernisation process, the set of rules regarding State aid is currently under review. With respect to rural development policy one of the main goals of the revision process is to provide a clear set of State aid rules as a reference point for expenditure under the EAFRD measures in the programming period 2014-2020. Thus, future ABER will be closely linked to the provisions of the RDR.[76] However, one has to keep in mind, that the discussion process is not yet finished[77].

Regarding FIs included in a Rural Development programme supporting agricultural SMEs, the support will be not considered as State Aid, if the aid intensities established in the RDR are respected, even for top-ups from national or regional authorities linked to the FI[78].

In case of non-agricultural SME in rural areas and forestry activities, GBER and general de minimis applies: ceiling of 200.000 EUR (Gross Grant Equivalent) per final recipient during any period of three fiscal years

With respect to the consistency with other forms of public intervention addressing the same market presented in the General Methodology, there is no specific methodological guidance related to FIs targeting farmers and rural SMEs.

10.3 Additional public and private resources to be potentially raised by the financial instrument

The methodological considerations of Chapter 5 of this document, in combination with Chapter 5 of the General Methodology, also apply to FIs targeting SMEs under the EAFRD. However, there is one main difference that MAs of EAFRD have to take into account when estimating the volume of additional public and private resources. As a matter of fact, the national co financing must happen at the level of the Fund of funds or at the level of the financial intermediary, while co financing at the level of the final recipient is not allowed.

76 For further information see http://ec.europa.eu/agriculture/stateaid/policy/consultation-aber/index_en.htm

77 Thus the Regulations could be altered after the negotiation phase.

78 See Article 81 and 82 of Regulation (EU) No 1305/2013 (EAFRD)

10.4 Lessons learnt

As pointed out in Chapter 6 of this document, the ex-ante assessment shall include an assessment of lessons learnt from similar instruments and ex-ante assessments carried out in the past. The gathered information should be used for improving the effectiveness and efficiency of future FIs. Thus the approach presented in Chapter 6 of the General Methodology supplemented by the additional remarks with respect to SME as of chapter 6 of this document fully applies to FIs under the EAFRD.

Past experiences in implementing FIs under the EAFRD are fairly limited compared to FIs using SFs. Until now FIs are implemented under RDPs in eight Member States, namely France (Corse), Belgium, Bulgaria, Estonia, Italy, Romania, Latvia and Lithuania. These FIs, mainly loan and guarantee funds, target activities in the following domains:

- Modernisation of agricultural holdings (measure 121);
- Adding value to agricultural and forestry products (measure 123);
- Business creation and development (measure 312);
- Encouragement of tourism activities (measure 313).

As of May 2012, there have been no venture capital funds introduced into RDPs. The estimated total public expenditure for FIs under the EAFRD is around €531 m, which is 0.3% of the 88 RDPs' overall budget.[79]

Besides higher complexity and the additional management resources requirements, a further reason for the relatively low up-take of FIs under the EAFRD might come from difficulties to combine RDP grants with FIs under the 2007 to 2013 RDR. However, in 2014 - 2020 programming period, the flexibility in combining RDP grants and RDP loans or guarantees will be improved. Combining RDP grants and FIs may enable farmers and rural SMEs to cover a higher proportion of the total project costs, which could make it easier to achieve the total financial package required.

10.5 Proposed investment strategy

The General Methodology provides a description of the steps to be followed in order to develop a proposed investment strategy. Those steps apply to FI under all ESI Funds, and thereby, also to FIs under the EAFRD.

However, in reference to the clearly defined strategic approach of the RDPs, the ex-ante assessment should draw special attention to the consistency of the envisaged FI with the overall RDP strategy. That means that "any FI supported by the EAFRD must be in compliance with the RDP, its objectives under priorities and focus areas, the eligibility rules under measures, the expenditure related provisions, co-financing elements, monitoring and reporting requirements." Thus, the description of the strategy of the FI should "... justify the choice, the combination and the prioritisation of the FI's proposal in the light also of the results of the SWOT analysis and the needs identified and linked to the measures concerned (respectively the beneficiaries under these measures or eligible operations*),* together with the financial allocations according to the interventions."

Hence, the ex-ante assessment should provide answers to the following questions:

- How does the FI aim to address the strengths, weaknesses, opportunities and threats as identified in the RDP's SWOT analysis?

- How does the FI aim to address the needs identified in the needs assessment of the RDP?

---

[79] European Network for Rural Development: Rural development financial instruments: New opportunities to tackle the economic crisis, in: EU Rural Review, Autumn 2012; http://enrd.ec.europa.eu/publications-and-media/eu-rural-review/en/eu-rural-review_en.cfm

- How does the FI fit into the intervention logic at priority, focus area and measure level?
- What is the expected contribution of the FI to the targets at focus area(s) level?
- How does the FI (or the different types of FI support) and other forms of support (i.e. non-repayable forms of support) under the relevant measure(s) work together to address the needs identified, and thus, to achieve the objectives? What are the expected synergies?
- Is the budgetary allocation of the FI aligned to the needs and challenges identified?

One aspect, which might be by comparison to the SFs of more practical relevance, is that FIs under the EAFRD may contribute to more than one measure. For example, the ex-ante assessment may come to the result that lack in access to finance is a broader problem in the envisaged region and therefore hits farmers and rural SMEs to the same extent.

Thus, the MA may decide to set up an FI as a loan fund aimed at supporting:

- Farmers according to the Articles 17 and 19 of the RDR (contribution to the objectives of focus area 2A); and
- Farmers and micro- and small enterprises in the food sector according to Article 19 as well as producer groups and organisations in the agriculture sector according to Article 27 (contribution to the objectives of focus area 3A).

If the envisaged FI is intended to follow such a construction, the ex-ante assessment should provide evidence that the measure-specific co-financing rates, rules on eligibility, and monitoring requirements are respected.

10.6 Specification of expected results consistent with the relevant Programme

The steps for defining the expected results of any FI are detailed in the Chapter 8 of the General Methodology. As Chapter 8 also stresses the differences in monitoring requirements between the SFs and the EAFRD, no further remarks needed here.

11 Specificities for the ex-ante assessment of financial instruments focusing on microcredit

The previous chapters have presented a methodology for the ex-ante assessment of FIs aimed at enhancing the competitiveness of SMEs. However, the target final recipients of microcredit instruments, explicitly included in the Thematic Objective 3, display a few peculiarities that need to be addressed separately from the rest of SMEs.

Microfinance can be defined as the provision of a range of financial services including credit, savings, insurance and money transfers, by different service providers, targeted at poor and low-income people. Microcredit can be considered as a specific sub-set of microfinance products, as it typically refers to very small loans for borrowers with little or no collateral. This is particularly relevant in view of setting up an FI targeting SMEs under TO3, especially micro-enterprises. It should be noted that microfinance instruments may also be used to target Thematic Objectives 8, 9 and 10 that focus on Inclusive Growth and would be primarily co-financed through the ESF.

This chapter aims to provide the reader with the key considerations and tools necessary to perform a successful ex-ante assessment of an FI focusing on microcredit[80].

11.1 Financial exclusion and microcredit

Financial exclusion is defined as "a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong"[81]. Although this definition is focusing on people and households, a similar reasoning can be applied to enterprises. Financially excluded businesses generally include self-employed, new and existing entrepreneurs with micro-credit needs and nearly bankable businesses, such as young firms or start-ups without a sufficient track record. Other categories of entrepreneurs who are more likely to be financially excluded are women, ethnic minorities, people with disabilities and recent migrants. Finally, social enterprises are also often excluded from mainstream financial circuits.

As financially excluded businesses and entrepreneurs constitute a very heterogeneous group, the underlying causes of their financial exclusion may differ significantly and include issues related to both the supply side and the demand side. An analysis of the reasons explaining the limited access to finance for SMEs has already been provided in Chapter 3.

However, these issues are further exacerbated by the size of the company and of its financial needs. For instance, the management and transaction costs for a bank are significantly higher when providing a large number of relatively small loans. In addition, the characteristics of the potential clients pose a few serious risk management challenges to commercial banks, due for instance to the absence of a track record, collateral and established banking relations, to the difficulty to collect information and to perform proper due diligence, or to the insufficient financial literacy. Moreover, financially excluded entrepreneurs and businesses may not even apply for traditional financing if they perceive their chances of succeeding as too low, for instance due to negative past experiences.

This situation is even worse in times of crisis and credit crunch where mainstream financial institutions are more risk averse and constrained by liquidity considerations.

---

80 Nonetheless, it is worth reminding that the devepoment of a dedicated and more detailed guidance on microcredit FI may need to be produced in the future, as emerged during the needs analysis for the establishment of the Financial Instruments Technical Advisory Platform (FI-TAP).

81 European Commission (2008), *Financial services provision and prevention of financial exclusion*, Directorate-General for Employment, Social Affairs and Equal Opportunities Inclusion, Social Policy Aspects of Migration, Streamlining of Social Policies

Microcredit is generally recognised as an effective financing channel for job creation and social inclusion, which can attenuate the adverse effects of the current financial crisis while contributing to entrepreneurship and economic growth in the EU[82]. According to the 2007 Communication "A European initiative for the development of microcredit in support of growth and employment"[83], microcredit in the EU means loans under 25,000 EUR, tailored to the needs of microenterprises employing fewer than 10 people and, unemployed or inactive people who want to go into self-employment but do not have access to traditional banking services.

Despite the fact that this issue ranks high on the EU policy agenda, the development of this market segment is relatively recent in most EU countries. The European Commission has acknowledged a lack of necessary intermediaries, capital and environment to exploit the potential of microcredit in the EU[84]. The initiative identified four main objectives to be pursued in order to create a favourable environment for the development of microcredit:

- Improve the legal and institutional environment in the Member States;
- Further change the climate in favour of entrepreneurship;
- Promote the spread of good practices; and
- Provide additional financial capital for non-bank Microfinance Institutions (MFIs).

FIs focusing on the provision of microcredit can be an effective and efficient way of pursuing these objectives. However, the provision of microcredit is a vast and multifaceted issue and the group of concerned potential beneficiaries and recipients is quite heterogeneous. Indeed, **significant differences exist between Central and Eastern Europe, and Western Europe[85]** with regard to the development of the market segment, the profiles of intermediaries, target final recipients, loan size and so on. Microcredit was introduced in Central and Eastern European countries during their transition to a market economy mainly as a way for developing private sector entrepreneurship and private banking institutions. Later on, MFIs and NGOs started to get involved in the provision of microfinance on the Central and Eastern European market and commercial banks started to be interested in downscaling their provision of microloans.

In Western European countries the market is much less mature and microcredit is mainly perceived as a tool to promote economic growth and social cohesion, thus concentrating on social and financial inclusion. The development of efficient operational models for Western European microcredit providers has also been hindered by the existence of a well-developed, mature and competitive financial services and banking sector and a well-enforced legal environment[86].

As a preliminary step, the ex-ante assessment should clearly define and understand the main targeted stakeholders of the FI, namely its final recipients and its intermediaries. The main specificities are detailed in the following paragraphs and will have to be confirmed during the ex-ante assessment.

[82] European Commission (2012), Report from the Commission to the European Parliament and the Council on the application of Directive 2006/48/EC to microcredit, COM(2012) 769 final, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0769:FIN:EN:PDF

[83] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0708:FIN:en:PDF

[84] European Commission (2007), Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions "A European initiative for the development of micro-credit in support of growth and employment", COM(2007) 708 final, http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0708en01.pdf

[85] These two geographical aggregates, in the European Union context roughly correspond to the EU15 (Western Europe) and EU13 (Central and Eastern Europe).

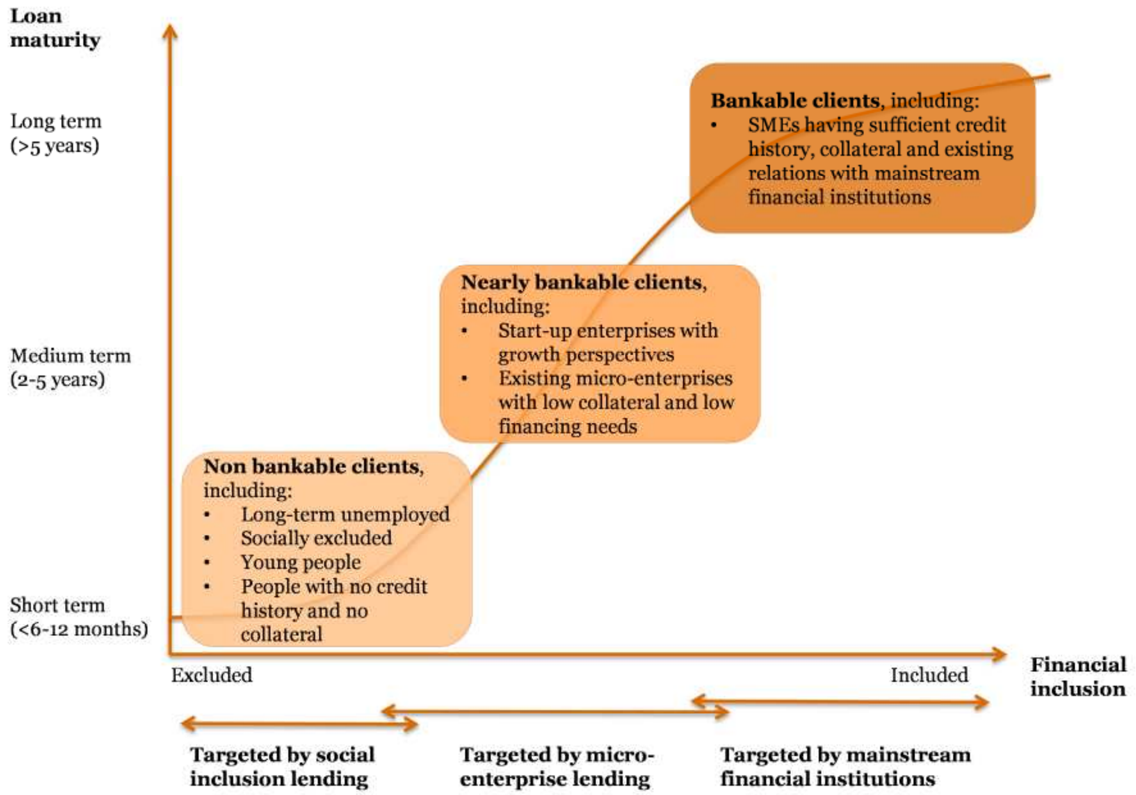
[86] Krämer-Eis, H. and Conforti, A. (2009), Microfinance in Europe. A market overview, Working paper 2009/001, EIF research & market analysis, http://www.eif.org/news_centre/publications/EIF_WP_2009_001_Microfinance.pdf, and Bruhn-Leon, B., Eriksson P.-E. and Krämer-Eis, H. (2012): Progress for Microfinance in Europe. EIF Working Paper 2012/13. http://www.eif.org/news_centre/publications/eif_wp_2012_13_microfinance.pdf

11.1.1 Classification of potential final recipients

The European Microfinance Network reports that every third microloan is directly addressed to support a start-up business, particularly in Western Europe[87]. In 2011, 38% of all microloans were disbursed to women, while 12% went to ethnic minorities and immigrants. In addition, 17% of loans were disbursed to people living in rural areas. Clients below the poverty line are also targeted and they represent 13% of the whole lending activity in 2011.

The main distinction among the different types of potential final recipients concerns their level of financial inclusion and bankability. The characteristic of the main client group allows distinguishing two approaches to microcredit: **microenterprise** lending and **social inclusion** lending. The first one focuses on providing small loans to nearly bankable enterprises that have difficulties in accessing the mainstream finance circuit. The latter is aimed at supporting the self-employed, and the socially or financially excluded. Figure 7 shows the positioning of microcredit clients.

Figure 7: Positioning of a microcredit client



Source: PwC

87 European Microfinance Network (2012), Overview of the microcredit sector in the European Union, http://www.european-microfinance.org/data/file/overview2010-2011-final.pdf

11.1.2 Classification of potential intermediaries

MFIs are financial institutions specialising in banking services for low-income groups, individuals or businesses who do not have access to mainstream financial circuits. Compared to commercial banks, MFIs have the following distinctive features:

- They aim for both financial return, and social and economic impact;
- They have lower collateral requirements and can also provide uncollateralised loans;
- Their delivery system is labour-intensive since it requires a closer relationship between borrower and lender;
- Their management and operational costs are higher due to the fact that they generally provide a large number of loans with a short-term maturity;
- They charge higher interest rates to cover their higher operating costs and risks;
- Their financial returns show a lower correlation with the economic cycle;
- They often provide additional services such as mentoring, coaching, training, and business and technical support; and
- Their credit assessment and due diligence methods are less standardised and automated, especially for less mature institutions.

The landscape of MFIs operating in a country or region can be extremely varied and complex. For this reason, it is useful to classify these providers according to their business model, different focus on microcredit activities and maturity.

Microcredit providers can be further classified into bank and non-bank providers.

Bank providers are banks for which microcredit represent a small part of their operations, either as part of a social responsibility programme or as part of their commercial activities. The main providers in this category include:

- Dedicated units within a commercial bank;
- Credit unions;
- Cooperative banks; and
- Savings banks.

Non-bank providers tend to develop in markets with low financial services penetration rates and limited public or third party support. Unlike bank MFIs, non-bank MFIs do not have access to deposits as a source of funding, since according to the EU Regulation, non-banking institutions are not allowed to collect deposits. However, some Members States restrict almost all lending activities to banks, for instance Germany[88]. Non-bank MFIs include:

- NGOs or foundations;
- Specialised MFIs;
- Government bodies or agencies; and
- Community development financial institutions.

[88] Thomson Reuters Foundation (2011), Creating Jobs in Europe: Legal and Regulatory Frameworks of Microenterprises and Microcredit in Europe

The following paragraphs strengthen the specificities of the ex-ante assessment for microfinance against the general ex-ante methodology and the methodology described for SME in the present document.

11.2 Analysis of market failure, sub-optimal investment situations and investment needs

11.2.1 Analysis of market weaknesses impacting the business environment

The first issue to be addressed is the **regulatory environment** within which microcredit takes place as this varies significantly across EU countries. The existence of a specific legal framework has an impact on the way MFIs function and on the results they can deliver. A few EU countries, notably France, Romania, Italy[89], Hungary, Latvia, Lithuania and Slovenia, have adopted specific laws and regulations taking into account the nature of microcredit and the peculiarity of MFIs. Moreover, the existence of certain legal exemptions may result in the creation of a specific market niche for micro-lenders.

In addition, other aspects of the regulatory environment affect both micro-lenders and micro-borrowers, for instance tax laws, legal provisions and enabling environment for self-entrepreneurship and the existence of usury rates and interest rate ceilings. All these factors need to be taken into account when performing an ex-ante assessment for an FI focusing on microcredit since they are determinant for the type and business model of MFIs operating in the country or region as well as on the demand by micro-enterprises.

11.2.2 Demand analysis

The reasons for market failure limit the competitiveness of SMEs have been presented in Chapter 3 of this methodology. The considerations made in that chapter linked to both the insufficient supply of financing and the inadequacies on the demand side still holds for micro-enterprises. However, a few additional considerations have to be kept in mind when performing an ex-ante assessment for microcredit-focused FI.

On the demand side, micro-enterprises face similar weaknesses to those identified for SMEs in general. However, issues related to their lack of sufficient collateral, inefficient management methods, unclear governance structures, and low survival rate, are even more serious for micro-enterprises. In addition, there may be serious issues of awareness, and even understanding, of the processes and procedures required in order to obtain access to capital, particularly for people at risk of social exclusion. These categories also show very low financial services penetration rates and insufficient relations with banks and financial institutions.

11.2.3 Supply analysis

On the supply side, issues of information asymmetry exert more severe impacts on access to finance for micro-enterprises, since they imply **higher costs and credit risk for commercial banks**. The loan amounts may be too small to offset the higher risk and operating costs of the business, for instance related to the specifics of borrower, such as difficulties in assessing the credit standing of start-up or small entrepreneurs, and the high risk of default. This could result in earnings for a commercial bank being insufficient[90].

---

[89] In Italy a law has been introduced in 2010 but after more than 3 years still need to be implemented.

[90] European Banking Federation (2010), Microfinance within the EU banking industry: policy and practice, Report written by the European Banking Federation's Working Group of experts in the financing of Small and Medium-sized Enterprises (SMEs), http://www.ebf-fbe.eu/uploads/D1093k%20Microfinance%20EU%20banking%20industry.pdf

In addition, especially in Western Europe, MFIs have serious problems of **self-sustainability**, since they heavily rely on subsidies or on shareholder contributions. MFIs predominantly receive their funding from public sources at EU, national or regional level. Furthermore, MFIs themselves, particularly the less mature ones, may lack the necessary competences to successfully develop their business, provide their services and demonstrate the necessary creditworthiness to attract private funding. As a result, these institutions often need **technical support for institutional capacity building**.

The first step in conducting a supply analysis for microcredit is to conduct a **market segmentation** identifying:

- The main typologies of MFIs in the country or region under consideration;
- The products they offer; and
- The clients they target.

This can be done based on the methodology presented in chapter 3. As already noted in chapter 3, while the supply analysis appears to be relatively easy to complete, the demand side is more difficult to assess. On the one hand, this is due to the market's own difficulty to conduct intensive analysis and to the lack of adequate marketing programmes that could gauge demand. On the other hand, as discussed in Chapter 11.1.2, the landscape of potential final recipients of microcredit products is very complex and heterogeneous. Demand assessment is easier for micro-enterprise lending than for social inclusion lending.

As regards micro-enterprise lending, it is necessary to consider the **population of existing and potential start-up and micro-enterprises** and the **portion of them unable to access mainstream financing**. The first piece of information can be retrieved from national or regional official statistical data, while the second can be estimated based on the rejection rate of loan applications by commercial banks (the General Methodology already provides a detailed description of the approach to estimate unrealised demand that applies also to microfinance).

When it comes to social inclusion lending, demand-side estimates become more challenging since, the potential clients mostly belong to the informal sector and are difficult to survey in order to assess their financing needs.

11.2.4 Operational tools

The principles detailed in Chapter 3 still apply. As a result, it is important to define a research strategy and to triangulate different sources of information in the way described in the Chapter 3.3 to obtain an estimate of the financing gap to be covered by the envisaged FI.

In addition to the sources already cited in Chapter 3, useful information can be found in the European Microfinance Network periodic surveys that provide an overview of the microcredit market in Europe. Moreover the already cited Access to Finance surveys published by the European Commission and the European Central Bank also include data on microenterprises.

As regards indicators and statistical data, it is important to consider the following indicators, if available[91]:

- Unemployment rate and long-term unemployment rate;
- People at risk of poverty or social exclusion;
- People at risk of poverty after social transfers;
- People living in households with very low work intensity;
- Severely materially deprived people;
- Population in a situation of financial exclusion;
- Readiness for self-employment; and
- Average number of companies created per year.

These indicators can be used to estimate the demand for microcredit instruments by unborn enterprises and potential entrepreneurs coming from socially excluded layers of the population. Such indicators can be retrieved either from national or regional statistics or from Eurostat.

Finally, as regards the other operational tools mentioned in the General Methodology, namely interviews and surveys, one important aspect to be taken into account is that significant technical support needs may arise from different stakeholders, particularly MFIs and micro-entrepreneurs. The stakeholders' perception of their technical support needs could be addressed as part of the interviews and/or surveys process.

Box 7: Example of demand assessment for social inclusion lending[92]

The following example details an approach to estimate the demand for an FI promoting social inclusion through entrepreneurship for a segment of the population at risk of poverty.
In line with the triangulation of sources approach this estimate should be accompanied by other information about demand.

Step 1: Identify the population at risk of poverty out of the economically active population
Economically active population is defined as the share of population that is either employed or looking for an employment. For the purpose of this demand assessment it seems possible to consider the number of citizens aged between 25-64 years. Data on the population at risk of poverty can be retrieved from the national official statistics or from Eurostat.

Step 2: Estimate the number of potential business creators
Based on international microfinance expert consultation (which could be cross-checked against other information when conducting the market assessment) around 45% of the population at risk of poverty can be considered as potential business creator and therefore potential demand for micro-loans devoted to self-employment business creation. Within this subgroup 3% (example; to be specified when conducting the market assessment) can be expected to start a credible entrepreneurial activity if suitable sources of finance are available. This share is to be considered as already net of the non-bankable initiatives.

Step 3: Estimate the potential financing need
National or EU microcredit statistics, information from other sources (e.g. surveys and expert interviews) and, if available, trends and forecasts will allow estimating the (current and potential future) average loan amount per client.
Multiplying this number by the estimated number of potential business creators would lead to an estimate of the financing need.

[91] See Guidelines for SME Access to Finance Market Assessments (GAFMA), section 5 "Recommendations for specific chapters"

[92] The example has been developed on the basis of the demand assessment for microfinance products carried out in the SME Financing Gap Assessment for Sweden prepared by the EIF in the framework of the JEREMIE initiative. See the GAFMA for a broader outline of a comparable approach. Further detail is available in the GAFMA Annexe "The executive toolbox for microcredit analysis".

11.2.5 Suboptimal investment situations

A situation of suboptimal investment exists when there is an investment gap between a quantitative EU (or national) objective and the current trend of the selected indicator. Indeed, despite an existing investment activity (which might represent an efficient allocation from a pure market perspective) this might be insufficient to achieve the politically set target. The missing investment amount to achieve the quantitative objective quantifies the suboptimal investment situation.

To give an example: Policy objectives in terms of unemployment rate are gaining importance and targets on (youth) unemployment are more and more common. An action to reduce unemployment is to foster self-employment and entrepreneurship.

When formalised in quantitative terms, policy objectives regarding unemployment rate reductions can be used as benchmark for measuring the suboptimal investment situation in some segments of the microcredit sector.

11.3 Assessment of the value added of the financial instrument

11.3.1 Analysing quantitative and qualitative dimensions of the value added for the financial instrument

After demonstrating the existence of a market failure due to a financing gap for micro-enterprises, the ex-ante assessment must focus on assessing the value added of an FI focusing on microcredit. The methodological steps and elements of analysis described in chapter 4 are valid for microcredit FIs as well. Nonetheless, when it comes to identifying the dimensions of value added, the following elements are particularly relevant for microcredit FIs:

- **Critical mass, effectiveness and cost efficiency** are generally crucial since microcredit is a market segment where a minimum scale needs to be achieved in order to attract private capital. Setting up an instrument using ESIF resources can help federating a larger number of local and regional intermediaries, thus mutualising their management and transaction costs and being able to reach a larger number of clients;

- The envisaged FI has to strike the right balance between two, potentially conflicting objectives, namely maintaining a focus on the specific needs identified in a market segment or in a region and achieving a sufficient diversification of the risk;

- ESIF support can help **build up the key competencies for local MFIs**, thereby increasing the supply and diversification of microcredit products. Over time this will improve the level of maturity and sophistication of microcredit intermediaries active in the country or region under consideration. This impact can be further enhanced through the provision of technical support to MFIs (e.g. for branch expansion, for setting up a more efficient management system); and

- **Direct and indirect economic and financial benefits,** such as job creation, the reduction of poverty and the fight against social and financial exclusion, also need to be evaluated. Appropriate consideration needs to be given to the fact that socio-economic impacts of microcredit are mostly local and mainly concentrated in the region in which the concerned MFIs operate. The analysis should test and demonstrate that revolving support can have a more sustainable long term impact than grants.[93]

[93] A detailed description of the methodology is available in Chapter 4 of the General Methodology.

11.3.2 *Identifying possible State aid implications*

In addition to what has been presented in the General Methodology and in Chapter 4.3 of this document, particular State aid considerations may be necessary for FIs targeting microcredit. As a matter of fact, *de minimis* rules require 50% collateral for loans And this can potentially be a blocking issue for microcredit FIs financed by public resources, both national and ESIF contributions. Alternatively it is possible to calculate the GGE of the FI, on the basis of the reference rate, although this may represent a serious challenge for microcredit providers, particularly non-bank providers, who often lack sufficient administrative capacity.

11.4 *Additional public and private resources*

As discussed in Chapter 5.1.1, the supply analysis will have already identified the main MFIs operating in the country or region under consideration. This phase of the ex-ante assessment should focus on identifying the synergies among them in order to gather the necessary resources to match the financing gap identified during the market assessment.

For both banking and non-banking MFIs, public intervention is necessary to bridge the financing gap. Additional public support can come at the EU, national and regional level. For instance, an FI focusing on microcredit can be jointly supported by the EIF, particularly through Progress Microfinance, national public banks (e.g. promotional or state-owned bank), cooperative banks, saving banks and other private MFIs.

Despite the Regulation which allows leveraging additional public and private sources at the level of the final recipient, this has little importance for the microcredit sector as the amounts needed are very limited.

The other elements of the ex-ante assessment as per Article 37 (2) CPR that have not been addressed in this chapter were not deemed to present any specificities with respect to the methodology provided for SMEs.

11.5 *Proposed investment strategy*

Details on the steps to be followed in order to develop a proposed investment strategy are presented in the General Methodology and Chapter 7 of this guidance. This paragraph focuses on the microcredit specificities related to the scale and focus of the envisaged FI.

When conducting an ex-ante assessment for an FI focusing on microcredit, special attention must be given to the definition of target final recipients and, as a consequence, to the type of financial products to be offered. As discussed in Chapter11.1.1, the characteristics of the main client group and the average volume of the loans provided allows distinguishing two main lending models for Micro Finance Institutions in Europe, namely **microenterprise lending** and **social inclusion lending**.

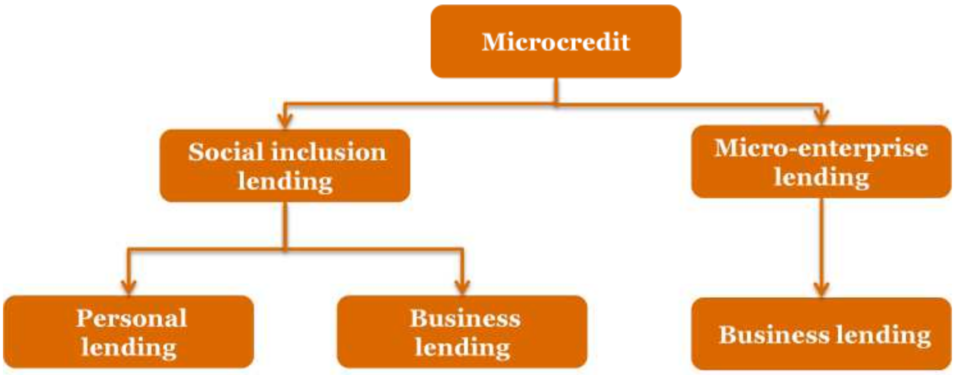
Social inclusion lending can be further classified in:

- **Business lending**, defined as a loan under 25,000 EUR to support the development of self-employment and microenterprises set up by financially excluded entrepreneurs; and
- **Personal lending**, defined as a loan under 25,000 EUR to cover a client's personal or consumption necessities, such as rent, personal emergencies, education, and personal consumption needs (e.g. white goods)[94].

[94] European Microfinance Network (2012), Overview of the microcredit sector in the European Union, http://www.european-microfinance.org/data/file/overview2010-2011-final.pdf

The dominant lending model of a MFI is connected to the number of loans the organisation disburses per year as well as to the longer or shorter term at which these loans are issued. Figure 8 below represents the classification of microcredit lending models.

Figure 8: Classification of microcredit lending models



Source: EMN, 2012

MFIs that implement the microenterprise lending model mostly provide loans to nearly bankable, microenterprises that have difficulties accessing loans below 25,000 EUR from mainstream finance institutions, due to risk aversion, lack of collateral and/or lack of credit history. The average value of the loans provided under microenterprise lending model is significantly higher than in the model of personal lending. These institutions typically provide guarantees and funded instruments, such as loans and equity. As a general rule, loans to micro enterprises generally have longer maturity (2-7 years) than social inclusion lending.

Social inclusion lending, on the other hand, focuses on lending to self-employed individuals excluded from banking services, due to their socioeconomic status. The clients of these institutions may be socially or financially excluded, for instance, long-term unemployed, ethnic minorities or young people. The average loan sizes are relatively low, meant to support basic income creating activities.

Loans are usually relatively short term, usually under 12 months with immediate regular weekly or monthly repayments. The loans are generally relatively small but the amounts lent can progressively increase as borrowers regularly repay their loans thus demonstrating their creditworthiness. MFIs focusing on social inclusion lending tend to have simplified and rapid application and disbursement procedures.

FIs active in the social inclusion lending have to concentrate on business lending (i.e. aiming at providing loans smaller than 25,000 EUR, tailored to micro-enterprises).

Micro and small companies represent more than 90% of all European businesses and 99% of start-ups in Europe are micro and small enterprises out of which one third is launched by formerly unemployed people[95].

One of the options available to MAs for the setting up of FIs focusing on microcredit in the programming period 2014-2020 is an EU-level FI into which ESI Funds can be invested.

95 Krämer-Eis, H. and Conforti, A. (2009), Microfinance in Europe. A market overview, Working paper 2009/001, EIF research & market analysis, http://www.eif.org/news_centre/publications/EIF_WP_2009_001_Microfinance.pdf, and Bruhn-Leon, B., Eriksson P.-E. and Krämer-Eis, H. (2012): Progress for Microfinance in Europe. EIF Working Paper 2012/13. http://www.eif.org/news_centre/publications/eif_wp_2012_13_microfinance.pdf

The **Employment and Social Innovation Programme (EaSI)**[96] will support Member States in the design and implementation of employment and social reforms. One pillar of this Programme is the European Progress Microfinance Facility that is an FI for microfinance and social enterprises.

The initial budget allocated to access to microfinance is €77.75 m. Guarantees, loans, equity and mezzanine to MFIs and other financial institutions should result in €400 m to €450 m of microloans.

For any other aspect please refer to the General Methodology and to the previous chapters dedicated to SME specificities.

11.5.1 Envisaged combination with grants

The combination with grants is an important consideration for microcredit FIs since, as discussed in the supply and demand analysis, both MFIs, especially the less mature ones, and micro-enterprises and potential entrepreneurs are likely to need technical support. MFIs may need grants for capacity building, particularly to establish financially sustainable business models and to demonstrate their creditworthiness to receive public and private financing.

As an example, the EIF, through the **JASMINE initiative**, helps MFIs active in the EU to improve the quality of their internal processes, to scale up their operations and to maximise the impact of microcredit products on microenterprises development and unemployment reduction. Selected MFIs have access to an institutional diagnosis, or an in-depth rating report performed by specialised rating agencies as well as advisory, tailor-made consulting and training offered to both management and staff to address the weaknesses identified during the institutional assessment.

Nevertheless, micro-entrepreneurs and potential entrepreneurs may need technical support, coaching, advisory services and training in order to ensure the success of their business. This is particularly true for socially excluded potential entrepreneurs. As already mentioned in Chapter 11.2.3, since different stakeholders may have different technical support needs, their perception could be collected during the stakeholder consultation process.

96 Further information available on the website: http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=1093&furtherNews=yes

12 *Specificities for the ex-ante assessment of financial instruments focused on the fisheries and aquaculture sector*

Articles 37 to 46 CPR apply to FIs established under all ESI Funds. The methodology for the analysis of the components of the ex-ante assessment in Article 37 (2) CPR in the fisheries and aquaculture sector is the same than in the agriculture sector, with the following specificities that need to be taken into account in setting-up FIs under the European Maritime and Fisheries Fund (EMFF).

Access to financing has always been costly and difficult for firms in the fisheries and aquaculture sector. In many Member States, the sector is considered by the financial sector as high risk in terms of lending and access to credit. In addition, firms are very small. The Commission estimates that at least 95% of firms in fisheries are microenterprises. Estimates suggest that 95% of aquaculture firms are SMEs (with at least 60% being microenterprises). Most firms in the processing sector are also SMEs. There are also a small number of large aquaculture (and processing) firms (notably in Greece, the UK and Spain) which are quoted on the stock exchange.

In fisheries, suppliers of consumables (fuel, bait, ice, etc.) have traditionally acted as sources of short term credit to fishermen (normally for the duration of the fishing trip). In addition, in some MS, specialized branches of local banks were important sources of financing. However, these sources of financing are progressively drying up under the current crisis and loan conditions are getting tougher. Thus, firms are increasingly dependent on own resources.

Under the 2007-2013 European Fisheries Fund (EFF), the aquaculture and processing sectors have received significant amounts of public support in the forms of grants (processing 17.4% and aquaculture 14.8% of EFF commitments). Calculations done by the Commission indicate that the leverage effects in these two sectors are significant. With regards to aquaculture, one Euro of EFF funding has a leverage effect of around EUR 1.68 of additional national funding, of which EUR 0.43 public and EUR 1.25 private. As for processing, one Euro of EFF support has a leverage effect of EUR 2.52 of additional national funding (EUR 0.52 public national and EUR 2 private). This means that public support, if well targeted, can be an effective way of generating greater leverage and helping firms to grow and become more competitive.

Given the limited uptake of FIs under the EFF in the 2007-2013, for the 2014-2020 period, setting up FIs in the fisheries and aquaculture sector under the EMFF will be a challenge for Managing Authorities located in often small fisheries administrations.

It will therefore be important to try to avoid setting up completely new sector-specific instruments, but rather build on existing national, regional or local FIs (sector-specific or other). Another alternative is to explore synergies with other FIs already set up in the ERDF, ESF or EAFRD, or to be established in the 2014-2020 period.

a) Consistency with the strategy of the Programme for the European Maritime and Fisheries Fund (EMFF Operational Programme):

Each EMFF OP is programmed on the basis of a strategic approach, including an assessment of the strengths, weaknesses, opportunities and threats, and taking into account the results of the needs assessment. The strategy of the EMFF OP therefore defines the priorities, objectives, targets and measures selected for achieving the goals. FIs for the fisheries and aquaculture sector should therefore be focused on the objectives set out in the strategy of the EMFF OP.

b) Consideration of EMFF-specific rules:

FIs set up under the EMFF should take care not to support ineligible operations, a full list of which is included in the EMFF. Examples include the construction of new fishing vessels or importation of fishing vessels. Other fund-specific rules in the EMFF set specific conditions for the application of measures (for engine replacement, start-up support for young fishermen, on-board training, permanent and temporary cessation) or set phasing out dates (2017 for permanent cessation; 2019 for storage aid).

Although all sizes of firms can be supported by the EMFF, support for firms other than SMEs in the processing sector can only be granted through FIs. Thus, demand for FIs in the fisheries and aquaculture sector under the EMFF will mostly likely be focused in the processing sector.

c) Sector specific State aid rules[97]:

State aid rules apply to aid granted by the Member States to enterprises in the fisheries and aquaculture sector, with the exceptions of payments made by MS pursuant to, and in conformity with the EMFF, within the scope of Article 42 of the Treaty. In addition, a Block Exemption Regulation establishes the conditions under which national provisions are exempted from the notification requirement of Article 108 (3) of the Treaty. Finally, a specific *de minimis* Regulation sets a national cap and individual ceilings per beneficiary below which aid measures are deemed not to meet all the criteria of Article 107 (1) TFEU. The Commission has also adopted guidelines on the examination of State aid to the sector.

[97] Further details in Chapter 4.3.2 of the General Methodology

13 *Ex-ante assessment completeness checklist*

No specificities to the general approach are foreseen under Thematic Objective 3 to the completeness checklist described in chapter 10 of the General Methodology. This checklist should be applied to FIs focusing on SMEs including microcredit, agriculture and fisheries.

Appendix A

Bibliography[98]

[98] This bibliography is to a large extent based on EIF's GAFMA.

- Akerlof, G. A. (1970): The Market for "Lemons": Quality Uncertainty and the Market Mechanism, Quarterly Journal of Economics 84 (3), 488–500.
- Arrow, K. J. (1985): The Economics of Agency, in: J. W. Pratt und R. J. Zeckhauser, Principals and Agents: The Structure of Business, Boston, 37–51.
- Bogliacino, F. and Luchese, M. (2011): Access to Finance for Innovation: The role of Venture Capital and the Stock Market. European Commission, Joint Research Centre, Institute for Prospective Technological Studies. IPTS Working Paper on Corporate R&D and Innovation No. 5/2011. November 2011.
- http://iri.jrc.es/papers/WP%2005-2011%20final.pdf
- Bondonio & Martini (2012): Counterfactual Impact Evaluation of Cohesion Policy: Impact, cost-effectiveness and additionality of investment subsidies in Italy, for DG Regional and Urban Policy.
- Breedon, T. et al. (2012): Boosting finance options for business. Taskforce to boost finance options for business. March 2012. http://www.bis.gov.uk/assets/biscore/enterprise/docs/b/12-668-boosting-finance-optionsfor-business.pdf
- Bruhn-Leon, B., Eriksson P.-E. and Krämer-Eis, H. (2012): Progress for Microfinance in Europe. EIF Working Paper 2012/13. http://www.eif.org/news_centre/publications/eif_wp_2012_13_microfinance.pdf
- Da Rin, M., Hellmann, T. and Puri, M. (2011): A survey of venture capital research. TILEC Discussion Paper No. 2011-044, CentER Discussion Paper No. 2011-111, and NBER Working Paper No. 17523. October 2011. (Forthcoming in Constantinides, G. et al. (eds.): Handbook of the Economics of Finance, Vol. 2, Amsterdam, 2012.) http://www.nber.org/papers/w17523.pdf
- Deakins D., Roth D., Baldock R., Whittam G., (2008): SMEs Acces to Finance: Is there still a debt finance gap? Institute for Small Business & Entrepreneurship.
- Dutta, S. (2012): The Global Innovation Index 2012. http://www.wipo.int/export/sites/www/freepublications/en/economics/gii_2012.pdf
- ECB (2012). Euro area MFI interest rate statistics: February 2012. Press release. 3 April 2012. http://www.ecb.eu/press/pdf/mfi/mir1204.pdf
- Economisti Associati et al (2011a): Combined ex-ante evaluation and impact assessment of the successor to the Entrepreneurship and Innovation Programme under the Competitiveness and Innovation Framework Programme 2007-2013, Final Report, 24.5.2011.
- Economisti Associati et al (2011b): Combined ex-ante evaluation and impact assessment of the successor to the Entrepreneurship and Innovation Programme under the Competitiveness and Innovation Framework Programme 2007-2013, Final Report, Annex A: Component #1 – financial instruments, 24.5.2011.
- Ecorys (2012): EU SMEs in 2012: at the crossroads. Annual report on small and medium-sized enterprises in the EU, 2011/12, Report prepared for the European Commission.
- Eurobarometer (2005): Flash Eurobarometer Survey No. 174, "SME Access to Finance", October 2005.
- Eurobarometer (2009): Flash Eurobarometer Survey No. 271, "Access to finance", September 2009.
- European Banking Federation (2010), Microfinance within the EU banking industry: policy and practice, Report written by the European Banking Federation's Working Group of experts in the financing of Small and Medium-sized Enterprises (SMEs). http://www.ebf-fbe.eu/uploads/D1093k%20Microfinance%20EU%20banking%20industry.pdf
- European Central Bank (2013): Survey on the access to finance of small and Medium-sized enterprises in the euro area. http://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html
- European Commission (2005): DG Enterprise and Industry: Best practices of public support for early-stage equity finance, Final report of the expert group, September 2005. http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=1202

- European Commission (2007): Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions "A European initiative for the development of micro-credit in support of growth and employment", COM(2007) 708 final. http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0708en01.pdf
- European Commission (2008): Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Think Small First - A Small Business Act for Europe (COM(2008) 394 of 23.6.2008).
- European Commission (2008), Financial services provision and prevention of financial exclusion, DG EMPL.
- European Commission (2011): Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: Review of the "Small Business Act" for Europe (COM(2008) 78 final, 23.2.2011).
- European Commission (2011): The added value of the EU budget, Commission Staff Working Paper accompanying the document "Commission Communication: A budget for Europe 2020", SEC(2011) 867 final.
- European Commission (2012): What are counterfactual impact evaluations teaching us about enterprise and innovation support? Regional Focus series 02/2012. http://ec.europa.eu/regional_policy/sources/docgener/focus/2012_02_counterfactual.pdf
- European Commission (2012), Factsheet - Financial Instruments in Cohesion Policy 2014-2020. http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/financial_instruments_en.pdf
- European Commission (2012): Report from the Commission to the European Parliament and the Council on the application of Directive 2006/48/EC to microcredit, COM(2012) 769 final. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0769:FIN:EN:PDF
- European Commission (2012): Proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006. COM(2011) 615 final/2. Brussels, 14.3.2012. http://ec.europa.eu/esf/BlobServlet?docId=233&langId=en
- European Commission (2013): Summary of data on the progress made in financing and implementing financial engineering instruments reported by the managing authorities MAs in accordance with Article 67 (2) (j) of Council Regulation (EC) No 1083/2006. Programming period 2007-2013 (situation as at 31 December 2012).
- European Commission (2013): Regional policy for smart growth of SMEs - Guide for MAs and bodies in charge of the development and implementation of RIS3. http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/sme_guide/sme_guide_en.pdf
- European Commission (2013): EU Farm economics 2012 based on FADN data. http://ec.europa.eu/agriculture/rica/pdf/EU_farm_economics_2012.pdf
- European Commission (2013), Guidance on Ex Ante Conditionalities PART II. http://ec.europa.eu/regional_policy/what/future/pdf/preparation/part2_guidance_ex-ante_conditionalities_guidance.pdf
- European Commission (2013): Thematic guidance fiche No. 3 – Competitiveness of Small and Medium-sized Enterprises (SMEs), Version 1 22/04/2013.
- European Commission and EIB (2013), Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period.

- European Court of Auditors (2012a): Opinion No 7/2011. On the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006. Official Journal of the European Union.
- European Court of Auditors (2012b): Special Report No 2/2012. Financial instruments for SMEs co-financed by the European Regional Development Fund. http://eca.europa.eu/portal/pls/portal/docs/1/13766742.PDF
- European Investment Bank (2014): Ex-ante assessment methodology for Financial Instruments in the 2014 – 2020 programming period – Volume I - General methodology for ex-ante assessments covering all thematic objectives.
- European Investment Bank (2014): Ex-ante assessment methodology for Financial Instruments in the 2014 – 2020 programming period – Volume II - Strengthening research, technological development and innovation (Thematic Objective 1).
- European Investment Bank (2014): Ex-ante assessment methodology for Financial Instruments in the 2014 – 2020 programming period – Volume IV - Supporting the shift towards Low Carbon economy (Thematic Objective 4).
- European Investment Bank (2014): Ex-ante assessment methodology for Financial Instruments in the 2014 – 2020 programming period – Volume V - Integrated approaches to territorial development, including financial instruments for urban development.
- European Investment Fund (2007): SME Access to Finance in Sweden. Final Evaluation Study, JEREMIE. Mimeo.
- European Investment Fund (2009): Executive Summaries of Evaluation Studies on SME Access to Finance in EU Member States/Regions carried out by EIF in the Context of the JEREMIE (Joint European Resources for micro to medium enterprises) Initiative from 2006 to 2008. 1 March 2009. http://ec.europa.eu/regional_policy/archive/funds/2007/jjj/doc/pdf/jeremie_sme_access.pdf
- European Investment Fund (2014): SME Access to Finance Market Assessment for Bulgaria. Mimeo.
- European Investment Fund (2014): SME Access to Finance Market Assessment for Rhône-Alpes. Mimeo.
- European Microfinance Network (2012): Overview of the microcredit sector in the European Union. http://www.european-microfinance.org/data/file/overview2010-2011-final.pdf
- European Network for Rural Development (2012): Final Report on the ENRD Rural Entrepreneurship Thematic Initiative: Rural Finance, Final Version, 28th March, 2012. http://enrd.ec.europa.eu/themes/entrepreneurship/rural-finance/en/rural-finance_en.cfm
- European Network for Rural Development (2012): Rural development financial instruments: New opportunities to tackle the economic crisis, in: EU Rural Review, Autumn 2012. http://enrd.ec.europa.eu/publications-and-media/eu-rural-review/en/eu-rural-review_en.cfm
- Government of Canada (2002): "Gaps in SME Financing: An Analytical Framework". SME financing data initiative, February 2002.
- Groh, A., Liechtenstein, H. and Lieser, K. (2011): The Global Venture Capital and Private Equity Country Attractiveness Index, 2011 annual, IESE Business School, University of Navarra.
- Grünfeld, L.A., Iversen, L.M. and Grimsby, G. (2011): The need for government supported capital measures in the market for early stage risk capital in Norway. Menon Business Economics. Publication no. 18/2011. October 2011.
- Huerga, J., Puigvert, J. and Rodriguez, C. (2012): Enhancements on ECB MFI Interest Rate Statistics. In: OECD - The Statistics Newsletter. Issue No. 55. March 2012. http://www.oecd.org/dataoecd/26/34/49803839.pdf
- International Finance Corporation (2011): G-20 SME Finance Policy Guide. http://www.ifc.org/wps/wcm/connect/f3ef82804a02db409b88fbd1a5d13d27/G20_Policy_Report.pdf?MOD=AJPERES

- Jansson, K.H., Huisman, C.J., Lagerkvist, C.J., Rabinowicz, E. (2013):Agricultural Credit Markets Institutions - A comparison of Selected European Countries, Factor Markets Working Paper n 33. http://www.ceps.be/book/agricultural-credit-market-institutions-comparison-selected-european-countries
- Jayo, B. et al. (2010): Overview of the Microcredit Sector in the European Union, EMN Working Paper no 6, July 2010.
- Krämer-Eis, H. and Conforti, A. (2009): Microfinance in Europe. A market overview, Working paper 2009/001, EIF research & market analysis. http://www.eif.org/news_centre/publications/EIF_WP_2009_001_Microfinance.pdf
- Krämer-Eis, H., Lang, F. and Kyriakopoulos, A. (2012). European Small Business Finance Outlook 1/2012. EIF Research & Market Analysis. Working Paper 2012/14. May 2012. http://www.eif.org/news_centre/research/eif_wp_2012_14_esbfo-may2012_fv.pdf
- Krämer-Eis, H. and Lang, F. (2012). The Importance of Leasing for SME Finance. EIF Research & Market Analysis. Working Paper 2012/15.
- Krämer-Eis, H. and Lang, F. (2014): Guidelines for SME Access to Finance Market Assessments (GAFMA). EIF Working Paper. Forthcoming Q2/2014.
- Kuntchev, V., Ramalho, R., Rodriguez-Meza, J. and Yang, J.S. (2012). What have we learnt from the Enterprise Surveys regarding access to finance by SMEs. 14.02.2012. http://www.enterprisesurveys.org/~/media/FPDKM/EnterpriseSurveys/Documents/Research%20Papers/Enterprise-Surveys-access-to-finance-and-SME.pdf
- OECD (2000): Small and Medium-sized Enterprises: Local Strength, Global Reach. OECD Policy Brief. June 2000. http://www.oecd.org/dataoecd/3/30/1918307.pdf
- OECD (2006). Financing SMEs and Entrepreneurs, OECD Policy Brief, November 2006.
- OECD (2006). The SME Financing Gap, Vol. 1, Theory and Evidence.
- OECD (2006). The SME Financing Gap, Vol. 2, Proceedings of the Brasilia Conference, 27-30 March 2006.
- OECD, 2008; Rural Policy Reviews: Scotland UK – Assessment and Recommendations.
- OECD (2013). Entrepreneurship at a Glance 2013. OECD Publishing.
- OECD (2013): Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard. OECD Publishing.
- Petrick, M., Kloss,.M (2013): Exposure of EU Farmers to the Financial Crises, in Choices - Magazine of food, farm and resource issues, 2nd Quarter 2013. http://www.choicesmagazine.org/choices-magazine/theme-articles/the-eurozone-crisis-and-its-implications-for-agriculture-in-selected-regions-of-the-world/exposure-of-eu-farmers-to-the-financial-crisis
- PwC (2012), Risk Sharing Finance Facility (RSFF): New Ways to Finance Innovative Mid-Caps Growth Capital, report prepared for the European Investment Bank.
- Roxburgh, C., Lund, S., Dobbs, R., Manyika, J. and Wu, H. (2011). The emerging equity gap.
- Growth and stability in the new investor landscape. McKinsey Global Institute. http://www.mckinsey.com/Insights/MGI/Research/Financial_Markets/Emerging_equity_gap
- Schwab, K. (2011): The Global Economic Competitiveness Report. World Economic Forum. http://www.weforum.org/issues/global-competitiveness
- Shane S. and Cable D. (2002), Network Ties, Reputation, and the Financing of New Ventures, Management Science, Vol. 48, Issue 3, March 2002.
- Stein, P., Goland, T. and Schiff, R. (2010). Two trillion and counting. Assessing the credit gap for micro, small, and medium-size enterprises in the developing world. World Bank Group, International Finance Corporation (IFC) and McKinsey & Company. October 2010. http://mckinseyonsociety.com/downloads/reports/Economic-Development/Two_trillion_and_counting.pdf
- Stiglitz, J. and Weiss, A. (1981): Credit Rationing in Markets with Incomplete Information.American Economic Review, vol. 71, no. 3, pp. 393-410.
- Thomson Reuters Foundation (2011): Creating Jobs in Europe: Legal and Regulatory Frameworks of Microenterprises and Microcredit in Europe.

- Tykvová, T., Borell, M. and Kroencke, T.-A. (2012): Potential of Venture Capital in the European Union. European Parliament (Directorate-General for Internal Policies. Policy Department A, Economic and Scientific Policies. Policy Area Industry, Research and Energy). http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=66851.
- UEAPME Study Unit (2011). The EU Craft and SME Barometer 2011/H2.
- Venturelli, V. and Gualandri, E. (2008). Assessing and measuring the equity gap and the equity requirements for innovative SMEs. The Global Economy and Finance Journal, Vol. 1, No. 1, March 2008, pp. 87-95.
- Veugelers, R. (2011). Mind Europe's early equity gap. Bruegel policy contribution. Issue 2011/18.
- World Intellectual Property Organization (2012): International Patent Filings Set New Record in 2011. http://www.wipo.int/pressroom/en/articles/2012/article_0001.html.
- World Bank (2013): Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises, Published October 25, 2013.

Appendix B

Data sources for indicators and statistics for SME financing supply and demand

Table 5: Sources for indicators and statistical data[99]

	Data source	Description	Responsible
Indicators and statistical data	**Structural business indicators**	Indicators concerning access to finance	Eurostat http://epp.eurostat.ec.europa.eu/portal/page/portal/european_business/introduction
	Data on Access to Finance	Links to data and additional statistics from other sources related to the access to finance of SMEs	European Commission http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm
	Better access to Finance	Available instruments and additional information regarding access to finance	European Commission http://ec.europa.eu/enterprise/policies/finance/index_en.htm
	Global Entrepreneurship Monitor.	Indicators on entrepreneurship	http://www.gemconsortium.org
	Global Venture Capital and Private Equity Country Attractiveness Index	Broad range of indicators useful to assess the market maturity and possible market weaknesses. Indicators concerning the loan market, the environment for entrepreneurs in general and for start-ups in particular. Data for 80 countries, including 18 in Eastern Europe and 17 in Western Europe (including comparisons within peer groups).	Groh, A. et al., 2011 http://blog.iese.edu/vcpeindex/
	Doing Business	Measures of business regulations for SMEs in 183 economies and selected cities at the sub-national level.	http://www.doingbusiness.org/
	Global Innovation Index 2012	Innovation-related data for more than 140 countries including country comparisons.	http://www.wipo.int/export/sites/www/freepublications/en/economics/gii_2012.pdf
	The Global Economic Competitiveness Report.	Country performances and rankings including indicators concerning the innovation environment.	Schwab, K. (2011): World Economic Forum. http://www.weforum.org/issues/global-competitiveness

99 This table is an update of sources mentioned in the GAFMA.

	Data source	Description	Responsible
	Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard	Indicators on SME financing and related scoreboards for particular countries (Denmark, Finland, France, Hungary, Italy, The Netherlands, Portugal, Slovak Republic, Slovenia, Sweden, Switzerland, and the United Kingdom).	OECD http://www.oecd-ilibrary.org/industry-and-services/financing-smes-and-entrepreneurs-2013_fin_sme_ent-2013-en
	Entrepreneurship at a Glance 2013	Entrepreneurship indicators, including access to finance. This publication contains also cross country comparisons	OECD http://www.oecd-ilibrary.org/industry-and-services/entrepreneurship-at-a-glance-2013_entrepreneur_aag-2013-en
Surveys	**Survey on the access to finance of SMEs in the Euro area**	Aggregated results for the Euro area Country specific data for eleven euro area member states and for various enterprise size classes. General sub-statistics (e.g. most pressing problems of SMEs) which give insight into the situation of SMEs in a particular country Details on SMEs' behaviour with respect to different financing sources.	ECB and European Commission http://www.ecb.de/stats/money/surveys/sme/html/index.en.html
	Eurobarometer surveys	Insights into the intended use of different financial instruments by final beneficiaries.	European Commission http://ec.europa.eu/public_opinion/index_en.htm

Table 6: Examples of data sources for different market segments

Financial product	Supply	Demand
Short-term loans, bank overdrafts and credit lines	MFI interest rate statistics on ECB website	
Medium and long-term loans	National banking statistics, ECB Bank Lending Survey and SAFE	
Leasing	Leaseurope	Outstanding volume of leased objects Penetration rate (new leasing volume/GDP)
Factoring	International Factors Group	Penetration rate
Export credit		Export statistics (Berne Union, OECD, EC)
Guarantees (including export guarantees)	European Mutual Guarantee Association (AECM)	
Venture capital and growth capital	European Venture Capital Association (EVCA) and national venture capital associations	Venturelli and Gualandri paper[100]
Technology Transfer Funds	EU scoreboard on Innovation Performance Global Competitiveness Index (World Economic Forum)	
Business angel financing	European Business Angel Network	

[100] Venturelli V. and Gualandri E. (2008): Assessing and measuring the equity gap and the equity requirements for innovative SMEs, The Global Economy and Finance Journal Vol I. No 1 March 2008, pp. 87-95

Appendix C

Example of a supply side interview

Interview guide for supply side representatives

This interview guidance aims to facilitate the collection of data and information on the available supply of SME finance. Potential interviewees include public and private entities such as banks, micro credit institutions, incubators, accelerators, pension funds, insurance funds, business angels and leasing companies.

The actual list of interviewees should be tailored to cover the full spectrum of potential financing sources for SMEs in the region or country under consideration.

Part 1: Interviewee's investments in SMEs

1. Could you please briefly describe the three main solutions currently offered to SMEs?
   a. What is the volume invested for each solution and your capacity for the next three years?
   b. What are the eligibility criteria for each solution?
   c. Are you adopting a single or multi-player approach? If you apply a multi-player approach which actors do you involve in the process (co-investment)?

The table below provides illustrative options for answers:

Description	Equity, debt, hybrid, guarantee, other
Volume	Amount of present and future supply (in number of loans and nominal value of loans)
Eligibility criteria	e.g. size of investment and company, sector, location, type of investment (target activities / objectives), (personal) collateral
Key challenges and obstacles	e.g. cost, market acceptance, legal complexity, expectations for guarantees, risk profile
Approach	Single or multi-player

2. What are the key Strengths, Weaknesses, Opportunities and Threats of the current funding offer to SMEs?

3. What are some of the reasons why you declined to make investments (e.g. related to management, product, commercial considerations)?

4. What specific obstacles do you face as a venture capitalist / bank / promotional bank / agency investing in your region or country as a whole (e.g. cost, market acceptance, legal complexity, expectations for guarantees, risk profile, better conditions outside your country)?

Part 2: Market trends and challenges

1. How would you quantify the market demand for financing SMEs in your region or country? How many companies in your territory fit into your potential pipeline?
2. Which sectors would you say are most likely to experience a growth in demand in your region or country? What would be the most likely objectives or target areas for investment?
3. In which geographical area do you foresee the most significant growth in the future?
4. What are the key challenges for funding SMEs?
5. In your region or country, what are the emerging trends in SME financing in terms of:
   a) Instruments from the private sector
   b) Instruments and mechanisms from the public sector
   c) Policy framework
6. Is market demand higher than the current supply? Is there a funding gap in your region or country?

Part 3: Prospective solutions

1. Which are the most effective models to fund SMEs?
2. How do you see the role of public sector funding for supporting SME funding?
3. Is there a market need in your country or region for specific instruments for SMEs? If you were to define an ideal vehicle to put in place for SMEs tomorrow what would its characteristics be?

Appendix D

Example of policy maker interview

Interview guide for supply side representatives

This interview guidance aims to facilitate the collection of data and information on the available supply of SME finance. Potential interviewees include public and private entities such as banks, micro credit institutions, incubators, accelerators, pension funds, insurance funds, business angels and leasing companies.

The actual list of interviewees should be tailored to cover the full spectrum of potential financing sources for SMEs in the region or country under consideration.

Part 1: Market trends and challenges

1. How would you quantify the market demand for financing SMEs in your region or country? How many companies in your territory fit into your potential pipeline?
2. Which sectors would you say are most likely to experience a growth in demand in your region or country? What would be the most likely objectives or target areas for investment?
3. In which geographical area do you foresee the most significant growth in the future?
4. What are the key challenges for funding SMEs?
5. In your region or country, what are the emerging trends in SME financing in terms of:
   d) Instruments from the private sector
   e) Instruments and mechanisms from the public sector
   f) Policy framework
6. Is market demand higher than the current supply? Is there a funding gap in your region or country?

Part 2: Prospective solutions

1. Which are the most effective models to fund SMEs?
2. How do you see the role of public sector funding for supporting SME funding?
3. Is there a market need in your country or region for specific instruments for SMEs? If you were to define an ideal vehicle to put in place for SMEs tomorrow what would its characteristics be?

Appendix E

Survey structure for demand side

This interview guidance aims at facilitating the collection of data and information on the demand for financing by SMEs. The actual list of interviewees should be tailored to cover the full spectrum of SMEs potentially applying for finance in the region or country under consideration.

1. *In which region is your company based?*

2. *In which sector does your business primarily operate?*

3. *What is the legal form of your business?*

4. *In which year was your business first established?*

5. *How was your company started?*

- Personally started the business;
- Took over from an existing business;
- Took over from family;
- Spin-off from another company;
- Bought an existing business;
- Spin-off from a University or a research institution project; and
- Other.

6. *Would you consider your business as a start-up? A start-up is a young company with a high potential for growth and job creation. (Please indicate Yes or No)*

7. *What is the current stage of development of your business?*

- Seed [business model created, no commercial production];
- Start-up [prospecting, production not commercialised];
- Post-creation [activities started, no profits];
- Expansion / development [development of profitable activities];
- Maturity [stable commercial activities with low or no growth];
- Redeployment; and
- Buyout / transmission.

8. *Please indicate if you have any of the following staff (Please indicate Yes or No)*

- CEO / Managing Director;
- COO / Head of Operations;
- CFO / Head of Finance;
- Human Resources Director;
- Director for Legal Affairs; and
- CIO / Head of IT.

9. *Over the last three years (this year, last year and two years ago), how many full-time equivalent (FTEs) were working in your company on average?*

- 0 and 9 employees;
- 10 and 49 employees; and
- 50 and 249 employees.

10. *What was the majority ownership situation of your business at the beginning of the last three years (this year, last year and two years ago)?*

- Sole proprietor, family and friends;
- Subsidiary of a national company;
- Subsidiary of a foreign company;
- Private equity, i.e. the provision of capital and management expertise to companies in order to create value and generate capital gains after a medium to long holding period;
- Partnership; and
- Listed company.

11. *Please provide us with the following financial information regarding your business for the last two years (last year and two years ago):*

- Sales;
- Cash;
- Total Assets;
- Total Long-Term Debt;
- Total Short-Term Debt;
- Grants; and
- Proportion of domestic market as compared to international market (% of sales).

12. *Over the last three years (this year, last year and two years ago), which source(s) of funding has your company used?*

- Short-term loans, bank overdrafts and credit lines;
- Medium and long-term loans;
- Public bank loans;
- Family and / or friends;
- Investments by the owner(s);
- Private grants or donations;
- Government grants;
- Public institutions supporting investments (through commercial banks, for instance interest subvention);
- Leasing / renting companies;
- Factoring;
- Guarantees (including export guarantees);
- Venture capital funds, i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses;
- Technology transfer funds;

- Business angels, i.e. entrepreneurs (usually individual entrepreneurs) who provide capital for a business start-up, usually in return for owning part of the business;

- Replacement, rescue / turnaround and buyout capital;

- Mezzanine or hybrid financing, i.e. loan financing that gives the lender the rights to convert to an equity interest in the business if the loan is not fully repaid on time;

- Private investors;

- Retained earnings;

- Equity investment (including quasi-equity products);

- Corporate bonds;

- Microcredit; and

- Not Applicable: Our company did not use any source of funding.

13. *How much of loan and equity funding did you SEEK during the last three years (this year, last year and two years ago) in Euro?*

- Loan (all types of credit including microcredit); and
- Equity finance (all types of equity and quasi-equity financing).

14. *How much of loan and equity funding did you OBTAIN during the last three years (this year, last year and two years ago) in Euro?*

- Loan (all types of credit including microcredit); and
- Equity finance (all types of equity and quasi-equity financing).

15. *How successful were you in obtaining each type of the products listed below over the last three years (this year, last year and two years ago)? (Please indicate the level of success for each of the following sources: Successful, Partially successful or Unsuccessful)*

- Short-term loans, bank overdrafts and credit lines;

- Medium and long-term loans;

- Leasing;

- Factoring;

- Subsidised loans;

- Subsidies by the government (government grants);

- Foreign government bodies or international organisations;

- Trade credits (by suppliers);

- Advanced payments (by customers);

- Guarantees (including export guarantees);

- Venture capital funds, i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses;

- Technology transfer funds;
- Business angels, i.e. entrepreneurs (usually individual entrepreneurs) who provide capital for a business start-up, usually in return for owning part of the business;
- Replacement, rescue / turnaround and buyout capital;
- Mezzanine or hybrid financing i.e. loan financing that gives the lender the rights to convert to an equity interest in the business if the loan is not fully repaid on time;
- Equity; and
- Microcredit.

16. *What were the reasons / needs for the financing means you sought over the last three years (this year, last year and two years ago)?*

- Finance working capital;
- Ensure debt consolidation;
- Acquire another company;
- Acquire land / building;
- Acquire machineries / equipment;
- Launch a new product / service;
- Develop international activities / enter a new market (geographic expansion);
- Finance export sales;
- Finance R&D and innovation; and
- Not Applicable: Our company did not seek for funding.

17. *How did the following factors change over the last three years (between two years ago and this year)? (Please indicate your answers in Much worse, Worse, Unchanged, Better, Much better, No opinion)*

- The financial situation of your business;
- The cost (interest and other) of obtaining finance for your business;
- The debt / turnover ratio of your business;
- Other terms or conditions of finance (e.g. loan maturity, collateral levels, covenants, guarantee, conditions, duration, etc.);
- The burden of effort of obtaining finance for your business; and
- The willingness of banks to provide finance.

18. *When asking for finance during the last three years (this year, last year and two years ago), according to you, what were the reason(s) behind the difficulties you experienced? (Please indicate one or more of the options listed below)*

- The financial situation of your business;
- The cost (interest and other) of obtaining finance for your business;
- The debt / turnover ratio of your business;
- Other terms or conditions of finance: loan maturity, collateral levels, covenants, guarantee, conditions, duration, etc.;

- The burden or effort in obtaining finance for your business;
- The lack of capability of your team to find the best option;
- The lack of equity investors;
- The difficulty for you to fulfill the applications requirements;
- The lack of willingness of banks to provide finance; and
- Not Applicable: Our company did not experience any difficulty.

19. *Over the last three years (this year, last year and two years ago), have you ever felt discouraged in seeking finance? (Please indicate Yes or No)*

20. *How successful were you in obtaining loan finance from each of the following sources over the last three years (this year, last year and two years ago)? (Please indicate the level of success for each of the following sources: Successful, Partially successful or Unsuccessful)*

- The owner(s) / director(s);
- Other employees of your business;
- Family, friends or other individuals outside your business;
- Other businesses;
- Commercial banks;
- Development banks;
- Public entity (national, regional or city); and
- Not Applicable: Our company did not request loan financing in these years.

21. *Over the last three years (this year, last year and two years ago), how did you guarantee your loan? (Please indicate one or more of the options listed below)*

- Owner collaterals;
- Family and friends;
- Company collaterals;
- Business partners;
- Mutual guarantee schemes such as cooperatives;
- Other guarantee schemes fully or partly provided by the government (any level);
- Financial institution; and
- Not Applicable: Our company did not use loan financing or did not guarantee its main loan in these years.

22. *Over the last three years (this year, last year and two years ago), which were the reasons for being unsuccessful - or partially unsuccessful - in receiving loan financing? (Please indicate one or more of the options listed below)*

- Poor credit rating;
- Lack of own capital;
- Insufficient collateral or guarantee;

- Insufficient or risky potential (of the business or project);
- Already too many loans or too much debt;
- No loan history;
- Poor loan history;
- No reason given;
- Interest rates were too high;
- Non-interest-rate related conditions of the loan were inacceptable (e.g. maturity, covenants); and
- Not Applicable: Our company did not request loan financing or was successful in receiving loan financing in these years.

23. *Did you experience changes in bank financing terms and conditions in the past 12 months? (Please indicate any changes in the bank's terms and conditions - of any – Increased, Unchanged or Decreased).*

- Level of interest rates;
- Level of cost of financing (other than interest rate);
- Available size of the loan / credit line;
- Available maturity of the loan;
- Collateral requirements; and
- Loan covenants / Information requirements, etc.

24. *Over the last three years (this year, last year and two years ago), what sources for equity finance did you use?*

- Existing shareholders;
- Directors not previously shareholders;
- Other employees of your business;
- Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses;
- Business angels i.e. entrepreneurs (usually individual entrepreneurs) who provide capital for a business start-up, usually in return for owning part of the business;
- Mezzanine or hybrid financing i.e. loan financing that gives the lender the rights to convert to an equity interest in the business if the loan is not fully repaid on time;
- Family, friends or other individuals, not any of the above;
- Initial Public Offering (IPO) or other stock market offerings i.e. the first issue of shares by a private company to the public in order to generate capital;
- Banks;
- Other financial institutions e.g. finance houses and subsidiaries of banks;
- Other businesses;

- Government;
- Other equity finance source; and
- Not Applicable: Our company did not seek for equity finance in these years.

25. *If you have not opted for equity financing over the last three years (this year, last year and two years ago), could you please indicate the reasons?*

- Existing shareholders did not feel able to subscribe for more shares;
- New investors asked for too much equity in exchange for the funds offered;
- New investors were asking for too many concessions / control in exchange for equity finance;
- New investors felt the development potential of the business was insufficient or too risky;
- New investors felt that the business had too many debts;
- Absence of equity investment in my sector;
- Absence of equity investment in my region / country;
- None of the above; and
- Not Applicable: Our company opted for raising equity finance.

26. *Would you be willing to give a seat in your Board in order to raise equity? (Please indicate Yes or No)*

27. *Over the last three years (this year, last year and two years ago), have you ever been in contact with…*

- A commercial bank proposing you a EU FI;
- A commercial bank proposing you a bank loan;
- A public bank;
- A bank proposing private equity financing;
- A national programme;
- A regional programme;
- Business angels;
- Venture capitalists;
- Incubators;
- Accelerators;
- JEREMIE fund; and
- None of the above.

28. *Have your ever raised funds (debt, equity or other types of finance) from a financial institution located…? (Please indicate Yes or No)*

- Outside your region but within your Country;
- Outside your country but within the European Union; and
- Outside the European Union.

29. *Do you feel you have sufficient access to the following financial products? (Please indicate Yes or No)*

- Bank guarantees;
- Debt financing;
- Equity financing;
- Hybrid financing; and
- Venture capital.

30. *Please rank your preferred form of financing.*

- Bank guarantees;
- Debt financing;
- Equity financing;
- Hybrid Financing; and
- Venture Capital.

31. *To what extent did you feel comfortable in fulfilling the following requirements? (Felt comfortable, Needed assistance, Had no capacity)*

- Filling in the application forms;
- Fulfilling the administrative information;
- Meeting specific requirements; and
- Preparing your business plan.

32. *Did you have to pay unexpected fees to secure funding? (Please indicate Yes or No)*

33. *To what extent, do you face a lack of transparency or scarce information when looking for finance?*

34. *Considering all kinds of financing, to what extent are the complexity and the cost of procedures a barrier to ask for financing?*

35. *When looking for finance, do you feel you lacked support from: (Please indicate Yes or No)*

- Your region / city;
- The government;
- Public financial institutions;
- Guarantee fund;
- Development banks;
- Equity funds;
- Business angels;
- Commercial banks; and
- Chamber of commerce.

36. *Do know the following initiatives supporting SME in your Country/Region? (Please indicate Yes or No)*

37. *Did you encounter any illegal practices during the development of your business? (Please indicate Yes or No)*

38. *What volume of each of the following financing sources do you envisage to ask for during each of the NEXT three years (next year, in one year, in two years) in Euro?*

- Short-term loans, bank overdrafts and credit lines;

- Medium and long-term loans;

- Leasing;

- Factoring;

- Subsidised loans;

- Subsidies by the government (government grants);

- Foreign government bodies or international organisations;
- Trade credits (by suppliers);
- Advanced payments (by customers);
- Guarantees (including export guarantees);
- Venture capital funds, i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses;
- Technology transfer funds;
- Business angels, i.e. entrepreneurs (usually individual entrepreneurs) who provide capital for a business start-up, usually in return for owning part of the business;
- Replacement, rescue / turnaround and buyout capital;
- Mezzanine or hybrid financing i.e. loan financing that gives the lender the rights to convert to an equity interest in the business if the loan is not fully repaid on time;
- Equity; and
- Microcredit.

39. *What would be the purpose of this funding for the NEXT three years (next year, in one year, in two years)?*

- Finance working capital;
- Ensure debt consolidation;
- Acquire another company;
- Acquire land / building;
- Acquire machineries / equipment;
- Launch a new product / service;
- Develop international activities / enter a new market (geographic expansion);
- Finance export sales;
- Finance R&D and innovation; and
- Not Applicable: Our company does not envisage to ask for funding in these years.

40. *From what different sources do you plan to secure your future funding over the NEXT three years (next year, in one year, in two years)? (Please indicate the five most relevant finance sources)*

- The owner(s) / director(s) of your business;
- Other employees of your business;
- Family, friends or other individuals outside your business, excluding business angels;

- Other businesses;
- Leasing companies;
- Commercial banks;
- Public banks;
- Other financial institutions;
- Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses;
- Business angels i.e. entrepreneurs (usually individual entrepreneurs) who provide capital for business start-up, usually in return for owning part of the business;
- Mezzanine or hybrid financing i.e. loan financing that gives the lender the rights to convert to an equity interest in the business if the loan is not fully repaid on time;
- An Initial Public Offering or other stock market offerings i.e. the first issue of shares by a private company to the public in order to generate capital;
- A government body within Bulgaria (government grants);
- Foreign government bodies or international organisations; and
- Not Applicable: Our company does not plan to ask for funding in the next three years.

41. *In five years' time, do you intend to: (Please indicate Yes or No)*

- Keep the business;
- Sell it / spin it off; and
- Have an Initial Public Offering (IPO).

42. *Please rank the following factors limiting business growth: (Please rank the five most important factors in the short-term (up to 1 year), the five most important factors in the mid-term (from 1 to 3 years) and the five most important factors in the long-term (from 3 to 5 years)*

- General economic situation;
- Political situation;
- Limited demand in the local / domestic markets;
- Limited demand in foreign markets;
- Limited availability of suitable new personnel;
- Loss of existing personnel;
- Business transfer problems e.g. inheritance;
- Cost of labour increasing;
- Unability to finance necessary investment into equipment;
- Products getting outdated (R&D necessary, product lead time);
- Inability to follow the technological competition;
- Change in the competition (as new entrants in the market);
- Price competition / small margins;
- Unfair competition, e.g. dumping;
- Regulatory framework;
- Lack of fiscal incentives;
- Difficult access to information technology (e.g. broadband);
- Other infrastructure weakness;

- Not enough offer of financing;
- Available financing not appropriate to your need; and
- Do not see constraints (nothing ticked above).