Incentivizing the take-up of financial instruments within EU Structural Funds Framework

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1. What is Blending?

General Definitions

The strategic use of **development capital** – from **public sources** like Government aids or Development Banks, or from philanthropic sources like foundations – for the **mobilization** of additional external commercial capital from **private investors** towards **sustainable development** in **developing countries** (both emerging and frontier markets).

– OECD, the World Economic Forum (WEF) and the Taskforce by the Business and Sustainable Development Commission

Blended Finance

A tool to "provide **financial support** to a **high-impact** project that would not attract funding on strictly commercial terms because the **risks** are considered too high and the **returns** are either unproven or not commensurate with the level of risk."

– International Finance Corporation (IFC), WBG

EIB Definitions

Combining EIB finance with EU budget (as in the Project Bond Initiative) to invest in **higher risk** projects for **innovation** (as for the InnovFin mandate).

– Dario Scannapieco, VP EIB & President EIF

Combining EIB lending with grants from **private** and **public** sector partner institutions, and from **philanthropic organizations**, to help clients address critical **funding gaps** in their markets.

– EIB website, Blending

Comprehensive Definition

The strategic use of **development capital** – from **public sources** like Government aids or Development Banks (as EIB), or from philanthropic sources like foundations – for the **mobilization** of additional **public** or **private** capital towards **sustainable development** according to **UN SDGs agenda** in both **developing** and **developed** countries, in order to provide financial support to **risky but high-impact** projects with otherwise unattractive **returns** for investors, thus addressing critical **funding gaps** in the markets.

1. Blending Mechanism

- Market failures
- Lack of financing for risky investments with positive externalities

PUBLIC capital

Investments complying with

- Investable
- Bankable
- Return

FINANCIAL ADDITIONALITY

PRIVATE commercial capital

Investments complying with

ECONOMIC ADDITIONALITY

OECD DAC Blended Finance Principles:

1. Anchor blended finance use to a **development rationale**;
2. Design blended finance to **increase the commercialization of commercial finance**;
3. Tailor blended finance to **local context**;
4. Focus on **effective partnering** for blended finance;
5. Monitor blended finance for **transparency** and **results**.

A win-win-win solution:

1. it benefits **countries in need for development** by increasing the amount of resources invested in the upgrading of their economies, societies and lives;
2. it makes **public and philanthropic capital providers** better off as their investments are leveraged and enabled to reach a greater impact;
3. it provides **private investors** with attractive returns.

1. Blending: a Tool to Cover the Investment Gap

Investment GAP Definition

The **difference** between the **available funding** and the **latent and real demand** in mainly developing countries, accounting for the need to both **expand and renew infrastructures**, and also the one to **finance sustainable investments** according to the **UN SDGs** priorities.

Figures:

- 2014 estimate following the UN SDGs formulation: **USD 2.5trillion annually**;
- 2016 estimate: **3%** of global GDP, **14%** of global annual savings, **11%** of the value of global capital markets, estimated at USD 218 trillion;
- 2017 estimate: **USD 3.7trillion annually**, despite an annual global spending on infrastructure of about USD 2.7trillion;
- 2018 estimate: **between USD 3.3 trillion and USD 4.5 trillion a year;**
- Estimate 2030 of private sector business opportunity of SDGs related investments: **USD 12 trillion** and **380 million new jobs**.

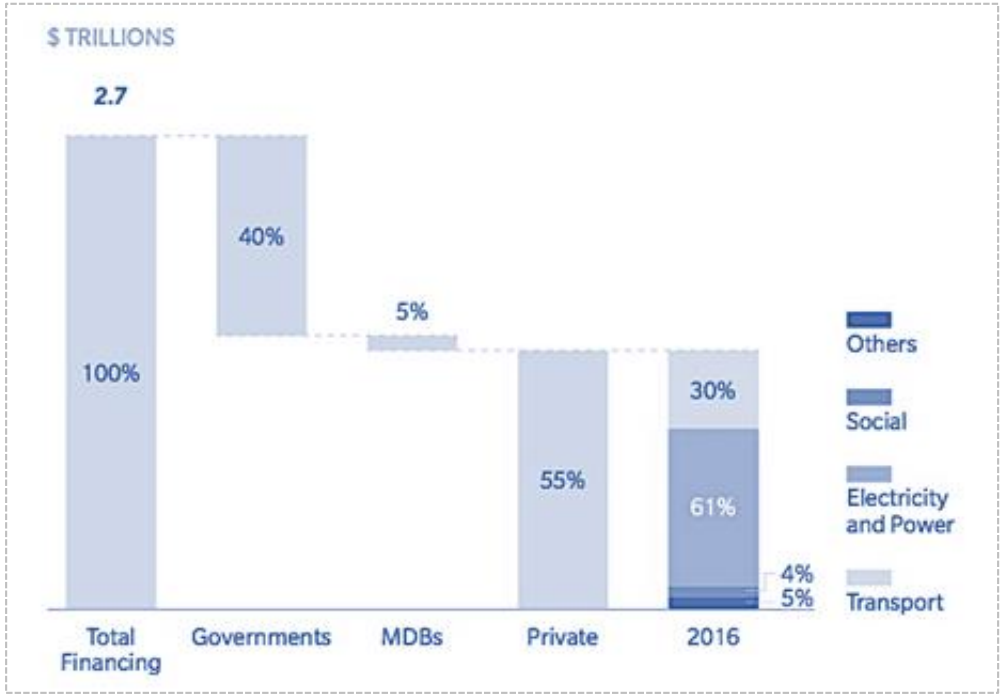


***Figure 1**: Global Infrastructure financing; Source: APRC analysis of data from Asian Development Bank, World Economic Forum, World Bank, and InfraDeals, published in Marsh & McLennan Companies' Asia Pacific Risk Center. Closing the Financing Gap, 2017.*

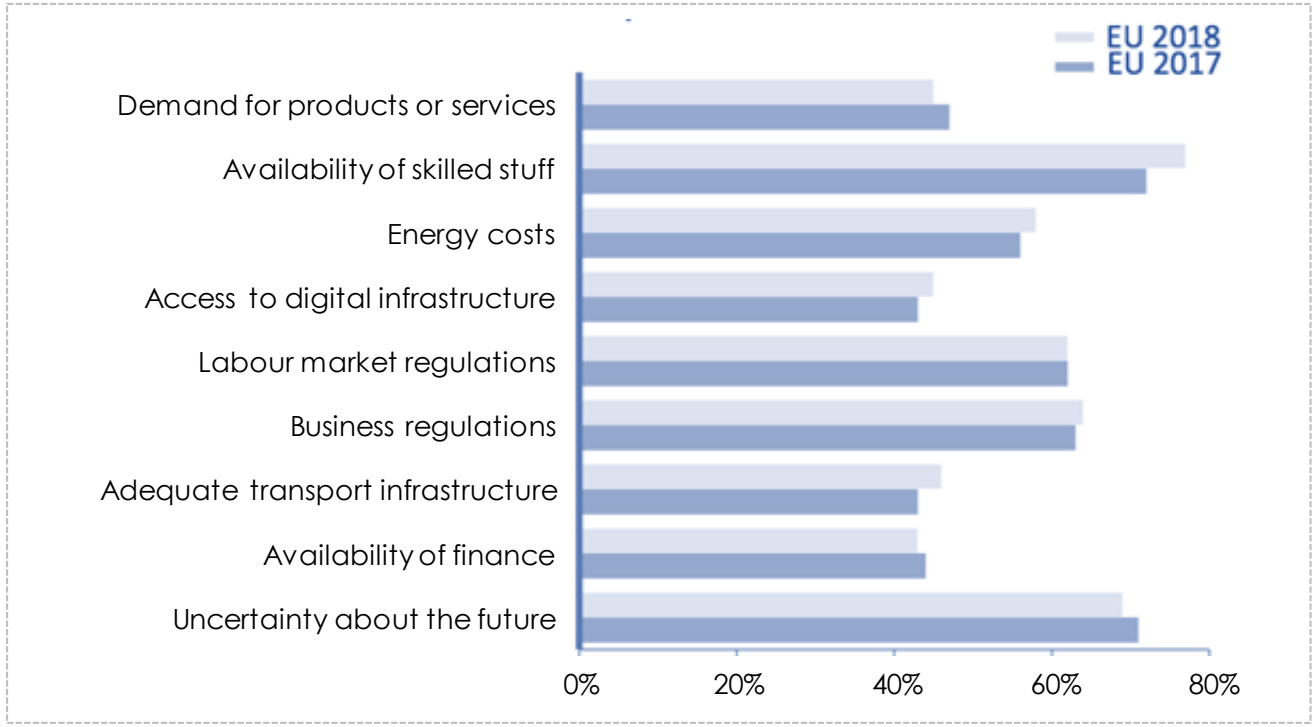


***Figure 2**: Barriers to corporate investment; Source: Scannapieco D., Long Term Investment and Public Private Partnerships: the role of the EIB Group, 2018.*

1. Macroeconomic Overview: Why Blending?

EU Financial Markets Condition

Banks' risk aversion and Basel III → bank deleveraging.

Corporations:

- Banks do not lend money to them due to crisis backlash and high risk → lower investments;
- Should be incentivised to borrow by low interest rates, BUT due to uncertainty they are less prone to.

Private Investors: difficulties to find high yields at bearable risk in the market.

GDP per Capita, 2017 (NUTS 2)

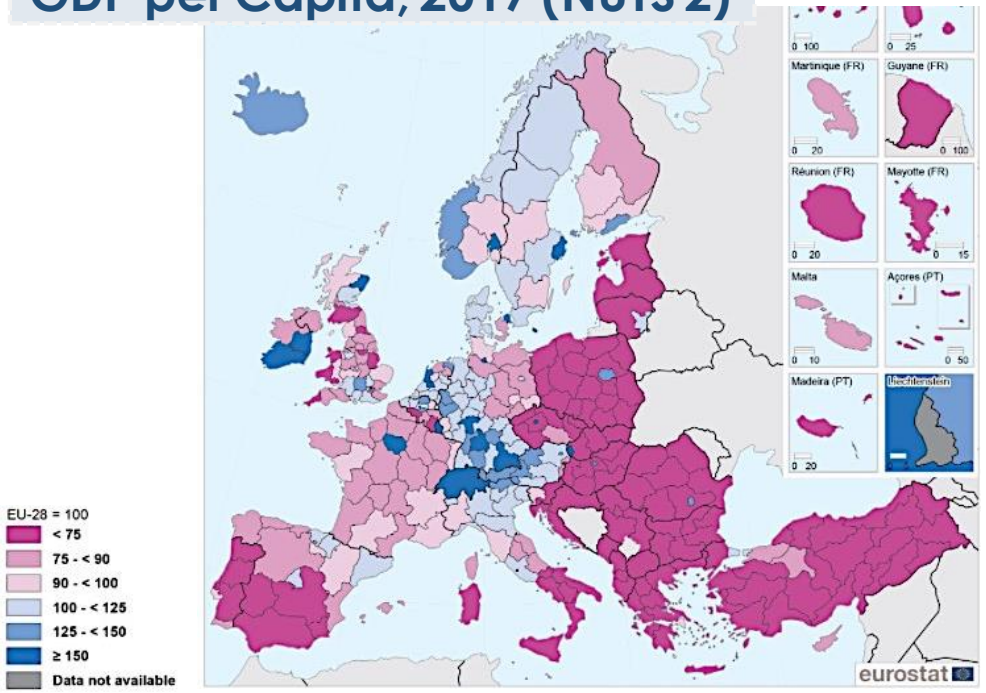
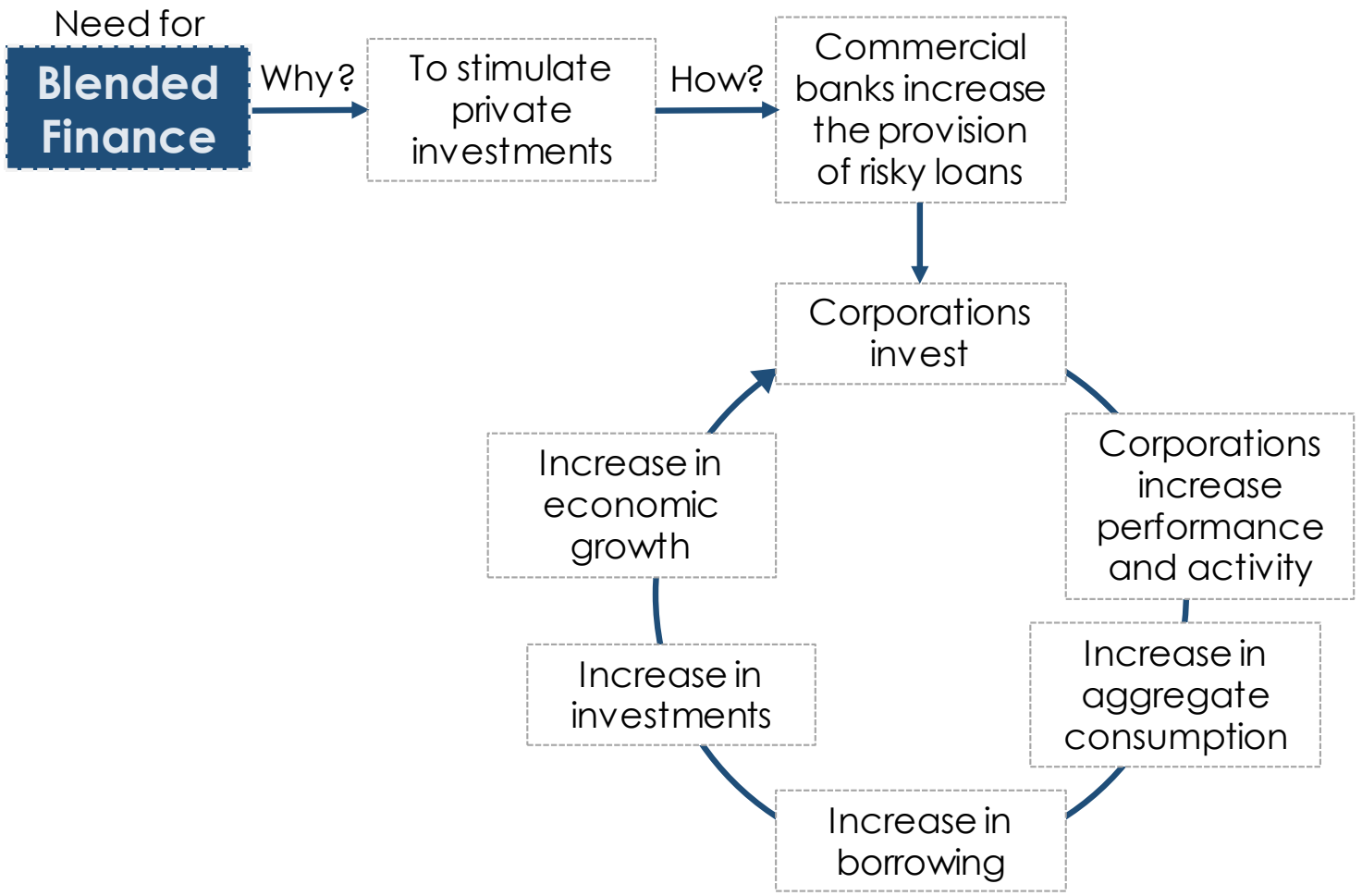


Figure 3: GDP per capita, 2017 – NUTS 2; Source: https://ec.europa.eu/eurostat.



2. EU Shifting Away from Grant Dependency

New Strategic Objectives

01. Sustainability

02. Selection of better quality projects

03. Revolving and leverage effect

Sustainability

- Financial Instruments (FIs) are more sustainable than grants from a budgetary point of view;
- In light of the recent financial crisis and the impossibility for EU government to further increase the Debt/GDP ratio to revamp demand, FIs can help recover investment.

Selection of Better Quality Projects

- Due to the involvement of the competencies lying within the private sector, the process of the selection of projects should improve;
- Financial Instruments with respect to grants can limit the risk of politicization of decision, moral hazard, adverse selection etc.

Revolving and Leverage Effect

- Financial Instruments represent a way to mobilize private capital and facilitate long term investments;
- Another peculiarity of FIs is the repayment of the outlay and therefore the possibility to reuse the funds.

2. Target Recipient, Market Failure and Rational for FIs

Different **FIs** can be used to **resolve different market failures** which arise **for** the **potential recipients**

	Final Recipient	Market Failure	Rationale	Financial Instrument
1	Micros, start-ups, entrepreneurs	Imperfect info, risk aversion	Credit availability, cost of capital	Microfinance (loans; loan guarantees)
2	Mainstream SMEs	Imperfect info; externalities	Credit availability; cost of capital	Loans; loan guarantees; mezzanine finance
3	Disadvantaged social groups	Imperfect info; externalities	Difficult to access conventional finance	Microfinance (loans; loan guarantee)
4	Education & training	Externalities; merit goods	Hard access to conventional finance	Long-term soft loans
5	High-growth firms, spin-outs, high tech	Externalities; imperfect info (imp. info.)	Conventional funds not available for scale needed	Long-term loans; mezzanine; equity
6	R&D	Externalities; risk aversion	Conventional funds not available	Long-term loans; mezzanine; equity
7	Renewables and green energy	Merit goods; externalities; risk aversion	Long-term needs; scale of funds	Long-term loans; structured finance
8	Energy-inefficient residential building	Merit goods; externalities; imp. info.	Long-term needs; no track record	Long-term loans
9	Regeneration of urban areas	Merit goods; externalities	Complex, long-term funding needs; risk	Loans; guarantees; equity; mezzanine
10	Infrastructure	Merit goods; externalities	Complex, long-term funding needs; risk	Long-term loans; structured finance

Source: EPRC compilation.

2. Financial Instruments

Project phase:
- = Preparation & Authorization
- = Construction
- = Operation & Refinancing

	Political	Technical	Construction	Operations	Bankable Pipeline	Credit/Rating	Liquidity of Debt	Upstream Resources	Commodity Price	Currency	Reputation	Local Intermediaries	Transaction Cost	Output	Off-take & Demand
Guarantee & LCs	Preparation, Operation	Preparation, Construction	Construction	Operation		Preparation, Construction, Operation								Operation	Operation
Insurance	Preparation, Operation	Preparation, Construction	Construction	Operation				Construction, Operation							
Hedging									Construction, Operation	Construction, Operation					
Junior Debt	Preparation, Operation	Preparation, Construction	Construction	Operation		Preparation, Construction, Operation					Preparation, Construction			Operation	Operation
Securitization						Preparation, Construction	Preparation, Construction								
Grants					Preparation	Preparation						Preparation	Preparation		
Contractual Mechanisms				Operation										Operation	Operation

3. ESI Funds – European Structural and Investment Funds

Key Features

- **ESI Funds** (*European Structural and Investment Funds* or *Structural Funds*) are the core tools for the achievement of the EU growth goals set out in the **Europe 2020 strategy**;
- In the 2014-2020 programming period, the ESI Funds have been channelling **EUR 643 billion** (planned amount);
- The ESI Funds focus on five areas:
    1. Research and Innovation,
    2. Digital technologies,
    3. Supporting the low-carbon economy,
    4. Sustainable management of natural resources,
    5. Supporting Small and Medium Enterprises;
- Depending on the thematic objective, the funding from the EU Multi-annual budget can be channelled through five funds:
    1. European Regional Development Fund (ERDF),
    2. European Social Fund (ESF),
    3. Cohesion Fund (CF),
    4. European Agricultural Fund for Rural Development (EAFRD),
    5. European Maritime and Fisheries Fund (EMFF).

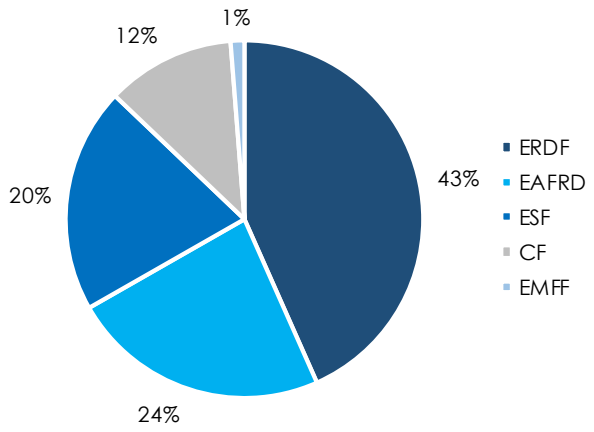


***Figure 4**: ESIF funding allocation across funds; Source: personal elaboration of the EC data.*

Management of the Funding

- The ESI Funds are jointly managed by the European Commission (EC) and the EU Member States (MS) under shared management, in accordance with the principle of subsidiarity;
- The allocation of the ESI Funds is determined by a **partnership agreements** between the EC and MS. The Partnership Agreement outlines the country's strategy and list of programmes that might be programmed with ESI Funds. However, the exact amount of ESI Funds to be allocated to each country is determined on the basis of the GDP per capita and other indicators (multi-dimensional approach), such as the potential impact of ESI Funds in terms of human capital, research and development, quality of institutions, capacity building, social capital and territorial capital;
- Once allocated, the management and supervision of the ESI Funds is carried out by the Managing Authorities i.e. institutions at the national level appointed by the individual MS;
- The European Investment Bank (EIB) can be included in the framework, but its role is defined by the Member States on a case by case basis.

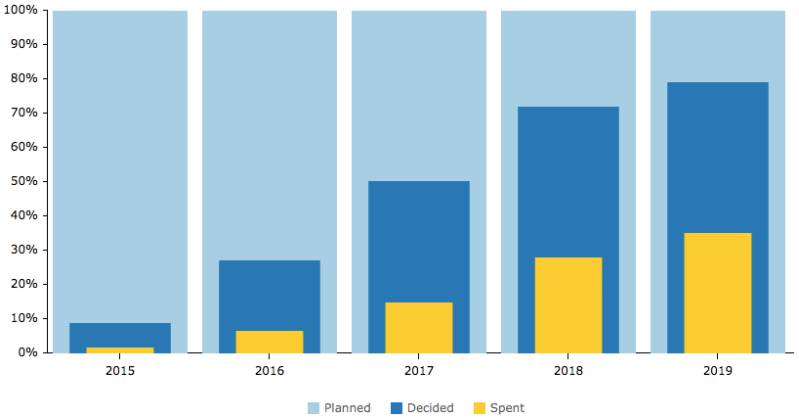


***Figure 5**: ESIF funding planned vs. spent amounts per year; Source: https://cohesiondata.ec.europa.eu/overview.*

3. Previous EU Experience with FIs

- ESI Funds act as catalysts to attract **further public funding**, since they oblige MSs to co-finance from the national budget;
- ESI Funds, especially ERDF, ESF and CF, are capable of attracting **private funding** through the possibility of disbursing EU funding in the form of **Financial Instruments**;
- In the programming period 2014-2020, 6% of the overall ESIF funding has been provided in the form of financial instruments (estimated). In the previous programming period, the percentage was lower, amounting to 4% of the total funding;
- As of *Figure 6*, a higher usage of FIs can be observed for the support of **SMEs.**

Usage of FIs Across Themes (in EUR million)

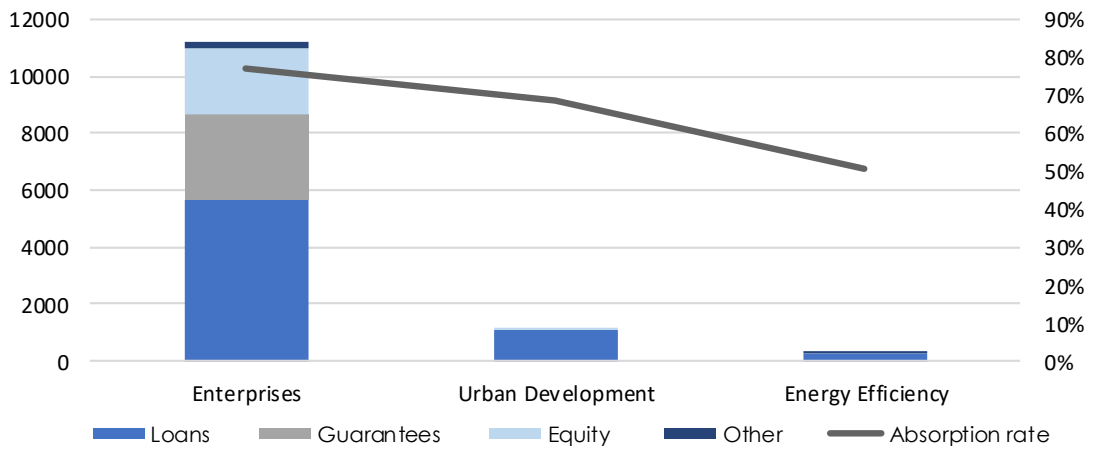


***Figure 6**: Allocation of ESIF funding in the form of FIs between 2007-2013; Source: personal elaboration.*

Usage of FIs Across EU countries (in EUR million)

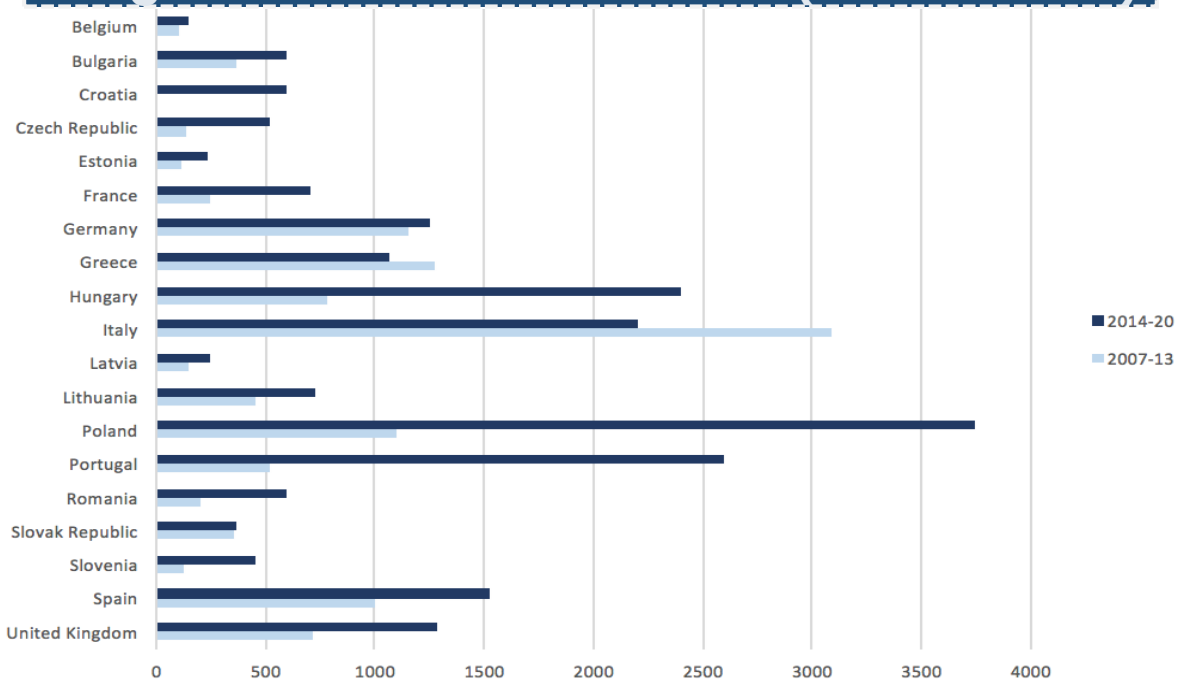


***Figure 7**: Usage rate of FIs across Member States between 2007-2013 and 2014-20; Source: personal elaboration.*

- There are **significant variations** across Member States in terms of:
  - Usage rate,
  - Absorption rate

  of the FIs;
- *Figure 7* provides a graphical representation of the usage rates of FIs across the EU Member States in the two programming periods under review;
- **Key findings**: all EU Member States have increased the planned percentage of FIs in 2014-20 compared to the previous programming period, except for Italy and Greece.

4. Case 1 – FIs for Urban Development in Portugal (1)

National Context

- More than 60% of the Portuguese population live in urban areas;
- Urban spaces represent a strategic importance for territorial cohesion and increase competitiveness in Portugal;
- Identified needs:
    1. 1 million buildings in need of significant improvement,
    2. Housing represents 17% of the national energy consumption;
- Financing gap (estimated): EUR 2-3 billion over a period of 7 years.

Key Features of the Programme

- Managing body: IFRRU 2020 (Financeiro para a Reabilitação e Revitalização Urbanas);
- Vision: urban rehabilitation as an instrument to revitalise cities in Portugal;
- Strategic objectives:
    1. Easier access to investment for developers of urban rehabilitation projects,
    2. More favourable financing conditions than those available in the market,
    3. Different financial products available and suited to the specificities of the projects;
- Timing: July 2015-December 2025;
- Funding sources: ERDF, Cohesion Fund, national co-financing, EIB and the Council of Europe Development Bank (CEB).

Financial Additionality of the Programme

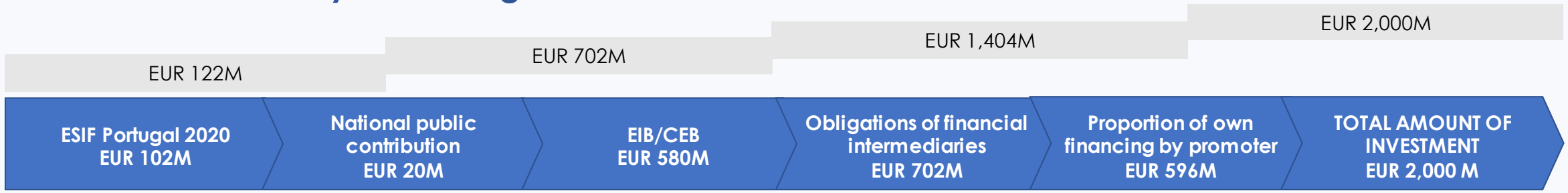


***Figure 8**: The IFRPU 2020 multiplier effect; Source: EU Commission & EIB (2019).*

4. Case 1 – FIs for Urban Development in Portugal (2)

FoF Set-Up

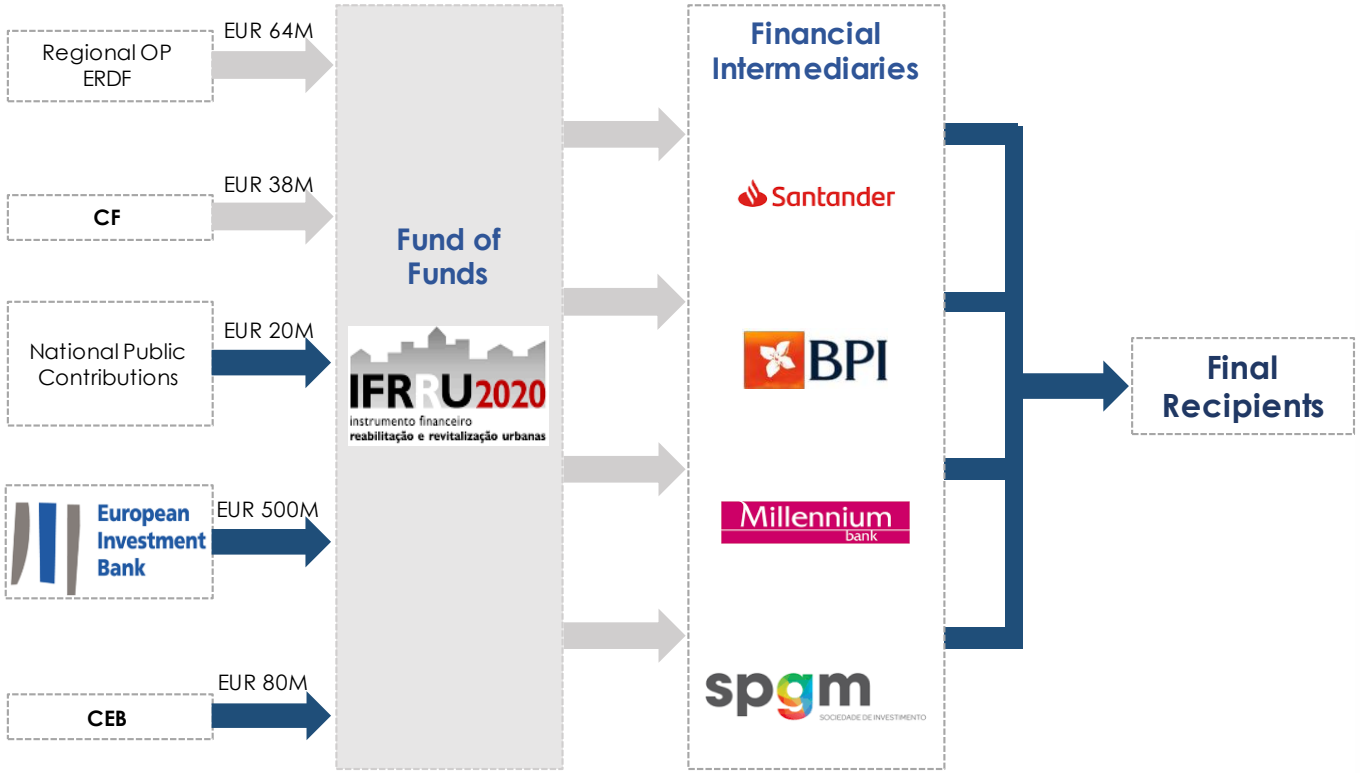


Figure 9: Design of IFRRU 2020; Source: Financial instruments for urban development in Portugal – IFRRU 2020 – Case Study (fi-compass).

Eligible Projects

- 3 **types of projects** have access to IFRRU 2020 funding:
  1. Projects in designed urban rehabilitation areas (ARU);
  2. Urban rehabilitation action plans (PARU);
  3. Projects in action plans for deprived neighborhoods (PAICD).

The Application Process

- 3 key elements to apply for support:
  1. Municipality opinion;
  2. Energy certificate;
  3. Application for funding.

Figure 10: IFRRU 2020 project cycle; Source: Financial instruments for urban development in Portugal – IFRRU 2020 – Case Study (fi-compass).

4. Case 1 – FIs for Urban Development in Portugal (3)

Financial products offered by IFRRU 2020:

1. **Funded risk sharing loan instrument**;
2. Unfunded guarantee product

Loan Instrument

Final recipient	Any entity, including natural and legal persons, public and private sector organisations.
Eligible projects	ARU and PARU to improve buildings aged 30 years or more and abandoned industrial units or spaces. PAICD to improve social housing (aged 30 or more), integrated private housing units and public space.
Fixed interest rate	Below market price based on transparent pricing that passes on the benefit of lower cost ESI Funds and other public funding.
Preferential terms	Grace period of investment period + 6 months (max 4 years in total). It may cover up to 100% of investment needs.
Average loan amount	EUR 2.3 million.
Loan period	Up to 20 years.
Eligible investments	Investment in the renewal of the buildings which may be used for any purpose including, housing, economic activities or public/collective use.

***Figure 11**: Key terms of the loans under IFRRU 2020; Source: Financial instruments for urban development in Portugal – IFRRU 2020 – Case Study (fi-compass).*

Interest Rate Composition

Beneficiary	Interest rate: own resources	May be required, depending on the need/project/candidate
Bank Funds	Interest rate: Euribor + spread z%	At least 50% of the loan
Public funds	**ESIF + National public contribution from the State Budget** (Portugal 2020) 0%	
	CEB Euribor + spread x%	
	EIB Euribor + spread y%	

***Figure 12**: Loan pricing methodology; Source: Financial instruments for urban development in Portugal – IFRRU 2020 – Case Study (fi-compass).*

4. Case 1 – FIs for Urban Development in Portugal (4)

Achievements

- Up to September 2019, 151 funding contracts has been signed for a total investment amount of EUR 479M;
- The Financial Instruments have supported projects and delivered impact in all 7 Portuguese regions.

Success Factors

- National coverage, but local approach due to the significant involvement of the municipalities in the project selection;
- Creation of competitive loan environment thanks to the competition among the financial intermediaries that had a national coverage;
- Effective communication campaign performed through a wide range of channels such as Internet (website and social media), direct contact (one-to-one meetings, public information sessions) and dedicated email helpdesk.

Main Challenges

- Complexity in managing multiple stakeholders;
- Achieve additionality from blending;
- Difficulties in supporting projects in deprived areas.

Figure 13: Financial results of IFRRU 2020 (as at September 2019); Source: Financial instruments for urban development in Portugal – IFRRU 2020 – Case Study (fi-compass).

Results (contracted projects until Sept 2019)

995	new residents
770	renovated households
2,684	jobs
248,589 m^2	renovated public or commercial buildings
16,720 toe	primary energy consumption
8,308 ton	greenhouse gas emissions reduction

Figure 14: Results of IFRRU 2020 (as at September 2019); Source: Financial instruments for urban development in Portugal – IFRRU 2020 – Case Study (fi-compass).

4. Case 2 - FIs for Energy Efficiency in Lithuania (1)

ESI Funds in Lithuania

2007-2013	2014-2020
• Total Structural funds : EUR **6,775**M: ▪ EUR **443**M FIs (**7%**); • Private resources attracted (**financial additionality**): ▪ EUR 430M into SMEs; ▪ EUR 80M into energy efficiency.	• Total ESIF funding (planned): EUR **6,709**M: ▪ EUR **1,140**M FIs (**17%**); • Private resources attracted (**financial additionality**): ▪ EUR 227M into SMEs, ▪ EUR 570M into energy efficiency.

Financial Additionality of ESI Funds in Lithuania

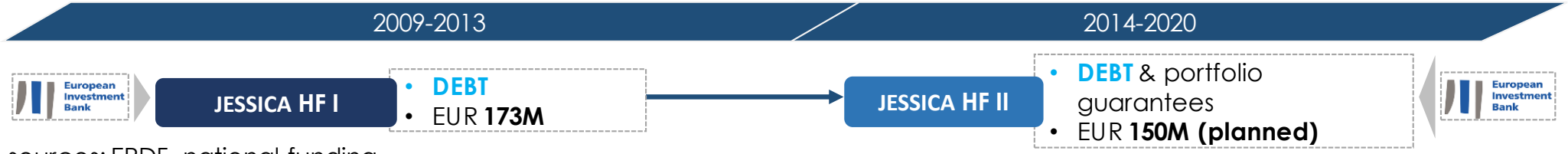
Energy Efficiency in Lithuania – National Context

- 68% of the Lithuanian population lives in urban areas in multi-family buildings;
- Identified needs:
  1. Very inefficient residential housing infrastructure (inefficient heating systems and little maintenance),
  2. Huge energy losses,
  3. Lack of initiative from apartment owners,
  4. Very conservative commercial banks approach,
  5. More than 38,000 multi-apartment blocks (equivalent to 800,000 apartments) are in need for renovations,
  6. Problems in construction sector during crisis;
- Funding gap: **EUR 1bn until 2023**.

4. Case 2 - FIs for Energy Efficiency in Lithuania (2)

Key Features of the Programme

- Programme: **JESSICA** - Joint European Support for Sustainable Investment in City Areas;
- Objectives:
  1. Increase energy efficiency in multi-apartment buildings,
  2. Ensure that cumulative annual heating costs and return on investment cost after renovation do not exceed the heating costs before renovation;
- Strategic objectives: (i) to improve living standard of population, (ii) to revive construction sector, (iii) to reduce dependency on single energy supplier;
- Timing: 2 programming periods (1) 2007-2013, (2) 2014-2020;



- Funding sources: ERDF, national funding.

Features of the JESSICA HF

- JESSICA FoF (equivalently JESSICA HF) is managed by the EIB on behalf of the Lithuanian MAs;
- No procurement procedure has been performed for EIB selection. Rationale for EIB management:
  1. Inefficient public administration in managing ESI Funds,
  2. Lack of skilled public officials in the public administration,
  3. Lack of technical knowledge on FIs in the public administration,
  4. EIB expertise.

Final Recipients

- Individual owners of apartments in multi-apartment buildings;
- Administrators of multi-apartment buildings;
- Municipal administrators of multi-apartment buildings.

FoF Set-Up

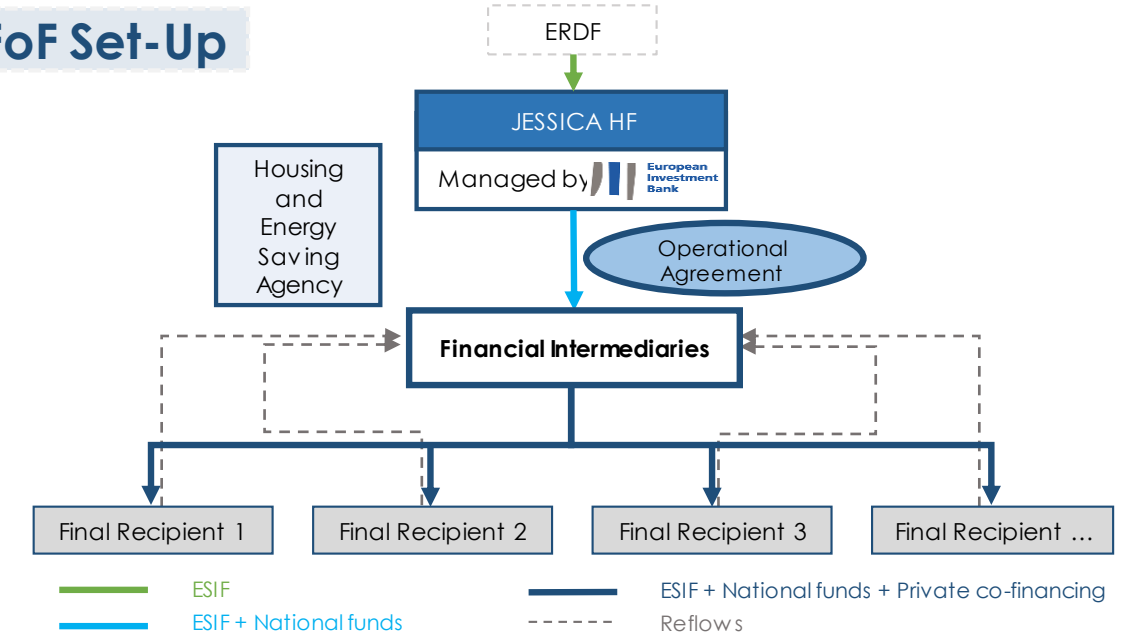
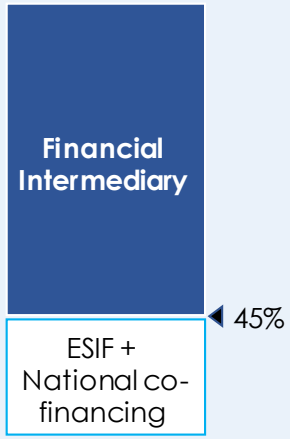


***Figure 15**: JESSICA HF set-up; Source: personal elaboration of the EC data.*

4. Case 2 - FIs for Energy Efficiency in Lithuania (3)

Preferential Loan

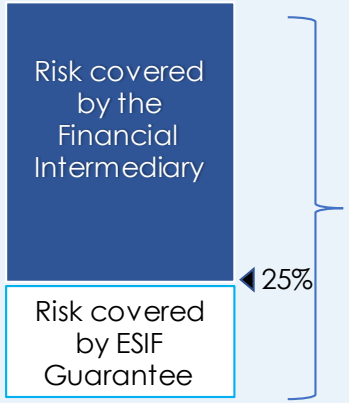
- **Borrower**: House-owner associations;
- **Fixed interest rate** at **3%** p.a.;
- **Credit maturity 20 years**;
- **Grace period**: 2 years;
- **Guarantee requirement**: none;
- 15% **interest subsidy** in the form of the **write-off** in case of 20% of **energy savings**, **energy efficiency** Class D achieved upon completion of renovations;
- Extra 25% **written-off** if **energy savings** reach 40% from State budget and Climate Change Programme.



Preferential loan

Portfolio Guarantees

Risk leverage



Preferential loan

A **Portfolio guarantee** secures the repayment of 25% of the principal amount of the loan to a financial institution. The underlying loan should be given at a **lower interest rate** and granted to **SMEs** (new or already established) for its development.

Main challenges

- Lack of appropriate legal framework for FIs;
- Lack of well-organized housing associations, which slowed down adoption of FIs;
- Difficulties in creating appropriate FIs (e.g. loans for multi-apartment renovation works), as well as new types of FIs;
- Low income people benefited from state support and had no incentive to participate in the programme;
- Larger number of intermediaries increases costs.

Success factors

- Creation of a specialized agency has contributed to more coherent urban regeneration programmes;
- It allowed the creation of a nationwide financing scheme with a local approach to project selection;
- A larger portfolio and risk spread.

Results of the 2007-2013 OP

- Attracted EUR 80M of private financing;
- N° of completed buildings: 850;
- Energy savings: 67% per building;
- Better quality of projects.

Expected results of the 2014-2020 OP

- Expected private co-financing: EUR 655M;
- Revolve 80% of the EU funding from 2009-2013 programming period;
- N° of buildings planned: 4,473;
- Energy savings: 50-80% per building;
- Better quality of projects.

4. Case 3 - FIs for SMEs in Lithuania (1)

National Context

- N° of SMEs: 183,552 (99.8% of all enterprises);
- N° of persons employed: 717,458 (76.1% of all enterprises);
- Value added: EUR 12bn (68.5% of all value added created by enterprises);
- Lithuania performs above the EU average in most SBA areas, and has improved its performance in (i) responsive administration, (ii) single market, and (iii) **access to finance**;
- Current issues:
  - VC capital financing need to be increased,
  - SME financing sources need to be diversified and expanded, such as microcredits;
- In the 2016, 3 key governmental measures: (i) *Law on Crowdfunding*, (ii) *Co-investment Fund*, (iii) *Introduction of High-Impact Technologies in Industry+*.

Set-Up of Funds for SMEs

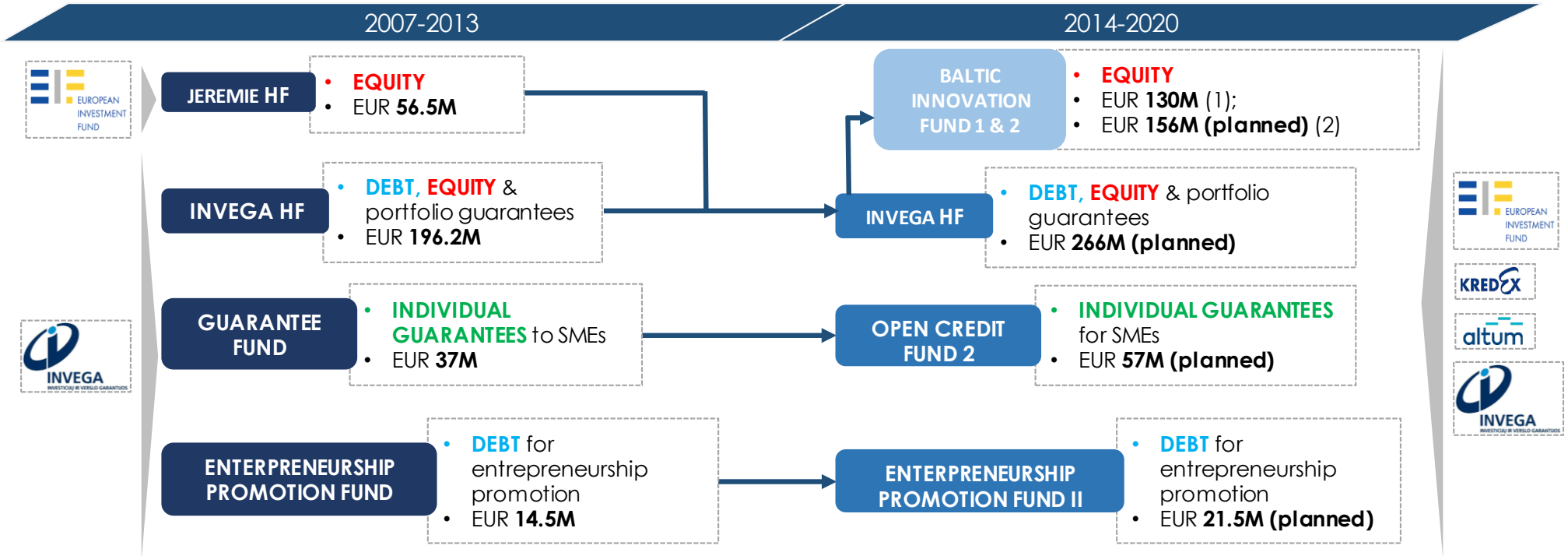


***Figure 16**: Set-up of the HF for SMEs; Source: personal elaboration of the EC data.*

4. Case 3 - FIs for SMEs in Lithuania (2)

Indirect Equity Funding

Selected Financial Intermediary	Product type	Eligibility	Initiative
INVEGA	Equity	SMEs	BALTIC INNOVATION FUND; NVEGA HF

Set-Up of JEREMIE HF

JEREMIE HF

EU funding: EUR **42**M
Private funding: EUR **15.43**M

20%

BUSINESS ANGEL FUND I

- Target: innovative & export oriented SMEs;
- Co-investors: **Business Angel (50%)**;
- Investment size: EUR 50,000 to EUR 600,000 per company;
- **Functioning:** BAF I + Business Angel;
- Invest in equity;
- Participate in **business development together** with founders of the company.

80%

VC FUNDS

10%

Practica Seed Capital Fund

- Target: early stage (seed, start-up) SMES;
- Investment size: EUR 3,000 to 200,000 per project;
- Investment period: 2 years.

23.5%

Practica VC Fund

- Target: SMEs expanding working capital, capex and similar;
- Investment size: EUR 200,000 to EUR 3 million per project;
- Investment period: 2 years.

30%

Lithuania SME Fund (BaltCap)

- Target: SMEs with growing aims;
- Investment size: EUR 3 million per enterprise;
- Investment period: diverse.

37%

LitCapital I

- Target: SMEs seeking fast growth and expansion;
- Investment size. EUR 1 to 3 million per enterprise;
- Investment period: 3 to 6 years.

77 SMEs

Figure 17: JEREMIE HF set-up; Source: personal elaboration.

Debt Products

Selected Financial Intermediary	Product type	Eligibility	Initiative
Capitalia	Loans	SMEs	EFSI; EaSI
Swedbank	Loans	SMEs	EFSI; COSME
Trind Ventures	Loans	SMEs	Innov Fin Equity
OP Corporate Bank plc; Šiauliy bankas; UniCredit Leasing	Loans	Innovative SMEs	Innov Fin SME; Guarantee Facility; EFSI
Šiauliy bankas	Loans	SMEs and Mid-caps	EREM CBSI

2007-2013

JEREMIE HF

- Fund size: EUR **57.43**M;
- Managing entity: **EIF**;
- Products:
  1. Business Angels co-investment funding (pre-seed),
  2. Seed + VC funding.

INVEGA HF

- Fund size: EUR **196.2**M;
- Managing entity: **INVEGA**;
- Products: **VC funds**.

2014-2020

INVEGA HF

- Fund size: EUR EUR **266.5**M;
- Managing entity: **INVEGA**;
- Products: **VC funds.**

BALTIC INNOVATION FUND 1 & 2

- Fund size: EUR **130M** + EUR **156**M (planned);
- Managing entities: **KredEx**, **Altum**, **INVEGA**;
- Products: **VC funds**.

4. Case 3 - FIs for SMEs in Lithuania (3)

Results of FIs for SMEs in 2007-2013 Programming Period

General PI category	Specific PI category	Private investment attratected, MEUR	N° new technology based firms created	Research & support for jobs created	Submitted patent applications	Increase in N° of jobs created (%)	Increase of turnover (%)	Increase in profitability (%)	Leveraging & R&D expenditure
Business development and productivity (grants)	Internationalisation and visibility	24.4				Up to 5%	Up to 15%		
	Business processes	27.19							
	Technology upgrading	231.9				0.11	12%		
Generic access to finance	Fis for business development	347.8				Up to 21%	Up to 16%		
Innovation promotion Infrastructures and related services (grants for intermediaries)	Infrastructure								
	Services		165						
Support for networking, knowledge and technology transfer	Clusterisation promotion (grants for intermediaries)	8.65							
	Knowledge transfer (vouchers)	1.51							
Support for R&D projects (grants)	Direct funding for business R&D	55.14		320	10				
	Business R&D infrastructure	46.75		187					

	Target achieved
	Target almost achieved
	Target not achieved

	Significant impact
	Significant impact in specific PI cases
	No impact

***Figure 18**: Impact of ESI Funds in Lithuania in 2007-2013 programming period; Source: Support to SMEs – Increasing Research & Innovation in SMEs and SME development, Work Package 2, Lithuania; Sept 2015.*

- N° of SMEs: 2,798 (3.6% of total N° of Lithuanian SMEs);
- Micro and Small Enterprises were most active in requiring FIs;
- Grants did not crowd-out FIs;
- FIs had small negative impact on the market;
- Beneficiaries were attracted by:
  - Easy administration (grants required 3x greater bureaucratic burden),
  - Tailored facilitation,
  - Mentoring support → good quality projects → attract private money;
- Less attractive for financial intermediaries when FIs were given on specific conditions (i.e. policy goals).

JEREMIE HF Results & Comments

Quantitative results:

- Turnover of portfolio companies +66% (EUR 96.92M);
- Export of portfolio companies +31% (EUR 44.5M);
- N° of employees +14% (1,559).

Qualitative evidence:

- Formation of VC ecosystem;
- Private VC funds entered the market;
- Developing network of private investors (Business Angels Network of 100).

Comments on VC:

- Mentoring, advice, contacts and other help created benefits;
- Limitations:
  - Restrictions on ceilings,
  - Territorial restriction unattractive for private investors,
  - Seed capital fund launched at very end.

Comments on Business Angels Fund I:

- 1/2 of the investments would not be made without it;
- Limitations:
  - Max EUR 0.6 million per SME,
  - Unstable regulatory framework for businesses,
  - Lack of good quality business proposals.

5. Main Issues

Objective drift

Delegating governance of ESI Funds may lead to **inefficacy** in allocation of resources;

Prioritization of financial metrics over policy goals of the ESI Funds.

Uneven dissemination

Following the market trend may lead to an **unbalanced allocation of resources** towards certain sectors/areas.

Critical mass

The sizes of the funds may be **insufficient** to crowd-in and attract private capital.

Instability

Political instability and short-lived governments do not allow a steep learning path for MAs (PAs) and a cohesive investment policy.

Off-the-shelf vs. tailor-made

While off the shelf instruments are easier to implement and ex-ante compliant with regulation, there is a **need for tailor-made FIs** in order to respond to local needs.

Managing Authorities

For the MAs

- Lack of **administrative capacity** and **expertise** in setting up FIs;
- **Administrative burden** (e.g. carrying out the ex-ante assessment);
- Lack of control and monitoring of **recycled funds**.

Financial Intermediaries

For the FIs

- **Administrative burden** related to public procurement for selection (is the fund a co-investor or just a fund manager?);
- Management **fees** adjusted to market;
- Lack of alignment of interests may lead to **objective drift**;
- **Interdependency** between the life of the fund and the programming period.

Final Recipients

Final Recipients

- Administrative burden;
- Unawareness.

5. MAs Interest and Needs in Capacity Building Activities

Thematic objectives

There is a need for further assistance and training on all the thematic objectives in order to draft more effective OP.

Programming

"Programming is a key management tool. […] it involves the determination of objectives to be achieved against the background of an analysis of the socio-economic context, and the identification of Priorities and Measures capable of converting these objectives into forms of intervention, or projects, that will deliver the outcomes desired"

The lack of competence of the public administration in important areas can limit the effective implementation of ESI Funds

Implementation

Implementation tasks can be considered the ones that influence the most the adoption of ESI Funds: preparing projects pipeline, ensuring the proper procedures on preparation of calls for proposals, ensuring transparent selection of processes, coordination with other funds, ensuring that beneficiary has adequate administrative, financial and operational capacity to implement projects, support of the intermediate bodies, developing and implementing an effective information and communication strategy.

Evaluation

"Feedback complements the use of strategic objectives and decentralized implementation processes. Feedback systems should be improved to produce consistent monitoring and evaluation systems, which include transnational thematic evaluations by the Commission. Strict financial control would also become more important"

5. Financial Intermediaries in the Different Implementation Schemes

	Time resource and limitation	Management control and flexibility	Effective use of resources	Reach
Single-stage procedure	Fast implementation.	Less operators in the system, opportunity for greater control.	Limited opportunities for the involvement of private capital (no further funds).	Harder to find an intermediary that reaches the target group and is able to provide a wide range of products (**efficacy**).
FoF - EIB	Experience and knowledge is available, but the local system must be built up, taking up time (**specialization, tailored**).	Control is more costly (translation, visits). Development policy objectives of MSs may be limited (**objective drift**).	There are opportunities to involve additional private capital through financial intermediaries.	By choosing financial intermediaries, a wide selection of target group can be reached.
FoF – Financial institution in which a MS is a SH or which has a public interest	The system can be developed rapidly.	Development policy objectives can be under control.	Effective use of resources may be undermined by the lack of administrative capacity and/or politicisation in selecting initiatives to fund.	Can be selected for the specific product group.
FoF – market operator governed by public or private law	The market operator may lack experience, it must be ensured that there are no market distortions (**time consuming**).	Lack of control on development policy objectives (**prevalence of market considerations, objective drift**).	Resources can be provided to the target group in an effective way.	Can be selected for the specific product group.
MA's direct implementation	Capacities and competences are limited. Aid can only be granted to final recipients through intermediaries.	Development goals are under strict control.	Limited opportunity to involve private capital (**limited leverage**).	Not possible to develop a national branch network. Not eligible to provide capital type products.

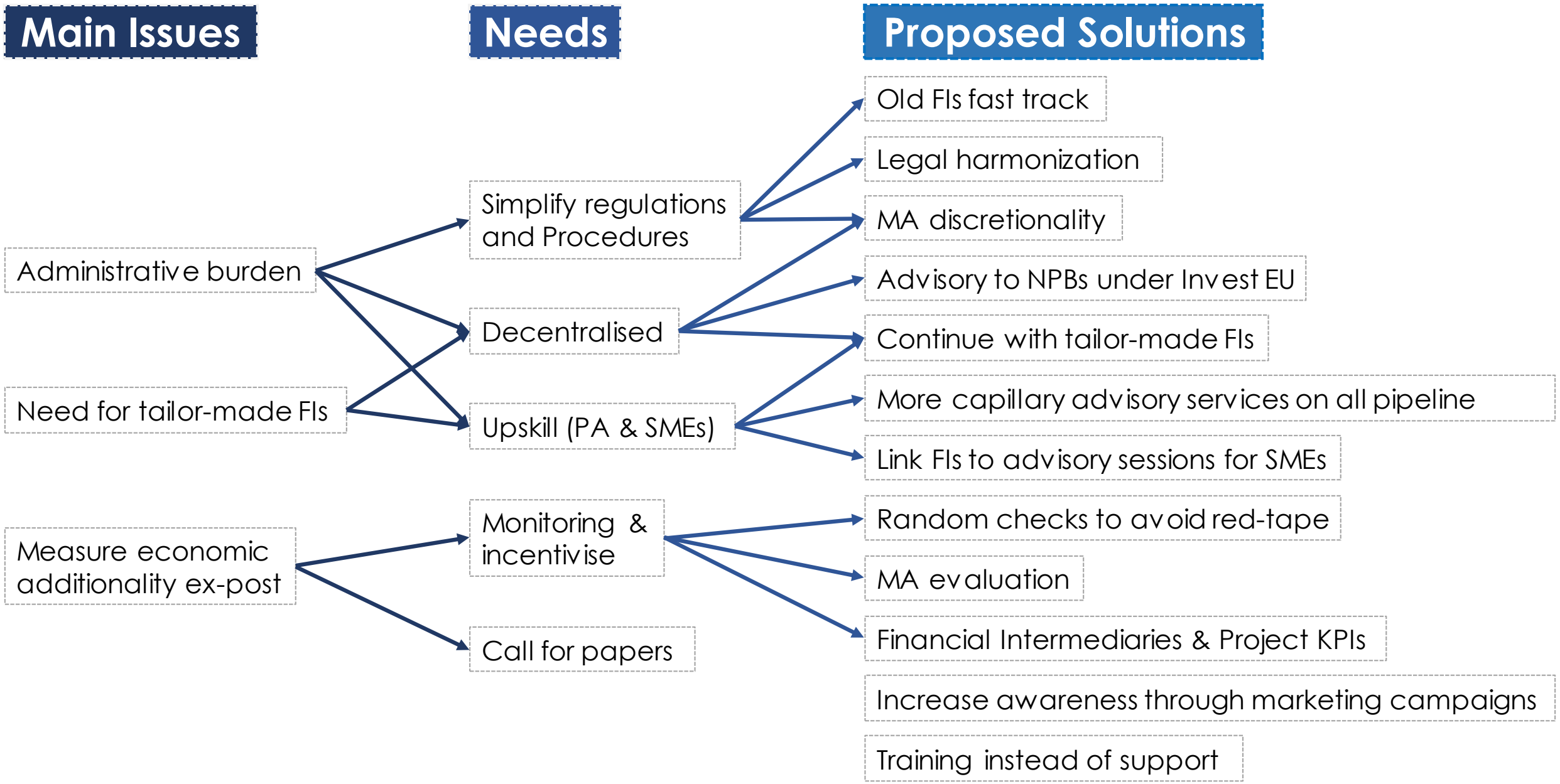
5. Final Recipients: Lack of Ability and Awareness

Financial instruments per se require more **corporate finance expertise**. This may be an issues in regions where the level of human capital is lower. The lack of complementary support can be crucial for the lack of implementation of financial instruments.

Financial systems display complex institutional geography that influence their functioning. This **produces geographical effects on the ability of entrepreneurs to access finance**, which works to the disadvantage of peripheral economies and this impacts the capacity to implement FIs.

As regards the **problem of awareness**, a large research project, PERCEIVE, tackled the issue of the perceptions of Cohesion Policy by European citizens. According to this research there is a clear communication problem. Europe must learn to better communicate its policies.

6. Recommendations



6. Recommendations: the General Framework

Policy Learning

No radical changes:

- Preference for simplification;
- Leverage the continuity of operations thanks to long-lasting regulations designed to continue over subsequent programming periods;
- Incentivize MAs engagement in the efficient and effective use of FIs.

More substantive and comprehensive judgment on the quality of the FIs features and procedures, avoiding the occurrence of complaints due to the lack of care in terms of evaluation evidence about FIs' effectiveness.

Call for Papers

Involve EU institutions as the JRC, but also the whole academic world, to overcome the need to expand the analysis about FIs, in order to measure:

- Economic additionality;
- Performance.

Evaluate effectiveness incorporating the majority of intellectual inputs possible to provide a relevant judgment about the functioning of FIs.

Good PA and Structural Reforms

FIs are no substitutes for good public governance and structural reforms: FIs are a tools for implementing a kind of market distortion allowing for positive spill-overs, to overcome market failures.
However, they are not enough to reach cohesion goals.

Evaluate the best alternative between FIs and public reforms and action on a case by case basis, to understand which is the best tool to ensure the reach of the cohesion goals though a sustainable (still unexploited) competitive advantage.

6. Simplify Regulation while Ensuring Efficacy

Old FIs fast-track

- If an instrument is well-functioning, no need to close it and re-open it at the end and beginning of successive programming periods;
- Monitoring and evaluation;
- Overarching evaluation of economic additionality and performance of single FIs.

- **Reduction of administrative burden;**
- **Incentivizing of the efforts of the MAs in improving the instruments management;**
- **Learning by doing;**
- **Avoid rent-seeking;**
- **Avoid crowd-out.**

Legal Harmonization

Use of Recycled Funds

Need for an explicit strategy. Range of options:

1. MAs full discretion;
2. Best practice with continue advisory and conclusive MAs evaluation and feedback;
3. Compulsory procedure.

- **Leverage option 1 or 2 according to MA level of competence;**
- **Avoid option 3 since it increases the regulatory burden.**

State Aid Law

1. Issues in communication between MA and EC and need for simplicity, training and advise;
2. Desire for less stringent regulation;
3. Differentiation of rules between MAs.

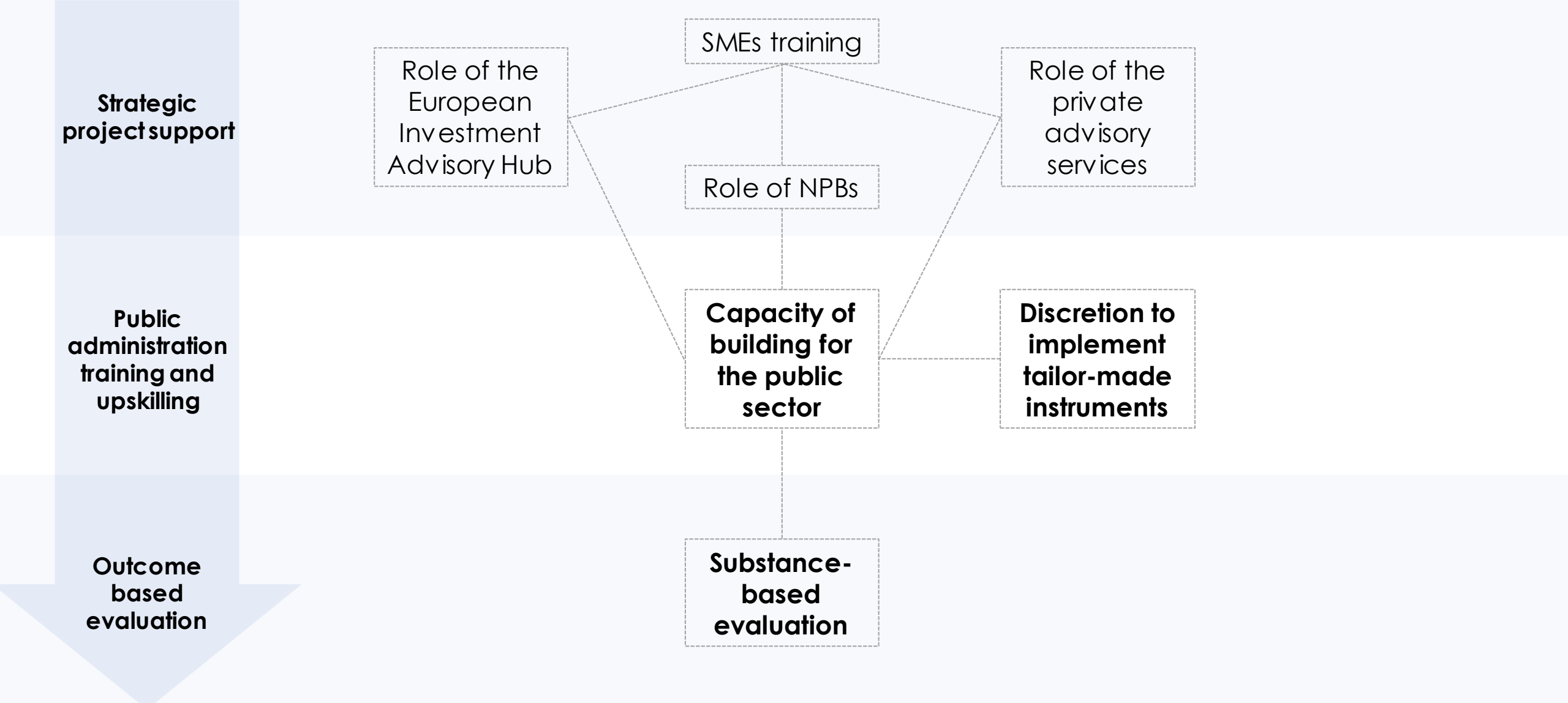
1. **Improve communication, training and advice;**
2. **Revise regulation;**
3. **Avoid opportunistic behavior and politics allowing for more action and MAs discretion.**

Clearer Rules

- Distinguish between best practice and compulsory behaviour requirements to MAs;
- Timing for management of clarification requests.

- **Fine-tuning and policy clarification;**
- **No radical changes.**

6. Decentralize and Upskill to install competences where needed and value creation



6. Monitor and Incentivise

Identified Issues	Suggested Solution
Evaluation based mainly on financial indicators.	Increase performance based evaluation (KPIs at all levels); Standardize performance measures by taking inspiration from performance auditing.
Limited and slow interim and ex-post evaluation.	Enforcement of standing arrangements for monitoring and reporting; Application of the sanction mechanisms by the EC (*Art. 142* of the *Common Provisions Regulation*); Allow for certified private experts to perform intermediate and ex-post evaluations.
No budgetary consequences for incomplete or lacking reporting.	Enforce the "performance reserve".
Lack of predefined performance self-evaluation structures and little control over final recipients.	Create and implement standardized project KPIs; Allow for additional performance reporting (less legal compliance and more substance-based project evaluation); Provide learning support on how to perform self-evaluations.
Lack of control checks.	Randomized control checks performed by representative of the EC or national authorities.
Lack of proactive fraud detection.	Making compulsory the adoption of national anti-fraud strategies and data analytics tools; More active fraud monitoring by the EC.
Poor performance of financial intermediaries.	Set higher fees for financial intermediaries; Set fees on the basis of the projects' KPIs; Link more important objectives with higher fees.

6. Key Performance Indicators (KPIs)

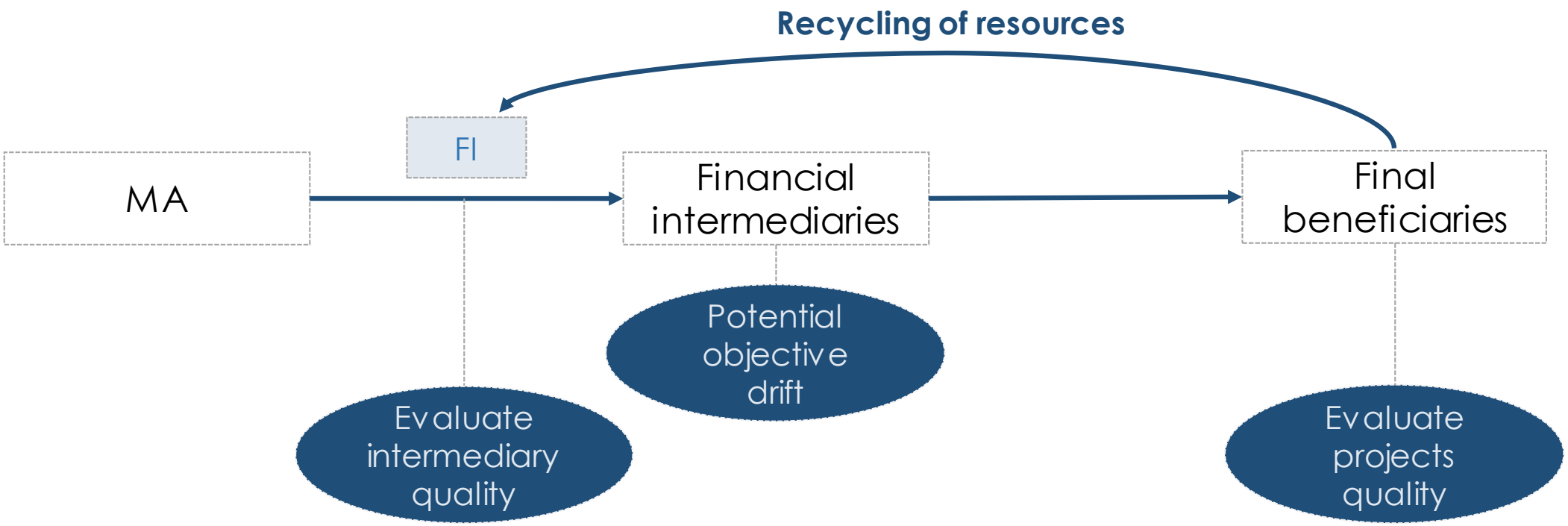


***Figure 19**: Risks and needs in the ESI Funds mechanism; Source: personal elaboration.*

Features of KPIs

- Specific to ensure validity & appropriateness;
- Meaningful and understandable for involved actors and policy makers;
- Capture multiple aspects: social, economic and financial;
- Include different lenses: effectiveness, efficiency and cost-effectiveness;
- Clear: non-ambiguous desired direction of movement, targetable, timely and actionable.

6. Information Spreading and Marketing Campaigns

Issues

- Entrepreneurs and local financial actors do not consider or know about EU policy instruments, to the detriment of their businesses;
- There are barriers like language and inability to present ideas in a proper format.

Proposed Solutions

- Advertising campaigns;
- Face-to-face seminars.

Advertising for JESSICA in Lithuania

- Overall, the campaign has been successful in rising awareness;
- Variety of communication tools to reach current and potential homeowners to circulate key information on the overall benefits;
- 2 main communication tools:
  - TV advertising,
  - Public Relations Campaigns (e.g. face-to-face seminars;
- Effectiveness of the tools:
  - Face-to-face seminars and meetings proved to be most effective in encouraging homeowners to participate in the JESSICA scheme,
  - Television campaigns had the largest reach;
- Problems: decrease in interest that was driven by:
  1. Questions were not answered in a timely manner,
  2. Financing package was not finalised at the time of the campaign.