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Repayable Finance Options for Interreg Programmes: Financial Instruments Across Borders

-Draft Version-

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Section 1: Introduction

1.1 Objectives of the Paper

Between 2013 and 2014 INTERACT looked intensively at the potential for Interreg[1] projects to recover some part of *grants*[2] paid to *final recipients* by introducing *Repayable Finance* (RF) schemes[3] and *Financial Instruments* (FIs)[4].This work has included:

- Two INTERACT newsletters[5]highlighting the potential of RF/FIs for Interreg programmes and introducing a regional ERDF-based loan scheme from Ireland as a possible model for Interreg projects
- A background paper on *financial instruments* and their potential relevance for Interreg programme managers.[6]

This paper was developed during a project that took up the work done by INTERACT over the past two years, including the facilitation of workshops, study visits, interviews and the aforementioned articles/papers. The project additionally facilitated a series of interviews with Interreg MAs on the issue of RF in Interreg programmes, and culminated in a workshop in Brussels with experts and representatives from three Interreg MAs (CBC Spain-Portugal, CBC Grande Region, and CBC Germany-Netherlands). The workshop covered the following issues:

- Interests and needs of Interreg MAs in implementing RF schemes
- Differences between grants, repayable assistance and financial instruments
- Fit of RF schemes with Interreg programme structure, objectives and logic
- Challenges in developing a model of RF in Interreg framework

This paper aims to:

- Outline the relevant regulative background for RF Schemes under European Structural and Investment Funds (ESIF),
- Further examine the Irish loan scheme as a possible RF model, and
- Set out a route map for Managing Authorities (MA) interested in modernising their approach to include RF options.

[1] Note: For an explanation of the abbreviations used in this paper please refer to annex D.

[2]Note: Some of the financial terms used in this paper will be unfamiliar to Interreg stakeholders. Therefore we have provided a glossary in annex C of this paper. The terms explained in the glossary are highlighted in *cursive*.

[3] The term "RF schemes" is used in this paper as a collective term for aid schemes that offer financial means to specific target groups. This includes *financial instruments* and other forms of providing aid that is refundable by the *final recipient*; e.g., partly- or fully-reimbursable *grants*.

[4] FIs are currently known simply as *financial instruments* (FIs). FI will be the acronym used in the rest of this paper to refer to *financial (engineering) instruments*.

[5]http://admin.interact-eu.net/downloads/7686/Newsletter_INTERACT_Winter_2013_can_financial_instruments_be_successfully_implemented_in_European_Territorial_Cooperation_programmes_.pdf and

http://admin.interact-eu.net/downloads/8708/INTERACT_Newsletter_Spring_2014_Financing_the_Future_Web_Edition.pdf

[6]http://admin.interact-eu.net/downloads/8114/INTERACT_Draft_paper_FINANCIAL_INSTRUMENTS_IN_EUROPEAN_TERRITORIAL_COOPERATION_PROGRAMMES_2014_2020_06_2013.pdf

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The paper concludes with an outline model that with further work could be developed into a pilot initiative for Interreg programmes.

In the past programming period the area of RF under ESIF was divided into:

- *Financial Engineering Instruments* (FIs), which were implemented in dedicated fund structures managed by financial institutions, and focussed on leveraging private capital into ESIF interventions. The JEREMIE initiative is the best known activity in this regard.
- *Repayable Assistance* (RA) schemes, which were directly implemented by Managing Authorities (MAs) or public bodies to provide reimbursable *grants* and credit lines to *final recipients*. These schemes were less standardized than FIs and did not always involve a financial institution for management. RA is a *grant*, even if recoverable, thus expenditure eligibility rules are more specific than for FIs.

In the 2014-2020 programming period the regulation for FIs was streamlined. The regulatory background for RA schemes is currently under detailed consideration by the European Commission, and a new regulatory note developed by COESIF/EGESIF[7]is anticipated in early 2015. This will impact any future RF pilot implemented by Interreg Programmes that does not work within the FI regulation provided in the *Common Provisions Regulation* (CPR) for the 2014-2020 programming period. However, we believe that the fundamental logic of what we are suggesting in this paper will be consistent with the EU's forthcoming note.

Based on work done over the past years, INTERACT is optimistic that the Interreg programme's MAs should be capable of bringing forward RF schemes within their Interreg programmes. Some of the analysis included in this report may seem daunting. However, many national authorities have successfully introduced complex schemes involving *financial instruments*. Interreg MAs are used to having to operate in an even more complex environment than their national counterparts. This new strand is simply an opportunity to further develop their capabilities, project reach and impact.

Last but not least, this work and all the efforts made must be seen in the bigger context of the strategic political environment. The calls for doubling the share of the Financial Instruments in the Structural Funds may not be new, but the investment focus introduced by the Juncker Commission is already affecting the lower levels of policy implementation in terms of signals sent to the Member States and the Managing Authorities. Interreg may not be seen as the primary target of these efforts. Still, it is important that Interreg follows these developments, learns and dares to try out these tools. Standing on the sidelines may endanger its future, as the pressure to use these instruments will probably only increase.

1.2 Relevance of Repayable Finance for Interreg programmes

The potential relevance of RF for Interreg programmes is based on the following issues:

1) **Enhanced efficiency** – repaid funds can be used to fund future ERDF activities.
2) Repaid funds can be used to **match fund future projects**

[7]Coordination Committee for European Structural and Investment Funds and European Group of Experts in Structural and Investment Funds. These two bodies have replaced the Committee of the Coordination of Funds (COCOF).

3) **State Aid** can be reduced - Where RF replaces *grant*s State Aid is also reduced to private sector recipients; e.g., SMEs

4) **Private sector involvement** can be *leveraged* through their ability to lend against the prospect of beneficiary repayments. This can provide up-front investment, including match funding for ERDF, and also helps enforce commercial disciplines, potentially strengthening project management.

5) **Promoting innovation in a cross-border/transnational framework** is a key Interreg objective. Interreg programmes currently make very little use, if any, of RF mechanisms. To change this could be a major innovation.

6) By promoting *revenue* generation and the profitability of supported activities, Interreg programmes can achieve a **more sustainable impact.**

7) By drawing on expertise and know-how from national and regional authorities, financial institutions, intermediaries and *final recipients,* Interreg programmes will be increasing the internationalising of their own activities, building institutional capacity through international partnerships working with public and private actors.

8) The use of repayable financial products ranging from reimbursable *grants* through *loans* and *guarantees* to *equity* capital has the potential to increase financial support for important target groups that experience challenges otherwise in raising finance for international activities.

Any beneficiary will naturally prefer a *grant* to any form of RF. However, the key issue is not beneficiary preference but rather the impact of the programme as a whole. Money is always limited, as underlined by the recent financial crisis, and public bodies have a responsibility to use whatever finance is available to them as effectively as possible. Consequently, where *loans* or other forms of RF can be substituted for *grants* and thereby increase outcomes and outputs, this should be done.

The Irish scheme's beneficiaries took up the *loans* offered because their only realistic alternative was to not proceed with their projects. Beneficiaries will be disappointed to find that whereas in the past they had a *grant,* now they have to repay. But if they receive genuine value they will still participate. The key is to assess the value to the SME or other organisation of the service provided. For example, cheese manufacturers in a transnational programme were enabled to improve their product offering across Europe through the development of advanced technologies. On the basis that this has been a successful programme, the SMEs would possibly have agreed in advance to pay something in return for the tangible benefits realised.[8]

Section 2: Repayable Finance in ESIF

2.1 Introduction

EU Cohesion Policy via ESIF exists to support regional competitiveness and employment, and thereby to stimulate growth within the least developed regions of the European Union (EU). In support of this agenda, the *CPR* for the programming period 2007-2013[9] included provisions for the use of FIs to invest in enterprises, primarily SMEs (Article 44a), Urban Development (Article 44b), and Energy Efficiency and

[8]http://www.rfidjournal.com/articles/view?3558
[9]COM (2011) 615 Final

Renewable Energy in Buildings (Article44c). During the last programming period, national and regionally sponsored FIs developed markedly with a total of 940 loan, *guarantee*, *equity/venture capital* and other funds being reported to DG Regional and Urban Policy at the end of 2012. 92% account for FIs for enterprises, 6% for urban development projects, and less than 2% for funds for energy efficiency/ renewable energies[10].

2.2 Overview of Repayable Finance schemes in the 2007-2013 programming period

FIs were set-up in 25 Member States (i.e., all except Ireland and Luxembourg) and received financial support from 175 operational programmes. By the end of 2012, cohesion policy support for FIs for enterprises constituted EUR 10 billion of Operational Programme (OP) contributions, including EUR 7 billion of Structural Funds and EUR 3.5 billion of national public and private co-financing. The financial support was delivered to enterprises utilising a variety of financial products, including *loans*, *guarantees*, *equity/venture capital* investments and other financial products such as interest rate and *guarantee* fee subsidies.

There is no overview data available on the implementation of **repayable assistance schemes co-financed by Structural Funds** throughout the EU in the 2007-2014 programming period. A mapping exercise was initiated by the Commission in the preparation of amending the ESIF CPR on the issue of *repayable assistance*, reimbursable *grants* and credit lines in 2008 (see next chapter for details), but was not made public. Anecdotal evidence indicates that such schemes were implemented in many Member States; e.g., Germany, Ireland, Spain, Portugal and Slovenia. Most of these schemes were targeted at enterprises/SMEs. An example from Ireland is presented in more detail in section 4.

Cross-border or transnational financial engineering instruments with Structural Funds co-financing were not realised in the past programming period, with the exception of a cross-border cooperation programme investing ERDF resources in a cross-border/transnational *equity* investment fund (EUREFI, see chapter 3.3 for details).

Financial instruments that invest in more than one region/country are an option actively supported by the Commission for the ongoing programming period.
A recent example of a transnational financial engineering initiative is the **Baltic Innovation Fund (BIF)** managed by EIF and pooling national resources from the three Baltic States recycled from successful ERDF *financial engineering instruments*. The BIF reinvests these resources as a *fund of funds* into national *venture capital* vehicles. With a total volume of EUR 100 million (EUR 40 million of which is co-funding provided by EIB), the fund is a good example of leveraging and recycling ERDF resources multiple times to enhance the impact for (trans-)regional cohesion.

From an Interreg perspective, the example of the Baltic Innovation Fund shows that bigger FIs at transnational level can be created in a fund of funds[11] structure, if established national financial institutions join resources and pool them under the management of the EIF. Such a construction can *leverage* additional resources for the regions at the transnational level (additional co-financing by EIB) and the regional level (additional private investors in *venture capital* funds).

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[10]See: DG Regional and Urban Policy (2013): Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds.

[11] A fund of funds' role is not to make individual investments to the final beneficiaries but to set up smaller focussed funds based on geography, market category (e.g. renewable energy, biotech) or financial instrument (loan, equity, etc) that will make investments to SMEs

In the case of the Baltic Innovation Fund, the FI addresses a known lack of *venture capital* available to start-ups and SMEs in a multi-country region with similar national market situations and market sizes. This is not always the case in Interreg programme areas. Also, the Baltic Innovation Funds does not address transnational cooperation activities of *final recipients*. The specific VC funds that operate under the *fund of funds* have strict national investment focus.

Even though it does not include ERDF financing itself, the transnational *fund of funds* structure of the Baltic Innovation Funds could be seen as a model for Interreg programmes to set up a central fund structure at (cross-border/transnational) programme level, channelling financial resources into national/regional sub-funds for financing *final recipients*. Such an approach would need a sufficient volume of ERDF resources and co-funding (private and public) to be invested at the programme level, an involvement of financial institutions at both cross-border/transnational and national/regional level, and a market situation at national/regional level in which such an FI does not compete with existing financing offers for the chosen target group(s). In the proposed pilot approach for RF in Interreg, described in chapter 5 and 6 of this paper, a more "light touch" version of such a model is described.

The development of the Baltic Innovation Fund indicates that national financial institutions in Europe are looking closer into the options of transnational fund structures to realise economies of scale, especially in the field of *equity*. This might open up possible cooperation options for Interreg programmes to participate with more specific RF approaches that align with their specific objectives in the field of cross-border/transnational cooperation.

2.3 Lessons learned from ESIF MAs in the 2007-2013 programming period

A Stocktaking Exercise in 2013[12] reported that the main reasons reported by ESIF MAs for establishing FIs are their revolving nature and their ability to attract additional capital from financial institutions. FIs are considered to have been particularly valuable during the financial crisis, as mainstream banks dramatically reduced their support for SMEs whereas FI doors remained open. In doing this they delivered strongly against their market failure addressing rationale. The report also highlights ESIF MA experience/learning dealing with FIs in the past programming period that may be of interest to Interreg programme managers interested in developing RF schemes in the 2014-2020 programming period. The report contained some further lessons:

- The **lack of experience with any revolving instruments in the public sector** meant that the learning curve was steep and the required cultural change took time. It was necessary to find ways to reconcile the interests and views of numerous stakeholders before schemes could be implemented on the ground.
- ESIF Stakeholders often had firm views, **seeing grants as less complex and far easier to deliver** than revolving mechanisms, even when the latter is the best solution from a market perspective. This was a key challenge for realising RF schemes in ESIF during the past programming period, and it is now a key challenge in the context of the Interreg programme's *grant*-dominated world.
- Many FIs hit difficulties in **attracting the desired private sector co-investment**- one of the key benefits and a prime reason for establishing FIs. The issue of attracting suitable private sector *co-investment* is a challenge that Interreg programmes have to confront, especially if they plan to

[12]Mazars/Ecorys/EPRC (2013): Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period

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set-up fund-based instruments with higher capital volumes. Given these challenges, a simple RF scheme without private sector involvement at fund level is probably the best way forward for most Interreg MAs.

- Ex-ante (advance) market assessments are necessary to the design of any new FI, including size of fund, target sectors, projects and products. These are now compulsory for all ESIF-based FIs, Interreg included, so Interreg programmes should decide early on how to prepare such assessments. Simple RF schemes that do not qualify as FIs (e.g., *reimbursable grants*) are not subject to the same rigorous requirements as FI. However, a well-researched market appraisal is always to be recommended for any scheme if it is to be well-focussed and effective once implemented.
- Some MAs experienced challenges in the implementation of FIs where their *investment strategy* was focused on too small a target group. This can happen when the target regions do not have sufficient critical mass to carry the costs of an FI. Some responded by changing their products or broadening investment criteria. It is very helpful to build in the flexibility to modify financial products so as to respond proactively to changing economic circumstances, such as during the current Europe-wide recession. Such flexibility is similarly important in piloting RF options in Interreg. Most programmes have at best only limited knowledge about how to proceed with RF schemes, and it will be a great advantage to be able to change the scope in the light of experience.

2.4 Regulation of FIs in the 2014-2020 programming period - state of play

The regulation of FIs was revised and streamlined by the EU for the programming period 2014-2020. In the following part of the paper, the most relevant changes in the regulative framework with regard to an implementation of RF schemes in an Interreg framework are presented.

Scope of activities/implementation options

By way of contrast with the 2007-2013 programming period, the regulation of FIs for 2014-2020 does not exclude specific sectors, beneficiaries/*final recipients*, types of projects and activities. Member States and MAs may use *financial instruments* in relation to all thematic objectives covered by OPs and for all ESI Funds, where it is efficient and effective to do so. FIs can now be implemented (see *CPR*, Art.38for reference):

- as part of Union level FIs, managed directly or indirectly by the Commission (*CPR*, Art 38(1)(a))
- at national, regional level, transnational or cross-border level(*CPR*, Art 38(1)(b))
- as tailor-made or „off-the-shelf „set-ups (*CPR*, Art.38(3)
- as a fund structure, implemented by EIB or other suitable financial institutions/bodies (*CPR*, Art.38(4)(b))
- as a *loan/guarantee* scheme implemented directly by the MA (*CPR*, Art.38(4)(c))

This last point is of special interest for Interreg programme stakeholders, as it addresses the possibility to implement FIs in a “light touch” way, allowing piloting of *loan/guarantee* schemes even in areas like cross-border/transnational cooperation, where the market situation is yet unclear, institutionalised private co-financing is not (yet) an option, and only a limited number of interventions can be expected.

Following the regulation for RA in the past programming period[13], which allowed MAs to *co-finance* RF schemes in the form of a) reimbursable *grants*, or b) credit lines managed by the MA through *intermediate bodies* (IBs) which are public financial institutions, the new *CPR* allows MAs to implement FIs themselves (or via an IB) at national/regional, transnational or cross-border level, if they consist solely of providing *loans* or *guarantees*. In such cases, there is no advance payment of ERDF resources in a fund structure. Instead, payment of ERDF resources follows a *grant* model; e.g., implementing MAs will be reimbursed on the basis of the actual *loans* provided or *guarantee* amounts committed for new *loans*, and without the possibility to charge management costs or fees under the FI operation. These can, however, be covered under the programme's technical assistance.

The regulations for implementing reimbursable *grants* as part of RF schemes are still somewhat unclear. DG Regional and Urban Policy communicated that there will be a Guidance Note from COESIF-EGESIF on the matter, but we are already receiving signals that there will in general be a stricter interpretation on what is classified as an FI, falling under regulation following *CPR*, Art 37.

Based on this situation, this paper proposes that Interreg MAs focus on piloting "light touch" FI schemes regulated under *CPR*, Art.38(4)(c) (see chapter 5 for more details).

Ex-ante market assessment

The new regulation features specific rules for the assessment of market gaps and needs in the preparation of FIs. FIs must be designed on the basis of a formal ex-ante assessment. The assessment encompasses the following elements (see *CPR*, Art. 37(2) for reference):

- Analysis of market failures, suboptimal investment situations and investment needs;
- Assessment of the value-added element of the FI;
- Estimate of additional public and private resources to be potentially raised by the FI;
- Assessment of lessons learnt from similar instruments and ex-ante assessment carried out in the past;
- Proposed *investment strategy*;
- Specification of expected results;
- Arrangements for the ex-ante assessment to be reviewed and updated.

Such an ex-ante assessment helps avoid overlaps and inconsistencies between funding instruments implemented by different actors at different levels. This is especially relevant if FIs are implemented to operate in cross-border/transnational contexts (see chapter 5.5 for details on how to approach market assessments in an Interreg framework), since Interreg programme stakeholders need to carefully consider under which conditions even "light touch" FIs fit into the market situation in their programme areas:

- There must be potential for the project beneficiaries to benefit from the project to the extent that they are willing and able to repay a *loan/grant*
- They need to find a 'niche' of financial service provision that is:
    a) not already covered by mainstream financial institutions and existing national/regional FIs and
    b) addressing economically-viable activities of a cross-border/transnational cooperation character.

[13] See Regulation EC 1310/2011, amending Council Regulation EC 1083/2006 as regards repayable assistance

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A preparatory study on FI implementation facilitated by the Cross-border Cooperation (CBC) programme Germany/Netherlands[14] on these issues highlighted that there are options available, but many in rather risky market segments with unclear market outlook; e.g., internationalisation of SMEs, cross-border innovation processes or joint ventures. In Interreg frameworks there may therefore be more cases where a *grant* and *loan* combination may be the most appropriate approach, as opposed to a *grant* on the one side and a commercially-priced *loan* on the other.

This option was more feasible in the past programming period with *repayable assistance* (reimbursable *grants* and credit lines) as a distinctive type of ESIF intervention regulated by the *CPR* (Art.43a-b). However, we understand that this option is likely to cease to be available as an ESIF intervention type of its own. The option of directly-managed credit lines is already part of the FI regulation (Art. CPR, Art.38(4)(c) see above), while a detailed regulation on reimbursable *grants* is still forthcoming.

Based on this situation, Interreg MAs would do well to think in terms of RF schemes that will be part *grant* and part *loan* scheme, and to be prepared to produce a formal ex-ante market assessment before implementing such a scheme. The key aspects of preparing a suitable market assessment in the process of setting up an RF pilot scheme in the context of Interreg programmes are presented in chapter 5.4.

Usage of capital resource reflows and gains in FIs

Under the new *CPR* the rules for dealing with capital resource *reflows* and gains in FIs were streamlined (*CPR*, Art.43-45). In FIs *reflows* can occur **prior to investment in final recipients**, if a fund structure is chosen into which ESIF resources are paid in advance, generating interest or other gains. These *reflows* are to be used for the same purposes as the initial EU contribution within the eligibility period.

The EU share of *reflows* from **investments in final recipients** are to be used during the eligibility period for further investment in the same or other instruments, in line with the specific objectives set out under a priority in the OP. In the case of fund structures, the *reflows* can also be used for the preferential remuneration of investors operating under the market economy investor principle and providing *co-investment* at the level of *financial instrument* or *final recipient* and management costs/fees.

In general, repaid capital resources, gains and other earnings attributable to the EU contributions to FIs are to be used in line with the aims of the OP for a period of at least 8 years after the eligibility date.

For Interreg programmes, these rules indicates that the time frame for the thematic commitment of the EU part of repaid resources within an RF scheme's operation is much longer than the normal project duration in Interreg projects. Therefore it seems advisable for Interreg programmes to implement RF schemes in an organisational setting that allows them to offer the financial products over a longer period of time, and to combine them with standard Interreg projects that address the same target group. In chapter 5.8 a proposal for a suitable organisational structure for an RF pilot scheme in a CBC programme is presented.

Co-financing

Significant additional flexibility has been introduced by the new framework whereby national public and private co-financing contributions may be provided at the level of the FI or at the level of the investment in the final recipient (*CPR*, Art.38 (9)). So co-financing does not have to be paid upfront but may be

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[14] The study was not published officially and is only available in German. It was forwarded to the authors of this study. Interreg stakeholders interested in the results of the study should contact the Ministry of Economics in North Rhine-Westphalia.

provided at later stages of *financial instrument* implementation. In many FI projects a private contribution will be present and is encouraged to increase *leverage* (it may also be required by State Aid rules). The interviews with Interreg MAs in the preparation of this paper indicated that it might be very challenging for Interreg programmes to include private co-financing in their pilot RF schemes, due to the cross-border/transnational nature of the instruments and the unclear market demands. Therefore this paper proposes a focus on match funding by public co-financing as a first step (see chapter 5.7 for more details).

Reporting

The new framework requires MAs to send to the Commission **a specific report on operations comprising financial instruments,** as an annex to the annual implementation report (*CPR*, Art.46). Based on these reports the Commission will provide summaries of data collected.

Eligibility of expenditure

Generally, eligibility rules for FIs are much simpler than for the provision of *grants*. Expenditure that is eligible at the closure of the project/FI (see *CPR*, Art.42 for reference) is mainly the payments to *final recipients* (for example, *loans* actually disbursed) and management costs and fees. In cases in which the FI is implemented directly by the MA, management costs are not eligible as part of the instrument's budget. Where FIs are combined with *grants* (see *CPR*, Art.37 (7) and (8) for reference), the provisions of the relevant article for *grants* apply to the *grant* part.

State Aid[15]

For FIs, State Aid regulations have to be complied for all actors involved in implementing the instrument: MA, *fund of funds* manager and *financial intermediary* implementing specific funds. Aid provision needs to be considered at different levels: the *fund manager* (who is remunerated), the private investor (who is co-investing and may receive aid) and the *final recipient*. In general, *repayable finance* gives MAs more flexibility in State Aid provision to *final recipients* than do *grant* schemes, as the amount of State Aid provided is considerably lower (only the difference to market conditions for similar financial products). The complexity of the applicable State Aid regulations differs for the different financial products provided by FIs. Most *loan* schemes for SMEs can be covered by *de-minimis* or Block Exemption Regulation. For cross-border/transnational RF schemes the same State Aid regulation applies as for *grant* provision to SMEs in ETC programmes (see chapter 3.6). For an example on how to deal with State Aid in the case of an RF pilot scheme in a CBC programme, see chapter 5.9.

Technical Assistance

With regard to covering preparatory activities for the set-up and implementation of FIs (market assessment studies, development of investment strategies and business plan, negotiations with financial institutions, etc.), there are two types of TA budget available for MAs. On the one hand, this is the TA budget foreseen in the specific programme[16]. On the other hand, there are specific Commission resources available for horizontal and bilateral support of MAs setting up FIs. Since the European Commission anticipates a wider use of *financial instruments* in the 2014-2020 programming period, the focus and nature of the Commission funded TA programmes have been adjusted accordingly. A new **Technical Advisory Platform for Financial Instruments (FI-TAP - http://www.fi-compass.eu/)** has been established to support MAs and project sponsors in designing and implementing FIs. Most interesting for Interreg MAs in this regards is the **multi-region strand** which aims to support MAs and financial institutions from different countries in developing

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[15] The State Aid rules of the EU are currently in the process of modernisation. The recent status quo can be found here: http://ec.europa.eu/competition/state_aid/modernisation/index_en.html

[16] In Interreg programmes this amounts to around 7% of total programme budget and is mostly used for covering the overhead costs of managing the programme.

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joined FIs for pilot implementations[17]. Upon request, representatives of the Commission told the authors that the upcoming project calls within this strand will mostly target ESIF Goal 1 MAs. They were not rejecting the idea of supporting a pilot by Interreg MAs. INTERACT is in contact with the Commission in order to ensure that Interreg is not forgotten in this strategic development.

[17] See http://www.fin-en.eu/files/5014/0965/3781/Documento3.pdf and http://www.fi-compass.eu/

Section 3: Main challenges for Interreg programmes to develop Repayable Finance schemes

3.1 Introduction

Despite the promotion of the benefits of RF schemes within Interreg Programmes over the past two years by INTERACT, the European Commission, the European Investment Fund and others, evidence of significant uptake is still missing. This lack of progress can mainly be linked to the unclear situation regarding feasible models for implementation of RF schemes in a cross-border/transnational programme's framework. Despite this situation, INTERACT reports that Interreg programme managers are aware that broader public private partnerships are essential to stimulating private sector activity in their programme areas, and a change of mindset is necessary to open up for private sector partners, capital and innovation. The authors of this paper share this view and are convinced that piloting RF schemes can be a catalyst for these developments.

An exploratory survey of Interreg programme stakeholders during the course of developing this paper showed that some Cross-border Cooperation (CBC) programmes are actively looking into setting up pilot *financial instruments* or other forms of RF schemes at the moment. Other Interreg programmes have considered the option for the 2014-2020 programming period but decided to wait until a broader knowledge base for the implementation of RF schemes in Interreg is available. So it can be stated that a lot of questions remain to be answered before any activity will happen in the 2014-2020 programming period. This situation is comparable to the situation for ESIF MAs during the beginning of the past programming period, when FIs under ESIF were beginning to become more widespread[18].

3.2 Lessons learned from past Interreg projects

In the past programming period only one Interreg programme involved an RF activity that qualified as an FI scheme (EUREFI INTERREG, see below). Other projects set out to develop cross-border/transnational FI schemes but failed to achieve their objectives. An example of one of these is the JOSEFIN project, details of which are provided in this section.

EUREFI INTERREG

EUREFI is a cross-border/transnational *venture capital* "*fund of funds*"[19]set up to invest *equity* capital into SMEs that during their expansion or start-up phase have the potential to operate in more than one country. It was managed by a Luxembourg-based fund management company called "Europe et Croissance Sàrl". It also provides advisory services to the SMEs in which it invests, helping with strategy development and business planning, and by providing non-executive director input at Board level.

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[18] The stocktaking exercise in Mazars/Ecorys/EPRC (2013) reports that delays in establishing FIs in the past programming period were attributed by MAs to the 'newness' of FIs and how the EU regulatory framework is more suited to grant funding rather than more market-orientated repayable instruments. They also highlighted a lack of clarity with regard to regulations including State Aid, and legal and commercial complexities.

[19] A fund of funds' role is not to make individual investments to the final beneficiaries but to set up smaller focussed funds based on geography, market category (e.g. renewable energy, biotech) or financial instrument (loan, equity, etc) that will make investments to SMEs

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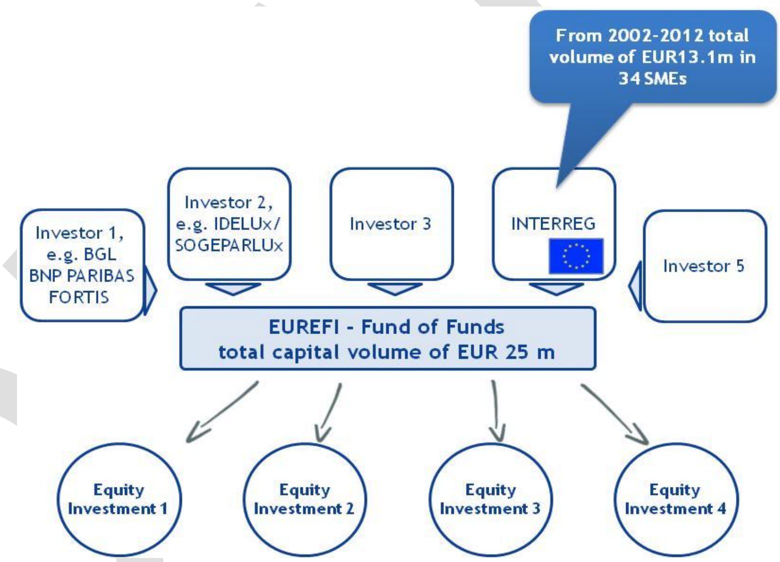
The EUREFI managers are highly experienced in cross-border/transnational business, which is attractive expertise for small companies wanting to succeed in the European market. Up to 2011, EUREFI invested around EUR 25M in Luxembourg and the adjoining regions in Belgium and France. The fund was *co-financed* by private capital actors (e.g., BNP Paribas Forte, BGL) as well as public institutions and local development agencies. By the end of 2011 EUREFI had invested in 29 SMEs. During 2011 it invested a total amount of EUR 2.451 M in 7 enterprises. The smallest investment was EUR 24K, the biggest EUR 830K. Between 2008 and 2009, at the time of the world financial crisis, the fund lost substantial value (EUR 1.65M.) after years of growth. Based on information from the *fund manager*, around 80 – 90% of the investment since 2002 was successful, and only 10-15% of companies failed. The companies come from very different sectors, with trading companies comprising the largest share (18.9%), followed by metal production (15.9%), automotive (13.5%) b2b services (12.9%) and other investment funds (10.5%).

The EUREFI Interreg project was initialized by the CBC programme Wallonie-Lorraine-Luxembourg during the programming period 2000-2006, and was continued by the CBC programme Grande Region during the programming period 2007-2013.The project invested ERDF resources of the CBC programme alongside other co-investors into a specific EUREFI Interreg fund. CBC Grande Region did not carry out any gap analysis/ex-ante assessment before the two investment rounds. The following graph gives an overview of the *fund of fund* structure of EUREFI.

Figure 1:EUREFI – Fund and investment structure



Source: evers&jung

During the first phase (2002-2008) the EUREFI INTERREG fund supported 28 SMEs with a total volume of EUR 11.6 million. During the second phase (2009-2012) the CBC Grande Region programme invested EUR 1.2 million ERDF into a fund with a total capital volume of EUR 4 million. Between 2009 and 2012 the fund made 6 start-up or growth investments with a total volume of EUR 1.47 million. The EUREFI INTERREG fund was closed in 2012 due to a lack of demand for *equity* capital in the target regions. It seems that the whole EUREFI fund had a crisis regarding its *investment strategy* (including selection criteria for finding suitable investment cases) in 2012, and needed to rethink the business model. Causes mentioned by the management in interviews with INTERACT were the impact of the financial crisis, as well as major business development trends in new information and communication technologies. Unused funds were returned to the CBC Grande Region Programme.

The cross-border cooperation element in EUREFI INTERREG project operated on two levels:

1) Fund level, with the establishment of co-financing by *financial intermediaries* from Luxembourg France and Belgium and
2) Final beneficiary level, with investments in companies that carry out their activities across borders.

Although the fund ultimately closed, valuable lessons can be drawn for Interreg programme stakeholders from the EUREFI project:

- Successful management of a cross-border/transnational VC fund depends on **specific knowledge**, e.g., a good understanding of the legal environment, the market and the financing landscape/banking culture in all countries covered.
- This knowledge, as well as operational skills, can be delivered by an experienced fund management with a suitable track record in the provision of *equity* capital to the target groups of SMEs.
- *Fund managers* of transnational funds are interested in accessing additional capital from public sources, like Interreg programmes, although the administrative burdens and reporting issues involved are challenging for their day-to-day work.
- From the viewpoint of Interreg MAs, the delegation of programme resources to an externally-managed *fund of funds* is less burdensome than setting up a specific fund by themselves. However, it limits/shields it from influencing day to day decisions (e.g., selection process of companies, conditions of investments, etc.).
- The alignment with the programme's specific objectives is difficult, if the Interreg programme is only one investor of many that provide resources into a *fund of funds* structure. Also, there is less direct interaction between MA and financial institutions compared to a specific fund or an RF scheme implemented directly by the MA, limiting the option for building up lasting partnerships.
- The success of such a project depends on the skills of the investment managers in selecting local finance and delivery partners (for the sub-funds), and ultimately in delivering successful SME investments.
- Information on market situation and outlook needs to be included when the decision to invest programme's resources into a fund is made. In the ongoing programming period this has to be based on a detailed ex-ante assessment.

Besides the EUREFI INTERREG project, only a few other Interreg projects could be identified that address the issue of piloting RF schemes in a cross-border/transnational environment. One of these projects was the JOSEFIN project.

JOSEFIN - Joint SME Finance for Innovation
JOSEFIN is an illustration of the difficulties that can be encountered when initiating a new transnational *financial instrument* within an Interreg project. JOSEFIN (2009-2012) was realised as part of the Baltic Sea Region programme. The partnership included 24 institutions from different countries in the Baltic Sea Region: Germany, Poland, Lithuania, Latvia, Estonia, Sweden and Norway under the Lead Partnership of Investitionsbank Berlin (the public promotional bank of the Federal State of Berlin). The partnership comprised publicly-owned *financial intermediaries* and banks, regional administrations (with responsibility for SME support measures and/or innovation), and public agencies for regional development, innovation management or similar tasks. The project aimed at piloting a combination of innovative *guarantee* instruments (innovation *loan* guaranties) alongside business coaching. The *loan guarantees* were originally planned to be based on a transnational *guarantee* fund to be backed by a counter-*guarantee* from the Competitiveness and Innovation Framework Programme (CIP) and to be used by the financial institutions that were partners in the project.

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Ultimately it proved to be impossible to establish such a transnational *guarantee* fund under CIP/EIF rules at that time. Nevertheless, the project was successful in initiating or developing regional and national level *guarantee* mechanisms in all participating regions, with the exception of Norway's Oslo Capital region. The project was also successful in facilitating the cooperation of three regional financial institutions within Germany to successfully apply for a CIP counter-*guarantee* for innovation *loans*. The project included a detailed market analysis on the access to finance situation for innovative SMEs and support to internationalisation of SMEs' business in the participating regions. It showed a low take up of commercial banks that are reluctant to provide *loans* to SMEs, especially in the case of innovation or international activities.

From the perspective of Interreg programme stakeholders, the JOSEFIN project can be seen as a good example of the opportunities and limits in preparing cross-border/transnational FIs within the framework of traditional *grant*-based Interreg projects. Interreg projects like JOSEFIN can help with the preparatory work needed to set up more complex FIs in a transnational framework, by bringing together a critical mass of national or regional financial institutions and piloting a cooperation framework with regional support agencies that need to be involved in ultimately delivering the financial products.

Since experience with RF in Interreg is limited, it is helpful to identify the most important challenges that Interreg programmes encounter and to consider them in a little detail. From the combined experience accumulated during this study, including JOSEFIN, EUREFI, our stakeholder interviews and the EU stocktaking studies, we have identified the following **central challenges**. We take these points one by one in the following sections of this chapter:

- The need for a change of mindset of Interreg programme stakeholders, especially at MA/Joint Technical Secretariat (JTS) level[20]
- Additional know-how and skills required at MA/JTS level
- Dealing with the lengthy setup process of FIs
- The need to clearly demonstrate transnational/cross-border added-value
- Lack of previous market/private sector focus within Interreg programmes.

3.3 Change of mindset of Interreg programme stakeholders

The most profound challenge for Interreg programme stakeholders is the needed change of mindset. The preparation of RF schemes requires a very different approach than the traditional *grant*-based project interventions Interreg programmes are used to. Most organisations are resistant to change, and MAs/JTs are no exception. Gradually the pressure will build in the form of reduced funding, and greater demands on what is available will encourage innovative thinking. "Necessity is the mother of invention" and forward-thinking stakeholders will want to get ahead of the curve, developing new methods of operating before circumstances force the situation.
Stakeholders will have to get their heads around the way that these new products will work, and to find innovative and perhaps unexpected areas in which they suddenly become valuable. They will need to

[20] The MC members should not be forgotten, though, as ultimately they will need to feel secure with this implementation method.

understand the way that the private sector operates. The private sector will always be looking for profit, for example, and sound project structures will be needed to ensure that the profit motive is used for the benefit of the final beneficiaries rather than simply pouring into the coffers of the private providers of expertise and capital. The use of RF pilots on a small scale, as presented in chapter 5, can be a way for Interreg programme stakeholders to learn, and to make mistakes whilst keeping the consequences of failure within reasonable bounds.

3.4 Know-how and skills needed

The know-how and skills needed to set-up and implement a *financial instrument* to finance market actors differ from the skill set in a programme framework that deals exclusively with *grant*-based funding. While some activities are comparable; e.g., the analysis of durability with regard to the beneficiary, in the latter case the focus is on controlling the eligibility of supported activities at the closure of funded projects. The management and controlling of RF instruments is more demanding with regard to the decisions that need to be taken in the process of providing and retrieving RF. The following points are especially relevant:

- An assessment of the market for repayable products requires an understanding of how the finance industry works. Both the demand side (who will take up the products) and the supply side (existing players in the market) must be taken into account.
- The performance of any repayable fund depends on the quality of assessment processes. Assessing the ability and commitment of businesses to repay a *loan* is very different from assessing a business for a *grant*.
- Appointing non-expert assessors is a false economy. *Grant* assessors may have some of the skills required for RF and it may be possible to strengthen or extend their skills. However, it is vital to recognise that the more complex the instrument, whether *loan*, *guarantee*, *mezzanine* or *equity*, the more expert the analyst must be. Failure to recognise this can result in substantial losses, including the potential failure of the project.
- Placing investments means there will be an on-going relationship with the business at least until the *loan* is repaid, shares sold or redeemed, etc. The higher the risk, the more closely the investment will need to be monitored.
- In addition to taking decisions on individual investments, funds have to consider the balance of risk within the portfolio as a whole. Too much reliance on one type of business, or industry, or size of business can increase the overall portfolio risk. This requires skilful and expert management.
- MAs will be dealing directly with profit-driven finance intermediaries and capital providers. They need to become expert in understanding their motivations and ensuring that they are focussed on achieving the MAs' objectives. Goal congruence is essential.

3.5 Dealing with the design and set-up process of FIs

Although the process of setting up FIs has been streamlined by the European Commission in the forthcoming programming period, it can still be a lengthy procedure. Interreg programme stakeholders can deal with this by choosing an implementation option that is less complex; e.g., the setting up of a simple *loan* and *grant* scheme that is directly managed by the MA. It also seems advisable to involve committed financial institutions early on in the process to be able to delegate preparatory activities to them, learning from their financial engineering expertise in the process. A step-by-step explanation of the preparation

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and design/set-up process to introduce an RF pilot scheme in an Interreg programme is provided in chapter 5.
Whilst complex, many other ESIF programmes have operated FI schemes for many years now. Since others have done this and have a track record, MAs with a determination to implement even the most complex FIs will be able to secure the expertise to implement new Interreg FI schemes and, subject only to the availability of funds and a positive market assessment, will be able to do this.

3.6 Cross-border/transnational context

The cross-border/transnational nature and objectives of Interreg programmes sets additional challenges for realising RF schemes. The new ESIF framework allows FIs to be implemented at cross-border or transnational level. The example of the Baltic Innovation Fund (see chapter 2.2) shows that a *fund of funds* structure allows a pooling (and leveraging) of national resources at transnational level, to deliver financial products back at national level.
Based on the feedback of Interreg MAs in a workshop during the preparation of this paper and the commitment of Interreg programmes to focus on supporting cross-border/transnational activities, there are some issues that need to be taken into account when Interreg programmes decide to prepare such schemes:

- It is particularly important to identify the **cross-border/transnational character of the financed activity at final beneficiaries' level**. This comes down to identifying target groups and market situations that both qualify as being subject to market failure or suboptimal investment situations, and that add to territorial cohesion by way of intensifying cross-border/transnational exchange. This includes the financing of internationalisation of SMEs, the funding of cross-border/transnational cooperation between SMEs and research institutions for developing innovative products and services, and the financing of cross-border/transnational joint-ventures.
- When Interreg MAs are implementing RF schemes directly or via financial institutions, the **different national regulations regarding the provision of financial services and products** in the relevant countries need to be taken into account. For example, in Germany only licensed financial institutions are allowed to provide *loans*, while in the UK there is no such limitation. There might also be differences in the regulation of public organisations investing national co-financing in *financial instruments*. A recent analysis commissioned by the Germany-Netherlands CBC programme indicates a possible new regulatory limit for Dutch authorities investing national public resources in *financial instruments*.
- The application of **State Aid rules**; e.g., the *de-minimis* scheme for financial products with a *grant* equivalent under EUR 200 000, needs to be adapted to the cross-border/transnational frameworks Interreg programmes operate in. Interreg programmes that already involve SMEs as beneficiaries (see below) have to deal with these issues already. In the past programming period *de-minimis* was the common option for allocating Interreg funds that are considered State Aid. During 2014-2020 Interreg programmes will possibly be in a position to provide *de-minimis* aid in addition to any *de-minimis* an SME receives from another country, as long as the SME is not located in the same country as the MA of the relevant programme. This should help simplify State Aid considerations when certain Interreg beneficiaries are also recipients of nationally-funded programmes.

3.7 SMEs as (final) beneficiaries of Interreg programmes

Not all programmes allow SMEs to participate as beneficiaries. If they do they can include SMEs to:

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- Cooperate in Interreg projects in a non-economic/social way. In this case the SMEs can receive programme funds under the same conditions as all other (non-private) beneficiaries and the *grant* allocated to them is not State Aid.
- Carry out economic activities within Interreg projects, in which case they will be in receipt of State Aid under the relevant scheme, generally *de-minimis* or *General Block Exemption Regulation*.

A recent report by INTERACT on the involvement of SMEs in Interreg programmes[21]stated that in the 2007-2014 programming period only 55% of ETC programmes treated SMEs as eligible to receive ERDF support. Among those programmes open to SMEs, 22% of projects financed include SMEs as beneficiaries. When all Interreg programmes are taken into account, less than 10% of all Interreg programmes across the EU involved SMEs, and overall SMEs represent 4.4% of all beneficiaries (i.e., public and private legal entities) financed by Interreg programmes. It is necessary, therefore, that Interreg programmes interested in developing RF schemes to finance SMEs as final beneficiaries allow them to be eligible as beneficiaries.

Many of the **challenges in involving SMEs as beneficiaries** carrying out economic activities in Interreg projects can be reduced if the SMEs are included as final beneficiaries of RF schemes. Especially the stated reluctance of SMEs to participate in Interreg-funded projects due to heavy administrative and time-intensive procedures and required pre-financing can be reduced by offering financial products like repayable *grants* or *loans*. *Financial instruments* offer MAs simpler eligibility processes with lower administrative burdens for the final beneficiaries/SMEs. They also provide a way to address an issue with *revenues* generated by SMEs. This is also a challenge in standard *grant*-based Interreg projects where *revenue*s must be deducted from ERDF support, whereas FI mechanisms allow for repayments by beneficiaries to be collected and reused within the same, subsequent or alternative programme.

3.8 A way forward for Interreg programmes in the 2014-2020 programming period

The insights gained in the preparation of this paper indicate that the presented challenges for Interreg programmes in their way towards the implementation of RF schemes can be most readily addressed through an easy to use "light touch" model of RF. The model will fit within an Interreg programming logic and project structure, will include a *loan* element, and will also deliver cross border/transnational outputs. Because it does not include private investment at the fund level and because it is limited to a simple 0% interest *loan,* the financial know-how and skills required will be less than for more sophisticated mechanisms, and therefore easier for the MA to appreciate and manage.

In the rest of this paper we set out this simple RF model scheme as an “aunt Sally”[22]. Our thinking is that it can be used as an aid discussion with the Commission and MA partners. It may be that difficulties are found with the model, as suggested. However, we believe that working together with our partners can be used as a springboard towards a model that will be both theoretically and practically sound. We trust that it will be a first step towards many future RF/FI Interreg projects.

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[21] http://admin.interact-eu.net/downloads/8322/INTERACT_Publication_Involvement_of_SMEs_in_ETC_programmes_Achievements_Future_Perspectives.pdf

[22] “i.e. a person or thing set up as an easy target for criticism.”

Section 4:A model of a "light touch RF scheme" as a blueprint for Interreg programmes

4.1 Introduction

In the light of the challenging situation that Interreg MAs face when they look at implementing RF schemes in their programmes' frameworks, it seems advisable to condense the available options in the field of ESIF-funded FIs into a "light touch model" that empowers Interreg programmes to pilot RF in a setting that allows:

- A manageable learning curve for the involved Interreg stakeholders (MAs, JTS) regarding know-how and skills
- Direct control for MAs in terms of alignment to programme's policies and objectives
- Flexibility in terms of market approach (target groups, addressed market gap) and cross-border/transnational aspects (level of cooperation at final beneficiaries level)
- Low level of regulation (cost management, eligibility rules, State Aid)
- Working with simple financial engineering mechanisms
- Clear presentation of financial streams (co-financing, repayments, legacy issues)

With the scheme: "Micro-Enterprise – Innovation and Entrepreneurship", implemented in 2007-2013 in the framework of two regional ERDF OPs in Ireland (S&E and BMW Regions[23]), INTERACT identified in its newsletter from spring 2014 an intervention model that is a potential blueprint for such a light touch RF approach in Interreg. The following chapter introduces the scheme and considers how it may be used as a blueprint.

4.2 How the Irish model works

General set-up/history

The scheme is jointly financed by the ERDF and the Irish public sector. It is overseen by Enterprise Ireland's (EI) Central Co-ordination Unit and until recently was operated by 35 City and County Enterprise Boards (CEBs). It had a total volume of EUR 15 million in the 2007-2013 programming period under Priority Axis "Innovation, ICT and Knowledge Economy" Measure 1. In 2014, following a Government decision, the CEBs were disbanded and the responsibilities transferred to EI. In future, local delivery of the micro scheme will be through 31 Local Enterprise Offices (LEO Network).

Enterprise Ireland is an Irish national organisation that supports initiation, growth and development of Irish SMEs, including the coordination of *micro enterprise* activities in Ireland. They have 31 Local Enterprise Offices focused on *micro enterprise* development. The Micro Enterprise Policy Unit of the Department of Enterprise, Trade and Employment has overall responsibility for *micro enterprise* development.

[23] South and Eastern (S&E) Region – Limerick, Carolow, Clare, Cork, Dublin, Kerry, Kildare, Kilkenny, Meath, Pipperary, Waterford, Wexford, Wicklow.Border, Midan and Western (BMW) Region – Cavan, Donegal, Galway, Laois, Leitrim, Longford, Louth, Mayo, Monaghan, Offaly, Roscommon, Sligo and Westmeath.

The scheme is an example of a simple repayable assistance scheme that is in part *grant* and in part an interest-free *loan*.

Originally, the scheme offered two products:

- Partly-refundable *grants* (with a *loan* element repayable over 3-5 years, interest free or at a highly preferential rate)
- *Equity* in the form of preferred shares

During the 2007-2013 programming period the option of offering preferred shares was dropped, to make the model simpler and more focused.

The model targets established *microenterprises* which are defined by the European Commission as companies with less than 10 employees.

Intervention logic ("philosophy")

The core philosophy behind the scheme is that available funds must be used more efficiently. The Irish Government's logic is that if money is repaid it can be used to make further *grant* investments. So from a *grant* scheme that averages EUR 30 000 per case, and if it had EUR 3 000 000 available, 100 *grants* would be possible. However, if 30% is repaid then the additional EUR 1 000 000 can be recycled to make an additional 33 loans. In due course 30% of this will be also returned, meaning more loans again. So the original 100 cases supported ultimately becomes 142, while the 30% repayment generates 42% of additional activity.

In the 1980s most enterprise support in Ireland from the EU was based on grants. Gradually this has reduced over the years, especially with the introduction of the JEREMIE initiative, starting in 2006, financial engineering instruments with EU funds have become more widely used in place of *grants*. At the same time, funds available for Ireland from the EU have begun to shrink.

Specifically, the Irish Government took the decision that 30% of funds available for the *micro enterprise* facility should be repaid. Historically they have required LEOs to recover 30%[24], although they have not been prescriptive as to whether this translates into 30% of each grant being repayable or a mix of some repayable at higher rates, some lower and some not at all. Each LEO has decided its own policy at this level.

The Irish approach can be considered an interesting and significant innovation in the field of RF/RA. As a principle, public funds should clearly be used as efficiently as possible. The Irish scheme appears to point to a way of achieving this on the basis of the simple logic that scarce funds can be made to go further, helping more businesses and generally delivering higher outputs than conventional grant schemes. This simple logic makes the Irish Government's approach more progressive than regions that focus on *grant* alone. Whilst the introduction of repayment of part or all of what would otherwise be a 100% *grant* will not always be the appropriate method – there may be a disincentive effect for the recipient - it is common sense that the reverse will also apply and that such a disincentive may not exist. The authors of this paper

[24] To achieve this rate after non-recoverable debt write-off it would be necessary to set the rate above 30% unless future recycling is taken into account, in which case the target may be achievable with a lower recovery rate for each loan advanced; the actual level will depend on the level of bad debt write-off.

share with INTERACT the hope that by highlighting the potential of reimbursable *grants* and interest-free *loans* for supporting SMEs and start-ups in a repayable way, this paper will encourage experimentation with this idea in the Interreg framework, evaluate the results of such trials, and share findings to facilitate EU-wide learning.

EU Regulation

In the past programming period the Irish model did not need to comply with formal obligations for *Financial Engineering Instruments* laid down in Art 44 of the *CPR* (EC 1083/2006). Instead, it was regulated as a *repayable assistance* scheme by Regulation EC 1310/2011, amending Council Regulation EC 1083/2006 (see chapter 2.4 for details of this regulation).

In accordance with this Regulation, repayments received from repayable *grants* are paid into separate bank accounts managed by the individual LEOs, and disregarded for the purpose of subsequent expenditure declarations. Grant awards subsequently funded from these repaid/recycled amounts must respect the same EU rules and regulations on eligibility, publicity, etc.

The implementation plan for the scheme in the OPs provided that a portion of the *grant* assistance issued can be in repayable form, in certain circumstances. Each individual LEO is required by Enterprise Ireland to ensure that a minimum portion of their total budget in this measure is issued in repayable form (the minimum specified for 2007-2013 programming period was 30%).This requirement applies to *grants* approved, whether funded from the Exchequer grant or from the refundable aid account. LEOs are required to actively monitor and manage the approval of *grants* throughout the year to ensure that the maximum requirement of 30% is met. LEOs have the flexibility to decide how to meet the overall requirement.

During the 2014-2020 programming period the classification of the Irish model as a repayable assistance scheme may change, as the Commission announced that there will be a new regulatory base for repayable assistance, treating schemes that were defined as “credit lines” under Regulation EC 1310/2011 as financial instruments, and changing the regulation of reimbursable *grants*. Forms of RA are treated distinctly from FIs in Article 66-69 of the Common Provisions Regulation (EU) 1303/2013 and are referred to in the preamble to the regulation (62,63).

Financial products

This section includes some details of the Irish scheme in outline only, but with more detail on one product, the priming (start-up) *grant* (Measure 1 Funding), by way of illustration. Further information is available on the websites of individual Local Enterprise Offices[25].

In the past programming period the scheme (Measure 1 Funding) offered two different types of *grants* with repayable elements to micro enterprises:

- Priming grants
- Business expansion grants

The following is an extract relating to priming grants from the South Cork Local Enterprise Office website:

"A Priming Grant is a business start-up grant, available to micro enterprises within the first 18 months of start-up. "Priming grants may be available for sole traders, partnerships, community groups or limited companies that fulfil the following criteria:

- Located within the LEO's geographic area
- A business which on growth may or may not fit the Enterprise Ireland portfolio
- A business employing up to 10 employees
- A manufacturing or internationally-traded service business
- A domestically-traded service business with the potential to trade internationally
- A domestically traded service being established by a female returning to the workforce, or unemployed persons where the potential for deadweight and displacement does not exist."

"The maximum Priming Grant payable shall be 50% of the investment or EUR 150 000 whichever is the lesser. Grants over EUR 80 000 and up to EUR 150 000 shall be the exception and shall only apply in the case of projects that clearly demonstrate a potential to graduate to Enterprise Ireland and/or to export internationally.

"In all other cases, the maximum grant shall be 50% of the investment or EUR 80 000 whichever is the lesser. A percentage of any grant assistance will be in refundable form at the discretion of the LEO.

"Subject to the 50% limit, a maximum grant of EUR 15 000 per full time job created shall apply in respect of any employment support granted."

"LEOs can assist in the establishment, and/or development, of new and existing enterprises from individuals/sole traders, companies and community groups subject to the following eligibility criteria:

- The enterprise must be in the commercial sphere
- The enterprise must demonstrate a market for the product/service
- The enterprise must have a capacity for growth and new job creation
- The enterprise must not employ more than 10 people."

[25] E.g. https://www.localenterprise.ie/SouthCork/Financial-Supports/

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Loan Profile

Terms vary between different LEOs, and some LEOs may offer different terms for different products. The following information relating to *grant* investments in Kilkenny is publicly available information[26]:

- Maximum EUR 150 000 per company
- 24 grants approved 2012, value EUR 513 000
- Range in 2012 EUR 4 333 to EUR 66 313
- Average EUR 21 000
- Part repayable years 3-7(Grace period for the first 2 years)
- Interest free

Financial management

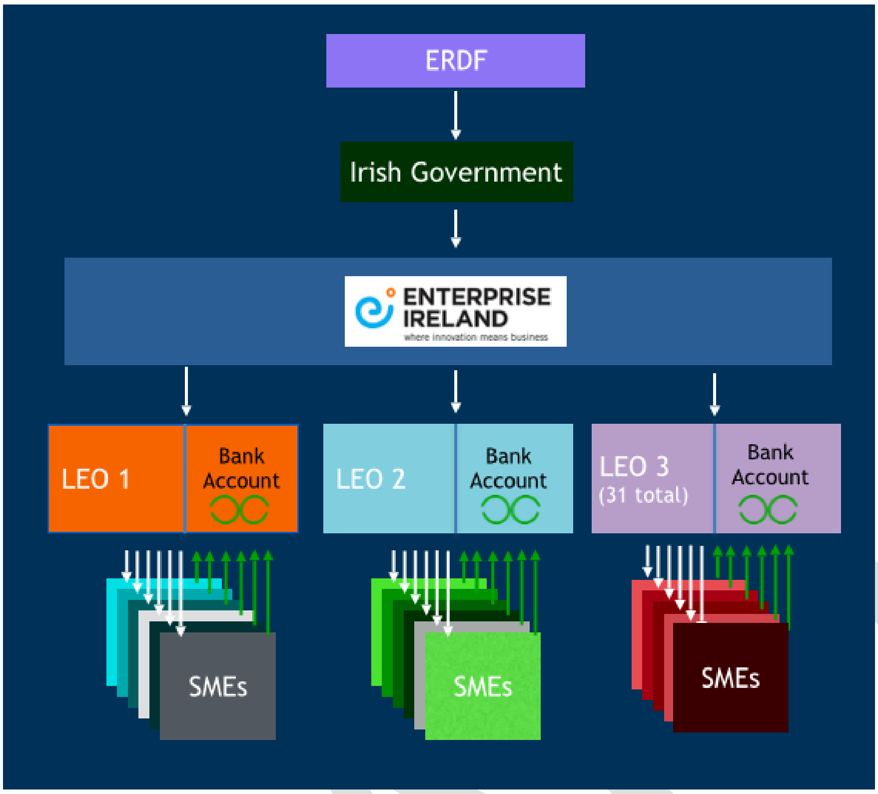
The ownership of the individual refundable aid balances has historically resided within each individual LEO. Separate bank accounts are maintained for all refundable aid repayments and from which funds are issued to make new *grant* investments. LEOs are under instruction to disburse the balances in their refundable aid accounts on an on-going basis, and may not allow the build-up of balances beyond those necessary to meet known commitments. These balances can only be used to fund business projects/activities in accordance with the criteria that apply to support under Measure 1 of the OP (Priming and Expansion Grant Investments), and must meet the evaluation criteria and limitations applicable to Measure 1. The value of outstanding repayments at each year-end is noted in the accounts, as are amounts written off, as due to be repaid but non-recoverable.

The only income that must be deducted from a declaration of EU-eligible public expenditure by a LEO is the bank interest earned on the refundable aid (repayable aid) account, and no other income need be deducted from either *grants* paid from the Measure 1 account or the refundable aid (repayable aid) account. Income received in respect of debtors' interest and loan fees is not deducted from declared co-financed expenditure, provided it is used to invest in qualifying SMEs in the same programme area. This is subject to the approval of the Regional OP Managing Authorities and the ERDF Certifying Authority, and may be subject to an amendment to the National Eligibility Rules (Circular 16/2008).

The inserted chart shows how funds flow from the EU and Irish Public Sector to Enterprise Ireland, from that organisation to the local delivery units, and from them to micro enterprises. The repayable elements of grants are repaid into separate bank accounts, recycled and used again to make grants to SMEs.

[26] Kilkenny county Enterprise Board Annual Report and Financial Statements 2012

Figure 2: Overview of Irish repayable grant model's structure



Source: Ampersand

Co-financing

The *co-financing* partners are the Irish Government through the local enterprise vote of the Department of Enterprise Trade and Employment, and the EU Commission through the ERDF allocation to the BMW and S&E Regional Operational Programmes.

Management

In delivering to beneficiaries, the LEOs use their own in-house staff members to appraise and monitor grants. Originally a third party deliverer was engaged. However, following a review it was decided to use the LEO network's own staff.

LEOs comprise, on average, a professional staff complement of 4. A Chief Executive Officer, Assistant CEO, Business Advisor and an Administrative Support person. Expertise in supporting client companies and promoting and developing entrepreneurship at local level exists within LEOs. The CEO, ACEO and Business Advisor positions involve client inter-facing roles, and the holders of these posts normally possess a relevant third level qualification and experience.

Enterprise Ireland (EI) considers that for them and for this scheme the use of in-house managers is more effective than the alternative use of third-party project managers. The only third-party costs incurred are for tendered experts; e.g., mentors and trainers. In the following quote, Martin Corry of Enterprise Ireland highlights the skills needed and nurtured within the scheme.

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"Training people to analyse enterprises is very much about training people to understand business. That is why in Ireland we have involved excellent business analysts and evaluators who have helped us build a training programme for public sector staff. Through this programme our staffs have become skilled commercial analysts with full confidence to take sound business decisions about each application for repayable assistance."[27]

Others may wish to follow EI's example in operating schemes in-house or by using third-party contractors. Practice is likely to vary on this point, depending on the circumstances of each region/organisation[28].

Selection/appraisal of final beneficiaries

The LEO Network pursues a systematic appraisal of all project proposals. An overriding requirement is the avoidance of duplication, *displacement* or *deadweight*. Each LEO has an evaluation panel in place, comprised of public and private sector personnel, which adjudicates on projects submitted at local level.

The key selection criteria are national guidelines, and include the following:

- the quality of the project proposal and its local relevance;
- the commercial viability of the project proposal;
- overall funding proposals for the project;
- the cost effectiveness of the project proposal;
- the contribution of the proposal to the development of the enterprise in terms of internal capacity;
- potential for *deadweight* or *displacement*;
- potential to increase the competitiveness of the enterprise and added value to local enterprise development; and
- adherence to cross cutting themes.

In addition, the assessment of the economic viability of the investment takes into account all of the sources of income of the enterprises concerned.

Dealing with defaults/write-offs

As for every repayable finance scheme, EI has to deal with situations where companies are not repaying. There is no standardized procedure for LEOs when a company defaults on an agreed repayment instalment. Different recovery methods are possible. When the company cannot afford to repay at all and the company is liquidated, the outstanding amount is written off. The LEOs have the possibility to initiate a recovery process, but this is not mandatory and the decision is at the discretion of the LEO. The written off amounts in the scheme are dealt with like a lost *grant*. Based on the available data, the write-offs in the scheme appear to be low compared to *default* rates in unsecured *loan* funds. This indicates that the screening/appraisal process of the scheme works well in selecting beneficiaries with a robust ability to repay the repayment part of the grants. *Final recipients* may also benefit from the range of management supports and mentoring services facilitated by LEOS.

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[27] Martin Corry, Business Development Manager, HPSU Validation and Micro Enterprise Ireland, Enterprise Ireland

[28] Few Goal 1 MA's implementing FI approached by INTERACT pointed out to the importance of competence of financial institutions in this respect. They may even possess a credit history of some potential beneficiaries, which is an important part of 'capacity to repay' assessment.

Monitoring arrangements

Monitoring arrangements operate at three levels:

- At the level of the individual enterprises that are the recipients of repayable assistance it is the responsibility of the relevant LEO to monitor the progress of the enterprise and to ensure an orderly exit from the investment in due course.
- The activity of each LEO is monitored by the LEO Central Coordination Unit within Enterprise Ireland. This includes monitoring of the activities and compliances of the LEOs with the operating rules applicable to repayable assistance (as set out in business plan), and ensuring that all reported expenditure is eligible and has been duly incurred in approved activities. For this, Enterprise Ireland has a specific fund management and control system, including audit trail and spot checks. Movements in the repayment account and decisions taken with regard to those accounts must be transparent and reported.
- The outcomes and results of the *micro enterprise* themes, including the repayable assistance element, are monitored by the Regional Operational Programme Monitoring Committees using a suite of performance indicators that define the expected outputs and results of the overall interventions undertaken by the LEOs.

4.3 Lessons learned by Enterprise Ireland in implementing the scheme

Martin Corry of Enterprise Ireland (EI) has highlighted the following lessons learned in operating the Micro Enterprise Repayable Assistance Scheme29:

- A **clear and consistent philosophical basis for the change** needs to be shared by the main decision makers in the programme, including the institutions involved, and translated into overall policy objectives. There will be resistance from sceptics who do not want change. EIs approach has itself come about as a direct consequence of a change in mood in Brussels and in the Irish exchequer.
- The best way of popularising the transition from *grants* to repayable elements is to have a **pilot scheme** with a manageable funding volume to test the general approach, develop it and convince people with actual results. It is advisable to create this pilot as a joint initiative between public and private sector partners.
- **Skilled, experienced and independent staff** must take the investment decisions. This applies whether analysts are employed in-house or sub-contracted.
- Project and investment approval mechanisms should take account of both public policy and commercial considerations. A **public-private partnership** is therefore desirable with an investment committee, comprising of, for example, a combination of municipality, local businessmen, local bankers, etc. It should include the flexibility to take into account local or regional as well as national conditions.
- Using public institutions and their resources for managing and delivering the scheme, especially in the pilot stage, may make it easier for the public authorities to **control the development and outcomes**. Sub-contracting to third-party members can follow at a later stage, as appropriate.

[29] These are Martin Corry's personal views; it should not be assumed that they are endorsed by the writers of this report.

- **Simplicity of scheme design** facilitates the transition from *grants* to *repayable finance* elements. This applies to the financial products offered, as well as behind-the-scenes organisation. Revolving funds must be separately managed from grant funds.
- Public money is a scarce and valuable resource. Only projects with the potential for **economic impact** should be supported.
- Only projects with a **viable business case** should receive support, including an assessment of ability to pay.
- Systems must be in place to ensure an **appropriate balance** between safeguarding funds and stimulating entrepreneurial activity.
- **Be flexible** and look at each company individually. Consider allowing local discretion over interest charged, level and timing of repayment, depending on the business, sector, etc.
- Once you have established a successful pilot, make sure to **communicate** it as **good practice** and follow it up with more resources.

4.4 Differences in the framework conditions for the Irish scheme and Interreg programmes

There are some important differences in the setting of the presented Irish model and Interreg programmes that need to be taken into consideration in the development of a blueprint for repayable finance in Interreg:

- The Irish scheme operates at the national/regional level, not at cross-border/transnational level as Interreg programmes. This has implications for the organisation of the selection process and *grant/loan* provision, as well as the level of required cross-border/transnational cooperation of final beneficiaries.
- To secure Interreg funding, projects must involve international collaboration rather than simply address local needs. Inevitably, Interreg projects will be more complex than a "vanilla" Irish type scheme delivered by international partners. (see chapter 5 for more details)
- Some EU countries have strict banking regulation (e.g., France, Germany), limiting the provision of financial products by non-banks in Interreg programmes covering these countries.
- Established networks of regional enterprise that support agencies like the Irish LEOs/LEOs are not available in all EU countries. In an Interreg programme region this might be the case for the regions in one country but maybe not for the others.
- In some EU countries the availability of ERDF co-funded FIs/FIs at the national/regional level is well developed already. This makes it harder for Interreg programmes that cover these countries to identify a suitable market segment of enterprise finance/support with clear market failure/gaps.

4.5 Success factors for a replication as a light touch Repayable Finance scheme in Interreg

The following specific success factors have been identified during this study. We have included those that appear to be of particular importance in designing future Interreg repayable finance schemes. In the interests of relevance and brevity we have not included here good practice points that would apply generically to any ERDF-funded project:

- The eligibility rules for Interreg programmes must provide for repayable *grants* and *loans*.

- Interreg programme stakeholders must be committed to initiate the change from *grants* to repayable forms of finance.
- Implementation is likely to be easier in programme areas that feature similar regional market conditions with regard to enterprise development and access to finance. Potentially, CBC programmes have an advantage over transnational programmes in view of their having geographical borders in common. Also, potential partner organisations are more likely to be more culturally alike in CBC programme areas, compared with those in transnational programme areas.
- A sound initial market and needs analysis is essential, identifying potential target groups and economic conditions.
- The project must include a market need for business activities with a clear international element.
- The pilot scheme follows a simple approach, offering one financial product for a specific target group:
    - The target group should be start-ups/enterprises/*SMEs* with a viable business case and a sound economic outlook.
    - The financial product should be very simple, like a *grant* with a flexible repayable element attracting no interest.
- The pilot is managed directly by Interreg programme stakeholders at the scheme level and by established public partner organisations with access to the target group at the regional level to provide the *grants*/*loans*.
- Management/operational costs are minimised using standard tendering mechanisms.
- The programme design involves securing appropriately qualified and experienced staff. *Grant* and *loan* analysts have overlapping skills but they are not identical.

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Section 5: A Guideline for Interreg MAs to proceed towards piloting Repayable Finance schemes

5.1 Introduction

In its first chapters this paper presented the main framework conditions for Interreg programmes that plan to introduce RF schemes, examples of such schemes in the ESIF context, and an overview of the opportunities and challenges that Interreg MAs face when they decide to use revolving funds in their programme's activities. Based on this, we suggest two main (non-exclusive) implementation options for Interreg MAs:

1) An RF pilot scheme focused on reimbursable *grants*/interest free *loans* to start now
2) A pilot (non-repayment) project as a pathfinder with a view to a fully-fledged FI scheme to start later during the 2014-2020 or in the next programming period

This guideline sets out the main steps toward the first option[30]. It identifies central questions that Interreg stakeholders have to deal with during the path towards an operational pilot, and gives advice on how these questions can be addressed. Since the EU regulation on *repayable assistance*/reimbursable *grants* in the ongoing programming period is still in the making, some of this advice will be less specific than we would like it be. **Nevertheless, we aim at identifying options that will work even in a scenario in which the Commission decides to regulate the provision of reimbursable grants as an FI activity.**

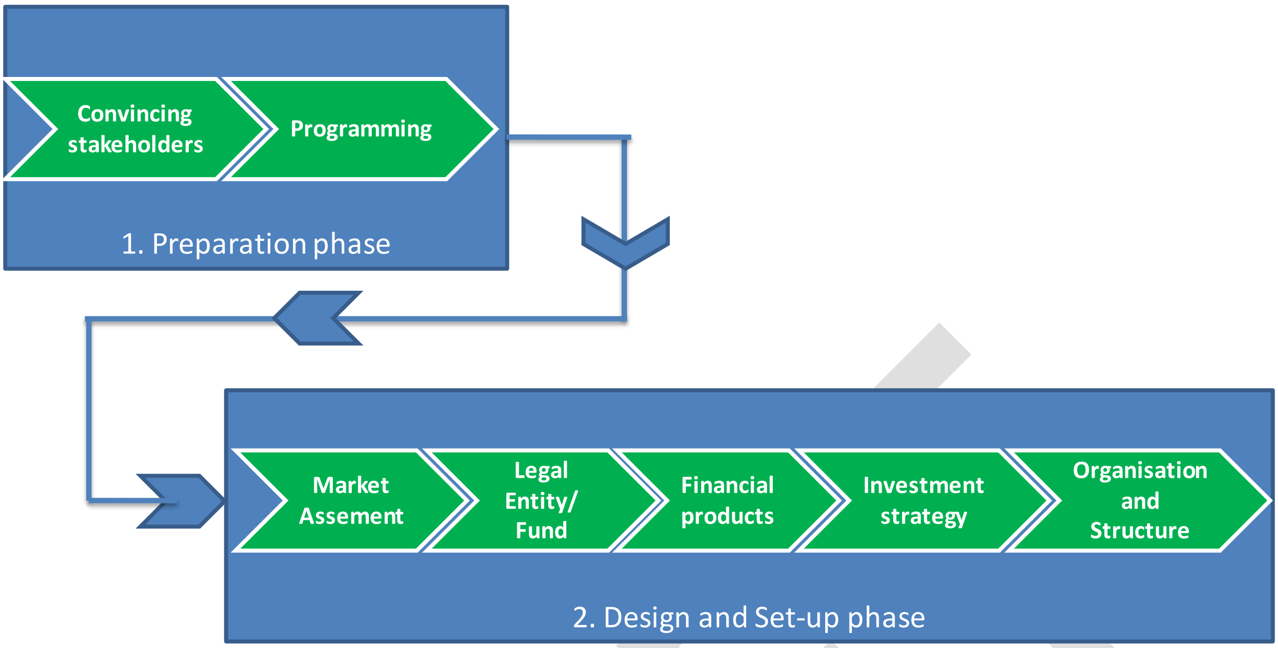
The process of realising an RF pilot scheme in the framework of an Interreg programme consists of two phases:

- The preparation of the introduction of an RF pilot scheme into the programme
- The design and set-up of the specific RF pilot instrument

These two phases can each be broken down into separate steps which cover important aspects in the process towards a workable RF pilot scheme in Interreg (see following visualisation).

[30] Interreg MAs that decide to go for the second option also might find the guideline helpful to identify central questions/issues that could be addressed in a preparatory Interreg project or an FI development project funded under the multi-regional strand of the FI TAP (see chapter 3).

Figure 3: Process towards a workable RF pilot scheme in Interreg



Source: evers&jung

In the following subchapters we examine each of these steps in more detail and identify the main options and "to do's" for Interreg MAs. The latter ones are highlighted in a separate box at the end of each subchapter. They are right now in a draft version and should be further developed by INTERACT in interaction with Interreg programmes to be able to take into account the programme's specific situations (e.g., the economic situation in the programme area, availability of experienced financial institutions, and level of experience in including RF *final recipients*, like SMEs in projects), since the preparation of this paper showed that there is no one-size-fits-all solution to most of the challenges Interreg programmes face when they want to pilot RF schemes.

On the contrary, the starting situations and the resulting options for decisions along this path are very diverse, therefore we have chosen a fictional example to illustrate how a given programme can go through the process and come up with an RF pilot scheme that fits its needs and expectations. For this we chose a fictional CBC programme, covering two countries, in which a group of people (called in the following "RF drivers") working in the programme's stakeholders organisational bodies (Monitoring Committee, Managing Authority and Joint Technical Secretariat) decide to pilot the use of revolving funds in the area of start-ups and/or small SMEs. The programme offered already in the past programming period the option to involve SMEs as beneficiaries in its projects, and chose the Thematic Objectives (TOs) 1 and 3 as priorities in its Cooperation Programme. The project layout that results from this fictional example is then transferred into a draft financial model in chapter 6.

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5.2 Convincing the programme's stakeholders

As a first step, the RF drivers have to convince Interreg programme stakeholders that there are substantial benefits in implementing RF schemes/FIs in the Interreg programme. Only if that step is successful, will all parties confirm their readiness to dedicate the required resources of the programme to such an activity and commit to support the exploration/piloting process.

The key arguments that the RF drivers would present are as follows. RF/FIs:

- Can be a catalyst for **attracting private sector investment** to the programme area, improving the access to finance for businesses.
- Represent a **more efficient use of funds** – allowing *grants*/investments to be made of a greater value and/or in higher volumes or over a longer period of time.
- Help **wean SMEs away from grant dependency** (growing up) - the fact that *loans* have to be repaid is a "mind focuser". SMEs will only take on such an obligation where they have faith that the project will generate growth.
- Provide a greater assortment of **potential financing options** and investment activities, allowing growth-oriented businesses choice.
- Businesses expand across the region and beyond, hence **boosting business** volumes, employment and tax *revenue*s, facilitating a knowledge-based economy.
- Generate potential for developing **closer cooperation with financial institutions** in the programme area.
- Add to the **skills and experience** of both public and private sector experts.

The RF drivers also use successful past programming period case studies to *leverage* ERDF resources and create positive incentives in the regions as **RF achievements** possible for Interreg programmes. There are many such examples available on the web portals of DG Regional and Urban Policy[31].

The RF drivers define the introduction of RF in Interreg as a **broader innovation process** for the programme to support innovative SMEs that can benefit from willingness on the part of the public sector to try out new things. They make sure that Interreg stakeholders have the right level of knowledge and understanding of RF options to be able to drive the process, stay in control and feel a share of ownership.

The RF drivers do not pitch the planned RF activities as a stand-alone scheme, but to **complement other, non-repayable CBC projects** in the field of supporting SMEs and start-ups, for a more substantial interaction with the business community and network, and to enhance efforts to promote entrepreneurship and innovation in the CBC programme area. By such integration, the RF scheme can act as a useful addition to the cross-border support services offered to SMEs and start-ups via purely *grant*-based cooperation projects, involving, for example, business support organisations and research organisations. It also helps to focus the partner organisations of these projects on identifying economically-viable cooperation projects that can receive a *loan*/repayable *grant*. On the other hand, the RF scheme benefits from these projects in terms of pipelining *final recipients*, supporting them with business development services or other relevant activities and covering delivery costs of the *loans*/*grants*. A more detailed description of how such an

[31] See http://ec.europa.eu/regional_policy/thefunds/fin_inst/index_en.cfm and http://ec.europa.eu/regional_policy/thefunds/instruments/index_en.cfm

interaction between an RF scheme and non-repayable Interreg cooperation projects can look is given in chapter 5.8.

To do's for Interreg MAs:

- ✓ Identify the most important decision makers in a programme's framework. Especially look out for supporters of RF in institutions that are involved both in ESIF operations and in Interreg programming and implementation (e.g., ministries)
- ✓ Develop the argumentation why your programme benefits from an RF instrument on a cross-border level (select the most important points for your programme and for your decision makers from the list above, do not choose too many)
- ✓ Identify prior projects in your or similar Interreg programmes that addressed market level beneficiaries that could be financed by RF instruments. Use these projects as a case for further developing the programme via RF schemes.

5.3. Dealing with programming issues

To allow an Interreg programme to implement RF pilot activities the Cooperation Programme needs to be written in a way that does not explicitly rule out RF schemes/FIs. Since most Interreg CPs for the ongoing programming period 2014-2020 have already been handed in to the Commission, the option of RF pilots is only available for Interreg programmes that already opened up this possibility in their CPs. If it is planned to realise fully-fledged FIs that will *leverage* private capital into the scheme, it is advisable to indicate in the financial tables of the CP that the co-financing for the programme will be from both public and private sectors.

The **ERDF resource to be used** for a pilot RF scheme depends on the specific approach chosen and the market situation in the programme area. Allocating a relatively small budget for an initial pilot scheme will avoid the temptation for managers to make inappropriately high risk investments simply to use up approved budgets. A pilot *loan* scheme in a CBC programme could be viable at a total budget, including co-financing, of EUR 3-5 million.

The Interreg programmes willing to pilot RF schemes should have some experience in the **participation of SMEs as end users of cooperation projects or even as beneficiaries**[32], as this involves dealing with questions of providing State Aid to SMEs (see chapter 3.7), and reduces the effort of building up expertise in State Aid regulations only for the RF pilot scheme (see chapter 5.9).

Another important aspect is that the formulation of **thematic objectives** in the CP should allow stakeholders to engage with targeted beneficiaries (and investment activities) of RF (e.g., SMEs and start-ups) so as to ensure congruence of objectives. The most relevant TOs for RF activities in the framework of Interreg programmes addressing SMEs with viable business cases are:

- TO1: strengthening research, technological development and innovation;

[32] Since the ESIF CPR for the ongoing programming period allows managing authorities to implement FIs directly in acting as the formal beneficiary of the reimbursement (CPR Art. 38(4)(c)), this requirement may be technically avoidable, but an exclusion of SMEs as beneficiaries limits the programme's design options in the field of RF/FIs and the integration of the RF scheme with other Interreg projects that include SMEs.

- TO3: enhancing the competitiveness of *small and medium-sized enterprises (SMEs)*;

Other TOs might also allow the implementation of more specialised FIs; e.g., TO4: Energy and TO6 IP6: resource efficiency in SME. However, a simple RF scheme probably makes the most sense as a pilot approach.

Possible objectives for a pilot RF/FI scheme are:

- Addressing risk capital/finance gaps in Interreg programme areas.
- Generating positive returns over the lifetime of FI to reward investors.
- Generating economic outputs – jobs, turnover/profits growth, international trade, private sector *leverage*, increased organisational capacity etc.
- Creating a longer term legacy/revolving fund for future investment or to cornerstone future Interreg project bids.
- Creating sustainable supply side infrastructure; e.g., new fund management and other finance based organisations.

Interreg funded projects generally have to demonstrate:

- joint development,
- joint financing,
- joint staffing, and
- joint implementation.

In other words, it is mandatory that supported activities are in line with the cooperation objectives of the programme and are implemented in cross-border/transnational partnerships. For RF schemes a way to address this requirement is to realise them at the level of the organisations delivering the financial products. The *final recipients* should be involved in some kind of cross-border/transnational activities which can also be supported by other, integrated Interreg projects. These activities must be defined as eligible for funding under the TOs of the programme's Cooperation Programme, and could include the following types:

- Internationalisation of business activities of existing SMEs (TO3)
- Creation of start-ups based on cross-border/transnational cooperation in start-up support structures (TO3)
- Cross-border/transnational cooperation (between companies or between companies and research actors; e.g., research and technological development performers) for developing innovative products and services (TO1 and TO3)
- Cross-border/transnational joint ventures (TO1 and various other TOs)
- Development of *revenue* creating infrastructure (various TOs)

A good example of a first assessment of these options for a CBC programme is a study that the MA of the CBC programme Deutschland-Nederland commissioned in 2013[33].

[33] The study was not published officially and is only available in German. It was forwarded to the authors of this study. Interreg stakeholders interested in the results of the study should contact the Ministry of Economics in North Rhine-Westphalia.

In our fictional example the CBC programme's MA decides to look closer into the option of piloting an RF scheme under TO3: enhancing the competitiveness of *small and medium-sized enterprises*. SMEs from the programme area have a low level of internationalisation and do not yet utilise the available options for cooperating with business support structure in the adjoining regions. Start-ups in the CBC area are missing out on the international market potential on their doorsteps, overall entrepreneurial activity is low, and unemployment levels are rising in the regions due to structural and economic factors. The chosen investment priorities under TO3 reflects this, focussing on promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new companies, and on developing and implementing new business models for SMEs, in particular with regard to internationalisation. The ERDF budget reserved for TO3 amounts to EUR 30 million. The programme's MA decides to align the planned RF pilot with these investment priorities in aiming for:

- better access to start-up finance for entrepreneurship activities that develop new business ideas in the cross-border regions, and
- better funding for young SMEs to develop their business models for internationalisation.

At the implementation level the scheme will demonstrate cross border cooperation by:

- focusing on business activities that foster SME internationalisation; e.g., cross-border cooperation and joint market development,
- using business support structures on both sides of the border,
- the creation of new start-ups through cross-border/transnational cooperation,
- the creation of new business incubator structures in both countries, and
- facilitate cross-border entrepreneurship/business plan competitions(with a *loan* as one of the top prizes).

To do's for Interreg MAs:

- ✓ Check if an RF instrument as a pilot scheme fits into the Cooperation Programme and can be implemented without a programme adaptation as a type of *grant*-based project.
- ✓ Scan the TOs in your Cooperation Programme for the ones that fit best for an RF scheme. It should allow selecting *final recipients* with viable business outlooks.
- ✓ Decide about the general objective of the scheme and how it connects to your programme's strategy to involve market actors and produce cross-border/transnational impact under the relevant TO,
- ✓ Decide about the conditions the financed projects/companies have to fulfil regarding cross-border/transnational impact.

5.4 Market assessment

A crucial step in preparing the pilot is to assess the market for the scheme. The MA will need to understand the target beneficiary group, its size and composition, its strengths and weaknesses, opportunities and threats. Also, specifically the potential for the group to access international markets, engage with business support structures, whether public or private sector, and the likelihood that new incubators can be created. This will be done via an **explorative market study.** This doesn't need to be facilitated by an external service provider, but experience shows that MAs often do not have the experience and personnel resources to do such an assessment in an efficient and substantial manner. In the context of national/regional ESIF operations, such market assessments for FIs are done in the framework of the ex-ante evaluation of the CP. In Interreg frameworks, such market assessments could be part of preparatory projects or (see chapter 5.8) as an output of an Interreg project that is integrated with the piloted RF scheme.

Main questions to be addressed by such an exploratory analysis are:

- Is there a critical mass of *final recipients* in the chosen target group in the programme area that would be viable for support?
- What are the specific investment needs of the identified target group related to the activities foreseen for funding (working capital, investment capital, *equity*, training, specialist input)?
- What is the average and total value of required finance?
- Is there a market gap for accessing suitable finance for these needs? What financial options are available to the chosen target group? This has to take into account existing or planned FIs at national regional level in the countries/regions that are part of the programme area.
- If there is a market gap, and can it be quantified for the programme area?
- Are there different regulatory framework conditions in the regions covered by the programme area?

Additionally, a market assessment for an RF scheme in Interreg context should also analyse the availability of business support structures for the chosen target group in the programme; e.g., business incubators, cross-border training/mentoring/specialist offers. These structures will form the basis of the international cooperation element in the scheme.

The results of the market assessment should then be used to define the specific characteristics of the RF scheme to be piloted. This includes the decisions on the kind of financial product that fits best to the identified needs (*grants*, debt finance, *guarantees*, *equity* finance, equity-like finance, risk/*venture capital*) (see chapter 5.6) and on the most suitable conditions (in terms of repayment structure, risk structure, etc). The quantification of the financing needs and market gap should be used to identify the parameter for the RF scheme.

The exploratory market assessment can also be used as preparation for a **formal ex-ante assessment** later on, which is required by the EU Commission for implementing ESIF-based interventions that are regulated as FIs[34].

In our example, the MA uses the programme Technical Assistance (TA) to commission a service provider to conduct an exploratory market study on the financing situation of start-ups and SME internationalisation in the programme area. The expert report shows that the number of start-ups is low compared to other comparable regions, and that the level of SME internationalisation is also low, with a lot of companies reporting missing financing options for internationalisation activities. Supply of bank finance has retracted since the financial crisis, leaving higher risk investments, like SME internationalisation of start-ups, underserved. For start-ups there are FIs in place in both countries that offer *microcredit* of up to EUR 25

[34] The individual elements of such an ex-ante assessment can be found under Article 37 (2) in the CPR. There are also detailed guidelines and support documents for MAs available under http://ec.europa.eu/regional_policy/thefunds/fin_inst/index_en.cfm.

000, and some *venture capital* funds targeting high-growth technology start-ups with *equity* needs over EUR 200 000. This leaves a market gap in the area of debt finance and easily-accessible investment capital over EUR 25 000 and up to EUR 200 000. For SME internationalisation no specific FI is in place, as the national/regional FIs only focus on financing investments in the same region/country.

The market study calculates that there is a market gap in the programme area for investment and working capital in start-ups of at least EUR 20 m per year, and a gap of EUR 30 m for SME internationalisation in the form of debt finance. The regional disparities are negligible.

Based on this, the MA decides to move forward with piloting an RF scheme that offers *grant/loan* combinations to start-ups and SMEs up to EUR 200 000. The total volume of the scheme is set at EUR 10 m (including co-financing), to be disbursed over a period of six years, after which a legacy pot will be available to continue to lend as long as funds and market conditions warrant.

After the initial set-up and design of the scheme (see following subchapters), a formal ex-ante assessment is commissioned to approve the findings of the explanatory market assessment and the design decisions that were taken based on these. The ex-ante study helps to further fine-tune the scheme's approach, including its fund structure and *investment strategy*.

To do's for Interreg MAs:

- ✓ Conduct an explanatory market assessment (financed by TA) as the first step of the set-up and design process of the pilot RF scheme
- ✓ Do not develop any scheme where you do not know if there is a market demand throughout the programme area.
- ✓ It is important to find a market segment that lacks supply by financial institutions. Do not develop a scheme if there are enough suitable *financial instruments* already in the market.
- ✓ Focus on differences between the countries/regions in your programme area. These can limit the successful implementation of the scheme.
- ✓ Stick to the market-based recommendations regarding your decisions for the further design of the scheme. If you choose an FI approach, they will need to be assessed by a formal ex-ante assessment later in the process, before the scheme can be implemented.

5.5 Legal entity and fund structure

Once stakeholders are convinced that RF should be included in their programme, they have solved programming issues and a market assessment is available, the time will have come to take a decision about structure and in particular whether or not a fund structure[35] is appropriate. A fund is an existing or new legal entity that will act as the accountable body for holding, disbursing, monitoring and recovering project funds in an FI. The alternative is for the MA to act as the accountable body without using a separate legal entity.

[35] This could be a *specific fund* or a *holding fund*, as used in JEREMIE ESIF structures. Holding funds are organised as *fund of funds* under which specific funds; e.g., for loans, equity and guarantees, are implemented. Each specific fund is treated as a separate FI.

Setting up a dedicated fund structure has several benefits:

- The project is ring fenced within a legal entity whose purpose and function is clearly defined.
- EU institutions, banks, public authorities, *financial intermediaries* and others accept and understand the use of *fund manager*s as a mechanism for the management of finance projects, making relationships with these institutions more straightforward.
- It allows the advance allocation of total ERDF resources in large tranches[36] as opposed to smaller claims in arrears (see below), provides advance *cash flow* for the project and reduces some of the workload for the MA (less frequent but larger ERDF drawdown requests), and helps the MA meet N+3[37] targets[38].
- Fund management costs can be covered under the same operation subject to limits regulated by State Aid regulations and the provisions laid down in the implementing acts for FIs[39]. Projects run directly by public authorities face greater challenges in accessing finance for operating costs (see below).
- It helps with:
    - bringing in additional (private) co-financing at fund level
    - the recruitment of financial professionals
    - procurement of financial services
    - delivering financial products in regions with a strict national banking regulations
- In a cross-border/transnational setting involving an internationally-based fund management operation can overcome international barriers to trade.

But this has also some important implications:

- Set-up and operating costs can be high, and the scale of the project will have to be of sufficient critical mass to cover these.
- This is especially true if the fund is to be managed by an international finance institution like the European Investment Fund[40].
- Some holding companies for *holding funds* set up at a national level employ their own staff to make investment decisions (e.g., Finance Wales). However, most contract with external *fund managers* to manage the specific funds.
- With an external fund management there is no direct control for the MA on the investment decisions, and only a limited learning potential for stakeholders. This can also be a major advantage by distancing the MA from individual decisions whilst keeping the connection with the achievements of the project as a whole.

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[36] Under the new ESIF regulation 25% can be allocated per tranche and then future tranches released on the basis of demonstrated progress against plans – project spend and outputs.

[37] N+3 relates to EU-imposed deadlines by which time ERDF must be spent. Where a fund structure is used and advance drawdown of funds is permitted, N+3 targets can be easier to achieve than when ERDF is claimed in arrears.

[38] However, the use of FI simply for avoidance of N+2/3 is an abuse, which does not serve the goal of building further competence in this area. It generates a policy response with stricter rules and more demanding structures for implementation.

[39] See forthcoming implementing act and State Aid regulations for FIs.

[40] A subsidiary company of the European Investment Bank.

- The costs of external fund management may be higher than an internal solution (but not necessarily). However, specialist investment expertise is required when making investment decisions. Not to use independent third-party expertise may well prove a false economy.
- The integration with other *grant*-based activities in the programme is more challenging, especially if the managing financial institution is not involved in other Interreg programmes' project activities. Anecdotally, professional *fund managers* are not noted for genuine collaboration with publicly-funded business support, even where they are contracted to deliver a publicly-funded investment service.

In our example, the CBC programme's MA decides not to set up a fund structure for the pilot scheme, mainly due to cost factors and the comparatively low number of interventions expected in a pilot exercise.

In the 2014-2020 programming period there is the possibility to implement *financial instruments* directly at national/regional, transnational or cross-border level, as opposed to setting up a fund with a dedicated *fund manager* if the instruments consist solely of providing *loans* or *guarantees* (*CPR* Art.38(4)(c)). In the past programming period this was also possible for RA schemes offering credit lines via financial institutions as intermediary bodies (IB)[41].

Where an MA decides to implement an RF/FI scheme directly:

- The MA is considered to be the beneficiary and will be reimbursed by the Commission on the basis of the actual *loans* provided or *guarantee* amounts committed for new *loans*. There is no advance payment. The applications for interim payments and for payment of the final balance need to include the total amount of the payments effected by the MA for investments in *final recipients* (see *CPR*, Art.41(2)). So the MA must be in a position to provide *cash flow* finance for the project, since ERDF claims will be paid in arrears.
- The MA can involve a financial institution as an IB to implement the *loans*/*guarantees* and manage the *reflows*. In this case the ERDF reimbursements are forwarded to the IB.
- Management costs are not eligible under the same operation; however, they can be covered using the programme's technical assistance budget[42].
- The MA has to consider that this option is not possible in all Member States: it is subject to national banking regulations which need to explicitly allow for the MA/IB to issue both *loans* and *guarantees*.
- A so-called Strategy Document has to be provided that has to be examined by the Monitoring Committee. The elements of such a document are provided in the annex IV of the *CPR*[43].

The MA of the example checks for all these issues and decides to pilot a scheme that is managed by the MA and implemented by a national financial institution as an IB. The IB will also be lead partner of an

[41] See Article 43a paragraph (1)(b) of the General Regulation (December 2011)

[42] See Short Reference Guide for Managing Authorities, provided by Commissions Services, Ref. Ares(2014)2195942 - 02/07/2014(http://ec.europa.eu/regional_policy/thefunds/fin_inst/pdf/fi_esif_2014_2020.pdf), p. 11.

[43] It includes (a) the investment strategy or policy of the financial instrument, general terms and conditions of envisaged debt products, target recipients and actions to be supported; (b) a business plan or equivalent documents for the Financial Instrument to be implemented, including the expected leverage effect referred to in Article 37(2) of GPR; (c) the use and re-use of resources attributable to the support of the ESI Funds in accordance with Articles 43, 44 and 45 of GPR; and (d) monitoring and reporting of the implementation of the financial instrument to ensure compliance with Article 46 of the GPR

integrated CBC project to set up a cross-border cooperation structure for identifying and supporting potential *final recipients* of the scheme (see chapter 5.8 for more details).

To do's for Interreg MAs:

- ✓ Based on the market analysis, a decision needs to be taken on whether to set up a fund or to implement the scheme directly through the MA or an *intermediate body*.
- ✓ Compare the costs of an internal management in comparison to an external management.
- ✓ If the market outlook is unclear and demand is expected to be limited during the pilot phase, a fund structure is a costly option.
- ✓ Check if there is enough Technical Assistance for the internal management available.
- ✓ Check if the MA is allowed to implement a financial scheme directly in your country according to the national banking regulations.

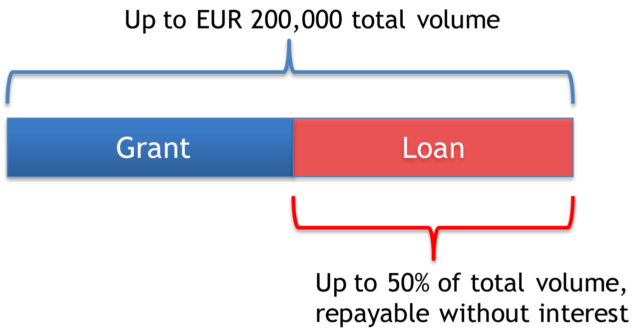
5.6. Choosing the right financial product

There are many options for financial products to be delivered as an RF scheme under ESIF. From reimbursable *grants* to *loans*, guarantees, *equity* and equity-like products. The decision on which one of these products is the right one for the objectives of the instrument needs to be based on market assessments and the financing needs of the chosen target group. If the MA decides to implement the scheme directly and without setting up a dedicated fund, it is only possible to provide reimbursable *grants*, *loans* or *guarantees*.

For an Interreg programme that wants to pilot the use of revolving funds in supporting SMEs, reimbursable *grants* or interest free *loans* are the most interesting products, since they are straightforward in their delivery process (money is paid out to *final recipients* and then repaid by them in an agreed repayment structure) and can be seen as an evolution of the provision of *grants*, to which Interreg programme stakeholders are accustomed, while *guarantees* are more complex products. Interest-free *loans* can also be combined with pure *grant* financing. In this case, a defined part of the overall sum of funding which a company receives is provided as an interest-free *loan*. For the implementation and management of the scheme it is advisable to treat such combinations as two different lines of funding available; a *grant* and a *loan*. The *loan* is fully repayable by the *final recipient*, while the *grant* does not need to be repaid. The maximum amount of the total funding should be set according to the State Aid regulation that the MA wants to apply (see chapter 5.8 for more details). The maximal amount of the *loan* in relation to the *grant* amount does not need to be limited at the scheme level, but should be set at a level that on the one hand makes the overall funding agreement attractive to the *final recipients* and on the other hand allows for flexibility in terms of viability of the funded business case.

In our example, the MA chooses to offer a *grant/loan* combination to start-ups and young SMEs. The overall funding limit is EUR 200 000. The *loan* element may take up to 50% of total funding volume. The *grant* part of the funding is non-refundable, while the *loan* part is to be repaid over 5 years, with an initial *grace period* (payment holiday) of 6 months for early-stage SMEs and 12 months for start-ups.

Figure 4: Financial product: grant/loan combination



Source: evers&jung/Ampersand

To do's for Interreg MAs:

- ✓ Decide about your product, following the recommendations in the market analysis.
- ✓ If no fund structure is chosen, the options for financial products are limited to *loans* and *guarantees*. For a pilot scheme a *loan* product is the most straightforward option.
- ✓ Think about a combination of *grants* and *loans*, as this gives more flexibility in implementation.
- ✓ *Equity* products and *guarantees* are more advanced products that need to be implemented either with a fund structure or by an experienced financial institution.

5.7 Developing an investment strategy and a business plan for the scheme

Based on the decisions on the general structure of the scheme and the financial product to be offered, an *investment strategy* (IS) and business plan (BP) must be developed by the MA to be included in the Strategy Document. An *intermediate body* (e.g., a public financial institution) that will be involved should be included early on in the process (in practice it is likely to be the institution that prepares the IS and BP). There needs to be an agreement on how the scheme will support the specific characteristics of the Interreg programme area and the Cooperation Programme objectives.

The IS and BP will include:

- The mission, values, aims and objectives of the project.
- How the project will be managed - the organisational structure and how it fits within the host organisation(s), who will be the lead partner, and roles and job descriptions of personnel, including project manager, fund management professionals, business advisors and administration staff.
- The products and services to be delivered.
- The market for the products and services and how these will be promoted (marketed) to beneficiaries.
- How the project will be financed, including sources of public *co-finance*.
- Details of project milestones, target outputs and outcomes– jobs created, private sector *leverage*, start-up numbers, businesses supported, value of international trade contracts generated, business incubators established, etc.
- Timetable.
- Legal and regulatory issues, including the future use of *recycled funds*.

Examples of possible **investment approaches** for RF schemes which can be set up in Interreg programmes include:

- An instrument that enables a financial institution to lend to research & development-intensive projects within SMEs expanding across an Interreg programme area. This would enable the financial institution to lend at beneficial rates to SMEs participating in cross-border R&D activities.
- An investment fund for 'spin-off' projects from a network of Universities across an Interreg programme area, possibly targeting certain desirable activities such as 'low carbon economy', or which involved students or academics working with counterparts across the region. An expansion of a successful model already used in the Knowledge Transfer Partnerships in the UK, for example, to boost the commercialisation of new technologies developed in Universities into small businesses.

In our example the MA decides to involve a public financial institution from country A with a track record in financing start-ups and internationalisation projects of companies as IB to implement the planned *grant/loan* scheme. The project is to provide funding (and business support) for

a) start-ups from country A or B that cooperate with support institutions in both countries to exploit the cross-border market and/or other international markets, and
b) early stage SMEs from country A and B seeking cross-border collaboration to generate business growth.

The total value of the scheme is set at EUR 10 million (including co-financing), out of which EUR 3.5million will be advanced as *loans* (not including *loans* advanced out of repayments). The *grants* finance 100% of the eligible costs of the funded company, the *loans* at least 50% of the required investment/working capital. The **leverage** of the *loan* part will be calculated based on the realized public co-financing. In our example, the public co-financing will amount to 25% of the disbursed volume of *loans*[44], resulting in a *leverage* of 1.3.This *leverage* will be increased by the additional private capital mobilised by the *final recipients,* and result in an added value of up to 2.6[45].

The national **co-financing** for RF schemes/FIs under ESIF can be public or private, at the level of the fund (in case there is a fund structure), the MA/IB (in case there is no fund structure), or the investments in *final recipients* (e.g., through own contributions by a company for a funded investment). In the case of Interreg programmes, the level of required co-financing is set at programme level and the matching funds are usually provided at the level of project partners, following the logic of joint financing. For a cross-border/transnational RF scheme implemented directly by an Interreg MA there is the challenge of organising and managing national public co-financing, since national matching funds will only be available for financing *final recipients* in one country.

In our example, the public financial institution selected as IB is from country A and will provide matching funds for the *grants/loans* provided to start-ups/SMEs from country A. The co-financing needed for providing *grants/loans* to *final recipients* from country B will be provided by a public authority from

[44] Based on a co-financing rate of 75% in the fictional CBC programme.

[45] The Commission distinguishes between the *leverage*, which is calculated based on the additional public and private resources that are provided to the final recipient via the FI, and the *added-value,* which also includes the contribution of the final recipient in realising the financed activity.

country B[46].Both co-financing budgets will be handled by the IB and drawn upon separately for realising the individual *grants/loans* to *final recipients* in country A or B[47].

Funds repaid by *final recipients* on each side of the border will be paid by the IB into a separate bank account designated for each country. Funds in these accounts can only be released to be used for the same purposes and on the basis specified in the original Strategy Document of the scheme. In time this may be varied with the approval of the MA where market conditions change.[48] It may also be possible to use *recycled funds* in the future as co-financing for a new Interreg or national fund, again subject to MA approval.

The criteria for **eligible costs** that apply for the reimbursement of the MA by the Commission are that the resources claimed have been spent for payments to *final recipients* (e.g., *loans* actually disbursed) and for the benefit of *final recipients*.

At the level of *final recipients* the **eligibility criteria** for the *loans* can be chosen by the MA. In our example case they are the following:

- Falls within the EU definition of an SME
- High Growth Potential
- Located in Country A region X, or Country B region Y
- Seeking international markets for product(s)
- If based in AX - Seeking collaboration with at least one SME in BY or to make sales in BY
- If based in BY - Seeking collaboration with at least one SME in AX or to make sales in AX
- Working with support organisations in both countries (the project can make introductions).

The **eligible cost criteria** for the *grants* to SMEs use the standard Interreg cost criteria for *grants*.

To do's for Interreg MAs:

- ✓ RF schemes need a thorough *investment strategy* and business plan. Look at examples from ESIF funding to get an idea of the level of detail needed.
- ✓ If possible, involve an experienced financial institution that already acts as an *intermediate body* for ESIF implementation. Can the IB prepare the strategy and the business plan?
- ✓ Decide where the co-financing comes from - public sources or private money? For a pilot it is advisable to focus on public *co-finance* as this reduces complexity in the set-up process.
- ✓ Decide about the eligibility criteria for the *final recipients* and, if you combine *loans* with *grants*, about how the categories of eligible costs apply to them

5.8. Choosing the appropriate organisational structure

[46] Which could be part of the CBC programme's Steering Committee.

[47] See the graph below.

[48] Changes can only be made in accordance with CPR rules, which foresee that the ESIF share of capital resources paid back from investments can only be used for further investments in the same or other financial instruments, in line with the OP.

Based on the decisions taken with regard to the target group, the financial product, the use of a fund structure and the IS/BP of the scheme, the MA needs to identify a suitable organisational structure for the scheme that fits into the programme's project structure. Since this is highly dependent on the specific characteristics of the piloted RF approach and the Interreg programme, we are focussing here on presenting an approach that fits with the fictional example we have provided in this chapter.

The RF scheme in our example is implemented directly by the MA and will be regarded as a series of 'single projects' for which the MA is reimbursed with ERDF resources by the Commission after financing in advance the ERDF part of the *loans/grants* provided to the *final recipients*. The CBC programme's MA will be the beneficiary of the original ERDF *grants*. For Interreg MAs it is important to check early in the process if this is possible, based on national budget availability. If an IB is involved[49], the budget for the advance financing can also be provided by the IB. In this case the MA needs to develop a contractual agreement with the IB to set the reimbursement process[50] for the *grants/loans* that are delivered by the IB to the *final recipients*. This delivery is done in cooperation with partner organisations at regional level, and these are responsible for the initial assessment of projects and for supporting the *final recipients* in their repayment process.

In our example, a public financial institution that is already designated as the *intermediary body* will be the body with overall responsibility for managing the RF scheme in accordance with the IS and BP, and reporting to the MA. Other partners that can be involved are as follows:

- an SME/business advisory service in country A and B
- a start-up specialist service in country A and B

Programme stakeholders other than the IB will not be directly selecting enterprises/*final recipients*. However, they set the *investment strategy* and eligibility criteria to be followed during the selection process of *final recipients*. Also, by appointing individuals to represent them on a stakeholder group that will meet regularly during the project, partners can monitor progress and provide informed advice and support to the management team.

As formal beneficiary of the ERDF contributions, the MA can, if it deems it appropriate, deny funding for any *final recipients* selected by the IB. The MA will also systematically check whether the implementation is in line with the procedures agreed in the Strategy Document, and carry out management verification checks at the level of the financial institution.

The direct management and preparatory costs for the scheme (dealing with ERDF *grants*, setting up IS and BP, setting up and managing the separate accounts for co-financing and repayments, etc.) that occur at the level of the MA and the IB will be covered by technical assistance of the CBC programme, not by the ERDF reimbursements for the scheme, which only cover direct payments to *final recipients*.

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[49] To be able to act as an *intermediate body* the organisation needs to be formally designated by the MA. During this process the MA needs to ensure that transparent procedures for selecting beneficiaries are in place, compliance with Union law is safeguarded, verification procedures are in place, as well as an inclusion into the Management Control System (MCS) of the programme (for more details see: http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/guidance_ms_designation_en.pdf).

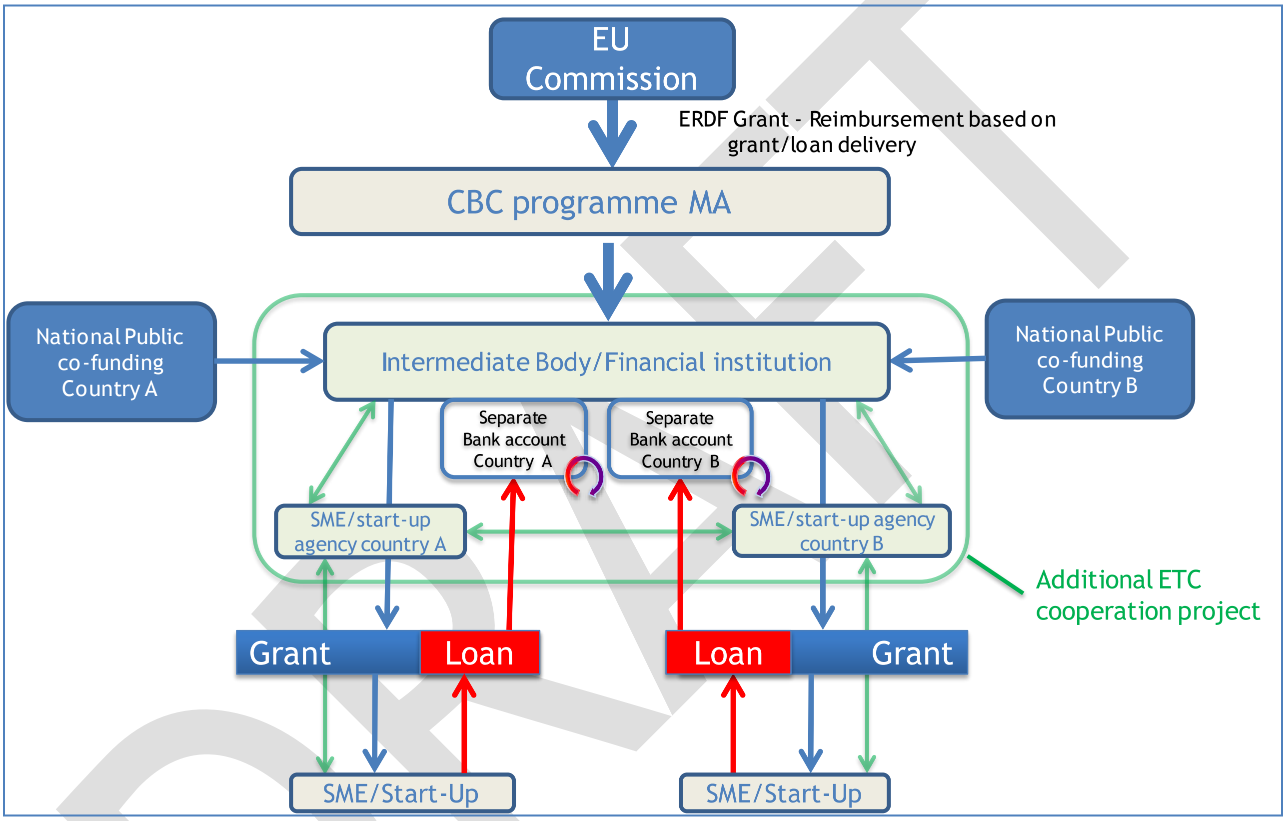
[50] Such a contractual agreement needs to take into account the national budget regulation regarding the specific ETC programme.

To cover the operating/management costs for the IB and the involved partner organisations at regional level, the scheme will be integrated with a standard CBC project that may also include other cooperating partner organisations from country A and B; e.g.,

- Business incubator operators
- Universities
- Public sector organisations responsible for promoting international trade

The following diagram visualises such an organisational structure:

Figure 5: Organisational Structure of RF pilot scheme and integrated Interreg project



Source: evers&jung

To do's for Interreg MAs:

- ✓ Find the suitable organisational structure for the scheme. It has to fit the specific situation in the programme; e.g., the organisations available as implementation partners.
- ✓ In the case of a directly-implemented RF scheme: Choose an organisational structure to integrate a purely *grant*-based Interreg project that covers costs of delivery and allows supplying additional non-financial support for *final recipients*.
- ✓ Check early on if you are able to finance part of the *loans* (ERDF part) in advance and be reimbursed by the Commission later on. If not, set up a contractual agreement with an IB to provide the budget for this and be reimbursed later on by you.
- ✓ Clearly define the tasks of the involved partners in the decision-making process on *grant/loan* provision.
- ✓ Organise the scheme in a way to be able to separate the financial *reflows* into country-specific

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accounts based on the recycled match funding used.

- ✓ Calculate the costs and the reimbursement of the costs of the implementation process.

5.9. Dealing with State Aid

For *financial instruments*, State Aid regulation normally has to be complied with by all levels involved: MA, *fund of funds* and the *financial intermediary*. Aid needs be considered at different levels where it may be received: the *fund manager* (if he is remunerated out of the fund volume), the private investor (who is co-investing and may receive aid), and the final recipient.

In our example the only relevant level is the final recipient, who receives the *grant/loan*. The CBC programme's MA decides to cap the overall funding volume available to individual companies at EUR 200.000 to allow compliance with *de-minimis* regulation. In other scenarios it might be feasible for the programme to rely on *general block exemption regulation* (GBER), especially if agreements have already been established at Member State level to deal with State Aid for SMEs acting as beneficiaries in ETC projects via GBER.

To do's for Interreg MAs:

- ✓ Check if and which State Aid regulations apply. If no fund structure is used, State Aid only is provided at the level of *final recipients*.
- ✓ If possible, build on the experience in dealing with SMEs as beneficiaries in ETC projects.
- ✓ State Aid regulations for RF/FI interventions focus on the difference of the offered product's conditions to market conditions. Use the market assessment to identify the level of market conditions and design the financial products accordingly.
- ✓ If you combine *grants* and *loans*, set the maximum *grant* volume at a level that allows additional State Aid provided by the *loan* part.
- ✓ Use the expertise of State Aid specialists – for example, in the framework of the ex-ante assessment.
- ✓ Use the new possibilities for cross-border financing for SMEs in the new group block exemption regulation (GBER).

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Section 6: Draft Financial model of a pilot scheme

6.1 Grant/loan scheme – Project outline

Note: The following example is still at an early stage of development, and whilst it is intended to stimulate the generation of ideas, all assumptions should be tested before being used in a real situation. It is not a template and INTERACT accepts no responsibility if it is used as such.

In chapters 1 to 5 we considered the background to and issues involved in developing an Interreg-compliant project that will meet Interreg requirements. In this final chapter we start to imagine what a particular scheme would look like in both narrative and financial terms. The imaginary project is outlined under standard business plan headings.

Project introduction

The formerly steel- and coal-dominated AB cross-border region is suffering from the classic symptoms of industrial decline. This project is a bold attempt to expand the small contingent of small research-based SMEs operating on each side of the border, by helping them to find cross-border partners with a view to enhanced growth and profitability.

Along with similar regions across Europe, the Commission recognizes the vital positive contribution already made by innovative SMEs. By supporting the efforts of individual SMEs to seize cross-border business opportunities, the project will make a vital contribution to regional growth, helping to replace former industries with vibrant, resilient and profitable business activity.

The project builds on the XBF Innovation scheme[51] Interreg 2007-13, introducing a wider range of research institutions, an improved methodology and a new approach to financial assistance - part *grant*, part interest-free *loan*.

Socio-economic analysis

The target region covers the north east of Country A and the South West of Country B, two regions with a common 150 km border. Despite the geographical proximity, the historical business connections between the two regions have been few. Country A and B have both suffered as a result of the recent financial crisis, and the border region peripheral to both economies has faced greater struggles than the more prosperous commercial centres of ZYX and CBV, which are beginning to regain some of their former resilience.

The tentative progress previously made through the creation of new forms of SME-based business activity following years of industrial decline suffered a severe setback during the world financial crisis. Proactive public policy, including this project, can make a difference at this critical juncture, helping to make inroads into the evils of high unemployment, high sickness, low activity and high crime levels.

[51] Also imaginary

Market needs assessment

In recent years the region has spawned a small and fragile group of R&D-based SMEs. Country A and B both have a relative strength in life sciences; Country A is stronger in advanced materials manufacturing, and Country B in financial services. Both have emerging creative services sectors.

Whilst there are pockets of excellence in both countries, SME activity on both sides of the border is mostly focused on local markets. However, some clusters are emerging and our detailed market research evidences strongly-expressed aspirations for stronger links with research institutions and to exploit opportunities on the opposite side of the border. Similarly, research institutions confirm their commitment to developing closer links with innovative SMEs wherever located.

The financial crisis greatly added to the woes of target SMEs in accessing start-up or expansion funding. This is due to their having limited financial reserves, combined with a low-risk appetite on the part of a negative banking sector. Our detailed research evidences a clear market gap for this project at the levels envisaged. The introduction of a repayable element is understandably not enthusiastically welcomed by target SMEs, but they accept the principle and our assessment is that this is unlikely to significantly reduce demand for these products.

Management and delivery

The IB will have overall responsibility for the project, which also includes partners L,N and M from Country A and B,C,D and E from Country B.

A voluntary board comprising representatives of business development agencies, universities and commerce will assist the IB in monitoring and providing advice and guidance.

Each partner will recruit and appoint specialist professional staff to implement the project. Staff currently employed by partners will be eligible to apply.

Since the purpose of the programme is to secure additional cross border business, we would partner with local agencies (5 research organisations and 4 business support agencies) on both sides of the border to bring this about.

Products

SMEs will be supported by specialist facilitators who will be able to recommend *grant* and *loan* packages with loan volumes of EUR 40 000-80 000 per SME. The overall volume (*loans* plus *grant* packages) will be up to EUR 200 000 per SME; i.e., the maximum grant would be EUR 200 000 less the loan amount. The larger element of the package will generally be a *grant,* with a smaller part being an interest-free *loan*. The *loan* element is repayable over 5 years.

There will be two support strands – one for established businesses and one for start up businesses.

See below annex A for detailed terms.

Process

Applications for support will be made through the completion of application forms which will be assessed by case officers following agreed appraisal guidelines.

The criteria against which requests for support will be assessed are as follows:

- Business acumen/viability based on track record and personal impression of assessor
- Innovation
- Employment security/creation
- Collaboration (cross border)
- Existing companies: good track record
- Convincing business plan

Finances

Detailed finances are set out in appendices A and B, and a summary is included in the tables in this section. In summary:

- Total project cost EUR 10 million
- 31 *grant/loan* packages at an average of EUR 80 000 (existing businesses)
- 25 *grant/loan* packages at average of EUR 40 000 (start-up businesses)
- We anticipate a *default* rate of 10% for existing businesses and 20% for start-ups, meaning that at the end of the project a legacy of just under EUR 3 million will be available for reinvestment

Note that because ERDF is received in arrears, a repayable 0% loan from national resources has been included in the *cash flow*. This is continually repaid and reissued as ERDF is repaid. The maximum value of this facility at any time during the project is EUR 631 000.

Outputs

We predict the following outputs, based on our detailed research and financial analysis:

- 350 new jobs created
- 56 businesses supported, including 29 start-ups
- EUR 6.7 million of cross-border business generated

Risk Analysis

Summary risk factors are:

1. Losses to be higher than expected. This would reduce lasting outputs and the legacy available for future investment. However, our research indicates that estimates have been prudently compiled, and economic conditions are expected to be more favourable going forward.
2. There could be reduced take-up attributable to the introduction of the repayable element. However, in the past round we had more viable applications than we had funds to approve by a factor of 3:1.
3. The importance of recruiting capable professionals cannot be over-stressed. However, we have proven capabilities amongst current staff, and whilst the required skills are specialized we are confident that recruitment of suitable managers will be achieved.

6.2 Financial model - Detailed assumptions

The following tables provide an overview of a financial model for *grant/loan* scheme. Scheme parameters are as follows:

- Size: EUR 10 million
- Contributions – ERDF 50%, National match 50%
- National funding drawdown – monthly in advance of need
- National funding is also used to provide *cash flow* until ERDF funds are received
- ERDF drawdown – 3 months following quarterly claim period
- *Loans* fund EUR 3.5 million
- Interest rate 0%
- Management costs – investment period 2.0% of Fund
- Management costs – realization period 0.05% of Fund
- Management costs are recoverable from *grant* during the first four years of the fund
- Target beneficiary group 1 – Early stage small businesses
- Target beneficiary group 2 – Start up small businesses
- Repayment term (*loan* term) for both products 5 years
- Capital repayment holiday (*grace period*):
    - Early stage - 6 months
    - Start ups - for the early-stage *loans* – 12 months
- Investment period – all *loans* to be placed over 4 years.
- *Defaults* occur in month 18 following advance of the *loan* (early stage) and month 15 (start up)
- The *loans* can finance up to 50% of the investment/working capital of the funded company

Detailed assumptions can be found in Annex A.

Cash flows, *Income Statement* and Statement of financial position forecasts can be found in Annex B.

6.3 Financial model - Summary

The total cost of the intervention is EUR 10m comprising:

- *loans* of EUR 3.5 million
- *grants of* EUR 5.7million
- *management costs of* EUR 0.8million.

Loans are repaid over five years, with all *loans* forecast to be repaid before the end of year 9.

Management costs have been included in the model calculated at 2% of the total *grant* value (EUR 10 million), whilst *loans* are being made and then 0.5% whilst the *loans* are being monitored/recovered.

10% of early stage *loans* are forecast to *default* in the 18th month, following advance and start-up *loans* at 15 months. The remainder are forecast to be repaid in full and on time. Because the model assumes that they *default* after repaying some of the capital, the actual loss of value is a lower percentage of capital than the percentage loss of original investments by number. The fund at the end – i.e. original capital less losses and costs - is EUR 2.9 million, or 29% of the original *grant* capital.

In summary, and on the basis of the assumptions invented for the purpose of this illustration, a legacy of nearly EUR 3m is forecast from the original EUR 10 million. This would be available to reinvest or to use as match for a new fund. In addition, businesses have been supported, private sector *leverage* achieved, jobs created and cross-border business entered into.

Note that more detailed assumptions, together with a project *cash flow* aimed at financial specialists, are included as technical appendices A and B.

Figure 6: Summary of Financial and socioeconomic outputs.

Overview		**Total**
Total grant	€	10,000,000
Loan element	€	3,500,000
Management costs (total)	€	800,000
Net grant	€	5,700,000
Proportion recovered (legacy fund:total grant)		29%
Loans (number)		56
Legacy Fund	€	2,860,417

Source of Funding		**Total**
ERDF	€	5,000,000
Public Sector match	€	5,000,000
Total	€	10,000,000

Management fees	**% of loan capital per annum**
Years 1-4	2.0%
Years 5-9	0.5%

Loan element parameters		**Early stage**		**Start-up**
Loan value	€	2,500,000	€	1,000,000
Number of months investing		48		48
Type of product		0% loan		0% loan
Negotiation (arrangement) fees		1%		1%
Private sector leverage		100%		100%
Average value	€	80,000	€	40,000
Number of loan/grant packages		31		25
Loan term (months)		60		60
Grace period (payment holiday) (months)		6		12
Target group		SMEs		SMEs
Default month for non performing loans		18		15
Expected default		10.00%		20.00%
Effective default (Proportion of original value)		7.64%		18.37%

Outputs		**Total**		**Early stage**		**Start-up**
Private sector leverage	€	3,500,000	€	2,500,000	€	1,000,000
Cross border business generated	€	5,625,000	€	3,125,000	€	2,500,000
New jobs		350		250		100
Businesses supported		56		31		25
Start ups incl in businesses supported		25		-		25

Source: Ampersand

INTERACT is co-financed by the European Regional Development Fund ERDF

Annexes

A: Assumptions for financial model of loan scheme

INTERACT Small Loans Financial Model Assumptions

Version 4 (February 2015)			**Early stage**	**Start-up**
Fund name:				
Small Loans Fund				
Product name			Small loans	Start ups
Product description			0% loan	0% loan
Product type			Debt	Debt
Investments placed				
Average value	€'s	62,222	80,000	40,000
Average grant value	€'s	101,333	130,286	65,143
Total average grant plus loan value	€'s	163,556	210,286	105,143
No of beneficiaries	Number	56	31	25
Loan fund size	€'s	3,500,000	2,500,000	1,000,000
Grants fund size	€'s	5,700,000	4,071,429	1,628,571
Total fund size (loan plus grant)	€'s	9,200,000	6,571,429	2,628,571
Managmeent costs	€'s	800,000		
Total Fund	€'s	10,000,000		
Interest				
Base rate - annual	%		0.00%	0.00%
Interest receivable (gross) - Premium over Base IRR	%		0.00%	0.00%
Capital Repayment				
First repayment	Month number		6	12
Final repayment	Month number		60	60
Repayment method			Equal instalments	Equal instalments
Additional payment payable with final instalment	€'s		0%	0%
Premium payable with each capital instalment	%		nil	nil
Default				
Non-performing portfolio	%		10.00%	20.00%
Effective default rate			7.64%	18.37%
Non-performing portfolio default month	Month number		18	15
Fees				
Negotiation fee (payment time zero)	%		1%	1%
Outputs				
(All outputs over investment period plus 1 year)				
Private sector leverage	%		100%	100%
Cross border business generated	€'s per business		250,000	100,000
New jobs	No per €1,000,000		100	100
Businesses supported	Number per €1,000000		4.76	9.51
Start ups incl in businesses supported	Proportion of businesses supported		0%	100%

Source of Funds	Value	%
ERDF	5,000,000	50%
National Match Funding	5,000,000	50%
Total Fund	10,000,000	100%

Draw down of funds		
National match		As needed
ERDF months following quarterly claim	Months	3

ERDF claim		
First claim made up to	First month	3
Claims interval	Months	3

Management fees	
Yeaars 1-4	2%
Years 5-10	0.50%

B: Cash flow overview

INTERACT Small Loans Financial Model
Version 3 (November 2014)
Income Statement

	Total	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
	€	€	€	€	€	€	€	€	€	€	€	€
Income												
Negotiation fees												
Small loans	**25,000**	3,846	5,769	7,692	7,692	-	-	-	-	-	-	-
Start ups	**10,000**	1,539	2,308	3,077	3,077	-	-	-	-	-	-	-
Interest												
Small loans	-	-	-	-	-	-	-	-	-	-	-	-
Start ups	-	-	-	-	-	-	-	-	-	-	-	-
Grant income	**10,000,000**	1,615,385	2,323,077	3,030,769	3,030,769	-	-	-	-	-	-	-
Total income	**10,035,000**	**1,620,769**	**2,331,154**	**3,041,538**	**3,041,538**	-	-	-	-	-	-	-
Expenditure												
Fund managers fees	**1,100,000**	200,000	200,000	200,000	200,000	50,000	50,000	50,000	50,000	50,000	50,000	-
Grants disbursed	**5,700,000**	876,923	1,315,385	1,753,846	1,753,846	-	-	-	-	-	-	-
Movement on bad debt provision												
Small loans	**190,909**	29,371	44,056	58,741	58,741	-	-	-	-	-	-	-
Start ups	**183,673**	-	16,955	43,093	52,983	56,515	14,129	-	-	-	-	-
Total expenditure	**7,174,583**	**1,106,294**	**1,576,395**	**2,055,680**	**2,065,570**	**106,515**	**64,129**	**50,000**	**50,000**	**50,000**	**50,000**	-
Net expenditure	**2,860,417**	**514,476**	**754,759**	**985,858**	**975,968**	**(106,515)**	**(64,129)**	**(50,000)**	**(50,000)**	**(50,000)**	**(50,000)**	-
B/fwd		-	**514,476**	**1,269,234**	**2,255,093**	**3,231,061**	**3,124,546**	**3,060,417**	**3,010,417**	**2,960,417**	**2,910,417**	**2,860,417**
C/fwd	**2,860,417**	**514,476**	**1,269,234**	**2,255,093**	**3,231,061**	**3,124,546**	**3,060,417**	**3,010,417**	**2,960,417**	**2,910,417**	**2,860,417**	**2,860,417**

INTERACT is co-financed by the European Regional Development Fund ERDF

INTERACT Small Loans Financial Model
Version 3 (November 2014)

Cash flow	**Total**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**	**Year 11**
	€	**€**	**€**	**€**	**€**	**€**	**€**	**€**	**€**	**€**	**€**	**€**
Inflows												
Negotiation fees												
Small loans	**25,000**	3,846	5,769	7,692	7,692	-	-	-	-	-	-	-
Start ups	**10,000**	1,539	2,308	3,077	3,077	-	-	-	-	-	-	-
Funds drawn down												
From ERDF	**5,000,000**	499,615	1,179,231	1,426,923	1,515,385	378,846	-	-	-	-	-	-
National Match	**5,000,000**	807,692	1,161,539	1,515,385	1,515,385	-	-	-	-	-	-	-
National funds to cover ERDF	**3,365,256**	570,385	774,359	1,010,256	1,010,256	-	-	-	-	-	-	-
Loan Repayments												
Small loans	**2,309,091**	9,091	98,671	224,784	376,486	495,338	461,189	354,021	220,280	69,231	-	-
Start ups	**816,327**	105	17,619	62,313	117,975	177,813	183,674	141,287	87,912	27,630	-	-
	-	-	-	-	-	-	-	-	-	-	-	-
Total income	**16,525,674**	**1,892,273**	**3,239,496**	**4,250,431**	**4,546,256**	**1,051,997**	**644,862**	**495,308**	**308,192**	**96,860**	-	-
Outflows												
Fund managers fees	**1,100,000**	200,000	200,000	200,000	200,000	50,000	50,000	50,000	50,000	50,000	50,000	-
National funds repaid	**3,365,257**	262,308	792,051	921,795	1,010,256	378,846	-	-	-	-	-	-
Grants												
Small loans	**4,071,429**	626,374	939,560	1,252,747	1,252,747	-	-	-	-	-	-	-
Start ups	**1,628,572**	250,550	375,824	501,099	501,099	-	-	-	-	-	-	-
New investments		-	-	-	-	-	-	-	-	-	-	-
Small loans	**2,500,000**	384,615	576,923	769,231	769,231	-	-	-	-	-	-	-
Start ups	**1,000,000**	153,846	230,769	307,692	307,692	-	-	-	-	-	-	-
Total outflows	**13,665,257**	**1,877,692**	**3,115,128**	**3,952,564**	**4,041,026**	**428,846**	**50,000**	**50,000**	**50,000**	**50,000**	**50,000**	-
Inflows less outflows before repayment to H Co	**2,860,417**	**14,580**	**124,367**	**297,866**	**505,230**	**623,151**	**594,862**	**445,308**	**258,192**	**46,860**	**(50,000)**	-
	-											
Net cash flow	**2,860,417**	**14,580**	**124,367**	**297,866**	**505,230**	**623,151**	**594,862**	**445,308**	**258,192**	**46,860**	**(50,000)**	-
B/fwd		-	**14,580**	**138,947**	**436,813**	**942,043**	**1,565,194**	**2,160,056**	**2,605,364**	**2,863,556**	**2,910,416**	**2,860,416**
C/fwd	**2,860,416**	**14,580**	**138,947**	**436,813**	**942,043**	**1,565,194**	**2,160,056**	**2,605,364**	**2,863,556**	**2,910,416**	**2,860,416**	**2,860,416**

INTERACT Small Loans Financial Model
Version 3 (November 2014)
Statement of Financial Position

	Year 1 €	Year 2 €	Year 3 €	Year 4 €	Year 5 €	Year 6 €	Year 7 €	Year 8 €	Year 9 €	Year 10 €	Year 11 €
Investment portfolio											
Small loans	346,154	780,350	1,266,055	1,600,058	1,104,720	643,532	289,511	69,231	-	-	-
Start ups	153,742	349,937	552,224	688,959	454,631	256,829	115,542	27,630	-	-	-
Total Investment Portfolio	**499,895**	**1,130,287**	**1,818,279**	**2,289,017**	**1,559,351**	**900,360**	**405,052**	**96,860**	-	-	-
Current assets											
ERDF account	308,077	290,385	378,846	378,846	-	-	-	-	-	-	-
Bank account	14,580	138,948	436,814	942,044	1,565,195	2,160,057	2,605,365	2,863,557	2,910,417	2,860,417	2,860,417
Total current assets	**322,657**	**429,332**	**815,660**	**1,320,890**	**1,565,195**	**2,160,057**	**2,605,365**	**2,863,557**	**2,910,417**	**2,860,417**	**2,860,417**
National funds account	(308,077)	(290,385)	(378,846)	(378,846)	-	-	-	-	-	-	-
Net Assets	**514,476**	**1,269,234**	**2,255,093**	**3,231,061**	**3,124,546**	**3,060,418**	**3,010,418**	**2,960,418**	**2,910,417**	**2,860,417**	**2,860,417**
Represented by:											
Profit and loss account	**514,476**	**1,269,234**	**2,255,093**	**3,231,061**	**3,124,546**	**3,060,417**	**3,010,417**	**2,960,417**	**2,910,417**	**2,860,417**	**2,860,417**
Total funds	**514,476**	**1,269,234**	**2,255,093**	**3,231,061**	**3,124,546**	**3,060,417**	**3,010,417**	**2,960,417**	**2,910,417**	**2,860,417**	**2,860,417**

C: Glossary[52]

Cash Flow

One of a company's key performance indicators is its Cash Flow. The cash flow aggregates data regarding all cash inflows a company receives from both its ongoing operations and external investment sources, as well as all cash outflows that pay for business activities and investments during a given period. The cash flow statement is one of the three main financial statements of a company.

Co-finance

FIs have the possibility to attract other sources of finance in addition to the programme's resources. Co-finance can either be public or private funding.

Co-investment

Co-investments are typically *equity* investments made directly into an enterprise alongside other (mayor) investments.

Common Provisions Regulations

The common provisions regulation (CPR) is a horizontal regulation covering all European structural and investment funds. It encompasses principles, processes and measures for ensuring effectiveness and added-value of the FIs.

De-minimis

The COMMISSION REGULATION (EU) No 1407/2013 defines de minis as follows: "It is appropriate to maintain the ceiling of EUR 200 000as the amount of de minimis aid that a single undertaking may receive per Member State over any period of three years. That ceiling remains necessary to ensure that any measure falling under this regulation can be deemed not to have any effect on trade between Member States and not to distort or threaten to distort competition." FIs that meet these criteria are therefore not subject to the notification procedure.

Deadweight

FIs are implemented to initiate investments of enterprises. Deadweight is that portion of increased investments that would have happened anyway, irrespective of the FI. This unwanted result is called Deadweight effect. FIs can be designed to minimise deadweight effects, but they cannot be eliminated completely.

Default

If the Final Recipient does not repay at the date stipulated or repays less than the agreed amount, he is in Default. The risk of default is always accompanying *repayable finance*. Managing Authorities can reduce this risk by carefully assessing the ability and commitment of businesses to repay its financial obligations (see chapter 3.4).

Displacement

In well-functioning markets finance supply is offered by private credit institutions. If Public finance schemes target *Final Recipients* that otherwise would get a *loan* from private institutions, they crowd out private investors. This effect is called Displacement. If *repayable finance* schemes cover segments of well-functioning markets the risk of Displacement is evident. To prevent eventual Displacement of private finance supply, public schemes should be comprehensively designed and address only target groups that are excluded from private forms of supply (see chapter 4.2).

Equity

[52] Solely for the purpose of this paper.

Equity investment means the provision of capital to a firm, invested directly or indirectly, in return for total or partial ownership of that firm, and where the Equity investor may assume some management control of the firm and may share the firm's profits[53].

Final Recipients

The term Final Recipient refers to enterprises, Public Private Partnerships, projects and any legal or natural person receiving Repayable Investments (namely through *Equity* participations, *loans*, *Guarantees* and other forms of Repayable Investments implemented through similar transactions, with the exception of *Grants*) from a Financial Engineering Instrument[54].

Financial Engineering Instrument

An instrument such as *venture capital*, *guarantee* or loan fund launched by an operational programme and implemented in 2007-2013 programming period by a professional financial institution according to the *investment strategy*[55].

Financial Instrument

Financial Instruments is the term used in preference to Financial Engineering Instrument for the 2014-2020 programming period[56].

Financial Intermediary

Financial institutions such as *venture capital* funds, *loan* funds, *guarantee* funds, banks, etc. selected by Managing Authority to implement FI[57]. They are acting as an intermediary between the supply and demand of financial products.

Fund manager

The individual(s) or entity(ies) responsible for implementing the *investment strategy* and managing the portfolio of investments related to the *Financial Engineering Instruments* (being e*quity* funds, l*oan* funds, *guarantee* funds), in accordance with the stated goals and provisions as set out in the Funding Agreement[58].

General Block Exemption Regulation

Council Regulation No 994/98 of 7 May 1998, amended by Council Regulation No 733/2013 of 22 July 2013, enables the Commission to adopt so-called Block Exemption Regulations for State Aid. With these regulations, the Commission can declare specific categories of State Aid compatible with the Treaty if they fulfil certain conditions, thus exempting them from the requirement of prior notification and Commission approval[59].

Grace period

The period during which the final recipient is not required to make payments. An initial grace period of 6 months (or longer, for start-ups) is often stipulated in public finance schemes.

The terms grace period and repayment holiday are used synonymously.

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[53] Source: Mazars/Ecorys/EPRC (2013): Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period.

[54] Source: ebd.

[55] Source: Pelc/INTERACT (2013): Financial Instruments in European Territorial Cooperation Programmes 2014-2020.

[56] Source: Mazars/Ecorys/EPRC (2013): Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period.

[57] Source: Pelc/INTERACT (2013): Financial Instruments in European Territorial Cooperation Programmes 2014-2020.

[58] Source: Mazars/Ecorys/EPRC (2013): Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period.

[59] Source: COM, http://ec.europa.eu/competition/state_aid/legislation/block.html, accessed 08 December 2014

Grant

Grants are a non-repayable form of finance; in other words, the beneficiary is not required to repay the received finance. In Interreg context, this means that grant funds can only be spent once and cannot be used to match fund future projects.

Guarantee

A Guarantee is a commitment by a third party, called the guarantor, to pay the debt of a borrower when the latter cannot pay it themselves. The guarantor is liable to cover any shortfall or *default* on the borrower's debt[60].

Holding Fund/Fund of Funds

An umbrella fund set up by an Interreg programme to invest in more than one FI. The role of a Holding Fund will be to manage ERDF funds on behalf of the Interreg programme MA. The Holding Fund, together with the Interreg programme stakeholders (MA and Monitoring Committee), will develop an *investment strategy* stating that the conditions for ERDF funds will be invested in an Interreg programme area.

Based on its expertise and working closely with the Interreg programme Managing Authority, a Holding Fund will evaluate, select and accredit *financial intermediaries*, and monitor implementation of Interreg FIs. It may also provide technical assistance to *financial intermediaries*[61].

Income Statement

The income statement measures a business's economic condition. It shows all *revenue*s and expenses over a certain time period. The final figure is the company's profit or loss. The other financial statements of a company are the balance sheet and the *cash flow* statement.

Intermediate Body

Intermediate body means any public or private body which acts under the responsibility of a managing or certifying authority, or which carries out duties on behalf of such an authority, in relation to beneficiaries implementing operations (see CPR, Art. 2(18)).

Interreg

Since 2014 most European Territorial Cooperation programmes use Interreg for communication purposes.

Investment Strategy

The strategy developed jointly by an Interreg programme and Financial Institution selected for the implementation of FIs. It outlines the mission, objectives and investment policy of FIs, and how the funds invested in FIs will be spent in the Interreg programme following ex-ante assessment. It is based on both Interreg programme objectives and investment principles[62].

Leverage

An advantage of FI with EU funds is the potential ability to engage both private and/or public financial sectors with additional capital to increase the effect of the FI. Article 223 of the Regulation no. 1268/2012 defines the *leverage* effect as "Financial instruments shall aim at achieving a *leverage* effect of the Union contribution by mobilising a global investment exceeding the size of the Union contribution. The *leverage* effect of Union funds shall be equal to amount of finance to eligible final recipients divided by the amount of the Union contribution".

Loan

Loan as the typical form of debt financing is the purchase of the present use of money with the promise to repay it in the future according to a pre-arranged schedule and at a specified rate of interest. Loan

[60] Souce: Ebd.

[61] Source: Pelc/INTERACT (2013): Financial Instruments in European Territorial Cooperation Programmes 2014-2020.

[62] Source: Ebd.

contracts formally spell out the terms and obligations between lender and borrower. Loans can be classified as long-term (with maturity longer than one year), short-term (with maturity shorter than two years), or as credit line (for more immediate borrowing needs). They can be endorsed by co-signers, *guaranteed* by the government or secured by collateral - such as real estate, accounts receivable, inventory, savings, life insurance, stocks and bonds, or the item purchased with the loan. The interest rate charged on the borrowed funds reflects the level of risk the lender undertakes by providing the money. For example, a lender may charge a start-up company a higher interest rate compared with the interest rate it charges a company with a proven profit record from the past[63].

Negotiation fees

A 'one off' payment from the SME to the Fund when individual loan/grant packages are advanced.

Maturity

One characteristic feature of *repayable finance* (e.g. *loans*, repayable *grants*, etc.) is that the finance has to be repaid by a certain date. Maturity is the technical term to express this date.

Microcredit

Small *loans*, usually up to EUR 25 000, granted either by specialised microfinance institutions or other *financial intermediaries*.

Micro enterprise

A small business employing 10 people or fewer, and with a turnover of EUR 2 million or less, or balance sheet total of EUR 2 million or less.[64]

Mezzanine

Mezzanine financing consists of a mix between debt financing and *equity*. It can be distinguished between *equity* mezzanine – i.e., forms of mezzanine that have many elements of *equity* – and debt mezzanine – i.e., forms of mezzanine that have many elements of debt financing. Mezzanine financing is usually unsecured and subordinate (so-called „junior") to normal debt financing (so called "senior loans"). That means in case of liquidation or insolvency the creditor of the mezzanine financing may only be satisfied after the claims of other creditors. Mezzanine is an extremely flexible form of financing. It is believed that the use of mezzanine financing will continue to grow[65].

Small and Medium-sized Enterprises

Micro, small and medium-sized enterprises employ as defined in EU law employ less than 250 persons, have a turnover of max. EUR 50 m, and a balance sheet with total of max. EUR 43 million.

Reflows/Recycled Funds

Monies advanced to beneficiaries subsequently repaid and available for reuse by the project or Managing Authority.

Repayable assistance

A form of support from the European Structural and Investment Funds where part of it is to be reimbursed to the operational programme. Similar to one-off grants, repayable assistance may cover eligible costs actually incurred and paid, standard scales of unit costs, lump sums and flat-rate financing[66].

Repayable assistance should not be confused with *financial instruments*. Even though the basic mechanism of both schemes is similar and funds are offered to enterprises in the commercial sphere with growth

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[63] Source: Ebd.

[64] http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm

[65] Source: Ebd.

[66] Art 67 of Common Provisions Regulation (EU) No 1303/2013, 17 December 2013

potential and the ability to repay the funds, a repayable assistance scheme can be simpler. It can be operated by a managing authority without involving a financial institution for management and offered to beneficiaries as, for example, interest-free *loans* which are partially repayable after the initial repayment holiday[67].

Repayable Finance

The term Repayable Finance is used in this paper as a collective term for aid schemes that offer financial means to specific target groups. This includes *repayable assistance* and *financial instruments*.

Revenue

The income generated from sale of goods or services, or any other use of capital or assets, associated with the main operations of an organization before any costs or expenses are deducted[68]

Venture Capital

Professional *equity* co-invested with the entrepreneur to fund early stage (seed and start-up) or expansion of an enterprise. The aim of venture capital investors is to support companies with high growth potential, helping them grow and create value over several years by providing advice, incentives, networking and knowledge through a range of specific investment structures. Venture Capital is considered as a factor that substantially reduces the required time to introduce an innovation on the market.

[67] Source: repayable assistance: evolution or revolution for European Territorial Cooperation?, by Katarzyna Pelc, in: INTERACT Newsletter, financing the future, INTERACT Programme Secretariat, Spring 2014

[68] http://www.businessdictionary.com/definition/revenue.html#ixzz3M35iNXDY

D: Abbreviations

BGL	Banque Générale du Luxembourg
BIF	Baltic Innovation Fund
BNP	Banque Nationale de Paris
BP	Business Plan
CB	Cross-Border
CBC	Cross-Border Cooperation
CEB	Country Enterprise Boards
CIP	Competitiveness and Innovation Framework Programme
COESIF	Committee for the European Structural and Investment Funds
COM	European Commission
CP	Cooperation Programme
CPR	*Common Provisions Regulations*, Regulation (EU) No 1303/2013
EGESIF	European Group of Experts in Structural and Investment Funds
EI	Enterprise Ireland
EIB	European Investment Bank
EIF	European Investment Fund
ERDF	European Regional Development Fund
ESIF	European Structural and Investment Funds
ETC	European Territorial Cooperation
EU	European Union
EUR	Euro
EUREFI	Europe Regions Funding
Eurostat	Statistical Office of the European Union
F(E)I	Financial (Engineering) Instrument
FI-TAP	Technical Advisory Platform for Financial Instruments
GBER	Group Block Exemption Regulation
IB	Intermediary Body
INTERACT	Animation, Cooperation and Transfer for European cooperation programmes
IS	Investment Strategy
JEREMIE	Joint European Resources for Micro to Medium Enterprises
JOSEFIN	Joint SME Finance for Innovation
JTS	Joint Technical Secretariat
K	Thousand
LEO	Local Enterprise Offices
m	Million
MA	Managing Authority
OP	Operational Programme
R&D	Research and Development
RA	Repayable Assistance
RF	Repayable Finance
SME	Small and Medium-sized Enterprises
TA	Technical Assistance
TO	Thematic Objective
VC	Venture Capital

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