COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a
COUNCIL DECISION
on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs)

THE GROWTH AND EMPLOYMENT INITIATIVE

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. INTRODUCTION

The Amsterdam Council, in the context of measures for the alleviation of unemployment, invited the European Investment Bank (EIB) and European Investment Fund (EIF), *inter alia*, to develop a facility to provide venture capital for high-technology projects of SMEs. The EIB and EIF have already responded by creating the European Technology Facility (ETF).

The European Parliament is intending to make available resources in the Community budget for the support of SMEs under its Growth & Employment Initiative. The present Commission proposal puts forward a programme for the application of those funds in a way which complements the Amsterdam initiative and the subsequent EIB action programme, as well as the capabilities of the EIF and current Community instruments. The proposal gives a particular emphasis to innovative SMEs, including technology-based companies, which may be unable to raise finance from banks or other commercial sources because of the risks associated with their particular stage of development, notably SMEs in their growth phase and SMEs establishing cross-border joint ventures in order to allow them to internationalize their strategies within Europe.

The European Council in Luxembourg on 20-21 November 1997 welcomed the European Parliament's initiative providing for the strengthening of budgetary resources earmarked for employment, a move given a positive reception by the Council. It invited both institutions to formalize their agreement and the Commission to make proposals, as soon as possible, for new financial instruments to support innovatory and job-creating small and medium-sized enterprises, so that the Council can adopt them speedily.

The Luxembourg European Council of November 1997 also acknowledged the importance of the role that large pan-European risk capital markets can play in job creation and the Commission will report to the European Council in Cardiff in June 1998 on barriers to the development of such markets in the Union, e.g. relating to obstacles to the listing of SMEs on stock exchanges or differences in national laws and practices, including fiscal policies.

The Community, in its economic policy, acts in accordance with the principle of an open market economy with free competition favouring an efficient allocation of resources. Starting point of all efforts is a healthy overall economic framework at Community level, e.g. in the areas of the completion of the internal market, research and development policy and competition policy, and alongside with the coordination of national macro-economic policies and employment policies. The coordination of Member States' employment policies is to be implemented through the adoption of employment guidelines which are consistent with the broad economic policy guidelines. Furthermore, Community policies are systematically examined as regards their possible contribution to the creation of employment. In support of this general policy framework parallel programmes stimulating the creation of employment are developed, like the present one in favour of SMEs. The programme bases itself in the wider context of the improvement of the access to financing by SMEs and of the need to further develop entrepreneurial spirit in Europe.

2. FINANCIAL OBSTACLES HINDERING INVESTMENT BY AND THE GROWTH OF SMEs

SMEs have a vital role in the creation of new employment. Their ability to develop new business ideas, detect niche markets and to take advantage of innovation and new technologies ensures future competitiveness. A dynamic SME sector makes a foremost contribution to the continuous renewal of the economy as a whole.

SMEs often face significant problems in raising finance and most SMEs are undercapitalized. The inadequate access to finance is strongly felt in the start-up phase of new firms and is especially true for fast growing technology-oriented firms. When seeking to establish joint ventures abroad, especially in order to commercialize innovation, the financial difficulties of SMEs are exacerbated by the proportionately high cost of the preparation and implementation of cross-border investment.

New firms and SMEs looking to expand have particular difficulty in obtaining risk capital, such as equity and subordinated debt. Whilst some resources are available through national schemes, the role of venture-capital funds as providers of risk-capital to small firms remains very limited in most Member States. It is usual for most emerging SMEs, especially the small ones, to have no access to risk capital other than the personal resources of the founders. The limited availability of venture capital in the European Union and in particular the lack of early stage capital may be illustrated by the fact that, according to OECD, in 1996 venture capital investments in the US amounted to ECU 9 billion, of which approximately 37% was accounted for by investments in start-ups, whereas in Europe total venture capital investments were only less than ECU 7 billion and just 12% of the total went to start-ups. Figures collected by the European Venture Capital Association indicate an even lower proporionate share of start-ups (6.5%).

The raising of debt finance is also difficult for SMEs as banks are often reluctant to lend to them. The lending risk inherent in new firms and firms exploiting new technologies is high and difficult to assess, and is increased by their usual low capitalization. Loans are often only available to SMEs against tangible security, making operations such as the exploitation of innovation and new technology in high-growth sectors and the establishment abroad, alone or through joint ventures, particularly difficult to finance.

The modest size of loans sought by the smallest companies does not make them more easily available. The costs associated with the making of a loan are broadly the same irrespective of loan size, whereas a larger loan generates a higher income stream, leading banks to concentrate their efforts on larger companies.

To summarize, one of the main obstacles faced by SMEs in developing their operations, in particular those involved in innovative technology with a high growth potential, is the lack of finance. Sources of equity capital are few, and banks are unwilling to lend because of the risks involved in financing small companies. Therefore, the most effective methods of providing support for job-creating SMEs are those that transfer some financing risk to a third party, i.e. guarantees, or those that actually provide funds where funds are not available from banks, i.e. venture-capital and grants.

3. OBJECTIVE OF THE PROGRAMME

With the objective to help unlock the job-creating potential of high-growth and small businesses, and in particular those SMEs exploiting advances in technology, the programme aims to facilitate the establishment and growth of innovative companies, by supporting their investment activity through increased availability of finance, and thereby stimulating employment creation. Although there will be no *ex-ante* conditionality as regards the new employment created, the Commission will, however, within 48 months from the date of the decision, provide an overall *ex-post* evaluation of the programme, notably covering its impact on the access to financing by SMEs, its immediate effects on the creation of employment and the prospects for the creation of employment in the long term.

The programme aims to foster job-creation by facilitating the establishment and growth of SMEs through financial instruments which add risk-sharing capacity in those areas of SME financing where market mechanisms fail to encourage the purely profit driven financial institutions to supply the adequate financial services to SMEs. It will cover three areas where the lack of finance limits the growth and employment creation of SMEs, and will improve the financing conditions for SMEs by aiming:

- to promote the creation and early development of innovative SMEs with high growth potential by improving access to equity capital for SMEs, acting as a catalyst in attracting other investors to invest in those companies and by encouraging the development of the venture-capital markets across the Union. Investment in the start-up phase of new companies is a segment of the venture-capital market which is clearly underdeveloped in Europe. It entails the highest risks which potentially translate into high losses and therefore justifies a public sector involvement without which onward investments to early stage and emerging SMEs will not take place. The public intervention will be carefully targeted in order to provide leverage while avoiding any crowding out of private investment;

- to promote the creation of transnational joint-ventures by SMEs within the European Union, and thereby help SMEs to benefit from the opportunities of the single market through better exploitation of their limited financial and human resources and greater proximity to clients. Because of the reluctance of financial institutions to finance cross-border joint ventures between SMEs, very few are established. Removal of some of the obstacles for the creation of transnational joint ventures between SMEs facilitates the creation of new businesses which otherwise would not be realized, such as the exploitation of research & development results by transnational research consortia through joint venture production facilities. Few alternative sources for comparable financial assistance exist;

- to improve the conditions for raising debt finance by SMEs across the European Union by, in particular, increasing the volume of loans available to SMEs, and by improving access to debt finance for SMEs by reducing the collateral requirements imposed by the loan programmes of many lenders, and encouraging risk-taking in SME lending by banks. This segment of SME lending, especially non-collateralized lending, including lending to finance intangible assets, entails risk which commercial financial institutions do not easily accept.

This proposal aims to encourage the development of activities leading to new employment by helping to lower some of the financial obstacles impeding the organic job-creation accompanying the establishment and growth of innovative SMEs. By supporting the emergence and development of new providers of jobs, as opposed to providing rewards for immediately created new jobs, the proposal is intended to encourage continuing employment creation by the SMEs benefiting from the schemes put forward.

There is still considerable diversity between the financial markets in the Member States. Whilst there has been significant convergence in the segment serving large corporates, the supply of financial services for smaller companies varies from country to country, as does the nature of national support schemes for SMEs. The three schemes contained in the proposal may thus encounter different interest in the different Member States. However, the overall proposal is intended to cover a broad range of needs throughout the European Union.

Given the differences between the financial markets in the Member States as well as the different characteristics of the three schemes, it is proposed to allocate funds flexibly to the three schemes.

The stimulation of risk capital in Europe might require further Community attention or reporting.

4. DESCRIPTION OF THE PROPOSED PROGRAMME

In line with the objectives stated above, three parallel schemes are proposed, as follows:

- *a risk capital facility,* managed by the EIF through investment in relevant specialized investment funds. The facility will reinforce the European Technology Facility by targeting a segment of the venture-capital market with a higher inherent investment risk, notably SMEs at establishment and early stages;

- the provision of *financial contributions*, under the management of the Commission, for the establishment of transnational joint ventures by SMEs within the European Union;

- *a guarantee facility*, managed by the EIF, to increase the availability of loans to small or newly established firms through risk sharing with national guarantee schemes, mutual guarantee schemes and other appropriate institutions, including the EIB.

Three parallel schemes are put forward to reach as many growing SMEs as possible. The use of more than one scheme also helps to ensure that funds can be disbursed rapidly. This three-pronged approach will also make it easier to adopt simple structures for the individual schemes and to optimize the impact of the programme through flexible allocation of funds to the different schemes during the life of the programme.

The proposed programme is fully coherent with other Community actions and the operations of the EIB and the EIF. The proposed schemes complement EIF's own proprietary venture capital operations and the risk-sharing schemes being established by the EIB following the Amsterdam Summit, including the ETF managed by the EIF. The *risk capital facility*, by focusing on a segment of the market with a higher element of risk, will reach SMEs which neither the EIB nor the EIF can easily support because of their statutory higher risk criteria. Similarly, the *guarantee facility*, by targeting businesses involving a comparatively high element of risk, complements the SME operations of the EIB and the EIF. As regards the *scheme supporting the establishment of transnational joint ventures*, the action complements other schemes for assisting the search of a business partner for SMEs, namely BC-NET, EUROPARTENARIAT and INTERPRISE, under the research programmes and under the Innovation Programme (Cordis, Innovation Relay Centres, I-TEC PARTNER, etc.).

The proposed programme respects subsidiarity and proportionality. Each of the three facilities is focussed on extending financial assistance to SMEs at a stage of their development when the availability of funding from commercial sources or national schemes is limited. The proposed programme is complementary with other Community measures. Furthermore, it respects the principle of subsidiarity by adding a European dimension to the capital markets in the Member States, corresponding to the common concerns as regards the evolution of the markets, and increases the capacity in the Member States for SME financing. It is limited to the minimum necessary to achieve its objectives and does not exceed what is necessary to this end, and therefore respects the principle of proportionality.

5. IMPLEMENTATION OF THE PROPOSED PROGRAMME

The three parallel schemes shall be implemented in cooperation with national and local financial intermediaries so as to enable them to be tailored to conform with the specific features of a particular national market. This will help maximize the impact of the schemes as well as help avoid any disturbance of markets. The intermediaries will be selected in conformity with market practice and in a fair and transparent manner, and participation in the programme will be open to all intermediaries willing and able to comply with the criteria of each programme. In order to avoid any distortion of competition, steps will be taken to encourage a maximum number of financial intermediaries to participate in the implementation of the programme. Information on the existence and operation of the programme will be made widely available, both on the level of financial intermediaries and potential beneficiaries.

- **ETF start-up**

  A risk capital scheme managed by the EIF. To be implemented via investments in relevant specialized venture-capital funds which, for example, may be smaller or newly established venture-capital funds, funds operating regionally or funds focused on a specific sector, such as information and communication technologies, health care, biotechnology or environment, or venture-capital funds linked to research centres and science parks.

- **Joint European Venture - JEV**

  Financial contributions supporting the establishment of transnational joint-ventures within the EU between SMEs. To be distributed through financial intermediaries under the overall management of the Commission. The maximum aggregate contribution of ECU 100 000 will cover expenses relating to the administrative and regulatory preparation of a cross-border joint venture, as follows:

  - A first tranche, up to ECU 50 000, to cover 50% of eligible expenses, notably for market research and the preparation of the business plan, environmental impact studies, the preparation of legal documentation and other expenses relating to the administrative and regulatory preparation of a cross-border joint venture.

  - A second tranche, covering up to 10% of the investment in fixed assets.

  This scheme will be built on the pilot initiative adopted by the Commission in its Decision 97/761/EC of 5 November 1997 launched in the framework of the third multiannual programme for SMEs in the European Union (1997-2000).

- **SME guarantee facility**

  A guarantee facility managed by the EIF on a trust basis. Budgetary allocation to cover the full cost of the facility, i.e. EIF's guarantee losses and management fee, which shall be contractually capped at a prespecified level. This cap will be determined on a case by case basis to reflect the operating environment of each intermediary and, indicatively, could amount to 5-10% of the original face value of the underlying portfolio. There shall be no contingent liability on the Community budget. By meeting the full cost of the facility from the Community budget, as opposed to only paying guarantee fees to the EIF, the facility may be targeted to sectors that the EIF because of its risk/return criteria would not be able to include in its own risk portfolio.

  The SME guarantee facility will be focused on SMEs with growth potential, and in particular to small or new and emerging companies. The facility, to be made available through guarantees and counter-guarantees, will leverage the capacity of guarantee schemes already operating in the Member States within the public or private sector, including mutual guarantee schemes. The Facility may also be used to increase the risk-taking capacity of financial institutions providing loan finance to the target SMEs, as well as to support any new risk-sharing instruments the EIB may develop. By seeking to work using existing instruments where possible, benefits will be passed on to SMEs through national and/or regional schemes designed to respond to the needs of companies operating in their territory.

6. FINANCING AND EVALUATION

The proposed Council decision is for a programme, receiving budgetary allocations during three consecutive years, financed by ECU 420 million entered in the 1998-2000 budgets on the new chapter B5-5 "Employment", in particular budgetary lines B5-510 "Technology facility for SMEs" and B5-511 "Joint European Venture".

Exact yearly allocations for each scheme may be varied in line with absorption figures and the efficiency of the schemes in terms of their objectives. An indicative distribution of 40% for the ETF start-up scheme, 20% for the Joint European Venture scheme and 40% for the SME guarantee facility is foreseen.

The budgetary appropriations allocated to the ETF start-up scheme will be transferred to the EIF into a special Community account. Neither the intermediary venture-capital funds nor the final investee companies will therefore directly receive Community funds.

The budgetary appropriations covering the cost of the SME guarantee facility will also be transferred to the EIF and be credited to a special Community account to secure EIF's outstanding risk under the scheme at any one time. The intermediary financial institutions will therefore not directly receive Community funds.

The Commission will report yearly on the implementation of this programme to the budgetary authorities and will provide an overall evaluation of the functioning and impact of the scheme within 48 months from the date of its adoption.

Proposal for a

COUNCIL DECISION

on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs)

THE GROWTH AND EMPLOYMENT INITIATIVE

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 130(3) thereof,

Having regard to the proposal from the Commission[1],

Having regard to the opinion of the European Parliament[2],

Having regard to the opinion of the Economic and Social Committee[3],

Having regard to the opinion of the Committee of the Regions[4],

(1) Whereas the European Council, meeting in Amsterdam on 16 and 17 June 1997, in the context of measures for the alleviation of unemployment, invited the European Investment Bank (EIB) and the European Investment Fund (EIF), *inter alia*, to develop a facility to provide venture capital for high-technology projects of SMEs and by so doing, acknowledged, not only the link between SMEs, innovation and technology, and new jobs, but also the role of risk-capital in underpinning job-creation;

(2) Whereas the European Special Council on Employment, meeting in Luxembourg on 20 and 21 November 1997, welcomed the European Parliament's Growth and Employment Initiative, providing for the strengthening of budgetary resources earmarked for employment; whereas the European Council invited the Commission to make proposals, as soon as possible, for new financial instruments to support innovative and job-creating SMEs, so that the Council can adopt them speedily; whereas these new instruments must reinforce the European Technology Facility, financed by the European Investment Bank and administered by the European Investment Fund, by opening a "risk capital window", supporting the creation of transnational joint ventures between SMEs within the European Union and establishing within the European Investment Fund a special guarantee fund to facilitate risk-taking by institutions providing finance for small and medium-sized enterprises;

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[1] OJ

[2] OJ

[3] OJ

[4] OJ

(3) Whereas the EIB and EIF have already responded by creating the European Technology Facility (ETF), which will provide venture-capital for technology oriented SMEs by using established venture-capital funds as intermediaries;

(4) Whereas, on 9 December 1996, the Council adopted Decision 97/15/EC[5] on a third multiannual programme for small and medium-sized enterprises in the European Union; whereas this programme includes the objectives of improving access to loan and risk capital financing, facilitating the development of specific financial instruments and stimulating the development of capital markets for fast-growing SMEs;

(5) Whereas, on 5 November 1997, the Commission adopted Decision 97/761/EC[6], approving a support mechanism for the creation of transnational joint ventures by SMEs in the European Union, a financially limited initiative launched under the third multiannual programme for SMEs;

(6) Whereas, on 15 December 1994, the Council adopted Decision 94/917/EC[7], adopting a specific programme for the dissemination and optimization of the results of activities in the field of research and technological development, including demonstration (1994-1998) which provides for activities to improve the European environment for financing the exploitation, adaptation and dissemination of technology by appropriate Community schemes; whereas the Commission on 25 November 1996 adopted a communication on the "First action plan for innovation in Europe - innovation for growth and employment"[8], setting out for innovation financing to be facilitated in Europe, especially by encouraging investment in risk capital and equity, particularly in start-up investment and innovative, high-growth firms, which are a major source of new jobs, and by reinforcing European Investment Fund action in favour of innovation; whereas this Decision should be implemented in appropriate coordination with the abovementioned activities;

(7) Whereas the lack of venture capital constitutes a particular difficulty for new firms and SMEs looking to expand, especially those exploiting new technology and innovative ideas; whereas this segment of the venture-capital market is underdeveloped in Europe and entails the highest risks which potentially translate to high losses; whereas a determined public sector involvement will assist private sector operators to make onward investments to early stage and emerging SMEs;

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[5] OJ L 6, 10.1.1997, p. 25.

[6] OJ L 310, 13.11.1997, p. 28.

[7] OJ L 361, 31.12.1994, p. 101.

[8] COM(96) 589 final, 25.11.1996.

(8) Whereas SMEs frequently encounter difficulties in obtaining bank financing for the development of transnational joint ventures because of the higher risk for financial institutions; whereas the development of joint ventures between Community SMEs makes it possible to make better use of the opportunities of the Internal Market, to increase investment and trade and to have a positive effect on employment and economic growth; whereas advances and subsidies constitute the most suitable measure to overcome the financial obstacles for SMEs to create transnational joint ventures;

(9) Whereas bank loans constitute an important source of external funding for SMEs; whereas the raising of debt finance is difficult for SMEs as banks are often reluctant to lend to them; whereas loans are often only available to SMEs against tangible security; whereas loan guarantees constitute a cost-effective instrument to facilitate access to loans; whereas both tangible and intangible investments should be eligible under the scheme; and whereas a significant leverage effect can be achieved with a guarantee instrument;

(10) Whereas this Decision constitutes the legal basis for specific measures which are complementary with other Community measures and which cannot be better carried out at Member State level and therefore respect the principle of subsidiarity; whereas the Decision is limited to the minimum necessary to achieve its objectives and does not exceed what is necessary to this end and therefore respects the principle of proportionality;

(11) Whereas the definition of SMEs as set out in Commission Recommendation 96/280/EC[9] should be applied in the implementation of this Decision;

(12) Whereas the EIF was set up in June 1994 to contribute to the pursuit of Community objectives by stimulating investment in trans-European networks and small and medium-sized enterprises; whereas the Community has become a member of the EIF by virtue of Council Decision 94/375/EC[10]; whereas the Fund is empowered to issue loan guarantees and to make equity investments according to its Statute;

(13) Whereas the EIF has indicated its willingness to participate in the implementation of the ETF start-up and the SME guarantee facility schemes under this Decision;

(14) Whereas the Joint European Venture (JEV) scheme will be administered by the Commission in accordance with its Decision 97/761/EC;

(15) Whereas the measures financed by the EIB and the EIF do not fall under the provisions of the Treaty on State aid; whereas those measures, if they have effects on beneficiary SMEs comparable to those arising from State aid, have to observe the limits and conditions laid down for the compatibility of comparable State aid;

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[9] OJ L 107, 30.4.1996, p. 4.

[10] OJ L 173, 7.7.1994, p. 12.

HAS DECIDED AS FOLLOWS:

Article 1

Objective of the programme

A programme of financial assistance for innovatory and job-creating small and medium-sized enterprises is hereby set up with the aim to facilitate the establishment and growth of innovative SMEs (hereinafter "the programme") as defined in Recommendation 96/280/EC, by supporting their investment activity through increased availability of finance, and thereby stimulating the creation of employment.

Article 2

Description of the programme

The programme shall consist of three complementary facilities which shall be a risk-capital scheme ("ETF Start-up") managed by the European Investment Fund (EIF), a scheme for financial contributions supporting the creation of transnational joint-ventures by SMEs within the European Union ("Joint European Venture") managed by the Commission and a guarantee scheme ("SME Guarantee Facility") managed by the EIF.

Article 3

The ETF start-up facility

1. The Community shall provide risk-capital participations in SMEs primarily at their establishment and early stages and/or innovative SMEs through investments in relevant specialized venture-capital funds, particularly in smaller or newly established funds, funds operating regionally or funds focused on specific industries or technologies, or venture-capital funds financing the exploitation of R&D results, e.g. funds linked to research centres and science parks.

2. The EIF shall select, make and manage the investments into the venture-capital funds. The detailed terms and conditions for implementing the ETF start-up facility, including its monitoring and control, shall be laid down in a cooperation agreement between the Commission and the EIF.

3. The cooperation agreement shall take account of the indicative outline set out in Annex I.

Article 4

Joint European Venture - JEV

1. The Community shall provide financial contributions to SMEs for the setting-up of new transnational joint ventures within the European Union. The Community contribution is intended to cover a part of the expenses incurred in the conception and the setting-up of transnational joint ventures. The maximum contribution per project shall be ECU 100 000 covering:

(a) up to 50% of the eligible expenses, with a maximum of ECU 50 000;

(b) up to 10% of the total amount of investment made in fixed assets.

2. Eligible expenses for the purposes of point (a) of paragraph 1 are those essential expenses related to the conception and setting-up of a transnational joint venture defined in point 6 of Annex II and created by European SMEs.

3. Applications for contributions shall be channelled to the Commission through a network of financial intermediaries. In the implementation of the JEV, the indicative outline set out in Annex II shall be taken into account.

Article 5

The SME guarantee facility

1. The Community shall provide budgetary allocations for the purpose of covering the cost of guarantees and counter-guarantees issued by the EIF in order to promote an increase in the availability of loans supported by guarantee schemes operating in the Member States in the public or the private sector, including mutual guarantee schemes; the scheme may also support any risk-sharing SME instruments the EIB or any other appropriate financial institutions may make available.

2. The budgetary allocation shall cover the full cost of the facility, including EIF's guarantee losses and any other eligible costs or expenses of the facility. The cost of the facility shall be capped; there shall be no contingent liability on the Community budget.

3. The facility shall be targeted to SMEs with growth and therefore employment creation potential. Priority shall be given to small enterprises with up to 100 employees. The guarantees issued by the EIF shall be partial guarantees; there shall always be a risk-sharing arrangement between the EIF and the intermediary financial institution.

4. The detailed terms and conditions for implementing the SME guarantee facility, including its monitoring and control, shall be laid down in a cooperation agreement between the Commission and the EIF.

5. The cooperation agreement shall take into account the indicative outline set out in Annex III.

Article 6

Reporting and evaluation

1. The Commission shall report annually to the European Parliament and the Council on the implementation of this Decision, notably on its impact on the access to financing by SMEs, its immediate effects on the creation of employment and the prospects for the creation of employment in the long term.

2. The Commission shall within 48 months at most from the date of its adoption, provide an evaluation on the programme, notably on its overall utilization, its immediate effects on the creation of employment and the prospects for the creation of employment in the long term, in particular for the purpose of assessing possible future action beyond the initial period.

Article 7

Final provision

This Decision shall enter into force on adoption by the Council and shall cover a three-year period.

Done at Brussels,

For the Council
The President

ANNEX I

Indicative outline of the implementation of the ETF start-up scheme

1. Introduction

The ETF start-up will be operated by the EIF on a trust basis. The EIF will invest the Community funds allocated for the scheme in relevant specialized venture-capital funds, particularly in smaller or newly established funds, funds operating regionally or funds focused on specific industries or technologies, or venture capital funds financing the exploitation of R&D results, e.g. funds linked to research centres and science parks which in turn provide risk capital for SMEs. The ETF start-up scheme will reinforce the European Technology Facility established by the EIB in cooperation with the EIF by adopting an investment policy involving a higher risk-profile, both as regards intermediary funds and their investment policies.

2. Intermediaries

The EIF shall use its best efforts to target investments into smaller or newly established funds, funds covering specific regions, whether assisted or not, or focusing on specific industries or technologies, or venture-capital funds linked to research centres and science parks. The intermediaries will be selected in conformity with best business and market practice in a fair and transparent manner in order to avoid any distortion of competition, having regard to the aim of working through a wide range of specialized funds.

3. Maximum investment

The maximum aggregate investment in an intermediary venture-capital fund shall be 25% of the total equity capital held by the relevant fund, or 35% in exceptional cases such as new funds which are likely to have a particularly strong catalytic role in the development of venture-capital markets for a specific technology or in a specific region. No commitment in a single venture-capital fund shall exceed ECU 10 million. The intermediary venture-capital funds shall comply with established market practices with regard to portfolio diversification.

4. Life of the facility

The ETF start-up scheme is established as a long-term facility that will usually take 5 to 12-year positions in venture-capital funds. The EIF shall use its best efforts to fully commit the funds allocated to the facility not later than during the calendar year following the year in which the relevant budgetary payments are made. In any case, investments will not exceed 16 years from the time of signature of the cooperation agreement.

5. Realization of investments

As most of the investments to be made under the ETF start-up scheme will be in unquoted, illiquid venture-capital funds, the realization of those investments will be based on the distribution of the proceeds received by the intermediary funds from the sale of their investments in SMEs.

6. Reinvestment of proceeds from realized investments

Proceeds from realized investments may be reinvested during the first four years of the operations of the scheme. The reinvestment period can be extended by up to three years, subject to a satisfactory evaluation of the facility 48 months after its adoption.

7. Trust account

A separate trust account shall be set up within the EIF to hold budgetary funds underpinning the scheme. This account shall be interest bearing; interest earned shall be added to the resources of the facility. The investments made by the EIF under the ETF start-up scheme and EIF's management fees and other eligible expenses shall be debited from, and the proceeds from realized investments shall be credited to the trust account. After the fourth anniversary of the scheme or, provided that the reinvestment period of the scheme is extended, after the end of the extended reinvestment period, any balances on the trust account, other than funds committed and not yet drawn down/invested and funds reasonably required to cover eligible costs and expenses, such as EIF's management fee, shall be returned to the Community budget.

8. Court of Auditors

Appropriate arrangements shall be made to allow the Court of Auditors of the European Union to exercise its mission in order to verify the regularity of payments made.

ANNEX II

Indicative outline of the implementation of the Joint European Venture scheme

1. Introduction

The Joint European Venture scheme will provide financial contributions to support the establishment of transnational joint ventures between SMEs within the European Union. It is based on the limited initiative launched under the third multiannual programme for SMEs, adopted by Commission Decision 97/761/EC of 5 November 1997, approving a support mechanism for the creation of transnational joint ventures by SMEs in the European Union[11].

2. Intermediaries

The scheme will be accessible to SMEs through intermediaries, which may be banks or other appropriate financial institutions. The network of financial intermediaries will comprise financial intermediaries selected in conformity with the abovementioned initiative of 5 November 1997, following a new call for expression of interest published in the *Official Journal of the European Communities*. The Commission will check the eligibility of the applications in the light of the programme objectives.

3. Application procedure

Applications for financial contributions under this scheme shall be submitted by SMEs to one of the intermediaries. The intermediary shall be entrusted with the evaluation of the application, and, in the event of a favourable opinion, passing it on to the Commission. The Commission shall check the eligibility of the applications in the light of the objectives of the scheme, in particular the employment effect.

4. Payment of financial contributions

The contributions, the total of which shall not exceed ECU 100 000 shall be paid to the SME, through the financial intermediary which shall pass on all payments without delay and deductions.

Payments under the first tranche, up to ECU 50 000, to cover 50% of eligible expenditure for the conception and preparation of the joint venture, shall be made in two instalments. A reimbursable advance of 50% (maximum ECU 25 000) shall be paid as soon as the application has been accepted by the Commission. A second payment of 50% (maximum ECU 25 000) shall be made on presentation of supporting documents for all the expenditure incurred and on the basis of a detailed project evaluation report which permits an assessment of the feasibility of the joint venture as well as the investment

[11] OJ L 310, 13.11.1997, p. 28.

envisaged. After acceptance of the documents by the Commission, the reimbursable advance will be converted into a grant.

Payment under the second tranche, covering up to 10% of the investment, shall be made after receipt by the Commission of satisfactory evidence of completion of the investment and commencement of the new activity.

Any SME benefiting from a payment under the second tranche (10% of the investment) must undertake to submit to the Commission, for a period of five years, information of the activities of the joint venture set up and, in particular, on the number of jobs created.

5. External management cost

In the management of the programme, recourse shall be made to external assistance specialized in monitoring projects. This assistance shall be provided by external contractors selected following a call for expression of interest. A maximum of 5% of the budgetary allocation shall be reserved to cover the external management cost of the initiative.

6. Definition of a joint venture

The concept of a "joint venture" shall be interpreted broadly, that is including any form of consortium, partnership or joint venture in the strict sense, which should lead to a new legal entity, of an industrial, service, commercial or craft nature, subject to the following conditions being met:

- the project shall create new economic activities, involving investment and employment creation within the Community. Transfers of existing economic activities are not eligible. Similarly, purchases of existing enterprises are not eligible;

- the partners shall play an active part in the joint venture and assume an adequate measure of responsibility. Any joint venture in which one of the partners owns more than 75% will be ineligible. Any change in the holdings in the joint venture within three years following the signing of the contract with the Commission must be submitted to the Commission for a review of its financial participation;

- the joint venture must be newly created by at least two SMEs from two different Member States.

7. Eligible expenses

Eligible expenses are those relating to the conception and setting-up of a joint venture: Expenses incurred as part of the preparatory action (market surveys, preparation of the legal framework, environmental impact assessment, technical standards, business plan, etc.); expenses for external experts (lawyers, advisers, accountants): fees based on actual costs, transport costs, accommodation and subsistence expenses (in accordance with the provisions laid down within the framework of the Commission's contracts for the provision of services); expenses for internal experts (relating to travel abroad): daily allowance, transport costs and accommodation and subsistence expenses (in accordance with the provisions laid down within the framework of the Commission's contracts for the provision of services).

For the grant, covering up to 10% of the investment made, an investment is considered to be any purchase or production of tangible or intangible assets which are accounted for as fixed assets in the balance sheet of the joint venture and valued in accordance with generally accepted accounting standards.

Financing costs and expenses relating to partner search are excluded.

8. Obligations of the beneficiaries

Appropriate arrangements shall be made to allow the Court of Auditors of the European Union or the Commission to exercise their mission in order to verify the regularity of declarations made by beneficiaries in support of payment claims submitted by them as well as the corresponding payments made.

Indicative outline of implementation of the SME guarantee facility

1. Introduction

The SME guarantee facility will be operated by the EIF on a trust basis. Whilst the EIF will provide counter-guarantees or, where appropriate, co-guarantees for guarantee schemes operating in Member States, and direct guarantees in the case of the EIB or any other appropriate financial intermediary, its losses from the relevant guarantees shall be covered by Community funds. This will permit the targeting of the scheme to SMEs with growth potential experiencing particular difficulty in raising finance because of the perceived high risk inherent in lending to them, such as small or newly established companies.

2. Intermediaries

Guarantee schemes operating in the Member States within the public or private sector, including mutual guarantee schemes, the EIB or any other appropriate financial institution in connection with any risk-taking SME facilities they may make available. Intermediaries will be selected in conformity with best business and market practice in a fair and transparent manner, having regard to: (a) the effect on the volume of debt finance made available to SMEs, and/or (b) the effect on the access to debt finance by SMEs, and/or (c) the effect on risk-taking in SME lending by the intermediary concerned.

3. Eligible SME lending

The financial criteria governing the eligibility of SME lending for guarantees under the SME guarantee facility shall be determined individually for each intermediary in the framework of the guarantee schemes they are already operating, with the aim of reaching as many SMEs as possible. These rules shall reflect market conditions and practices in the relevant territory. The guarantees and counter-guarantees will mainly be available to cover lending to SMEs with less than 100 employees. Particular attention shall be given to lending to finance intangible assets.

4. EIF guarantees

The guarantees given by the EIF shall relate to individual loans in a specific loan portfolio, which may be an existing loan portfolio, where that leads to the expansion of lending to SMEs, or a loan portfolio to be created within a specific period of time. The guarantees issued by the EIF shall cover a part of the credit risk inherent in the underlying loan portfolio with the risk shared with the relevant financial intermediary.

5. EIF's capped maximum cumulative losses

The EIF's obligation to pay its share of loan losses to the intermediary will continue until the cumulative amount of payments made to cover losses from a specific loan portfolio, reduced by the cumulative amount of corresponding loss recoveries, reaches a pre-agreed amount, after which EIF's guarantee is automatically cancelled.

6. EIF *pari passu* with intermediary

The guarantees given by the EIF shall usually rank *pari passu* with the guarantees or where appropriate with the loans given by the intermediary.

7. Trust account

A trust account shall be set up within the EIF to hold the budgetary funds underpinning the scheme. This account shall be interest bearing; interest earned shall be added to the resources of the facility.

8. EIF's right to withdraw funds from the trust account

The EIF shall have the right to debit the trust account for payments to meet its obligations for the maximum cumulative losses under the guarantee facility, and, subject to agreement by the Commission, any other eligible costs, for example its management fees, eligible legal fees and promotional expenses of the scheme.

9. Loss recoveries payable to the trust account

Any moneys recovered from loan losses for which payment has been made under guarantees called shall be credited to the trust account.

10. Duration of the scheme

It is envisaged that the individual SME guarantees will have a maturity of 5-10 years. Provided that adequate funds are held in the trust account, the EIF will enter into new guarantee commitments up to the fourth anniversary of the adoption of the facility. Any amount outstanding on the trust account at the time of expiry of the outstanding guarantees shall be repaid to the Community budget.

11. Court of Auditors

Appropriate arrangements shall be made to allow the Court of Auditors of the European Union to exercise its mission in order to verify the regularity of payments made.

FINANCIAL STATEMENT

1. TITLE OF OPERATION

THE GROWTH AND EMPLOYMENT INITIATIVE

2. BUDGET HEADINGS INVOLVED

B5-510 Technology facility for SMEs

B5-511 Joint European Venture

3. LEGAL BASIS

Article 130

4. DESCRIPTION OF OPERATION

4.1. General objective: In keeping with the Amsterdam Summit conclusions, this action, in the context of equal opportunities, is aimed at increasing employment and growth by enhancing the availability to SMEs of loans or any other types of medium- or long-term debt finance and/or equity. The appropriations are intended to give SMEs improved access to finance for job-creating investment.

This programme covers, in particular, the financing of:

- participations in investment funds, such as venture-capital funds, concentrating on investment in newly established firms and/or high technology or innovative SMEs;
- expenditure intended to cover part of the conception and set up expenses incurred during the creation of transnational joint ventures within the Community between SMEs, and to cover part of the cost of the realized transnational investment;
- cost of guarantees and counter-guarantees extended by the EIF in order to facilitate the increase in the volume of loans made and risk borne by national guarantee schemes, mutual guarantee schemes, the EIB or other appropriate financial intermediaries in connection with their SME operations.

4.2. Period covered: 1998-2000.

4.3. Arrangements for renewal: The Commission will report on the implementation of this programme to the budgetary authorities and will provide an overall evaluation of the functioning and impact of the programme within 48 months of its adoption. Based on this evaluation, the Commission will determine whether to propose to the legislative authority an extension of the programme.

5. CLASSIFICATION OF EXPENDITURE/REVENUE

5.1. Non-Compulsory Expenditure.

5.2. Dissociated Credits.

5.3. Type of revenue involved: proceeds from equity participations; repayments of unused budgetary appropriations

6. TYPE OF EXPENDITURE OR REVENUES

ETF start-up scheme: The expenditure will take the form of budgetary allocations for risk-capital investments into SMEs primarily at establishment and early stages and/or innovative SMEs through relevant specialized venture-capital funds, for example in sectoral funds or smaller or newly established ones. The facility shall be managed by the EIF, who shall select and make the investments into these venture-capital funds. The budgetary allocation shall cover all eligible expenditure, including EIF's management fees and other expenditure, such as promotion cost.

Joint European Venture scheme: The expenditure will take the form of financial contributions intended to cover some of the expenses incurred in setting up a joint venture. The maximum contribution per project shall be ECU 100 000 covering: (a) up to 50% of the eligible expenses, with a maximum of ECU 50 000; (b) up to 10% of the total amount of investment made. The budgetary allocation covers the full cost of the facility, including advances, subsidies and external management cost (5% of the Community budget) and other eligible expenditure such as promotion costs. ECU 1 000 per file approved will be reserved for the remuneration of the intermediary banks.

SME guarantee facility: The expenditure will take the form of subsidies for the purpose of paying the cost of guarantees and counter-guarantees extended by the EIF in order to facilitate the increase in the volume of loans made and risk borne by national guarantee schemes, mutual guarantee schemes, the EIB or other appropriate financial intermediaries in connection with their SME operations. The budgetary allocation shall cover the full cost of the facility, i.e. EIF's guarantee losses and management fee and any other eligible expenditure such as promotion costs The cost of the facility shall be capped so that the overall cost does not under any circumstances exceed the amount to be made available in the budget.

Any revenue will be available for re-use in accordance with Article 27 of the Financial Regulation of 21 December 1977, as last amended by Regulation (EC, Euratom, ECSC) No 2335/95 (OJ L 240, 7.10.1995, p. 12).

7. FINANCIAL IMPACT

7.1. Method of calculating total cost

Total cost of the programme is estimated at ECU 420 million. This amount notably includes all operational cost (management, administration, control, etc.), promotion costs and the costs related to the evaluation of this action.

7.2. Distribution of costs (in current appropriations)

It is not possible to reliably foresee the exact amounts to be allocated for each action in the coming years; the figures given below for the years 1998-2000 are thus only indicative. At the moment, an indicative distribution of 40% for ETF start-up, 20% for European Joint Venture scheme and 40% for the SME guarantee facility is foreseen. The Commission will adapt the allocation to the different schemes over the three-year period to take account of their absorption and efficiency in terms of the quality of the projects submitted, their impact on the access to financing by SMEs and their prospects for job creation in the long term.

Amounts in ECU million	Budget 1998	Budget 1999	Budget 2000	Total
ETF start-up risk-capital scheme (venture-capital investments including management fees and promotion cost)	50 (indicative)	50-70 (indicative)	50-70 (indicative)	150-190 (indicative)
Joint European Venture financial contributions (advances and subsidies including external management cost, management fees and promotion costs)	20 (indicative)	30-40 (indicative)	30-40 (indicative)	80-100 (indicative)
SME guarantee facility subsidies for guarantees (losses, management fee, promotion cost)	50 (indicative)	50-70 (indicative)	50-70 (indicative)	150-190 (indicative)
	120	150	150	420

7.3. Schedule of commitment and payment appropriations

Amounts in ECU million	1998	1999	2000	Total
Commitment appropriations	120	150	150	420
Payment appropriations	60	180	180	420

8. ANTI-FRAUD MEASURES

ETF start-up scheme: The scheme will be managed by the EIF. EIF will be responsible for identifying and evaluating opportunities for possible investments in intermediary venture-capital funds, which will on-invest into the target SMEs, and will exercise the same diligence in performing this task as in conducting operations which involve its own equity operations as well as its operations under the European Technology Facility funded by the EIB. Subject to certain contractual obligations, EIF will only make minority investments of up to a maximum of 25% of the capital of each venture-capital fund (or 35% in exceptional cases), so that the venture-capital funds themselves and other investors in these funds have an interest in the successful conclusion of the venture-capital operation. The individual amounts invested in each venture-capital fund will be limited to a maximum of ECU 10 million.

Joint European Venture: Subsidies or acceptance of the services and preparatory work, feasibility studies or evaluations ordered will be verified by the Commission before payment, taking into account contractual obligations and the principles of economy and sound financial or overall management. Fraud prevention measures (checking, submission of reports, etc.) are included in all agreements or contracts concluded between the Commission and the beneficiaries of the payments. The application procedure for the JEV initiative has two phases. The first concerns expenses related to the creation of the joint venture, while the second concerns expenses related to the investment.

In the first phase, a European SME will submit a request for a contribution to a financial intermediary in the network. The latter will assess the request and forward it to the Commission services if it meets the eligibility criteria. These services will then take a unanimous final decision on the award of a Community contribution. One of the first anti-fraud measures will thus operate at the level of each financial intermediary, who will assess the economic and financial feasibility of the project presented. As an aid to this assessment, the financial intermediaries will have at their disposal a users' guide which includes a list of all the eligibility criteria, as well as examples of requests for contributions. In addition, each financial intermediary will have to provide the Commission with a detailed opinion on any consultant employed. Finally, the fees of any single consultant may not exceed 25% of the eligible expenses for the creation of the enterprise. In the second phase relating to the investment, the request will be subject to several checks: by the Commission services, including the financial services (in particular concerning the verification of the creation of new activities and jobs and of accounting records). Finally, it is anticipated that the average period for processing a request will be six months for award of the initial contribution. The timing of the second contribution will depend on the date and type of the investment made.

SME guarantee facility: The scheme will be managed by the EIF. The appraisal, monitoring and administration of the loans will be carried out by qualified financial intermediaries and subject to certain contractual conditions imposed by the EIF. The guarantee provided by the EIF to the intermediary financial institution will only be a partial guarantee of the exposure of this intermediary, so that the intermediaries have an interest in the successful conclusion of the lending operation as they will cover the remaining part of the credit risk of the loans. The cost of the facility will be capped so that the overall cost does not under any circumstances exceed the amount to be made available in the budget.

Appropriate arrangements shall be made by the managers of the schemes with the relative intermediaries to allow the Court of Auditors of the European Union in collaboration with Commission services to exercise its mission in order to verify the regularity of payments made.

9. ELEMENTS OF COST-EFFECTIVENESS ANALYSIS

9.1. Specific objectives:

The programme aims to facilitate the establishment and growth of innovative companies, by supporting their investment activity through increased availability of finance.

The ETF start-up scheme will promote the creation and early development of innovative SMEs with high growth potential through improving the access to equity capital for SMEs, acting as a catalyst in attracting other investors to invest in those companies and encouraging the development of the venture-capital market. The Joint European Venture scheme will promote the creation of transnational joint ventures by SMEs within the EU, and thereby help SMEs to benefit from the opportunities of the single market through better exploitation of their limited financial and human resources and greater proximity to the clients. The SME guarantee facility will facilitate the access of SMEs to debt finance, and thereby encourage risk-taking in SME lending by banks, and in particular increase the volume of bank debt available to SMEs.

Target population: SMEs as defined in Commission Recommendation 96/280/EC. In the case of the SME guarantee facility, priority will be given to small enterprises up to 100 employees.

9.2. Justification of the action:

The programme consists of three complementary schemes in order to:

- achieve a rapid distribution of the benefits;
- avoid delay in realizing the corresponding employment;
- reach as many job-creating SMEs as possible; and
- ensure that reasonable eligibility rules and rapid disbursement can be combined.

ETF start-up scheme: The targeted segment of the venture-capital market is underdeveloped in Europe and entails the highest risks which potentially translate to high losses, which justifies a strong public sector involvement assisting private sector operators without which onward investments to early stage and emerging SMEs will not take place.

Joint European Venture: Because of the reluctance of financial institutions to finance transnational joint ventures between SMEs, very few are created. This scheme aims at removing the obstacles for the creation of international joint ventures in the European Union, and hence stimulates new activities and economic growth, which otherwise would not take place, creating stable and viable jobs as well as helping SMEs to benefit from the opportunities of the single market.

SME guarantee facility: This segment of SME lending, especially non-collateralized lending including lending to finance intangible assets, entails risk which commercial financial institutions do not easily accept. The corresponding employment creation which otherwise would not materialize justifies public sector involvement.

9.3. Monitoring and evaluation of the operation

The following elements will be considered when evaluating the overall effectiveness of the proposed action:

- the impact on the access to financing by SMEs, its immediate effects on the creation of employment and the prospects for the creation of employment in the long term;
- the overall demand for the programme;
- the aggregate volume of investments realized in the context of the present programme;
- the access by SMEs to the programme;
- the take up of the programme;

- the effects of the programme on the creation of enterprises and other beneficiary effects on SMEs, e.g. the improvement of their competitiveness;

- and other factors, e.g. the efficiency of the programme in terms of intermediaries.

The budget authority will be informed of the effects of this initiative. Possible extensions of the programme or of individual schemes under the programme will be examined in the light of the results achieved and the evaluation of the initiative, which will be transmitted to the budgetary authority within 48 months at most from the date of its adoption.

10. ADMINISTRATIVE EXPENDITURE

The proposed operation will not involve any increase in the number of Commission staff or administrative expenditure.

10.1 Effect on the number of posts

Type of post		Staff to be assigned to managing the operation		Source		Duration
		Permanent posts	Temporary posts	Existing resources in the DG or department concerned	Additional resources	
Officials or temporary staff	A	4	0	4	0	-
	B	0	0	0	0	0
	C	0	0	0	0	0
Other resources		0				
Total		4	0	4	0	-

10.2 Overall financial impact of additional human resources

	Amounts	Method of calculation
Officials		
Temporary staff	0	
Other resources (indicate budget heading)	0	
Total	0	

10.3 Increase in other administrative expenditure as a result of the operation

ECU

Budget heading	Amounts	Method of calculation
	0	
Total	0	

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