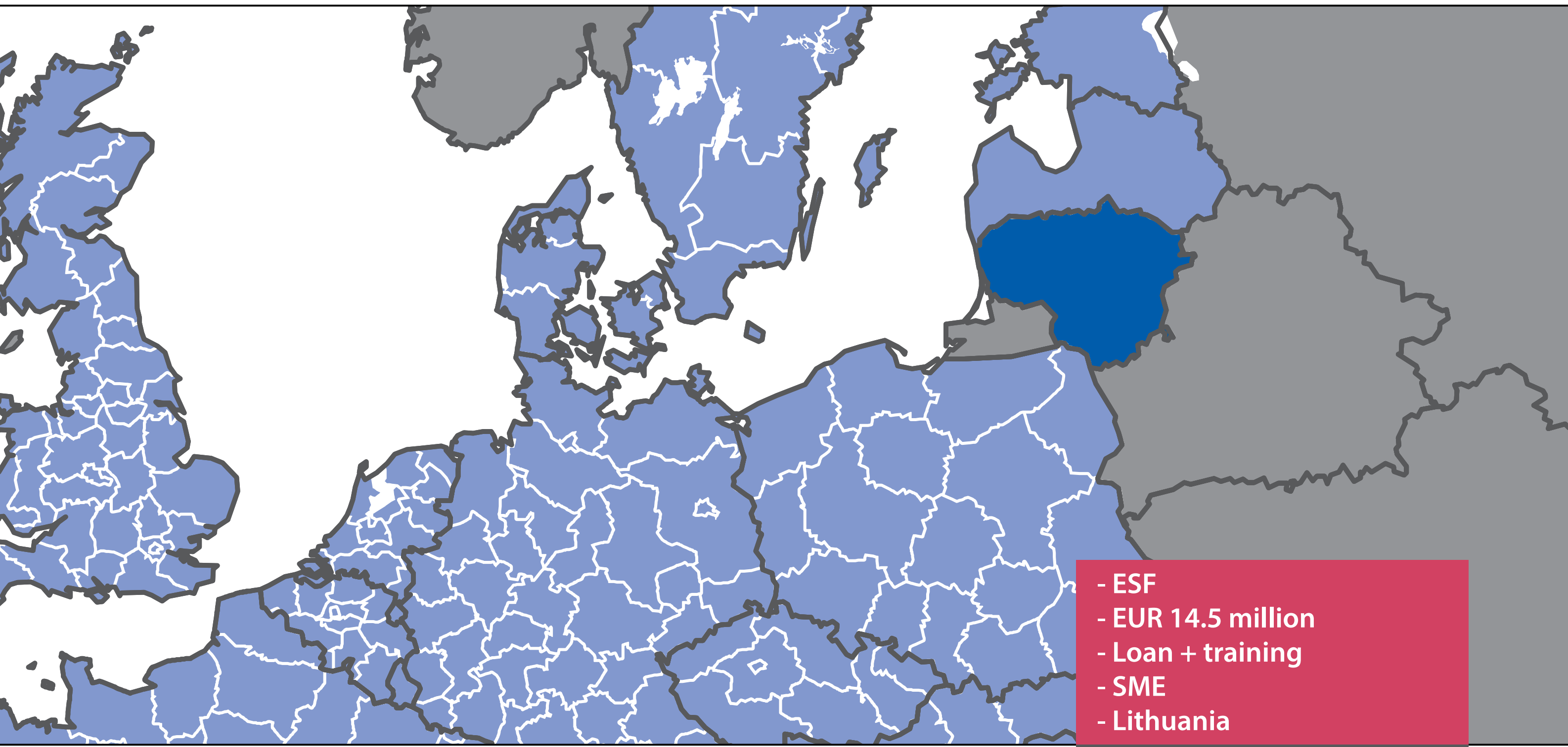

- ESF
- EUR 14.5 million
- Loan + training
- SME
- Lithuania

… supporting entrepreneurs to develop a sustainable business …

Entrepreneurship Promotion Fund (EPF)

Case Study

European Commission

European Investment Bank

The EU bank

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The authors of this study are a consortium of three companies: t33 (lead), University of Strathclyde – EPRC and Spatial Foresight.

Abbreviations

IB	Intermediate Body
EPF	Entrepreneurship Promotion Fund
ERDF	European Regional Development Fund
ESF	European Social Fund
INVEGA	State owned JSC "Investicijų ir verslo garantijos"
LCCU	Lithuanian Central Credit Union
OP	Operational Programme
SME	Small and Medium Enterprise

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1 Summary

This case study describes how the Lithuanian government used part of its European Social Fund (ESF) allocation to develop entrepreneurial talent in the country through a financial instrument. A total of EUR 14.48 million of ESF funds was distributed as low-interest loans and loans on favourable terms, in combination with training and consultations on how to strengthen their SMEs and start-ups. The financial instrument helped companies such as Veri Beri, a successful food-producing SME founded by a brother and sister. The ESF instrument helped the company when the commercial loan market refused to finance them due to their insufficient credit history. With a EUR 23,000 loan from the instrument, the company grew and it now employs nine people and exports its products to nearby countries.

Over 1,000 SMEs and entrepreneurs in similar situations as Veri Beri took advantage of the ESF loans, with interest rates 1.5 – 3.5% lower than commercial ones, and benefited from cost-free business development training programmes. All this took place in a market environment which discouraged young or disadvantaged people from putting their business ideas into practice. More importantly, over 1,700 new jobs were created through the Entrepreneurship Promotion Fund (EPF).

This case study shows how young SMEs, as well as unemployed people, disabled people, young people and older workers took advantage of low-interest loans and free training to set up businesses. A major factor underlying these achievements was the close cooperation between a variety of public and private players, including ministries, a state-owned social fund and 57 credit unions. Using the opportunities available in the Structural Funds legislation to use ESF allocations as loans instead of grants, the Lithuanian government reused the money over a period of five years to bridge an important market gap: access to SME financing. The case study reveals that the ESF can be used successfully for financial instruments. The combination of loans and free training was very important not only for financing SMEs, but also for ensuring their sustainable development. Close monitoring of market conditions, along with expertise from a well-known state fund ensured that emerging market gaps were immediately addressed and that the instrument was flexible enough to satisfy the demands of young SMEs.

This case study reflects good practice insofar as the financial instrument addresses an important market gap in entrepreneurial access to finance, not only by providing loans, but also by offering free training and consultancy in order to help socially disadvantaged and other entrepreneurs develop sustainable businesses.

Name

Entrepreneurship Promotion Fund (Lithuania)

Funding source

ESF (OP for the Development of Human Resources 2007-2013)

Type of FI

Loan combined with training and consultations (final recipients can also make use of other related instruments, i.e. guarantees, interest rate subsidies and subsidies for employee salaries)

Financial size

EUR 14.48 million (entirely ESF contribution)

Absorption rate

78.32% (at end of December 2013)

EU leverage

1

Re-investment

24.2%

Thematic focus

SME

Type of final recipient

Micro and small enterprises younger than one year, entrepreneurs and business-oriented social enterprises. Priority given to unemployed people, disabled people, young people under age 29 and individuals over 50.

Partners involved

Steering committee composed of members form the Republic of Lithuania's Ministry of Finance (MoF) and Ministry of Social Security and Labour (MoSSL) and observers from the holding fund. Managing Authority – MoF. Intermediate Body – MoSSL. JSC "Investicijų ir verslo garantijos" (INVEGA) manages the holding fund. Financial intermediation and training are assigned to the consortium of 57 credit unions coordinated by the Lithuanian Central Credit Union (LCCU). Labour exchange offices, NGOs and local communities are involved in publicity actions.

Timing

July 2009 – September 2015

Main results

New jobs created: 1,758 (up to March 2014)

Individuals / enterprises using the scheme: 1,017 (up to September 2014)

2 Objectives

The EPF offers loans at better-than-market conditions, in combination with free training to micro and small enterprises that have been operating for less than one year, as well as individual entrepreneurs and business-oriented social enterprises. Priority is given to disadvantaged groups, i.e. unemployed people, disabled people, young people under age 29 and individuals over 50.

The EPF is implemented under the OP for the Development of Human Resources 2007-2013 and funded by the ESF. The OP objective is to provide adequate and productive human resources that contribute to economic development, employment and a knowledge-based society. The EPF contributes to the priority axis for quality employment and social inclusion. The main aims of the EPF are to promote self-employment and entrepreneurship, as a sustainable way to keep people active in the business and labour market, and job creation.

The Lithuanian government established the EPF as a response to the economic downturn, the increase in unemployment and the limited access that enterprises had to sources of finance. To tackle these issues and achieve the aims of job creation and self-employment, a combination of free training and loans with favourable conditions was used.

The EPF focused on start-ups and prioritised disadvantaged groups in order to fill the gap in funding for these groups, since other low-interest ERDF loans did not specifically concentrate on these areas.

3 Set up of the financial instrument

Setting up the EPF required close cooperation among all institutions involved. Selecting an experienced and well-known holding fund manager and financial intermediaries with good accessibility to clients and the correct approach towards target groups was crucial for implementing the EPF.

3.1 Preceding events

The first version of the OP planned to implement measures for the development of entrepreneurial skills such as training but did not mention the EPF. However, the increased unemployment rate and credit policy in the market at that time, which narrowed the possibilities of receiving financing for businesses, stimulated a search for new and sustainable ways to tackle these problems. It was understood that training on its own was not sufficient to create jobs in these economic circumstances, thus the training should be combined with loans at conditions more advantageous than those offered by the market. The government adopted a resolution in March 2009 to consider the possibility of a new FEI scheme (loans combined with training and consultations) under the ESF. In April 2009, the addition of the EPF into the OP was approved by the Monitoring Committee, and about two months later it was approved by the European Commission. The contract for implementing financial engineering measure „Promotion of entrepreneurship" between the holding fund manager (state-owned institution INVEGA), the managing authority (represented by the Ministry of Finance) and the intermediate body (represented by the Ministry of Social Security and Labour) was signed on the 30 December 2009.

A market assessment performed in 2007 had concluded that there was a need for a social micro-financing pilot scheme amounting to EUR 1 million that could provide loans to socially excluded people for the purpose of starting a business. Additionally, it was identified that existing start-up and micro-financing schemes were not sufficient to cover the demand of potential and existing micro enterprises. The serious economic situation in 2009 demanded a review of the amount for the social micro-finance scheme that had been estimated in the 2007 market assessment. Addressing the gap in financing for micro enterprises was also considered. Thus, the EPF was created to provide loans and training for micro and small enterprises that were registered and operating for less than one year, as well as individual entrepreneurs and business-oriented social enterprises with the priority of supporting disadvantaged groups. The EPF's value was set at EUR 14.48 million.

INVEGA, the state-owned institution chosen as the holding fund manager, already had the necessary experience and administrative capacity, since it had previously been responsible for providing microcredits and loans from state funds to SMEs.

Financial intermediaries were selected under a public procurement procedure launched by the holding fund manager on 31 March 2010. Key requirements for the financial intermediary were extensive geographical coverage of potential clients and accessibility in rural areas. The scale of the EPF was considered small from the commercial banks' point of view, and they did not participate in the selection procedure. Following the tendering procedure, the managing authority signed a contract with a consortium of credit unions led by the LCCU on 30 July 2010. The consortium is made up of 57 credit unions, with 154 sales points.

3.2 Funding and partners

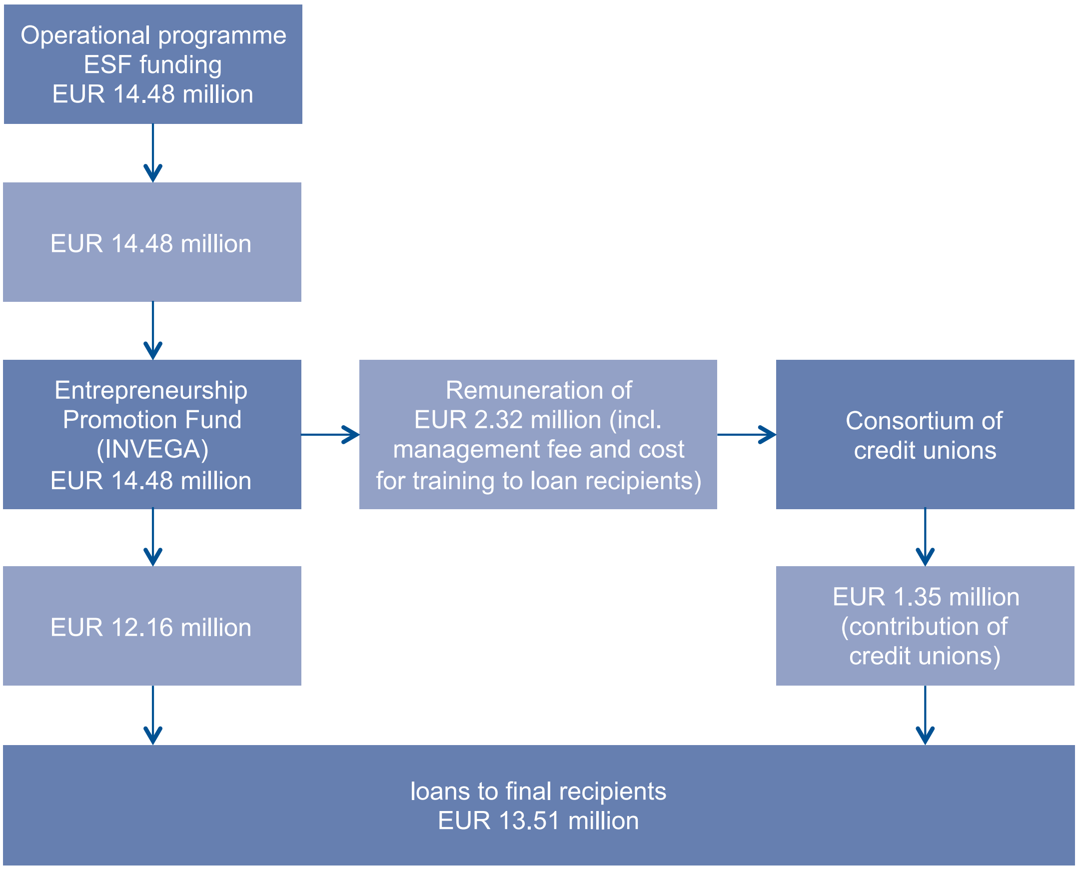
A **steering group**, which consists of delegates from the managing authority, the intermediate body and the fund manager, monitors the implementation of the investment strategy, as well as results and actions taken to reach the OP goals. The **managing authority** is responsible for all financial issues. It supervises the holding fund manager and approves the manager's expenditure reports. The Ministry of Social Security and Labour act as the IB. INVEGA, an institution owned by the state, manages the **holding fund**.

The consortium of credit unions provides **financial intermediation** and training to final recipients. The public employment offices, NGOs and local communities are involved in publicity events.

The ESF funds the EPF (EUR 14.48 million in total, of which EUR 2.32 million for management and training) with an additional contribution by the consortium of credit unions (EUR 1.35 million), which provides 10% of the funds allocated for loans.

At the final recipient level, the actual amount received is at least 10% lower than the amount of the loan. This is due to the national regulation of credit unions, which stipulates that loan recipients have to become members, or shareholders, of the credit union. In financial terms, this requires a deposit of at least 10% of the loan amount into the credit union account. After the loan is repaid, the deposit is returned.

Figure 1: Funding of the Entrepreneurship Promotion Fund



Source: Spatial Foresight, 2014

3.3 Implementation

The EPF is implemented through the holding fund manager, INVEGA, and the financial intermediary (LCCU). INVEGA was established in 2001 and is supervised by the Ministry of Economy. Since its establishment, INVEGA has been involved in administering state guarantees and credit instruments, and later started acting as a holding fund manager for guarantees, managing interest rate subsidies funded by ERDF and partial subsidies for employee salaries funded by the ESF.

The consortium of 57 credit unions coordinated by the LCCU provides consultations and loans to the final recipients. The LCCU is also responsible for coordinating free training and consultations.

Initially the plan was to issue all the funds by the end of 2013; however, the deadline was postponed until the end of September 2015. On the one hand, the longer establishment procedures meant that some targets could not be achieved, but on the other hand, the high demand for loans encouraged banks to continue issuing new loans to final recipients. By the end of September 2014 all funds were already distributed as loans to final recipients, and financial intermediaries were providing new loans from repaid funds (24% of the funds were already re-invested).

3.4 Governance

The managing authority and the IB were designated by a resolution of the Government of Lithuania and the OP. The holding fund manager acts under a tripartite agreement with the managing authority and the IB. The agreement legally establishing the EPF was concluded on 30 December 2009. It describes EPF activities, sets rules for the funds accounting rules and describes how financial intermediaries are selected. The holding fund manager is permitted to receive annual management fees of up to 2% of the total fund. The actual management fee, however, is lower and is financed from interest revenues, investments, etc.

The financial intermediary acts according to an agreement signed with the holding fund manager. The agreement sets the investment strategy, including loan conditions, output and result indicators, obligations in the event of defaulted loans, and management fees.

4 Strategy

The EPF aims to address the market gap in access to finance for start-ups by providing loans in combination with training. A regular analysis of market circumstances and credit demand was important to keep the strategy relevant to potential recipients.

4.1 Investment strategy

The instrument provides loans at better-than-market conditions in combination with free training. The primary aim is to promote self-employment and entrepreneurship as a sustainable way of keeping people active in business and the labour market and to create jobs. As mentioned, the loans target micro and small enterprises that have been operating for less than one year, as well as individual entrepreneurs and social enterprises.

Veri Beri – firm funded by the financial instrument

In October 2012 a brother and sister started a family business with the brand name Veri Beri. Their idea was to manufacture exclusive, naturally sweetened "fruit strips" from fruit juice and puree without any added sugar, preservatives or artificial flavours. This type of premium sweet was not available in Lithuania or any of the Baltic States.

The equipment was purchased using own capital. However, further business development required a significant volume of working capital. In 2013, the company took out a loan of EUR 23,000 from the EPF in order to cover rental costs and to buy raw materials for producing the fruit strips.

The combination of loans and training is a very important aspect of the strategy. Although training is not obligatory, it is very popular among final recipients. It has been shown that providing training on different aspects of business development improves final recipients' entrepreneurial and management capacities. From the EPF perspective, providing training increases the scope for creating jobs and reduces the probability of loan defaults by the final recipients.

The investment strategy to target start-ups, prioritising disadvantaged groups, i.e. unemployed people, people with disabilities, people under age 29 and individuals over 50 is at the core of the EPF's design and implementation. The investment strategy resulted in selecting credit unions as financial intermediaries, since commercial banks would normally not offer financing to start-ups, due to their lack of business history and available guarantees.

Prioritising disadvantaged groups is visible in the EPF's result and output indicators. 15% of the loans have to be issued to final recipients from the priority target groups.

4.2 State Aid

The EPF provides loans of up to EUR 24,907; thus it falls under the de minimis aid rule, as a difference between the market price of loans and the price paid for the loans offered by the EPF.

4.3 Financial products and terms

The annual interest rate for loans was 5.49%[1], which was on average 1.5-3.5% lower than the market rate. The repayment date is the end of 2018. Prior to the strategy being changed, the repayment date was the end of 2015. The loans for working capital are issued for shorter periods, usually two to three years.

No administration fees are applied for issuing the loans. However, due to Lithuanian credit union regulations, the loan recipient has to become a member, or shareholder, of the credit union by depositing at least 10% of the loan amount into the credit union's account.

In addition, final recipients have to finance 10% of the project value from their own funds.

[1] *The annual interest rate of loans consists of: (1) 3 months VILIBOR + 0.1% (but no less than 2% and no more than 6%); and (2) the credit union margin (no more than 3.49%).*

A crucial factor that led to the success of the instrument is the fact that EPF final recipients can usually make use of other instruments, such as:

- **guarantees** (financial instrument financed by the ERDF). Up to 80% of loans can be secured by such guarantees. These guarantees increase significantly the possibility of applicants receiving a loan, since people starting a small business, particularly young people, who are targeted under the scheme, usually do not have property that could serve as collateral.
- **interest rate subsidies** (global grant financed by the ERDF). Up to 95% of the loan interest is subsidised through this instrument. This aid reduces the price of financing to the minimum value.
- **partial subsidies for employee salaries** (global grant measure financed by the ESF). This aid provides the possibility to lower some of the financial burden arising from paying salaries.

The EPF loans are combined, if needed, with training and technical assistance with application documents. The training covers different types of business development basics, e.g. accounting, marketing, and human resources. It also includes training on how to prepare a business plan, which is a requirement for receiving an EPF loan.

By the end of September 2014, due to the re-investment nature of the instrument the value of loan agreements with final recipients was 24% higher than the total amount of EPF. In other words, 24% of funds were already re-invested.

4.4 Final recipients targeted

The target groups are micro and small enterprises, registered and operating for less than one year, individual entrepreneurs, and business-oriented social enterprises. Priority is given to unemployed people, disabled people, young people under age 29 and individuals over 50.

The IB, holding fund and financial intermediaries all work at raising awareness, also involving partners such as public employment offices, NGOs and local communities. Innovative communication measures, such as TV shows, are also used. Moreover, it is important that the consortium of credit unions has a wide range of sales points, ensuring good accessibility to the clients.

Veri Beri – firm funded by the financial instrument

The owners considered several different possibilities for financing Veri Beri. Commercial bank loans were not available for the start-up, due to the requirements for business track record and collateral. The owners found information about EPF loans on the internet. This opportunity was very attractive to them, since this FI was designed particularly for start-ups. Also, the owners of the business belonged to an EPF priority group, i.e. young people.

The business owners prepared the business plan required by the credit union themselves. They took advantage of the training on human resources in business provided under the EPF.

4.5 Project types

The projects mostly include financing of new micro or small businesses. Most loans are provided for investments, but loans for working capital are also issued. Around 70% of end recipients are micro and small enterprises, with the rest being individual entrepreneurs. 65% of loans are issued to men entrepreneurs and 35% to women. The average loan amounts to EUR 15,900.

The economic sectors of projects were very diverse. Catering services, repair and maintenance of transport vehicles, wholesale and retail trade were very popular. Innovative manufacturing and services were also supported.

4.6 Changes in Strategy

There were several changes in strategy. At the initial stage of the EPF's development, it was planned that if the final recipient fulfilled job creation conditions, some of the loan amount (30%) would be turned into a grant. Such an approach was important, considering the economic circumstances and the public perception of EU support, since the general public understood EU support in terms of grants or subsidies. Only later it was discovered that due to existing EU regulations on financial instruments, part of the loan could not be converted into a grant. Thus it was obvious that changes in the strategy would need to be made and other means with regard to the loans would need to be found.

The possibility to receive interest rate subsidies, not only for the loans issued with INVEGA guarantees, but for all loans, was established in January 2012. The subsidy level was increased from 50% to 95% of the interest paid. In August 2013, the possibility of obtaining a partial subsidy for employee salaries was introduced, giving additional advantages to EPF final recipients. In addition, the deadline for issuing loans was pushed back until the end of September 2015 (previously it was up to the end of 2013).

5 Achievements

The EPF issued its first loan in November 2010. Since then the EPF has promoted self-employment and entrepreneurship as a sustainable way to keep people active in the business and labour market, which has resulted in the creation of almost 2,000 jobs.

5.1 Output

By the end of September 2014, 1,017 loans had been issued, of which 479 loans to persons from the priority group. By the end of March 2014 these loans had helped create 1,758 new jobs, of which 610 among young entrepreneurs.

Veri Beri – firm funded by the financial instrument

The EPF loan had a critical role in developing the family business Veri Beri. It matched the needs and opportunities of the start-up very well. The possibility of combining loans with other products provided by INVEGA was also very useful for developing the business from an initial idea. In the past two years, the family start-up established by the brother and sister team has grown to nine employees.

The fruit strips are now sold in across Lithuania and are popular with customers due to their natural ingredients and unique taste. Veri Beri has recently started exporting its products to Estonia and Finland.

6 Lessons learned

The challenges of establishing and implementing the EPF were successfully overcome. Lessons were learned and the experience will be used for implementing financial instruments in 2014-2020.

6.1 Main success factors

The managing authority's and the intermediate body's idea of providing a **combination of free training and loans** accurately addressed the market gaps in possibilities offered to start-ups. The target groups typically lacked business experience and had limited opportunities to obtain finance.

Innovative, specific publicity measures were very important to attract potential loan recipients' attention. Publicity measures were implemented at all levels, involving such partners as public employment offices and NGOs. **Close cooperation among all institutions involved** in designing and implementing the EPF was crucial and is perceived to be one of the success factors in the operation of the scheme

INVEGA, an **experienced and high profile holding fund manager**, was an important element. Since INVEGA was well known among individual entrepreneurs and enterprises, and also had extensive experience with loans and related financial instruments, it was able to attract potential loan recipients and to manage the EPF well.

At the level of financial intermediaries, it was a plus to have the consortium of 57 credit unions coordinated by LCCU involved in implementation. On the one hand, this consortium (with 154 sales points) ensured **good accessibility to the clients, including those in rural areas**, and on the other hand, credit unions, as compared to banks, had a more **positive approach towards small and inexperienced businesses**, which was the EPF target group.

Regular analysis of demand and market circumstances, as well as **established possibilities of applying for other instruments** managed by INVEGA, i.e. guarantees, interest rate subsidies and partial subsidies for employee salaries, greatly increased credit use and demand.

6.2 Main challenges

The EPF's establishment required more time than initially expected. The institutions establishing the EPF considered that some of the **EU regulations concerning FIs were not sufficiently clear**.

Business conditions at the beginning of implementation were very difficult, thus the demand for loans was not as high as expected. At the initial stage of EPF development, it was planned that if the loan recipient fulfilled the job creation criteria, some of the loan (30%) would be converted into a grant, though it later turned out that this was not possible. As a result, steps were taken to make financing conditions more favourable. The Ministry of Economy reached an agreement with INVEGA to apply interest rate subsidies. The possibility to get a partial subsidy for employee salaries was also introduced.

FI implementation requires **flexibility in implementation** due to changing economic conditions and demand for the instrument. However, flexibility is limited by public procurement regulations and procedures.

6.3 Outlook

Although it is not common practice, the EPF revealed that the ESF can be used successfully for financial instruments. The ESF objectives were achieved through promoting self-employment, increasing entrepreneurship skills and giving priority to disadvantaged groups such as unemployed people, disabled people, young people and the older workers.

The experience of EPF implementation and the results achieved signal the need to continue providing socially-oriented support for start-ups and to continue implementing this financial instrument in the 2014-2020 period, when it is planned that there will be an increase in financial support and a greater orientation towards encouraging people facing difficulties to start and develop their own businesses, and to create new jobs.

www.fi-compass.eu
contact@fi-compass.eu

European Commission
Directorate-General
Regional and Urban Policy
Unit B.3 "Financial Instruments and IFIs' Relations"
B-1049 Brussels

European Investment Bank
Advisory Services
fi-compass
98-100, boulevard Konrad Adenauer
L-2950 Luxembourg