Supplement no. 1:

ANALYSIS OF BEST PRACTICES IN OTHER EU COUNTRIES

ANALYSIS OF BEST PRACTICES IN OTHER EU COUNTRIES

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2. ANALYSIS OF BEST PRACTICES IN OTHER EU COUNTRIES

2.1. Introduction

2.1.1. Qualitative Scope: relevant practices vs. best practices

Best practices in the EU with respect to financial tools designed to further entrepreneurial development are examined in this section.

The use of the concept of "best practices" that is made here requires some qualifications.

First, sometimes practices that are identified as best practices are narrow operational details within one kind of tools or one kind of institutions. For instance, among (say) 100 European guarantee firms, a particular way of setting up success fees to be paid to employees used by 1 or 2 firms may be defined as best practice because it proved to be imaginative and efficient. This is important for that particular kind of institutions but it is not important for the more general approach that has to be followed in this project. So, that kind of detailed operational best practices are not examined in the current project.

Second, sometimes the practices of one country may be identified as best or very good but they only work well in the context of the traditions and institutions of that country. For instance, in the UK, venture capital can be efficiently leveraged by State promotion because there are many private venture capital firms and because there are traditions of an active and efficient stock market. However, this is less relevant for the Czech Republic because this country does not have the same economic background. On the other hand, the Polish experience with respect to venture capital and guarantee funds is not generally considered as best practice, but it has some similarities with the Czech case because it is also being promoted by the Central State through a development bank.

So, the concept of “best practice” is combined with the concept of “relevant practice” for the Czech situation in order to avoid unnecessarily detail in best practices that are not too relevant for the Czech Republic (like the UK example) and in order to include cases that may not be the best in Europe but which may contain useful examples (like the Polish State-promoted venture capital and guarantee funds).

2.1.2. Regional Scope: EU Objective 1 Regions (CSFs)

The search for best or relevant practices has been limited to regions that are classified as EU Objective 1 regions, including those that are phasing-out by the end of 2005 or of 2006

2.1.3. Types of Financial Tools for SMEs (terminology)

2.1.3.1. Direct State financial support (grants, soft loans, interest rate subsidies)

Direct Financial Tools of State support includes:

- Grants: money given to firms; it is not to be reimbursed, i.e., it is not to be given back to the State (generally, the beneficiary firm should convert the sum of the grant into Capital of the firm)
- Soft loans: loans made by State agencies with favourable terms; the State support or subsidy consists in one or more of the following factors: (i) the repayment schedule is more favourable (longer) than usual, (ii) the interest rate is lower than what would normally be charged by a commercial bank, (iii) the beneficiary firm would normally not be able to obtain classic loan from a bank
- Interest rate subsidies: the firm uses a classic bank loan but the State pays to the bank part (a certain percentage) of the interest

2.1.3.2. Indirect State financial support or alternative finance (risk equity and loans; guarantees)

Indirect State Financial Support is generally directed at filling up "market failure", in particular, the "market failure" that arises from SMEs having difficult access to classic forms of finance (such as own wealth of the owners, bank credit or the stock market). As a consequence, it is also often called "alternative finance", in the sense of alternative to classical tools.

Such finance may consist in (1) Equity and Loans (including leasing) and/or in (2) Guarantees and Counter-guarantees:

- Equity and loans may be classified according to various criteria:
  - According to the stage of the firm
    - very early stage (a stage of initial concept; seed capital)
    - early stage (setting up the firm; start-up capital)
    - subsequent/later stages (bridge financing, mezzanine financing, growth financing, turn-around financing, etc.)
  - According to the use of the finance
    - to buy fixed assets (machines, patents, etc.)
    - to increase working capital
    - to make financial restructuring of the firm (improving the structure of the balance sheet)
    - to provide for financial strengthening (money to increase the capital of the firm or to provide shareholders' loans as own capital or to provide shareholders' loans as liabilities)
    - to provide various forms of finance under the shape of project finance (complex financing structure; unusual in State support for SMEs)
  - According to the aims of the financial operations
    - to set up a firm (creation)

- modernization
- rationalization
- turnaround (firms in difficult situation)
- expansion of output
- expansion of output capacity (growth)

o According to the kind of institution

- State Administration (for instance, a department of one Ministry); however, such departments do not usually manage financial tools due to lack of in-house financial expertise
- Public specialized agencies (like Czechinvest, in the Czech Republic, or PARP, in Poland)
- Specialized institutions wholly owned, partly owned, controlled, influenced or trusted by the State (like firms, agencies or foundations of regional/local development that operate risk/venture funds, as those existing in Poland and in other countries)
- State banks (often development banks owned by the State like the CMZRB, in the Czech Republic, the BGK, in Poland, or the IBB-Investitiones Bank Berlin, Landesbank of the Land of Berlin, Germany)
- Risk Capital/Venture Capital firms, both non-profit organizations (including those wholly or partially owned by the Sate) and for-profit private firms
- Business Angels
- Private banks (most commonly, commercial banks or investment banks owned by banking/financial groups that sign protocols with the State)

- With respect to guarantees and counter-guarantee:

o Financial Guarantees for SMEs (to increase SMEs access to classical or alternative finance); they are generally provided by

- State owned banks or financial institutions (often public development banks, like the CMZRB, of the Czech Republic, the BGK, of Poland, the KfW-Kreditanstalt für Wiederaufbau, of the Federal State of Germany, or the IBB-Investitiones Bank Berlin, Landesbank of the Land of Berlin, Germany)
- specialized guarantee banks (like the BBS-Bürgerschaftsbank Sachsen, Landesbank for guarantees of the Land of Saxony/Sachsen, Germany, or the other *Bürgschaftsbanken* of Germany and Austria)
- specialized mutual guarantee firms (like the specialized mutual guarantee firms of Portugal, Spain or Hungary)
- State agencies that have the promotion of SMEs as their mission or as one of their missions (like the SBS-Small Business Service, of the UK, or the SBA-Small Business Administration, of the USA; the Polish agency PARP used to provide guarantees either directly or through selected local/regional development institutions but that role has now been moved to the guarantees program of BGK, a State development bank)
- other institutions (foundations, non-profit organizations, regional/local development agencies and other firms or institutions that operate guarantee funds, like those that exist in large numbers in Poland)

- o Counter-guarantees: these are guarantees for guarantees (similar to reinsurance); they increase the capacity of the front-line guarantee institutions to issue guarantees; they are generally provided by
  - institutions at the national level, usually, specialized counter-guarantee institutions (like CERSA, of Spain, SPGM, of Portugal, or Hitelgarancia, of Hungary)
  - the EBRD also has lines of counter-guarantee (like those used by the CMZRB, of the Czech Republic)

- Note on guarantees: generally, the institutions that provide financial guarantees (guarantees pertaining to loans, usually, bank loans) also provide other types of guarantees (technical and miscellaneous guarantees, like those to receive advance payments, to ensure performance of contracts or to enable withdrawal of goods before payment of customs duties); the focus here is on financial guarantees

2.1.3.3. Note on Risk/Venture Finance

Venture Capital means finance (money to buy equity, to provide loans or both) provided to help the creation of a firm (a venture, a joint venture; thus the name Venture Capital). The investee firm/entrepreneur does not have track record and/or real estate/wealth to obtain classical bank credit.

So, Venture Capital is associated to the earlier stages of the investee: Seed Capital, Start-up Capital, Start-up Capital for Young Entrepreneurs, Start-up Capital for High-tech.Firms, etc.).

Risk Capital means finance (for equity or for loans) for a firm with higher than average risk (making it difficult to obtain classical bank credit), whatever the stage of the firm.

So, Risk Capital includes earlier stage finance (like Seed Capital and Start-up Capital), as well as later stage finance (like Growth/Expansion Finance, Bridge

Finance, Mezzanine Finance, Turnaround Finance, Financial Restructuring, MBIs, MBOs, etc.).

As a consequence, Risk Capital (high risk) is a more general concept and should be used instead of Venture Capital (high risk at early stage of firm). However, very often the two concepts are used interchangeably as if they were synonymous.

It should also be noted that the expression Risk/Venture Capital is sometimes used for investment operations that are at the borderline between Risk Capital and conventional Equity Investment. For instance, Pension Funds (or rather, firms that manage Pension Funds) are not supposed to make risky investments with the money of retired workers. However, those pension funds that are not too risk-adverse diversify the portfolio by investing a (usually small) percentage in less safe/more risky assets. Banks managing Investment Funds on behalf of their clients usually do the same.

It happens that it is quite common for surveys on Venture/Risk Capital activities to cover with no distinction both types of investment[1], namely: (i) the more risky investments that would not normally be undertaken by private investors without some kind of State support (like State finance or guarantee for high-tech start-ups or for young entrepreneurs) and (ii) the less safe/more risky component of investment portfolios (like those of the Pension Funds and Investment Funds managed by banks or those of private firms which specialise in more risky investments) which are the result of portfolio diversification of private investors and do not usually receive State aid. Obviously, component (ii) is not relevant for the current project.

[1] The CVCA (České venture kapitálové asociace) is a case in point. The title of its website in English (www.cvca.cz/www/cvca/wwwcvca.nsf/EZM) is "Czech Venture Capital and Private Equity Association", thereby adding the private equity component. And, as a matter of fact, among the full members we find standard private equity investment houses like Erste Bank Acquisition Finance, Central Europe, of the Austrian Erste Bank group, and DBG Eastern Europe, s.r.o., of the German Deutsche Bank group.

2.1.3.4. Note on Funds

In the current context, a fund is a revolving sum of money for equity/loans or for guarantee/counter-guarantees.

It is revolving because, at the end of the operation, the money is recovered and becomes available for a new similar operation.

However, if the Risk/Venture capital institution sells the equity at a loss or is not repaid a loan, the fund (sum of money) decreases. In that case, the State may want to "replenish" the Fund. The same happens with a guarantee fund if claims paid exceed income from fees.

A Fund (in the sense of a revolving sum of money for a specific purpose) is something different from the institution that operates that Fund or other Funds (the same institution may manage more than one Fund).

However, it is quite common for people to refer to (say) a Counter-Guarantee Fund while they mean the institution that manages that Fund. The distinction between "Fund=money" and "Fund=managing institution" should always be kept in mind.

An important Best Practice for Fund management is that Funds should be ring-fenced. That is to say, one Fund should not pay for losses of other Funds. More to the point, one Fund should not go bankrupt due to losses incurred by another Fund.

Two different Funds are obviously ring-fenced if they are managed by two different institutions. If they are managed by one single institution, they should be ring-fenced by accountancy practices (separate accounts) made possible by the Bye-Law of the institution.

2.1.3.5. Note on Financial Tools for Agriculture and for Fishing

In several EU countries State support for Agriculture and for Fishing is dealt with through separate tools and separate institutions. This is generally due to the following

factors: (i) the production and investment cycle in agriculture is somewhat specific; (ii) sometimes agriculture has traditional organizations that survived through decades and through economic and political changes, (ii) there are separate EU Structural Funds for Agricultural and for Fishing (EAGGF- European Agricultural Guidance and Guarantee Fund/Guidance section; FIFG-Financial Instrument for Fisheries Guidance).

The nature of the main financial tools for agriculture and for fishing is generally the same as for the other sectors (if anything, the most innovative financial tools are less common in agriculture and fishing than in the other sectors).

So, not much attention will be paid to the specific financial tools for agriculture and fishing.

2.2. Germany

2.2.1. Financial tools in Germany

As one of the most developed countries in the world, Germany has a well developed financial system.

Banks (bank financial tools, in general) play an important role. In fact, Germany is the "finance capital" (*finanzkapital*) country. The typical intermingling of interest between banks and industrial firms/conglomerates with banks loans is one of the main sources of enterprise finance (as opposed to the Anglo-American tradition of separation between banks and industry and of a greater role for the Stock Exchange and for equity investment houses).

EU and BIS (Bank of International Settlements, based in Basle, Switzerland) rules on maximum exposure of banks in a single firm or group (through equity ownership or loans) is bringing down the importance of this finance capital feature of the country's entrepreneurial landscape. As a consequence, other types of financial or para-financial firms are being developed in Germany, namely, equity investment subsidiaries of banks to manage investment funds on behalf of clients, equity investment by institutional investors (pension funds, insurance companies, holding companies, etc.).

The medium-size business[2] (*Mittelstand*) was also one of the noted backbones of post-WW II reconstruction and further development. There is Federal level (Bund) aid, mostly channelled through KfW-Kreditanstalt für Wiederaufbau (a large Federal financial group that started as the implementing agency of the Marshall Fund). And there is also Regional State (*Land*) aid, mostly channeled through Land-level development agencies or banks (*die Landesbanken* and Bürgschafts-banken/guarantee banks).

[2] It refers to middle-size firms (*Mittelstand*) only, rather than SMEs (in German, KMUs)

At present, EU support through the Structural Funds and other EU programs and initiatives takes similar shapes and is being channeled through the mentioned Federal and Regional agencies.

Equity investment became quite developed. First, many equity investment firms were created to manage money of the banks, of their clients, of pension funds, of labour union funds, etc.. With excess liquidity to invest, these firms and bank departments entered the venture capital business as a means of diversifying the portfolio into more risky (less safe) areas. Some of such equity investment firms developed special expertise to assess the risk in less conventional businesses, like technology-driven firms, innovative lines of business, etc..

On the other hand, both the Federal State (*Bund*) and the Regional States (*die Länder*) promoted SME creation and development through mechanisms of risk/venture capital, often for start-ups but also for technology, R&D, innovation, women entrepreneurs[3], disadvantaged minorities, etc..

The borderline between risky private venture capital and public risk capital became fuzzy.

There is a tendency now for Federal (Bund) and Regional (Land) aid to take the shape of supporting firms by sharing the risk of market-led operations (for instance, to offer to buy equity or to make a loan or to provide a financial guarantee in a risky technological start-up operation led by a private venture capital firm or a private business angel that does not want to take took much risk).

However, in many other cases, the risk is very high and no private venture firm or business angel would take it. In such cases, the *Bund* or *Land* agencies have to take the lead and accept all the risk or a large part of it.

[3] The EU Equal Program promotes equality of opportunities for women and also for disadvantaged sectors of the population.

In addition to equity and loans (and grants, in some cases), financial guarantees are also a post-WW II tradition in Germany. This is done through a network of regional (*Land*) guarantee banks (*die bürgschaftsbanken*).

The main features of those guarantee banks are the following:

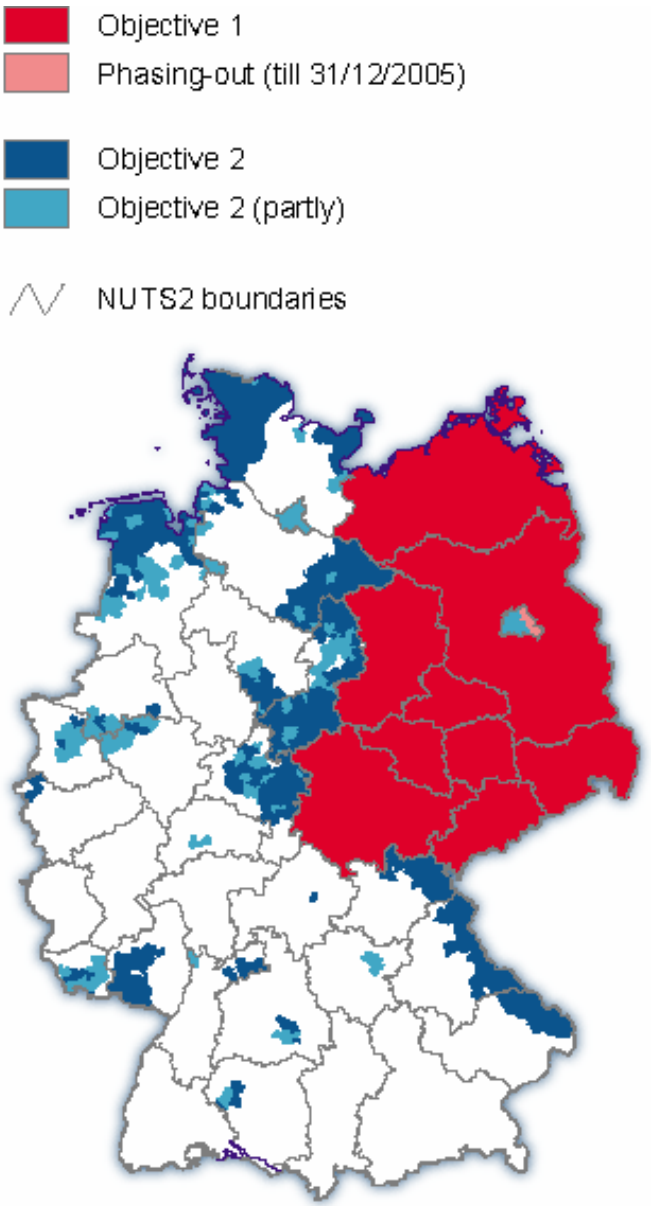
- There are 24 such banks. Their scope of activity is regional (and, sometimes, sectoral) and they are coordinated by a national association (*der Verband*). Most of them were created between 1949 and 1955. After the Reunification, guarantee banks were created in the new Regional States (*die neue Länder)*;
- They are corporations/limited liability share-companies (GmbH) owned by a vast array of institutions of the Land or with activities in the Land (Land Ministries, Land agencies and banks, private banks, chambers of commerce, industrial associations, craftsmen associations, etc.). As they are known to be implicitly or explicitly supported by the Government of the Land, re-insurance, counter-guarantee or replenishment of risk funds are taken for granted;
- Despite the legal status of corporations (GmbH), they are mutual organizations; that means that the clients have to be shareholders/associates of the guarantee banks, at least as long as the guarantee is outstanding;
- Due to prudence rules about conflicting interests, the shareholders can be beneficiaries of guarantees but they cannot be clients. For instance, suppose a local bank (Bank A) that owns 1% of the local guarantee bank (Bürgschaftsbank B). A loan of Bank A to the Firm X can be guaranteed by the Bürgschaftsbank B (the Firm X is a client of both the Bank A and the Bürgschaftsbank B; and Bank A is the beneficiary of the guarantee). However, if the local bank (Bank A) seeks funding from a larger bank (say, Deutsche Bank) by contracting a loan, this loan cannot be guaranteed by Bürgschaftsbank B, because then Bank A would be a client and a shareholder at the same time (conflicting interests);
- Guarantees cannot be provided for non-feasible enterprises; however, for viable/feasible firms in bad shape (for example, near bankruptcy), there may exist

special public financed lines for financial restructuring and similar operations (but this is unusual);

- They are qualified as bank-financial institutions and, as a consequence, their guarantees are considered as solid as mortgages on real estate for the purpose of the provisioning requirements of the banks under the Basle I solvency rules (this is an advantage for the banks that provide the loans; this advantage will be reinforced by the Basle II solvency rules);
- The guarantees typically cover between 50% and 80% of the bank loan. For firms, the typical duration of the guarantees is 8-10 years (max.: 15 years), in other words, the guarantees are mostly directed for long-term loans (the average length of all the guarantees portfolio is usually longer because those guarantee banks also issue guarantees of up to 25 years for housing);
- The costs for the client are relatively low: generally, a fee for the analysis of the project (a fixed sum paid at the time of the application), an yearly commission or premium (something like 1% of the outstanding guaranteed amount, for an average level of risk) and, in the case of mutual guarantee companies, the acquisition of stock/shares to qualify as a member/shareholder of the guarantee company (typically, stock/shares of something like 1% of the initial guaranteed amount; those shares can be sold after the end of the guarantee);
- Up to now, the system has been completely bank-led. In fact, the applications for guarantees were submitted by the main bank of the entrepreneur (*die Hausbank*). In other words, the entrepreneur approached the bank for a loan. If the bank felt that the risk was too high (or that the mortgages available were insufficient), the bank itself would send the file to the guarantee bank;
- Recently, a new practice is being tried. It is called BoB-*Bürgschaft ohne Bank* (guarantee without bank). The entrepreneur submits the project directly to the guarantee bank. It he obtains the pledge of a guarantee, the entrepreneur can then approach various commercial banks to find out which one offers the best terms for the guaranteed loan.

2.2.2. EU Support - Objective 1 Regions and Regional Policy

The Objective 1 territories of Germany are made up of East-Berlin and the new Regional States (*die neue Länder*), i.e., the territories of the former DDR-Deutsche Democratic Republic. East-Berlin is phasing out of Objective 1 (until the end of 2005).



The Regional States[4] (*Länder*) are Federate States with elected bodies: in other words, they are self-governing regions.

Such *Länder* (Regional States; self-governing regions) coincide with NUTS 1 regions and they cover one or more EU NUTS 2 regions (known in the Czech Republic as Cohesion regions).

There is a nationwide Regional Development Program for Objective 1 2000-2006, setting up the overall structure and aims (5 priorities/*schwerpunkte* plus technical assistance). This program is agreed with and approved by the EU Commission.

Afterwards, the Objective 1 Program is subdivided by the German Federal Government into 6 regional Operational Programs (1 for each of the 6 States/*Länder*) and 3 sectoral programs (Federal/*Bund* level).

The structure of the Objective 1 support for Germany is as follows:

Objective 1 Operational Programs (OPs)	NUTS 1	NUTS 2	NUTS 3
OP East-Berlin (*Ost-Berlin*); phase out by the end of 2005	City of Berlin (self-governing State), only the eastern part of the territory	The same as NUTS 1	The same as NUTS 2
OP Brandenburg	Land of Brandenburg (self-governing State)	• Brandenburg-Nordost	• 18 NUTS3 territories
		• Brandenburg-Südwest	• 10 NUTS 3 territories
OP Mecklenburg-Western Pomerania (*Mecklenburg-Vorpommern*)	Land of Mecklenburg-Western Pomerania (self-governing State)	The same as NUTS 1	• 18 NUTS 3 territories

[4] The terminology and translations of some designations are sometimes a bit confused and confusing. This paper uses the most common translations found in international and EU documents (e.g., Regional State for the German *Land*, Province for the Austrian *BundesLand*, Regional State for the Spanish Comunidad Autonoma, etc.). If there is no standard translation, the name in the original language is used (e.g., Kraj in the Czech Republic).

Objective 1 Operational Programs (OPs)	NUTS 1	NUTS 2	NUTS 3
OP Saxony (*Sachsen*)	Free State of Saxony (self-governing State)	• Chemnitz	• 12 NUTS 3 territories
		• Dresden	• 11 NUTS 3 territories
		• Leipzig	• 6 NUTS 3 territories
OP Saxony-Anhalt (*Sachsen-Anhalt*)	Land of Saxony-Anhalt (self-governing State)	• Dessau	• 6 NUTS 3 territories
		• Halle	• 7 NUTS 3 territories
		• Magdeburg	• 11 NUTS 3 territories
OP Thuringia (*Thüringen*	Land of Thuringia (self-governing State)	The same as NUTS 1	• 23 NUTS 3 territories
OP Transport Infrastructures (Federal level)	All Objective 1 territories		
OP Human Resources (Federal level)	All Objective 1 territories		
OP Fishing (Federal level)	All Objective 1 territories		

It is interesting to notice that, in the Objective 1 Community Support for Germany, the regional Operational Programs have been set for the self-governing NUTS 1 regions (States/Länder). On the contrary, in the Czech Republic, the 8 NUTS 2 Cohesion regions are administrative units and they often cover more than one of the 14 *Kraj* (self-governing regions) which make up the NUTS 3 level.

It should be noted that, in addition to the Objective 1 EU Structural Funds, the territories of the former DDR also benefit from substantial support from the 2 levels of the German State, the Federal/national level (Bund) and the State (Land) level.

For these various sources of public support, the most important implementing institutions with respect to financial tools for SMEs are the following:

- KfW (Kreditanstalt für Wiederaufbau (Federal/*Bund* level)
    - it is a nationwide State Bank created in the aftermath of WW II; it was the main channel in Germany of the ERP-European Reconstruction Program (also know as Marshall Plan)
    - now, it grew to become a large financial group owned by the Federal State
    - it is the implementing agency for several Federal Programs
    - it has several specialized subsidiaries, one of which is a bank for medium-size firms, the KfW Mittelstandsbank
- one development bank of regional scope owned (or contracted or trusted) by the *Land* (*die Landesbank*)
- one guarantee bank (*die Bürgerschaftsbank*), also of regional scope, generally owned by the Land (together with national banks that operate in the Land, local saving banks, local entrepreneurial associations and chambers of commerce, etc.); sometimes, the guarantee bank also plays the role of regional development bank/agency
- in most earlier *Länder* (those of Western Germany before the reunification) and in some of the new *Länder* (those of Eastern Germany after the Reunification), there are investment/venture capital firms wholly or partly owned by the *Land* or by one its banks
- in the richer *Länder* there are more than one development bank or guarantee bank[5] and there are also various public (or private-public) specialized agencies of the Land, like venture capital firms for innovation or for hi-tech, innovation centers, incubators, etc..

[5] For instance, in Bavaria (*Bayern*) there are 5 guarantee banks altogether.

2.2.3. Berlin: an example of a well developed business support structure

The following tables show the financial support programs available to Berlin firms, both through the regional Objective 1 OP Berlin East and through Objective 2 and Federal/Bund and Regional/Land financing programs.[6]

Creation of own employment/sole proprietorship/firm (in German, *Existenzgründungs*)

Enterprise Creation Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-)kofinanziert	Combination possible (Kombinierbar)	De-minimis rule
Master craftmen grant (Meistergründungsprämie) (Implementation: Chamber of Commerce of Berlin; Land Ministry of the Economy, Labour and Women)		X			X	X	X		X			Once up to (einmalig bis zu) 10 230 €	X	X	X
Bridge finance (Überbrückungsgeld) (Implementation: Employment Centers / Agenturen für Arbeit)		X							X			70,8 % bei Vorbezug Arbeitslosengeld oder 35,6 % bei Vorbezug Arbeitslosenhilfe für die Dauer von 6 Monaten	X		
Employment Program / Loans for employees to create own job /firm (ARP/Existenzgründungs-darlehen) (implementation: IBB)		X	X		X	X	X	X				Typically 15 000 €	X	X	X
European Reconstruction Program (Marshall Plan) Capital for firm creation (ERP-Kapital für Gründung) (Implementation: KfW Mittelstandsbank/Bonn or KfW Information Center/Berlin)		X			X			X				maximum 500 000 € per created firm (pro Vorhaben)		X	X
European Reconstruction Program (Marshall Plan) Fund for Start-ups, early phase (ERP – Startfonds: Modul Frühphase) (Implementation: KfW Mittelstandsbank/Bonn, through a Mentor)		X		X	X	X	X			X		maximum 150 000 €		X	
Finance for equal opportunities (women, minorities) (Equal Credit) (implementation: IBB)		X			X	X	X	X				maximum 25 000 €		X	X

[6] The European Social Fund programs for professional training and those of the ERDF specific for the protection of the environment are not considered here.

Enterprise Creation Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-)kofinanziert	Combination possible (Kombinierbar)	De-minimis rule
My PLC – Start-up grant (Ich-AG/ Existenzgründungszuschuss) (Implementation: Employment Centers / Agenturen für Arbeit)		X			X	X			X			Monthly: € 600 in the 1st year, € 360 in the 2nd year, € 240 in the 3rd year. Es gilt RV-Pflicht. Das max. Arbeitseinkommen darf 25.000 €/Jahr nicht überschreiten.		X	
Loans for start-ups (StartGeld) (Implementation: KfW Mittelstandsbank/Bonn or KfW Information Center/Berlin)		X	X		X	X		X				maximum 50 000 €			
Microloans (Mikro-Darlehen) (Implementation: KfW Mittelstandsbank/Bonn or KfW Information Center/Berlin)		X	X	X	X	X		X				maximum 25 000 €			

Investments

Enterprise Growth/Investment Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-)kofinanziert	Combination possible (Kombinierbar)	De-minimis rule
Grant for investing abroad (Außen-wirtschafts- förderungsprogramm) (Implementation: IBB)			X	X					X			Maximal 50 % der förderfähigen Kosten/ festgelegte Förderhöchstgrenzen	X		
Film support in the Berlin-Brandenburg region (Filmförderung) (Implementation: Medienboard Berlin-Brandenburg GmbH and Berlin Brandenburg Film Commission)	X					X	X	X	X			Depending on the specific project (case by case)	X		
Community Initiave foor the Improvement of the Regional Business Structure (GA – Gemeinschaftsaufgabe) (Implementation: IBB)		X	X		X				X			10% for creation; 20% for development (10 % Grundförderung; 20 % Höchstförderung)	X	X	

Enterprise Growth/Investment Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-)kofinanziert	Combination possible (Kombinierbar)	De-minimis rule
Fund for SMEs (KMU-Fonds) (Implementation: IBB)			X	X	X			X				bis 500.000 € (bei Konsortialdarlehen zuzüglich Hausbankanteil)	X	X	X
Subsidy Programs for Co-operation with Third States (Zusammenarbeit mit Dritt-Staaten) (Implementation: ERIC BERLIN, EuRo Info Centre in der Wirtschaftsförderung Berlin International GmbH)			X			X	X		X			30–100 % of the eligible costs (der förderfähigen Kosten)	X		
Equity Investment by the Mittelständische Beteiligungengesellschaft Berlin-Brandenburg (Beteiligungen der MBG) (Implementation: MGB GmbH, a subsidiary of the Bürgschaftsbank zu Berlin-Brandenburg)		X	X	X	X	X				X		Tipically up tu 1 Mio. €		X	
Guarantees (Bürgschaften) (Implementation: BBB Bürgschaftsbank zu Berlin-Brandenburg GmbH and PwC Deutsche Revision AG Wirtschafts-prüfungsgesellschaft)	X				X	X					X	Max 80 % of each default (eines Ausfalls)		X	X
European Reconstruction Program (Marshall Plan) Equity Investment Program (ERP-Beteiligungsprogramm) (Implementation: KfW Mittelstandsbank)			X	X	X	X		X				New Länder and East Berlin: max. 1 Mio. €; Old Länder and West Berlin: max. 500 000 €		X	
European Reconstruction Program (Marshall Plan) Capital for Growth (ERP-Kapital für Wachstum) (Implementation: KfW Mittelstandsbank)				X	X			X				Max. 500 000 € per calender year		X	
European Reconstruction Program (Marshall Plan) Regional Development Program (ERP-Regionalförderprogramm) (Implamentation: KfW Mittelstandsbank)			X	X	X			X				Max. 500 000 € per calender year		X	
Consultancy for investing Abroad (Finanzierungsberatung Ausland) (Implementation: IBB)			X		X							projektabhängig, i. d. R. ab 500.000 €		X	
Guarantee for Employee Equity investment (Garantien für Arbeitnehmer-beteiligungen) (Implementation: IBB)		X	X	X	X	X					X	Max. 80 %		X	X
IBB (Investitiones Bank Berlin) Enterprise Growth Program (IBB-Wachstums-programm) (Implementation: IBB)			X		X	X		X				Min. 500 000 €, max. 5 000.000 €		X	
Bonus for Equity investment 2005-2006 (Investitionszulagen 2005–2006)			X		X				X			12,5–27,5 % of the acquisition costs		X	
Capital for Employment and Investment (Kapital für Arbeit und Investitionen) (Implementation: KfW Mittelstandsbank)			X		X	X		X				Max. 4 Mio. € per project		X	

Enterprise Growth/Investment Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-)kofinanziert	Combination possible (Kombinierbar)	De-minimis rule
KfW/European Reconstruction Program (Marshall Plan) Export Financing Program (KfW/ERP-Exportfinanzierungs-programm) (Implementation: KfW Mittelstandsbank)			X					X				Max. 85 Mio. €		X	
KfW Risk/Venture Capital Program (KfW-Risikokapitalprogramm (Implementation: KfW Mittelstandsbank)			X	X	X	X				X		Max. 5 Mio. €			
Consolidation Fund (Konsolidierungsfonds) (Implementation: IBB)			X	X	X	X		X				Tipically, max. 1 Mio. €		X	
Liquidity Fund (Liquiditätsfonds) (Implementation: IBB)			X	X		X		X				Tipically, max. 1 Mio. €		X	
Special Program Guarantees for loans of up to € 50 000 (Sonderprogramm Bürgschaften für Kredite bis 50 000 €) (Implementation: BBB BÜRGSCHAFTSBANK zu Berlin-Brandenburg GmbH)		X	X	X	X	X					X	Max. 80 %			X
Corporate Loan (Unternehmerkredit) (Implementation: KfW Mittelstandsbank)	X				X	X		X				Max. 5 Mio. € per project		X	
Corporate Loan Abroad (Unternehmerkredit – Ausland) (implementation: KfW Mittelstandsbank and International Business / Wirtschaftsförderung Berlin International GmbH)	X				X			X				Max. 5 Mio. € per project		X	

Technological R&D

Technological R&D Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-Vorfinanziert)	Combination possible (Kombinierbar)	De-minimis rule
6th EU R&D Framework Program (6. Rahmenprogramm der EU) (Implementation: EuRo Info Centre ERIC BERLIN/Innovation Relay Centre (IRC) in der Wirtschaftsförderung BERLIN International GmbH)			X						X			Depending on the specific project: 35% or 100% of the eligible costs (vorhabensabhängig: 35 % und 100 % der förderfähigen Kosten	X		
E-TEN (e-Government and Services / EU eEurope program) (Implementation: ERIC BERLIN, EuRo Info Centre in derWirtschaftsförderung Berlin International GmbH)			X						X			10 %–50 % of the costs eligible for subsidy (der förderfähigen Kosten)	X		
Intelligent Energies for Europe (Europe EIE)			X						X			50 % of the costs eligible for subsidy (der förderfähigen Kosten)	X		
Subsidy Program for Research, Innovation and Technologies (ProFIT – Programm zur Förderung von Forschung, Innovationen und Technologien)	X				X	X	X	X	X	X		Grants of max. €300 000 per individual project and/or to max. € 400 000 per partner of group project. Loans and equity investment up to max. €500 000. (Zuschüsse bis maximal 300.000 € bei Ein-zelvorhaben bzw. bis maximal 400.000 € bei Verbundvorhaben je Partner, Darlehen/ Beteiligungen bis maximal 500.000 €)	X		
Berlin Risk/Venture Fund (VC Fonds Berlin)			X	X	X					X		offene Minderheitsbeteiligungen bis zu 49 % des Stamm-/Grundkapitals	X		
Future Fund Berlin (Zukunftsfonds Berlin)	X				X	X	X	X	X	X		Depending on the specific project; only R&D costs (vorhabensabhängig; nur Kosten für FuE)	X	X	
Future Fund of the IBB-Investitiones Bank Berlin (Zukunftsfonds der IBB)		X	X	X	X	X		X	X	X		Grants up to max. € 5 000; loans up to max. €100 000; Equity Investment up to max. € 2.5 Mio. (Zuschüsse bis 5.000 €, Darlehen bis 100.000 €, Beteiligung bis 2,5 Mio. €)	X		
European Reconstruction Program (Marshall Plan) Innovation Program (ERP-Innovations-programm) (Implementation: KfW Mittelstandsbank)			X	X	X	X		X		X		Max. 5 Mio. €			
European Reconstruction Program (Marshall Plan) Start-ups Fund (ERP-Startfonds) (Implementation: KfW Mittelstandsbank)		X	X	X	X	X	X			X		Max. 3 Mio. €; max. 1.5 Mio. € in the round of financing (in der ersten Finanzierungsrunde)			

Technological R&D Programs	Who				For what			What				How much	Miscellaneous		
	No restrictions (Ohne Einschränkung)	Founders New firms (Gründer)	Existing firms (Bestehende Unternehmen)	SMEs only (Nur KMU)	Equity Investment (Investitionen)	Working capital (Betriebsmittel)	Wage costs (Lohnkosten)	Loans (Darlehen)	Grants (Zuschuss)	Equity Investment (Beteiligung)	Guarantee (Bürgschaft)		Co- Financed by the EU (EU-Kofinanziert)	Combination possible (Kombinierbar)	De-minimis rule
InnoNet – Promoting Innovative Net works (Implementation: VDI/VDE Innovation + Technik GmbH)					X	X	X		X			Max. 85% of the R&D costs of the research institutes, up to max. 1.5 Mio. € (Maximal 85 % der zuwendungsfähigen Kosten der beteiligten Forschungsein-richtungen, max. 1,5 Mio. €)			
Innovationsassistent (Implementation: IBB)		X	X	X			X		X			Max. 60 % of the consultancy costs (der Beratungskosten)			
INNO-WATT (Implementation: EuroNorm GmbHProjektträger des BMWA für das Programm INNO-WATT)			X				X		X			40 % to 70 % of the total costs			
INSTI Innovation Campaign (INSTI-Innovationsaktion) (Implementation: TSB Technologiestiftung Innovationsagentur GmbH and EuroNorm Gesellschaft für Qualitätssicherung und Innovationsmanagement mbH)		X	X	X					X			Max. 25% of the consultancy costs (der förderfähigen Beratungsleistungen)			
INSTI Patent Campaign for SMEs (INSTI-KMU-Patentaktion) (Implementation: TSB Technologiestiftung Innovationsagentur GmbH)		X	X	X					X			50%			

With respect to the financial tools used by Land of Berlin, the following features should be noted:

- the whole array of financial tools are used: grants, loans (including soft loans and micro-loans), equity investment (risk/venture finance) and guarantees
- there are many programs for the State to help firms by sharing the risk, both through loans awarded to entrepreneurs and would-be entrepreneurs for them to subscribe equity in firms (loans for equity investment/*investitionen*) and of direct equity investment by development agencies (*beteiligung*); this are means of leveraging private-led initiative and private finance
- the use of financial guarantees is quite developed (there are two *Landesbanken* providing guarantees); this is yet another way of sharing risks to leverage private initiative and private finance.

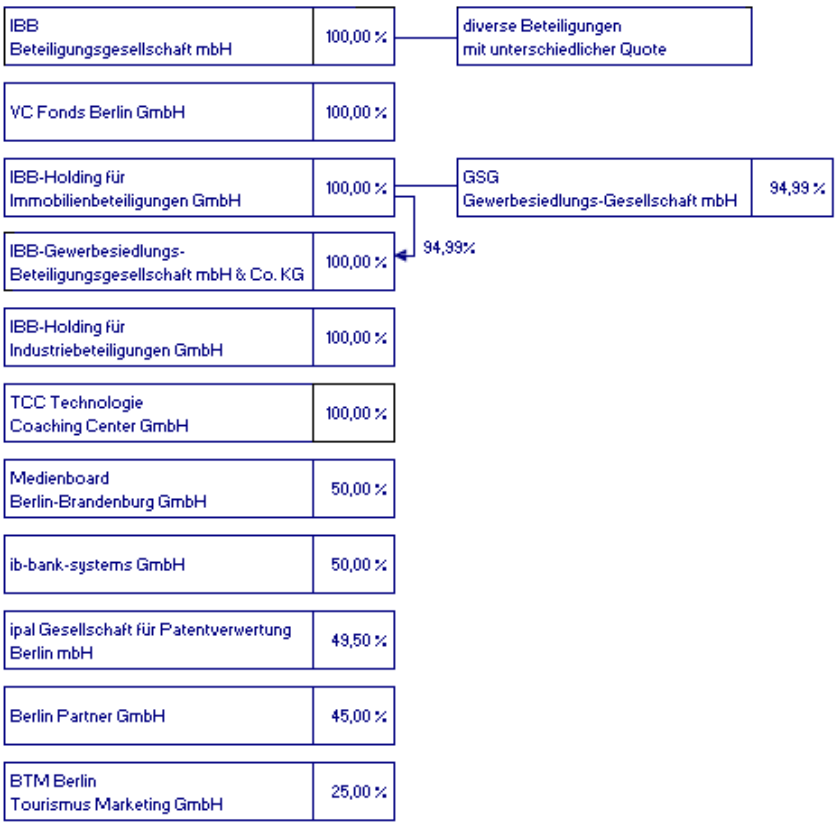
As can be seen, the most important implementing agencies are the following:

- one development bank of the Land of Berlin, the IBB-Investitions Bank Berlin, for grants, loans, equity investment and guarantees
- one equity investment (venture capital) firm of the Länder of Berlin and of Brandenburg, the MBG-Mittelständische Beteiligungengesellschaft Berlin-

Brandenburg GmbH, whose majority owner is the BBB-Bürgschaftsbank zu Berlin-Brandenburg GmbH

- two Land banks providing guarantees, the guarantee department of the above mentioned IBB-Investitions Bank Berlin and the BBB-Bürgschaftsbank zu Berlin-Brandenburg GmbH
- the Federal development finance group, KfW Kredit für Wiederaufbau, intervening mostly through its subsidiary for the SMEs, the KfW Mittelstandsbank
- several Berlin agencies for the promotion of technological development and innovation

The IBB-Investitions Bank Berlin is the main agency of the Regional State (*Land*) for enterprise development, as shown by the vast array of wholly or partly owned subsidiaries, including 4 wholly owned corporations of Equity Investment/Risk Capital firms. One of them (IBB-Beteiligungsgesellschat GmbH) manages the Regional/*Land* "Future Berlin" Fund entrusted to the IBB (*Zukunftsfonds der IBB*), aimed at



technology-driven firms. Another one (VC Fonds Berlin GmbH) manages various EU co-financed risk capital funds (VC Fonds Berlin GmbH).

2.2.4. Saxony: the example of a new Land

The Free State of Saxony (*Freistaat Sachsen*) was chosen because it is a neighbour of the Czech Republic, because it is one of the most populated of the new *Länder* and because it has the largest support Community Support Program after Thuringia/*Thüringen*.

The structure of the regional operational program (OP Sachsen) is not very different from that for Berlin (surveyed in the previous section).

The main differences arise from the difference in the context.

East-Berlin benefited from various long-standing institutions and practices that were already available in West-Berlin. On the contrary, in Saxony the type of economic environment existing in Western Länder had to be created anew after 1989.

The main agencies created by the Free State of Saxony to promote change were the following:

1) SAB–Sächsische Aufbaubank (*Landbank*/bank-agency for regional development)
2) BBS-Bürgschaftsbank Sachsen GmbH (*Landesbank* for guarantees)
3) MBG Sachsen- Mittelständische Beteiligungsgesellschaft Sachsen mbH (*Land* firm for equity/venture/risk finance)

1) The SAB–Sächsische Aufbaubank - Förderbank is the central development agency of the Free State of Saxony. It is owned by the State and acts on its name.

It provides several regional development services.

Additionally, it manages various promotional programs. Those that involve financial tools are the following:

- Equity Investment Measure of the Community Initiative “Improvement of the regional business structure“ (*Gemeinschaftsaufgabe "Verbesserung der regionalen Wirtschaftsstruktur" (GA) – Investitionsmaßnahmen*)
- Finance for Creation and Growth of Businesses (*Gründungs- und Wachstumsfinanzierung*)
- Loans for reinforcing the liquidity of the firm (*Liquiditätshilfedarlehen der gewerblichen Wirtschaft*)

- Program “Stoping the crisis and Starting Anew“, loans for insolvent firms with recovery plan (*Programm "Krisenbewältigung und Neustart"*)
- Program for Recovery and Reorganization of SMEs, loans for SMEs with restructuring plan (*Programm zur Rettung und Umstrukturierung von kleinen und mittleren Unternehmen*)
- Program of guarantees (*Bürgschaftsprogramm*) Note: terms of the guarantees are not very different from those of the BBS-Bürgschaftsbank Sachsen GmbH mentioned below; however, SAB manages some special subsidized programs, like those for films and the media.

The SAB also manages some programs of technological development, but they consist mostly in subsidies:

- Subsidies for Individual Training in Technological Development Projects of SMEs(*Einzelbetriebliche FuE-Projektförderung*)
- Subsidies and Equity Investment for Research by Cooperation between SMEs (*FuE-Verbundprojektförderung Program*)
- Subsidies for SMEs costs with research assistants (*Innovationsassistentenförderung*)
- Subsidies for SMEs costs with Information and Communication Technologies (*KOMPRI 2.2 - Kommunikation und Prozessintegration*)
- Subsidies for the Promotion of Technological Centers for SMEs (*Technologiezentrenförderung*)
- Subsidies for Demonstration and Pilot Projects of Information and Communication Technologies in SMEs (*Telematikförderung*)

SAB also carries out other activities for the promotion of SMEs which are in a way or another linked to some financial tools that are available to firms, but they consist mostly in services and not in financial tools. At the most, they imply either small grants or the small subsidies that are implicit in free services. The following list gives an idea of the mentioned activities:

- Promotion of SMEs - Advice on how to make business abroad (*Mittelstandsförderung Außenwirtschaftsberatung*)
- Promotion of SMEs – Coaching for the Creation of Firms (*Mittelstandsförderung – Gründercoaching*)
- Promotion of SMEs – Intensive Advice/Coaching/Environmental management/ Profit R&D program (*Mittelstandsförderung - Intensivberatung / Coaching / Umweltmanagement / Profit*)

- Promotion of SMEs – Zones with special development problems (*Mittelstandsförderung - in Gebieten mit besonderen Entwicklungsaufgaben (GmbE)*)
- Promotion of SMEs – Cooperation (*Mittelstandsförderung – Kooperation*)
- Promotion of SMEs – Cooperation in zones with special development problems (*Mittelstandsförderung - Kooperation in Gebieten mit besonderen Entwicklungsaufgaben*)
- Promotion of SMEs – Search, information and documentation (*Mittelstandsförderung - Mittelstandsforschung, Information und Dokumentation*)
- Promotion of SMEs – Management advice (*Mittelstandsförderung - Organisationseigene Beratung*)
- Promotion of SMEs – Promotion of Product Design (*Mittelstandsförderung – Produktdesignförderung*)
- Promotion of SMEs – Regional cooperation (*Mittelstandsförderung - Regionale Kooperation*)
- Promotion of SMEs – Presence in Tranregional Trade Fairs (*Mittelstandsförderung - überregionale Messeauftritte*)

2) The BBS-Bürgschaftsbank Sachsen GmbH provides the following products:

- Standard guarantees (*bürgschaften*)
  - Max. cover: 80% of the bank loan
  - Max. amount: € 1 million
  - Length: 8/15 years, depending on the case (23 years subsidized loans and for housing)
  - Application through the firm's bank (*die Hausbank*)
- Guarantees for existing firms: differences in relation to standard
  - For firms that do not have enough guarantees (e.g., real estate) to get loans from the bank and for qualified entrepreneurs duly certified
- Guarantees without bank (BoB-*Bürgschaft ohne Bank*): differences in relation to standard
  - Max. amount: € 160 thousand
  - Application direct to the Bürgschaftsbank (no need for *Hausbank*)
- Guarantees for Leasing and for Acquisition on Installments (*mietkauf*): differences in relation to standard
  - Length: max. 15 years
  - Application through the leasing firm (or leasing department of *Hausbank*)
- Special Guarantees for Creation and Growth of Enterprises: differences in relation to standard
  - Max. cover: 60% of the bank loan
  - Max. amount: € 750 thousand
  - Length: max 20 years

- Application through the Sächsische Aufbaubank (the development bank of the Saxony State)

The list of shareholders gives an idea of the scope of the interested institutions:

- ABN AMRO Bank (Deutschland) AG
- Baden-Württembergische Bank AG
- Bayerische Hypo- und Vereinsbank AG
- Commerzbank AG
- Deutsche Bank AG
- Dresdner Bank AG
- DZ BANK AG
- Deutsche Zentral-Genossenschaftsbank
- Landesbank Sachsen Girozentrale
- SchmidtBank Beteiligungsgesellschaft VGmbH (until 20. August 2004)
- SEB AG
- Sparkassen- und Giroverband für die Sparkassen in den Ländern Brandenburg, Mecklenburg-Vorpommern, Freistaat Sachsen und im Land Sachsen-Anhalt (OSGV)
- Volksbank Chemnitz eG
- Volksbank Raiffeisenbank Döbeln eG
- Volksbank Riesa eG
- Volksbank und Raiffeisenbank Görlitz eG
- Allgemeiner Arbeitgeberverband Sachsen e. V.
- Handelsverband Sachsen e. V.
- Handwerkskammer Chemnitz
- Handwerkskammer Dresden
- Handwerkskammer zu Leipzig
- Industrie- und Handelskammer Dresden
- Industrie- und Handelskammer Südwestsachsen
- Chemnitz-Plauen-Zwickau
- Industrie- und Handelskammer zu Leipzig
- Landesverband der Freien Berufe Sachsen e. V.
- Landesverband des Sächsischen Groß- und Außenhandels/Dienstleistungen e. V.
- Verband der Sächsischen Metall- und Elektroindustrie e. V.
- Verband Garten-, Landschafts- und Sportplatzbau Sachsen e. V.
- Vereinigung der Sächsischen Wirtschaft e. V.

3) The Mittelständische Beteiligungsgesellschaft Sachsen mbH (short name: MBG Sachsen) is a equity/venture/risk capital subsidiary 100% owned by the guarantee Landesbank, the BBS-Bürgschaftsbank Sachsen GmbH.

The main MBG Sachsen mbH products are the following:

- Standard Equity investment (ERP/Marshal Plan Program – coordinated by KfW)
    - Amount: min. € 50 thousand, max. € 1 million (exceptionally, €2.5 million)
    - Share of firm's social capital: from 10% to 30%
    - Duration of the Equity Investment: 15 years, maximum
    - Redemption at nominal value of the equity
- Equity investment in technology driven firms: differences in relation to standard
    - Amount: max. € 2 million (exceptionally, €2.5 million)
    - Duration of the Equity Investment: 10 years, maximum
- Equity investment in handicrafts: differences in relation to standard
    - Duration of the Equity Investment: 6 years, maximum
- Co-operative Equity Investment: differences in relation to standard
    - Project: innovation, qualified entrepreneur
    - Condition: another typical silent partner must be involved
    - Amount: not defined

The main conclusions are the following:

- The structure and the nature of the promotion tools used by the Regional State (Land) of Saxony are not very different from those of Berlin
- But the economic environment is much less developed and the institutions that make market economies feasible had to be created anew
- The public sector efforts with regard to enterprise development are concentrated in 3 institutions:
    - one Development Bank (SAB), which also plays the role of development agency, of manager of EU/Federal/Land programs (grants, loans, equity, as usual) for SMEs and of guarantee bank (with emphasis on guarantees for special programs)
    - one guarantee bank (BBS) of the classical network of German *bürgschaftbanken*,
    - one risk/venture/equity firm (MBG Sachsen), which is just a subsidiary of the guarantee bank for the equity investment business and which manages some lines of enterprise support (like the ERP equity investment program of the Federal KfW)
- Risk capital is not yet well developed. In fact, the indirect support to enterprise development through public cooperation in market-led initiatives through public

risk/venture/equity finance is much less developed than in Berlin. In a large part, this is due to the fact that the number of private players/partners that could lead entrepreneurial projects if the public sector joined to share the risk is much smaller than in Berlin. So, the public sector (including EU support) has to concentrate in a smaller number of projects. In other words, there are less opportunities for public money to leverage private projects and be spread by a larger number of firms.

- Financial guarantees come out as a fundamental tool for indirect support of private market-led initiatives. The BBS-Bürgschaftsbank Sachsen GmbH is very active, it brings together as shareholders a large number of private partners and it carries out the conventional guarantee business plus the management of some public sector support programs. And the SAB–Sächsische Aufbaubank – Förderbank, the development arm of the Regional State/Land, also provides financial guarantees, with less emphasis on conventional financial guarantee business and more emphasis on special public sector support programs.

2.3. Austria

2.3.1. Introduction

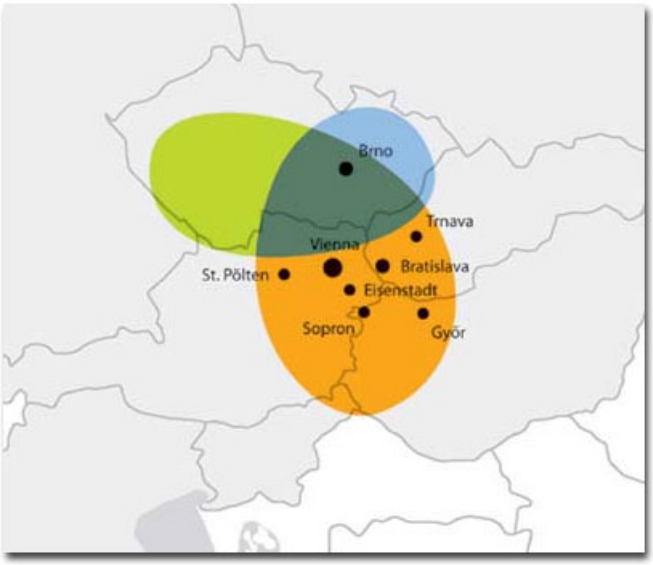
With respect to financial tools for regional entrepreneurial development, the case of Austria is similar to the German one.

Main differences to be noted are the following:

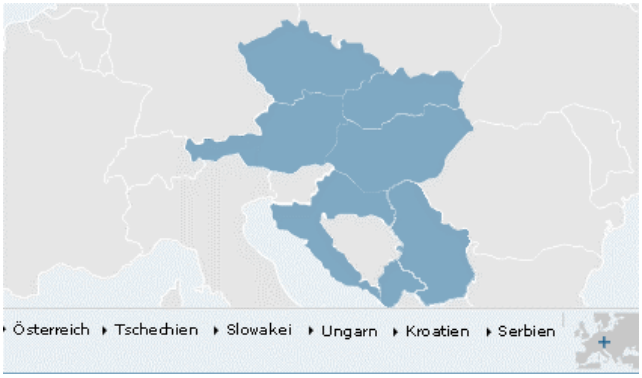
- Austria is a small developed country without serious problems of internal regional underdevelopment; so, the priority to become a *focus* of initiative and influence in Central Europe is stronger than the problem of regional backwardness
- The EU Objective 1 territory is only a small part of the country: it is the self-governing Province[7] of Burgenland (covers 3 NUTS 3 territories)
- There are Federal and Provincial promotional tools and institutions as in Germany, but there seems to exist less institutions at the level of the Provinces, probably because the country is smaller than Germany and the scope of the Provinces may be below the feasibility level for certain activities

With respect to the Public sector, the strategy of Austria becoming more and more central in regional development in Central Europe is well exemplified by the Centrope Region Project (see map below) which brings together neighbouring regions of EU countries (Austria, the Czech Republic, Slovakia and Hungary) and whose geographical centre is Vienna. This project co-financed by the Interreg programmes of the involved countries.

[7] Austria is a Federal State made up of self-governing *Bundesländer* (plural of *Bundesland*), equivalent of the German *Länder* (plural of *Land*). However, for Austria the word *Bundesländer* is generally translated by Federal Provinces or simply Provinces.



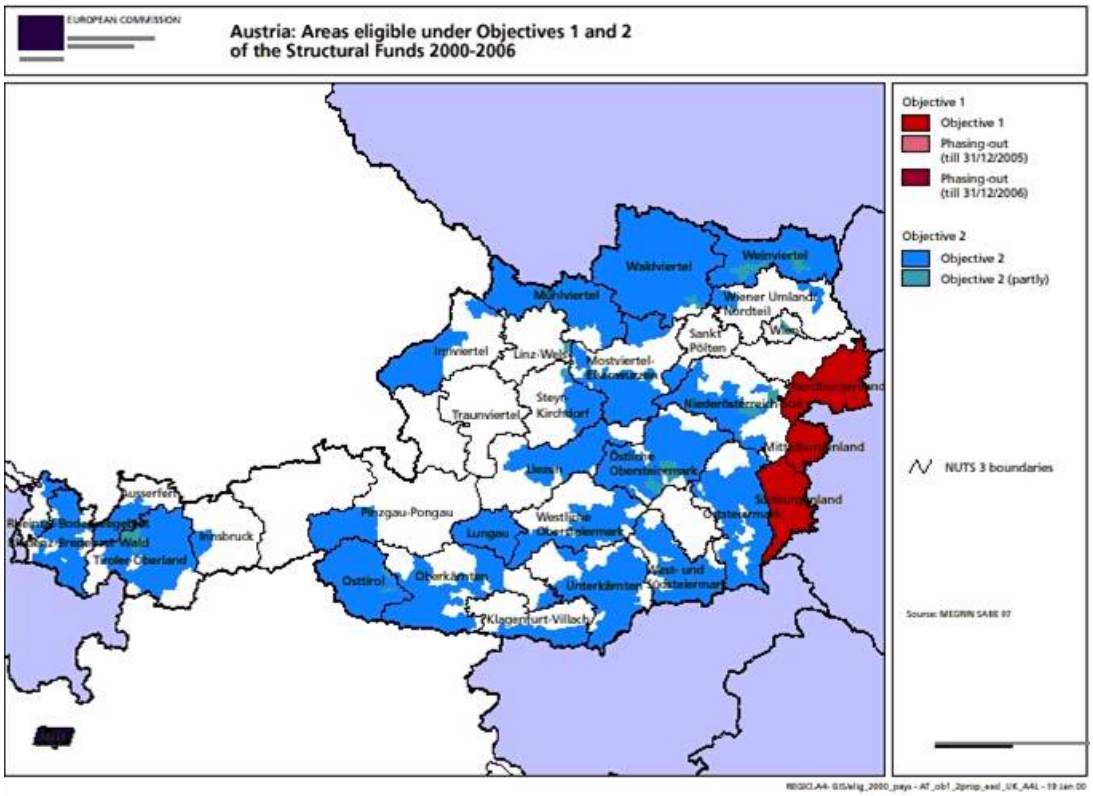
With respect to the private sector, the strategy followed by some enterprises is well exemplified by what the Austrian based Erste Bank group defines at its home market (*Heimmarkt*), shown in the map below.



2.3.2. The Objective 1 region: Burgenland

The Objective 1 Program for Austria is the regional Operational Program (OP) for the self-governing Province of Burgenland.

Objective 1 Program	NUTS 2	NUTS 3
OP Burgenland 2000-2006	Province of Burgenland (self-governing territory) Capital Town: Eisenstadt	• Central Burgenland (*Mittelburgenland*)
		• North Burgenland (*Nordburgenland*)
		• South Burgenland (*Südburgenland*)
		•



Burgenland is a small territory in the east of Austria. It has a population of some 270 000 inhabitants, 3.3% of the country's population.

Likewise, the support provided under Objective 1 is small: some € 270 thousand of EU co-financing for projects of the Public sector and for projects of private firms.

The planned breakdown of the EU Objective 1 funds is the following:

1. Commerce and industry: approx. 34%
   - 1.1. Reinforcement of the development of enterprises
   - 1.2. Aid to the re-structuring of firms (including marketing)
   - 1.3. Infrastructure support (Public investment)

1.4. Information and communication technologies (networks and software)
1.5. Creation of instruments to reinforce the Own Capital/Equity of SMEs

2. Research, technology, innovation: approx. 11%
   2.1. Business clusters and Centres of Competencies
   2.2. Centres of Technology, Incubators and High Schools (Public investment)
   2.3. Innovative jobs/services
   2.4. R&D
3. Tourism and culture: approx. 19%
4. Agriculture and forestry, nature conservation: approx. 16%
5. Human resources: approx. 20%

Like in Germany, the financial tools provided by the Objective 1 Program are reinforced by finance provided by the Federal State and by the Province.

Below is information on business grants available to firm in Burgenland (only Industry and Trade and R&D):

Program (implementing agencies)	Eligible costs	Incentive
Young Entrepreneur Follow-up Grants (AWS program topped up by WiBAG)	Grants for young entrepreneurs to set up or take over a company (for equity)	Grant (=non-refundable subsidy)
Innovative Business Ideas (WiBAG program)	Subsidy for external intangible costs (studies,…) and internal staff costs.	Grant of 25%, up to € 7 200 (max.: for a 1 year)
Business Clusters and Networks (WiBAG program)	External intangible costs and investment costs (pilot projects; demonstrations) for firms to set up cooperative ventures	Grant of 50%, up to € 80 000 per firm and € 100 000 per cooperative venture
Trade and Industry Grants: in accordance with the 1994 Economic Promotion Act for Burgenland (WiBAG)	For SMEs Fixed assets and some operating costs	Grants and financial guarantees (case by case)

Program (implementing agencies)	Eligible costs	Incentive
Trade and Industry Grants: Grants to enhance economic development (AWS and AWS/ERP Fund)	Innovation and Technology (new business concepts by SMEs); restructuring of micro-firms. Fixed assets and some operational costs	Grant of 10% (exceptionally, 20%)
Trade and Industry Grants: Research & development grants (WiBAG and OeFGG, the Austrian Research Promotion Agency	WiBAG: operational and R&D costs of firms OeFFG: R&D costs of firms and opportunities for venture/equity finance	WiBAG: Grants of 20% to 50% OeFFG: Grants and venture/equity finance
Trade and Industry Grants: Environment & ecology grants (WiBAG and Kommunalkredit)...	For waste disposal enterprises and similar environmentally relevant services: some fixed assets costs	WiBAG: grants of up to 50% Kommunalkredit: loans, guarantees
Trade and Industry Grants: Internationalisation grants (WiBAG)	Small firms only: costs of opening up markets Participation in foreign trade fairs: only first-time participation at the relevant fair.	Grant 10%
Trade and Industry Grants: Grants for improving the structure of small and medium sized enterprises in Burgenland (WiBAG and AWS guarantees)	Fixed assets in projects not exceeding € 210 000 and which can be expected to produce long-term benefits.	WiBAG: grant 10% Financial guarantees by the AWS BürgesFörderungs (guarantee) department
SME Promotion (WiBAG's SME Campaign)	Expenses to tap into the markets in the new EU member states from the offices in Burgenland	Large variety (mostly small grants)
Objective 1 Projects: 1.1 Reinforcement of the development of enterprises (WiBAG and AWS)	Fixed assets and intangible investments	Grant: 30% in North Burgenland; 35% in Central and South Burgenland

Program (implementing agencies)	Eligible costs	Incentive
Objective 1 Projects: 1.2 Aid to the re-structuring of firms, including marketing (WiBAG)	Fixed assets and intangible investments	Grant: 30% in North Burgenland; 35% in Central and South Burgenland
Objective 1 Projects: 1.3 Infrastructure support (Public investment)	Investment by public agencies	Grant: max. 60%
Objective 1 Projects: 1.4 Information and communication technologies - networks and software (WiBAG, AWS, FFG)	Fixed assets (investment projects) or some operational costs (R&D projects)	Grant: 30% in North Burgenland; 35% in Central and South Burgenland
Objective 1 Projects: 1.5 Creation of instruments to reinforce the Own Capital/Equity of SMEs (WiBAG)	Setting up of specialized Risk/Venture Funds for SMEs: equity share in Venture firm/fund	Max. 50% of the Equity of the venture capital firm
Objective 1 Projects: 2 Research, technology, innovation (WiBAG and other agencies of the Province)	Most public infrastructure for R&D and public agencies costs in R&D	Grants: 50%-75%
WiBAG's Athena Burgenland Venture Capital Fund (managed by IPO Beteiligungs Management AG)		Equity and loans for SMEs of Burgenland
National Programs of AWS: Double Guaranty Fund	Loans to subscribe equity for creation of early stage financing of SMEs	Guarantees of up to 100% for up to € 1 million per SME (10 years)
National Programs of AWS: Guarantees for Equity	Loans to subscribe equity or other forms of own capital of SMEs	Guarantees of up to 50% for up to € 2 million per SME (10 years)
National Programs of AWS: Financial Guarantees	Investments in Austria by private SMEs	Guarantees for up 85% of the loan (100% in case of R&D projects) at low cost
National Programs of AWS: Promotion of the Creation of Firms by Young Entrepreneurs	Equity invested in SMEs	Combination of grants, loans and financial guarantees

Program (implementing agencies)	Eligible costs	Incentive
National Programs of AWS: Guarantee of Equity (to promote the risk/venture capital market in Austria)	Equity finance invested in SMEs by venture or asset management firms	Sovereign guarantee of the Austrian Republic
National Programs of AWS: Promotion of Technology driven businesses	Various situations in various programs	Mostly loans and guarantees
National Programs of AWS: Exchange for Business Angels		Free or low cost service of matching supply and demand of Business Angels finance

2.3.3. Institutions

The most important institutions for Burgenland, the Objective 1 region of Austria, are the following:

1) AWS (or AWSG) Austria Wirtschaftsservice GmbH

It is the somewhat equivalent of the German KfW.

It is a public agency wholly owned by the Federal State and it resulted from the merger, in November 2001, of several State institutions. It was also become the manager of the previously independent ERP Fund, the still financially muscled left-over of the post-WW II Marshall Fund.

It manages the most important and strategic Federal development tools: grants, soft loans, conventional loans, risk/venture/equity finance, guarantees (including Sovereign guarantees) and counter-guarantees, and recommendations of tax benefits for the Ministry of Finance).

It is geared both to large and very large firms (for example, deals to attract strategically important investment by multinationals) and to SMEs. This is the result of having absorbed development institutions of very different nature, for example, the

former FGG (an institution of financial guarantees for large firms) and the Bürges Förderung (an institution created in 1954 to support private investment in SMEs through financial guarantees and public grants).

It operates from its headquarters in Vienna (*Wien*). It has no regional offices, but it cooperates with regional institutions like the development agencies of the Provincial Goverments, specially in relation to the management of Federal programs for regional development and of some of the EU Structural Funds for regional development (namely, some of the Objective 1 programs.

2) WiBAG – Wirtschaftsservice Burgenland Aktiengesellschaft

It is the development institution of Burgenland and it is wholly owned by the State of the Province

It is a kind of regional version of the AWS owned by the Provincial State of Burgenland. It promotes regional entrepreneurial development and it provides services to firms which, supposedly, are more efficient if managed at the regional/local level, like providing information to firms or owning (totally or partially) the technology centres of the Province of Burgenland.

It manages the specific grants and financial tools which are financed by the budget of the Province.

It also manages most of the EU Objective 1 co-financed programs aimed at enterprises.

And it helps local firms to get information and to apply for programs (both Federal programs and EU Program managed by Federal level institutions like the AWs or the OeFGG (the Austrian Research Promotion Agency).

WiBAG acts at various levels at the same time: directly (directly managed programs), indirectly (for example, by shifting to IPO Beteiligungs Management AG the

management of the Athena Venture Fund) and in cooperation with national agencies (for example, in the programs managed by AWS or OeFGG).

2) The guarantee systems

Like in Germany, the backing of bank loans and of equity finance by guarantees is also traditional and important in Austria.

There are two sources of such guarantees: (a) those of the Federal and Provincial programs and (b) those of the network of private specialized guarantee corporations.

a) The guarantee programs of the Federal and Provincial institutions (like the AWS and the WiBAG, respectively) have already been described above. The main feature is that those are the lines of guarantees for promoting entrepreneurial development and have a component of EU, Federal, or Provincial subsidy (at the least, this subsidy is made up of low cost service).

b) There is also a network of privately owned guarantee firms (know as *Bürgschaftsgesellschaften* or *Kreditgarantiegesellschaften*) which deal with the more traditional and conventional guarantee business, both for SMEs and for private costumers (like house buyers); they are market oriented and are not involved in managing or passing on EU/State/Provincial promotion programs, unless they enter into specific cooperation agreements with the Provincial Governments; they are private regional firms owned by banks and by local institutions (like regional Chambers of Commerce, associations, etc.). they contribute to a common Counter-guarantee Fund managed at the national level (it is implicit that the Federal State or the Provinces will intervene if the counter-guarantee fund runs into difficulties); while in Germany there are one or more guarantee bank in each *Land*, the Austrian guarantee firms are less numerous.

2.3.4. A note on financial tools for SMEs

The Austria case for its Objective 1 region is somewhat similar to the German case.

However, the following differences should be noted:

a) In the Austrian Burgenland OP there is more reliance on grants (non-refundable subsidies), but the amount of the grants for private firms is not too generous (30%-35% of the eligible costs)

b) Unlike the German case, there is an emphasis on accumulation of promotion tools (for instance, several of the Burgenland grants are conditional on the project receiving also public aid from one or another Federal program

c) Private venture/equity finance is less developed than in Germany; so there are Federal programs to provide guarantees to push private sources (pension funds, equity/asset management firms, investment departments of banks) to enter the business of venture finance for SMEs

d) In the Objective 1 Burgenland OP the 1.4 Sub-measure consists in the creation of a venture finance fund for Burgenland firms (it is an initial, though not very sophisticated, step at the Provincial level)

e) Financial guarantees are as traditional and important as in Germany, but there is a more distinct separation between public promotional guarantees (provided by AWS and the AWS-like institutions of the Provinces) and the traditional guarantee business (the private the specialized guarantee firms)

f) By and large, there seems to be less decentralization and stronger reliance on Federal guidance and co-financing.

2.4. Poland

2.4.1. Introduction

Germany and Austria are examples of good practices based on long-existing institutions and large experience, The case of Poland is different.

Poland is instructive because it is a Eastern Europe post-1989 history that illustrates:

- the vigour of regional and local initiative, if sources of finance are available
- the strong demand for loan funds and for credit guarantees
- the important role of such indirect financial tools, the guarantee funds in particular, for giving a direction to regional/local para-financial institutions, for organising them and for setting/imposing accountancy/audit standards
- the shifting balance between support for regional autonomy and defence of centralization
- the shifting balance between institutions that control sources of finance, namely, the Ministry of Economy (national or EU programs for enterprise development), the Ministry of Finance (banks) and the Ministry of Regional Development (often a broker between various strategies).

2.4.2. Regional Development and the Objective 1 CSF

The country is administratively divided into 16 Higher Territorial Self-governing units denominated Provinces/Voivodships (*wojewodztwa*) which coincide with the 16 NUTS 2 regions. The table and the map below provide the details.

MARTA: CHECK AND FINISH THE TABLE (TRANSLATIONS)

Nuts 1	**NUTS 2** Self-governing regions: 16 Provinces/Voivodships (*wojewodztwa)*	**NUTS 3 (*)**
Central Poland (*Centralny*)		
	Lodz (*Lodzkie*)	3 NUTS 3 regions
	Mazovia (*Mazowieckie*)	5 NUTS 3 regions
(*Poludniowy*)		
	Lesser Poland (*Malopolskie*)	3 NUTS 3 regions

Nuts 1	**NUTS 2** Self-governing regions: 16 Provinces/Voivodships (*wojewodztwa)*	**NUTS 3 (*)**
	Silesia (*Slaskie*)	4 NUTS 3 regions
(*Wschodni*)		
	(*Lubelskie*)	3 NUTS 3 regions
	Sub-Carpatia (*Podkarpackie*)	2 NUTS 3 regions
	(*Swietokrzyskie*)	1 NUTS 3 regions
	(*Podlaskie*)	2 NUTS 3 regions
(*Polnocno-Zachodni*)		
	Greater Poland (*Wielkopolskie*)	5 NUTS 3 regions
	(*Zachodniopomorskie*)	2 NUTS 3 regions
	Lublin (*Lubuskie*)	2 NUTS 3 regions
(*Poludniowo-Zachodni*)		
	Lower Silesia (*Dolnoslaskie*)	4 NUTS 3 regions
	Opole (*Opolskie*)	1 NUTS 3 regions
(*Polnocny*)		
	Cuiavia and Pomerania (*Kujawsko-Pomorskie*)	2 NUTS 3 regions
	Varmia and Masuria (*Warminsko-Mazurskie*)	3 NUTS 3 regions
	Pomerania (*Pomorskie*)	3 NUTS 3 regions

(*) Each of the 45 NUTS 3 region is made up of several Districts (*Powiat*), of which there are 314 altogether; each District covers several Communes (G*mina*), which are the lower level basic self-governing units and of which there are 2 478 altogether). MARTA: FIGURES TO BE CHECKED. A DIFFERENT SOURCE MENTIONS 380 POWIATS AND 2 489 GMINAS.

It should be noted that the Provinces have in fact a dual self-government / central government character. On one hand, the Governor of a Province/Voivodship, the Voivoda, is appointed by the Prime-Minister and his role is to safeguard the interests of the national State at the regional level (centralising feature). On the other hand, the regional executive body is the Regional Council (*sejmiki*), which is elected by direct proportional popular vote. In turn, the *sejmiki* elects the Marshall, who is the chief regional executive officer and represents the region (regional self-government).

Though somewhat subordinated to the Voivoda, the latter regional units of self-government, in force since 1999, are gaining experience and expertise, thereby becoming more important in the field of regional government and in designing, programming and implementing regional economic development plans.

With respect to EU Structural Funds, the whole country is included in the Objective 1.

The EU Objective 1 CSF (Community Support Framework) for Poland 2000-2006 has the following structure (the activities most concerned with support to enterprises are printed in **Bold**):

NAME OF THE PROGRAM **(SOP=Sectoral Operational Program)** **(P=Priority)** **M=Measure**	**CSF FUNDS(%)**
SOP Improvement of the Competitiveness of Enterprises (SPO WKP - *Sektorowy Program Operacyjny Wzrost konkurency-jnosci przedsiebiorstw*,) P 1 Enhancement of a knowledge-based economy and the business environment M 1.1 Strengthening business support institutions (market information, advice, etc.) **M 1.2. Improvement of access to external sources of financing for SMEs** M 1.3. Infrastructure for enterprise development (industrial sites, technology incubators, science &technology parks) M 1.4. Strengthening the cooperation between the R&D sphere and the competitive economy (enhance innovation) M 1.5. System of on-line access to information and public services P 2 Direct support to enterprises M 2.1 Advice for SMEs **M 2.2 Investment grants for SMEs (for large firms, only innovation, new products or new jobs)** M 2.3 Investment grants for enterprises to EU environmental protection standards	15.1%
OP Human Resources Development	17.8%
OP Transport	14.1%
OP Restructuring and modernisation of the food sector and rural development	14.1%
OP Fisheries and fish processing	2.4%

NAME OF THE PROGRAM **(SOP=Sectoral Operational Program)** **(P=Priority)** **M=Measure**	**CSF FUNDS(%)**
ZP: Integrated Program of Regional Development (ZPORR-*Zintegrowanego Programu Operacyjnego Rozwoju Regionalnego*) P 1 Development and modernisation of the infrastructure used to enhance the competitiveness of the regions (mostly public investment) P 2 Strengthening the Human Resources Development in the regions (mostly public investment) P 3 Local Development M 3.1 Rural areas, development and restructuring (public investment in infrastructure) M 3.2 Areas of industrial decline and restructuring (public infrastructure investment for a better climate for starting-up new businesses M 3.3 Urban areas threatened by marginalisation, former industrial and military sites (public infrastructure investment for revitalisation) **M 3.4 Micro-enterprise start-ups of less then 10 employees and 3 or more years of operation (other firms must apply under the OP Improvement of the Competitiveness of Enterprises)** M 3.5 Local educational and social infrastructure	35.9%
OP Technical Assistance	0.3%
Total 2000-06 CSF (Community Support Framework) for Poland	100.0%

The similarities between the Czech and the Polish cases are basically the following:

- The Sectoral Operational Programs (SOPs) have nationwide coverage and they are basically managed by the correspondent national Ministry
- The regional component consists of an integrated OP, like in the ČR (but unlike in Germany or Austria, where each Objective 1 NUTS 2 region has its own OP).

The main differences are the following:

- in the ČR, the NUTS 2 territories are mostly statistical units with scant autonomous administrative basis, while in Poland the NUTS 2 regions coincide with the 16 Self-governing Provinces/Voivodships, in which the Voivoda and the Marshall have to permanently try and reach agreements in order for the regional level to be efficient

- in the Polish case, each Province must negotiate a regional long-term Development Strategy and negotiate a Regional Contract with the Central Government, thereby coming to what amounts to a Regional Operational Program for the Voidvodship; those Regional OPs are brought together in the Integrated Regional Operational Program (obviously, the more dynamic and experienced Provinces manage to have more autonomy in the definition of the Regional Contract).

As Poland is a large country with traditions of decentralisation (thwarted during the central control period of the communist regime), the implementation of Self-governing Regions came as a natural development after 1989. However, as in other countries, the practical outcome expresses shifting balances (or even ambivalence) between divergent driving forces. First, the shifting balance between concerns about national unity, on one hand, and the push towards regional self-government (which was also fostered by the concepts on "new regionalism" in economic development), on the other. Second, the shifting balance between the importance of regional development in the EU support policies (the principle of subsidiarity at the country level) of the 1990s[8], on the one hand, and the growing concerns of the EU Commission over the efficiency of the use of the Structural Funds (requirements of programming capacity, administrative capacity and partnership/decentralisation which are not easily met by many less developed and less experienced regional administrations), on the other.

For instance, the growing importance and autonomy of regional economic programming and promoting led to the creation of the Ministry of Regional Development and Construction (MRRiB-*Ministerstwo Rozwoju Regionalnego I Budownictwa*), which was created in 2000 and replaced the former Department for Regional Development Programming of the Ministry of the Economy. On the other hand, the former Polish Agency for Regional Development was merged with the former Polish Foundation for the Promotion of SMEs into the now existing PARP (*Polska Agencja Rozwoju Przedsiebiorczosci*Polish Agency for Enterprise

Development), which keeps a regional development department but is a more encompassing institution.

2.4.3. The SPO WKP in more detail

The Sectoral Operational Program Improvement of the Competitiveness of Enterprises (SPO WKP-*Sektorowy Program Operacyjny Wzrost konkurencyjnosci przedsiebiorstw*) is examined here in more detail because it is the program that addresses the problem of financial tools for SMEs.

This program has not been available until the current year of 2005. Therefore, It is a new opportunity for Polish SMEs. Like similar programs in other countries, the SPO WKP is a co-finance program: ERDF (European Regional Development Fund), Polish Public finance and private finance.

The relevant Measures and Submeasures are those shown in the next 2 tables.

Measure 1.2. Improvement of access to external sources of financing for SMEs **Managing Authority: Ministry of the Economy, Labour and Social Affairs** **Implementing Agency: PARP-Polish Agency for Enterprise Development**		
Submeasures	**Eligible costs**	**Incentive**
1.2.1 – raising the capitals of micro-loans funds (beneficiaries: non-profit institutions that manage micro-loan funds)	Funds for loans up to € 30 000 - interest rates not lower than the EU reference rate - previous risk analysis is required (entrepreneurs or firms in difficult situation are excluded) Administration costs (not more than 5%)	Grant of up to 70% of the eligible costs

[8] The Phare-Struder pilot regional development program is an example.

Measure 1.2. Improvement of access to external sources of financing for SMEs **Managing Authority: Ministry of the Economy, Labour and Social Affairs** **Implementing Agency: PARP-Polish Agency for Enterprise Development**		
Submeasures	**Eligible costs**	**Incentive**
1.2.2 – raising the capitals of credit guarantee funds (beneficiaries: credit guarantee funds)	Credit guarantee funds fulfilling the following requirements: - guarantee costs must cover risk, administrative costs and return on equity - guaranteed loans at interest rates not lower than the EU reference rate - previous risk analysis is required (entrepreneurs or firms in difficult situation are excluded) Administration costs (not more than 2%)	Grant of up to 80% of eligible costs
1.2.3 – supporting the creation process of funds of seed capital (beneficiaries: creation of risk capital firms for seed capital/early stage venture finance)	Equity of the Seed Capital firm Administration costs (not more than 5%).	Grant of up to 50% of the eligible costs and - not lower than 5 000 000 pln - not higher than 50 000 000 pln MARTA: HOW MUCH IS THAT IN €UROS

Measure 2.2 Investment grants for SMEs **-Support for product and technological competitiveness of SMEs** **-In the case of large firms: only innovation, new products or new jobs** **-Managing Authority: Ministry of the Economy, Labour and Social Affairs** **-Implementing Agency: PARP-Polish Agency for Enterprise Development**		
Submeasures	**Eligible costs**	**Incentive**
2.2.1 – support for new investments (beneficiaries: SMEs; large firms may be beneficiary but only in case of innovation, new products or new jobs)	Fixed and intangible assets. Job creation	Assets: grants according to the regional aid map for Poland but not exceeding 50% of the eligible costs Job creation: maximum € 4 000 per new job Budget ceiling for large firms: ¼

Measure 2.2 Investment grants for SMEs -Support for product and technological competitiveness of SMEs -In the case of large firms: only innovation, new products or new jobs -Managing Authority: Ministry of the Economy, Labour and Social Affairs -Implementing Agency: PARP-Polish Agency for Enterprise Development		
Submeasures	**Eligible costs**	**Incentive**
2.2.2 – supporting the internationalization of companies by covering some of the costs of international fairs and exhibitions (beneficiaries: SMEs)	Costs of fairs and exhibitions	Grants according to the regional aid map for Poland but not exceeding 50% of the eligible costs

This outline of the most important tools for firms in the CSF for Poland brings about the following comments:

- There are direct grants (non-reimbursable subsidies) to investment by firms (in fixed and intangible assets) but they are awarded in restrictive conditions, namely, mostly to SMEs and only up a maximum of 50% (regional graduation) of the eligible costs [9]
- as a consequence, when they want to create, to modernize or to expand firms, entrepreneurs and SMEs (including those that apply for grants of the Structural Funds) have to look for complementary forms of finance, namely, loans (mostly bank loans) and partners (equity capital and para-equity loans); in other words, SMEs that want to make use of the Structural Funds are confronted with the perennial and universal problem of having difficult access to conventional credit
- Poland's CSF addresses this problem in 2 ways:
    - in general for SMEs: by financing the development and improvement of the existing mechanisms of guarantees for loans
    - in particular for the riskiest segment of investors (micro-firms and start-ups/early stage SMEs): by promoting the expansion of micro-loan finance and of Seed Capital finance

These policies take place in the context of a complex web of existing loan capital and credit guarantee institutions.

[9] There is a recent trend in the EU Support Frameworks to reduce direct subsidies (grants) and to replace them by financial tools, both direct (soft loans) and indirect (risk/venture capital and financial guarantees). For instance, in the 1st CSFs for Portugal, grants were the prevailing tool and a generous one at that (up to 75% of the investment costs). In the 3rd CSF (2000-2006), there are no grants, only reimbursable interest-free loans. In the meanwhile, a system of mutual guarantee for SMEs has been successfully implemented and there were attempts to develop risk/venture capital, but the latter were not very successful until now.

The support for credit guarantee funds is therefore one the most important tools of the so-called alternative finance that is being promoted in Poland. It is considered in some detail in the next section.

2.4.4. Credit Guarantees in Poland

2.4.4.1. A note on terminology and the legal framework

Quite often Polish credit guarantees are referred to in English as pledge/guarantees.

This is due to some peculiarities of translation in relation to the legal framework.

In Polish, the nouns *poręczenie* and *gwarancja* are usually translated as "pledge" and "guarantee", respectively.

That is what happens, for example, in the following case: *Ustawa z dnia 8 maja 1997 o poreczeniach i gwarancjach udzielanych przez Skarb Panstwa oraz niektore osoby prawne* is translated as "Act on Pledges and Guarantees issued by the State Treasury and by some Corporate Bodies, of the 8th of May 1997".

However, there are different meanings for the word *poręczenie* (pledge), of which the most relevant are the following:

1) A guarantee of quality (e-g., a 1 year guarantee on a brand new TV set acquired in a retail shop), because it is a "pledge" by the manufacturer to replace or repair the TV set if it is found faulty
    - this type of "pledge" is covered by the Civil Code and does not apply to the relationship between a borrower and a lending institution
2) a credit guarantee (*poręczen kredytowwych*), in which a legal person (the guarantor: a bank or a credit guarantee institution) "pledges" to pay the liabilities of the borrower (the debtor) if the latter fails to settle a debt towards the lender (the beneficiary of the guarantee: the lending bank or the loan fund)[10]
    - this is a financial instrument and it is ruled by the Commercial Code, the Banking Laws and by specific legislation such as the above mentioned Act on *Pledges* and Guarantees.

[10] The same kind of "pledge" can be obtained through a credit insurance policy (e.g., when a firm buys credit insurance for its receivables), in which case the legal framework of insurance applies and the correspondent terminology is used.

When the word *poręczen* comes alone in a type 2) context and the word is translated by “pledge”, it becomes necessary to show that it is a type 2) “pledge”. In order to do that, the expression pledge/guarantee is often used.

However, the correct expression should be “credit guarantee” (or just “guarantee”, meaning “credit guarantee”) and this is the translation that is adopted in the current report.

“Credit guarantee” is the general expression: it applies to (credit) guarantees issued by credit guarantee institutions as well as to (credit) guarantees issued by banks.

When such a guarantee is issued by a bank, one can be more specific and call it “bank guarantee”. For example, if the State Development Bank issues guarantee in favour of Commercial Bank A to cover a loan of the Commercial Bank A to the Company X (which is carrying out a project of strategic relevance), it is a bank guarantee.

When such a guarantee applies to the relationship between a borrower and a bank, it may be called “financial guarantee”. For example, if a specialized credit guarantee institution issues a guarantee to cover a loan obtained by Enterprise X from a loan fund (or from a venture capital firm), it is a credit guarantee. If the covered loan to Enterprise X is obtained from a bank, the guarantee is called financial guarantee.

There is another problem of terminology that should be cleared at the outset. It is the difference between a fund an the institution that manages the fund.

A “fund” is a revolving amount of money that is used for specific purposes (e.g., to pay to the bank an instalment on a loan if the debtor (borrower) defaults.

Such a fund (revolving amount of money) is managed by an institution. But the institution may manage more than one fund (it is quite common). For example, it may manage a loan fund and a credit guarantee fund. Or it may manage or 2 or more guarantee funds: one for loans for SMEs in general, a second one for loans for young

entrepreneurs and a third one for loans for high-tech firms. If the institution is named Fund Something, there might arise a confusion between the Fund=sum of money for a specific purpose and the Fund=managing institutions. This happen in Poland as well as in other countries. One has to analyse the context in order to know if it is a Fund (sum of money) or a Fund (managing institution).

2.4.4.2. The early situation

Before joining the EU, there was in Poland a situation of a multitude of institutions providing risk/venture loans (loan funds) and credit guarantees (credit guarantee funds) for SMEs[11].

The creation and development of such institutions was mostly influenced by the following factors:

- Poland was a forerunner of the collapse of communist control in Eastern and Central Europa (early 1989 "round-talks", the ensuing legalization of *Solidarność* and elections) and Western Powers and the Polish Diaspora provided financial and organizational support for the creation of various institutions that promoted private entrepreneurship and participation in the post-communist privatizations; as a consequence, several national, regional or local loan funds, guarantee funds and entrepreneurial advice services were promoted by initiatives like the Polish-British Enterprise Program or the Polish-American Enterprise Fund
- National sources shared this trend through institutions promoted by the Polish Foundation for the Promotion of SMEs (the forerunner, together with the Polish Agency for Regional Development, of PARP) and by the Agency of Agricultural State Ownership
- The trend towards regionalization led to many initiatives by regional and local forces (Voivodas, Marshalls MARTA: WHAT THE POLISH WORD?, Local Chambers of Commerce, emerging local entrepreneurs, etc.) to create non-profit institutions for promoting private investment
- The Government policies of regional self-government, the need to provide for the management of State firms, their eventual modernization and sale to private owners, the push for regional/local *foci* for attracting private and foreign investment (like industrial parks) led to the creation of a network of semi-official Regional Development Agencies (RDAs) and their association (NARDA-National

[11] In this context, funds mean the money managed by an institution, not necessarily the institution itself.
On the difference between pledges and guarantees in the Polish legal framework, see appropriate section below.

Association of Regional Development Agencies), partly pushed by regional authorities (for example, the Regional Marshals) and partly supervised by the Polish Agency for Regional Development, first, and by PARP, later[12]

- During the pre-accession period, the EU (through the Phare Local Initiative Program, the EBRD-European Bank for Reconstruction and Development and the EIF-European Investment Fund) also promoted loan and guarantee funds
- The State-owned bank BGK (*Bank Gospodarstwa Krajowego* -Bank of National Development) was also active in the risk loans and the financial guarantees businesses, tapping financial sources both domestically (the Central State) and foreign (for instance, the European Investment Fund), both for own use and for passing on to regional/local institutions

By the late 1990s, the situation was the following:

- There were many regional and local non-profit institutions providing at the same time one or more of various kinds of services: (i) advice/information for firms, (ii) domestic and international promotion of the region and (iii) management of loan funds and of guarantee funds[13]
- For lack of specific legal framework, such institutions were often created as foundations or even as commercial/financial partnerships with non-profit Bye-Laws[14]
- Because the operation of such institutions (therefore, the ability to attract finance for funds and the ability to get the banks to accept their guarantees) depended on their credibility, they usually follow conventional accountancy rules and presentation of financial statements (like the balance sheets and P&L accounts of commercial enterprises)
- Because they resulted from piecemeal initiatives, those institutions are not uniform across the country, but the most active ones came to be organized under 3 associations:
    - KSU (*Krajowy System Uslug*-National System of Services), created in XXXX (MARTA: WHEN WAS IT?), it was promoted by PARP which imposed accountancy and audit requirements; it covers several multi-purpose regional and local institutions

    - KSFPK (*Krajowe Stowarzyszenie Funduszy Poreczen Kredytowych*-National Association of Credit Guarantee Funds), established in 1996, brings together many non-profit institutions specialized in credit guarantee

[12] Most of those RDAs still exist but NARDA was disbanded and the Polish Agency for Regional Development was replaced by PARP (*Polska Agencja Rozwoju Przedsiebiorczosci*¬Polish Agency for Enterprise Development) whose Regional Development Department took over the role (and part of the employees) of NARDA.

[13] Initial and ensuing finance for the funds often came from the mentioned foreign sources, from the Provinces/Voivodships and from PARP).

[14] With diverse names, e.g., the Warsaw *Fundacja Malych I Srednich Przedsiebiorstw*-Foundation

that adopted accountancy/audit standards in order to be creditworthy and to be able to compete for grants from Polish or EU sources:
    - number of KSFPK members: 27 in 2002, 61 by the end of 2004
- the BGK/KFPK system
    - KFPK (*Krajowy Fundusz Poreczen Kredytowych*National Credit Guarantee Fund) was created by the Government in 1997 with money from national public sources: the bank BGK is the manager of this Fund[15]
        - Size of the KFPK fund: € 12 million in 1997, € 30 million in 2003 and € XXXX million in mid-2005
    - BGK issues KFPK guarantees in 3 ways:
        - directly, through its 25 branches
        - indirectly, through banks (around year 2000, BGK had protocols with 26 banks)
        - indirectly through guarantee institutions in which the BGK/FKPK became a partner/shareholder
            - at the time there was a preference for companies specialized in credit guarantee activities, but multi-purpose institutions (e.g., managing loan funds and guarantee funds at the same time) were also acceptable as long as they kept separate books/accounts for each fund
            - by the end of 2002, BGK was a partner/shareholder in the following institutions that issued credit guarantees:
                - *Lubuski Fundusz Poręczeń Kredytowych Sp. z o.o.* (Zielona Góra)
                - *Pomorski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.* (Gdańsk)
                - *Fundusz Poreczeniowy Sp. z o.o.* (Katowice)
                - *Funduszu Rozwoju i Promocji Województwa Wielkopolskiego S.A.* (Poznań)
                - *Dolnośląski Fundusz Gospodarczy Sp. z o.o.* (Wrocław)
                - *Wrocławski Fundusz Poręczeń Kredytowych Sp. z o.o.* (Wrocław)

[15] BGK is not allowed to issue KFPK guarantees to protect its own loans to clients.

2.4.4.3. Pre-accession organizing steps

Government steps to promote credit guarantees for SMEs and, at the same time, to organize an unified system at the national level were taken in 2001:

- Until the early 2000s, the systems had ran separately, neither cooperating nor competing
    - for the KSU and KSFPK members, PARP passed on Phare grants (mostly, the Local Initiative Program) by periodically putting out tenders to which the institutions could bid (quality of the project and acceptance of auditing requirements were decisive criteria: 19 institutions were contemplated in 2001 with 32 million pln)
    - in the BGK/KFPK system, in addition to direct business (through its branches), there were guarantees for other banks to pass on to their clients and guarantees for regional/local institutions to pass on to local investment projects
    - an important feature is that, in all systems, the lending banks played a central role: in many cases (and mostly in the BGK's system), it was the lending bank that would propose for guarantee the loans that otherwise would not be approved by the bank; in the case of regional/local loan/guarantee institutions, it happens more often that the entrepreneur is advised about which banks are likely to accept the guarantee and approve the loan
- In 2001, the Central Government approved a Program called Capital for Entrepreneurs (*Kapital dla Przedsiebiorczych*) in order to unify and organize an efficient nationwide network of loan and credit guarantees. The following steps and directions were adopted:
    - PARP discontinued its autonomous activity in credit guarantees (end of Phare funds; CSF funds were not yet available)
    - BGK reoriented its management of the KFPK fund towards the following aims
        - Focus on <u>SMEs</u>: avoid supporting large firms/operations (targeted operations: maximum € 5 million)
        - <u>Equity investment in regional/local non-profit specialized guarantee companies</u>[16] (i.e., to become a partner, a shareholder) in order to promote their expansion and also to gain more influence on their running (i.e., to be a silent partner or an influent partner, depending on the circumstances)
            - this implies promoting institutions that have equity, i.e., that take the legal form of companies (with non-profit Bye-Laws)

[16] Such companies are often called funds (like the already mentioned *Wrocławski Fundusz Poręczeń Kredytowych Sp. z o.o.*, causing confusion between fund=legal person/company and fund=sum of money.

        - this also implies that such companies cannot manage loan funds and guarantee funds at the same time anymore (promotion of specialized credit guarantee network)
    - to decrease BGK's activity as direct guarantor (i.e., the guarantees by BGK itself) and to increase its activity in counter-guarantees for the guarantees issued by credit guarantee companies
    - to pass on to PARP the role of giving grants for guarantees to the regional/local institutions (PARP is the implementing agency of the financial tools sub-measures of the Polish CSF)

- by the end of 2006 (i.e., by the end of the 1st CSF), the shape of the system should be the following:
  - BGK, as manager of the fund KFPK, should become
    - organizer and promoter of the guarantee system (by becoming equity partner/shareholder of existing sound non-profit guarantee companies and by being a partner/shareholder in the creation of new ones)
    - supervisor of the system (by watching that the institutions follow sound risk analysis and financial rules; the means for this are (i) the equity stakes, (ii) the analysis of the financial statements of the institutions and (iii) the power to award or to deny applications for counter-guarantees depending on the transparency and creditworthiness of the applicants
    - counter-guarantor (providing counter-guarantees for the portfolios of the institutions rather than issuing guarantees or giving money for guarantee funds)
    - as a consequence, the fund KFPK will become formally or informally split into:
      - an equity fund (for the BGK to buy equity stakes)
      - a counter-guarantee fund
  - PARP: provider of grants to sound institutions (basically, CSF grants)

2.4.4.4. Recent developments

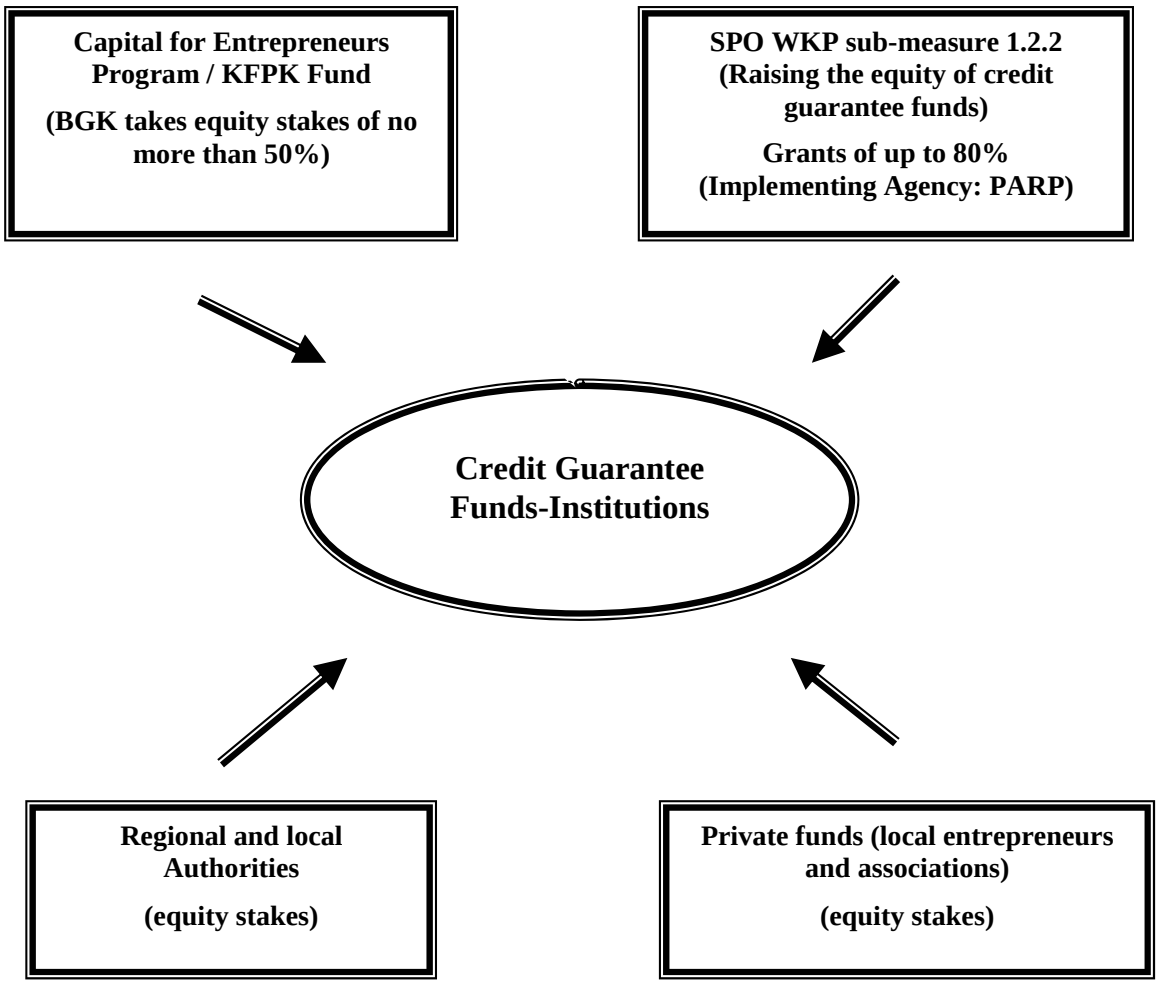
Some results of these policies can already be mentioned:

- the universe to reorganise: by 2000 there was a wide variety of credit guarantee institutions (in practice, many of them were guarantee subsidiaries or departments of multi-purpose institutions, like the development agencies of regional or local scope): some were very small, with small equity and few employees (usual scope: 1 *powiat* or several neighbouring *gmina*), while others were larger (operating at the scale of a Voivodship)
- The aim: by 2006 is to have a network of 16 regional credit guarantee institutions (1 per Voivodship) and 100 local ones.

- Program Capital for Entrepreneurs-*Kapital dla Przedsiebiorczyc*)
    - by the end of 2004 BGK had become partner/shareholder in 17 guarantee companies
- 2005-2006 SPO WKP's sub-measure 1.2.2-Raising the capital/equity of credit guarantee funds (implementing agency: PARP):
    - Planned Budget: € 1.2 million to grant to 55 credit guarantee companies
        - It is assumed that this corresponds to indirect support for loans amounting to €130 million awarded to 2 200 entrepreneurs/firms
    - Grants approved in the 1st round of applications for sub-measure 1.2.2 (January 2005): 15 projects amounting to total grants of 172 million PLN[17] (average grant: 1.5 million PLN)
        - Provinces/Voivodships that submitted the largest number of applications
            - Silesia – 3 projects
            - Varmia and Masuria – 3 projects
            - Western Pomerania – 2 projects
            - Lower Silesia, Cuiavia and Pomerania, Lublin, Lesser Poland, Mazovia, Pomerania, Greater Poland –1 project each
        - Largest project in value: the Lublin project (*Lubelski Fundusz Porczen Kredytowych*Lublin Fund for Credit Guarantee): grant of 40 millions pln
    - 2nd round of applications (ended May 31, 2005): 9 recommendations for approval[18] The following graph illustrates the current developments concerning the pledge/guarantee funds/institutions.

[17] Out of 21 applications amounting to total grants of 247 million

[18] At the time of writing, they are pending evaluation and decision by the Steering Committee and the Minister of Economy, Labour and Social Affairs.



Thus, specialized credit guarantee non-profit companies of regional or local scope became one of the backbones of the Polish Government's strategy to bring together indirect support to SMEs and the regional dimensions of self-government and regional development. As mentioned before, the aim for 2006 is to have a network of 16 guarantee companies of regional level (one per Voivodship) and 100 local ones.

2.5. Spain: Mutual Guarantee for the Autonomous Communities

2.5.1. Introduction

Nowadays Spain is like a federation of autonomous States, the Autonomous Communities (*Comunidades Autónomas*). To a certain extent, it reminds the German political organization, which is based on the *Länder*, each one of them with its own Parliament, Government and enterprise development agencies.

Likewise, Spain's Autonomous Communities do have a large degree of political and administrative autonomy.

The interesting point about Spain is the importance of the system of Mutual Guarantee Corporations. It was created in 1979 and it evolved to become a system of regional and sub-regional Mutual Guarantee institutions deeply ingrained in the economic policies of the Governments of the Autonomous Communities. In a sense, such guarantee institutions became important instruments for the regional development policies of the Autonomous Communities.

Spain's mutual guarantee system is considered an example of good practices because, following what were considered the best relevant practices at the time, it was created anew only 25 years ago, without any previous tradition or experience in the field[19]

2.5.2. Spain's Autonomous Communities and the Regional OPs

Upon the death of the dictator General Franco in November 1975, his personally-designated heir Prince Juan Carlos de Bourbon assumed the position of King and Head of State. With the ensuing transition to democracy and the approval of the Spanish Constitution of 1978 some regions (the Basque Country, Catalonia, Galicia

[19] This is to be compared with the 55 years of the German and Austrian systems, which were set up after World War II and benefited from the tradition of the local saving banks created in the 19th Century.

and Andalusia) were given far-reaching autonomy, which was then soon extended to all Spanish regions, resulting in one of the most decentralized territorial organizations in Western Europe[20].

Currently, regional political and administrative devolution in Spain is based on 17 Autonomous Communities (*Comunidades Autónomas*) and 2 Autonomous Cities (*Ciudades Autónomas*).

Madrid, the country's capital town, is in itself 1 Autonomous Community.

The Balearic Islands (off the east coast of Spain) make up 1 Autonomous Community and the same applies to the Canary Islands (off the western coast of Morocco).

The 2 Autonomous Cities (Ceuta and Melilla)[21] are administered directly by the Spanish Central Government and called Places of Sovereignty (*Plazas de Soberanía*). However, for the sake of simplifying the current text, they are also referred to as Autonomous Communities.

The Autonomous Communities coincide with the NUTS 2 Regions (list and map below).

NUTS 1	NUTS 2 17 AUTONOMOUS COMMUNITIES 2 AUTONOMOUS CITIES	NUTS 3 50 Provinces (*Provincias*)
NORTHWEST(*Noroeste*)		
	GALICIA	4 NUTS 3 territories
	ASTURIAS or PRINCIPALITY OF ASTURIAS (*Principado de Asturias*)	1 NUTS 3 territory
	CANTABRIA	1 NUTS 3 territory
NORTHEAST (*Noreste*)		
	BASQUE COUNTRY (*EUSKADI-País Vasco*)	3 NUTS 3 territories
	NAVARRE or FORAL COMMUNITY OF NAVARRE (*Comunidad Foral de Navarra*)	1 NUTS 3 territory
	LA RIOJA	1 NUTS 3 territory

[20] However, radical nationalism in the Basque Country (with its terrorist group ETA) continues to be a pending problem. And the very recent moves to quasi- independence in Catalonia add to the problems of far-reaching decentralisation.

[21] They are 2 small enclaves located in the northern coast of Morocco.

NUTS 1	NUTS 2 17 AUTONOMOUS COMMUNITIES 2 AUTONOMOUS CITIES	NUTS 3 50 Provinces (*Provincias*)
	ARAGON (*Aragón*)	3 NUTS 3 territories
COMMUNITY OF MADRID (*Comunidad de Madrid*)	COMMUNITY OF MADRID (*Comunidad de Madrid*)	1 NUTS 3 territory
CENTER (*Centro*)		
	CASTILE-LEON (*Castilla y León*)	9 NUTS 3 territories
	CASTILE-LA MANCHA (*Castilla-la Mancha*)	5 NUTS 3 territories
	EXTREMADURA	2 NUTS 3 territories
EAST (*Este*)		
	CATALONIA (*Cataluña*)	4 NUTS 3 territories
	VALENCIA (*Comunidad Valenciana*)	3 NUTS 3 territories
SOUTH (*Sur*)		
	ANDALUSIA (*Andalucía*)	8 NUTS 3 territories
	REGION OF MURCIA (*Región de Murcia*)	1 NUTS 3 territory
BALEARIC ISLANDS (*Illes Balears*)	BALEARIC ISLANDS (*Illes Balear-Islas Baleares*)	1 NUTS 3 territory
CANARY ISLANDS (*Islas Canarias*)	CANARY ISLANDS (*Islas Canarias*)	2 NUTS 3 territories
CEUTA	AUTONOMOUS CITY OF CEUTA (*Ciudad Autónoma de Ceuta*)	1 NUTS 3 territory
MELILLA	AUTONOMOUS CITY OF MELILLA (*Ciudad Autónoma de Melilla*)	1 NUTS 3 territory

It should be noted that the small red spot in the northeast of the map is the small landlocked Principality of Andorra. It is neither part of Spain nor of France nor a member of the EU: it is one of the independent micro-states of Europe[22]. It owes its economic prosperity to mountain tourism, tax-free shopping and generous corporate taxation (it is a tax haven).

The relations with the EU are determined by the "Agreement between the European Economic Community and the Principality of Andorra" (signed on the 28th of June 1990 with effect as of the 1st of July 1991). Andorra is not entitled to EU Structural Funds.

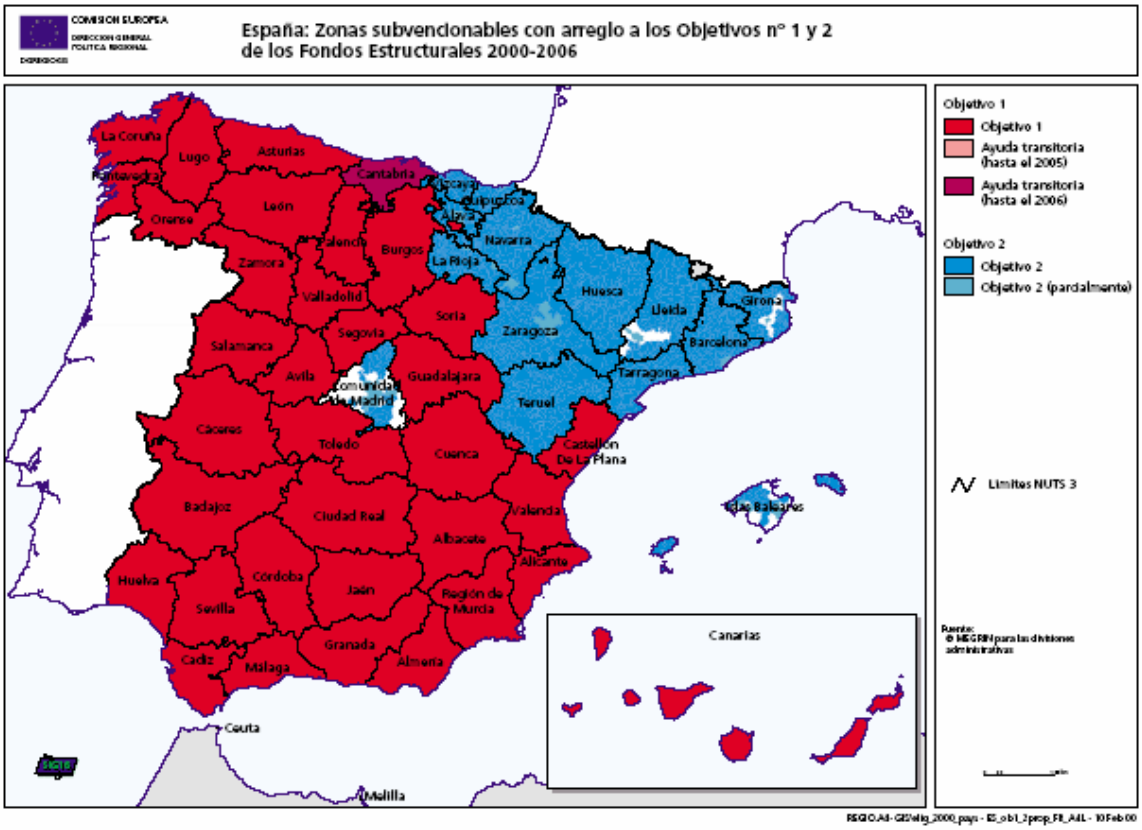
With respect to EU Regional Policy, the Objective 1 Regions of Spain (see map below) include 12 Autonomous Communities which cover most of the country.

The Regions not covered by the Objective 1 are Madrid (the capital town, in the geographical centre of the country), the Balearic Islands and 5 Autonomous Communities located in the northeast part of the country near the border with France (the Basque Country, Navarre, La Rioja, Aragon and Catalonia). Neighbouring Cantabria is still in Objective 1 but in a transitional stage (phasing out until the end of 2005).

[22] Andorra is traditionally ruled by 2 co-princes: by inherence, the President of France and the Catholic Bishop of the nearby Spanish town of La Seu d'Urgell.

Until very recently, Andorra's political system had no clear division of powers into executive, legislative and judicial branches.

A new Constitution (approved and ratified in 1993) establishes Andorra as a sovereign parliamentary democracy that retains the 2 mentioned co-princes as Heads of State. The new legislative body is the unicameral General Council of the Valleys (*Consell General de les Valls*), which is a parliament elected by direct popular vote. The General Council determines the executive body (Govern) by electing the Head of the Government (*Cap de Govern*), who then appoints the members of the Executive Council (Ministers). The external defence of the country is the responsibility of France and Spain together.



The 2000-2006 CSF (Community Support Framework) for Spain complies with the NUTS 2 level of regional devolution in Spain.

So, apart from the usual Technical Assistance item, Spain's current CSF is made up of the following Programs:

- 12 separate Regional Operational Programs (1 for each Objective 1 Autonomous Community; Cantabria is included as it is still phasing out of Objective 1)
- 9 Multi-regional Operational Programs
    - Improving Competitiveness and Developing Production
    - Research & Development and Innovation
    - Information Society
    - Encouraging Employment
    - Vocational Training
    - Entrepreneurial Skills and Continuous Training
    - Against Discrimination (women, disabled persons, marginalized persons)
    - FIFG (Financial Instrument for Fisheries Guidance) Operational Program
    - Improving Agricultural Structures and Production Systems

The financial programming is not very clear about the amounts directly awarded to the 12 Regional Operation Programs because it sets up the break-down by qualitative Priorities rather than by Programs.

However, the important point is that the Autonomous Communities, especially the strongest ones, have considerable bargaining over the amounts they will receive. In addition to negotiating with the Central Spanish Government, they have direct access to the EU Commission to discuss the magnitude and the content of their own Regional Operational Programs. And last but not the least, each one of them has very considerable autonomy over the allocation of the funds that it receives under its Regional Operational Program.

One of the relevant features of administration by the Autonomous Communities is that the Mutual Guarantee institutions (first created in 1979) became important tools in the implementation of regional economic strategies, backing up the initiatives of the regional SMEs Promotion agencies.

So, the following sections deal with the emergence and development of the Spanish system of Mutual Guarantee institutions of regional scope.

2.5.3. Spain's Mutual Guarantee System

2.5.3.1. Note on the terminology

In Spain, the mutual guarantee institutions are called SGRs, acronym for *Sociedades de Garantía Recíproca* – Reciprocal Guarantee Companies. The acronym (singular, SGR; plural, SGRs) will therefore be used when referring to them.

But why are they called "Reciprocal" rather than "Mutual", specially considering that the inspiration for the model of organization is the French *Mutualités*? For 2 reasons, a political one and a legal one.

1) In the early decades of the 20th Century, workers' cooperatives, mutual insurance, mutual credit and other forms of mutualism had been promoted in

Spain (as in France or in Portugal or Italy) by left-wing and anarchist political movements and trade-unions, and these ideologies were defeated in the Spanish Civil War (1936-39); then, during the ensuing fascist regime (1939-1975) led by General Franco, mutualism was curtailed, if not crushed or banned[23]; in the initial years of the "smooth transition" towards democracy that followed the death of Franco (November 1975), the word "mutual" was still politically sensitive

2) In the immediate following year (1976), when the Spanish mutual guarantee system was thought out, the authorities of the time chose the somewhat synonymous word "reciprocal" for official denomination of the legal person that was created on purpose (*Sociedad de Garantía Recíproca – SGR*, created by Royal Decree in February 1977).

2.5.3.2. Antecedents

In 1974, the Chamber of Commerce of Barcelona[24] took steps to try and create a mutual guarantee institution for the entrepreneurs of Catalonia.

The timing of this initiative (1974) is not irrelevant. It is right after the 1st Oil Shock (17th of October 1973) unleashed by the Arab OPEC countries' reaction to the Yom Kippour War (also know as the October War).

In other words, in the midst of the worst recession that the Spanish economy (and the world economy as a whole) had faced in several decades, the relatively independent-minded and cosmopolitan Chamber of Commerce of Barcelona brought

[23] A note must be made about the Basque Country (*Guipúzcoa*), a nation (also a Province and now an Autonomous Region) of northern Spain which is known for its strongly autonomist past and for its unique non-Latin language (*Euskara* - Basque), the co-official language of the Region. It is also, though sadly, known for the independentist terrorist organization ETA (*Euskadi Ta Askatasuna* – Basque Country and Freedom) and for the world famous Picasso painting "Guernica", which depicts the suffering of the civilian population brought by the *Luftwaffe*'s Condor Legion aerial bombing on the small Basque town of *Gernika-Lumo* in April 1937 to prop up the Nazi-supported nationalist faction of General Franco during the Spanish Civil War).

In the Basque Country, mutualism and workers' cooperatives survived during the fascist regime. Some of the latter grew to become enterprises of considerable size and organizational efficiency, the famous example being the *Mondragón Corporación Cooperativa* (Mondragon Cooperative Corporation).

[24] Barcelona is the capital town of Catalonia (*Cataluña*), another of the Spanish nations (now also Autonomous Region) with its own regional official language (the *Catalan*, a French-influenced version of the old *Castellano*; the modern version of *Castellano*, also known as Spanish, is the first official language of Spain).

Barcelona, not far from the northeast border with France, is a traditionally important and developed economic and cultural pole of Catalonia.

out to the open was what was being talked about in the corridors of the entrepreneurial and financial circles: (i) that SMEs were cash-strapped and struggling for survival and crying out for State assistance; (ii) that banks wanted the State to step in and provide credit guarantees for SMEs so that they (the banks) could go back to "business as usual" instead of facing shrinking lending portfolios and increasing bad loans.

As a matter of fact, SMEs were in bad need of more working capital to make ends meet and avoid defaulting once and again on their liabilities, including the service of their debt towards the banks. But whatever real guarantees (industrial premises, machinery, personal real estate of the owners) they (the firms) could (or were willing to) give to the banks had already been mortgaged to secure previous loans (including those for starting up or for buying machinery). For SMEs in such a situation, survival was the word; expansion, modernization or innovation was the least of their worries. But the banks, according to a good old financial rule ("do not put good money on top of bad money"), were recalling the total amount of the loans at the first sign of default, rather than "putting in" more money to help the strained firms to surf the crisis. Banks needed additional solid guarantees (that the SMEs themselves could not provide) to be convinced to keep the same level of lending, let alone to increase it.

However, the fascist regime of Franco was still in power and autonomous initiatives of self-minded small or medium entrepreneurs or their representatives were not particularly welcome. Furthermore, the political and economic environment was stressful: the brother fascist regime of neighbouring Portugal, which had been under threat due to similar economic reasons, to the unending Colonial Wars in Portuguese Africa and to frustration in face in failed attempts at economic and political liberalization, fell under an unopposed (thereby, peaceful) military coup (April 1974: the *Revolução dos Cravos*-Carnations' Revolution); the Portuguese Revolution soon showed left-wing leanings that revived the "threat of communism" which had been

the justification for the Spanish Civil War of the second half of the 1930s; Franco, was 82 years old and still Head of the State.

In such circumstances, the creation of mutual guarantee was not a priority, even in face of pressing short-term economic needs. The attempt of the Chamber of Commerce of Barcelona led nowhere at the time.

2.5.3.3. Creation of the legal framework (1977-78)

Soon afterwards, Franco died (November 1975).

His appointed successor, D. Juan Carlos de Bourbon, become King of Spain and started what came to be called "smooth transition" (*transición suave*) towards political democracy and economic liberalism.

It became immediately clear that the previous context of economic protectionism[25] and State dirigisme was coming to an end and that the Spanish economy would have to open up to Europe and face increasing competition. Future membership of what is now the EU[26] was already in the horizon (it took place 10 years later, in 1985, when the two other then recent democracies of Europe, Portugal and Greece, also became members).

In the economic field, one of the priorities of the Spanish Government of the time was to start preparing its firms, specially the fragile SMEs, for the "European shock". And one the backbones of this turn in terms of economic and financial policy was to speedily set up a nationwide system of guarantee institutions to back up the SMEs. The organizational model would be the French *Mutualités* to combine State backing and private influence and initiative (what would now be called a PPP-Public-Private Partnership).

[25] Neighbouring Portugal was a member of the UK-led EFTA-European Free Trade Association. Spain was not even that.

[26] The then EEC-European Economic Community, also known at the time as European Common Market or, simply, Common Market.

And, actually, the process was quite swift for the times: political decision and initial preparation in 1976, legal framework in 1977 and 1978. In 1979, the first SGRs, a new type of firms/legal persons, were being created.

This is the official explanation both for the initiative and for the relatively swift implementation of the legal framework. However, considering the antecedents, one may wonder about the actual balance between the weight of foresightedness concerning the preparation of the Spanish economy for the "European shock" and the weight of the pressing needs that had surfaced in 1974 and had remained unsolved.

Whatever the case, the Regional-oriented public-private partnership system that exists in Spain today is the development of what was started back in 1976-79 under the aegis of the Central State[27], largely financed by the national budget[28], and it was later adapted according to accumulated experience and changing circumstances.

The first step was the publication of the legal framework:

- Creation of a previously unexisting legal person, the *Sociedad de Garantía Recíproca-SGR* (Real Decree of the 25th February 1977)
- Regulation of the legal, fiscal and tax regime of the SGRs (Real Decree of the 26th July 1978).

The main features of the framework created by these two laws were the following (when important changes occurred at a later stage, this is indicated in the text):

- the SGRs were created as a new specific type of firm; they are neither cooperatives nor limited responsibility partnerships nor joint-stock corporations
    - at this stage, they were not considered financial firms
- the one and only objective of the SGRs is to issue (underwrite) guarantees, i.e., they cannot engage in other lines of business

[27] There were no regional autonomies at the time.
[28] This was before EU membership and Structural Funds.

- he SGRs are, in practice, non-profit organizations (technical details apart, most of the profits, if any, have to be retained in the SGR)
- there are 2 types of members/partners of the SGRs
    - Supporting Members or, simply, Supporters (called *Socios Protectores*-Protecting Partners)
        - they subscribe and own equity of the SGR
        - but they cannot benefit from the services of the SGR
            - e.g., a SGRs cannot underwrite guarantees to cover the transactions of its Supporters)
        - altogether, they cannot own more than 50% of the Equity/Voting Rights
        - typical types of Supporting Partners
            - public bodies and agencies
                - initially, the SMEs Agency of the Central State[29] and the Provinces
                - later, after the creation of the Autonomous Regions, also the Governments of the Autonomous Regions and their public agencies
            - banks (large or small/local)
            - entrepreneurial associations (regional or local associations, chambers of commerce, etc.)
            - large firms (occasionally)
    - Participants Members (called *Socios Partícipes*-Participant Partners)
        - only SMEs
        - they have to be owners of an equity share of the SGR, at least for as long as they have live guarantees underwritten by the SGR[30]
        - and they can benefit from the services of the SGRs
            - on other words, and this is the basic principle of mutualism, a firm has to be or to become a partner of the SGR in order to have the SGR as guarantor (i.e., issuer of the guarantee) of the loan that it (the firm/participant partner) is getting from the bank (lending bank)

[29] The Madrid-based *IPyME-Instituto de la Pequeña y Media Empresa* (Institute of the SMEs).
[30] They can sell their equity share afterwards, if they want so.

- Requirements to create a SGR
  - very loose at this stage (minimum 10 members; minimum Social Equity of € 0.3 thousand; no licensing needed)
- Scope of activity:
  - regional (e.g., some neighbouring Provinces, a whole Autonomous Community)
  - or sectorial (e.g., transportation=lorry owners, handicrafts, etc.)
    - sectorial SGRs virtually disappeared after the crisis of the mid-1980s
- Counter-guarantees: in the early 1980s, the SGRs created a joint-stock corporation to provide counter-guarantees for their guarantees (similar to reinsurance; the idea is to put various portfolios together to diversify and bring down the risk that is taken by each individual SGR). That corporation, SOGASA (*Sociedad de Garantias Subsidiarias, SA*-Company of Subsidiary Guarantees, joint-stock corporation), had the following features and practices
  - it was created by the SGRs, which owned 100% of the Equity
  - it covered the whole portfolio of the SGRs that subscribed the Contract of Adhesion to SOGASA
  - the percentage of cover changed during time (it tended to stabilize at 50%)
  - the counter-guarantee was not free: annual commissions were charged, though low, were charged
  - SOGASA was not financially self-sustaining: it depended on subsidies from the State' SMEs Agency on a more or less annual basis

- Some technicalities
  - Social Equity
    - the units in which Social Equity is divided are called "Units of Participation" (as opposed to the shares or the partnership parts of the usual commercial companies)
    - Social Equity is not fixed: there is a Minimum Social Equity that is set in the Bye-Laws of the SGR, but, with no need to change those Bye-Laws, Total Social Equity can increase (up to 3 times the Minimum) as new members join and have to buy Units of Participation or existing members want buy additional Units of

Participation (always at nominal value) and it can decrease (down to the Minimum of the Bye-Laws) as members leave or want to reduce their participation and are reimbursed for the correspondent number Units of Participation (again, at nominal value[31])

- this mechanism is similar to an open investment fund, like those funds that are managed by banks and whose Units of Participation are bought by savers when they have excess cash and sold back (hopefully with capital gain) when they need money for expenses, except that in the SGRs there are boundaries (Minimum and Maximum) and transactions are made at nominal value (no gains, no losses)
- this mechanism also makes it easier for firms to subscribe Units of Participation, as they have to when they want a guarantee, and to leave and get the money back if they so want, after the end of the life of the guarantee
- finally, this mechanism makes it easier for the leverage effect to work, because fresh money comes into the Equity when business expands (for a guarantee for a loan of € 100, the member has to buy, say, € 1 of Units of Participation), and the opposite happens when business contracts (however, in both cases, this is not quantitatively very significant)

- Own Equity[32]
  - if it falls below a certain floor[33], either members bring in fresh money (buying Units of Participation) to fill the gap or they have to close the shop (liquidation)
- Fund of Technical Provisions
  - in lines of business that deal with uncertainty (like insurance and banking), firms are required to keep as Reserves a level of Assets that is thought to be statistically adequate for the firm to remain solvent in the future; in insurance they are called Technical Reserves, in banking they

[31] In other words, as opposed to what happens in buying and selling shares or partnerships in companies, there are neither capital gains nor capital losses in transactions of Equity/Units of Participation of the SGRs.

[32] Basically, Own Equity is Total Social Equity plus Net Retained Profits accumulated from the past, i.e., less Accumulated Losses, if there are never any profits to show.

[33] 2/3 of the Total Social Equity.

are called Provisions, in the guarantee business the terminology is not uniform

- the Fund of Technical Provisions of the SGRs belongs this type of Reserves
- technical details apart, the Reserves requirements became more stringent after the mid-1980s crisis (currently, they are as stringent as for banks)

2.5.3.4. The system's start-up (1979-83)

The main features were the following:

- Very fast growth
  - starting in 1979, a larger number of SGRs was quickly set up (30 in a couple of years)
  - the number of Participant firms shot up
  - likewise, the value of the guarantees issued was quite significant
    - another pressing need for bank loans (and for the guarantees that could make them possible) certainly played a large role in this immediate fast growth
      - the legislation that made SGRs possible had came right in time for the recession of the 2nd Oil Shock (it came in the wake of the Iranian Revolution: the Shah of Iran fled the country on the 16th of January 1979, the Ayatollah Khomeini arrived from France a fortnight later, on the 1st of February)
- The Central State was the main promoter and financer of SGR creation
  - the SME Agency of the Ministry of the Economy, the IPYME-*Instituto de la Pequeña y Mediana Empresa Industrial* (Institute of the Industrial SMEs) was a constant presence among the founding Supporting Participants

2.5.3.5. Crisis of the system and State rescue operations (1983-85)

After the initial explosive growth, the economic recession of early 1980s brought the SGRs to a serious crisis:

- there was wide defaulting on debt service by manufacturing and trading firms in general, and by SMEs in particular

- numerous SGRs became insolvent because they had not enough Reserves or new business income to cover the claims they had to pay as guarantors of their Participant Members/Clients; this was a result of various factors:
    - lack of experience (recession came after only 4-5 years of operation)
    - careless acceptance of risk, mainly during the first 2-3 years after the creation of the SGRs
        - pressing demand and insufficient experience led to reckless risk analysis
        - the consequences were not felt at the moment, they came later: on medium-long term loans guaranteed right at the beginning, in 1979-81, many borrowing firms managed to survive and keep the debt service on time until, a couple of years later, the onset of recession led them to default)
    - inadequate counter-guarantees (SOGASA, the counter-guarantee joint-stock company owned by the SGRs went into financial trouble and had to be rescued by the State through the SMEs Agency)
    - insufficient prudential supervision
- the State had to step in through a wide (and costly) rescue operation, providing 2 types of subsidies
    - subsidies for Equity (it had been “eaten up” by accumulated losses)
    - subsidies to replenish the depleted Reserve Funds
- that State assistance came from 3 sources
    - the Central State, through the SMEs Agency of the Ministry of the Economy
    - the Provinces
    - the Governments of the recently set up Autonomous Communities
- many SGRs were liquidated or merged
    - the number of SGRs went down from 30 to 20 (there are 22 nowadays)
    - the sectorial SGRs of national scope were particularly hit: they all closed down (nowadays, there is only 1, in the very specific business of guarantees for shops that take in tobacco and other vending machines)
    - the SGRs that fared better were those that operated at the regional or provincial level, due to the following reasons
        - the relation of proximity is an important factor in the risk analysis of SMEs (people who know each other; fellow entrepreneurs of the same village who are already members give information on

the reputation of new potential members/clients; the premises of the firms can be visited because they are not far away; occasionally, debts by a former client/member who disappeared from the region can be recovered because, say, 5 years later, the SGR "learns" that he just bought or built a new house in his original village, etc.)

- diversification of the portfolio reduces risk (by covering risk from firms of various sectors within the same region, the SGRs of regional or provincial scope are less exposed to a crisis that hits only one particular industrial or trade sector (provided, of course, that the regional economy is sufficiently diversified itself, which would not be the case, for example, of a territory dominated by agriculture and small retail shops)

2.5.3.6. Strengthening of the system (1985-94)

The almost ten years that following Spain's entry in the then EEC had positive effects on the shaping of the system.

- the improvement of the economic situation brought some relief to the system and contributed to increase its stability
- various SGRs received now and again new subsidies to improve their financial strength
  - the State's SMEs Agency was and remained the main source of such subsidies
  - but the Governments of the Autonomous Communities increasing did the same and, at the same time, increased their links with the SGRs of their territories
- the 1st counter-guarantee corporation promoted by the Central State was set up by the State's SMEs Agency in 1985; it was called *Sociedad Mixta de Segundo Aval, SA*-Mixed Company of Second Surety, Joint-stock Corporation) and its main features and practices were the following
  - the Equity was owned by Central State agencies; the SGRs had no voice on the corporation
  - both the acceptance of risk (i.e., the underwriting of counter-guarantees) and the terms (percentage of cover, price, terms of reimbursement, etc.) were decided case by case
    - in practice, only guarantees related to loans subsidized by State were counter-guaranteed

  - after a couple of years, the corporation started to have firms as direct clients for guarantees, thereby becoming at the same time a counter-guarantor and a competitor of the SGRs
  - however, given the frailty of the counter-guarantee corporation that had been created and was owned by the SGRs (SOGASA), the presence of the *Sociedad Mixta de Segundo Aval, SA* as an alternative counter-guarantor (this one with the credibility of being owned by the State) brought some comfort to the SGRs
- so that the SGRs could be able to cover riskier loans that were considered as a national priority, the State's SME Agency started to provide counter-guarantees of 25% that could be added to the counter-guarantee provided by the *Sociedad Mixta de Segundo Aval, SA* (normally pushing up total counter-guarantee to 75% cover)
- an important legal change took place in 1988: the SGRs were classified and as financial firms, with the following consequences
  - demanding bank-like prudential rules were imposed on the SGRs
  - the Central Bank became the supervisory authority of the SGRs
    - before, there was no proper supervision; the creditworthiness of the SGRs rested on their own audited financial statements
  - comment 1: keeping by the new prudential rules placed some strain on the SGRs, but it also contributed to make them more transparent and financially reliable
  - comment 2: the new legal and supervisory framework could have another positive side effect, that of giving to the guarantees issued by the SGRs a favourable weight/value in terms of the Basle rules on bank provisioning, thereby making those guarantees more attractive for the banks
    - ideally, an SGR guarantee would have the same weight as a bank guarantee, like it happens with the Mutual Guarantee Companies of Portugal and with the Guarantee Banks of Germany and Austria; however, this is not yet the case in Spain)
- there was another important development that started to be shaped in the late 1980s: Protocol bank credit lines for SGRs clients
  - usually, banks send to the SGRs those clients that cannot provide enough real guarantees (e.g., real estate to mortgage) for the bank to make the loan but to whom the bank would lend the money if comforted with a SGR guarantee

- as the reliability and bargaining power of the SGRs increased, some of them managed to make Covenant for credit lines by banks (particularly local savings banks) that inverted the relationship:
  - SGR' clients and potential clients submit the project to the very SGR (not to the bank)
  - the SGR makes the risk analysis
  - if it is positive and if the project fills the requirements of the Conent, the SGR sends the file to the bank for automatic approval of the loan (no second risk analysis by the bank, no analysis fee to pay to the bank, no further delays)
  - after some successful pioneering experiments, this practice is now quite common in Spain and nowadays most SGRs have Covenants for credit lines with almost all banks that operate in Spain
- comment 1: this practice confirms that SGRs have an important role in assisting SMEs, even to the point analyzing the client's demand and helping him to find the most favourable form of finance
- comment 2: practices like these confirm the competitiveness of the SGRs and their ability to withstand market conditions without continuous and heavy subsidization
- comment 3: a development is now making way also in Germany, the BoB-*Bürgschaft ohne Bank* (i.e., approaching the guarantee institution first and the bank afterwards.

2.5.3.7. Modernization of the legal framework (1994-95)

The basic structure of the system was shaped by the developments of the preceding period.

In 1994-95, the legal framework was brought up to date and the system was completed by the reformulation of the counter-guarantees.

- a new legal framework for the SGRs was defined that basically compiles previous changes and makes technical adjustment, nothing strategically new was introduced (Law 1/1994, of the 11th of March)
- a new a single State-backed counter-guarantee corporation was create to replace the 2 previous one (1995)

The main features of the SGRs system as adjusted by the 1994-95 reformulation are the following:

- the SGRs are a specific type of firm (as since the beginning)
- the SGRs classified as financial firms (confirms the legal adjustment of 1988)
- the SGRs issue guarantees (as since the beginning; but then this was the only allowed objective)
- the SGRs can provide paid services to SMEs (like advice, consultancy and training) and they can subscribe participations in institutions (like entrepreneurial associations, economic development companies, etc.) whose objective is to assist SMEs of the same region (slight enlargement of the allowed activities in line with the actual nature of the SGRs)
- the SGRs are, in practice, non-profit organizations (as since the beginning)
- the SGRs have 2 types of members/partners, Supporters (up to 50% of the Equity, cannot benefit from the products and services of the SGR) and Participants (as since the beginning)
    - note: by now, the Governments of the Autonomous Communities and of the Provinces had already replaced the Central State's SMEs Agency as main Supporting Members
- Requirements to create a SGR (entry barriers) are made more stringent
    - minimum number of members jumps from 10 to 150
    - Minimum Social Equity jumps from € 0.3 thousand to € 1.8 thousand
    - previous license by the Ministry of the Economy is now required
    - comment: previous license is stringent entry barrier; however, it is largely a precautionary move because the network of SGRs was already in place
- Scope of activity of the SGRs: the territory or sector defined in the Bye-Laws (as since the beginning)
    - comment: innocuous, because the regional nature of the existing SGRs was already consolidated (the only sectorial SGR that survived was the already mentioned one for the vending machines) and the entry barriers were made tougher
- Counter-guarantees: the 1994 Law made it possible for the State to create State-backed counter-guarantee corporations; in 1995, the following moves took place:
    - The 2 previous counter-guarantee corporations were closed down and their assets and liabilities were transferred to a new corporation

- the new corporation is CERSA-*Compañia Española de Reafianzamento, SA* - Spanish Company of Re-guaranteeing, joint-stock corporation, whose main features and practices are the following
  - it is almost wholly owned by the Central State and the initial Equity and Reserve Fund came from the national budget (the SGRs own small symbolic percentages of the Eqquity and did not put money for the Reserve Fund)
  - with respect to guarantees for medium-long term loans for SMEs, CERSA provides automatic cover (without further analysis), but there are several restrictions with the consequence that, in practice, only small and simple guarantees for straightforward small loan amounts are automatically counter-guaranteed; all the others are decided upon case by case analysis (the actual proportion between the two situations is difficult to know, but some SGRs complain that the restrictions make automatic counter-guarantee much less encompassing than it seems)
  - with respect to guarantees for short-term loans, they are all accepted (or not) upon case by case analysis
  - the percentage of cover tends to be 50%, but it can go from 30% (minimum) and 75% (maximum)
  - the counter-guarantees are provided free of charge, but, when the claims ratio[34] of a particular SGR goes up, penalties are charged which are tantamount to fining that SGR
- comment 1: many SGRs would like to have something closer to automatic guarantee for the whole portfolio at 75% percentage of cover; they argue that if risk sharing with the counter-guarantor were more generous and encompassing they could assist many more SMEs and innovative risky projects, which is probably true
- comment 2: nevertheless, the new corporation, the new rules and the clear State-backing for the counter-guarantee corporation brought some order to what was a messy and unclear situation before

- Some technicalities
  - Social Equity
    - the units in which Social Equity is divided are called “Units of Participation” (as since the beginning)

[34] It is the ratio between the total amount paid in indemnities (claims) during one year and the outstanding guaranteed amount at the end of the year. In car insurance, If there is a recession, if new risky clients are accepted, etc., the claim ratio is likely to go up.

- some rules on the Social Equity, Own Equity and the Reserve Fund were changed with two purposes: (i) to make the organization more flexible and (ii) to impose prudential rules and financial reliability

2.5.3.8. SGRs, Regionalization and EU Structural Funds

The important role that the SGRs today as financial institutions of regional development was the result of a long process.

- the 1st visible step came in the wake of the mid-eighties crisis - this period is the beginning of a shift towards the reorganization of the guarantee system in line with power devolution to the regions due to the conjugation of the following already mentioned factors:
  - the regional division of the country was underway and the first Autonomous Communities had been created and their had been elected[35]
  - the Governments of those Autonomous Communities and of the Provinces took part in the financial rescue operation of the SGRs of their territories
    - by doing so, they started the process of becoming the important (if not the main) Supporting Members of the SGRs of their territories that they are nowadays
    - additionally, they gained an influence on the decisions over which SGRs to rescue or not to rescue, which SGRs were to be "mergers" and which were to be "merged"
    - finally, they started to get experience on how to have influence on regional economic development through institutions that they had to manage together with other important local players (banks, entrepreneurial associations, Chambers of Commerce) and with the interested parties themselves (the local entrepreneurs that would seek the SGRs guarantees in order to gain access (or better access) to bank loans
  - the crisis, the rescue operation and the consolidation of the ensuing years showed that the SGRs of regional scope had fared better under the crisis and got stronger during the recovery

[35] The executive body at the regional level is the Government (*Gobierno*) of the Autonomous Community; those at the sub-regional level are the *Diputaciones* of the Provinces.

- as new Autonomous Communities were created and power devolution progressed, similar processes occurred in other parts of the country
- the links between the regional and sub-regional authorities grew closer throughout time due to the following factors
    - the reorganized SGRs developed to be reasonably lean and efficient operations that displayed considerable financial expertise and could survive under market conditions[36] (i.e., without heavy and continuous subsidization)
    - when the Central State's SMEs Agency was extinguished, 1997, to give way to the regional agencies created by the Governments of the Autonomous Communities, the cooperation between those regional agencies and the SGRs of the region flowed easily
    - when such regional agencies (directly or through regional venture capital companies) started to manage regional[37] funds (e.g., for start-ups, for young entrepreneurs, etc.) cooperation in risk analysis and in risk sharing with the SGRs started almost spontaneously
    - finally, when the EU Structural Funds started to have an Operational Program for each Autonomous Community (since 2000), the links between the Autonomous Governments and the SGRs increased and the role of the latter as financial players for the SMEs of their territories became even more visible

EU Structural Funds have been and will be still for some years to come a very important source of business for the SGRs.

But the important point is that the system as a whole (SGRs of regional or subregional scope; cooperation with the Governments and agencies of the Autonomous Communities; State-backed counter-guarantee) was able to evolve and set up the SGRs as feasible specialized financial institutions that play 2 important roles: (i) they assist and help local SMEs; (ii) they assist regional development strategies.

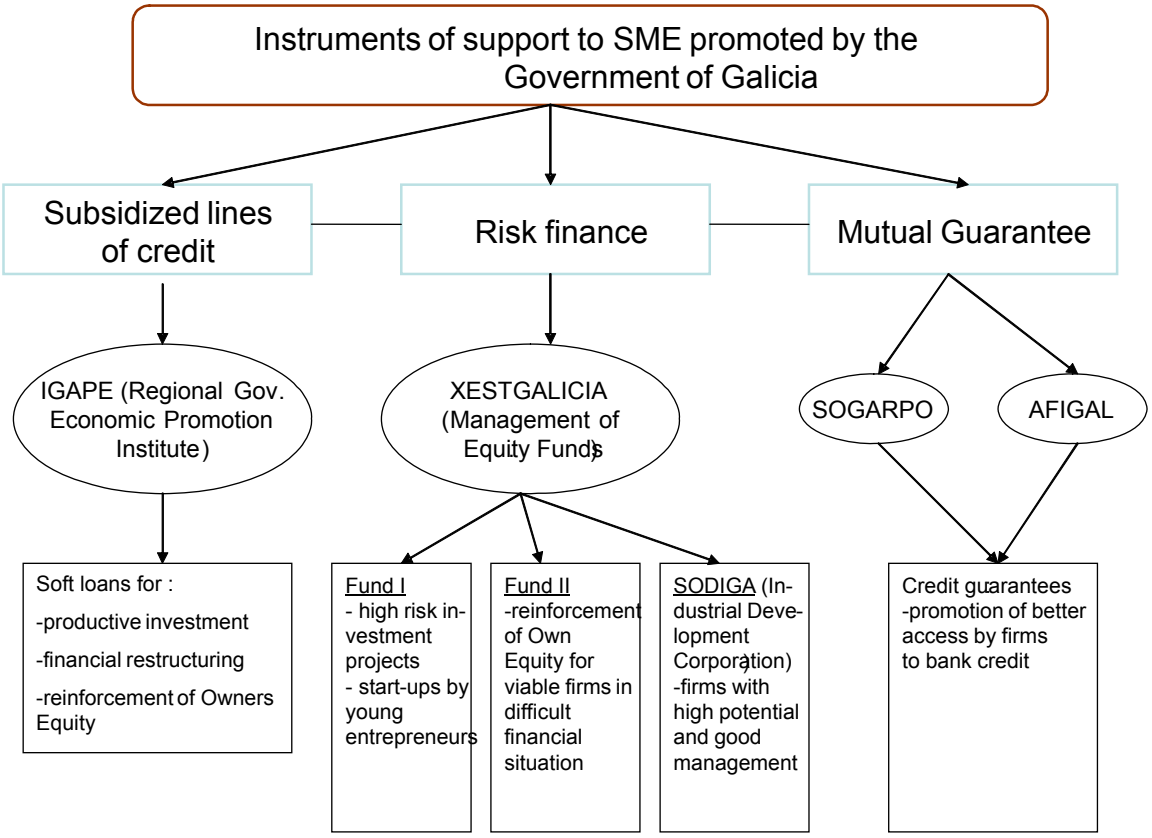
[36] A mentioned example is the expansion of the bank credit lines for automatic lending under Covenant between the SGRs and the banks.

[37] Regional both in the sense of the territorial scope and in the sense that they were tools of the policies of the Government of the Autonomous Region and were financed by its budget.

2.5.3.9. Galicia: an example of regional structure of SME support

Galicia is an Autonomous Community in North-eastern Spain.

The structure of main currently existing instruments of support for SMEs is depicted in the graph below.



The most direct institution of regional development of the Government of Galicia is IGAPE, a public agency that was created after the extinction of Central State's SMEs Agency, in 1997.

In terms of financial tools, IGAPE basically runs programs soft loans. Those for productive investment (both tangible and intangible) are co-financed by the EU through the Regional Operational Program for Galicia of the CSF for Spain. Those for

financial restructuring and for Owners to increase the Equity of their firms are financed by the regional budget.

XESTGALICIA is a corporation wholly owned by the Government of Galicia which does the management of Government Funds of risk/venture finance.

Typically, it runs directly 2 equity funds, an “aggressive” one and a “defensive” one (Fund 1 and Fund 2). The first is aimed at projects there are too risky to fall under the criteria of the more conventional programs of IGAPE, like high-tech investment projects and start-ups by young entrepreneurs. The second is aimed at helping entrepreneurs increase equity of firms which are feasible but which are in bad financial shape (and, because of that, cannot benefit from the more conventional finance). Only the “aggressive” fund is co-financed by the EU through the OP for Galicia.

XESTGALICIA also plays the role of venture equity investor through its shareholding in SODIGA, which is more directed to the manufacturing industry. SODIGA runs an industrial park and manages an equity fund for investing in risky projects (due to high level of specialization) of firms with sound management.

SOGARPO and AFIGAL are the two SGRs, mutual guarantee institutions, of Galicia. Their territories do not overlap. SOGARPO covers the Western areas while AFIGAL covers the Eastern areas.

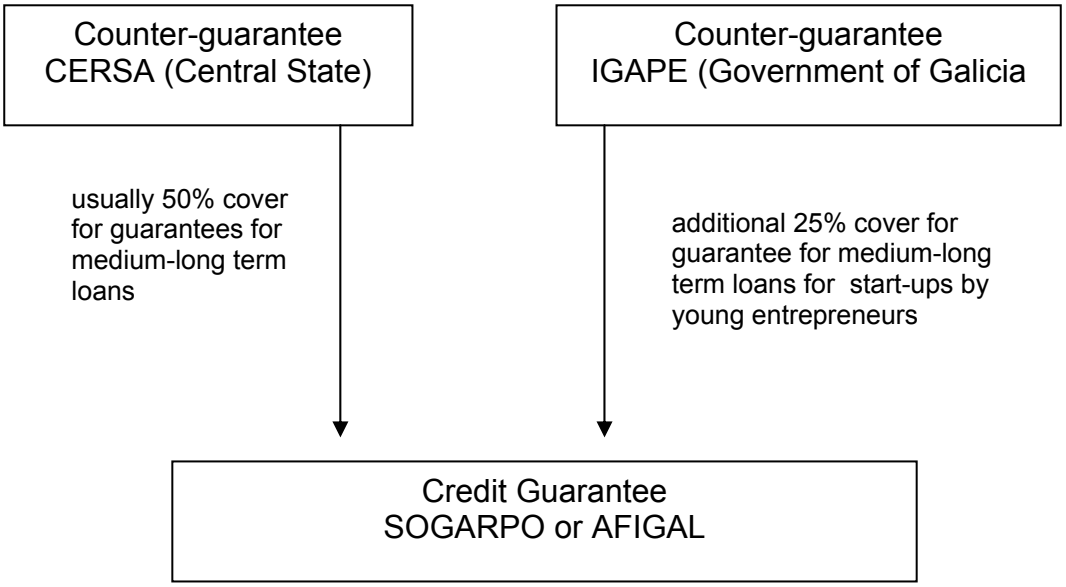
As for the other SGRs of Spain, the Government of the Autonomous Community is the main single partner[38], followed by the executive bodies of the Provinces. However, as mentioned generally about the equity structure and nature of the SGRs, the regional authorities play an important but not controlling role in the SGRs, as opposed to what happens in IGAPE or XESTGALICIA.

The 2 SGRs of Galicia have been created before Spain joined the EU and before the Structural Funds. They have clients that do not benefit from supporting funds of

[38] Some 15% of the equity, in both cases.

IGAPE and they have clients that joined in order to get guarantees for loans of the programs of those institutions.

The 2 SGR cover the soft loans of IGAPE with the same criteria and rigorous risk analysis that they apply for other projects. However, for guarantees for medium-term loans to enterprises that fulfil certain requirements (e.g., start-ups by young entrepreneurs, like those that benefit from equity investment of the "aggressive" Fund 1), there is a Covenant thanks to which the regional Government (through IGAPE) provides additional counter-guarantee of 25% which adds up to the 50% provided by CERSA under normal circumstances, with a final result of counter-guarantees of 75%. The SGRs can therefore provide guarantees for "firms of Fund 1" that it would not provide otherwise. The 2 instruments of support complement each other: XESTGALICIA puts money into a firm to become a silent or helping partner, while the extra counter-guarantee cover makes it possible for the SGRs to help the firm secure medium-long-term bank loans for start-ups by young entrepreneurs, including those of Fund 1. That is the mechanism shown in the graph below.



2.5.4. Portugal's IMIT (1995-1999): an example of a EU supported operational program for a declining sector (textile) and its main territory (Vale do Ave)

Recognizing the necessity of the adaptation of the Portuguese textile industry to the new requirements of the international situation, mainly, the consequences of the increased competition due to the GATT/WTO agreements, the European Union Council adopted the regulation (CE) n.º 852/95, of 10 of April of 1995: for the period 1995/1999, it set up a specific program for the modernization of the textile industry in Portugal - the IMIT (Initiative for the Modernization of the Industry of Textiles), whose Regulation of application was approved by the national resolution n.º 96-A/95, of 6 of October.

IMIT was set up as a Community Initiative. This means that its budget came from Community funds over and above the then ongoing 2nd Community Support framework for Portugal.

Total budget of IMIT: € 455 million (75% EU co-financing, 25% Portuguese co-financing)

Execution level by the end of the initiative: 95%

Structure of IMIT

Subprogram 1 – Enterprise Modernization

This subprogram was aimed at stimulating directly the enterprise initiatives concerning the development of integrated projects for the textile industry modernization and reorganization of the firms in this sector.

Type of grants/subsidies: refundable (loans) and non refundable (grants) up to 50% of the eligible costs.

Subprogram 2 – Access to financial instruments

To ensure the necessary co-financing of the enterprise initiatives concerning *subprogram 1*, instruments of financial engineering were created that allowed the companies to improve the conditions of the bank loans, as well as contributing for the diversification of the financing sources that the companies traditionally look for. In this context, the following instruments were created:

1) Venture capital fund for the textile industry – FRIE IMIT BES (Espirito Santo Bank)

- FRIE IMIT BES had the main purpose to assume participation of risk capital in companies of the textile sector
- Objective - to contribute for the consolidation of the textile sector, through the reinforcement of the company's equity. Focus on applicants of subprogram 1
- Managing entity: CAPITAL ES – Venture Capital Firm of Espirito Santo Bank
- The fund was set up in 1999, resulting of a partnership between the IAPMEI (Portuguese Institute to SMEs Support, a public agency) and Espirito Santo Bank, under the framework and funding of IMIT.
- Through the application of funds from the IMIT, IAPMEI has delegated to CAPITAL ES the assessment, the risk analyses and the investment decision of operations in the textile sector. IAPMEI ensured that all the operations were eligible according to the EU laws
- Until the end of 2004, had been materialized operations in the global sum of 15 million euros.

2) IMIT Fund - Additional endowment of the National Counter Guarantee Fund.

- Integrated in the National Counter Guarantee Fund, the IMIT fund was constituted with € 20 million by the end of 1999 with the purpose to minimize the risk profile of the textile industry/sector, facilitating to the companies the access to credit (bank loans), in particular those with projects approved within the scope of the subprogram 1.
- Managing entity of the fund - SPGM – Portuguese Society of Mutual Guarantee.
- Implementing entities - The SGMs (Societies/Corporations of Mutual Guarantee), through the awarding of guarantees to the companies

- IMIT Fund - Results - 100 million euros had been contracted by the SGMs concerning operations of guarantee involving, which correspond of a total amount of guarantees of 50 million euros.

Complementarily, initiatives were developed specifically guided for the reinforcement of the cooperation networks between the companies, associations and technological centres. Simultaneously was set-up a group of practises in order to promote the quality and design, the productivity, the innovation, environment protection, etc..

2.5.5. Portugal's new program for depressed sectors and regions

Portugal has launched in 2003 a new program to establish long term sustainable solutions for SMEs in depressed sectors and regions. This program will be available until the end of 2006.

Based on the recommendations and after the diagnostic made by a team of Ministry of Industry and Trade and lead by a University Teacher; specific tools where established by Portuguese Government to those sectors and regions with the main purpose of upgrading their economical potential, specific resources and advantages.

The financial tolls / instruments established where the following:

1) Within the scope of profitable firms and new firms

- Tax credit / rebate;
- Tax reserve for the investment (accumulated with tax credit);
- Additional endowment of the Venture Capital Syndication Fund (VCSF) of € 20 million. Through this instrument, the Portuguese State added a significant amount of money to reinforce the competitiveness of the SMEs located in those sectors and regions.

The Venture Capital Syndication Fund (VCSF) is not a new venture capital operator in the market. The main purpose of this fund is through the application of funds from the financial innovation measure of the Operational Program of Economy, leverage the activity of the venture capital operator's trough co-financing.

The assessment, the risk analyses and the investment decision are made by the operators (private venture/equity firms own by banks, etc.). The VSCF ensures that the operations are eligible according to the EU laws.

Through the VSCF the Portuguese State (Ministry of Economy) transfers to the market specialized operators the management of a significant amount of money to finance SMEs, in the same terms and conditions they use in their own operations.

As an example, when a private venture capital firm approves an operation with its own resources, 50% of the funds invested can be obtained through VSCF which will get the same conditions and yield as the private operator.

2) Within the scope of firms in bad financial conditions but with economical potential

- New venture funds (public and private subscription) to reinforce their equity;
- Co-financing of the wage costs for employees maintenance up to 50% for a period of 18 months
- Periodic public tenders to give non refundable subsidies of up to 40% for former employees to invest in new firms (endowment of each tender € 15 million).

2.5.6. A note on business angels

2.5.6.1. Introduction

To provide a conceptual framing of the figure of the "Business Angels", it is important to clarify the following concepts: "Business Angels", such as its proper name indicates, it is "capitalist of individual risk" who cover the necessities of financing that the "institutional venture capital funds / firms" do not reply namely "seed capital" and "start-ups" projects.

However, to differentiate the spectre of investors with these characteristics is usual to split the Business Angels in four groups: "guardian angels" (the veterans of the industry), angels with professional experience (former-executives of multinationals and other large firms), angels of financial income (very healthy individuals) and angel entrepreneurs (entrepreneurs that they had won on their own businesses).

The Business Angels Entrepreneurs have a widened focus of the investments whom they only invest in activities and sectors that they know better, providing not only financial resources but also contacts through their relations and its proper experience, giving precious advice what for a young company is a truly accelerator.

These Business Angels are generally, old SMEs entrepreneurs who sold their businesses and that they intend to reinvest a part of its capitals in companies who can allow continuing to participate in the "enterprise game" and to ensure attractive yields in the future.

Resuming we can conclude that a Business Angel is a private investor who invests its own money in non public companies with high growth potential and share its experiences, contacts and time with the entrepreneurs.

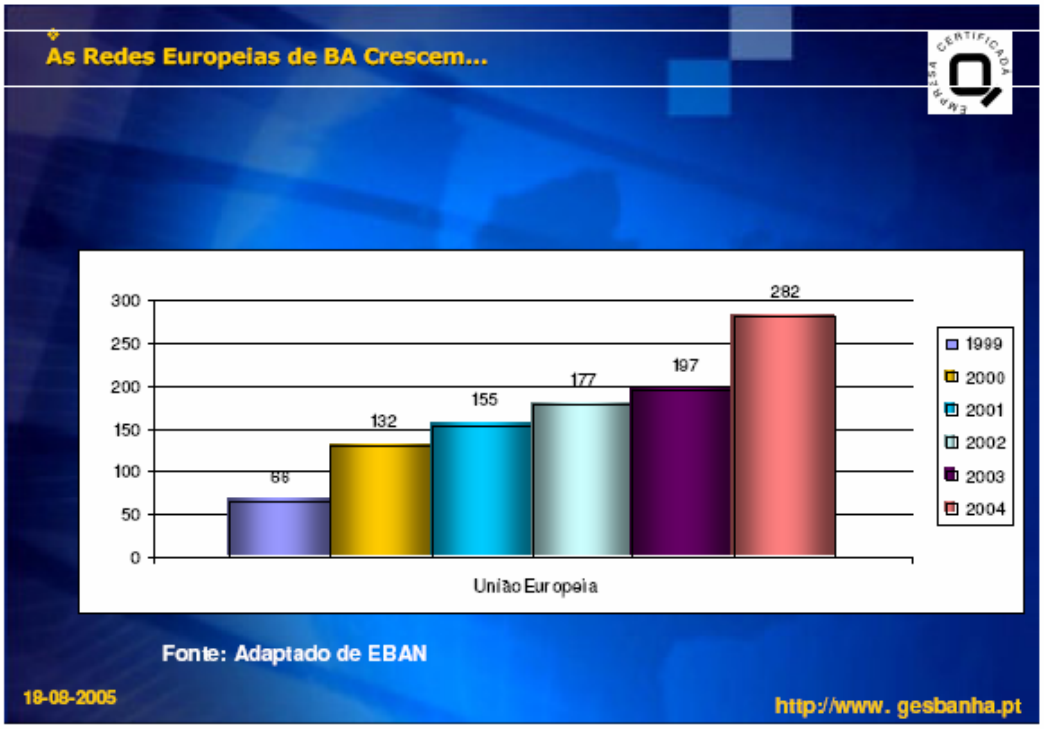
The main motivation of a BA reflects its profile: as investor, obtaining a long term profit, at the moment of the selling the shares (private or public IPOs).

While old entrepreneurs they look the enthusiasm and the excitement of the creation of a company, where the development can be spectacular and fast.

Currently the Portuguese market has a Club of Business Angels- www.businessangelsclub.com, which is active member of the Business Angels Euronet (EBAN) and in which 20 investors are referenced.

For instance, in France there are approximately 3 000 and 4 000 Business Angels for comparison to about 50 000 existing in the United Kingdom 500 000 in the United States.

In the following chart we can see the last evolution of BA Clubs on the European Market.



2.5.6.2. Legal and fiscal framework of the Business Angels activity in France and the UK

Some empirical studies had shown that in 10 businesses, one succeed, 2 or 3 are close to the break-even point, and remains 6/7 have completely of being supported by the Business Angel. In order to encourage the Business Angels to be active, some EU States Members had introduced some tax incentives in order to stimulate their investments in an environment more favourable to an activity of high risk.

That is still more important to compensate the lack of entrepreneurial spirit and the aversion of in the EU countries culture. Before getting into the particular analysis of the fiscal framing in France and the UK it is important to refer that the tax incentives can be introduced in 2 phases of the investment cycle: (i) when the investment is

made (ii) when the exit occurs. The tax incentives can cover the gains and the losses of the BA.

2.5.6.2.1. French Model

Starting for the analysis of the existing investment modalities in France:

I. Direct investment made by a private investor (person)
   a) Fiscal reduction of 25% of the invested total sum, with the limit of € 20.000/ (For passive citizen) or € 40,000/ (For couple);
   b) Applies to the maintenance of the shares participation during at least for 5 years;
   c) Applies to investments in non public companies;
   d) Do not exist minimum and maximum for the invested sums.

II. Investment through a single person company (SUIR)
   a) The bred company meets exempt for income tax and gains with the shares sold during a period of 10 years;
   b) The shareholder meets exempt of tax in the case of dividends distribution;
   c) Shares above 5% and less than 20% of the capital of the participated company;
   d) The shareholder (BA) and its family cannot have more than 25% of the vote rights and exercise managing functions;
   e) The participated company can not have more than 5 years of existence;
   f) The minimum Share Capital is of 37. 000

III. Investment through Institutional Operators
   a) The investors (BA) can decide to invest its savings through the institutional market operators (banks, private equity firms, etc.) which are the responsible for the management and application of the venture capital funds.

IV. Investment in Mutual Venture Capital Funds
   a) For the subscriber of the participation units of the Venture Capital Investment Funds, the gains with the valuation of the shares are exempt of fiscal taxation;
   b) The investment portfolio of the Venture Capital Investment Funds has to be placed at least in a percentage of 50% in non-public companies;
   c) Ownership of the participation during 5 years.

V. Investment in Mutual High-Tech Venture Capital Funds
   a) The Subscription of the Participation Units allows the right to a reduction of taxes in the following sums: 25% of the sum invested in the limit of 12.000/ (for passive citizen) or 24,000/ (for the couple);
   b) For moreover, the investor benefits of tax exemption in the gains with the valuation of the shares;

c) The investment portfolio of the Mutual High-Tech Fund has to be placed at least in a percentage of 60% in High-Tech companies recognized by the Ministry of Economy;
d) Ownership of the participation units during 5 years.

VI. Investment in Local Investment Funds
a) The Subscription of the Participation Units allows the right to a reduction of taxes in the following sums: 25% of the sum invested in the limit of 12.000/ (for passive citizen) or 24,000/ (for the couple);
b) For moreover, the investor benefits of tax exemption in the gains with the valuation of the shares;
c) The investment portfolio has to be placed at least in a percentage of 10% in non-public companies with less than 5 years of existence; - Investments in limited and determined geographic areas;
d) Ownership of the participation units during 5 years.

2.5.6.2.2. UK Model

a) For the fiscal exercises of 2004/2005 the investments carried through in non-public companies are tax deductible in a percentage of 20%, calculated on the sum invested up to 200. 000£ (approximately 295,000 euros);
b) The tax benefit will be increased up to 40% for investment losses;
c) For social participations (shares) kept for 3 years or more, the gains obtained with the selling of shares will be tax exempt;
d) The investors shall be UK residents;
e) The shares have to be kept during at least 3 years;
f) An investor can not have individually (direct or indirectly) more than 30% of the shares of the participated company,
g) The investments that mention in its agreements repurchase models based in guarantees or another type of exit agreements can not benefit of tax exemption.

2.5.6.3. Conclusions

Despite the crucially of the legal framework to mobilize the appearance of the informal investors (BA), thus compensating, the lack of entrepreneurial culture in the EU, diverse States Members consider essential the support of its Public Agencies to the Regional Networks of Business Angels.

With effect, a study promoted by the Dutch Ministry of Economy concluded the necessity to stimulate the Business Angels Networks through the continuous

information flow on the activity of BA. For curiosity, are planned for 2005, 64 meeting of Business Angels, organized, sponsored and financed by the Dutch Governmental Entities.

In France, country where the problematic of the financing of the SMEs through informal investors it has become an important issue for the Official Entities, the development and support of Regional Networks of Business Angels deserved a concrete initiative, formalized through a protocol between the France Angels – the Main Network of Business Angels and the French ANVAR – French Innovation Agency which the France Angels assumed the responsibility to create a School of Business Angels.

Through this initiative, the France Angels with local partners such as technological parks, universities, associations of entrepreneurs, financial entities), develop continuously actions of territorial Marketing and information and training to potential investors with Business Angel profile.

In summary, the importance of the state co-financing, for activities developed by Business Angels in the information dissemination can leverage the potential of the BA and the financing of the SMEs.

3. GLOSSARY

3.1. Glossary of Report 1 (for reference only; all glossaries to be merged later)

Adopted Acronym	English name (and explanation)	Native language acronym	Native language name
CARA	Czech Association of Development Agencies (members: 13 ARRs; Prague does not have a ARR yet)	ČARA	Česká asociace rozvojových agentur (členství: 13 ARR)
ČARA → ARR	Regional Development Agency of the Czech Republic	ARR	Agentura pro regionální rozvoj
ČARA → RRA	Regional Development Agency of the Czech Republic	RRA	Regionální Rosvojová Agentura
CMZRB	Bohemian-Moravian Guarantee and Development Bank	ČMZRB	Českomoravská záruční a rozvojová banka, a.s.
CR	The Czech Republic	ČR	Česká republika
CRR	Centre for Regional Development of the CR	CRR	Centrum pro regionální rozvoj ČR
CSF	Community Support Framework		
CVCA	Czech Venture Capital Association	CVCA	České venture kapitálové asociace
CZ	Czech or refers to the Czech Republic		
EURADA	European Association of Development Agencies (ČARA is the Czech member)		
JPD2	Single Programming Document (SPD) for Prague (ERDF component)	JPD2	
JPD3	Single Programming Document (SPD) for Prague (ESF component)	JPD3	
MD	Ministry of Transport	MD	

Adopted Acronym	English name (and explanation)	Native language acronym	Native language name
MMR	Ministry of Regional (Local) Development	MMR	*Ministerstvo pro místní rozvoj*
MPO	Ministry of Industry and Trade	MPO	
MPSV	Ministry of the Environment	MPSV	
MPVS	Ministry of Labour and Social Affairs	MPVS	
MZe	Ministry of Agriculture	MZe	
NDP	National Development Plan		
OP	Operational Program	OP	*operační program*
OPI	Infrastructure OP	OPI	*OP Infrastruktura*
OPPP	Industry and Enterprise OP	OPPP	*OP Průmysl a podnikání*
OPRLZ	Human Resources Development OP	OPRLZ	*OP Rozvoj lidských zdrojů*
OPRVMZ	Rural Development and Multifunctional Agriculture OP	OPRVMZ	*OP Rozvoj venkova a multifunkční zemědělství*
RDA	Regional Development Agency (UK or other country, except the CR)		
RPS	Department of Community Support Framework (Ministry of Regional Development)	RPS	*Odboru Rámec podpory Společenství (Ministerstvo pro místní rozvoj - MMR)*
RRA → ČARA	Regional Development Agency of the Czech Republic	RRA	*Regionální Rosvojová Agentura*
SROP	Joint Regional OP	SROP	*Společný regionální operační program*

3.2. Glossary of Report 2

Adopted Acronym	English name (and explanation)	Native language acronym	Native language name
SGR	Mutual Guarantee Company: legal status of mutual guarantee company (Spain)	SGR	*Sociedad de Garantía Recíproca*
SGM	Mutual Guarantee Corporation: legal status of mutual guarantee corporation (Portugal)	SGM	*Sociedade de Garantia Mútua*
SPGM	Portuguese Company of Mutual Guarantee: legal status of investment corporation (Portugal)	SPGM	*Sociedade Portuguesa de Garantia Mútua*
BGK	Bank of National Development (Poland)	BGK	*Bank Gospodarstwa Krajowego*
PARP	Polish Agency for Enterprise Development (Poland)	PARP	*Polska Agencja Rozwoju Przedsiebiorczosci*
KSU	National System of Services (Poland)	KSU	*Krajowy System Uslug*
KSFPK	National Association of Credit Guarantee Funds (Poland)	KSFPK	*Krajowe Stowarzyszenie Funduszy Poreczen Kredytowych*
KFPK	National Credit Guarantee Fund: fund managed by BGK (Poland)	KFPK	*Krajowy Fundusz Poreczen Kredytowych*
SPO WKP	Sectoral Operational Program Improvement of the Competitiveness of Enterprises (Poland)	SPO WK P	*Sektorowy Program Operacyjny Wzrost konkurencyjnosci przedsiebiorstw*
MRRiB	Ministry of Regional Development and Construction (Poland)	MRRiB	*Ministerstwo Rozwoju Regionalnego I Budownictwa*
WiBAG	Burgenland's Business Services (Burgenland, Austria)	WiBAG	Wirtschaftsservice Burgenland Aktiengesellschaft
KfW	Credit Service for Reconstruction (Germany)	KfW	*Kreditanstalt für Wiederaufbau*

Adopted Acronym	English name (and explanation)	Native language acronym	Native language name
BIS	Bank of International Settlements (Basle, Switzerland)		
KMUs SMEs	SME – Small and Medium-size Enterprises (in German)	KMUs	*Kleine und Mittelstand Unternemhen*
SMEs	SME – Small and Medium-sized Enterprises		
KfW Mittelstandsbank	KfW Bank for Medium-size enterprises	KfW Mittelstandsbank	*KfW Mittelstandsbank*
ERP	European Regional Development Program (Marshall Plan in Germany and Austria)	ERP	*Europeische Regionalförderprogramm*
IBB	Investment Bank of Berlin (Germany)	IBB	*Investitions Bank Berlin*
BBB	Guarantee Bank for Berlin and the Brandenburg (Germany)	BBB	*Bürgschaftsbank zu Berlin-Brandenburg GmbH*
MBG	Berlin and Brandenburg Equity Investment in SMEs (Germany)	MBG	*Mittelständische Beteiligungengesellschaft Berlin-Brandenburg GmbH*
SAB	Development Bank of Saxony (Germany)	SAB	*Sächsische Aufbaubank*
BBS	Guarantee Bank of Saxony (Germany)	BBS	*Bürgschaftsbank Sachsen GmbH*
MBG	Equity Investment in SMEs of Saxony (Germany)	MBG	*Mittelständische Beteiligungsgesellschaft Sachsen mbH*
AWS (or AWSG)	Austrian Business Service (Austria)	AWS (or AWSG)	*Austria Wirtschaftsservice GmbH*
EBRD	European Bank for Reconstruction and Development		
EIF	European Investment Fund		
IFC	International Finance Corporation (World Bank Group)		

Adopted Acronym	English name (and explanation)	Native language acronym	Native language name
World Bank IBRD	International Bank for Reconstruction and Development (known as World Bank)		
IBRD World Bank	International Bank for Reconstruction and Development (known as World Bank)		
IMF	International Monetary Fund		
MIGA	Multilateral Investment Guarantee Agency (World Bank Group)		
KdP	Capital Funds for Entrepreneurs (Poland)	KdP	*Kapital dla Przedsiebiorczych*
KUKE	Export Credit Insurance Company (Poland)	KUKE	*????*
EGAP	Department for Export Credit Insurance (Czech Republic)	??	*???*