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**SMALL AND MEDIUM ENTERPRISES FINANCIAL
FACILITY (SME FF) – EUROPEAN COMMISSION
FINANCIAL INSTRUMENT FOR SMES**

1. Introduction

Due to Small and Medium Enterprises (SMEs) [Commission Recommendation...] strong presence in the key sectors such as services and knowledge-based activities, SMEs today play a central role in the European Union (EU) economy. A positive and robust correlation between entrepreneurship and economic performance has been found in terms of growth, firm survival, innovation, employment creation, technological change, productivity increases and export [*Action plan...* 2004, p. 3]. Small and medium enterprises are one of the key sectors for generating employment and growth in Europe. One of the European Union's aims is to promote successful entrepreneurship and to improve the business environment for SMEs, to allow them to meet the challenges faced in today's economy to realize their full potential [<http://europa.eu.int...>]. At the Community level, almost every policy takes programmes for SMEs into consideration.

One of major challenges confronting SMEs is getting access to financial resources, as they are often considered as a high risk investment, with potentially low returns which only materialize in the medium to long term. In a changing financial environment and to some extent due to the new rating culture, banks are reluctant to provide credit to what they perceive as their riskiest clients, potentially providing insufficient profit margins – an attitude which leads to high transactions costs for SMEs [*Consultation document...*, p. 3]. This paper covers mainly the SME Finance Facility (SME FF) – Community financial instrument, which main goal is to increase SMEs access to loans and leasing operations. The design of the SME FF and allocated resources were described.

2. Division of the European Union financial instruments for SMEs

The EU financial instruments can be defined as means of EU financial intervention designed to meet given objectives in the most effective way.

The EU provides financial assistance to SMEs from the Member States and often from candidate countries. This assistance is available in different forms such as grants, loans, guarantees. Financial instruments for SMEs are available either directly or indirectly. In the first case funding goes from the European Union sources to the final beneficiary. In the second case support is available e.g. through the European Union's Structural Funds, managed at national level or using financial intermediaries.

With respect to the fact that the EU financial assistance is available directly or indirectly, the financial instruments can be divided into the following categories:

- financial instruments directly available to SMEs – this funding has specific objectives¹ designed and implemented by different Directorates General (DGs) of the European Commission (EC). SMEs can apply directly for the financing, generally on condition that they present sustainable, value-added and trans-national projects. The support of the European Union consists of subventions which generally cover 50% of the costs of a project.
- financial instruments indirectly available to SMEs:

This is illustrated by the following two categories of instruments [*European Union Support...*, p. 2]:

a) Structural Funds – these financial instruments are designed to help reducing disparities in the development of regions, and to promote economic and social cohesion with the EU. European regional development funds are a major funding source for SMEs, through the different thematic programmes and community initiatives in the fields of agriculture, regional policy, employment and social affairs. The programmes are managed and the projects selected at national and regional level,

b) financial instruments available to SMEs through International Financial Institutions (IFIs) – they are intended to increase the volume of credit available for SMEs and to encourage banks to develop their SME lending capacity.

3. Financial instruments available to SMEs through international financial institutions

SMEs in both candidate countries and Member States have benefited from participation in different Community programmes which combine EU resources with

¹ Environment and energy (examples of programmes: LIFE III – Environment, Intelligent Energy for Europe (2003-2006), Marco Polo (2003-2010), innovation and research (examples of programmes: The Sixth Framework Programme for Research and Technological Development (2002-2006), EUREKA – A Network for market oriented R&D, eContent (2002-2005), eTen), education and training (examples of programmes: SOCRATES, LEONARDO DA VINCI).

resources from IFIs. The IFIs participating in the programmes are: European Bank for Reconstructure and Development (EBRD), Council of Europe Development Bank (CEB) in association with Kreditanstalt für Wiederaufbau (KfW), European Investment Bank (EIB), European Investment Fund (EIF). The Table 1 below presents selected financial instruments available to SMEs via mentioned IFIs, relevant budget sources and institutions responsible for implementing these instruments.

Table 1. Selected financial instruments for SMEs managed with international financial institutions

Financial Instrument	Budget source	Implementing IFI	DGs involved in implementation
SME Finance Facility	Phare, Meda, National Pre-action Plan for Cyprus	CEB/KfW EBRD EIB	ELARG ECFIN
ETF Start up	Multi Annual Programme	EIF	ENTR ECFIN
SME Guarantee Facility	Multi Annual Programme	EIF	ENTR ECFIN
Seed Capital Facility	Multi Annual Programme	EIF	ENTR ECFIN

Source: [*Creating an entrepreneurial... 2003*].

SME FF is one of the financial instruments available via IFIs. The budget sources for SME FF are: Phare, Meda, National Pre-action Plan for Cyprus, depending on geographical implementation of the financial instrument. Other instruments are for example: ETF Start up, SME Guarantee Facility, Seed Capital Facility – they are called Multiannual Programme (MAP) instruments. The legal base for MAP instruments is Council Decision No 2000/819/EC of 20 December 2000 on a multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005) amended by Decision No 593/2004/EC of 21 July 2004 of the European Parliament and of the Council. The instruments are funded by the Commission and are operated by the European Investment Fund (EIF) on behalf of the European Commission.

4. SME Finance Facility

Since the start of the transition process in the Central and Eastern European countries, the Commission has developed cooperation with the candidate countries. This cooperation has benefited SMEs. Agenda 2000 called on the Commission to set up a Multicountry Facility to induce financial intermediaries in ten Central and Eastern European candidate countries to expand and to maintain their debt and equity financing of SMEs in the long term. As a result, the SME Finance Facility was launched in April 1999 [*Creating an entrepreneurial... 2003*, p. 100]. The instrument was set up using the legal base of the Phare programme [Council Regula-

tion (EEC)...]: the Phare Regulation and Common Decision of 24 October 2001, 30 October 2001 and 4 December 2001 [*Strategic Evaluation...* 2004, p. 102].

The SME FF is designed to encourage the growth and development of SMEs by facilitating access to loans, leasing and equity operation with various financial institutions [*Strategic Evaluation...* 2004, p. 100]. It offers a range of products to local financial intermediaries. The instrument combines resources from IFIs: EBRD (since 1999), CEB/KfW (since 2000), EIB (since 2001) with Phare support (in the Phare applicant countries), Meda budget (Turkey), funding from the National Pre-Accession Programme (Cyprus). The SME FF is currently operational in Bulgaria, the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic, Slovenia and Turkey. The Commission co-ordinates the implementation of the SMEFF with the EBRD, CEB/KfW and EIB through Steering Committee, where each party is represented.

Participation in the SME FF can be presented on different levels:

- level I – Commission,
- level II – International Financial Institutions (IFIs),
- level III – local financial institutions (FIs),
- level IV – final beneficiary (SME) (Fig. 1).

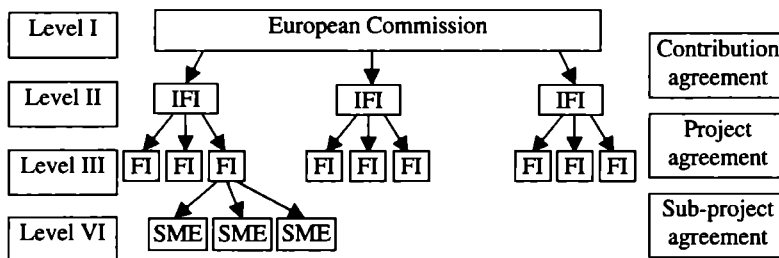


Fig. 1. Institutions participating in the implementation of the SME FF

The total budget of the SME FF, expressed as the total of dedicated EU resources and IFI resources, is above EUR 2.1 billion, of which only EUR 32 million are dedicated to an equity window, including the resources from IFIs [*Strategic Evaluation...* 2004, p. 100-102].

Most of the resources from the Commission (Level I) are in the form of grant and can be utilized as performance fees/transaction fee (compensating the banks and leasing companies for part of costs related to SME lending), technical support (aimed at training of bank staff in loan appraisal, supervision and administration, improving information systems, strengthening management capabilities such as marketing and SME client relationship management [*Strategic Evaluation...* 2004, p. 101]) and other approved incentives. Commission sets the terms of implementation of the SME FF in contribution agreements signed with the IFI. Commission

ensures providing the EU resources to the SME FF, approving the project², monitoring the correct implementation of the project, coordination between IFIs as appropriate, reporting to Council and Parliament and final evaluation. The ratio between Community allocation to a single project and IFI fundings shall generally be equal to or higher than 5/1³. The Table 2 below shows resources allocation from the Community and IFIs as specified in the Commission Decisions. In the 2004 there was no funding allocation to the instrument.

Table 2. Resources under SME FF (data in million euro)

	1999	2000	2001	2002	2003	Total as specified in the Commission Decisions	Total in actual terms
EBRD (at least)	150	150	150	150	125	725	916,25
Phare	50	30	30	20	25	155	155
CEB/KfW (at least)		113	150	75	75	413	413
Phare		21	30	15	15	81	81
EIB (at least)			300	150	100	550	550
Phare			30	15	10	55	55
CEB/KfW (at least)			20			20	20
Meda			4			4	4
CEB/KfW (at least)					15	15	15
Cyprus					1.5	1.5	1.5

Source: Commission Decisions, [*Strategic Evaluation...* 2004, p. 102].

IFIs (Level II) offer loans to the FIs (Level III) to extend loans and financial leases to SMEs (Level IV). Financing is channeled to those FIs that have demonstrated a satisfactory level of financial strength, branch network, knowledge of their clients, appropriate management capacity and commitment to SMEs in their lending policy. The average loan/lease to a participating bank or leasing company is between EUR 5 million and EUR 15 million. The IFIs are responsible for defining the terms of the programme in cooperation with the Commission, selecting FIs (banks, leasing companies) in beneficiary countries, assessing and approving project proposals before their submission to the Commission. They ensure fundings to FIs and ensure that sub-projects⁴ are implemented between FIs and SMEs. The IFIs are also responsible for monitoring the implementation of projects and reporting to the Commission. The table below presents number of project signed by the IFIs by the end of year 2004.

² Projects include financial packages providing resources from the IFI together with the Commission support.

³ The rate is 10/1 for EIB projects.

⁴ Sub-project is defined as a sub-loan to an individual SME made by a FI according to stipulations and conditions set down in the project.

Table 3. Number of projects signed by IFIs

	EBRD	CEB/KfW	EIB
Operational	72	31	23
To be signed	3	1	0

Source: [*Le processus...* 2005].

IFIs are responsible for promoting the Facility, selection and execution of sub-projects, monitoring of the sub-projects and reporting to IFIs [*Eurofunding towards...* 2004]. Maximum loan/lease to an SME is 250 000 EUR.

SMEs must be privately-owned legal entities and must not conduct business or engage in any activities relating to gambling, real estate, banking, insurance or financial intermediation, arms, or activities excluded by the FIs.

5. Conclusions

The SMEFF is evaluated as an effective financial instrument. This effectiveness relates to the overall purpose which is to focus on skill transfer and institutional development of private sector banks to enable them to lend on a suitable basis to SMEs. The structuring of the instrument means that the Commission money is not tied up in loan funds. The key to the effectiveness of the programme is the clear separation of responsibilities, and the good understanding of each other's interests and expertise.

Although the facility will continue to disburse funds until the end of 2006 in the new Member States countries, there will be a continuing need for institutional support in some countries (Poland, Slovenia). Discussions have been started with the Structural Funds on this, but it is not clear what level of priority it will be given. A pilot action for micro- enterprises was also developed for 2004 within the SME Multiannual Programme with the view to inclusion of an action in the next multi-annual action plan (2006-10) [*Strategic Evaluation...* 2004, p. 106].

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PROGRAM FINANSOWANIA SEKTORA MAŁYCH I ŚREDNICH PRZEDSIĘBIORSTW JAKO INSTRUMENT FINANSOWY KOMISJI EUROPEJSKIEJ

Streszczenie

Małe i średnie przedsiębiorstwa (MŚP) odgrywają ważną rolę w gospodarce krajów Unii Europejskiej (UE). Ich rozwój przyczynia się m.in. do wzrostu gospodarczego, tworzenia nowych miejsc pracy, zmian technologicznych, wzrostu eksportu, zwiększenia produktywności. Jednym z zadań Unii Europejskiej jest promowanie przedsiębiorczości oraz stwarzanie warunków do jej efektywnego rozwoju. Instytucje UE w swoich programach stawiają duży nacisk na rozwój sektora MŚP.

Istotnym wyzwaniem stojącym przed MŚP jest uzyskanie dostępu do źródeł finansowania. W związku z faktem, iż są one rozpatrywane jako przedsiębiorstwa obciążone wysokim ryzykiem inwestycyjnym, finansowanie ich działań, w ramach oferowanych tradycyjnie kredytów bankowych, odbywa się na mniej korzystnych warunkach niż przedsiębiorstw o niższym ryzyku.

W artykule dokonano podziału instrumentów finansowych oferowanych przez UE dla sektora MŚP. Szczególną uwagę zwrócono na instrumenty dostępne dla tego sektora poprzez udział w ich finansowaniu międzynarodowych instytucji finansowych. Celem artykułu jest przedstawienie Programu Finansowania Sektora Małych i Średnich Przedsiębiorstw (Small and Medium Enterprises Financial Facility (SME FF)). Program ten to jeden z instrumentów finansowych tworzonych dla małych i średnich przedsiębiorstw przez Komisję Europejską przy współpracy z międzynarodowymi instytucjami finansowymi. Zadaniem tego instrumentu jest rozszerzenie dostępu do kredytów dla sektora MŚP.