Ex-ante Assessment Report

Financial Instruments
Business Competitiveness, Employment, Social Enterprise

ESIF 2014-2020

Final Report

September 2015

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Glossary

3S	Strategy for Smart Specialisation (RIS 3)
AECM	European Association of Mutual Guarantee Funds
BICRO	Business Innovation Croatian Agency
CBS	Central Bureau of Statistics
CATI	Computer-Assisted Telephonic Interview
CEDRA	Cluster for Eco-social Innovation and Development
CEPOR	SME and Entrepreneurship Policy Centre (Croatia)
CF	Cohesion Fund
CIP	Competitiveness and Innovation Framework Programme
CORDIS	Community Research and Development Information Service
CPI	Consumer Price Index
CPR	Common Provisions Regulation
CRANE	Croatian Business Angels Network
DFI	Development Finance Institution
DG	Directorate General
DG Enterprise	Directorate General for Enterprise and Industry
DG Regio	Directorate General for Regional and Urban Policy
EAFRD	European Agricultural Fund for Rural Development
EBITDA	Earnings before interest, taxes, depreciation and amortisation
EBIT	Earnings before interest and taxes
EC	European Commission
ECB	European Central Bank
ECF	(also FGS) Economic Co-operation Fund
EDP	General government gross debt
EEN	Enterprise Europe Network
EFF	European Fisheries Fund
EIB	European Investment Bank
EIF	European Investment Fund
EPRC	European Policies Research Centre
ERDF	European Regional Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
EU	European Union
EUSEF	EU Social Enterprise Fund
EVCA	European Venture Capital Association
FDI	Foreign Direct Investments
FEI	Financial Engineering Instrument
FGS	Economic Co-operation Fund
FI	Financial Instrument
FINA	Financial Agency
GDP	Gross Domestic Product
HANFA	Croatian Financial Service Supervisory Agency
HAMAG BICRO	Croatian Agency for SMEs and Investments after merger with BICRO (from 1 May 2014)
HAMAG INVEST	Croatian Agency for SMEs and Investments (before May 2014)
HBOR	Croatian Bank for Reconstruction and Development
HHI	Herfindahl-Hirschman Index
HICP	Harmonised Index of Consumer Prices
HNB	Croatian National Bank
HRK	Croatian Kuna
HVCA	Croatian Private Equity and Venture Capital Association
IB	Intermediate Body
IPA	Instrument for Pre-accession Assistance
IUS	Innovation Union Scoreboard
JEREMIE	Joint European Resources for Micro to Medium Enterprises
LFS	Labour Force Survey
MA	Managing Authority
MEC	Ministry of Entrepreneurship and Crafts
MLPS	Ministry of Labour and Pension System

MRDEUF	Ministry of Regional Development and EU Funds
NACE	Statistical Classification of Economic Activities in the European Community
NEET	Youth neither in employment, education or training
NSRF	National Strategic Reference Framework
NUTS	Nomenclature of Territorial Units for Statistics
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OP	Operational Programme
OPCC	Operational Programme Competitiveness and Cohesion 2014-2020
OPEHR	Operational Programme Efficient Human Resources 2014-2020
PA	Partnership Agreement
PPS	Purchasing Power Standards
RDA	Regional Development Agency
SBA	Small Business Act
SMAF Index	SME Access to Finance Index published by DG Enterprise and Industry
SME	Small and Medium-sized Enterprise
SME Survey	SME Access to Finance Survey 2014undertaken and funded by the BIZimpact II EU-funded project implemented on behalf of the Ministry of Entrepreneurship and Crafts. This Survey was expressly commissioned with the aim to provide quantitative data and feedback for the ex-ante assessment
SO	Specific Objective
TA	Technical Assistance
VaR	Value at Risk
WG	Working Group
YEI	Youth Employment Initiative

Executive summary

This ex-ante assessment report was produced within the framework of a broader Technical Assistance project co-financed from the EU IPA Programme for Croatia: *Preparation of Future Programming Documents and Accompanying Project Pipelines*. The TA project was aimed at the strengthening of Croatia's administrative capacity to effectively undertake programming effort in the context of ESIF 2014-2020 and assistance in the development of associated project pipeline. The report was developed between September 2013 and March 2015 based on iterative and interactive process involving all relevant stakeholders who could contribute to the independent review as to how financial instruments can best work in the country. The draft report was subsequently consulted with the EC Services and stakeholders and the current version reflects observations and comments collected until August 2015.

The summary is a combination of the description of major economic challenges, findings of lessons learned, conclusions and strategic recommendations in regard to the recommended roll-out of FI's interventions within the framework of activities of TO 3, TO 8 and TO 9, all related to supporting entrepreneurships and SME development.

Economic context

- Between 1995 and 2007 Croatia's economic growth had been propelled by foreign direct investments and domestic consumption fuelled by strong increase in credits. Consumption and investments had been the main contributing factors to fast economic growth. At the turn of 2008 and 2009 positive developments were disrupted by the global financial crisis.

- Croatia experienced economic decline in the period 2008-2013, which had disastrous effect on economy and enterprise, i.e.: decrease in investments, gross capital formation, consumption, foreign trade and key market segments, including employment, financial and capital marketplace. Overall, the corollary of the economic regression and feeble enterprise sector emerge as central to the rationale for the ESIF 2014-2020 intervention framework.

- The country features excessive macroeconomic imbalances. Between 2008 and 2013 Croatia's EDP index increased from 30% to almost 68%. Despite being a moderate innovator as measured by IUS, the country's enterprise sector struggles to be internationally competitive, which manifest in low share of exports in GDP (EUROSTAT).

- Financial position of enterprises is weak, which manifests in current liquidity index below 1.0 for all size segments of SMEs with micro firms being most affected (FINA).

- Labour force-wise, the country's working contingent remains fairly stable but activity rates epitomise negative trends in the labour market staying 10 percentage points below the EU average. Employment rate is currently approx. 15 percentage points below the EU average. The youth and individuals at the age 50+ experience the most pronounced exclusion from the labour market (CBS and EUROSTAT).

- Risk aversion is highly pronounced across the country. With non-performing banking loan portfolio exceeding 30%, long term lending by banks virtually does not exist.

- Measured by HHI index the Croatian banking sector is moderately concentrated but at the same time is considerably less competitive market place than the EU on average (ECB). The latter has also significant negative impact on lending to enterprises trends, augmented by displacement effects of investing into treasury bonds rather than into economy.

- After turmoil of 2008 when almost 2/3 of the annual GDP amount faded away from investors' portfolios, the Croatian capital market has actually never recovered. The current capitalisation of the Zagreb Stock Exchange is comparable to that at the end of the year 2008 (Zagreb Stock Exchange Trading Summary).

Main findings and recommendations

- There is high level of uncertainty in regard to economic outlook and financial position of enterprises alongside households' budget compromising confidence in economy. That has negative effect on the availability of finance, especially for SMEs, as banks are highly risk averse.

- Highly leveraged companies with low profitability and insufficient collateral cannot access finance and are not able to invest even if there are investment opportunities. High indebtedness causes payment backlogs making significant number of companies non-bankable.

- Capital markets are underdeveloped and businesses feature poor financial performance, compromising investments in venture capital vehicles.

- With severely low levels of employment opportunities there is lack of financial sources that could stimulate self-employment opportunities. Available resource is insufficient to meet likely demands or not tailored to the actual needs.

- Croatian development finance institutions enjoy good track record but they are either undercapitalised or fragmented and have to re-finance their operations using commercial sources. That compromises their strategies and adaptability to change.

- There is continuous focus on subsidised finance facilities and demarcation between viable but non-bankable and bankable projects does not virtually exist.

- Despite relatively low nominal interest rates in Croatia the cost of borrowing appears to be high for significant number of enterprises (validated both, through qualitative method - FGI and expert panel and quantitative approach - SME Survey).

- Financial institutions clearly demonstrate that risk is the main cause of low levels of lending in the country (qualitative methods - expert panel findings).

- Due to high overleveraging companies need working capital more pronouncedly than elsewhere in the EU, on average.

- The fixed assets gap measured by the ratio of fixed assets to net worth is negative as they remain in abnormally high levels in relation to the total assets. The latter however are predominantly obsolete and there is a need to facilitate investments in new productive assets in order to increase enterprise competitiveness.

- The most immediate investment needs (financing gap)[1] are between approx. €308 million and €542 million, including long- and short-term financial needs. Due to weak financial position of businesses these needs can be addressed by supporting lending to enterprises and provision of grants.

- Equity gap is estimated at between €22 million and €53 million.[2]

- The amount set aside for FI's within TO3 of the OPCC 2014-2020 is deemed to be sufficient to address basic needs of Croatian SMEs at this juncture. Higher allocations can cause implementation and absorption constraints due to brand new implementation modalities of some FI's.

- The amounts set aside for FI's under TO 8 and 9 of the OPEHR 2014-2020 are deemed to be relatively high given limited experience of financing self-employment and social enterprises through FI's. In order to be successful their roll-out under TO8 requires close and intimate relation with the HZZ and business support institutions. For TO 9 financial instruments are recommended only when critical mass of viable social enterprises has been established with grants and other non-refundable forms of support and validated.

- The review of Operational Programmes OPCC 2014-2020 and OP EHRD 2014-2020 alongside progress with activities to roll them out reveal needs for more symbiotic relationship between operations supported under TO 1 and TO3 of the OPCC 2014-2020 and more comprehensive provision of various types of incentives for SMEs, e.g. combination of financial instruments with grants, including consultancy and training aid. The latter specifically concerns instruments and measures offered under TO 8 and TO 9 of the OPEHR 2014-2020.

[1]Financing gap was computed using methodology presented in the EU SME Initiative ex-ante assessment but based on the actual data from FINA representing the actual financial statements of companies. The share of high growth firms, share of loans approved below the requested amount, number of firms that refused to sign loan contract and firms' unwillingness to apply (e.g. due to the fear of rejection or undersized collateral) come from quantitative SME Survey executed entirely for the purpose of this ex-ante assessment.

[2]The lower value of the cohort derives from the computed financing gap but considering start-ups only while the end value of the cohort is calculated based on the actual level of equity and reserves (FINA) assigned to start-ups and high growth firms.

Strategy in nutshell

- The proposed Strategy is built on the recommended demarcation line between financial instruments and grants. Grants shall aim to finance viable but non-bankable ventures or high-risk projects while financial instruments can support more customary and traditional sectors.

- Whereby relevant capacities exist (debt instruments), implementation modalities include entrusting the roll-out of FI's to existing development finance institutions. This can help address the identified market failure without superfluous delay experienced in numerous countries for 2007-2013 programming perspective. The selection of the EIF or other international financial institution in accordance with Article 38 point 4 (b-ii) of the CPR is recommended to manage equity instruments. This is due to insufficient experience of the national institutions to implement support measures to VC.

- The table below outlines causal association between the proposed FI's and market failures. Details on these can be found in the main body of the document.

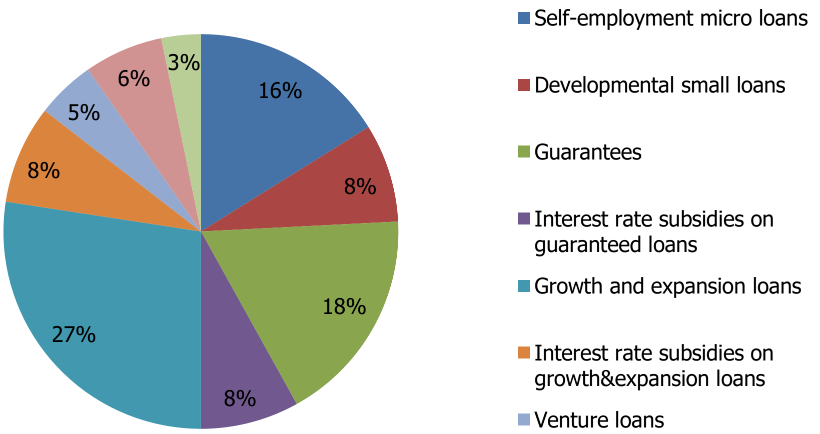
Instrument	**Addressed Market Failure Causes and Effects**
Long-term loans for firms in growth and expansion phase, irrespective of technological advancement and targeting investment projects	Uncertainty related to economic outlook, lack of business confidence in economy (market powers and imperfect knowledge) resulting in the lack of or abnormally limited provision of long-term finance by the commercial banking sector (only 2% are long-term loans to businesses as indicated in statistics by the HNB).[3] Significant size of non-performing bank loans portfolio (market powers and obstructing laws leading to risk aversion) resulting in high collateral requirements. Lending facility will be offered together with interest subsidies within the same operation.
Developmental small loans (including micro loans) with combination of investment finance and working capital finance or working capital loan only with extended maturity period (up to 5-7 years)	Poor economic and financial performance by businesses, especially micro and small firms, highly leveraged companies and payment backlogs (market powers) resulting in scarce investments, low liquidity and high working capital needs; these result in virtual lack of long-term finance made by banks
Loan guarantees for various loan facilities and possibly leasing. Are recommended as individual guarantees but if critical mass is reached can be developed into portfolio guarantees	Significant size of non-performing bank loans portfolio (market powers and obstructing laws leading to risk aversion) resulting in high collateral requirements, especially for micro and small firms. Guarantee facility will be offered together with interest subsidies towards the guaranteed loans within the same operation.
Equity finance: venture capital for investments targeting amounts higher than other financial instruments offered (e.g. between €1-3 million) and realised primarily in sectors with high growth potential, including those identified in 3S strategy. Synergies in investment strategy can be established with the VC initiative financed from the World Bank loan	Underdeveloped capital markets, low levels of business investment opportunities and divestment (market powers) resulting in virtual lack of VC industry
Optional/alternative: e.g. subordinated loans or hybrid finance (e.g. venture loan/debt-based recoupable investment, mezzanine or performance-based-indexed loan): ▪ For growth and expansion or	Highly leveraged companies, insufficient collateralisation, especially for long-term projects or in sectors with high risk where commercial banks or highly risk averse (market powers or imperfect knowledge)

[3] Spreadsheet g3a available on HNB website

Instrument	Addressed Market Failure Causes and Effects
▪ Projects associated with technology transfer stemming from outsourced R&D or commercialisation based on own R&D works, open innovation, incubation, etc. This would be complementary to equity schemes in terms of size and target groups but finance projects with lower rates of return to those preferred by venture investors. Hybrid finance can be an alternative to angel investment, or complement it	
Optional: support to angel investments under the condition that synergies have been established with the intended seed co-investment fund financed from the World Bank resources and managed by HAMAG BICRO	Underdeveloped capital markets, low levels of business investment opportunities and divestment (market powers) resulting in low supplies of angel investment capital
Micro start-up loans to set-up a business by unemployed individuals. These micro loans could have extended maturity of up to 5 years and e.g. 1 year grace period)	Lack of credit history, limited or no business track record (information asymmetry) resulting in the lack of instrument or product for newly established companies, especially those run by low-skilled but economically active individuals Low levels of employment opportunities resulting in low employment rates (market forces)
Optional: loans for social enterprises (conditional on the complementary validation of the demand for debt finance by social enterprises, which could not be authenticated during ex-ante assessment process)	Lack of credit history, limited or no business track record (information asymmetry) resulting in the lack of instrument or product for newly established companies, especially those run by low-skilled but economically active individuals

- The total indicative contribution from the ESIF 2014-2020 budget to Financial Instruments is estimated at €310 million of which €250 million come from the ERDF and €60 million from the ESF. The ESF contribution is split between €50 million for self-employment micro loans (indicatively) and €10 million for social enterprises. The share of contributions from ESIF per each FI in the total allocation under TO3, TO8 and TO9 is depicted in the figure below (allocation towards interest subsidies is illustrated separately though these will be offered within the same operation with growth/expansion loans and guarantees).

Figure 0: Percentage contribution from ESIF 2014-2020 per financial instrument



Source: own elaboration

- The expected conservative net leverage effect of the ESIF contribution is approx. 250% and when contribution by final recipients considered is considered, this ratio is estimated at circa 288%.

Introduction

1. The importance of SMEs to economic development and job creation is increasingly recognised around the world, as suggested by the scale and scope of government interventions. The EU and Croatian Government have been continuously supporting SMEs and their environment to encourage and stimulate the sector to grow.

2. While larger well-established companies only produce limited gains in employment, the SME sector is the main contributor to job creation - especially in the Croatian economy - where micro, small and medium enterprises create more than 64% of all jobs.[4] This is why the need to stimulate SME growth turns out to be more urgent and pressing as the expectations to sustain and create additional employment become an important objective of economic policies in Europe and, similarly, in Croatia -experiencing consecutive 6 years of economic decline.

3. The Europe 2020 Strategy opens opportunities for the implementation of EU flagship initiatives. Among them there is a priority "An industrial policy for the globalisation era" to improve the business environment, notably for SMEs, and to support the development of a strong and sustainable industrial base able to compete globally. This priority reinforces a broader goal of smart and sustainable growth in Europe.[5]

4. Building on Europe 2020 Strategy the Commission developed a package of thematic interventions to deliver on the Strategy headline objectives. It is assumed that respective actions and operations will be delivered through grants and financial instruments. Among the latter ones there are instruments supporting innovation and competitiveness of SMEs, which are specifically tailored to **address gaps in SME access to finance** for better growth and job creation, notably through new investments and promotion of knowledge-based economy. In addition to these, financial instruments can support self-employment and social economy.

5. The **financing gap** term is used to describe "a sizeable share of economically significant SMEs that cannot obtain financing from banks, capital markets or other suppliers of finance due to structural market characteristics".[6] In this context it is also acknowledged that a share of SMEs that do not currently have access to funds would have the capability to use those funds effectively if they were available.

6. In the 2000-2006 ERDF programming period and, to a greater extent, in the 2007-2013 ERDF programming period, financial engineering instruments were used by the Commission and most Member States in the context of the EU cohesion policy to address **financing gap** or 'Macmillan gap'.

7. The Croatian government intends to make use of innovative financial instruments when implementing selected activities of the Operational Programme Competitiveness and Cohesion 2014-2020 and Efficient Human Resources Operational Programme 2014-2020, hence this document, which has been prepared in response to the requirements of Article 37 of the Common Provisions Regulation. It underpins the rationale and strategy for the use of innovative financial instruments for business competitiveness, employment creation and social economy in Croatia, co-financed within the ESIF framework for the years 2014-2020.

8. The main phase of the ex-ante assessment was carried out in the period September 2013 - March 2014. A mature draft of the report was developed which was subsequently consulted with the EC Services and main stakeholders. Observations and comments captured during that process are reflected in this document. The proposed strategy stems from the recent experience of the use of financial instruments in the country and pertinent lessons learned; builds on strategies outlined in the draft Operational Programme Competitiveness and Cohesion for 2014-2020, and aims to complement financial instruments horizontal initiatives undertaken by the EC, delivered through central management modalities.

9. This document is composed of the following sections:

   a. Introduction;

   b. Background with approach and methodology of the assessment;

[4] Source: The Croatian SME Observatory Report, 2013
[5] EUROPE 2020: A strategy for smart, sustainable and inclusive growth, Communication form the Commission, COM (2010) 2020 final
[6] The SME Financing Gap, Theory and Evidence, Volume I, OECD, 2006, page 16

c. Preliminary considerations;

d. Description of lessons learned from earlier interventions through innovative financial instruments- this includes assessment of lessons learnt from similar instruments and ex-ante assessments carried out by Croatia in the past, experience of other EU countries, and how these lessons are applied going forward;

e. Narrative of situational context, existing market failures and investment needs in the light of the achievement of specific objectives set out under a priority and to be supported through financial instruments;

f. Proposed investment strategy, including an examination of options for implementation arrangements within the meaning of CPR Article 38, financial products to be offered, final recipients targeted, envisaged combination with grant support as appropriate; the strategy ensuring that there is consistency with other forms of support, including those within the framework of the European Structural and Investment Funds, possible State aid implications and the proportionality of the envisaged intervention and measures to minimise market distortion;

g. Financial allocations alongside the outline of value added and leverage effect (additional funding raised by the financial instrument down to the level of the final recipient);

h. Specification of the expected results and how the financial instrument concerned is expected to contribute to the achievement of the specific objectives set out under the relevant priority including indicators for this contribution;

i. Final provisions;

j. Bibliography and references;

k. Annex I which contains details of the SME quantitative survey on access to finance carried out in January-February 2014.

10. The ex-ante assessment report covers financial instruments implemented under Thematic Objective 3 of the Operational Programme Competitiveness and Cohesion 2014-2020 and Thematic Objective 8 and 9 of the Efficient Human Resources Operational Programme 2014-2020.

Background and approach

11. The ESIF 2014-2020 promotes much wider use of financial engineering instruments financed from ERDF and ESF than ever before. Arguably the use of revolving finance facilities contributes to increased additionality, efficiency and sustainability of intervention when compared to traditional grant funding: empirical research on ODA flows shows that grants tend to suppress domestic tax base while, by contrast, loans encourage and stimulate revenue raising.[7]

12. The point of departure of the ex-ante work is decision of the Croatian Government to indicatively allocate approx. €250 million for financial engineering interventions within TO3 of the OPCC, €50 million within TO8 of the OPEHR. In addition to these TO9 of the OPEHR also intended to support social enterprises with the use of financial instruments with financing up to €10 million.

13. The planning for and implementation of financial instruments is conditioned on carrying out examination as to what extent financial engineering can address existing developmental gaps and market failures and how financial instruments can contribute to the achievement of broader policy objectives set in each Operational Programme. In this context the ex-ante assessment reviews both, the supply side and demand for financial instruments in the earmarked policy areas. In addition to that, it also looks into causal association between OP's expected results and corresponding outputs.

14. The mandate for the execution of this ex-ante assessment are the provisions of Articles 37-38 of the CPR while the methodology used is based on *Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period* (Vol. I and IV) handbooks developed for the Commission and EIB Group. In addition to that the ex-ante assessment report builds on earlier considerations, findings and recommendations to ensure complementarity of the solutions proposed herewith, e.g.:

    a. *Financial Instruments: A Stock-taking Exercise in Preparation for the 2014-2020 Programming Period*, Final Report for EIB, March 2013;

    b. *Ex-ante assessment of the EU SME Initiative*, European Commission, December 2013;

    c. *Financial Instruments for SMEs co-financed by the European Regional Development Fund*, Special Report No 2/2012, European Court of Auditors, 2012

    d. *SME Financing Gap Assessment in Croatia*, EIB Report, March 2011;

15. The ex-ante assessment has been exercised by party independent from all stakeholders participating in the programming process, with the use of participatory approach. The assessment process followed generic good practice evaluation model that includes: planning, structuring, data capturing, data analysis, reporting and production of recommendations. In particular, reporting included generation of debriefing notes aimed at sharing staged findings and observations with stakeholders and debate with them matters arising along with corresponding strategic recommendations.

16. Stakeholder group included experts and practitioners from the MEC, HAMAG BICRO, HBOR, HVCA, CRANE, banking sector institutions, chambers of commerce, leasing companies, factoring companies, RDA's and other development organisations and institutions. Stakeholders worked in a collaborative manner, establishing a Working Group facilitated by the ex-ante assessment team and the Ministry of Entrepreneurship and Crafts. Thus the ex-ante team had an opportunity to apply interactive and iterative approach to the assessment and the course of the review was closely associated with the broader programming effort.

17. The approach undertaken included triangulation principle to produce findings and corresponding recommendations from three research perspectives and viewpoints: i) data, data sources and their reliability, ii) research perspectives and iii) research and assessment methods. The assessment progress was systematically communicated to the MRDEUF and MEC in order to ensure proper interface with the programming effort and subsequent design of strategic OP intervention.

[7]B. Clements, S. Gupta, A. Pivovarsky, and E. R. Tiongson, *Foreign Aid: Grants versus Loans*, Finance and Development, September, 2004

18. The FI's ex-ante assessment process had commenced before the ex-ante evaluation of the draft Operational Programme Competitiveness and Cohesion kicked off. The work on both documents was carried out in parallel albeit no direct interaction between ex-ante evaluation and ex-ante assessment teams occurred.

19. The OPCC ex-ante evaluation report gave limited feedback on the proposed forms of support and only marked links between the strategic change sough after and the pathways of this change. Ex-ante evaluation conclusions were not substantiated by thorough analysis of the cause-effect intervention logic and distinct analyses of the causal link between outputs and results were missing, especially in regard to FI's. Consequently, the ex-ante evaluation report had limited informative value from ex-ante assessment perspective.

20. EHRDOP interventions-wise, no mature draft ex-ante evaluation report was available at the time of the development of this ex-ante assessment report. The final report - similarly to the one for OPCC - provided no practical merit for the development of this ex-ante assessment report.

21. The situational context provided in this document is primarily developed based on data within public domain. However, for more insight into the situation in enterprise sector raw data sets were acquired from FINA to enrich analysis.[8]

22. The assessment of lessons learned in Croatia was carried out by the ex-ante assessment team based on data from monitoring system of the respective institutions and qualitative analysis - individual semi-structured interviews and focus group interview. The review of lessons learned in other Member States was done based on desktop research (studies, analysis, presentations, reports), individual interviews and feedback received during organised learning and networking events (seminars, conferences).

23. Market failures and investment needs were identified with the use of available statistics on the enterprise sector, through SME quantitative survey, and qualitative analysis (focus group interview and expert panel facility). In addition to these, desktop research, literature review were carried out. The quantitative survey was carried out in the form of Computer-Aided Telephonic Interview (CATI) on the representative sample of 1,000 respondent SMEs.

24. The identified investment gaps are three-dimensional: 1) fixed assets gap and/or assets-related equity/capital gap resulting from sub-optimal structure of enterprise assets financing based on FINA data, 2) financing gap related to the unmet demand expressed by viable SMEs for loan finance (lending gap) and 3) venture capital gap (viability gap).

25. The monetary value of financing gap in regard to debt funding has been computed as multiplication of the number of financially viable[9] SMEs but yet unsuccessful in obtaining loan finance that they need (CATI) and of the average loan amount in the sector in regard to short-term and long term loan (FINA and CATI).

26. The venture capital gap[10]primarily concerns the size of equity in early stages of development and growth phase of enterprises (up to 2 years old) computed as the amount of equity and reserves as of end of 2013 multiplied by the number of high growth SMEs and 4% representing share of SMEs with track record up to 2 years in the total number of micro, small and medium enterprises registered as legal entities. Alternate option includes a fraction of start-ups in the total financing gap calculated according to the method contemplated in the previous para.

27. Investment strategy, intervention logic and its modus operandi were developed in consultative manner based upon reflection on lessons learned, institutional and organisational capacities and capabilities, funding available, policy and OP objectives, relevance, utility, the assumed scope of intervention from centrally managed initiatives and expected impact of the proposed interventions.

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[8]FINA collects financial reports from all businesses which are VAT vendors (with annual turnover exceeding HRK 230,000) and those that register voluntarily. FINA's does not include the majority of crafts sector (only circa 4,400 of +65,000 crafts report to FINA) and smaller ventures qualified as free professions but it is estimated that entities registered with FINA represent approx. 55% of all enterprises (including crafts) and more than 90% of Croatia's GVA (own calculation).

[9]The approach is adapted from EU SME Initiative ex-ante assessment where viable businesses are considered to be those that are high growth SMEs (whose turnover in 2013 grew by 20% or more when compared to 2012) but their application for finance was approved below originally requested amount or firm's refusal of financial conditions, or firm's unwillingness to apply due to possible rejection or undersized collateral even when financing was needed (for reasons other than those of economic or capacity nature) - based on CATI.

[10]Since fixed assets gap is already linked to equity gap resulting from sub-optimal structure of balance sheets of firms the gap concerning PE/VC is named "venture capital gap" and not "equity gap" in order to avoid misunderstanding.

28. The table overleaf outlines key consultative and networking events, workshops and meetings of which outcomes and findings were found of significant importance for the realisation of ex-ante assessment.

Date	Description
13/09/2013	Individual semi-structured interview with HAMAG BICRO: assessment of guarantee performance in recent years
18/09/2013	1st FI's WG meeting at MEC: discussion on action plan and milestones to be achieved; participants also included representatives of banks and HVCA.
10/12/2013	SIGMA OECD/EC seminar: discussion on Slovenian and Hungarian experience in the implementation of financial instruments project in 2007-2013 ERDF programming period
18/12/2013	Individual semi-structured interview with Privredna Banka Zagreb, assessment of impact of CIP portfolio guarantee programme for micro-lending; key findings concerned high lending potential for micro firms through addressing low appetite for risk.
14/01/2014	2nd WG meeting at MEC: presentation of situational analysis and main findings
20/01/2014	Individual semi-structured interview with HAMAH INVEST: assessment of new products under development (equity instruments)
05/02/2014	Individual semi-structured interview with HBOR: assessment and review of lending products and interventions
06/02/2014	Seminar at ARPA - meeting with auditors from Lithuania and Portugal to discuss the countries' experience with implementation of financial instruments and selection of financial intermediaries in ERDF 2007-2013 programming period
07/02/2014	Focus group interview with SMEs, chamber of commerce, chamber of crafts, regional development agencies, HAMAG BICRO and HBOR: discussion on SME sector needs in regard to access to finance and to-date experience on development finance product delivery. Main qualitative feedback included critique of lending criteria, amorphous design of grant schemes alongside compliance and evaluation criteria.
09/02/2014	Individual semi-structured interview with CRANE: review of business angels practices and experiences, and their developmental needs
06/03/2014	Strategic planning workshop with MRDEUF and MEC: building intervention logic related to Thematic Objective 3 and development of specific parts of the draft CF ERDF OP 2014-2020
21/03/2014	Expert panel discussion on main findings of the quantitative survey on access to finance and possible scope, contents and implementation modalities for FI's within TO1 and TO3. Participants included: representatives of banking sector, development finance institutions, CRANE, HVCA and Working Group members. Key feedback from financial institutions centred round addressing lending risk issues.
18/06/2014	Debriefing meeting with stakeholders: ex-ante assessment team response to comments on first draft of ex-ante assessment document
23/06/2014	Debriefing meeting with stakeholders: ex-ante assessment team response to comments on first draft of ex-ante assessment document (cont.)
04/07/2014	Debriefing meeting with the MEC and other stakeholders - discussion on the EC delegated Act, implementation options and detailed design of instruments
07/07/2014	Debriefing meeting with the MEC and MLPS to discuss demarcation lines between 1) the ERDF and ESF financial instruments and 2) grants and financial instruments
12/08/2014	Individual semi-structured interview with CEDRA on the state of social entrepreneurship in Croatia and broader Balkan Region

13/08/2014	Semi-structured interview with the champion of the first ethical bank movement in Croatia on social entrepreneurship and EUSEF perspective
03/12/2014	Debriefing meeting with the MEC, MLPS and MRDEUF on ex-ante assessment findings and strategic closing recommendations

Preliminary considerations

29. The ex-ante assessment logic is constructed on two building blocks:

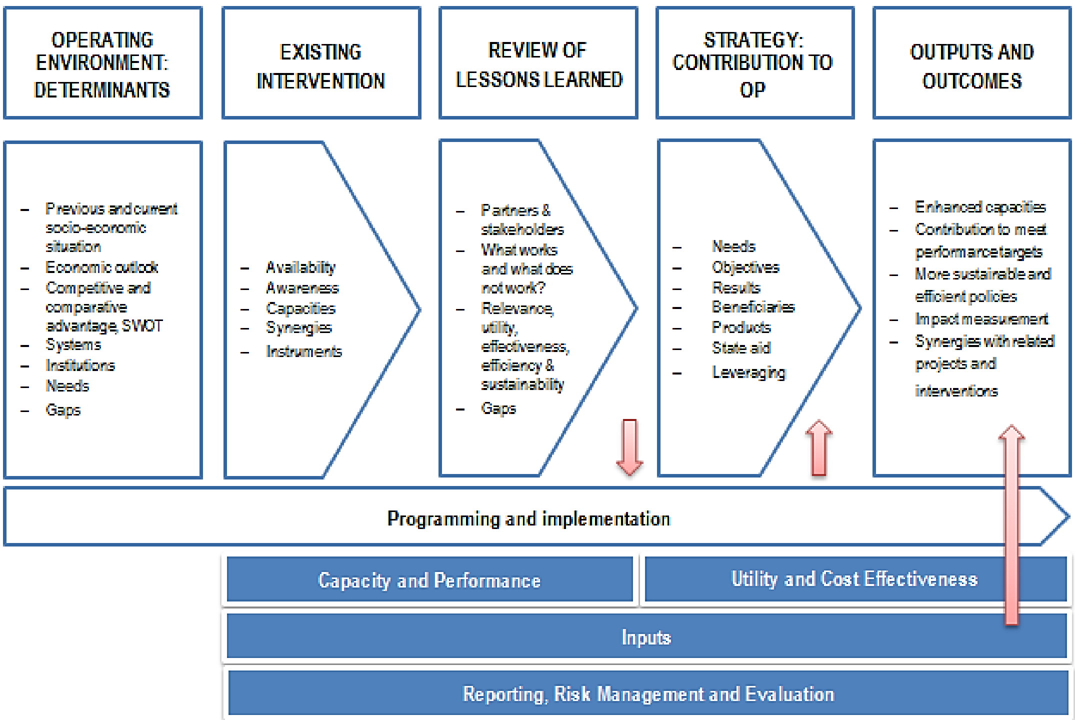
   a. Market assessment (including lessons learned from earlier interventions): parts indicated in para 9 (d) and (e) and

   b. Recommendations in regard to delivery and management modalities parts indicated in para 9 (f-i).

30. On strategic level the draft Partnership Agreement (as of April 2014) recognises financial instruments as an important form of stimulating competitiveness and entrepreneurship and accentuates the importance of supporting and promoting financial engineering in the context of market failures and limited access to finance. The PA clearly advocates for FI's in the area of business competitiveness, agriculture, energy efficiency and employment policies.

31. As access to development finance aspects include both, grants and financial engineering instruments, FI delivery and management modalities draw on clear intervention demarcation line between grants and financial instruments. For this the FI implementation strategy is built on the assumption that if a policy objective can be correspondingly achieved through grants and financial instruments, the latter are recommended. This shall in return enhance consistency and efficiency of the concerned priority axis and its focus area. To this effect the following aspects of consistency are considered: 1) financial consistency, 2) governance consistency and 3) institutional co-ordination consistency. Consistency aspects considered during ex-ante assessment, and their broader environment, are illustrated in the figure below.

Figure 1: Illustration of financial instruments ex-ante assessment environment



Source: own elaboration

32. Financial consistency aims to avoid duplication and displacement effects of the intervention and enhance its effectiveness, mainly through the demarcation line contemplated in the previous para.

33. Governance consistency is considered to promote and take advantage of the optimal level of institutional management capacities, especially in the context of supporting similar target groups and final beneficiaries.

34. Institutional co-ordination consistency builds on the financial and governance aspects. It focuses on the identification of good practices and achievement of critical mass and economies of scale thus articulating policy consolidation and concentration facets.

35. Correspondingly, relevance and utility of the intervention are considered to be an essential aspect of the priority axis design. To this effect, ex-ante assessment work looks into linkages and intersections with other forms of support, including 'soft' grants.

36. Ex-ante assessment considers Croatia's recent experience in the use of financial instruments and lessons learned from the implementation of financial engineering measures in other EU Member States. It thus builds and picks on key aspects of the experience gained and knowledge acquired.

37. The ex-ante assessment document encompasses recommended solutions for the entire programming period 2014-2020 and provides for alternative options to choose from in order to retain reasonable degree of flexibility. These aim to help address likely policy implementation dilemmas without major review of the ex-ante assessment process.[11]

[11] E.g. due to significant change in the context of FI intervention or its assumptions

Lessons learned from earlier instruments and similar measures

38. Development finance market in Croatia exists since 1992, when the Croatian Credit Bank for Reconstruction was established, renamed in 1995 as the Croatian Bank of Reconstruction and Development (HBOR). Other institutions providing development finance include: HAMAG BICRO - the Croatian Agency for SMEs and Investments, founded in 1994 as a loan guarantee institution[12] and the network of Regional Development Agencies (founded between 1999 and 2008). The institutions herein offer primarily loan and guarantee facilities.

39. Development finance instruments also include private equity funds established within the framework of Economic Development Programme initiative and bottom-up business angel movement.

40. Financial instruments in Croatia have in the past targeted all segments of micro, small and medium sized companies. Currently the main strategic direction for the use of financial engineering instruments is guided by the SME Development Strategy of the Republic of Croatia for 2013-2020, which builds on the earlier programmes and assistance, including the SME Promotion Programme for the years 2008-2012.

41. The 2013-2020 SME Development Strategy outlines five key strategic objectives which will be achieved through various delivery mechanisms, assuming significant contribution from the ESI Funds. These policy objectives are: i) improvement of economic performance through increase in investments in RDI, business networking and business linkages; ii) improvement of access to finance to address market gap in the provision of development finance for small businesses; iii) promotion of entrepreneurship; iv) development of entrepreneurial skills and v) improvement of business environment.

42. Based on the earlier experience of Croatian development finance institutions the Strategy document identifies market gap in the provision of finance to SMEs in €25,000-€100,000 funding threshold. However, the Strategy is based on meagre input from the assessment of earlier interventions and acknowledges that "there has been very little attempt to evaluate SME policy, either on ex-ante or ex-post basis and this, simply, has to change."[13]

43. For that this FI's ex-ante assessment does not only seek to inform financial instruments intervention logic for 2014-2020 ESIF but also to provide complementary contribution to the actual review of those earlier interventions, which are broken down by type and category FI.

44. Lessons learned in Croatia are augmented by key findings of the FEI's use in other Member States in the 2007-2013 programming perspective.

Microcredit and lending

45. The concept of microfinance in the EU evolved over years and is currently considered to be lending of small loan amounts (up to €25,000) to microbusinesses and economically active individuals. Dedicated microcredit programme financed from public funds in Croatia was only introduced in 2013 while earlier lending schemes supported the broader SME sector.

46. Meanwhile microcredit dominates as the most prevalent size of financing of SMEs. 41% of all SMEs and 72% of micro businesses indicate that they use long-term loans meeting microcredit threshold. These ratios are correspondingly: 56% and 73% for short-term loan finance.[14]

47. To-date policy support to microcredit is considered to be amorphous. Efforts were made to provide finance to micro enterprises as such, including start-ups. HAMAG BICRO used to offer special guarantees bank loans up to HRK 200,000 (equivalent of approx. €26,500) but the scheme is no longer in place. Other guarantee products indeed helped micro businesses but they failed to promote and support lending of small amounts.

[12]Indeed, 1994 marks the establishment of the Croatian Guarantee Agency (HGA), which in 2002 became the Croatian Agency for SMEs (HAMAG) and in 2011 was transformed into HAMAG INVEST (Croatian Agency for SMEs and Investments). In May 2014 HAMAG INVEST merged with BICRO (Croatian Business Innovation Agency) into the Croatian Agency for SMEs, Innovations and Investments (HAMAG-BICRO)

[13] The SME Development Strategy of the Republic of Croatia for 2013-2020, Executive Summary, p. 2

[14] Source: SME Access to Finance Survey 2014

48. Microcredit programme contemplated in para 45 was introduced by HAMAG BICRO as a pilot scheme. Micro loans were offered at subsidised interest rate of 0.99% and the programme financed 32 firms disbursing loans totalling HRK 2.1 million. The average loan amount was approx. €8,750. Eligible expenditures included fixed assets and working capital. In 2014 the Agency continues with micro credit programme albeit some modifications as to the min. and max. loan amount and eligibility of costs are introduced.[15]

49. HAMAG BICRO microcredit programme of 2013 was heavily under-budgeted. In response to the call for project proposals the Agency received 220 project applications of which 69 were considered to be viable. The available budget sufficed to finance only 32 projects. Further 151 project applications were assessed as non-viable or incomplete. The latter indicates inefficient delivery of essential associated business support services or the lack thereof and that the organisation of micro-lending scheme through call for proposals modality without adequate outreach assistance can compromise utility of the intervention understood as feasibility and suitability of the form of support offered.[16]

50. HAMAG BICRO's microcredit facility offered maturity of up to 5 years and 12-month grace period; the actual time for the repayment of loan principal is yet to come thus data on the quality of portfolio is not available at this juncture.

51. Earlier, special micro loan facilities through were available through Vaba Bank Varazdin and Privredna Banka Zagreb (PBZ). Both banks benefitted from EIF funding.[17] In December 2010 Vaba bank received a €5 million senior loan to match bank's own equal contribution to the scheme totalling €10 million while in April 2012 PBZ received portfolio guarantee aimed at supporting new micro loans to businesses with lack or undersized collateral. The target increase in new micro loan portfolio was €30 million.

52. Vaba bank utilised the whole micro loan facility amount through 2012 while by the end of 2013 PBZ extended 650 loans to the tune of approx. €7 million. The average loan size is €13,340 and the average borrower employs less than 3 persons.[18] As such, the two banks succeed in targeting micro businesses with small loans. However, while in case of PBZ the majority of loans are used for working capital purpose, Vaba bank primarily focused on small scale investment projects. Micro loans are offered to other banks' clients and such applications are processed smoothly if the applicant reports to FINA.

53. All implemented microcredit facilities confirm that there is significant demand for microcredit programmes and these can be run both at market and subsidised interest rate. The rationale for them also includes relaxation of collateral requirements and inclusion of working capital financing.

54. Lending facilities offered by HBOR are mostly extended to the broader SME sector where micro firms are considered to be equally important as small and medium enterprises. HBOR's credit lines address specific sectors or groups of enterprises (e.g. tourism, agricultural businesses, export-oriented companies, innovative businesses) or specifically start-ups. HBOR offers direct lending, on-lending through a network of participating banks, risk-sharing with commercial banks and also as of 2014. Subordinated debt lending facility. The table below shows aggregated performance figures for micro business and SME lending for 2009-2014 period, showing an increase in performance for 2010 - 2013 period for micro businesses lending. Micro businesses lending activities show a decrease in 2014, while the SME lending is decreasing since 2013, as a result of further deterioration of macroeconomic performance. .

Table 1: Number and amount of loans for micro businesses and SMEs extended by HBOR in 2009-2014 and the share of loans for micro businesses in total HBOR operations to SMEs; amounts in HRK million

Year	Number of loans to micro businesses	Number of loans tor SME-s	Share (%)	Amount of loans to micro businesses	Amount of loans to SME-s	Share (%)
2014	369	728	50,7%	456,8	2.100,9	21,7%
2013	489	1080	45,3%	603,1	3.502,7	17,2%
2012	460	1348	34,1%	549,3	4.566,8	12,0%

[15] Min. amount and maximum amounts are set at HRK 10,000 and 120,000 and vehicles are excluded from the list of eligible expenditures

[16] HAMAG BICRO does not have local branch offices

[17] Vaba bank received EIF funding where the Fund acted as co-financier of the operation within its statutory mandate (Risk Capital) and PBZ benefitted from loan portfolio guarantee scheme within the framework of the EU-funded Competitiveness and Innovation Programme. Around the cut-off date of data collection also Zagrebačka Banka started benefiting from EIF portfolio guarantee under Progress Microfinance Initiative and subsequently HBOR joined CIP portfolio guarantee initiative for micro-enterprises.

[18] Source: individual semi-structured interview with PBZ EU Desk representative, December 2013

2011	393	1331	29,5%	397,1	3.610,0	11,0%
2010	310	1343	23,1%	325,1	3.134,8	10,4%
2009	376	977	38,5%	414,0	2.938,0	14,1%

Source: HBOR raw data handed to ex-ante assessment in March 2015

55. The average loan amount in 2014 for micro company was HRK 1.2 million and HRK 1.1 million in the whole 2009-2014 period (an equivalent of €150,000)[19]thus significantly exceeding the threshold identified in the SME Strategy 2013-2020 as the market gap in the provision of finance to SMEs.

56. Key sectors and groups of enterprises targeted by HBOR-run loan facilities are reflected in Croatia's strategic policy documents (e.g. the SME Development Strategy 2013-2020) but specific measures targeting those groups have cross-cutting character and are not sector-specific.

57. Tourism and agriculture, which are covered by HBOR intervention, traditionally make up an important part of Croatian economy and value chains but they may appear to be high-risk sectors as the rate 52% of the share of profitable businesses in all firms is below the average for the whole country (57%).[20] These sectors traditionally require longer loan maturity period and - in case of agriculture - also preferential interests rates. For tourism sector HBOR offers loans with maturity up to 17 years, including grace period of up to 4 years at 3-4% per annum while agricultural businesses can obtain loans with maturity up to 12-14 years and grace period from 2 to 5 years with interest rate at 3% p.a. Such long repayment periods are indeed seldom available from the commercial banking sector institutions.

58. When mortgage is used as security loan collateralisation level by HBOR is normally 150% whereas for disadvantaged areas e.g. islands and mountainous the collateralisation ratio is 130%. The level of collateralisation thus appears to be generally lower than in commercial banking institutions.[21]

59. Most of HBOR loan facilities are offered with preferential interest rates and these vary through sectors and/or types of undertakings. Export financing is excluded from preferential interest rates as not allowed under state aid schemes.

60. In recent years HBOR used innovative approach of auctioning funds to work with commercial banks for on-lending. The bank required that on-lending banks bid with the lowest interest rate possible to match HBOR funding. And though the facility primarily targeted working capital loans its modus operandi should be appreciated for an innovative attempt to lower the cost of loan finance to the final borrower.

61. In order to finance its operations, HBOR raises funding on financial markets through bonds and global loans from international financial institutions. These are guaranteed by the State.

62. HBOR operates out of its seat in Zagreb and has five representative regional offices throughout the country: in Split covering the Dalmatia region, in Pula covering the Istria region, in Osijek covering the Slavonia region, in Gospić covering the Lika region and in Rijeka covering the Primorje and Gorski Kotar region. The regional offices enable direct access to clients, stronger support to small and medium-sized enterprises, easier access to information, strengthening of regional activity and balanced development of all regions in the Republic of Croatia. HBOR has no branch offices but through its cooperation with commercial banks (HBOR cooperates with 25 out of 27 commercial banks present at Croatian market), covers the entire territory of the Republic of Croatia. HAMAG BICRO lacks regional footprint affecting accessibility of their products and services.

Loan guarantees

63. HAMAG-BICRO is the main Croatian guarantee organisation and offers individual loan guarantees to SMEs, including micro businesses. Micro firms do not feature as a specific target group as HAMAG BICRO's guarantee products are primarily structured to support specific business needs and types of projects. Yet, micro businesses make up the majority of HAMAG BICRO's beneficiaries. The guarantees offered target: 1) new entrepreneurs, 2) business growth, 3) liquidity, 4) agriculture, 5) contract performance and 6) leasing contracts.

[19]Own calculation based on HBOR raw data
[20] Own calculation based on FINA data
[21]During FGI SME borrowers confirmed levels of collateralisation 2-3 times higher than that of HBOR

Table 2: Number and amount of loan guarantees for micro businesses in 2009-2013 and their share in total HAMAG BICRO guarantee operations to SMEs; amounts in HRK million

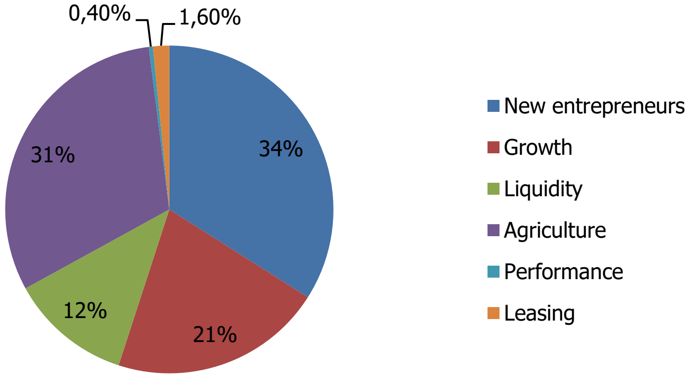
Year	Number	Share (%)	Amount	Share (%)
2013*	291	70.9	221.7	49.2
2012	166	68.3	156.1	49.6
2011	78	69.6	67.7	43.9
2010	95	71.4	109.6	61.5
2009	90	85.7	103.6	79.5

Source: HAMAG BICRO raw data
** Preliminary data*

64. As evidenced by data above in the reference period 7 of each 10 businesses benefitting from HAMAG BICRO guarantees are micro firms. They make up 53.6% of the total guarantee portfolio amount. Consequently, both numbers and amounts of guarantees issued reveal HAMAG BICRO's micro enterprise focus.

65. The average guarantee amount for micro firms stands at HRK 914,860 (approx. €121,980) and the most popular guarantee product among micro firms is that supporting start-ups followed by agricultural businesses. More detailed information on the share of various guarantees in the total number of guarantees issued is provided in the figure below.

Figure 2: Share of various guarantee products for micro firms in total number of guarantees extended in 2009-2013

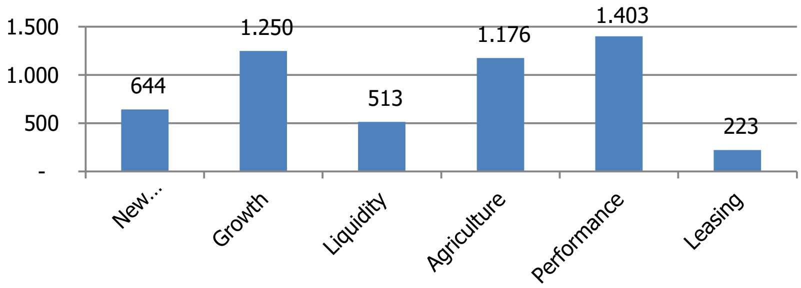


Source: Own elaboration based on HAMAG BICRO raw data

66. Performance and leasing guarantees were only introduced as new guarantee products in 2012 and account for meagre 2% of the total number of guarantees issued.

67. Performance guarantees are the most sizeable individual product with HRK 1.4 million average guarantee amount while leasing guarantees come with the lowest average amount of HRK 0.22 million (chart below).

Figure 3: Average guarantee amount in micro enterprise sector in 2009-2013 in HRK '000

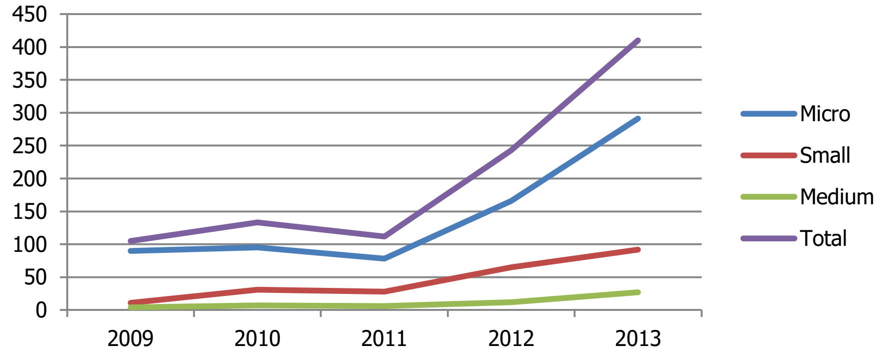


Source: Own calculation based on HAMAG BICRO raw data

68. The introduction of new guarantee products by HAMAG BICRO followed needs assessment and thus can be viewed as evidence-based. There are however concerns of the economy of scale as these new products will yet have to prove to be able to work on a larger scale.

69. Over years the dynamics in HAMAG BICRO guarantee performance are positive except for the year 2012 - due to the economic crisis coupled with the organisational and legal transformation from the Croatian Agency for SMEs into the Croatian Agency for SMEs and Investments.

Figure 4: Number of guarantees extended to SMEs in the years 2009-2013

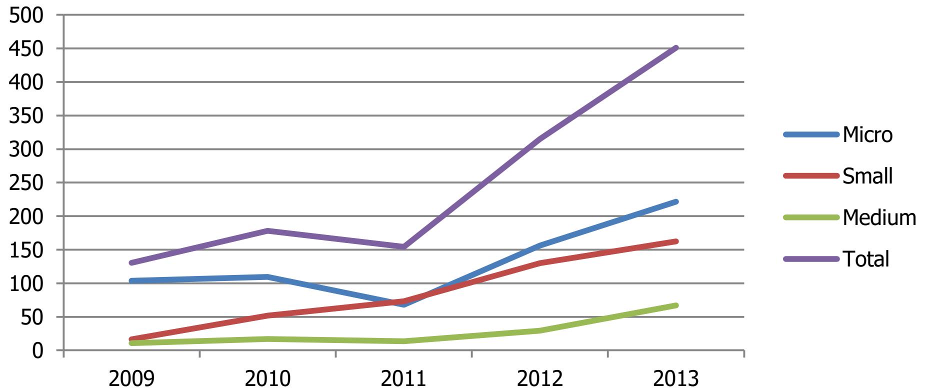


Source: Own elaboration based on raw data from HAMAG BICRO

70. The year 2012 marks significant growth in the number of guarantees issued, which was primarily caused by the introduction of first call guarantees (up till 2011 guarantees were conditional).[22]Consequently, in the years 2009-2013 the number of guarantees almost quadrupled from 105 to 410, with the increase in the number of guarantees for small businesses by 8.4 times, for medium businesses - increase by 6.7 times and for micro firms - increase by 3.2 times.

71. The trends in the volume of guarantees followed those in regard to the number of guarantee issued (figure below).

Figure 5: Amount of loan guarantees extended to SMEs in 2009-2013, in HRK million



Source: Own elaboration based on raw data from HAMAG BICRO

72. New guarantee business volume worth HRK 315 million in 2012 is an equivalent of 0.0545% of GDP. This puts Croatia on pair with Spain (0.092%) where guarantee organisations have much longer track record and organised as mutual guarantee associations.[23]

73. Croatian guarantees are significantly more sizeable than guarantee products across AECM members: the average guarantee amount granted to a Croatian SME (approx. €163,343) is more than 4 times higher than the average across AECM members (€39,350). To large extent this occurrence is attributable to the centralisation of the scheme, similarly to guarantee programmes offered by the Czech-Moravian Guarantee and Development Bank, Romanian Rural Credit Guarantee Fund or subsidiaries of the Hungarian Foundation for Enterprise Promotion (range of €130,000 - 180,000) while on the other end there are sectoral or regional Italian, French, Spanish or Polish guarantee organisations extending guarantee products between €15,000 to 50,000 on average. That means that guarantee support provided by national

[22]Some provisos of conditional guarantee contracts are reported to have been disputed by participating banks hence the shift towards first call guarantees

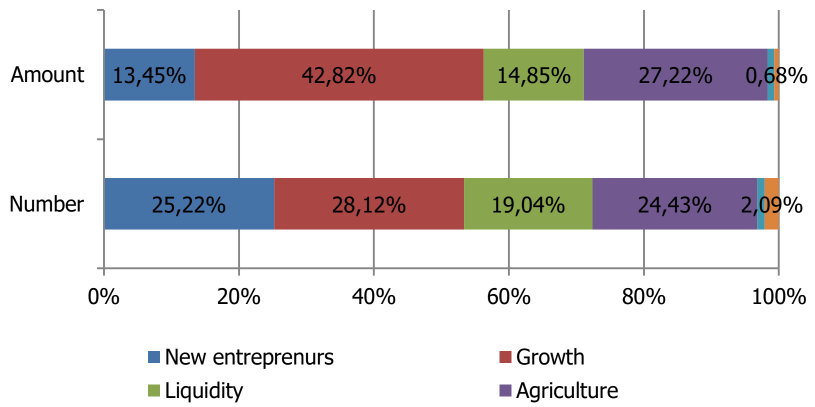
[23]Source: own calculation based on row data from HAMAG BICRO, HNB and AECM (2012)

guarantee programmes (including Croatia) goes to larger undertakings than support provided under regional guarantee schemes.

74. On average HAMAG BICRO guarantee covers 56% of the loan principal; there are however variations between various guarantee products: guarantee for new entrepreneurs covers 76% of the initial loan amount while guarantee for growth - approx. 50%.

75. Judging by the number of guarantees issued products supporting business growth, start-ups and agricultural sector are almost equally popular. In terms of portfolio amount structure business growth and agriculture make up a vast majority of the total HAMAG-BICRO portfolio amount (figure below).

Figure 6: Share of various guarantee products in total portfolio of HAMAG BICRO by total amount; average for 2009-2013



Source: Own elaboration based on raw HAMAG BICRO data

76. In 2012-2013 HAMAG BICRO backed loans made with HBOR re-financing and this guarantee activity represents 27% of the Agency's portfolio.

77. HAMAG BICRO's guarantees are virtually backed by indeterminate state budget provisioning arrangements against writ-offs. Supplementary, this practice is not supported by approximation of non-performing portfolio and probability of default based on VaR or any other statistical method. Consequently, all claims against HAMAG guarantees are paid from state budget provisions and not from the Agency's resources. These shall be considered to be a major flaw in the way how HAMAG has been mandated to fulfil its mission.

78. Guarantees were also offered on limited scale by Regional Development Agencies that benefitted from national programmes aimed at the promotion of local and regional socio-economic development. The main objective of the establishment of RDAs was to initiate a special purpose vehicle to animate entrepreneurship and growth on county level and impart ownership of local development into local self-government units and county authorities. The RDA support programme (that time) was run by the Ministry of Economy, Labour and Entrepreneurship and included the establishment of revolving funds in selected RDAs. In the period 2008-2012 the programme resulted in the extension by 8 RDAs of 179 guarantees to the tune of HRK 21.1 million. The average guarantee amount was HRK 117.8 (approx. €15,800). 101 (56% of all loan guarantees) were granted by the Istria Regional Development Agency and two other RDAs (Zagorska and Sibensko-kninska) extended 45 guarantees. It is thus noted that the overall scale of RDA guarantee operations has been insignificant and not reaching economy of scale.

79. There were no essential guidelines, standards or recognised code of good practice for RDA guarantee operations that would include e.g. provisioning policies, liquidity management, bank reporting, risk concentration and exposure, leveraging, etc. The MEC terminated supporting RDAs in regard to guarantee facilities but the Ministry of Economy continues with assistance to RDAs. Its size and consistency are of insignificant levels.

Self-employment measures

80. In the times of economic decline and continuous deterioration of employment opportunities, support towards self-employment and associated ALMPs appears to be one of the key socio-economic policy measures.

81. The HAMAG BICRO pilot micro loan scheme of 2013 contributed to financing of 7 projects submitted by unemployed persons. 5 other applications were declined due to the shortage of funding. Beyond that there is no experience in Croatia of supporting self-employment of jobless individuals through financial instruments.

82. In 2011 the Croatian Employment Service (HZZ) introduced self-employment subsidies. In the period 2011-June 2014 HZZ financed 7,438 unemployed persons to the tune of HRK 180.4 million. The average subsidy amount was HRK 24,240 (approx. €3,231) and is considered to be low for sustainability purpose. Females account for 40.1% of all self-employment subsidy contracts and youth - for 27.8%.[24]

Table 3: Number and amount of self-employment subsidies in 2011-2014

Item	2011	2012	2013	2014 (June)
Number of recipients	772	928	4,906	832
Amount of subsidies	22,731,813	19,088,864	117,823,727	20,657,581

Source: HZZ raw data

83. The dynamics observed in the period 2011-2014 are somewhat stable except for the year 2013, which marks the peak in the overall performance. This was caused by single contribution of EU-funded IPA programme to the self-employment subsidy scheme run by HZZ. In other periods the scheme was financed entirely from Croatian national budget only.

84. In 2013 IPA financing helped increase the total level of self-employment subsidies by 6 times when compared to 2012. Consequently, the density of self-employment subsidy contracts per 1,000 unemployed grew from 2.9 in 2012 to 14.2 in 2013.[25]

85. Decision on granting self-employment subsidy is made by HZZ-certified entrepreneurship counsellor during short interview with the unemployed applicant. During the interview a HZZ counsellor investigates the applicant's business idea, skills and capacities to register and run economic activity. The appraisal process is short, lasting usually approx. half an hour[26] and in independent view is insufficient to select individuals with or with likely business acumen and aware of all economic opportunities.

86. HZZ does not verify sustainability of the jobs created or survival rates of the businesses registered through the scheme. The Agency however pursues eligibility and compliance criteria regarding expenditure incurred by subsidised project owners. To this effect inspections and controls are exercised over period of 12 months from the subsidy contract date. These evidence that 78.7% of all the subsidised projects meet compliance criteria, i.e. are executed in accordance with the individual project objectives and expenditure list approved for financing. Consequently, 21.3% of subsidy beneficiary are not compliant with their contractual obligations, which is considered to be relatively high and raises concerns of insufficient follow-up support to the beneficiaries.

87. Geographical distribution of subsidy contracts (table below) is strongly correlated with the population number: the computed Spearman rank correlation coefficient (*P*) for Croatia's counties is 0.88. At the same time territorial distribution of self-employment subsidies reveals meagre correlation with the number of unemployed persons. The computed (*P*) for Croatia's counties for this ratio is only 0.03 for 2013 and 0.11 for 2012, which can be interpreted as random association.[27]

Table 4: Number of subsidies per county in 2011-2014 and share of each county in the total subsidies extended

Breakdown of recipients per county	2011	2012	2013	2014	TOTAL	Share
BJELOVAR-BILOGORA	23	28	125	18	194	2.6%
BROD-POSAVSKA	18	31	118	26	193	2.6%
DUBROVNIK-NERETVA	28	30	203	64	325	4.4%
CITY OF ZAGREB	136	160	872	65	1,233	16.6%
ISTRIA	18	32	208	64	322	4.3%
KARLOVAC	17	17	109	12	155	2.1%

[24]Source: HZZ raw data handed to ex-ante assessment

[25]Calculated as the number of subsidy contracts to the total annualised number of registered unemployed persons in the respective year: in 2012 there were 324,324 unemployed persons and in 2013 this number increased to 345,112 (HZZ Yearbook 2013, p. 18)

[26]Source: information received during individual semi-structured interview with HZZ services

[27] The coefficient value ranges between +1 and -1 and describes monotonic relationship between two variables; population data per county were taken from the 2013 Statistical Yearbook for Croatia, p. 126

KOPRIVNICA-KRIŽEVCI	6	17	75	23	121	1.6%
KRAPINA-ZAGORJE	26	31	175	41	273	3.7%
LIKA-SENJ	5	2	36	6	49	0.7%
MEĐIMURJE	25	18	176	49	268	3.6%
OSIJEK-BARANJA	120	124	654	129	1,027	13.8%
POŽEGA-SLAVONIJA	11	10	57	9	87	1.2%
PRIMORJE-GORSKI KOTAR	78	87	471	33	669	9.0%
SISAK-MOSLAVINA	28	38	185	53	304	4.1%
SPLIT-DALMATIA	43	69	460	91	663	8.9%
ŠIBENIK-KNIN	24	24	79	11	138	1.9%
VARAŽDIN	22	41	169	26	258	3.5%
VIROVITICA-PODRAVINA	52	40	138	25	255	3.4%
VUKOVAR-SRIJEM	42	64	213	30	349	4.7%
ZADAR	23	20	98	5	146	2.0%
ZAGREB COUNTY	27	45	290	47	409	5.5%
TOTAL*	**772**	**928**	**4,911**	**827**	**7,438**	**100.0%**

Source: HZZ raw data
** Comments: total number for 2013 and 2014 differs from data in Table 3 due to the actual signature date of 5 subsidy contracts entered on GIS data base*

88. Counties with registered unemployment rate higher than Croatia's average of 19.3% (December 2013) account for 71% of all unemployed and for 56.7% of the total number of self-employment subsidies.

Table 5: Number of unemployed per county and density of subsidy contracts per 1,000 unemployed in 2012-2013

Breakdown of recipients per county	Unemployed 2013	Density 2013	Unemployed 2012	Density 2012
BJELOVAR-BILOGORA	12,698	9.84	12,027	2.33
BROD-POSAVSKA	17,912	6.59	17,197	1.80
DUBROVNIK-NERETVA	8,025	25.30	7,579	3.96
CITY OF ZAGREB	45,916	18.99	41,994	3.81
ISTRIA	9,071	22.93	8,185	3.91
KARLOVAC	11,478	9.50	11,331	1.50
KOPRIVNICA-KRIŽEVCI	9,083	8.26	8,156	2.08
KRAPINA-ZAGORJE	8,548	20.47	8,214	3.77
LIKA-SENJ	3,439	10.47	3,200	0.63
MEĐIMURJE	7,923	22.21	7,528	2.39
OSIJEK-BARANJA	36,627	17.86	34,438	3.60
POŽEGA-SLAVONIJA	6,953	8.20	6,435	1.55
PRIMORJE-GORSKI KOTAR	19,321	24.38	18,453	4.71
SISAK-MOSLAVINA	20,444	9.05	19,739	1.93
SPLIT-DALMATIA	45,893	10.02	43,523	1.59
ŠIBENIK-KNIN	8,129	9.72	7,827	3.07
VARAŽDIN	11,035	15.31	10,447	3.92
VIROVITICA-PODRAVINA	10,470	13.18	10,180	3.93
VUKOVAR-SRIJEM	21,404	9.95	19,768	3.24
ZADAR	11,160	8.78	10,700	1.87
ZAGREB COUNTY	19,583	14.81	17,403	2.59
TOTAL/AVERAGE	**345,112**	**14.23**	**324,324**	**2.86**

Source: own calculation based on HZZ Yearbook 2013, p. 18 and raw HZZ data

89. IPA financing towards self-employment subsidies boosted in 2013 the number and the density of beneficiaries per 1,000 unemployed but at the same time triggered more inequalities in the distribution of those subsidies. This is best illustrated by:

a. Computing standard deviation (σ) from the average density value on the entire population: in 2012 σ=1.08 and in 2013 σ=6.36;

b. Comparing the total increase of the subsidies density per 1,000 unemployed for Croatia (397%) to the change of the index value for specific counties, i.e.: the county with the highest increase of the index was SisaK-Moslavina county with 1,575% growth, followed by Međimurje (829%) and Dubrovnik-Neretva (539%) while the most underperforming counties were: Šibenik-Knin (growth by 217%), Virovitica-Podravina (235%) and Brod-Posavina (265%). It should be noted that the latter two counties are also among five NUTS-3 territories with the highest unemployment rates in the country: registered unemployment rate in Brod-Posavina in 2013 was 33.9% and in Virovitica-Podravina the index was 34.3%.

Social enterprises

90. Social entrepreneurship is not fully recognised by the laws of the Republic of Croatia and social enterprises can operate either as cooperatives, for-profit entities or are run by NGOs. This causes limitations to their performance and possible support in the context of unjustified market privilege due to the lack of public benefit recognition. Each legal form of an economic undertaking and its activities in the sector of social entrepreneurship is regulated by a special law or a set of laws. In 2011-2013 some laws were amended, including for associations, foundations, companies, rehabilitation and employment of persons with disabilities, public procurement and cooperatives. Social cooperatives are individually recognised and privileged. Excluding legal entity forms other than a cooperative the Croatian legal environment prevents disadvantaged target groups from their exploitation by insincere project drivers (through taking majority stake) yet at the same time limits genuine partnership formation between communities themselves and NGOs.

91. Of 1,198 cooperatives reporting to FINA there are only approximately 70-100 genuine social enterprises. The bulk of cooperatives are well-established legal entities primarily employing people with disabilities but almost half of all cooperatives do not employ a single individual.[28]

92. In 1998 the Croatian government established Office for Cooperation with NGOs with an attempt to create more enabling conditions for cooperation and partnership with non-governmental, non-profit sector, especially with associations. In 2009 the Council for Civil Society Development was set up as an advisory body to the Government of the Republic of Croatia acting towards developing cooperation between the Government with the civil society organisations in the implementation of the National Strategy for Creating an Enabling Environment for Civil Society Development, the development of philanthropy, social capital, partnership relations and cross sector cooperation.

93. The main institution financially supporting civil society organisations and social enterprises is the Foundation for Civil Society Development. It is a government-owned entity founded in 2006 supporting NGOs, civil society, media campaigns, human rights, schools, etc. Up until 2013 its main source of income derived from national lottery and gambling revenue. The Foundation annual reports reveal investing between HRK 25-30 million per annum in its support programmes. The bulk of grant support was directed to Community Support Organisations for projects aimed at their stabilisation and development, approx. HRK 15 million annually.[29]In 2012 limited funding was granted only to promote best social innovation projects.

94. There has been limited or virtually no investment support to social enterprises through offering start-up or endowment capital from domestic resources. Some sectoral interventions, e.g. managed by the Ministry of Tourism addressing rural tourism, can be regarded as support to rural initiatives having a social goal. In 2014 the Ministry of Tourism supported 83 projects to the tune of HRK 3.68 million.

95. Within the IPA OP Human Resources Development 2007-2013, there were 9 projects, which to some degree financed social entrepreneurship activities albeit the broader intervention focused on employment, employability and social welfare.[30] Support to social entrepreneurship was also facilitated by various IPA CBC Programmes 2007-2013, in which Croatia participated, both bilateral cross-border programmes and IPA Adriatic CBC.

[28]Source: data on the number of cooperatives comes from the Croatian SME Observatory 2013 while estimate on the share of genuine social enterprises in the total number of cooperatives comes from CEDRA (individual semi-structured interview) and FINA
[29]Source: own elaboration based on Foundation's Annual Reports 2010-2012
[30] Ivankovic Knezevic K., Milicevic F., Sesar I., Leonhardt Brlek P., *Host Country Report: Peer Review on Social Entrepreneurship*, Ministry of Labour and Pension System, Zagreb, 2013

96. Since 2014 grant and subsidy facilities are offered from the ESF HRD Operational Programme 2007-2013 but there is no specific intervention dedicated to finance social innovation or social enterprises. The scope of assistance contemplated in the previous sentence now targets institutions and not final recipients. It is thus supply-driven and unfocused as objectives of the intervention seek to: 1) enhance the capacity of NGOs to provide social services and strengthen partnerships and cooperation with civil society stakeholders in the field of social services (OP code HR.5.2.04 with EU co-financing of €17.2 million) and 2) strengthen the capacity of civil society organisations active in the local communities to obtain public funding for the implementation of solutions tailored to local problems and to strengthen their capacity to directly work in areas relevant to the ESF (HR.5.2.05 with EU co-financing of €7.6 million).

97. Arguably, the main driver of social entrepreneurship concept in the country is SLAP - the Association of Creative Development in Osijek, which set up an informal network, the Forum of Social Enterprise (SEFOR). In 2011 this bottom-up initiative was financed through IPA EU-funded Programme to the tune of €120,100 and yielded in bringing together approx. 80 organisations and providing education, research and business counselling for the implementation of social employment projects with individual enterprises and self-employed individuals. The project also resulted in the establishment of the Cluster for Eco-Social Innovation and Development (CEDRA).

98. CEDRA currently runs 5 outreach offices in Osijek, Cakovec, Rijeka, Split and Dubrovnik and supports rural communities, farmers and cooperatives through the provision of advice, training and mentoring. These activities are also aimed at fundraising for various micro and larger projects. Funding is mobilised from commercial banking sector and from development finance institutions abroad.[31]In total circa 45 experts work for CEDRA across the country and with regional partners in the Balkans.

99. The Ministry of Labour and Pension System works with the civil society organisations to design support measures for social entrepreneurship and the elaboration of the National Strategy for the Development of Social Entrepreneurship. The draft Strategy defines social enterprise as "business venture that is based on the principles of socially, environmentally and economically sustainable business that invests profit/surplus completely or partly for the benefit of the community." Civil society organisations participated in the Strategy development, including their contribution during Working Group meetings.

100. The draft Strategy sets four strategic objectives: 1) development of legal and institutional framework for the development of social enterprise, 2) support to efficient access to fiancé framework, 3) promotion and development of social enterprise capacity through education and training, both formal and informal, 4) visibility and promotion. Research and monitoring are considered to be horizontal and cross-cutting strategic issues.

101. The adoption of the Strategy has to be augmented by appropriate changes to the laws in order to enable various types of legal entities to be recognised as fully-fledged economic undertakings (e.g. NGOs running economic activity) and allow economic undertakings to be run on not-for-profit basis (e.g. limited liability companies). The laws and working definitions underlying future social entrepreneurship interventions should recognise nine key features or dimension of social enterprise:[32]

Economic dimension	A continuous activity producing goods and/or selling services	Social enterprises, unlike the traditional non-profit organisations, are normally not engaged in advocacy activities as a major goal or in the redistribution of financial flows (as, for example, grant-giving foundations), but they are directly involved in the production of goods or the provision of services to people on a continuous basis. The provision of such goods or services represents, therefore, the reason, or one of the main reasons, for the existence of social enterprises.
	A high degree of autonomy	Social enterprises are voluntarily created by a group of people and are governed by them in the framework of an autonomous project. Accordingly, they may depend on public subsidies but they are not managed, directly or indirectly, by public authorities or other organisations (federations, private firms, etc.) and they have both the right of "voice and exit" (the right to take up their own position as well as to terminate their activity).
	A significant level of economic risk	Those who establish a social enterprise assume totally or partly the risk of the initiative. Unlike most public institutions,

[31]Source: based on individual semi-structured interview with CEDRA

[32]Borzaga, C., J. Defourny, *The Emergence of Social Enterprise*, London, New York, 2001

		their financial viability depends on the efforts of their members and workers to secure adequate resources.
	A minimum amount of paid work	As in the case of most traditional non-profit associations, social enterprises may also combine monetary and non-monetary resources, voluntary and paid workers. However, the activity carried out in social enterprises requires a minimum level of paid workers.
Social dimension	An explicit aim to benefit the community	One of the principal aims of social enterprises is to serve the community or a specific group of people. To the same end, a feature of social enterprises is their desire to promote a sense of social responsibility at local level.
	An initiative launched by a group of citizens	Social enterprises are the result of collective dynamics involving people belonging to a community or to a group that shares a certain need or aim and they must maintain such a dimension in one way or another.
	A decision-making power not based on capital ownership	This generally means the principle of "one member, one vote" or at least a voting power not distributed according to capital shares on the governing body which has the ultimate decision-making rights. The owners of the capital are obviously important (although not all social enterprises have equity capital) but the decision-making rights are shared with the other stakeholders.
	A participatory nature, which involves the persons affected by the activity	Representation and participation of customers, stakeholder orientation and a democratic management style are important characteristics of social enterprises. In many cases, one of the aims of social enterprises is to further democracy at local level through economic activity.
	Limited profit distribution	Social enterprises not only include organisations that are characterised by a total non-distribution constraint, but also organisations like co-operatives in some countries, which may distribute profits only to a limited extent, thus avoiding a profit-maximising behaviour.

102. Limited experience to-date in Croatia and more comprehensive experience of other member States in supporting social enterprise clearly demonstrate that social entrepreneurship can be supported both, through grants and financial instruments. Yet, typology of instruments to be used in an efficient manner depends on the type of project supported and required capital inputs. Some social undertaking projects experience financing gap similar to that computed during Cost Benefit Analysis process and thus require grant funding while others can yield acceptable levels of profitability to become viable for FEI's.

103. Non-entrepreneurial attitude, insufficient management skills and access to markets issues appear to be the key areas affecting sustainability of social enterprises, especially in new EU Member States. These interventions must be financed through grants or external technical assistance programmes.[33]

Private Equity and Venture Capital

104. Having experienced turmoil of domestic capital market in 2008 the Croatian government unveiled in 2010 an initiative to revive investor confidence in venture capital and private equity markets, launching Economic Cooperation Funds project. The underlying assumption of the public intervention worth HRK 1 billion was pari passu co-investment into PE/VC vehicles that would subsequently invest in companies to create jobs, strengthen existing business and start-ups. On strategic level the initiative aimed at the positioning of Croatia as a PE/VC hub in South East Europe. The initiative resulted in the establishment of 5 FGS's (Fondovi za Gospodarsku Suradnju) totalling HRK 2 billion. The smallest fund managed to raise HRK 155 million and the largest one - HRK 600 million. These funds are, namely:

   a. Alternative Private Equity FGS/Nexus FGS II;
   b. Honestas FGS;
   c. Nexus FGS;
   d. Prosperous FGS;
   e. Qauestus Private Equity Kapital II.

[33] Source: own elaboration based on various materials by Coffey International Development - Specialists in Developing Communities and NESsT

105. In the period 2011 - February 28th 2015 HRK 946.3 million (representing 52.57% of the target funds capitalisation) was invested by five funds in 25 undertakings. The average amount per investment is HRK 37 million (approx. €4.98 million) while the smallest single investment is HRK 10 million and the largest is HRK 143,55 million. The most aggressive fund committed 82.92% of its target capital while the lowest commitment level among all Economic Cooperation Funds was at 29.46%. The table below outlines key characteristics of the FGS's performance.

Table 6: Key data on FGSs and their performance in 2011-February 28. 2015

Name of Fund	Committed capital (HRK)	Invested capital (HRK)	% of committed value
Alternative PE FGS/Nexus PE II FGS	600.000.000,00	176.784.240,14	29.46
Honestas FGS	155.000.000,00	65.144.185,10	42.03
Nexus FGS	380.000.000,00	265.769.491,58	69.94
Prosperous FGS	340.000.000,00	169.042.082,84	49.72
Quaestus FGS	325.000.000,00	269.497.552,08	82.92
TOTAL	**1.800.000.000,00**	**946.237.551,74**	**52.57**

Source: Ministry of Entrepreneurship and Crafts/HBOR

106. Given the median equity investment amount per company (€4.27 million) Croatian FGSs on average invest in larger undertakings than PE/VC companies in selected new EU Member States.

Table 7: Key data on performance of PE/VC funds in selected European countries

Country	Number of investee companies	Amount invested (€ '000)	Average investment (€ '000)	No. of PE/VC companies
Austria	129	115,399	895	129
Baltics	56	21,032	375	56
Czech R.	5	16,607	3,321	5
Hungary	43	102,810	2,391	43
Bulgaria	3	65,085	2,169	3
Other CEEs	17	138,005	8,117	12
Poland	71	544,004	7,662	71
Europe	**4,975**	**36,459,491**	**7,328**	**5,153**

Remark: Item "Other CEEs" include all ex-Yugoslavia and Slovakia
Source: own calculation based on EVCA Yearbook 2013

107. Since the FGS initiative is in the early roll-out phase a detailed and comprehensive review can be performed at this juncture except for a broader reflection on the system. In general, the Economic Cooperation Funds managed to attract pension funds and participation of other financial institutions as strategic investors. On average the significance of the impact at the level of their contribution to addressing SME access to equity finance gaps can be considered to have remained at low levels despite three investments in start-ups. According to the European Business Angels Network this gap considers financing in range between €0.5-3 million, depending on the country. Indeed, small and medium sized enterprises are not the primary target group for the FGSs. They are considered to be private equity vehicles investing in established mature companies in growth and expansion phase and not venture capital operators.

108. The other two existing VC funds in Croatia made only 5 investments in the period 2011-2013.[34]

109. There are preparatory works on the design of an equity guarantee facility to stimulate business angel investors. This will be the first Croatia's measure ever to support business angel movement however no details are available due to very early stage of this intervention concept.

110. The equity guarantee facility for angel investors to be financed from domestic funds is considered to work as a pilot programme but is not supported by specific needs assessment or a thorough review of the business angel movement in Croatia. Elsewhere in Europe evidence of the effectiveness of public support to business angel networks and associations is mixed: while tax incentives appear to be highly effective in the UK and have promising outlook in Spain or Italy, they were abolished in the Netherlands and Sweden. Similarly, equity guarantees for angel investors were abolished in Belgium and the Netherlands when evaluation studies showed that the schemes did not yield in good value for money or the

[34]Source: EVCA

deals applying to the scheme would have been closed without the guarantee support.[35] The ultimate efficiency and effectiveness of support instruments and measures depend on the type of angel investor[36], efficiency of their network and the scale of their operations.

111. To-date experience and performance of business angels demonstrate fairly limited co-operation with existing business support organisations and R&D infrastructure. Their enhanced cooperation could arguably improve financing of prospective ventures and undertakings.

112. The Croatian government is currently negotiating funding arrangements with the World Bank. A €20 million loan intends to finance a VC fund, seed co-investment facility and technical assistance. The support seeks to leverage private funding for the VC fund resulting in the establishment of VC vehicle with target value of €25 million.

Support to R&D

113. Before merging in May 2014 with HAMAG INVEST the Business Innovation Croatian Agency BICRO was the main hub for provision of research and development support programmes to technology and knowledge-based SMEs. One of them was Razum that aimed to provide financing to start-ups and established SMEs undertaking applied research leading to the introduction of new or improved products or services. Eligible projects were those in the pre-commercialisation phase and financing was offered in the form of conditional grants, also known as repayable advances. Other support programmes included: Proof of Concept, IRCRO - Research and Development Programme for collaborative R&D between domestic SMEs and R&D organisations and EUREKA - being similar to IRCRO but focusing on R&D collaboration with partners from other EUREKA participating countries.

Table 8: Spending on RDI projects in 2009-2013 (in HRK '000)

Year/Programme	PoC	IRCRO	EUREKA	Razum	Total*
2009	0	6,351	0	25,992	**32,343**
2010	3,456	3,869	5,418	19,781	**32,523**
2011	8,983	2,109	2,485	0	**13,577**
2012	10,234	1,800	1,761	11,322	**25,117**
2013	13,049	0	0	0	**13,049**
TOTAL*	**35,722**	**14,129**	**9,664**	**57,095**	**90,618**

Source: HAMAG BICRO
** The actual 'total' amount may differ due to approximation*

114. Facilities previously offered by BICRO were financed from domestic funds by the Ministry of Science, Education and Sport, IPA and the World Bank but funding was not available on permanent basis hence periods of inactivity in three of four programmes.

115. HBOR runs a lending programme for innovators. Eligible entities are SMEs and crafts that have a positive decision by HAMAG BICRO, have a developed product (attested prototype) and/or technology and that satisfy at least one of the three following conditions: have a patent application in Croatia and/or abroad; that have started an industrial rights property procedure in Croatia and/or abroad; or operate at least 2 years with proven expenditure on R&D. To-date 20 projects to the tune of €18.4 million were financed.

116. Volatility of funding sources for R&D programmes and fragmented project tracking systems contribute to variegated results of the support offered and make it difficult or impossible to review sustainability of support from R&D/proof of concept phase to commercialisation phase.

117. There shall be an established reference ratio between expenditure earmarked for R&D projects and targeted volume of investments. Satisfactory performance index is around 1:2 and very satisfactory when reaching 1:3, meaning that 1 unit invested in RDI works translates into 2 or 3 units of the ultimate investments made in economy.[37]

[35]Based on *Evaluation of Member States' Business Angel Markets and Policies Final Report*, Centre for Strategy and Evaluation Services for the European Commission, 2012
[36]CORDIS distinguishes between: entrepreneur angel, corporate angel, income seeking angel, wealth maximising angels, latent angel and virgin angel. They all have different interests and objectives.
[37] Based on exchange of views with selected Managing Authorities during 2014-2020 programming activities and qualitative research methods used during ex-ante assessment development process

Related experience of other EU countries

118. In this section the main focus concerns financial instruments performance and best practice observed in EU Member States. Since the meaning of 'best practice' can be viewed in various contexts and perspectives, for the purpose of this ex-ante assessment document best practice is viewed as "planning of operational practices that have proven successful in particular circumstances and which are used to demonstrate what works and what does not and to accumulate and apply knowledge about how and why they work in different situations and contexts" (adapted from the UN, UNFPA). The selection of countries for the presentation of 'best practice' aims at outlining key elements of systems and institutional arrangements existing elsewhere, which can be further considered as a concepts as to how to further enhance development finance environment in Croatia.

119. For many years EU policy guidelines recommended the use of returnable forms of support and financial engineering instruments have been extensively supported through decentralised management modalities and, since the establishment of the EIF in 1994, also through horizontal measures and subsequent centrally managed initiatives. EU Members States have used various strategies to support FEIs for small and medium sized enterprises. Existing financial instruments schemes include public, semi-public, private, public-private vehicles and institutions, operating on national, regional and/or local level or having sectoral character.

120. Financial instruments are one of a few forms to deliver on policy objectives concerning SME competitiveness. As currently the most of FEIs (perhaps except for non-subsidised lending schemes) include state aid elements the breakdown of state aid forms best illustrates strategic approaches to supporting economies.

Table 9: Typology and diversity of state aid used by selected EU Member States

Country	Grants	Tax rebates	Equity	Soft loans	Guarantees
EU-27	52.0%	41.6%	1.1%	3.2%	2.1%
Germany	47.0%	50.0%	0.2%	2.1%	0.6%
France	36.8%	60.0%	0.1%	2.9%	0.2%
Italy	78.9%	13.7%	0.3%	6.8%	0.3%
Netherlands	78.8%	18.7%	1.5%	0.1%	0.9%
Austria	79.4%	3.2%	0.0%	3.0%	14.3%
Poland	70.9%	24.6%	2.8%	1.5%	0.1%
Sweden	18.1%	81.7%	0.1%	0.2%	0.0%
UK	42.8%	44.6%	11.7%	1.0%	0.0%

Source: DG Competition and EFTA Surveillance Authority, 2012

121. Countries where state aid-driven interventions are most prevalent in relation to GDP are: Malta (state aid accounts for 1.43% of GDP), Portugal (1.02% of GDP), Greece (1.01% of GDP), Slovenia (0.91% of GDP), Hungary (0.86% of GDP), Czech Republic (0.73% of GDP), Sweden (0.72% of GDP) and Poland (0.58% of GDP) while the EU-27 average is 0.42% of GDP.[38]

122. 2007-2013 programming period brought significant funding towards financial engineering instruments (FEI's). Initiatives JEREMIE and JESSICA augmented by further operations and activities identified in Operational Programmes contributed to the establishment of 940 FEI's of which 70 acted as holding funds, or funds of funds. By end of 2012 €17.5 billion was committed to various FEIs. The largest contributors were: Italy, Poland, Greece, the UK and Germany, all accounting for circa 67% of the total amount allocated to financial instruments.[39]

123. At the end of 2012 a total of 816 specific funds for enterprises offering all types of financial products (namely: loans, guarantees, equity/venture capital and other products like interest rate subsidies, guarantee fee subsidies, interest rate rebates and equivalent measures) were set up in 25 Member States. Funds for enterprises implemented under a holding fund constitute the majority (i.e. 445 funds) of specific funds for enterprises. The remaining 371 specific funds were implemented without a holding fund structure. There were significant differences among Member States as regards geographical coverage, total number, type and size of specific funds for enterprises, and their implementation pace:

[38] State Aid Scoreboard for 2011, EFTA Surveillance Authority, March 2013

[39] Source: *Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds Programming period2007-2013*, European Commission, September 2013

a. 15 Member States reported 445 specific funds implemented under national and regional holding funds;

b. In 9 Member States (AT, BE, CZ, DE, DK, EE, FI, NL and SE) all specific funds for enterprises have been set-up as independent legal entities without a holding fund;

c. In 11 Member States (EL, ES, FR, HU, IT, LT, LV, PL, PT, SI, UK) specific funds were implemented with both modes of implementation i.e. with holding fund and without holding fund;

d. Almost all holding funds (except JEREMIE HF in Slovakia) set up to implement specific funds for enterprises were operational, namely they selected financial intermediaries) and made contributions to specific funds;

e. According to the data reported to the Commission, 10 holding funds in 9 Member States were managed by the EIF, thus 38 remaining holding funds were managed by national financial institutions and bodies selected either through public procurement procedure or through direct entrustment modality;

f. Out of 816 specific funds, 29 were set-up under ESF operational programmes in 7 Member States (DE, DK, EE, IT, LT, LV and PL). Those specific funds (mostly offering loans) have been established progressively as from 2008, with 18 funds set-up in 2011-2012;

g. Implementation progress-wise, countries that had not chosen holding fund (or fund of funds) option succeeded to implement FEI's much faster than countries with holding fund structures;

h. High number of specific funds in some countries may raise concerns about their sustainability, economies of scale and critical mass. On the other hand however, there are issues pertaining utility of larger funds and their accessibility by smallest undertakings, which are most frequently underserved and experience exclusion from the mainstream financial services and products.

124. Lending facilities dominated the market (351 funds). There were 128 guarantee funds established, 124 VC funds, 96 mixed funds and 119 funds on which no specific information was provided to the Commission.

125. Horizontal issues compromising effectiveness and efficiency of the FEI's implementation as identified by the European Court of Auditors are: low capacity of Managing Authorities to manage financial instruments programmes and projects, poor implementation guidance in Operational Programme document, relatively low leverage effect except for some guarantee schemes, delays caused by procurement modalities, possible overlaps with other forms of support and sub-critical mass of the funds created.[40]

126. Selected country best practice cases are provided overleaf.

Country	Key features of development finance best practice
Sweden	There are 12 regional VC funds in the country managed by public sector agencies and they cover the entire country. The funds are run in the form of PROJECTS financed from ERDF and co-financed by the regions. These projects are time-bound. All 12 funds are managed by 5 different project owners. Each fund is allowed to invest in its own region only. Of €264 million, 73 million originate from the ERDF and the balance is equally distributed between public and private sector institutions. The Swedish intervention in the VC market is a direct response to the economic crisis of 2008-2010 and subsequent decline of capital markets: while in 2007 66 funds were able to raise funding the year 2008 brought new funding to 24 vehicles only and subsequent 5-6 times decline in the amount of new funds committed to VC industry. Regional funds are amalgamated by interventions of Norrlandsfonden which operates in five northernmost counties with the lowest population density. This fund offers variety

[40]Based on: *Financial Instruments for SMEs co-financed by the European Regional Development Fund*, Special Report No 2/2012, European Court of Auditors, 2012

	of instruments, including equity, flexible soft loans, convertible bonds and guarantees. The fund has approx. €120 million under management. The institutional set up of development finance in Sweden is considered to be a smart blend of nation-wide instruments and regional sensitivity targeting disadvantaged areas.
Hungary	Hungary has one of the lowest levels of concentration of assets of the banking sector. In 2013 the five largest banks accounted for 51.2% of the total assets of Hungary's banking sector. Development finance institutions in Hungary exist since early 1990's with Hitelgaranzia - Garantiqa Creditguarantee Co. Ltd. (Garantiqa) being one of the first loan guarantee organisations established in Central and Eastern Europe. Since 1992 <u>Hitelgaranzia is a partnership between the Hungarian State (represented by the Hungarian Development Bank - MFB), Hungary's most significant commercial banks, co-operative savings associations and some business member organisations and enterprise interest group associations</u>. In December 2012 the entity had a guarantee portfolio of HUF 387 billion (approx. €1.3 billion) and HUF 323 billion (€1.1 billion) in December 2013. Micro enterprises account for approx. 80% of the guarantee portfolio and guarantees cover most of the banking products from credit card facilities through working capital loans to loans for investments and growth. Guarantees with maturity longer than 2 years account for approx. 11% of the total guarantee portfolio. Hitelgaranzia has a state counter-guarantee. Hungary features another guarantee institution called Startgaranzia, which specialises in covering first loss on loan portfolio of start-ups. In 2007-2013 perspective Hungary used a combination of holding fund structure (the National Development Agency selected Venture Finance Hungary which subsequently set up 184 specific programmes with 120 intermediaries committing approx. €463 million towards small lending facilities, guarantees toward factoring operations, microcredit, business angels) and a special fund without holding fund (Szechenyi Capital Investment Programme and Fund with total budget of €47.5 million).
Estonia	Estonia has one of the highest levels of banking assets concentration in Europe. Its five largest banks account for 89.7% of the all banks' assets. In these circumstances the country tries various instruments to support SMEs. KredEx is Estonia's development finance institution set up in 2001 with the original mandate to provide export credit insurance and loan guarantees. <u>KredEx is also second-level Intermediate Body</u>. The fund offers guarantees towards bank loans and directly offers start-up loans, microcredit guarantees, subordinated loans and mezzanine finance. Virtually, the entire Estonia's development finance is offered through KredEx. Estonia is an example of clear demarcation lines between grants and financial instruments: while in principle grants finance R&D and early phases of enterprise development, financial instruments support traditional investment activities and **businesses that cannot get loans or can get them on considerably worse terms** from the market for their investment needs. PE/VC is offered as a cross-border initiative with Latvia and Lithuania through Baltic Innovation Fund (fund of funds), a very unique initiative in the EU.
Lithuania	Lithuania (with 87.1% share of total assets of five largest credit institutions) is the third country in the EU with the least competitive banking market place after Greece (94% index) and Estonia (89.7%). Non-banking institutions in the country are allowed to disburse consumer loans, but not loans for business purposes. In 2010 INVEGA (state-owned guarantee institution) launched an open international public procurement tender for microloans for marginalised individuals, financed from the ESF. <u>The tender was won by the federal association of Lithuanian Credit Unions</u> - LCCU (57 credit unions with 154 points of sale). The credit unions are already well equipped with loan processing IT systems and have qualified loan officers for loan decisions and ongoing services for maintaining and ensuring loan repayments. Operators can receive ERDF guarantee

	Interest rates vary but in most cases have commercial character to cover high running costs. Credit unions work with 11 subcontractors who specialise in providing training and consultancy. Support is provided in the pre-start, start and growth phases of self-employment, new micro- and small business (not older than one year and social) and social enterprises. There are two types of training: 1) general training "Basics of entrepreneurship" and 2) entrepreneurship training: "Creation of a business plan", "Accounting and tax basics", "Business and labour law basics", "Business management basics", "Marketing basics" and "Human resources in business". General training is obligatory for all participants and entrepreneurship training can be chosen according to an assessment of the skills and needs of a start-up. The sessions are free, optional and based on the 'first come first served' principle. Clients are free to take all modules if they wish or only choose some. Access to training and consultancy in different regions of Lithuania is ensured as training is organised in 15 towns in all counties of Lithuania. Moreover, co-operation was started with NGOs, the labour exchange office and communities to better reach out to ESF priority groups. LCCU has accepted the challenge of managing this project, which includes not only distributing the loans but also organising the training and consultancy. The reason for this is that LCCU is interested in high-quality work with participants, but also in the growing potential client base for the credit unions participating in the project.
Latvia	To help businesses to achieve a sustainable cash flow during their first year of operation, the Latvian ESF-funded "Support to Self-employment and Business Start-up" programme offers financial resources in the form of grants in addition to the loans. There are two different types of grants: – *Grant for sustaining economic activities:* this is available to businesses wishing to start or having already started economic activities within the last year. These grants are disbursed within one year after signing the loan agreement. The grant is up to 35% of the amount of the loan, with a ceiling of €5,120. For the next 12 months the client has access to 1/12 of the grant each month. – *Grant for repayment of the loan: this is only given upon successful implementation* of the project and if the loan was used in compliance with the stated purpose. The maximum grant is €2,840, with a ceiling of 20% of the amount of the loan in the case of businesses wishing to start or having already started economic activities within last year, and a ceiling of 10% of the loan in the case of businesses that started the economic activities more than a year ago. The take-up of grants is in line with expectations: an amount of €1.56 million in "grants for sustaining economic activities" was issued along with €31,500 in "grants for repayment of the loan". Although grants for loan repayment are not eligible under ESIF 2014-2020 regulatory framework the Latvian performance-driven incentives used in the previous programming period and follow-on support is the case to be promoted.
The Netherlands	In the Netherlands, a common vision for microfinance was created through the establishment of a steering group, the Council for Microfinance. Up to 2006 activities and publicity concerning microfinance focused on Dutch involvement in developing countries without taking note of some major government programmes in the Netherlands that could be categorised as microfinance programmes. A growing number of private foundations and other non-governmental organisations started microfinance projects in the Netherlands, often supported by EU co-financing (mainly ESF, EQUAL) and with local funding (public and sometimes private). The Council used to consist of high ranking individuals from the government and the private sector including microfinance experts The Council was set up to make policy recommendations to government through the Minister of Economic Affairs and to formulate solutions to improve access to microfinance in the Netherlands. Since early 2008 a special Support Bureau for Microfinance Initiatives has become operational within the Ministry of Economic Affairs and funds have been made available to create a central facility to support local initiatives. The government has adopted the Council's advice and has developed a comprehensive programme including coaching, mentoring and a guar-

	antee scheme. This has enabled the establishment of the nationwide microcredit organisation Qredits. In 2011 the Committee for Entrepreneurship and Finance was established as successor of the Council for Microfinance.

Situational context and market failures

127. Croatia entered the European Union in July 2013 and thus is the newest EU Member State. Its size is 56,594 km^2 and population density tops 75.4 inhabitants per km^2, which is considered low as per European standards. With 4,262,140 inhabitants (2013) the country makes up 0.843% of the EU-28 population.[41]

Economy and enterprise context

128. From 1995 up to 2008 Croatia's economic growth had been propelled by large foreign direct investments and domestic consumption powered by strong increase in credits. Consumption and investments had been the main contributing factors to fast economic growth. In 2009 positive development trends were disrupted by the global financial crisis.

129. There is evidence of spatial concentration of growth and employment opportunities in the country and the most successful in this regard are the biggest urban centres of Zagreb, Rijeka and Split, a few towns along the Adriatic coast and area north of Zagreb comprising of Varaždin and some small towns. Contrary to those urban areas and functional territories, border areas with less developed non-EU Member States determine peripheral socio-economic functions with low levels of economic opportunities and associated high unemployment rates. These underdeveloped territories are the areas that suffered most during the war of 1991-1995.

130. Since 2009 Croatia's economy has been in 5-year long period of economic decline marked by increasing regional disparities: some areas like Zagreb followed by Rijeka and Istria and several other localities in the Dalmatian part of the country (Zadar especially) are developing despite overall economic decline resulting in the widening of the development gap on sub-regional level.

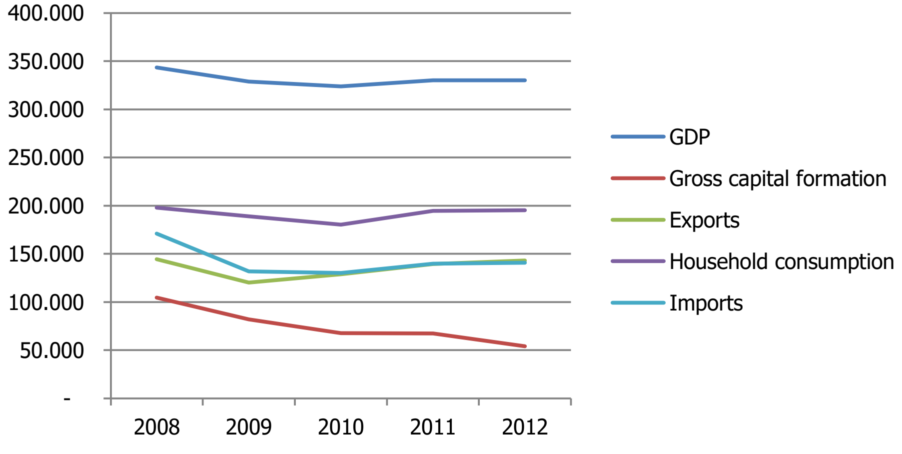
Table 10: GDP growth rate in 2008-2013

Country	2008	2009	2010	2011	2012	2013
EU (28 countries)	0.4	-4.5	2	1.6	-0.4	0.1
Croatia	2.1	-6.9	-2.3	-0.2	-2.2	-0.9

Source: EUROSTAT

131. The main and most persistent contributor to GDP contraction was the decline in gross capital formation. Decrease in exports and imports also affected economy but to a lesser degree. These subsequently recovered from negative trends.

Figure 7: Trends in key GDP variables in years 2008-2012 in HRK billions



Source: Croatia in Figures, 2013, Croatian Bureau of Statistics

[41] Source: EUROSTAT

132. Croatia features one of the most volatile consumer price index changes across Member States. 2013 HICP index value is 2.3% against the EU average of 1.5%. Only Estonia and Romania recorded higher than Croatia increase in HICP when compared to the year 2012 (3.2% each).[42]

133. The Croatian currency Kuna remained relatively stable. When deflated by CPI it appreciated by 5.5% in the period 2005-2012. Similar trends are observed in other new EU countries except for Poland and Hungary whose local currencies depreciated by 0.3% and 2.4% respectively.[43]

134. Between 2004 and 2010 the structure of Croatia's imports did not change while it did for exports. The country now relies less on low-tech industrial output as it managed to progress toward mid-to-low and mid-to-high industries but at the cost of high-tech sectors where other countries were growing faster. Overall changes in exports structure are considered to be positive but the Revealed Comparative Advantage of selling goods and services abroad declined.[44].

135. Croatia experiences excessive macroeconomic imbalances. While the economy contracted in 2009-2013 the decline compromised net position of the national budget, increasing general government gross debt (EDP).

Table 11 EDP in the years 2008-2013 (% of GDP)

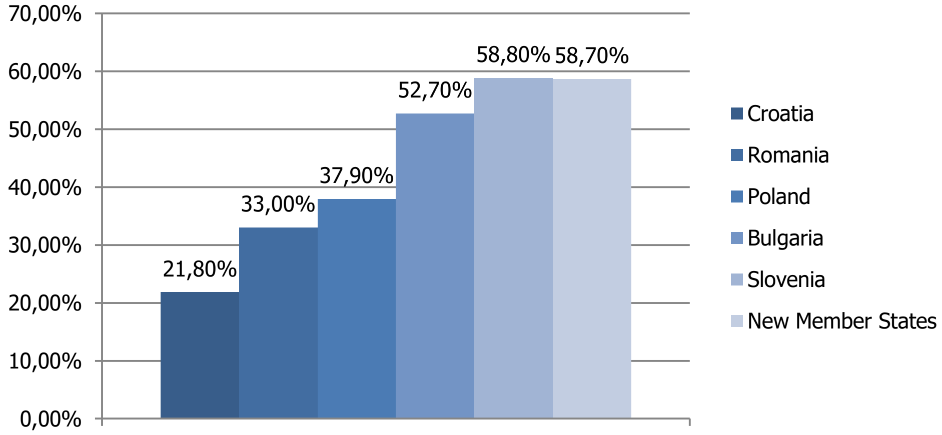
Country	2008	2009	2010	2011	2012	2013
Croatia	30.0	36.6	45.0	52.0	56.2	67.4

Source: EUROSTAT

136. Innovation Union Scoreboard 2014 recognises Croatia as a moderate innovator. With the IUS aggregate index of 0.306 on average the country performs better than e.g. Lithuania (0.289), Poland (0.279) or Romania (0.237). Croatia scores relatively high on human resources and linkages & entrepreneurship sub-indices and underperforms in the following IUS fields: research systems, finance and support, investment by companies, intellectual assets and economic effect.[45]

137. Yet, being a moderate innovator, business competitiveness is Croatia's strategic weakness. It manifests inter alia in low share of exports in the country's GDP.

Figure 8: Share of exports in GDP in Croatia and selected New EU Member States (2011)



Source: EUROSTAT

138. Relative Comparative Advantage of Croatia's export is a cause of concern, too. In recent years the country lost significant exports markets (similarly to Hungary, Finland or Italy).Declining level of technological innovation and cost competitiveness remain one of the main causes of the decrease in selling goods and services abroad.[46]

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[42]Source: EUROSTAT
[43]Source: HNB
[44] Source: *Assessment of the National Innovation System in Croatia*, OECD, 2013
[45]Innovation Union Scoreboard 2014, DG Enterprise and Industry
[46] Source: *Assessment of the National Innovation System in Croatia*, OECD, 2013 and *Communication from the Commission to the European Parliament, the Council and the Eurogroup* COM (2014) 150: Results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

Table 12: Revealed Comparative Advantage of Croatian exports in 2004 and 2010

Industry	2004	2010
High-tech	0.44	0.24
Mid-high tech	0.52	0.71
Mid-low tech	2.00	1.95
Low-tech	1.61	1.50

Source: Assessment of the National Innovation System in Croatia, 2013, OECD

139. SMEs make up 99.7% of all enterprises, which contribute to 64% of employment and 54% of Value Added. A snapshot of key data on the SME sector is provided in the table below.

Table 13: Number of enterprises, employment and contribution to Value Added in 2010-2011

Size	Enterprises				Employment				Value Added	
	2010		2011		2010		2011		2010	2011
	No.	%	No.	%	No.	%	No.	%	%	%
Micro	175,556	90.9	166,897	90.7	379.2	25.3	356.8	24.3	17.3	17.1
Small	13,645	7.1	13,242	7.2	270.5	18.1	264.6	18.0	17.9	17.9
Medium	3,311	1.7	3,304	1.8	320.5	21.4	320.4	21.8	19.6	19.6
SMEs	**192,512**	**99.7**	**183,443**	**99.7**	**970.2**	**64.8**	**941.8**	**64.2**	**54.7**	**54.6**
Large	589	0.3	594	0.3	527.8	35.2	525.0	35.8	45.3	45.4
Total	**193,101**	**100**	**184,037**	**100**	**1,497.8**	**100**	**1,466.8**	**100**	**100**	**100**

Source: The Croatian SME Observatory Report 2013

140. Excessive macroeconomic imbalances are reflected in fast-increasing government debt, sizeable external liabilities and poor enterprise performance. This is particularly reflected in the declining trends of operating income (table below). This primarily caused by decrease in exports and dwindling domestic consumption.

Table 14: Operating income of Croatian enterprises in 2008-2013 in HRK billions

Enterprise Size	2008	2009	2010	2011	2012	2013
Micro	84.8	73.1	71.1	76.7	50.3	62.3
Small	124.5	103.8	96.8	106.4	103.4	104.3
Medium	120.4	104.8	101.4	110.7	100.3	100.8
Other SMEs*	34.5	30.1	29.6	29.5	27.2	29.1
Large	310.5	275.8	277.8	294.5	268.2	261.8
Total	**674.7**	**587.6**	**576.7**	**617.8**	**549.4**	**558.3**

Source: own elaboration based on raw data from FINA
** Note: Other SMEs include: crafts, cooperatives, free professions and others not classified by FINA under micro, small and medium businesses*

141. Volatile sales and increase in operating expenditure levels continued to negatively affect net profit of Croatian businesses.

Table 15: Net profit of Croatian enterprise sector in 2008-2011 in HRK billions

Enterprise Size	2008	2009	2010	2011	2012	2013
Micro	1.1	-1.1	-4.1	-4.9	-3.2	-1.7
Small	3.6	0.9	0.9	3.7	0.4	0.9
Medium	1.9	0.6	-4.1	-0.3	0.2	-0.1
Other SMEs	1.3	0.7	0.9	1.0	1.0	1.1
Large	9.3	3.3	4.7	6.8	4.4	3.3
Total	**17.2**	**4.4**	**-1.7**	**6.3**	**2.8**	**3.5**

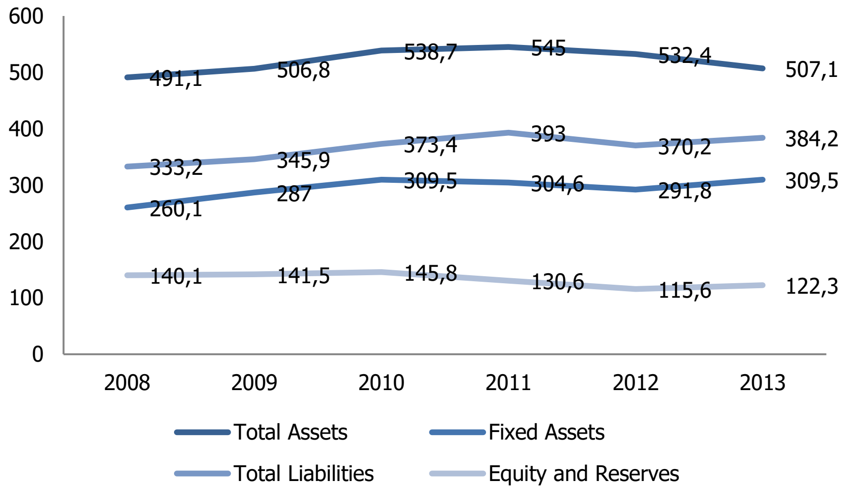
Source: own elaboration based on raw data from FINA

142. Survival rate of Croatian SMEs between 2002 and 2012 topped 60.7%. The changes in absolute number of all enterprise size categories in the period under consideration in percentage points were as follows:

micro firms: -43.5%, small enterprises: +16%, medium companies: -22.9% and large enterprises: -32.5%.[47]

143. Consequently, equity and reserves of enterprise sector were depleted and their assets remained stagnant, both in terms of value and quality. Meagre increase is fixed assets formation is due to micro firms using chiefly informal sources of financing and newly subscribed equity and reserves.

Figure 9: Fixed assets, equity and reserves and liabilities of Croatian SMEs in 2008-2013 in HRK billions



Source: own elaboration based on raw data from FINA

144. The decrease in profit generating opportunities and persisting payment backlogs resulted in highly levered companies. Micro firms and small companies were most severely affected. Selected financial business performance indicators for 2013 are provided below.

Table 16: Selected business performance indicators of Croatian companies in 2013

	Total liabilities/assets	Total liabilities/equity and reserves	Equity and provisions/fixed assets	Total income/total assets	Days current receivables outstanding	Current liquidity (minus inventories)	Current liquidity
Micro	0.86	6.26	0.23	0.56	152	0.53	0.82
Small	0.75	2.94	0.46	0.34	95	0.75	1.05
Mid	0.67	2.07	0.54	0.77	91	0.65	0.92
Large	0.52	1.10	0.65	0.74	89	0.75	0.92
Average	**0.64**	**1.81**	**0.54**	**0.54**	**98**	**0.67**	**0.92**
Coops	0.80	4.04	0.51	0.54	257	0.81	1.03
Crafts	0.59	1.44	0.83	1.06	87	0.93	1.31

Source: FINA

145. Deteriorating economy affected investment climate. Arguably, the most pronounced effect was observed for investments in fixed assets. Gross capital formation dropped from HRK 104.5 billion in 2008 to HRK 63.9 billion in 2012 - by 38.9%. Similar rates of decline in investments were recorded across all NACE sectors.[48] FDI's in 2013 worth €550 million represented approx. 45% of those in early 2000's.[49]

People and social context

146. In terms of population number the city of Zagreb with 790,017 inhabitants is the largest area, followed by, Split-Dalmatia county (454,798 inhabitants), Zagreb county (317,606 inhabitants), Osijek-Baranja (305,032 inhabitants) and Primorje-Gorski kotar (296,195 inhabitants). These territories account for 50.5% of Croatia's total population.[50]

[47]Source: The Croatian SME Observatory Report 2013, Zagreb 2013
[48]Source: Croatia in Figures 2013, CBS, Zagreb 2013, PC-Axis databases available on www.dzs.hr
[49] Source: HNB: http://www.hnb.hr/statistika/estatistika.htm
[50]Source: 2013 Statistical Yearbook, page 126, CBS

147. Population by ethnicity-wise, Croats make up the majority of Croatia's population; they account for 90.4%. The largest minorities include Serbs (4.4%), Bosniacs (0.7%) and Italians, Albanians and Roma (0.4% each).[51]

148. Croatia's GDP per capita in PPS is 61% of the EU average. This puts the country above Bulgaria, Romania and all accession countries and below Hungary, Latvia (67%) and Poland (68%), being new EU Member States.

149. The country's working age contingent remains fairly stable. Between 2007 and 2012 it increased from 2,749 thousand to 2,755 thousand. The activity rate, however, epitomises negative trends in the labour market. For many years Croatia's activity rates were approximately 10 percentage points below the average in the EU-27 (around 71%) and it further decreases: from 63.2% in 2007 to 60.5% in 2012.[52]

150. Young people (15-24) have low participation rates, nearly half of the national average. The youth activity rate between 2007 and 2012 decreased mainly due to higher participation rates in education. In addition to low levels of participation in the labour market by young people, activity rates of individuals in age cohort 50-64 years are approx. 10 percentage points lower than the EU average.[53] The youth and individuals at the age of 50+ experience most pronounced exclusion from the labour market.

Table 17: Activity rates in Croatia 2007-2012

Age cohort	2007	2008	2009	2010	2011	2012
Total	48.8	48.5	47.6	46.6	45.7	45.3
15-24	34.5	34.7	34.2	34.2	31.4	29.6
25-49	84.1	84.2	83.2	82.5	82.5	82.9
50-64	50.2	50.5	51.3	51.1	50.7	51.1
Average 15-64	**63.2**	**63.2**	**62.4**	**61.5**	**60.8**	**60.5**
65 & over	5.2	5.5	5.9	5.3	5.3	4.9

Source: CBS based on LFS

151. Employment rates in Croatia mirrored those of activity rates and are the second-lowest in the entire European Union, after Greece. Between 2009 and 2013 Croatia's employment index decreased from 61.7% to 53.9% and is currently approx. 15 percentage points below the EU average. (Greece stands at 53.2%).[54]

152. Activity and employment rates are lower for women than for men in the Croatian labour market. "Eurostat data reveal that reasons for inactivity are somewhat different since the main reason for women's inactivity in the age group 20-64, besides retirement, is 'other family or personal responsibilities' while for men this is 'education'. This indicates that general stereotypes about the roles of men and women are still present in Croatia."[55]

153. Unemployment rate (LFS) increased from 8.4% in December 2008 to 17.2% in December 2013. It thus doubled in 5 years unveiling the genuine depth of the economic crisis. Males were more affected by economic crisis: unemployment rate of men increased from 7% in 2008 to 17.8% in 2013 while the unemployment rate of females increased from 10.1% to 16.6% in the same reference period.[56]

154. Continental Croatia has been more affected by economic decline than Adriatic NUTS-2 region: in 2008 unemployment index in these two regions was at 8.2% and 8.7% and increased to 18.2% and 14.8%respectively.

155. Between 2008 and 2012 net earnings of those employed increased from HRK 5,178 to HRK 5,478 - by 5.8%.[57]

[51]Source: 2013 Statistical Yearbook, page 110, CBS
[52] Source: 2013 Statistical Yearbook, page 156, CBS and 2012 Statistical Yearbook, page 164, CBS
[53]Own elaboration based on Eurostat and ILO data sets
[54]Source: EUROSTAT, Europe 2020 indicators
[55]Source: *The Employment and Social Cohesion in Croatia*, collective work edited by L. Smajda for the European Parliament's Committee on Employment and Social Affairs, page 13
[56]Source: CBS, HZZ
[57]Source: Croatia in figures 2013, CBS, Zagreb 2013

156. Registered weighted unemployment rate in 2012 was at 18.1% and increased to 19.3% in 2013. Only 7 of 21 Croatian counties had unemployment lower than the national average. On the other end 14 counties with unemployment rate higher than the country's median account for 56.2% of the total population and 71.7% of all registered unemployed individuals. The most affected counties with unemployment rate in 2013 higher than 25% are: Karlovac (25.0%), Požega-Slavonia (26.2%), Bjelovar-Bilogora (28.5%), Osijek-Baranja (30.2%), Sisak-Moslavina (33.9%), Virovitica-Podravina (34.3%), and Vukovar-Srijem (34.7%).[58]

157. At risk-of-poverty rate increased from 17.4% in 2008 to 20.5% in 2012. At risk-of-poverty or social exclusion currently remain 1,370 thousand people making the value of this index 32.3%.[59]

158. As already indicated Croatia features significant regional disparities and inequalities in socio-economic development level. Not only do these relate to unemployment but also to the actual poverty, which both are strongly correlated in Croatia. When applying three indices: 1) headcount poverty ratio or poverty incidence (percentage of the total population below the poverty line), 2) poverty gap or poverty depth and 3) squared poverty gap or poverty severity, the most impoverished counties are those that have unemployment rate 25% or higher (para 155) except for Šibenik-Knin which - with unemployment rate at 21.9% - is the fifth most impoverished territory in the whole country.[60]

Financial institutions context

159. Croatia features all major types of financial institutions: banks (including housing savings banks), insurance companies, leasing companies, factoring enterprises, pension fund management companies and investment fund management firms. While banking institutions are regulated and supervised by the Croatian National Bank, all other financial intermediaries are regulated and supervised by the Croatian Financial Services Supervisory Agency. HANFA is also responsible for the supervision of operations of brokerage companies, investment consulting firms, regulated stock exchanges, underwriting companies, etc.

160. The state and performance of Croatian financial institutions is the genuine reflection of the deteriorating macroeconomic situation of the country.

Banks and lending to businesses

161. There are 30 banks in the country: 6 considered as large banks, 3 medium-sized and 21 small banks. In addition to these there are also 7 housing savings banks and 26 credit unions, of which performance is not included in the analysis due to their insignificant contribution to the banking sector as such. 12 banks are in domestic ownership, 16 are in foreign ownership and there are two state-owned banks.[61]

162. In recent years the Croatian banking sector experiences significant consolidation trends: the number of banks decreased from 60 in 1998 to 30 in 2013.

163. HHI index value for Croatia is at 1,434 and thus the Croatian banking sector is considered to be moderately concentrated. However, when compared to the EU average of 652 HHI, Croatia is a significantly less competitive market place than the European Community on average. Five largest banks in Croatia account for 72.9% of all banking sector assets, which is the seventh highest concentration in the EU, after Greece, Holland, Estonia, Finland, Latvia and Malta.

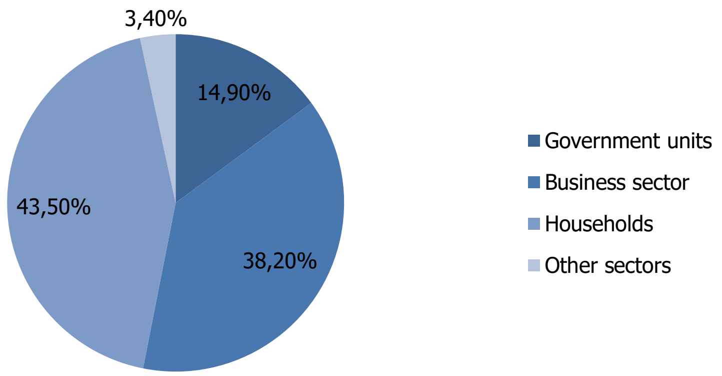
164. Revolving short-term loans, overdrafts and credit card credits dominate lending market in Croatia. These facilities account for 55.5% of the new loans extended between 2010 and May 2014. In terms of loan size small loans up to HRK 2 million account for 6.2%, loans from HRK 2 million to HRK 7.5 million - for 9.3% and loans over HRK 7.5 million - for 29% of new loans portfolio in the period concerned.[62]

165. With 43.5% share in total loan portfolio households account for the largest portion of banks' lending operations, followed by enterprises and government units.

[58]Source: own calculation based on CBS and HZZ data
[59]Source: CBS, EUROSTAT
[60]Based on I. Rubil, *Accounting for Regional Poverty Differences in Croatia: Exploring the Role of Disparities in Average Income and Inequality*, Zagreb Institute of Economics, Zagreb, 2013, page 13-18

[61] Source: http://www.hnb.hr/publikac/epublikac.htm
[62] Source: own calculation based on *op. cit.*(spreadsheet g3a)

Figure 10: Composition of banks' loan portfolio as of end 2013



Source: http://www.hnb.hr/publikac/epublikac.htm

166. Lending to enterprises is in decline since 2012. Year-on-year change in December 2012 to December 2011 was -11.25% and -0.08% in December 2013to December 2012, with further decrease observed through 2014. Consequently, as of end of 2013 loan portfolio to businesses was below the level recorded in 2010.[63] Similar trends are noted for households but on much lower scale.

167. In period 2011-2013 the monthly average amount of new business volume of loans to corporations was HRK 4,993 million and 98.2% of those loans was short-term credit (with maturity up to 12 months).[64]

168. Despite the decrease in new business volume of loans there are significant changes in loan maturity structure in banks' balance sheets. These, in conjunction with the finding in the previous para, best demonstrate loan portfolio under restructuring and that long-term bank finance for new projects is almost non-existent in the country (see table below).

Table 18: Total outstanding loan balance to enterprise sector in HRK billion at year-end and structure of loans to enterprise sector by maturity in 2010-2013 (year-end), in %

Loan maturity	**2010**	**2011**	**2012**	**2013**
Outstanding loans balance	112.2	122.0	108.4	108.2
Up to 1 year	24.1%	23.8%	21.3%	21.3%
Over 1 up to 5 years	32.1%	29.5%	25.9%	24.1%
Over 5 years	43.8%	46.7%	52.8%	54.6%

Source: own calculation based on raw data published by HNB (spreadsheet d5b), available on http://www.hnb.hr/publikac/epublikac.htm

169. Increasing borrowing needs of government units pull resources from the banking system and the share of finance to public sector in total banks' assets is on the rise.

170. Risk aversion is also caused by the deteriorating quality of loan portfolio which is a serious cause of concern.

Table 19: Partly recoverable and fully irrecoverable loans as % of total loans by sector as of year-end

Loan maturity	**2010**	**2011**	**2012**	**2013**
Total	**11.2**	**12.4**	**13.9**	**15.7**
Government units	0.3	0.3	0.2	0.1
Corporations	18.1	20.3	24.9	28.3
Households	7.8	8.6	9.5	11.1
Other sectors	6.8	4.5	4.6	5.8

Source: HNB http://www.hnb.hr/eindex.htm

[63]Source: *op. cit.*

[64]Source: own calculation based on HNB raw data http://www.hnb.hr/publikac/epublikac.htm (spreadsheet g3a)

171. Risk aversion is clearly exhibited by primary liquidity ratio in the banking sector. Between 2005 and early 2013 the index varied between 0.2 and 0.8. At the end of 2013 it reached 5.14 and is still on the rise displaying over-liquidity.

172. Loans to Croatian SMEs make up approx. 66.1% of the total business loan portfolio.[65] The average loan size computed as outstanding loan amount in the SME sector per undertaking is approx. HRK 1.8 million and 262 million for large enterprises.[66] Within SMEs these figures vary as outlined in the table below.

Table 20: Average loan size in the SME sector in HRK 000'

Enterprise Size	Short-term loan debt	Long-term loan debt	Total loan debt	% of long-term loans in total loans
Micro	142	401	543	73.9
Small	991	3,599	4,590	78.4
Medium	8,462	20,267	28,729	70.5
Cooperatives	206	419	625	67.1
Crafts	111	564	675	83.6
SMEs	**458**	**1,384**	**1,842**	**75.1**

Source: own calculation based on raw data from FINA

Leasing

173. There are 23 leasing companies currently operating in Croatia and Croatian leasing market is characterised by relatively high market concentration. 5 largest lessors in gradually increase their market share measured by value of the newly concluded contracts: in 2011 they accounted for 48.9%, 52.9% in 2012 and 56.8% in 2013 of all assets leased in Croatia.

174. Leasing market is in sharp decline, both in terms of the number and outstanding value of active contracts. Their value decreased between 2011 and 2013 by 25.2%. With outstanding amount of leasing contracts of 14,431 million as of end of 2013 the Croatian leasing market accounts for approx. 4.7% of the country's GDP.[67]

Table 21: Leasing portfolio structure in 2011-2013 by type of leasing contract (value in HRK million)

Type of contract	Number of active contracts			Value of active contracts		
	End of 2011	End of 2012	End of 2013	End of 2011	End of 2012	End of 2013
Operating lase	65,885	54,177	47,662	5,606	4,581	3,792
Finance lease	68,708	63,184	57,468	12,868	11,174	10,324
Loans	4,300	3,084	1,974	819	603	315
Total	**138,893**	**120,445**	**107,104**	**19,293**	**16,328**	**14,431**

Source: HANFA

175. The year 2012 marks small signs of leasing market recovery: the number of newly concluded contracts increased when compared to the previous year for the first time since 2009 so as their value. This increase is due to higher demand for the lease of property and other items (not classified as cars, vehicles, vessels, aircraft or machinery).

Table 22: Newly concluded contracts in 2011-2013 (value in HRK million)

New leasing contacts	Number of new contracts			Value of new contracts		
	2011	2012	2013	2011	2012	2013
	30,656	26,395	28,969	5,562	4,827	5,657

Source: HANFA

Factoring

[65]Source: EU SME Initiative ex-ante assessment, country fiche
[66]Based on raw data from FINA for loans obtained from banks and other credit institutions
[67]Source: own calculation based on HANFA raw data available on http://www.hanfa.hr/EN/nav/110/monthly-report.html

176. There are currently 14 factoring companies operating in the country and both, the number and amount of their operations increases. In 2011 factoring market amounted to HRK 11.4 billion and increased to HRK 15.8 billion in 2012 and HRK 17.3 in 2013, thus for the first time exceeding the value of leasing market in the country. The size of factoring market now accounts for almost 5% of the country's GDP.

177. Bill of exchange discount operations are the most popular form of factoring transactions: their share grew from 43.9% in 2012 to 49.5% last year, outgrowing the volume of domestic and foreign factoring transactions. This indicates serious liquidity problems in enterprise sector, which is validated by more frequent than ever before use of bridging loans. These account for more than 2% of all operations by factoring companies (growth from 0.9% share in 2012 and 0.5% in 2011).[68]

Capital market

178. Enterprises raise funds in the primary market in exchange for shares, bonds and other instruments. The volume of primary capital market in Croatia is represented by changes in the amount of subscribed equity in the enterprise sector. Variations in the subscribed equity between 2008 and 2013 are outlined in the table below.

Table 23: Subscribed capital of Croatian enterprise sector in HRK billion

Size of enterprise	2008	2009	2010	2011	2012	2013
Micro	39.9	40.7	42.2	45.6	37.9	43.2
Small	16.6	17.7	18.4	19.0	23.9	26.5
Medium	35.0	36.7	39.8	39.3	35.3	37.5
Other SMEs	8.0	7.5	7.6	7.3	6.3	6.6
Large	205.3	204.8	200.7	202.9	198.8	200.9
Total	**304.8**	**307.4**	**308.7**	**314.1**	**302.2**	**314.7**

Source: own calculation based on row FINA data

179. Micro and small enterprises appear to be the most effective in fundraising while medium and large enterprises either depleted their equity or its growth was insignificant when compared to the year 2008, marking first occurrence of the economic decline. However there is no clear source of verification how much of that newly subscribed capital came from individual, private and institutional investors.

180. According to HANFA in 2013 there were 111 registered open-end investment funds in Croatia. 89 of them were working under public offering regime, 15 through private offering and 7 open-end venture capital funds. They were managed by 19 managing companies. The total capitalisation of these funds (annual median of net assets) was HRK 13.2 billion. There were also 4 closed-end investment funds with public offering and 3 funds with public offering in real estate with total value of their net assets HRK 1.4 billion. At the end of 2013 the total value of net assets of all investment funds was HRK 14.6 billion.[69]

Table 24: Total value of investment funds net assets from 2007 to 2013, in HRK billion

Type of Fund	2007	2008	2009	2010	2011	2012	2013
Open-end money	4.1	3.9	6	6.9	7.2	9.1	9.8
Open-end bond	0.7	0.6	0.7	2	1.6	0.5	0.4
Open-end balanced	10.3	2.3	2.1	2.1	1.4	1.2	1
Open-end equity	14.9	3.1	3.2	3.3	2.4	2.1	2
Total open-end	**30.0**	**9.9**	**12**	**14.3**	**12.6**	**12.9**	**13.2**
Closed-end funds	3.7	1.9	1.8	1.9	1.7	1.6	1.4
TOTAL	**33.7**	**11.8**	**13.8**	**16.2**	**14.3**	**14.5**	**14.6**

Source: own elaboration based on HANFA data

181. After the collapse of capital markets of the year 2008 the Croatian equity market has never recovered. At the end of 2013 it represented only 43.3% of the capitalisation recorded at the end of 2007, clearly illustrating the size of losses incurred by investors and the funding gap that emerged in the last 6 years. Indeed, only open-end funds investing in money market managed to raise additional funding while all

[68]Source: HANFA

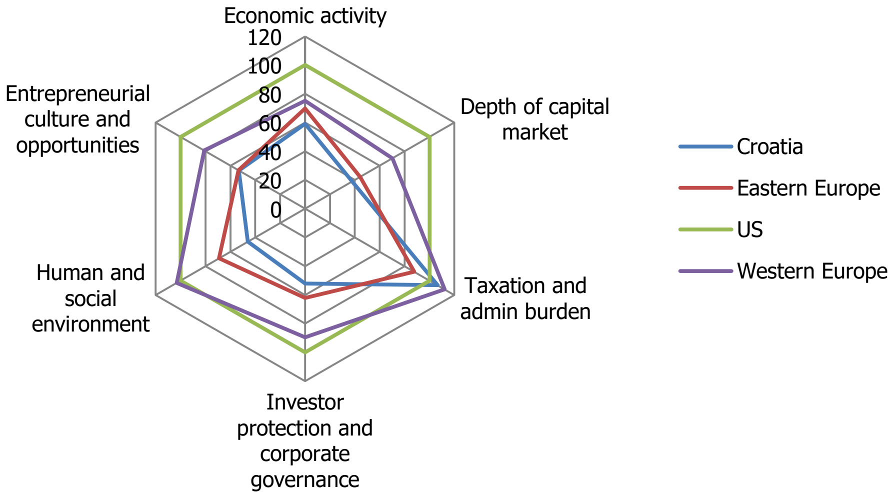
[69] In addition to those there were2 investment funds established under special legal act with HRK 1.5 billion worth net assets under management. These funds for war veterans are not a part of analysis in this document.

other funds shrank between 56% (open-end bond funds) to 970% (open-end balanced investment funds).

182. Closed-end investment funds include 2 fully established private PE/VC funds with net assets totalling HKR 121.8 million and 5 FGS's with HBOR as qualified investor (characterised in this report earlier).

183. In general, Croatia and the larger South East Europe region do not feature well developed venture capital and private equity market. According to the Venture Capital and Private Equity Country Attractiveness Index 2013 the country is ranked 65th most attractive destination for PE/VC.

Figure 11: Comparison of Croatia's PE/VC attractiveness against Eastern and Western European countries



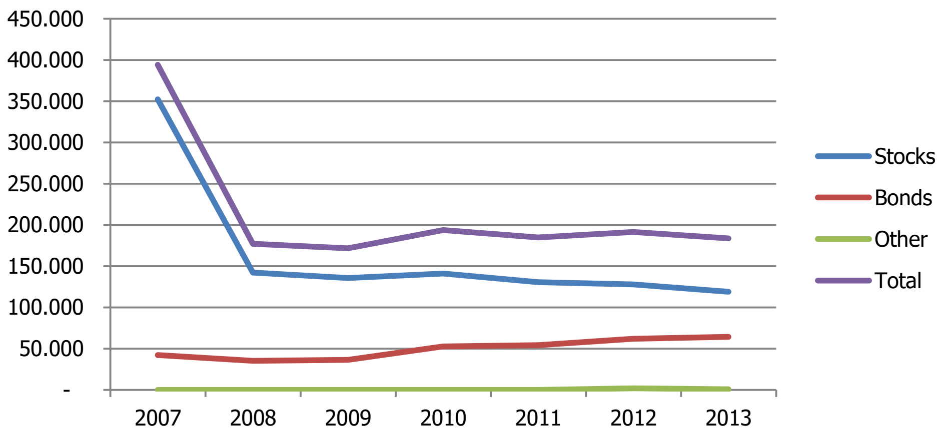
Source: IESE Business School Barcelona

184. The IESE index components include various cross-cutting aspects that PE/VC investor consider as essential in this sector and Croatia is considered to be the second least attractive market place within the EU, after Greece. Country peer group comparison situates Croatia slightly lower than Latvia, Romania and Bulgaria and higher than Ukraine, and Georgia. When compared to other countries in the region Croatia stands out in terms of taxation and administrative burden (the latter is considered too high though) but underperforms in regard to economic environment (GDP decline and perspectives), depth of capital market and human and social environment, especially in the area of labour market rigidities.

185. Established in 2008, the Croatian Business Angels Network (CRANE) groups 15 individual investors interested in equity investment in small companies and start-ups. Since 2009 they invested €1.3 million in 13 undertakings. All individual investments are in the range €50,000 to 200,000. CRANE promotes innovative entrepreneurship and business skills and work with institutions supporting business incubation processes. They receive approx. 300 expressions of interest a year of which 5-10% meet detailed screening criteria for small equity investments. CRANE is considered to be a small organisation: by comparison the Slovenian network of individual investors groups more than 70 members.

186. The Zagreb Stock Exchange is the centre point of the secondary capital market in the Republic of Croatia. Established in 1991 it is owned by banks, insurance companies and private brokerage companies. Securities (socks and bonds) are traded regularly on the stock exchange and this segment of capital market has been very popular from mid-1990's. Only in the period 1995-2000 the Zagreb Stock Exchange capitalisation grew almost ten times up till 2007. After sudden decline in 2008 the capitalisation remained constant or meagrely fluctuated in recent years. Its main trends are outlined in the chart below.

Figure 12: Market capitalisation of Zagreb Stock Exchange in HRK million in 2007-2013



Source: own elaboration based on the Zagreb Stock Exchange Trading Summary 2008-2013

187. The Zagreb Stock Exchange is the best barometer of the economic situation in the country: at the end of 2013 the total capitalisation of the secondary capital market was HRK 183.7 billion - less than a half of that in 2007 totalling HRK 393.9 billion.[70] The amount that vanished from the stock exchange at the turn of year 2007 and 2008 accounts for approx. 2/3 of the annual GDP and since then the market actually never recovered. In 2007 there were 355 companies listed on the Zagreb Stock Exchange and through 2013 their number decreased by 164.

Identification of market problems and failures

188. As highlighted by the Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period (volume III, section 3.1), the concept of market failure is not exclusively related to the capacity of the market to ensure the equilibrium between demand and supply of various types of funding, but can be determined as a **complex interaction of market weaknesses related to the general business environment**. However, for the purposes of determining the gap between supply of and demand for SME financing, market failure to access external finance by SMEs is herewith defined as failure by viable, or potentially viable, SMEs, to obtain from the "market" the amount of finance they need to establish, grow and develop.

189. Economic literature sets out market failure descriptively (Pareto, Bator, Coase, Arrow, Toumanoff, Wiliamson, Akerlof, Barzel, Stiglitz) as a situation where the market is not capable of allocating resources efficiently or optimally due to the presence of inherent impediments or defects of market exchange forces resulting from resource allocative inefficiencies. V. Pareto's resource inefficiency paradigm pronounces that resources cannot be readjusted to make one consumer better off without making another worse off. Market malfunction can also be explained by (or rooted in) transaction costs theories and attributed to private rather than public goods or property (J. R. Commons).

190. Market failures are caused inter alia by: productive resource immobility or its scarce, imperfect knowledge, imperfect competition (monopolies or oligopolies), hysteresis, low-level equilibria, missing or incomplete goods (or infrastructure), negative externalities (costs and benefits), obstructive rights and laws, information asymmetry, inequalities, etc. These all relate to what is described as "a complex interaction of market weaknesses related to the general business environment" in para 188.

191. Two complementary and partially overlapping methodologies are recommended by the EIF and EIB to analyse relevant market failures. The EIF methodology mostly focuses on analysis of the supply (finance providers) and the demand (SMEs) side. The methodology proposed by the Commission/EIB advocates for a deeper analysis of the business environment (based on causes-effects) and more detailed examination and segmentation of the demand in order to support the identification of future trends in supply and demand. Preferably, the analysis should lead to identification of the main reasons, type and size of market failures and suboptimal investment situations.

192. The occurrence of market failure concerning access to finance in Croatia has been manifested in various publications and research papers. However these various attempts to identify the size and causes of

[70] Source: The Zagreb Stock Exchange Trading Summary for the years 2008-2013

market malfunction have produced conflicting results and outcomes. The table below provides a summary of main findings identified through desktop research.

SBA Fact Sheet	Access to Finance Survey	Ex-ante Assessment of the EU SME Initiative	SMAF Index
SME access to finance is one of the 10 main topics or themes analysed on annual basis under the SBA initiative. Croatia's performance in the area of SBA access to finance is monitored by only 4 indicators out of 10, which are above or on a par with the EU average. These indicators include: willingness of banks to provide a loan, access to public financial support including guarantees, strength of legal rights and depth of credit information.[71] In general the SBA Fact Sheet 2013 denotes that "SMEs benefited from inexpensive and partly subsidised loans before the crisis, and were suddenly confronted with a lack of liquidity and reduced access to business loans". Notably, one of the indicators available and computed for Croatia concerns willingness of banks to provide a loan. According to the survey 14% of SME respondents indicated deterioration in accessing bank loans when compared to the previous year while for the EU the average was 27%. This implies that on average, bank finance is more available in the country than in the EU. Other indicators: rejected loan applications and unacceptable loan offers,	SMEs' Access to Finance Survey is a periodic survey carried out by the EC in cooperation with the ECB. Among many survey questions SME respondents are asked to evaluate a pre-supplied list of eight potential problems that their companies may currently be facing on a 10 point scale. The 2013 survey pinpoints access to finance as the second, just after finding customers, most pressing problems the European SMEs face. Namely, 22% of SMEs rank finding customers (resulting from market saturation) as the main issue while access to finance is raised as a problem by 15.1% of the SMEs. For Croatian SMEs access to finance is a serious issue and it appears to be the most important pressing problem ranked by 23% of the country's SMEs. Indeed, only SMEs in Cyprus and Greece ranked access to finance higher that Croatia with 40% and 32% responses respectively. The 2013 Survey also identifies Croatia as economic environment where bank loan is the most preferred form of financing to realise growth ambitions. Amongst those countries where the largest proportion of SMEs favoured bank loans, the proportion varied from a high of 83% in Croatia to 35% in	The analysis carried out for the elaboration of the ex-ante assessment of the EU SME Initiative was, inter alia, aimed at the estimation of the share of financial viable SMEs unsuccessful in obtaining loan financing and computation of the SME loan financing gap in monetary terms. The ex-ante assessment report identifies that the fraction of 5.2% of the viable Croatian SMEs have difficulty to obtain a loan. With this percentage Croatia is behind Hungary, Finland, Cyprus, Austria, Germany and Czech Republic but at the same time significantly outpaced other EU Member States. Consequently, findings and conclusions of the ex-ante assessment report indicate that access to finance in the country is not seriously constrained for viable businesses. The estimated interval for SME financing gap in monetary terms is between €59 million and €434 million.	The SMAF index provides an indication of the changing conditions of SMEs' access to finance over time for the EU and its Member States. The index is calculated using a baseline of EU 2007=100, and so allows comparison between countries and across time. The base reference of 2007 deliberately provides a baseline before the onset of the financial downturn. The composite Index illustrates access to debt and equity finance and individual sub-indices concern debt and equity characteristics separately. The latest Index value is available for the year 2012. The composite Index for Croatia at 110.6 puts the country above the EU average of 104.1 and for debt finance subindex the country scores 114.0 points. For equity finance the sub-index is at 93 against the EU average of 98. SMAF Index thus implies that SMEs in Croatia have significantly better access to loans than enterprises across the EU. Indeed only Germany, Austria, France, Holland and Slovakia outperformed Croatia. On the other hand SMAF Index for equity finance indicates that this type of funding for SMEs is available for small and me-

[71] This relates to SBA Fact Sheet 2013. SBA Fact Sheet 2014 include 6 indicators:1) rejected loan applications and unacceptable loan offers (% of loan applications by SMEs), 2) access to public financial support including guarantees (% of respondents indicating deterioration), 3) willingness of banks to provide a loan (% of respondents indicating deterioration), 4) total amount of time to get paid (days), 5) bad debt loss (% of total turnover) and 6) strength of legal rights. In general, data sets used in the most recent SBA analysis disclose deterioration in the area of indicator 2 and 3 while the new indicator 5 illustrates the depth of economic crisis.

relative difference in interest rate levels between loans up to €1 million and over €1 million, total duration to get paid, lost payments, venture capital investors - early stage and EU regional funds for entrepreneurship and SMEs and EU funding for business creation and development, were not available for Croatia in 2013. Figures published for the first time in 2014 do not contain time series.[72]	Cyprus – although the low number of SMEs interviewed in both these countries means the results should be treated with caution. Only 18% of Croatian SMEs do not recognise any obstacles to get loan finance. On contrary, 48% of respondents find interest rates or price too high and 22% point at insufficient collateral or guarantee as the main barriers to access finance. Only Portuguese SMEs more frequently complained about interest rates or price (61%). 65% of Croatian SME respondents are interested in a loan up to €250,000 with the cohort 25,000-100,000 most prevalent, as indicated by 37% SMEs.		dium companies on conditions less competitive than in the EU on average. In fact Croatia is on par with Germany and outperformed Bulgaria, Greece, Spain, Italy, Luxembourg, Poland, Romania and Slovakia.

193. The matrix presented above clearly denotes relatively conflicting findings across the four study reports. In addition to that the largely positive feedback from SBA Fact Sheet 2013 and SMAF Index analysis is incompatible with statistical data sets outlined in the earlier sections of this report, especially in regard to the availability of and demand for long-term finance. These reveal serious structural problems on the side of financial institutions (supply side) and the SME sector (demand side).

194. In that context the suitable differentiation between market failures and sub-optimal investment situations is required. While the latter are essentially demand-driven, the market failures can be both supply- and demand-driven.

195. Sub-optimal investment situations can be observed also when significant investments volumes have taken place but their levels or funding is insufficient to achieve broader economic or policy objectives. These sub-optimal situations lead to limited SME propensity for investing and can be caused by the overall economic outlook, fear of funding application rejection, current financial standing of the undertaking or lack of tailored-made products for specific investment projects.

196. Market failures exist both, on the supply and demand side of the equilibrium. On the supply side market malfunction can be caused by high concentration of banking operations among a limited number of institutions, their risk aversion due to *inter alia*: general economic outlook and uncertainty of future performance by enterprises, high levels of defaulted loan portfolio, insufficient information provided by investors, especially with regard to innovative investment and technology transfer, highly leveraged balance sheets of businesses leading to insufficient availability of assets for collateralising the anticipated additional external finance, high administrative costs for processing funding applications and loan pricing policies, underdeveloped capital markets, low levels of business opportunities or alternative investment opportunities outside private sector. On the demand side market failure can be triggered e.g. by lack of business confidence leading to zero risk tolerance and further decline in propensity to invest that only deepens suboptimal investment situation.

197. The depth of market failures and sub-optimal investment situations are evidenced earlier in the document and are augmented by key findings of the SME Access to Finance Survey 2014 (box overleaf).[73]

[72] *Op. cit.*
[73] Undertaken and funded by the BIZimpact II EU-funded project implemented on behalf of the Ministry of Entrepreneurship and Crafts. This Survey included CATI approach to interview representative stratified sample of 1,000 Croatian SMEs and was expressly

Key findings and conclusions of the SME Survey 2014 (BIZIMPACT II)

- Majority (82%) of Croatian SMEs are located in urban areas. Only 18% are based in a rural settlement, which appears to be major impediment to stimulate the creation of significant job opportunities in rural areas.

- A meagre 1% of SMEs are genuine start-ups with up to 1 year of business track record; 3% have between 1 and 2 years of track record and 11% between 2 and 5 years of experience. This indicates that the bulk of Croatian economy is ascribed to well-established businesses with long track record; indeed 65% of them have been in business for more than 10 years.

- 70% of SMEs operate at local level, in their vicinity, 26% sell their goods and services across the country or nation-wide and 4% are truly export-oriented companies. With such a meagre fraction of companies operating in international markets and dwindling domestic demand Croatia's economy is likely to struggle if not aiming at export-oriented markets.

- When compared 2013 to 2012, only 9% of SMEs recorded 20% or more increase in turnover, for 30% of small and medium firms their turnover increased below 20%. For 26% turnover remained the same in 2013 as it was in 2012 and sales declined in case of 35% of SMEs. Remarkably, micro-firms turnover grew more frequently than that of small and medium companies and mid-sized businesses were most frequently affected by the decrease in turnover.

- 58% of SMEs claim they have invested in fixed assets in the last 2 years but the distribution of responses varies across the sector: only half of micro firms invested in fixed assets but this percentage grows for small companies to 66% and 81% for medium-sized businesses. Thus, the larger the undertaking the more investment-oriented it is.

- The most prevalent type of investment is machinery and equipment (78%), followed by vehicles (28%). Only 6% of SMEs invested in RDI.

- Small-scale investments are the most popular: 34% of all investments in equipment and machinery were below 5,000 and 61% were in the range of microcredit cohort up to €25,000.

- The use of external financing is not very popular among SMEs. Only 26% of SMEs applied for external finance in the last two years, including: 18% of micro companies, 35% of small firms and 48% of medium enterprises.

- Of those who applied, only 54% received financing in the full amount required. In 16% of cases finance was approved partially and 29% of applications were rejected. This percentage is considered to be high in the times of relationship banking where initial screening is exercised before the actual application. Interestingly, in most cases the reason of application rejections was not communicated to the applicant. In 2% of cases finance was approved but the SME declined loan conditions.

- The main reason of not applying for external funding were sufficient own resources (30%). Too high interest rates were the main reason for of not using external finance for 24% SMEs, difficult market situation for 18% and fear of rejection - for 17%. Micro enterprises more frequently than the rest of SMEs decided to avoid external financing due to saturated market conditions and interest rates considered to be high.

- Short-term finance in the form of overdraft, credit card credit or working capital loan is the most prevalent form of external finance, claimed by 61% of SMEs. The smaller the company the more it requires short-term finance.

- 44% of short-term financing does not exceed €25,000, 62% is up to €100,000 and 79%below €500,000.

- Long-term finance-wise, 41% does not exceed €25,000, 61% is up to €100,000 and 78% - up to €500,000.

commissioned with the aim to provide quantitative data and feedback for this ex-ante assessment. Stratification criteria included: NACE category, size and type (inclusion of crafts)

- 39% of SMEs consider applying for external finance in the next two years. Those which will not apply indicate the main reason as: lack of project for financing (28%), using own resources (24%) and fear of losing control over business (15%). Only 8% of respondents perceive interest as too high to use external financing.
- The main objective of external finance will be product, process or organisational innovation: 38%, followed by ICT: 12%, better energy efficiency: 12%, for 10% of SMEs the main goal of using external finance will be compliance with environmental regulations and standards.
- SMEs appear to be dissatisfied with commercial financial institutions: only 15% indicate they will use commercial banking sector against 32% preferring a development finance institution, e.g. HBOR or HAMAG BICRO. 34% of SMEs prefer a non-returnable grant.
- 34% of SMEs anticipate financing up to €25,000 and 71% up to €500,000. Most frequently companies look at cohort €100,000-500,000 (19% of responses).
- Companies are moderately positive about economic outlook: 47% believe that it will improve, 30% think it will remain the same and as much as 19% believe it will deteriorate. The most sceptical group are micro firms and mid-sized businesses remain the most optimistic among SMEs.
- Respondent SMEs appear to have limited knowledge of business support institutions and development finance institutions. While entrepreneurs are well aware of those organisations, they do not know what they can be offered in terms of support. Only 32% of respondents admitted they had known about e.g. available guarantee programmes. Wide visibility of institutions like HBOR or HAMAG BICRO may also increase expectations of scaling up incentive schemes co-financed from ESI funds 2014-2020.

Evidence of market failure and sub-optimal investment situations

198. The earlier considerations and analysis of the broader socio-economic context led to the identification of key problem 'nodes' related to the areas where financial instruments are considered for implementation (business competitiveness, employment, social enterprises).

199. These problems nodes are as follows: i) low levels of high-tech-value-added growth enterprises capable of competing domestically and internationally - for business competitiveness, ii) low levels of validated sustainable start-ups run by previously unemployed individuals - for self-employment of the unemployed and iii) insignificant number and capacities of sustainable social enterprises.

200. For each problem node the corresponding market failures and sub-optimal investment situations have been identified, along with their causes and effects. There is also a reference to earlier considerations and findings to validate and demonstrate the underpinning evidence.

Problem node: low levels of high-tech-value-added growth enterprises capable of competing domestically and internationally

Causes	Market failure	Effect	Underpinning evidence
Uncertainty related to economic outlook and financial forecasts and lack of business confidence in economy	Market powers Imperfect knowledge	Lack or limited finance for SMEs, especially those innovative	Decline in GDP Volatility of operating income Virtual lack of long-term bank finance (only 2% of all loans)
Highly leveraged companies, low profitability and insufficient collateralisation Payment backlogs in economy	Market powers	Lack or shortage of finance for SMEs lacking required collateral Low liquidity	High indebtedness - ratio of liabilities to assets (86% for micro and 75% for small companies) Abnormal days current receivables outstanding, especially for micro firms (152 days)

Causes	Market failure	Effect	Underpinning evidence
Lack of credit history or limited business track record	Information asymmetry	Lack of finance for start-ups in early stages of development, especially in 24 months after establishment, irrespective of sector or branch	Though this factor/cause is largely observed across Europe there is no clear evidence of this gap in Croatia, most likely due to the fact that these fledgling businesses are discouraged to request external finance before the actual application process. Consequently,
Significant size of underperforming bank loan portfolios	Market powers and obstructive laws leading to risk aversion	High interest rate and collateral requirements, especially for small loans Banks' willingness to finance treasury bonds instead of companies (push-out effect)	SME Survey (BIZIMPACT II) Access to Finance Survey (DG Enterprise/ECB) Increase of the share of loans to government by 2%
Underdeveloped capital markets, low levels of business investment opportunities and divestment	Market powers	Virtual lack of VC funding and limited presence of PE	HANFA data IUS-2014 data
Lack of business confidence in economy	Scarce investments and primary focus on liquidity issues Limited expenditure on R&D	Limited interest in external financing except for working capital needs	Low percentage of SME applying for external finance (26%) - SME Survey (BIZIMPACT II) Sufficient internal funds that remain unused in case of 30% of SMEs - SME Survey (BIZIMPACT II) Most bank loans are short-term loans (98%)
Poor economic and financial performance by businesses	Limited propensity for new investments	Lack of or limited investments in new fixed assets, especially by small and medium enterprises Fear of funding application rejection Funding applications rejected by banking system	FINA data Not applying due to fear of rejection (17%) - SME Survey (BIZIMPACT II) 29% of SMEs applying for loans were declined their application - SME Survey (BIZIMPACT II); for 16% funding was approved only in part

Problem node: low levels of validated sustainable start-ups run by previously unemployed individuals

Causes	Market failure	Effect	Underpinning evidence
Negative shocks and stresses due to sharp and deep economic decline	Hysteresis	Fast increasing unemployment and low employment levels	Unemployment rate (LFS, HZZ) Employment rate (LFS)

Causes	Market failure	Effect	Underpinning evidence
No experience of start-up loans and attention to self-employment subsidies	Imperfect knowledge Information asymmetry	Reliance on subsidies at levels inadequate to establish and develop a firm Lack of thorough evaluation of self-employment support measures and their sustainability	Feedback from HZZ Lack of association between the number of assisted individuals and the number of newly registered businesses in business registers
Lack of integrated ALMP measure for inclusive entrepreneurial assistance and development	Lack of funding in sizes adequate for establishment and growth of micro business and required aftercare support	Funding through subsidies used primarily for subsistence and not entrepreneurial activities	Lack of association between the number of assisted individuals and the number of newly registered businesses in business registers (statistics)

Problem node: insignificant number and capacities of sustainable social enterprises

Causes	Market failure	Effect	Underpinning evidence
Lack of full recognition of social enterprise in Croatian legislation	Obstructive laws	Difficulty to formulate adequate policy response for broader category of undertakings	Analysis and actions defined in the draft National Strategy for the Development of Social Entrepreneurship to recognise social economy and social enterprises
Lack of or limited funding for social enterprises	Transaction costs	Difficulty to raise money domestically, high cost of loans (if any available)	CEDRA experience and track record
Underdeveloped and underfinanced institutional environment for development of social entrepreneurship Lack of dedicated financial products for social enterprises	Lack of or limited exploitation of local competitive advantage, especially in impoverished communities	Lack of or limited level of mobilisation of local communities to establish effective and sustainable entrepreneurial partnerships	Limited number of projects financed under IPA HR and other programmes Significant interest in self-employment subsidies yielding questionable results CEDRA experience and track record

Investment gap

201. Propensity for investment is contingent on numerous factors, aspects and their dynamics. Literature points *inter alia* at: association of interest rates and investments, expectations as to the economic outlook and thus changes in the capital stock (essentially the depreciated capital to be replaced), the level of economic activity, current capacity utilisation, the cost of capital goods, technological change, etc.

202. Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period recommends quantifying the value of investment gap. Quantification of the gap can be done twofold through: i) computing viability gap not associated with the financial structuring of the project, which is therefore the potential size of and intervention with the support of ESI Funds to increase supply and/or ii) financing gap which is associated with unmet demand for financing.

203. Investment gap can also be associated with fixed assets gap, particularly relevant to an economy in crisis. This however requires suitable assumption as to the time period required for 'closing the gap' (if any) and optimal level of assets vs. sources of their financing and vice versa.

204. Investment gaps calculated below are as follows:

a. Fixed assets gap and/or associated equity/capital gap resulting from sub-optimal structure of enterprise assets financing;

b. Financing gap related to the unmet demand expressed by viable SMEs for loan finance (lending gap);

c. Venture capital gap that can be calculated twofold: 1) a fraction of the financing gap concerning high growth start-ups or a fraction of the current equity and reserves of SMEs being in a start-up phase (up to 2 years old) associated with the percentage of high growth firms.

Fixed Assets and Equity Gap

Optimal level of fixed assets is defined in literature as a ratio of fixed assets to net worth (or net assets), which is the difference between the company's total assets and its total liabilities. The index expresses in percentage terms the portion of company's total assets that is tied up with fixed assets, such as property, plants and equipment. It represents the portion of total assets that cannot be used as working capital (and during economic decline working capital is highly needed). The higher the ratio, the lower the solvency. A ratio 0.75 or higher is usually undesirable because it indicates that the undertaking may be vulnerable to solvency problems. In some circumstances this index is acceptable at higher level (which was, in fact, during economic boom).

Using data illustrated in Figure 9 it is evident that the Croatian SMEs have been highly leveraged for many years. The ratio of fixed assets to net worth between 2008 and 2013 fluctuated as follows:[74]

2008	2009	2010	2011	2012	2013
1.65	1.78	1.87	2.01	1.79	2.52

Assuming that a desirable level of fixed assets to net worth is approx. 1.45 (level of 2006-2007 recognised by banks and validated by credit boom) **the amount of fixed assets gap is negative and amounts to approx. HRK 130.5 billion** (approx. €17.45 billion).[75] Thus in accounting terms the Croatian SMEs do not experience fixed assets shortage. On contrary, these remain in abnormally high levels in relation to the total assets, given the current level of liabilities. These assets however are frequently obsolete and enterprises need to invest in new technologies to be more competitive and efficient and smart investment strategy in new fixed assets is highly sought after.

Alternatively, in order to bring SMEs to a reasonable degree of equilibrium an excess of **approx. HRK 89.9 billion** (approx. €12 billion) of total liabilities should be addressed. And **this amount is considered to be the equity gap** (amount of equity/capital missing to ensure reasonably optimal balance sheet structure).

Financing Gap - lending

Market failure in access to bank financing occurs when not all viable SMEs can raise loans. This can be caused by the rejection of loan application, partial approval of the requested loan amount, firm's refusal of the loan condition or enterprises' unwillingness to apply for loan financing even when loan is needed.

The computation below is based on the methodology used in the EU SME Initiative ex-ante assessment. Data on the share of high growth SMEs and reasons of failure derive from SME Survey (BIZIMPACT II) and the average loan size is computed as outstanding loan balance based on FINA data as of end of 2013 at exchange rate of 7.5.

Assumptions	Total number of SMEs reporting to FINA	100,852
	Share of high growth SMEs (increase in turnover 20% or more) in total number of SMEs reporting to FINA	9% = 9,076
	Average loan size - long term	€111,615
	Average loan size - short term	€49,908
	Average loans size - total	€161,524
	Share of loans approved below the requested amount	16%
	Firm's refusal to sign loan contract	2%
	Firm's unwillingness to apply (fear of rejection, undersized collateral)	19%
Value of Gap	All loans	9,076 x 161,524 x (16% + 2% + 19%) = 542,416,975

[74]Source: own calculations based on raw data from FINA
[75]This amount will be proportionally higher if the model 0.75-1.0 ratio has been applied

(all failure reasons)	Long term loans	9,076 x 111,615 x (16% + 2% + 19%) = 374,816,564
	Short-term loans	542,416,975 - 374,816,564 = 167,600,411
Value of Gap (unwillingness to apply + decline loan conditions)	All loans	9,076 x 161,524 x (2% + 19%) = 307,858,283
	Long-term loans	9,076 x 111,615 x (2% + 19%) = 212,733,725
	Short-term loans	307,858,283 - 212,733,725 = 95,124,558

The financing gap (lending) based on average loan size as of end of 2013 is between €307.9 million and €542.4 million and 69.1% of the gap is made up by long-term financing (maturity over 12 months). The value of the gap in Croatia may appear to be on the decrease over time but this is attributable only to the decline in the average loan amount granted by the banking sector. Indeed, the **perceived** gap increases as it is being replaced by sharp increase in liabilities towards non-financial institutions: liabilities out of prepayments (long-term liabilities) or liabilities payable based on share in operating result.

Venture Capital Gap

Venture capital gap is computed as an investment opportunity in high growth SMEs being in a start-up stage (up to 2 years old only). Data on the share of start-ups in total number of SMEs and share of high-growth firms derive from the SME Survey (BIZIMPACT II) and data on total equity and reserves of Croatian SMEs is adapted from FINA data (only equity and reserves of legal entities are considered): the amount of HRK 109,907,433,481 is converted into € @ 7.5 exchange rate.

Assumptions	Share of start-ups	4%
	Financing gap (computed above) in €	542,416,975
	Share of high growth firms	9%
	Total equity and reserves of SMEs (end of 2013) in €	14,654,324,464
Value of the gap (based on financing gap)	542,416,975 x 4% = 21,696,679[76]	
Value of the gap (based on SMEs' equity and reserves)	14,654,324,464 x 9% x 4% = 52,755,568	

The financing gap (VC) is in the range of €21.7 - 52.8 million. It is thus a gap corresponding to the customary size of a venture capital vehicle for start-up companies.

[76] This calculation abstracts from 9% of high growth SMEs as this fraction is already included in the value financing gap worth €542,416,975

Investment strategy

205. The proposed investment strategy is a combination of needs- and opportunity driven interventions addressing the identified market failure causes and sub-optimal investment situations. The strategy retains reasonable level of flexibility as to the choice of recommended instruments, target groups and possible combination with grants for the effective disbursement of funds and broader efficacy of the ESI Funds intervention.

206. The recommended terms and provisions stem from consensus reached in participatory and consultative manner during the development of the OPCC and the execution of the ex-ante assessment exercise.

Fit in the broader Operational Programme intervention framework

207. The use of financial instruments within TO3 of the OPCC 2014-2020 directly stems from the Specific Objective 3a1 formulated as "Better access to development finance for SMEs" (OPCC version, December 2014). **FI's thus appear to be a horizontal goal and not a means of delivery**. The specific objective thus accentuates the need to strengthen development finance institutions present in Croatia. Accordingly, it is expected that access to public financial support including guarantees will be improved, as measured by SBA Fact Sheet and that the fraction of respondents indicating deterioration will decrease from 22% in 2013 to 15% in 2023 (result indicator). Indirectly, the FI's are also expected to contribute to results of other specific objectives represented by indicators such as: value added per employee, no. of innovative companies, development, growth, exports or innovation. The planned instruments and products include: microloans, lending programmes, guarantees, venture capital, angel equity investments and hybrid instruments (optional).

208. As far as employment and employability are concerned, the planned micro loans will work to achieve Specific Objective 8.4.2 formulated as "Increase employment of unemployed through facilitating aces to and provide support for self-employment and entrepreneurship". The corresponding result indicator is defined as participants in self-employment six months after leaving (labour market) and it is expected that the index will increase from 80% in 2012 to 85% in 2023 (based on draft OPEHR, November 2014).

Demarcation between grants and financial instruments

209. The underlying rationale and assumptions for the selection of financial products and target groups are the identified market failures, sub-optimal investment situations and changes sought after by the intervention logic as defined in the respective operational programme.

210. The recommended guidance towards financial products clearly demonstrating strategic orientation deriving from market failures and/or sub-optimal investment situation. The demarcation line between financial instruments and grants and the proposed financial products (and amounts) are indicative and can be further adjusted during more detailed design of instruments or their implementation (flexibility).

Grants	Financial instruments
The underlying principles for the use of investment grants should be that they only finance initial investment, working capital being not eligible, thus addressing most serious sub-optimal investment situations in the Croatian economy and that each project will have to demonstrate contribution/positive influence on sustainable employment by job creation or, when applicable, job retention.	With overleveraged firms, general under-liquidity in the Croatian economy and highly risk-averted financial institutions any attempt to restore confidence in markets is required. Thus, debt instruments will support financing of general entrepreneurship while equity and quasi-equity are expected to address projects with prospective high returns. The proposed guidance on FI's includes
TO3 of the OPCC	TO3 of the OPCC
▪ Grant funding should primarily address substantiated developmental needs of riskiest ventures, which may be otherwise non-bankable i.e. those innovating through technology transfer and R&D	▪ Long-term loans for firms in growth and expansion phase, irrespective of technological advancement (including combination with interest rate subsidy).

commercialisation yielding returns below expectations of private equity investors. These grants will be aligned with regional aid modalities or aid for start-ups as defined in Regulation 651/2014. Large enterprises shall not be eligible. ▪ Investment grants will be also offered to projects which are able to reasonably demonstrate their potential contribution to regional development measured through increase in firm's sales, employment and export. In addition, investment projects will have to prove an incentive effect of the aid. TO8 of the OPEHR ▪ Small grants for self-employment and bonus payments for successful job finding and its retention should be available to all job seekers and especially for those inactive, long-term unemployed, excluded from the labour market, etc. Grants should have limited amount (but their scope should be extended onto individuals who can crack the labour market themselves). Higher amounts should only be offered as microloans. TO9 of the OPEHR ▪ Social enterprises' demand for financial instruments was not authenticated during ex-ante assessment due to insignificant size of the sector and its fledgling state. Social enterprises can thus benefit from grant funding in the early phase into the implementation of the Operational Programme. Financial instruments could only be offered when the number of social enterprises has reached critical mass to ensure economy of scale and cost-efficiency of the management of financial instruments schemes.	▪ Developmental small loans (including micro loans) with combination of investment finance and working capital finance or working capital loan only with extended maturity period (up to 5-7 years). ▪ Loan guarantees for various loan facilities and possibly leasing, targeting the window between microlending and long-term loans for growth and expansion. Are recommended as individual guarantees but if critical mass is reached can be developed into portfolio guarantees. ▪ Equity finance: venture capital for investments targeting amounts higher than other financial instruments offered (e.g. between €1-3 million) and realised primarily in sectors with high growth potential, including those identified in 3S strategy. The ultimate investment strategy is recommended to explore synergies with the VC established from the World Bank loan. ▪ **Optional/alternative: e.g.** subordinated loans or hybrid finance (e.g. venture loan/debt-based recoupable investment, mezzanine or performance-based-indexed loan)[77] for growth and expansion or projects associated with technology transfer stemming from outsourced R&D or commercialisation based on own R&D works, open innovation, incubation, etc. This would be complementary to equity schemes in terms of size and target groups but finance projects with lower rates of return to those preferred by venture investors. Hybrid finance can be an alternative to angel investment, or complement it. ▪ **Optional:** support to angel investments under the condition that synergies have been established with the intended seed co-investment fund financed from the World Bank resources and managed by HAMAG BICRO. TO8 of the OPEHR ▪ Micro start-up loans to set-up a business by unemployed individuals. These micro loans could have extended maturity of up to 5 years and e.g. 1 year grace period). TO9 of the OPEHR ▪ **Optional:** loans for social enterprises (conditional on the complementary validation of the demand for debt finance by social enterprises, which could not be authenticated during ex-ante assessment process).

[77] This could as well be amalgamated with repayable advance concept however clear definition of project 'success' shall be elaborated

Combination with grant support

211. There was limited interest among stakeholders in combining financial instruments with grant support despite increased flexibility of state aid modalities introduced by new legislation in 2014. Examination of such options was conducted by the stakeholders only after main ex-ante assessment phase.

212. Grant funding will be offered in direct combination with growth and expansion lending facility in the form of interest rate subsidies. Similar combination of interest rate subsidies will also be offered in case of guarantees.

213. Indirect mix of financial instruments and grants is recommended with aid for consultancy, training, or from research & development aid, clusters or innovation aid for SMEs. Support towards soft skills building and investment can be offered for projects financed form the ESF. The ultimate decision on this however rests with the relevant Managing Authority.

Consistency with COSME

214. In principle, capped portfolio guarantee under COSME initiative is designed to focus on individual loans up to €150,000 that mature in up to 10 years.

215. Individual loan guarantees financed from the OPCC 2014-2020 will target similar loan segment in terms of maturity <u>but higher it terms of individual loan amount</u>. The maximum guarantee amount will be validated during ex-ante risk assessment to respect prudent risk concentration principles.

216. The proposed guarantee scheme will thus complement COSME interventions in regard to the single loan size as individual loan guarantees will basically target larger loans than those supported through COSME. In addition to that loan finance will be available in several banks while COSME facilities operated by the EIF are expected to be available in a limited number of banking institutions - up to 2-3.

217. Growth and expansion loans are expected to be larger in size to those supported by COSME guarantee mechanism and should be available in min. 6-8 banks operated in the country.

218. Microcredit facilities both financed from the ERDF and ESF will primarily target viable but non-bankable clientele hence developmental microloans will also complement COSME interventions.

Consistency with HORIZON 2020

219. Guarantee mechanism offered within the framework of Horizon 2020 can target innovative SMEs that finance their operations through debt between €25,000 and €7.5 million, including traditional lending and mezzanine. In addition to small and medium companies the facility can also finance small midcaps up to 499 employees. Thus, the eligible target group of Horizon 2020 differs from the target groups selected for individual guarantees & growth and expansion loans and the instruments implemented through shared management modalities will complement those offered by the EIF.

220. While equity mechanisms offered through Horizon 2020 aim to build pan-European equity and capital markets - chiefly on cross-border basis - the limited allocation on VC and business angels (optional) is aimed at serving the enhancement of the underdeveloped domestic equity market.

221. Concluding, the Horizon 2020 may constitute a supplementary function to the equity schemes supported under the OPCC 2014-2020.

Implementation arrangements and options

222. The recommended strategic option to support FI's is the contribution to financial instruments set up at national level, under the responsibility of the Managing Authority (Article 38 paragraph 1 point (b) of the CPR).

223. In general, the recommended package of financial instruments will be tailored-made in order to address specific needs of the target groups. For risk sharing loan facility the deviation from of-the-shelf could concern loan maturity for specific sectors and state aid regime at the level of SME. Alongside tailor-made conditions support for specific sectors or generic types of projects shall comply with standard terms and conditions for risk sharing loan facility.

224. Modalities earmarked for each financial instrument/product are outlined in section 'Financial products offered and target groups'.

225. The Managing Authority is recommended to use the following modalities and associated options for the implementation of financial instruments:

   a. Entrustment of guarantee, microloan (and optionally hybrid instruments) to HAMAG BICRO, which is a financial institution and body governed by public law aiming at the achievement of public interest and remaining under full control of public authorities; HAMAG BICRO will then select financial intermediaries to participate in loan guarantee programme(s); the selection of financial intermediaries participating in the guarantee programme will be exercised through an open, competitive, transparent, non-discriminatory and objective selection procedure;

   b. Entrustment of lending scheme for growth and expansion to HBOR, which is a Croatian development finance institution aiming at the achievement of public interest and remaining under full control of public authorities; HBOR will act as the primary financial intermediary operating the loan facility. In case of on-lending, financial intermediaries will be selected through transparent, open and competitive procedure.

   c. Entrustment of venture capital programme and support to business angel investors (optional instrument) to the EIF and/or other international finance institution, who will successively select financial intermediaries based on co-investment facility for the both types of investment vehicles. The entrustment however shall be made in sync with the actual progress of the implementation of the VC scheme financed from the World Bank resources.

226. The recommended FI's implementation arrangements in terms of the entrustment modalities draw on significant experience and successful implementation by HAMAG BICRO and HBOR of similar actions in the past. The entrustment FI's to the two national level in-house institutions is in compliance with the EU and national legal framework, and all relevant case law of the European Court of Justice.

227. The entrustment of support to venture capital operator(s) and business angels to the EIF is informed by limited experience of Croatian public authorities in successful mobilisation of venture capital investors. Nevertheless, both HAMAG BICRO and HBOR are commended to get involved in collaborative work with the EIF and/or other international finance institution, aiming to acquire first-hand experience on the subject at hand.

Financial products offered and target groups

228. In order to ensure flexibility of the approach, the proposed financial products are outlined in **descriptive** rather than prescriptive **manner**. The Managing Authority is recommended to choose from the instruments that will complement the grant schemes to be designed. Each financial product/instrument is illustrated in individual product identification data sheet hereunder.

229. Detailed design of instruments shall further develop specific linkages to the eligibility criteria as defined in Article 37(4) of the CPR.

INSTRUMENTS FINANCED FROM OPCC 2014-2020, THEMATIC OBJECTIVE 3

Growth and expansion loans

Rationale and strategic orientation: Limited access to long-term finance for expansion and growth clearly results from risk-averted banks and deteriorating quality of their loan portfolio. With only 2% share of long-term loan finance in all new loans made to enterprise sector in recent years[78] businesses struggle to meet their investment needs irrespective the sector, size, technological advancement or level of innovation. Inability to realise vital investment needs compromises enterprise potential to grow and compete domestically and internationally.

[78] Spreadsheet g3a available on HNB website

In the light of immense credit crunch in Croatia **no viable investment associated with general entrepreneurship lending** should be left behind. Priority can be given to enhance investments in new technologies, innovative products and R&D.

Financing source & contribution to OP specific objective and results: Funding towards growth and expansion lending facility will be provided from the ERDF under Thematic Objective 3 of the Operational Programme Competitiveness and Cohesion 2014-2020.

The target group for this financial product is the entire SME sector. While general entrepreneurship investment lending will contribute to the Investment Priority 3.1 *Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators*, financing towards investments in new technologies, innovative products, processes and services will speak to Investment Priority 3.4 *Supporting the capacity of SMEs to grow in regional, national and international markets, and to encourage in innovation processes* and its associated specific objectives.

Type of instrument and amount of individual financing: Support includes long term-loans. In order to ensure coordination with other products and grants, lending can target undertakings with proven track record and established market position (small and medium firms) with preferred individual amount of financing between €100,000 up to €2-3 million. Micro businesses will benefit from other product - developmental small loan. Implementation arrangements can include:

- Off-the-shelf modality (e.g. for generic projects and sectors); [79]

- Tailor-made approach towards specific types of ventures which can deviate from the standard terms and conditions in regard to e.g.: loan maturity, aid regime (e.g. other than *de minimis*) in order to better address volatility of the *current e*conomic outlook and deteriorating banks' loan portfolios.

Lending will be offered in combination with interest subsidies within the same operation.

Eligible costs: Loans could finance both investments in tangible and intangible assets combined with working capital. Pure working capital shall be excluded from financing. Grant part will subsidise interest rates.

State aid regime, aid intensity: Tailor-made products (individual state aid scheme) shall be drafted based on Regulation 651/2014 and/or *de-minimis* regulation and other possible state aid schemes.

Collateralisation: Standard banking practice in regard to collateral and taking into account additionally to be achieved by the usage of ERDF co-financing.

Financial intermediary/operator: Loan facility is recommended to be entrusted to HBOR which will manage lending activities, through financial intermediaries to be selected through transparent, open and competitive procedure.

Developmental small loans

Rationale and strategic orientation: Micro lending is becoming more and more popular in Europe, including Croatia. The SME Survey (BIZIMPACT II) indicates that nearly 80% of investments made in equipment and machinery in the last two years by Croatian SMEs fall into the cohort €0-50,000.

Micro enterprises finance their borrowing needs through overdraft, short-term credit line or credit card facility more frequently than any other size group within the SME sector (42%) against 34% of small and 32% of medium-sized enterprises. They also face the severest liquidity problems in the entire SME sector and experience payment backlogs more distinctly than the whole SME sector, as earlier evidenced in this report.

External factors and high risk aversion make micro firms non-bankable as financial institutions prefer short-term lending. Despite those hurdles the smallest firms increased the number of employees in 2013 when compared to 2012 while other size groups were more into jobs shedding.[80] Micro firms, including self-employed, appear thus to work as a buffer against higher unemployment rates and need access to finance on terms and conditions that can

[79] At the time of ex-ante assessment there was overwhelming evidence of the need for tailored-made financing. However while the economy recovers this may change and shift towards off-the shelf approach can be considered
[80]Source: raw data from FINA, 2012 and 2013

hardly be offered by commercial banking sector, including longer loan repayment periods and affordable level of collateralisation. Financing should address both, investment needs and/or working capital needs.

Financing source & contribution to OP specific objective and results: Funding towards developmental micro-lending facility will be provided from the ERDF under Thematic Objective 3. Strategic reference is laid down in the Operational Programme Competitiveness and Cohesion 2014-2020.

The broad target group and purpose of this financial product make it suitable primarily for the contribution to Investment Priority 3.1 *Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators*, especially in the context of supporting start-ups and financing small-scale business opportunities. Micro loans could also contribute to the implementation of operations under Investment Priority 3.4 *Supporting the capacity of SMEs to grow in regional, national and international markets, and to encourage in innovation processes* financing small-scale investments in innovative enterprises or augment other measures offered explicitly through this IP, e.g. those referring to clusters.

Type of instrument and amount of individual financing: Small loans up to €50,000 with separate microloan window up to €25,000 for all types of SMEs. Loan maturity could be up to 5-7 years depending on the loan amount and the borrower's situation. Grace period of up to 1 year of can be offered. Loan financing exclusively working capital should up to €25,000 and be max. 3 years in duration. Additional criteria for other ratio between capital investment and working capital financing can be established at a later stage. The facility will offer tailor-made instruments/products and thus individual state aid scheme shall be established.

Eligible costs: Loans could finance both, investment inputs and working capital part of the project. Specific restrictions may apply to the type of assets financed through the loan, in addition to those stipulated by relevant Regulations and rules. Specific types of businesses could raise finance exclusively for working capital as outlined in the paragraph above. Financing of working capital has to be substantiated by loan application form and business plan for audit trail purpose.

State aid regime, aid intensity: Developmental small loans including investment capital could be offered below market rate. The choice between *de minimis* or other state aid modalities defined by Regulation 651/2014 can be decided at a later stage. **In this context the investment in the Financial Instrument shall be considered as investment on market terms and not as financial support by public authority. The key advantage of the small loan facility will be better accessibility due to reduced collateral requirements, to which adds lower interest rates**. Loans entirely financing working capital shall be offered at market interest rates.

Collateralisation: Personal guarantee or bill of exchange in accordance with good practice in Croatia, e.g. validated by notary office for loans up to €25,000. In case of fixed assets purchase pledge can be issued against tangible assets or mortgage for higher amounts.

Financial intermediary/operator: Loan facility is recommended to be entrusted to HAMAG BICRO which will manage lending activities. The organisation already has experience in micro-lending. Lending will require coordination and alignment with capacity building of the borrower, mentoring and after-care. These shall be delivered to the borrower through a standardised and/or bespoke approach by an experienced and qualified local business support institution/service provider.

Guarantees

Rationale and strategic orientation: Access to long-term loan finance is virtually non-existent in Croatia. Data on credits granted in recent years indicate that approx. only 2% of all lending to economic undertakings has maturity longer than 12 months. On one hand this negative trend is caused by lowered demand for investment finance and on the other - by risk aversion on the side of banking institutions which came under pressure to restructure their defaulted loan portfolios.

Although the percentage of companies communicating shortage in collateral is relatively low (up to 4%, depending on the size class across the SME sector) there are 18% of companies, whose loan applications were only partially approved. Though frequently the reason of partial approval is unclear, one of them arguably is insufficient collateral available for the bank after valuation.

Liquid and reliable collateral can also decrease loan pricing as the spread includes costs associated with the probability of loan default and recovery, hence loan guarantees granted by reputable financial institutions or public authorities are more popular in the light of highly risk-averted banks.

Financing source & contribution to OP specific objective and results: Funding towards developmental micro-lending facility will be provided from the ERDF under Thematic Objective 3. Strategic reference is laid down in the Operational Programme Competitiveness and Cohesion 2014-2020.

The broad target group being the entire SME sector and purpose of this financial product make it suitable for the contribution equally to Investment Priority 3.1 *Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators*, as well as operations under Investment Priority 3.4 *Supporting the capacity of SMEs to grow in regional, national and international markets, and to encourage in innovation processes*.

Type of instrument and amount of individual financing: Eligible transactions covered by the guarantee must be newly originated eligible risk finance loan transactions, including lease instruments. Max. guarantee amount should consider prudent risk concentration criteria per undertaking and per individual loan.

The maximum guarantee rate can be up to 90% of the loan principal. Guarantee maturity shall in principle not exceed 10 years, unless the nature of the investment requires longer maturity. The facility will thus offer tailor-made instruments/products.

Guarantees will be offered as a package together with interest rate subsidy towards the guaranteed loans and managed under the same operation.

State aid regime, aid intensity: No arrangement fees will be charged for approving/processing guarantees. Aid comprised in guarantees will be calculated on the basis of safe-harbour premium laid down for the respective type of undertaking and the gross grant equivalent will fall under *de minims* aid or Regulation 651/2014. In case an annual fee is charged, aid comprised in guarantee will be reduced by that amount.

Collateralisation: Personal guarantee or bill of exchange. Other types of collateral shall be restricted to absolute minimum and be informed by risk levels.

Financial intermediary/operator: Guarantee facility is recommended to be entrusted to HAMAG BICRO. The organisation already has significant experience in the management of guarantee programmes with lending and leasing institutions. HAMAG BICRO shall announce its new/extended guarantee programme(s) and select financial intermediaries on open and transparent basis.

Venture capital

Rationale and strategic orientation: Croatia features one of the lowest rates of private equity and venture capital supply across the EU albeit data from the EVCA exhibit limited performance in terms of private equity investments, venture capital is almost non-existent in the country. Indeed, IUS-2014 scoreboard indicates null value for VC in Croatia.

Earlier strategic attempts to enhance the development of PE/VC in Croatia yielded variegated results as investment funds' strategies gravitated towards larger individual investments rather than innovative start-ups with high growth potential. This happened for a number of reasons and, arguably, one of them was the establishment of the FGSs in the times of deep economic decline when investors were highly risk-averse and investment managers were forced not to take more risk than was absolutely necessary to produce the risk/return ratios the sources of capital asked the managers. The main purpose of the intervention is to regain investors' confidence in the Croatian equity market and contribute to the development of more innovative financing methods of SMEs and their business management capacities and capabilities.

Financing source & contribution to OP specific objective and results: Funding towards VC vehicle will be provided from the ERDF under Thematic Objective 3 of the Operational Programme Competitiveness and Cohesion 2014-2020.

The target group for this financial product will be the entire SME sector, most likely originating from business incubation and open innovation processes and sectors and businesses identified in 3S strategy. Support to VC facility will contribute to the implementation of Investment Priority 3.1 *Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators* and Investment Priority 3.4 *Supporting the capacity of SMEs to grow in regional, national and international markets, and to encourage in innovation processes*.

Type of instrument and amount of individual financing: Co-investment facility with targeted amount per undertaking, indicatively between €1-3 million. Investment strategy should include potential high-growth ventures, especially in sectors promoted by 3S strategy (but not limited to).Early stage (seed, start-up) and later stage venture shall be the primary target group provided that investees meet the criteria set out in Articles 21 and 22 of Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Article 107 and 108 of the Treaty. Generalist finance should be excluded.

Eligible costs: As per standard definition for eligibility of costs for co-investment facility.[81]

State aid regime, aid intensity: There are two scenarios or steps recommended for the VC vehicle:

1. Selection of the fund manager in compliance with Article 21 of Commission Regulation (EU) No 651/2014 in terms of investee eligibility and Article 13 of Commission Delegated Regulation (EU) No 480/2014 on thresholds for management costs and fees alongside other conditions that will be published for off-the-shelf equity instruments;

2. In case the selection procedure contemplated in the previous para fails due to insufficient co-financing by private investor or deviation from the eligible investment strategies, a tailor-made instrument should be designed based on further market analysis.

Collateralisation: Not applicable.

Financial intermediary/operator: The European Investment Fund or other international finance institution that will subsequently select the financial intermediary (fund manager).

Notes:

- Support to VC vehicle is primarily recommended in order to mobilise potential investors and increase supply of finance available to address market failures in equity/capital markets.

- Supplementary analysis and market research shall be exercised in order to validate constantly changing appetite for risk and the supply side, the latter in the light of the anticipated VC scheme financed from the World Bank loan. The analysis shall be completed before entrusting the implementation of this instrument/product to the EIF or other international financial institution.

- During ex-ante assessment works a factual need for preferential remuneration of private investors could not be clearly established and validated in monetary terms due to virtual lack of the presence of institutional VC private investors in the country. Such a need however shall be considered to be reasonably high and thus reflected in the evaluation criteria during the selection of financial intermediaries.

- Should the demand for supplementary VC be not validated the funding envisaged for VC within this ex-ante assessment report can be moved to enlarge lending scheme for growth and expansion or any other instrument or product subject to the notification to the Monitoring Committee.

Venture loan

Rationale and strategic orientation: Long-term debt finance is scarce in Croatia and financing of projects stemming from RDI is sparse. The existing lending facility for innovators managed by HBOR yielded limited number of ventures despite preferential interest rates offered and in spite of significant number of research and development projects sponsored earlier by BICRO. **Although the causes of these occurrences are complex in nature, arguably one of them is associated with the inherent character of a banking institution that normally invests in a company rather than in a project**. Meanwhile financing of RDI is more than investing in an economic undertaking. It is also about investing in a product and in people and in the potential they form all together. These aspects are often more important than the company per se, aspects which are not considered by a commercial lender or even a development banking institution.

RDI projects, especially those promoted by new-born start-up companies, are frequently non-bankable and in risk-averted environment cannot get financing they require. There is therefore a need for a limited recourse financial structure where debt used to finance the project is paid back from the cash-flow generated by the project (and directly linked to the project performance, both in terms of pricing and return) rather than from the balance sheet of the project promoter.

[81]At the time of the development of this ex-ante assessment report standard off-the-shelf conditions for risk capital investments were not available.

Venture loan could finance projects that are not meeting requirements of venture capitalists or angel investors i.e. cannot demonstrate high returns in a short to mid-term perspective yet they are promising in mid-term perspective, or are of too low value for VC or too high for business angel, or are not fully incubated for VC investor to take risk.

Financing source & contribution to OP specific objective and results: The target group for this financial product is the entire SME sector, most likely originating from business incubation and open innovation processes or stemming from technology transfer resulting from outsourced R&D or internal RDI works with the ultimate goal of commercialisation. This venture loan facility will thus contribute to Investment Priority 3.1 *Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators* and support investments in new technologies, innovative products, processes and services and commercialisation of R&D works will speak to Investment Priority 3.4 *Supporting the capacity of SMEs to grow in regional, national and international markets, and to encourage in innovation processes* and its associated specific objectives.

Type of instrument and amount of individual financing: Loan, sub-ordinated loan and/or quasi-equity finance between approx. €200,000 to 1,000,000 with interest rate indexed against the ultimate project performance indicators, e.g. fraction of turnover, etc. The minimum amount shall be ultimately set to avoid overlap with the anticipated seed/business angle scheme financed from the World Bank loan.

Eligible costs: finance offered shall be chiefly investment finance with owner's equity required at a certain minimum %. Financing of working capital can be eligible but limited (e.g. up to 20% of the loan amount).

State aid regime, aid intensity: the presence of state aid element will depend on the % participation in the investment. Initially the scheme is expected to comply with Article 21 of the Commission Regulation (EU) no 651/2014. Specific innovative projects may however require higher intensity levels and appropriate notification procedure will thus be necessitated. Aid for start-ups modality can also be applied.

Collateralisation: Pledge against assets, personal guarantee, equity conversion option.

Financial intermediary/operator: HAMAG BICRO. The institution already gained experience in the delivery of repayable advances for R&D projects.

INSTRUMENTS FINANCED FROM OPEHR 2014-2020, THEMATIC OBJECTIVE 8

Self-employment micro loans

Rationale and strategic orientation: Employment and activity rates in Croatia are low and unemployment is one of the highest in the EU. Yet, finance for self-employment in Croatia is limited in terms of global amounts allocated towards the ALMP's. HZZ offers only self-employment subsidies and data indicate that in the period 2011 - June 2014 the average individual amount of subsidy was approx. €3,200.Given that the average net earnings are approx. €730, the self-employment subsidy is considered to be insignificant to have meaningful impact on a new business requiring investment in fixed assets and when striving for economic sustainability.

The Ministry of Labour and Pension System plans to retain the programme of subsidies that will gradually phase out. Hence, there is a need to introduce a measure that would enable financing self-employment projects of a larger size, hence the recommended loans for unemployed individuals seeking self-employment opportunities. The revolving character of the intervention measure would enable to serve more beneficiaries in mid- to long-term perspective. Consequently, the existing subsidies should also be extended in terms of eligible actions covered and e.g. used as an incentive for job-seekers to find a job.

Financing source& contribution to OP specific objective and results: Funding will be provided from the European Social Fund under Thematic Objective 8. Strategic reference and details are provided in the Operational Programme Effective Human Resources 2014-2020. The indicative allocation under the OP for financial instruments is €50 million. Self-employment loans will be financed under ESF Investment Priority 8.i: *Access to employment for job seekers and inactive people, including long-term unemployed and people far from the labour market, also through local employment initiatives and support for labour mobility* and 8.ii: *Sustainable integration into the labour market of young people (ESF), in particular those not in employment, education or training, including young people at risk of social exclusion and young people from marginalised communities, including through the implementation* *of the Youth Guarantee*. The corresponding specific objective is formulated as: 8.i.2*Increasesustainable self-employment of unemployed people, especially of women*. Secondary though insignificant impact can be achieved for 8.ii.1 *Increase employment and integration of long-term unemployed NEETs into the labour market and for all NEETs from 2019*.

Type of instrument and amount of individual financing: microloan/small loan up to €25,000. In case of a partnership of 2 or more unemployed individuals the maximum loan amount could increase e.g. to €35,000 to allow for flexibility and partnership building. Loan maturity could be up to 5 years with 1 year of grace period. **Youth and long-term unemployed are recommended to benefit from repayable advances instead of standard microcredit (successful business criteria)**.**Similar mechanism/conditions may be introduced for category of borrowers falling under the term "second chance entrepreneurship".** Size of financing will be that for microloan.

Eligible costs: Loans could finance both, investment inputs and working capital part of the project. No specific ratio between the two is established to ensure flexibility of this financial product but ideally the loan should cover both types of expenditure.

State aid regime, aid intensity: Loans are recommended to have preferential interest rate, up to 1% and the scheme can be run on *de minims* modality.

Collateralisation: Personal guarantee or bill of exchange in accordance with good practice in Croatia.

Financial intermediary/operator: Loan facility is recommended to be entrusted to HAMAG BICRO. The organisation already has experience in micro-lending and working with unemployed individuals. Technical assistance to develop project for financing, mentoring and after-care shall be delivered to the borrower through a standardised approach by specially appointed experienced and qualified local business support institution or mentors network.

INSTRUMENTS FINANCED FROM OPEHR 2014-2020, THEMATIC OBJECTIVE 9

The OPEHR 2014-2020 indicatively set aside an amount of €32 million to support social enterprises.

Financial instruments for social enterprises **are only recommended as mid-term option**. This is because:

1. Ex-ante assessment could not validate the existence of a significant critical mass of the ultimate target group and its capacity to implement viable projects;

2. There is no meaningful experience of supporting social enterprises, e.g. through grants and thus project monitoring culture and understanding of the sector specificities by policy makers and financial institutions is limited.

For that it is recommended that the Managing Authority for the OPEHR initially runs a pilot investment grant scheme that could also allow for interest rate subsidy (preferably as start-up aid) shortly after the adoption of the OP.

Subsequent counterfactual external review of the supported projects and beneficiaries against neutral sample shall be carried out. Findings of the review should ideally investigate the composition of the target group, its structure and authenticate suitability of the use of financial instruments (debt). **The review contemplated earlier in this paragraph shall be included in the Evaluation Plan for the OPEHR**.

Loan finance for social enterprises

Rationale and strategic orientation: Social enterprises, like all business ventures, leverage economic ideas through the application of funding and capital. To bring innovative products and services to market in order to produce robust and scalable social change, businesses of this kind must have access to finance. Without access to capital, even the most compelling social enterprise idea will go nowhere.

Social economy and social enterprise movement in Croatia are fledgling as evidenced earlier in this document. Legal framework for social ventures is yet shaping up; there are scarce sources of financing social entrepreneurship and very few success stories. Though cooperative movement has long and strong tradition in Croatia, it largely applies only to agriculture meanwhile social entrepreneurship goes far beyond legal forms and focuses on specific societal values and principles. On the other end civil society organisations grow in numbers but very few of them (9.1%)

have economic character.[82] Croatian associations are very small on average, rely vastly on volunteer work; they also have insufficient knowledge, organisational and management skills. Similarly to associations cooperatives other than those in agriculture are also feeble; half of them have not got a single employee and the average number of employees per cooperative is less than 3 persons.[83]

Financing source & contribution to OP specific objective and results: The Operational Programme Effective Human Resources 2014-2020 anticipates support for social enterprise seeking the increase in their number and employment levels. Financing is envisaged under Investment Priority 9.v *Promoting social entrepreneurship and vocational integration in social enterprises and the social and solidarity economy in order to facilitate access to employment*. The change sought after is formulated as (SO 9.v.5): *Increase the number and sustainability of social enterprises and their employees*.

Indicative OP activities are inclusive and include *inter alia*: provision of business development services, especially consulting services, supporting the initiatives of CSOs to develop social entrepreneurship programmes and plans in different business fields with special attention given to their specific needs (e.g. business skills), support for development and dissemination of relevant information and knowledge within formal and informal education in order to enhance social entrepreneurship's appeal at all educational levels, implementation of financial services such as interest rate subsidies, guarantees, microfinance and start-up loans for social enterprises or support of social/ethical banks and other innovative financial initiatives in terms of training, visibility, networking etc.

Type of instrument and amount of individual financing: Subsequently to the roll-out of a pilot grant scheme and the review of its results and outcomes, the Managing Authority may decide whether it shall continue with investment grant funding or implement support through direct collateralised lending facility. **Loan conditions should be carefully designed, including interest rates, to give the borrower's management structure incentives to operate the organization efficiently**. Lending should be linked to training and capacity building/mentoring activities and the entire package offered all-in. Maximum loan amount shall be established based on the review of the pilot grant projects. Guarantees are not recommended at this juncture as there is virtually no evidence that existing social enterprises can raise loan finance domestically.

Eligible costs: investment and working capital with the supplementary finance for capacity building (training and mentoring).

State aid regime, aid intensity: subsidised loans and incentives to the borrower can be offered on *de minimis* modalities or as a tailor-made aid scheme subject to notification.

Collateralisation: Collateral will include standard practice applied for development finance in Croatia.

Financial intermediary/operator: The scheme is likely to be introduced around the middle of the OP implementation period. The role of the financial intermediary is recommended to be exceptionally entrusted to HAMAG BICRO. Direct entrustment could significantly speed up the roll-out of the lending facility – important in the context of the proposed phased implementation of the entire activity.

Summary of state aid implications

230. The summary of state aid issues outlined in the financial instruments data sheets is tabulated below.

Instrument	State aid elements	Action required
Growth and expansion loans	Tailor-made products (individual State aid scheme) shall be drafted based on Regulation 651/2014 and/or *de-minimis* Regulation. During the enquiry other individual state aid schemes were also signalled as an option to unlock lending to SMEs.	The Managing Authority shall consult with the Ministry of Finance whether tailor-made lending scheme complies with Regulation no 651/2014 or individual notification will be sought after. The Managing Authority and the financial intermediary shall monitor the uptake of available funds and banks' risk appetite.

[82]Status in May 2014, according to the Register of Associations URL: http://www.appluprava.hr/RegistarUdruga/
[83]Source: own calculation based on FINA data (2013)

Developmental small loans	Some loans may be offered at market interest rates while aid granted through loans with subsidised interest rate will fall under *de minimis* modalities.	N/A
Guarantees	Guarantees will fall under *de minimis* modalities, regional aid or start-up aid. Aid modalities will be established individually for each undertaking.	N/A
Venture capital	The investment strategy aims to comply with the provisions of Article 21 (10-b) of the Regulation 651/2014	The MA and appropriate IB shall carefully review the ultimate investment strategy in order to consider other targeted undertakings defined in Article 21, including start-ups.
Venture loan	In general the scheme will comply with risk finance aid (Regulation 651/2014, Article 21) or, where relevant, aid for start-ups. Higher aid intensities require notification.	The Managing Authority and relevant IB shall monitor the uptake of available funds and use their discretion whether the use of higher intensities is substantiated by demand and SME needs. Notification of scheme exceeding thresholds of Article 21 will then be required.
Self-employment loans and repayable advances	The scheme will operate under *de minimis*.	N/A
Loan finance for social enterprises	The scheme will operate under *de minimis*.	N/A

Financial allocations, leverage effect and value added

231. Financial allocations recommended below are indicative and serve as guidance only. This is due to spreading decline of the quality of banking loan portfolio, which may affect the proposed overall design of instruments and products.

232. The following conjectures and overarching assumptions guided the proposed interventions:

    a. Support to unlock accessibility of long-term loan finance for established businesses is essential to kick-start investments in SMEs (growth and expansion); in case of slow uptake of funds and/or further deterioration of banks' portfolios, new and innovative products will be developed in line with market needs;

    b. Microcredit shall be widely available for viable but non-bankable individuals (e.g. unemployed and other disadvantaged persons - ESF) and entrepreneurs (ERDF) on terms and conditions that will not compromise their liquidity;

    c. Loan guarantees are highly recommended but continuous monitoring of the interplay with growth and expansion lending facility is essential; financial reallocations between the two instruments may be required in the course of the implementation of financial instruments programmes;

    d. Lending to social enterprises does not appear to be able to reach critical mass at this juncture due to very limited scale of the sector however limited loan facility is recommended through phased approach;

    e. Venture/hybrid loans will have pilot character. Any changes to the proposed hybrid finance facility shall be made in conjunction with or consideration given to any support towards business angels and/or venture capital;

    f. Any changes to or limited accomplishment of support for VC should be made in alignment with lending facility for growth and expansion, through e.g. increasing/decreasing allocation for product, or change in the maximum/minimum loan amount.

233. Alignment of interest rate with private co-financing will apply to loans for growth and expansion. It is recommended that interest rate adjustment due to no cost funding from ESI funds will be subject to evaluation criteria during the selection of the on-lending financial intermediaries.

234. For the leverage effect the following **indicative assumptions** were taken into consideration:

    a. Loans for self-employment (ESF) do not envisage co-financing by the borrower and only national public contribution will be made to match ESI Funds;

    b. Developmental small loans (ERDF) will not be co-financed from national resources but co-financing of the projects by the borrower will be required (25% on average);

    c. ERDF will solely finance guarantee mechanisms; the average multiplier of 4.5 is envisaged (to back estimated non-performing loan portfolio rate at 20-25%) and at average guarantee rate of 75% and input by the borrower - circa 15% on average;

    d. ERDF input towards lending for expansion and growth will be matched by national co-financing (HBOR), participating banks (between 40 and 50% being contribution from financial intermediaries, depending on the type of loan, and 25% being the contribution from final recipients for each project financed);[84]

    e. ERDF will entirely contribute financing towards interest rates subsidies for growth and expansion loans and guaranteed loans

[84] The aggregate contribution by financial intermediaries is indicative since it will be validated via competitive procedure for selection of participating banks.

f. Funding from the ERDF towards venture loans will be augmented by public national contribution (15%); SMEs will be required to co-finance projects;

g. Venture capital facility will be on average a 50-50 funding match with private investors;

h. Social enterprises will on average provide 15% contribution towards each project financed and national co-financing towards the facility will also be provided at 15% rate.

Table 25: Indicative financial allocation per product/instrument and leverage, in €

Product	ESIF Contribution	National public co-financing	Total public	Financial intermediary contribution	Funding available to Final Recipient	Final recipient contribution	Total investment
Developmental small loans	25,000,000	0	25,000,000	0	25,000,000	7,941,176	**32,941,176**
Guarantees	55,000,000	0	55,000,000	0	247,500,000	37,125,000	**284,625,000**
Subsidies towards guaranteed loans	25,000,000	0	25,000,000	0	25,000,000	0	**N/A**
Growth and expansion loans	85,000,000	85,000,000	170,000,000	155,000,000	325,000,000	110,000,000	**435,000,000**
Subsidies towards growth and expansion loans	25,000,000	0	25,000,000	0	25,000,000	0	**N/A**
Venture loans	15,000,000	2,647,059	17,647,059	0	17,647,059	5,294,118	**22,941,176**
Venture capital	20,000,000	0	20,000,000	20,000,000	40,000,000	6,000,000	**46,000,000**
Self-employment micro loan	50,000,000	8,823,529	58,823,529	0	58,823,529	0	**58,823,529**
Social enterprise lending	10,000,000	1,764,706	11,764,706	0	11,764,706	1,764,706	**13,529,412**
TOTAL	**310,000,000**	**98,235,294**	**408,235,294**	**175,000,000**	**775,735,294**	**168,125,000**	**893,860,294**

Source: own elaboration

235. Leveraging effect of the ESIF financing broken down by the Fund is thus as follows:[85]

a. For ERDF: €250 million are expected to yield € 705.1 million of funding available to final recipients and the net effect (excluding contribution by the final recipients) is thus approx. 282% while the gross effect including inputs from the final recipients and multiplier effects is circa 329%;

b. For ESF (€50 million+ €10 million) the net leverage effect is estimated conservatively at 17.6%. When contribution by the final recipient is concerned, this leverage is approximately 20.6%

236. The net leverage effect for all FI's under TO3, TO8 and TO9 is 250% as €310 million of ESI Funds are expected to translate into €775.7 million of funding available to final recipients.[86]

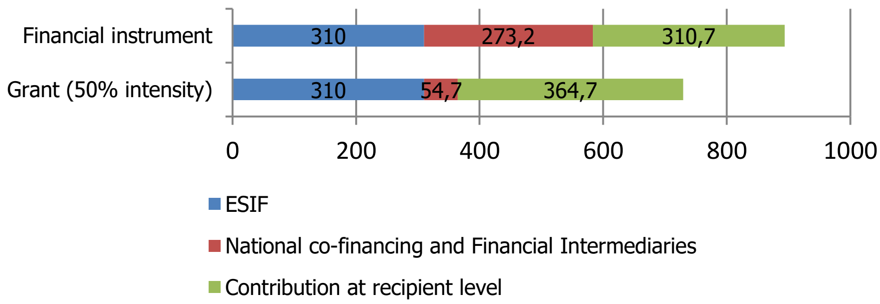
237. €310 million of ESIF contribution is expected to finance approx. 893.9 million in the ultimate investments. The gross multiplier effect is thus estimated at 288%.

238. The illustration of the difference in total (gross) leverage effect between the financial instruments (including final recipient's contribution) and hypothetical grant funding at 50% aid intensity is depicted in the figure below.

Figure 13: Gross leverage effect of contribution to financial instruments under TO3, TO8 and TO9 in comparison to alternate contribution to grant funding; amounts in € millions

[85] The ultimate leverage will be determined by the level of co-financing towards growth and expansion loan facility and the actual multiplier effect of the guarantee scheme.

[86] It includes the sum of national co-financing, private co-financing and estimated volume of loan portfolio extended through guarantees in relation to ESIF contribution.



Source: own elaboration

239. As outlined in the figure above, financial instruments add only insignificant value to the broader interventions reviewed in this ex-ante assessment when compared to grant funding. €310 million of the contribution from ESIF is expected to yield investments worth circa €893.9 million when channelled through financial instruments. It shall be noted however that the calculation abstracts from management fees and that revolving effects of resources are not factored. The same ESIF amount allocated towards grants could result in investments worth €729.4 million at 50% of aid intensity. The lower the intensity the higher this leverage can be.

240. **When compared to grants, financial instruments could add more value in quantitative terms only in mid- to long-term perspective, and when taking into account their revolving character**. Yet, this effect shall be adjusted by non-performing portfolios and likely write-offs alongside management fees of financial intermediaries.

241. In **qualitative terms** - especially through debt instruments - FI's will inarguably yield indirect economic benefits supporting entrepreneurship development through access to finance, which would not normally be available given the existing risk-averse position of the banking sector in the country and non-existence of grants for general entrepreneurship (demarcation). This is expected to contribute to new investments and strengthening sustainability of the existing jobs alongside livelihood of households.

242. At the time of the development of this ex-ante assessment report no need for preferential remuneration of financial intermediary was identified.

FI's contribution to OP objectives& monitoring arrangements

243. The section below outlines strategic intervention logic linking the proposed instruments and products with the monitoring framework provided in the OPCC 2014-2020 and OPEHR 2014-2020. Supplementary assessment of the association between the means of delivery and the monitoring framework is also provided.

244. Only most suitable output and result indicators were considered for analysis (performance framework).

Table 26: Review of intervention logic by instrument/product

Instrument	Investment Priority	Specific Objective	Result Indicator	Output Indicator(s)	Analysis and Commentary
Self-employment micro loans (ESF)	8.i: Access to employment for job seekers and inactive people, including long-term unemployed and people far from the labour market, also through local employment initiatives and support for labour mobility	8.i.2 Increase sustainable self-employment of unemployed people, especially of women	CR06: Participants in employment, including self-employment, six months after leaving (to decrease from 57% to 54%) SR102: Participants in self-employment, six months after leaving (to increase from 18% to 20%)	SO103: Women who received support for self-employment: 9,365 SO104: Number of start-ups supported: 12,919	IP 8.i will be implemented through grants, subsidies and non-refundable forms of aid alongside financial instruments (micro-lending). FI's should target individuals with validated business acumen and feasible and viable business plan. Women being specific target group of this IP appear to be a sub-set of the targeted number of supported start-ups. Please, note that the description of the IP and internal consistency of the OP does not allow concluding that all start-ups are expected to benefit from FI's and thus the value of SO104 included entities receiving other forms of support, including training and consultancy aid. With the estimated average value of single micro loan of approx. €9,000 (benchmark of Poland, Hungary) the budget of €50 million can support up to 5,560 start-ups in the first round of FI uptake. Revolving character of the FI

Instrument	Investment Priority	Specific Objective	Result Indicator	Output Indicator(s)	Analysis and Commentary
					could possible further finance up to 1,600 entities (7,160 in total through 2023) Depending on the uptake of the FI budget, the actual average size of investment and the quality of loan portfolio further additional allocation is recommended to contribute more to the achievement of the SO104 value through the FI. Youth can also benefit from the FI offered under IP 8.i.
	8.ii: Sustainable integration into the labour market of young people (ESF), in particular those not in employment, education or training, including young people at risk of social exclusion and young people from marginalised communities, including through the implementation of the Youth Guarantee	8.ii.1 Increase employment and integration of long-term unemployed NEETs into the labour market and for all NEETs from 2019	CR06: Participants in employment, including self-employment, six months after leaving (to increase from 45% to 50%)	No specific output indicator pertains to FI.	It is very unlikely that the IP 8.ii can offer sustainable support through FI to the target group of NEETs. Only limited number of beneficiaries receiving scholarships (SO114) could qualify for FI offered primarily under IP8.i.
Social enterprise lending (ESF)	9.v: Promoting social entrepreneurship and vocational integration in social enterprises and the social and solidarity economy in order to facilitate access to employment.	9.v.5: Increase the number and sustainability of social enterprises and their employees	CR04: Participants in employment, including self-employment, upon leaving (to increase from 30% to 60%) SR207: Social entrepreneurs and social enterprises employees who improved their business and work related skills (to increase from 60% to 90%)	CO23: Number of supported micro, small and medium enterprises (including cooperative enterprises, enterprises of social economy): 170	Despite limited number of the existing genuine social enterprises (approx. 100) the target set through CO23 appears to be achievable albeit great effort is required to stimulate the establishment of new social enterprises. This is why support shall be phased and FI can be offered not as seed finance but finance to support growth and expansion (including working capital). Average investment support per

Instrument	Investment Priority	Specific Objective	Result Indicator	Output Indicator(s)	Analysis and Commentary
					social enterprise should be around €110,000-120,000 to achieve the target.
Developmental small loans Guarantees Growth and expansion loans Subordinated loans Venture loans Venture capital	3.1 Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators	3.a.1: Better access to finance for SMEs	3.a.11: Access to public financial support including guarantees (% of respondents indicating deterioration to decrease from 22% to 15%)	CO01: Productive investment. Number of enterprises receiving support: 3,360 CO03: Productive investment. Number of enterprises receiving support other than grants: 2,507 CO07: productive investment. Private investment matching public support to enterprises (non-grants): €87.5 million	The estimated share of FI recipients to the total number of beneficiaries (CO03/CO01) is approx. 74.6%. Output indicators appear to be underestimated: the single allocation for microcredit should exceed result indicator CO04 and other FI's are expected to well surpass the target. The recommended FI's and the quotient CO03/CO01 are expected to contribute to the achievement of result indicator 3.a.11 as 1.3-1.5% of all Croatian SMEs can benefit from the support offered by the Programme. With grant funding and soft support included the OP intervention can cover more than 2% of all SMEs in the country. The target of 1,800 businesses receiving microloan can be exceeded if the average loan size is below €23,500, which is very likely. The target set in CO07 can also be exceeded. The single growth and expansion lending scheme could surpass the target value of this output indicator. Though FI's are primarily included in IP 3.1, the

Instrument	Investment Priority	Specific Objective	Result Indicator	Output Indicator(s)	Analysis and Commentary
					products and instruments offered shall have positive impact on the activities within the IP 3.4: Supporting the capacity of SMEs to grow in regional, national and international markets, and to encourage in innovation processes and related specific objectives: 3.d.1 SMEs' development and growth improved in domestic and foreign markets and 3.d.2 SMEs' innovativeness enhanced. Despite that direct causal association between the FI's and result indicators - 3.d.11: Value added per employee in SMEs (to increase from €16,824 to €25,000) 3.d.12: Share of SME exports in total export of goods (to increase from 44% to 47.5%) 3.d.21: Innovative SMEs compared to total number of SMEs (to increase from 33.10% to 35%) - cannot be quantified due to insufficient narrative of the intended grant support and 'soft' forms of assistance. These should be further elaborated in an action plan or equivalent of programme complements. Due to meagre total financial allocation on TO3 the FI's contribution to SO 3.d.11 can-

Instrument	Investment Priority	Specific Objective	Result Indicator	Output Indicator(s)	Analysis and Commentary
					not be clearly validated, similarly to SO 3.d.12 alongside SO 3.d.21 due to significant likelihood of deadweight effect of this intervention. It shall be noted that targets set for the three specific objectives: 3.d.11, 3.d.12 and 3.d.21 can be negatively impacted by substitution and displacement effects if demarcation between grants and financial instruments is not respected.

Source: own elaboration

245. It is recommended that dedicated FI Joint Task Force is established for the FI's covered by this ex-ante assessment as an advisory body to the Monitoring Committees. The Task Force should serve as a think-tank and specifically deal with the performance and progress of all financial engineering instruments implemented under TO3 and TO8. It shall also advise the MA and Monitoring Committee as to the roll-out of FI's under TO9 (OPEHR) and/or use of alternative instruments to those recommended as core instruments and products.

246. The minimum monitoring and reporting requirements laid down in the CPR and delegated acts shall be reviewed and expanded in the context of the recommendations in the paragraphs below.

247. In liaison with the respective Intermediate Bodies the MA shall set up monitoring system that captures contribution to result and output indicators as defined in the respective Operational Programme, pertaining to the instruments recommended herein. Performance is recommended to be reviewed on quarterly basis or more frequently. The table below outlines indicative milestones for the arrangement of FI's for their roll-out.

Table 27: Milestones for FI's roll-out

Common national rule for financial instruments	Jun-15
Establishment and verification of management and control systems for FI's	Nov-15
Detailed description of products and financial services	Dec-15
Funding agreement with entrusted bodies	Dec-15
MIS	Jun-16
Selection of financial intermediaries (for debt instruments)	Sep-16
Selection of financial intermediaries (VC/PE)	2017
FI's implementation	From 1Q 2017
On-going evaluation	Sep-17

Source: own elaboration

248. In addition to the monitoring of contribution to output indicators the level of management costs and quality of portfolio shall be assessed with same frequency. In principle, the debt instruments portfolios are expected to be indicatively 30% healthier on average than the banks' loan portfolios as these still endure negative consequences of the economic decline in the years 2008-2013.

249. Leverage effect shall also be reviewed alongside indicators contemplated in the two previous paragraphs.

250. Corrective or preventing measures, including suspension of the instrument or its modification, shall be taken in case of significant deviation from the expected results or outputs.

Final provisions

251. The ex-ante analysis was carried out in the period from September 2013 through March 2015, allowing for the production of a reasonable snapshot of the genuine situation on the ground and association of the ex-ante assessment works with the broader programming exercise.

252. The document covers only financial engineering instruments to be delivered within the framework of Thematic Objective 3 of the OPCC and Thematic Objective 8 and 9 of the OPEHR. Assessment of FI's delivered under other Thematic Objectives shall be included in separate ex-ante assessment analysis and report.

253. More detailed design of the FI's and coordination with other forms of support shall be based upon the framework provided in this ex-ante assessment document alongside the respective delegated acts and Regulations adopted by the European Commission.

254. The ex-ante assessment report shall be submitted to the Monitoring Committee established for the OPCC 2014-2020 and separately for the OPEHR 2014-2020 for information purpose. The summary findings and conclusions of this assessment (pages 6-9: "Executive summary") shall be published within three months of the date of the finalisation of the document.

255. Any amendment to the ex-ante assessment report shall be sent to the EC for information purpose.

256. Given the time horizon of the OPCC and OPEHR implementation the ex-ante assessment report can be reviewed and updated during the roll-out phase of the Programmes, particularly in case when the market conditions at the time of implementation do not reflect those when the ex-ante assessment was carried out (trigger point).[87] The review can be initiated by the Managing Authority.

257. In addition to the provisions of para 255-256 the review of the ex-ante assessment can also be requested by the respective Programme Monitoring Committee.

258. Modification or revision of the ex-ante assessment is recommended to be carried out by external body, free of conflict of interest.

259. Financial reallocation between instruments or products can be exercised without full amendment of this report, including discretionary introduction of products or instruments marked earlier in this report as 'optional': subordinated loan finance, hybrid instruments, angel investments, loan/guarantee programme for social enterprises. To this effect an individual needs assessment per instrument and the review of its consistency with other forms of support shall be prepared by the Managing Authority and submitted for review by the relevant Monitoring Committee.

260. Prudent ex-ante risk assessment for guarantee products shall be exercised in order to compute an appropriate multiplier ratio between the amounts established to cover expected and unexpected losses from loans and the corresponding new loan portfolio. The ex-ante risk assessment contemplated in the previous sentence shall use statistical methods of value at risk computation and be desirably validated by an actuary. This amount shall be used to estimate the amount of eligible costs under ESIF 2014-2020 for guarantee products.

261. Due to perpetual changes in the quality of banks loan portfolio the ex-ante risk assessment referred to in the previous para shall be reviewed around the middle of the ESIF implementation period.

262. Performance-based calculation methodology for management costs and fees should be adopted in accordance with Article 13 of the Commission Delegated Regulation no 480/2014, ensuring alignment of interest between the Managing Authority and bodies implementing financial instruments. This methodology should take into account the performance of the financial instrument, the quality of support provided to final recipients, as well as their contribution to the objectives and outputs attributable to the programme contributions. The methodology should be included in the relevant funding agreement and the Monitoring Committee must be informed in advance of the proposed methodology. The Monitoring

[87] These can concern situations such as: negative GDP data for 2014 and 2015, significant deterioration of banks loan portfolio, etc.

Committee should receive regular reports on the management costs and fees effectively paid, every twelve months.

263. The ceilings referred to in the previous para shall in principle comply with the Commission's proposal on the fees and remuneration for bodies implementing financial instruments (or fund of funds, if relevant):[88]

- Base remuneration for the management of contributions, for equity: committed by the managing authority, or by the fund of funds where applicable, under the relevant funding agreement to bodies implementing the financial instrument, calculated *pro-rata temporis* from the moment of signature of the relevant funding agreement until the end of the eligibility period, the repayment to the managing authority or the date of winding up, whichever is earlier; or in all other cases, paid to bodies implementing the financial instrument, calculated *pro-rata temporis* from the moment of effective payment to the financial instrument until the end of the eligibility period, the repayment to the managing authority or the date of winding up, whichever is earlier

- Performance-based remuneration relating to programme contributions paid (in case of guarantees committed) to final recipients and where appropriate from resources re-invested which are attributable to programme contributions, which are still to be paid back to the financial instrument, calculated *pro-rata temporis* from the moment of payment to the final recipient until the repayment of the investment, the end of the recovery procedure in the case of write-offs or the end of the eligibility period, whichever is earlier

264. The contents of funding agreements with financial intermediaries shall comply with Annex IV to the CPR, subsequent delegated acts and Implementing Regulations.

[88]Including instances where the remuneration of private investors selected through an open tender exceed those thresholds, which are allowed under the Commission's guidance provided in the delegated acts

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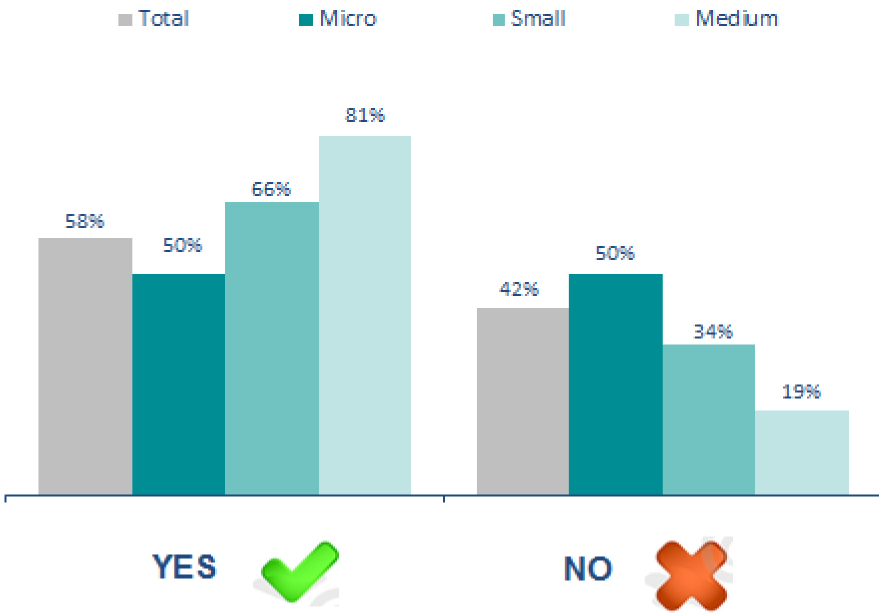
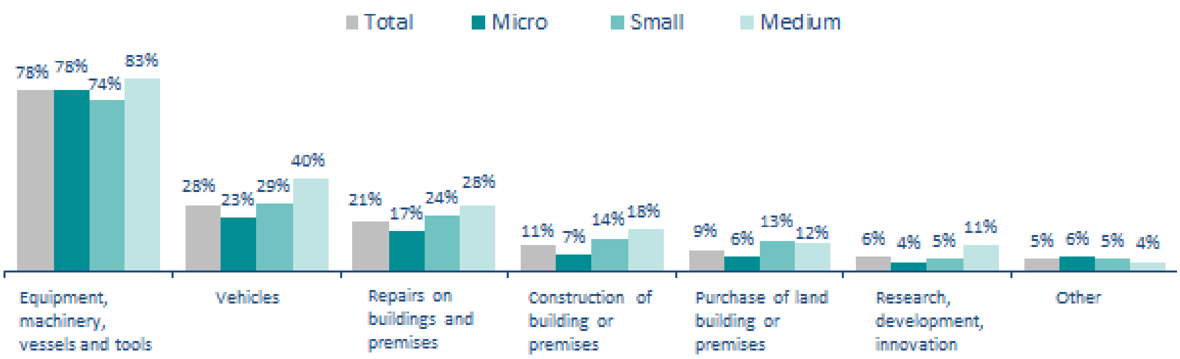
Annex I Distribution of responses to SME quantitative survey

2.1 Did you make any investment in fixed assets in the last 2 years?



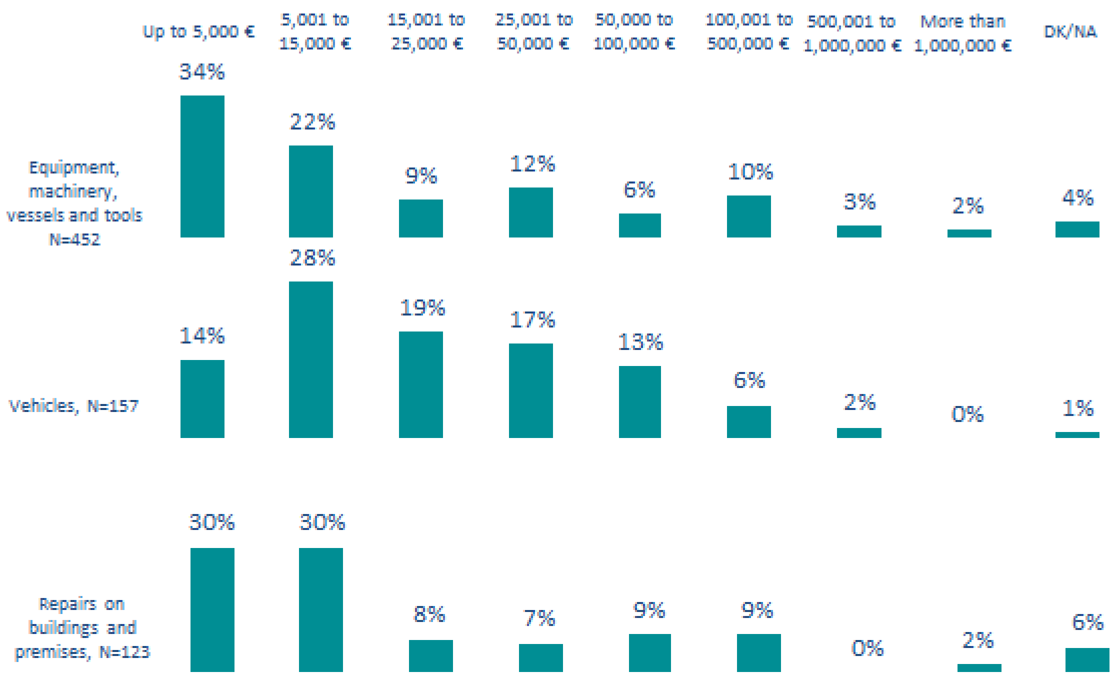
Base: Total N=1002/Micro N=609/Small N=279/Medium N=113

1.2 Type of investment

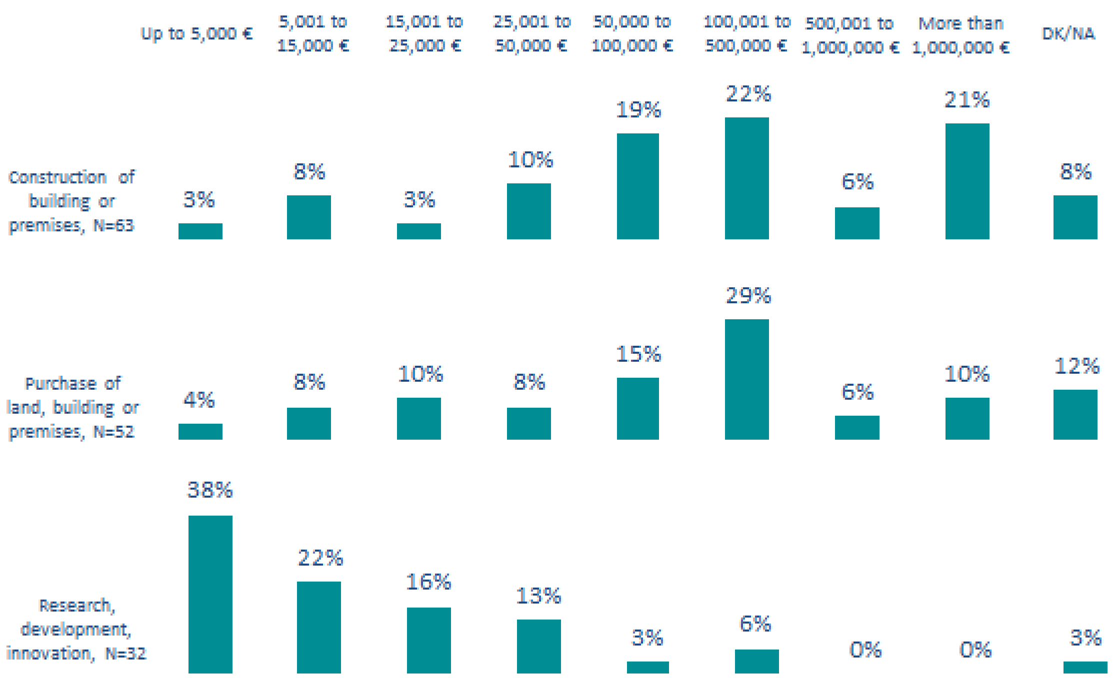


Base: Total N=582/Micro N=305/Small N=185/Medium N=91

1.3 Amount of investment

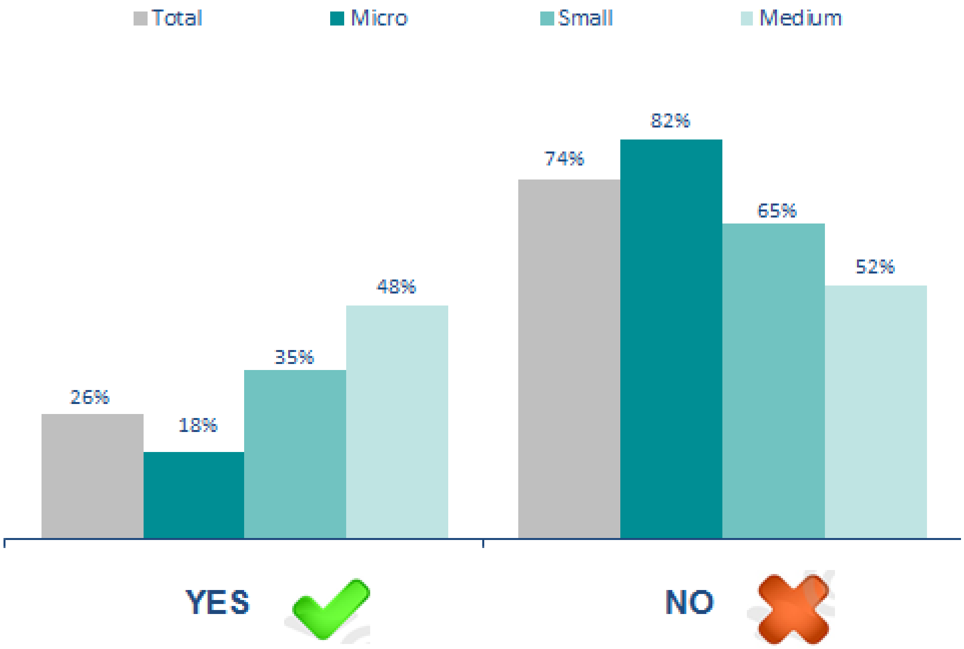


Base: Total N=582



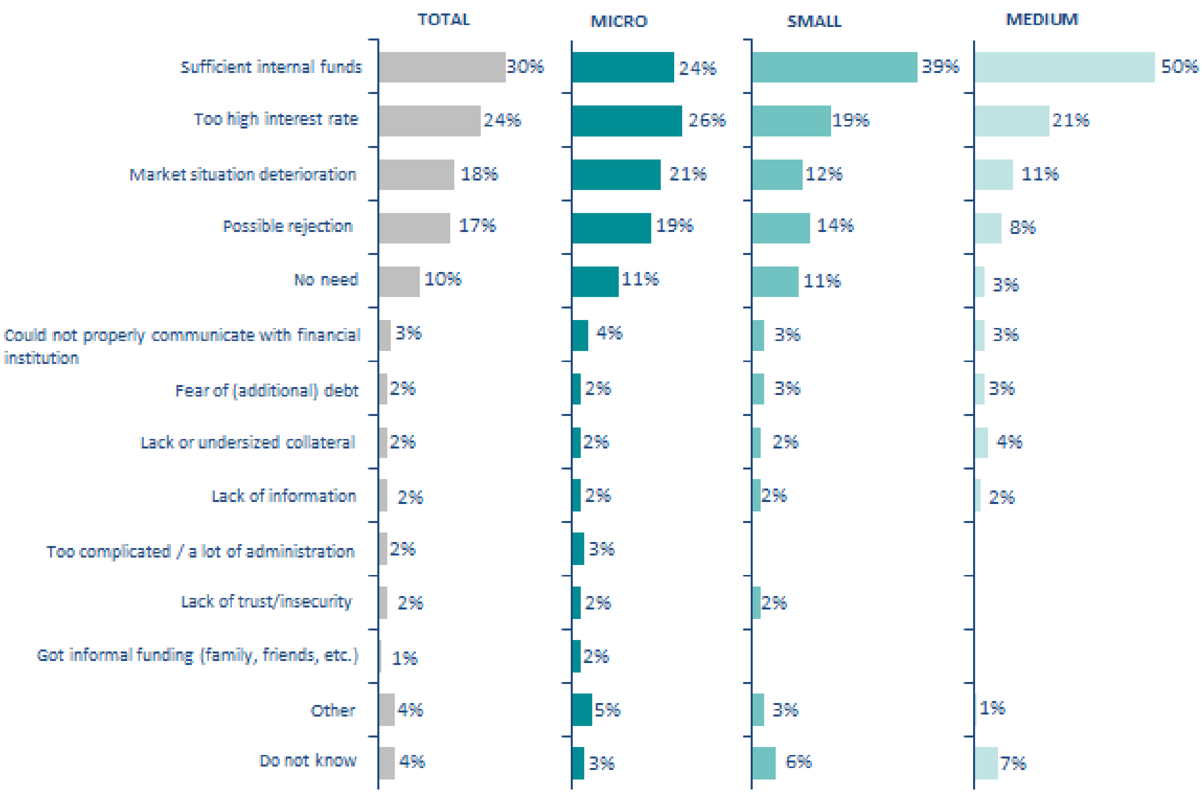
Base: Total N=582

3.1 Applying for external finance in the last 2 years



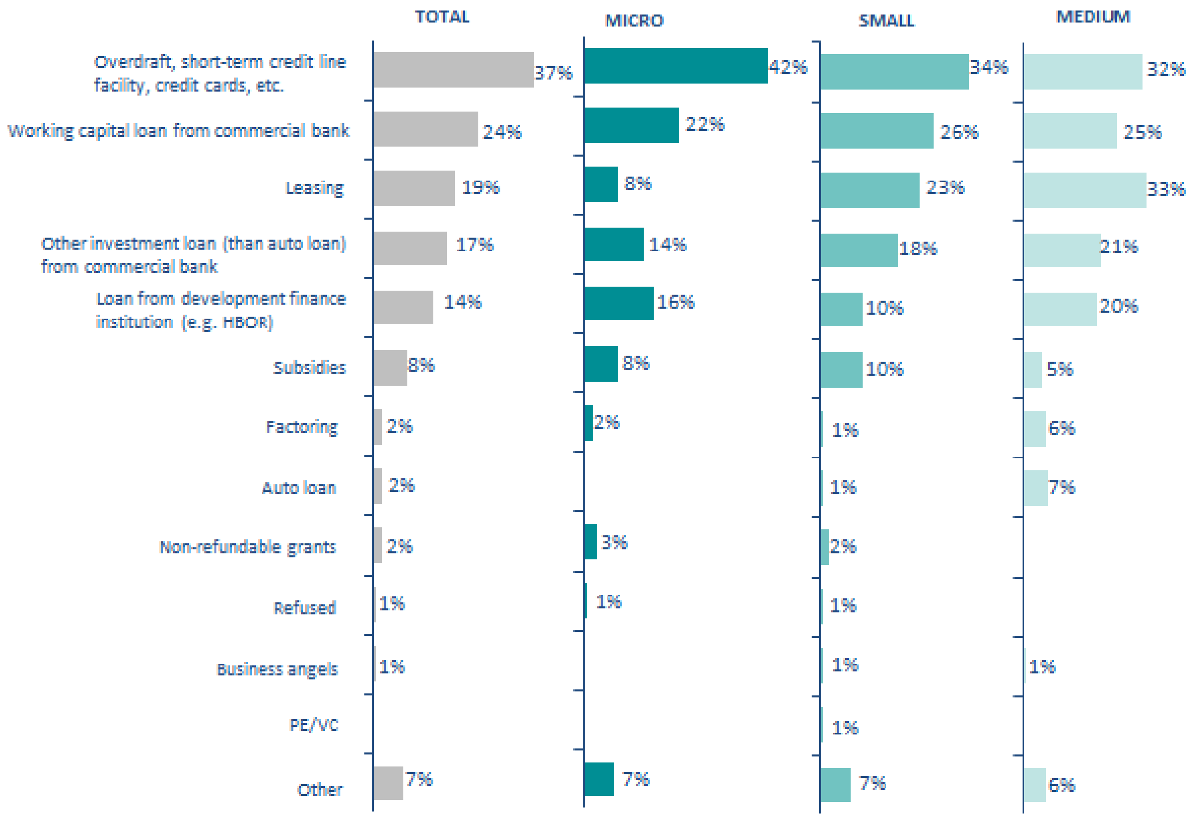
Base: Total N=1002/Micro N=609/Small N=279/Medium N=113

3.2 Reasons of not applying for external finance



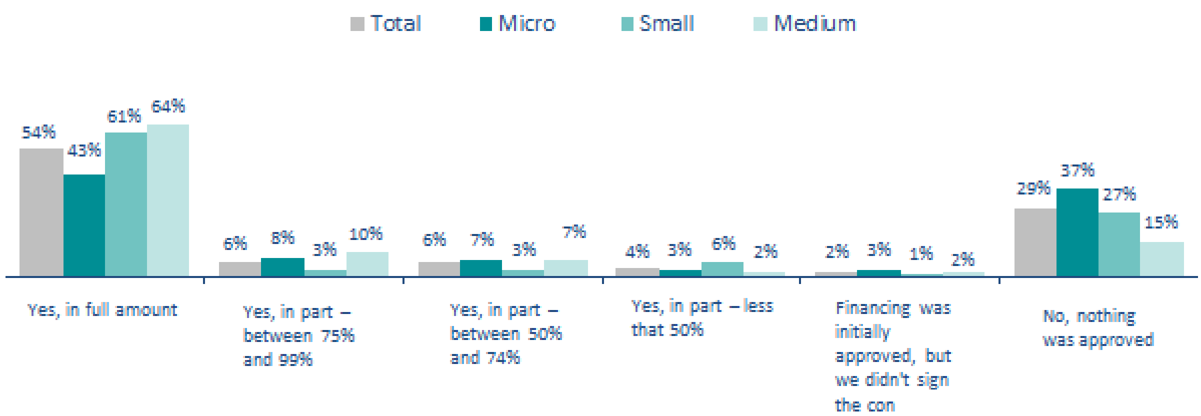
Base: Total N=743/Micro N=499/Small N=185/Medium N=59

3.3 Most prevalent types of finance



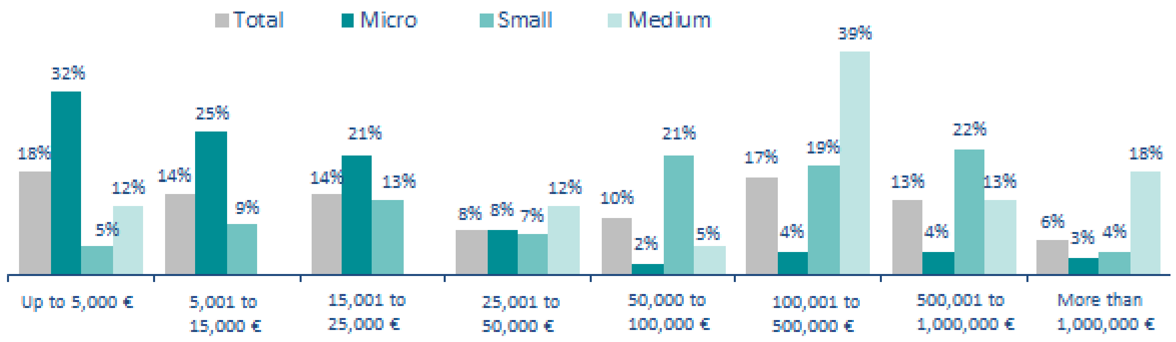
Base Total N=262/Micro N=110/Small N=97/Medium N=55

3.4 Success rate in applying for external finance



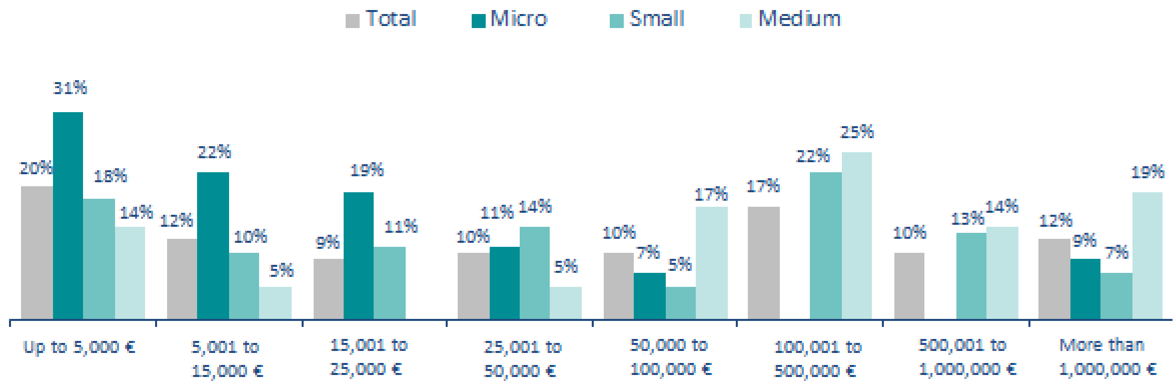
Base Total N=262/Micro N=110/Small N=97/Medium N=55

3.5 Amounts of approved short term financing



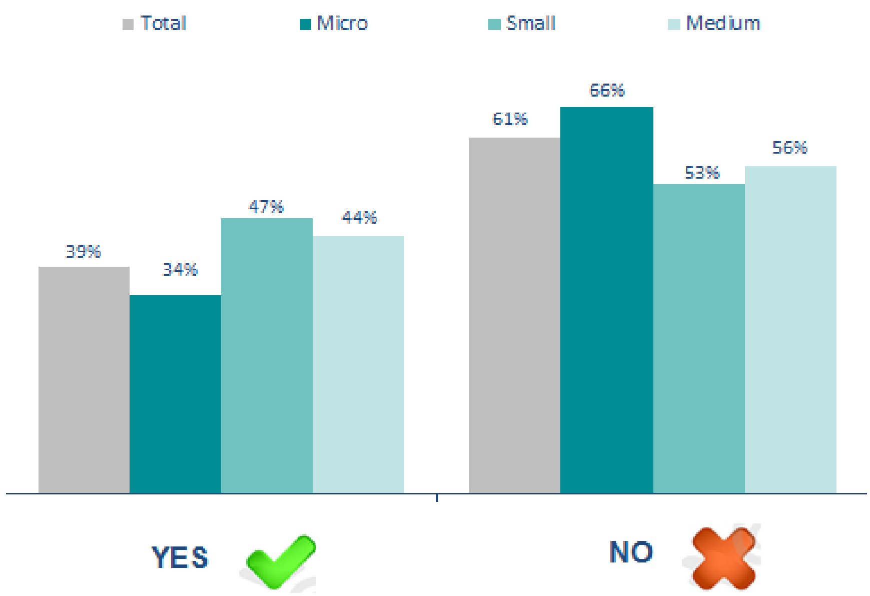
Base: Total N=115/Micro N=48/Small N=44/Medium N=23

3.6 Amounts of approved long term financing



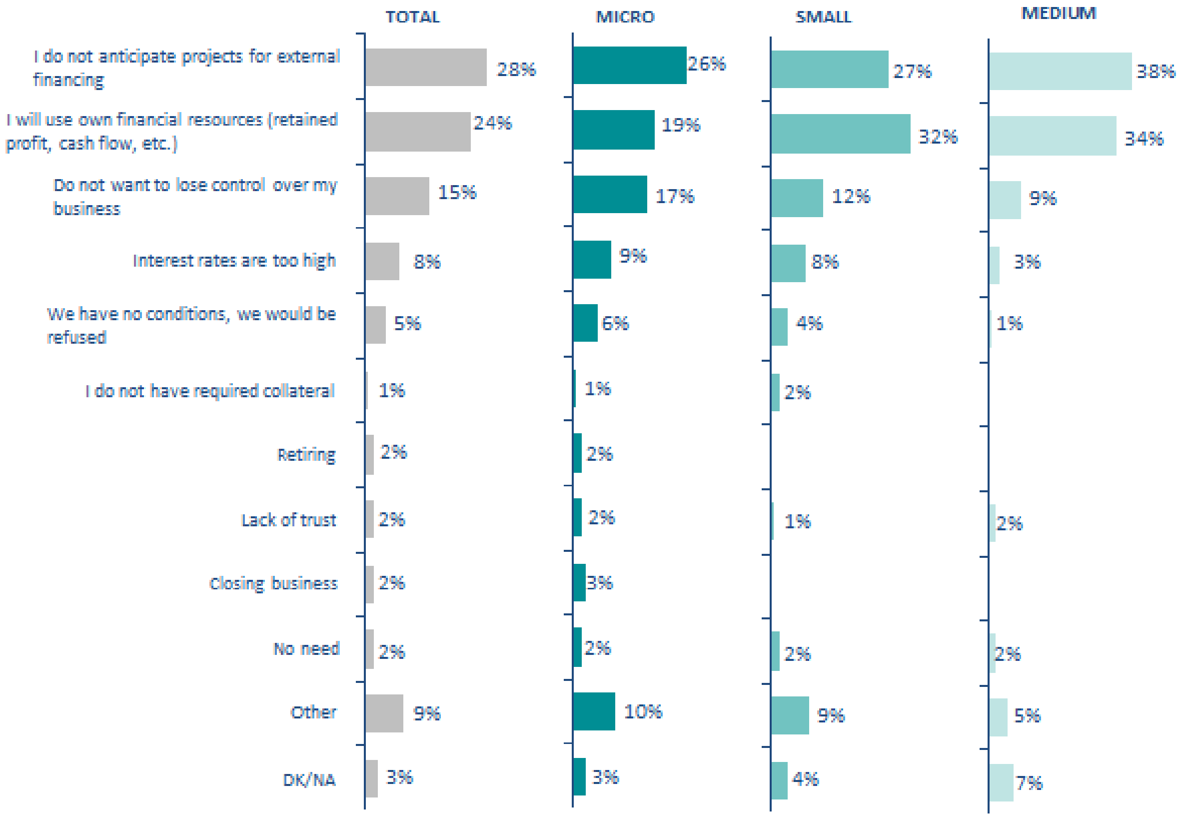
Base: Total N=100/Micro N=26/Small N=39/Medium N=35

1.2 Intention to apply for external finance in the next two years



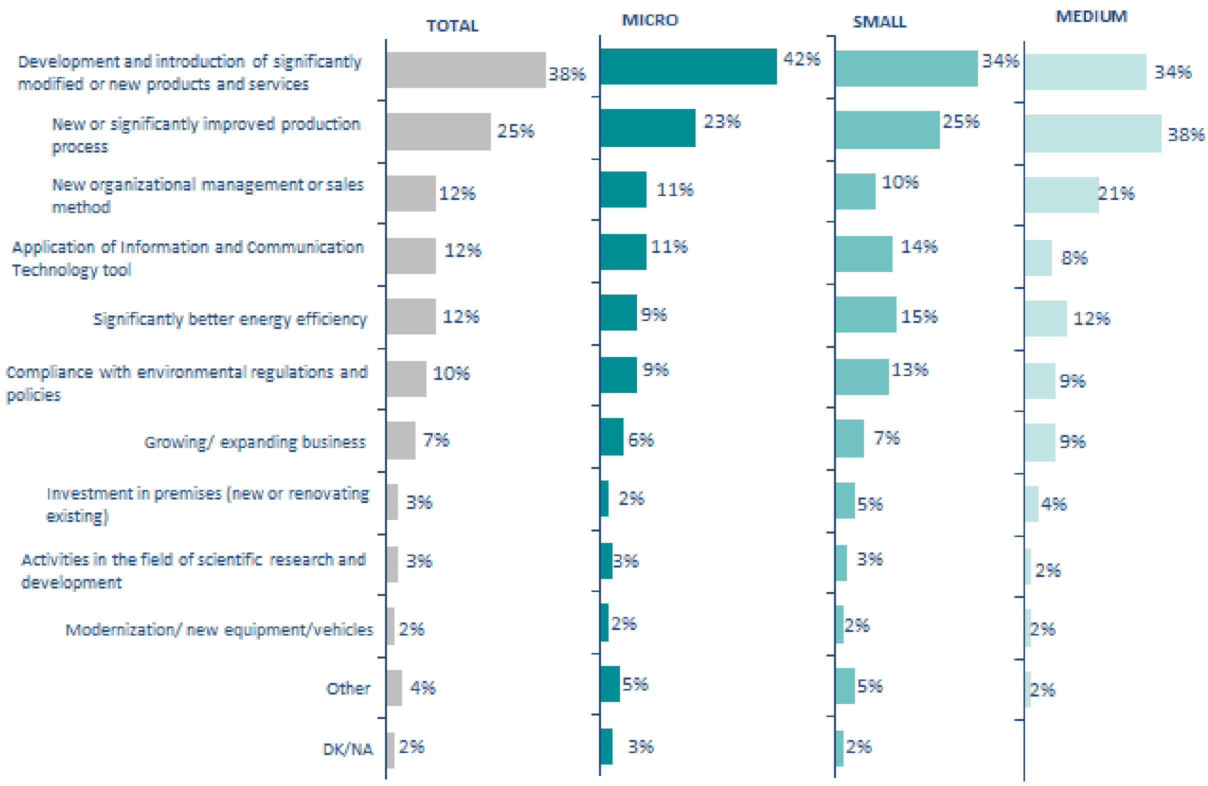
Base: Total N=1002/Micro N=609/Small N=279/Medium N=113

1.3 Reasons of not planning to apply for external finance



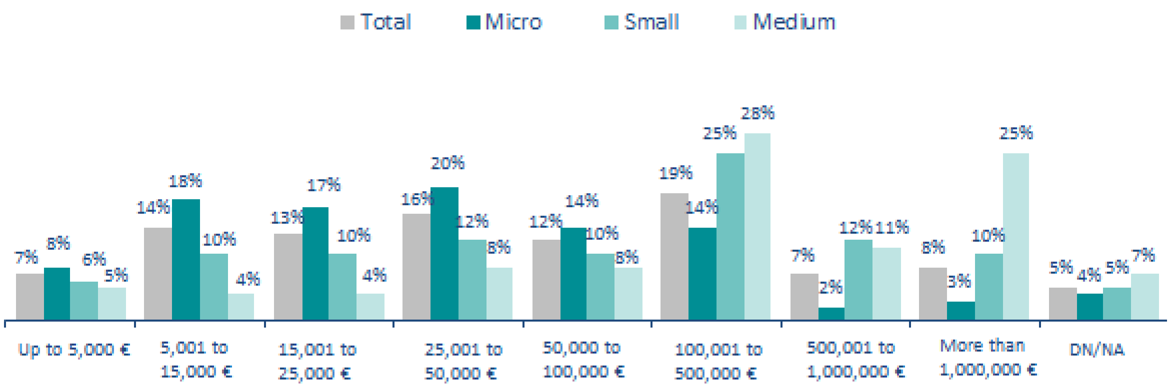
Base: Total N=614/Micro N=403/Small N=147/Medium N=64

4.4 Key objectives of projects to be externally financed



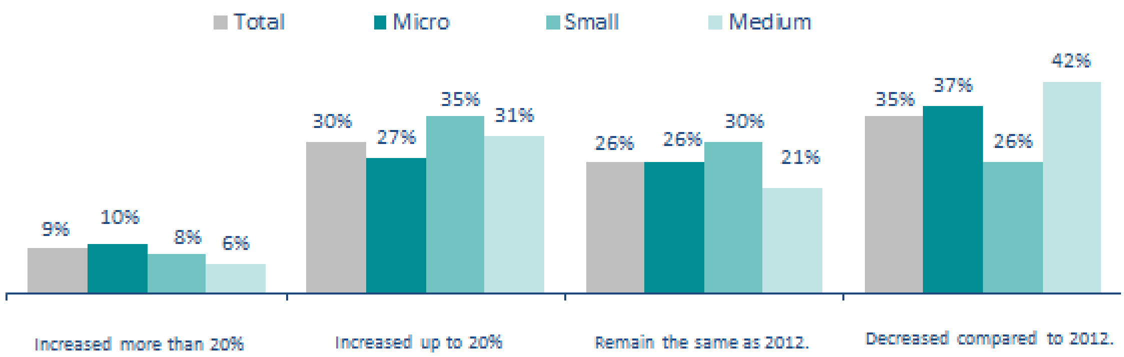
Base: Total N=392/Micro N=210/Small N=133/Medium N=50

4.7 Planned amounts of investments



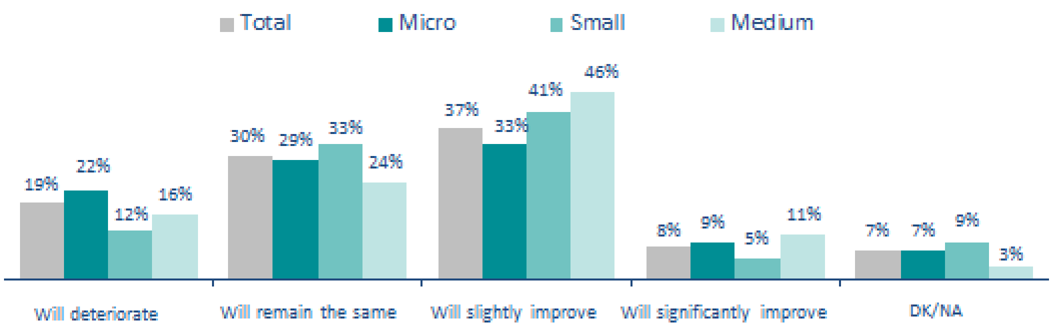
Base: Total N=392/Micro N=210/Small N=133/Medium N=50

5.0 2013 income in comparison to 2012 income



Base: Total N=1002/Micro N=609/Small N=279/Medium N=113

5.1 Estimated economic outlook for next two years



Base: Total N=1002/Micro N=609/Small N=279/Medium N=113

Change Log

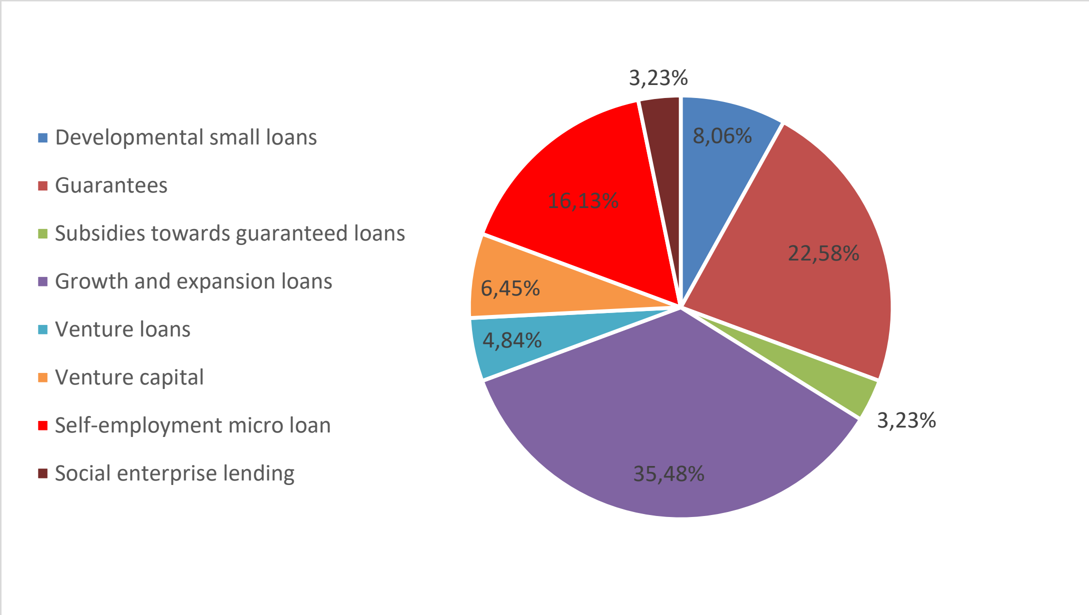
Ex-ante Assessment Report: Financial Instruments, Business Competitiveness, Employment, Social Enterprise - 2014-2020

Versions v.1.0. to v.1.1. – June 17, 2016

1. **Executive summary - Strategy in a nutshell – 2nd bullet** is amended **in the second and third sentence** to read as follows: „The selection of HAMAG-BICRO in accordance with Article 38 point 4 (b-iii) of the CPR or EIF or another international financial institution in accordance with Article 38 point 4 (b-ii) is recommended to manage equity instruments. This is due to experience of HAMAG-BICRO to implement support measures to VC. "

2. **Executive summary - Strategy in a nutshell – 2nd row of the table under 3rd bullet** is amended to read as follows **:**
3. **Executive summary - Strategy in a nutshell – 4th bullet** is amended by deleting the words „growth/expansion loans and".

4. **Executive summary - Strategy in a nutshell – Figure 0** is replaced in its entirety by the following:



5. **Executive summary - Strategy in a nutshell – The second sentence of 5th bullet** is amended by modifying "250" to "306" and "288" to "362".

6. **In para 7, first sentence is amended** by replacing „response to" with „line with".

7. **In para 210, in table column Financial instruments, 1st bullet** is amended by deleting the words "including combination with interest rate subsidy."

8. **Para 212** is replaced in its entirety by the following: „Combination of interest rate subsidies will be offered in case of guarantees."

9. **Para 227** is replaced in its entirety by the following: „The entrustment of support to venture capital operator(s) and business angels to the EIF or HAMAG BICRO. HAMAG-BICRO has been involved in two Venture Capital projects, both financed with World Bank loans. The first project called VENCRO was initiated in 2006 and a fund manager was selected in 2008, however, due to the inability of the fund manager to raise capital from private investors in light of the global financial crisis, VENCRO was cancelled. The second project called the Innovation and Entrepreneurship Venture Capital (IEVC) Project was initiated in 2015 and the loan agreement became effective on 6 October 2015. The Fund would be managed by a private fund manager selected through an international competitive selection process, acceptable to the World Bank."

10. **In para 229, Instruments financed from OPCC 2014-2020, Thematic objective 3, Growth and expansion loans, section Rationale and strategic orientation** is amended by replacing "clearly" with "partly" and "averted" with "averse". The following sentence is added at the end of the text: „Undercapitalisation of SMEs negatively affects their access to finance by rendering them unable to meet the collateral requirements demanded by the risk-averse banks. "

11. **In para 229, Instruments financed from OPCC 2014-2020, Thematic objective 3, Growth and expansion loans, section Type of instrument and amount of individual financing** is amended by modifying "€2-3 million" to "€10 million" and by deleting the sentence „Lending will be offered in combination with interest subsidies within the same operation."

12. **In para 229, Instruments financed from OPCC 2014-2020, Thematic objective 3, Growth and expansion loans, section Eligible costs** is amended by deleting the sentence: „Grant part will subsidise interest rates." is deleted.

13. **In para 229, Instruments financed from OPCC 2014-2020, Thematic objective 3, Developmental small loans, section State aid regime, aid intensity** is amended by deleting the sentence: „In this context the investment in the Financial Instrument shall be considered as investment on market terms and not as financial support by public authority" and by adding the words „to small loans" after the word „accessibility".

14. **In para 229, Instruments financed from OPCC 2014-2020, Thematic objective 3, Venture capital, section Financial intermediary/operator** is amended by deleting the word „or" and by inserting the words "or HAMAG-BICRO" after the word „institution".

15. **In para 234, point b**) is amended by modifying the number „25" to the number „15".

16. **In para 234, point c**) is amended by modifying the number „4.5" to the number „5" and the number „15" to number „10".

17. **In para 234 point d**) is amended by modifying the number „25" to the number „30".

18. **In para 234 point e)** is amended by deleting the words „growth and expansion loans and".

19. **In para 234 Table 25** is replaced in its entirety by the following:

Product	***ESIF***		***National public co-financing***	***Total public***	***Financial intermediary contribution***	***Funding available to Final Recipient***	***Final recipient***	***Total investment***
	ERDF	***ESF***						
Developmental small loans	*25.000.000*		*0*	*25.000.000*	*0*	*25.000.000*	*0*	*25.000.000*
Guarantees	*70.000.000*		*45.000.000*	*115.000.000*	*0*	*575.000.000*	*106.666.667*	*681.666.667*
Subsidies towards guaranteed loans	*10.000.000*		*0*	*10.000.000*	*0*	*0*	*0*	*N/A*
Growth and expansion loans	*110.000.000*		*0*	*110.000.000*	*110.000.000*	*220.000.000*	*33.000.000*	*253.000.000*
Venture loans	*15.000.000*		*2.647.059*	*17.647.059*	*0*	*17.647.059*	*5.294.118*	*22.941.177*
Venture capital	*20.000.000*		*0*	*20.000.000*	*20.000.000*	*40.000.000*	*6.000.000*	*46.000.000*
Self-employment micro loan		*50.000.000*	*8.823.529*	*58.823.529*	*0*	*58.823.529*	*0*	*58.823.529*
Social enterprise lending		*10.000.000*	*1.764.706*	*11.764.706*	*0*	*11.764.706*	*0*	*11.764.706*
Total	***310.000.000***		***58.235.294***	***368.235.294***	***130.000.000***	***948.235.294***	***150.960.785***	***1.099.196.079***

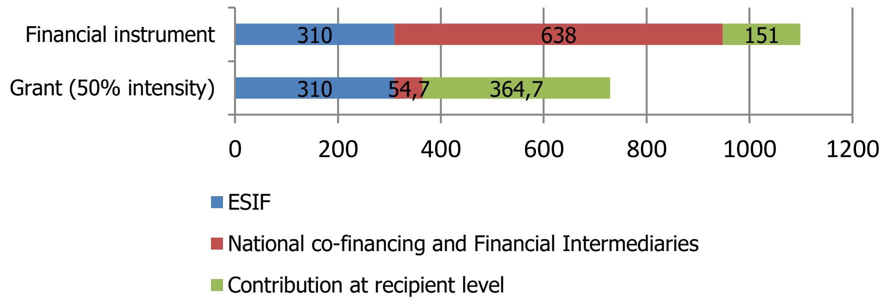
20. **In para 235, point a)** is amended by modifying the number „705.1" to the number „877.6", the number „282" to the number „351" and the number „329" to the number „411".

21. **In para 235, point b)** is amended by deleting the sentence "When contribution by the final recipient is concerned, this leverage is approximately 20.6%."

22. **Para 236** is amended by modifying the number „250" to the number „306", and the number „775.7" to the number „948.2".

23. **Para 237** is amended by modifying the number „893.9" to the number „1.099", and the number „288" to the number „354".

24. **In para 238, Figure 13** is replaced in its entirety by the following:



25. **Para 256** is amended and to read as follows**:** „Given the time horizon of the OPCC and OPEHR implementation the ex-ante assessment report can be reviewed and updated at any time throughout the duration of the Programmes, particularly in case when the market conditions at the time of implementation do not reflect those when the ex-ante assessment was carried out, or relevant new information becomes available to the Managing Authority (trigger point). The review can be initiated by the Managing Authority.

Footnote 87 is amended to read as follows: „These can concern situations such as: negative GDP data for 2014 and 2015, significant deterioration of banks loan portfolio, a significant change in market conditions, etc."