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FINANCIAL ENGINEERING INSTRUMENTS IN COHESION POLICY

STUDY

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DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT B: STRUCTURAL AND COHESION POLICIES

REGIONAL DEVELOPMENT

FINANCIAL ENGINEERING INSTRUMENTS IN COHESION POLICY

STUDY

This document was requested by the European Parliament's Committee on Regional Development.

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Abstract

This study provides an overview of the current situation as well as of the advantages and the challenges linked to the use of Financial Engineering Instruments (FEIs) in Cohesion policy. Based on this 'easy-to-read' guide to FEIs and the lessons learned so far, the study presents recommendations on how to improve the use of innovative financial instruments in the future.

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CONTENTS

LIST OF ABBREVIATIONS

BGK	Bank Gospodarstwa Krajowego
bn	Billion(s)
CDC	Caisse des Dépôts et Consignations
CEB	Council of Europe Development Bank
CIP	Competitiveness and Innovation Programme
COCOF	Committee for the Co-ordination of the Funds
COSME	Programme for the Competitiveness of Enterprises and SMEs
CP	Cohesion Policy
CSES	Centre for Strategy & Evaluation Services
CSF	Common Strategic Framework
EAFRD	European Agricultural Fund for Rural Development
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	European Court of Auditors
ECB	European Central Bank
ECP	European Cooperation Programme
EEEF	European Energy Efficiency Fund
EERP	European Economic Recovery Plan
EIB	European Investment Bank
EIF	European Investment Fund
EIT	European institute for Technology
ELENA	European Local Energy Assistance
EMFF	European Marine and Fisheries Fund
EPF	Entrepreneurship Promotion Fund
EPMF	European Progress Microfinance Facility
ERDF	European Regional Development Fund

ESF	European Social Fund
ETC	European Territorial Cooperation
ESIF	East of Scotland Investment Fund
EU	European Union
EU 12	Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia
EU 15	Austria, Belgium, Finland, France, Denmark, Germany, Greece, Irland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom
EURES	EURopean Employment Services
FEI(s)	Financial Engineering Instrument(s)
FP7	The Seventh Framework Programme
GDP	Gross Domestic Product
GNI	Gross National Income
IB	Intermediate Body
IBG	Beteiligungsgesellschaft Sachsen-Anhalt
ICT	Information and Communication Technology
INVEGA	Investicijų ir verslo garantijos
JASMINE	Joint Action to Support Micro-finance Institutions in Europe
JASPERS	Joint Assistance to Support Projects in European Regions
JEREMIE	Joint European Resources for Micro-to-Medium Enterprises Initiative
JESSICA	Joint European Support for Sustainable Investment in City Areas
KfW	Kreditanstalt für Wiederaufbau (Bank for Reconstruction)
LGTT	Loan Guarantee Instrument for TEN-T projects
m	Million(s)
MA(s)	Managing Authority/ies
MC	Monitoring Committee
MFI	Micro-Finance Institutions

MLG	Multi-Level Governance
MS	Member State(s)
NGO	Non-Governmental Organisations
NRW	North Rhine-Westphalia
OP(s)	Operational Programme(s)
PFEI	ERDF Programme on Financial Engineering Instruments - Slovenia
PSCI	Programme for Social Change and Innovation
R&D	Research and Development
ROP/RP	Regional Operational Programme
RSFF	Risk Sharing Finance Facility
RSI	Risk Sharing Instrument
RTD	Research and Technological Development
RTDI	Research, Technology Development and Innovation
SBA	Small Business Act
SEB	Skandinaviska Enskilda Banken
SEF	Slovene Enterprise Fund
SF	Structural Funds
SME(s)	Small and Medium-Sized Enterprise(s)
TA	Technical Assistance
ToR	Terms of Reference
TTP	Technology Transfer Pilot project
UDF	Urban Development Fund
WSLF	West of Scotland Loan Fund

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EXECUTIVE SUMMARY

Objective of the study

Cohesion Policy resources have increasingly been used in the form of **'Financial Engineering Instruments' (FEIs)** in the period of 2007-2013 in order to enhance the commercial practices when using public resources. More precisely, while Cohesion Policy resources have traditionally provided grant funding to achieve the objectives defined in the national or regional Operational Programmes' (OPs) priorities, Managing Authorities (MAs) have used some of their Structural Funds (SF) allocations through FEIs in order to increase the impact and sustainability of EU funds within Cohesion Policy. Instead of investing resources through grants in a 'one way' investment, FEIs have the aim of increasing the public investments.

There are three principal forms of FEI used in 2007-13 Cohesion Policy programmes: **equity**, **loans** and **guarantees**. Using these types of financial instruments, according to the SF Regulations, three main policy objectives can be targeted: **SME development, urban development** and **energy efficiency.** FEIs can thereby form a part of the implementation strategy of an OP and fall under Article 44[1] of the SF General Regulation.

In view of drawing recommendations to complement the current legislative proposals for the future use of FEIs in 2014-2020, the present study offers a thorough overview of the use of such instruments so far, describes the advantages, the challenges and the future plans for developing FEIs in the next programming period. The analysis is built on three separate methodological 'tools', namely a literature review, six case studies (of OPs that have made use of FEIs) as well as 29 interviews with financing institutions, financial intermediaries and strategic bodies.

Background and overview

Reporting on FEI use was voluntary until recently, which is why there are gaps and inconsistencies across the existing data. However, the available data shows that the use of FEIs in SF has increased substantially across Member States (MS) in the programming period of 2007-2013. By the end of 2011, 592 funds had been set up through 178 OPs mainly in the framework of the European Regional Development Fund (ERDF) to implement FEIs. Most commonly, these instruments were used in the form of loans rather than guarantee or equity instruments. In 90% of the cases, FEIs were used to target enterprises (Article 44(a) measures), followed by 7.8% Urban Development projects (Article 44(b)), while so far only 2.5% of the recorded cases were aimed at supporting Renewable Energy projects (Article 44(c)). Article 44(a) measures are supported by all types of FEIs (loans, guarantees, equity, venture capital and other products) while Article 44b and Article 44c only take the form of loans.

There are substantial differences across Europe in the total number and size of FEIs. There is in fact a strong concentration of FEI in Poland, France, Italy, the UK and Germany (accounting altogether for 75% of all FEIs). Italy, Greece, Poland, Germany and the UK account for 49% of SF contribution to FEIs. The main reasons for these differences are varying socio-economic conditions, differing traditions and a lack of knowledge and experience with commercial practices amongst public actors.

[1] Article 44 of Council Regulation (EC) No 1083/2006 was amended in 16 June 2010 by Regulation (EU) No 539/2010 of the European Parliament and of the Council of June 2010. The amendment introduced categories (a), (b) and (c); category 44(c) was therefore introduced relatively late in the period. Art. 44 covers only SF (i.e. strictly ERDF and ESF)

The advantages of using FEIs

The leading idea behind using FEIs to realize public activities is for public funds to be used in a more effective way, improve the commercial quality of the investments by involving private actors and to unlock new sources of finance.

In short, the main advantages identified across the literature and field research are:

- **Leverage effect** – This study finds that while the use of FEIs has substantially increased over the 2007-2013 period, the leverage effect cannot concretely be measured yet, given that it is generally too soon to tell. The study however argues that compared to grants, FEIs can have a greater financial impact, due to the ability to attract additional public and private sector resources, thus multiplying the effect of SF resources and the national/regional contributions.
- **Sustainability** - FEIs can promote a long-term recycling of public funds, which has been largely welcomed by various stakeholders in times of public budgetary constraints. MAs have the possibility to reinvest SF at the level of the region beyond the end of the programming period, helping achieve better value for public money.
- **Capacity building** - FEIs use is seen to have the potential of building institutional capacity through partnerships between the public and private sectors. The use of FEIs in fact increases the involvement of financial intermediaries/institutions in carrying out EU regional policy. Pooling of expertise and know-how from both types of stakeholders could potentially improve the quality of projects.
- **Risk coverage** – This advantage has most frequently been highlighted by the interviewees. FEIs are used by public institutions to support enterprises or projects which are considered to be risky by private actors. This is particularly important for relatively small start-ups active in certain sectors (e.g. high tech, ICT) which otherwise would not be able to attract financial support in the context of the risk aversion of private investors.
- **Speeding up programme implementation** - For MAs, FEI use can speed up programme implementation, accelerating the absorption of funds and reducing the risks of automatic de-commitment.
- **Urban development** – In the absence of financial or other instruments on the market for supporting urban development projects, the use of FEIs for urban development funds supported under the JESSICA initiatives are considered to be very important in this field. The use of FEIs opens up new opportunities for private sector participation in urban development projects which again helps leveraging additional funding through Public Private Partnerships in contrast to grants.
- **Indirect effects** – Where FEIs are based on gap analyses in the regional and national markets, they can have indirect effects on the development of the economy, such as the creation or safeguarding of jobs.

The disadvantages of using FEIs

While these instruments are largely welcome by the stakeholders consulted in the framework of this study, several challenges remain. The following challenges have been identified as being the main factors hindering an effective use of FEIs:

- **Negotiation and set-up period** – Although it depends on the amount of experience with using FEIs, the length of time it has taken to design, negotiate and launch FEIs has been highlighted as a major obstacle by many of the MAs involved.
- **Structural Funds Regulations** – The Regulations have been criticised the most frequently on the ground. They are considered to be complex, difficult to implement with real market situations and contradictory with regards to specific provisions (e.g. whether the exclusion of retail activities includes e-commerce).More worryingly, while FEIs are argued to cover the investment risks with public resources, the Regulations prevent from supporting enterprises facing economic difficulties. This clearly is a paradox.
- **Know-how and experience** - Partly due to the lack of knowledge and experience of public actors with commercial practices and, vice versa, the insufficient understanding of EU Regulations amongst financiers, FEIs have been reported to be difficult to set-up and implement. The different kinds of expertise are only rarely pooled.
- **External challenges** - External problems have been reported as a reason for the slower implementation rate of some FEIs. These problems include demand side issues such as lack of investment in the context of the economic crisis, or supply side problems such as competing with other types of business support.
- **Monitoring and reporting** - Monitoring challenges remain reported obstacles particularly regarding the contribution of FEIs to OP objectives. However, stakeholders are generally used to these types of requirements when working with public institutions.

The future of FEIs

The European Commission puts increasing importance on the use of FEIs which are to become more important in 2014-2020 as a more efficient alternative to traditional grant-based financing. Building on the experiences with FEIs so far, the European Commission's proposals for the 2014-20 legislative framework aim to increase the flexibility, taking into account national and sector specificities, improve the coherence and consistency between instruments, raise visibility and transparency, and to reduce the number of instruments to ensure a sufficient critical mass in a context where the amount of funding available is scattered across a large number of regions and recipients. The regulatory proposals aim to:

- Offer greater flexibility to EU MS and regions in terms of target sectors and implementation structures;
- Provide a stable implementation framework founded on a clear set of rules building on existing guidance;
- Capture synergies with other forms of support such as grants;
- Ensure compatibility with financial instruments at EU level.

Moreover, in the draft Regulation for 2014-2020 laying down common provisions for the five Common Strategic Framework (CSF) Funds, the European Commission has dedicated Title IV entirely to Financial Instruments (FIs). It lays out a single set of rules for governing FIs in all five CSF funds. A separate title enables a clearer presentation of the instruments' specificities. The changes regarding FEIs between the period of 2007-2013 and the next programming period of 2014-2020 are analysed in detail in this study.

Recommendations

Based on a comprehensive overview of the current situation as well as the advantages and challenges of such instruments in the EU27, this study presents recommendations in view of ensuring a more effective use of FEIs in 2014-2020.

First, there is a strong need for improving the level of knowledge about SF and about financing and overcoming public authorities' habits of preferring grants over FEIs. The proposed solutions include for the European Institutions, the EIB, the EIF and MAs to communicate 'hard results' once they become visible, inter alia through networking platforms. The European Parliament should also encourage the European Commission to offer trainings in finance, SF Regulations and state aid to the different actors involved. Moreover, the European Parliament should ask the Commission to strengthen the practical support through establishing a European help-desk.

Second, the market gaps and needs for using FEIs must be thoroughly assessed in ex-ante assessments in order to justify the relevance of moving away from grants. The European Parliament should ensure that a set of clear, transparent and measurable result indicators is identified by the MAs together with the Commission (other than "job creation and job safeguarding"). MAs and government authorities should clarify the incentives for the actors from the financial sector to get involved in EU programmes, such as the advantage of offering more competitive products than private markets.

Third, the legislators and the European Commission must ensure that the regulatory framework allows for an adequate degree of flexibility especially in view of accommodating financial/ commercial practices and state aid rules. The regulations should also ensure that the instruments do not suffer from the effects of scattering the available funds due to the regional approach.

Fourth, the daily management and administration of FEIs must be facilitated as far as possible by ensuring that the Regulations become more flexible and practice-oriented with regards to staff-related costs, offering off-the-shelf instruments and considering the option of reducing administrative burden by establishing a single OP for FIs.

Finally, urban development projects require a high level of cooperation between relevant actors at all levels of administration and the EIB, the MAs and the Urban Development Funds (UDFs). Efforts towards more cooperation should be ensured by the European Institutions. In order to ensure the success of such projects, UDFs should be established quickly, investment-ready projects should be identified at an early stage, and suitable resources should be made available in the OPs.

1. INTRODUCTION

The use of '**Financial Engineering Instruments'** [2] (FEIs) is an innovative way of spending EU budget that is to complement grants or subsidies. In fact, in Cohesion Policy, Structural Funds (SF) resources have typically been allocated to beneficiaries (organisations or projects) through (non-repayable) grant funding to achieve the objectives and outputs defined in the national or regional Operational Programmes' (OPs) priorities. In the period of 2007-2013, Managing Authorities (MAs) have however increasingly been using SF resources through **'commercial practices',** using **FEIs** in the form of **equity, loans** or **guarantees** (operated on a repayable basis in contrast to grants).

Those market-driven instruments are invested or lent, reimbursed, and invested again at the end of the agreed period with the aim of maximizing the returns from the public investments and increasing the impact and sustainability of the investments. According to the General SF Regulation (Article 44[3]), FEI can target three main policy objectives: **SME development, urban development** and **energy efficiency.** The operation of FEI may also involve the **EIB and EIF** (European Investment Bank and European Investment Fund), as well as other private or public sector partners not traditionally involved in Cohesion Policy implementation.

The **purpose of this study** is to provide a clear and concise overview of the use of FEIs while critically assessing the framework, implementation and effectiveness of this type of instruments. Moreover, it aims to formulate strategic and operational recommendations in the context of the ongoing planning processes at EU and OP level with regards to implementing Financial Instruments (FIs) in Cohesion policy 2014-2020.

The **methodological approach** is based on three separate 'tools', namely a literature review, selected case studies as well as interviews. In order to provide insight in theory and practice single examples from both, the interviews and the case studies are used in the narrative or in the form of boxes as well.

The present study is divided into **six chapters**. A background chapter provides an overview of the various forms of FEIs including their purpose, different approaches and evolution within and beyond Cohesion policy. Subsequently, the reader is given insight into the advantages as well as the disadvantages in using FEIs. Then, the study draws a future path for FEIs taking into account the current state of the legislative proposals for 2014-2020 and the future developments on the ground followed by conclusions and recommendations.

This study primarily addresses EU legislators as well as actors dealing with all kinds of FEIs outside and under Cohesion funds. This includes MEPs and EU officials directly or indirectly involved in the negotiations of the legislative package for 2014-2020 as well as European Funding Institutions, financial intermediaries, strategic bodies, and – in general - actors involved in the field of Cohesion Policy and FEIs.

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[2] This is the terminology used by the European Commission for the current period. For the future programming period (2014-20) the term "FEI" will be replaced by Financial Instruments ("FI"), in line with the European Commission's proposals.

[3] Article 44 of Council Regulation (EC) No 1083/2006 was amended in 16 June 2010 by Regulation (EU) No 539/2010 of the European Parliament and of the Council of June 2010. The amendment introduced categories (a), (b) and (c); category 44(c) was therefore introduced relatively late in the period. Art. 44 covers only SF (i.e. strictly ERDF and ESF).

2. METHODOLOGY

The present study is built on three separate methodological 'tools', namely a literature review, selected case studies as well as interviews. The thematic chapters and sub-chapters each include thematically relevant results from the comparative assessments of the case studies as well as the interviews, in addition to the literature review. Moreover, single examples from both, the interviews and the case studies, are used in the narrative or in the form of boxes as well. The challenge of compiling the information into the analysis has been the large amount of qualitative and quantitative information collected (e.g. entire reports or graphs provided by the interviewees). This section describes the approaches to the case studies and interviews in more detail.

2.1 Case Studies

Six case studies have been selected in agreement with the European Parliament to complement the literature review and interviews. The case studies, developed through desk research are intended to provide an overview of the use of FEIs within six selected OPs, these were:

- Sachsen-Anhalt (Germany)
- Ita-Suomi (Finland)
- Languedoc-Roussillon (France)
- Śląskie (Poland)
- Strengthening Regional Development Potentials (Slovenia)
- Lowlands and Uplands Scotland (UK).

The six case studies selected (see Table 1) represent a balance of types of European Regional Development Fund (ERDF) OPs (both Convergence and Regional Competitiveness and Employment (RCE)), a geographic spread (insofar as is possible with six examples) and a range of OP sizes (from €2,600m for the Sachsen-Anhalt ERDF OP in Germany to €910m for the Lowlands and Uplands Scotland ERDF OP in the UK)[4].

Table 1: The case study OPs

MS	OP	OBJECTIVE[5]	OP TOTAL (in € m)	EU INITIATIVE	TARGET OF FEIs
DE	Sachsen-Anhalt ERDF	CON	2,600	N/A	SMEs
FI	Itä-Suomi	RCE	1,500	N/A	SMEs
FR	Languedoc-Roussillon	RCE	1,300	JEREMIE	SMEs
PL	Śląskie ERDF ROP	CON	2,020	JESSICA	urban development, SMEs
SI	Strengthening Regional Dev. Pot.	CON	2,010	N/A	SMEs
UK	Lowland and Uplands Scotland ERDF	RCE	910	JESSICA JASMINE	SMEs and urban development

Source: case study reports.

[4] As a general point, it should be noted that all figures related to FEIs themselves should be treated with caution, and are provided as a rough indicator of the general size of allocations and instruments only. It should also be noted that figures from the Commission's 2013 report (containing 2011 data) do not always (rarely) tally with figures obtained from national sources.

[5] CON = Convergence; RCE = Regional Competitiveness and Employment

The case studies provide a small sample of the different approaches taken to FEI use amongst Cohesion Policy programmes. They demonstrate the use of FEI in support of different Cohesion Policy objectives (e.g. enterprise support/SMEs, urban development), different forms of FEIs (i.e. loans, guarantees and equity schemes), a range of financial relevance to the OP as a whole and varying degrees of the use of EU-level initiatives such as JEREMIE, JESSICA and JASMINE (as well as cases where these initiatives were not taken up). It should be noted that **all are ERDF OPs** (as highlighted in this study, European Social Fund (ESF) contributions account for only around 3% of the overall SF payments to FEIs).

Table 2: Use of FEIs within the case study OPs

MS	ERDF OP	OP PRIORITY WHERE FEIs USED	ERDF (€m) ALLOCATED TO FEIs	% OF OP	INSTRUMENTS
DE	Sachsen-Anhalt	Research, development and innovation Increasing the competitiveness of the economy	64 184.8	13	Equity Loans, equity
FI	Ita-Suomi	Promotion of business activity	24	9.3	Loans, equity
FR	Languedoc-Roussillon	Innovation, the knowledge economy, growth factors and competitiveness	15	4	JEREMIE: guarantees, equity and loans
PL	Śląskie	R&D, Innovation and entrepreneurship Sustainable urban development	16.6 51	4	Loans, guarantees JESSICA: urban development loans
SI	Strengthening Regional Development Potentials	Encouraging entrepreneurship	48	2.8	Equity, guarantees, loans
UK	Lowlands and Uplands Scotland	Research and Innovation Enterprise Growth Urban Development	116	31	Equity Loans, equity JESSICA: urban development loans

Source: Case study reports.

The desk research for the case study reports examined how the OP documents themselves addressed the issue of the use of FEIs in the programme areas, and what was envisaged to take place during the programme period, as well as how Annual Implementation Reports, ex ante and mid-term evaluations, and specific FEI ex ante assessments examined what has actually taken place. The individual case studies are included in Annex 1 of this study, while the main body of the study includes parts from a comparative analysis of the case studies. The case studies are supplemented with tables populated with data from the annexes to the Commission's 2013 summary report on FEIs (EC 2013a). These contain data to the end of 2011.

2.2 Interviews

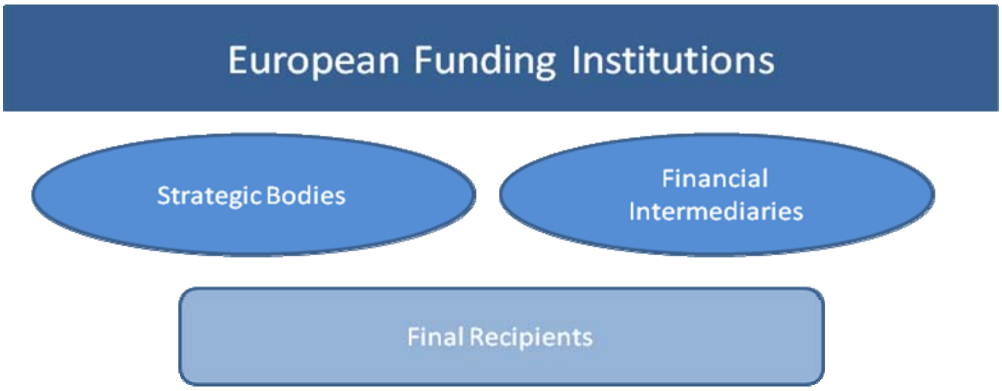
Semi-structured interviews have been conducted by phone and e-mail. These interviews were structured in a systematic way to feed into each thematic part of the study in either comparisons or individual examples.

In total, 29 interviews have been carried out to complement the literature review and case studies. The interviewees can be grouped as follows (see figure 1):

- European Funding Institutions (including representatives of the European Commission): eight interviewees
- Financial intermediaries ('intermediate body'[6] administering a FEI including holding fund and fund managers): 11 interviewees from 11 different MS
- Strategic bodies, i.e. actors involved in the issue but not directly involved in the money flow: four representatives from relevant departments in the Ministries and coordinating bodies and six MAs.

These groups have been formed according to the following logic of intervention.

Figure 1: Groups of actors in the logic of intervention of FEIs



Source: Metis, own elaboration.

It has been agreed that interviewing a few selected final recipients (SMEs, public bodies, …) would not contribute to the content given that this type of actors is not directly involved in the decisions nor the process of using FEIs. Moreover, financial intermediaries and MAs have proven to be reluctant in naming final recipients due to data protection. The exact list of interviewees is included in Annex 2 of this study.

6 The term 'intermediate body' is used here according to the definition laid down in Article 2 of the Council Regulation No 1083/06 (General Regulation): "any public or private body or service which acts under the responsibility of a managing or certifying authority, or which carries out duties on behalf of such an authority vis-à-vis beneficiaries implementing operations"

2.3 Literature review

An in-depth literature review was carried out to produce a descriptive overview of the current use of FEIs in Cohesion policy, focusing on the questions outlined in the study's Terms of Reference. The literature review used a range of existing publically-available EU-level information on the use of FEIs, relevant academic literature, and evaluative material at MS and regional level. This includes DG REGIO's summary report (updated in 2013) on the use of FEIs, and the 2012 reports on the use of FEIs from DG REGIO's expert evaluation network. Available material focuses most closely on the 2007-2013 programme period, and there is much more material available on some types of instruments than others. For example, in terms of FEIs for entrepreneurship and business development, recent available literature has tended to focus on the use of venture capital funds, rather than loans or guarantees. There is also less material available on FEIs for urban development projects, beyond the initial evaluation studies undertaken at preparatory phase.

It should be noted that the data available from different sources can be incomplete, out-of-date and sometimes contradictory. MS reporting on FEI use was, until recently, voluntary, and although mandatory reporting has now been introduced, there are still gaps and inconsistencies. The latest available overview data on implementation is also somewhat early to usefully evaluate results (end of 2011).

3. FINANCIAL ENGINEERING INSTRUMENTS: BACKGROUND AND OVERVIEW

3.1 What lies behind FEIs?

Traditionally, Cohesion Policy resources implemented through the SF have mainly provided grant funding to beneficiaries (organisations or projects) to achieve objectives and outputs in line with national or regional OPs' priorities. However, in order to increase the impact and sustainability of EU funds within Cohesion Policy, MAs have had the scope to use their SF allocations to fund FEIs, as an alternative to grants. The current (2007-13) period has seen an increased emphasis on such measures compared to past planning periods.

The typology of FEIs in the current Cohesion Policy period is rather complex. FEIs differ as to their **form**, their **purpose** and the **structures** through which they are operationalised. In broad terms, FEIs are measures that are operated on a repayable basis, as opposed to grants, which are non-repayable. These are sometimes referred to as 'innovative' or 'new' financial instruments or 'non-grant' instruments. This study uses the term 'Financial Engineering Instruments'. The operation of FEI may also involve the **EIB and EIF** (European Investment Bank and European Investment Fund), as well as other private or public sector partners not traditionally involved in Cohesion Policy implementation. Last, although the focus of this study is on Cohesion Policy, it is important to note not only that FEIs are not limited to Cohesion Policy, but also that their use in **other policy areas** is likely to be extended post-2014.

3.1.1 Forms of FEIs in Cohesion Policy

There are three principal forms of FEI used in 2007-13 Cohesion Policy programmes: **equity**, **loans** and **guarantees**. The key types and their characteristics are summarised in Table 3. In practice, however, there are variants on each type; moreover two or more instruments may be combined to provide the required funding 'package', and, indeed, these instruments may also be combined with grants. Different forms of intervention are suited to different investor risk profiles and the financing requirements of firms at various stages in the lifecycle of the undertaking (see, for example, CSES 2007, ECA 2012, Mason *et al* 2012, Michie and Wishlade 2011, Tillväxtverket 2011).

The three types of instrument are very different in their means of operation, the implications for the recipient firm and their budgetary impact and risk. Also important is the fact that, unlike grants, such measures do not necessarily involve State aid, since there is scope for public authorities to run such measures on a strictly commercial basis, taking them beyond the purview of DG Competition. That said one of the major complexities of operating such instruments within economic development policy is that of ensuring State aid compliance (Michie and Wishlade 2011).

Table 3: FEIs by specific fund-type classification

Form	Description
Equity	Direct investment in the share capital of an undertaking. Involves ownership and capacity to influence governance of the investee firm. May cover seed, start-up and expansion capital. May also be known as venture capital, which is a subset of private equity, strictly defined. Can take various forms, with different levels of risk. Risks for investors may be high (depending on security); so may be returns (depending on performance).
Loan	Borrowing to finance businesses or projects over a period of time and at an agreed rate of return, typically on the basis of the quality of cash flow and strength of the underlying assets; may be on commercial or subsidised terms.
Guarantee	Underwriting funds to provide security for firms that are unable to obtain financing otherwise; may cover all or part of the capital. May take the form of guarantees on bank loans, micro-credit or equity. May involve a fee or higher interest rate for the borrower.

Source: Michie and Wishlade (2011).

Across MS and regions, holding funds, MAs and financial intermediaries have reported about several kinds of instruments used to support businesses. Box 1 includes interesting examples of instruments used for each of the three main types – equity, loans and guarantees that have come across in the interviews.

Box 1: Loans, Equity and Guarantee products: A few examples

Equity

The main type of equity product encountered throughout the interviews is Venture Capital. To name an example, Aloitusrahasto Vera Oy - Seed Fund Vera Ltd, managed by the state-owned financing company Finnvera, offers ERDF co-financed venture capital investments in start-up and early-stage innovative enterprises in Finland. While subsidised loans and guarantees were already used in the previous ERDF programming period, venture capital for SMEs became available as a new ERDF instrument as late as August 2011. The fund targets early-stage start-ups (often entrepreneurs who are planning to start their own businesses for the first time) that are innovative and have a visible growth potential. The average first investment in a SME is €259,000-€300,000. So far, €6 m out of the €17.5 m (ERDF + public funds) were invested and 21 SMEs have been reached out of a target of 44 companies.

Other examples of equity products used under the ERDF are private equity capital instruments for established firms. For instance, BaltCap, a private capital equity investor for Batlic companies invests money from international and local institutions such as the EBRD, the EIF (using the Competitiveness and Innovation Framework Programme CIP), the SEB Asset Management, Swedbank Asset Management, Erste Bank and other banks, pension funds and insurance companies. They target larger investments of €3 m to €9 m into bigger companies.

Loans

Throughout the interviews, different types of loans were moreover mentioned. To name a few examples, in the framework of the Sachsen-Anhalt OP, SMEs can get initial financial support trough 'SME loans' (in total €237.9 m EU and national) and start-ups can apply for 'seed loans' (€10 m EU and national co-financing). In North-Rhine Westphalia the NRW

Bank offers micro-loans to start-ups of very small enterprises or very small enterprises that have been established for up to 5 years and which cannot prove their success yet and hence access any financial support from commercial banks. These micro-loans can absorb the risk of start ups in a way private banks cannot. The concept entails offering small start-ups small loans in the amount of €5,000 to €25,000 for up to 6 years with a fixed interest rate for the entire period. Start ups can even apply twice for micro-loans for as long as the amount does not exceed €25,000. Moreover, the state-owned bank closely cooperates with 'NRW Startercenters' which are advisory service providers for start ups. These micro-loans are financed 50% by the banks from the NRW region and 50% from the ERDF. Out of a total of €16.5 m, €10.5 m have already been spent for 521 deals since 2007.

Guarantee

One interesting example of guarantee products is the Risk-Sharing Instrument (RSI) offered by the Bank Austria. The RSI is a joint initiative of the EIF, the EIB and the European Commission. It is supported under the 7th Framework Programme for Research and Technological Development (FP7) and uses EIF's risk-taking capacity. It is part of, and complements, the existing Risk Sharing Finance Facility (RSFF), managed by the EIB. The guarantee covers, upon default, 50% of the outstanding amount of each loan. The EIF and UniCredit Bank Austria have signed the first guarantee agreement in 2012. UniCredit Bank Austria can now offer up to €120 m of new loans to innovative SMEs and small mid-caps[7] in the field of research, development or innovation (between €25,000 and €7.5 m) over the next two years, enabling entrepreneurs to gain easier access to finance. 50 % are financed by the EIF; 50 % by the UniCredit Bank Austria. This instrument helps offering SMEs and mid caps additional and cheaper loans to finance additional investments, working capital needs and R&D projects.

Source: Interviews.

3.1.2 Purpose of FEIs within Cohesion Policy

Under the SF Regulations, the use of FEI is targeted at three main policy objectives: **SME development, urban development** and **energy efficiency.** Specifically, FEIs can form a part of the implementation strategy of an OPs and fall under Article 44[8] of the SF General Regulation (EC 2012a:5):

(a) FEIs for enterprises, primarily SMEs, in the form of venture capital, guarantee and loan funds;

(b) urban development funds, that is, funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development;

(c) funds or other incentive schemes providing loans, guarantees for repayable investments, or equivalent instruments, for energy efficiency and use of renewable energy in buildings, including in existing housing.

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7 As defined in Article 1 of the Title I of the Annex of the Commission Recommendation 2003/361/EC, small mid-caps have up to 499 employees and are to be distinguished from small and medium-sized enterprises.

8 Article 44 of Council Regulation (EC) No 1083/2006 was amended in 16 June 2010 by Regulation (EU) No 539/2010 of the European Parliament and of the Council of June 2010. The amendment introduced categories (a), (b) and (c); category 44(c) was therefore introduced relatively late in the period. Art. 44 covers only SF (i.e. strictly ERDF and ESF).

3.2 Public policy objectives versus the economic rationale for using FEIs

An important dimension to the use of FEI is the scope for public policy objectives to be pursued through commercial mechanisms. There are several aspects to this. First is the idea that public funds could be spent more efficiently and effectively in this way. For example, the provision of equity capital to a growing SME has the capacity to deliver both in terms of economic development and by providing a return on public (and private) funds, which can be reinvested further. Second, there is the potential to involve the private sector in decision-making about the investments, with a view to improving the commercial quality of the investment decision. Third, publicly-funded FEIs can increase the pool of finance available to expanding firms – it is this logic that underpins the co-investment fund approach used in a number of MS – thereby contributing to the development of financial markets, potentially unlocking new sources of finance, for example, through the development of the business angels segment.

In the context of Cohesion Policy, a divergence between the objectives of SF and of FEIs can be noted. The latter are, by definition, a tool to increase the competitiveness and the economic success of the supported firms, covering the most promising players often located in advantaged regions. Cohesion policy,however, traditionally aims at reducing development disparities and promoting economic and social cohesion in the EU, thus also investing in weaker regions. Having said this, it is clear that its contribution to the EU2020 goals corresponds better with the nature of FEIs.

Support for SMEs and entrepreneurship is an important aspect of economic development policy. There has been increasing policy focus, at European, national and sub-national levels on the nurturing of high growth firms in need of (high risk) capital (OECD 2010). This reflects the fact that a very small proportion of new firm starts will account for the majority of benefits in terms of investment, employment and exports (Henrekson and Johansson 2010). The role of access to finance in facilitating the expansion of such firms has attracted increasing policymaker attention. This partly owes to the fact that significant numbers of *ambitious* new firms cite access to finance as a constraint on their development (Maula, Murray and Jääskeläinen 2007), and partly the role that private venture capital is considered to have played in the development of high technology firms in certain locations - like Silicon Valley and Israel - and in the development of some high profile firms such as Google and Facebook (Gompers and Lerner 2001). Reflecting this, concern has long been expressed at the relative underdevelopment of venture capital markets in European countries (Phillippon and Veron 2008). At the European level these considerations have led to initiatives both to stimulate the development of EU venture capital markets through regulation and through direct measures to provide venture capital such as the Competitiveness and Innovation Framework Programme, as well as the FEI measures under Cohesion Policy.

The idea behind supporting SMEs more generally is that they play a crucial role in furthering economic dynamism in regional and national economic systems through stimulating competitiveness and productivity, next to their key role in innovation and R&D (European Commission, DG Enterprise and Industry 2012b). In 2012, SMEs accounted for some 67% of total employment and 58% of gross value added in the EU (Wymenga et al 2012). However, SMEs face a wide range of challenges often not faced by large firms. Access to finance is well-recognised as a problem (CSES 2012:5) and especially in the recovery from the economic downturn, SMEs' access to finance has become more difficult (Tödtling-Schönhofer et al 2011: 11).

On the other hand, given budgetary pressures and restrictions at EU and national level, the use of FEIs can make the investments from public resources more efficient. As the investment is subsequently repaid to the FEI, FEIs enable SF to be invested in multiple final recipients over successive funding rounds beyond the initial programming period, thus (in theory) creating a lasting legacy from EU funds and greater efficiency of public investment. FEIs are also designed to attract co-investment from other sources i.e. additional resources from external (private sector) investors, helping to increase the leverage and multiplier effect of SF resources and, in principle, increasing the capital available for achieving policy objectives. This also opens new markets to different forms of public-private partnership, brings in the expertise of international financial institutions and enables the building of institutional capacity through these partnerships (EC 2013a:5-6). Collectively, these attributes potentially lead to greater value-added for policy interventions, as well as greater effectiveness and efficiency in terms of the use of public sector resources, enabling policymakers to achieve more with fixed or limited resources.

In the context of urban renewal, the JESSICA initiative is intended to leverage in other resources from public-private partnerships (in addition to the SF) as part of an integrated plan for sustainable urban development. Achieving this goal requires specific strategies that establish the framework for investments and complement the provision of infrastructure and public facilities in an integrated approach, mobilising a broad range of partners with different financing capabilities and management skills. It is anticipated that the public sector would maintain a key role within JESSICA funded projects, but not as the single or main investor and risk taker, but rather by providing the conditions for development and benefiting from increased and more differentiated resources to promote regeneration (EIB 2010).

The idea that public and private sector objectives can be aligned in this way is attractive, but the reality may be more complex. For example, it is widely acknowledged that access to finance is an obstacle to development for SMEs, but the lack of private sector provision may be the result of rational market decisions by the commercial sector. In a review of the use of FEI in disadvantaged regions, Mason et al 2012 note that geographical variations in investment activity reflect demand side factors rather than supply side gaps. In any economy there are likely to be only a small proportion of firms that are capable of earning the high returns that are sought by private sector venture capital funds. Moreover, although high growth firms can be found in all regions, the evidence indicates that they are disproportionately concentrated in core regions (BERR 2008, Anyadike-Danes et al 2009, Stam 2005). There are also qualitative differences between high growth firms in core and peripheral regions, for example in terms of size (both turnover and employment) and industrial composition (Gallagher and Miller 1991). The lack of venture capital investment in disadvantaged regions may therefore be a result of perfectly rational behaviour by private sector investors. While disadvantaged regions clearly face greater difficulties in accessing capital, they also typically exhibit market ‘thinness’ (Nightingale et al 2009).

However, there is an emerging consensus that regionally-focused public venture capital models are not effective in the absence of an entrepreneurial ‘ecosystem’. This highlights the need for policy to operate with a broader mix of tools to support the needs of actual or potential beneficiaries. In terms of finance, this could include grants to support the development of viable projects and a mix of repayable/non-repayable sources of finance tailored to the needs of a given project. However, non-financial support is also key in the form of capacity-building initiatives that promote the emergence of ‘investor-ready’ firms.

3.3 FEI structures under Cohesion Policy

Under Cohesion Policy programmes, there are different ways for MAs to organize or structure FEIs. Once a MA has decided to establish a FEI and has allocated the required amounts from SF within the relevant OPs, the MA assesses how to implement the FEI. This may be done through a holding fund or through a direct contribution from the OP to an FEI (EC 2013a: 11). MAs have four main options (see also Figure 2):

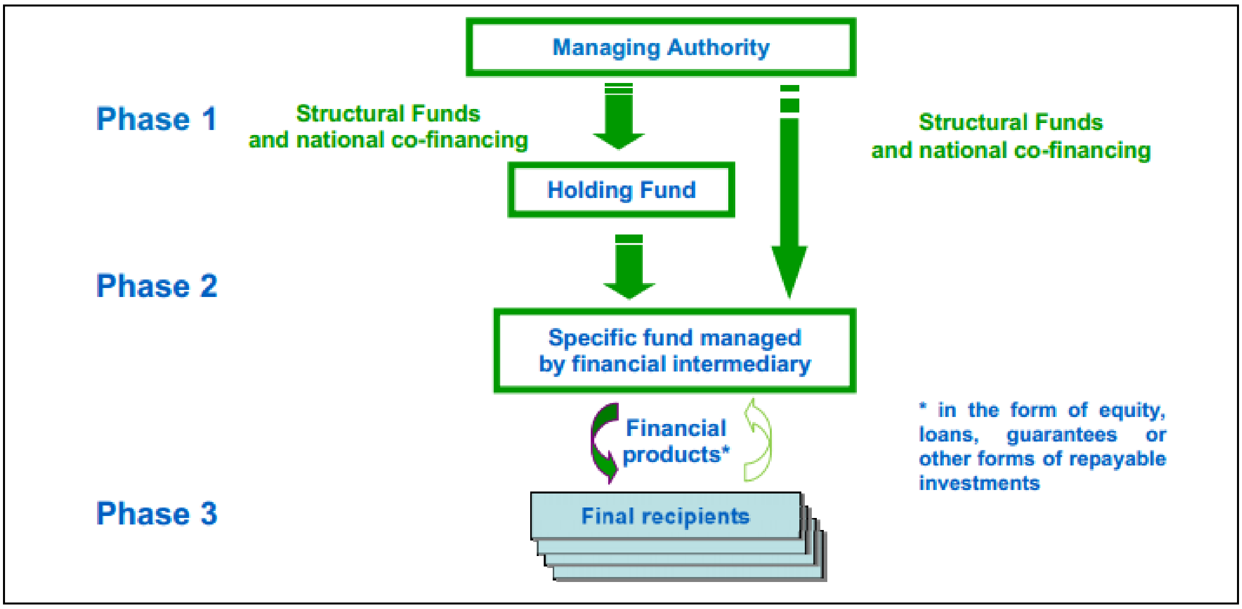
(a) OP makes a direct contribution to an FEI(s) (i.e. there is no holding fund), and the FEIs are managed by financial intermediaries (e.g. High-tech Fund in the OP Upper Austria)

(b) OP contributes to a holding fund and management of the fund is put out to public tender (e.g. Venture Finance Plc acting as the holding fund under the Hungarian OP for Economic Development)

(c) OP contributes to a holding fund and management is contracted to EIF/EIB (e.g. OP Languedoc-Roussillon)

(d) OP contributes to holding fund and management is contracted to a national financial institution, without tender under national law (provided that national law is compatible with the Treaty in this regard) (e.g. Regional OPs in Poland)

Figure 2: Two models of FEI implementation



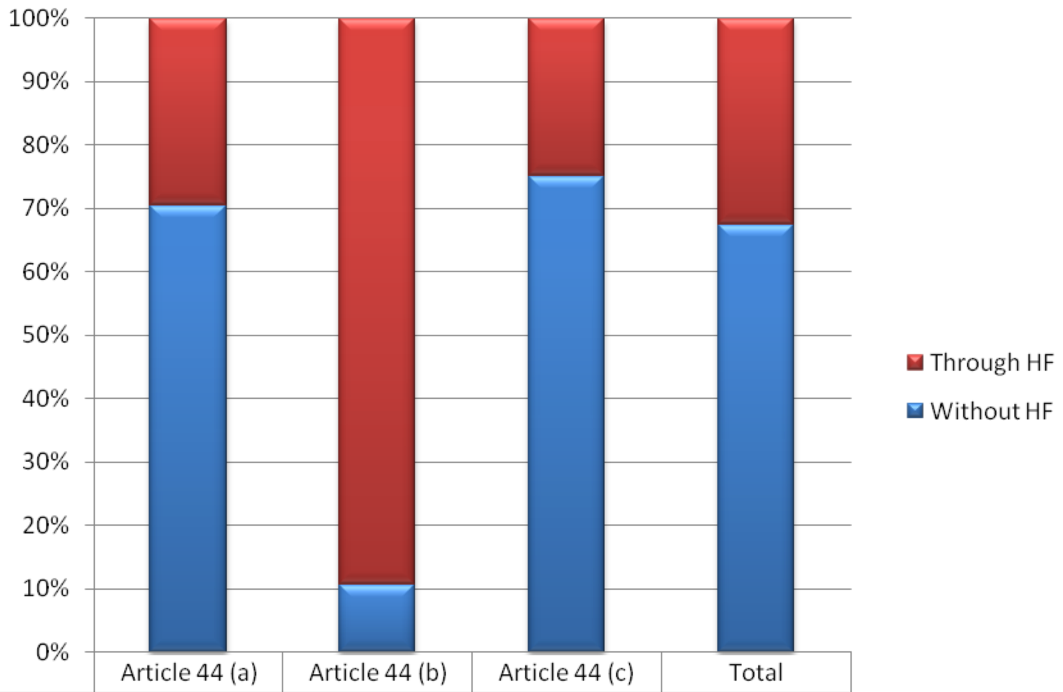
Source: European Commission (2013).

The specific funds, whether implemented directly or indirectly through a holding fund, can offer FEIs in the form of equity or repayable investments such as loans and guarantees.

3.3.1 Different approaches of managing FEIs

Most MS use both holding funds and direct contributions to implement FEIs[9]. In 2011, the majority of all specific funds (around 67%) were implemented without a holding fund structure (see figure 3). In total, 353 specific funds were implemented without holding funds and 171 funds were implemented through 68 holding funds. Most of the FEIs for enterprises operate without a holding fund, whereas most of the FEIs for urban development are implemented through holding funds. Holding funds are managed either by the EIB or the EIF (altogether 31), or by other domestic financial institutions or bodies (37, of which 34 are FEIs for SMEs).

Figure 3: FEIs implemented through and without holding fund[10]



	Article 44 (a)	Article 44 (b)	Article 44 (c)	Total
Through HF	143	25	3	171
Without HF	341	3	9	353

Source: EPRC, based on European Commission (2013).

9 The decision whether or not to use a holding fund is made by Managing Authorities depending on the circumstances in their region/country. Holding funds are perceived as providing a number of benefits, for example, use of a holding fund can potentially allow a 'portfolio approach' to be taken, giving more flexibility and allowing allocations to be moved between specific funds if necessary, depending on demand and economic conditions.

10 Note: In total, 68 holding funds have been set up, of which 47 are for FEIs for SMEs (Art 44(a)), 18 for FEIs for urban development projects (Art 44(b)) and 3 for FEIs for energy efficiency/renewable energies (Art 44(c)).

Box 2: Implementing FEI through a Holding Fund – the example of North East England

The system of using a holding fund can be illustrated with the aforementioned example of the OP North-East England. North East Finance was directly appointed by UK government to become the holding fund for the ERDF JEREMIE programme based on its long-standing experience in the region. The holding fund, which is composed of six team members, manages and monitors seven different specific funds. Each fund targets different types of companies, ranging from very early-stage companies with high-risk investments on to technology fund targeting companies that specialize in innovative technology as well as a fund for established businesses with customers and revenues that need capital to expand. The fund managers then deal directly with the companies. The financial intermediary Northstar Ventures for instance manages two of such funds. For each fund and each investment, 50% of the total public support is provided by the EIB, 36% by the ERDF and 14% by the UK government. The holding fund manages €143.5 m in total and the average investment varies highly between the funds. The micro-loan fund lends between approximately €1,000 and €29,000. If the micro-loan fund is included in the statistics, then the average investment per SME is €140,000. Excluding the micro-loan Fund data, the average investment per SME is €300,000.The holding fund reports back to the MA on a quarterly basis and is responsible for paying back the EIB.

Source: Interviews.

3.3.2 JESSICA and JEREMIE

To encourage the use of FEIs, the Commission, in collaboration with the EIB Group and with the Council of Europe Development Bank (CEB), created two "Cohesion Policy Joint Initiatives" - JEREMIE and JESSICA (EC 2012b) to facilitate SME access to finance and investments in sustainable urban development, respectively. The key features of these initiatives are outlined in Table 4.

Table 4: JEREMIE and JESSICA Initiatives

Initiative	Description
Joint European Resources for Micro to Medium Enterprises (JEREMIE) [11]	The JEREMIE initiative promotes use of FEIs to improve access to finance for SMEs, supporting MS to set up market-oriented FEIs with contributions from ERDF or ESF, for implementation directly or via a holding fund, and providing repayable forms of assistance such as equity, loans and/or guarantees.
Joint European Support for Sustainable Investment in City Areas (JESSICA)	The JESSICA initiative supports MA investment in urban development through FEIs. Contributions from the ERDF are allocated to Urban Development Funds (UDFs) which invest them in public-private partnerships or other projects included in an integrated plan for sustainable urban development. These investments can take the form of equity, loans and/or guarantees. Alternatively, MAs can decide to channel funds to UDFs using holding funds which are set up to invest in several

[11] Early in the 2007-13 programme period, many FEIs set up by Member States and regions (particularly where the EIF was involved) were referred to as 'JEREMIE' funds, however, JEREMIE is an initiative to support Managing Authorities in setting up FEIs for SMEs, rather than a type of fund itself.

Initiative	Description
	UDFs. The urban development projects can support: • urban infrastructure – including transport, water/waste water, energy; • heritage or cultural sites – for tourism or other sustainable uses; • redevelopment of brownfield sites – including site clearance and decontamination; • creation of new commercial floor space for SMEs, Information and Communication Technology (ICT) and/or Research and Development (R&D) sectors; university buildings – medical, biotech and other specialised facilities; • energy efficiency and renewable energy in buildings.

Sources: DG REGIO JEREMIE; EIB JESSICA website; Ward (2012).

In the context of JEREMIE and JESSICA, over 110 evaluations/studies and 'gap analyses' were carried out at MS and programme (OP) levels. These studies aimed at identifying opportunities and added value for the implementation of FEIs supporting access to finance for SMEs and investments in sustainable urban development. In addition, the JEREMIE and JESSICA Networking Platforms launched in 2009 supported the exchange of know-how and good practice between the Commission, MAs and other stakeholders (Michie and Wishlade 2011).

The JEREMIE Technical Assistance (TA) programme and the JESSICA TA Programme are in fact carried out by the European Commission in cooperation with the EIB and EIF to promote and communicate FEIs across MS. These should not be confused with the JEREMIE and JESSICA holding funds managed by the EIB and EIF on the mandates from MAs. According to a representative of the JESSICA Technical Assistance Unit of the EIB the TA system is often confused with Art.44 (a) funds.

The EIB manages 95% of the holding funds which have been set up for urban development (JESSICA) FEIs, while the EIF manages 27% of the holding funds which have been set up for FEIs for enterprises (JEREMIE).

The responsible unit at the EIB is separated into different geographic teams, each responsible for a different area in Europe (Northern Europe; Southern Europe; Central and Eastern Europe). These teams support the MAs of national as well as regional OPs setting up a JESSICA structure. JESSICA is implemented through 18 holding funds, 17 of which lie within the responsibility of the EIB and one is managed by KREDEX in Estonia. The EIB thereby takes up a lot of tasks from the MA. The JESSICA operation officers at the EIB cannot influence fund managers in their daily operational steps and decisions. For instance, the decision about the projects to be supported is taken by the Investment Board consisting of representatives from the MA, the fund manager, and other stakeholders involved.

The EIF has also provided expertise to MAs at pre-set up and set-up phases in relation to enterprise FEIs, and the EIB can also participate in enterprise FEIs through the provision of loan capital. For example, the JEREMIE Fund operating in Wales, UK has a total budget of

€175m, of which €88m is from an EIB loan, €76m is from ERDF, and €18m is from the Welsh Assembly Government.

Box 3: JESSICA Scotland

The €58 m/ GBP 50 m SPRUCE (Scottish Partnership for Regeneration in Urban Centres) Fund was launched in December 2011. Administered by Amber Fund Management Ltd., SPRUCE will support revenue-generating projects within 13 eligible local authority areas in the Lowlands and Uplands Scotland programme area, as determined by the Scottish Index of Multiple Deprivation. The fund was capitalised with €28m from ERDF Priority 3 (urban development) matched by €30m from the Scottish Government.

The SPRUCE Fund supports a wide range of urban regeneration activity within integrated, sustainable urban development plans. Eligible and investible projects include the development of office and commercial space, key transport projects and investment in energy efficient projects (including support for innovative approaches to energy efficiency retrofit measures).

The SPRUCE Fund can lend to public, private or joint venture bodies delivering regeneration or energy efficiency benefits within the designated local authority areas. Financial support from the SPRUCE Fund is provided in the form of loans of investment capital. The intention is that the fund will be recycled up to three times within 10 years.

Source: Case Study OP Lowlands and Uplands Scotland.

Looking at the case studies, MAs had less experience with co-funding FEIs for urban development projects, as this was a new possibility introduced in 2007-13 and supported by the JESSICA initiative. In both Scotland and Śląskie, the EIB was selected to manage the JESSICA holding funds (the holding funds then makes contributions to Urban Development Funds (UDFs) which fund individual projects). Both the Scotland and Śląskie JESSICA holding funds have each launched one UDF apiece, to support urban development projects in the programme areas. Boxes 3 and 4 describe two examples of JESSICA UDFs.

Box 4: JESSICA Śląskie

An agreement was signed between the EIB and the Bank of Environmental Protection in October 2011, launching it as the JESSICA UDF for the Śląskie region. Subsequently, a competition for potential beneficiaries was prepared and in December 2011, the Bank of Environmental Protection appraised applications for loans for urban projects under JESSICA. The allocation earmarked for this initiative was €51 m from ERDF plus €9 m from the state budget.

In April 2012, an agreement was signed between the Bank of Environmental Protection and the beneficiary, the City of Tychy, for the project "Cultural Passage Andromeda," which is the first JESSICA project in Śląskie and the fourth in Poland. The project will invest in a disused cinema "Andromeda”, transforming it into a dining and shopping centre, with space for a municipal art gallery, media centre and conference room. The investment is being made in conjunction with a project to revitalise Tychy Old Town and post-industrial degraded land in the area. For the realization of this project the city will receive a €1.1 bn loan. The value of the whole project is over €2.7 bn. After selecting contractors, the work is expected to take approximately 18 months.

Source: Case Study OP Śląskie.

3.3.3 Different ways of managing FEIs – Evidence from the Case Studies[12]

All the case study OPs had existing experience of using FEIs. In several, the FEIs (for SME support) that are currently being supported are continuations of instruments already used in the 2000-06 period. In Śląskie, for example, the funding for local, regional and sub-regional loan funds, micro-loan and guarantee funds which ultimately results in support for entrepreneurs is a continuation of measures from the previous programming period 2004-06. In Sachsen-Anhalt, the Land decided to continue the IBG Risk Capital Fund (IBG Beteiligungsgesellschaft Sachsen-Anhalt) following positive views of the performance in 2000-06 (although its management was transferred to a different body). As in Śląskie, use has been extended in 2007-13, as FEIs were seen to facilitate the creation of a resource base that could be used for long-term economic development policy, and also to improve the efficiency of development policy. In Eastern Finland also, interest subsidised loans and guarantees were in use in the 2000-06 period with good experiences. Languedoc-Roussillon had begun to develop repayable instruments in 2004, and the approach taken in Scotland was explicitly intended to build on experience under the 2000-06 Objective 2 programmes which previously operated in the region, particularly the Eastern Scotland Objective 2 programme. Similarly, in Slovenia, ERDF co-financed FEIs had previously been implemented in the 2004-06 period, although the amounts of funding involved were small. In the cases of Scotland and Śląskie, this previous experience was further extended in 2007-13 by introducing FEIs to the new theme (for co-funding of FEIs); as such, urban development projects were started under the JESSICA initiative.

Their previous experience impacted on the decisions MAs have made in terms of managing FEIs within their programmes (Table 5). Finnvera has many years of experience (since 1998) in the provision of non-grant financial instruments, and in Slovenia, the Slovene Enterprise Fund (SEF) has been in operation since 1992, and therefore has a long history of providing access to finance for SMEs, including credit guarantees and interest rate subsidies. Hence, when the decision was made to use ERDF to co-fund a holding fund supporting SMEs, it was decided to manage the holding fund domestically, as Slovenia had developed FEIs previously and considered that they had enough experience to continue with the management of SME support. Similarly, the Sachsen-Anhalt Land government decided to use the already existing Sachsen-Anhalt Investment Bank (the main public funding bank in Sachsen-Anhalt), as it was well-used to setting up and operating loan funds. The advantages of the Land Investment Bank were considered to be, first, that it is very familiar with the financial situation and difficulties of local firms and, second, that it is well used to working closely and constructively with the different Land authorities and playing a bridging role between the Land government, commercial/cooperative banks and local SMEs. Because the Bank is an 'in-house' body of the Land and is 100 percent owned by the Land, no public procurement procedure was needed.

Table 5: FEI management in case study OPs

OP	FEIs	Management
Sachsen-Anhalt ERDF	• SME Loan Fund (KMU-Darlehensfonds) • Ego.PLUS seed loan fund	• Sachsen-Anhalt Investment Bank • Sachsen-Anhalt Investment Bank

12 The figures used in this section are derived from the most up-to-date source currently available – the European Commission's 2012 summary report on the progress made in financing and implementing FEIs co-financed by Structural Funds. This presents the situation as at the end of 2011. The Commission had also previously reported (in 2011) on FEI use as at the end of 2010, based on information provided by Member States on a voluntary basis.

OP	FEIs	Management
	• IBG II Risk Capital Fund (Risikokapitalfonds IBG II)	• Goodvent Investment Management Ltd
Itä-Suomi	• Aloitusrahasto Vera Oy (Starting Fund Vera Ltd) • Subsidised loans and guarantees	• FINNVERA • FINNVERA
Languedoc-Roussillon	• JEREMIE holding fund	• EIF
Śląskie ERDF ROP	• Support for local, regional and sub-regional loan funds, micro-loan and guarantee funds • JESSICA holding fund	• Regional and local Development Agencies • EIB
Strengthening Regional Dev. Pot.	• Slovene Enterprise Fund (SEF) instruments	• SEF, venture capital companies
Lowland and Uplands Scotland ERDF	• Scottish Co-Investment Fund • Scottish Venture Fund • Scottish Loan Fund • West of Scotland Loan Fund • East of Scotland Investment Fund • JESSICA holding fund	• Scottish Enterprise • Scottish Enterprise • Maven Capital Partners • Consortium of local authorities • Consortium of local authorities • EIB

Source: Case Study reports.

In France, two public financial institutions play important roles in managing FEIs at national level: OSEO[13] for debt and guarantees and CDC[14] Enterprises for equity. However, the JEREMIE Fund in Languedoc-Roussillon is managed by the EIF, which was chosen as a fund manager over CDC. The support of the EIF was therefore perceived to be an important element of the JEREMIE Fund in Languedoc-Roussillon.

Table 6 shows the management costs reported by end 2011 for the FEIs within the case study OPs. These vary significantly between FEIs; between 1-2% is typical for many but there are several notable exceptions to this. This variation in costs/fees may in part be explained by differences in reporting, or by differences in timing with regards to funding tranches or fee payments.

Table 6: FEIs in case study OPs – management costs and fees[15]

MS	ERDF OP	Fund	OP contribution (€m)	Management costs /fees (€m)	Management costs/fees (% of OP contributions)
DE	Sachsen-Anhalt	SME Loan Fund (*KMU-Darlehensfonds)*	237.87	13.52	5.68%
		Ego.PLUS seed loan fund	10	0.81	8.10%
		IBG II Risk Capital Fund	85.01	0.23	0.27%

13 OSEO is a public-sector institution dedicated to economic development which provides financing and other support to SMEs.
14 CDC is a public investment bank.
15 Note: This data represents management costs and fees paid by the end 2011, not over the lifetime of the FEI, so in some cases will be an under-representation of the total management costs/fees to be paid.

MS	ERDF OP	Fund	OP contribution (€m)	Management costs /fees (€m)	Management costs/fees (% of OP contributions)
		(Risikokapitalfonds IBG II)			
FIN	Ita-Suomi	Finnvera equity	35.89	1.65	4.60%
FR	Languedoc-Roussillon	JEREMIE holding fund	30	1.73	5.77%
		JEREMIE FEI	2.2	0.39	17.73%
PL	Śląskie	Regional guarantee fund	5.95	0.48	8.07%
		JESSICA HF	62.83	0.45	0.72%
		JESSICA UDF	63.22	2.82	4.46%
SI	Strengthening Regional Development Potentials	Guarantee Fund	42.66	0	n/a
		PFEI (HF)	56.55	1.59	2.81%
		1. Guarantee FEI	21.5	0.53	2.47%
		2. Equity FEI 1	5	0	n/a
		3. Equity FEI 2	3.92	0.07	1.79%
		4. Equity FEI 3	9	0.18	2.00%
		5. Equity FEI 4	2.64	0.03	1.14%
		6. Equity FEI 5	3.68	0	n/a
		7. Equity FEI 6	2.5	0.03	1.20%
		8. Equity FEI 7	7.2	0	n/a
UK	Lowlands and Uplands Scotland	Scottish Co-Investment Fund	65.76	0.33	0.50%
		Scottish Loan Fund	43.39	0.53	1.22%
		Scottish Venture Fund	40.85	0.3	0.73%
		WSLF	18.0	0	n/a
		ESIF	6.0	0.36	6.00%
		JESSICA HF	60.0	0.93	1.55%
		JESSICA UDF (SPRUCE)	0	0	n/a

Source: EC 2013a, final column, own calculations.

In addition to encouraging the use of FEIs in Cohesion Policy programmes in the 2007-13 programme period (EC 2010, Council of the European Union 2011), the European Commission issued a series of guidance notes to MS to explain the rules concerning FEI implementation especially once the General Regulation was amended during the programme period both to extend the use of FEIs and clarify the implementation rules[16].

3.3.4 Communication

The interviews with MAs, holding fund managers and financial intermediaries across Europe have confirmed that SMEs or project managers in the case of urban development projects are informed of funding possibilities by all actors involved. In the case of urban development projects, project managers can learn about funding opportunities (JESSICA) through the MA's and UDFs websites. Businesses are generally informed by fund managers about suitable opportunities. For instance, the OP North East England holding fund 'North

[16] The Commission issued guidance notes to Member State authorities in the context of the Committee for the Co-ordination of the Funds (COCOF) on four occasions between mid-2007 and early 2011. The guidance given has, among other topics, explained rules on the selection of holding funds and financial instruments, including selection of EIB and EIF, and State aid issues.

East finance' raises the awareness of SMEs about ERDF financing possibilities through the local media, its official website, social media (twitter), networking events as well as by speaking with lawyers and corporate advisers. In the same OP, the fund managers also communicate about these funding possibilities for instance through directly targeting specific SMEs or start-ups that are included in their databases and might potentially be interested in such opportunities. The interviews have confirmed that SMEs do not know the source of the financial support up until the moment where the contracts are signed and the businesses are confronted with special conditions and requirements (e.g. with regards to reporting imposed by the European Commission). Although rare, there have been cases of early-stage businesses that refrained from operating with EU funds mainly due to complex legal requirements which they could not follow due to their early development stage and small size.

3.4 Take-up and development of FEIs in 2007-2013

This section provides an overview of the scope of use of FEIs established in the 2007-13 programme period. The figures are derived from the most up-to-date source currently available – the European Commission's 2012 summary report on the progress made in financing and implementing FEIs co-financed by SF. This presents the situation as at the end of 2011. The Commission had also previously reported (in 2011) on FEI use as at the end of 2010, based on information provided by MS on a voluntary basis.

3.4.1 Reporting and monitoring: The search for evidence on the use of FEIs

Given that Cohesion Policy follows the shared management principle (see below) MS were initially not obliged to report on the use of FEIs.

The 2012 report is an important step forward in improving the accuracy of information on the use of FEIs under Cohesion Policy, a gap that had been criticised by the Court of Auditors, among others (ECA 2012). The production of the report was made possible largely by an amendment to the General Regulation[17], which meant that, from 2012, MAs were formally required to report on implementation of FEIs.[18] However, gaps remain and the figures are not always easy to reconcile with information received directly from MAs. There have been several points of critique mentioned across the interviews with regards to reporting requirements, whether it regards fund managers or MAs. These are presented in Chapter 5 of this study.

When carrying out the interviews for this particular study, it was in general difficult for the authors to get information and detailed reports from banks and financial intermediaries due to data protection and confidentiality notices in their agreements with the MAs. Moreover, many interviewees argue that it is still too early to collect data (whether of qualitative or quantitative nature) or to draw any conclusions. However, specific evaluations are being carried out to analyse the success and the challenges of using FEIs. In Poland for example, the Ministry of Regional Development has commissioned an evaluation study entitled "Evaluation of FEIs realization within National Strategic Reference Framework 2007-2013" which analyses the implementation of FEI in the OPs for Innovative Economy, the Regional OPs and the OP Development of Eastern Poland. In France, the regional policy agency DATAR has commissioned a study in 2010 (Technopolis 2011) to analyse the usefulness and efficiency of FEIs by interviewing the MAs in France. This study is about to be finalised,

[17] An amendment of Council Regulation (EC) No 1083/2006 in December 2011 introduced an obligation for Member States to formally report on FEIs within their OP Annual Implementation Reports.

[18] Still, certain difficulties were experienced in gathering data and only around 20% of Member States reported the non-obligatory information on FEIs.

but the interviewee pointed out how difficult it was to draw any concrete conclusions before the end of the programming period.

3.4.2 An uneven take-up of FEI across Europe

Despite the problems with monitoring and availability of accurate data from previous years, it is evident that the variety, scope and amounts paid to FEIs have grown rapidly over the few last years (EC 2013a:5). However, significant differences between MS in the use and operation of FEIs can also be noted (Michie and Wishlade 2011).

By the end of 2011, a total of 592 specific funds had been set up, through 178 OPs in all MS, with the exception of Ireland and Luxembourg. There was also one cross-border fund implementing FEIs, the EUREFI venture capital fund supported under INTERREG IVA Grande programme (France, Belgium, Luxembourg) – and initially set up as long ago as the 1994-99 programme period, under INTERREG II. The total value of OP contributions to all FEIs amounted to €10,781 m; of this some €7,078 m were from the SF (both ERDF and ESF – although ESF contributions account for only around 3% of the overall SF contribution (EC 2013a:3).

Box 5: FEI in the ESF: The example of the Entrepreneurship Promotion Fund in Lithuania

Although it is rather rare, financial instruments are being used also in the framework of ESF programmes. The state-owned financing company "Investicijų ir verslo garantijos" (INVEGA) established by the government of Lithuania in 2001 has made such experiences. The company supports the development of SMEs in Lithuania by facilitating their access to financing.

In total, INVEGA manages €250.8 m stemming from ERDF and ESF resources combined with a national budget and reflows.

INVEGA takes up the following roles:

Holding Fund: INVEGA Fund €199 m (ERDF as well as reflows);

Holding Fund: Entrepreneurship Promotion Fund €15 m (ESF).

Separate FEI: Guarantee Fund €37.4 m (ERDF)

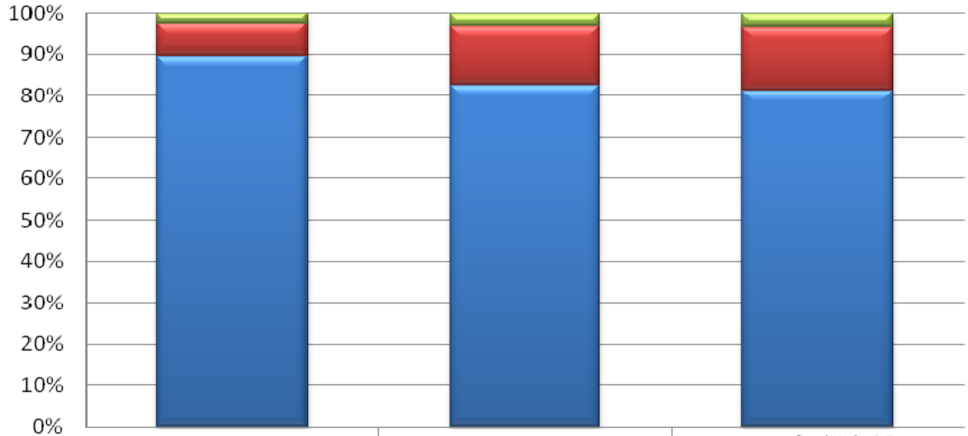
The Entrepreneurship Promotion Fund (EPF) – holding fund currently consists of one instrument called "Entrepreneurship Promotion". Running from December 2009 until the end of 2015, with a total budget of €14.5 m of ESF funding the instrument offers microcredits of up to €25,000 to SMEs (90% financed from EPF resources and 10% from Credit Unions' resources) through a consortium of 57 credit unions. The fund thereby helps people who are unemployed, under 29 years old or older than 50 years and who have established new businesses or have been working under a business license to get a loan combined with training. So far, €14.5 m have been committed, €6 m disbursed, 372 SMEs were supported and more than 3,000 persons have been trained. To encourage job creation, the ESF offers further subsidies if these businesses are able to create a job for an unemployed person.

Source: Interviews.

FEIs for enterprises (Article 44(a) measures) account for nearly 90% of all FEIs implemented in 2007-11. Accordingly most of the OP contributions - €8,903m and around 82% of the total are accounted for by FEIs for enterprises.

A much lower number of FEIs is targeted at urban development (Article 44b) (7.8% of the total number and 14.2% of OP contributions) and energy efficiency/renewable energies (Article 44(c)) (2.5% of the total number and 3.2% of OP contributions) – see Figure 4.

Figure 4: Number of FEIs and OP contributions to FEIs by end 2011 (€ m)[19]



	Number of FEIs[1]	OP contributions paid to FEIs (EUR million)[2]	out of which SF contribution (EUR million)[3]
Article 44 (c)	15	345	250
Article 44 (b)	46	1533	1075
Article 44 (a)	531	8903	5753
TOTAL	**592**	**10781**	**7078**

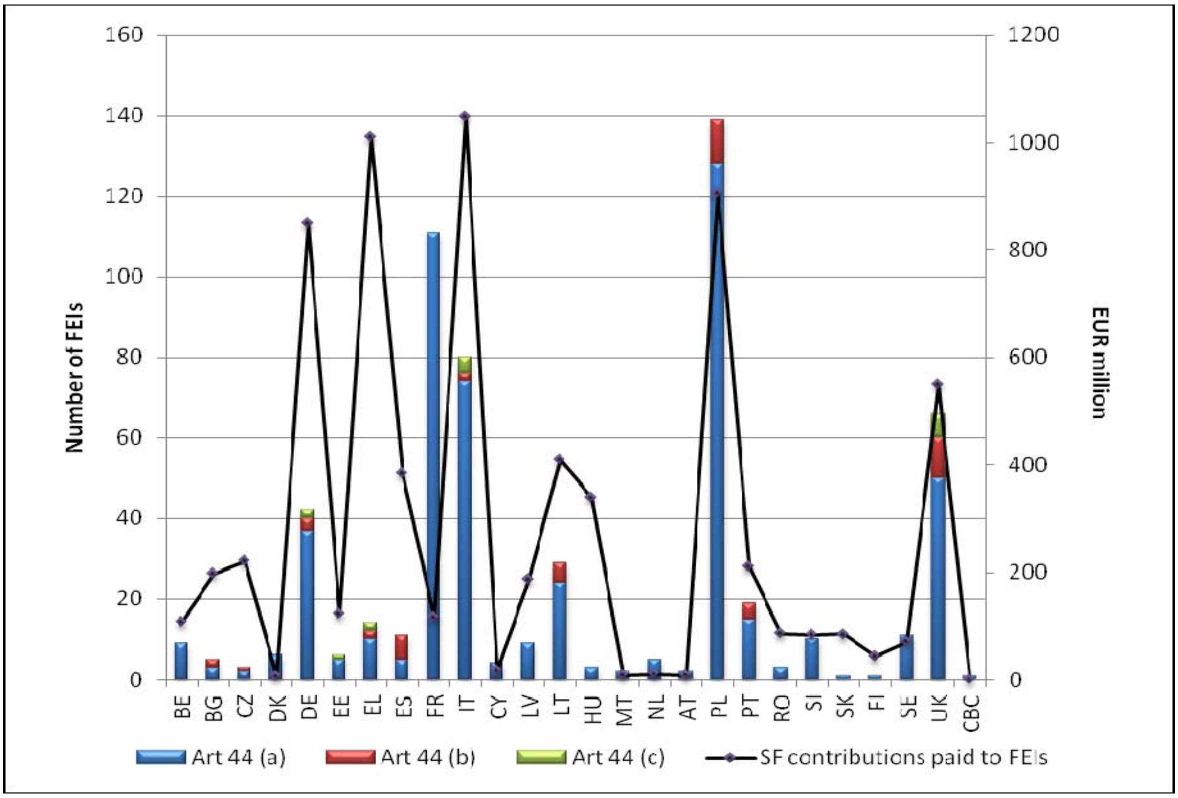
Source: EPRC, based on European Commission (2013).

There are substantial differences among MS in the total number and size of support to FEIs (Figure 5). There is strong concentration of FEI use in a few MS: Poland, France, Italy, the UK and Germany, together account for 75% of all fund using FEIs; and Italy, Greece, Poland, Germany and the UK together account for 49% of SF contribution to FEIs.

Some countries, such as France, have set up a large number of FEIs, but the SF contribution is relatively low, indicating that average fund size is small; however, this pattern is not universal – in Greece, for example, the reverse is true. Most countries have set up fewer than ten FEIs, with SF contribution of less than €200 m. In all countries, FEIs for SMEs were in the majority and FEIs were implemented in all, or nearly all, regions (see Ward 2012:7).

19 Note: 1) These numbers include 68 holding funds, of which 47 were set up for FEIs for SMEs under Art 44(a), 18 for urban development projects under Art 44(b) and 3 for energy efficiency/renewable energies under Art 44(c); 2) paid to holding funds and directly to specific funds implemented without a holding fund; 3) paid to specific funds implemented with and without a holding fund.

Figure 5: Number of FEIs and Structural Funds contributions paid to FEIs



Source: EPRC, based on European Commission (2013).

Support under Article 44(a) - FEIs for enterprises – is deployed through all types of FEIs (loans, guarantees, equity, venture capital and other products). By contrast, FEIs for urban development (Article 44b) and energy efficiency and renewable energies (Article 44c) so far only take the form of loans (Table 7).

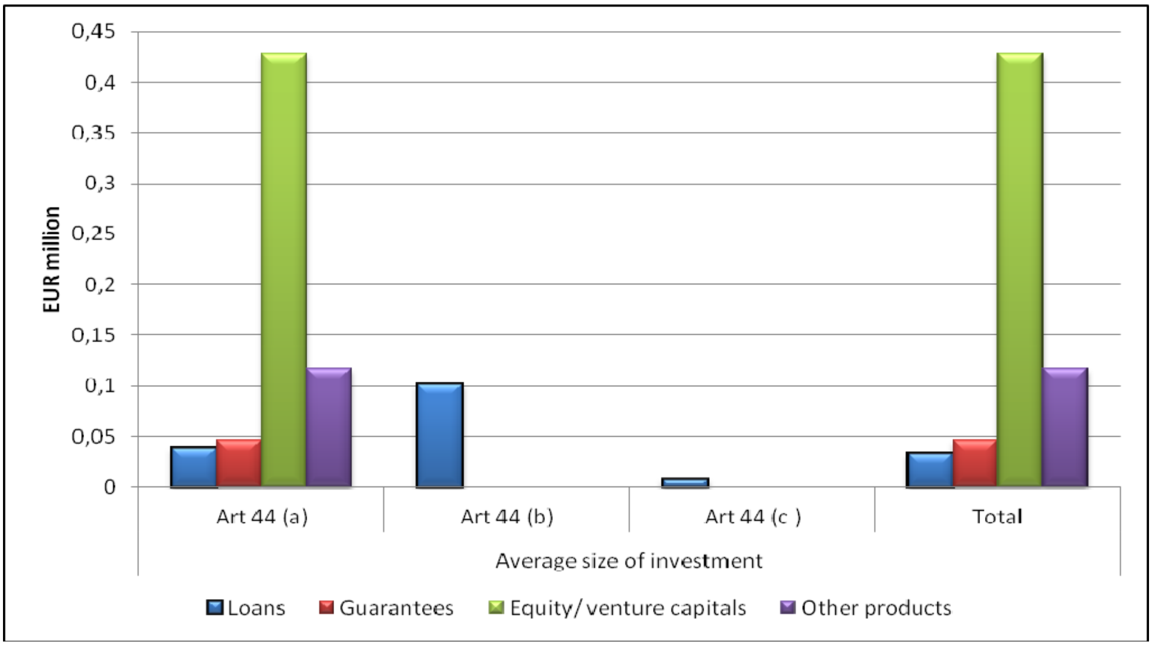
Table 7: Number of awards and amounts disbursed to final recipients

Fund structure	Art 44 (a)		Art 44 (b)		Art 44 (c)		Total	
	No	€m	No	€m	No	€m	No	€m
Loans	38.997	1.494.95	61	6.17	7,121	52.45	46,179	1,553.57
Guaran-tees	24.414	1,129.63					24,414	1,129.63
Equity	1,357	580.27					1,357	580.27
Other products	3,225	379					3,225	379

Source: EPRC, based on European Commission (2013).

Loans are the most frequently used instrument, and also account for the largest OP contribution to final recipients (€1,553.57 m) – see Table 7. A much smaller amount has, in contrast, been awarded to final recipients through equity/venture capital FEIs overall. However, when the *average* size of each investment is examined, (Figure 6), it can be seen that, on average, loan and guarantees are much smaller than the average equity/venture capital investment. There are also differences in average size of loan support among FEIs. The average loan size was smallest (€ 7,000) in FEIs for energy efficiency and renewable energies and highest in FEIs for urban development (€ 0.1 m).

Figure 6: Average size of investment per FEI type



Source: EPRC, based on European Commission (2013).

3.4.3 An uneven take-up of FEIs – A comparative analysis of the Case Studies

The case studies echo the point made in the literature review that significant differences between MS in the use and operation of FEIs can be noted (see Table 8). Among the case studies OPs, using national data obtained from the case study reports, Sachsen-Anhalt has by far the largest absolute allocation to FEIs, with an ERDF contribution of €248.7 m, nearly 13% of the ERDF allocation to the programme. This is also the largest allocation by far among the German Länder from the ERDF to FEIs. However, while the Lowlands and Uplands Scotland OP has awarded the lower figure of €116 m to FEIs, this represents around one third of the programme's ERDF resources. In contrast, the Slovenian 'Strengthening Regional Development Potentials' OP allocates only 2.8% of ERDF to FEIs.

All the case study OPs use FEIs to support SMEs; this is by far the most widespread use of FEIs co-financed by Cohesion Policy. Some provide general SME support; others target high-tech start-ups. Two of the OPs selected use FEIs for urban development (Śląskie in Poland and Lowlands and Uplands Scotland in the UK, both using the JESSICA initiative). Table 8 illustrates the different types of instrument that have been co-funded by ERDF in the case study OPs.

Table 8: FEI instruments in the case study OPs

OP	Funds	Purpose
Sachsen-Anhalt ERDF	• SME Loan Fund (*KMU-Darlehensfonds)* • Ego.PLUS seed loan fund	• Mezzanine/traditional loans to start ups and existing growing SMEs, especially in manufacturing sector • Mezzanine loans to SMEs of up to three years old for bringing a new product, process or service to market, as well as for R&D and investment projects

OP	Funds	Purpose
	• IBG II Risk Capital Fund (Risikokapitalfonds IBG II)	• Equity investments, convertibles and/or mezzanine loans to SMEs
Itä-Suomi	• Aloitusrahasto Vera Oy (Starting Fund Vera Ltd • FINNVERA subsidised loans and guarantees	• SMEs in ICT services, industry with manufacturing innovations, and innovation intensive services • SME start-up and development
Languedoc-Roussillon	• JEREMIE Fund • JEREMIE Fund • JEREMIE Fund	• CREALIA loans for innovative projects • SODIREC equity or co-investment funds • Banque Populaire du Sud guarantees
Śląskie ERDF ROP	• Support for local, regional and sub-regional loan funds, micro-loan and guarantee funds • JESSICA Fund	• Support for entrepreneurs • Urban development projects
Strengthening Regional Dev. Pot.	• Slovene Enterprise Fund instruments • Slovene Enterprise Fund instruments	• Debt financing (guarantees, counter-guarantees and credits) • Equity financing, through the provision of support for venture capital companies
Lowland and Uplands Scotland ERDF	• Scottish Co-Investment Fund • Scottish Venture Fund • Scottish Loan Fund • West of Scotland Loan Fund • East of Scotland Investment Fund • JESSICA Fund	• Private sector partner-led co-investment approach/early stage risk capital • High-growth SMEs • Unsecured and mezzanine debt finance to established growth and exporting businesses • Loan finance to new and growing SMEs • Loan finance to new and growing SMEs • Scottish Partnership for Regeneration in Urban Centres (SPRUCE) Fund

Source: Case Study reports.

Table 9 provides more detail on the FEIs used in the case study OPs, with data derived from the Commission's 2013 summary report. The table shows the OP contribution to the instruments, the total ERDF contribution, public co-financing and private co-financing. There is a great variation in size between FEIs, from the €237.87 m SME Loan Fund in Sachsen-Anhalt to the €2-3 m equity FEIs in Slovenia. As can be seen from the table, many funds do not employ private sector co-financing. These figures may be misleading for a number of reasons, however. They may overstate the private sector contribution (for example, high levels of private sector co-financing can be seen for the Slovenia equity schemes, but these had yet to complete an investment, at the time of reporting to the Commission). On the other hand, private sector involvement may take place at a later stage than co-financing at FEI/fund level, for example, in the Scottish Co-Investment Fund; investments are made pari passu with the private sector at the level of the investment.

Table 9: Funding contributions to FEIs in case study OPs

MS	ERDF OP	FEI	OP contribution (€m)	ERDF contribution (€m)	Public co-financing (€m)	Private co-financing (€m)
DE	Sachsen-Anhalt	SME Loan Fund (*KMU-Darlehensfonds)*	237.87	174.84	63.04	0
		Ego.PLUS seed loan fund	10	10	0	0
		IBG II Risk Capital Fund (Risikokapitalfonds IBG II)	85.01	63.76	21.25	0
FIN	Ita-Suomi	Finnvera equity	35.89	17.94	17.94	0
FR	Languedoc-Roussillon	JEREMIE holding fund	30	15	15	0
		JEREMIE FEI	2.2	1.1	0	0
PL	Śląskie	Regional guarantee fund	5.95	5.04	0	0.91
		JESSICA HF	62.83	53.41	9.43	0
		JESSICA UDF	63.22	53.74	0	0
SI	Strengthening Regional Development Potentials	Guarantee Fund	42.66	36.26	6.4	0
		PFEI - Prog of FEIs (HF)	56.55	48.07	8.48	0
		1. Guarantee FEI	21.5	18.28	3.22	0
		2. Equity FEI 1	5	4.25	0.75	5.21
		3. Equity FEI 2	3.92	3.33	0.59	4.08
		4. Equity FEI 3	9	7.65	1.35	9.41
		5. Equity FEI 4	2.64	2.25	0.40	2.75
		6. Equity FEI 5	3.68	3.12	0.55	3.83
		7. Equity FEI 6	2.5	2.12	0.37	2.60
		8. Equity FEI 7	7.2	6.12	1.08	7.49
UK	Lowlands and Uplands Scotland	Scottish Co-Investment Fund	65.76	17.76	48.0	0
		Scottish Loan Fund	43.39	4.53	36.00	2.86
		Scottish Venture Fund	40.85	24.0	16.85	0
		WSLF	18.0	7.2	5.4	5.4
		ESIF	6.0	2.14	2.06	1.80
		JESSICA HF	60.0	28.8	31.2	0
		JESSICA UDF (SPRUCE)	58.0	28.0	30.0	0

Source: EC 2013a, except SPRUCE figures from Scottish Government.

3.4.4 Evolution of FEI use

Overall, the use of FEIs has risen in prominence under Cohesion Policy programmes over successive programme periods, from € 0.57bn (0.44% of total SF allocations) under ERDF in 1994-99, to €1.3bn in 2000-06 (0.8% of total allocations), and €11.6bn in 2007-13 (4.4% of total allocations) (Michie and Wishlade 2011:19, Ward 2012:2). The use of the ERDF to co-finance FEIs has increased over time in most countries, but not all. In Belgium, Germany and the UK, funding was allocated to FEIs for the first time in the 1994-99 programme period and a number of other countries followed suit in the 2000-06 period, including Spain, the Netherlands and Austria as well as Latvia and Slovenia after 2004 when they entered the EU and became eligible for ERDF support (Ward 2012: 6). In most EU MS, ERDF support for FEIs was initiated in 2007-13. In general, use has expanded more in Convergence regions over the period than in Competitiveness areas. The expansion of FEI use from the 2000-06 period to 2007-13 has been entirely a result of more funding being set aside for loans, loan guarantees and other forms of credit rather than for venture capital funds, which on average have remained unchanged (Ward 2012: 6).

Box 6: Using FEI – an uneven take-up across Europe

The discussions with various stakeholders from different MS revealed important differences in their approach towards using FEIs to implement EU policy measures. An interview with a representative of the French regional development agency DATAR revealed that the share of FEIs in Structural Funds in France ranges only between 2% and 3% (which translates into €130 m in ERDF and €165 m in EAFRD). According to a study which is currently being carried out by Technopolis (to be published in 2013), the low use of FEI in EU Programmes in France is due to the lack of transparency and stability of the EU Regulations, a lack of competences at all levels of administration and a persistent reluctance to shift from grants to FEIs (See Chapter 5).

On the other hand, the interviews with MAs, holding Fund managers and fund managers in the UK and Germany give the impression that there is a long-standing tradition in using such instruments and the actors involved are therefore used to these types of processes. In Slovenia, Poland and Hungary, the interviewees however stressed the perceived advantages of FEIs for the economic development of the regions which was backed up by a high take-up and fast increases in using FEIs.

To name an example, Hungary has started using FEI in the current programming period in the framework of JEREMIE. In the ERDF OP for Economic Development (total budget: €3.4bn) and the Central Hungary OP (CHOP), Priority 4 is entirely dedicated to financial engineering (approximately 22% of total funding). In accordance with the JEREMIE initiative, this priority looks to tackle the failures of financial markets in Hungary and to improve the access of SMEs to a variety of FEIs and related advisory assistance through offering micro-credit, guarantee instruments and venture capital. Although in the first years of the programming period the MA was dedicated to setting up the operational structure, sufficient financial intermediaries have been selected to offer contracts to SMEs since 2009. The "tremendous" increase in offering FEIs in only a few years time has resulted in 8,600 final recipients having been reached in the Economic Development OP and 3,000 final recipients in the Central Hungary OP so far.

Poland has been qualified as the "leader in implementing JESSICA in Europe" for having had very positive experiences with implementing JESSICA by a representative of the unit in the Ministry of Regional Development responsible for coordinating the regional OPs. In Poland, the total budget for JESSICA is €257 m for a total of 20 contracts signed in 5 regions, namely Wielkopolska (€67 m, 8 projects), Zachodniopomorskie (€33 m, 3 projects), Śląskie (€60 m, 4 projects), Pomorskie (€57 m, 5 projects) and Mazowieckie (€40 m, 1 pending project). The most important increase took place in 2012.

Source: Interviews.

3.4.5 Reasons for different scope of FEI use among Member States

There are substantial differences in FEI use among MS. These are mainly due to differences in the financial markets' operations in different countries and diverging traditions and socio-economic conditions that affect how and to what extent FEIs are deployed.

The level of development and innovation in **financial markets** varies among MS. The ability of SMEs to obtain finance is seen as their 'most pressing problem' (for example, in the European Commission's 2011 SME access to finance survey), but this too differs between countries. In some, the most important obstacle to a firm obtaining a loan is simply that financing is not available at all (EC 2011b: 79); elsewhere, it may be limited by the collateral demanded in exchange for finance, the variable expertise in local branches to assess business prospects, the lack of a tradition of banking support for local enterprises, or simply the physical absence of local banks (Ward 2012). There are also differences in the innovation capacity of financial markets and the demand for financial support for investment. Moreover, the venture capital markets diverge across countries.

There appears to be a market gap and need for public support in countries where financial markets are less developed. However, there is no close relationship between the apparent extent of banking support for small enterprises and the share of ERDF devoted to loans. Also, there is only a weak relationship between innovative capacity and the share of ERDF devoted to venture capital (Ward 2012).
Some MS have both well-developed financial markets and a long tradition of public support for SMEs, but these are largely absent in others (Technopolis 2011: 38-40, Ward 2012). The impact of this on SF co-financed FEIs has two dimensions. First, FEI use under Cohesion Policy may not be attractive because such instruments are already considered sufficiently provided for under domestic arrangements. Accordingly, some MAs have considered that it makes more sense to draw on existing expertise and structures rather than setting up a parallel institutional framework (Michie and Wishlade 2011:22). Paradoxically, the absence of well-developed financial markets or traditions of public support for SMEs may also discourage the uptake of FEIs by MAs owing to lack of expertise and experience – indeed, this is one of the main reasons given for not using FEIs, especially in the EU 12 countries (Ward 2012).

Furthermore, as the use of FEIs has been new for many MS, grants have been preferred by policy-makers over FEIs. Also, the difficulties of incorporating wider objectives into financial engineering schemes as well as their unsuitability for projects which do not generate returns or for particular types of investments, such as RTD and innovation (Ward 2012), has prevented their use.

3.5 Beyond Cohesion Policy

3.5.1 FEIs outside Cohesion Policy

FEIs operating within Cohesion Policy programmes sit alongside a range of other initiatives and instruments at EU level, and operating domestically within EU MS. Table 10 below outlines some of the EU-level initiatives which provide FEIs. Close examination of these measures is beyond the scope of this study; however, it is important to note that similar measures operate in other areas of EU policy and that there is considerable experience with such measures in a number of MS.

Table 10: EU-level initiatives including FEIs

Initiative	Coverage	Description of the initiatives
7th Research & Development Framework Programme (FP7)	EU27, EEA, Candidate countries	FP7 includes the operated Risk Sharing Finance Facility (RSFF) which invests in SMEs in high growth areas and in other thematic areas. (volume: €2bn)
Competitiveness and Innovation Framework Programme (CIP)	EU27, EEA, Candidate countries	CIP includes initiatives developed by the EIF, e.g. High Growth and Innovative SME Facility (GIF) and the SME Guarantee Facility (SMEG). CIP is divided into three programmes: Entrepreneurship and Innovation Programme (EIP); ICT Policy Support Programme (ICT-PSP); and Intelligent Energy Europe Programme (IEE). The CIP has a budget of over €1bn to facilitate access to loans and equity finance for SMEs where market gaps have been identified.
European Progress Microfinance Facility (EPMF)	EU27, EEA, Candidate countries	Launched in 2010 with the aim of increasing the availability of microcredit loans to start up or develop a small business through microcredit providers. (volume: €200m)
Loan Guarantee Instrument for TEN-T projects (LGTT)	EU27	Established by the Commission and the EIB; aimed at facilitating private sector involvement in core European transport infrastructure, which often face difficulties in attracting private-sector funding due to the relatively high levels of revenue risk in a project's early operating stages. (volume: €1bn)
2020 European Fund for Energy, Climate Change and Infrastructure (Marguerite Fund)	EU27	Backed by six major European financial institutions to make capital-intensive infrastructure investments. It targets attractive long-term and stable risk-adjusted returns in the development of transportation, energy, and climate change. (volume: €1.5bn)
Technology Transfer Pilot project (TTP)	EU27	Funds technology transfer activities in universities, research organisations or SMEs through EIF investment in venture capital and other investment vehicles, which then focus on financing of projects to commercialise intellectual property. (annual budget of €2million)
Joint Action to Support Microfinance Institutions in Europe (JASMINE)	EU27	A joint initiative of the EIB Group aimed to support the development of microcredit providers. (budget: €50m)

Initiative	Coverage	Description of the initiatives
European Local Energy Assistance (ELENA)	EU27, EEA, Candidate countries	A joint initiative of the Commission and the EIB with the aim of supporting the EU's climate and energy policy objectives by helping MAs prepare energy efficiency or renewable energy projects, by developing 'bankable' investment projects that can attract outside finance from banks or other financial institutions such as EIB. (budget: €15m)
European Energy Efficiency Fund (EEEF)	EU27	A public-private partnership aimed at mitigating climate change through energy efficiency and renewable energy. Focuses on financing energy efficiency, small-scale renewable energy, and clean urban transport projects via direct investment and debt, mezzanine, leasing, equity, co-investment and risk-sharing instruments. (volume: €265m)

Source: European Parliament (2012b)**.**

FEIs co-financed under Cohesion Policy also operate alongside a range of domestic revolving instruments at MS level. As Mason et al (2012: 1) point out, FEIs are 'new' only in the Cohesion Policy framework and many countries have used such instruments as part of economic development policy for decades (e.g. CSES 2012, Technopolis 2011). In general, however, it is difficult to assess the scale and importance of the use of such revolving instruments, because they often tend to be operated at the subnational level and 'at arm's length' from public policymakers, albeit with public funds (Mason et al. 2012).

In a number of MS, such as Denmark, Finland, Germany, Spain and the United Kingdom, these domestic revolving instruments are well-established, while in others, especially smaller countries, they are less widely used. Many long standing domestic instruments are loans and accompanying loan guarantees, and hitherto, most of the public sector's involvement in the provision of access to finance through FEIs has been centred on the provision of general SME and entrepreneurship support. Indeed, the use of revolving instruments is an established part of broad SME policy in many EU MS. Another common usage for revolving instruments in MS is in support for innovation, through the provision of finance for technology-oriented firms, and support for R&D projects. There are also a number of examples of domestic revolving instruments supporting urban development. More recently, the public sector has also become involved in revolving instruments supporting the thematic areas of low carbon and renewable energy (Mason et al 2012).

3.5.2 Shared versus central management

While the instruments under SF, Cohesion Fund, the European Marine and Fisheries Fund (EMFF) and the European Agricultural Fund for Rural Development (EAFRD) follow the principle of 'shared management' between the EU and the MS, the funds in the areas of research, environment and external action are managed centrally by the European Commission. In the European Commission, these different instruments are therefore managed by different departments. The aforementioned CIP and EPMF facilities for instance fall under the responsibility of the DG for Economic and Financial Affairs (DG ECFIN). Both are managed by the European Commission together with the EIF. The same is true for the Risk Sharing Finance Facility (RSFF) where €2bn of EU and EIB resources aim to generate over €10bn of lending to Research, Development and Innovation projects as well as the Risk Sharing Instrument (RSI) where DG ECFIN is represented in the Steering Committee overseeing the implementation and the design of new products and extensions to the scope of the instrument (Guarantee schemes, risk sharing products). DG ECFIN now contributes to the design of several new centrally managed instruments for the next financing period (in the areas of growth, jobs and social cohesion as well as research, development and innovation) – see Table 11. According to a representative of DG ECFIN, Joint instruments are planned to be implemented enabling to combine central budget resources with SF resources as well as off-the-shelf instruments, i.e. standardized instruments for which the terms and conditions will be laid down by the European Commission based on the lessons learned and ensuring compliance with the state aid regulations.

Table 11: Shared versus central management: Future FEIs outside of Cohesion Policy

Instruments	Description
The Programme for the Competitiveness of Enterprises and SMEs (COSME)	COSME will run from 2014 to 2020, with a planned budget of €2.5 bn. COSME will facilitate access to finance for SMEs, support business creation and encourage entrepreneurship. COSME will include an equity facility named the 'Equity Facility for Growth' (EFG) which will invest in Venture-Capital funds as well as a debt window named 'Loan Guarantee Facility' (LGF) which will provide guarantees to financial intermediaries providing loans to SMEs. These facilities will be implemented by the EIF but the COSME Basic Act also foresees the possibility of implementation by other entrusted entities (art. 58).
Culture and Creative Sector Facility	Together with DG Education and Culture, DG ECFIN will manage the 'Culture and Creative Sector Facility' offering loan guarantees instruments to support SMEs in the media and creative sector (integrated with COSME and Horizon 2020). The aim is to facilitate the access to private funding through guarantees which could generate more than € 1bn in loans.
Erasmus for all	Erasmus for all will bring together all the current EU and international schemes for education, training, youth and sport, replacing seven existing programmes with one. It will support Master-level students to finance their studies abroad through cheap loans through with a planned budget of €880 m.
Programme for Social Change and Innovation (PSCI)	PSCI is planned to integrate the three existing programmes: Progress (Programme for Employment and Social Solidarity), EURES (European Employment Services) and the EPMF and extend their coverage. The PSCI will support policy coordination, sharing of best practices, capacity-building and testing of innovative policies, with the aim that the most successful measures be up-scaled with support from the ESF.
FEI under Horizon 2020	Horizon 2020 is the financial instrument implementing the Europe' 2020 flagship initiative 'Innovation Union'. With an €80bn budget, Horizon 2020 will combine all research and innovation funding currently provided through the Framework Programmes for Research and Technical Development, the innovation related activities of the CIP and the European Institute of Innovation and Technology (EIT).

Instruments	Description
	Under the Horizon 2020 programme a facility for debt ('Debt facility'), and a facility for equity ('Equity facility') will support SMEs, start-ups and small Mid-cap companies as well as universities involved in research, development and innovation based on the lessons learned from the current RSFF and RSI schemes. Horizon 2020 together with COSME will cover companies at different stages of their development. The planned support for research and innovation under Horizon 2020 is to strengthen the EU's position in science with a dedicated budget of €24,598 m; strengthen industrial leadership in innovation with €17 938 m (major investment in key technologies, greater access to capital and support for SMEs), and provide €31,748 m to help address EU-wide issues (e.g. climate change, sustainable transport and mobility, affordable renewable energy, ageing population, etc.).

Source: Interviews and official websites of the European Commission**.**

4. AT THE RIGHT TIME, IN THE RIGHT PLACE: THE ADVANTAGES OF FINANCIAL ENGINEERING INSTRUMENTS

The advantages of using FEIs under SF programmes (over other forms of support) have been outlined in a number of reports, including Cowling 2010, ECA 2012, EC 2012a, EC 2011, EC 2010, EP 2012, EP 2012b, Michie and Wishlade 2011, Ward 2012). The reported advantages, particularly for FEIs supporting enterprise development, include the following features:

- Leverage effect
- Sustainability
- Capacity building
- Risk coverage
- Speeding up programme implementation
- Urban development

These will be described and illustrated in the paragraphs below.

4.1 Leverage effect

The main perceived advantage of using FEIs is that they enable additional support to be channelled to SMEs, with a potentially greater financial impact than grants, due to the ability to attract additional public and private sector resources, thus multiplying the effect of SF resources and the national/regional contributions.

To name an example, in an interview, a representative of the North East Finance, a holding fund under the North-East England OP, claimed that the fund has been able to leverage more than GBP 1 per GBP 1 of private funds through the JEREMIE Initiative. Up to 2013, the fund invested about GBP 64m, alongside which over GBP 70 m of private capital and GBP 4 m of additional public funding have been invested. In short, North East businesses received over GBP 130 m as a result of the North East JEREMIE funds.

According to the interviews, such leverage effect is even more evident for certain small countries traditionally less attractive for international investments. For instance, an officer of Balt Cap, a financial intermediary operating in the Baltic States, pointed out that usually, international investments in the three Baltic Countries are reluctant to invest. However, through the JEREMIE Initiative, the institution was able to collect extra financing from other investors and thereby double the initial contribution of JEREMIE.

4.2 Sustainability

The use of FEIs can promote the long-term recycling of public funds, regarded as particularly important in times of public budgetary constraints. For regional MAs, they potentially enable the reinvestment of SF at the level of the region beyond the end of the programming period, helping achieve better value for public money. As pointed out by an officer of the North East England JEREMIE holding fund, FEIs have the potential to "increase the value of taxpayers' money".

Box 7: Moving away from grants – Evidence from the Case Studies

In Sachsen-Anhalt, the OP envisaged that as well as plugging a gap in SME funding, FEIs would contribute to the Sachsen-Anhalt Land government's strategy of reducing the use of grants and instead developing a set of revolving funds which would be available for supporting economic development in the long term, beyond the end of the SF programme period.

The main benefit of using FEIs in Poland was considered to be the ability to address significant under-investment, in a way that could support or lever in additional investment and, potentially, make profits. Moreover, at the current stage of the programme process in Śląskie, funding for grants is almost completely accounted for, and loans or guarantees can be offered to firms on better terms than from private banks.

In Finland, FEIs are perceived to be more efficient than grants in administrative terms, particularly given that they enable more regular and longer-term monitoring (Vironen 2011), while in Scotland, a major benefit of FEI use identified has been capacity building in the local financial community.

Source: Case Study reports.

4.3 Capacity building

FEIs use can help build institutional capacity through partnerships between the public and private sectors, can broaden the involvement of financial intermediaries/institutions in implementing EU regional policy and can encourage pooling of expertise and know-how, for example to support start-ups, or to improve the quality of projects.

Additionally, as emerged from the interviews, the creation of public-private synergies ultimately results in an alignment of interests between public and private actors, taking the best out of both. On the one hand, they enable the pursuit of public policy objectives which characterises public institutions, and on the other hand, they bring in the commercial-market mechanisms accompanying private investors. In the case of venture capital, pooling the expertise and know-how from private investors such as banks could provide an essential practical experience to SMEs, giving them a competent partner on site able to provide advice and technical support.

However, the access to know-how is perceived not only by the final beneficiaries, but also by the financial intermediaries or strategic bodies. One interesting example in this aspect is the 2009-2013 ERDF Programme on Financial Engineering Instruments (PFEI) for micro, small and medium-sized companies in Slovenia. Even though the practical knowledge of the OP officers on FEIs was "not optimal" at the beginning of the programming period in their own words, through the involvement of primarily American and Dutch experts and through the continuous dialogue with the EC, the institution was able to acquire a certain degree of expertise which facilitated its FEI-related activities. This particular OP is focused on supporting SMEs mainly through providing guarantees, loans and venture capital. Its budget has even been increased from €35.05 m to €118.15 m due to the high interest of SMEs in the funds. Moreover, additional national financial resources were provided in

December 2010 in the amount of €50 m and €5 m from the Slovene Enterprise Fund's earmarked capital in January 2013. The total budget for FEIs amounts to € 115m in January 2013.

The exchange of information and experiences amongst relevant stakeholders is seen as a crucial factor for achieving better results according to the interviewees.

4.4 Risk coverage

The use of FEIs may encourage investors to invest (more) in projects which are not attractive without public intervention, since such types of investments are considered too risky from normal private financial institutions. This is particularly important for relatively small start-ups active in high-risk sectors (e.g. high tech, ICT) which, especially in the context where private investors are reluctant to take any risks, would not have access to finance for their low disposable collateralisation.

One example is the initiative carried out by the NRW-Bank in Germany. In an interview, a representative of the bank described that through the NRW / EU.Mikrodarlehen (a fund made by 50% ERDF and 50% NRW regional contribution) the bank issues loans covering the financial needs of start-ups for a duration of 6 months. This specific type of loan, issued for an amount between €5,000 and €25,000, focuses on start-ups that cannot yet prove business success, and accordingly, would not be able to receive any classical form of loans from a private bank.

Lastly, another example is the CAT Invest Zealand, an ERDF co-financed fund operated by the financial intermediary 'CAT' in Denmark. A representative of the CAT described in an interview that the fund issues equities up to €1 m and not exceeding the 30% of ownership to a range of beneficiaries (e.g. scientists, inventors, idea generators and entrepreneurs) not otherwise supported by private institutions.

Also, in all the case study OPs, the main benefit to and rationale for using FEIs was to address an identified funding gap in the programme area, for example:

- in response to specific funding problems encountered by new SMEs in Sachsen-Anhalt
- as a response to identified problems in the availability of venture capital for start-up firms in Eastern Finland
- an identified problem of the lack of finance for financing the start-up and development of enterprises in Slovenia, due to an underdeveloped capital market, lack of venture capital funds, too few direct foreign investments, banking instruments not being adapted to financing the set-up and growth of enterprises and a lack of state subsidies (Kavas 2012).

According to the interviewees, the three aforementioned advantages of using FEIs, namely the leverage effects, the revolving nature and the risk coverage, ultimately result into having cheaper financing for SMEs (e.g. lower interest rates, lower collateral demand, extended grace period, no fees, etc.). These are variables which certainly contribute to stimulating the spending and economic activities of SMEs, supporting their business expansion and competitiveness.

4.5 Speeding up programme implementation

For MAs, FEI use can **speed up programme implementation**, accelerating the absorption of funds and reducing the risks of automatic de-commitment. Also, according to MAs once the fund is set up, the procedures to obtain financing are faster because they are less bureaucratised compared to grants.
In other words, the investments can be made in a quick manner. However, this practice has been criticised by the European Court of Auditors (ECA), and is discouraged by the European Commission. In fact, according to the ECA (2012), in contrast to grants, the current SF regulatory framework does not provide for automatic de-commitment meaning that wherever holding funds are in place, the financial resources are being held by within that holding fund during the life of the OP instead of being transferred to the final recipient (no disbursements).

4.6 Side/indirect effects

A number of advantages have been identified in using FEIs rather than grants by the interviewees:

- The use of FEIs can potentially **encourage efficiency among final recipients** through greater financial discipline through the heightened awareness of the need to repay loans (unlike grants). Throughout the interviews, this factor emerges also as 'assurance of quality' of the project. In other words, FEIs encourage companies to grow and become more competitive in order to return the investment, necessitating the planning and developing of a growth strategy. The shift from grants to FEIs requires more strategic thinking from the MAs.
- **Timing**: FEIs cover the planned investments ex-ante (pre-financing). Compared to grants, this is a considerable improvement since grants and subsidies cover expenses as ex-post reimbursements. This is of particular importance in the current period of economic downturn where companies can hardly afford the pre-financing of investments without any additional support.
- **Wider eligible cost**: FEIs have a broader spectrum of eligible investments than grants. While grants can merely cover hard costs (e.g. machines), FEIs have the possibility of covering staff-related costs. This is of particular importance for businesses involved in the fields of ICT or high-tech technology, which are sectors requiring considerable investment in human resources rather than machinery.
- Lastly, compared to grants or subsidies, **FEIs do not distort the competition** in the markets. While grants were allocated to beneficiaries whenever estimated necessary, FEIs are used in a more transparent manner and, through imposing commercial conditions, they are offered in a more competitive way.

In addition to the aforementioned qualities of FEIs, the interviewees pointed out two positive **indirect effects** of such instruments which may respond to the market gaps identified:

- The creation and safeguarding of jobs (and the possible consequent contribution to social security)
- The stimulation of players in the market

The Slovene Enterprise Fund for instance estimates that through the guarantees issued by the OP PFEI about 1.12 jobs per supported SME were created, with an increase in added-value per employee of 32% after three years of the investment. The North East England JEREMIE holding fund reports that through the seven specific funds implemented under the JEREMIE Initiative, about 2,000 jobs have been created or safeguarded.

With regards to the second point, an example which can enlighten the aspect is the case of the OP Lowlands und Uplands Scotland where, as revealed in an interview with a representative, business angels increased from 2 to 19 in about 10 years (2003-2013).

4.7 Urban development

The provision of new FEIs for **urban development** has been viewed as being particularly important, given that there are few financial or other vehicles on the market that play a similar role to the urban development funds supported under JESSICA initiatives (Michie and Wishlade 2011). This importance has been heightened by the economic crisis. Furthermore, the JESSICA initiative can act as a catalyst for the establishment of partnerships between MS, regions, the EIB, other banks and stakeholders and investors, to help address the problems of urban areas (EIB 2011). Encouraging new actors in the urban development arena, particularly the private sector, is frequently mentioned in the JESSICA feasibility studies, where the use of FEIs is viewed as providing new opportunities for private sector participation in urban development projects, helping leverage additional funding through PPPs, and mobilising additional support beyond grants.

An interesting example is the case of the Bank Gospodarstwa Krajowego (BGK), the only State development bank in Poland. The institution, among the varieties of its activities, also takes up the role of a UDF manager of the JESSICA Initiative in three polish districts, with a total budget of PLN 615 m. At the end of January 2013, the institution received 53 loan applications in the districts of Pomorskie and Wielkopolskie, issuing financing to 11 of them, for an amount of PLN 192.7m. One practical example worth mentioning among these 11 financed projects is the Leszno Shopping mall, a three level-building with 120 retail and services premises. The investment revitalised an area of 16,000 m^2 and had a total investment value of PLN 178m, 50m of which granted by JESSICA through loans with the following characteristics:

- Preferential interest rate
- Long loan maturity (max 20 years)
- Possible grace period of 1 year
- No fees or commissions

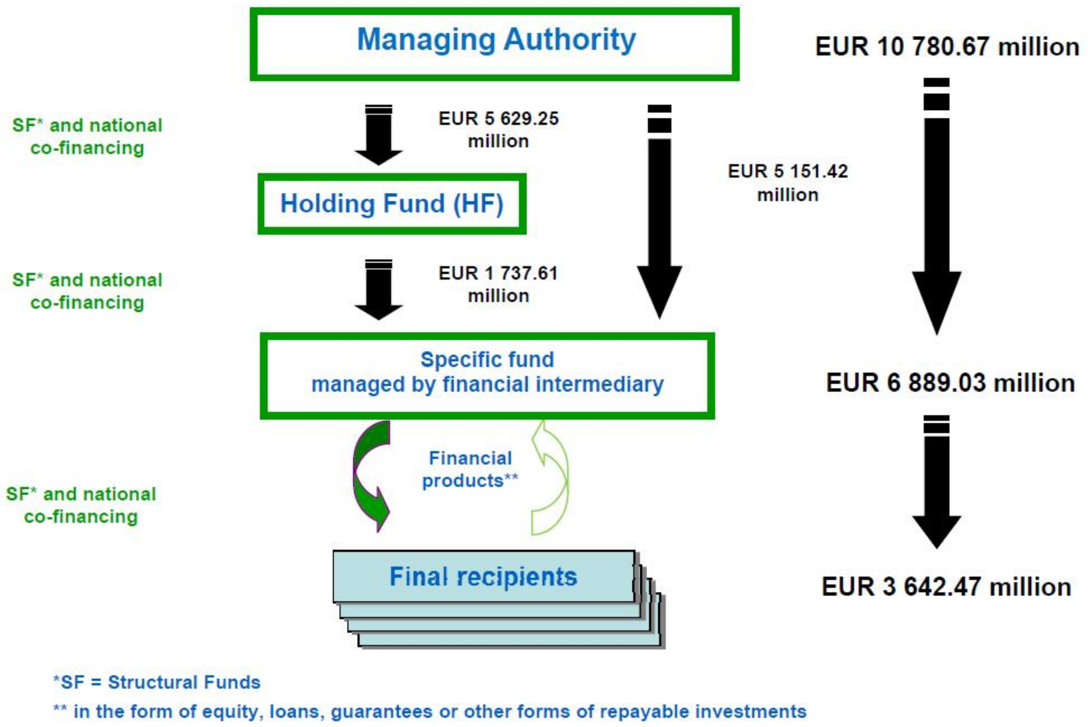
Another point made by the interviewees was that compared to grant projects, the urban development initiatives supported by FEIs are more effective because they need to have multi-use purposes and therefore cover more than only one need (e.g. buildings with residential and commercial components).

4.8 Meeting the objectives

As reported from the interviews, the effects on the ground from the implementation of FEIs are not yet visible. Northstar Ventures (fund manager under the North East England JEREMIE) mentioned that the funds, running only since 2010, will have plausible results in 2016. The same is true for the OP for Economic Development in Hungary, where the results will only be visible after the closure of the OP.

However, one way of knowing whether FEIs have been effective would be verifying extent to which funds are actually reaching the final recipients. By the end of 2011, approximately one third (€ 3,642.47 m) of the total value of OP contributions paid to FEIs (€ 10,780.67 m) had reached the final recipients (mainly SMEs). In total, € 6,889.03 m had reached specific funds and was available to support final recipients, while € 3,891.64 m remained in holding funds (Figure 7).

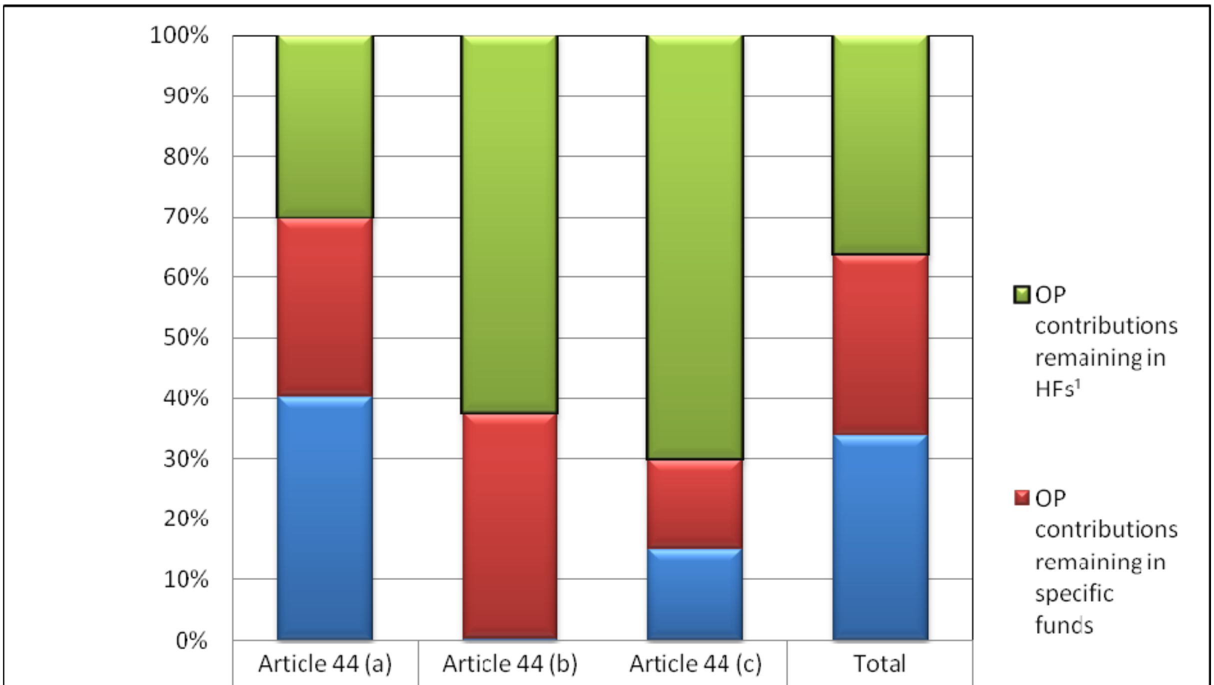
Figure 7: OP contributions to FEIs and paid to final recipients



Source: European Commission (2013).

The highest share of total OP contributions has been paid to FEIs for enterprises (€ 8,902.65 m) and the smallest to FEIs for energy efficiency (€ 1,533.15 m) – see Figure 8. Whereas FEIs for SMEs have paid already approximately 40% of OP contributions to final recipients, FEIs for urban development have paid less than one percent (0.4% - funds had at the time of the 2012 EC report only reached Germany and Latvia) and FEIs for energy efficiency 15%. A total of 70% of OP contributions remained in holding funds for FEIs for energy efficiency and renewable energies, and 62% in FEIs for urban development. The differences in the amount of contributions remaining in the holding funds can partly be explained by the different share of funds initially allocated to holding funds, and by the maturity of funds.

Figure 8: Use of total OP contribution paid to FEIs (%)[20]



	Article 44 (a)	Article 44 (b)	Article 44 (c)	Total
OP contributions remaining in HFs[1]	2693,87	956,44	241,34	3891,65
OP contributions remaining in specific funds	2624,93	570,53	51,08	3246,54
OP contributions paid to final recipients	3583,85	6,17	52,45	3642,47

Source: EPRC, based on European Commission (2013).

With respect to urban development, although most of the co-funded UDFs are at the early stage of implementation, there is a latent demand and some UDFs have proposed potential projects ready for implementation or under preparation in their business plans. However, there are some concerns regarding their ability to spend the total allocation before the end of the allotted period, including that infrastructure projects take a longer time to develop than other projects, and there are challenges around putting together packages of urban regeneration activity that generate enough return were identified (Michie and Wishlade 2011).

The Commission's 2013 summary report provides an indication of some of the results obtained by FEIs in the case study OPs by the end of 2011 (Table 12). There is, however, no associated EU-level data available yet on impact. i.e. jobs created or safeguarded. It should be added that the objective for ERDF FEIs to create or safeguard jobs has been largely criticised for being an inadequate criterion for measuring the success of an instrument. This is discussed in more detail in Chapter 5.

[20] **Note:** All figures in € m.

Table 12: Indicative results obtained by FEIs in the case study OPs

MS	ERDF OP	Fund	OP contribution to fund (€m)	Type of FEI	No. Products to Final Recipients	Amount to Final Recipients (€m)	SFs to Final Recipients (€m)
DE	Sachsen-Anhalt	SME Loan Fund (*KMU-Darlehensfonds)*	237.87	Loans	778	190.41	190.41
		Ego.PLUS seed loan fund	10	Loans	15	1.62	1.62
		IBG II Risk Capital Fund (Risiko-kapitalfonds IBG II)	85.01	Equity	74	27.85	27.85
FIN	Ita-Suomi	Finnvera /Veraventure	35.89	Loans	2949	21.11	10.56
				Equity	1	n/a	n/a
FR	Languedoc-Roussillon	JEREMIE Holding Fund	30	HF			
		JEREMIE FEI	2.2	Loans	18	0.40	0.20
				Guarantees	15	0.17	0.09
				Equity	8	1.63	0.81
PL	Śląskie	Regional guarantee fund	5.95	Guarantees	24	0.73	0.62
		JESSICA UDF	63.22	Loans	1	1.1	n/a
SI	Strengthening Regional Development Potentials	Guarantee Fund	42.66	Guarantees	910	42.66	36.26
		PFEI:					
		1. Guarantee FEI	21.5	Guarantees	252	18.82	16.0
		2. Equity FEI 1	5	Equity	0	0	0
		3. Equity FEI 2	3.92	Equity	1	0.1	0.09
		4. Equity FEI 3	9	Equity	7	2.45	2.08
		5. Equity FEI 4	2.64	Equity	0	0	0
		6. Equity FEI 5	3.68	Equity	0	0	0
		7. Equity FEI 6	2.5	Equity	0	0	0
		8. Equity FEI 7	7.2	Equity	0	0	0
UK	Lowlands and Uplands Scotland	Scottish Co-Investment Fund	65.76	Equity	207	31.38	12.55
				Loans	123	10.69	4.28
		Scottish Loan Fund	43.39	Loans	2	6.87	2.75
		Scottish Venture Fund	40.85	Loans	25	6.54	2.61
				Equity	48	23.33	9.33
		WSLF	18.0	Loans	225	7.42	2.97
		ESIF	6.0	Loans	21	0.85	0.3
		JESSICA UDF	n/a	Loans	n/a	n/a	n/a

Source: EC 2013a.

5. CHALLENGES RELATED TO USING FEIS AND LESSONS LEARNED

The disadvantages of using FEIs under SF programmes (over other forms of support) have been outlined in a various reports, including Michie and Wishlade 2011, Laakso et al 2012, Gross 2011, Lacave 2012, Gross 2011, ECA 2012 and others). The reported challenges, particularly for FEIs supporting enterprise development, include the following features:

- Negotiation and set-up period
- Structural Funds Regulations
- Know-how and experience
- External challenges
- Monitoring and reporting

5.1 Negotiation and set-up period

Although many MS and regional MAs had experience of negotiating and setting-up FEIs under their SF programmes in earlier programme periods, one of the major challenges in 2007-13 has been the length of time it has taken to design, negotiate and launch FEIs - certainly longer than anticipated by many of the MAs involved. This applies both to FEIs for enterprise support (Article 44a) and FEIs for urban development (Article 44b), and across different kinds of instruments (both debt and equity instruments).

As most FEIs have only recently progressed into the implementation phase, the evaluation literature understandably concentrates on the initial establishment stage. A 2011 report which gathered information from MAs in 17 MS reported time spans for the setting up and launch of FEIs supporting enterprise development of, for example, 18 months for the JEREMIE initiative in Latvia, 15 months from gap analysis to the granting of the first micro-loan in Hungary and another three years until the launch of venture capital activities, and two years to set up the North Denmark Loan Fund (Michie and Wishlade 2011). However, most of the specific funds set up in the current period have become operational by the end of 2011.

This was also one of the major outcomes mentioned in some of the case studies. For example, in Finland, the steering committees of the four programmes of mainland Finland decided on the preparation of a venture capital instrument in summer 2009. However, the administrative and legal processes (including a change in the law) took a long time and Aloitusrahasto Vera was only ready to start in August 2011 (Laakso et al 2012). In Śląskie, the negotiation of the JESSICA instrument from the letter of intent to the EIB to the signing of the Funding Agreement took just over a year. From signing of the Funding Agreement to transfer of funds to the UDF took an additional year and four months.

In Languedoc-Roussillon, selection of financial intermediaries was found to be a slow process, and the strict procurement rules of the EIF were perceived to have slowed down the process (Gross 2011, Lacave 2012). A number of features of national administrative systems made the set-up of FEIs complicated, in particular, in France (Languedoc-Roussillon) accounting procedures at the level of the regional State services (préfets) were not in line with EU requirements, since, under French law, préfets can only administer grants and the accounting system cannot register amounts repaid by a beneficiary. As a result, the ERDF grant for JEREMIE had to be transferred to the regional councils, who allocated funding to JEREMIE together with their own contribution (public match-funding). However, because the General Code of Territorial Authorities did not allow regional authorities to be involved in JEREMIE-type funds, the Finance Law had to be amended (Gross 2011).

In general, the quickest FEIs to becoming operational have been those for SMEs, in terms of the length of time between signing funding agreements and making awards to final recipients. In contrast, some FEIs for urban development were operational only by the end of 2011, although the first funding agreements were signed in 2008 (European Commission 2012). Indeed, FEIs for urban development might reasonably be expected to take longer to set up than FEIs for enterprise support, given that they are a relatively new instrument. MAs have reported that in some cases it has taken up to three years before UDFs were launched. This is in some cases despite the intention of operating a FEI having been foreseen at an early stage and incorporated into the OPs (Michie and Wishlade 2011). This lengthy preparation process can result in the need for additional market testing before launch of the FEI. According to the Commission, the delays can in most cases be explained by the novelty of the instruments and by State aid-related issues (ECA 2012).

Table 13 summarises the main causes to which implementation delays were attributed in a 2012 European Court of Auditors report (covering all types of FEI).

Table 13: Main reported causes of delays of implementing ERDF FEIs in the 2007-13 period

Cause of delay	MS
Time consuming structuring and negotiations	Greece, London, Hungary, Poland, Slovakia
Obtaining private sector contribution	London, West Midlands, Hungary
Administrative reasons	Andalusia, Greece, Poland, Sardinia
Management cost negotiations	Poland, Slovakia
Governance arrangements	Greece, Slovakia
Uncertainty of working capital eligibility	Hungary
Negotiating entity not a MA	Slovakia

Source: European Court of Auditors 2012.

In some cases problems were identified in the gap analysis which was carried out for FEIs launched under the Commission's JEREMIE initiative (EC 2012a, ECA 2012, EP 2012b): the gap analysis process was delayed and took up to two years of a seven year programme period. The launch of the JEREMIE initiative across the EU involved challenging workloads for all parties involved, and there was considerable time and resource pressure. Also, despite the standardised approach to the gap analyses (i.e. a common template), a range of approaches was taken in practice, from quite general statistical analyses to very detailed descriptions of the different actors at regional levels, types of instruments proposed and overlaps (EIB 2011).

Most of the interviewees also confirmed the finding that the setting-up process is generally very time consuming. Representatives of financial institutions considered the entire tendering process – from the preparation of the proposal until the signature of the contract – 'difficult'. For instance, a representative of the Bank Austria stated that "such preparatory work is only profitable if the market potential is high". The set-up period can take up to one year, claimed the expert from the Spanish holding fund institution. Furthermore, the interviewees agreed on the fact that the preparation of a tender is extremely complex and difficult and stakeholders need time to become acquainted with the topic. Another challenge was the negotiation of contractual issues. For instance, the MA of the EU Structural and Cohesion Fund in Cyprus needed almost two years for agreeing on the FEI contract.

5.2 Structural Funds Regulations

FEIs can be complex instruments and have been found to be **difficult to align with SF Regulations**. The literature suggests that some fund structures are more complex to set up than others - although the model selected will depend on issues such as the market structure in the MS or region concerned, and the funding gaps identified (CSES 2007). For example, in a holding fund (or Fund of Funds) model, ERDF funding is introduced at the level of the Fund of Funds, which then invests in other fund(s), alongside external investors, thus requiring a group of funds to be set up. Co-investment models on the other hand, where the public sector invests in a business and/or project pari passu alongside the private sector, are considered to be relatively simpler to set up.

According to the ECA (2012), deficiencies existed in the SF regulatory framework from the start, and the effectiveness and efficiency of FEIs for SMEs co-financed by ERDF in the current programme period has been hampered by the lack of fit between the SF Regulations and the specific features of FEIs. The ECA contends that this has contributed to significant delays and poor leveraging of private investment compared to other EU SME programmes. A number of issues were found by MAs to be unclear and had to be clarified by guidance issued during the programme period.

The complexity of public procurement processes, in particular ensuring compatibility between national and EU approaches, was found by MAs to be a significant source of delay in some programmes (Michie and Wishlade 2011). However, those programmes which chose the EIF as holding fund manager were able to do this through a direct award, potentially resulting in fewer delays. This was also the case for the German Länder (federal states), as the direct award route was used to appoint the Land developmental and promotional banks (which are owned by the Land governments) as fund managers.

Box 8: Unflexibile eligibility criteria in Structural Funds in Sachsen-Anhalt

There is also caution in Sachsen-Anhalt, where the Land government has agreed in principle that a number of other loan/equity instruments could be set up with EU funding in the current period (e.g. in fields such as climate protection and renewable energies, rail infrastructure, and water and sewerage infrastructure). However, these funds have not yet become operational because the MA is awaiting Commission clarification on a number of management and implementation issues (Schwab 2012). In relation to some of these themes (e.g. climate change), the ERDF OP AIR for 2011 states that funding provisionally allocated to FEIs in the 2007-13 ERDF OP has now been shifted to non-loan instruments, because the eligibility criteria of the SF Regulation cannot be met, as regards the need for instruments primarily to target SMEs (Land Sachsen-Anhalt, 2012).

Source: Case Study OP Sachsen-Anhalt.

Across all interviews, the Regulations were mentioned as one of the major challenges in implementing FEIs in EU programmes. A representative of the EIF claimed that the main problem is linked to the "shared management" system. In practice, the Commission set up the Regulations but does not provide any guidance on the application in challenging or ambivalent situations. For instance, the EIF signed a very unclear and un-concise contract with the Commission accepting high risks regarding the interpretation of unclear formulations. All groups of interviewees, covering representatives of financial institutions or intermediaries as well as MAs, complained about complex and vague Regulations.

For instance an expert of the Lithuanian SEB Bank stated that "SMEs do not have legal units to interpret the Regulations and have to take risks they are not fully aware of". A JEREMIE holding fund manager under the North East England OP mentioned a few examples from the ERDF Regulation that have caused confusion and contradictions. First, the Regulation does not allow management-buy-out. This means that in the case a company owner wants to retire and cannot find purchasers, the FEI framework does not support the step of selling the company to its managers. Second, venture capital cannot be invested in companies that would like to export, but if these companies grow quickly they will want to do so. Similarly, according to the Regulations, companies are not allowed to invest in retail, but it is not specified whether this includes e-commerce.

Some of the interviewees complained about the fact that the Regulations do not address the commercial practice and restrict the possibilities of investing the money. An expert from the NRW Bank illustrated this problem as follows: "The ERDF allows financing green chairs, a round table and a laptop but in case the SME needs red chairs, no table and a computer, the FEI does not allow the flexibility to address these needs. In other words the microcredit was linked with too detailed eligibility rules". The MA from Sachsen-Anhalt argued that since the future Regulations of FEIs have not been set in stone yet, it is not possible to plan how to improve the management of such instruments and to avoid the challenges encountered in the period of 2007-2013 yet. This is considered problematic given the fact that the MAs know how lengthy the procedures for setting-up such instruments can be.

Moreover, according to several interviewees, a major point of discussion has been the fact that according to Article 44 of the SF Regulation, FEIs (including venture capital) cannot be offered to companies that find themselves in "economic difficulties". There is no Community definition of what constitutes "a firm in difficulty". The Commission however defines a firm to be "in difficulty" when it is unable, (whether through its proper resources or with the funds obtained from its owners, shareholders or creditors) to hinder losses and, without any support from public authorities, will presumably go out of business in the short to medium term (EC 2012f). Given that the basic idea of this framework is for public money to be invested through commercial means to precisely support companies that cannot access financial support in private markets, this provision has been seen as a contradiction in itself.

There is another issue with regards to the difficulty of matching FEIs with the SF Regulations, namely timing. The timing of FEIs does not correspond to the timing of SF OPs. According to a representative of the unit responsible for coordinating regional OPs in the Polish Ministry of Regional Development, the **investment periods should be extended** (until the end of 2015) to provide UDFs and potential partners of JESSICA urban projects with more time to conclude investment agreements thus contributing to a successful implementation of the pilot FEI for urban development.

According to a representative from the European Commission, under the current legislation (i.e. Article 78(7) of Regulation 1083/2006) the resources repaid have to be used for the benefit of the same type of action. There is no time limitation which means the revolving money has to be used for the same purpose in 2013, 2015 and later on. The eligibility of the expenditures hence runs until the end of 2015. This means that in 2014 and 2015 the funds from two programming periods (2007-2013 and 2014-2020) will overlap. In the future Regulation there is a distinction between the use of revolving money within the programming period of 2014-2020 (+2) according to Article 38 of the proposed Regulation and the use of revolving funds after the programming period.

5.3 Know-how and experience

Capacity among MAs and European institutions has also been identified as a delay factor (Michie and Wishlade 2011, EC 2012a). For example, existing expertise has not always been well-aligned with actual needs, and there has often been a lack of specialist skills or knowledge in areas such as State aid control. The Commission has sought to meet the demand for appropriate guidance in a number of areas to support implementation (EC 2012, Michie and Wishlade 2011), but administrators in the MAs really required this much earlier in the planning process. The Commission (2012) highlighted that setting up FEIs under SF implied a whole new concept for some MS, requiring a demanding learning process (ECA 2012).

Where MS and regions have chosen *not* to invest (any or more) OP resources in FEIs, a major reason has been that grants are still viewed as being more suitable for many types of project, especially those that are early stage, risky, and a long way from commercialisation and income generation, as well as achieving the positive economic spill-over that the OP pursues. Managers of smaller programmes consider that the amounts involved would be too small to justify the set-up costs incurred, and a few are discouraged by a their lack of familiarity with FEIs, and concerns about potential regulatory and compliance issues (Ward 2012).

Particular problems regarding venture capital instruments have been observed in the case of Slovenia: there, the development and implementation of venture capital instruments has been found to be more challenging than loans, in part because Slovenia had no tradition of venture capital investments and the market is underdeveloped. There were numerous uncertainties around legal, administrative and tax requirements at both national and EU level. Implementation problems facing equity financing included: a lack of institutional investors; insufficient development of venture capital companies due to the financial crisis; lack of experience in managing venture capital companies; lack of exit possibilities; low cooperation between the public and private sectors; extensive reporting requirements; and (unrealistic) expectations of positive effects in the short term (Kavaš 2012).

The interviewees agreed that the setting-up and implementation of FEIs requires specific know-how which generally was not provided by the individual actors. The MAs and experts working in the public sector do not have sufficiently financing and banking know-how while the bankers and fund managers are not necessarily familiar with EU procedures, Regulations and bureaucracy. The specific expertise needed includes, beside banking know-how and state aid, expertise in the SF Regulations and procedures. A representative of the European Commission argued that those MS that have used FEIs in the previous programming period (e.g. UK) established the processes very quickly because they were already used to setting-up and implementing such instruments in combination with

Cohesion Policy funds. For some 'new' MS not familiar with using FEI within Cohesion Policy this process took longer.

The authorities tend to find the processes with regards to managing or implementing FEIs too complex. The typical reaction is to refrain from or reduce the use of FEIs.

Box 9: Needs related to using FEIs

The French agency for coordinating regional policy (DATAR) has recently commissioned a study about the use of FEIs in France. One of the main findings of the study is that a major challenge is the lack of competences at the level of the MA, at national level as well as at EU level in terms of Technical Assistance. According to the interviewee from the DATAR, there are 3 types of competencies that need to be combined for an effective implementation of FEIs:

First, the ability to select financial intermediaries who are familiar with the Structural Funds Regulation.

Second, competencies in state aid regulation are rarely combined with other skills such as financing know-how. In fact, even at the DATAR, some officials have a strong expertise in SF Regulations, others in State Aid law. There is a need to introduce a Technical Assistance office at national level that would combine these skills and different expertise provided to MAs and financial intermediaries. Such support would pay off within only some months.

Third, skills in financing are required (SMEs, financing instruments and mechanisms and so forth).

Furthermore, the representative of the DATAR speaks of a "cultural gap" among the stakeholders using FEIs. MAs have traditionally used grants and subsidies to support firms. Once MAs consider the possibility of using FEIs, they have to convince the locally elected authorities at the committees. Often, local actors prefer grants since they are one-way investments that do not need any follow-up over a longer term. According to DATAR, there is a need to convince the authorities that the 2014-2020 Regulations are sound and coherent.

Source: Interviews.

5.4 External challenges

The implementation rate varies significantly across different FEIs. External problems have been the main reason for the implementation rate of some FEIs having been slower than planned. This has included demand side issues such as lack of investment due to the economic crisis, or supply side problems such as the availability of other, competing types of business support (Michie and Wishlade 2011). According to CSES (2007), this is to be expected, given the different objectives and investment environments. However, this has not been the case for all instruments. For example, although little mid-term evaluation evidence is yet available, several reports on micro-credit funds show that demand has increased during the economic crisis, and that the funds have performed well (Meyer and Biermann 2010; Banke, Bötel and Schneider 2010).

According to a representative of an Austrian financial institution the market for microcredits shrank since 2008 due to the impact of the financial crises which resulted in unfavourable conditions for establishing or furthering start-ups. Entrepreneurs did not want to take too much risk by starting a business. Also, according to a representative of Polish Ministry of Regional Development responsible for JESSICA, "the current financial crisis reduces the willingness of private investors to proceed with implementing new projects and high indebtedness levels of most municipalities".

In several countries (e.g. in Greece, Hungary and Latvia), MAs have reported that the demand from final recipients for FEIs has been subdued, making it progressively more difficult to find suitable projects. This is because some firms have been found to be behaving more cautiously or have insufficient own funds to invest (Michie and Wishlade 2012). Risk aversion among fund managers was also seen as a reason for slow project absorption (CSES 2007). There is, however, some evidence of spatial variation in the level of interest from firms (Tillväxtverket 2011).

In some cases, MAs have reported that FEIs have become less competitive when aid rates of alternative instruments have been raised in response to the economic downturn (Michie and Wishlade 2011). However, co-financed loan and guarantees (i.e. debt instruments) tend to be designed as measures of 'last resort' i.e. where potential applicants cannot obtain alternative sources of finance.[21] Only a small proportion of businesses which were final recipients of the (domestically-funded) Small Firms Loan Guarantee Scheme in the United Kingdom, for example, reported possible access to alternative sources of finance (Cowling 2010).

For urban development instruments, there is little literature available on the implementation progress. The EIB has commissioned a number of 'Horizontal Studies' which may provide additional information in this area. However, urban development projects generally take longer to develop than other projects, and putting together packages of urban regeneration activity that generate enough financial return may be a challenge (Michie and Wishlade 2011). There is less experience with use of FEIs in urban development, and even less of reconciling SF regulatory requirements and implementation rules with complex urban development projects (JESSICA evaluation studies).

Specifically relating to the implementation of the JESSICA initiative in Poland as a whole, a number of issues arose according to the case study in Śląskie. Although there was high interest from public and private investors, this did not translate into ready-made applications for loans. So far, the impact of projects on urban development has been limited as their scale has not been sufficient to address the negative factors in degraded areas, and cooperation between private investors and city authorities has been limited.

Other factors which caused delay during the 2007-13 period were uncertainties due to lack of clarity over exit policies, including winding-up provisions for UDFs and re-use of resources returned to the UDFs, and the challenges presented by the JESSICA urban development funds in a State aid context. While the Commission had a well-developed basis for dealing with business development measures for SMEs, this was not the case for urban development measures, where there was no overarching framework setting out eligible expenditure types or projects (Michie and Wishlade 2011).

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21 Unlike loan and loan guarantee schemes, equity schemes do not in general explicitly act as lender of last resort (Cowling 2012).

Box 10: Picking regional cherries by the use of EIF

Significant change to FEIs is planned in Finland in 2014-20. The strategic value of interest subsidised loans has recently been questioned as well as one of Finland's public banks Finnvera's contribution to regional development (Ministry of Employment and Economy 2012). First, Finnvera's involvement is found to not necessarily be justified by market failure. In some instances Finnvera has been potentially crowding out banks, as Finnvera's subsidised loan products may have 'pick[ed] the regional cherries'. This may reflect to the common practices in the regions where SMEs have traditionally relied on Finnvera rather than solely on local banks, which implies that Finnvera finance is not necessarily addressing market failure but is about the pricing and conditions related to risk financing. On the other hand, although Finnvera works to address market gaps, there are signs that Finnvera crowds out private banks, particularly in the regions, as they have become too accustomed to the risk cover and do not want to take any risk on their own. Taking this into account, at the current interest rate, the strategic value of subsidised loans is questioned, and little value added found (Ministry of Employment and Economy 2012). On the other hand, the venture capital market is currently developing and public sector catalysing may be needed, particularly in the early phases (Koski & Yla-Anttila 2011). Correspondingly, the ERDF mid-term evaluation recommended increasing risk capital with ERDF funds (Karjalainen et al 2012).

Source: Case Study OP Ita-Suomi.

5.5 Monitoring and reporting

Although the Commission's 2012 report provides recent data on financial allocations to FEIs and final recipients as at the end of 2011, monitoring challenges remain, particularly regarding the contribution of FEIs to OP objectives. According to the ECA (2012), the standard Cohesion Policy monitoring instruments put in place for the ERDF are not well adapted to FEIs, as Monitoring Committees are not generally in a position to address the specificities of the different types of FEIs, and OP indicators do not distinguish FEIs and grants. As a result, most of the indicators used — output-oriented 'macro-indicators of development' — are not helpful in assessing the progress of FEIs or their revolving nature (ECA 2012). MAs have noted the difficulty of reconciling FEIs with the targets and indicators set out in the OPs. Also as noted by Michie and Wishlade (2011), measuring the performance of FEIs poses challenges, at both fund and EU level. Timescales may not match – in that, for example, - a typical venture capital fund will operate over an investment and management period of 8–10 years, longer than the seven-year SF programme period. As a result, the monitoring requirements from the MAs (or the European Commission) may imply additional monitoring to what is requested by the investors or fund managers.

To improve monitoring, the ECA recommended that the Commission and the MS agree on a small number of measurable, relevant, specific and uniform result indicators for FEIs, and that there should be more standardised ways of providing information (ECA 2012). Reporting provisions have been strengthened during the current programme period, with MAs being required to send specific reports to the Commission on operations comprising FEIs as an annex to the Annual Implementation Report (EC 2012a). According to a representative from the European Commission's DG REGIO, a longer list of indicators for the reporting on the use of FEIs had been proposed by the Commission. In June 2012, the SFC (data system for monitoring the SF implementation at EU level to be reported by MAs) has introduced new templates. However, the legislators restricted the reporting requirements as MS criticised them for being one-size-fits-all indicators and for being too detailed. The reporting requirement itself is likely to be maintained for the 2014-2020 financing period, but the legislative framework and the scope of reporting is still under negotiation.

As Cowling (2012) notes, most European FEIs do not have clearly established performance measurement criteria other than to distribute investments funds to fill a perceived gap in provision of finance. Indeed, he notes that 'most programmes with public funds do not appear to define the evaluative methodology or the data collection that will be needed to be put in place by the time of the launch of a new programme' and that 'formal evaluations often appear both superficial and an after-thought to the programme execution itself'.

It should moreover be highlighted that the success of FEIs should not be measured along the number of jobs created or safeguarded given that many enterprises outsource their activities which also created positive outputs for the outsourced suppliers. The success should rather be related to covering the needs and gaps identified in a given market (e.g. lack of financial resources for start-ups).

Box 11: Examples of monitoring and reporting practices on the ground

In the case of the OP for Economic Development in Hungary, the holding fund manager concludes an intermediary contract with the financial intermediaries. The holding fund then manages and communicates with the financial intermediaries on a regular basis, collects data and informs them on any possible regulatory or strategic changes. Financial intermediaries have to submit daily reports on new loan applications and newly concluded contracts as well as monthly reports on the status of implementing the portfolio to the holding fund manager through a new complex electronic data system. Internal audit checks are carried out by the holding fund manager but representatives of the MA may also be present at on-the-spot-checks. The holding fund manager reports back to the MA on a quarterly basis. In the majority of the cases analysed, MAs, the EIB/EIF, holding fund Managers and experts also regularly meet in the Advisory Boards (e.g. OP North-East England). The financial intermediaries, in turn, monitor the investments to companies and are often seated in the firms' boards.

In the case of Finland, SF regulatory requirements, issue around monitoring requirements relating to FEIs, where programme targets have been set for the priorities as a whole, not separately for Finnvera's projects. Further, as Finnvera uses its own monitoring system, transferring data to the ERDF monitoring system is perceived as being complicated. Finnvera's instruments with ERDF elements are seen to cause an administrative burden for Finnvera and decreases Finnvera's availability to interface and work directly with customers (Ministry of Employment and Economy 2012).

It has also been pointed out that varying definitions have caused problems in monitoring. For instance, in France data was criticised to be inconsistent, due to the fact that the beneficiaries were statistically linked to financial intermediaries instead of SMEs.

These numerous reporting and monitoring requirements have been qualified to be highly time consuming, complex and expensive (e.g. requirement to set-up a new electronic data collection system) which slow down the process of implementation.

In the OP Languedoc-Roussillon, reporting-related problems have caused for an instrument to even be dropped entirely. In fact, the financial intermediary who had been selected to manage micro-credits did not manage to fulfil the reporting requirements from the EIF (holding fund) and retired.

Compared to other challenges the experts did however complain about the reporting requirements to a far lower extent than about the difficulties related to complex regulations or the time-consuming process of setting-up FEIs.

Source: Case Study reports and Interviews.

6. DRAWING A FUTURE PATH FOR FEIS

6.1 Current state of regulative proposals for 2014-2020

Building on implementation experiences with FEIs in current and past Cohesion Policy cycles and reflecting the importance attached to them in the multiannual financial framework 2014-20, the European Commission proposes to further expand and strengthen the use of Financial Instruments[22] (FIs) in the next programming period as a more efficient and sustainable alternative to complement traditional grant-based financing (e.g. EC 2012a; EC 2012c)

The Commission's proposals for the 2014-20 legislative framework aim to balance flexibility with innovation and sound financial management of FIs, taking into account MS and sector specificities (EC 2012a). The aim is to improve the coherence and consistency between instruments; raise visibility and transparency; and to reduce the number of FIs to ensure a sufficient critical mass (EC 2012b).

Building on the implementation experience and in view of ensuring that the main criticisms voiced during the 2007-13 period are taken into account, the regulatory proposals aim to (EC 2012d):

- Offer greater flexibility to EU MS and regions in terms of target sectors and implementation structures;
- Provide a stable implementation framework founded on a clear set of rules building on existing guidance;
- Capture synergies with other forms of support such as grants;
- Ensure compatibility with FIs at EU level.

In the draft Regulation (EC 2012e) laying down common provisions for the five Common Strategic Framework Funds, the European Commission has dedicated Title IV entirely to FIs. There will be a single set of rules for governing FIs in all five CSF funds and a separate title allows for a clearer presentation of the instruments' specificities (Table 14).

Table 14: Legislative proposals and changes compared to 2007-2013

	Widening the scope of financial instruments	
	DESCRIPTION	**CHANGES COMPARED TO 2007-2013**
Art 32	• The CSF Funds may be used to support FIs under one or more programmes, including when organised through funds of funds, in order to contribute to the achievement of specific objectives set out under a priority.	• In contrast to the 2007-2013 programme period, the proposals are non-prescriptive regarding sectors, beneficiaries, types of projects and activities to be supported. The **scope of using FIs is being enlarged** and expanded to cover all funds as well as all

[22] For the future programming period (2014-20) the term "FEI" will be replaced by Financial Instruments ("FI"), in line with the European Commission's proposals.

	Widening the scope of financial instruments	
	DESCRIPTION	**CHANGES COMPARED TO 2007-2013**
	• FIs shall be implemented to support investments which are expected to be financially viable and do not give rise to sufficient funding from market sources.	thematic objectives and priorities in the OPs.
Art 32	Support of FIs shall be based on an ex-ante assessment which has established evidence of market failures or sub-optimal investment situations, and the estimated level and scope of public investment needs, including types of FIs to be supported	FIs successful design and implementation hinges on a correct assessment of market gaps and needs. Therefore, in the context of an OP, there is a new provision that FIs should be designed on the basis of an **ex ante assessment** that has identified market failures or sub-optimal investment situations, respective investment needs, possible private sector participation and resulting added value of the FI in question.
Art 32	Where FIs support financing to enterprises, including SMEs, such support shall in particular target the establishment of new enterprises, early stage capital, i.e., seed capital and start-up capital, expansion capital, or the realisation of new projects, penetration of new markets or new developments by existing enterprises without prejudice to applicable EU State aid rules.	
Art 32	FIs may be combined with grants, interest rate subsidies and guarantee fee subsidies. Where CSF Funds support is provided by means of FIs and combined in a single operation, with other forms of support directly related to FIs targeting the same final recipients, including technical assistance, interest rate subsidies and guarantee fee subsidies, the provisions applicable to FIs shall apply to all forms of support within that operation. In such cases, applicable EU State aid rules shall be respected and separate records shall be maintained for each form of support.	The new framework also contains clear rules to enable **better combination of FIs with other forms of support**, in particular with grants.

	A range of new implementation options	
	DESCRIPTION	**CHANGES COMPARED TO 2007-2013**
Art 33	MAs may provide a financial contribution to: (a) FIs set up at union level, managed directly or indirectly by the Commission. Contributions from the CSF Funds to FIs under paragraph 1a shall be placed in separate accounts and used, in accordance with the objectives of the respective CSF Funds, to support actions and final recipients consistent with the programme(s) from which such contributions are made.	Commission proposal offers **different implementation options** from which MAs may choose the most suitable solution. In the first option (a), **FIs are set up at EU level and managed by the Commission**, in line with financial regulation. OP contributions will be ring-fenced within EU-level instrument for investments in regions and actions covered by the OP from which resources were contributed. In terms of management and control, the same rules apply as for FIs implemented under direct management.
Art 33	(b) FIs set up at national, regional, transnational or cross-border level, managed by or under the responsibility of the MA. The MA may provide a financial contribution to the following FIs: • FIs complying with the standard terms and conditions laid down by the Commission, by means of implementing acts in accordance with the examination procedure referred to in Article 143(3); • Already existing or newly created Financial Institutions which are specifically designed to achieve the intended purpose and which respect the applicable Union and national rules.	For the second option (b), **FIs are set up at national or regional level** and the MAs can contribute programme resources to (1) **already existing or newly created** instruments tailored to specific conditions and needs and to (2). **standardised instruments ("off-the-shelf")**, for which the terms and conditions will be predefined. These instruments should be ready-to-use for a swift roll-out. For this second option (b), MAs may invest in the capital of existing or newly created entities dedicated to implement FIs or entrust the implementation to 1) EIB; 2) international or domestic financial institutions in which a MS is a shareholder or which is acting in public interest a body governed by public or private law selected in accordance to EU and national rules; and 3) FIs consisting solely of loans or guarantees may be implemented directly by MAs themselves.

	Clear financial management rules	
	DESCRIPTION	**CHANGES COMPARED TO 2007-2013**
Art 37	Support from the CSF Funds paid to FIs shall be placed in interest-bearing accounts domiciled within financial institutions in MS or invested on a temporary basis according to the principle of sound financial management.	The new framework contains **clear rules** in terms of the qualification of financial streams at the different levels of FIs and corresponding eligibility or legacy requirements.
Art 37	Interest and other gains attributable to support from the CSF Funds paid to FIs shall be used for the same purposes, including the reimbursement of management costs incurred or payment of management fees of the FIs (…), as the initial support from the CSF Funds either within the same FI, or following the winding up of the FI, in other FIs or forms of support in	Interest or other gains generated at the level of the financial instrument prior to investment in final recipients are to be used for the same purposes as the initial EU contribution.

	Clear financial management rules	
	accordance with the aims of the programme(s), until the end of the eligibility period.	
Art 38	Resources paid back to FIs from investments or from the release of resources committed for guarantee contracts, including capital repayments and gains and other earnings or yields, such as interest, guarantee fees, dividends, capital gains or any other income generated by investments, which are attributable to the support from the CSF Funds, shall be re-used for the following purposes, up to the amounts necessary and in the order agreed in the relevant funding agreements	EU share of capital resources paid back from investments is to be re-used for further investments in the same or other FIs, in accordance with the objectives of the OP.
Art 38	Gains and other earnings or yields, including interest, guarantee fees, dividends, capital gains or any other income receipts generated by investments, attributable to the support from the CSF Funds to the FI, shall be used for the following purposes, where applicable, up to the amounts necessary: (a) reimbursement of management costs incurred and payment of management fees of the FI; (b) preferential remuneration of private or public investors operating under the market economy investor principle, who provide counterpart resources to the support from the CSF Funds to the FI or who co-invest at the level of final recipients; (c) further investments through the same or other FIs, in accordance with the aims of the programme(s)	EU share of gains, earnings, or yields is to be used for: 1) management costs/fees; 2) preferential remuneration of investors providing co-investment at the level of FI or final recipient; and/or 3) further investment in the same or other instruments, in line with the OP.
Art 39	MS shall adopt the necessary measures to ensure that […] resources paid back to FIs, including capital repayments and gains and other earnings or yields generated during a period of at least 10 years after the end of the eligibility period.	Capital resources and gains and other earnings or yields attributable to the EU contributions to FIs are to be used in line with the aims of the OP for a period of at least 10 years after its closure.

	Streamlined reporting on implementation progress	
	DESCRIPTION	**CHANGES COMPARED TO 2007-2013**
Art 40	The MA shall send to the Commission a specific report covering the operations comprising FIs as an annex to the annual implementation report	The new framework requires MAs to supply a **specific report on FIs** annexed to the annual implementation report.

Source: Own elaboration.

The draft regulatory texts on FIs for the 2014-20 period (EC 2012e) show that the Commission has attempted to address many of the challenges that have arisen in 2007-13 in the new regulatory provisions. These include a number of modifications that directly address issues raised by MAs and the ECA, for example:

- Revised provisions relating to the ex-ante evaluations that must be undertaken before FIs are established;
- A reduction of the number of FIs to ensure a sufficient critical mass and to minimise disparities;
- State aid compliance and eligibility of management fees and costs;
- Clear Financial Regulation and use of revolving resources; and
- Regular reporting and monitoring.

It has been made clear that ex-ante evaluations will tie the findings related to market gaps more closely into the objectives and priorities of the CSF programmes, and will include more information on what type of financial products should be put in place. The added value of FIs under consideration must be explained, and there must be an assessment of lessons learned from similar instruments or ex-ante evaluations in the past.

According to a representative of DG REGIO, the economic crisis has had different impacts on the use of FEIs. On the one hand, FEI could have become more popular in a context where public funds are available in contrast to private money with private actors (e.g. banks) that are reluctant to take risks – a fact that has been confirmed throughout the interviews. On the other hand however, a slower take-up of FEI could also be caused given that entrepreneurs became more cautious and may have refrained from starting businesses and SMEs may have become reluctant to expand in the context of the crisis. In 2014-2020, MS will therefore be allowed to revise their ex-ante assessments throughout the period to reflect the changes in the market and the economic conditions.

A major concern in relation to absorption has been the alleged practice in 2007-13 of over allocation of OP resources to FEIs, which then remain in the funds instead of being disbursed to the final recipients, circumventing the automatic de-commitment rule (EP 2012b). This practice has been discouraged by the Commission, and Commission guidance since 2009 has repeatedly stressed that only payments made to final recipients will constitute eligible expenditure at programme closure (EC 2012a). To avoid over-allocations of EU resources, MAs will need to make phased payments to FIs in accordance with the actual investment progress at project level and anticipated capital requirements- this is in response to the Court of Auditors' critique on the practice of unjustified over-allocation of resources to FIs in order to avoid a de-commitment of funds (n+2).

A number of potential concerns remain – the European Court of Auditors has suggested that the Commission should, depending on the type of holding fund or fund, require contractually binding minimum leverage ratios, minimum revolving periods and data for the calculation of leverage indicators (ECA 2012). The Commission has however highlighted that achieving high leverage ratios must be balanced with public policy objectives of Cohesion Policy.

6.2 Future plans for FEIs at Member State level

In general, the interviewees welcomed the introduction of a separate chapter for FEIs, without any exceptions it has been stressed that the Regulations need to be simplified and clarified with regards to the restrictions of investment, reporting requirements, co-financing rules and combinations with grants. Similarly, although some interviewees have argued that these are challenges that private actors expect when working with public funds, the Regulations at EU level need to be more practical, output-oriented and applicable to real-life situations. In the words of the EIF, "there needs to be more private involvement to increase the leverage effect" given that public actors primarily focus on achieving policy-goals.

When confronted with practical examples of unclear provisions in the EU Regulations, a representative of the European Commission argued in an interview that the challenge at EU level is to find a legal wording and provisions that are general and flexible enough to accommodate the differing legislations and definitions of 27 MS, even more regions, and 200 OPs. The Commission stated that although in the future the Regulations will not become "easier" given the complexity of the subject, additional provisions will clarify the currently missing or generalised terms.

Moreover, a representative of the European Commission has argued that a Financial Instrument Inter-service Expert Group has been created in 2012. The European Commission officials from the relevant DGs meet regularly (18 meetings have been held so far) to discuss how procedures can be streamlined. The participants share their experiences; describe the challenges identified and discuss possible solutions with regards to FEI. These discussions are being translated into guidance notes.

The EU MS are required to prepare with the Commission a **Partnership Agreement** outlining the funding priorities for the 2014 – 2020 period. The (draft) template for the Partnership Agreement does not require for MS to specify their plans with regards to FIs (EC 2013b). Instead, the use of FIs is to be regulated at OP level. In fact, under section 3.A.2.3 on "The planned use of financial instruments (Article 87 (2) (b) (iii)CPR)" of the (draft) OP template, the authorities are required to describe the planned financial instruments including the indicative amounts planned to be used through these instruments (EC 2013c).

Across the case studies and interviews, the concrete plans for the next operational steps did not differ significantly between the various groups of interviewees. In fact, the general line of thought was that the FEIs established in the framework of EU programmes will be maintained and further developed as the interviewees have reported positive outcomes and experiences in general. Many stakeholders involved in the management of such instruments (banks, fund managers, MAs) have already planned to extend the use of FEIs introducing new products in the next period, based on the currently ongoing ex-ante programme evaluations and the lessons learned for the next programming period 2014-2020. This may represent a major increase in the share of ERDF devoted to FEIs, as in the case of Śląskie, where the MA expects to increase the amount devoted to FEIs to 14% of the SF allocation (current allocations are 4.5%). This is in line with the share suggested as appropriate by Poland's Ministry of Regional Development. A separate chapter in the draft Polish ERDF ROP for 2014-20 deals with FIs. In Slovenia, the MAs have stated that they would also like to channel further resources into FIs in future.

France will be undergoing particularly interesting developments with regards to FEIs in the near future. It can be observed that in general, the French regions have a cautious approach to FEIs; a significant concern is that an increased use of FEIs in the next programme period may lead to a reduction of non-refundable grants. In the words of a representative of the DATAR (French agency for coordinating regional policy), France needs to become "more reactive" to FEI and overcome the "cultural gap" of using grants especially in the context of the economic crisis where innovative ways are needed to overcome the budgetary crisis and private risk-aversion. This is strongly linked to the need of strengthening the competences of the authorities involved in the processes. One 'exception' may be the Languedoc-Roussillon OP (which was the first region to implement JEREMIE[23]), where the MA intends to develop new FEIs in future, in particular in the field of 'social innovation' (e.g. to benefit the ageing population), and to address the needs of enterprises in terms of working capital (BFR, *besoins de fonds de roulement*) following Basel III regulations and their expected impact on bank loans (Lacave 2012).

France is facing a "political momentum" according to the DATAR representative. Until now, the role of MAs was taken up by the préfets (state representatives in the regions). The SF MAs are now in the process of being decentralised. The ERDF will then be 100% decentralised, the ESF will be 60% decentralised (while it was only implemented by a national programme until now) and so will the EAFRD. Moreover, in order to obtain a more strategic approach, the regions are considering the option of creating a multi-fund approach combining the ESF, ERDF and EAFRD at regional level. According to DATAR, while the ESF in France has not used FEIs so far, the multi-fund approach and the process of decentralisation could "mark the start of a new era".

[23] The current JEREMIE will operate until 31 December 2015, and the objective is to recover a portion of the funds to reinvest in the 2014-20 programme (languedoc-rousillon.eu 2009).

7. CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions on the use of FEIs in Cohesion Policy

Despite existing problems of accurate monitoring and reporting data, it is clear that the variety, scope and amounts of FEIs implemented have grown rapidly over the past few years. By the end of 2011, 592 FEIs had been set up through 178 OPs (with the exception of Ireland and Luxembourg) mainly in the ERDF (the ESF accounts for only 3% of overall SF contribution to FEI). 90% of FEI were Article 44(a) measures targeting enterprises while Article 44(b) Urban Development and Article 44(c) Renewable Energy only accounted for 7.8% and 2.5% respectively. FEIs can take the form of loans, guarantees and equity, of which the first type is the most commonly used. The overall use of FEIs increased a lot in the period of 2007-2013, mainly in convergence rather than competitiveness regions.

The leading idea behind using FEIs is for public funds to be used in a more effective way, improve the commercial quality of the investments by involving private actors and to unlock new sources of finance. However, a point of discussion remains with regards to whether the public rationale of achieving public policy objectives does not differ too strongly from the private sector rationale. In any case, the main reason behind offering FEIs is the need of SMEs to access financing. This is especially true in the context of the economic crisis and the private actors' risk aversion in supporting SMEs and especially start-ups.

The latter point does not come without a contradiction. The interviewees have pointed out that while FEIs are communicated as being a solution to support enterprises which are considered to be 'too risky' by private investors, the SF Regulations do not allow for financing "firms in difficulty". There is no Community definition of what constitutes "a firm in difficulty", but according to the Commission this term applies to firms which are unable, (whether through their own resources or with the funds obtained from owners/shareholders or creditors) to avoid losses and, without any public support, are most likely to go out of business in the short to medium term (EC 2012f). The European Commission hence offers support to firms in insecure opportunities while at the same time hedging possible risks.

Similarly, the advantages identified come with a cost. In fact, while the leverage effect and the idea of sustainability are the main arguments for supporting the aforementioned idea of increasing public money, the effects are not visible yet in the large majority of cases and it will only be possible to analyse them in a few years time. It is clear however, that the financial discipline of the enterprises or project promoters is increased with FEIs compared to grants and that the 'taxpayers' money' in general is better spent with FEIs than grants since it is more likely to get repayments and increase the investments through leverage.

Moreover, while FEIs have been argued to potentially increase capacity levels within the support institutions, this issue has – at the same time - been raised as one of the main challenges. In fact, the lacking know-how and experience of MAs and EU officials in the field of financing (SME financing, financial mechanisms and instruments, etc.) on the one hand, as well as the difficulty of understanding the SF Regulations, policies and instruments among financial actors on the other, have caused delays, misinterpretations and frustration. This is strongly interlinked with the other main disadvantages highlighted by relevant stakeholders, namely the complexity of the Regulations and – consequently – the lengthy and complex processes of setting up FEIs. The main advantages and disadvantages identified are summarised in Table 15.

Table 15: The main favourable and hindering factors in the implementation of FEIs

Favourable effects of using FEIs	Factors limiting the success of FEIs
Leverage effect: FEIs have the ability to attract additional public and private sector resources, thus multiplying the effect of SF resources and the national/regional contributions.	**Negotiation and set-up:** The length of designing, negotiating and launching FEIs has been criticised for taking longer than anticipated by MAs (partly due to the complexity and incompatibility of the SF Regulations with state aid rules and commercial practices).
Sustainability: The use of FEIs can promote a recycling of fund. FEIs can potentially enable MAs to reinvest SF in the region beyond the end of the programming period and achieve better value for public money.	**Structural Funds Regulation:** The specific and complex features of FEIs as well as the national specificities with regard to public procurement have been found to be difficult to align with SF Regulations. A number of specific provisions have been found to clash with financial practices.
Capacity building: The partnerships between public and private sectors and the involvement of financial institutions/intermediaries in implementing EU regional policy can help pooling the expertise and know-how from various sectors.	**Know-how and experiences:** The lack of knowledge and experience of MAs and public (EU, national, regional) authorities about financial practices as well as state aid has been identified as a delay factor. Similarly, financial actors (e.g. fund managers) had difficulties in understanding and implementing SF Regulations.
Risk coverage: The use of FEIs can encourage investors to invest in projects which would not have been supported without public intervention. This is particularly relevant in the context of the economic crisis and the risk aversion of private actors.	**External challenges:** External problems have been the main reason for the implementation rate of some FEIs being slower than planned. These include demand side issues such as the economic crisis or supply-side issues such as competing types of business support.
Speeding up programme implementation: For MAs, the procedures for obtaining financial support through FEIs are faster than for grants once the funds have been set up. FEIs also encourage accelerating the absorption of funds, reducing the risks of automatic de-commitment.	**Monitoring and reporting:** The existing monitoring instruments put in place for the ERDF are not well adapted to FEIs. The targets and indicators sets in the OPs are not reconcilable with FEIs (e.g. job creation). The newly introduced SFC monitoring templates (2012) are considered to be unsuitable and too detailed one-size-fits-all indicators.
Urban development: There are few financial vehicles comparable to the UDFs supported under the JESSICA initiatives. The partnerships which can be established between MS, regions, the EIB and private actors can provide new opportunities for private sector participation and better address the challenges identified.	

Source: Own elaboration.

7.2 Findings and recommendations

In the following paragraphs, the main findings from this study's analysis are presented along with recommendations.

1. **Knowledge and expertise in SF Regulations, state aid rules and finance**

   Knowledge transfer and networking may contribute to the long-term impact of FEI. There is a strong need for improving the level of knowledge about SF and about financing and overcoming the public authorities' preferences of grants over FEIs. The hard as well as the soft results and effects of the use of FEIs have to be communicated and efforts made to contribute to better understanding of the instruments.

Recommendations

The European Institutions, the EIB, the EIF as well as the MAs should better communicate the advantages of using FEIs to public authorities if the use of such instruments is to be increased in the future. In order to do so, the concrete 'hard' advantages will have to be communicated once they become visible. These results will have to be communicated through networking platforms (such as the JESSICA and JEREMIE platforms), dedicated sections in reports and evaluations, etc.

The **European Parliament should encourage the Commission to offer more training** for the various types of actors involved. MAs should be trained in financing and state aid rules. This could be financed from Technical Assistance within the OPs. In parallel, the European Commission should encourage **MAs to offer trainings** to the fund managers about the SF Regulations where specific "do's and don'ts" according to the Regulations can be clarified.

The **European Parliament should ask the Commission to offer more practical support** and guidance in the future. The European Commission should consider the possibility of establishing a **help-desk** at European level to assist the involved actors and pooling knowledge about both EU Regulations and finance. Special workshops with experts from the field should be organised especially in the early phases of the next programming period.

2. **Analysing the need for using FEIs and moving away from grants**

   Although the financial intermediaries interviewed were all interested in managing FEIs in EU programmes in the future (mainly because of the stability and availability of funding), there have been echoes of reluctance to increasingly **move from grants to FEIs**.

   It is important to **build on and use experience** gained in terms of both FEI implementation and management. It has been noted that a review of previous experience with FEIs in the region or MS concerned, and an assessment of how new FEIs could fit in with existing provisions and institutions, would have been a useful addition to the gap analysis process carried out for some 2007-13 FEIs under the JEREMIE initiative, and, as mentioned above, this is being addressed in the proposals for the 2014-20 period. In relation to legacy funds, it is seen as important to keep the same management for successive implementation periods.

Successful design and implementation of FEIs hinges on a **correct assessment of market gaps and needs**. Reflecting this, for the 2014-20 period, FIs will be designed on the basis of an ex-ante evaluation, which should identify market failures or sub-optimal investment situations (including the financial gap analysis) that the instrument will address, as well as investment needs, possible private sector participation and the resulting value added. The ex-ante evaluation will also avoid overlaps and inconsistencies between funding instruments implemented by different actors at different levels.

Recommendations

The **incentives for the actors from the financial sector** should be further clarified and communicated **by MAs and public authorities**. More precisely, the MAs must inform the actors in the financial sector of the advantages related to managing funds within EU programmes such as crowding out private competitors by offering (at least slightly) better conditions and supporting SMEs that would otherwise be considered too risky by private actors. Financial actors should be informed based on past experiences and possibly the accounts from financiers and financial intermediaries who were directly involved in these processes in 2007-2013. Therefore, the **European Parliament** should ask the Commission to increase communication at MS as well as at European level to inform actors from the financial sector about the above.

The European Parliament should **ensure that the ex-ante assessments justify the use of a FI** in quantitative as well as qualitative terms. It must be clear why the OP decides to use FEIs instead of grants. Also, the needs identified must be consistent with the planned results.

In view of complying with the provisions related to regular reporting and monitoring in the regulatory proposals for 2014-20, the European Parliament should ask the European Commission and the MAs to identify a set of clear, transparent and measurable **result indicators.** These results must be consistent with ex-ante needs assessments. The current outputs in the ERDF should, in this sense, not (primarily) focus on job-creation or job-safeguarding. MAs should then use these indicators for reporting and monitoring to the Commission.

3. Providing an adequate regulatory framework

One of the main criticisms is related **to complex and rigid Regulations** (e.g. SF Regulations not being fit for FEI specificities). Beside the need to inform the process of setting up all FI-related Regulations by external experts from the financing sector who are involved in the process on the ground, there is a need for tailor – made FI Regulations which address the criticisms that have been voiced during the 2007-13 period. The regulatory proposals on FIs for the 2014-20 period do, in fact, aim to offer greater flexibility to EU MS and regions in terms of target sectors and implementation structures and to provide a stable implementation framework founded on a clear set of rules building on existing guidance.

The **size of funds** is important. A **regional approach may have a scattergun effect** and high overall costs. Providing access to finance below a critical mass is seen as unsustainable as the overhead costs of and the risks associated with investments or loans cannot be spread over a sufficient number of SMEs. On the other hand, for many

MS, critical mass was not achieved during this programme period as this was their first attempt to develop FEIs. The Commission argued that in some circumstances it was justifiable to have funds of smaller size to achieve Cohesion Policy objectives. It is worth noting that this phenomenon may be a feature of public sector funded FEIs more generally, especially equity–type FEIs – where 'the very small size of several hybrid VC funds bears [no] relevance to the realities of commercial practice in the VC industry' (Cowling 2012). Potentially addressing this issue, the Commission's draft regulatory texts on FIs for the 2014-20 period (EC 2012e) make provision for FIs to be set up at EU level, with OP contributions ring-fenced for investments within regions.

Compared to the period of 2007-13, the regulatory proposals for 2014-20 address indeed, inter alia, the following issues raised by MAs and the European Court of Auditors:

- State aid compliance and eligibility of management fees and costs;
- A reduction of the number of FIs to ensure a sufficient critical mass and to minimise disparities;
- Clear financial Regulation and use of revolving resources.

Recommendations

The European Parliament should ensure, in the negotiations of the CSF Regulations for 2014-2020, that **enough room for flexibility** is left especially for accommodating **state aid rules and financial / commercial practices** (differences in national/ regional market situations and financial traditions). The regulatory framework for FIs must leave enough room for flexibility to accommodate national differences and possible changes. Experts from the financial sector and possibly a **task force of actors** that have been involved on the ground in implementing FEIs in 2007-2013 should therefore inform the negotiations.

The legislators and the European Commission must ensure that the implementation of **FIs do not suffer** from the **deficiencies** of the regulatory framework at EU level and **scattering effects** of spreading the available funds over a large number of regional institutions. **A single (multi-fund) OP for all FIs** per MS could not only help ensuring a sufficient critical mass but also encourage the use of FEIs in other ESI Funds such as the ESF.

4. Facilitating and speeding up the implementation of FEIs

There are concerns in relation to **management costs and fees** which have not always been seen to be set up in a transparent manner. It is not always clear whether management costs are based on fund size, or investment size or whether they are tied to financial performance of the investments. In 2010, amendments to the General Regulation clarified the need to keep management fees in line with market practices, and the Commission's regulatory proposals for 2014-20 make further clarifications in this regard.

The interviewees had also pointed out that it is of utmost importance that FEI provide money to any types of procurements but also for services provided by **human resources** which is not always allowed for in the eligibility rules. In the words of a representative of the EIF, "for many businesses it is required to invest in know-how and not in cement, iron or computers. Services provided by human resources should also be eligible within the FEIs, if required".

Recommendations

An enterprise or a project is not solely composed of hardware but rather, and foremost, of staff. The European Parliament should ensure that public authorities are informed about the **need to take these costs into consideration** (with the support of the European Commission) and ensure that these rules do not hinder the effectiveness of FEIs.

The European Parliament should ensure that implementation can be sped up and management costs reduced through **offering off-the-shelf FIs**.

The European Parliament and the Commission should support Member States in their decision to establish one **single OP for all FIs** in order to facilitate the planning process and reduce the difficulties arising with setting-up FEIs within the OPs.

5. Ensuring positive conditions for successfully implementing urban development projects

The implementation of the JESSICA initiative in 2007-13 has been seen as helping to pave the way for the next period, and smoothing the transition from one kind of support to another. There are **several preconditions for success of urban development** FEIs: quick establishment of the UDFs, funding of investment-ready projects, identifying suitable OP resources and capacity to invest in projects during the lifetime of the current OP.

Recommendations

The positive results of supporting urban development projects with FEIs must be **communicated** by the European Commission, the EIB and MAs to national and regional governments. This must be encouraged by the European Parliament in the first place.

Relevant actors at the local, regional and national levels must cooperate closely with the MAs, the EIB and UDFs to identify the most suitable projects and target investments in a way to achieve substantial results. The European Institutions should ensure that Member States make efforts towards increasing such cooperation.

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9. ANNEX 1: CASE STUDIES

1. SACHSEN-ANHALT ERDF OP (GERMANY)

1.1 Characteristics of OP

The Sachsen-Anhalt ERDF programme in Germany is a Convergence programme, with a budget of c. €2.6 billion, and a Community contribution through the ERDF of c. €1.9 billion. This corresponds to around 7.3% of the total funds available for Germany under Cohesion policy for 2007-13.

The population of Sachsen-Anhalt is around 2.3 million inhabitants, with about one quarter of people living in the three main cities of Magdeburg, Halle and Dessau. Sachsen-Anhalt is one of the eastern German Länder and continues to be affected by the economic legacies of the past, reflected in a relatively high, although falling, unemployment rate of 10.0% in 2012 (Germany: 6.8%). However, the Land also has industrial strengths in sectors such as chemicals, mechanical engineering, food, automotives, biotechnology, and wood and sustainable materials.

The Sachsen-Anhalt ERDF OP has six priorities: innovation, research and development; increasing the competitiveness of the economy; improving the economic infrastructure; sustainable urban development, including educational infrastructures; environmental protection and risk prevention; and technical assistance.

1.2 Use of FEIs

FEIs are supported under Priority 1, 'Research, development and innovation' and Priority 2, 'Increasing the competitiveness of the economy', which together account for approximately 59% of total ERDF funding (Land Sachsen-Anhalt, 2007 p.141). The OP envisages that FEIs will be used in response to specific funding problems encountered by new SMEs in the Land. As well as plugging a gap in SME funding, the FEIs are also seen to contribute to the Sachsen-Anhalt Land government's strategy of reducing the use of grants and instead developing a set of revolving funds which will be available for supporting economic development in the long term, beyond the end of the Structural Funds programme period. A total of €248.7 million from ERDF has been allocated to FEIs, €220.9 to loan funds and €63.8 to venture capital (c. 12.9% of the ERDF allocation to the programme). This is the largest allocation by far among the German Länder from ERDF to FEIs (Schwab 2012).

Three FEIs have been co-financed by the ERDF programme in Sachsen-Anhalt. Two of these, both co-financed under Priority 2 of the OP, are managed by the Sachsen-Anhalt Investment Bank:

- The SME Loan Fund (KMU-Darlehensfonds) provides mezzanine or traditional loans to start ups and existing growing SMEs, especially in the manufacturing sector. The rationale for setting up the SME Loan Fund in Sachsen-Anhalt was that the Land authorities felt that private sector lenders did not provide sufficient funding for SME investment in Sachsen-Anhalt. This market failure is seen to exist across a wide range of SMEs and across a wide range of funding needs.
- As the loan fund potentially finances a range of types of firm and activity, the Sachsen-Anhalt Investment Bank markets the fund through a number of different strands, notably: IMPULS ('Impulse', loans for investment), WACHSTUM ('Growth',

mezzanine loans), IDEE ('Idea', loans for commercialising an idea), and MUT ('Courage', loans for pre-financing contracts). However, these different strands do not constitute separate funds or entities. The budget of the fund is €237.9 million (€174.8 million from ERDF).

- Land Sachsen-Anhalt has not tried to gain private funding as an input to the SME Loan Fund. However, in the case of most projects, a commercial/cooperative bank is involved in providing part of the funding to businesses, and so the managing authority argues that the fund does exert a leverage effect on private funding.
- A seed loan fund, Ego.PLUS, is being financed by the ERDF programme under the broader New Start-ups Initiative (Existenzgründungsoffensive (Ego)), which is co-financed by both the Land ESF and ERDF programmes. It provides mezzanine loans to SMEs of up to three years old for bringing a new product, process or service to market, as well as for R&D and investment projects. It has a budget of €10 million from ERDF.

In addition, the IBG II Risk Capital Fund (Risikokapitalfonds IBG II), funded under Priority 1 of the OP, provides equity investments, convertibles and/or mezzanine loans to SMEs. It invests in technology-oriented projects in seed, start-up and expansion phases, and is managed by a small, independent private investment company based in Sachsen-Anhalt (Goodvent Investment Management Ltd). The budget of the fund is €85 million (€63.75 million from ERDF).

1.3 Experience to date

Experience with negotiation and set-up

Following positive views of the performance of the IBG Risk Capital Fund that was already co-funded by the ERDF OP in 2000-06, the Land decided to continue with this instrument in 2007-13, although its management was transferred to Goodvent from 2007 (Land Sachsen-Anhalt, 2007 pp.108-109). It was also decided to extend the use of FEIs in 2007-13, as they were seen to facilitate the creation of a resource base that could be used for long-term economic development policy, and also to improve the efficiency of development policy.

Experience with administrative arrangements

The Sachsen-Anhalt Land government decided not to adopt a JEREMIE or JESSICA structure because the Sachsen-Anhalt Investment Bank was already in place, and is a structure well-used to setting up and operating loan funds. The Sachsen-Anhalt Investment Bank is the main public funding bank in Sachsen-Anhalt, is a service-provider for the Land government, and is part of the institutional framework that has developed in the Land since reunification. The advantages of the Land Investment Bank are, first, that it is very familiar with financial situation and difficulties of local firms and, second, that it is well used to working closely and constructively with the different Land Ministries and playing a bridging role between the Land government, commercial/cooperative banks and local SMEs. Because the Bank is an 'in-house' body of the Land and is 100% owned by the Land, no public procurement procedure was needed.

Experience with outputs and results

The most recent results are (AIR 2011):

- SME Loan Fund: 9,499 jobs created or safeguarded, 778 loan contracts signed with final recipients, involving €211.5 million committed in contracts signed with final recipients and €190.4 million effectively disbursed to final recipients.
- Seed Loan Fund: 15 loan contracts signed with final recipients, €2.1 million committed in contracts signed with final recipients and €1.6 million effectively disbursed to final recipients.
- Venture Capital Fund: 512 jobs created or safeguarded, 74 investments made in line with agreements signed, worth €27.8 million.

1.4 Future plans

Challenges and lessons learned

There have been two relevant evaluations undertaken in the 2007-13 period. First, there was an evaluation in 2009 of three main business investment instruments (namely the SME Loan Fund, the IBG II Risk Capital Fund, and the Regional Joint Task [GRW] funding for business investment) (Banke, Bötel and Schneider 2010).

The main relevant **conclusions of the evaluation** were as follows:

- Investment-oriented funding instruments for individual firms contribute to the goals of the 2007-13 ERDF programme in Sachsen-Anhalt. The three instruments evaluated are well differentiated from each other and facilitate investment-oriented funding that meets with the needs of firms in Sachsen-Anhalt.
- The instruments focus funding on firms with development potential. The types of firm funded contributes to the ERDF programme goals in Sachsen-Anhalt.
- In terms of expected employment effects, the likely effect on funded firms lags slightly behind the ERDF programme's ex ante targets (relative to the amount of funding allocated). However, actual employment effects will only emerge after the end of the project (at business level).
- The creation or continuation of revolving funds allows resources to be reused, as long as repayments are received from recipients. These instruments thus provide Land Sachsen-Anhalt with a medium-to long-term resource for supporting businesses.
- While the fund managers monitor risk at fund level, the evaluators recommended that these data should also be monitored at programme level (e.g. data relating to the number and volume of loans or equity participations; the length of loans or equity participation; repayment or failure-to-repay rate).

Second, the mid-term evaluation in 2010 covered the whole ERDF, ESF and EAFRD programmes and included sections on the SME Loan Fund (Bötel et al., 2010). The mid-term evaluation's assessment of the SME Loan Fund in Sachsen-Anhalt states the following:

- Relevance: The SME Loan Fund continues to be of relevance, as intervention is needed to address the lack of funding for SMEs and thus increase their competitiveness. Although a number of other federal and Land programmes also offer funding to SMEs, the SME Loan Fund's focus is complementary to these other instruments.

- Effectiveness: Monitoring data show that 100% of funds committed have been paid out but show no progress towards output and result indicators (e.g. number of projects funded, number of jobs created). However, the 2009 evaluation of business aid (see above) showed that there had been some progress on outputs/results.
- Contribution to programme goals: The fund makes an important contribution to extending and modernising business capital stock and thus to the goal of economic growth. The fund also contributes to the programme goal of 'improving employment opportunities' by stimulating productivity growth, which in turn leads to wage growth and thus employment effects.

Further, the mid-term evaluation's (Bötel et al., 2010) assessment of the IBG II Risk Capital Fund states:

- Relevance: The Fund is very relevant due to the small size of firms in the Land and thus the lack of own capital, limited creditworthiness and high risk of failure, which constrains credit for investment.
- Effectiveness: Monitoring data show that 100% of funds have been paid to the Fund but no projects had been implemented by mid-2010.
- Contribution to programme goals: The Fund will make a major contribution to the support of competitiveness and growth as long as funding starts to flow. The provision of risk capital will improve funding opportunities for business, leading to enhanced innovation capacity, which in turn underpins growth and employment.

Plans for 2014-20

The Sachsen-Anhalt Land government has agreed in principle that a number of other loan/equity instruments could be set up with EU funding (e.g. in fields such as climate protection and renewable energies, rail infrastructure, and water and sewerage infrastructure). However, these funds have not yet become operational because the managing authority is awaiting Commission clarification on a number of management and implementation issues (Schwab 2012). In relation to some of these themes (e.g. climate change), the ERDF OP AIR for 2011 states that funding provisionally allocated to FEIs in the 2007-13 ERDF OP has now been shifted to non-loan instruments because the eligibility criteria of the Structural Funds regulation cannot be met, as regards the need for instruments primarily to target SMEs (Land Sachsen-Anhalt, 2012 p.59).

2. ITÄ-SUOMI ERDF OP (FINLAND)

2.1 Characteristics of OP

The Itä-Suomi ERDF OP for 2007-13 is a Regional Competitiveness and Employment Programme which covers the Finnish regions of South Savo, North Savo, North-Karelia and Kainuu. The total budget of the programme is around €1.5 billion and Community assistance through the ERDF amounts to €365.6 million, accounting for approximately 21% of the total amount invested in Finland during the 2007-13 programme period. Eastern Finland has "phasing-in" status, which means a strongly diminishing financing profile over the programme period. Due to its sparse population and remoteness, the region benefits from a special allocation for sparsely populated areas of €35 per inhabitant per year from the ERDF (totalling €186 million).

The population of Eastern Finland is 649,000 people (at the end of 2011) (Statistics Finland 2012). With an area of 85,200 km2, the average population density is as low as 7.8 persons/km2. Many of the region's problems arise from its remote location and sparse population. The declining and ageing population and high unemployment rate have been Eastern Finland's key challenges for years. Slower economic growth than elsewhere in Finland weakens the potential to develop the competitiveness of the area. Socio-economic disparities within Eastern Finland have also increased, with peripheral rural areas lagging behind. However, development prospects have somewhat improved with new possibilities seen in the mining and forest industries and tourism (Karjalainen et al 2011).

2.2 Use of FEIs

The role of Financial Engineering Instruments (FEIs) in the Finnish ERDF programmes is rather small. Only a few mentions are made of FEIs in the NSRF and OPs. The Itä-Suomi OP 2007-13 outlines a need for venture capital in the programme area, with the aim of increasing risk capital for seed and start-up stages for companies but does not develop this idea further. The importance of loans in new business creation is also highlighted.
The use of FEIs is addressed under Priority 1 "Promotion of Business activity". The priority aims at developing productivity, creating more jobs and safeguarding existing jobs through supporting entrepreneurship and the growth of enterprises and through improving access to business services and finance.

FEIs, or more precisely interest subsidised loans and guarantees, were in use in the 2000-06 period in Eastern Finland with good experiences. Although the loans awarded to entrepreneurs were small, they proved to have an important employment effect. In general, the loans were perceived as a cost-effective tool to create employment and as having an important role in attaining the programme's quantitative goals. Furthermore, loans and guarantees were designed to fill an identified market gap (Laakso et al 2005; Net Effect 2005).

Building on the recommendations of the mid-term evaluation of the 2000-06 period, FEIs were also included in the palette of business support measures in the 2007-13 period. There are two forms of FEI in use in the present ERDF period: (1) subsidised loans and guarantees to SMEs, and (2) provision of venture capital for seed and start-up stages for innovative SMEs. Both forms of FEI are organised and administered by Finnvera, a specialised financing company owned by the State of Finland, which provides a wide range of financial services to enterprises in the whole country.

Subsidised loans from Finnvera to SMEs are granted for starting a business, developing the business (investments, working capital and small loan) and there are also certain special loans available, such as a loan for women entrepreneurs and environment. In addition, Finnvera provides guarantees for SMEs. ERDF support is used to lower the interest rate for the loan receiver and to cover the risk of guarantees in disadvantaged regions. The subsidy rate increases gradually by the level of disadvantage: highest subsidy rates are in the most disadvantaged regions in Eastern and Northern Finland. At the same time in the most advantaged regions Finnvera's loans are also available but without interest rate support from ERDF. Finnvera uses interest subsidies on a case by case basis as part of the funding if an application meets the requirements (therefore a company does not apply individually for an interest subsidy).

Venture capital for SMEs became available as a new ERDF instrument in August 2011, as a response to identified problems in the availability of growing start-up firms, which were considered to have an important role in regional development. Finnvera founded a new fund Aloitusrahasto Vera Oy (Starting Fund Vera Ltd) which is administratively a subsidiary of Finnvera. The total asset – received from four ERDF programmes and the State - of the fund was €17.5 million. The aim is to increase the asset up to €30 million by the end of the programme period. The requirements for investments are innovativeness and growth potential. The focus is on SMEs operating in ICT services, in industry with manufacturing innovations, and in innovation intensive services (other than ICT). The regional focus is in less advantaged regions such as Eastern Finland, and the approval criteria are lower in these regions. The administration of the ERDF funds within Aloitusrahasto Vera has been delegated to a separate firm.

In general, the high costs and high dead weight of investment grants have been noted by evaluators in Finland (2000-06, 2007-13). There is also economic and political pressure to decrease the volume of direct grants to enterprises and substitute some of them with loans, and complement them with venture capital.

2.3 Experience to date

Experience with negotiation and set-up

As interest subsidised loans were already used in 2000-06 with good experiences, they were also included in the business support palette in 2007-13. Also in spite of the fact that the role of FEI is fairly marginal in the official programme documents (NSRF and OPs), both the Ministry of Employment and the Economy and the coordinating bodies in the regions considered that there was an urgent need to introduce a venture capital instrument in the ERDF programmes. The steering committees of the four programmes of mainland Finland decided on the preparation of the venture capital instrument in summer 2009. However, the administrative and legal processes (including a change in the law) took a long time and Aloitusrahasto Vera was not ready to start until August 2011 (Laakso et al 2012). Initially, the regions also had concerns related to the revolving nature of the funds and the long-term competitiveness of Finnvera instruments. Some regions have questioned for example the destination of recycled funds; whether they end up in Finnvera and from there to areas where there is demand, or whether the state receives the returned funds as a compensation for its initial funding (Vironen 2010).

Experience with administrative arrangements

Both forms of FEI are organised and administered by Finnvera. Finnvera has many years of experience in the provision of non-grant financial instruments, which were started in 1998. According to the evaluation of Finnvera (MEE 2012), it performs well in regions and its collaboration is highly valued by SMEs and banks. Particularly in the regions, there are long traditions for collaboration between SMEs and Finnvera and also with local banks.

Some issues concerning Finnvera's involvement have been identified, mainly related to monitoring system. The objectives and targets have been set for the priorities as a whole, not separately for Finnvera's projects. The problem is that Finnvera registers only projected achievements but not the verification of achievements after the project is completed, unlike other organisations responsible for ERDF administration. Consequently, there is reliability problem connected with Finnvera figures (Laakso et al, 2011). As Finnvera also uses its own monitoring system, transferring data to the ERDF monitoring system is perceived as being complicated. On the other hand, regional policy instruments of Finnvera with ERDF elements cause an administrative burden for Finnvera and decreases Finnvera's availability to interface and work directly with customers (MEE 2012).

Despite this, FEIs are perceived to be more efficient than grants in administrative terms, particularly given that they enable more regular and longer-term monitoring. Nonetheless, difficulties have been experienced, particularly with respect to the legal framework. For instance in the EU context, the legal framework is viewed to be oriented largely towards grant-based instruments, and as such it does not necessarily take into account the specific traits that apply to non-grant instruments (Vironen 2010).

Experiences with outputs and results

In the Itä-Suomi OP, the aim is to use 90.7% of the funding for non-repayable support, 6.9% for loans, interest subsidies and guarantees and 2.4% for risk capital. By the end of 2011, 94.4% (€409.4m) had been committed to non-repayable instruments, 4.6% (€19.7m) to loans, interest subsidies and guarantees and 1.0% (€4.3m) to risk capital (Annual Implementation Report 2011). By the end of 2011, a total of 2,622 loan guarantees were committed in Eastern Finland with an average size of €7,330 (over the whole of Finland) (Karjalainen et al 2011). In general, Priority 1 under which FEIs operate has progressed rather slowly, not least because of the economic downturn.

Itä-Suomi has committed a total of €5 million to Aloitusrahasto Vera Oy. It is estimated that these funds will be invested in 13 companies (Houtsonen 2012). By the end of April 2012, a total of three investment decisions had been made totalling €0.6 million and four investment decisions were being processed, totalling €1.4 million (Table 1). In practice, there has been over-demand in Southern Finland and shortage of good applications in Eastern Finland to date. Taking all four mainland Finland OPs, 7-10% of applications had led to actual investments by April 2012 (Laakso et al 2012). After a slow start, it seems that there are suitable investment projects in pipeline. It is estimated that if the inflow of projects continues as it is now, there will be demand for more ERDF-backed investments than the commitment allows during this programme period (+2) (Houtsonen 2012).

Table 16: Investment decisions by Aloitusrahasto Vera Oy in Eastern Finland to end 2012

	South Savonia	North Savonia	North Karelia	Kainuu	Total
Investment decisions	0	4	1	0	5
Investment decisions in process	2	1	0	1	4
Investment decisions Possible projects	2	3	0	0	5

2.4 Future plans

In the evaluations from the previous (and present) period, the system of Finnvera's ERDF-based loans and guarantees is found to have worked well. For example in 2000-06 Finnvera was evaluated as the best functioning support system within ERDF. Its contribution to jobs and new business is also found to be high, while its costs are relatively low compared to grants (Laakso et al 2005). Correspondingly, no special issues concerning Finnvera's loan products were raised in the mid-term evaluation of the 2007-13 period or in the AIRs (Laakso et al 2012). Also Hyytinen and Ylhäinen (2012) found that Finnvera's loans and guarantees have helped business to make more investments, grow faster and hire more employees 2000-2008. On the other hand, effects on productivity growth have been found to be negative or irrelevant (Hyytinen & Ylhäinen 2012).

Controversially, the strategic value of interest subsidised loans has recently been questioned, as well as Finnvera's contribution to regional development (MEE 2012). First, Finnvera's involvement is found to not necessarily be justified by market failure. In some instances Finnvera has been potentially crowding out banks, as Finnvera's subsidised loan products may have 'pick[ed] the regional cherries'. This may reflect to the common practices in the regions where SMEs have traditionally relied on Finnvera rather than solely on local banks, which implies that Finnvera finance is not necessarily addressing market failure but is rather "business as usual" and is rather about the pricing and conditions related to risk financing. On the other hand, although Finnvera works to address market gaps, the domestic side can be seen to overfill given that commercial banks, particularly in the regions, have become too accustomed to the risk cover. Taking this into account, at the current interest rate, the strategic value of subsidised loans is found to be highly dubious, with little value added (MEE 2012).

Second, Finnvera's contribution to regional development is found to be unclear and there is a risk that Finnvera support postpones necessary structural adjustments. Promoting regional policy through public intervention in the form of company financing is no longer considered effective. More precisely, the evaluation raises the question whether Finnvera as a public financier is the optimal or even relevant actor to address regional policy targets, as there might be more effective tools for development than pure financial instruments.

On the other hand, the venture capital market is currently developing and public sector catalysing may be needed, particularly in the early phases (Koski & Yla-Anttila 2011). Correspondingly the ERDF mid-term evaluation recommends increasing risk capital with ERDF funds (Karjalainen et al 2012).

As a response to recent evaluation results, Financial Instruments will undergo fundamental changes in Finland in 2014-20. First, all risk funding for start-ups will be centralised in one organisation, Tekes (the Finnish Funding Agency for Technology and Innovation). Tekes is publicly-funded expert organisation for financing research, development and innovation in Finland. Currently, Tekes is responsible for aid and loan-based risk funding and Finnvera for equity. This will change at the beginning of 2014, when Tekes will take over Finnvera's equity responsibilities. Finnvera will continue to offer loans, but without an ERDF subsidy in the 2014-20 period.

There is interest in introducing up to a maximum of four new regional equity funds in 2014-20. These would create a form of nationwide coverage and be managed by Tekes. These funds would probably focus on supporting similar themes as to date, such as research and innovation, competitiveness of SMEs and access, use and quality of information and communication technologies.

3. LANGUEDOC-ROUSSILLON ERDF OP (FRANCE)

3.1 Characteristics of OP

The French Languedoc-Roussillon ERDF OP comes under the Regional Competitiveness and Employment Objective. It has a total budget of about €817 million, of which Community assistance through the ERDF amounts to €270 million. This accounts for approximately 1.9% of Community aid to France as part of Cohesion policy for 2007-13.

Languedoc-Roussillon is located in south of France and comprises five départements.[24] There are some 2.5 million inhabitants in the region (of which around 530,000 in the capital, Montpellier). Demographic change in Languedoc-Roussillon is characterised by very high population growth – twice the national average; over the period 1954-2004, the population of the region grew by around 1 million, 90% of which was accounted for by inward migration. Although migration has the effect of lowering the average age of the population and raising the average educational level, the population profile of the region is still older than the national average.

In 2009, GDP per head was just 78% of the national average, the second lowest in mainland France. The regional unemployment rate is the highest in France– around 40% higher than the average for mainland France in 2012. However, for 1994-2006, the rate of job creation was also the highest in France. This paradox is largely explained by the high rate of population increase noted above and a mismatch between the skills required for available jobs and those of the unemployed population.

3.2 Use of FEIs

France has a relatively large number of FEIs compared to other Member States (EC 2012): by end December 2011, there were almost 180 funds in operation with commitments close to €350 million under RCE OPs. The use of FEIs is concentrated on eight regions, which typically commit between three and five percent (16% in Corse) of OP funding to FEIs (Lacave 2012). Most French regions using FEIs offer loans for new firm formation or transfer. Ten have introduced equity instruments and eight use guarantee funds.

Languedoc-Roussillon is one of the two regions that have signed a JEREMIE agreement (the other is Centre). The OP has contributed €30 million to JEREMIE, just under 4% of the OP total.

- Equity finance for new firm formation. The EIF analysis suggested that local intermediaries tended to focus equity investment activity on growth and development of enterprises. This was true for both general and innovative start-up firms.
- Small-scale loan funding in the form of prêts d'honneur (unsecured loans) for generalist SMEs with good potential. Such financing, which theoretically ensures a link with small regional venture capital, does not exist in Languedoc-Roussillon and constitutes an important market gap.

[24] The discussion that follows in this section is drawn principally from data on INSEE and information in the OP for Languedoc-Roussillon.

On basis of the market failures, the strategic aim of JEREMIE is 1) to bridge the market gap in the micro-credit market between the available supply of financing and the potential demand assessed; 2) support the financing of innovative start-ups by increasing the available resources in the segment of seed technological or innovative projects and 3) creation of an investment vehicle for equity or quasi equity to support the emergence of a small supply of financing for high potential SMEs (EIF 2009).

JEREMIE is implemented under Priority I Innovation, the Knowledge economy, growth factors and competitiveness.

The total budget of €30 million (half of which is provided by ERDF), is split between guarantees (€14 million), equity (€11 million), and loans (€2 million). Some €3 million of the total have been set aside for management costs (Robino 2009). With leverage, this has been estimated to translate into €143 million available for SMEs in the region (Semaphore 2012). Each of the three instruments is managed by a different organisation, selected following calls for tenders:

- Loans are offered through CREALIA, with which the EIF signed a contract following a call for tenders. Loans are available for innovative projects in any sector of activity, but applicants must have the backing of a member of SYNERSUD, a network of start-up support and incubator units in the region (CREALIA, Bonnet and Robino 2012).
- Equity or co-investment funds are operated by SODIREC. SODIREC has to match the €11 million provided through JEREMIE with private sector funds (SODIREC, Bonnet and Robino 2012).
- Guarantees are provided on loans offered through the Banque Populaire du Sud, again following a call for tenders and an agreement between the successful tenderer and the EIF (Bonnet and Robino 2012).

3.3 Experience to date

Experience with negotiation and set-up

Formal agreement on JEREMIE was reached in 2008 and the EIF established an office in Montpellier the same year. After the launch of JEREMIE in October 2008, an investment board was established and the funds were disbursed in December 2008. Early in 2009 the portfolio of products was decided and a call for expressions of interest for the loan and equity funds was issued (languedoc-roussillon.eu 2009, Robino 2009).

The selection of financial intermediaries was a rather slow process, taking around one year. This was mainly due to the challenges faced in drafting the contracts because of the need to comply with both Structural Funds regulations and State aid rules at all levels. In addition, the strict procurement rules of the EIF were perceived to have slowed down the process (Gross 2011, Lacave 2012).

A number of issues arose that complicated the establishment of the funds. A particular concern related to the absence, or lack of clarity, of regulations on eligibility and coverage of costs in case of the default of a financial intermediary, the mechanisms for paying ERDF contributions, ownership of the funds and inconsistencies between JEREMIE and ERDF rules (Gross 2011, Sémaphores 2012).

A number of features of the French administrative system also made the set-up of financial instruments complicated. In particular, accounting procedures at the level of the regional State services (préfets) were not in line with EU requirements, since, under French law, préfets can only administer grants and the accounting system cannot register amounts repaid by a beneficiary. As a result, the ERDF grant for JEREMIE had to be transferred to the regional councils, who allocated funding to JEREMIE together with their own contribution (public match-funding). However, because the General Code of Territorial Authorities did not allow regional authorities to be involved in JEREMIE-type funds, the Finance Law had to be amended (Gross 2011).

Experience with administrative arrangements

In France, two public financial institutions play important roles in FEIs at national level: OSEO for debt and guarantees and CDC Enterprises for equity. The JEREMIE Fund in Languedoc-Roussillon is managed by EIF, which was chosen as a fund manager over CDC. EIF's support from the very beginning with setting up JEREMIE was also perceived important (Lacave 2012).

After an initial "know-each-other" phase, the collaboration between the regional authorities and EIF has been perceived to be constructive (Robino 2009), although the regional authorities have had to deal with two different cultures - their own, focused on regional economic development, and that of the EIF (Lacave 2012). In this regard, there has been some general criticism over EIF in France. First, the cooperation with the EIF has been seen as too demanding and the set-up of a holding fund too time consuming. Also, EIF has been criticised for promoting JEREMIE to regional authorities when the legal arrangements of the initiative were still undefined. Further, the EIF has been perceived as operating like a commercial bank, seeking all of its management costs to be covered, rather than like a public authority, which many regional authorities had expected (Gross 2011).

Despite the involvement of EIF, one of the main advantages of JEREMIE is perceived to be its embeddedness in the region, since the instruments are implemented through locally-based financial intermediaries (instead of nationwide or international funds) (Lacave 2012; Semaphores 2012).

Nevertheless, the managing authority anticipates some possible administrative difficulties in the future, mainly with respect to the lifecycle of funds, reporting, and ex post evaluations (Lacave 2012).

Experiences with outputs and results

By 30 January 2013, JEREMIE had contributed finance to 416 firms and €8.6 million of the €27 million available (i.e. the JEREMIE fund, less management costs) had been committed; as a result, some €54.1 million had been made available to firms (compared with €143.6 million, over the life of the fund). The breakdown between instruments in as follows.

	Number	JEREMIE commitments	Total financing
Loans	68	0.834	1.668
Equity	18	4.068	20.985
Guarantees	330	3.744	31.457

Source: Le Baromètre de Jeremie Languedoc-Roussillon, www.info-entrepriseslr.fr.

3.4 Future plans

In general, the French regions have a cautious approach to FEIs; a significant concern is that an increased use of FEIs in the next programming period may lead to a reduction of non-refundable grants. Despite this, the Languedoc-Roussillon managing authority intends to develop new FEIs in future, in particular in the field of 'social innovation' (e.g. to benefit the ageing population), and to address the needs of enterprises in terms of working capital (BFR, besoins de fonds de roulement) following Basel III regulations and their expected impact on bank loans (Lacave 2012). The current JEREMIE will operate until 31 December 2015 (languedoc-roussillon.eu 2009). The objective is to recover a portion of the funds to reinvest in the business in the implementation of EU programs 2014-20.

4. ŚLĄSKIE (SILESIA) ERDF ROP (POLAND)

4.1 Characteristics of OP

The Regional Operational Programme (ROP) for Śląskie Voivodeship (Silesia) in Poland 2007-2013 is an ERDF Convergence OP, with a total budget of €2.02 billion, €1.71 billion of which comes from ERDF (approximately 2.5 percent of the total EU money invested in Poland under Cohesion policy in 2007-13). The programme has ten priority axes, including: technical research and development, innovation and entrepreneurship; knowledge society; tourism; culture; environment; sustainable urban development; transport; educational infrastructure; health and recreation; and technical assistance.

Śląskie Voivodeship is inhabited by nearly 4.7 million people, i.e. 12.2 percent of the total populace of Poland. It is one of the most urbanised regions in Poland (the urban population accounting for 78.4 percent) and has the largest population density in Poland (377 people/km², the national average being 122 people/km²). Śląskie Voivodeship is the second most populated voivodeship in Poland after the Mazowieckie Voivodeship (13.6 percent). In terms of spatial and functional structure, the Voivodeship is divided into four sub-regions (the so-called development policy areas): the northern sub-region (with area of 3,050 km²), the southern sub-region (2,354 km²), the central sub-region (5,577 km²), and the western sub-region (1,353 km²). The central sub-region - the largest in terms of area – is inhabited by 2,835,000 people (i.e. 61 percent of the total populace of the region), over four times as many as in other sub-regions of the Voivodeship.

4.2 Use of FEIs

Financial Engineering Instruments (FEIs) account for 2% of all Cohesion policy spending in Poland. They operate in the Regional Operational Programmes (ROP), the OP Development of Eastern Poland, the OP Innovative Economy, and the OP Human Capital.

In the Śląskie Voivodeship ERDF ROP, FEIs are envisaged under two priorities. There is support under Priority 1, for projects to facilitate access to external financial resources for SMEs, technological research and development (R&D) innovation and entrepreneurship, and also under Priority 6, sustainable urban development. Together these account for c. 4% of ERDF resources in the ROP.

Under Priority 1.1.1 Technological research and development (R&D) innovation and entrepreneurship, the ROP provides additional financial support (beyond the use of grants) to entrepreneurs who are resident in the region or maintain investments in the region, through the recapitalisation of local, regional and sub-regional loan funds, micro-loan and guarantee funds. This is a continuation of measures from the previous period 2004-06, but has extended support to SMEs to include loans and guarantees, and has an ERDF contribution of c.€16.6 million.

Reference to FEIs is also included under Priority 6 (Measure 6.2.3), sustainable urban development: "In order to increase the efficiency of actions aiming at urban renovation it is allowed to apply within the priority the JESSICA initiative, including support in the form of renewable financial tools (loan and guarantee funds and other related tools)" (Regionalnego Programu Operacyjnego Województwa Śląskiego na lata 2007-2013, p118).

Further to this, a JESSICA Holding Fund has been set up, managed by the EIB, which makes contributions to Urban Development Funds (UDFs). These will provide equity, loans and/or guarantees to urban projects, aimed at the revitalisation of degraded areas in big and small cities as described in Priority 6 of the ROP. The allocation earmarked for this initiative is €51 million from ERDF, plus €9 million from the state budget. Private capital can occur at the stage of projects, although it should be noted that the private sector is not very involved at the regional level – it is much more active in the OP Innovative Economy where a 'Fund of Funds' invests in venture capital in cooperation with firms.

In October 2011 an agreement was signed between the EIB and the Bank of Environmental Protection, which officially began to operate as the UDF for the Śląskie region. Subsequently, a competition for potential beneficiaries was prepared and in December 2011, the Bank of Environmental Protection appraised applications for loans for urban projects under JESSICA. In April 2012, an agreement was signed between the Bank of Environmental Protection and the beneficiary, the City of Tychy, for the project "Cultural Passage Andromeda," which is the first JESSICA project in Śląskie and the fourth in Poland. The project will invest in a disused cinema "Andromeda", transforming it into a dining and shopping centre, with space for a municipal art gallery, media centre and conference room. The investment is being made in conjunction with a project to revitalise Tychy Old Town and post - industrial degraded land in the area. For the realization of this project the city will receive a €1.1 billion loan. The value of the whole project is over €2.7 billion. After selecting contractors, the work will take approximately 18 months.

4.3 Experience to date

Experience with negotiation and set-up

The negotiation of the JESSICA instrument from the letter of intent to the EIB to the signing of the Funding Agreement took just over a year. From signing of the Funding Agreement to transfer of funds to the UDF took an additional year and four months (see Table 1).

Table 17: JESSICA timeline

09.07.2010	Signing of Financing Agreement
September 2010	Selection of members of the Investment Board
04.10.2010	First Investment Board meeting
November 2010	Choosing an implementation consultant
November/December 2010	Starting a business information and promotion
December 2010/January 2011	Defining the market potential UDF (Urban Development Funds)
I Q 2011	Preparation of the documentation relating to the selection process for the UDF
28.02.2011	Second Investment Board meeting
14.04.2011 – 10.05.2011	First stage selection procedure UDF – Call for Expression of Interest
25.06.2011	Third Investment Board meeting
31.08.2011	Fourth Investment Board meeting - Start of contract negotiations as the operational management of Bank of

	Environmental Protection as manager UDF
24.10.2011	The signing of Operational Agreement with the UDF
November 2011	Transfer funds to the UDF
December 2011/January 2012	Running a competition for potential applicants
3 April 2012	Agreement signed between the Bank of Environmental Protection and the beneficiary - City of Tychy – for project "Cultural Passage Andromeda," which will develop an uninhabited cinema building in close connection with the project of the Tychy Old Town revitalisation. This is the first project in Silesia, and the 4th in Poland under a JESSICA initiative.

Experience with administrative arrangements

For the 2007-13 period, the Marshal's Office of each of Poland's 16 regional self-governments has the role of Managing Authority (MA) for the ERDF ROPs, and the regional government in Śląskie has established a Regional Development Unit (ERDF) for this purpose. Generally, regional administrative capacity has expanded rapidly since Poland's first Cohesion policy programme period (2004-06), responding to the demands of managing and implementing a substantial amount of funding. Nevertheless, this capacity is developing from a traditionally weak base and capacity building on the 'demand' and 'supply' side remains a priority. The signing of agreements between the European Investment Bank and the Bank of Environmental Protection, which officially began to act as Urban Development Fund for the Śląskie Voivodeship, was linked to training conducted for potential applicants/ beneficiaries and beneficiaries of the ROP. The main topics of the training were revitalisation, the JESSICA initiative and public-private partnership.

Experience with outputs and results

Under Priority 1, as of mid-2012, the progress of the various instruments varies. Loan funds have performed strongly: the Local Development Agency has already paid the full amount available. The other two loan funds are progressing in terms of take-up: The Upper Silesian Fund (66 percent) and the Regional Development Agency fund (39 percent). The least developed is the guarantee fund, which granted guarantees for 24 percent of funding available.

Under Priorty 6 and the JESSICA initiative, a meeting was held in March 2012 to discuss the current state of implementation in Śląskie and analyse implementation issues. Representatives of Bank of Environmental Protection presented the principles and steps in the process of applying for a loan. During the presentation of projects applying for funds under the JESSICA initiative, the issue of updating the Local Revitalization Program (LRP) was raised. To gain support from the JESSICA initiative, projects must be integrated with the LPR which is developed by the local government (city / municipality). This means that the area where the project is located is considered degraded, based on the criteria set out in the special guidelines of the ROP's MA. The project must also demonstrate in the application how it will contribute to LRP priorities. Some potential beneficiaries face problems with the process of updating the LRP and also with the relatively narrow scope of the programme, which results in a lack of opportunity to receive support under the JESSICA initiative (AIR 2012).

Referring to experience with the JESSICA initiative in Poland as a whole:[25]

- There is high interest from public and private investors, which, however, does not translate into ready-made applications for loans.
- There is substantial differentiation among planned projects (e.g. shopping centres, incubator business, office space, hostel, hotel, underground car parks, urban markets).
- There is significant diversity in the size of proposed projects.
- There is significant variation in the level of funding that is anticipated.
- The effects of revitalisation projects are underestimated by private investors and at the same time there are high expectations for preferential rates.
- So far, the impact of projects on urban development has been limited as their scale has not been sufficient to address the negative factors in degraded areas.
- Cooperation between private investors and city authorities has been limited – there has been difficulty in agreeing social investment aspects.
- There has been little evidence of projects prepared under public-private partnerships, although such projects are in preparation.

4.4 Future plans

Challenges and lessons learned

There is experience of using FEIs at the regional level in Poland. The level of funding involved has increased in the current programme period and regional institutions are adapting quickly. However, there are some constraints. For instance, there is a perceived push by the European Commission to develop a smaller number of larger funds and instruments. Polish Regional Financing Institutions have small budgets (of around €1 million) and there may be a need for restructuring.

The main benefit of using FEIs in Poland is seen as being the ability to address significant under-investment, with the potential to support or lever in additional investment and make profits. Moreover, at the current stage of the programme process, funding for grants is almost completely accounted for, and loans or guarantees can be offered to firms on better terms than are avaliable from private banks.

Plans for 2014-20

The managing authority plans to make more use of financial instruments in 2014-20 than currently. Areas where they will be the most appropriate will be indicated on the basis of the ex-ante evaluation. In the draft for the future ERDF ROP, there is a separate chapter covering this issue. In the current period, 4.5% of funds of the ROP were allocated to these instruments, mainly to support SMEs and urban revitalisation (JESSICA). In the next period, the amount is expected to increase to about 14% of the ERDF allocation, in line with the share suggested by the Ministry of Regional Development.

[25] Based on 'Urban development: the JESSICA Initiative' presentation by Ewa Wnukowska, Departament Of coordination and implementation of Regional programmes, Ministry of Regional Development, National Territorial Forum, Warsaw 16th February 2012.

5. SLOVENIA: STRENGTHENING REGIONAL DEVELOPMENT POTENTIALS OP

5.1 Characteristics of OP

The Slovenian 'Strengthening Regional Development Potentials' OP (SDRP, Operativni program krepitve regionalnih azvojnih potencialov) is a national ERDF-funded Convergence OP which aims to foster the country's competitiveness while ensuring balanced regional development. The total budget of the OP is €2.01 billion, with an ERDF contribution of €1.71 billion (approximately 40% of the total EU money invested in Slovenia under Cohesion policy in 2007-2013).

The OP is divided into five priority axes: three focusing on competitiveness, research excellence, economic development infrastructure and integration of natural and cultural potentials; one on the development of regions; and one on technical assistance. Approximately 62% of the OP's funding is allocated to competitiveness and integration measures, and approximately 36% of funds are allocated to the development of regions.

5.2 Use of FEIs

Under Priority 1.2 for 'Encouraging Entrepreneurship', the Slovenian 'Strengthening Regional Development Potentials' OP foresees implementation of a range of different forms of financing to support SMEs alongside grants, including venture capital funds, debt and guarantees, to tackle the identified problem of the lack of finance for financing the start-up and development of enterprises. This is due to an underdeveloped capital market, lack of venture capital funds, too few direct foreign investments, banking instruments not being adapted to financing the set-up and growth of enterprises and a lack of state subsidies. ERDF co-financed FEIs had previously been implemented in the 2004-06 period in Slovenia, although the amounts of funding involved were small.

The OP states that the measures to support entrepreneurship will mainly be implemented by the Slovene Enterprise Fund through provision of financial engineering instruments. (The Slovene Enterprise Fund (SEF, Slovenski Podjetniški Sklad) is a public financial institution.) Cooperation within the JEREMIE initiative was seen as a possibility at this time.

The Slovene Enterprise Fund Holding Fund was created in 2009. The Holding Fund operates nationwide, and offers a Programme of Financial Engineering Instruments (PFEI) including debt financing (guarantees, counter-guarantees and credits) and equity financing, through the provision of support for venture capital companies. The budget of the Holding Fund is €56.55 million, of which €48.07 comes from the ERDF (corresponding to 2.8% of the ERDF share of the OP) and €8.48m in national co-financing (plus €50 million from the Ministry of Education, Science and Technology for debt financing).

The Holding Fund is managed domestically by the Slovene Enterprise Fund. The domestic management option was chosen as Slovenia had developed FEIs previously and considered that they had enough experience to continue with the management of SME support. A call was issued to allocate funds to six financial intermediaries, who manage specific venture capital funds. The financial intermediaries involved include venture capital companies (equity financing), a guarantee fund, banks (debt financing) and regional agencies (counter guarantees). In addition, a loan fund was introduced in December 2012.

5.3 Experience to date

Experience with negotiation and set-up

The SEF is an implementing institution under the Ministry of Economic Development and Technology in Slovenia, so each instrument must to be agreed with the Ministry. The SEF had intense negotiations with the ERDF managing authority at the time (Government Office for Local Self-Government and Regional Policy, GOSP)[26] to prepare the Holding Fund in line with EU guidelines and directives. In addition, the SEF met several times with DG REGIO, whose guidelines and recommendations were included during the preparation of the Holding Fund.

Experience with administrative arrangements

In the context of the JEREMIE initiative, the EIF carried out a gap analysis in 2008. After an analysis of different options for the management of the funds, the Slovenian Ministry of Economic Development and Technology decided to create a domestically-managed 'JEREMIE-like holding fund'. Slovenia had previously developed FEIs and decided that it had enough experience to continue with the management of SME support. The SEF had been in operation since 1992, and therefore has a long history of providing access to finance for SMEs, including credit guarantees and interest rate subsidies.

Experience with using guarantee funds for bank loans with interest rate subsidies has been positive, with no major problems in implementation having been identified (Kavas 2012). Development and implementation of venture capital instruments has been more challenging, in part because Slovenia had no tradition of venture capital investments and the market is underdeveloped. There were numerous uncertainties around legal, administrative and tax requirements at both national and EU level. Implementation problems facing equity financing included: a lack of institutional investors; insufficient development of venture capital companies due to the financial crisis; lack of experience in managing venture capital companies; lack of exit possibilities; and low cooperation between the public and private sectors because of a lack of knowledge on venture capital on the public side, and extensive reporting requirements; and (unrealistic) expectations of positive effects in the short term (Kavas 2012).

Experience with outputs and results

The implementation of the Holding Fund is seen as a long-term task – as it took two years to actually involve SMEs, and it is expected to take seven years to really see the results. However, some positive results are already being seen. Under the equity finance line, six active venture capital companies have supported 14 SMEs and invested €14.3 million of venture capital (Ministry presentation 2012). The guarantee credit line is running particularly well, and almost all the funds are spent, and it is considered that finding suitable projects for the instruments has not been problematic after the initial set-up stage (Kavas 2012). In 2012, 222 guarantees were supported, worth €44.3 million (Ministry presentation 2012).

5.4 Future plans

The managing authority would like to channel further resources into financial instruments in future.

[26] In February 2012, the managing authority GOSP has been integrated into the Ministry of Economic Development and Technology after a change of government and associated institutional changes.

6. LOWLANDS AND UPLANDS SCOTLAND ERDF OP

6.1 Characteristics of OP

The Lowlands and Uplands Scotland (LUPS) ERDF OP for 2007-13 is a Regional Competitiveness and Employment Programme which covers the 'Lowlands & Uplands Scotland' area, defined as the whole of the NUTS II areas for Eastern Scotland, North-East Scotland and South-Western Scotland (i.e. all of Scotland apart from the Highlands and Islands). A total of €375.958 million of Community funding (ERDF) contributes to a programme total of €909.8 million.

The population of the LUPs region is c. 4.7 million people, or 93% of the population of Scotland as a whole, concentrated in the so-called Central Belt area around and between Glasgow and Edinburgh (OP 2009:6). Economic performance across the region is mixed, with different challenges facing urban and rural parts. Economic activity in the region tends to be centred on the main metropolitan areas. There are problems of economic decline and social exclusion concentrated in some urban areas, and problems of under-employment, low earnings, distance from markets and dependence on primary industries in the more peripheral, rural parts of the region.

6.2 Use of FEIs

FEIs are used under three Priorities in the LUPS OP: primarily in Priority 2 Enterprise Growth and Priority 3 Urban Development, and, to a lesser extent, Priority 1, Research and Innovation. Over the period, c €113 million ERDF has been awarded to FEIs; this represents around one third of ERDF receipts.

One of the objectives of Priority 2 for Enterprise Growth is to provide a range of different enterprise finance instruments, addressing gaps at different stages in enterprise formation and development across the region. This was explicitly intended to build on experience under the 2000-06 Objective 2 programmes which previously operated in the region. The East of Scotland Objective 2 programme, in particular, was considered by its mid-term evaluation to have had notable successes in a range of complementary risk capital products (OP 2009).

Allocations to specific FEIs are not discussed in the OP; these have been selected for support during the programme period. Under Priority 2, a total of £74.45 million has been committed to date to five funds. Three are managed by the Scottish Investment Bank, an arm of the economic development agency Scottish Enterprise:

- a continuation of the Scottish Co-Investment Fund (SCF), first launched in 2003 to address long-standing weaknesses in the supply of early stage risk capital in Scotland by encouraging and supporting supply-side development, through a private sector partner-led co-investment approach. In 2007-13, SCF is a €76 million (£66.7 million) equity investment fund part-funded by ERDF (€30.5 million/£26.7 million) and matched by public sector funds totalling €45.7 million (£40 million).
- the Scottish Venture Fund (SVF), a €57 million (£50 million) evergreen fund which forms contractual partnerships with active venture capital fund managers, corporate venturers and business angel syndicates to invest in high growth SMEs. SVF also invests on a pari passu basis with co-investment partners. The SVF was awarded

€23 million (£20 million) ERDF grant (2009) matched by €34 million (£30 million) from public sector sources.

- the Scottish Loan Fund (SLF), launched in 2010 as a €57 million (£50 million) loan fund providing unsecured and mezzanine debt finance to established growth and exporting businesses. The Loan Fund received a €23 million (£20 million) ERDF grant in 2010.

A further two Priority 2 FEIs are managed by consortia of local authorities (councils):

- The West of Scotland Loan Fund Ltd (WSLF) involves a consortium of the 12 local authorities in the West of Scotland, providing loan finance to new and growing SMEs across the west of Scotland. The WSLF was awarded €6.8 million (£6 million) ERDF grant (2009) matched by public sector funds of €5 million (£4.5 million) and private capital from Barclays Bank of €5 million (£4.5 million), providing total fund capitalisation of €17 million (£15 million).
- The East of Scotland Investment Fund, a consortium of nine local authorities in the east of Scotland providing loan finance to new and existing SMEs across member local authority areas. The Fund was awarded €2 million (£1.8 million) ERDF grant (2010) matched with €2 million (£1.7 million) from the member local authorities and €1.7 million (£1.5 million) from the Royal Bank of Scotland, providing a total fund capital of €5.7 million (£5 million).

In addition, awards have been made under Priority 2 to The Prince's Scottish Youth Business Trust (c. €800,000/£700,000) and the LINC Scottish Angel Capital Programme (c. €2.7 million/£2.4 million). It is worth noting that the Prince's Scottish Youth Business trust is one of the 14 EU non-banking organisations selected under the first stage of delivery of JASMINE, a joint EIB /DG REGIO initiative. JASMINE (Joint Action to Support Micro-finance Institutions in Europe) is a technical assistance pilot initiative which aims to help micro-credit and micro-finance providers improve their internal processes.

In the OP, it was foreseen that some activities under Priority 3 (Urban Development) could potentially be taken forward through a revolving-loan facility under the JESSICA initiative, although there were no definite plans to do so at the time of the drafting of the programme. In June 2010, a funding agreement was signed with the European Investment Bank (EIB) to establish a €57 million (£50 million) JESSICA Holding Fund in Scotland. This involves a grant of €27 million (£24 million) from ERDF.

Last, under Priority 1 (Research and Innovation), support has been awarded to a continuation of the Genomia Fund, a seed and pre-seed fund which seeks to support the commercialisation of emerging technologies and to start the process of bringing them to market (c. €411,000/£360,000).

The role of the private sector varies in the FEIs supported. Through the SCIF, for example, Scottish Enterprise has attempted to avoid what they describe as a classic fault of private sector intervention in the early stage risk capital market, i.e. setting up funds that compete with private sector provision. By partnering with private sector investors, and allowing them to take investment decisions and decide when to bring the SCIF into the deals, the private sector is stimulated. The underpinning approach is to work with the market and also to act fully commercially, wherever possible on pari passu terms.

6.3 Experience to date

Experience with negotiation and set-up

There has been considerable experience with the use of FEIs during previous programme periods. The East of Scotland Investment Fund, for example, was originally developed during the 1994-99 programme period, and the lengthy learning process fed into later programme periods. The SCIF also underwent a lengthy set-up, as it involved introduction of an innovative model: Scottish Enterprise carried out a detailed analysis of Scotland's early stage risk capital markets to identify potential market failures, followed by a market consultation (in 2002) with the main actors (financial intermediaries and investors). The model for SCIF was refined and launched in 2003.

In terms of JESSICA, a consortium was appointed to manage the Urban Development Fund (UDF). The Scottish Partnership for Regeneration in Urban Centres (SPRUCE) Fund has been operational since late 2011. The first investment from the SPRUCE fund was announced in November 2012.

Experience with administrative arrangements

The largest of the enterprise-oriented co-funded FEIs are administered by the Scottish Investment Bank, an arm of Scottish Enterprise. The co-funding element of the FEIs was found to introduce a number of challenges in terms of their administration in previous periods. In 2000-06, for example, there were geographically ring-fenced funding allocations to four different Scottish programmes which were contributing to the Scotland-wide FEIs (this has been simplified in 2007-13 to two programmes). It was found that the nature of the FEIs and their commercial orientation did not work well with the geographic targeting inherent in separate Structural Funds programmes: 'the very nature of these equity and loan funds militates against geographic targeting since investment decisions must be based on purely commercial considerations' (Report to PMC October 2011).

Experience with outputs and results

Progress with implementation of FEIs under Priority 2 of the programme is considered by the managing authority to be excellent (AIR 2011):

- By the end of 2011, the SCIF had assisted 55 SMEs via 123 separate loans, totalling €10 million (c. £9 million) and 93 SMEs (34 of which have also received loan funding) had been assisted with 207 separate equity investments, totalling c. €30 million (£26 million). The number of jobs created or safeguarded is estimated at between 448 and 664.
- The SVF had issued 25 loans, totalling c. €6 million (£5.5 million), assisting 11 SMEs, and assisted 23 SMEs with equity instruments (nine of which also received loans), with a total of €22 million (£19.5 million) having been invested. The number of jobs created or safeguarded is estimated at 317.
- Under the SLF, Maven Capital Partners was appointed as the Fund Manager in April 2011 and two loans were issued by the end of 2011, resulting in a total investment of €6.5 million (£5.7 million). It was forecast that by the end of 2011, € 10 million (£9 million) of loans would have been issued from the Fund.
- Between April 2009 and the end of December 2011, the West of Scotland Loan Fund issued loans totalling €6.8 million (£6 million) to 225 SMEs. €2.8 million (£2.5

million) of this total was contributed by ERDF. A total of 2237 jobs have been safeguarded.

- From the inception of the East of Scotland Loan Fund in December 2010 to the end of December 2011, the fund issued loans totalling €810,000 (£706,500) to 21 SMEs, €288,000 (£251,000) of this contributed from ERDF, safeguarding 263 jobs.

In addition, the first investment from the SPRUCE Fund, the JESSICA UDF, was made in November 2012, awarding just over €2.4 million (£2.1 million) support to the project, which is expected to create up to 117 full time job equivalents.

6.4 Future plans

Challenges and lessons learned

The Scottish Government commissioned an evaluation of ERDF-supported venture capital and loan funds in 2006-08, covering some €46 million (£40 million) of ERDF allocated within several programme periods (1994-99, 2000-06 and 2007-13). The report's conclusions found that ERDF-supported funds played a relatively small part in the Scottish market overall but a significant role in early stage equity financing. They confirmed that the ERDF co-funded FEIs have addressed areas of continuing market failure and that additionality of the SCIF programme was very high (over 90%). This view was held by both the business and investment community. It was found that the nine funds examined (responsible for approximately €4.6 million (£4 million) per annum) invested in more than 350 new businesses, 700 existing businesses and created more than 5,300 new jobs. There was a long term effect on the development of the financial community, especially angel syndicates and the encouragement of new lenders to enter the Scottish market. Other findings included:

- The co-investment fund model helped develop the local financial community;
- There was an issue over finding high enough quality investments so that they can meet repayments, but not so high they could have been financed commercially;
- ERDF funds have a series of targets (horizontal themes, jobs created) which are "not necessarily appropriate to funds investing for the long term in high-tech companies";
- Equity funds appeared to have a higher effect on turnover and loan funds a more immediate effect on jobs;
- Early stage fund and micro-loan funds are less likely to be self-sustaining because of the relatively high cost of administration relative to the sums invested;
- Policy recommendations concluded that: 'to allow funding to be concentrated on good prospects which are likely to help the Scottish economy, geographical constraints on the allocation of funding should be removed.'

Further, a case study of the SCIF carried out in 2009 (Harrison 2009) noted that the approach taken differed to that taken in England where government has been a direct investor (acting in a subordinate position with capped returns and taking 'first-loss' if the capital base is eroded). In the case of SCIF, Scottish Enterprise does not enter into deals itself but funds 'a contractual partnership' with private sector venture capital fund managers, business angels and business angel syndicates, who find and negotiate the deals.

10. ANNEX 2 LIST OF INTERVIEWEES

European Funding Institutions

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
Louise White (JESSICA TA) **EIB**	Municipal and Regional Head of Unit	L, G, E	l.white@eib.org	
Hubert Cottogni **EIF**		L, G, E	h.cottogni@eif.org	
Hanna Dudka **European Commission DG Regio** Unit B3 – Financial Instruments and International Financial Institutions Relations	An interview with an official of the DG REGIO, who is actively involved in the development and implementation of FEIs should be interviewed to get more insight on Europe-wide experiences as well as insider information on the developments after 2013.		Hanna.DUDKA@ec.europa.eu	
Roger Harvenith **European Commission DG Ecfin**	SME, innovation and employment		Roger.Havenith@ec.europa.e u	
Margrit Rieger	The NRW Bank supports SME start-ups for up to 5 years through „NRW/EU.Mikrodarlehen" in the	Micro-loan	Margrit Rieger	D

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
NRW.BANK	initiative of the North Rhine-Westphalian Ministry of Finance in cooperation with the NRW „STARTERCENTER"s http://www.nrwbank.de/de/foerderlotse-produkte/NRWEUMikrodarlehen/15262/nrwbankproduktdetail.html		Bereich Individualförderung Telefon: +49 251 91741-2637 Margrit.rieder@nrwbank.de	
Natalija Iniakina **Head of Corporate Loans, SEB Bank Lithuania** **Jeremie**	Competitive loans to SMEs using Structural Funds	L JEREMIE	natalija.iniakina@seb.lt	LT
Marek Szczepański **Director of the Department of Regional Development / European Programmes Department** **At BGK, Poland, Wielkopolska UDF**	JESSICA Poland	JESSICA	Marek Szczepański tel. (0-22) 522 94 10 marek.szczepanski@bgk.com.pl JESSICA@bgk.com.pl	PL

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
Mag. Susanne Götz-Hollweger **Direktor** **8844 Export- und Investitionsfinanzierung** **Financing & Advisory**	(Artikel Kleine Zeitung) SME support, EIF, for innovative and research-oriented enterprises, competitive credit. "Risk Sharing Instrument" is a common contribution from the EU and BankAustria.		susanne.goetz-hollweger@unicreditgroup.at http://www.bankaustria.at Corporate & Investment Banking Bank Austria - Member of UniCredit Schottengasse 6 - 8 1010 Wien, Österreich Tel.: +43(0)50505/42772 - Fax:+43(0)50505/44490	AT

Financial intermediaries ('beneficiairies')

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
Alastair Smith, **North East England JEREMIE - Holding Fund manager**	Part of holding fund management team	JEREMIE	Tel: +44 (0) 191 211 2300 Alastair.smith@northeastfinance.org	UK
Alasdair Greig, **North Star Ventures**	Specific fund manager under the North East England JEREMIE	JEREMIE	alasdair.greig@northstarventures.co.uk North Star Ventures http://www.northstarventures.co.uk/our-funds/current-funds/north-east-accelerator-fund-20-m.htm	UK
Tarja Berge, **Almi Invest** **Sweden**	*Almi Invest* is responsible for 8 funds organised in 7 separate regional venture capital funds. The aim of these funds, which so far have invested in 55 companies, is to invest in companies.	E VENTURE CAPITAL	http://www.almiinvest.se/sv/Team/ tarja.berge@almiinvest.se	SE
Christian Matzinger, **Oberösterreich Hightechfonds Fund manager**	The OÖ Hightechfonds focuses on start-ups in Upper Austria working in high-tech sectors (IT, new/renewable energy).	E VENTURE CAPITAL	Tel: +43 732 777800 32 matzinger@hightechfonds.at	AT

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
Erkki Välttilä **Finnvera Venture Capital Finland**	Finnvera is a specialised financing company owned by the State of Finland organising and managing FEI in ERDF in Finland.	L, G, E (venture capital)	Tel : +358 29 460 2582 Pauli.heikkila@finnvera.fi http ://www.finnvera.fi/Liiketoiminnan-aloittaminen/Tee-ideastasi-totta/Ota-yhteyttae-Finnveraan-puhelimitse	FI
Villy Vibholt, **The Fund CAT Invest Zealand**	The Fund invests in the Zealand Region and supports the creation and development of new enterprises. The fund is within the CTA Science park (Forskerparken CAT), which is a privately held company.	Capital Fund	villy.vibholt@catscience.dk www.catinvestzealand.dk	DK
Simona Grobelnik, **Slovene Enterprise Fund (SEF)**	Holding fund that manages guarantees, counter-guarantees and credits for SME through Slovene Programme of Financial Engineering Instruments for SMEs.	G	Simona Grobelniksimona.grobelnik@podjetniskisklad.si	SI
Peeter Saks Martin Kodar **BaltCap**	BaltCap is the leading private equity investor in the Baltic States (Estonia, Latvia and Lithuania). In 2010, BaltCap launched BaltCap Latvia Venture Capital Fund and Lithuania SME Fund which are	E	Tel: +372 6650 280 peeter.saks@baltcap.com Martin.Kodar@baltcap.com	EE, LV, LT

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
	established under the JEREMIE initiative managed by the EIB.			
Audrius Zabotka **INVEGA**	INVEGA is a state owned (100%) Limited Liability Company, established by the Government of Lithuania in 2001. It promotes the development of SMEs in Lithuania facilitating their access to financing.	JESSICA (ERDF, ESF)	info@invega.lt Audrius Zabotka audrius.zabotka@invega.lt	LT
Stefan Mathesius, González Alvarez Carmen **Agencia Invega**	JEREMIE holding fund Manager in Andalucia	JESSICA (L, G, E)	Stefan Mathesius smathesius@agenciaidea.es; González Alvarez Carmen cgonzaleza@agenciaidea.es	ES
Pierre-Yves Karlshausen **SOWALFIN S.A.**	Public Interest Joint Company in the Walloon Region	L (ERDF)	Pierre-Yves Karlshausen PYKARLSHAUSEN@sowalfin.be	BE

Strategic bodies

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
Aleksandra Kedzierska **Ministry of Regional Development, Poland**	Coordinating Unit of Regional OPs ; focus on JESSICA	JESSICA	aleksandra.kedzierska@mrr.gov.plm	PL
Marcin Piłka **Ministry of Regional Development, Poland**	Coordinating Unit of Regional OPs ; focus on JEREMIE	JEREMIE	marcin.pilka@mrr.gov.pl	PL
Mickael Vaillant **DATAR France**	DATAR is the French Regional Policy Agency and coordinates the OPs		Mickael.vaillant@datar.gouv.fr	FR
Agathie Charalambidou, **Planning Bureau Cyprus**	Planning Bureau - Cyprus	JEREMIE (L, G)	Tel: +357 22 602866 acharalambidou@planning.gov.cy	CY
Juliane Krause **MA Sachsen-Anhalt**	Case Study OP Sachsen Anhalt	L, E	Krause@MF.Sachsen-Anhalt.de	DE
Sébastien Massart **Economic Adviser to the Préfet**	Case Study OP Languedoc Roussillon	E, G JEREMIE	+33-46-7616934 Jean.pouessel@languedoc-roussillon.pref.gouv.fr	FR
Nena Dokuzov **MA OP Strengthening**	Case Study OP Strengthening regional Development Potential, Slovenia Managing	G, E	Tel.: +386 1 400 33 47 Fax.: +386 1 433 10 31	SI

Interviewee	Description	Type of Instrument (L for Loan, G for Guarantee, E for Equity)	Contact details	MS
regional Development Potential, Slovenia	Authority		E-mail.: nena.dokuzov@gov.si	
David Souter, Ian McCall **MA OP Lowland and Uplands Scotland ERDF (Case Study)**	**Case Study OP Lowland and Uplands Scotland ERDF**	L, E Urban development JESSICA JEREMIE	Tel: 0300 244 1091 europeanstructuralfunds@scotland.gsi.gov.uk	UK
Alenka Marovt **Programme on financial engineering instruments (PFEI) for micro, small and medium-sized companies for the period 2009-2013** **Slovenia**	The Programme of Financial Engineering Instruments for SMEs was introduced in October 2009, updated in April 2010, and is still ongoing. The aim of the PFEI is to reduce the financial gap for SMEs and offer debt financing (through guarantees, counter-guarantees and credits) and equity financing (by supporting VC companies to invest in innovative and high-growth companies), all managed through a holding fund (SEF).	G; E	http://www.eu-skladi.si/funds/best-practices/op-rr/programme-on-financial-engineering-instruments-pfei-for-micro-small-and-medium-sized-companies-for-the-period-2009-2013 alenka.marovt@gov.si	SI
Krisztina Szabo **MA OP Economic Development**	Hungarian National Development Agency	JEREMIE in Hungary	szabo.krisztina@nfu.gov.hu	HU

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