# ESIF financial instruments: setting the scene

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# What are the financial products?

### Loans

Agreement which obliges the **lender** to make **available** to the **borrower** an agreed sum of money for an **agreed period** of time and under which the borrower is **obliged to repay** that amount with interest within the **agreed time**

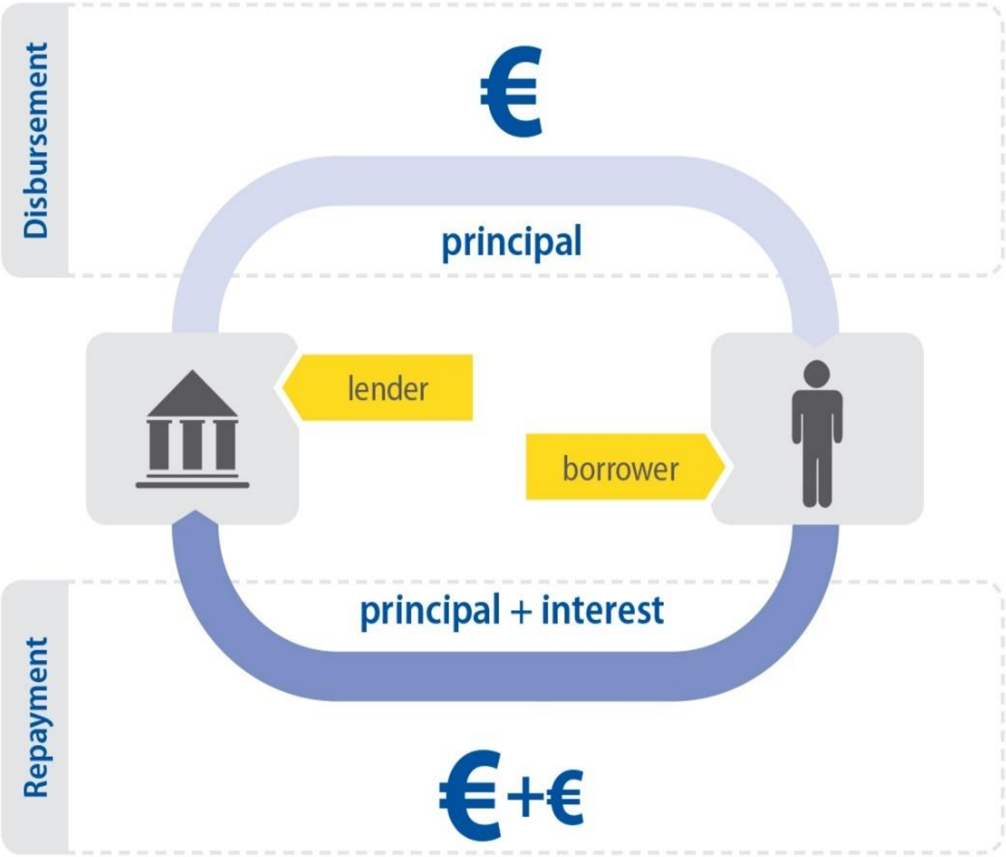
### Guarantees

Written commitment to **assume responsibility for** all or part of a **third party's debt** or obligation **if an event occurs** which **triggers** such **guarantee**, such as a loan **default**

### Equity

**Provision of capital** to a firm, invested directly or indirectly **in return** for partial **ownership** of that firm. Equity investor may assume some management control of the firm and may share the firm's profits

# How does a loan work?




**Key features:**

- **lower** than market **interest** rates
- **longer** repayment **periods** (incl. grace periods)
- **reduced** collateral requirements

=> soft loans

# Loans – pros and cons

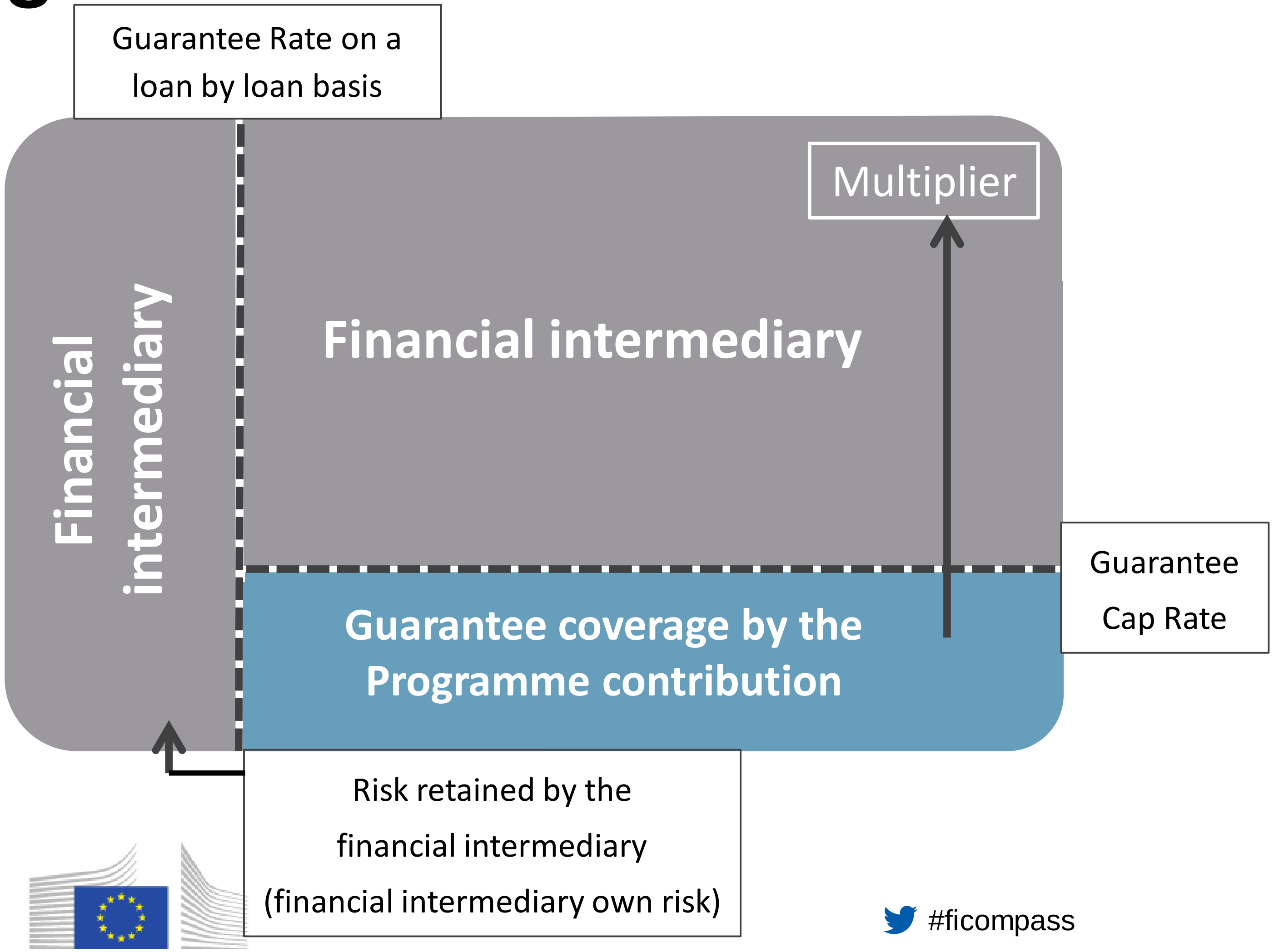
## PROS

- **Not** too **difficult** to administer (limited management costs/fees)
- Budgeting easy, due to **defined repayment schedule**
- The **lending mechanism** is **well understood**, need for **capacity building** is **limited**
- Loans **preserve** the **equity** of FRs

## CONS

- Funded product: requires **more resources** than unfunded products
- **Limited additional benefits** as know-how of the F.Int is not transferred

# How does a portfolio guarantee work?




**When it is useful:**

- High collateral requirements by banks;
- Risk-aversion of banks to finance riskier projects;
- Tightening of lending conditions stemming from regulatory pressure.

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# Guarantees – pros and cons

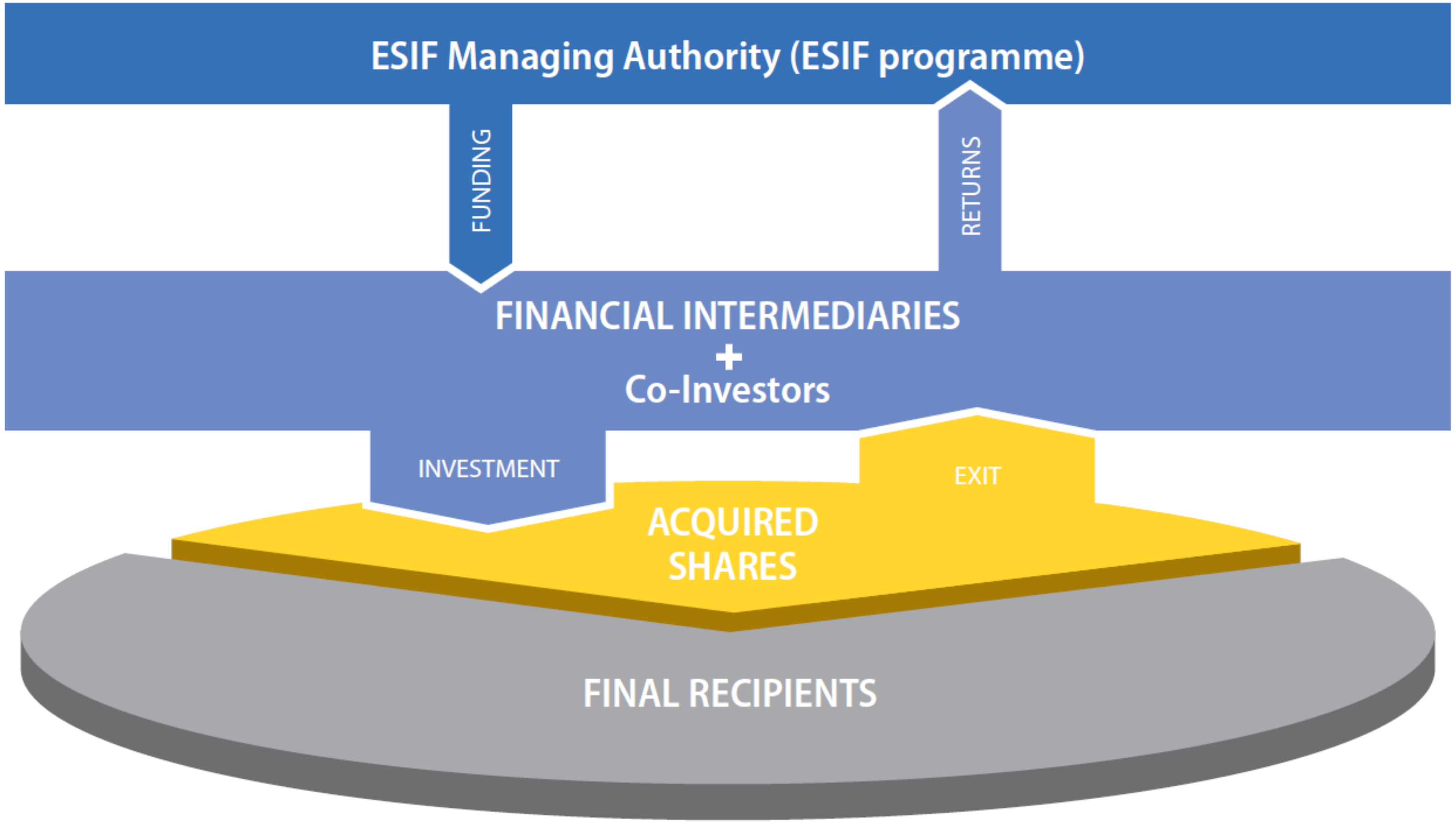
## PROS

- Benefits for FRs include, e.g. **lower or no guarantee fees**, lower or no **collateral requirement** and lower **risk premium**
- Can **preserve the equity** of FRs as there is normally no claim on the ownership of the enterprise
- Since contributions cover only a portion of the loans there is a **high leverage effect**
- Unfunded products such as guarantees require **less initial support** than funded products such as loans
- It can, in some cases, **provide capital relief** to the lender

## CONS

- The guarantee represents a risk reserve for the lender and does **not provide liquidity**
- **Estimating** the appropriate **cap**, or maximum limit, can be **challenging**
- There is **no transfer** of business **expertise** to FRs

# Equity - How does it work?

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# Equity – pros and cons

## PROS

- **Higher potential returns** compared to pure debt instruments
- **Active role** in project management and access to shareholder information **for the investor**
- Stimulates **investment by local private equity** industry also **in riskier areas** not previously serviced.
- Company can **benefit from investor's** management **expertise**

## CONS

- **Insolvency risk** for all the invested capital
- Time-consuming and cost-intensive investment
- **Complexity** in terms of administering than normal loans (high set-up and operational costs)
- Short-term financing is not possible, since **returns** are expected only in the **long term**
- Establishing the process for the investment can be challenging

# Which products and FI to choose?

**The choice of the financial products will depend on:**

- the market failures
- the suboptimal investment situations and investment needs to be addressed
- the acceptable level of risk, reward and ownership that a MA  is willing to consider

**tailored financial products**

**‘off-the-shelf’ instruments**

# Q&A


financial instruments
revolving
capacity building
added value
ERDF
funding agreement
ESF
EU guidance
governance
ex-ante assessment
technical support
seminars
leverage
financial intermediaries
microfinance
co-financing
case studies
investments
ESIF
fi-compass
final recipients
business plan
Thank you
thematic objectives
advisory services
guarantees
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conferences
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