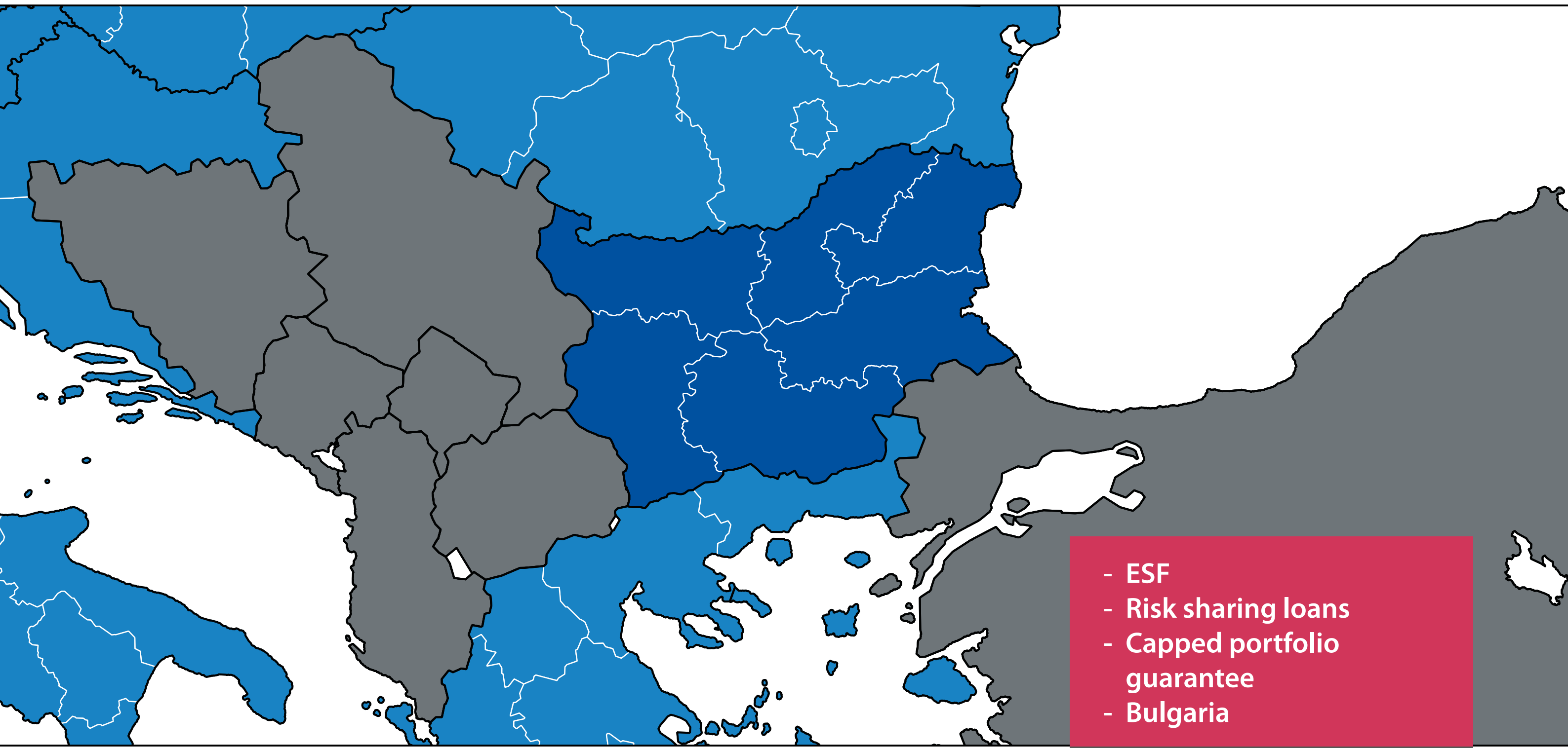
fi-compass ESF



- ESF
- Risk sharing loans
- Capped portfolio guarantee
- Bulgaria

Fostering job creation through microfinance

ESF Financial instruments for microfinance in Bulgaria

Case study

European Commission

European Investment Bank The EU bank

DISCLAIMER

Abbreviations

Abbreviation	Full name
CIP	Competitiveness and Innovation Programme
BDB	Bulgarian Development Bank
BNB	Bulgarian National Bank
EAA	Ex-ante assessment
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EIF	European Investment Fund
ERDF	European Regional Development Fund
ESIF	European Structural and Investment Funds
FA	Funding Agreement
FMFIB	Fund Manager of Financial Instruments in Bulgaria
FoF	Fund of Funds
FI	Financial Instrument
FR	Final Recipient
JFI	Jobs Microfinance Institution
HRDOP	Human Resource Development Operational Programme
MA	Managing authority
MF	Ministry of Finance
MLSP	Ministry of Labour and Social Policy
OPIC	Operational Programme Innovation and Competitiveness
SE	Social Enterprise

Table of contents

1. Summary

The case study covers two financial instruments implemented in Bulgaria under the Operational Programme Human Resource Development (HRDOP): **Risk sharing micro-finance facility** and **Capped portfolio guarantee for microloans**. Both instruments target Start-ups, included owned and managed by youths under 29, disabled people and unemployed people and social enterprises. Their aim is to improve the access of these groups to financing.

The purpose of the case study is to explore Bulgaria's experience with these financial instruments since the Programme's inception in May 2015 to January 2022. Given the lack of previous experience with financial instruments in the social domain, the case study also provides a picture of the process of transitioning from a grant-only culture to financial instruments.

The financial instruments were designed to respond to a number of market failures, including the reluctance of financial institutions to lend to the above-mentioned target groups, which were not considered viable to receive commercial loans. Testimony from one final recipient underlined the role of the microfinance loan facility in helping to take the newly registered company out of the grey economy, providing vital support to expand the product line, create a website and start online sales. The financial instruments furthermore provide more favourable conditions of the underlying loans provided to the target group compared to commercial bank loans, i.e. thanks to their lower-than-market interest rates and longer grace periods.

The two financial instruments also show how EU funding could leverage private financing, and how a managing authority can take advantage of the revolving effect of financial instruments. Additionally, the EU funds allow the financial intermediaries to share the credit risk, consequently serving a broader segment of clients. The gradual uptake of the two financial instruments is a good example of the learning curve that establishing ESF-funded financial instruments may entail, and of how the payoff can be positive in the medium-long term. Another useful feature of this case study is the Fund of Funds structure ensuring the thoroughness and effectiveness of the selection process of financial intermediaries. The participation of both microfinance institutions and commercial banks has been crucial to the deployment of the financial instruments due to their complementary focus and experience. Non-financial services such as coaching in the business plan preparation or mentoring during business operations have also proven to be of key importance and will need to be developed further.

Key takeaways for managing authorities willing to set up similar financial instruments can be summarised as follows:

- Build a profound knowledge of the needs of target groups in terms of financing and coaching.
- Being mindful that a successful process entails some time (from the ex-ante assessment, to the design and implementation phases).
- Financial intermediaries' knowledge of the market, and peculiar interest, can be harnessed and aligned to the policy needs of the managing authority.
- Developing knowledge of the potential positive effect of combining grants and financial instruments.

Risk sharing micro-finance facility

THE FINANCIAL INSTRUMENT

Funding source

ESIF, Operational Programme Human Resource Development

Type of financial products

Risk sharing micro-finance facility

Financial size

EUR 17.6 million programme resources (15% national resources[1])

Thematic focus

Improving access to finance for:

- Start-ups, owned and managed by unemployed people; youths under 29; people with disabilities
- Social enterprises
- Start-ups owned and managed by people starting their first enterprise or self-employment

Timing

From 17 May 2016 to 31 December 2023

Partners involved

Ministry of Labour and Social Policy; Fund of Funds; Mikrofund; SIS Credit; Fibank

ACHIEVEMENTS

Absorption rate

Total amount of disbursed OP resources divided by programme resources committed with financial intermediaries
45,86% of programme resources: ESIF and national funding (as of January 2022)

EU leverage (as of 31 January 2022)[2]

1.56 times – Microfinance facility

Main achievements (as of 31 January 2022)

- 468 final recipients supported
- EUR 7.4 million contracted loans with eligible final beneficiaries of which EUR 5.6 million programme resources.

1 EUR 102 258 of the total agreed amount are supported under the YEI (with 8.11% of national contribution).
2 EU leverage is calculated as the total amount of finance to eligible final beneficiaries, i.e. EUR 7,421,182 divided by the total amount of ESIF allocation to this financial instrument, i.e. EUR 4,750,702.

Capped portfolio guarantee for microloans

THE FINANCIAL INSTRUMENT

Funding source

ESIF, Operational Programme Human Resource Development

Type of financial products

Capped portfolio guarantee for microloans

Financial size

Capped portfolio guarantee for microloans: **EUR 3.1 million** programme resources (15% national resources)

Thematic focus

Improving access to finance for:

- Start-ups, owned and managed by unemployed people; youths under 29; people with disabilities
- Social enterprises
- Start-ups owned and managed by people starting their first enterprise or self-employment

Timing

From 17 May 2016 to 31 December 2023. (FI in operation since March 2021)

Partners involved

Ministry of Labour and Social Policy; Fund of Funds; Unicredit, BDB Microfinancing

ACHIEVEMENTS

ESIF programme multiplier (for guarantee funds)

5x

Main achievements (as of 31 January 2022)

9 loans allocated

2. Objectives

From 2014, unemployment rates in Bulgaria were persistently high, especially among young people and vulnerable groups. They varied between 10% in cities to more than 16% in villages, while unemployment in the age group 15-24 was more than 17.8%[3]. The percentage of the population at risk of social exclusion was 40.3%[4] of the population was at risk of social exclusion.

Consequently, the job and business creation were a priority for the government. Labour skills in Bulgaria needed upgrading and re-aligning to market demand, and people with disabilities and minority groups faced difficulties in accessing the labour market. Unsurprisingly against such a backdrop, the social economy in Bulgaria was underdeveloped and needed support (only 126 registered social enterprises in 2014).

The objectives of the Operational Programme Human Resource Development (HRDOP) are addressed in five priority axes with defined investment priorities. The Risk sharing micro-finance facility instrument is defined in relation to the objectives of Priority axis I and II. It also contributes to certain thematic objectives under Regulation 1303/2013 for the period 2014-2020, namely the promotion of sustainable, quality employment and the support of labour mobility (Thematic Objective 8), and the promotion of social inclusion, combating poverty and all forms of discrimination (Thematic Objective 9).

The aim of the two financial instruments, both the **Risk sharing micro-finance facility** and the **Capped portfolio guarantee for microloans**, is to provide HRDOP final recipients (FRs), including social enterprises, with easier access to finance if they wish to start a business, thus creating new jobs and self-employment opportunities. The FR are offered preferential conditions compared to those on the market (reduced interest rates and collateral requirements).

A number of market failures are addressed by the two financial instruments. The target groups lacked access to finance and had difficulties in engaging with financial institutions in general. Two types of financing institutions - commercial banks and microcredit institutions – are licensed to provide loans up to EUR 25 000 under the Risk sharing micro-finance facility and up to EUR 50 000 under the Capped portfolio guarantee for microloans facility. According to the Ex-ante assessment (EAA), the commercial banks considered financing socially excluded persons and start-ups without a credit history beyond their mission and appetite, resulting in very low volumes of microfinance. The prudent approach taken by the financial institutions was due to a perceived lack of capacity and management skills among self-employed people and micro-enterprises, and to a lack of credit history. The state of microfinancing in Bulgaria was also perceived as a market failure by the EAA, as it mostly channelled funds to enterprises which already complied with the usual conditions required by the commercial banks (providing collateral, and against high interest rates). As a result, microfinancing was closer to being a banking product than an activity with a social mission.

Financial instruments had not been used in the HRDOP in the 2007-2013 programming period. Since financial instruments are expected to be used more extensively in the EU, including for vulnerable groups, the managing authority (Ministry of Labour and Social Policy) embarked on its first experience. Moreover, stakeholders expect financial instruments to complement grants and bring additional added value.

3 Eurostat: Employment and activity by sex and age – annual data
4 Eurostat: People at risk of poverty or social exclusion

During the 2007-2013 programming period, a significant EUR 813 million grant scheme under the HRDOP was put into place to support people not active on the labour market, as well as socially vulnerable groups. These grants continued during the 2014-2020 period. Financial instruments were made available through the holding fund JEREMIE[5]. These were targeted exclusively for Small and Medium Enterprises (SMEs). The Progress Microfinance initiative targeted similar groups of final recipients compared to the two financial instruments analysed in this case study, and it was implemented through three financial intermediaries, including Jobs Microfinance Institution (JFI), a subsidiary of the Bulgarian Development Bank (BDB)[6]. The initiative aimed to improve access to finance for vulnerable groups such as people who have recently lost their jobs or small family businesses.

5 JEREMIE was managed by managed by the European Investment Fund (EIF)and counted with the following FI: Loan portfolio guarantees; Risk-sharing financing; Venture capital fund; Acceleration and Seed Funds; Mezzanine Capital Fund; Co-Investment Fund; and Competitiveness and Innovation Programme (CIP).

6 https://ec.europa.eu/commission/presscorner/detail/en/IP_19_6167

3. Design and set up

The section includes the timeline of the introduction of the two financial instruments from the EAA to the date of this report. It describes the main findings of the EAA and provides an overview of the processes leading to the appointment of an implementing body and the selection of financial intermediaries.

Time period	Action taken
2014	Completion of the ex-ante assessment.
2015	Setting up of the Fund of Funds – Fund Manager of financial instruments in Bulgaria.
2015-2016	First detailed investment strategy drafted for Risk-Sharing Micro-Finance Facility.
2016	Selection of The Fund Manager as the implementing body by the managing authority of HRDOP 2014-2020.
2016	Negotiations on the funding agreement between FMFIB and the MA and signing of the agreement (from March to May).
2017	First agreements signed with financial intermediaries (risk-sharing instrument) and first investments to final beneficiaries approved (December).
2018	First investments (microcredits) disbursed to final beneficiaries (January).
2020	First agreements signed with financial intermediaries (guarantee instrument).
2021	Partial reduction of funds for financial instruments under HRDOP 2014-2020 by amendment to the Funding agreement (July).

3.1 Ex-ante assessment

The Ex-ante Assessment (EAA) was carried out by PwC Bulgaria and the goal was to analyse the potential for the use of financial instruments (FI) in Bulgaria in the 2014-2020 period. The methodology for conducting the EAA was developed by PwC for the European Commission (EC) and the European Investment Bank (EIB). It was adapted for Bulgaria and included an overview of the political context, the coherence between the Partnership Agreement and the HRDOP, a description of the market context, the value added of the financial instrument, a quantification of the financing gap among other items. The EAA pointed to a significant mismatch between the demand and supply of funding to ESF target groups, providing the funding gaps as per below. The methodology to quantify demand is based on indicators (e.g. the number of social enterprises), estimations of needs (e.g. the annual trainings) and interviews.

Financing gap, i.e. unmet financing needs of socially excluded people and people at risk of poverty, amounted to:

- EUR 11.7 million for Young people under 29 in need of funding (loan and/or grant) for training and starting up their own company, or to find a new job;
- EUR 294.7 million for individuals who need funding to create a company (business micro-loan to start a company);
- EUR 68.2 million for individuals who need funding to find work (personal micro-loan for job-hunting).

For enterprises, the following amounts were calculated:

- EUR 74.2 million for micro-enterprises seeking funds for employees training and/or as working capital;
- EUR 12.7 million for training centres;
- EUR 8.8 million for social enterprises.

As no EEA update has been conducted, the EAA for the new programming period is expected to capture the evolution of the demand.

To the managing authority (MA), financial instruments were expected to provide **added value compared with grant**s in a number of ways:

Providing funding for target groups at interest rates below those available on the market (above 6% as of July 2014).

- Leveraging financial intermediaries' own resources (expected multiplier of 1:1.4 to 1:1.5 for the portfolio guarantees and expected leverage of 1:1.5 to 1:1.9 for the microcredits);
- The revolving character of the financial instruments, which increases the effectiveness of funds insofar as the MA can reinvest the decommitted guarantees and the loan repayments;
- Capillary geographical coverage, through the country-wide networks of financial intermediaries;
- Decreased administrative burden for final recipients, improve cash flow management, provision of working capital;
- Improving the business planning capacity of the final recipients;
- Increasing the capacity of microfinance institutions to deliver on their social mission.

The EAA identified three potential delivery options for the two financial instruments: **Option 1**: the MA to select the financial intermediaries to deploy the financial products (no Fund of Funds structure); **Option 2**: appointment of a Fund of Funds, which in turn selects and works with the financial intermediaries; **Option 3**: direct implementation of the MA (the MA to select the final recipients).

After weighing the advantages and disadvantages of each option, the MA went forward with **Option 2**, which was perceived to have the following additional benefits:

- a FoF can be a beneficiary of ESI Funds as well as national and regional co-financing;
- possibility of a co-investment at FoF level;
- single entry point for the MA (the FoF operates as an umbrella, under which specific financial instruments are deployed);
- potential synergies between different financial instruments managed by the FoF;
- a professional FoF manager can better engage with financial intermediaries, resulting in improved terms and conditions for the underlying products offered to final recipients.

As of 2014, EIF-funded Progress Microfinance initiative was the only existing financial instrument for socially disadvantaged people and leveraging funds from microfinance institution. The MA proposed to address the market gap through both a risk-sharing loan facility and a guarantee facility and decided to take the two financial instruments forward. They were expected to complement EIF-funded Progress Microfinance initiative by providing not only microcredit, but also micro-guarantees, which were absent in Bulgaria as of 2014; they would be made available to final recipients through a limited number of financial intermediaries. For this reason, a crowding out effect on private lenders will not arise as several financial instruments providing microfinance products (micro-credits and micro-guarantees) can coexist in Bulgaria given the large financial gap.

3.2 Selection of the implementing body and financial intermediaries

3.2.1 Selection of the Fund of Funds / implementing body

As recommended in the EAA and in line with EC Regulation 1303/2013, the government decided to create a 100% government-owned company in the form of a FoF and manage the financial instruments under four ESIF-funded OPs for the 2014–2020 period, including the HRDOP. The FoF was established as a sole owner joint-stock company, formally called "Fund Manager of financial instruments in Bulgaria" (FMFIB), and was constituted in July 2015. FMFIB is responsible for the management of all EU funding allocated to financial instruments by the Bulgarian managing authorities. Through the establishment of FMFIB, the Bulgarian government aimed to secure the efficient and sustainable management of the public resources, achieve economies of scale and build professional expertise at the national level in the management of financial instruments. A representative of the Ministry of Labour and Social Policy (MLSP) became a member of the Supervisory Board, together with representatives of all other ministries involved managing financial instruments under ESIF, as well as representatives from the Ministry of Finance.

Within the technical support framework, the World Bank, the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) supported the Bulgarian authorities in the set-up of the FMFIB and throughout the set-up of the ESIF FIs.

In December 2021, FMFIB had thirteen financial instruments under management, operating in six sectors. A total of EUR 548.9 million ESIF programme resources (ERDF, CF, ESF, EAFRD and EMFF) have been committed to the financial instruments, which has in turn mobilised EUR 645.8 million of other public and private co-investment. As a result, it is expected that approximately EUR 1.22 billion will be invested through shared management financial instruments in Bulgaria in the 2014-2020 programming period.

The MA of HDROP **signed in May 2016 a Funding Agreement** with the FMFIB for the management and implementation of the two financial instruments under HRDOP. The committed amount was initially around EUR 35.9 million for the two financial instruments (EUR 30.5 million for the Risk-sharing micro-finance facility and EUR 5.4 million for the Capped portfolio guarantee for microloans) but subsequently reduced to EUR 20.7 million in July 2021 (EUR 17.6 million for the Risk-sharing micro-finance facility and EUR 3.1 million for the portfolio guarantee). National co-financing amounted to 15%. It has to be noted that EUR 102 258 of the total agreed (EUR 20.7 million) come from the Youth Employment Initiative (YEI) (with 8.11% of national contribution). The guarantees from the Fund of Funds are up to 80% per individual loan made and are capped at 25% of losses on the guaranteed portfolio. The Investment Strategy encompasses all elements of both financial instruments and is an attachment to the Funding Agreement. The time between the establishment of the FoF in July 2015 and the signing of the Funding Agreement in May 2016 was not brief, but during this period specific activities were implemented for the organisational and functional start of the activities of the new entity. The audit of the Management and Control Systems of the FMFIB was completed in May 2016, representing a milestone for the signing of all ESIF Funding Agreements. The first operational agreements with the financial intermediaries were signed in December 2017 – more than one and a half years after the signing of the Funding Agreement. Even this may seem a prolonged period, it also included a market testing exercise carried out by the FoF, which was instrumental for successively carrying out the actual selection process.

3.2.2 Selection of the financial intermediaries

The FoF selected financial intermediaries for both financial instruments through a negotiated procedure. Two separate calls were launched for the Risk sharing micro-finance facility (April 2017 and September 2018) and two calls for the **Capped portfolio guarantee for microloans** (May 2019 and March 2021).

In the 2016-2021 period, the FoF selected **five financial intermediaries for the HRDOP financial instruments** – two microfinance institutions and one bank for the Risk sharing micro-finance facility; one microfinance institution and a bank for the Capped portfolio guarantee for microloans. The first agreements with financial intermediaries under the Risk sharing micro-finance facility were signed in December 2017 and for the financial intermediaries under the Capped portfolio guarantee for microloans in June 2020 and July 2021.

Tables 1 and 2 summarise the eligibility and award criteria used in the procedure.

Table 1: Criteria for selection of Financial Intermediaries for both Financial Instruments under the Public Procurement Act

Indicative eligibility criteria	• A licensed bank or a financial institution which complies with the requirements of the Bulgarian National Bank (BNB). • Complies with the national and EU framework on the prevention of money laundering, combating terrorism and tax fraud, incl. EU, FATF and UN. • Experience in country, micro-credit and financial instrument management. • Skills to assess final recipients and their projects and able to effectively and efficiently manage the loan portfolio created. • Adequate corporate governance, risk management, monitoring, internal control, reporting systems, including with respect to the state aid regime. • Financial and organisational capacity and is able to secure co-financing. • Complies with the European Code of Good Conduct for Microcredit Provision[7].
Indicative award criteria	• Levels of management costs and fees. • Amount of co-financing above minimum requirements. • Microcredit conditions, including total interest applied to borrowers, given interest-free financing from the FMFIB and co-financing. • Improved borrowing conditions offered to FR, compared to existing practice, such as collateral requirements foreseen. • Additionality of intervention, i.e. readiness of the intermediary to expand activity in the target segment if already active with similar facilities. • Portfolio building strategy, e.g. marketing and communication measures. • Timetable for the generation of a new portfolio.

The procedure for selecting financial intermediaries included a process of market consultation, which contributed to designing acceptable conditions for the financial instruments and alignment with intermediaries' appetite and expectations.

The ESF financing provided by FMFIB is to be on-lent interest-free, while the co-financing provided by the intermediary could be at market rate. Financial intermediaries are expected to provide co-financing with their own resources for the Risk sharing micro-finance facility, minimum 10% of the each loan.

Both the FoF and the financial intermediaries perceived the selection procedure as a lengthy and cumbersome process. The procedure and the instruments were not familiar for the financial institutions and at the initial call only two intermediaries signed agreements. A further call gathered interest from additional candidates and risk sharing funding agreements respective portfolio guarantees were signed with the following counterparts.

7 https://ec.europa.eu/social/main.jsp?catId=1482&langId=en

Table 2: Signed operational agreements and respected values

Financial intermediary	Amount of the operational agreement
Risk sharing micro-finance facility	
Mikrofond: (1st funding agreement) (2nd funding agreement)	BGN 2 million (EUR 1.02 million) BGN 3 million (EUR 1.53 million)
SIS Credit (1st funding agreement) (2nd funding agreement)	BGN 1.4 million (EUR 0.72 million) BGN 2.5 million (EUR 1.28 million)
Fibank	BGN 15 million (EUR 7.67 million)
Capped portfolio guarantee for microloans	
Unicredit Bulbank	BGN 5 million (EUR 2.56 million) (the amount set aside as a capped guarantee)
BDB Microfinancing	BGN 1 million (EUR 0.51 million)

SIS Credit is a microfinance institution established in 2006. It offers loans up to BGN 50 000 (around EUR 25 000). It focuses on agricultural and business loans. Since 2012, SIS Credit has been a member of the Microfinance Centre[8] and since 2013 of the European Microfinance Network[9].

Mikrofond is a microfinance institution and member of the Microfinance Centre. Its mission is to provide business loans for micro-entrepreneurs and to finance the needs of low-income families (home improvements, education, health care, etc.). It offers fixed-rate business loans for start-up businesses, agricultural loans and micro-loans for businesses through a network of offices nationwide.

First Investment Bank (Fibank) is the biggest bank with Bulgarian capital in the country. Fibank offers a diverse range of products and services for individual and corporate clients. As of 31 June 2021, Fibank has 126 branches in the country.

UniCredit Bulbank is the largest bank in Bulgaria with significant experience in supporting SMEs and mid-caps.[10]

BDB Microfinancing was created in 2010 as a part of the Group of the Bulgarian Development Bank (BDB) with the main purpose of providing micro-finance to Bulgarian businesses.

8 https://mfc.org.pl/
9 https://www.european-microfinance.org/
10 In October 2021 UniCredit Bulbank and the EIB signed a guarantee agreement of EUR 60 million that is expected to unlock new loans of nearly EUR 200 million to support Bulgarian businesses suffering from the economic consequences of the COVID-19 pandemic.

The selection of both **microfinance and banking institutions** is complementary and beneficial for the deployment of the financial instruments. Microfinance institutions are mission-driven and can provide more support to individual clients to improve their credit applications. Moreover, microfinance institutions serve riskier segments of the target groups. However, the drawback is that they do not possess a wide network of branches that allows banks to deploy the financial instruments more efficiently across the country, especially bearing in mind that the target group are unlikely to reach a branch unless it is located in the proximity.

3.3 Funding and governance

Funding sources

On 15 July 2021, an agreement for a budget reduction was signed decreasing the overall budget for the two financial instruments from EUR 35.9 million to EUR 20.7 million. The reduction was made in order to adapt the amounts to the actual demand. In terms of funding, 85% comes from the ESF and 15% from national resources (an amount of EUR 102 258 is co-financed at 91.89 % under the Youth Employment Initiative and 8.11% with national resources). The funders defined the target groups of the two FIs and the reporting requirements (described later in the text) and the flexibility and adaptability of the loan conditions with regards to the actual needs of the target groups.

Following the recommendation of the Ex-ante Assessment for an optimal governance option, **HRDOP MA signed a Funding Agreement with the Fund of Funds** outlining the roles and responsibilities for the implementation of the financial instruments under the HRDOP. The commitment period of the agreement is between May 2016 and December 2023 while the residual period is from January 2024 to December 2031 for the monitoring of repayments and possible reinvestment/recycling of repaid funds. FMFIB shall, at the expense and on behalf of the managing authority, operate the FoF, select eligible financial intermediaries and conclude respective Operational Agreements.

The FoF has to follow an agreed **Investment Strategy and Business Plan** as defined in the Funding Agreement. It is obliged to develop appropriate selection procedures for financial intermediaries taking into account the market needs and the requirements of the OP. The main elements of the Investment Strategy include the HRDOP context and intervention logic, the implementation mode, the number and type of FIs, the types of final recipients and the type of investment support, as well as the expected results.

The Fund of Funds monitors the implementation of financial instruments and operational agreements. It is responsible for providing the MA with quarterly and semi-annual progress records and related data, as well as for delivering a narrative report on the utilisation of funds, the progress made on all its functions and the results achieved on semi-annual and a yearly basis.

Remuneration of the FoF

The management fee is divided into:

- Basic remuneration: 1st year of Funding Agreement (FA) (3% per year of the amounts disbursed by the MA); 2nd year of FA (1%); 3rd year of FA (0.5%). Disbursement under the Funding Agreement is scheduled to be at tranches of up to 25 % of the committed amount;
- Performance-based remuneration: 0.5% per annum of the funds paid by FMFIB to the financial intermediaries for lending;
- Fee for re-invested amounts: to cover further operating income, a fee of 0.5% shall apply to amounts that are reinvested by financial intermediaries and thus remain under management.

As of January 2022, the MA has paid management costs and fees totalling EUR 541 056 to the FoF.

Both the funding and the governance structure are in line with the analysis and the recommendations of the Ex-ante Assessment.

Indicators

The indicators under the HRDOP are listed below.

Financial instrument	Indicator
Priority Axes I and II (YEI)	Leverage effect
	Number of final recipients supported with microloans
	Volume of microloans disbursed to final recipients
Microfinancing with risk-sharing (incl. YEI)	Leverage effect
	Number of final recipients with microloans -total
	Including number of final recipients – social enterprises
	Total number of microloans disbursed to final recipients
	Including volume of microloans disbursed to final recipients – social enterprises

In addition, for both financial instruments, the additional number of created jobs is a result indicator. The reporting of the financial intermediaries is in line with these indicators.

4. Implementation

The section describes the financial products and their terms and includes a brief section on state aid. It also provides an overview of the appraisal process for the final recipients.

4.1 Financial products and terms

The financial instruments were conceived based on the analysis of suboptimal investment situations and investment needs identified by the EAA. Minor subsequent adjustments of the financial instruments were made as described below.

Risk sharing micro-finance facility

Table 3: Financial product key characteristics – initial and current

Eligibility	SME's that have been registered within the last 2 years (updated to within last 5 years) and social enterprises
Loan tenor	Up to 10 years
Utilisation period	Loans disbursed to the final recipients no later than 31 December 2023.
Grace period for repayment of the principal	Up to 2 years (updated to 3 years during the COVID situation)
Collateral required	The collateral for the receivables under the microcredits must secure the funds provided by the OP and the co-financing by the financial intermediary. The financial intermediary and the FoF rank equal in terms of receivables under the provided financing
Loan amount	Up to EUR 25 000, min. EUR 2 500 (updated to cancellation of min. amount during the COVID situation), paid in EUR or BGN
Interest rate	Fixed or floating, in line with market levels (specific to the type of borrowers, type of loan and term), only in respect of the part provided by the financial intermediary
Risk sharing component	The contribution from HRDOP is up to 80% (updated to up to 90%) in each loan and the 0% interest rate for the OP contribution aimed at achieving favourable conditions for the supported target groups. The actual risk-sharing rate should be divided proportionally between HRDOP and the financial intermediary on the basis of their actual contribution

Capped portfolio guarantee for microloans

Table 4: Financial product key characteristics

Guarantee rate of each defaulted eligible microcredit	80%
CAP rate*	25%
Loan amount	Max EUR 50 000
Fund contribution	100%
Maturity	Up to 10 years
Grace period	Up to 2 years (updated to 3 years during the COVID situation)

*Rate identifying the maximum loss (CAP) amount covered on the portfolios of eligible microcredits. The maximum CAP amount is the maximum liability under this FI, and is calculated as the product of the volume of the target loan portfolio, the guarantee rate and the guarantee cap rate

The financial instruments offer mentoring and coaching (business plan development, training to prevent over-indebtedness and support with administrative paperwork), which are provided to final recipients by all financial institutions. Costs related to the provision of such services are covered by the management fee paid under the Risk sharing facility while no management fee is paid under the Guarantee facility.

Final recipients deemed such non-financial support as essential to the success of the micro-loans. However, financial intermediaries have concluded that the management fee does not cover to a sufficient extent the costs related to the business development services provided.

4.2 State aid

The Fund of Funds, as the administrator of state aid, is guided by all relevant regulations and guidelines including Preliminary Block Exemption Regulation (GBER) № 651/2014 and Regulation (EU) № 1407/2013 on de minimis aid. It has been confirmed by the FoF that all agreements are signed under de minimis clause in compliance with Regulation (EU) № 1407/2013. According to the operational agreements signed with Microfond, SIS Credit, FIBank, UniCredit Bulbank and BDB Microfinancing the Fund Manager partially delegates to the financial intermediaries the functions of state aid administration related to the entry of the state aid data in the web-based Information System "Register of Minimum Assistance". During the on-site inspections of the financial intermediaries, the Fund of Funds inspects how the intermediaries perform these obligations. The interviewed financial intermediaries did not highlight state aid as being a burden.

4.3 Appraisal process

The appraisal process for the two financing instruments is relatively simple and after the **initial contact** there is an **eligibility check**. If positive, there follows a brief **stage of guiding and mentoring** performed by the credit officers during which the business idea is clarified and the business plan is finalised. After that, there is a **formal assessment** in line with the methodologies of the different financial intermediaries. Mikrofond follows a **5C methodology**, which provides due diligence guidance with some flexibility for the respective credit officer. The 5C methodology aims at assessing the creditworthiness of potential borrowers through the following elements: credit history, capacity to repay the loan, capital committed to the project, collateral and loan's terms and conditions.

Financial intermediaries emphasise the importance of mentoring for the target groups given low levels of financial literacy and entrepreneurship skills.

The establishment of a **trusted relationship** is key. It is also crucial to strike a good **balance between the ambition of the applicant and a degree of realism** and decide on an optimal rather than maximum investment. The objective is not to maximise financing but to establish sustainable businesses. As a result, a very low rate of loans has defaulted. For example, for SIS Credit only 2% of the loans have defaulted.

The approach of commercial banks is different and decisions are taken on the basis of figures and standard information. Both approaches – the more formal one of commercial banks and the more personal one by microcredit institutions - are relevant and complementary.

Final recipient story: Made Right

The entrepreneur's idea is the creation of an online platform for the design of tailor-made men's shirts. No similar platform exists in Bulgaria. The enterprise is a first attempt by the young entrepreneur who is otherwise employed in the IT industry. The start-up started with own savings, renting a space in Pleven and the purchasing of second-hand sewing machines. While they have been working on the web platform, they could also work as sub-contractors sewing shirts. Currently, they are employing three seamstresses.

The demand for their services forced them to start looking for financing. They wanted to take the next step in developing their business. The EUR 17 895 loan allowed them to purchase new machines and renovate one of the spaces to turn it into an office. It also serves as a financial buffer for buying materials and paying salaries.

Before signing the contract with SIS Credit they tried approaching normal banks. Despite having high personal revenues for the Bulgarian context, banks rejected the applications because of the lack of history of the firm. They were offered high-interest consumer loans instead. The procedure was easy and the turnaround was quick. SIS Credit advises were appropriate. A business plan was required and drafted with the support of the Financial Intermediary. They received a loan at 3.5% interest rate (two times lower than applicable market rate at that time). There was a possibility for a grace period of up to one year which was not taken up by the final recipient. Launching the platform is the next step for the start-up.

5. Output

The section gives an overview of the performance of the two funds versus the adopted targets. It also lists the reporting indicators of the financial intermediaries. Finally, the section describes the implication stemming from the Covid-19 pandemic on the uptake of the funds and presents the testimonies of final beneficiaries regarding the role of the loans in their businesses.

5.1 Performance (main outputs and results)

Interest, demand and visibility

The uptake of the two instruments has not been smooth from the onset. The demand was low in the beginning but has been growing ever since. One of the reasons for the slow start is that the target groups had traditionally received grants rather than loans and it took time to appreciate the advantages of loans to grants (as elaborated previously in the text).

Final recipient story: Robo Solutions, Sofia

The company is owned and managed by a young person. The activity consists of courses for children from 4 years of age upwards in robotics and mathematics aimed at early childhood development and fostering an interest for science and mathematics through fun games.

Robo Solutions learned about SIS Credit through positive feedback from friends. They turned to SIS Credit in August 2020 and did not consider any other sources of funding. The EUR 12 782 loan helped the company extend its robotic classes to fun maths classes based on games within the Smetalo Academy. The loan was used for developing materials, hiring rooms and purchasing a 3D printer. It was crucial for increasing their clientele and entering a new market through the extension of their courses and production of their own materials.

The loan tenor is five years, with a six-month grace period (first two months capital and interest, from third month onwards the interests are to be repaid).

The interest rate is relatively favourable compared to commercial one, being a decisive factor for Robo Solutions to take-up the microloan. The application process and interaction with SIS Credit were smooth, requiring only one meeting as the business idea was already mature.

The final recipient considered the reporting duties not burdensome and has not required assistance in complying to its reporting duties throughout the loan tenor. The company has been doing fine after the loan although activities are slower than expected due to Covid-19. Some 60-70 kids have been subscribed to the course which is less than the target of 100 for 2021. In the future, the company plans to extend their services to other cities beyond Sofia and to develop the next levels of the courses and have them throughout the year.

Moreover, the time for the deployment of the two instruments has coincided with the Covid-19 pandemic, which limited opportunities for active promotion of the instruments and possibilities for face-to-face meetings and coaching. The uptake improved considerably after some of the initial requirements were adapted, such as increasing the period from the establishment of eligible start-ups from three to five years, derogation of the minimum loan amount of BGN 5 000. The slow start was also due to an overall low experience in Bulgaria regarding the implementation of financial instruments for these target groups.

The table below illustrates the implementation of the two financial instruments as of January 2022. Indicators are reported against the target value (in the first column). The number of implemented microcredits for the Risk sharing micro-finance facility is about 36% of the target value around two years before the end of the eligibility period. During the interviews, stakeholders were confident that the target would be reached. The implementation of the **Capped portfolio guarantee for microloans** is in the initial stages and it is difficult to judge if targets will be reached.

Table 5: Targets versus implementation

Risk sharing micro-finance facility			
	Targets as of 31 December 2023	Implementation as of 31 January 2022	Value of contracted loans as of 31 January 2022
Number of Final recipients supported by microcredits (Youth Employment Initiative only)	8	11	BGN 14.5 million (EUR 7,4 million), out of which BGN 10.9 million (EUR 5.6 million) programme resources
Number of Final recipients supported by microcredits (without YEI)	1 315	449	
Social enterprises	17	8	
Capped portfolio guarantee for microloans			
Number of final recipients supported with guaranteed microloans	500	9	BGN 227 249 (EUR 116 014)
out of which Social enterprises	4	0	

Table 6: Number of loans (Risk sharing microfinance facility) as of 31.01.2022

	Number of approved loans	Total (EUR)	Of which ESF (EUR)	Leverage
Microfond	123	998 756	641 821	1.56
SIS Credit	101	1 377 259	892 587	1.54
Fibank	258	5 045 167	3 216 294	1.57
	482	7 421 182	4 750 702	1.56

The stakeholders' feedback on the two financial instruments is summarised in the table below.

Stakeholder	Assessment
Final recipients	A number of positive impacts were elaborated in the three testimonies such as: • Helped start a business and take it out of the grey economy • Helped grow existing business • Overcame reluctance of commercial banks • In addition, FIs reported 516 additional number of created jobs as a result of the microloans
Financial Intermediaries: Banks	• Helped improve their offer • Access to new customer • Gained experience with financial instruments under HRDOP
Financial Intermediaries: Microfinance institutions	• Helped improve their offer • Gained experience with financial instruments under HRDOP • Further experience with the target group
Managing authority	• A considerable administrative burden, especially initially, since there was no high-level expertise in financial instruments within the MA • The initial expectations about the possible results were based on a growing economy scenario

Coverage of final recipients

The number of representatives of the target groups becoming the final recipients to date is not as was initially expected. Only 11 microenterprises owned and managed by youths under 29 became final recipients as of 31 January 2022. Due to the low results, the financing specifically targeting youth entrepreneurs, originating from the Youth Employment Initiative, was significantly reduced in the funding agreement and was utilised for other youth-supporting grant measures under the HRDOP.

The same is valid for the target group of the social enterprises (SEs). So far, only 8 SEs have become final recipients. As SEs were more prone to using grants rather than repayable support, and as grants were partially available in the period, Bulgarian SEs did not develop any interest in taking credits. SEs in Bulgaria are also weak economically and, in business terms, the majority of them are not deemed to have debt capacity.

5.2 COVID implications

The Covid-19 crisis slowed down economic activities in Bulgaria, including among the target group of the two financial instruments. Starting a business became riskier. As a result, financial intermediaries have struggled with the conditions for a minimum number of loans included in the operational agreements with the Fund of Funds.

In order to increase the demand, the MA and the FoF fine-tuned the conditions and introduced a number of changes, which made it easier for start-ups to apply:

- Definition of a start-up enterprise changed – SMEs that have been registered within the last five years (instead of within three years);
- Easing the requirements for providing supporting documents for working capital financing,
- Elimination of the minimum amount of BGN 5 000 (EUR 2 564) per microloan and the minimum period of 12 months before repayment;
- Increasing the possible grace period from two to three years and the possibility to defer payments for servicing loans already granted within the grace period up to three years to include interest and not only the principal.

For working capital loans granted as a temporary measure to provide an effective response to the COVID-19 crisis - it is not necessary to require a business plan or equivalent documents, as well as evidence to verify whether the support provided through the financial instruments has been used as intended.

As a result, interest in the two financial instruments was rekindled.

Project/final recipient name: HR Partners Group

The company, HR Partners Group, is owned and managed by a young person, formerly unemployed. The activity is the online sale of own brand natural cosmetics. Cosmetics were from the outset appreciated by clients, prompting the entrepreneur to build a business more professionally. The start-up is selling successfully online in Bulgaria and, for the time being, does not intend to open a physical retail business or work with other distribution channels.

Initial approaches for finance with the banks were rejected on the grounds of a lack of business track record and collateral. This caused the entrepreneur to seek alternative routes and took contact with Mikrofond and SIS Credit. A first loan of EUR 3 000 was signed with Mikrofond in 2020 which allowed the company to start producing, marketing and selling one product. The product range was expanded with additional hair products including an own brand of vitamins for long hair (Elia). To continue its growth, the company signed a second loan of EUR 12 782 with SIS Credit in 2021 which allowed to launch the vitamins product and order new packaging material.

The application process was easy and the drafting of the first business plan was the only difficulty.

The interest rate of the loan is 3.5%, first interest payment after six months. The loan helped the entrepreneur start a legitimate business, increase sales and enter the new market of health supplements. The plans for the future include the developing and launching new products.

6. Lessons learned

6.1 Main challenges

The Ministry of Labour and Social Policy and the Fund of Funds faced a number of challenges in the process of establishing the two financial instruments. Overall, there was not enough experience in the country for the delivery of financial instruments for vulnerable groups under operational programmes. As expected, vulnerable groups were viewed by potential financial intermediaries (especially banks) as high-risk clients, making the process for the selection of financial intermediaries very difficult. Nevertheless, this perception has been changing.

At the same time, microfinance organisations, more experienced with the HRDOP target group recipients, do not have a country-wide network of offices and could not perform an intense and far-reaching marketing and communication strategy to roll out the Risk sharing micro-finance facility quicker and in larger volumes. Hence, the complementarity between different types of financial intermediaries – commercial banks and microcredit institutions – is positive and should be maintained.

An entrepreneurial ecosystem cannot be created overnight. While grants were the most common option in the past, testimonies from the target group of vulnerable micro entrepreneurs point out that many prefer to obtain debt financing with much shorter notice and less bureaucratic reporting requirements. Thus, there has been a shift away from relying on grants only. However, it is worth mentioning that grants are still necessary for most of the final recipients targeted by the ESF financial instruments in Bulgaria, as they do not show fully viable business models according to financial intermediaries' appraisal. In the 2021-2027 programming period, the increased opportunities for combining financial instruments with grant support can help managing authorities devising integrated and leaner measures to support such final recipients.

In the case of solid business cases, in particular with high innovation potential, financial instruments can be used to improve the offer of financial intermediaries' own products, and/or to provide technical assistance along the way. In addition, the cap of EUR 25 000 may be exceeded for some of these more robust final recipients.

In the opinion of the MA, one drawback has been the underestimation of the promotion of financial products among the potential final recipients. Overall, communication has not been sufficiently intense and regular which is another reason for the slow uptake. Most stakeholders associate more intense communication in the future with a faster uptake of the two financial instruments.

In general, following an ambitious ex-ante assessment all actors had very high expectations which have not materialised due to the above obstacles and the Covid-19 pandemic. This experience would certainly make actors more realistic in the future. Nevertheless, it is noteworthy that adequately sized allocations for financial instruments underpin sufficient interest from the private sector, effective use of public resources, and significantly mitigate the need for corrective reallocation of funds within the respective operational programme.

6.2 Main success factors

The EAA has provided suitable yet ambitious recommendations which laid the foundations of the two financial instruments. The governance model through a Fund of Funds was an asset for the MA since the direct delivery or the selection of financial intermediaries would have been very difficult for an MA with limited expertise in FIs. The Fund of Funds model is beneficial since it provides an opportunity for the transfer of experience gained under the other OPs and cost efficiency with regard to operational resources.

The quality and commitment of the financial intermediaries engaged in the instruments are of huge importance. In the present case, the selected microfinance organisations have demonstrated a good experience and knowledge of providing financial support to vulnerable recipients while banks have good country-wide outreach to more recipients, as such are complementary. They (especially the banks) have the opportunity to expand lending into new and promising segments taking a "controlled" risk through the risk sharing mechanism. The returns on the resource allocated to managing the instruments are optimised through management fees. The management of instruments under the HRDOP contributes to strengthening the identity of the financial intermediaries as socially responsible organisations whose activities are based on sustainable banking.

Constant monitoring of the implementation processes by the Fund of Funds and flexibility to discuss and make minor but important changes to the financial agreement with the MA have been instrumental in attracting more financial intermediaries and opening up to more final beneficiaries.

6.3 Future outlook

Although appreciated by various stakeholders, the uptake of the two financial instruments has been slow in the beginning and stakeholders have faced different challenges. However, most stakeholders were adamant that lessons have been learned and that both financial instruments should be continued. The EAA 2021-2027 suggested the structuring of a new additional FI on improvement of working environment.

Certain changes have been suggested by various stakeholders to improve the uptake and the overall performance of the two financial instruments. One change deemed possible is to blend financial instruments and grants in a single operation with up to 40% of grant component. The grant component of the operation could potentially finance:

- improving the capabilities and employability of employees in existing micro-enterprises so that they can provide even better training, coaching and guidance;
- improving the sustainability of existing micro-enterprises: training of micro-enterprise managers, even more assistance in the preparation of business plans, provision of information on existing financial opportunities;
- coverage of certain operating costs of social enterprises and learning centres, such as for HR.

This approach of providing grants and financial instruments under a single operation is to result to a single delivery mechanism and increased efficiency. At the same time, introduction of new models of support such as providing support through financial instruments and grants in a single operation may require pre-emptive investments in capacity building at the level of organisations managing financial instruments.

Another alternative would be to provide a fixed grant for financial intermediaries to further increase their interest and benefits from providing financial instruments. Such amount could increase the level of support provided to final recipients, by means of business development services.

The Ministry of Labour and Social Policy shared a vision centred on the preparation and conditioning of the target groups so that they can benefit from the financial instruments optimally in the future. This would involve trainings, support to already created enterprises (and social enterprises) including mentoring on the development of a business idea and the options for financing, marketing, etc. In this way, financial instruments become a part of a bigger package of services for the target group.

The two financial instruments were adapted to the respective financial intermediaries involved. In the context of the current high liquidity on financial markets, risk sharing with banks under guarantees were naturally more attractive as they target the specific need for risk mitigation of final recipients. On the other hand, microfinance institutions typically have less access to funding, relying mostly on banks. As such, the financial instrument involving both a funding and a risk sharing component in one was the more efficient way to support the activity of this group of microfinance providers. All stakeholders are unanimous in their opinion that both types of financial intermediaries need to be involved in the future.

There is also the suggestion of having more flexible requirements with regards to the selection of financial intermediaries (price, minimum management fee, etc.), with the exception of the requirement regarding the support they provide to potential final recipients.

With regards to avoiding the crowding out of loans by grants, an increased attention into strategic, upfront planning can avoid parallel and overlapping procedures. In addition, as expressed throughout this document, the combination of grants and financial instruments could represent an appropriate solution for the targeted groups.

Finally, regular and intense communication flows with potential final recipients across the country (by means of various channels) could increase the awareness and interest in the financial instruments.

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