EJSM Vol. 27/2, 3/2018, ISSN: 2450-8535 | www.wnus.edu.pl/ejsm | DOI: 10.18276/ejsm.2018.27/2-42 | 347–354

Repayable financial instruments in the European Union – the range of effect and efficacy

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Received 18 January 2018
Accepted 2 September 2018

JEL classification G21, G23, H70, L26

Keywords financial instruments, JEREMIE Initiative, micro, small and medium enterprises

Abstract One of the goals of the Cohesion Policy is ensuring the conditions for economic growth, well-being and social integration in the European Union. As a result of the policy, the differences in the economic development should be decreased. Repayable assistance is becoming the more and more popular form of supporting those goals, and its fundamental feature is the need to repay the received sum. Repayable financial instruments as part of the EU programmes exemplify how commercial solutions applied on financial markets may be implemented at the level of public intervention and management of funds available under operational programmes. Capital management in a market manner in relation to public intervention measures was already observed in the early 1990s. Initially, these were isolated measures taking the form of loan funds, guarantee funds or venture capital. Financial instruments may be applied in relation to three areas: enterprises, particularly micro, small and medium, public-private partnerships and other projects aimed at urban development (urban area development funds) and in the area renewable energies and energy efficiency. As at the end of March 2017, in the member states there were 1,058 Financial Instruments which took the form of, *inter alia*, loans, guarantees, and venture capital, out of which 89% financed growth and operations of enterprises, 7% – urban development, and 4% – energy efficiency and renewable energies.

Introduction

One of the goals of the Cohesion Policy is ensuring the conditions for economic growth, well-being and social integration in the European Union. As a result of the policy, the differences in the economic development should be decreased. Repayable assistance is becoming the more and more popular form of supporting those goals, and its fundamental feature is the need to repay the received sum. Despite the need to pay the funds back, this form of assistance is viewed favourably by all beneficiaries, and due to the revolving mechanism it generates more benefits, as the funds that were once disbursed to beneficiaries come back from them, thus multiplying the value of the support and the number of beneficiaries. This type of financing with the European Union funds in the 2007–2013 programming period was exemplified by Financial Engineering Instruments (FEI) which constituted a way to apply the structural funds to implement the Cohesion Policy, thus contributing to the long-term and sustainable economic growth in the individual regions and the whole European Union. In the 2014–2020 programming period, the repayable assistance to finance development was referred to as Financial Instruments (FI).

The aim of this paper is to demonstrate the idea, scope and levels of repayable assistance and to analyse its efficacy. The area under research includes the EU member states which implemented the FEI in the 2007–2017 programming period.

Theoretical aspects of financial instruments

Repayable financial instruments as part of the EU programmes exemplify how commercial solutions applied on financial markets may be implemented at the level of public intervention and management of funds available under operational programmes. Capital management in a market manner in relation to public intervention measures was already observed in the early 1990s. Initially, these were isolated measures taking the form of loan funds, guarantee funds or venture capital.[1] Later on the process accelerated, taking the form of various financial instruments. The idea behind the financial instruments is supporting the Cohesion Policy, at the same time complying with the rule of risk sharing and assistance in achieving the goals stipulated in the operational programmes of the member states.

Reorientation of the European Commission from the subsidy instruments towards repayable instruments to ensure effective use and management of structural funds was connected with the possibility of obtaining significantly better results in terms of both economic and social issues. The major reasons for implementing Financial Instruments, set out in the Regulation (EU) No. 1303/2013 of the European Parliament and of the Council of 17 December 2013 include: (*Financial Instruments…*, 2013; p. 52; Mackiewicz, Przybyłowski, Rybkowski, Tamowicz, 2014, p. 28):

a) supporting the implementation of regional policies to assist development of the SME sector, in particular enterprises at their early stage of development (start-up capital), supporting urban development or urban regeneration, support for mitigating and reducing climate changes by increasing energy efficiency;
b) reducing the financing gaps by providing entrepreneurs with better access to financing, also via offering more attractive interest rates, or greater availability of venture capital;
c) more effective use of public funds compared to grants (subsidies), due to the revolving mechanism and engagement of public funds, whereby the volume as well as scope of support is multiplicate;
d) possibility of engaging capital from other financial institutions, leading to financial leverage;
e) other technical aspects that enable greater absorption of the EU funds, also those increasing their certification level.

Introduction of the repayable assistance was preceded by an analysis of needs in a given region with regard to enterprise financing and effective allocation of funds, and also investment priorities. The analysis was also aimed

[1] The sample countries and regions are: Spain (Andalusia), Belgium (Meuse-Vesdre), Great Britain (Merseyside), Portugal (Modernizacao do Tecido Economico), Evaluation of Financial Engineering Measures in Structural Policies, Structural Policies Final Report, European Commission, April 1998.

at enabling correct implementation of implementable financial instruments (*Financial Instruments…*, 2013, p. 39) via the Holding Fund (HF) or by direct engagement of the Managing Authority in forwarding the funds to financial intermediaries (Figure 1).[2]

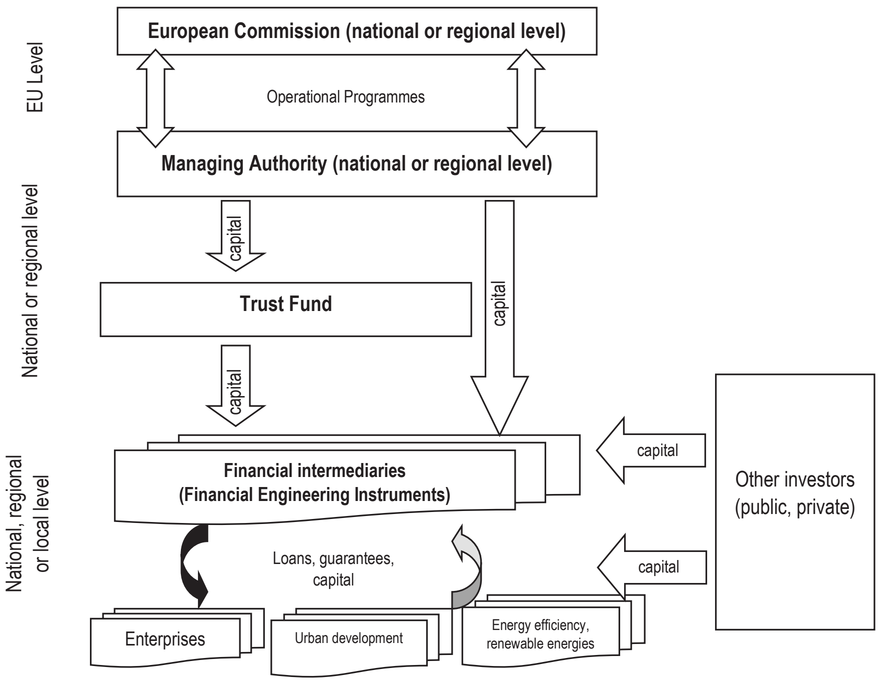

Figure 1. Structure and manner of implementing the Financial Engineering Instruments

Source: own study based on *Financial Instruments…*(2013), p. 39.

Implementation of repayable assistance in the EU

Repayable instruments had been applied in the Cohesion Policy earlier, but a significant increase was seen in the years 2007–2013 when their total amount in operational programmes amounted to EUR 16.4 bn. The amount allocated to repayable assistance in the years 1994–1999 is estimated to be EUR 0.57 bn, whereas in the 2000–2006 period it amounted to EUR 1.2 bn. The assistance was dedicated exclusively to enterprises and implemented in several member states. It was not until 2007 that repayable financial instruments started to play a more substantial role. Halfway through the programming period, financial instruments were implemented in nearly all member states, and in addition to enterprises development their scope included urban areas development and energy efficiency (*Summary of data…*, 2017, p. 7).

[2] That was done in 12 regions in Poland.

Financial engineering instruments may be applied in relation to three areas: enterprises, particularly micro, small and medium, public-private partnerships and other projects aimed at urban development (urban area development funds) and in the area renewable energies and energy efficiency. The contribution made by the Management Authorities at the end of March 2017 amounted to nearly EUR 17 bn, of which over EUR 11.5 bn derived from the Structural Funds (EFRR, EFS), and more than EUR 5 bn constituted the national contribution. Compared to the preceding year, there was a slight increase by 5.5 % (EUR 885.88 m). Analysing the particular countries, it is easy to notice diversification in this respect. Some countries saw a considerable increase in the levels of funds earmarked for financial engineering instruments (Slovakia, Italy, Romania), whereas elsewhere there was a decrease in the funds levels (Greece, the Czech Republic, Finland). The total value of funds disbursed to be managed by the Trust Funds was nearly EUR 7.5 bn (EUR 1.7 bn of national contributions). 94% of the funds was disbursed to specific intermediaries. The Managing Authorities also supplied funds without participation of the Trust Fund (EUR 9.44 bn, out of which nearly 3.5 bn accounted for the national co-financing). In some countries (e.g. Poland, France, Germany, Italy) the amount invested in the final recipients covered the funds which had already been repaid and reused, which shows the revolving mechanism in action, which multiplies the assistance value.

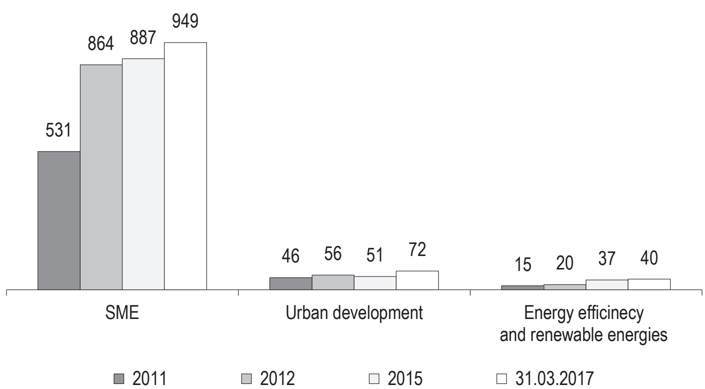

Figure 2. Number of funds under Financial Engineering Instruments that financed the particular kinds of beneficiaries

Source: own elaboration based on Summary of data… (2016), p. 24; Summary of data… (2017), p. 64.

As at the end of March 2017, in the member states there were 1,058 Financial Instruments which took the form of, *inter alia*, loans, guarantees, and venture capital, out of which 89% financed growth and operations of enterprises, 7% – urban development, and 4% – energy efficiency and renewable energies (Figure 2). Among them, there were 77 holding funds and 981 specific instruments, in the form of loans, guarantees, venture capital and others.

Kinds of repayable instruments and end beneficiaries

Member states implemented financial instruments depending on the kind of the final recipient and kind of intervention. The most commonly used form of assistance was provision of guarantee products totalling nearly EUR 4 bn, the average value of which was at the level of EUR 16,000. Also popular were debt products in the form of loans and credits totalling almost EUR 8.5 bn and the average amount of assistance being ca. EUR 45,000.

The third group included equity instruments (EUR 2.7 bn) with an average capital entry amounting to EUR 410,000 (Table 1). The financial instrument also covered a possibility of obtaining subsidies to pay back interest or to cover guarantee fees in connection with loans and suretyships financed with the structural funds, however, their share and significance were negligible.

Table 1. Number of products and amounts disbursed to final recipients by specific funds

	All specific funds	FEIs for enterprises	FEI for UDF	FEI for EE and RES	All specific funds	FEIs for enterprises	FEI for UDF	FEI for EE and RES
	numer of products				amounts (mln EUR)			
Loans	164,171	110,539	1,613	52,019	8,491.47	6,498.13	1,347.62	645.72
Guarantees	193,095	193,095	0	0	3,717.27	3,717.27	0.00	0.00
Equity/venture capital	5,368	5,319	26	23	2,694.52	2,631.42	54.41	8.69
Other products	9,415	9,415	0	0	288.92	210.96	36.28	41.68
Total	372,049	318,368	1,639	52,042	15,192.18	15,192.18	13,057.78	696.09

Source: Summary of data… (2017), p. 39.

Most often the financial instruments supported the SME sector, and these had the longest history, as the first of them were in place as early as in the years 1994–1999. In legal terms, the instruments for enterprises were stipulated in art. 44 of the Regulation of the Council as part of the operational programmes, structural funds that may finance instruments that support the development of enterprises, urban areas and renewable energies, mainly in the form of debt, guarantee and equity instruments (Council Regulation (EC) No. 1083/2006 of 11 July 2006). Out of the total amount, 93% was obtained by entrepreneurs via various forms of instruments. In terms of quantities, 4 countries were dominating (i.e. Poland, Hungary, France, Italy), which established 67.5 % (640) of all the financial instruments throughout the EU (Figure 3). In terms of value, the highest amounts of funds earmarked for financial instruments for enterprises (ca. 60 % of allocations) were used in Italy (EUR 4.4 bn), Denmark (EUR 1.6 bn), Great Britain (EUR 1.17 bn) and Poland (ca. EUR 1 bn). Similarly as in the case of all instruments, the dominating group among the beneficiaries were the micro-, small- and medium-sized enterprises. Until now, more than 300,000 end

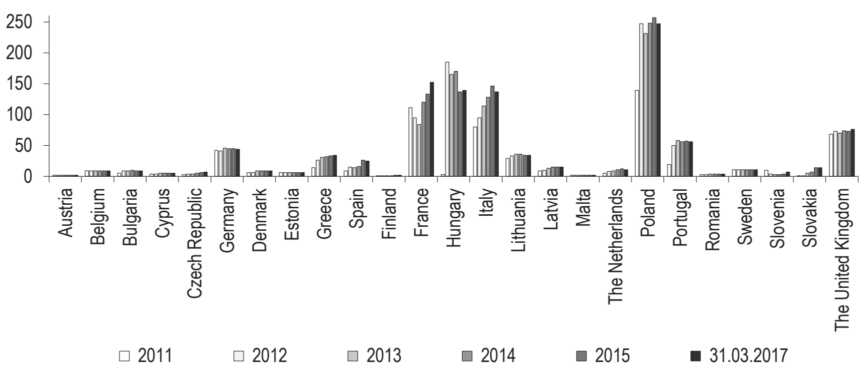

Figure 3. Number of Financial Engineering Instruments for enterprises in the EU in selected years

Source: own elaboration based on Summary report… (2011), pp.13–21; Summary of data… (2013), pp. 27–39; Summary of data… (2016), p. 45.

beneficiaries have availed themselves of financial engineering instruments (of which ca. 32,000 in Poland), out of which over 37% were micro-enterprises, and 28% – sole proprietors (Table 2).

Table 2. Number of end beneficiaries of Financial Engineering Instruments in the EU as at the end of March 2017

Kind of end beneficiary	Number of enterprises	Supported by means of			
		loans, credits,	guarantees, suretyships	venture capital	other instruments
Large enterprises	463	290	158	6	9
SME	221,810	86,848	120,977	4,481	9,504
Micro-enterprises	118,010	48,492	63,060	3,253	3,205
Sole proprietors	88,668	64,113	24,555	0	0
Urban projects	688	667	3	18	0
Other end beneficiaries	3,339	2,917	284	0	138
Total	314,968	154,835	145,977	4,505	9,651

Source: Summary of data... (2016), p. 43.

The provisions of Art. 44 of Council Regulation (EC) no. 1083/2006 made it possible to apply financial instruments and public funds to establish public-private partnerships in order to finance urban regeneration. This in turn enables creation of conditions to generate sustainable economic and social growth in degraded urban areas which would otherwise be doomed to further marginalisation Public funds are to help create appropriate conditions for private capital location, which will lead to regenerating the degraded urban areas and to creating new, attractive jobs. The first financial instrument in that regard was established in 2009, which was preceded by analyses to find out whether providing this kind of financing was advisable. By 31 March 2017, there were 72 financial instruments in 11 member states,[3] out of which 88% were implemented by the Holding Funds. The funds from the operational programmes earmarked for urban regeneration amounted to nearly EUR 1.6 bn, out of which ca. 93% were disbursed to special funds for urban area development. Urban regeneration projects were predominantly financed by means of debt instruments totalling EUR 1.3 bn. In Great Britain, Holland and Spain there was also a small share of equity instruments (26 items) totalling EUR 54 k (Table 3).

Repayable assistance for financing of urban areas is getting more and more popular and shows a noticeable upward trend, especially with regard to the value of funds disbursed to end recipients. Similarly as in the case of the instruments for enterprises, its benefits include the possibility of obtaining financial leverage due to engagement of private funds. The Pomeranian Province is one of the places where, thanks to private funds, a financial leverage was obtained at the level of 1.8, which helped achieve social effects that were important for the local communities (fi-compas, 2018).

The amendment of the Regulation of the European Commission in 2010 made it possible to apply repayable financial instruments to finance renewable sources of energy and energy efficiency. As at the end of March 2017, there were 40 instruments of this kind in operation in 9 member states, totalling EUR 730 m. Most of them were implemented without using a holding fund (23). Nearly 700 m euros were disbursed to final recipients, which

[3] Bulgaria (3), the Czech Republic (5), Denmark (4), Greece (6), Spain (6), Italy (8), Lithuania (8), the Netherlands (3), Poland (12), Portugal (9), the United Kingdom (8).

amounted to ca. 95% of the sum intended for this purpose in the operational programmes. The highest sums were disbursed by Italy, Greece, Slovakia and Great Britain (over EUR 100 m in each of them). The major form of assistance was debt instruments in the form of loans. Only in Denmark and Holland these were equity instruments (Table 4).

Table 3. Main information about Financial Instruments for urban development as at 31 March 2017

Member state	Number of Financial Instruments	Cinstributions paid to FI (mln EUR)	Cinstributions paid to final recipients	
			mln EUR	%
Bulgaria	3	33.00	30.14	91
Czech Republic	5	44.11	41.69	95
Denmark	4	41.75	42.68	100
Greece	6	112.98	98.16	87
Spain	6	195.16	144.85	74
Italy	8	289.19	258.03	89
Lithuania	8	173.42	167.02	96
The Netherlands	3	13.47	13.45	100*
Poland	12	279.88	283.93	101
Portugal	9	132.50	159.76	121
The United Kingdom	8	280.12	199.60	71
Total	72	1595.59	1438.31	90

* The Netherlands, Poland and Portugal payments to final recipients include revolving amounts, interest from treasury management.

Source: own elaboration based on: Summary of data… (2016), pp. 53–55.

Table 4. Main information about Financial Instruments for energy efficiency and renewable energies as at 31 March 2017

Member state	Number of Financial Instruments	Cinstributions paid to FI (mln EUR)	Cinstributions paid to final recipients	
			mln EUR	%
Germany	1	5.90	5.51	93
Denmark	2	20.09	18.66	93
Estonia	1	66.71	71.05	106
Greece	2	101.00	88.75	88
France	4	6.09	5.97	98
Italy	12	155.75	134.68	86
The Netherlands	4	9.94	12.67	127*
Slovakia	1	244.70	244.70	100
The United Kingdom	13	120.23	114.09	95
Total	40	730.43	696.09	95

* Greece, Italy, the Netherlands and the United Kingdom payments to final recipients include revolving amounts, interest from treasury management.

Source: own elaboration based on: Summary of data… (2016), pp. 56–60.

Conclusions

Despite their relatively short history, repayable instruments financed with public funds have become an established form of assistance on the financial market. Following the period when assistance in the form of grants and subsidies enjoyed great popularity, initially the need to repay the borrowed amount was not enthusiastically welcomed by the market. Nevertheless, as part of the JEREMIE initiative, they became an alternative to subsidies also in Poland, providing numerous benefits. One of them was making use of the market solutions, as a result of which the public intervention in the economy is not as significant as in the case of grants and subsidies. An unquestionable benefit is the repeated use of the funds due to the revolving mechanism. In countries such as Poland or Portugal the funds earmarked for supporting enterprises via repayable instruments have been used twice. Another advantage is the potential for increasing the assistance by involving private funds. At each level of financial instruments implementation there is a possibility of using additional public and private funds, thus increasing their global value. In the EU, the greatest number of private funds co-financed the financial instruments in Denmark (71%), Austria and Latvia (68%), Holland (51%), and Great Britain (49%) (Summary of data…, p. 29), whereas in Poland it was only 1%. In order to increase the level of assistance, it is necessary to consider greater involvement of private funds in financial instruments, which in some regions may significantly contribute to increasing the financial leverage.

Moreover, from the point of view of a long-term development of a given region, it would seem advisable to enhance the regional financial market, or in some cases to establish it. Reinforcement of both local financial institutions (loan funds, credit guarantee funds, development agencies) and instruments specific for each region has built the foundations for establishing regional development institutions. The idea of financial instruments has initiated a new approach to support provided to enterprises (and other entities), and its outcomes have started to materialise in the form of transformations on the local and regional financial markets.

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Cite this article as: Pluskota, P. (2018). Repayable financial instruments in The European Union – the range of effect and efficacy. *European Journal of Service Management*, *3* (27/2), 347–354. DOI: 10.18276/ejsm.2018.27/2-42.