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On the Importance of Financial Instruments to Facilitate Growth

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Abstract

Small and Medium-Sized Enterprises (SMEs) constitute the backbone of all market economies worldwide; the EU is not an exception. As such, they merit particular attention from the part of the public authorities, in times of financial crisis when alternative financing sources are needed. Traditionally, the public authorities, being at the European or national level, used subsidies to assist SMEs in activities presenting some investment risk, and /or enhancing entrepreneurial high value-added export-oriented activities, producing tradable goods. This study presents the way financial instruments (FIs) were introduced into the European Union (EU) programs supporting SMEs during the financial and economic crisis and the intervention logic behind them.

JEL Classification: L26; L38; M21.
Keywords: SMEs; Subsidies; Financial instruments; Leveraging; Financial crisis.

1. Introduction

SMEs are an important growth factor for the EU's economy; they represent 98% of the enterprises and provide at least 2/3 of the existing jobs in the EU - 28 (European Commission, 2017). Nevertheless, SMEs often are facing serious problems expanding their activities and innovation. One of the major obstacles to their growth can be attributed to their limited access to financing.

In the OECD countries, SMEs provide on average 70% of jobs and 50-60% of added value (OECD, 2017). In developing countries, the World Bank Group (2017) estimates that formal SMEs provide 40% of the jobs and 60% of the added value. It considers that 4 out of 5 new jobs are created by formal SMEs.

The Annual Report on European SMEs published in the European Commission in 2017 qualifies SMEs as the backbone of the European economy. The European SMEs, in

2016, provided 67% of total jobs and generated 57% of value-added in the EU-28 non-financial business sector. Almost all (93%) of the SMEs were micro-SMEs employing less than 10 persons.

Depending on the sector, the European SMEs can be accounted for 70% of the EU-28 employment ("retail and wholesale" sector) or even 80% in "accommodation and food services", "business services" and "construction" sectors, in 2016 (European Commission, 2017).

In Greece and Cyprus, SMEs contribute by more than 80% in terms of both employment and creation of value-added (European Commission, 2017).

Furthermore, all around the world, in market economy countries, public authorities, and economic and financial institutions agree on the paramount importance of SMEs in their economies. In particular, the innovative ones, able to reap the fruits of technology and/or knowledge economy, are considered as the main job and added value creator, while they provide for sustainable (environmentally friendly) and inclusive development.

At the same time, SMEs because of their size, managerial weaknesses, or lack of skills are more exposed to imperfections and discriminations by the financial industry (they can face limited or no access at all to financing) and state institutions (public procurement legislation can be discriminating SMEs by requesting excessive collaterals and/or guarantee letters).

Access to financing is crucial for start-ups and established SMEs. Especially for start-ups, the problem can be more acute, due to the absence of collaterals and/or enough activity records to access financing through the traditional banking sector (OECD, 2006). Sometimes, formal credit suppliers do not treat equally SMEs and large firms as they do not offer a full range of financial products and services to which SMEs can claim to have access.

Financing for SMEs in the appropriate forms is important at all stages of the business life cycle, to enable these firms to start-up, develop and grow, and make contributions to employment, growth, and social inclusion. Access to finance improves the post-entry performance of start-ups and industries which are more dependent on external finance grow relatively faster in countries with more developed financial markets, thanks to enhanced information sharing and risk management, and a better allocation of resources to profitable investment projects. On the other hand, financing constraints that prevent firms from investing in innovative projects, seizing growth opportunities, or undertaking restructuring in case of distress negatively affect productivity, employment, innovation, and income gaps.

This paper attempts to make a critical analysis between the two main delivery tools of the EU policy to assist SMEs, subsidies, and revolving assistance (FIs) to enhance development policies to correct for market failures. A distinction is going to be made between interventions under direct and shared management. The introduction of revolving assistance to SMEs, from the Structural Funds, coincided with the beginning of the economic and financial crisis. The efficiency and effectiveness of this type of assistance are being examined, in terms of leveraging (making investment attractive to private investors) and revolving (use every euro more than once). Nevertheless, revolving assistance existed before the financial crisis with centrally managed instruments (e.g. Competitiveness and Innovation Framework Program (CIP), and reference is made as a benchmark for evaluating the implementation of financial instruments under shared management. The paper will also examine the specific case of the introduction of financial instruments as a tool for delivering Structural Funds assistance to Greek SMEs during the time of the ongoing and unprecedented financial and economic crisis (period 2008 -2015).

It is noteworthy that few studies have tried to investigate the impact of FIs as a means of boosting the development of SMEs achieving sustainable growth within the EU economy. This paper attempts to fill this gap in the empirical literature by focusing mainly on the FIs as a tool to deliver EU policy goals over the period of the financial crisis (2007–2013).

The relevant study provides several novelties to the literature. First, it contributes to the financial literature by showing that FIs influence corporate decisions and outcomes, hence playing an important role in SMEs' survival mechanisms. The existing literature has mainly examined the relationship between the financial performance (Margolis et al., 2009) and value of firms that practice corporate sustainability (Cho et al., 2010; Fatemi et al., 2015; Malik, 2014; Porter, 1991; Porter and Kramer, 2011; Porter and van der Linde, 1995). These studies have linked sustainability with better prospects in terms of value and performance. However, no empirical studies have examined the impact of FIs on SMEs' growth.

The rest of this paper is organized as follows. Section 2 presents the literature review, while Section 3 discusses the methodology along with the data used. In Section 4 we focus on the role of the several European Union Institutions involved in the SMEs support policies. Section 5 presents the main findings of this study, while Section 6 encapsulates the paper while presenting some useful policy implications.

2. Literature Review

Most of the related studies examine the link between sustainability and corporate value (Carroll *et al*., 2012; Heal, 2004, 2008; Landier and Nair, 2009). Based on the existing studies of Kempf and Osthoff (2007) and Statman and Glushkov (2009), it is argued that portfolios consisting of firms with strong sustainability policies appear to perform better than those with weak sustainability policies. Researchers based on sustainability score, over time, take more optimistic investment decisions about firms' future financial performance (Ioannou and Serafeim, 2015). Eccles, et al., (2014) argue that there is a positive link between corporate sustainability and financial performance; thus, firms with high sustainability are more long-term oriented and issue ESG reports as a transparency and accountability business strategy. Galbreath (2013), as well as Margolis and Walsh (2003), claim that firms with ESG strategies are more likely to accumulate capital at a lower cost as they build stronger reputations.

Despite the rich literature on the sustainability-performance nexus, a limited number of studies examine the impact of financial instruments (e.g., subsidies, corporate bonds, etc) on firms' growth. Subsidies have been used for a long time and various reasons, mainly to promote activity in specific sectors. Subsidies to private undertakings in the EU are not allowed as stipulated in Article 107 of the Treaty for the functioning of the EU (TFEU) unless, after examination of the measure as foreseen in the Articles 108 and 109 of the same Treaty, it is considered as complying with the Internal Market. Targeted subsidies/grants may provide a particular incentive to small firms underinvesting in innovative solutions to change their approach towards innovation. Subsidies/grants might play the role of certification as well of the recipient SME towards external financings, such as banks and venture capitalists (Meulemen & De Maeseneire, 2012).

Nevertheless, the new exceptional circumstances created by the financial crisis imposed on the EU institutions and national authorities to seek for leveraging of the scarce public resources (to underline that the budget of the EU hardly represents the 1% of the GDP of the Union). Other than loans and guarantees used normally by credit suppliers, more elaborated delivery tools have been put in place such as risk capital provision through equity or semi-equity products to respond to the need of boosting ISMEs by government and/or international lenders.

Subsidies or grants have been for a long time the traditional way of delivering support to SMEs to promote specific policy goals. Nevertheless, within the framework of shared management (cohesion policy), national authorities have not always focused to provide subsidies to the most job-creating and innovative sectors. Spreading thinly scarce public resources to as many SMEs has limited considerably the impact of public assistance to SMEs (European Commission, 2016).

Public authorities realized during the crisis that scarce public resources need to be managed more carefully and started seeking ways for leveraging them (e.g., attract private investors, and revolve them). In the EU, the use of financial instruments was introduced to increase the efficiency and effectiveness of scarce public resources.

Up to date, the relevant literature does not confirm their success but neither their failure, within the EU. Further below, financial instruments implemented under shared management are dealt with. There are some others, managed centrally by the European institutions to which reference is made, as a benchmark for evaluating the implementation of the shared management ones.

The European Commission (2016), in the Ex-post evaluation report of cohesion policy programs 2007-2013, examined a limited sample of EU Member States delivering the objectives of their Operational Programs for the programming period 2007-2013 through financial instruments. The relevant strategic objectives were reached at 50% approximately (European Commission, 2016). Attracting private co-investment was difficult to evaluate due to the absence of relevant data; but for some EU Member States, in the UK, with a long tradition in venture capital, some EUR 400 million of private contribution were attracted through financial instruments (European Commission, 2016). Limited data did not allow us to draw secure conclusions about "leverage" and "revolved" funds. The overall experience though is considered positive as the lessons learned are many and allowed the legislator to treat them beforehand in the related legislation for the period 2014-2020 (allocation of the funding to Funds following their successful reach of the funding to the final beneficiaries-SMEs; management fees related to the Fund performance, etc.).

Lastly, ECA (2016) went through all the 972 European Regional Development Fund (ERDF) financial instruments and the 53 European Social Fund (ESF) financial instruments set up by the EU Member States in the period 2007-2013 and implemented under shared management, as well as the 21 financial instruments implemented through central management. The recommendations by the ECA are reflecting their findings, like the ex-post evaluation report mentioned above, about leverage and revolved funds. The ECA highly recommends paying particular attention to the ex-ante assessment, to optimize the size of the financial instruments, and suggests some legislative improvements regarding the leveraging and the monitoring of the implementation of the financial instruments.

3. Data and Methodology

The data analyzed is collected through secondary research from public data and reports available from the most relevant sources. These sources are:

a) European Commission. The European Commission is the executive body of the European Union in charge of the implementation of European policies. Furthermore, as being accountable for the use of European taxpayers' money, it is within its remit to publish ex-post evaluations of the implemented operations.
b) European Parliament. The parliament is one of the legislative pillars of the European Union and one of its roles is to control the operations of the European Commission.
c) European Court of Auditors. It has the charge to control the legality, regularity, and effectiveness, and efficiency of the operations undertaken by the European Institutions. As such it is publishing regularly a series of Special Reports screening specific EU operations.
d) European Investment Bank/European Investment Fund. They are the financial branches of the EU and because of their credit rating of AAA can secure easily financial resources from the capital markets, contrary to the ability of some EU Member States in trouble with their credit rating.
e) International Financial and Policy Institutions, mainly OECD and World Bank. Some of their reports have been useful to understand the rationale and the scope of interventions in favor of SMEs.

Primary data is comprising a qualitative analysis of the replies to the questionnaires sent to targeted officials of the European Commission and some national authorities involved with the implementation of financial instruments in Greece. Some open-ended questions have been used as well to confirm further some research assumptions the existence of a well-designed implementation strategy with the use of suitable indicators.

The questionnaire was articulated around the following four themes: i) Identification of the occupancy of the interviewed; ii) Use of subsidies and their targeted or not utilization; iii) Use of revolving funding; blending of financial instruments with subsidies; the role of financial intermediaries; the role of Fund managers being local or international; leveraging; blending with extra-cohesion resources; iv) Financial instruments in Greece; use of working capital; introduction of novelties, like venture capital.

The interview (open-ended) questions aimed to identify the usefulness of subsidies, to what extent the implementation of the financial instruments during the period 2007-2013 followed a specific intervention logic, recognizable through the evidence provided by the ex-ante assessments, the set - up of specific output indicators and the recognizable impact of these financial instruments in alleviating the market failure of SME financing.

The intervention logic is a widely used method to define policy interventions within the EU financing programs. According to the European Commission (2016), the scope of this method is threefold, where:

At the *top*, there is the overarching goal of economic and social cohesion which often is translated as an effort to reduce disparities, measured as disparities on GDP/head. Nevertheless, other economic objectives can be considered as well as needing improvement/convergence, such as innovation or facilitation of entrepreneurship or social objectives (*social inclusion or health*) and territorial objectives (*improve transport services*)

Then, in the *middle* story, you may find the European strategic objectives and priorities as set in the Lisbon Agenda or the EU 2020 strategy for a smart, sustainable, and inclusive

Europe. At the *ground* floor, you find the individual policy themes such as assistance to SMEs and easing their access to financing, as far as they contribute to a double objective, i.e.: reducing disparities and strengthening economic activities and social and territorial cohesion.

The use of the intervention logic can be seen as an attempt of policymakers to define a pathway for policy interventions: a pathway based on an ex-ante assessment the needs of the program are established and the new situation sought is set. Adequate indicators (input or output) define the intermediate steps of the process.

This intervention logic describes well the strategic objectives and goals and the ways to achieve them. Nevertheless, it remains quite weak in accompanying each measure with an appropriate monitoring system and indicators to be able to attribute future successes and failures to the policy interventions. For this study, the intervention logic has been chosen for the analysis of the data collected and the conclusions drawn over the achieved results.

4. Subsidies to SMEs in the EU

The EU has put in place specific programs in favor of the SMEs, which, as already mentioned, are managed centrally by its services or they are running under shared management, i.e.: managed by the regional or national authorities of EU Member States within the framework of Operational Programs approved and monitored by the European Commission as part of the place-based interventions of the cohesion policy.

For the period 2007-13, the most important instrument, in terms of funding, for SMEs was the Competitiveness and Innovation Framework Program (CIP). CIP ran from 2007 to 2013 with a total allocation of EUR 3,621 billion.

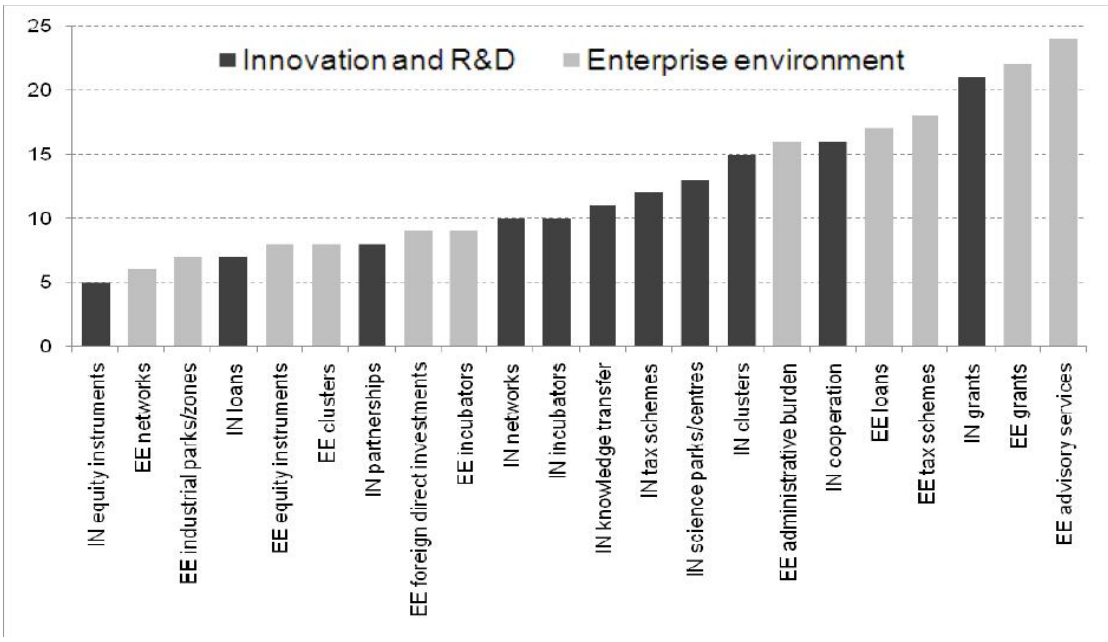
According to the European Commission (2014b), the CIP has developed around three pillars-operational programs that are aimed at enhancing the competitiveness of enterprises and their innovative capacity in their respective areas of intervention. Judging from the outcomes of the CIP, and this despite that it was a program combining so many heteroclite elements, it managed to achieve its objectives and in particular making Innovation a central element for assisting SMEs and to introduce financial instruments aside from the direct subsidies as a delivery tool for the SMEs policy in particular in financial crisis times (European Commission, 2011).

Other similar and centrally managed programs were “Research for the benefit of SMEs” in the “Capacities” program of the Seventh Framework Program for Research and Technological Development (EUR 1.3 billion), Europe INNOVA, PRO INNO Europe, eco-innovation, SME-instrument, etc.

The EU actively supports SMEs through the Operational Programs (OPs) run in all Member States and regions and supported by the Structural Funds (now Structural and Investment Funds) under the principle of shared management.

Already, in the programming period 2000-2006, out of the 122, 8 billion total ERDF resources in the EU-25, 25,8% was earmarked for supporting enterprise environment including large enterprises, direct support to SMEs together with measures to support research and innovation. SMEs received 62% of this funding (European Commission, 2009). Various instruments were used to meet the objectives of encouraging the growth of enterprise and innovation with great emphasis given to advise SMEs and to shared business services (Figure 1).

Figure 1. Frequency of support instruments across surveyed Member States



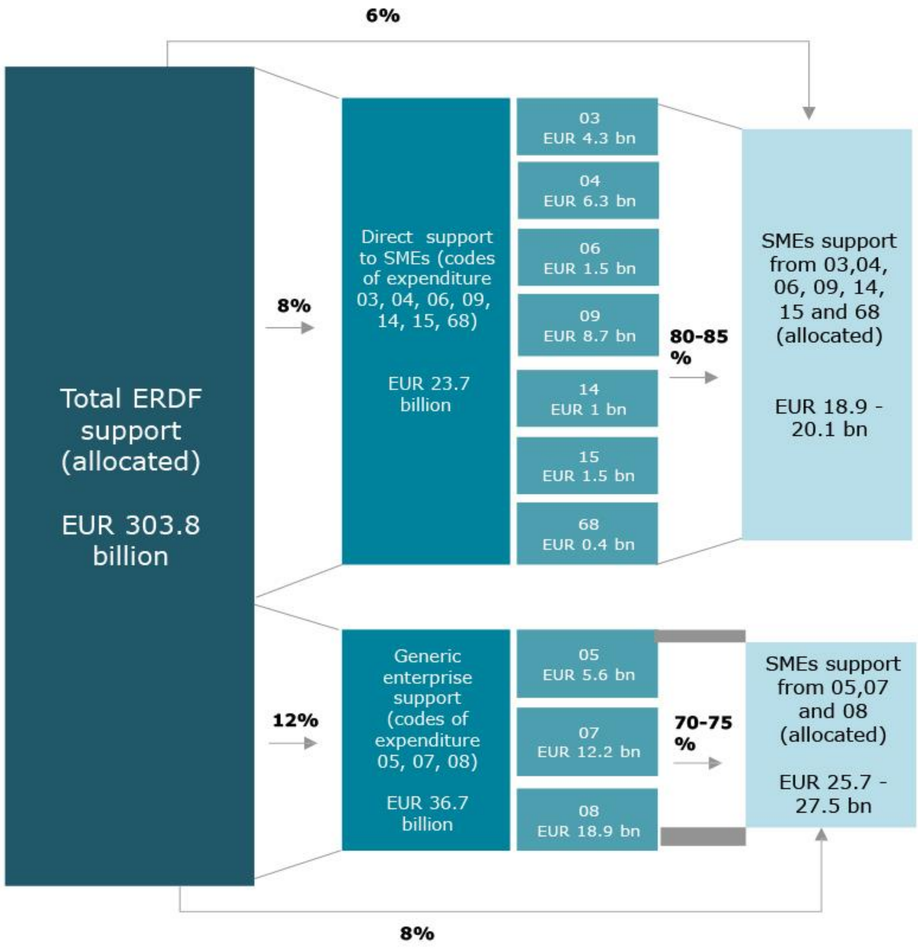
Source: European Commission, 2009, p.8

An important finding concerned the quite "*sector neutral*" approach in terms of targeting economic sectors (European Commission, 2009). This trend, on the other hand, does not seem to be characteristic of the centrally managed programs in favor of SMEs which focus on knowledge and innovation.

Weaknesses in clear and selective targeting have been identified also in the programming period 2007-2013, despite the overall logic of intervention targeting SMEs activities in innovative and high value-added sectors, following the Lisbon strategy objectives. Indicative of the lack of focus of the schemes implemented is the number of policy instruments (an average of 13 instruments per Operational Program) put at the disposition of the SMEs by the national authorities in charge of the management and implementation of the OPs covering a great variety of themes from generic access to financing to eco-innovation (European Commission, 2016). The influence of the economic and financial crisis on the selectivity of the aid to SMEs agreed at a first stage with the EU administration in the context of the approved OPs is discussed below.

While considering the outcomes and the impact of the EU assisting SMEs, cohesion policy is gaining more importance. For the period 2007-2013, the ERDF allocations were EUR 303,8 billion, out of which 8% (EUR 23,7 billion) were allocated for direct support to SMEs and 12% (EUR 36,7 billion) for generic enterprise support (Figure 2).

Figure 2. Amount of ERDF funds allocated to business and SME support between 2007 and 2013

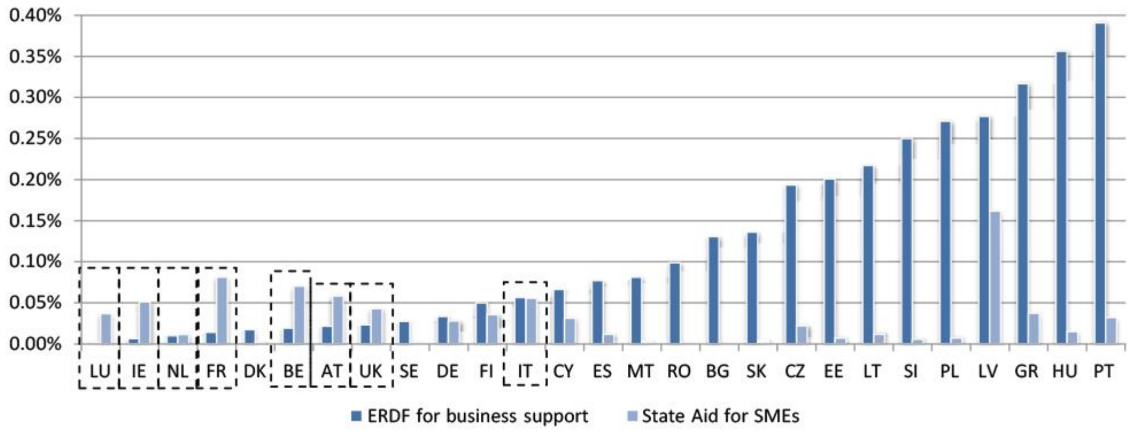


Source: European Commission, (2016)

European Regional Development Fund resources allocated to SMEs throughout the different OPs is estimated that represents a volume of EUR 47, 5 billion supporting directly over 400.000 SMEs together with 121.400 startups, all over the EU (European Commission, 2016). The figure itself is barely significant when compared to approximately 23 million SMEs registered in the EU. It is becoming significant when and where this assistance has been supporting undertakings active in targeted manufacturing activities and exporting their goods as there lies the growth potential of the EU regions (European Commission, 2016).

For some Member States, like Greece and Portugal or the 12 new Member States that was the only public resource available to support SMEs (Figure 3).

Figure 3. ERDF allocated to business support and State Aid expenditures for "SMEs" by Member State (both as a percentage of GDP)



Source: European Commission, (2016)

Nevertheless, and despite the crisis and the credit crunch, significant changes happened as undertakings took advantage of the ERDF support and anticipated and or accelerated their investment. Consequently, of anticipation of investment, it was observed an improvement of the economic performance of SMEs in terms of productivity or profitability. Another important observed change is the willingness of SMEs to take risks or get involved in the project including RTD (European Commission, 2016).

5. The Role of Financial Instruments

FIs are defined as "*measures of financial support provided on a complimentary basis from the budget (of the EU) to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants*" (Regulation EU, EURATOM No 966/2012[1]).

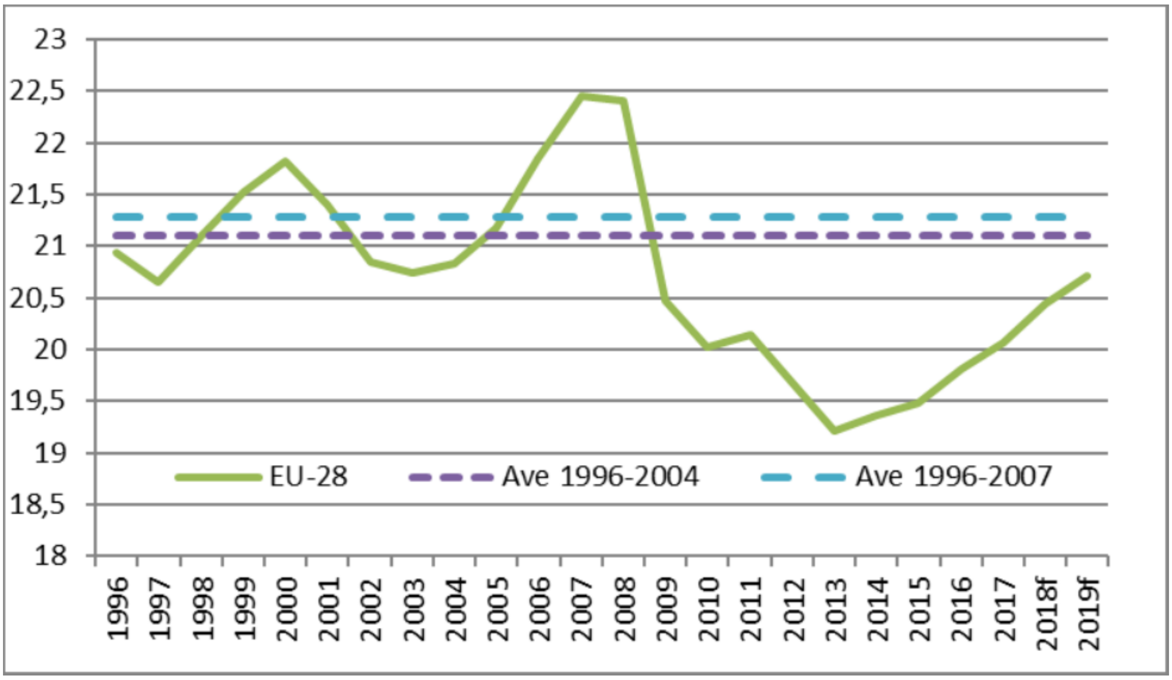
FIs, if implemented correctly, can offer the following advantages: a) revolving, every euro of public resources allocated can be used more than once; and b) leverage, the quality of the investments to be financed can attract private resources (ECA, 2016). They can additionally improve c) the sustainability of public finances, in contrast to the one-off character of grants, as at least a part of the public resources can be reused for the same purpose and d) ensure better involvement and commitment of the final recipient as the risk is shared (European Parliament, 2017b).

The credit crunch which accompanied the financial and economic crisis worked as an additional challenge for the public authorities looking to increase the effectiveness of the scarce public resources.

Investment is particularly vulnerable to changes in economic conditions. In the recent crisis, investment rates in the EU decreased from over 22% of GDP around 2007 to 20% approximately around 2012 (Figure 5). Consequently, the effort needed for the recovery lasted long, and for some EU Member States will last longer.

[1] Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002

Figure 5. Evolution of EU-28 investments as a percentage of GDP



Source: European Commission, (2018)

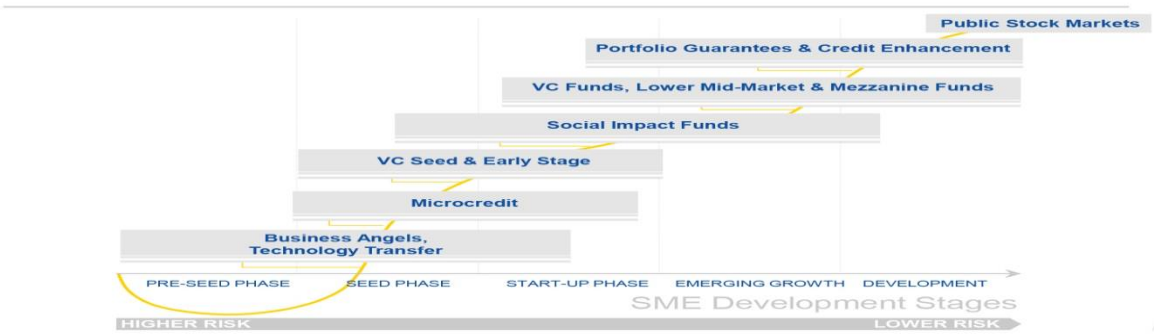
The EU institutions and national authorities had no other option but to seek for leveraging of the scarce public resources (to underline that the budget of the EU hardly represents the 1% of the GDP of the Union (ECA, 2016)). Having in mind also that the funding gap of the financial market, i.e. the capital needed to finance the economic activities goes far beyond the financing needs of the SMEs.

5.2 Typology of Interventions through FIs

Other than loans and guarantees used normally by credit suppliers, more elaborated delivery tools have been put in place such as risk capital provision through equity or semi-equity products to respond to the need of boosting innovative SMEs by government

FIs constitute state aid and need to be notified to the Commission to obtain clearance. However, the EU offers the possibility to the Member States, in the programming period 2014-2020, to use some instruments for which the state aid clearance is already obtained, to increase efficiency and availability of FIs in a relatively short time. These are called “off-the-shelve” instruments and include the Loan fund for SMEs based on a portfolio risk-sharing loan model (Risk Sharing Loan - RSL), the Guarantee Fund for SMEs (Capped Guarantee Portfolio), and the loan fund for energy efficiency and renewable energy in the residential building sector (Renovation Loan) (European Commission and EIB, 2015). From the EIF (2018), we get the information on what kind of FI is better adapted to each stage of an SME development (Figure 6):

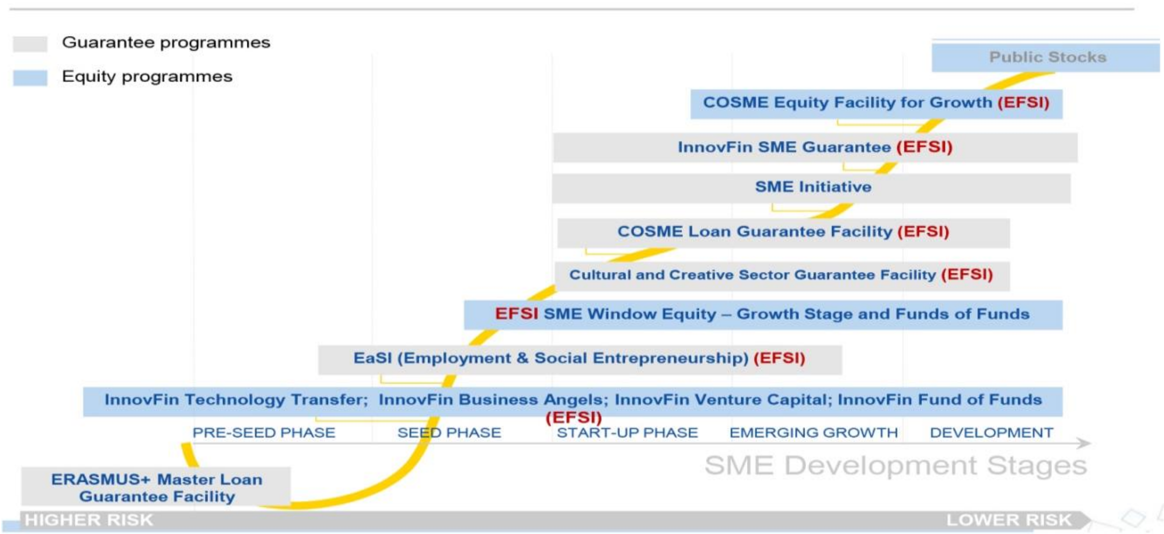
Figure 6. Helping businesses at every stage of their development



Source: EIF, 2018.

Once again the EU has developed for these stages the following centrally managed FIs (Figure 7).

Figure 7. EU programs helping businesses at every stage.



Source: EIF, 2018.

The above instruments refer to the programming period 2014-2020. Similar instruments, although more limited, existed for the period 2007-2013. The supply of solutions has been therefore large and diverse. However, there is a question of how the SMEs have used all these possibilities offered to them, addressing them the access to financing.

The vast majority turned to loans where the amount and the interest to be paid were computable, known in advance and there was no interference to the ownership of the company (most of them, family companies, passing ownership from one generation to another). Nevertheless, companies with a high growth perspective and lacking the cash flow allowing them to get financing from conventional sources were more tempted by the Equity solutions (European Commission, 2016).

5.3 Governance and management of the interventions through FIs

Like in the case of subsidies, FIs in the EU are either centrally managed or implemented under shared management. The EIB and the EIB Group (EIF included) are managing the majority of the centrally managed FIs. In principle, the Fund manager is designated at the time of drafting the corresponding legislative proposal.

Most centrally managed FIs have been developed as an effort of the EU to tackle the consequences of the financial crisis and disinvestment in the EU. For instance, the Investment Plan for Europe (known as well as the Jünker Plan) is an attempt by the European Commission to answer, at a central level, to the disinvestment challenge of the EU. It was presented in November 2014, and it was built around three mutually reinforcing pillars. The idea was to combine resources from the Structural and Investment Funds (EUR 16 billion) with the resources of EIB (EUR 5 billion) to serve as a guarantee to mobilize at least EUR 315 billion in investments up to 2020 (EIF, 2018). The plan (EIF, 2018) consist of three pillars:

a) The European Fund for Strategic Investments (EFSI), aiming at mobilizing at least EUR 315 billion in additional investment until 2020.

b) The second pillar aims at ensuring that this extra investment reaches the real economy through the European Investment Advisory Hub (EIAH) and

c) The European Investment Project Portal (EIPP). The objective of the Investment Plan's third pillar is to improve the investment environment, both at the European level and the level of individual Member States.

Under shared management, there is a multitude of management and operational structures. FIs are set by the Member States in the form of standalone funds or sub-funds of a Holding Fund (sometimes referred to as a “Fund of Funds”). These funds are using financial intermediaries which are usually banks rather than public administration departments, selected in compliance with the applicable public procurement rules and the relevant state aid rules (ECA, 2016). A Holding Fund can add flexibility and strategic vision of the interventions in multiple areas, but at the same time, it can add a layer for management, additional fees, and overheads (European Commission, 2016).

5.4 Achievements and shortcomings of the use of FIs (programming period 2007-2013)

It should be noted though that the FIs are concluded for an average period of 10 years, meaning the FIs could continue producing their effects much beyond the official closure of the OPs and their ex-post evaluation.

Within the framework of shared management, 25 out of the 28 EU Member States have used FIs during the programming period 2007-2013. There were set up 972 FIs co-financed by the ERDF and 53 FIs co-financed by the ESF (ECA, 2016). The contributions of the OPs (using either ERDF or ESF resources) had reached by the end of 2014 the amount of 16 billion euros. The allocations for FIs, during 2007-2013, have been multiplied by more than ten times compared to the allocations during 2000-2006 (EUR 1,3 billion) and those for the period 1994-1999 (EUR 0,6 billion). For the same period 2007-2013, the allocations from the EU budget to FIs managed at a central level were 5,5 billion (ECA, 2016).

According to ECA (2016), the two main challenges set at the beginning of 2007-2013 were not addressed at the expected level, i.e.:

- leveraging public resources by attracting additional private resources. ECA considers that at least at the time of their survey concluded in 2015, both central and shared management FIs did not attract the expected level of private resources.

- revolving of the funding was not a success either, mainly because of the over-sizing of the funds (which means some resources were returned to the national authorities in charge of the OPs, as there were not enough guarantees that they will be disbursed to the final recipients, on time and before the closure of the programming period 2007-2013).

Two main reasons have been identified as regards the partial achievement: a) the lack of an appropriate assessment of the market needs by the Member State and/or the manager of the central managed FI, and b) the fact that the national authorities in charge of the management of FIs, in the case of shared management, over-dimensioned the FI to avoid decoupling of funds from their OPs, foreseen according to the provisions of the ERDF or ESF specific regulations.

ECA (2016) criticizes these two issues overlooked by the EU when asking the Member States to generalize the use of FIs. As regards a) and despite that ECA (2016) reports that the 82% of the respondents to their survey ascertain that they have carried out their market assessment, the oversizing of the FIs implemented puts into question the robustness of their analysis. Then, concerning b) there might be a question of another backdrop of the quite loose legislative provisions of the programming period 2007-2013. There was no obligation on the part of the national authorities in charge of the management of the OPs to relate the payment to a Fund to any performance condition. This weakness of the legislation has been exploited, as explained above, by the Member States to avoid decommitment of funds, as foreseen in the specific ERDF or ESF Regulations.

The European Commission (2016), in the ex-post evaluation of the cohesion programs 2007-2013, reports also limited achievements in terms of leveraging. More specifically, for the sample they have used, the analysis showed that the private resources mobilized were limited to EUR 615 million out of EUR 10,5 billion paid by the OP to the Funds (i.e. only 6%). There is a big variation of this level of private resources mobilized across the Member States, the biggest success coming from the UK, a country with long experience in using FIs.

Concerning the latter, the lack of experience and administrative capacity was identified as a major issue hindering the set - up of the FIs at the regional and national levels. The situation was much easier where some similar structures used to exist already, like national promotional banks. When there was not national expertise available, the Member State relies upon external expertise, the most usually used is the EIF (European Commission, 2016).

The specific economic and legislative context of each Member State plays a very important role as well. For example, in France, the development of FIs is hindered by the relevant laws (European Commission, 2016). In Greece, social structures wishing to develop micro-credit interventions outside the traditional banking system were unable to proceed as the national law allows the provision of credit only by the licensed banks (Hellenic Ministry of Economy and Development, 2017).

Another important issue discussed is the level of guidance from the regulation and the EU services to the Member States about the set-up of the FIs which was quite limited. Some incidents were supporting this postulate, like the issue with the Enterprise and Innovation Fund in the Czech Republic which despite that it was one of the pioneers in setting up a FI, the European Commission audit services found irregularities in the scope of its operations and finished by suspending its operations. On the other hand, though, there were Guidance papers issued by the Committee for the Coordination of the Funds (COCOF) which was trying to fill in the legislation gaps (European Commission, 2016).

Furthermore, the level of management costs and fees and their linkage to the performance of the FI was identified as another weakness of the FIs implementation system. Despite that all Fund managers were selected through a competitive process, the regulation was allowing a quite high percentage of the value of the portfolios or the allocations to the fund to be charged as fees without any performance condition. Here again, we have a mixed picture, with only one national authority (in North England) having conditioned the management fees to the performance of the Fund. Fund managers were charging the maximum allowed, even if their funds were not performing as expected, and others charged much lower fees (European Commission, 2016).

It should be noted though that the FIs are concluded for an average period of 10 years, meaning the FIs could continue producing their effects much beyond the official closure of the OPs and their ex-post evaluation.

The monitoring and reporting system for FIs became compulsory only after 2011, but even then, the data collected need further verification as there was no guidance to the Member States on how to collect and present these data. Monitoring and reporting mechanisms were not capturing the need of adapting the investment strategies of the FIs to follow the big economic and financial challenges brought by the financial crisis (European Commission, 2016).

Therefore, the conclusion to be drawn for this scaling up implementation of FIs during 2007-2013 is that until 2015 - a year of the conclusion of the ECA report and the ex-post evaluation, the revolving and leveraging objectives are not addressed at the level expected. Furthermore, the initial design of the FIs to boost the functioning and competitiveness of the SMEs and in particular of the startups was blurred with the rise of the credit crunch provoked by the financial and economic crisis.

Although the great majority of Risk Sharing FIs created for the period were focusing on assisting the ISMEs in upgrading their technology and business processes, the pressure from the financial crisis deviated a great part of the available funding in financing working capital. A piece of softer evidence though exists proving that the FIs improved access to financing in many of the countries examined in the sample used by the ex-post evaluation (European Commission, 2016).

Nevertheless, these findings do not cancel the expectations on the possible benefits expected from the FIs implemented correctly, for instance; a) secure access to financing for SMEs and start-ups facing difficulties in their financing because of market asymmetries and failures; b) leveraging of additional resources, in principle private; c) reinforced financial discipline because of the risk-sharing profile of the financing scheme, instead of the risk-free profile of the one-off subsidies schemes and d) access to measures accompanying the financing, such as technical expertise and consultancy (in particular for the venture capital and equity schemes).

Although the comparison of the outcomes of the subsidies system to the ones of interventions implemented by FIs cannot be realized with certainty, because of the lack of reliable data, the trend is that lessons learned from the 2007-2013 period should and will serve for better implementation in 2014-2020, to increase the quality of investments and the shared responsibility in managing those investments.

Most of the shortcomings revealed during the implementation of FIs in the period 2007-2013 have been addressed at least in the legislation governing the period 2014-2020. In particular, the following ECA recommendations have already been taken on board as legislative measures for the period 2014-2020 (Regulation (EU) No 1303/2013[2]): Ex-ante assessments became compulsory for the shared management FIs and the results of the midterm review have to be followed by the centrally managed ones; Specific guidance on every aspect of the implementation of FIs under shared management became readily available and a specific coordination committee (Expert group on European Structural and Investment Funds (EGESIF)) between EC – Member States replaced the Committee for the Coordination of the Funds (COCOF) put in place for the period 2007-2013; The size of the FIs should be the result of coordination between EC and Member State and in any case performance indicators are used to regulate the flow of funding to the funds and the management fees and costs; Performance indicators define the management costs and fees, as well.

6. Conclusions and policy implications

There is a consensus that SMEs are the backbone of all economies worldwide and within the EU. SMEs constitute the main source of wealth and employment and as such, they merit particular attention from the part of the public authorities, in times of financial crisis and the need for alternative financing sources.

There is also an open question to what extend grants or subsidies which constitute the traditional way of the public authorities to assist SMEs can continue to be considered as the major delivering tool for development policies. However, few studies have tried to investigate the impact of FIs as a means of boosting the development of SMEs achieving sustainable growth within the EU economy.

This paper attempts to fill this gap in the empirical literature by focusing mainly on the FIs as a tool to deliver EU policy goals over the period of the financial crisis (2007–2013). The empirical results based on field research, provide useful implications for policymakers and government officials. Specifically, the feedback received was positive though, in the questions about combining subsidies with FIs as a factor increasing the efficiency of both tools, they were of mixed opinion, regarding the role played by the financial intermediaries when used in such cases of blending subsidies and FIs.

Regarding the questions about FIs, the respondents recognize the positive impact the FIs can have on public financing by their two main aspects, the revolving, and the leveraging nature. Some reserves were expressed regarding the credit scoring used by the financial intermediaries which can be an obstacle to finance investments carried by investors with poor financial records.

Based on the above, we argue that the purpose of using FIs is not to crowd out the traditional credit providers, although, if they do not play their role, the public authorities are fully legitimized in intervening to correct market failures.

[2] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

However, there are two more elements not studied thoroughly, such as the national policy to support SMEs (e.g., national development laws, which combine financing with fiscal measures), and the credit policies applied by the traditional credit suppliers. The massive introduction in the EU budget of the FIs as an alternative delivering tool for development policies, despite their obvious rationale, does not seem yet to have convinced all the stakeholders of their efficiency.

Few studies have addressed the question of FIs drive firms' growth and longevity. Therefore, this paper contributes to the literature by providing sharp inference and guidance to policymakers (ministries, regulators, government authorities, etc) and market participants (managers, stakeholders, investors, etc) by exploring the importance of financial sustainability on firms' strategy. Yet, despite the growing concern about the impact of financial aid on corporate growth and long prosperity, it is argued that the specific research topic remains an open challenge for researchers and policymakers. Part of the reason can be attributed to the fact that different industries have different dynamics depending on their unique characteristics, such as the degree of innovation implemented, the level of market recognition, and the way they compete.

Based on the empirical findings, a range of government policies to foster SME access to finance must be introduced in the aftermath of the financial crisis, including new policy initiatives, scaling up existing measures, and policy experimentation. Credit guarantee schemes remain the most widely adopted policy instrument in OECD countries, and their design is continuously being revised to keep up with evolving needs (OECD, 2018). Export guarantees and measures to support trade credit, direct lending schemes, interest rate subsidies, as well as the provision of business advice and consultancy to SMEs looking for external finance constitute some other commonly used policy instruments.

Lastly, SME skills and strategic vision are key ingredients to broaden the range of financing instruments. Targeted financial education programs are not only a matter of increasing knowledge about individual instruments. They can also help entrepreneurs to develop a long-term strategic approach to business financing, enhance understanding of the economic and financial landscape of relevance to their business, identify and approach providers of finance and investors, understand and manage financial risk for different instruments.

Disclaimer

This paper solely presents the views of its authors and not the views of their affiliated organizations.

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