



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 1.12.2003
COM(2003) 713 final

**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL
AND THE EUROPEAN PARLIAMENT**

Access to finance of small and medium-sized enterprises

TABLE OF CONTENTS

1.	Executive summary	3
2.	Council request	4
3.	Financial instruments supporting SMEs	5
3.1.	Financial instruments of the EU.....	5
3.2.	Member States.....	6
3.3.	Accession and candidate countries.....	6
3.4.	Policy framework	7
4.	Bank lending	8
4.1.	Code of conduct	8
4.2.	Microlending.....	8
4.3.	Measuring SMEs' access to finance	10
4.4.	Rating of SMEs.....	10
4.5.	Guarantee instruments.....	12
4.6.	EIF activities	12
4.7.	EIB global loans.....	14
5.	Equity finance	15
5.1.	Market failures in risk capital	15
5.2.	Good practices in training	16
5.3.	Increasing the liquidity of capital markets	17
6.	Conclusions	18
6.1.	Improving framework conditions.....	18
6.2.	Focusing on early-stage finance, in particular guarantees and microlending	18
6.3.	Increasing equity	19
	ANNEX Overview of recent national actions in SME finance.....	21

1. EXECUTIVE SUMMARY

Improving access to finance is an important aspect of fostering entrepreneurship in Europe. The role of the public sector should primarily be to improve the general framework conditions of finance and take limited direct action only when market failures warrant it. Experience has shown that best results in SME finance are achieved when the public sector works with the markets and acts as a catalyst to encourage their development.

Financial instruments. The problems of finance facing start-up businesses require long-term solutions involving the public sector. Most Member States have programmes and institutions that aim to overcome the gap in early-stage SME finance caused by high risk and high overhead costs. Efficient public support mechanisms need to be tailored to local conditions and need to be simple and accessible. This can only be achieved by using local banks and venture capital funds as intermediaries – as happens with the Community financial instruments.

Bank lending. Experience from the EU financial instruments shows that loan guarantees are a very efficient way to use limited public funds and directly address the problems of lacking collateral and intangible assets. To improve the conditions of bank lending, the Commission has facilitated discussions about a code of conduct for credit institutions and SMEs. It has also produced a report on best practices in microlending. The Community financing institutions, the European Investment Bank (EIB) and the European Investment Fund (EIF) provide important support to SMEs' access to finance.

The increasing risk awareness of banks has led them to expand the use of internal rating of SMEs, which will gradually lead to a rating culture where SMEs need to signal their creditworthiness to the banks, regularly discuss their credit standing and deliver timely information.

Equity finance. Many SMEs need stronger balance sheets although formal venture capital is an option only for entrepreneurial growth companies. In addition to developing European venture capital markets, promoting the possibilities provided by business angels and business angel networks should continue to receive attention at regional, national and European level.

The proposed new capital requirements for banks from 2007 onwards will increase stability and competition in European financial services markets, and they should also bring benefits to the SME sector. The effects of the new rules for the European economy, and in particular for SMEs, are the subject of a study being carried out on behalf of the Commission.

Conclusions. To efficiently promote entrepreneurship in Europe, further European, national and regional public sector actions should be focused on three areas of SME finance: (1) improving the framework conditions; (2) focusing on early-stage financing, in particular guarantees and microlending; and (3) increasing equity in SME balance sheets.

- **Improving the framework conditions.** Besides completing the single market and removing obstacles from growth, developing financial markets will be a particular challenge in the accession countries because they suffer from low level of equity investments and bank lending. These countries merit special attention, as otherwise the underperforming financial markets will hamper entrepreneurship and growth.
- **Focusing on early-stage finance, in particular guarantees and microlending.** The persistent gap in early stage finance makes it necessary that the public sector continues to work with the private sector to overcome it. Easily and widely available guarantee instruments that share risk between the private and public sectors effectively address SMEs' difficulties in getting bank loans. Microlending can provide start-ups with a

decisive help and loan guarantees should be used efficiently to promote it. The use of national financial intermediaries and national programmes makes it possible for financial instruments to be tailored to the different financing traditions providing additional leverage to programmes targeted at the financing gap in early stage SME finance.

- **Increasing equity.** The needs of entrepreneurial growth companies and the mainstream European SMEs are different, but both need stronger balance sheets with enough equity. Retained earnings are the best form of financing growth and investment. The Member States should review whether their tax laws inhibit firm growth by taxing retained earnings more than distributed profits. For entrepreneurial growth companies, liquid and well-functioning venture capital markets are essential.

2. COUNCIL REQUEST

In its meeting on 4 and 5 December 2001 the Energy and Industry Council approved conclusions on small and medium-sized businesses' (SMEs') access to finance and invited the Commission to submit an initial assessment of progress in 2003. The conclusions were partially addressed to the European Investment Fund (EIF), the European Investment Bank (EIB), and to the countries participating in the Multiannual Programme for Enterprises and Entrepreneurship (2001-2005).

The Council invited the Commission to:

- Encourage professionalism of the various players in the field of equity finance by identifying good practices in the field of public and private training;
- Facilitate contacts between banks, other financial providers and SMEs in order to draft a European code of conduct between banks and SMEs and thus strengthen their understanding of each other, and determine best practices for reducing the complexity of the administrative procedures involved in financing or government guarantees;
- Measure on a regular basis SMEs' access to finance;
- Explore ways of reducing the informational asymmetries between capital supply and demand, looking in particular at risk assessment methodologies that are accessible, transparent and suited to SMEs' requirements;
- Explore ways to increase liquidity of capital markets;
- Submit an initial assessment of progress in 2003;

In particular, the Council called on the European Investment Bank (EIB) to direct its global loans more towards segments where market failures are significant and to make sure that the EIB's financing efforts have an impact at the level of SMEs as well.

The Council invited the Commission and the European Investment Fund (EIF) to:

- Conduct an analysis in the field of risk sharing schemes between the private and public sectors, with particular reference to guarantee systems and the various forms of securitisation;
- Reflect upon the setting up of a guarantee system that facilitates fund raising and creates a significant multiplier effect for private investment sources (banks, risk capital, business angels) consistent with state aid rules;

- Focus action concerning risk capital on segments where market failures are most evident.

The Council called the Member States to give priority to initiatives related to access to finance, such as actions promoting entrepreneurship, good practices in the financial management and quality financial information concerning SMEs; and to encourage contacts between banks, other finance providers and SMEs in order to improve their mutual understanding.

3. FINANCIAL INSTRUMENTS SUPPORTING SMES

3.1. Financial instruments of the EU

The financial instruments of the Multiannual programme for enterprises and entrepreneurship (2001-2005) provide European leverage and support for SME financing. These instruments are implemented by the European Investment Fund (EIF), which is the risk finance arm of the European Investment Bank (EIB). Furthermore, the European Regional Development Fund has allocated €1.5 billion to SME development in the Member States for the period 2000-2006.

The SME Guarantee Facility provides guarantees for guarantee schemes and financial institutions within the public and private sector that support lending to SMEs. The facility includes micro-credit guarantees, equity guarantees, and guarantees for loans financing IT equipment, software and training. The SME Guarantee Facility has proved to be a very effective tool and since 1998 it has benefited more than 125 000 SMEs in a wide range of sectors. More than 90% of enterprises benefiting from loan guarantees are microenterprises with fewer than 10 employees and their job creation has increased significantly¹. About 45% of beneficiaries are start-up firms.

The latest yearly report on the financial instruments indicated that the guarantee facility made possible lending to SMEs that is 58 times the budgetary spending, which is an extremely efficient use of EU funds².

The ETF Start-up Scheme supports the financing of SMEs in their start-up phase by investing in venture capital funds and business incubators. The funds should in particular be seed funds, smaller funds, funds operating regionally or funds focused on specific sectors or technologies, or venture capital funds financing the exploitation of R&D results. EIF invests usually about 15 % in the capital of a new venture fund and the rest of the investment must be raised from other sources, although under the current unfavourable market conditions very few new funds have been successfully set up. The ETF Start-up mostly benefits entrepreneurial growth companies in an innovative technology or service area.

The ETF Start-up Scheme is an effective instrument that has increased the supply of venture capital to SMEs, particularly in the early stages of development and in the high technology sectors where there is an identified market failure. So far, more than 200 companies with high growth potential have benefited. The ETF Start-up has had a significant impact on growth and employment, and a further positive influence on job creation is foreseen over the next few years, particularly in information technology, biotechnology and life sciences. The structure of the scheme, using co-investments by EIF in venture capital funds, has been deemed to be an efficient way of making larger amounts available to final beneficiaries and an efficient use of Community resources. The use of national financial intermediaries and

¹ See the report "Measures on financial assistance for innovative and job creating small and medium-sized enterprises", COM(2003) 480 final, 5.8.2003.

² The budgetary resources were €155.7m, which allowed guaranteeing loans worth of €9.02bn.

national programmes make it possible for the Community instruments to be tailored to the different financing traditions and market circumstances of the participating countries.

The Seed Capital Action provides support for the long-term recruitment of new investment managers to reinforce the capacity of seed funds. The grants are aimed at covering management costs of hiring in new funds or incubators that include seed capital in their global investment programme. However, as few new funds have been set up for seed capital, there has been little demand for this instrument.

The persistence of the gap in early-stage SME finance and the good experiences gained from the financial instruments, in particular from the SME Guarantee Facility, speak for the need to continue to provide such instruments also in the future. With regard to the ETF Start-up Scheme, companies with growth potential will be the ones to provide employment and growth in the future and the catalytic role of the public sector activities in their early-stage venture finance continues to be essential.

3.2. Member States

Most Member States have programmes supporting SMEs' access to finance³. In order to establish best practices and to find out the most efficient leverage achievable for limited public funds, evaluations of SME support programmes provide important information. As an example, the evaluation⁴ of the Finnish Industry Investment venture capital programmes urged clearer focus on market failures, concentration on working through financial intermediaries, and a coordination of policies with other agencies. Comparable efforts of consolidating and simplifying the financial instruments are going on eg. in Germany where the KfW-Mittelstandsbank is taking over and streamlining instruments targeted at SMEs.

One way to facilitate SMEs' access to venture capital is to set up US-style small business investment companies. Under this scheme, government guarantees allow investment companies to borrow money at low rates on the capital markets. Together with privately raised capital the money is then invested in SMEs. Although these investment companies that benefited from public guarantees made only 11% of the total amount of US early-stage venture capital investments in 2002, it was almost 60% of the total number of deals. Several of the existing promotional SME banks in the Member States function in a way comparable to the small business investment company scheme, including KfW in Germany, Finnvera in Finland and BDPME in France. Furthermore, both United Kingdom and Belgium are looking at the possibilities of having a programme comparable to the small business investment company scheme. The UK programme would give funds favourable-rate government loans to complement their private financing. Paying back these loans could be deferred until cash flows from the investments materialise and the government would get a proportion of the profits⁵.

The flexibility of the European Union financial instruments can provide additional leverage to a variety of national SME financing programmes, including new initiatives as described above.

3.3. Accession and candidate countries

The financial systems of the accession and candidate countries supply less equity investments and bank lending than in the current Member States. The average ratio of

³ See the annex of this report.

⁴ M. Maula and G. Murray: Finnish Industry Investment Ltd. An International Evaluation. Kauppa- ja teollisuusministeriö, 2003.

⁵ Bridging the finance gap: a consultation on improving access to growth capital for small businesses, HM Treasury, April 2003.

domestic bank lending to GDP in the accession countries is around 40 %, whereas the average for the euro area is 140 %⁶. Small firms suffer most from underdeveloped financial and legal systems, including unclear bankruptcy laws. In particular, if corporate performance is not transparent and creditor rights are weak, collateral-based lending is not attractive for banks. Weak legal protection also discourages the use of trade credit and long-term lending, which is at a low level in the accession and candidate countries⁷.

Credit constraints limit the growth of SMEs in most accession and candidate countries, but there are differences. In countries that have a business environment favourable to financing, also the SME sector is numerically stronger. Furthermore, foreign bank penetration has improved financing conditions for all firms, including SMEs.

Venture capital markets in the accession and candidate countries suffer from the weak and illiquid stock markets that limit investors' exit possibilities and the preferred exit option of venture capital funds in these countries is to find foreign strategic investors. The venture capital investments have concentrated on later stage investments, mature enterprises and low-tech companies⁸. The countries lack high-tech entrepreneurship, but the foreign-dominated and young venture capital industry might also lack the means like local knowledge and informal networks to find potential entrepreneurs. Furthermore, there are administrative and cultural barriers to entrepreneurship emanating from universities and research institutions and links between them and businesses are weak.

Overall, the accession and candidate countries need to pay attention to the further development of their financial systems. This includes capacity building throughout the financial sector making it easier for banks to become more acquainted with SMEs and more willing to provide medium and long-term lending. Furthermore, a gradual emergence of an equity culture will open the way for a more developed venture capital industry.

Since 1999 the European Commission has been supporting capacity building in the financial markets of the accession and candidate countries through the SME Finance Facility, which has been funded by the Phare and Meda programmes. This facility has been managed by the European Bank for Reconstruction and Development, the Council of Europe Bank in cooperation with the KfW, and by the EIB, which have offered credit lines to local banks for SME lending. These banks have also received financial incentives to train their personnel and to lend to SMEs.

The adoption of the body of European Union legislation and the implementation of the Financial Services Action Plan will help the accession and candidate countries to solidify their legal environment, which will facilitate the development of financial markets.

3.4. Policy framework

The problems of finance facing start-up businesses are to a large extent structural and require long-term solutions involving the public sector. The US experience shows that even under very favourable conditions early-stage venture capital investments continue to be dependent on the participation of the public sector. However, the role of the public sector should be seen as a facilitator and catalyst rather than provider of ready-made solutions. The experience of many Member States has shown that risk sharing between public and private sectors in a partnership between banks and SME development institutions is an efficient way of alleviating finance problems facing SMEs.

⁶ Financial Sectors in EU Accession Countries, ECB, 2002.

⁷ L. Klapper, V. Sarria-Allende and V. Sulla: Small and Medium-Size Enterprise Financing in Eastern Europe. World Bank, 2002.

⁸ I. Iliev: Barriers to Venture Capital Investment in Innovative SMEs in CEEs – Causes and policy Implications. Annual Anglo-Polish SSEES Colloquium, London, 2003.

Simplicity and accessibility of support mechanisms must be one of the overriding goals of SME policy. The consistent message from entrepreneurs is that their key task is to run a business, not to deal with bureaucracies. They do not have time for targeted specific programmes that require heavy procedures and long processing times. From the beneficiary viewpoint, the simplicity of dealing with their habitual bank (or venture capital fund) but getting the benefit of local, regional, national or European public participation is valuable.

The need to promote entrepreneurship on a wide front, taking on board both entrepreneurial growth companies and mainstream SMEs, requires financial instruments that are defined broadly enough so that they can be used for various purposes according to changing market needs, like financing second chance entrepreneurship or transfers of businesses.

The limited public funds available for improving SMEs' access to finance should aim at maximum efficiency in both the Member States and accession countries. The aim should be to develop markets and work in partnership with the private sector to achieve high leverage. European actions should complement and support national and regional efforts to develop early-stage finance. The accession countries pose a particular challenge, as such national and regional efforts are very recent and in the early phase of operations.

4. BANK LENDING

4.1. Code of conduct

The Council invited the Commission to facilitate contacts between banks, other financial providers and SMEs in order to draft a European code of conduct between banks and SMEs. The aim is to strengthen their mutual understanding, and to determine best practices for reducing the complexity of administrative procedures when applying for a loan or a guarantee.

In September 2002 the Commission invited a high-level expert group from the banking sector and from SME organisations to explore the possibilities of setting up such a code. The group agreed on a compromise text, which was submitted to the national banking and SME organisations for comments. By the end of October 2003, four organisations had confirmed their willingness to endorse the resulting European Code of Conduct for Credit Institutions and SMEs. These were Eurochambres, UEAPME, UNICE and the European Group of Savings banks, which is one of the main providers of loans to SMEs. The European Association of Cooperative Banks and the banking Federation of the European Union had requested additional time for consulting their national members. The Commission seeks to finalise the discussions with the European banking and SME organisations on the code soon.

4.2. Microlending

The use and importance of microloans (up to €25 000) and microlending programmes has increased in Europe and the Commission has produced a report on best practices in microlending⁹ based on the work of an expert group. The group reviewed microlending programmes in Europe aiming to find good practices that supported enterprise creation. It also sought examples of national programmes developing cooperation between promotional SME financing institutions and local banks, looked at the role of guarantee schemes in microlending, and reviewed the leverage achieved by establishing partnerships with business support services.

⁹ "Microcredit for small businesses and business creation: bridging a market gap", Enterprise Directorate-General, 2003.

The report concluded that insufficient supply of microloans is a major issue when business creators are unemployed persons, women or belong to ethnic minorities. Supporting the supply of microloans is therefore not only an issue of entrepreneurship and economic growth, but also of social inclusion.

Banks often look at microcredit as a high risk and low return activity due to the high failure rate and overhead costs. Although the situation varies between the Member States, banks usually are not active enough in microlending. In the majority of accession and candidate countries credit supply constrains business creating and the growth of SMEs.

Most countries recognise the need for public support for microcredit and provide such support. However, further measures are necessary to overcome the market gap. These measures should concentrate on creating a favourable regulatory and fiscal environment for investors supplying funds to microcredit institutions. Other actions could support lending programmes aimed at microfinance institutions, sharing risk with guarantee societies and promoting business support services.

Guarantee schemes enable banks to provide microcredits because both the risk and the capital requirements are lower. Publicly owned promotional SME banks are an efficient way to provide loans and loan guarantees because they can use local banks to lend further to SME borrowers. Public sector instruments can have both credit and guarantee components, or microloans can be provided without collateral. At the European level, the Multiannual programme has a special microcredit guarantee window that has helped to set up several guarantee schemes in the Member States.

Although the main barrier for start-ups and small businesses is access to finance, not the interest rate, some countries still provide microloans with a subsidised rate. In an environment where interest rates are very low, subsidised interest rates are irrelevant. A more market driven approach would allow lending costs to be covered and would make private microlending industry at least potentially self-sustainable. It should also be noted that the practice of setting usury rate, ie. ceiling for acceptable interest rate, makes it impossible for financial institutions to provide financing to risky start-ups. This can also be a barrier to entrepreneurship and self-sustainability of the private microcredit industry.

In order to strengthen European and national partnerships in microfinance, the report recommended that the EU should increase the budget of the SME Guarantee Facility of the MAP, in particular the microcredit window. The European Regional Development Fund and European Social Fund should also be used to promote microcredit activities based on existing good practices, in particular in accession and candidate countries.

The report recommended that the Member States should improve their legal framework and financial environment to make it easier for microlending institutions to raise funds and provide microloans for start-ups and small enterprises. Because the microcredit industry should aim for self-sustainability, the level of public support should gradually decrease and it should be carefully adapted to the targeted businesses. The Member States should also encourage co-operation between microfinance institutions and business support service providers.

In the interests of high performance and good governance, the report encouraged microcredit institutions to assess and monitor their performance with clear targets. They should also exchange views on the quality of credit decisions and the adequacy of reserve policies. The industry also needs clear risk management procedures.

4.3. Measuring SMEs' access to finance

The Council invited the Commission to measure on a regular basis SMEs' access to finance. This request refers to the problem that the shortcomings of comparable national statistics do not allow the development of a coherent picture of developments in SME financing at European level. This problem has already been alleviated by the European Central Bank, which started in April 2003 a quarterly survey of bank lending to the private sector. This survey seeks to answer some of the questions about bank lending to firms, including SMEs. The European SME Observatory also regularly reports on SME financing questions.

The European Commission has updated its recommendation on the SME definition¹⁰, which will come into force in 2005, and will contribute to the clarity and comparability of SME statistics. The Commission will continue to review the availability of data on SME finance conditions.

4.4. Rating of SMEs

The Council invited the Commission to explore ways to reduce the information asymmetries between capital supply and demand, looking in particular at risk assessment methodologies that are accessible, transparent and suited to SMEs' requirements.

This invitation stemmed, among other reasons, from the ongoing changes in the European banking system, in particular the proposed introduction of new capital adequacy rules for banks (the Basel II process)¹¹.

The new capital requirement rules are designed to increase the soundness of the European banking system. They aim to align the calculation of regulatory capital charges more closely with banks' own economic processes and risk assessments, and they will bring increased stability and competition to European financial services markets. As such they should confer positive benefits on the SME sector and European industry as a whole.

During the negotiating process much attention has been paid to direct effects of the proposal on banks' SME lending. The July 2003 discussion document proposed parameters that would not put SMEs in a disadvantaged position against other bank clients. A study of the potential impact of the new rules carried out by the Basel Committee and the European Commission indicated that the regulatory capital requirements for lending to SMEs will be lower than under current rules.

However, the proposed rules have other effects on SME finance. Three are particularly important: the emerging rating culture of SMEs, the venture capital investments of banks, and the securitisation of SME lending by banks.

While banks are generally expected to have sound risk management in place and to assess the risk of customers properly, the new capital requirement rules will support the improvement of banks' risk management, measurement and control. The increase in risk awareness of banks can lead to an expanded use of banks' internal rating systems which may influence banks' information requirements concerning their SME customers.

A goal of internal rating systems is to make loan pricing reflect more accurately firm riskiness: stable and profitable companies will pay less, riskier ones will pay more. A sound risk assessment requires that SMEs provide information about their current situation and

¹⁰ Recommendation no 2003/361/EC, OJ L 124 of 20.5.2003.

¹¹ Review of capital requirements for banks and investment firms. Commission services consultation papers, 22 November 1999, 5 February 2001, 1 July 2003.

future prospects so that the banks can make a rating. In the long run the information requests will lead to a rating culture where SMEs perform structured business analysis and provide the banks with revenue and production forecasts, sector prospects, management succession plans, and other information. Banks will decide on the level of sophistication required of their rating systems balancing their complexity, feasibility and costs. Information requirements should be proportionate taking into account the size of exposure and the riskiness of the borrower.

The rating culture should be based on structured analysis, openness and communication. SMEs have to signal their creditworthiness, document their economic situation, present their planning concepts and balance sheets, regularly discuss credit standing and deliver timely information to the banks. For technology intensive companies, the rating system should include technology risk assessment (technology rating¹²) to enable potential investors to appraise the risks and rewards of investments in technology projects. By enabling companies' technology projects to be rated according to risk and reward, technology rating can increase confidence in the viability of such companies. Based on reviews of technology-rating tools, the Commission will, in cooperation with SMEs and financial institutions, look at ways to promote the use of such tools.

The Commission has organised several meetings of an expert group on the rating of SMEs to review how changes in bank behaviour are influencing bank lending to SMEs. Banks are anticipating the likely changes brought by the proposed new capital requirements. Such changes include the differentiation of SMEs' loan costs according to risk. Banks' capital requirements are only one factor affecting the new environment, and the expert group has also noted other changes in finance environment like new technologies, globalisation and the convergence of all financial services. Banks are increasingly competing internationally and only those that are solidly profitable can stay in the game in the long run.

From the point of an SME, the information requirements of banks and venture capitalists are becoming more similar and all enterprises need to pay increasing attention to their investor relations. The objectives, strategic plans and expected developments of the firm need to be presented to investors clearly and transparently in order to build long-term confidence in the company and its management. SMEs need tools and capabilities for planning and dealing with banks.

The Commission is working on establishing frameworks and spreading good practices that help firms in the new financial environment. To help companies in presenting comparable and reliable information, all listed companies will use International Accounting Standards and International Financial Reporting Standards from 2005 onwards¹³. The gradual adoption of these standards by SMEs will increase transparency and make it easier for banks and investors across borders to understand the information presented and to make comparisons. The Commission's Communication on enhancing corporate governance¹⁴ sets the framework for further action in this area.

To provide practical advice on how to deal with banks, the Commission is launching two actions that will take place in 2004 in the countries participating in the Multiannual programme. The first action is to draft a guide for SMEs on how to deal with banks and how to provide the information that the banks need in a rating environment. The second action is a series of seminars for SMEs and their organisations on the same subject.

¹² See the Communication on investing in research, COM(2003)226, 30.4.2003.

¹³ Regulation EC 1606/2002, OJ L243, 11.9.2002.

¹⁴ COM(2003)284, 21.5.2003.

In conclusion, the continued improvement of banks' rating systems has the potential to change the relationship between SMEs and banks. On one hand, rating systems will lead to an increasing price differentiation according to customer risk. On the other hand, banks will be able to process loan requests quickly and adopt a more structured approach to loan approvals. Consequently, banks would be in the position to communicate the results of their risk assessment to clients, and clients could use it as a starting point in improving their business strategy.

4.5. Guarantee instruments

The Council invited EIF to conduct an analysis in the field of risk-sharing schemes, and to reflect upon the setting-up of a guarantee system that facilitates fund raising. Loan guarantees allow the sharing of the borrower's credit risk between the lending bank and the guarantor.

As a part of preparing this report, all countries participating in the Multiannual Programme were invited to provide information about new risk sharing schemes. The results presented in the annex show Member States are very active in this field and some are developing new innovative ways of expanding their programmes. Thus there is a wide agreement on the benefits of loan guarantees, as they can give financial institutions incentives to lend to risky SMEs. Guarantee instruments are also a very efficient way to use limited public funds to achieve a high leverage effect and guarantee activities can be expanded through increased awareness at national and regional level.

The Commission launched in autumn 2003 a benchmarking project on guarantees to increase their visibility and to establish best practices. The project will carry out a survey of national administrations and guarantee institutions in order to establish the extent to which guarantee schemes are currently being used. The results of the survey will be used as a starting point for discussions in an expert group and the results of the survey and the discussions will be presented in a final report outlining the advantages and disadvantages of guarantee schemes.

It is necessary that all publicly supported guarantee schemes are consistent with the State aid rules laid down in the EC Treaty¹⁵ and in particular with the Commission notice on State aid to guarantee schemes¹⁶. Under this notice guarantees must be linked to a specific financial transaction undertaken by SMEs and must not cover more than 80% of the amount of each outstanding loan, and may not be granted to SMEs in financial difficulty. The terms of a guarantee scheme must be based on a risk assessment for granting the guarantee and the premiums must reflect such risk as well as the administrative costs of the scheme. The State aid rules give the Commission the power to assess guarantee schemes and it must grant authorisation before such schemes can be implemented. However, SME-oriented schemes where the aid amounts involved are small (less than €100 000 over a three-year period) are exempt from the authorisation requirement¹⁷.

4.6. EIF activities

The purpose of EIF's guarantee products is to provide effective support for SMEs by increasing the volume of bank lending to SMEs. Guarantees are particularly attractive in this respect for the public sector because they provide high leverage for public funds as lending

¹⁵ The State aid rules are laid down in Articles 87-89 of the EC Treaty.

¹⁶ Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C71, 11.03.2000, p. 14.

¹⁷ Commission Regulation (EC) No 69/2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid, OJ L10, 13.01.2001, p. 30.

can be expanded substantially through relatively small guarantee amounts. The lending banks also benefit from lower regulatory and economic capital.

EIF's status as a AAA-rated multilateral institution allows its financial intermediaries to have:

- Lower regulatory capital on assets guaranteed by the EIF;
- Expanded lending capacity and improved return on equity in their SME operations;
- Easier risk transfer to third party investors;
- Easier credit risk transfer to the capital markets through bond issuance guaranteed by EIF.

EIF addresses market failures and supports SME lending by managing programmes on behalf of the European Commission. These are called the EIF trust activities. The EIF's operations involving its own resources and risk, on the other hand, are always on a commercial basis, aiming at an adequate risk-adjusted return on equity for the Fund.

EIF intends to focus the SME Guarantee Facility activities on new markets and intermediaries, in particular in the accession countries, while extending its cooperation with current intermediaries in the European Union.

The key success factor in the implementation of the SME Guarantee Facility has been the ability to work with well-functioning existing programmes by adapting the Facility requirements to the specific market characteristics without imposing a fixed structure throughout the Union.

Likewise, EIF will seek cooperation with a wide range of financial institutions in the accession countries, including commercial banks, guarantee schemes, promotional banks and microcredit institutions. The possibility of cooperation with development banks and the EIF bank shareholders is currently being explored.

At the same time, EIF works in close cooperation with the services of the Commission to develop new programmes, as to ensure continuity in the availability of the European Community guarantee facilities. In this context, in addition to the existing guarantee products of the Multiannual Programme, a wider use of products enhancing loan securitisation could be explored because these products present high added value and high leverage effect on the available resources.

The EIF guarantees have developed from straightforward portfolio guarantees towards more sophisticated products such as credit default swaps and financial guarantees on asset-backed securities. This development is likely to continue, with a further shift towards structured finance transactions, which fit well with the limited underwriting capacity of the EIF. These transactions allow to transfer credit risk on large portfolios with limited guarantee commitments from EIF. It can therefore underwrite target risk profiles comparable or better than those covered in credit insurance transactions and achieve a much better diversification in its overall portfolio. Credit enhancement by securitisation has become the main product involving EIF's own risk, representing 74 % of guarantees signed in 2002.

Financial institutions will likely use more securitisation techniques to manage their portfolios, to diversify funding sources at attractive conditions, as well as to provide enhanced financial services to their customers. EIF has conducted a study on securitisation and sees its main role in securitisation transactions in supporting SMEs' access to debt finance by facilitating credit risk transfer from the originating banks to the capital markets. This is particularly important since the SME securitisation market is still in its early stage in

Europe as it is based on heterogeneous assets with a relatively long maturity. EIF also seeks to stimulate interest in asset-backed financing among stakeholders.

The proposed new capital requirement rules establish a regulatory framework for the capital treatment of banks' securitisation exposures. Banks will be permitted to rely on rating agencies to calculate the level of regulatory capital that they must hold against such exposures. This could make a positive contribution to the development of securitisation markets in the EU.

4.7. EIB global loans

The Council invited the European Investment Bank to direct its global loans more towards segments where market failures are significant and to make sure that EIB's financing efforts have an impact at the level of SMEs as well.

Under its statutes, the EIB seeks to enhance lending to SMEs located in less developed areas of the Union and regards the global loan mechanism as an essential tool for channelling funds to SMEs. EIB is a wholesale provider of capital market funds, but it reaches SMEs through a network of commercial banks.

The main advantage of EIB funding is the medium and long-term nature of the debt, which helps address some capital market weaknesses. EIB funding is advantageous also because it is at fine interest rates, thanks largely to EIB's AAA credit rating. This beneficial impact of EIB global loans may become even more important in the future, as commercial banks adapt to changing circumstances and concentrate on their most profitable lines of business. In some markets this might imply a reduction in SME lending. In the perspective of enlargement of the Union, term finance for SMEs may continue to be scarce in the new Member States, hence the importance of EIB's continuing role in that area.

A proper evaluation of the economic effectiveness of global loans cannot be achieved if restricted purely to a microeconomic approach, based on analyses of the SME beneficiaries. The most relevant aspect of global loans is the structural supply-side effect of having a systemic influence on both availability and pricing of term loans to SMEs. In this context, it is important that EIB cooperates with many banking intermediaries, including smaller and regional financial institutions. Diversification of intermediaries enhances competition by promoting the transfer of EIB's favourable lending terms to the final beneficiaries and contributes to a better coverage of beneficiaries, particularly at regional level.

EIB's global loans are also targeting specific EU policy objectives such as for SMEs in less developed areas, environmental improvements and energy saving, where the market availability of debt may be limited. Such dedicated global loans are often complementary to or in support of national or regional programmes aiming to address market weaknesses. The EIB's innovation initiatives¹⁸ support the target of investing 3 % of European GDP into research by investing in innovative and R&D oriented SMEs both in the mainstream and in the high technology sectors. The wider range of instruments and increased funds (€50 billion for 2003-2013) available for these investments signal the EIB's commitment to innovation financing. The EIB network of partner banks using the global loans can be an effective tool in signalling and in helping to implement EU policy.

In managing its global loans EIB continues to increase the number and spread of its financial intermediaries. A further policy focus is the increasing use of dedicated or specialised global loans for EU policy objectives and national and regional initiatives. Apart from facilitating

¹⁸ Innovation 2000 Initiative and Innovation 2010 Initiative.

the targeting of global loans at segments where market failures or weaknesses are significant, this will also increase the visibility and transparency of global loans.

EIB recognises the importance of transparency and draws the attention of intermediaries to ensuring that SME beneficiaries are aware of the EIB origin of the funds. Such SME awareness contributes to encouraging competition between intermediaries and to improving the impact of EIB's favourable financial conditions at the SME level. EIB gives full information of its partner banks and other intermediaries on its website.

5. EQUITY FINANCE

5.1. Market failures in risk capital

The Council invited EIF to focus action concerning risk capital on segments where market failures are most evident.

EIF seeks to support the emergence of a truly European venture capital market by providing appropriate financing to high-growth companies in their start-up, later-stage or development phases, by investing in early-stage, high-tech, regional and pan-European funds, traditionally the less developed segments in Europe. About 45% of EIF portfolio is composed of early-stage investments as opposed to 10% of the total European venture capital investments. EIF investments contribute to the development of sectors like biotechnology, converging technologies, new materials, ICT and nanotechnology. EIF aims to react flexibly to market needs, and to develop innovative financial instruments for achieving Community objectives.

The venture capital portfolio of EIF continued to expand from €2 billion in 2001 to €2.45 billion in 2002 despite the market downturn. EIF has contributed to financing about 15% of the total number of SMEs benefiting from early-stage investments in Europe since 1997¹⁹. The EIB Group is instrumental in closing Europe's technological and competitiveness gap.

The EIF total portfolio (including the EIF's own funds, and the EIB and Commission mandates) as of 1 September 2003 was:

	Portfolio	Number of funds or intermediaries	Number of SME beneficiaries
Venture capital	2.5bn	190	1800
Guarantees	5.5bn	118	more than 200 000

The increasingly balanced geographical spread of investments demonstrates EIF's commitment to promoting investments in southern Europe and in the accession and candidate countries where the risk capital markets are less developed.

EIF has extended its activities towards second round and later-stage financing in order better to meet market needs. This has reinforced EIF's presence in the SME financing cycle, which follows the goal set by the November 2002 Competitiveness Council that stressed the role of the EIB Group in financing innovation in the difficult market conditions. To counterbalance and mitigate the higher risk of its venture capital operations, EIF will seek a more balanced portfolio through investments in mid- and later stage SME-oriented private equity funds.

¹⁹ EVCA Yearbook 2003.

A stand-alone advisory unit, independent from EIF's investment activity, was established in late 2002 with the aim of providing advice in the field of financial engineering, principally related to SMEs. The advisory service contracts state that the provision of such services should not lead to an EIF involvement as investor or guarantor. The two first contracts were signed with the Instituto de Fomento de Andalucía (IFA) and the Gouvernement de Wallonie (Ministry of Economic Affairs). The first was for technical structuring of seed funds and microcredit operations and the second dealt with the general SME policy framework.

Although investments in SMEs focusing on innovation and R&D might require stronger participation of the public sector than currently is the case, it is important to point out that any government-backed action to deal with market failures must comply with the State aid rules of the treaty and specifically with the Commission communication on risk capital and State aid²⁰. According to the communication, Member States may adopt measures to provide or promote risk capital or equity financing to SMEs in their start-up or development phases. This can happen only provided such financing can be justified, for example, by an equity gap due to investor risk aversion, information asymmetry, difficulty to assess risk, or high transaction costs. At the same time, the communication aims to minimise distortions of competition in the internal market. It requires proportionality between public funds and the identified market failure, as well as state behaviour comparable to that of a private investor through profit-driven decisions, the involvement of private investors under the same conditions in the provision of risk capital, and appointment of independent management.

5.2. Good practices in training

The Council invited the Commission to encourage professionalism of the various players in the field of equity finance by identifying good practices in the field of public and private training. This is important as venture capital funds provide not only equity capital, but also managerial skills that are critical for the success of high-tech and knowledge-based start-ups. This combination of financial and managerial know-how sets high requirements for the staff of venture capital funds.

The background for the Council's request is the stock market boom of 1999-2000, when the prospect of high returns in the venture capital industry attracted fund managers who did not always have enough experience. The investments made were often short term and the investors did not have sufficient knowledge about the technologies and market potential of the supported start-up firms. The subsequent burst of the market bubble has led to a much more realistic operating environment and considerable consolidation of the industry has already taken place and this is likely to continue.

Although European financial institutions are well staffed with qualified finance professionals, finding persons that combine finance skills with entrepreneurial and specific sector and technological knowledge is difficult. One of the strengths of the Silicon Valley has been the easy flow of people between high-tech start-ups and venture capital funds. Such exchange of experience rarely happens in Europe, although informed and efficient venture capital operations would benefit from combined finance/technology expertise. In Europe, attention should focus on cooperation between venture capital funds and universities and research institutions that can provide expertise on specific areas.

To increase expertise in finance and in entrepreneurial and technical capabilities, training programmes are an alternative. Such training programmes should reflect both the acquired body of knowledge in the industry and its dynamic and changing nature in portfolio management, asset valuation, derivatives and quantitative analysis. The training courses of

²⁰

Commission communication on state aid and risk capital, OJ C235, 21.08.2001, p. 3.

EVCA, the European Venture Capital and Private Equity Association, are addressing these problems.

The venture capital industry itself is the primary source of information about its training needs. Based on the Council request, the Commission tried to launch a tender aiming to provide a clear view on existing training structures and to identify the needs of the industry. However, no offers were received, which indicated a lack of market interest in this topic.

5.3. Increasing the liquidity of capital markets

The Council invited the Commission to explore ways to increase liquidity of capital markets. Here, the primary task at European level is to establish a stable and harmonised framework of laws and regulations that allow the full development of markets. The Risk Capital Action Plan and the Financial Services Action Plan are the tools to achieve an environment that fosters the liquidity in European financial markets.

Liquid capital markets are essential for SME finance. In venture capital, investors need exit possibilities for their investments, and banks lending to SMEs need ways of increasing their lending and reducing risk through guarantees or securitisation. Liquidity would also be served by removing remaining obstacles from venture capital funds to operate across borders, eg. by creating an European fund structure as advocated by the Commission's Communication "Investing in research: an action plan for Europe"²¹.

The European Union will continue to build a single financial market to support growth and investment. Besides implementing framework legislation, identifying best practices and using the open method of cooperation, the Commission can be a catalyst in overcoming identified gaps in the markets for SME finance.

The efficient use of limited public funds and the need to work with markets preclude the use of grants in SME support. Experience has shown that SME finance can be increased without increasing bureaucracy for the beneficiaries by using venture capital investments and loan guarantees implemented through local financial intermediaries. These instruments should be focused on early-stage finance where the identified market gap is, and they should achieve sufficient volume to make a difference. Because new high-performance companies emerge in unexpected fields, the instruments should benefit SMEs in all sectors. Clarity of purpose and mechanisms also increase the visibility of European action.

To explore ways to further improve SMEs' access to finance, the Commission will launch a study on using asset-backed securities in enhancing SME lending. Such securitisation transactions allow banks to sell loans from their balance sheets to other investors and expand their lending capacity. The study will analyse the markets in Europe and compare them with other economies. The study will also assess the appropriateness of existing legislation and the role of the public sector action in using securitisation instruments in SME finance.

The Commission is committed to the long-term development of European venture capital markets, in particular early-stage venture finance. The new capital requirement rules concerning equity exposures are designed to enhance financial stability and to protect bank customers, including SMEs. In 2002, bank-related venture capital firms provided about 26% of the total venture capital in Europe and securitisation of SME lending is becoming an important tool for increasing liquidity in that market. The effects of the new capital requirement rules are the subject of a study being carried out on behalf of the Commission.

²¹ COM(2003)226, 30.4.2003.

6. CONCLUSIONS

6.1. Improving framework conditions

To efficiently promote entrepreneurship in Europe, there are three areas in SME finance where further European, national and regional public sector actions should be focused.

- (1) Improving the framework conditions;
- (2) Focusing on early-stage financing, in particular guarantees and microlending;
- (3) Increasing equity in SME balance sheets.

An entrepreneurial culture needs favourable framework conditions and the single European financial market facilitates entrepreneurs' access to finance. The completion of the Risk Capital Action Plan is a major achievement and completing the Financial Services Action Plan will lead to better availability of both bank lending and equity finance. These actions also improve the environment of entrepreneurs and mitigate the effects of the business cycle by creating confidence in the future.

Bank lending will remain the main source of outside financing for a large majority of SMEs and it needs to be promoted, in particular using loan guarantees. A specific concern is the low supply of credit to the private sector in the new Member States due to the perceived high risk. Here, capacity building in the banking sector is essential to overcome the short history of available data and experience. Furthermore, banks' lending capacity can in general be increased by developing securitisation to sell SME loans off from banks' balance sheets.

Member States and accession countries recognise the importance of SMEs' access to finance and have introduced measures that aim to improve the provision of guarantees for bank lending and risk capital investments in SMEs. Many have also introduced additional tax incentives for companies and investors.

In developing more targeted public sector action in SME finance, the need to use limited public funds efficiently and complying with the State aid rules of the Treaty set three conditions. First, public action should be limited to areas of clear market failure; second, it should work with the market mechanism to overcome the failure; and third, it should be implemented by market professionals.

There are two areas where targeted policies are needed, early stage finance and equity base of SMEs. First, the persistent gap in early-stage finance warrants direct public sector action and most Member States have specialised SME financing institutions to address this financing gap. Second, the public and private sectors need to work together to promote stronger equity base for European SMEs.

6.2. Focusing on early-stage finance, in particular guarantees and microlending

To achieve the Lisbon targets the public sector should continue to work with the private sector to overcome the persistent gap in early stage finance and to support the knowledge-based economy. To provide conditions for a broad-based growth and to foster R&D and innovation, both mainstream SMEs and entrepreneurial growth companies need national and European financial instruments expanding both bank lending and equity investments.

Easily and widely available national and European guarantee instruments that share risk between the private and public sectors do effectively address SMEs' difficulties in getting bank loans. From the SME viewpoint, simplicity and accessibility of guarantees mechanisms is a condition for their efficiency, and this can only be achieved by using national and local banks as intermediaries. The use of efficient and low-cost access technologies in accessing guarantees and bank loans should be encouraged.

Microfunding can provide entrepreneurs, mainstream SMEs and entrepreneurial growth companies with decisive help and it can be effectively promoted through guarantees and through improving the legal framework to facilitate fundraising and lending by microcredit institutions. Microfunding programmes should aim to be sustainable so that public sector support could gradually decrease. Cooperation between microfinance institutions and business support service providers should be encouraged.

The new rules on the regulatory capital requirements are designed to increase the soundness of the European banking system and they aim to align the calculation of regulatory capital charges more closely with banks' own economic processes and risk assessments. As the new rules will bring increased stability and competition to European financial services markets, they should confer benefits on SMEs and on European industry as a whole.

Banks have continued to develop their use of internal rating systems for their customers, including SMEs. This is consistent with the basis of the new capital requirements framework. Rating systems require structured information about the firm and its prospects, placing an obligation of analysis and transparency on the firm itself. Access to bank lending can be facilitated by helping SMEs to adjust to the wider use of ratings.

Entrepreneurs need information about financing alternatives and on how to approach different finance providers like banks, venture capitalists or business angels.

The use of national financial intermediaries and national programmes makes it possible for the Community financial instruments to be used flexibly, tailored to the different financing traditions providing additional leverage to programmes targeted at the financing gap in early stage SME finance. To achieve results and visibility for European financial instruments, they should be clearly focused on early-stage finance, have enough volume to be meaningful in an enlarged Europe, and they should not be sector specific but benefit all SMEs. The possible role of the public sector in enhancing the lending potential of banks through an increased use of securitisation of banks' SME lending portfolios should also be explored.

At national level, both the Member States and the SME financing institutions should regularly evaluate the efficiency and appropriateness of their financial instruments and adjust them as needed according to market demand.

6.3. Increasing equity

The needs of entrepreneurial growth companies and the general European SME sector are different, but both need stronger balance sheets with enough equity. Stronger equity base will also enhance the chances of SMEs by improving their risk rating. The sources for additional equity are retained earnings, informal risk capital investors, venture capital funds and institutions providing quasi-equity instruments like subordinated loans.

Entrepreneurial growth companies will produce most of European growth and employment. These firms need equity investments from business angels and venture capital funds in several financing rounds. For this reason the continuous development of venture capital markets is essential for the long-term competitiveness of the European economy, and all obstacles that hamper the functioning of the single financial market should be removed. European level participation through risk sharing provides venture capital funds focusing in early stage investments with credibility and ability to attract private funds.

Because business angels provide important advice and financing for innovative companies before they have access to the formal venture capital market, promoting the possibilities provided by business angels and business angel networks should continue to receive attention at regional, national and European level.

In the mainstream SMEs retained earnings are the best form of financing for growth and investment. However, retained earnings often suffer from unequal tax treatment and the Member States should review their fiscal arrangements taking into account the need to promote firm growth. Furthermore, experience shows that investments by informal risk investors like friends, family and business angels can effectively be promoted through tax breaks. The Member States and accession countries should likewise encourage the financial transparency of SMEs in order to promote confidence and good governance.

ANNEX

Overview of recent national actions in SME finance²²

Belgium

New initiatives in risk sharing

The federal level “Participatiefonds” is renewing and widening its products. The new “*Solidaire Lening*” microlending programme aims to finance individuals who wish to become self-employed but who can’t get starting capital. €1.24 million euros have been reserved for loans up to €12 000.

Several tax incentive schemes both for companies and individual persons have been introduced or are under discussion.

At regional level, the Walloon region has consolidated its SME financial support instruments to the new organisation “Sowalfin”. Its goal is to provide a variety of instruments like loans, guarantees and venture capital. Furthermore, “*Les bourses de préactivité*” provide grants of up to €15 500 for pre-seed and seed capital purposes.

The Walloon region is also supporting business angel networks. The region is thinking about introducing a SBIC-type fund system, and looking ways to coordinate better finance provision, to think about proximity finance and microloans.

The Brussels region has launched a social fund “*Brusoc*” aiming to encourage individuals to become self-employed.

The Flemish region’s “*Participatiemaatschappij Vlaanderen*” is setting up a centralised SME financing institution, “*KMO-Financieringsagentschap FIGARO*”. It will guarantee bank loans (75% public, 25% private risk) and aims also to activate risk capital provision to close the equity gap through “*ARKimedes-Fonds*”. These lend to or participate in venture capital funds with attractive market-oriented terms.

Dialogue between banks and SMEs

At federal level a working group consisting of representatives from different interest groups considered SMEs access to finance and presented its recommendations in a final report in February 2003. In Brussels, the “*Comité Bruxellois de Concentration Economique et Sociale*” combines representatives of social partners. In Flanders, a survey of SME financing has produced a list of concrete proposals for different stakeholders.

Denmark

New initiatives in risk sharing

The government is creating a €67.3m entrepreneurship fund aiming to close financing gaps in cooperation with private investors, who should invest at least 50 %.

The existing Danish Investment Fund uses equity, convertible loans, and loans with a profit component. It can invest either directly to companies or it can use venture capital funds. In 2002, it invested €39.7m directly and committed

²² For those Member States and other countries participating in the Multiannual Programme that answered the Commission information request in May 2003.

€37.7m to venture capital funds. Its loan guarantee scheme supporting bank lending to SMEs will be redesigned with relaxed participation rules. The scheme has guaranteed in total €135m of loans.

Tax initiatives have been introduced for investment funds and for employee stock options.

The government is continuing its support for loans and risk capital for pre-seed activities.

Dialogue between banks and SMEs

Several guides on how to access finance have been launched through private/public cooperation. The regional business service system also facilitates contacts between banks and SMEs.

Germany

New initiatives in risk sharing

The fusion of KfW and DtA and the concentration of SME instruments into the “KfW Mittelstandsbank” will lead to simplified instruments, will improve the supply of loans and will increase the importance of subordinated loans. Also guarantee systems will become more important. Guarantee schemes which have their costs covered by risk premiums will continue to be an important tool.

In venture capital, Germany is developing new SME instruments that aim to provide direct investments. KfW is running pilot projects in this area. The “BTU-Early Stage Financing Programme” provides risk capital for innovative start-ups.

The “pro mittelstand” initiative of the government will lower many taxes and other charges for start-ups and microenterprises.

Dialogue between banks and SMEs

A dialogue between the Ministry of Economy and Labour and banking organisations has been established in order to ensure SME financing.

Spain

New initiatives in risk sharing

A SME lending securitisation programme gives state guarantee for securities issued by investment vehicles. At least 80 % of the securitised lending has to be to SMEs and at least 80 % of the obtained funds have to be used for the same purpose. Over three years a total of 12 investment vehicles have used the programme for a total of €4.9bn of securities issued.

A new instrument has been introduced supporting technology-oriented SMEs. In 2002 the Ministry for Science and Technology has €24m to give 7-year non-interest bearing loans without guarantees to technology-oriented risk capital funds. The Ministry participates in profit sharing for investments.

The participation loans of the “Empresa Nacional de Innovación” have been amended with a similar technology-oriented subordinated loan programme of €24m (for 2003). The interest rate of these loans between €150 000 and €900 000 is determined by the profitability of the firm.

AXIS is a public risk capital investor who gets its capital the Instituto de Crédito Oficial (ICO) and the EIF. ICO offers also lending programmes, including innovation lending and microlending (set up with the MAP microlending guarantees), for SMEs accessible through financial

intermediaries.

Other SME support programmes target information technologies, innovation, research and industrial technologies.

Dialogue between banks and SMEs —

France

New initiatives in risk sharing

The creation of the “fonds d’investissement de proximité” is aimed at providing regional development through investments in SMEs. The funds combine profit and development objectives. Private investors in these funds benefit from tax incentives. These funds can also finance guarantee funds and mutual guarantee societies.

Tax incentives for individuals investing in unquoted companies have been increased and so has loss deductibility. Tax incentives have also been given to business angels.

The application of the usury rate concept has been removed from loans made for commercial or professional activities.

The risk sharing activities of SOFARIS are being reoriented towards small enterprises with less than 10 employees, paying particular attention to simple and rapid application process through local banks. SOFARIS guarantees usually 50 % of the loan but for start-ups this is 70 %.

The “Jeunes Entreprises Innovantes” project provides tax and social charge advantages for small enterprises that have investment projects.

Dialogue between banks and SMEs

Dialogue is usually conducted between credit institutions and SMEs, but wider consultations have been organised on eg. the proposed new capital adequacy rules.

Ireland

New initiatives in risk sharing

The “Business expansion scheme” has provided tax incentives since 1984 for private investors that invest in small and new companies in certain sectors for long-term. Total funds invested 1984-2003 were €1041m. The “Seed Capital Scheme” provides tax refund for individuals setting up their own business.

Enterprise Ireland has in 2002 decided to invest €95m into 12 new venture capital funds with a particular region and sector focus. Enterprise Ireland has also invested €9m in a regional fund focusing on export potential and €25m in a high-tech fund. It has established a database of business angels.

Dialogue between banks and SMEs

Department of Enterprise has had a round table from 2001, which has met six times.

Luxembourg

New initiatives in risk sharing

The government and the “Société Nationale de Crédit et d’Investissement” have introduced a new start-up loan scheme for new entrepreneurs and existing SMEs in the traditional sectors that fulfil certain conditions. The loan does not require collateral and can cover up to 40 % of investment needs.

Dialogue between banks and SMEs –

Netherlands

New initiatives in risk sharing The guarantee scheme has been modified to become more accessible for start-ups, including lengthening the definition of a start-up to under five years.

Dialogue between banks and SMEs –

Austria

New initiatives in risk sharing “Austria Wirtschaftsservice” (AWS) has introduced a “Gewinnwertpapier”, which is a long-term (at least 10 years) loan instrument to an SME. It gives the lender right to a share of the profits of the company and the capital is guaranteed by the AWS. So far 14 such securities have been issued.

The AWS is developing a “Double-Equity-Fonds” scheme, which will double the own capital of a new firm through guaranteed loan or venture capital participation (supported by the MAP SME Guarantee Facility).

AWS has relaunched its “Gründungbonus” scheme whereby the AWS gives a 14 % bonus to those saving for founding capital purposes.

At regional level, Styria has developed a “Venture Capital” action programme giving both a grant for advice and preparation, and at most €750 000 of risk capital. Lower Austria has set up “TecNet” fund investing start-up and early-stage minority shares in technology-oriented enterprises. Burgenland has set up a venture capital fund in the framework of Objective 1 regional funds.

Dialogue between banks and SMEs The AWS informs financial institutions regularly about developments in the SME field. At Federal level, the “Gründer-Round-Tables” bring together stakeholders that are relevant for setting up businesses, and similar initiatives exist also at regional level (eg. in lower Austria).

Finland

New initiatives in risk sharing The activities of the Finnish Industry Investment Ltd have been refocused on seed and start-up risk capital financing. In addition, the state-owned special financing institution FINNVERA has been given the right to do equity investments.

The Finnish National Fund for Research and Development (SITRA) has the task to develop tools for firm creation and investment readiness.

The government is thinking of tax and regulatory incentives for private investments in venture capital.

Dialogue between banks and SMEs —

Sweden

New initiatives in risk sharing To simplify and clarify its instruments, ALMI Business Partner has combined its three microloan products into one. Loans can be up to €27 000 with a

maturity of up to 6 years, with or without collateral. The interest rate is higher than normal interest rates of commercial banks so as not to crowd out private lending. ALMI has to cover all default losses with its interest income.

A new program supports mutual guarantee schemes through regional guarantee societies. Support is given to set up mutual guarantee societies and to provide information. So far about €325 000 has been used for this purpose.

The Swedish Business Development Agency (NUTEK) supports setting up regional business angel networks. Of the about 30 networks that are being set up, 17 have received grants. NUTEK itself acts as a network of networks and provides the networks with tools like handbooks and research. There is also a project aiming to activate female business angels.

The Innovation Centre Foundation (SIC) encourages in particular young and female inventors and has built a regional innovation system aiming to have one innovation office in every municipality.

Dialogue between banks and SMEs

—

United Kingdom

New initiatives in risk sharing

The UK government is a minority partner in eight regional venture capital funds that have been set up to cover the equity gap in venture capital investments up to €725 000.

The government is also participating with 50 % in the Community Development Venture Fund (Bridges Fund) which is operating in the most deprived areas of England and invests in businesses with good growth potential.

The “Early Growth Funding” programme is under development and targets start-ups with an average risk capital investment of €72 000.

Dialogue between banks and SMEs

The Small Business Investment Taskforce advises the Small Business Service in finance issues. It is composed of finance providers and users. In addition, the Ethnic Minority Business Forum represents the interests of ethnic minorities and has an access to finance subgroup.

Cyprus

New initiatives in risk sharing

The Ministry of Commerce, Industry and Tourism has introduced a loan guarantee scheme for manufacturing SMEs aiming to reorganise or expand. Under this scheme commercial banks lend to SMEs with an up to 100 % government guarantee for loans up to €169 000. The interest rate will be subsidised by up to 2 percentage points when rates are over 5 %.

Dialogue between banks and SMEs

—

Czech Republic

New initiatives in risk sharing

The Ministry of Industry and Trade runs a newly updated programme guaranteeing both loans and equity investments into SMEs.

Dialogue between

Representatives from all stakeholders are represented in the “National

banks and SMEs Discussion Group on SMEs” which participates in the formulation of SME policies.

Estonia

New initiatives in risk sharing The Estonian Credit and Export Guarantee Fund (KredEx) provides loan guarantees, leasing guarantees, and export guarantees through financial institutions. The KredEx guarantees are counter-guaranteed by the state. KredEx guarantees have allowed bank lending worth of €47.3m.

Enterprise Estonia implements the public SME support policies. It gives grants and advice for start-ups. The grant can be up to €6400.

Dialogue between banks and SMEs KredEx has organised several regional round table meetings that have improved understanding and have led to new bank products being launched.

Latvia

New initiatives in risk sharing The Mortgage and Land Bank of Latvia lending to SMEs is guaranteed by the state. The bank has lent €39m to SMEs, partially with subsidies. The bank will pay special attention to start-ups and microenterprises.

KfW and several Latvian banks are cooperating to lend under the EU Phare programme and its SME Finance Facility, having provided in total €71m of loans and €11m of grants.

The Ministry of Economics is planning to create a venture capital fund providing risk capital for SMEs. The Latvian Development Agency already has a fund called “Norway Latvia Business Development Fund” which has fully invested its capital of €2.4m in SMEs.

The “Latvian Guarantee Agency” is being reorganised into a limited liability company. It provides guarantees of up to 70 % for start-up lending.

Dialogue between banks and SMEs The “SME National Forum” is organised by the Mortgage and Land Bank of Latvia and the Ministry of Economics to enhance the dialogue between the government and SMEs.

Lithuania

New initiatives in risk sharing The government has established a guarantee institution called “INVEGA”, which provides guarantees of up to 80 % for investment lending to SMEs and up to 50 % for working capital lending. It also provides interest rate subsidies of up to half of the interest paid. For 2003, €8.7m has been reserved for guarantees.

Several banks are participating in Phare-financed SME Finance Facility programmes in cooperation with the EBRD and the KfW, one of which has a microlending programme. Three banks are also involved in other Phare-financed SME development projects. A separate programme targets women entrepreneurs and is supported by the Council of Europe Development Bank and the Nordic Investment Bank.

Dialogue between banks and SMEs Following the EU round table, a national round table of bankers and SMEs will be organised in the second half of 2003. In addition, a recent seminar discussed guarantee products for SMEs.

Malta

New initiatives in risk sharing The IPSE provides assistance to manufacturing sector restructuring, including partial loan guarantees and partially subsidised interest rate.

Dialogue between banks and SMEs –

Poland

New initiatives in risk sharing The loan and credit guarantee programme “Capital for the Entrepreneurial” seeks to establish a system of local and regional financial institutions (about 100 in all) to help SMEs to access finance. The government plans to allocate €9m to the programme. The local and regional funds are being set up and will provide loans up to €25 000 and guarantees for SMEs and entrepreneurs. The aim is to ensure simple loan availability, not to provide preferential terms. The participating institutions would be selected through a contest.

Dialogue between banks and SMEs –

Slovenia

New initiatives in risk sharing The priority is to overhaul the “Slovene Enterprise Fund” to better provide SMEs with a selection financial instruments, like loans with subsidised interest rates, loan guarantees and venture capital. In 1996-2002 the fund lent €87m worth of subsidised loans and invested €174m in SMEs. The fund is now introducing loans with grace periods and loan guarantees. Several SME support schemes exist at local and regional level.

Dialogue between banks and SMEs The Ministry of Economy has carried out a survey of bank services to SMEs and organised a dialogue on how to improve their services. A national round table has existed for four years and the Chamber of Commerce and Industry has also organised meetings between banks and SMEs.

Norway

New initiatives in risk sharing Although a comprehensive supply of financial instruments for SMEs exist (grants, loans, guarantees, equity investments), these have all been operational for several years.

Dialogue between banks and SMEs —

Bulgaria

New initiatives in risk sharing The Agency for Small and Medium-size Enterprises (ASME) and the Encouragement Bank have produced a plan that aims to establish a general credit guarantee scheme for SMEs. An existing microcredit guarantee scheme has guaranteed credits of €7.5m.

Several banks have lending programmes that target SMEs, including a cooperation programme with the KfW.

Dialogue between banks and SMEs —

Turkey

New initiatives in risk sharing

The Small and Medium Sized Industry Development organisation (KOSGEB) participates in the Credit Guarantee Fund of Turkey, which has guaranteed €36m of loans. The KOSGEB also participates in the Partnership to the SME Investments, which provides capital and advice for SMEs' investments. KOSEB also cooperates in providing low-interest loans to SMEs.

A Credit Guarantee Fund provides guarantees of up to 50 % for bank lending to SMEs. In addition, the Eximbank has a specific SME oriented export credit line. It is also obliged to direct 30 % of its export guarantees to SMEs and it provides interest rate subsidies for SMEs in underprivileged areas.

The Initiative Capital Investment Partnership aims to increase venture capital investments.

Dialogue between banks and SMEs

The Chamber of Commerce is organising regular meetings on SME issues. The banking sector and venture capital funds are also in contact on SME finance.