

Medlemmerne af Folketingets
Europaudvalg og deres stedfortrædere

Asiatisk Plads 2
DK-1448 København K
Tel. +45 33 92 00 00
Fax +45 32 54 05 33
E-mail: um@um.dk
Telex 31292 ETR DK
Telegr. adr. Etrangeres
Girokonto 300-1806

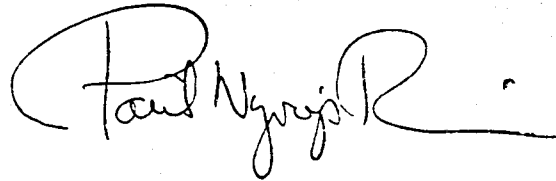
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Til underretning for Folketingets Europaudvalg vedlægges i forbindelse med det ordinære møde i Det Europæiske Råd i Nice den 7.-9. december 2000 Kommissionens meddelelse vedr. de finansielle instrumenter for SMV'er.



5. The total i2i programme will involve the commitment of EUR 12-15 billion by the Bank over the three years 2000-2002 directed to the targets of the Lisbon Conclusions, including the financing of R & D, dissemination of innovation and better equipped and trained human capital. While not limited to SMEs, i2i will support areas of great importance to SMEs, enhancing the climate for start-ups and technology ventures with high growth potential. In the context of i2i, the Bank will have to adapt its financial instruments to activities which are potentially higher-risk, have limited or back-ended revenue-generating potential and/or low collateral, and to develop appropriate forms of co-operation with the other financial institutions.

The EIF

6. The EIF offers guarantees to financial institutions on portfolios of SME loans and takes and manages equity stakes in venture capital funds. Both activities are conducted to a certain extent on its own balance sheet and to a larger extent under mandates from EIB (European Technology Facility –ETF) and the EU (ETF Start-Up and the SME Guarantee Facility, Growth and Environment scheme).

7. Under the reform of the EIF agreed by its shareholders in June 2000 the EIF has become the specialist venture capital arm of the EIB group, taking over the existing and new activity of the Bank in this field, as well as continuing to manage the EU programmes. The concentration in one institution of the expertise and the funding capacity for the venture capital market represents a significant rationalisation of the activity of the group. It should enhance the coherence of the activity and facilitate communication with the market. The EIF, on behalf of the EIB group, has become a key player in the financing of venture capital on a pan-European basis. It has the capacity to provide a significant further boost to early-stage and technology investment and to act as a major catalyst to private sector money in this field. At the same time the EIF is expected to develop its guarantee activity in support of SMEs, where a good deal of experience has already been acquired.

The Commission

8. With the termination of new lending under Article 56 of the ECSC Treaty the Commission itself has ceased to be a lender in support of SMEs. The largest sources of budget-based funds benefiting SMEs are now the Structural Funds (co-financing of regional support schemes, including inter alia financing of regional venture capital and seed funds etc) and the Framework Programme for Research and Technological Development (which, inter alia, finances specific measures to promote research by and for SMEs, technology transfer etc). Otherwise the most important specific instrument for helping investment in SMEs throughout the EU is the Growth and Employment Initiative, with two of its component programmes (ETF Start-Up and the SME Guarantee Facility) implemented for the Commission by the EIF and the third (support for cross-border joint ventures between European SMEs) managed directly by the Commission. The other Commission instruments are much smaller in scope and many are of a pilot nature.

9. The current arrangement of Community programmes already reflects some of the lessons learned from earlier actions about the design of schemes, which will need to be borne in mind in considering future action, in particular:

- the importance of critical mass

- the need to avoid overlap and exploit synergies
- the importance of simple and user-friendly administrative arrangements

The Framework for Future Community Action

10. Future Community action in support of SMEs should continue to be offered through four windows (loans, equity, guarantees, grants), with a focus on working with and through the market. Instruments involving budgetary funds should be limited to countering identifiable market failures, while respecting EU competition rules; should be the subject of annual reports; and should form part of a coherent overall Community policy involving improvements in the legislative and business environment (notably, the Financial Services Action Plan).

11. Grant mechanisms should, wherever possible, be linked to a product of one of the other three windows so as to maximise additionality and avoid the risk of duplication. Only exceptionally should the Commission propose to manage directly any new grant-based support for investment, bearing in mind in particular the implications for human resources and distance from the financial beneficiaries. The EIB and EIF should be the preferred partners but the Commission should retain the flexibility to work with national and other international financial institutions where there are specific advantages in doing so.

Recommendations

12. **Enhancing the Growth and Employment Initiative.** Much has been done already to focus the Community's financial instruments on the political priorities identified at the Lisbon European Council, notably i2i and the reform of the EIF. Four extensions to the Growth and Employment Initiative could, however, usefully be considered:

- guarantees for **micro-credits**, which could encourage commercial banks and others to be more active in this area. Micro-credits are sometimes made available through specialised non-bank institutions which have limited or no access to bank finance because of their low levels of available collateral. A guarantee scheme could facilitate access to bank finance by such institutions and also provide leverage to banks themselves.
- **equity guarantees** for investments in early-stage companies. If properly constructed and funded, such schemes, which are available in some of the Member States, could help to attract otherwise hesitant investors into the funding of venture capital companies. Under schemes in France and Germany, for example, public sector institutions guarantee a share of the possible losses to which the intermediary funds are exposed. In return they are paid a fee and under some schemes the guarantor may take a share in the profits.
- **guarantees to underpin the financing of internet and e-commerce applications by smaller companies.** This is already suggested by the Commission in its proposed multiannual programme for enterprise and entrepreneurship (2001-2005). The guarantees would cover loans for hardware, software and training.
- **investment in incubators** (and associated mentoring services). Business incubators in recent years have developed from simply offering low-cost office space to

providing management services and funding for start-ups. They are particularly high risk because of the aggregation of a portfolio of start-ups at the riskiest stages of their development. Again there is some experience in the Member States (e.g. the Twinning Scheme in the Netherlands). This could be a useful complement to the existing ETF Start-up programme.

13. **Improving co-ordination and coherence.** All the institutions have recognised the need for good coordination and coherence of actions in support of SMEs. This means ex ante cost/benefit analysis of new actions, appropriately timed evaluation ex post, systematic feedback from market operators as well as from the political authorities and good dialogue within and between institutions. The Commission intends to establish internally a senior level Steering Committee to review the coherence of proposed new actions on an ongoing basis. It would also be appropriate to establish a working party involving the Commission, the EIB and EIF to help design joint actions where appropriate. At the political level an annual report prepared by the Commission, together with the EIB and the EIF, and presented to the European Parliament and the Council would ensure appropriate accountability and give early warning of the need for any new action.

14. **Better transparency and accessibility for SMEs.** A single web-site access point (one-stop information shop for SMEs and financial institutions) covering all Community financial instruments, including the EIB group, should be created, with appropriate links to the relevant web-sites of the Member States.

1. INTRODUCTION

The importance of significantly improving the flow of funding for innovative Small and Medium sized Enterprises (SMEs)¹ and new entrepreneurs to foster employment was highlighted in the conclusions of the Lisbon European Council of 23 and 24 March 2000. Under the heading "Creating a friendly environment for starting up and developing innovative businesses including SMEs", the European Council asked in paragraph 15:

"...the Council and the Commission to report by the end of 2000 on the ongoing review of EIB and EIF financial instruments in order to redirect funding towards support for business start-ups, high-tech firms and micro-enterprises, as well as other risk-capital initiatives proposed by the EIB".

The arguments for stimulating early stage financing had already been developed by the Commission in its original paper on risk capital² and in subsequent reports. In its e-Europe proposals (December 1999), the Commission made a commitment "(...) to carry out a major policy review with Member States to improve the coherence of available instruments (...) and examine how they can be better used to stimulate early stage financing."

The goal of the Lisbon Council is to stimulate the new knowledge-based economy and the information society (infrastructure and content) as well as the entrepreneurial spirit in the European Union, by creating more innovative companies and taking full advantage of R&D efforts. This will be a powerful engine for growth, competitiveness and jobs. In addition, it will be capable of improving citizen's quality of life and the environment. Despite significant progress, wide regional disparities persist. However Europe as a whole still lags far behind the United States as funding still largely remains directed to later-stage development in more traditional sectors.

Creating a dynamic environment, in which ideas are spawned, companies created and grown, includes providing:

- **an appropriate regulatory framework** conducive to the creation and support of start-ups and the development of integrated capital markets;
- **adequate funding opportunities** to growing companies at every stage of their development with public intervention focused where there are market failures;
- **the availability of a range of support services** and a favourable physical, economic and social environment (e.g. mentoring, incubators, technology parks, clusters of enterprises, etc.).

The European Council (paragraph 41 of the Lisbon European Council conclusions) identified a particular role for the Union in the mobilisation of the necessary resources:

¹ SME's are defined by the Commission in accordance with the Commission Recommendation (96/280/EC) of 3 April 1996 concerning the definition of small and medium-sized companies (OJ L 107 30.4.1996) as companies which have fewer than 250 employees and have either an annual turnover not exceeding EUR 40 million or an annual balance-sheet not exceeding EUR 27 million and conform to the criteria of independence.

² Risk Capital – a key to job creation in the European Union - SEC (98)552, April 1998.

"Achieving the new strategic goal will rely primarily on the private sector, as well as on public-private partnerships. It will depend on mobilising the resources available on the markets, as well as on efforts by Member States. The Union's role is to act as a catalyst in this process, by establishing an effective framework for mobilising all available resources for the transition to the knowledge-based economy and by adding its own contribution to this effort under existing Community policies while respecting Agenda 2000".

2. DESCRIPTION OF COMMUNITY FINANCIAL INSTRUMENTS

This communication focuses on the instruments managed by the EIB, the EIF and the Commission specifically aimed at increasing the supply of finance to final SME beneficiaries and/or financial intermediaries or investment funds specialised on SMEs. They take the form of direct supply of capital (loan or equity) and/or financial incentives (guarantee or grant instruments). The table 1 below lists the most relevant Community financial instruments³, including for completeness some programmes that have now terminated.

Reference is also made to other Community grant programmes, albeit not directly relevant to this review, which provide grant aids relevant to the development of the new knowledge-based economy. These include in particular the Framework Programme for Research and Technological Development (FP-RTD) and support provided by the European Regional Development Fund (ERDF) at a regional level, as well as horizontal measures to improve the business environment.

³ The annex gives detailed information on each financial instrument.

Table 1: relevant Community financial instruments

Managed by	On-going/terminated or phasing out	Name	Source of funding	Target group	T/G (*)	Equity/loan	Guarantee/grant	Resources allocated EUR mios	Period of EC budgetary appropriations
EIB	On-going	Global loans	EIB	SMEs	G	Loan		12.700	-
	Terminated or phasing out	SME Facility (Edinburgh)	EIB and EC	SMEs	G	Loan	Grant	loan: 1.000 grant: 100	1994-1997
EIF	On-going	Own resources	EIF	Venture capital funds, technologically-oriented SMEs	T	Equity		80	-
		European Technology Facility - ETF(**)	EIB	Specialised venture capital funds, young SMEs	T	Equity		250	-
		Amsterdam special action programme (ASAP - SME window)	EIB	SMEs	T	Equity		1.000 on EIB reserves	-
		Innovation 2000 Initiative (continuation of SME window)	EIB	SMEs	G	Equity		1.000 on EIB reserves	-
		ETF Start-up Facility within Growth and Employment Initiative	EC	Venture capital funds, innovative European SMEs	T	Equity		168	1998-2000
		SME Guarantee Facility within Growth and Employment Initiative	EC	European SMEs	T		Guarantee/grant	Guarantee: est. 2,200 grant: 198	1998-2000
		Growth and Environment Scheme	EIF and EC	European SMEs	G		Guarantee/Grant (****)	Guarantee: 681.7, grant: 25	1995-1997
EC	On-going	Innovation : I-TEC within 4th FP-RTD	EC	Venture capital funds focusing on technologically innovative SMEs	T		Grant	11	1997-1998
		Eurotech Capital	EC	Venture capital funds and SMEs	T	Equity	Grant	9.5	1989-1996
		JEV within Growth and Employment Initiative (***)	EC	SMEs	G		Grant	59	1997-2000
		CREA	EC	Seed capital funds	T		Grant	8	1998-2000
	Terminated or phasing out	ECSC Art 56	ECSC	Companies	G	Loan	Grant	loan: 1,531, grant: 216	ECSC 1993-1997
		JOP (***)	EC	European SMEs	G		Grant	164	1991-2000
		ECIP (***)	EC	Mainly European SMEs	G		Grant	392	1988-1999
EBRD	On-going	SME Finance Facility Phare	EBRD & EC	Eastern European SMEs	G	Equity/Loan	Guarantee/Grant	Equity: 25, loan: 275, grant: 80	1999-2000
CEB/KfW	On-going	SME Finance Facility Phare	CEB/KfW & EC	Eastern European SMEs	G	Loan	Guarantee/grant	Loan: 113, grant: 21	2000
Member States	On-going	ERDF: VC funds	EC & Member States	SMEs	T/G	Equity	Grant	Not available	2000-2006

- (*) T = targeted to business start-up, high-tech firms, micro-enterprise
G = targeted to general SMEs
- (**) Part of ASAP
- (***) Co-operation instruments
- (****) Grants here take the form of payment to EIF of guarantee commissions rather than subsidies to beneficiary SMEs

2.1. EIB

The EIB is a leading source of funding to financial institutions for onlending to SMEs⁴ as well as an increasingly important source of risk capital.

2.1.1. Loans

Since 1968 the EIB has developed its global loan instruments allowing the Bank to fund small- and medium sized projects by SMEs (or local authorities) through the intermediation of some 150 institutions. Subloans provided must conform to economic, financial, technical and environmental criteria established by common agreement. The Bank takes risk on the intermediary institution, not on the SMEs that receive the subloans. The Financial Intermediaries decide on the subloans and their terms (interest rates, duration, collateral where appropriate to SMEs) according to their credit policy. In 1997, the Bank extended its global loan concept to "portfolio based" financing where financing is provided for a portfolio of subloans rather than on an individual basis. In terms of volume, global loans financing SMEs totalled some EUR 12.7 billion during the period 1995-1999, financing 55,000 SMEs in the productive sectors, though without any specific targeting at high-tech or start-ups.

Within the scope of its new "Innovation 2000 Initiative" (i2i), the Bank proposes to allocate over the next three years, within its current eligibility rules, an amount between EUR 12 and EUR 15 billion to the five following priority sectors:

- human capital;
- SMEs and enterprise spirit;
- research and development;
- networks of information technology and communication;
- dissemination of innovation.

While not limited to SMEs, this initiative will support areas which are of crucial importance to the development of SMEs and in particular for start-ups and ventures with a technological orientation and high growth potential. The Bank envisages the development of a range of financial instruments particularly designed to support these priority sectors.

2.1.2. Equity

The risk capital SME operations of the Bank were initially managed by the Bank under the Amsterdam Special Action Programme (ASAP), under which EUR 1 billion of the Bank's annual surpluses was earmarked to support risk-sharing operations. Within the framework of Innovation 2000 Initiative, the Board has allocated a further tranche of EUR 1 billion for similar purposes. Action in this field focuses on the support of innovative SMEs through intermediaries as well as developing risk capital markets throughout the Union.

By mid 2000, 62 venture capital operations were signed, amounting to EUR 843 million. Most of these funds concentrate on technological investments. Regional funds were also often financed (mainly in the UK and in the new Länder of Germany), and the Bank implemented several operations in the Cohesion countries. In addition, the EIB had made available EUR 250 million to the EIF under a specific mandate (European Technology Facility), of which 127 million were committed by the EIF for the financing of 26 funds. In June 2000, it was agreed by the Fund's shareholders that the Bank should take a majority shareholding in

⁴ SMEs are defined by the EIB as companies with fewer than 500 employees and having fixed assets of up to EUR 75 million. This definition differs from the Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized companies (OJ L 107 30.4.1996).

the EIF's capital (while maintaining its tripartite structure) and restructure the Fund so as to turn it into the EIB's specialised risk capital arm. This regrouping of all venture capital activities within the EIF, already implemented, as well as the additional EUR 1 billion allocation of resources to this area decided by the EIB in parallel is intended to considerably strengthen the group's effectiveness, improve the readability of its actions and clarify the respective roles of the EIB and the EIF in this area.

2.2. EIF

The EIF supports the financing of SMEs⁵ by acquiring, holding and managing equity stakes in venture capital funds or by facilitating SMEs access to loan finance through guarantees. As well as using its own resources it also manages funds entrusted to it by third parties, in particular the Community and the EIB, in order to meet the above objectives.

2.2.1. Equity

The amounts available and committed by the EIF as equity to venture capital funds as at 30 June 2000 were respectively:

Table 2: EIF equity investments

Source of Funds	Available € million	Committed € million
Own resources	± 80 ⁶	74.6
EIB - ETF ⁷	250	125.9

Furthermore it has committed more than EUR 48 million under the ETF Start-up Facility funded by the Community as part of the Growth and Employment initiative of the European Union. The EIF makes these investments in its own name on behalf of the Community.

2.2.2. Guarantees

As at 30 June 2000, the Fund had committed under its SME guarantee and structured finance activities the following amounts based on its own resources:

Table 3: EIF guarantees

Type of Activity	Committed € million
Credit Enhancement	29.3
Credit Insurance	106.4
Structured Finance ⁸	77.6
Growth and Environment ⁹	681.7

Furthermore it has guaranteed more than EUR 1,309 million under the SME Guarantee Facility funded by the Community as part of the Growth and Employment initiative of the European Union. These guarantees are issued by the EIF in its own name, on behalf of the Community, without any contingent liability on the EIF's own resources.

⁵ SMEs are defined by the EIF as companies with fewer than 500 employees and having fixed assets of up to EUR 75 million. This definition differs from the Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized companies (OJ L 107 30.4.1996).

⁶ Equivalent to 20% of paid-in capital.

⁷ European Technology Facility.

⁸ Structured transactions where the EIF provides partial guarantees to financial institutions financing specialised investment funds providing loan or mezzanine finance to SMEs.

⁹ Available Community budget of EUR 25 million covers the payment of guarantee fees on behalf of SMEs.

2.3. Commission

The largest sources of budget-based funds benefiting SMEs are the Structural Funds (co-financing of regional support schemes, including inter alia financing of regional venture capital and seed funds etc) and the Framework Programme for Research and Technological Development (which, inter alia, finances specific measures to promote research by and for SMEs, technology transfer etc). Otherwise the most important specific instrument for helping investment in SMEs throughout the EU is the Growth and Employment Initiative, with two of its component programmes (ETF Start-Up and the SME Guarantee Facility) implemented for the Commission by the EIF and the third (support for cross-border joint ventures between European SMEs) managed directly by the Commission.

The programmes drawing on budgetary resources include a number of pilot schemes, many in the process of being phased out, as well as schemes launched from the outset with substantial resources (notably, the Growth and Employment Initiative). Some involve the direct supply of capital; others various financial incentives as described in Table 1. Most of the instruments under review are under the financial responsibility of the individual services managing the relevant budgetary allocations. In some cases, the administration is sub-delegated to the Commission's Financial Operations Service in Luxembourg which has specific experience of working with a wide network of external financial institutions that deal directly with final beneficiaries (JOP, JEV, SME Finance Facility Phare). In some cases the Commission also draws on the help of Technical Assistance Offices (TAOs) under Commission control; while other programmes are managed for the Commission by financial institutions (notably EIB, EIF and EBRD) on the basis of fiduciary mandates.

The amount of funds allocated through the Community budget to the relevant EC instruments mentioned in Table 1 totalled approximately EUR 580 million for Internal Policies and approximately EUR 660 million for External Policies as at 31 December 2000. In addition, for Structural Policies, the European Regional Development Fund (ERDF) contributes to SME development in specifically designated areas, either through grants (e.g. for research and development of for advisory services) or loans or seed and venture capital. The intervention of the ERDF is made through the intermediation of the Member States and regional authorities.

Finally, the Framework Programme for Research and Technological Development (FP-RTD) supports a variety of actions: specific measures to promote research by and for SMEs; actions to facilitate interfacing between researchers, enterprises and investors (help desk, investment fora); various measures to encourage technology transfer and the diffusion of best practices in innovation through networking of innovation actors at European level and benchmarking; a number of instruments to promote the exploitation of the technologies generated in the Joint Research Centre. The latter include contracting with a private fund management company to raise and invest a dedicated seed capital fund, the setting up of an incubator, an internal entrepreneurship course for scientists and participation in a network of large public research institutions for supporting the creation and development of spin-off companies.

3. ANALYSIS OF EXISTING FINANCIAL INSTRUMENTS

3.1. EIB

3.1.1. Loans

Since the late 1960's the EIB extends global loans to a network of financial intermediaries for the funding of SME's and small projects. The financial intermediary determines the loan conditions on the basis of a risk assessment of the client and the origin of the funds.

With the introduction of the single currency, the competitive funding advantage of the EIB under its global loans has decreased to the extent that more commercial banks notably in the Euro-12 zone can directly access the interbank money market. Nevertheless, benefiting from a triple A rating, EIB loans remain attractive for commercial banks with a lower rating.

In certain cases EIB SME lending has been tied to additional incentives benefiting the final beneficiary such as interest rate subsidies (e.g. the Edinburgh Facility) enhancing the attractiveness of the Bank's funding.

As noted earlier, the Innovation 2000 Initiative prepared by the EIB and adopted at the Lisbon European Council intends to reallocate EUR 12 to 15 billion of lending capacity to priority sectors. It should contribute to the reinforcing of the effectiveness of the Bank's intervention in areas where hitherto it has had only limited involvement (e.g. R&D). A major challenge for the Bank will be to adapt its traditional lending instruments to activities which are potentially higher-risk, have limited or back-end revenue-generating potential and/or low collateral.

3.1.2. Equity

It is too early to assess the financial returns on existing risk capital investments by the Bank. Marketing of venture capital products by the EIB has been successfully undertaken in all Member States and operations thus launched cover a wide range of equity arrangements and quasi-equity arrangements with a number of investments funds and other financial institutions. Additionally, the EUR 250 million entrusted by the Bank to the EIF has had a positive effect, adding critical mass to the EIF.

3.2. EIF

3.2.1. Equity

In view of the limited amount of own funds hitherto available to the EIF and the availability of funding from other largely private sources for other parts of the equity market, the Fund has concentrated its operations on early-stage and technology funds. It has succeeded in creating a solid market position in this area. Despite limited human resources, its professional expertise is widely recognised.

As is the case for the EIB, it is too early to make a full assessment of the prospective financial returns on its venture capital operations. Many investments are still in the early stages and will take several years to mature. However, some significant capital gains have already been realised. The impact in terms of growth and employment also can only be judged properly at a later stage but early figures from investee companies on job creation are encouraging.

3.2.2. *Guarantees*

The EIF's guarantee instruments allow lending financial intermediaries to benefit from a risk weighting of 20% on the guaranteed portion of their loans, increasing market capacity commensurately. Most loans have been granted recently and it is therefore premature to evaluate the performance of these instruments.

3.3. **Commission financial instruments**

Most of the financial instruments related to SME financial support have been developed over the past ten years under varying circumstances in response to initiatives from many sources: the European Parliament, the Council and the Commission services in order to address specific policy objectives.

Four important lessons can be learned from past experience and best practice incorporated in the design of future instruments.

Firstly, achieving critical size is important so that a significant market impact can be reached when spread over all 15 Member States. For smaller pilot instruments, it has been difficult for the Commission to involve an international or national financial institution. In such cases, the Commission managed the instrument itself, gaining experience and fulfilling its role of supporting innovation, but sometimes incurring a disproportionate administrative burden.

A second lesson is the need to avoid overlap between specific financial instruments.

Thirdly, the administration of the schemes should be as simple and user-friendly as possible (issues here include the coherence and transparency of programme rules and regulations, the easy identification by potential beneficiaries of the correct point of entry, the harmonisation and simplification of internal approval and control procedures, the appropriate consideration of competition rules in the design of the relevant instruments).

Finally there is a growing need and opportunity to develop synergies between Commission instruments (including the FP-RTD, the ERDF-grants and loans and measures to facilitate access to financing) and the other financial instruments, in particular those of the EIB/EIF and Member States. This is particularly relevant in view of the new EIB Innovation 2000 Initiative which, through its loan and risk capital instruments, will support more broadly the emergence of an innovation and knowledge society (including research and development, diffusion of innovation, electronic networks, actions in favour of the audio-visual and content industry etc.).

4. **THE FRAMEWORK FOR FUTURE COMMUNITY ACTION**

In their future support for investment by SMEs, and particularly in the framework of the new knowledge-based economy, the Community's financial instruments must continue to work with the market to create the right conditions and encouragement for the private sector to fulfil its potential. In this context it should be recognised that financing private projects is essentially a commercial and private sector activity. Those instruments, of course, must not distort markets and must be fully compatible with Community competition rules.

Instruments involving budgetary funds should therefore be focused on addressing identifiable market failures; should be well co-ordinated with national and with non-budgetary instruments; and should form part of a coherent overall policy involving improvements in the

legislative and regulatory environment (especially the Financial Services Action Plan) as well as the financing of investments where the needs cannot be adequately met by the private sector.

The financial characteristics of Community institutions and their ability to assume risk must be taken into consideration. Proper recognition should also be given to the fact that the EIB and the EIF must consider the strength of their respective balance sheets. Moreover, the EIB, as a substantial user of borrowed funds, must ensure its actions do not impair its credit rating and access to the market.

Commission budget expenditures, while subject to other imperatives such as value for money and properly structured financial procedures, do not need to take into account to the same extent criteria such as return on capital or credit assessment. Due attention however should be given to potential market distortions and competition rules.

Hereunder it is reviewed how these objectives might be achieved through the articulation of four distinct but complementary windows covering both the full spectrum of direct supply of capital and other financial incentives.

4.1. Direct supply of capital

4.1.1. Loan window

The EIB, as a banking institution, will continue to be the provider and manager of funds within the loan window.

In the SME sector in particular, the Bank has privileged accessing the final beneficiaries through the intermediation of credit institutions closer to the customer base. The EIB is already reflecting on the design of new lending products to complement its traditional global loans so as to meet the needs of the new environment.

In some circumstances it may be appropriate, as in the past, to combine the EIB's lending facilities with enhancements from the Community budget, provided the arrangements can be administered simply and real added-value can be demonstrated. These could include among others technical assistance and interest rate subsidies (where they serve to achieve specific predefined measurable objectives eligible under the competition rules).

4.1.2. Equity window

Sources of funds used for "investment" will come from the EIF's own resources and from the trust funds managed by the EIF for the EIB on a fiduciary basis. Where market failures exist, the Community budget could also provide further equity resources to the EIF on a fiduciary basis. One idea that merits further consideration is the opening of a special facility under ETF Start-up to finance the **funding of business incubators**, where the particular risks are a deterrent to many private sector investors. This is discussed further in Section 5 below. The management of Community instruments grouped under the umbrella of the "equity window" should, whenever possible, be undertaken by the EIF.

For seed and venture capital part-financed by ERDF, the Commission and Member States should co-ordinate their efforts in particular with the EIF, but also with other international and national financial institutions. One-stop-shops could avoid duplications, overlaps or competition between the various instruments. One-stop shops also have the advantage of creating transparency with regard to the access to financial instruments.

The EIF now has the statutory ability to extend its operations to cover investments in the accession countries. There may be a case for budgetary support in certain circumstances to mitigate the higher risk profile of such activity. Co-ordination between the Commission, the EIF and the EBRD will in any case be required.

4.2. Financial incentives

4.2.1. Guarantee window

Guarantee instruments, which if properly managed provide the specific advantage of introducing leverage benefiting the overall financing capacity of the market, are an important part of the financing portfolio.

In the field of guarantees for SMEs the Community budget provided two kinds of support: payment of EIF guarantee commissions under the Growth and Environment Scheme (1995-1997) and the underwriting of the risk of guarantee calls under the SME Guarantee Facility (1998-2000) managed by the EIF. In both cases the budget has played a role in enhancing the guarantee capacity of the Fund under specific arrangements that place a cap on the EU budgetary liability. It is appropriate that the Fund should continue to build on its expertise in the SME guarantee field, where considerable experience has already been acquired, with further budgetary support as necessary for any new actions that carry risks that are too high for the Fund's balance-sheet to support. There are in any case practical barriers under existing budgetary rules to the more direct involvement of the Commission itself in the issue of guarantees.

Against that background two new targets for EIF guarantees could now usefully be considered. The first is that of **micro-credits**, where the funding capacity of the market is severely limited by collateral constraints. Many of the existing providers of micro-credits are non-bank institutions with limited or no capacity to raise loan finance because of their inability to provide the necessary collateral. A micro-credit support scheme could provide a substitute for collateral for such organisations. It could also be of use in expanding the capacity of those banks who are already working in the field on a small scale.

The EIF could also provide capacity for **guaranteeing equity** or quasi equity risks together with the Community budget where appropriate. Although there are different views at Member State level on the relevance of equity guarantees, they seem nevertheless a useful way of reducing risk and avoiding some of the difficulties linked to public ownership of equity stakes in SMEs. In the major schemes operated in France and Germany the public guarantee institutions underwrite a share of the potential risk of investments by intermediary funds. In return they earn a guarantee fee and in some circumstances may share in any profits. Such a scheme at EU level would require careful design, drawing on the experience elsewhere. In any case, great care must be taken to avoid the risk of moral hazard.

4.2.2. Grant window

Resources of the grant window are fully financed by the Community budget. Of all the four instruments, grants most clearly contain a risk of distortion of competition and need to be carefully assessed under the competition rules.

Except for grants linked to FP-RTD, ERDF and similar programmes which because of their nature and objectives have specific implementation mechanisms, grants should, whenever possible, be linked to a product of the other three windows, in order to remove from the

Commission the administrative burden of marketing and of managing individual projects. The aim is to create additionality by including grant elements or risk-taking capacity of one institution to enhance a programme funded by another, for example interest subsidies attached to loans, technical assistance combined with credit lines, guarantee premiums assumed by EC budget etc.

The EIB and the EIF would be preferred partners for initiatives meeting their respective objectives. In this context, the Commission has proposed delegating to the EIF the management of its instruments to improve the financial environment of SMEs (Proposal for a Council decision on a Multiannual Programme for Enterprise and Entrepreneurship (2001-2005)¹⁰).

However, the Commission should retain the flexibility of combining its resources with other International Financial Institutions, multilateral or national development banks or private sector banks, whenever such distribution channels appear to be more suitable, for example in the case of strategic partnerships between EU SMEs and those of the accession countries and of the emerging economies. This should allow obtaining the best value for money for Community grants. Only to the extent that the Commission cannot identify a suitable financial intermediary should it consider managing directly a specific grant instrument after carefully evaluating the human resources required.

The design of future new instruments must be particularly responsive to the characteristics of the markets to be addressed. This will require enhanced co-ordination between EU institutions in the design of instruments which should be the norm to ensure coherence of political objectives with market characteristics.

With regard to grants provided by the Community budget, the Commission must retain the responsibility for monitoring their proper use. It must therefore be involved in the conception, control and evaluation of all instruments involving budgetary funds as well as in the design of the appropriate inter-institutional operational and reporting procedures. The ongoing enhancement of the management culture of the Commission through the application of jointly accepted standards will greatly facilitate the work of the statutory control bodies (Internal audit, Court of Auditors, Budget Authority).

5. RECOMMENDATIONS

Recommendations are made under three headings:

- measures to refocus the available financial instruments on the political priorities identified at the Lisbon European Council;
- measures to improve the coherence and co-ordination between the various Community financial instruments;
- measures to enhance the visibility and accessibility of Community actions.

¹⁰ COM (2000) 256 of 11.5.2000.

5.1. Refocus the range and impact of available financial instruments

5.1.1. *EIB/EIF funded instruments: Innovation 2000 Initiative*

The EIB's Innovation 2000 Initiative (i2i) described in 2.1.1. is under implementation, and with operations already approved or under assessment in each of its five core areas including Research and Development as well as the media/content industries. The reformed EIF is entrusted with all venture capital and SME-guarantee operations for the EIB/EIF-group. The EIF will in particular administer the additional 1 billion of funds made available by EIB for new venture capital operations which should be a significant complement to the funds available from the private sector for technology funds in particular. Finally, the Bank will continue to extend its network of intermediary institutions for global loans in favour of SMEs; it will also extend its operations under i2i to the candidate countries.

5.1.2. *Commission -funded instruments*

In order to address identified market failures while maintaining a sufficient size for each available instrument, the following extensions of the Growth and Employment Initiative might be considered.

5.1.2.1. SME Guarantee Facility

Within the SME Guarantee Facility managed by the EIF, a specific **microcredits** section could be implemented to meet the needs described above. The guarantee rate should be higher and cap ratios should be more flexible than for normal loans in order to encourage financial institutions to undertake these smaller loans which have higher unit processing costs.

Furthermore, the extension of the SME guarantee scheme to **equity** investments would make a full range of guarantees available to market participants. Guarantees provide a higher leverage effect than direct equity investment and have the further advantage of reducing ownership problems. In this context, extending guarantees to local or regional seed capital and/or early stage funds could substantially reduce the existing equity gap, as discussed in the previous section.

Finally, under the proposal made by the Commission for a new multiannual programme for enterprise and entrepreneurship (2001-2005) a new loan guarantee facility (ICT) managed by the EIF should facilitate the introduction of **Internet and e-commerce applications** for smaller and microenterprises mainly from the traditional economy. The guaranteed loans would cover hardware, software and training in order to help smaller businesses get up to date in this areas and increase their competitiveness.

5.1.2.2. ETF Start-up Facility

Within the ETF Start-up Facility a window facilitating the creation and development of **business incubators and associated mentoring schemes** could be launched. Business incubators in recent years have developed from simply offering low-cost office space to providing management services and funding for start-ups. Incubation is a particularly high-risk investment because it aggregates a portfolio of start-ups in the riskiest stage of their development. There is some experience in the Member States (for example, the Twinning Scheme in the Netherlands) which could help in the design. It would a useful complement to the present ETF Start-up Facility.

5.1.3. Regrouping of similar Commission financial instruments under one budget line

In addition, the responsiveness and transparency of the budget-funded instruments will be enhanced by regrouping the instruments mentioned above under one budget line. This will:

- provide a single legal base to cover all the financial instruments;
- allow budgetary transfers between instruments where appropriate;
- encourage higher visibility and greater coherence between the various instruments.

The newly introduced budget line "B5-511 Improvement of the financial environment for SMEs" should be used for the purpose of regrouping all financial instruments in the field of Internal Policies.

Because ERDF supported activities are part of overall programmes, negotiated with the Member States, for social and economic cohesion, the instruments used in this context cannot form part of the single budget line.

5.2. Improving co-ordination and coherence.

The Commission and the EIB group have all recognised the benefits of good co-ordination and coherence. This means in particular:

- (i) ex ante evaluation of each new instrument, including its contribution to Community policies and taking into account the possible environmental impacts, the definition of a minimum critical size and absorptive capacity;
- (ii) ex post evaluation once instruments have acquired a reasonable level of experience;
- (iii) the systematic feedback of views from market operators and beneficiaries, as well as the political authorities;
- (iv) ongoing dialogue within and between the institutions.

As far as the Commission itself is concerned, co-ordination will be enhanced by the establishment of a standing inter-service Steering Committee at senior level with a mandate to review the coherence of instruments to finance SME investments. This would build on the experience of existing ad hoc groups.

Given the growing and critical importance of the EIB and the EIF in helping to achieve Community objectives in the SME field, it would also be appropriate to envisage the creation of a specific working group involving specialists from each of the institutions so as to help avoid overlap and to consider the most effective design and implementation of joint actions. A similar arrangement was put in place in the past to ensure good co-ordination of support for investments in the trans-European Networks.

Finally, at political level, the Commission proposes to prepare, together with the EIB and the EIF, an annual progress report on the support by the Community's financial instruments for SMEs. This would be presented to the European Parliament and the Council as a means of ensuring political momentum in meeting the objectives of Lisbon and early warning of the need for new political initiatives.

In addition to these co-ordination measures the Commission will consider further the scope for enhancing the organisation of the interface between its services and market operators in both the design and implementation of new instruments, drawing on the lessons underpinning

the proposed reform of the implementation of Community External Aid (SEC (2000) 814) and the externalisation of the management of Community programmes (SEC (2000) 823).

5.3. Better transparency and accessibility for SMEs

Despite the publicity given to individual programmes of support by the Community directed at the SME sector it can be difficult for SMEs and others to understand and to keep abreast of the different sources of Community finance. A single Website access point could act as a one-stop information shop for SMEs and other interested parties, including financial institutions, by explaining the features of all Community financial instruments, including those of the EIB Group, and how to access them. This site should be carefully designed so as to facilitate the dissemination of relevant information and to provide appropriate links to corresponding programmes in the Member States.