

**Inspire policy making by territorial evidence**



# **Financial Instruments and Territorial Cohesion**

Applied Research

**Final Report**

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## Abbreviations

CF	Cohesion Fund
COSME	EU programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises
COCOF	Committee of the Coordination of Funds
CPR	Common Provisions Regulation
CS	Case Study
EAPB	European Association of Public Banks
EAFRD	European Agricultural Fund for Rural Development
EAGGF	European Agricultural Guidance and Guarantee Fund
EC	European Commission
ECA	European Court of Auditors
EFSI	European Fund for Strategic Investments
EGTC	European Grouping of Territorial Cooperation
ERDF	European Regional Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
ESPON	European Territorial Observatory Network
EU	European Union
EWRC	European Week of Regions and Cities
FI	Financial Instruments
FIR	Final Implementation Report
FTE	Full Time Equivalent
JEREMIE	Joint European resources for Micro to Medium Enterprises
JESSICA	Joint European Support for Sustainable Investment in City Areas
LAU	Local Administrative Unit
MA	Managing Authority
MOP	Multiregional Operational Programme
NOP	National Operational Programme
NPB	National Promotional Bank
NUTS	Nomenclature of Territorial Units for Statistics
OP	Operational Programme
PMC	Programme Monitoring Committee
PST	Project Support Team
QoG	Quality of Government
RCE	Regional Competitiveness and Employment
ROP	Regional Operational Programme
SF	Structural Funds
SFC	System for Fund Management in the European Union
SME	Small and Medium Sized Enterprises
SWOT	Strengths, Weaknesses, Opportunities, Threats
TO	Thematic Objective



# **Executive summary**

## **Background**

There has been a significant and sustained increase in the use of repayable financial instruments (FIs) in Cohesion policy over the 2007-13 and 2014-20 programme periods. Repayable instruments are relatively new tools in the European Structural and Investment Funds (ESIF), particularly under the ESF, EAFRD and the Cohesion Fund. What does the increasing shift to using financial instruments imply for territorial cohesion? What evidence is there on the effectiveness of using financial instruments as a complement to grants, in terms of added value for territorial development?

The objective of this ESPON study is to provide a territorial analysis of the impacts of ESIF financial instruments in 2007-13 (and where data allows, 2014-20). To assess the evidence and undertake the analysis, the study has involved a literature review, an extensive data collection and regionalisation exercise, data analysis and mapping, development of a methodology for measuring the added value of financial instruments and the analysis of the territorial added value and impact of FIs. Five case studies provide an in-depth picture of selected financial instruments implemented in regions in Italy, Spain, Poland, Sweden and Norway.

## **Definitions and rationales**

Financial instruments have had a high profile in Cohesion policy in the 2007-13 and 2014-20 programming periods. However, they remain a comparatively small policy tool. For 2007-13, the amount of Structural Funds committed to FIs at closure was just under €11.5 billion, equivalent to about 3.7 percent of total commitments. Even if ambitions for 2014-20 are realised, FIs would still account for less than six percent of total ESIF commitments.

Financial instruments comprise very diverse financial products - loans, guarantees and equity – which are implemented in different ways. These products have many variants and have little in common with one another, save the principle that the capital is repayable (unlike grants). FIs are used to address a range of different geographies and policy targets. In 2007-13, the main policy targets addressed using ESIF financial instruments were enterprise support, urban development projects and energy efficiency/renewable energy projects.

The main rationale for public intervention in economic development policy is to support activities that the market will not undertake alone or at all. In this context, publically-funded financial instruments are a niche policy tool which are only suitable in certain circumstances: for a limited range of policy objectives; where they generate enough revenue or savings to repay the capital advanced, and where commercial funding would not cover any or all of the cost.

Evidence suggests that financial instruments can add value and complement grants in a variety of ways:

- FIs generate a legacy that can be used in the region again; in some countries that have used ESIFs FIs since 2000-06, this legacy is still being recycled.
- FIs can help generate better quality projects than grants alone, partly because the project promoter or entrepreneur shares the risk.
- FIs can help address a 'subsidy culture' among businesses. Reflecting this, a number of countries are moving away from domestic grant support for SME development.
- They can provide an important signal to the private sector and sometime trigger private sector investment that would not have happened otherwise.
- They can help develop regional capital markets and business angels.
- In the specific context of the crisis, FIs were valuable in sustaining investment in businesses that could no longer access bank finance.

### **Main findings – territorial distribution of FIs**

The increasing emphasis on financial instruments under the Structural Funds has a number of implications for territorial cohesion. This partly arises because Cohesion policy now extends to all regions, so Structural Fund financial instruments can be offered in all regions. At the same time, many of the obstacles to development in more disadvantaged regions also make the implementation of financial instruments more challenging. This includes lower quality of government and lack of administrative capacity, as well as limited regional economic dynamism and the absence of a thriving business ecosystem. The tendency for the banking sector to become more centralised and more reliant on automated credit rating systems has also had direct implications for the quality of local knowledge in the sector, as has a decline in 'relationship' banking, especially in rural areas.

Little has hitherto been known about the spatial incidence of FIs in Cohesion policy. Financial instruments have more complex reporting and operational structures than grants, with implications for data availability. Analysing the regional distribution of financial instrument spend is complex because the geography and governance of FIs varies and regional data is not always available.

Twenty-five Member States used Structural Fund financial instruments in 2007-13. Some €17 billion in OP contributions was committed to FIs (including €11.5 billion of Structural Funds), of which €15.2 billion reached final recipients. Italy accounted for almost 30 percent of all contributions to financial instruments in 2007-13. The use of financial instruments also varies widely between countries (and within them) in terms of scale, product types, policy objectives and governance.

On average, EU Member States committed €426 million (EU amounts) to financial instruments in 2007-13, amounting to 3.4 percent of total Cohesion policy allocations, 0.013 percent of GDP and €23 per head. There are wide variations around these averages: Italy

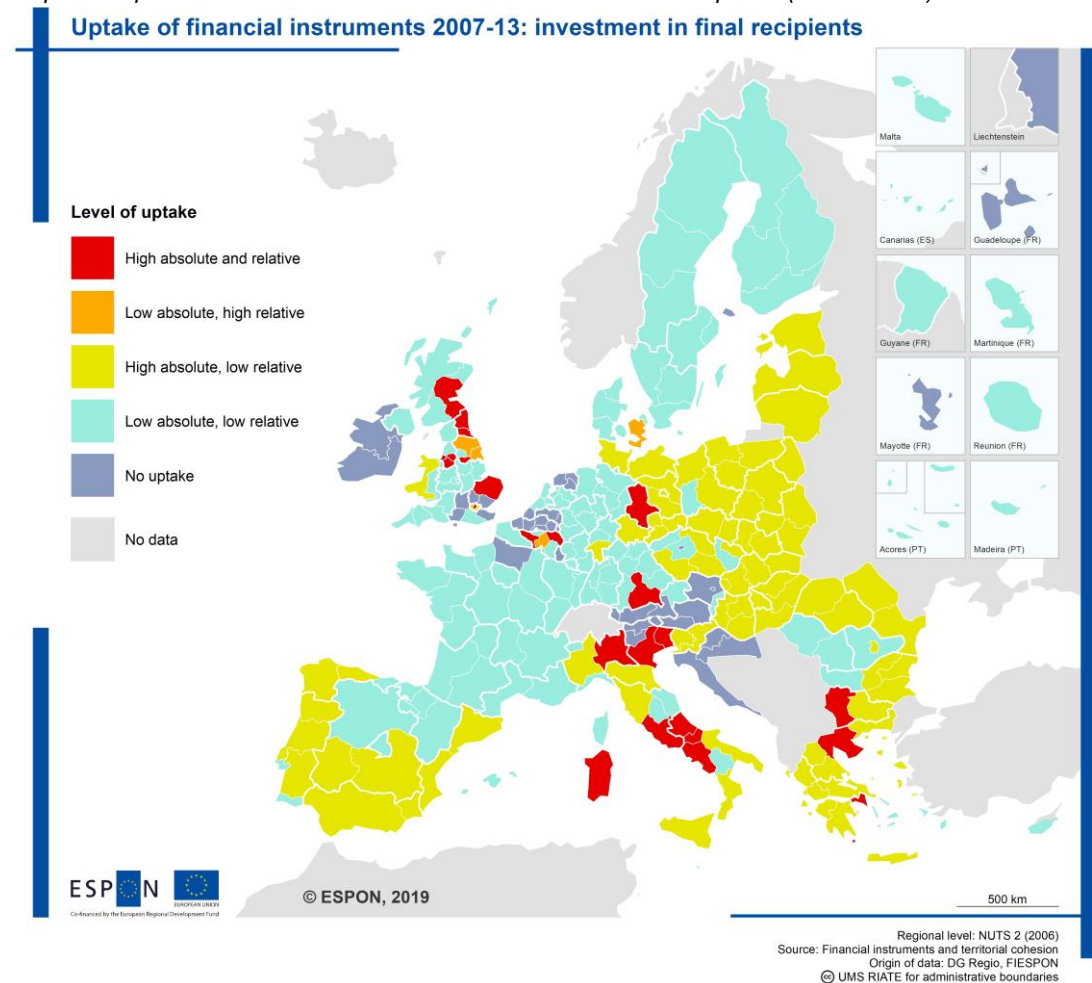
committed over €3 billion in Structural Funds to FIs, amounting to over 10 percent of its Cohesion policy allocation; in Lithuania, FIs amounted to around 0.2 percent of GDP in 2007-13.

This study has mapped the use of Structural Funds financial instruments in the 2007-13 period at a subnational level. This mapping shows substantial variations in the use of co-financed financial instruments in different countries. Comparing FIs to grants, **regions within Italy, Belgium, Denmark the UK and Greece invested the largest shares** of Structural Funds in the form of FIs (but there are marked internal differences within these countries). There are **marked differences between regions in levels of investment in enterprises, with, in general, much higher levels in the Convergence regions than elsewhere** (not including co-financing). Investment in urban development and energy projects accounts for only a small proportion (about 15 percent) of overall FI expenditure, and is concentrated in a few countries.

In terms of the use of different financial products, countries and regions differ in their choices, with some offering all three types (loans, guarantees and equity). In general, there is **a dominance of loan finance in central and eastern Europe, the Baltic countries, Belgium Denmark, Greece and Spain; a dominance of equity in Portugal and Sweden; a mix of loans and equity in the UK; a mix of all three product types in Germany, and France; and a mix of loans and guarantees in Italy.**

In terms of FI 'uptake', there are **'pockets' of high absolute and high relative uptake in a number of regions in Italy, the United Kingdom, Belgium, Greece, Bulgaria and Germany** (see Map 0-1). By contrast, the regions where there is **low absolute and low relative uptake are extensive, covering France, Sweden, Finland, much of Germany and Denmark, as well as parts of Spain and Romania.**

Map 0-1: 'Uptake' of financial instruments – investment in final recipients (EU amounts)



Source: authors. Note: The thresholds used to identify regions as high or low absolute and relative uptake are €20 million and 10 percent of OP expenditure, respectively

The geographies of finance and of administrative capacity are important to the understanding of the territorial dimension of FIs - financial systems are inherently spatial, characterised by complex institutional geographies that both reflect and influence their functioning. This, in turn, affects the ability of entrepreneurs to access finance, typically to the disadvantage of peripheral regional economies. This implies the need for policy explicitly to focus on regional disparities in access to finance. However, under many FIs there is evidence to suggest that **pressure to spend within the lifecycle of the Operational Programme (governed by ESIF rules) is a more important driver of spend than regional equity.**

There are numerous models of governance for financial instruments, partly reflecting the scope of the OPs that offer them, but also involving more complex arrangements than grants. Financial instruments have been implemented through a wide variety of institutional structures at national and subnational levels. In most countries, **FIs are offered from a (sometimes overlapping) mix of national, multiregional and regional OPs.** In some regions, financial instruments are offered within the region from **up to five different OPs**, often for similar purposes.



A key issue for the study has been to gain insights into the territorial distribution of national and multiregional financial instruments. This is an important issue for territorial cohesion since it raises the question of whether the incidence of expenditure on FIs is simply demand-led (by the regional presence of SMEs) or whether FIs proactively seek to address regional disparities in access to finance. The latter seems comparatively rare and may be partly related to pressures to spend within the lifecycle of the Operational Programmes. In general, it does appear that **FIs are mainly demand-led**. However, the governance structure for financial instruments can help offset this tendency by, for example, seeking to ensure the involvement of regional and local intermediaries.

Among ESIF managing authorities (MAs) that opted not to use FIs, the **drivers for this decision are not primarily territorial**, but related to the content and scale of their Operational Programmes and decisions about the relationship with domestic policy. Conversely, other MAs justify the use of FIs on the basis of the limited budget and the importance of generating a legacy. Other key factors in the decision are also not necessarily territorial, and include perceived obstacles such as culture, lack of experience, complexity, administrative capacity, lack of critical mass, domestic competition and a view that existing commercial finance provision is adequate.

### **Main findings – added value and impact of FIs**

The added value of financial instruments relates to criteria such as sustainability, efficiency, quality, development of local financial markets and the impact on a subsidy culture. This is different from impact, for which the two most commonly reported indicators are jobs created and numbers of firms supported. However, it should be noted that within the existing data, even some basic measures of spend are unreported or implausible and the level of expenditure almost everywhere is too small to lend itself to econometric analyses of its effects. Moreover, collection of quantified data related to the impact of financial instruments is not consistent between managing authorities. Many MAs *do* provide data on job creation (this is the most common impact indicator recorded), but definitions of this diverge even within countries. Beyond job creation (where relevant), the vast majority of MAs do not collect any data on FI implementation other than that which had to be reported to meet regulatory requirements (and even this is often incomplete and inconsistent). In short there is **no basis on which to build a wide-ranging comparative assessment of the impacts and added value of financial instruments**.

To analyse differences in added value and impact for this study, a typology of European NUTS 2 regions was developed on the basis of eligibility for Structural Funds, financial systems, quality of government and urban/rural categorisation. This has found that FIs were used in 28 different types of NUTS 2 region in 2007-13. The relative share of FIs in relation to ERDF and ESF funding was the **highest in urban regions with a market based financial system**, the **lowest is in rural regions with a market based financial system**. This strong urban-rural gradient is not found in regions with bank-based or former-socialist financial

systems. A total of 77 percent of all Structural Funds contributions to final recipients through FIs was allocated in Convergence/Phasing Out regions. About **16 percent of all Structural Funds invested in final recipients through FIs is accounted for by a single Convergence region type – low QoG, bank-based financial system, urban – comprising three regions** (Campania, Sicilia and Attiki).

The geography of fund managers differs widely between EU Member States, varying between highly centralised and more regionalised. There is a **concentration of fund management in urban areas. Legacy (the repayment of funds to be used again) is higher in regions with a lower quality of government.** This may be because financial markets work less well in these regions and FIs are financing less risky project than in areas with high quality of government. In areas with a low quality of government, more final recipients are reached by the same investment, than in regions with a higher quality of government, largely owing to the wider use of guarantees and loans.

Job creation data reflects national differences in reporting, and is often of doubtful quality and thus is of limited value in assessing impact. At the same time, it is worth noting that job creation is anyway often not a key objective of financial instruments so that while job creation data is more widely available than other indicators, it does not really capture the impact that FIs can have.

Regions which have a high uptake of FIs are more efficient in relation to management costs and fees and have higher rates of return than low uptake regions. In most types of regions, high uptake of FIs results in larger investments in relatively fewer final recipients.

### **Main findings - Insights from practice**

The study provided insights from the operation of FIs in five case study areas: Lombardia, Mellersta Norrland, Andalucía, Wielkopolskie and Norway. Most of the FIs generated a positive impact in terms of **diversification of sources of financing** both for firms and urban projects, especially in those regions that suffered from strong financial constraints during the financial crisis. Demand outstripped supply in most cases, but particularly for loan and guarantee products. There is no evidence of cannibalisation effects, either with other public or private sources of finance.

Governance and administrative arrangements were found challenging in the case study regions during the implementation and execution phases in 2007-13. Here financial intermediaries and international financial institutions such as the EIB/EIF have played an important role. The process of selecting, screening and managing the **relationship with intermediaries has proven to be a key element for the success of FIs.** FIs appear to be more effective where Financial Intermediaries have a clearly focused investment strategy, fully coherent with the FI targets. There is an opportunity for skills to be transferred between more and less experienced actors, for example, between national promotional banks or the EIB/EIF and local actors.

The case studies highlighted the trade-off required between different targets of FIs: absorption capacity, promotion of innovation and sophistication of economic activity, and territorial cohesion within the regions, and noted that these are not always compatible. Most of the instruments placed **less emphasis on territorial factors** within the region than on other priorities. The outcome is that **FIs were concentrated in zones with better economic performance**. It can be concluded that FIs have not contributed to overcoming territorial imbalances, raising the question as to whether this is coherent with regional policy objectives.

It is notable that there is an almost universal **lack of ex post evidence of territorial and economic impact** measured using quantitative and systematic evaluation methods within the case study regions. Only the Norwegian case carried out continuous econometric impact evaluations. Field and econometric impact evaluation practices are crucial in order to continuously improve the performance and impact of FIs.

However, one of the key positive outcomes found is **the generation of innovative and entrepreneurial culture and know-how transfer among the actors involved**. While this immaterial capital is difficult to measure, the case studies highlighted this effect as one of the most positive ones, which can be **relevant to the long-term economic performance of the regions**.

### **Policy recommendations**

The data analysis has highlighted how small a proportion of Cohesion policy spend FIs represent and the study has revealed both the paucity of the data available and its lack of comparability. These shortcomings are a significant obstacle to a fine-grained assessment of the added value and impact of FIs. That said, it is clear that FIs do have positive effects. Although frequently used for working capital rather than to fund investment, FIs have helped mitigate the impact of financial crisis in many regions. There is evidence that they have led to a more sophisticated and diversified financial market for SMEs, generated substantial leverage and legacy for reinvestment and enabled knowledge transfer and capacity building.

In terms of informing the discussion on the use of financial instruments in future programming periods, several policy recommendations can be highlighted.

EU regulatory issues are a significant reason for MAs not to use FIs, there is therefore a need to **ensure that administrative requirements are not a disincentive** to use FIs rather than grants. It is worth noting that the draft regulations for the 2021-27 period propose additional simplifications.

Some regulatory requirements have the potential to undermine the effectiveness of financial instruments. The combination of the seven-year programming period (which is relatively short in financial product terms) and the requirements to ensure that funding is spent quickly can conspire to make managing authorities more risk-averse. Care should be taken to **ensure that regulatory requirements do not undermine** policy objectives.

Partly related to the above, financial instruments have the potential simply to reinforce existing spatial disparities in access to finance because of the pressure to disburse budgets and avoid decommitment. Perhaps as a result (and also due to the absence of delineated assisted areas for Structural Funds since 2000-2006), there appear to be comparatively few examples of FIs that proactively target disadvantaged areas. There is a need to **ensure that financial instruments do not reinforce existing disparities** in access to finance, with potential negative consequences for territorial cohesion. In context of territorial cohesion, there is a need to be clear about what the policy objectives actually are, and potentially accept that there may be a trade-off between a focus on disadvantaged regions and some of the benefits of financial instruments e.g. FIs may be more costly to implement in more remote regions. In short, publicly-backed FIs should not largely replicate what the private sector can do, but rather intervene where it cannot or is unwilling to at the scale required.

Policymakers point to the importance of **policy learning, experience and progressing** from simple to more sophisticated financial products. This study focuses on the data available for the 2007-13 period, as implementation of FIs in the 2014-20 period has been slow and many Member States and regions have so far reported little data. Since the closure of the 2007-13 period, the issue of administrative capacity has been receiving increased attention at EU level. Specifically relevant to financial instruments, EU level Technical Assistance platforms such as *fi-compass* were introduced in 2014-20, and have made significant efforts to increase capacity within the field of financial instruments.

Consideration should be given to **the role of data collection and reporting** for financial instruments to improve the understanding of policy effects and added value. The data currently available for analysis of the added value and impact of financial instruments, even after a comprehensive survey of MAs for data collected at regional level, and any additional indicator data collected, is insufficient to assess the complementarity of financial instruments and grants.

Implementation of ESIF financial instruments certainly involves a steep learning curve for managing authorities, and the case studies have emphasised the key role which international financial institutions such as the EIB/EIF, national and regional promotional banks and financial intermediaries with local knowledge and relevant expertise can play. There is an ongoing need for capacity building in FI implementation, and governance structures need to **combine financial expertise and local knowledge** if they are to address territorial cohesion.

# 1 Introduction

## Key points

- Financial instruments have developed a high profile in Cohesion policy, but only accounted for about 3 percent of spend in 2007-13; even if ambitions for 2014-20 are realised, FIs would amount to less than 6 percent of Cohesion policy expenditure.
- The high profile of FIs partly owes to Commission and EIB strategies to encourage their use, but is also due to implementation challenges for domestic stakeholders.
- The rationale for financial instruments is that they are more sustainable and more efficient than grants, and have the capacity to produce better quality projects.
- Financial instruments are a niche policy tool, but are far from homogenous; they comprise very diverse financial products – loans, guarantees and equity – implemented in different ways and addressing an array of aims and objectives.
- Little is known about how this diversity plays out in geographical terms and what implications this might have for territorial cohesion.
- The focus of the study is on FIs in 2007-13 where FIs were principally used to support enterprises, but also investment in urban development and energy efficiency and renewables.
- With 2007-13 programmes closed and preparations underway for 2021-27, this is an opportune time to contribute to debates on the future directions of policy.

The term ‘financial instrument’ (FI) has become firmly embedded in the lexicon of EU Cohesion policy and FIs now have a high profile in the European Structural and Investment Funds (ESIF) implementation. The main type of financial instrument or product are loans, guarantees and equity. These have grown significantly in importance as policy delivery tools in Cohesion policy: in 1994-99, ERDF spend in the form of FIs was estimated at just €300 million, rising to some €1.2 billion in 2000-06 (CSES, 2007); for 2007-13, Structural Fund commitments to FIs reached almost €11.5 billion (European Commission, 2017); and indications from the 2014-20 Operational Programmes (OPs) are that ESIF commitments to FIs could rise to over €20 billion. That said, while the growth in the use of FIs is striking, these sums remain very modest in relation to overall Cohesion policy spend: in 2007-13 commitments to FIs were just over 3 percent of Cohesion policy allocations; even if the 2014-20 ambitions to further increase the use of FIs were achieved, FIs would still represent less than 6 percent of OP indicative allocations.

## 1.1 The rationale and aims of financial instruments

Three main arguments have been advanced for the use of financial instruments as a complement to or in place of grants (European Commission, 2012).

First, **sustainability**: because funds are, in principle, repaid, they can generate a legacy to be reinvested. Second, **efficiency**: financial instruments can leverage-in private capital (for example, a public guarantee may encourage a bank to lend where they otherwise would not)

thus supporting higher investment with less public funds. Third, **quality**: support has to be repaid, so firms and project promoters may be more committed to project success than for grant-aided investments. In addition, the due diligence required from financial intermediaries may result in improved project quality.

## 1.2 Financial instruments are complex and diverse

The high profile accorded to FIs partly owes to their relative novelty in Cohesion policy<sup>1</sup> and their active promotion by the European Commission and the EIB Group, but also, more notoriously, to the **challenges involved in their operationalisation**. These complexities have resulted in FIs becoming a distinct strand of Cohesion policy implementation from a regulatory and reporting perspective. In addition, the expertise required of policy practitioners, together with the involvement of financial intermediaries in policy implementation, has often meant that FIs have become the preserve of specialist stakeholders.

The emergence of FIs as a 'niche' tool of Cohesion policy has arguably contributed to the impression of homogeneity. In fact, ESIF 'financial instruments' are **highly diverse**. They embrace an array of financial products – loans, guarantees, counter-guarantees, venture capital, quasi-equity, mezzanine funds and combinations of products - that not only operate in completely different ways, but can be of widely differing scales, address a variety of policy objectives, use various modes of governance and function within diverse socio-economic and institutional contexts. For instance, a counter guarantee scheme that benefits several thousand microenterprises annually has little in common with an urban development fund that makes a handful of investments over the programming period; the only commonality is the intent that the capital involved should be released or repaid for reinvestment.

## 1.3 The territorial dimension to financial instruments

Little has been written about how this **diversity in use and type of financial instruments plays out in territorial terms**. Cohesion policy FIs are implemented in a variety of ways that affect their use 'on the ground'. This owes to a number of factors, in particular:

- Operational Programmes that fund financial instruments may be regional, multiregional or national in scope
- Domestic structures and traditions – such as the presence of national and regional promotional banks or the role of the private sector – differ widely and affect both the type of financial products used and how they are implemented
- The role of the EIB group differs between countries and regions, partly, though not wholly as a function of the degree of domestic experience and expertise with FIs

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<sup>1</sup> Though they have long been used in domestic and international development and economic strategies.

- The scale of Cohesion policy funding varies considerably between regions and countries, affecting Managing Authority decisions about whether and how to channel Cohesion policy funds into financial instruments
- The presence of domestic instruments also plays a role in decisions whether and how to use FIs in Cohesion policy. For instance, Cohesion policy may be used essentially to boost the funds available under existing financial products, or may be used to set up entirely new financial products.

While these factors affect the territorial dimension of FIs, the focus on the regulatory aspects of implementation has meant that many substantive granular questions remain unanswered. For example:

- What types of financial product are used where, and why?
- What is the incidence of investment through FIs in different geographies?
- How do modes of governance differ between territories, and does this matter for the performance of financial instruments?
- What can be said about the impact of financial instruments in different territorial contexts?
- What insights can regions with experience of financial instruments offer for the operationalisation of financial instruments in other geographies?

The aim of this study is to address these and other related questions.

#### **1.4 Scope of the study**

The timing of this study is such that the focus is on experiences with Cohesion policy FIs in the 2007-13 programming period. Reporting for this period is now closed, enabling an assessment of patterns of spend, outcomes and impacts. In 2007-13, financial instruments could be used only to support enterprises, urban development projects and energy efficiency and renewable energy investment. Most use was made by the ERDF, with both fewer countries and very modest spend under the ESF. EAFRD spend on FIs was smaller still and the Cohesion Fund did not allow for the use of FIs in the 2007-13 period.

In 2014-20, FIs can be used for any thematic objective and by any of the Funds. That said, indications from the Operational Programmes and early implementation are that enterprises remain the main target of FI support, and that their use beyond the thematic objectives for SME competitiveness (TO3) and low carbon economy (TO4) are limited; ERDF remains the main source of FI funding under Cohesion policy. While progress in 2014-20 does not yet permit an analysis of expenditure, a growing body of literature and insights from stakeholders gathered as part of this study does enable the experiences of both periods to contribute to debates on the future of FIs in Cohesion policy post-2021. Experience so far in the 2014-20 period is discussed in the Scientific Report which accompanies this report.

## 1.5 Structure of the report

Against this background, this report is structured as follows. Chapter 2 sets out the **objectives and approach** of the study. It outlines the methodology for the research, which builds on the Terms of Reference, and involves both quantitative and qualitative dimensions. The quantitative component involves the construction of regional typologies against which differences in policy and performance might be assessed. The qualitative component involves five case studies of regions / financial instruments where there is substantial experience. Chapter 3 explains the **concept of, and rationales for, financial instruments** in the wider context of economic development policy. Chapter 4 explores the **territorial dimension to financial instruments**, focusing on the geographies of finance at national and subnational levels, the role of administrative capacity in policy implementation and the relationship between financial instruments and territorial disadvantage. Chapter 5 sets the scene for these analyses by providing a comparative overview of the **scale and governance of FIs under Cohesion policy**, principally at Member State level. This provides a basis for understanding the more fine-grained regional-level analyses in Chapter 6, which assess **territorial patterns of commitment, investment, product and policy objectives** under financial instruments within Operational Programmes. This data is explored further in Chapter 7 which analyses the **added value and impact of financial instruments** using the regional typologies constructed. This is complemented by an overview of the case studies in Chapter 8. These draw on five **different experiences with financial instruments**, looking in-depth at the operation of specific Cohesion policy financial products in Andalucía (Spain), Lombardia (Italy), Mellestra Norrland (Sweden) and Wielkopolskie (Poland) together with long-standing domestic experience with FIs for regional development in Norway. Chapter 9 draws together elements from all these analyses against the backdrop of current debates on financial instruments in Cohesion policy post-2021.<sup>2</sup> It seeks to contribute to those debates by drawing **policy conclusions and recommendations** from the analysis in this study. The Appendix includes the list of regions and their categorisation in the regional typology.

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<sup>2</sup> The regulatory proposals for the 2021-27 period relating to financial instruments are discussed in the Scientific Report accompanying this report.



## 2 Objectives of the study and approach to the research questions

### Key points

- The objective of the study is to provide evidence on the added value of Cohesion policy financial instruments at the *territorial* level.
- The methodology for the study has comprised both quantitative and qualitative elements.
- An extensive data collection exercise was undertaken to complement existing data. This included a survey of managing authorities. Where regionalized data did not exist, the data was regionalized on the basis of relevant proxies.
- This was followed by mapping of the data, the construction of regional typologies and an assessment of the added value of financial instruments.
- Five case studies examine FI implementation in regions with different territorial characteristics.
- Input from stakeholders was gathered at two EWRC events in October 2018.

### 2.1 Research questions

The overall aim of this study is to ‘provide evidence on what the increasing shift to using financial instruments implies for the objective of territorial cohesion and whether using financial instruments as a complement to grants is a more effective way to implement ESI Funds in terms of added value for territorial development.’ More specifically, the study aims to address a number of key policy questions:<sup>3</sup>

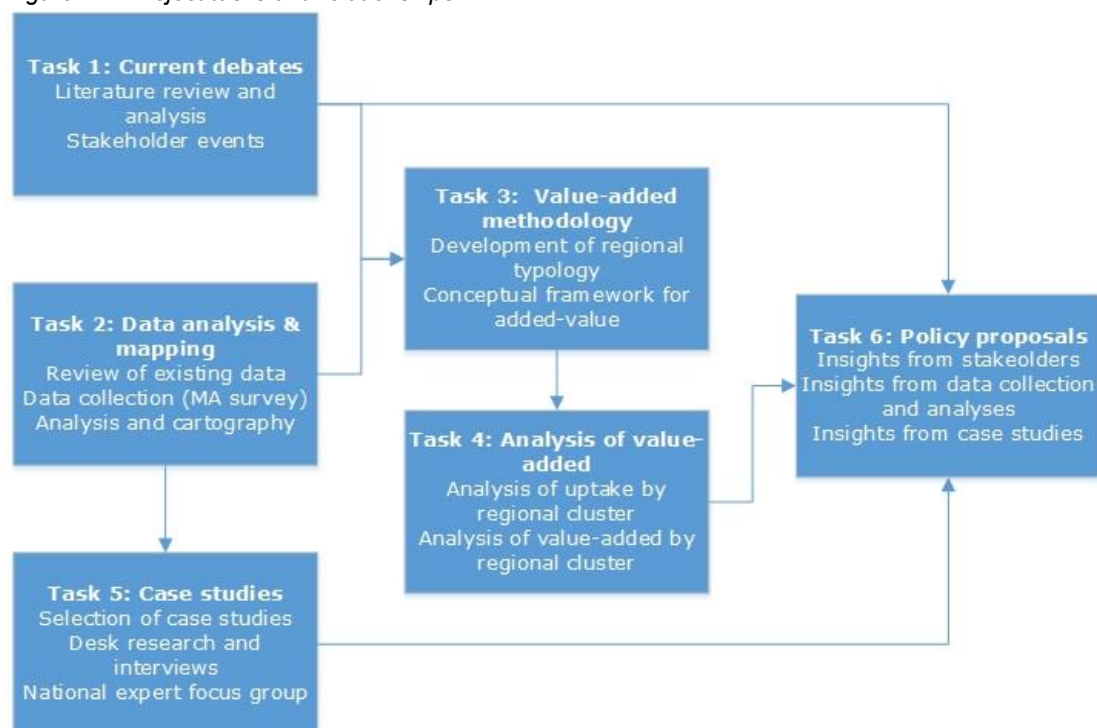
- What added value do ESIF financial instruments produce and how are the benefits distributed across countries and regions?
- Where and how are financial instruments being implemented and what are the main territory-related drivers and obstacles?
- What does the increasing shift to financial instruments imply for the objective of territorial cohesion?
- Is using financial instruments as a complement to grant schemes an effective way to implement European Structural and Investment Funds in terms of added value for territorial development?
- How are different territorial features, governance mechanisms and administrative capacities supporting or hindering the use of financial instruments in this new setting in terms of regional development?

The Terms of Reference for the study also specified six tasks through which these questions should be addressed. These and the links between them are summarised in Figure 2-1 and discussed in the sections that follow.

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<sup>3</sup> ESPON EGTC (2017) Terms of Reference: “Financial Instruments and Territorial Cohesion”.

Figure 2-1: Project tasks and relationships



Source: Authors from ESPON EGTC Terms of Reference

## 2.2 Task 1: currents debate on Cohesion policy and ESIF financial instruments

Current debates on Cohesion policy are set against the background of wider reappraisals of the future directions of the EU,<sup>4</sup> its financing<sup>5</sup> and the negotiation of the post-2020 financial framework.<sup>6</sup> Although financial instruments are a small percentage of overall Cohesion policy spend, they have a high profile in policy debates, partly owing to the challenges in implementation. A key question is whether these operational aspects themselves have a territorial dimension. In exploring these issues, this task comprised two main elements:

1. **A review and analysis of the literature on financial instruments**, with particular emphasis on the geography of FIs, the role of governance and their implications for territorial Cohesion.
2. **Consultation with key stakeholders** on the experience with financial instruments in 2007-13 and 2014-20. In addition to insights from various fora, two stakeholder events were organised at the European Week of Regions and Cities in October 2018. The first, a

<sup>4</sup> European Commission (2017) White paper on the Future of Europe: Reflections and Scenarios for the EU27 by 2025: [https://ec.europa.eu/commission/sites/beta-political/files/white\\_paper\\_on\\_the\\_future\\_of\\_europe\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf)

<sup>5</sup> High Level Group on Own Resources (2016) Future Financing of the EU: [http://ec.europa.eu/budget/mff/hlgor/library/reports-communication/hlgor-report\\_20170104.pdf](http://ec.europa.eu/budget/mff/hlgor/library/reports-communication/hlgor-report_20170104.pdf)

<sup>6</sup> A Modern Budget for a Union that Protects, Empowers and Defends – the Multiannual Financial Framework for 2021-2027, COM(2018) 321 final, 2 May 2018.

practitioner event mainly involving Managing Authorities, and the second, arranged in liaison with ESPON EGTC, involving key institutions (European Commission, EIB and ECA).

The outputs from Task 1 informed both the regional typologies developed in Task 3 and the policy proposals in Task 6.

### **2.3 Task 2: territorial analysis and mapping of the regional distribution of ESIF financial instruments**

The overall objective of this task was to analyse and map the way in which FIs are used in the implementation of ESI Funds. This included the identification of the different financial products used (loans, guarantees, equity), the distribution of FIs compared to grant expenditure and the policy objectives addressed through FIs. The aim was to analyse the distribution at NUTS 2 level, and NUTS 3 if feasible. Task 2 involved three elements:

#### **2.3.1 An overview and assessment of existing data.**

The main source of information on the implementation of ESIF FIs is the Summary of Data (European Commission, 2017), which is European Commission summary of the data provided annually by managing authorities on FIs. Some of this data is public; with the support of ESPON EGTC and the European Commission (DG Regio), the project team also obtained access to the unpublished data submitted by the Managing Authorities. The team also assessed other resources, such as the European Commission's *project categorisation data*.<sup>7</sup> In principle, this dataset classifies ESIF investment by priority theme, sector, territory, location and form of finance, at the level of ERDF and Cohesion Fund OPs. In practice, however, this dataset had many shortcomings for the present study: location data is often absent; the definitions of financial instrument do not coincide with the Summary of Data definitions; the sector codes are not applied meaningfully in the case of repayable instruments (i.e. managing authorities typically report data on financial intermediaries rather than the type of final recipient targeted); and the priority themes do not coincide with policy target aims defined for financial instruments (namely enterprises, urban development and energy efficiency and renewables). Reporting on *core indicators*<sup>8</sup> was also reviewed, but this lacks information on location (other than the relevant OP – many of which are national or multiregional) or by form of finance. Collectively, the various datasets presented some key shortcomings and challenges, including but not limited to:

- NUTS 2 data only available where the OP coincides with NUTS 2 (about 46 percent of total financial commitments to FIs); no NUTS 3 data

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<sup>7</sup> 2007-2013 ERDF CF Categorisation Project Selection AIR2014 Raw: <https://cohesiondata.ec.europa.eu/2007-2013/2007-2013-ERDF-CF-Categorisation-Projectselection-/b5xq-38ds>

<sup>8</sup> 2007-2013 ERDF CF achievements – core indicators by programme: <https://cohesiondata.ec.europa.eu/2007-2013/2007-2013-ERDF-CF-achievements-core-indicators-BY-/dsvh-4gnx>

- reporting errors and gaps in compulsory data; much more serious shortcomings in voluntary data
- lack of consistency between datasets in definition of financial instruments and policy objectives
- no reporting on core indicators disaggregated by form of finance.

### 2.3.2 Data collection.

Reflecting the outcome of the data assessment, the team launched a major survey of all Managing Authorities offering FIs in 2007-13, with data requests tailored to each Managing Authority, seeking three inputs:

- a) validation/correction of the data on financial instruments submitted by Managing Authorities to the Commission at the time of programme closure
- b) additional data on the contribution made by financial instruments to OP indicators (e.g. reduction of CO<sub>2</sub> emissions) or other impacts
- c) regionalised data – geographical information below the level of the OP, and NUTS 3 regions if possible.

A total of 190 Managing Authorities were contacted by email. Up to four reminders were sent, with priority given to telephone follow-up for Managing Authorities with particularly high levels of FIs commitment. This is reflected in the outcome of the survey which shows that respondents accounted for 45 percent of the total number of OPs, but about 55 percent of spending commitments on FIs and of investments in final recipients.

Table 2-1: Summary of survey responses

	<b>Number</b>	<b>€m committed to FIs 2007-13</b>	<b>€m invested in final recipients 2007-13</b>
<b>OPs offering FIs</b>	190	11,165	10,250
<b>Survey Respondents</b>	86	6,196	5,587
<b>Respondents as a percent of total</b>	45.2%	55.5%	54.5%

Source: authors

Of the 86 respondents:

- 8 MAs provided corrections to the data provided through the Final Implementation Report (FIR) process
- 47 stated that indicators other than those in the FIR were collected. These were only provided in a few cases, and in practice did not always prove to be additional to FIR reporting.

Regarding the territorial dimension, the picture was more complex reflecting the different geographical scope of the OPs:

Table 2-2: Availability of data at NUTS 2 and use of proxies

	<b>Approach to regionalisation</b>	<b>Number of OPs</b>	<b>% of OPs</b>	<b>EU amounts invested in final recipients (€m)</b>	<b>% of EU amounts invested in final recipients</b>
OPs corresponding to NUTS 2	n.a.	139	73.2	5222	50.9
Multiregional and nationwide OPs	Regionalisation based on official data (response from MA, FIRs, national experts, Ex. ante evaluations, project categorisation data, previous knowledge)	29	15.3	3298	32.2
	Regionalisation using proxy variables (regional proportions of employed in SMEs; GDP or total population)	22	11.6	1730	16.9
		190	100	10250	100

Source: authors

- Some 50.9 percent of investment in final recipients is *de facto* regionalised since the OPs operate at NUTS 2
- 32.2 percent of investment was regionalised on the basis of official data or specific knowledge (such as the location of urban development programmes)
- For 22 OPs (16.9 percent of investment) no official data was available and proxies were used. For enterprise support FIs, the main proxy used was the regional share of employment in SMEs; for urban development, regional shares of population was used in the absence of other data.

Regarding regionalisation below NUTS 2, only 26 respondents collected this data (amounting to investment of around €1,986 million (about 19 percent of the total invested in final recipients). Of this investment amount over 75 percent was accounted for by five OPs.

### 2.3.3 Data analysis and mapping

In a third stage, which involved further quality control and plausibility checks, the data was analysed in order to map a number of dimensions, including

- the scale of FIs investment in final recipients at the regional level
- the type of financial product deployed
- numbers of OPs engaged in offering FIs in a given region
- the relative importance of FIs in a given region both in relation to grants and in relation to the regional economy
- the type of policy objectives addressed through FIs

## 2.4 Task 3: A methodology for measuring added value

The aim of this task was to provide a methodology to help measure what added value different types of projects financed by ESIF FIs have for different types of territories. To this end, the Terms of Reference required the development of a regional typology.

### 2.4.1 Development of a regional typology

The range of factors discussed later in this report (see Chapter 4) in relation to the geography and governance of financial instruments points to a complex and multidimensional framework.

At **national** level, the extent to which mature financial markets and institutions exist, and the nature of those institutions, affects not only the type of financing typically sought by firms and public authorities in order to invest, but also the institutional frameworks available to deliver ESIF co-financed FIs – for instance the presence of promotional or development banks. The national context is important: access to finance is conditioned by broad models of capitalism and the role of the State in investment finance. Specific characteristics related to access to finance can be identified, notably the sophistication of financial markets, the role of banks, the development of venture capital, the availability of patient capital and the role of public intervention. Looking specifically at how national financial systems influence SME finance Moritz *et al*, (2015) distinguish between **bank-based, market-based and former socialist countries**.

<b>Bank-based</b>	<b>Market-based</b>	<b>Former socialist</b>
AT BE CY DE ES FI FR GR IE IT LU NO PT	FI NL SE UK	BG CZ EE HR HU LT LV PL RO SI SK

The national financial context affects issues such as availability of finance *per se*, but it also provides the institutional framework for the implementation of FIs. **The domestic landscape for FIs is complex, varied and opaque** (Wishlade et al 2017). Some countries have longstanding sophisticated structures which provide experienced mechanisms for disbursing ESIF cofinanced FIs. In others, new national promotional banks (NPBs) are in the process of being established in response to the aftermath of the financial crisis. In some central and eastern European countries ESIF funding is the mainstay of economic development policy and may also be a significant component of the resources of NPBs. Elsewhere the picture is more fragmented, with niche funds, regional and sectoral banks and other financial institutions playing various roles.

At the **regional** level, the interplay of a number of factors is relevant to the implementation and impact of FIs:

- **Eligibility for ESI Funds and levels of regional development.** Designation as a Convergence (or Less Developed Region (LDR) in 2014-20) region reflects levels of economic development as measured in GDP(PPS) per head. As a measure of economic development, GDP per head is not ideal, but its importance in the present context also lies in the scale and intensity of ESIF financing, which has a bearing on the use of FIs. The methodology therefore distinguishes between Convergence and Phasing-out regions, on the one hand, and Regional Competitiveness and Employment regions and Phasing-in regions on the other.
- **Geography of finance.** Access to finance has a strong spatial component, partly arising from physical distance and partly from the geographies of financial institutions. This implies that regions that are more distant from agglomerations tend to be more disadvantaged with respect to access to finance. The methodology distinguishes

between urban, intermediate and rural areas to reflect this assumption, adapting existing approaches to produce a classification at NUTS 2.

- **Quality of government.** The capacity of public policy to respond to regional disadvantage is partly contingent on the quality of government. This is especially pertinent in the context of financial instruments given the implementation challenges experienced by many Managing Authorities. The methodology uses a Quality of Government index to distinguish high, medium and low quality of government regions.

Using these factors - ESIF eligibility, finance system, quality of government, and urban-rural classification – a typology of regions using FIs was developed as summarised in Table 2-3, which shows the main criteria and Table 2-4, which shows the number of regions falling within each regional typology (this also shows that large numbers of regions fall within the same type, and some types are merely hypothetical). The methodology for each criterion is described further in the Scientific Annex to this study.

Table 2-3: Factors affecting the uptake and implementation of financial instruments

Factor	Relevance	Indicator	Elements
National financial context	Type of financial institutions and main patterns in sources of finance for SMEs	National system of finance	Bank-based Market based Former socialist
Cohesion policy eligibility	Broadly reflects level of development (GDP-PPS per head as % of EU average). Different designations reflect different intensities of Cohesion policy support	2007-13 Cohesion policy categories	Convergence and Phasing-out (C+PO) Phasing-in and Regional Competitiveness and Employment (RCE+PI) Non-EU ESPON 4 (NEE)
Geography of finance	Degrees of agglomeration reflect development of local financial markets	Urban, intermediate, rural classification	Urban Intermediate Rural
Quality of government	Affects administrative capacity to implement FI, which are generally acknowledged to be more complex than grants	Quality of government index	High Medium Low

Source: authors

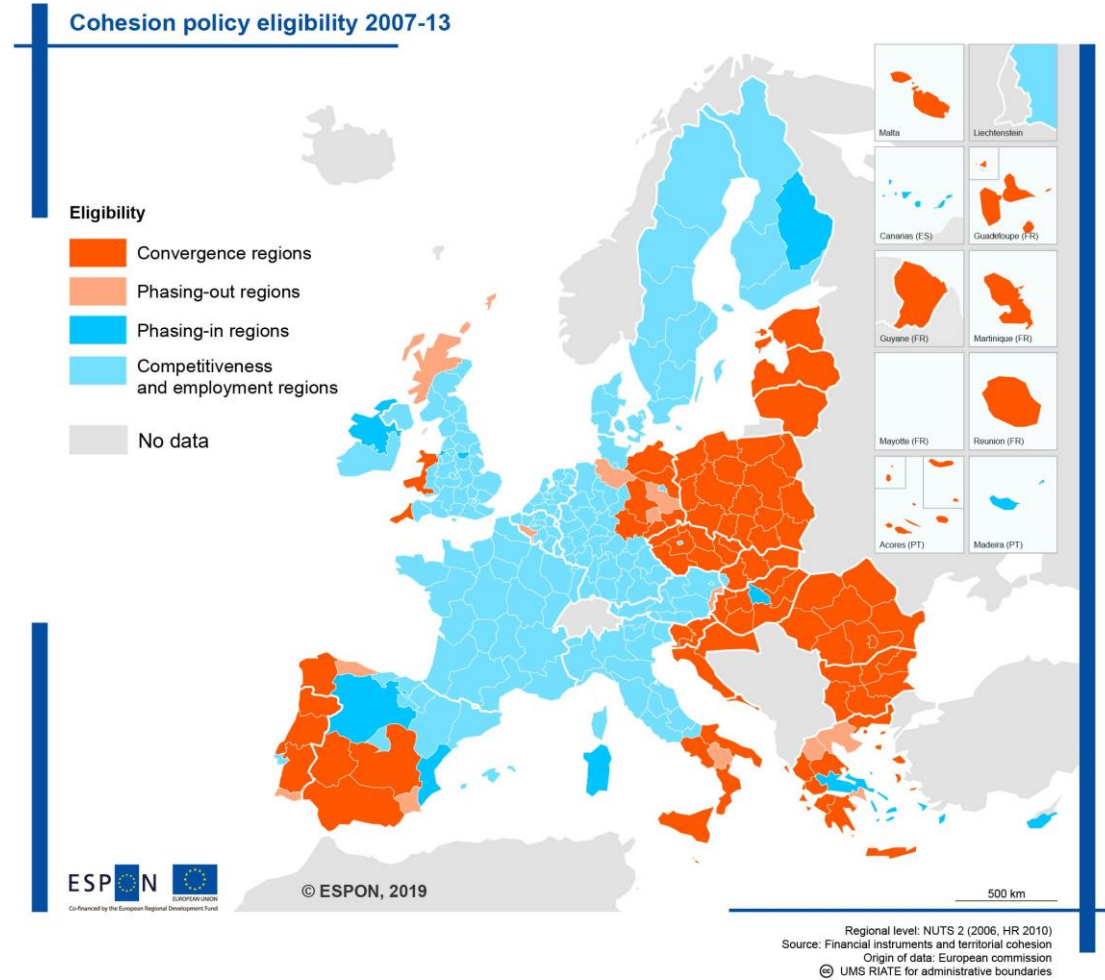
Table 2-4: Number of NUTS 2 regions in each regional typology

Eligibility	Quality of government	Financial context and geography of finance								
		Bank based			market based			former socialist		
		Urban	Inter-mediate	Rural	urban	Inter-mediate	rural	urban	Inter-mediate	rural
C+PO	High QoG		1	3						
	Medium QoG	9	9	7	2	1		4	9	20
	Low QoG	3	3	10				3	4	13
RCE+PI	High QoG	14	13	23	24	11	8			
	Medium QoG	21	21	10	11	5				
	Low QoG	3		5				1		
NEE	High QoG	1	3	5	2	5				
	Medium QoG									
	Low QoG									

Source: authors based on Official Journal of the European Union, 6.9.2006, L243; 28.3.2007, L87; Moritz, Block and Heinz, 2015; Masiak, Moritz and Lang, 2017; Demircuc-Kunt and Levine, 1999; Charron, Dijkstra and Lapuente, 2015; Teorell et al, 2017; De Beer et al., 2014

For clarity, these typologies are illustrated in two separate maps. See Map 2-1 for eligibility criteria and Map 2-2 for the criteria relating to financial systems, quality of government and urban and rural classification.

Map 2-1: Convergence and Phasing Out (C+PO) and Regional Competitiveness and Employment and Phasing-In (RCE+PI)



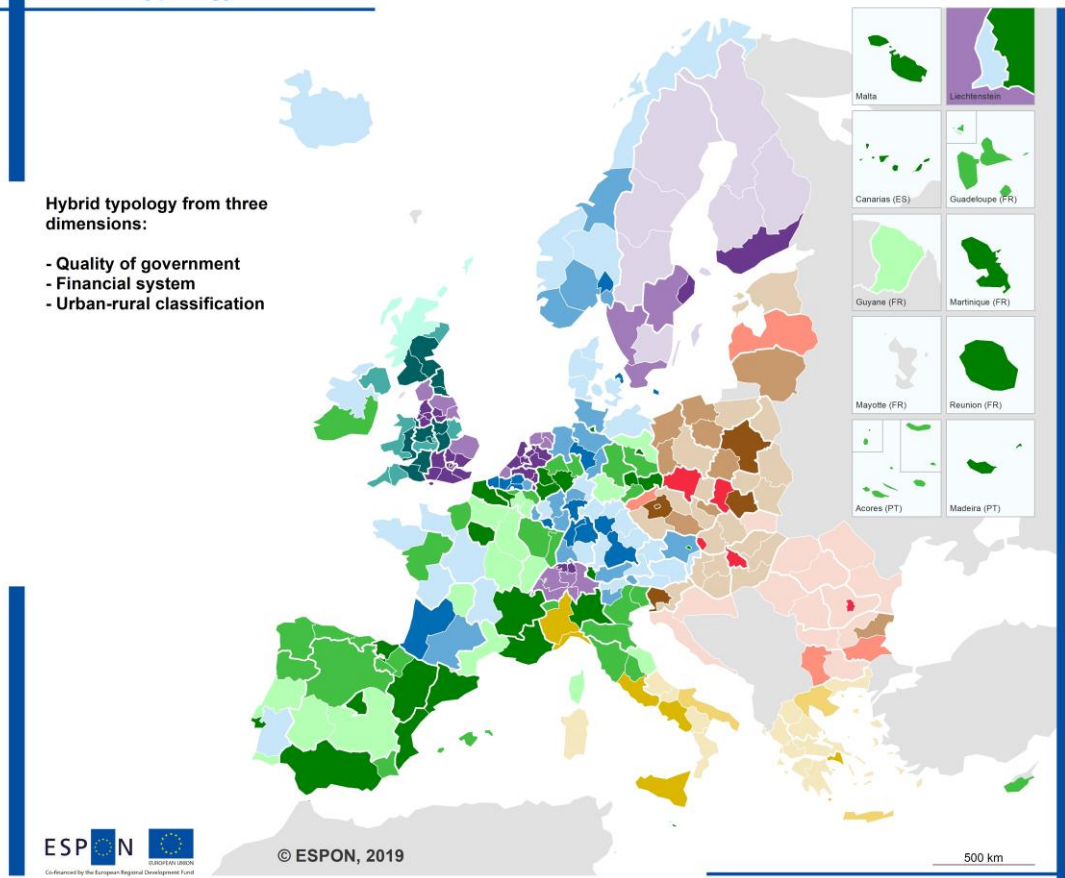


Map 2-2: Quality of government, financial system and urban-rural classification

**NUTS 2 typology**

Hybrid typology from three dimensions:

- Quality of government
- Financial system
- Urban-rural classification



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Regional level: NUTS 2 (2006 except HR 2010)  
Source: Financial instruments and territorial cohesion  
Origin of data: De Beer et. al (2014); Moritz et. al (2015);  
Charron et. al (2015); Eurostat  
© UMS RIATE for administrative boundaries

	QoG	Finance	Urban/rural	
	high	bank based	urban	No data
	high	bank based	intermediate	
	high	bank based	rural	
	high	market based	urban	
	high	market based	intermediate	
	high	market based	rural	
	medium	bank based	urban	
	medium	bank based	intermediate	
	medium	bank based	rural	
	medium	former socialist	urban	
	medium	former socialist	intermediate	
	medium	former socialist	rural	
	medium	market based	urban	
	medium	market based	intermediate	
	medium	market based	rural	
	low	bank based	urban	
	low	bank based	intermediate	
	low	bank based	rural	
	low	former socialist	urban	
	low	former socialist	intermediate	
	low	former socialist	rural	

Source: authors

## 2.4.2 A framework for analysis

The Terms of Reference also specified a framework to analyse in a comparative way the outcomes produced by financial instruments. This is replicated below.

Figure 2-2: Model regions for the analysis of financial instruments

<b>Based on the geographical specificities (urban, rural, etc.) level of development and financial situation, available infrastructure and governance mechanisms</b>					
Cluster /group 1		Cluster /group 2		Cluster /group 3	
Model region A	Model region B	Model region A	Model region B	Model region A	Model region B
High uptake of FI	Low uptake of FI	High uptake of FI	Low uptake of FI	High uptake of FI	Low uptake of FI

ESPON EGTC – Terms of Reference

The intention of this model is understood to be to compare regions of the same 'type' but distinguishing between high and low 'uptake' regions with a view to isolating – in Task 4 - the impact that the use of financial instruments has had.

The notion of 'uptake' is not defined in the Terms of Reference, but for the purposes of the study has been understood in two ways:

- the *absolute* scale of financial instruments measured by the EU amount invested by FIs in final recipients in the region
- the *relative* importance of financial instruments measured by the EU amount invested by FIs in final recipients in the region as a proportion of total payments under the relevant OP.

In practice, a number of factors render this matched pairing approach to assessing the impact of financial instruments problematic – indeed, early assessments of the data made clear that the approach outlined in the Terms of Reference could not yield credible results. This for a number of reasons. First, the overall scale of financial instruments is small – too small to conclude that their use has had any discernible macro effects. Second, specific indicators on financial instruments are only rarely collected and available; where they are available their quality and definition does not lend itself to generalization across a cluster or group of regions. Third, 'uptake' of financial instruments is comprised of expenditure on financial products of different types operating over different timescales and, notwithstanding the development of regional typologies, varying economic, institutional and political contexts, none of which can readily be controlled for in assessing the potential impacts of instruments with very modest levels of spend.

Notwithstanding these issues, the regional typologies *are* a useful way to explore differences in the uptake of financial instruments, the key drivers, the policy choices made and the added value achieved; however, the basis for analysis focuses on the differences *between* groups, where distinct patterns emerge, and not *within* groups of the same type.

## 2.5 Task 4: The added value of financial instruments at territorial level

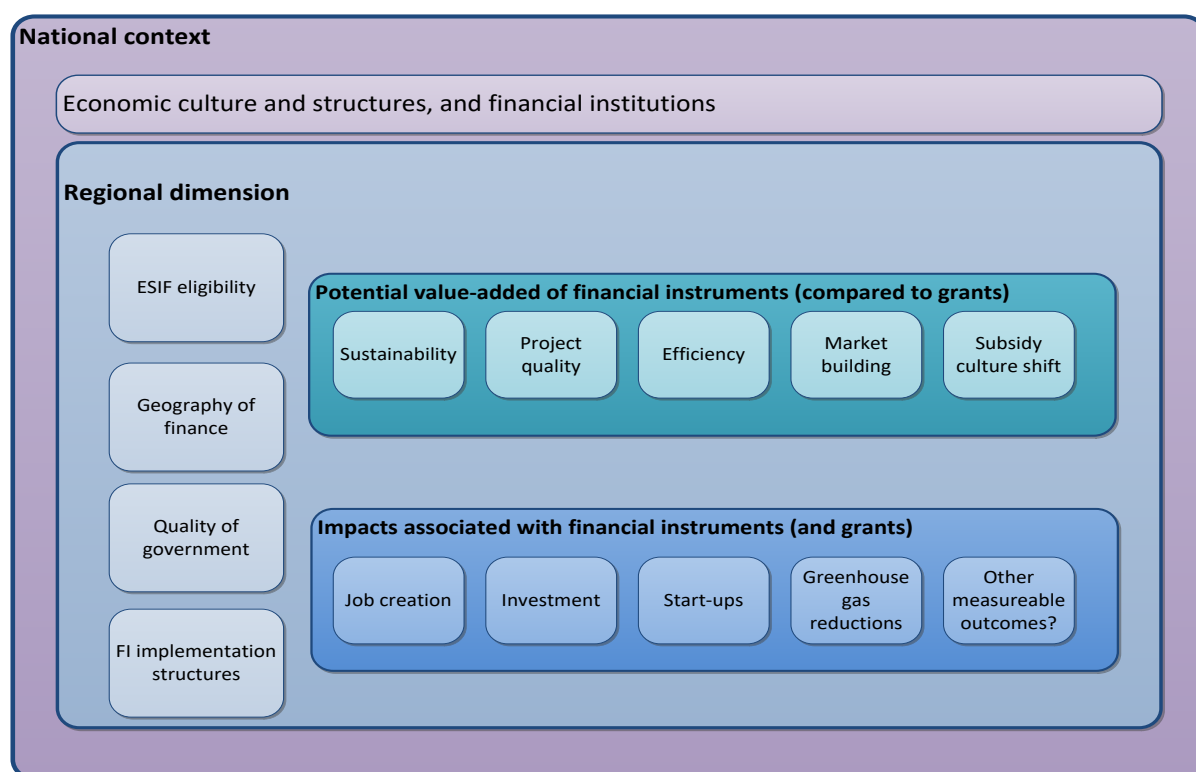
The overall aim of this study is to ‘provide evidence on what the increasing shift to using financial instruments implies for the objective of territorial cohesion and whether using financial instruments as a complement to grants is a more effective way to implement ESI Funds in terms of added value for territorial development.’

A first step was to explore the concepts of added value and impact as they apply to financial instruments. The analysis of the *added value* of financial instruments focuses on issues of sustainability, efficiency and quality, these being the main rationales for using financial instruments, as opposed to grants (see Section 3.3 below). In terms of *quantitative* measures, legacies and returns are suitable indicators for sustainability, and management costs and fees and leverage for efficiency. For quality, no comparative quantitative measures are available, but this was considered in the case studies (see 2.6).

As regards *impact*, the number of jobs created is the only measure for which data is widely available. Other data that measure impact of financial instruments specifically are only quantified for a relatively small selection of funds and programmes, as identified in the managing authority survey. This information can provide anecdotal insights, but does not lend itself to quantitative analysis owing to definitional, comparative and quality issues.

In addition, the achievement of ‘softer’ policy outcomes specific to FIs such as changing subsidy culture and developing local financial markets can be important outcomes from the use of financial instruments – and past studies show that such effects are real and valued. However, they cannot readily be quantified and may take different timespans to achieve in different regions. The key elements are summarised in Figure 2-3.

Figure 2-3: Financial instruments and territorial cohesion: a framework for analysis



Source: authors.

## 2.6 Task 5: Case studies

Given the complexities of financial instruments and the absence of comprehensive quantitative data, the qualitative component of the study is important. Five case studies were carried out on regions with experience with ESIF FIs which could provide insight on what might be expected elsewhere in Europe. The case studies were selected in consultation with ESPON EGTC and the Project Support Team and are as follows:

1. Italy: FI within the ROP Lombardia 2007-13;
2. Sweden: FI within the Mellersta Norrland OP 2007-13;
3. Spain: FI within the ERDF ROP Andalucía 2007-13;
4. Norway: providing a non-EU perspective within the ESPON membership;
5. Poland: FI within the ROP Wielkopolskie 2007-13;

The case studies were prepared using desk research and face to face interviews with stakeholders. The approach was tailored on a case-by-case basis, as the financial instruments selected represent a heterogeneous group. While all selected cases apart from Norway have experience with ESIF FIs,<sup>9</sup> they have been selected to ensure representation of

<sup>9</sup> Represented by high levels of commitments to financial instruments, either in absolute terms or as a percentage of OP Programme expenditure.

different types of regions/cluster type, a geographical balance across the EU, and different types of FIs in terms of thematic coverage. Each of the case studies can be considered as an 'outlier', in the sense of being a leading user of FIs, a 'pioneer', or an innovator in terms of the use of FIs.

## **2.7 Task 6: Policy proposals**

Task 6 draws on the various elements of the study. The desk research, survey work, analysis of added value and case studies were complemented by two events organised by the project team at the European Week of Regions and Cities in October 2018. The events provided both a 'bottom up' practitioner perspective on experience with FIs and hopes for the future, and a 'top-down' institutional perspective on the FI reforms under debate.

### 3 Financial instruments: definitions and rationales

#### Key points

- The term ‘financial instrument’ is used quite loosely, but includes an array of financial ‘products’ – loans, guarantees and equity.
- These products have many variants and have little in common with one another, save the principle that unlike grants the capital is repayable.
- The main rationale for public intervention in economic development policy is to support activities that the market will not undertake alone or at all.
- Financial instruments are only suitable as tools of public intervention where the investment is potentially income generating or cost saving.
- Financial instruments have a number of benefits over grants.
- They are more sustainable because capital is repaid and can be reinvested.
- They may generate higher quality projects because of the commitment to repay funds and through the due diligence of commercially-oriented fund managers.
- They may make more efficient use of public funds if they can attract private sector investment.
- Financial instruments may offer wider benefits, such as helping the development of local capital markets and challenging a ‘subsidy culture’.

#### 3.1 What are financial instruments?

The term **financial instrument** is used quite loosely, and often interchangeably with **financial product**. The conventional breakdown of financial products distinguishes loans, guarantees and equity, but there are variants on these and scope to combine them. In practice, the only commonality between the three groups of products is that, unlike grants, funding is in principle repayable and can be recycled.

**Loans** are comparatively easy to administer from a public administration perspective. The implementation of a loan fund can be “outsourced” to financial intermediaries or financial allocations can be used to increase the finance available through sources such as national and regional promotional banks. Loan products can help address credit rationing, as well as cost-of-credit issues (through interest rate subsidies or easier terms). Loans are often preferred by SMEs because there is no loss of control or ownership, but they can lack the flexibility required by young firms.

**Guarantees** are arguably the most straightforward financial product to design, implement and recalibrate as economic development needs change. They have most potential for impact where collateral-based lending is the norm and the business population is not asset-rich. The use of guarantees (in domestic and Cohesion Policy) is significant in only a few countries, and the sums covered are, on average, often modest, partly because they are frequently

combined with loans in microfinance packages for start-ups and young firms. However, where they are used, their reach can be significant in terms of the numbers of final recipients.

Publicly backed **equity or venture capital** is the least used of the three conventionally defined financial products and is often regarded as a specialist product for potentially fast-growing and/or innovative firms. Unlike in the US, equity and venture capital are not prominent sources of finance for SMEs in Europe, especially smaller ones. Equity products can provide significant amounts of medium- to long-term capital, but imply at least some loss of management control by founders and are typically more difficult to manage for public authorities.

### 3.2 The rationale for intervention and the role of financial instruments

In broad terms the **justification for public intervention** in economic development policy is to support activities that the market cannot or will not undertake alone, but which are considered in the wider public interest. The situations in which this can arise can be grouped into four main categories (Meiklejohn, 1999; Wislade *et al*, 2017), though two or more of these may be present at once.

First, the provision of **public goods** – those that are considered ‘non-excludable’, i.e. access to goods and benefits from which cannot be restricted to those who fund them, so there is no efficient private market for them. Classic examples include street-lighting and lighthouses.

Second, the supply of **merit goods** – those goods and services where public authorities consider they need to intervene to ensure provision at optimal levels. Examples include aspects of education, culture, health services, museums and libraries.

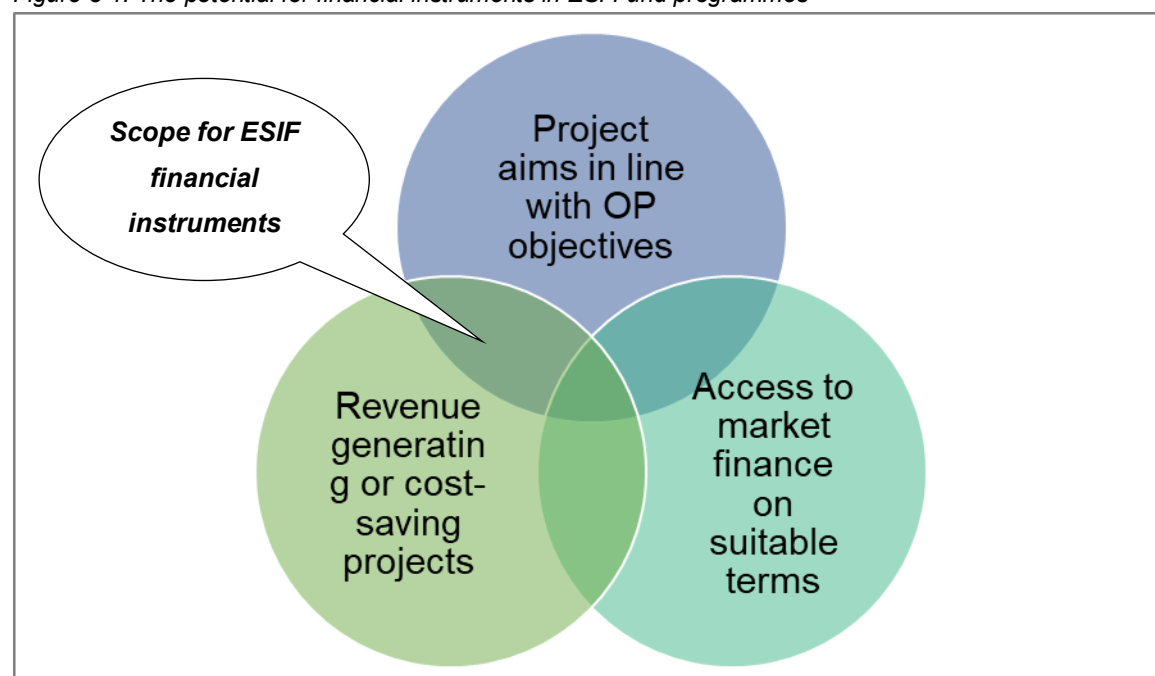
Third, the presence of **externalities** – the idea that the actions of an individual or a firm have spillovers which affect others, but which are not reflected in market prices. In other words, commercial assessments of returns on investment do not necessarily capture the wider societal or longer term benefits. Conventional examples are: research and development, where undertakings may be deterred from spending on R&D because they cannot reap all the gains from their investment (assuming it is successful at all), but others might ‘free-ride’ on their innovation; and vocational training, where the incentive to invest in firms’ staff skills may be limited because it increases the likelihood of employees being ‘poached’ by others.

Last, **imperfect information** – situations where certain types of project cannot obtain private finance at all or at affordable cost because banks or investors have insufficient information to assess risks accurately, or the costs of obtaining that information make transaction costs too high. Information asymmetries can be particularly acute among start-ups, who have no track record and new firms in high technology sectors, where the risks are difficult to assess precisely because their activities are innovative. Such firms often lack the collateral needed to secure capital, or the cost of capital is too high because of their risk profile; as a result, access to finance is likely to be especially difficult for certain categories of SME, notably start-ups, small and/or young firms and high tech enterprises (Siedschlag *et al*, 2014).

Assuming there is a rationale for public *financial* intervention (as opposed to regulatory measures, for example), the next question is **what form of intervention is appropriate?** The rationales outlined above suggest that, in general, FIs will be least appropriate in the case of public goods and most applicable in the case of imperfect information. In an ESI Fund context, financial instruments can be suitable as a policy delivery tool alone or in combination with grants where projects address Operational Programme objectives and the investment has the potential to generate revenue or savings to repay the capital advanced, but where the market is unwilling or unable to advance the capital either at all or on suitable terms. Another important consideration is the role of an incentive effect – will potential project promoters' behaviour be altered by the offer of a grant or will this represent a windfall gain? In summary, financial instruments may be more suitable policy tools than grants where:

- the **project has potential to generate revenue** (or costs savings) to repay the capital made available (this is an essential prerequisite, probably ruling out using FIs for the provision of public goods).
- the **private sector cannot provide the amount of capital required at an acceptable cost** for projects that contribute to policy objectives to go ahead (private finance may be available, but the costs and conditions are too onerous).
- the **need for incentives is limited** – the project promoter is persuaded to undertake the project, but lacks funds (implying that the issue is lack of finance, not cost of finance).
- the **amount of funding required is higher than could be covered by a grant** (due to State aid rules) and/ or relates to working capital requirements (also constrained by State aid rules, which relate to fixed capital investment).

Figure 3-1: The potential for financial instruments in ESI Fund programmes



Source: authors

While there is *potential* for the use of financial instruments across a range of policy areas and for a number of types of target recipients, there are significant areas of policy intervention where FIs are not suitable. This is not fixed in time or space: in some regions it may be



feasible to fund some types of investment through FIs whereas in others grant funding is needed; over time the use of FIs may become more mainstream, and / or more sophisticated, and ultimately may be replaced with more private sector finance.

Importantly, the rationales for intervention, the nature of the market imperfection and their impact on target recipients vary widely between policy objectives, so financial products (loans, guarantees, equity etc.) must be tailored to the needs of target recipients (Figure 3-2).

Figure 3-2: Target recipients, market imperfections and rationales for FI



Source: Wishlade et al (2017).

### 3.3 The potential benefits of financial instruments over grants

Three main arguments have been advanced by the European Commission for the use of financial instruments in ESI Funds, in place of grants (European Commission, 2012).

**Sustainability.** Because funds are, in principle, repaid, they can be reinvested for the same purpose in the region, generating the same or similar gains for the locality more than once,

unlike grants which not only may involve a windfall gain, but are also, by definition, not repaid. That said, the sustainability of FIs depends on a number of factors, including projects being sufficiently successful to repay the funds and management costs and fees at a level that do not erode returns, at least excessively.

**Efficiency.** Because financial instruments may have the capacity to attract private sector capital, they may increase the efficiency of public spending by leveraging in private capital. They may also cost the public sector less to administer than grants because of the involvement of financial intermediaries. On the other hand, the capacity to attract private capital may be doubled-edged – success in attracting private capital may be indicative of crowding-out private markets.

**Quality.** Because support has to be repaid, project promoters may undertake more robust analyses of project viability and be more committed to project success than for non-reimbursable support. In addition, the due diligence required from financial intermediaries may result in improved project quality and greater contributions to OP objectives. At the same time, tightly drawn funding agreements with financial intermediaries may result in project selection criteria that are scarcely different from commercial terms, limiting the added value induced by publicly-funded FIs.

In addition, some ‘softer’ benefits from financial instruments can also be claimed. In particular, FIs may contribute to ***the development of local financial markets***, particularly when combined with other instruments such as those supporting the development of business angel networks. Also, use of close-to-market measures and involvement of financial intermediaries may stimulate local financial markets to step in, lowering the need for public intervention longer term. The ex-post evaluation of ERDF financial instruments for SMEs (Wishlade, Michie, Familiari, Schneidewind and Resch, 2016) found that long-term use of FIs in the north-east of England had supported the emergence of a distinct regional financial intermediary sector in a disadvantaged part of England; and in Estonia, ERDF cofinanced housing renovation loans were discontinued in 2014-20 because the private sector had stepped in having observed a market opportunity developed during 2007-13 where none was perceived to have existed before (Wishlade, Michie and Vernon, 2017). In addition, a shift towards financial instruments may also result in a **cultural change away from subsidy dependency** towards greater acceptance of market-based finance. Such effects are more difficult to quantify, but evidence from recent studies supports their existence (Wishlade, Michie, Familiari, Schneidewind and Resch, 2016).

The effects, or potential effects, outlined above are specific to FIs. In addition, **FIs would also be expected to generate the same types of outputs in relation to OP objectives as grants**, including job creation, investment, new business starts, greenhouse gas reductions. Clearly the nature of such outputs will differ according to the projects financed. However, there is currently no analysis of the extent to which different instruments are associated with different outputs, and the absence of systematic collection of indicators by instrument means

it is unclear whether the *form* of intervention itself has an impact on meeting these aims. While there is no *a priori* reason to suppose that a euro spent in the form of a financial instrument would generate more jobs than a euro invested in the form of a grant for the same purpose, it can be argued that *even if the outputs are the same, FIs have more impact because of their revolving nature.*

The **relationship between grants and financial instruments** is rarely well articulated in policy. FIs are often perceived as a solution for difficulties in accessing finance, rather than as an alternative, or complementary policy delivery tool. FIs are only suitable for projects which generate revenue or cost savings, hence the focus on business support, urban development and low carbon economy; grants can only partially cover investment requirements, owing to State aid rules, but can provide an incentive to alter behaviour, for instance by funding feasibility studies or subsidising investments considered in the wider public interest. There is a need for the support offer to be coordinated (e.g. FIs will not be attractive when grants are available for similar purposes) and a plethora of schemes causes confusion for recipients (Evans, 2013). While the grant-FI relationship has not received much attention in the past, there are signs that this is rising up the agenda following the wider use of FIs in 2007-13. Some MAs perceived FIs as improving the capacity of Cohesion policy to meet targets, with a key benefit being the deterrence of grant dependency, the development of an “entrepreneurial culture” and support for (niche) market development. (Wishlade et al, 2016).

## 4 The territorial dimension of financial instruments

### Key points

- Little is known about the spatial incidence of Cohesion policy financial instruments.
- The geographies of finance and of administrative capacity are important to the exploration of the territorial dimension of FIs.
- At *national* level the geography of finance is shaped by domestic institutional financial contexts like the role of the public and private sectors in providing investment capital.
- There are significant differences in the geography of finance *within* countries with more remote and rural areas typically being disadvantaged.
- Administrative capacity is key to the ability to implement financial instruments, but quality of government tends to be lower in more disadvantaged areas.

### 4.1 The importance of spatial considerations

Much has been written about the implementation of financial instruments (FIs) under Cohesion policy since they rose to prominence in 2007-13. However, this has focused on the challenges involved in their implementation and little of it has had an explicitly spatial dimension. In part, this owes to the relative novelty of FIs as a delivery mechanism, leading to a steep learning curve for Managing Authorities (MAs) in setting up FIs, so that debates have been dominated by issues of *process* rather than of *substance*. This **study is an opportunity to address the ‘territorial gap’ in financial instrument research.**

Although Cohesion policy applies in all regions, the emphasis is on those facing obstacles to development. Typically these include low administrative capacity, a low rate of entrepreneurship, underdeveloped financial markets, and low density population. Central to this study is the hypothesis that many of the obstacles to development in disadvantaged regions are precisely those that make the delivery of policy through FIs challenging. In short, the implementation of FIs and their contribution to territorial cohesion lies at the nexus of the geography of finance and the quality of government. This study eschews an explicit definition of territorial cohesion which has been studied in depth through ESPON already (ESPON, 2013), focusing instead on a range of spatial dimensions relevant to FIs in Cohesion policy.

Importantly, in the context of this study, the **territorial component of Cohesion policy was diluted** from 2007 when it became an ‘all-region’ policy, more explicitly addressing horizontal objectives linked to the European 2020 agenda. Cohesion policy still retains a spatial dimension, reflected in the scale and intensity of funding for the less-developed regions, but the fine-grained discrimination outside these regions has disappeared. This is important, and especially so in the context of financial instruments, because little is known about the spatial incidence of FIs. There are, however, reasons to think that the uptake of FIs within an Operational Programme (OP) may be skewed towards the more developed areas – with the

risk of both crowding-out the private sector in such areas, as well as exacerbating existing infra-regional or infra-national disparities, depending on the spatial scope of the OP.

## 4.2 The geography of finance

At a general level, **access to finance is inherently spatial**. This is true at national and subnational levels. The *national* context is important: access to finance is conditioned by broad models of capitalism and the role of the State in investment finance. In their seminal work Hall and Soskice (2001) develop a framework to understand commonalities and differences between institutions in different economies. They distinguish liberal market economies (LMEs), epitomised in Europe by the United Kingdom, and coordinated market economies (CMEs), such as Germany, and suggest that a Mediterranean cluster might also be distinguished. Nölke and Vliegenthart (2009) expanded the typology to include dependent market economies (DMEs) typified by the VISEGRAD countries, but potentially including Romania (Ban, 2013). Others have suggested that the Baltic countries constitute a 'state-crafted neoliberal model' (tending towards the LME model), while Slovenia follows a neo-corporatist pattern (Bohle and Greskovits, 2007) more akin to coordinated market economies. Among other things, these models differ according to the primary means of raising investment capital, with LMEs more reliant on capital markets, CMEs tending towards domestic bank lending and internal funding, and DMEs drawing more on foreign direct investment and foreign-owned banks.

Alternative approaches have also been proposed. Amable (2003), pre-dating eastern enlargement, distinguishes market-based, continental, social democratic and Mediterranean capitalism. Specific characteristics related to access to finance are identified, notably the sophistication of financial markets, the role of banks, the development of venture capital, the availability of patient capital and the role of public intervention. The resulting clusters are not watertight or geographically comprehensive but they illustrate **the diversity of institutional financial contexts**. Looking specifically at how national financial systems influence SME finance Moritz *et al*, (2015) distinguish between bank-based, market-based and former socialist countries, covering EU28 (except Malta) and Norway (see Table 4-1). They show that SME financing differs more *between* these country groups than by firm, product or industry-specific characteristics. They also argue that government support programmes can only be effective if they take account of both SME characteristics **and** national supply-side conditions. In short, **national financial systems matter**.

Table 4-1: Financial market systems and SME financing

	<b>Bank-based</b>	<b>Market-based</b>	<b>Former socialist</b>	<b>Total</b>
<b>Main source of SME finance %</b>	AT BE CY DE ES FI FR GR IE IT LU NO PT	FI NL SE UK	BG CZ EE HR HU LT LV PL RO SI SK	
<b>Mixed</b>	16	24	15	17
<b>State-subsidised</b>	9	3	6	7
<b>Debt-financed</b>	19	12	11	16
<b>Flexible debt</b>	15	11	10	13
<b>Trade financed</b>	15	21	12	15
<b>Internal finance</b>	27	29	45	31
<b>Total</b>	100	100	100	100

Source: Moritz et al (2015: 25).

The national financial context affects issues such as availability of finance *per se*, but it also provides the institutional framework for the implementation of FIs. **The domestic landscape for FIs is complex, varied and opaque** (Wishlade et al 2017). Some countries have longstanding sophisticated structures which provide experienced mechanisms for disbursing ESIF cofinanced FIs. In others, new national promotional banks (NPBs) are in the process of being established in response to the aftermath of the financial crisis. In some central and eastern European countries ESIF funding is the mainstay of economic development policy and may also be a significant component of the resources of NPBs. Elsewhere the picture is more fragmented, with niche funds, regional and sectoral banks and other financial institutions playing various roles.

While the national level provides an important backdrop, a strand of entrepreneurship research shows that there are **significant differences in the geography of finance within countries**. Scholars have pointed to disparities between regions in the availability and type of investment capital available to firms due to the effects of space and place (Mason and Harrison, 2002; Berggren and Silver, 2012; Mason, 2012). The **physical distance** between firms and investors or lenders affects relations between them and investment flows. In the case of loan finance, larger distances between small business borrowers and their banks reduce in-person visits by bank staff, exacerbating information asymmetries. This increases the risk of poor investment decisions leading to higher default rates (Degryse and Ongena, 2005; DeYoung et al, 2008), but also the exclusion of viable investments from access to finance.

Related, **financial institutions have their own geographies**. Local and regional banking systems are more supportive of local economies because of vested interests in the local economy and lower information asymmetries; local banks are better at meeting the credit needs of local SMEs (Zhao and Jones-Evans, 2017). Local banks derive informational advantages from their proximity and close relationships with borrowers, and this is reflected in lower interest rates and collateral requirements (Jimenez et al, 2009; Casolaro and Mistrulli, 2008). However, in recent decades banking systems have become increasingly centralised in many countries, partly because of changes in the regulatory framework. One example of this is in Italy, where the decline in local banks has had particularly adverse effects for the *Mezzogiorno* (Alessandrini and Zazzaro, 1999; Alessandrini et al, 2009). Recent research on

Spain highlights a decline of 30 percent in the number of bank branches since the financial crisis, with potentially significant regional impact. The decline in bank branches is partly due to the conversion of *Cajas* into for-profit banks. *Cajas* had been established as not-for-profit entities in the 19th century with a social and economic development mandate in the regions, and played an important role in microfinance, especially in rural areas with low demand density and low-income communities (Martin-Oliver, 2019).

**Different forms of finance have different territorial patterns:** the concentration of venture capital investors in particular regions means that the local business community has much more knowledge of the role of venture capital and ways to access it, thus stimulating demand, whereas in regions with few venture capital firms knowledge is weak and incomplete, reducing demand and the prospects of success for those firms that do seek venture capital (Martin et al, 2005). Business angels and venture capital are also characterised by localised investing because of the need for 'soft' information that cannot readily be standardised or automated (Mason, 2007; Cumming and Dai, 2010; Avdeitchikova, 2009; Harrison et al, 2010). Longer distance flows of venture capital *do* happen, but generally through syndication with local investors. As a result, such flows gravitate towards regions that already have significant sources of their own (Florida and Smith, 1991; Sorenson and Stuart, 2001).

### 4.3 Quality of government and administrative capacity

The capacity of public policy to respond to regional disadvantage in the geography of finance is contingent on **quality of government**. Recent research has highlighted wide divergences in the quality of government within countries, as well as across the European regions as a whole. There is a broad correlation between levels of economic development and quality of government (Charron et al, 2013). Places with weak and/or inefficient institutions suffer from a variety of problems including corruption, rent-seeking, clientelism and nepotism and principal-agent or information problems. These lead to imperfectly functioning markets, lower efficiency and growth potential, and to institutional and government failure, affecting the capacity of governments to design and deliver public goods and policies. Moreover, *where Cohesion expenditure is higher, the importance of quality of government also increases* so that in regions where support is highest – over €120 per head per annum - the most efficient way to achieve greater economic and social cohesion is by improving the quality of government (Rodriguez-Pose and Garcilazo, 2015).

Issues of quality of government are especially pertinent in the context of financial instruments because of the challenges involved in their implementation. These have been well-documented generally (Mazars et al 2013; Nyikos 2016), in the context of support for SMEs (Wishlade et al, 2016) and in the case of FIs for energy efficiency and renewables where the challenges are even greater because of the specialist technical expertise also required (Wishlade et al, 2017). Managing authorities across the EU, irrespective of quality of government and including those with substantial experience of running co-financed FIs, find aspects of FI implementation difficult. Because of the correlation between quality of

government and levels of economic development, **disadvantaged regions are doubly disadvantaged**: access to finance is generally harder in the more disadvantaged areas, and these same regions may lack the administrative capacity to implement public policy measures to compensate for shortcomings in the geography of finance.

Also relevant is the **tier of administration** at which FIs are managed and implemented. In many countries FIs are funded from regional OPs and, self-evidently, apply to that region. In others, FIs are implemented under national or multiregional OPs and therefore straddle several regions; under other arrangements, several OPs contribute to nationally-managed funds. In addition, the 2014-20 Common Provisions Regulation introduced an option for MAs effectively to pool some of their resources into EU-level or joint instruments such as the SME Initiative where implementation is 'delegated up' to the EIB group. Such pooling or centralisation can help address some of the administrative and regulatory challenges of FI implementation. However, a clear lesson from evaluations and past studies is that FIs must be tailored to local needs and conditions (Veugelers, 2011; Tykvová et al 2012; Berggren and Silver 2012; Michie and Wislade 2011). A key policy question is whether and how it is possible to **reconcile centralised administration and local responsiveness**.

Comparatively little is currently known about the **spatial incidence of ESIF and other EU financial instruments**; indeed, it is an objective of this study to understand this better. However, there are reasons to think that the combined effects of the pressure to absorb funds, together with the greater density of investible projects might lead to investments being concentrated in the more prosperous areas within an OP area; the extension of Cohesion policy to all regions arguably increases this likelihood. There is an analogous situation in the European Fund for Strategic Investment (EFSI), under which, reflecting the market-led nature of the instrument, a larger share of investments is located in the more prosperous Member States (ECA, 2019), even though investment policy is ostensibly spatially neutral. There is also at least anecdotal evidence of crowding out of commercial finance.<sup>10</sup> At the same time, the regulatory requirements for EFSI and EU level instruments, such as COSME, are less demanding than for FIs under shared management, so that, perversely from a Cohesion perspective, *regions where ESIF are the main funding source for FIs are subject to tougher rules*.

#### **4.4 Financial instruments and territorial disadvantage**

This links to the **role of financial instruments in disadvantaged regions**, how the advantages claimed for FIs play out in different conditions and what this might mean for the roles of and relationship between grants and FIs. There are several aspects to this.

First, it is important to note that the **term 'financial instruments' encompasses financial products that have little in common among themselves** except that, unlike grants, the

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<sup>10</sup> As discussed at EAPB workshop on the role of public banks in supporting smart and resilient infrastructure as part of the European Week of Cities and Regions, 11 October 2017, Brussels.



capital advanced is repayable; this in turn means, of course, that FIs are only suitable for investments that are *at least potentially revenue-generating or cost-saving*.

Second, there is evidence that different types of **publicly-backed financial products can have limitations in terms of supporting disadvantaged regions**. This is most evident in the case of regional venture capital funds where the typical approach of governments has been to establish hybrid funds with private sector fund managers which comprise a mixture of public and private money, with private investors given certain incentives (Murray, 2007). However, it is debatable whether constraining funds by restricting their investments regionally is good practice (Veugelers, 2011), mainly because this typically results in small amounts of capital under management, in spite of generous incentives for private sector investors (Murray, 1998; Mason and Harrison, 2003 Growth Analysis, 2011). Small funds generally have a number of disadvantages, including relatively high management costs, limited scope to diversity and spread risk, and constraints on follow-on investment (ECA, 2012). However, it has also been argued that the real problem facing regional public sector venture capital funds is one of 'thin' markets in disadvantaged regions - these regions lack an appropriate ecosystem to support venture capital investing. In other words, it is not simply a problem of demand or supply (Nightingale, 2009).

Third, and in contrast, **some types of publicly-backed financial product may have more positive effects in disadvantaged areas** than in more prosperous ones. For instance, a study of Small Business Administration guaranteed lending in the US showed a correlation between the level of guaranteed lending and the level of employment in a local market (Craig et al, 2009). Crucially, this correlation was only significant in low income markets, perhaps suggesting a crowding-out effect in more prosperous areas. This also supports arguments for regionally-discriminating guarantee schemes, though these are alleged to be less attractive to commercial lenders.<sup>11</sup>

A further issue is that **the profile of firms in disadvantaged regions is different from that in thriving regions**. This has direct implications for the perceived benefits of FIs, and for the role of grant support, specifically:

**Sustainability:** default rates may be higher in more deprived areas, reducing the size of the legacy available for reinvestment in those regions, while more prosperous regions benefit from recycled funds.

**Quality:** proposed investments or enterprises may be of poorer quality in more disadvantaged areas - evaluations of enterprise creation initiatives in disadvantaged areas in the UK suggest that they are successful in encouraging start-ups, but that those businesses tend to be small, marginal and few of them generate a living wage (Rouse and Jayawarna, 2011).

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<sup>11</sup> As claimed anecdotally at DG REGIO workshop on 'Financial instruments as a delivery mechanism for ESIF post-2020', European Week of Cities and Regions, 10 October 2017, Brussels.

**Efficiency:** it may be more difficult to attract private finance in problem regions and management costs and fees may be relatively higher. Is there a trade-off between leverage and the ability to generate returns? If so, does this trade-off have particular spatial patterns?

**Disparities between regions are reflected in Cohesion policy FIs.** A Managing Authority survey in peripheral maritime regions showed that while 73 percent of respondents in Regional Competitiveness and Employment regions were satisfied with the result of FI implementation in 2007-13, only 44 percent of respondents in Convergence regions felt the same (CPMR, 2016). However, peripheral sparsely-populated areas located in more developed regions still reported poor uptake of FIs.

## 5 Financial instruments in Cohesion policy: scale and governance

### Key points

- Financial instruments have more complex reporting and operational structures than grants; this has implications for data availability.
- The use of financial instruments varies widely between countries (and within them) in terms of scale, product types, policy objectives and governance.
- 25 Member States used financial instruments in 2007-13.
- Some €17 billion in OP contributions was committed to FIs (including €11.5 of Structural Funds), of which €15.2 billion reached final recipients.
- Italy accounted for almost 30 percent of all contributions to financial instruments in 2007-13.
- On **average**, EU Member States committed €426 million (EU amounts) to financial instruments, amounting to 3.4 percent of total Cohesion policy allocations, 0.013 percent of GDP and €23 per head over the period 2007-13.
- There are wide variations around these averages: Italy committed over €3 billion in Structural Funds to FIs, amounting to over 10 percent of its Cohesion policy allocation; in Lithuania, FIs amounted to around 0.2 percent of GDP in 2007-13.
- There are numerous models of governance for financial instruments, partly reflecting the scope of the OPs that offer them, but also involving more complex arrangements than grants.
- In some regions, up to five different OPs offer financial instruments, often for similar purposes.

### 5.1 Definitions and structures of financial instruments in Cohesion policy

A broad overview of the definition of financial instruments was provided in Chapter 2. A complexity of the present study is that reporting on financial instruments under Cohesion policy is framed around the activities undertaken in Operational Programmes and the conclusion of funding agreements between Managing Authorities and fund managers.

Commission analysis of financial instruments distinguishes between **holding funds** and **specific funds** – with both ‘counted’ as financial instruments in the Commission’s Summary of data (European Commission, 2017). The investment activity is at the level of the **specific fund** which may offer one or more **financial products** (i.e. loans, guarantees, equity); in other words, the number of specific funds is *not* the same as the number of financial products offered.

Table 5-1: Number of financial instruments (funding agreements) – EU28 (2007-13)

Number of financial instruments	Holding Funds (HF)	Specific Funds (SF)	SF implemented directly	SF implemented under HF
1058	77	981	469	512

Source: European Commission (2017) Summary of data on the progress made in implementing financial instruments (at closure).

Box 5-1: What is a financial instrument in Commission reporting?

Quantifying the use of financial instruments is not straightforward. FIs were not defined precisely in the 2007-13 Structural Funds regulations. The General Regulation stated that to qualify as a financial engineering instrument, an OP contribution must target the specific final recipients/type of investments referred to in Article 44 (enterprises and urban development funds) and take the form of repayable investments (i.e. equity, loans and/or guarantees). Article 43(2) of the Implementing Regulation specified that co-financed financial engineering instruments must be set up either as independent legal entities governed by agreements between the co-financing partners or shareholders, or as a separate block of finance within a financial institution.

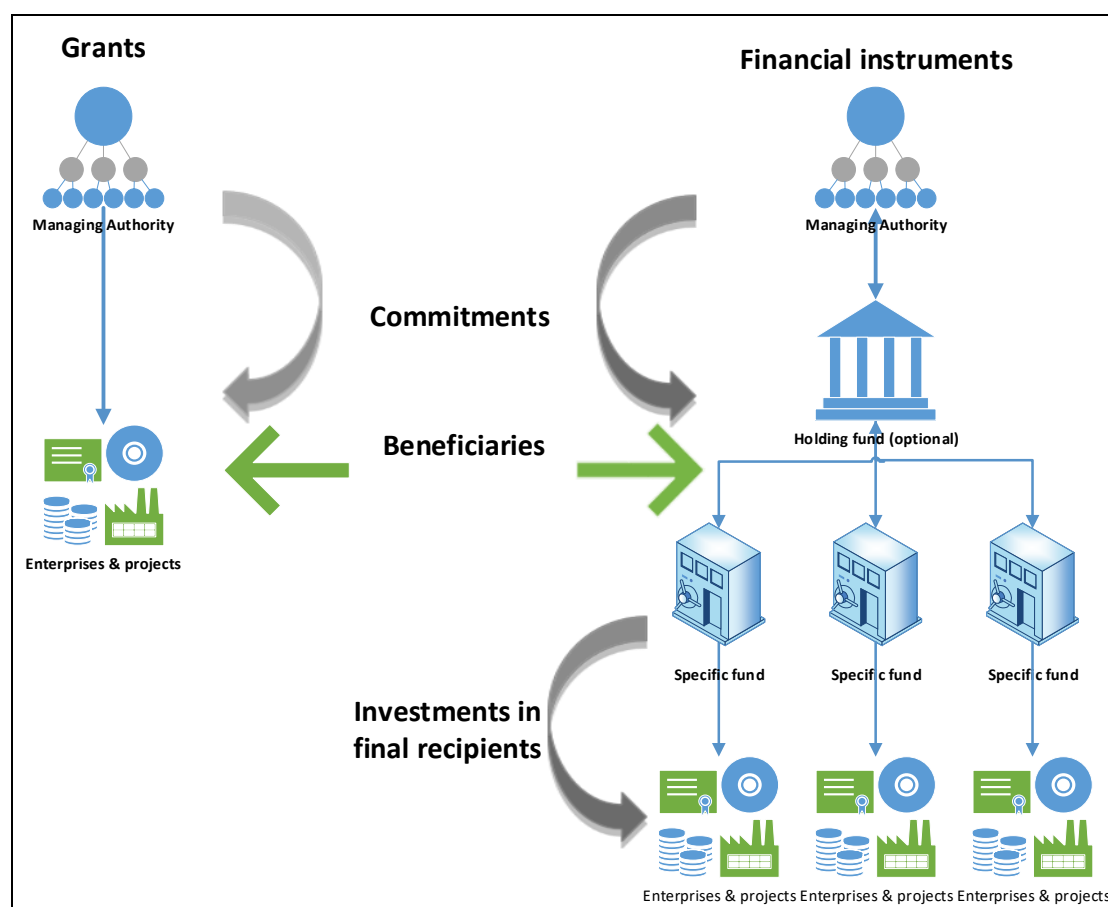
The template monitoring report provided with the February 2012 revised COCOF note (Guidance Note on Financial Engineering Instruments under Article 44 of Council Regulation (EC) No 1083/2006 COCOF\_10-0014-05-EN (12/02/2012)) supplied a form for managing authorities to complete and submit with their AIRs. This invited information on Holding Funds (Form I) and on Financial Engineering Instruments /Financial Intermediaries and provided a box for the 'total number of financial engineering instruments supported (no. of agreements signed)'. Member States have reported different circumstances in different ways:

- funding from two different OPs into one instrument has been reported variously as one FI (e.g. Hungary) or two FIs (e.g. UK).
- some entries represent different tranches of funding to the same FI, but were reported separately, perhaps because they involved a new funding agreement, e.g. Poland.
- a fund implemented locally with the same terms and conditions by many financial intermediaries is reported as many FIs, though it may essentially be only one 'financial product' – e.g. Hungary.

The notion of 'expenditure' is more complex for financial instruments than for grants. This is illustrated in Figure 5-1. For **grants**, commitments are made to the selected firm or project, and this is the *beneficiary* of ultimate payments. For **financial instruments**, commitments are made to holding funds and/or specific funds and these funds are the *beneficiaries*. The firms or projects which ultimately receive the loan, equity or guarantee from the financial intermediary are the *final recipients* of support.

This distinction partly accounts for the over-capitalisation of financial instruments early in the 2007-13 period; Managing Authorities could avoid, or at least postpone the prospect of decommitment under N+2/3 by committing funds to financial instruments. Related, by the end of the 2007-13 period, levels of commitment to FIs in some countries were substantially lower than they had been in previous years. (Wishlade, 2018). This in turn has implications for the concept of 'uptake' which is explored in this study.

Figure 5-1: Financial flows under grants and financial instruments



Source: authors

This distinction between **beneficiaries** and **final recipients** is also important for the data analysis. A critical issue concerns the limited obligations on reporting below the level of beneficiaries: for grants, fine-grained information is available on location, sector, size and other characteristics of the ‘target’ – not least because there are State aid compliance obligations to be met. By contrast, for financial instruments, the information available is much more limited, with very basic information such as the number of final recipients often not systematically reported.

## 5.2 Scale of financial instruments in Cohesion policy

In terms of data analysis, the focus of this study is on 2007-13, largely reflecting that this programme period has closed and therefore improved data availability. The following ‘headline’ figures emerge from this period (European Commission, 2017):<sup>12</sup>

- 25 Member States had established co-financed FIs in 2007-13 (Croatia, Ireland and Luxembourg had not) involving support from 192 OPs (including one cross-border-cooperation OP).

<sup>12</sup> Note that this data was said still to be subject to change as not all final closure reports had been approved by the time of the Summary of data report publication.

- Some €17 billion in OP contributions had been committed to FIs (including €11.5 of Structural Funds), of which €15.2 billion had reached final recipients – an overall ‘absorption rate’ of almost 93 percent of OP contributions, an increase of 20 percent compared to what was reported at the end of 2015.
- 77 holding funds and 981 ‘specific’ funds had been set up.
- Most of the funds provided support to enterprises – and all Member States using FIs supported enterprises; 11 Member States financed urban development and 9 Member States supported energy efficiency.

There are **wide variations** between Member States, both in their use of FIs (commitments) and levels of absorption (investment in final recipients):

- Italy alone accounted for over 29 percent of all OP contributions paid to FIs (€4.9 billion) by end March 2017.
- Other large Member States had also made significant payments to FIs by end March 2017 including Germany (€1.7 billion) and the UK (€1.6 billion); however, payments are not directly related to country size, with Greece and Poland also each paying over €1 billion, but France just €442 million.
- In 18 countries, over 90 percent of monies paid to FIs had been invested in final recipients, with Belgium, France, Lithuania Portugal and Romania all achieving full absorption. The lowest absorption rates are found in Spain (60 percent) and the Netherlands (74 percent), while the cross-border programme FI reported zero absorption.

More generally, there are **significant differences in the importance of FIs**. On **average**, EU Member States committed €426 million (EU amounts) to financial instruments, amounting to 3.4 percent of total Cohesion policy allocations, 0.013 percent of GDP and €23 per head over the period 2007-13. No clear pattern emerges from Table 5-2 which considers different measures of the significance of FIs in relation to EU averages.

Table 5-2: Measuring the significance of OP contributions to FIs (EU amounts)

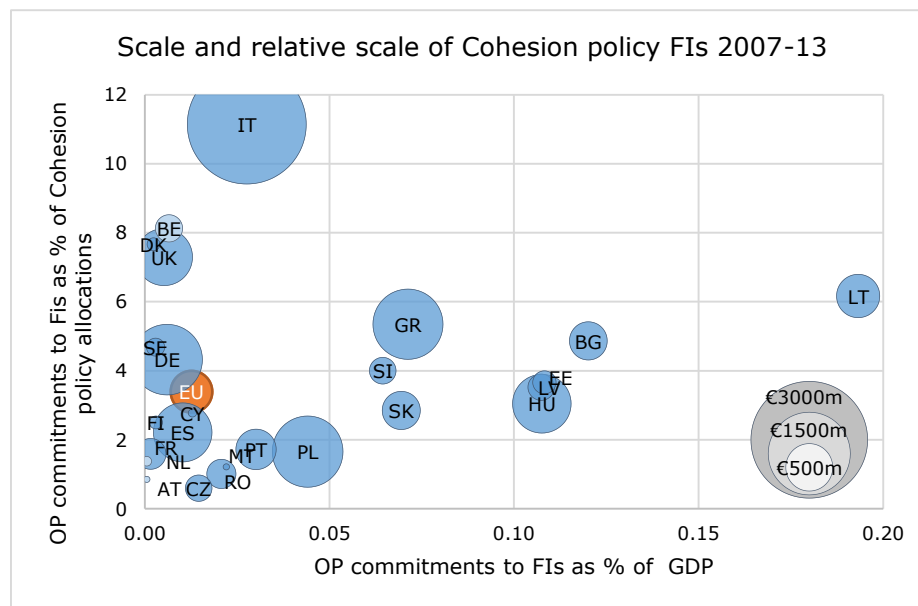
Above EU av. contributions to FIs (€m)		Above EU av. contributions to FIs as % of Cohesion policy allocations		Above EU av. contributions to FIs as % of GDP 2007-13		Above EU av contributions to FIs € per head 2007-13	
EU av	462	EU av	3.4	EU av	0.013	EU av	23
IT	3114	IT	11.1	LT	0.193	LT	135
PL	1113	BE	8.1	BG	0.120	GR	98
DE	1101	DK	7.7	EE	0.108	EE	93
GR	1081	UK	7.3	HU	0.108	SI	80
ES	768	LT	6.2	LV	0.107	HU	76
HU	759	GR	5.3	GR	0.071	LV	76
UK	722	BG	4.9	SK	0.069	SK	60
		SE	4.7	SI	0.064	IT	52
		DE	4.3	PL	0.044	BG	44
		SI	4.0	IT	0.030	PT	35
		EE	3.7	MT	0.028	PL	29
		LV	3.5	RO	0.022	MT	25
				CZ	0.021		
				CY	0.015		

Source: Authors' calculations from European Commission (2017); <https://cohesiondata.ec.europa.eu/>

Nevertheless, it can be said that:

- Italy and Greece made ‘above average’ OP contributions to FIs on all measures.
- Finland, France, the Netherlands and Austria made below average contributions to FIs on all measures (and Ireland, Luxembourg and Croatia made no OP contributions to FIs).
- This dispersed ‘pattern’ is reflected in Figure 5-2, which plots the relative economic importance of FI contributions (percent of GDP) against the share of FIs in the Operational Programme, while illustrating the absolute scale of contributions for each country.

Figure 5-2: The relative importance of Cohesion policy FIs, 2007-13 (EU amounts only)



Note: FIs are not offered in all parts of Belgium, Austria or the Netherlands.

Source: Authors' calculations from European Commission (2017); <https://cohesiondata.ec.europa.eu/>

### 5.3 The governance arrangements for financial instruments in Cohesion policy

ESIF FIs are implemented using **different governance models which operate at different territorial scales**, reflecting the territorial remits of the Operational Programmes but also more complex institutional relations, such as contributions from regional OPs to nationwide FIs. Three categories can be identified, namely those where:

- FIs are operated under **national governance only** – i.e. through OPs where the Managing Authority is part of central government
- FIs are operated under **regional governance only** – i.e. through OPs where the Managing Authority is a subnational authority
- FIs are operated under **both national and regional governance**.

In seven Member States, FIs in 2007-13 were only offered under *national* OPs, reflecting the absence of regional OPs, and governance was on a nationwide basis in the sense that there

was no devolution of responsibility to subnational authorities or explicit earmarking of funds between regions. With the exception of Cyprus, all the countries concerned were covered by the Convergence objective. Within this group there are, however, considerable variations in the use of holding funds, the extent to which ESF is used (in the Baltic countries and Slovenia), the number of funds and the number of OPs offering financial instruments (the Baltic countries and Slovenia all offering FIs under more than one OP).

Table 5-3: National governance of ESIF FIs only (2007-13)

MS	National	OPs offering FIs
CY	1 national JEREMIE HF comprising 4 specific funds	1
EE	No holding funds. 5 ERDF and 1 ESF specific funds	3
LT	1 ESF HF comprising 1 specific fund; 1 JESSICA (ERDF) HF comprising 7 specific funds; 1 ERDF HF comprising 16 specific funds; 1 JEREMIE comprising 5 specific funds; 1 specific fund	3
LV	1 national JEREMIE HF with 10 specific funds; 3 national ERDF specific funds; 1 national ESF specific fund	2
MT	1 national JEREMIE HF with 1 specific fund	1
RO	1 national JEREMIE HF with 3 specific funds	1
SI	1 national HF comprising 2 ESF and 3 ERDF specific funds; 1 specific fund	2

Source: Authors, using European Commission (2017) data.

In seven countries, the governance of FIs was at the regional level only. In France, Sweden and the United Kingdom, this resulted in nationwide availability of FIs through a single ROP in the region. By contrast, in Austria, Belgium and the Netherlands, the policy choices made by ROP managing authorities meant that FIs were not made available in all regions. In Denmark, two national OPs financed FIs, but the implementation of them was at the regional level.

Table 5-4: Regional governance of ESIF FIs only (2007-13)

MS	Regional/Sub-national/other	Coverage
AT	2 ROPs with ERDF specific funds	<i>Partial: 2 Länder out of 9</i>
BE	3 ROPs – 2 in Wallonia (8 specific funds) and 1 in Brussels (1 specific fund)	<i>Partial: no FIs in Flanders ROP</i>
DK	2 national OPs (1 ESF, 1 ERDF) fund 9 regional specific funds (4 ESF, 5 ERDF)	<i>Nationwide</i>
FR	All ROPs have HF and/or specific funds	<i>Nationwide</i>
NL	3 ROPs: 1 JESSICA HF comprising 2 specific funds; 7 specific funds	<i>Partial: 3 out of 4 ROPs</i>
SE	8 ROPs operate specific funds	<i>Nationwide</i>
UK	All ROPs have HF and/or specific funds	<i>Nationwide</i>

Source: Authors, using European Commission (2017) data.

In the remaining countries the situation was more complex. Both national and subnational financial instruments were in place in 2007-13. In some cases, such as Italy and Greece, the 'national' financial instruments only covered part of the territory – this is the case for two



significant Italian multiregional OPs (MOPs) managed by national ministries, but applicable only to the Convergence regions in the *Mezzogiorno*. Similarly, in Greece and Poland, for example, some financial instruments were managed by national authorities under OPs that covered several NUTS 2 regions, but not the entire national territory. Elsewhere, national OPs offering FIs covered the entire national territory (for example Germany and Spain), but FIs could also be operated at the subnational level providing total or partial coverage of FIs under ROPs.

Table 5-5: National and subnational governance of ESIF FIs (2007-13)

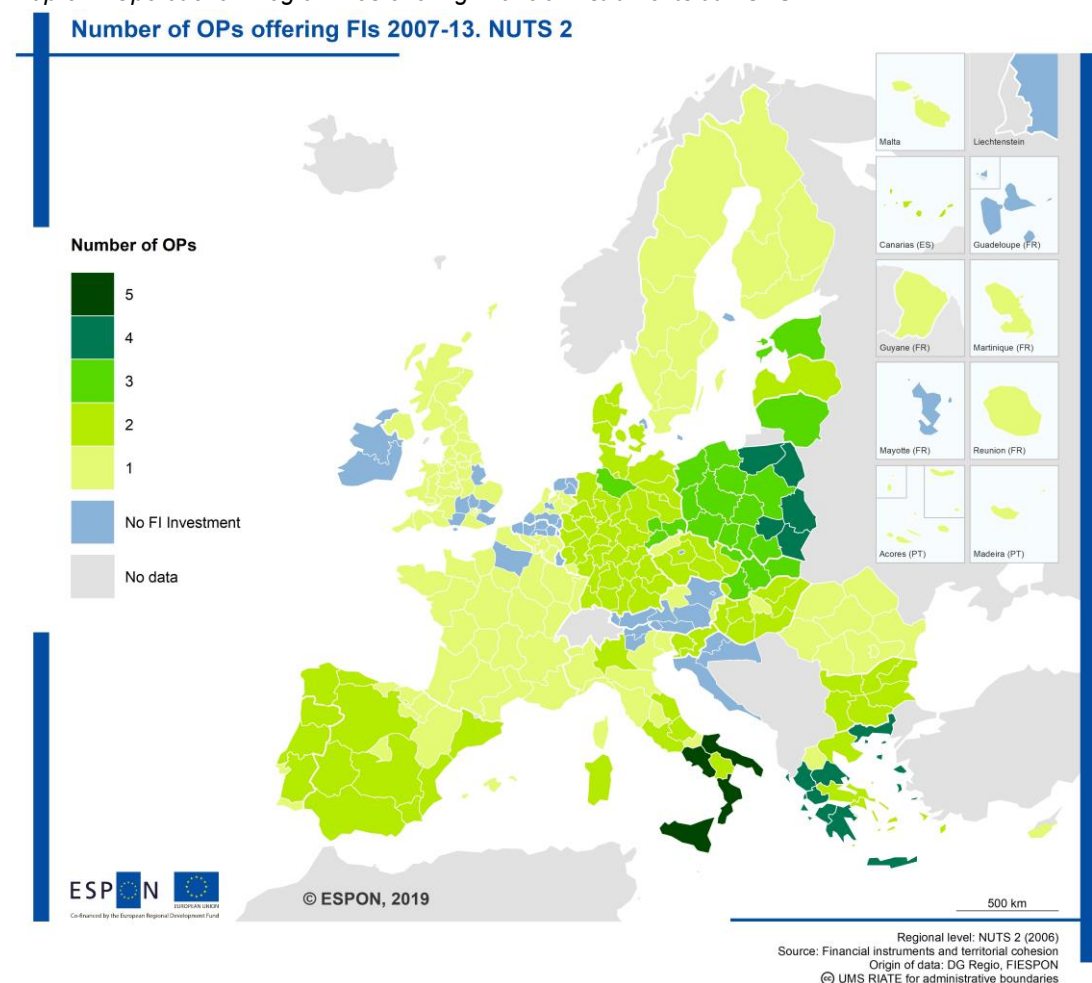
MS	National	Regional/Sub-national/other
BG	National JEREMIE HF with 5 specific funds	A JESSICA with 2 Urban Development Funds (UDF), one specifically for Sofia
CZ	2 FIs under the national 'enterprises and innovation' OP, which does not cover Prague	JESSICA Moravia-Silesia, with 2 UDFs JESSICA Fund for Prague (housing)
DE	4 national ESF FIs	ERDF FIs offered by 14 Lander Includes a JESSICA Fund in Hessen, also other city-based FIs such as 5 FIs in Berlin
EL	Most FIs set up through HFs with contributions from a combination of national (Convergence region only), fully national and regional OPs	Most FIs set up through HFs with contributions from a combination of national (Convergence region only), fully national and regional OPs
ES	1 national OP with FIs	FIs under regional OPs
FI	1 national FI to which 4 regional OPs contribute.	1 regional FI (Oulu)
IT	Several central government managed multi-regional OPs in Convergence regions (Puglia, Campania, Calabria and Sicilia) offer FIs	Many ROPs offer FIs JESSICA UDFs in Campania and Sicily
HU	The NOP Economic Development (which covers six regions and excludes central Hungary) and the Central Hungary (inc. Budapest) ROP both contribute to a HF.	7 regional OPs contribute to a centrally managed FI
PL	ESF NOP with FIs implemented via regional bodies. 1 ERDF NOP supporting FIs, 1 ERDF MOP Eastern Poland only	Many FIs under regional OPs 4 JESSICA FIs (Slaskie, Wielkopolska, Pomorskie, Zachodniopomorskie)
PT	1 NOP with FIs (Thematic factors of competitiveness) - covers Convergence regions only	4 regional OPs with FIs 5 regional OPs contribute to a JESSICA HF
SK	1 JEREMIE HF with 12 specific funds (funded from 3 OPs – one of which covers the Convergence regions only, one of which covers Bratislava only and one nationwide)	See previous – one specific fund under JEREMIE is for Bratislava region only  JESSICA fund funded from 3 OPs, one for Western Slovakia, Eastern Slovakia and Central Slovakia, one for Bratislava and from the Competitiveness and Economic Growth OP for the Convergence regions

Source: Authors, using European Commission (2017) data.

The overall picture in terms of the number of Operational Programmes offering financial instruments is both complex and inconsistent. Moreover, in the national (Table 5-3) and mixed

governance categories (Table 5-5), in particular, multiple Operational Programmes may be offering financial instruments in a given NUTS 2 region, often with similar investment targets and sometimes also with similar financial products. The extent to which multiple OPs offered FIs in the same region is illustrated in Map 5-1. This shows that in Germany, much of central and eastern Europe, and most of southern Europe, at least two OPs are involved in offering FIs. In reality, there may be limited or no overlap, for instance where one programme addresses urban development and another enterprise support.

Map 5-1: Operational Programmes offering financial instruments at NUTS 2



Source: authors

## 5.4 Comparative perspectives?

There is scant discernable or consistent pattern to the scale and governance of Structural Funds financial instruments across the Member States in 2007-13. The extent to which they are used, and how, is the product of a range of factors related to the size of OP allocations, experience with Structural Funds implementation, the presence of subnational structures to implement Structural Funds, domestic use of financial instruments, the existence financial institutions, such as national or regional promotional banks, as well as diverse policy choices and OP priorities.

In practical terms, these factors play out in different way in different countries (and within them). For example, under some OPs the modest scale of allocations led managing authorities to dismiss the use of FIs because of their perceived complexity, as in Flanders (BE), whereas in London the very fact that the ERDF budget was small underpinned the decision to use most of it in the form of FIs that would generate a legacy. Similarly, in some Member States the approach to FIs was to introduce *new* instruments operationalized through *new* implementation mechanisms, whereas in others, Structural Funds funding was used to augment *existing* domestic funding streams under *existing* domestic institutional arrangements.

## 6 The territorial distribution of FIs

### Key points

- Analysing the regional distribution of financial instrument spend is complex because the geography and governance of FIs varies and regional data is not always available.
- In most countries, FIs are offered from a (sometimes overlapping) mix of national, multiregional and regional OPs.
- The focus of the study is on investment in final recipients – firms, urban development projects etc.
- Comparing FIs to grants, regions within Italy, Belgium, Denmark the UK and Greece invested the largest shares of Structural Funds in the form of FIs (but there are marked internal differences within these countries).
- There are marked differences between regions in levels of investment in enterprises, with, in general, much higher levels in the Convergence regions than elsewhere (not including co-financing).
- Investment in urban development and energy projects accounts for a small proportion (about 15 percent) of overall FI expenditure and is concentrated in a few countries only.
- In terms of the use of different financial products, countries and regions differ in their choices, with some offering all three types. In general, there is a preponderance of loan finance in central and eastern Europe, the Baltic countries, Belgium Denmark, Greece and Spain; a dominance of equity in Portugal and Sweden; a mix of loans and equity in the UK; a mix of all three product types in Germany, and France; and a mix of loans and guarantees in Italy.
- In terms of FI 'uptake', there are 'pockets' of high absolute and high relative uptake in a number of regions in Italy, the United Kingdom, Belgium, Greece, Bulgaria and Germany. By contrast, the regions where there is low absolute and low relative uptake are extensive, covering France, Sweden, Finland, much of Germany and Denmark, as well as parts of Spain and Romania.

### 6.1 Introduction

Analysing the regional distribution of financial instruments is an important but complex task. The complexity arises from a number of conceptual and practical issues.

**The notion of a 'financial instrument'**. As described in Chapter 2, the term 'financial instrument' is used quite loosely and often interchangeably with 'financial product' (loan, guarantee, equity). Different types of reporting to the Commission use different classifications of form of finance.

The **geographical scope of the Operational Programmes (OPs)** and the financial instruments funded from them differs between countries and sometimes within them. Most OPs offering financial instruments cover a single NUTS 2 region; however, in financial terms

*these account for less than half of total commitments to FIs and investments in final recipients.*

Partly related to issues of geographical scope, **governance arrangements for FIs differ.** The norm is for regional programmes to be managed at the subnational level, but some nationally-managed programmes cover all or multiple NUTS 2 regions, as discussed in Chapter 5. Beyond this, implementation arrangements vary considerably with direct implications for data availability and analysis.

**The concept of ‘expenditure’ is more complex for financial instruments than for grants.**

For *grants*, commitments are made to the selected firm or project, and this is the *beneficiary* of ultimate payments. For *financial instruments*, commitments are made to holding funds and/or specific funds and these *funds* are the beneficiaries. The firms or projects which ultimately receive the loan, equity or guarantee from the financial intermediary are the *final recipients*.

## **6.2 The scope and governance of Operational Programmes offering financial instruments**

The analysis and mapping of the geographical distribution of *expenditure* is an important part of this study. A crucial issue is that many of the Operational Programmes offering financial instruments *do not* coincide with single NUTS 2 regions (though this is the ‘norm’ in terms of *number* of programmes). This would be the simplest and ‘ideal’ scenario from the perspective of a territorial analysis. However, as Table 6-1 shows, this occurs in only nine of the 25 countries offering FIs; of these nine, five are Member States where the NUTS 2 and NUTS 0 levels coincide (CY, EE, LT, LV, MT). In the majority countries the geographical scope of OPs offering FIs is either mixed and or overlapping.

Table 6-1: Geographical scope of Operational Programmes offering financial instruments (no. of OPs)

	NUTS 0	NUTS 1	NUTS 2	Multiple NUTS 2
AT			2	
BG	2			
BE			2	1
CY			1	
CZ	1		1	1
DE	1	9	7	1
DK	2			
EE			3	
ES	1		12	
FI			4	
FR			23	
GR	1		1	6
HU			7	1
IT			29	3
LT			3	
LV			2	
MT			1	
NL				2
PL	2		16	1
PT			7	1
RO	1			
SI	2			
SE			8	
SK	1		1	2
UK		8	5	2
Total	14	17	135	21

Note: This includes only those OPs which offered FIs in 2007-13; no OPs in Croatia, Ireland and Luxembourg did so.

Source: Authors.

Partly related, **Operational Programmes also differ in their governance arrangements.**

The norm is for programmes covering specific regions to be managed at the subnational level. However, there are several *nationally*-managed Multiregional OPs that cover only parts of national territory, in addition to nationally-managed programmes that cover the *entire* national territory; further, in some countries, the national level also corresponds to NUTS 2. The six variants on national / subnational governance arrangements and the regional scope of programmes (and financial instruments within them) are illustrated in Table 6-2.

Table 6-2: National and regional OPs depending on geographical coverage (EU amounts, € million)

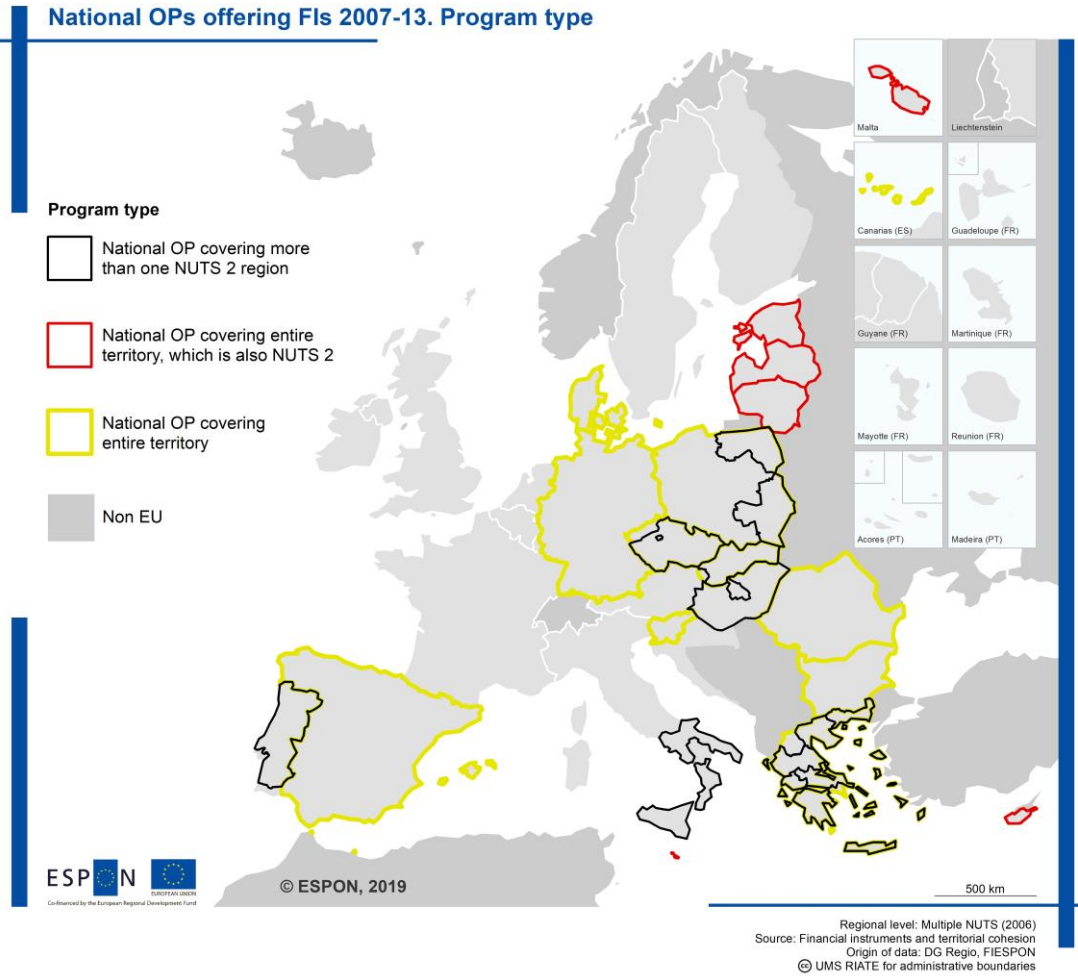
Gov_Geo code	Definition	Commitment / payment to FIs	% of total payments	Investments in final recipients	% of total investments in final recipients
<b>National Operational Programmes</b>					
C_N0	Nationwide NOPs	1371	12.3	1081	10.7
C_N2	NOPs where NUTS 0 and NUTS 2 are coterminous	713	6.4	681	6.7
C_MN2	National Multiregional OPs (cover only some NUTS 2 regions)	3304	29.7	2897	28.6
<b>Regional Operational Programmes</b>					
R_N1	Regional OPs at NUTS 1 level	1082	9.7	1063	10.5
R_N2	Regional OPs at NUTS 2 level	4451	39.9	4239	41.8
R_MN2	Regional OPs covering groups of NUTS 2 regions	224	2.0	180	1.8

Note: For the 'orange' OP types data there is no published reporting at NUTS 2.

Source: authors.

The national OPs offering financial instruments in 2007-13 are illustrated in Map 6-1. An important issue for the study was that **the scale of expenditure where there is no published reporting at NUTS 2 is large**. Nationwide Operational Programmes (C\_N0) and Multiregional OPs (C\_MN2) account for around 40 percent of all commitments to financial instruments and investment from those FIs in final recipients (see Table 6-2). The OPs concerned are heavily concentrated in eastern and southern Europe and in some cases account for all or most financial instrument expenditure in that country. For example, in Bulgaria, Romania, the Czech Republic, Greece, Hungary, Portugal and Slovakia, over 60 percent of investment in final recipients was under multiregional OPs. Most significant in overall *financial* terms are the Italian national OPs offering financial instruments in the *Mezzogiorno* regions. These Italian OPs account for around 10 percent of *all investments in final recipients* in the form of financial instruments in the EU.

Map 6-1: National Operational Programmes offering financial instruments (by NUTS scope)

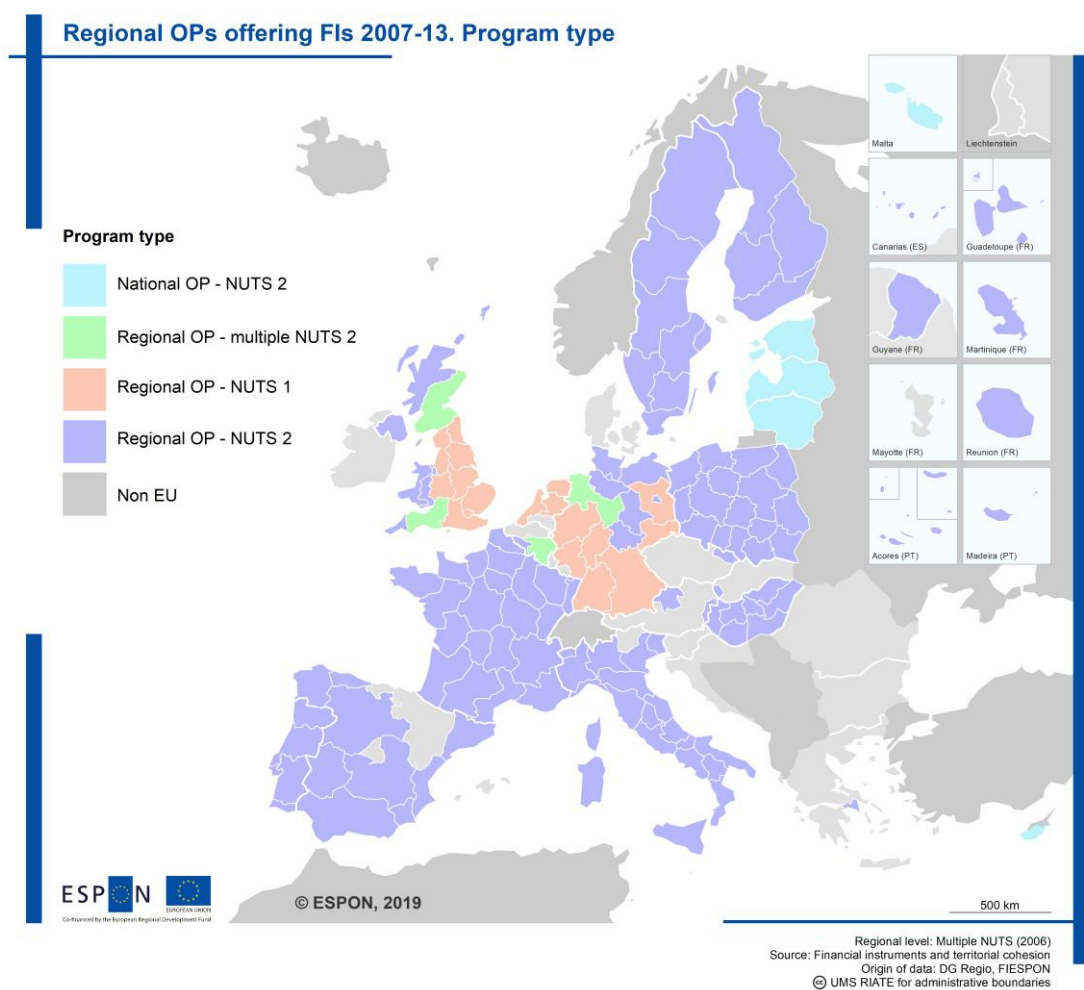


Source: authors.

Regional OPs offering financial instruments are illustrated in Map 6-2. These are mainly NUTS 2 regions, but different geographies apply in the Netherlands and Belgium, as well as in parts of Germany and the UK. In addition, Malta, Cyprus, Estonia, Latvia and Lithuania are NUTS 2 areas.



Map 6-2: Regional Operational Programmes offering financial instruments (by NUTS scope)



Source: authors.

### 6.3 The regional distribution of financial instrument investment

There are different ways of assessing the use or ‘uptake’ of financial instruments. As mentioned before, spending on financial instruments is a two-stage process: first, the *commitment* or payment of funds to an FI – essentially a managed fund; and second, the *investment* of those monies for the benefit of final recipients (firms, urban development projects, etc).

The focus of the discussion below is on the *investment in final recipients*. This is partly because it is only at this level that spend can have an impact, but also because there was no earmarking of funds for *commitments* under national Operational Programmes, so no analysis of regional commitments for these programmes is possible. Most countries achieved relatively high levels of absorption of financial instruments by the time of programme closure so the differences between commitments and investment in final recipients is generally limited. Indeed, for all three policy areas, over 90 percent of the sums allocated had been invested by the time of programme closure (see Table 6-3).

Table 6-3: OP contributions reaching final recipients and remaining in funds 2007-13 (€m at closure)

	OP contributions paid to HF or specific funds (€m)	OP contributions paid to final recipients (€m)	OP contributions remaining in funds (€m)	Absorption at closure (%)	Absorption at end 2015 (%)
Enterprises	14058	13058	1000	92.8	76.9
Urban development	1596	1438	157	90.1	68.6
Energy Efficiency	730	696	34	95.3	50.5

Source: Wislade (2018).

In part, this suggests a considerable acceleration of activity in the final stages of the programmes, since only around 75 percent of funds committed had been invested by the end of 2015,<sup>13</sup> and much less in the case of urban development and energy efficiency and renewables. On the other hand, some countries decommitted fairly substantial sums from OP contributions to FIs. For example, in Greece, the commitment reported in 2015 was €1,789 million, but at closure was €1,081 million. Similarly, in Spain commitments were reduced from €1,273 million to €989 million and in Portugal from €854 million to €610 million.

As described earlier, regionalised information on financial instrument investment in final recipients is not reported for FIs implemented on a nationwide or multiregional basis. The Managing Authority survey described in Chapter 2 yielded regionalised information for a significant share of expenditure under national and multiregional financial instruments. Where this information was not available, expenditure data was regionalised on the basis of relevant proxies.

### 6.3.1 How does expenditure on financial instruments compare with grants?

Comparisons of financial instrument spend between countries and regions are complicated by the very different orders of magnitude of Structural Fund spending and differentiated cofinancing rates. This can partly be addressed by setting investment in final recipients (Structural Fund amounts) against total spend under the ERDF and ESF. This is illustrated in Map 6-3. This shows very varied patterns of investment between countries, but in some cases also within them.

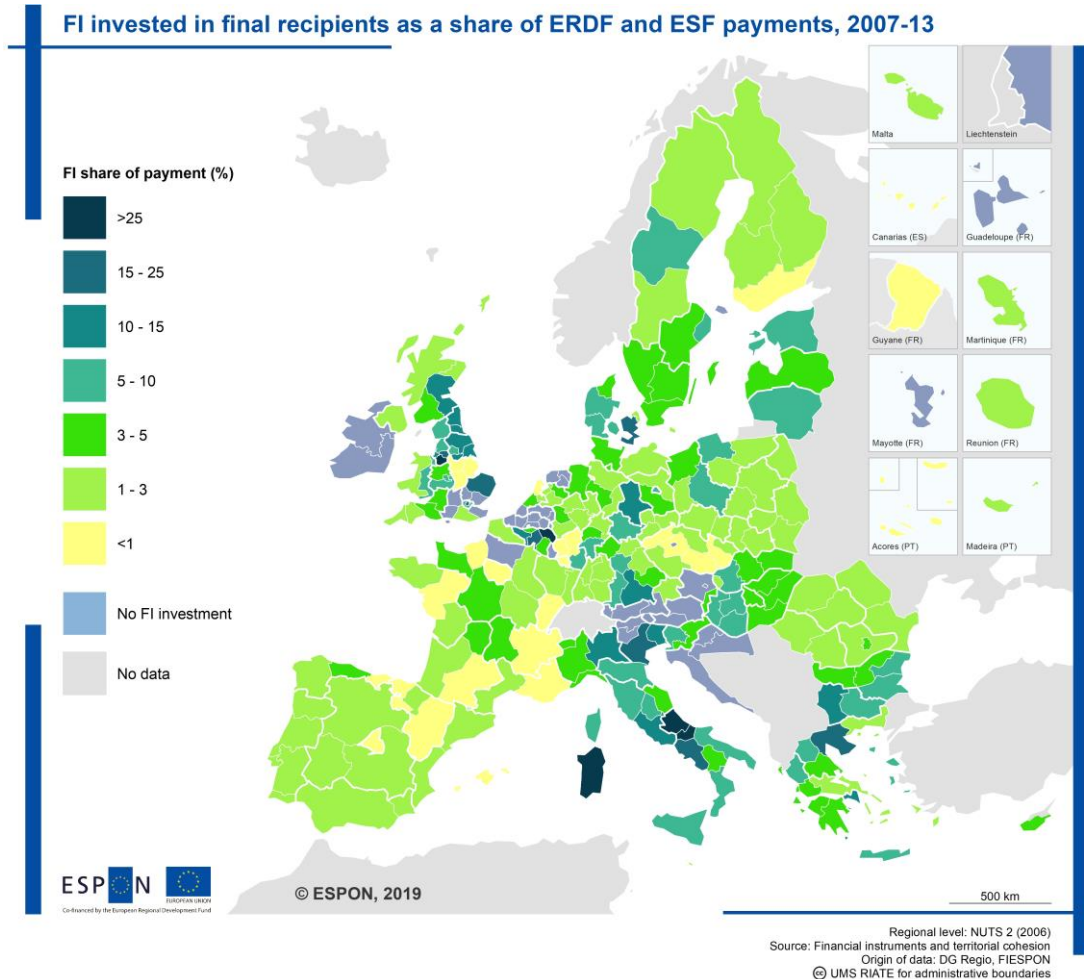
**Italy, Belgium, Denmark the United Kingdom and Greece all committed significantly more than the EU average on financial instruments** as a share of Cohesion policy allocations (see Figure 5-2 in Chapter 5). Not surprisingly, regions within these countries are amongst those that invested the largest shares of Structural Funds in the form of FIs. However, there are very marked internal differences. For example:

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<sup>13</sup> European Commission (2016) Summary of data on the progress made in financing and implementing financial engineering instruments reported by the managing authorities in accordance with Article 67(2)(j) of Council Regulation (EC) No 1083/2006.

- In Italy, in Abruzzo, Molise and Sardegna, over 25 percent of Structural Funds payments were in the form of FIs, but in Basilicata and Marche FIs only accounted for 3-5 percent of spend.
- In Belgium, FIs are not offered at all in Flanders and spend is very modest in the Brussels region. However, within the Wallonia Regional Competitiveness and Employment (RCE) OP which covers four NUTS 2 regions, there are substantial differences in the use of FIs, with FIs in Liège accounting for over 25 percent of Structural Fund payments, but just 3-5 percent in the neighbouring province of Luxembourg.
- In the United Kingdom, in Manchester and London more than 25 percent of Structural Fund spend was in the form of financial instruments, but in some regions, no investment at all was made in the form of FIs.

Map 6-3: Financial instruments in total ERDF and ESF spend



Source: authors.

The vast majority of Structural Fund expenditure on financial instruments is under the ERDF; the **European Social Fund accounted for only 4.3 percent of Structural Funds invested in final recipients through financial instruments**. Eight countries used the ESF to finance FIs in 2007-13 (all also used the ERDF), but the amount invested in final recipients from the

ESF amounted to just €438 million, compared with €9,686 million under the ERDF. Almost 80 percent of the ESF spend was accounted for by Germany and Italy (see Table 6-4). All three Baltic countries operated ESF financial instruments in 2007-13, while Poland and Italy had a large number of modestly sized funds. Given the very small size of the funds allocated to financial instruments under the ESF, and the fact that their objectives in this area overlap with the ERDF (support for enterprises, typically microenterprises and/or individuals starting up in business), ESF FIs are not considered separately in this report.

*Table 6-4: Use of financial instruments under the European Social Fund 2007-13*

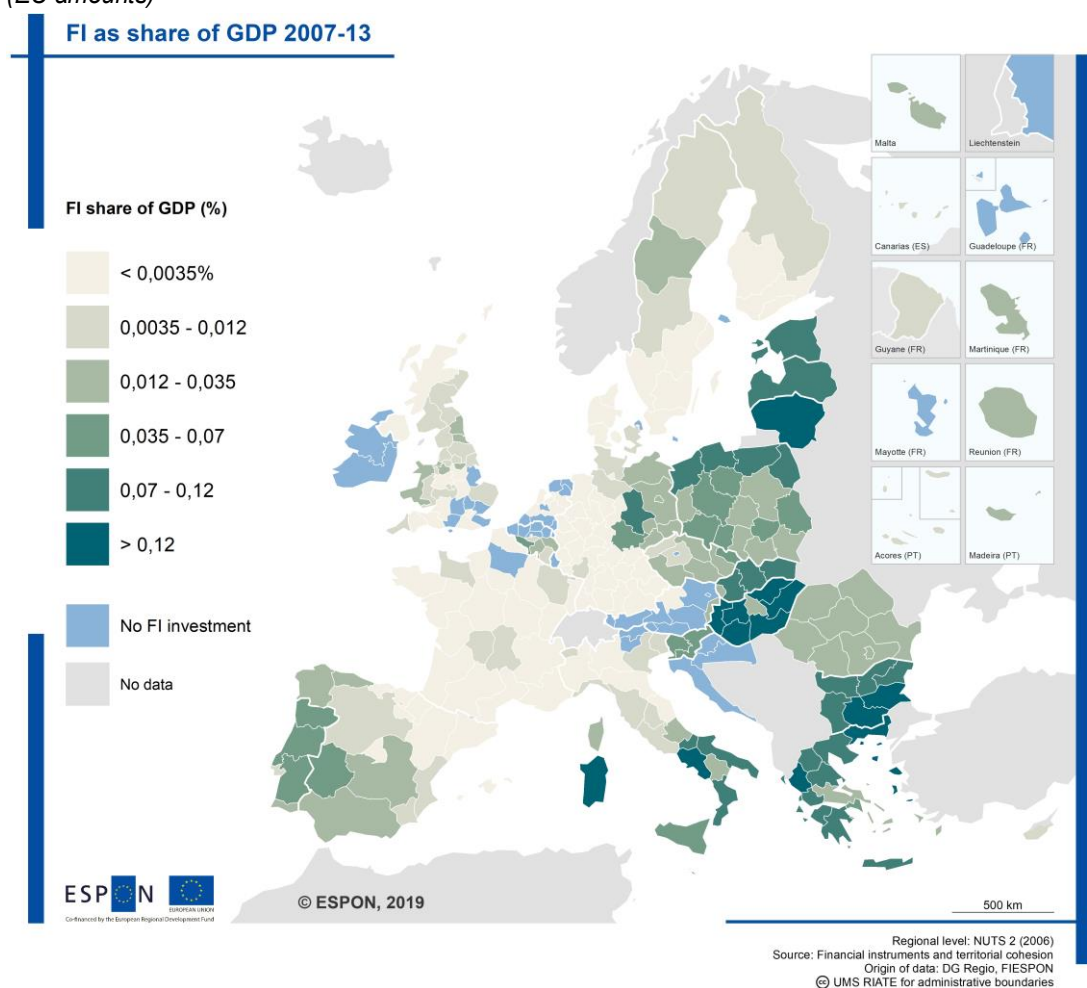
	<b>Number of specific funds</b>	<b>Average fund size (ESF amounts) €m</b>	<b>ESF OP contributions invested in final recipients (€m)</b>
Germany	4	33	114
Denmark	4	6	20
Estonia	1	6	6
Italy	17	15	232
Lithuania	1	14	12
Latvia	1	13	10
Poland	24	1	33
Slovenia	2	11	10

*Source: European Commission (2017)*

### **6.3.2 How important are FIs in real terms?**

As Map 6-3 shows, there are significant differences in the importance of financial instruments relative to overall Structural Fund spend – with investment in final recipients in a number of regions exceeding 15 percent of Structural Fund payments (against an average of around 3.4 percent). However, relative to the wider economy, spend on financial instruments is not significant: on average it amounted to 0.013 percent of GDP, and in only a few countries and regions – Lithuania and parts of Hungary, Greece, Bulgaria and Italy – does it exceed 0.1 percent of regional GDP (see Map 6-4).

Map 6-4: Financial instruments invested in final recipients as a percentage of regional GDP (2007-13) (EU amounts)



Source: Authors.

### 6.3.3 How are financial instruments targeted?

The General Regulation indicated that OP contributions could be used for financial products such as loans, guarantees and equity in certain policy areas. More specifically, Article 44 (as amended) envisaged that:

“As part of an operational programme, the Structural Funds may finance expenditure in respect of an operation comprising contributions to support any of the following:

- a) financial engineering instruments for enterprises, primarily small and medium-sized ones, such as venture capital funds, guarantee funds and loan funds;<sup>14</sup>
- b) urban development funds, that is, funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development;<sup>15</sup>

<sup>14</sup> These were sometimes referred to as JEREMIE, typically, but not systematically, when the European Investment Fund was involved in their design or implementation.

<sup>15</sup> These were usually referred to as JESSICA funds.

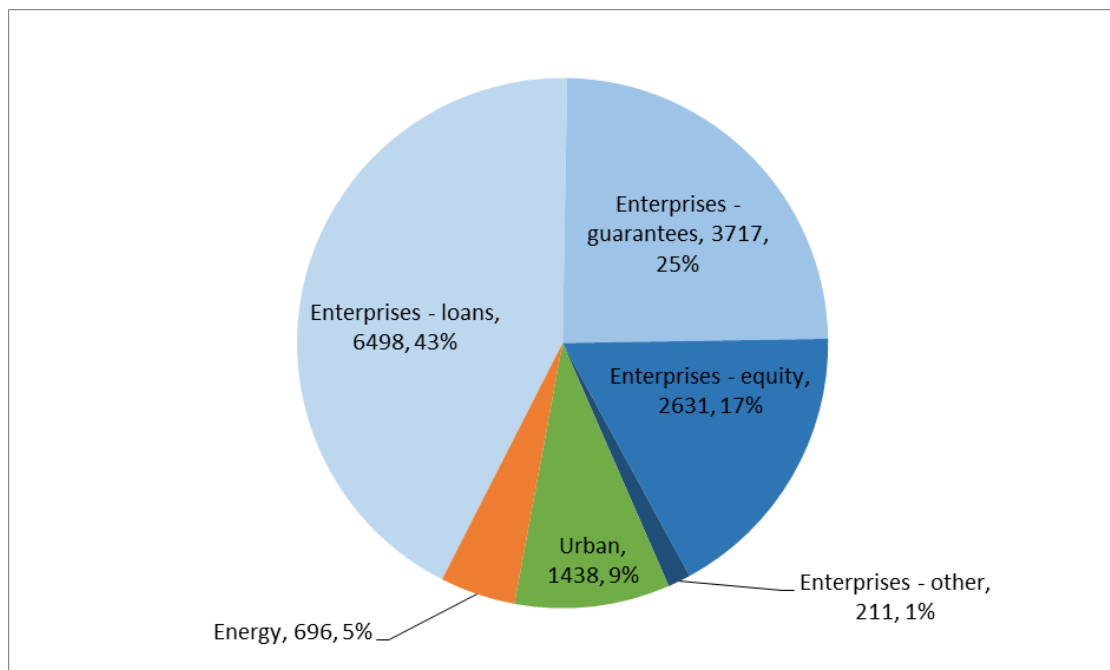
- c) funds or other incentive schemes providing loans, guarantees for repayable investments, or equivalent instruments, for energy efficiency and use of renewable energy in buildings, including in existing housing.”

In the Commission Summary of data (European Commission, 2017), financial instruments are classified as Article 44 a, b or c. In practice, however, the differences are not always clear cut, with funds to energy efficiency in urban areas sometimes classified as 44b and support for firms investing energy efficiency sometimes classed as 44a and sometimes 44c.

More importantly in terms of contrasting the use of financial instruments and grants, these three Article 44 groups do not map directly to the classifications used elsewhere in reporting to the Commission; this makes comparisons of the use financial instruments with, or as a complement to, grants virtually impossible. A brief overview is provided in the Scientific Annex, but definitional differences and misunderstandings in data reporting undermine the scope for a fine-grained analysis for the 2007-13 period. Alignment of definitions and a focus on Thematic Objectives in 2014-20 is likely to facilitate such comparisons. Nevertheless, the specific circumstances in which financial instruments are suitable policy tools (see Figure 3-1 and discussion on the rationale for FIs) is still likely to make this challenging.

Taking the three policy targets set out in Article 44 of the CPR – a) support for enterprises; b) urban development and c) energy efficiency and renewables - support for enterprises accounts for the vast majority. Indeed, some 85 percent of FI investment in final recipients is accounted for by Article 44a. Of this, around half is in the form of loans.

Figure 6-1: Amounts disbursed to final recipients (€m) and share of total at closure

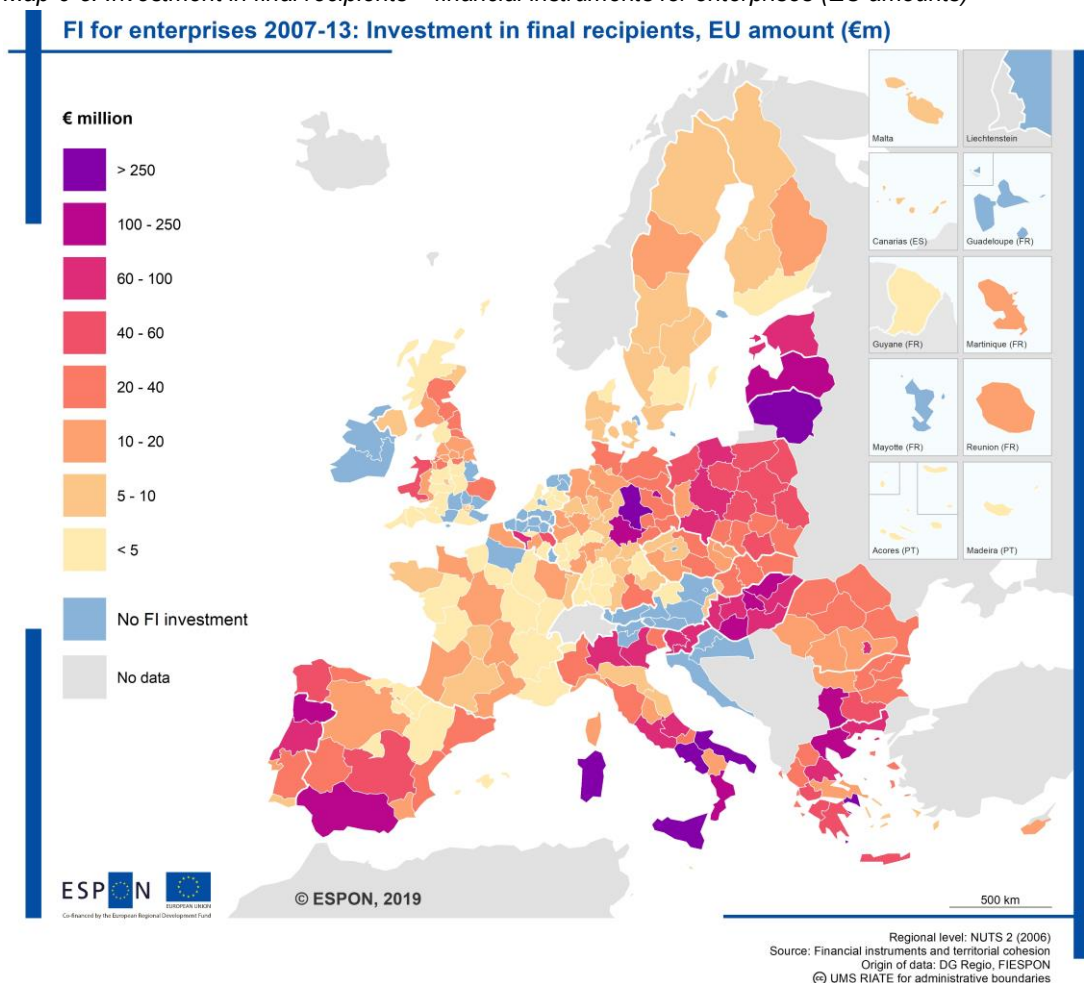


Source: authors from European Commission 2017.

The amounts invested in enterprises in absolute terms is illustrated in Map 6-5. This shows a rather different perspective from the share of FIs in total Structural Funds spend (see Map 6-3

above). This is partly because the much higher Cohesion policy allocations to Convergence regions conceals the scale of spend.

Map 6-5: Investment in final recipients – financial instruments for enterprises (EU amounts)



Source: authors.

In absolute terms, there are marked differences between regions in levels of investment in enterprises, with, in general, much higher levels in the Convergence regions than elsewhere. To this extent, the regional distribution partly reflects the availability of funding. As a result, and **looking at countries where FI investment is a significant share of Structural Funds spend**, the following points emerge:

- In **Italy**, Sardinia is prominent in terms of *absolute* investment through financial instruments for enterprises (as well as relative to Structural Funds as a whole), with more than €250 million invested through FIs in 2007-13; however, spend in Molise and Abruzzo is less significant in absolute than relative terms, and investments in Campania, Sicilia and Puglia are more significant.
- In **Belgium**, investments in the Walloon RCE programme are less significant in absolute terms than those under the Walloon Convergence programme for Hainaut.
- In **Greece**, Map 6-5 also suggests pockets of high in certain regions – notably Attiki.

- In the **United Kingdom**, FI investment is overall less significant when viewed in absolute terms, but in West Wales and the Valleys, the absolute spend is more prominent reflecting its Convergence region status.
- Elsewhere, high absolute levels of investment through FIs to enterprises emerge in Sachsen-Anhalt and Lithuania.

These data need to be treated with caution as they give only a partial perspective on expenditure, and this for two reasons. First, the data only concern the EU amounts of spend; these sums must be cofinanced by the Member States, and rates of cofinancing differ between countries and regions, ranging from 50 percent in most RCE regions to 85 percent in most Convergence regions. This in turn means that total OP investments in FIs would be doubled in, for example, the French, Finnish and Swedish regions, whereas in countries such as the Baltic states, Poland and Hungary, the inclusion of national contributions would increase absolute amount by only around 17 percent. Second, this presentation of the data takes no account of the underlying regional economy.

Turning to **investment in urban development and energy projects**, as noted above, this accounts for a small proportion (about 15 percent) of overall FI expenditure and is concentrated in a few countries only. At national level, the Structural Fund amounts invested in final recipients are shown in Table 6-5. As can be seen, overall levels of spend are modest with a total of just over €1.5 billion spent over 2007-13.

*Table 6-5: FI investments in urban development and energy projects, EU amounts (€m) 2007-13*

	<b>Urban development</b>	<b>Energy efficiency and renewables</b>	<b>Total</b>
Bulgaria	25.6		25.6
Czech Republic	37.9		37.9
Germany	28.8	5.5	34.3
Denmark		6.8	6.8
Estonia		17.7	17.7
Greece	98.2	88.8	187
Spain	116.0		116
France		0.5	0.5
Italy	185.6	54.0	239.6
Lithuania	132.6		132.6
Netherlands	5.9	4.8	10.7
Poland	242.4		242.4
Portugal	97.8		97.8
Slovakia		208	208
United Kingdom	105.4	56.6	162
<b>Total</b>	<b>1076</b>	<b>443</b>	<b>1519</b>

*Source: European Commission, 2017.*

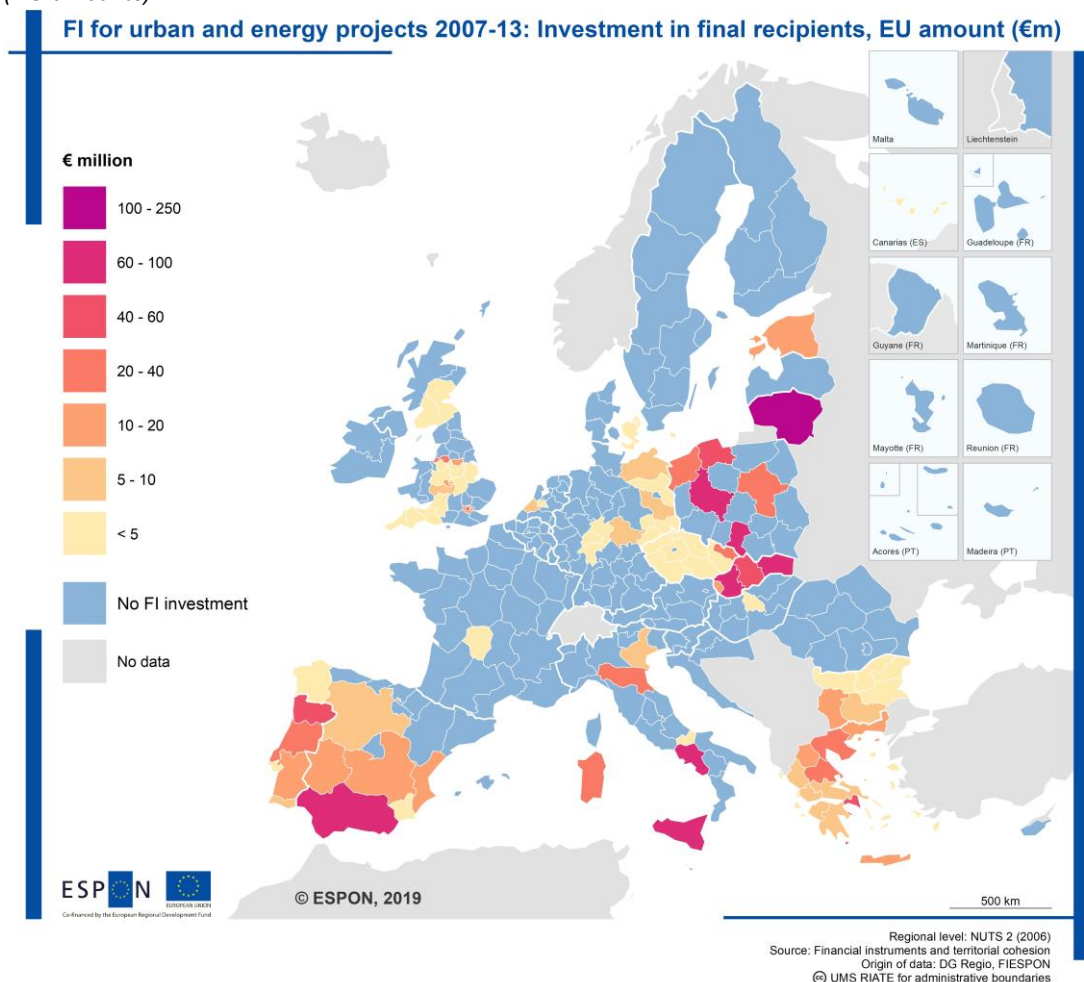
The scale of investments in urban development and energy projects at regional level is illustrated in Map 6-6. This shows that, in practice, such projects are concentrated in a few



regions. This is scarcely surprising given the nature of the projects targeted through urban development funds.

In absolute terms, the most prominent are Lithuania, Wielkopolskie and Śląskie (PL), eastern and western Slovakia, Campania and Sicilia (IT), Andalucía (ES) and London (UK).

Map 6-6: Investment in final recipients: financial instruments for urban and energy-related investments (EU amounts)



Source: authors.

### 6.3.4 Which financial products are used where?

As described in Chapter 2, financial products offered through Cohesion policy FIs differ widely in their application and mode of implementation. This results in widely varying numbers and scales of financial products (see Table 6-6). More specifically:

- Guarantees are the most used product in terms of number of financial products offered, though they are not used at all in some countries; although guarantees account for 53 percent of the number of products offered, they only account for 25 percent of the amount invested in final recipients (in this context, the amounts set aside to cover potential loan defaults).

- Loans are much more widely used than guarantees in the sense that most countries offering FIs offer loan products, but also insofar as they account for 57 percent by value of investment in final recipients.
- Equity is the least used financial product in numerical terms – accounting for just 18 percent of all investment in final recipients; however, the average investment is substantially higher – almost €0.5 million in the case of equity investment in enterprises and over €2 million for urban development projects.

Table 6-6: Number and scale of financial products offered by policy objective (2007-13)

	Enterprises			Urban			Energy			Total			
	No.	€m	Av. €	No.	€m	Av. €	No.	€m	Av. €	No.	%	€m	%
<b>L</b>	110,539	6498	58,785	1,613	1348	835,710	52019	646	12,419	164,171	45	8492	57
<b>G</b>	193,095	3717	19,250							193,095	53	3717	25
<b>E</b>	5,319	2631	494,642	26	54	2,076,923	23	9	377,826	5,368	1	2694	18

Note: L, G and E refer to loans, guarantees and equity, respectively.

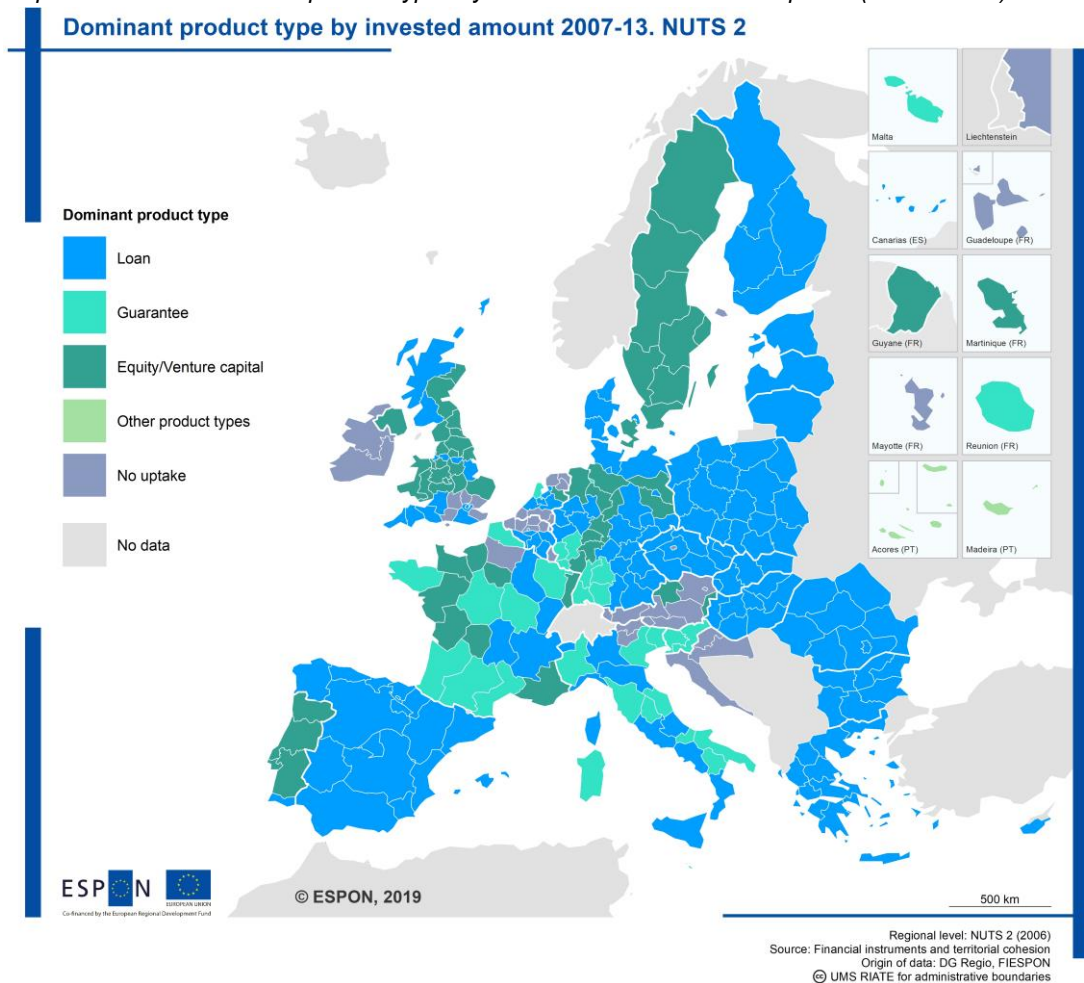
Source: Authors' calculations from European Commission, 2017.

These averages conceal quite wide variations between Operational Programmes – although the overall pattern is consistent: that there are large number of guarantees, but their value is low; there are few equity investments, but their value is generally high.

Countries and regions differ in their choice of financial product, with some offering all three types. Map 6-7 provides an overview, based on the financial products that account for the largest share of investment in final recipients. This shows:

- a preponderance of loan finance in central and eastern Europe, the Baltic countries, Belgium Denmark, Greece and Spain;
- dominance of equity in Portugal and Sweden;
- a mix of loans and equity in the UK; a mix of all three product types in Germany and France; and a mix of loans and guarantees in Italy.

Map 6-7: Dominant financial product types by amount invested in final recipients (EU amounts)



Source: authors.

### 6.3.5 Types of final recipients

Data on numbers of final recipients is not published in the Summary report (European Commission, 2017). It is sought from Managing Authorities as part of the reporting process, but only on a voluntary basis. As well as a total figure for number of final recipients, reporting also seeks the number of final recipients of the following types:

- Large enterprises
- SMEs, of which microenterprises
- Individuals
- Urban projects
- Other recipients

In practice, the number of final recipients supported was not reported systematically (in just 59 percent of specific funds was this done). As shown in Table 6-7, for only 75 percent of total investment are the number of final recipients known and the figures plausible.<sup>16</sup>

*Table 6-7: data availability on number of final recipients by number of funds and investment in final recipients*

	Number of specific funds (with or without holding funds)	Investment in final recipients (EU amount) €m
Total	1437	€10242
Data on number of final recipients	849	€7726
Availability of data	59 percent	75 percent

*Source: authors' calculations from Commission Summary of Data (voluntary information).*

Focusing *only* on those funds reporting plausible information on number of final recipients, Table 6-8 illustrate the breakdown of information available on support for enterprises.

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<sup>16</sup> For example, in several instances, the number of final recipients was very small in relation to the level of investment in final recipients and closer investigation of the instrument suggested that the number of financial intermediaries had been reported instead.

Table 6-8: Target final recipients by type – support for enterprises (Article 44a)

	Large enterprises	Micro-enterprises	Other SMEs	Individuals	Urban projects	Other	Ave. investment per final recipient €'000 (SF amount)
AT			33				262
BE		3846	487				39
BG	2	4111	3877				35
CY		353	156				31
CZ		259	3774				25
DE	37	1528	3142				158
DK		11	85				126
EE	14	529	276			138	104
ES	203	2197	2150				68
FI		15	6195				4
FR		2838	8974	1463			11
GR			10299				51
IT	166	52641	44568	31039	3		15
LT		2152	5211	223			35
LV	20	610	1648				62
MT		516	137				14
NL		75	163				50
PL		23348	6044	3239		452	20
PT	4	3857	6958				24
RO		2094	2919				42
SE	1	284	53				181
SI		2743	1967				31
SK		359	558				97
UK		358	2958			1	119

Note: (i) Italy reports three final recipients as urban projects; this may or may not be a reporting error (ii) the total of microenterprises and other SMEs can be considered an accurate count of SMEs, but it is not clear whether reporting systematically subdivided SME assistance to account for microenterprises.

Source: authors' calculations from Commission Summary of Data (voluntary information).

In practice, across the financial instruments for which data is reported, over 85 percent of final recipients are either microenterprises or larger SMEs. However, large firms do feature in some countries and in Estonia account for over 4 percent of final recipients; in Italy, Poland and France individuals make up a significant share of final recipients.

For urban development FIs (Article 44b), the data on final recipients is not particularly illuminating – almost all final recipients are classified as 'urban projects' or 'other recipients'. This means that there is no scope to identify, for example, the extent to which urban development programmes provide support through FIs to public or private organisations. Table 6-9 illustrates the breakdown of information available on support for urban and energy efficiency/renewables projects.

Table 6-9: Target final recipients by type – support for urban and energy efficiency/renewables projects (Article 44b/c)

	Large enterprises	Micro-enterprises	Other SMEs	Individuals	Urban projects	Other	Ave. investment per final recipient €m
BG					34		0.753
CZ	5			1	5	148	0.238
DE					18	12	0.959
GR					21		4.674
IT					21		4.560
LT						779	0.170
NL			8		22		0.196
PL	5	2	8		101		1.193
PT					158		0.619
UK			8	0	36		2.396

Source: authors' calculations from Commission Summary of Data (voluntary information).

### 6.3.6 Identifying regions with high and low uptake of financial instruments

The methodology for the study requires the identification of regions that are considered to have high and low 'uptake' of financial instruments; uptake has been interpreted as referring to the investment in final recipients in the form of financial instruments using Structural Funds.<sup>17</sup> The widely differing scales of Cohesion policy contributions complicate this task since a comparatively high absolute amount may not be significant where the spend in a given region is high; conversely, absolute amounts may be small, but represent a large proportion of total spend. In order to address this, the definition of high and low uptake takes account of both absolute amounts and the share of those amounts in total Structural Funds payments. The following thresholds are applied:

- High absolute: investment in the form of financial instruments exceeding €20 million;
- High relative: investment in form of financial instruments exceeding 10 percent of Structural Fund payments.

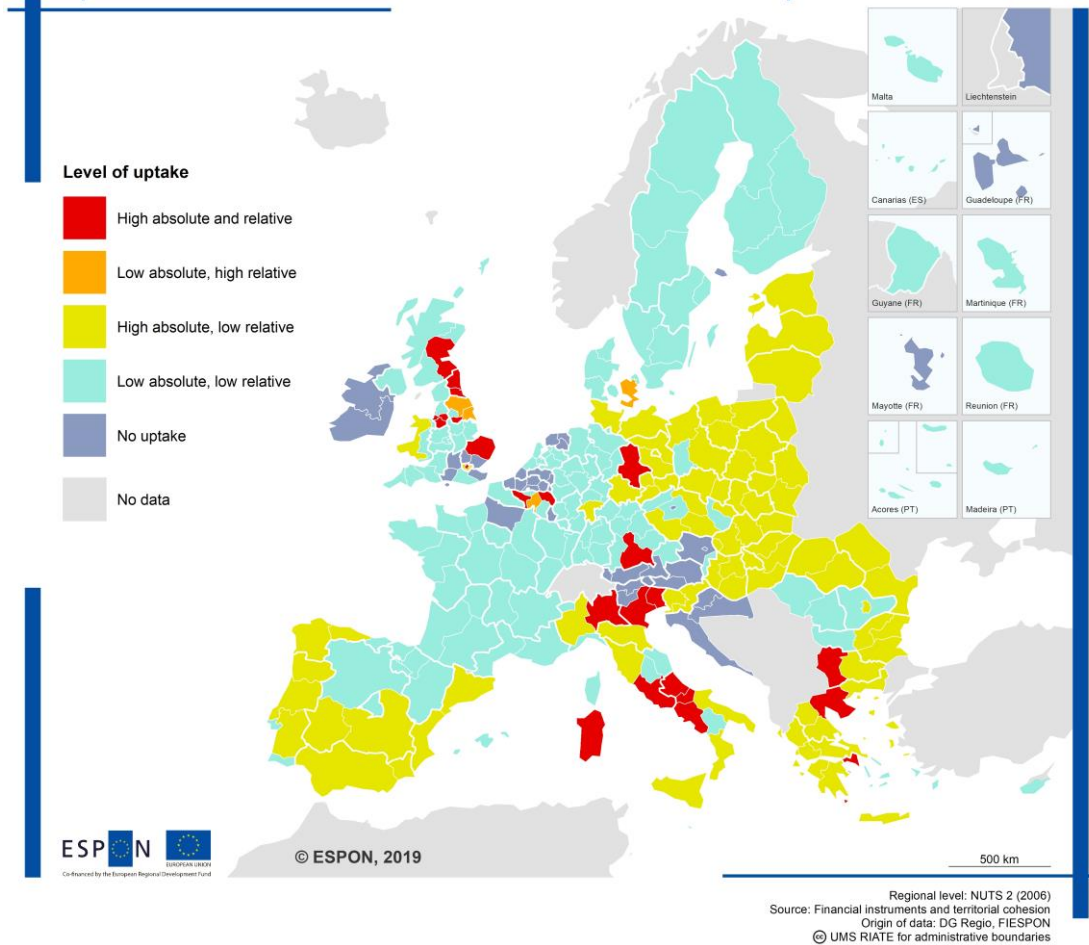
The resulting pattern is shown in Map 6-8. This shows 'pockets' of **high absolute and high relative uptake** in a number of regions in Italy, the United Kingdom, Belgium, Greece, Bulgaria and Germany.

By contrast, the regions where there is **low absolute and low relative uptake** are extensive, covering France, Sweden, Finland, much of Germany and Denmark, as well as parts of Spain and Romania.

<sup>17</sup> This corresponds to "SF contributions invested in final recipients" defined as "Structural Funds (ERDF or ESF) financial support provided to final recipients through the FEI operations" – see Summary of data (European Commission, 2017).

Map 6-8: High and low uptake of financial instruments (EU amounts)

**Uptake of financial instruments 2007-13: investment in final recipients**



Source: authors.

## 7 Added value and impact at territorial level of ESIF financial instruments

### Key points

- The '**uptake**' (investment in final recipients) and **added value** of financial instruments may differ between types of regions, depending on Structural Funds eligibility, financial systems, quality of government (QoG) and urban/rurality.
- A **single type of Convergence region** (low quality of government, bank based, urban) **accounts for 16 percent of all FI uptake**; this region type comprises just three regions: Sicilia, Campania and Attiki.
- Regions in *market*-based financial systems spend a higher share of Structural Funds through FIs than those in bank-based or former socialist countries.
- The added value of financial instruments, compared to grants, can be considered in relation to: **sustainability** – the extent to which they generate a legacy; and **efficiency** – how far FIs generate *leverage* and *fund management costs*. The **regional distribution of fund managers** is also a relevant factor in terms of the scope for FIs to develop local financial markets.
- **Legacy appears higher in regions with low QoG** – perhaps because financial markets work less well and FIs are financing less risky project than elsewhere.
- Although leverage is not easily measured with available data, it can be seen that **guarantees offer significant leverage, more so in urban than rural areas**.
- High uptake regions tend to be more efficient in relation to management costs and fees and have higher rates of legacy than low uptake regions, confirming the view that **critical mass is important**.
- **Fund managers are concentrated in urban regions**, and often in capital regions in former socialist countries, however, in Poland and Hungary fund management is more decentralised.
- The '**reach**' of financial instruments is **greatest in regions with low QoG** – ie. more final recipients are reached by the same amount of funds invested, largely because loans and guarantees are more likely to be used than equity in regions with low QoG.
- An exploration of 'model regions' suggests that **uptake and added value is *sui generis* rather than being capable of offering transposable outcomes or impacts**.
- The **key drivers of 'uptake' do not appear to be primarily territory related but the result of a complex mix of policy choices** at national and regional levels.

The focus of this chapter is on exploring the *added value* that financial instruments can offer in different types of regions compared to grants. It builds on the regional typology described in Section 2.4.1 above and uses the regionalised data gathered from the Commission's



Summary of Data (European Commission, 2017), including the available voluntary data<sup>18</sup> and the information gathered from the Managing Authority survey.

## 7.1 Added value and impact: definitions

For the purposes of this study, the **added value** of financial instruments concerns the effects that financial instruments can have *compared to grants*. This reflects the rationale for the use of FIs in place of, or as a complement to grants, discussed in Chapter 3 above. In this context, the key dimensions of added value that FIs have the potential to offer concern the following:

- **Sustainability.** Financial instruments are revolving funds that can be spent again; by contrast, grants are non-repayable. As such, the *legacy* reported by Managing authorities – the sum available for reinvestment is a measure of the added value that FIs can offer compared to grants. *The size of this legacy in relation to funds allocated to final recipients is therefore a measure for the sustainability of the programme.*
- **Efficiency.** Financial instruments have the capacity to attract funds from sources beyond the Operational Programme, most obviously in the case of guarantees where OP funding is earmarked to cover potential defaults on loans, but the loan itself is not financed from the OP, but rather by a commercial lender. As such, financial instrument can offer added value, compared to grants, through the leverage of additional finance, resulting in higher investment. *Leverage is a measure of the efficiency of the financial instrument.* At the same time, fund managers require remuneration so administering financial instruments carries an external expense that grants do not, as the costs are absorbed by the public administration. *Management costs and fees can be an indicator of the efficiency of the financial instrument.*
- **Quality.** Because support disbursed through financial instruments has to be repaid, project promoters may undertake more robust analyses of project viability and be more committed to project success than for non-reimbursable support. In addition, the due diligence required from financial intermediaries may result in improved project quality and greater contributions to OP objectives. No quantitative measures are available to assess project quality, but *the case studies provide insights into these more qualitative aspects and existing studies tend to support the view that financial instruments can generate better quality projects than grants.*
- **Development of local financial markets.** The development of financial markets differs by location in the EU. The governance of financial instruments can contribute to the development of local or regional financial markets. *Data on the location of fund managers is used to establish the extent to which financial intermediaries are centralised. The case studies also provide insights into this dimension.*
- **Impact on subsidy culture.** FIs can be regarded as promoting a more entrepreneurial attitude than grants, which may even fuel a dependency on subsidies. Quantitative data cannot provide an insight into the development of subsidy culture. However, the data *do* show that current use of FIs is relatively minor. The vast

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<sup>18</sup> Which covers all countries except Hungary, albeit with very varying degrees of completeness between financial instruments.

majority of ESIF funds are being awarded as grants and FI represent 20 percent of all ESIF funds in only two NUTS 2 regions (both in Italy: Molise: 20 percent and Sardegna: 25 percent). *Therefore, quantitatively, it cannot be expected that FI could achieve more than an entrepreneurial niche alongside a dominant subsidy culture.*

The effects, or potential effects, outlined above represent an added value that is specific to FIs. A further issue is the **impact** of financial instruments, **FIs would also be expected to generate the same types of outputs in relation to OP objectives as grants**, including job creation, investment, new business starts, greenhouse gas reductions. However, the absence of systematic collection of indicators by instrument means it is unclear whether the *form* of intervention in and of itself has an impact on meeting these aims. Outputs are only rarely attributed directly to FIs by managing authorities as such the availability of impact-related indicators for financial instruments is extremely limited; there is a dearth of detailed time-series data and considerable difficulties in defining the counterfactual situation.

The two most commonly reported impact indicators relate to:

- **Jobs created**, which is the most widely available measure of impact; and
- **Number of final recipients.**

Both of these indicators were collected as part of the voluntary reporting in the Final Implementation Report. Even these basic indicators are problematic: managing authorities use different definitions of jobs created, and data on number of final recipients is often implausible, missing or has been confused with number of beneficiaries (i.e. financial intermediaries). These shortcomings limit the usefulness of these measures for assessing impact and as such the discussion here focuses more on the added value of FIs as described above. That said, the case studies conducted for this report provide more qualitative insights on issues such as development of financial markets and capacity building. Further the Scientific Annex provides an overview of the availability of data gathered by managing authorities on core and OP indicators relating to financial instruments.

## **7.2 Uptake and choice of financial instruments**

### **7.2.1 Revisiting the typology of regions**

The development of a typology of regions was described in 2.4.1 above. In broad terms, this takes account of a number elements which are considered likely to affect the uptake and efficiency of financial instruments in different ways. These elements are as follows:

1. The **national financial context** (three categories - bank based, market based or former socialist);
2. The degree of **rurality** (three categories - urban, intermediate or rural);
3. The **quality of government** – QoG (three categories - high, medium or low); and
4. The **eligibility status for Cohesion policy** (three categories - Convergence/Phasing-Out, Regional Competitiveness & Employment/Phasing-In or non-EU ESPON).

Combining these elements and categories yields a theoretical 81 types of regions.<sup>19</sup> In reality, only 36 of these include actual NUTS 2 regions (see Table 7-1). A total of 31 types of regions are located in the EU, with the remainder in the non-EU ESPON countries.

Table 7-1: Regional typology: Number of NUTS 2 regions in each regional type

Cohesion policy Eligibility	Quality of government	Financial context and geography of finance								
		bank based			market based			former socialist		
		urban	Inter-mediate	rural	urban	Inter-mediate	rural	urban	Inter-mediate	rural
C+PO	High QoG		1	3						
	Medium QoG	9	9	7		2	1	4	9	20
	Low QoG	3	3	10				3	4	13
RCE+PI	High QoG	14	13	23	24	11	8			
	Medium QoG	21	21	10	11	5		1		
	Low QoG	3		5				2		
Non-EU	High QoG	1	3	5	2	5				
	Medium QoG									
	Low QoG									

Source: authors based on Official Journal of the European Union, 6.9.2006, L243; 28.3.2007, L87; Moritz, Block and Heinz, 2015; Masiak, Moritz and Lang, 2017; Demircuc-Kunt and Levine, 1999; Charron, Dijkstra and Lapuente, 2015; Teorell et al, 2017; De Beer et al., 2014

The NUTS 2 regions classified according to first three elements of this typology (quality of government, financial system and urban-rural classification) are shown in Map 7-1; the same colour-coding is applied as in Table 7-1. The fourth element – regional eligibility for Cohesion policy funding – shown on Map 7-2.

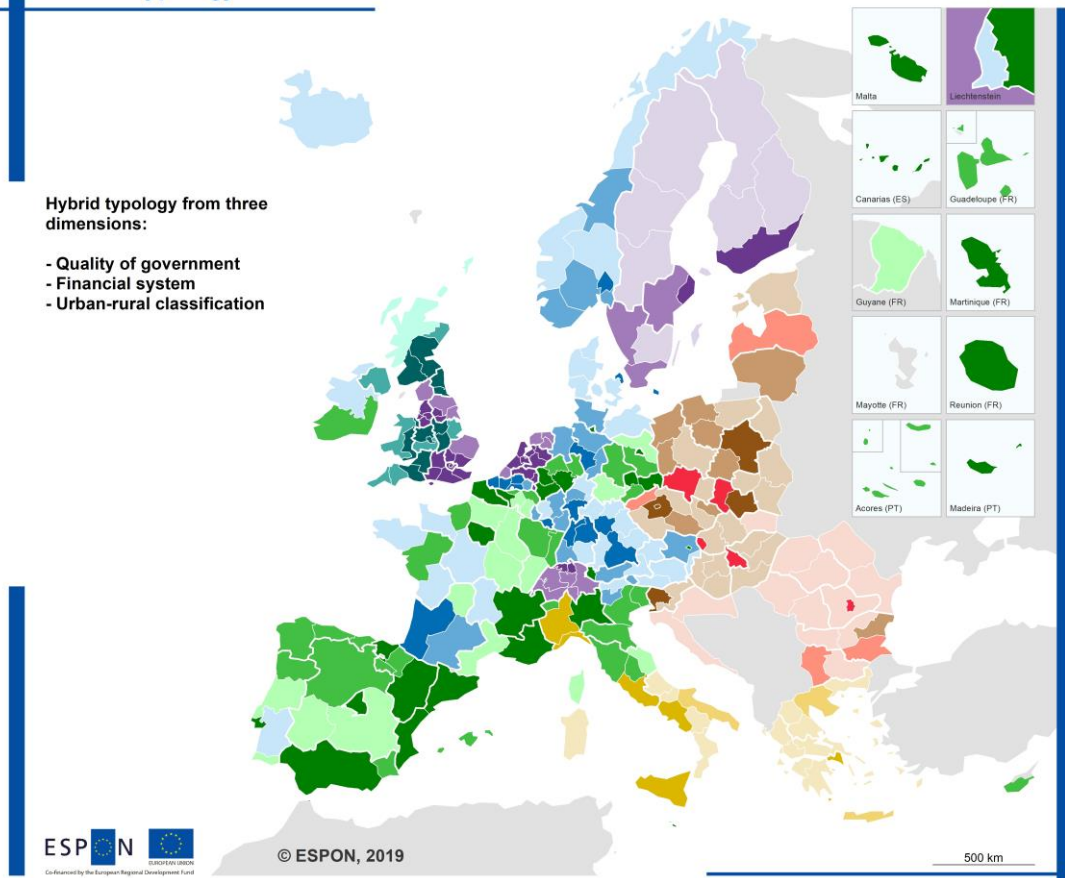
<sup>19</sup> 3x3x3x3=81.

Map 7-1: Regional typology: quality of government, financial system and urban-rural classification

**NUTS 2 typology**

Hybrid typology from three dimensions:

- Quality of government
- Financial system
- Urban-rural classification



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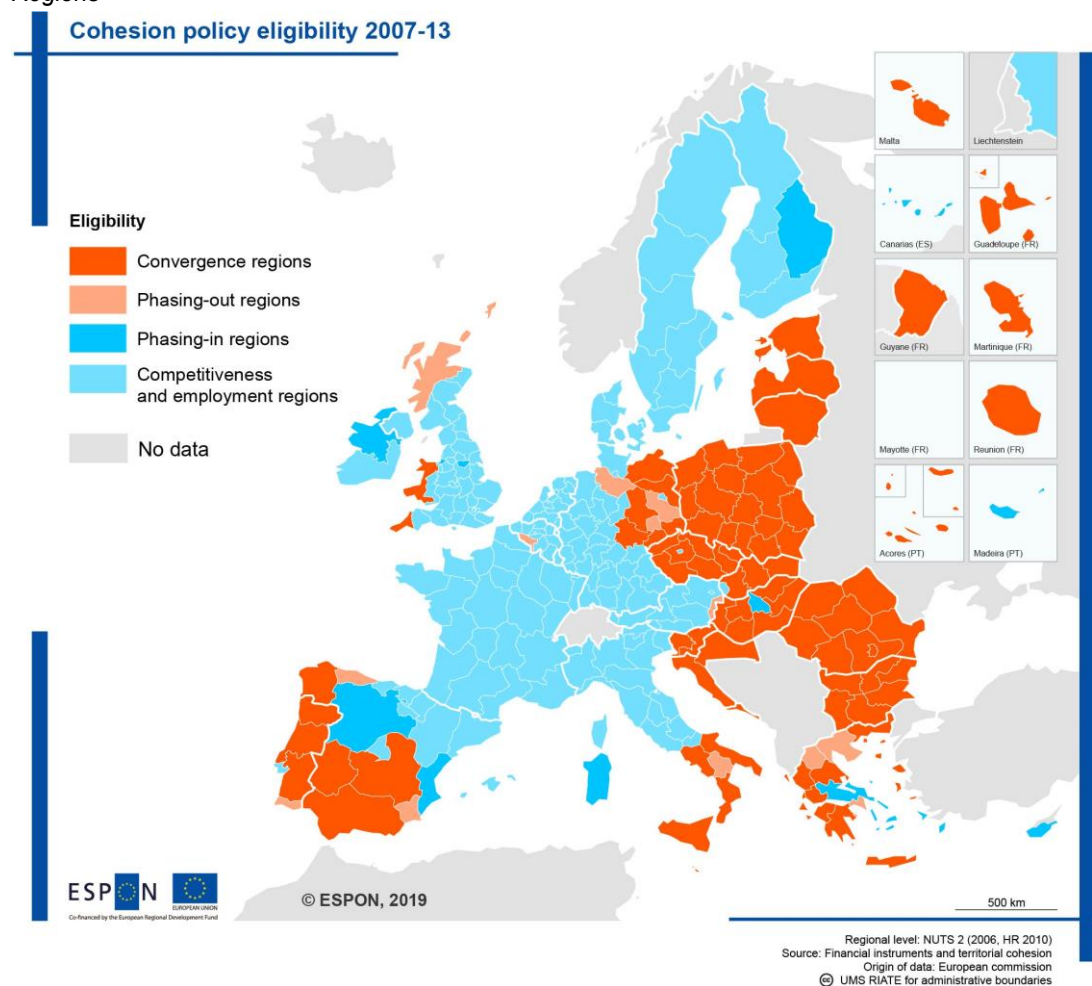
500 km

Regional level: NUTS 2 (2006 except HR 2010)  
Source: Financial instruments and territorial cohesion  
Origin of data: De Beer et. al (2014); Moritz et.al (2015);  
Charron et. al (2015); Eurostat  
© UMS RIATE for administrative boundaries

	QoG	Finance	Urban/rural	
	high	bank based	urban	No data
	high	bank based	intermediate	
	high	bank based	rural	
	high	market based	urban	
	high	market based	intermediate	
	high	market based	rural	
	medium	bank based	urban	
	medium	bank based	intermediate	
	medium	bank based	rural	
	medium	former socialist	urban	
	medium	former socialist	intermediate	
	medium	former socialist	rural	
	medium	market based	urban	
	medium	market based	intermediate	
	medium	market based	rural	
	low	bank based	urban	
	low	bank based	intermediate	
	low	bank based	rural	
	low	former socialist	urban	
	low	former socialist	intermediate	
	low	former socialist	rural	

Source: authors

Map 7-2: Convergence / Phasing Out and Regional Competitiveness & Employment / Phasing-In Regions



Source: European Commission

### 7.2.2 Use of Cohesion policy FIs across the regional types

A key issue for this study is the extent to which regions of different type use Cohesion policy financial instruments. Of the 289 NUTS 2 regions making up the ESPON area, 271 were eligible for EU Cohesion policy funding in 2007-13.<sup>20</sup> Within these 271 regions, Structural Funds were used to co-finance financial instruments in 239 regions (Table 7-2).

<sup>20</sup> Croatia became an EU Member State in July 2013 and is not included among the eligible regions.

Table 7-2: NUTS 2 regions in EU and regional typology (number and % for each element of typology)

Elements of typology		No. of NUTS 2 regions using FI		No. of NUTS 2 regions not using FI		No. Of NUTS 2 regions Total
		#	%	#	%	#
Finance	bank based	136	87.7%	19	12.3%	155
	market based	50	80.6%	12	19.4%	62
	former socialist	53	98.1%	1	1.9%	54
Urban/rural	urban	81	85.3%	14	14.7%	95
	intermediate	67	85.9%	11	14.1%	78
	rural	91	92.9%	7	7.1%	98
Quality of government	High QoG	71	73.2%	26	26.8%	97
	Medium QoG	124	95.4%	6	4.6%	130
	Low QoG	44	100.0%	0	0.0%	44
Eligibility	Convergence and phasing out	98	99.0%	1	1.0%	99
	RCE and phasing in	141	82.0%	31	18.0%	172
Total		239	88.2%	32	11.8%	271

Note: excludes Croatia

Source: authors

FIs are used in 30 of the 31 types of EU NUTS 2 regions; the exception is the typology RCE+PI, medium QoG, former socialist, urban – this type contains only the Prague region.

Table 7-3: Regional typology: regional types using Cohesion policy FIs (2007-13)

Cohesion policy Eligibility	Quality of government	Financial context and geography of finance								
		bank based			market based			former socialist		
		urban	Inter-mediate	rural	urban	Inter-mediate	rural	urban	Inter-mediate	rural
C+PO	High QoG									
	Medium QoG									
	Low QoG									
RCE+PI	High QoG									
	Medium QoG									
	Low QoG									

Source: authors, from Table 7-1.

On average, financial instruments invested in final recipients only account for 4.1 percent of all payments under the Structural Fund (Table 7-4). When the distribution of FIs and Structural Funds across NUTS 2 regions is examined, the following points emerge:

- Regarding **financial context**, the share of Structural Funds invested in final recipients as FIs is *higher in market-based regions, and lower in former socialist regions*.
- Regarding **rurality**, the share of Structural Funds invested in final recipients as FIs is *marginally higher in urban regions than in rural regions*.
- Regarding **quality of government**, perhaps surprisingly, the share of financial instruments is *relatively high in regions that have a low quality of government*. The *absolute* use of FIs is also higher in regions that have a low quality of government.

Importantly, however, such patterns must be treated with caution since high levels of spend in a few regions can distort the picture for the type as a whole.

Table 7-4: Allocation of Financial Instruments and Structural Funds by element of typology (NUTS 2)

Elements of typology		SF contributions invested in final recipients as FIs			ERDF and ESF expenditure 2007-2013	
		€m	av (€m) per NUTS2 region using FI	% of ERDF and ESF expenditure	€m	average (€m) per NUTS2 region
Finance	bank based	6,063	45	4.7%	129,376	789
	market based	700	14	5.0%	14,016	203
	former socialist	3,470	65	3.2%	108,155	1,931
Urban/rural	urban	3,732	46	4.5%	83,191	849
	intermediate	2,913	43	4.2%	69,028	803
	rural	3,588	39	3.6%	99,329	946
Quality of government	High QoG	852	12	3.6%	23,687	210
	Medium QoG	4,912	40	3.2%	155,865	1,199
	Low QoG	4,470	102	6.2%	71,995	1,565
Eligibility	Convergence and phasing out	7,849	80	4.0%	195,827	1,939
	RCE and phasing in	2,384	17	4.3%	55,720	324
Total		10,233	43	4.1%	251,547	921

Source: authors

The literature suggests that the uptake of financial instruments is likely to be relatively higher in agglomerations, as urban areas provide the financial services necessary to manage financial instruments. This analysis shows that **the uptake of FIs is only marginally higher in urban regions (4.25 percent) and marginally lower in rural regions (4.18 percent) compared to the average (4.20 percent)**. A closer look at the data shows that this relationship is primarily in market-based financial systems (Table 7-5). In bank-based systems the situation is the reverse and the uptake in rural areas (5.11 percent) is higher than in urban areas (3.34 percent).

Table 7-5: Uptake of financial instruments by national financial context and urban/rural classification

Urban/rural	bank-based	market-based	former socialist	total
Urban	3.34%	6.01%	2.62%	4.25%
Intermediate	3.99%	4.45%	4.31%	4.15%
Rural	5.11%	2.46%	3.02%	4.18%
Total	4.20%	5.04%	3.25%	4.20%

Note: Uptake of financial instruments refers to investments in final recipients – Structural Fund amount) as % of ERDF and ESF programmes

Source: authors based on Member State data provided by the European Commission

Turning to the use of different financial products, as noted in earlier discussions, loans are the most widespread product in the sense that all Member States using financial instruments use loans; however, the choice of financial instrument varies by quality of government. In particular, **the use of guarantees and equity/venture capital is closely related to the quality of government in the region** (Table 7-6).

Table 7-6: Share of FI product type by Quality of Government

Quality of government	Loans	Guarantees	Venture capital / equity	Other	FI total
High QoG	46.9%	8.0%	44.8%	0.3%	100%
Medium QoG	63.2%	15.5%	18.5%	2.8%	100%
Low QoG	56.9%	38.0%	4.6%	0.5%	100%
Total	59.1%	25.2%	14.6%	1.6%	100%

Source: authors based on Member State data provided by the European Commission

The **higher share of guarantees in regions with a low quality of government** (38 percent) might be explained by a number of factors. Among them is the fact that guarantees are relatively straightforward to design and implement – indeed much of the implementation is done by the financial intermediary, effectively enabling Managing Authorities partially to delegate the operationalisation of the FI. Another factor may be that, regions with low quality of government tend to be less prosperous and inhabitants of such regions less able to provide the collateral to secure bank loans. As such, the FI may not so much be addressing issues of capital scarcity as the absence of sufficient security on loans advanced. There may also be other factors that act as a disincentive to lenders in the absence of additional security – the lack of trust in credit history data on borrowers or the feasibility of obtaining investment permits in time. If the services of the State are less reliable, guarantees may provide an extra incentive for lenders to support SMEs. In areas where the quality of government is medium or high, guarantees and even soft loans are less necessary.

Conversely, the **wider use of equity in regions with High QoG** is partly linked with the greater complexity of those measures and the administrative capacity required to design and implement close-to-market measures which require the appropriate balance of risk and reward for the public and private sectors. At the same time, it is likely a reflection of the general perception of, and concern at, the underdevelopment of the venture capital sector in many European regions, in contrast with the US especially, and also Israel, where more developed and nimble private equity and business angel sector is often credited with the emergence of disruptive technologies.

Some caution must be exercised in drawing conclusions from such high level analysis. In particular, it must be recalled that these data *only* concern the use of Cohesion policy financial instruments. In many countries, especially those where RCE regions predominate, there is already a vast array of domestic financial instruments. In some cases Managing Authorities opt to supplement these measures by adding a block of finance from Cohesion policy – effectively increasing the resources available to an existing measure; this is typical of many FIs in Germany. In other cases there may be an explicit decision not to duplicate existing forms of support; in the United Kingdom, for example, the presence of a longstanding national guarantee scheme underpins the decision *not* to use Cohesion policy funds for guarantees, but to focus on loans and equity.



### 7.2.3 Defining high and low uptake of FIs

Based on the regionalisation of data and the criteria used for the typology of NUTS 2 regions, differences in **uptake** of financial instruments (EU amounts invested in final recipients using FIs) among the regions can be analysed. For the purposes of this study, high *absolute* uptake is defined as above €20 million of Structural Funds contributions invested as FIs in final recipients. High *relative* uptake is defined as where the amount of Structural Funds invested as FIs in final recipients is higher than 10 % of the ERDF and ESF expenditure in the region. The number of NUTS 2 regions falling into each category are shown in Table 7-7.

Table 7-7: High and low financial instrument uptake regions

Uptake	Regions	High relative uptake	Low relative uptake
High absolute uptake	107 regions	24	83
Low absolute uptake	132 regions	4	128
No uptake	50 regions (including regions outside EU in Iceland, Liechtenstein, Norway and Switzerland)		

*Note: Numbers of NUTS 2 regions with high and low absolute (above or below € 20 million) or relative (above or below 10 %) uptake of FIs, compared to total investment of ERDF and ESF programmes*

*Source: authors based on Member State data provided by the European Commission*

### 7.3 High and low uptake of FIs in the different region types

Uptake of FIs differs between regions depending on their Structural Funds eligibility, partly owing to the much larger scale of funds available to the Convergence regions. The interaction between levels of uptake and other elements of the typology – national financial systems, urban-rural typology and quality of government is illustrated in Map 7-3. This interaction is far from clear cut. For example, Map 7-3 shows that there has been both high absolute and relative uptake of financial instruments in the following region types:

- low quality of government, bank based, urban and intermediate region type
- medium quality of government, bank based, urban and intermediate region type
- low quality of government, former socialist, intermediate region type
- high quality of government, market based, intermediate region type.

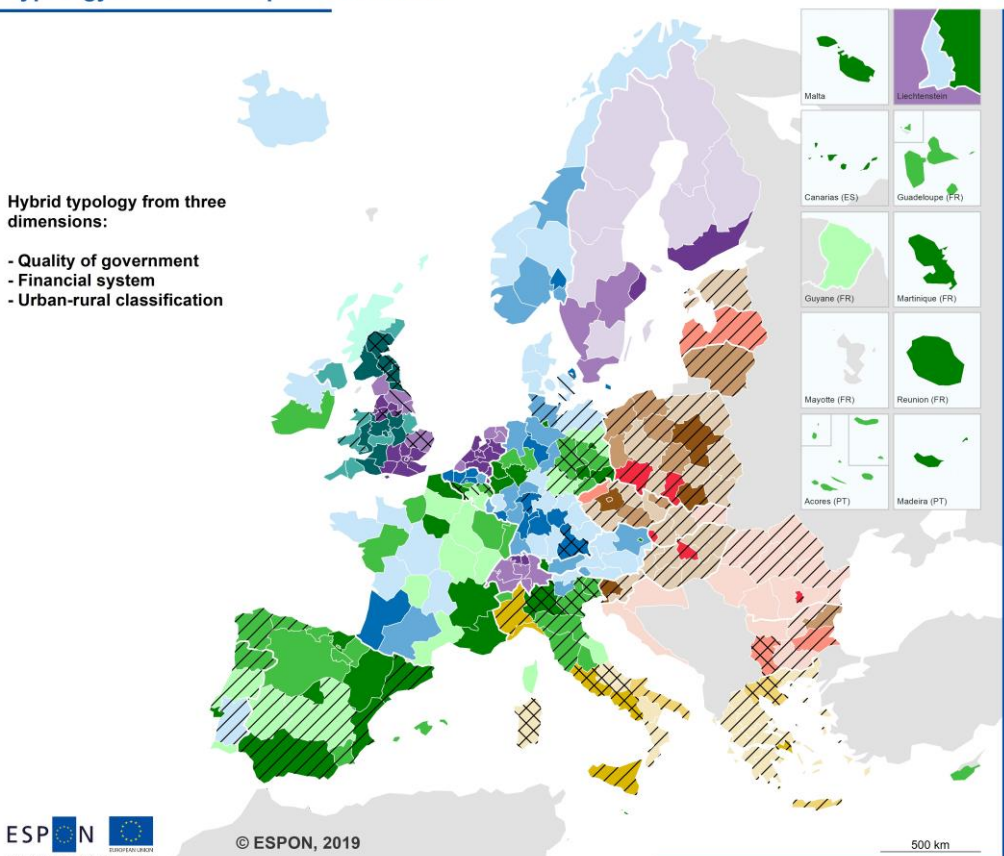
In other words, there are examples of high uptake regions among all region types, except rural.

Map 7-3: Regional typology and level of uptake of financial instruments

Typology and level of uptake at NUTS 2

Hybrid typology from three dimensions:

- Quality of government
- Financial system
- Urban-rural classification



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500 km

Regional level: NUTS 2 (2006 except HR 2010)  
Source: Financial instruments and territorial cohesion  
Origin of data: De Beer et. al (2014); Moritz et. al (2015);  
Charon et. al (2015); Eurostat  
© UMS RIATE for administrative boundaries

	QoG	Finance	Urban/rural		
	high	bank based	urban	No data	
	high	bank based	intermediate		
	high	bank based	rural		
	high	market based	urban	<b>Level of uptake</b>	
	high	market based	intermediate		High absolute and relative
	high	market based	rural		High absolute, low relative
	medium	bank based	urban	Low absolute, high relative	
	medium	bank based	intermediate		
	medium	bank based	rural		
	medium	former socialist	urban		
	medium	former socialist	intermediate		
	medium	former socialist	rural		
	medium	market based	urban		
	medium	market based	intermediate		
	medium	market based	rural		
	low	bank based	urban		
	low	bank based	intermediate		
	low	bank based	rural		
	low	former socialist	urban		
	low	former socialist	intermediate		
	low	former socialist	rural		

Source: authors

The following sections highlight some of the key points emerging from the analysis of FI uptake among the different regional types, based on Structural Funds eligibility.<sup>21</sup>

### 7.3.1 Convergence/Phasing-Out regions

Structural Funds contributions to final recipients in the form of FIs in Convergence or Phasing Out regions amount to €7.8 billion, 77 percent of the total EU amount invested in final recipients through financial instruments.

The breakdown by type of region is shown in Table 7-8. This shows that of the 101 Convergence/PO regions, only three NUTS 2 do not use financial instruments.<sup>22</sup>

In terms of FI uptake among those that do use FI, notable points include:

- The region type low quality of government, bank based, urban accounts for about 21 percent (€1,655 million) of Structural Funds invested in final recipients using FIs in the Convergence / PO regions – see also Figure 7-1. Strikingly, **just three regions make up this category - Sicilia, Campania and Attiki and together they account for 16 percent of all Structural Funds invested through FIs**. Campania alone invested €920 million of Structural Funds as FIs in final recipients. As such, Campania is the EU region with the highest amount of Structural Funds invested in final recipients through financial instruments in 2007-13.
- **All but one of the region type medium QoG, former socialist, rural has a high absolute uptake of FIs** (although a low relative uptake). The region with highest absolute uptake in this category is Wielkopolskie (€158 million), one of the case studies.
- In some of the Convergence/Phasing Out types, **uptake is concentrated in only a few regions**, and some of the quantitatively very high uptake regions (e.g. Norte, Andalucía) allocate relatively little of their Structural funding to FIs.

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<sup>21</sup> See also annex to Scientific Report for the full list of regions, including their type, and uptake of financial instruments, and a more detailed discussion in the Scientific Report.

<sup>22</sup> Two in Croatia, and Guadeloupe (FR) which did not report any investment in final recipients in the Summary of Data.

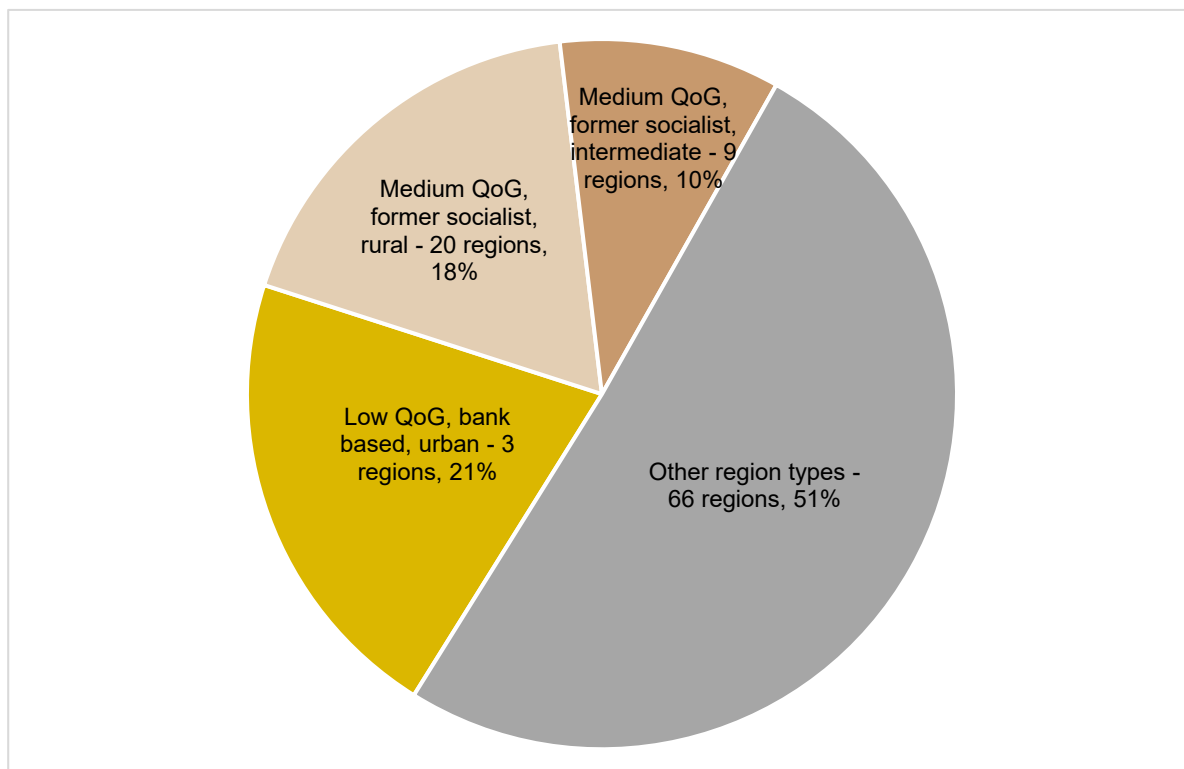
Table 7-8: Convergence and Phasing Out high and low FI uptake region types

Type of NUTS 2 region: quality of government, financial context, geography	No of NUTS 2 regions in type	Uptake: Absolute above € 10 m		Uptake: Absolute below € 10 m		No uptake	FIs to final recipients (€m)	FIs relative to ERDF + ESF	ERDF + ESF (€m)
		Relative above 10%	Relative below 10%	Relative above 10%	Relative below 10%				
Low QoG, bank based, urban	3	2	1				1654.60	11.16%	14820.44
Medium QoG, former socialist, rural	20		19		1		1422.58	3.41%	41699.89
Medium QoG, former socialist, intermediate	9		8		1		791.08	3.90%	20264.27
Medium QoG, bank based, intermediate	9	1	6		1	1	665.84	3.39%	19655.59
Low QoG, bank based, rural	10		9		1		621.85	4.63%	13419.22
Low QoG, bank based, intermediate	3	1	2				574.20	8.95%	6412.93
Medium QoG, bank based, urban	9	1	3		5		423.62	2.61%	16206.07
Medium QoG, bank based, rural	7		5		2		407.48	3.01%	13538.67
Low QoG, former socialist, rural	13		7		4	2	335.29	2.43%	13801.96
Low QoG, former socialist, intermediate	4	1	2		1		320.60	4.90%	6549.35
Low QoG, former socialist, urban	3		3				248.92	2.77%	8976.46
Medium QoG, former socialist, urban	4		3		1		216.36	1.82%	11861.22
High QoG, bank based, rural	3		2		1		89.01	1.81%	4927.39
Medium QoG, market based, intermediate	2		1		1		56.51	2.23%	2537.07
High QoG, bank based, intermediate	1				1		18.15	1.95%	931.47
Medium QoG, market based, rural	1				1		2.43	1.08%	225.24
Total	101	6	71		21	3	7848.51	4.01%	195827.26

Note: Typology of regions at NUTS 2 level and uptake of financial instruments, both absolute and relative to programme, inclusive of grants

Source: authors

Figure 7-1: Share of FI uptake among Convergence Regions



Note: The largest share - Low QoG, bank based urban - comprises Sicilia, Campania and Attiki.

Source: authors

### 7.3.2 Regional Competitiveness and Employment/Phasing-In regions

Structural Funds contributions to final recipients in the form of FIs in RCE/PI regions amount to €2.3 billion, 23 percent of the total EU amount invested in final recipients through financial instruments.

The breakdown by type of region is shown in Table 7-9. This shows that of the 172 RCE/PI regions, 31 do not use financial instruments.

Table 7-9: RCE and Phasing In high and low FI uptake region types

Type of NUTS 2 region: quality of government, financial context, geography	NUTS 2 regions in type	Uptake: Absolute above € 10m		Uptake: Absolute below € 10m		No uptake	FIs to final recipients (€m)	FIs relative to ERDF + ESF	ERDF + ESF (€m)
		Relative above 10%	Relative below 10%	Relative above 10%	Relative below 10%				
Low QoG, bank based, rural	5	3	1		1		446.56	17.48%	2555.40
Medium QoG, bank based, urban	21	1	3		15	2	358.10	2.40%	14940.00
High QoG, market based, urban	24	5	1		11	7	326.97	7.70%	4245.74
Medium QoG, bank based, intermediate	21	3	2		15	1	310.79	4.27%	7270.87
Medium QoG, market based, urban	11	3			8		155.61	6.40%	2429.60
Low QoG, former socialist, urban	2		2				135.42	3.69%	3672.81
Low QoG, bank based, urban	3	1	1		1		132.09	7.39%	1786.56
High QoG, bank based, rural	23			1	17	5	125.10	2.91%	4300.59
High QoG, bank based, urban	14	1	1		8	4	80.74	2.76%	2922.55
Medium QoG, bank based, rural	10			1	8	1	79.28	2.90%	2735.54
High QoG, market based, intermediate	11	1		2	4	4	77.86	6.07%	1282.62
High QoG, bank based, intermediate	13		1		7	5	75.83	2.57%	2952.53
High QoG, market based, rural	8				7	1	29.72	2.22%	1337.56
Medium QoG, market based, intermediate	5				5		22.04	1.88%	1171.38
Medium QoG, former socialist, urban	1					1	0.00	0.00%	1329.19
<b>Total</b>	<b>172</b>	<b>18</b>	<b>12</b>	<b>4</b>	<b>107</b>	<b>31</b>	<b>2356.12</b>	<b>4.29%</b>	<b>54932.92</b>

Note: Typology of regions at NUTS 2 level and uptake of financial instruments, both absolute and relative to programme, inclusive of grants

Source: authors

In terms of FI **uptake** among RCE/Phasing-In regions, notable points include:

- The **low QoG and bank-based rural** type has the **largest allocation of Structural Funds to final recipients** in the form of FIs (€446.56m). This category includes the regions of Sardegna, Molise and Abruzzo. The high uptake of this category can be attributed to the region of Sardegna (€310 million; accounting for 69 percent of this regional type). After Sardegna, the other Italian regions in this type, Molise and Abruzzo, both invested more than 30 percent of ERDF and ESF in final recipients via FIs.
- Outside Italy, there is **high relative uptake** in some UK regions (eg Manchester and East Anglia) and Liege (Belgium).

## 7.4 Geography of fund managers

An interesting dimension of the added value of FIs – certainly in the longer term - is the development of local financial markets. The geography of fund management can provide some insight into the potential contribution of the location of fund managers to this.

Fund managers manage specific funds or holding funds and are remunerated directly or indirectly for this activity. A fund manager is not necessarily located in the same NUTS 3 region as the region in which the fund itself is available. The location of the fund managers in different Member States, as well as the amount of money paid to these fund managers related to these different locations, has been analysed. These data reveal some insights into the territorial dimension of the governance of financial instruments. Except for the European Investment Bank and the European Investment Fund, which are institutionally based in Luxembourg but operate Europe-wide with offices in the Member States, all fund managers are located in the Member State in which they operate.

The data shows large differences in the territorial distribution of fund managers between Member States:<sup>23</sup>

- **Hungary and Poland have extensive and decentralised territorial coverage by fund managers.** In Hungary this was considered an important dimension of implementing a micro-credit scheme owing to the perceived need to build up capacity in the region and development relationship banking and support (Nyikos, 2015).
- Urban regions have the highest share of regions with fund managers. **In some Member States fund managers are only located in the capital region**, which is usually an urban NUTS 3 area. (eg Czech Republic, Slovakia, Romania and Bulgaria),
- In countries **where regional low QoG is low there tend to be more national programmes and fewer regionally-managed programmes.** This suggests that the promotion of local financial markets in practice starts with having a certain threshold value of quality of government before local parties are trusted to manage financial instruments.

Such a centralised versus more regionalised structure of fund managers may have an impact on independent regional governance capacity in relation to investments. By choosing regionalised fund managers, regionalised knowledge must be developed, which may contribute to the development of local financial markets and in turn contribute to the added value of financial instruments. Alternatively, national fund managers may use local branch offices to manage a large part of the work locally. In such a practice, however, the ultimate decision-making power may still be centralised and central management may correct local branches if they do not conform with centralised management rules. This would therefore result in less local autonomy in the financial market than with local fund managers.

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<sup>23</sup> See scientific report.

## 7.5 Management costs and fees

The Implementing Regulation (Article 43(4)) sets limits on management costs and fees as an annual average percentage of the capital contributed from the OP to the financial instruments. These are 2 percent for holding funds and for guarantee funds, 3 percent for loan and equity funds and 4 percent for microcredit instruments. These rates can be exceeded where competitive tendering shows that higher rates are necessary.

Data on management costs and fees is only available for around 80 percent of financial instruments; where there is no reporting or a zero return, it is unclear whether no fees at all are charged, or whether they have been met by the final recipient. Taking only those products where data is available, and eliminating implausible data, the Commission estimates that management costs and fees for loans amount to around 6.1 percent of OP contributions, those for guarantees to around 3.3 percent and those for equity to around 10 percent. However, these amounts exclude management costs and fees at the levels of holding funds, which may contain a mix of products, and therefore cannot be subdivided by product; overall, however, fees at the level of holding funds amount to around 4.4 percent for those reporting.

At a territorial level, average management costs and fees for rural regions *appear* lower than for urban regions. This might be explained by the fact that some urban regions, like capital regions, house large national programmes that consequently have higher management costs. Rural areas usually only house managers for funds that are restricted to their own area. However, a key factor is likely to be the regional incidence of different financial products. For example, equity products, which charge higher fees on average, are less prevalent in rural areas where the business 'ecosystem' is less suited to their use. Overall, however, it is difficult to make clear comparisons between region types partly owing to the role of holding funds and partly due to data gaps in reporting.

## 7.6 Leverage effect

Financial instruments *may* be a more efficient policy tool than grants because of their capacity to attract additional finance. In practice, only a partial view of the leverage achieved by Cohesion policy FIs can be obtained. This is because very few OPs report private contributions at OP level, and while there may be private investment at fund level, or at the level of the final recipient – such as bank loans associated with guarantees or equity co-financing - this information is not collected systematically.

### 7.6.1 The Commission's definition of leverage and the impact of the co-financing rate

Using the Commission's approach to leverage<sup>24</sup> and the available data, the figures suggest that there are only small differences in leverage within the C+PO eligibility regions relating to

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<sup>24</sup> The Commission's approach to measuring leverage is to divide total OP contributions to final recipients by the Structural Funds contribution. A complication of this approach is that OP co-financing rates differ between countries and regions, depending on their eligibility status i.e.



geographic location. This may result from differences in eligibility between regions within the set. Overall, these data suggest that most OPs in C+PO regions make maximal use of Structural Funds in cofinancing FIs – in other words, using the Commission approach, **in Convergence regions apparent leverage at the level of the OP is no more than the impact of the co-financing rate.**

The position is different in the RCE+PI areas. In **rural areas especially, and to some extent in intermediate areas, ‘leverage’ is higher than that which would result simply from the co-financing rate.** The leverage effect has also a distinctive relationship with quality of government: **low quality of government regions show a lower leverage effect in C+PO regions**, although the relationship is less clear in RCE+PI regions.

### **7.6.2 Data on the leverage generated by guarantees**

A more conventional approach to analysing leverage is to look at the extent to which the OP funding is linked to the generation of external finance. Data gaps in reporting mean that there is no scope to provide a comprehensive view, but there is some data on loan funding linked to co-financed guarantees. Cohesion-policy funded guarantees can support the granting of loans to final recipients from other public and private sector sources. One quarter (€ 2,525 million) of the Structural Funds’ contributions to final recipients using FIs are actually funding *set aside* to cover defaults on loans supported under guarantee contracts. Loans secured through the use of guarantees amount to €24,763 million in 2007-2013. This is 9.8 times higher than Structural Funds contributions blocked for the guarantee contracts.

The extent to which guarantees are used varies between regions (Table 7-10). In market-based financial systems, co-financed guarantees are hardly used (sometimes because public guarantees already exist using domestic funding). The exceptions are a few small programmes in Finland and the Netherlands; these show extremely high leverage, as €3.8 million of guarantees were used to secure €135.2 million of loans (35.4 times the guarantees). Guarantees are mostly (75% of all guarantees) used in bank-based systems and are used to secure 10.1 times as large loan portfolios. In former socialist systems (24.9% of all guarantees) this ratio is a little lower at 8.7.

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Convergence/Phasing-Out regions have higher-co-financing rates (and therefore lower rates of match funding must be sought). This implies that a certain rate of leverage is achieved when the requisite match funding is obtained, which varies between countries and regions.

Table 7-10: Use of guarantees and loan guarantee ratio by eligibility and urban/rural classification

Eligibility	Measure	Urban	Intermediate	Rural	Total
C+PO	Share of all guarantees	35.0%	21.0%	22.0%	78.0%
	Share of secured loans	39.2%	17.0%	16.6%	72.8%
	Loan to guarantee ratio	11.1	7.9	7.3	9.1
RCE+PI	Share of all guarantees	5.0%	5.0%	12.0%	22.0%
	Share of secured loans	14.2%	4.7%	8.4%	27.2%
	Loan to guarantee ratio	26.8	10.0	6.7	12.2
<b>Total</b>	<b>Share of all guarantees</b>	<b>40.0%</b>	<b>26.0%</b>	<b>34.0%</b>	<b>100%</b>
	<b>Share of secured loans</b>	<b>53.4%</b>	<b>21.7%</b>	<b>25.0%</b>	<b>100%</b>
	<b>Loan to guarantee ratio</b>	<b>13.1</b>	<b>8.3</b>	<b>7.1</b>	<b>9.8</b>

Notes: Refers to use of Structural Fund co-financed guarantees and ratio between loans and guarantees that secure these loans. Excludes Hungary

Source: Authors based on Member State data as provided by the European Commission

The amount of loans that can be secured by a co-financed guarantee is higher in urban areas than in rural areas (Table 7-10). The loan to guarantee ratio is also higher in areas that have higher GNP (and are therefore eligible for less Structural Funds funding). This has potential implications for territorial cohesion. **Urban areas, and especially prosperous urban areas, have better access to finance and so guarantees result in much higher levels of leverage than in rural areas, where guarantees secure fewer loans.**

## 7.7 Legacy

Legacy are the Structural Funds invested from Operational Programmes (OP) in final recipients that are repaid and returned to the managing authorities for reinvestment.<sup>25</sup> Data provided on contributions from OPs to final recipients are always provided at the level of specific funds; however, in the closure summary data, legacy is reported at the level of holding funds or at the level of specific funds, if managing authorities have not used a holding fund. For this and other reasons it is not possible to reach firm conclusions about the scale of legacy at the levels of financial products or territorial scales. The European Commission's summary of data (2017) indicates that in total €8,464.12 million of legacy has been returned to managing authorities.<sup>26</sup> Although reporting on legacy was mandatory at closure, in practice significant numbers of funds (about one-third, excluding Hungary) reported either zero legacy or made no return.

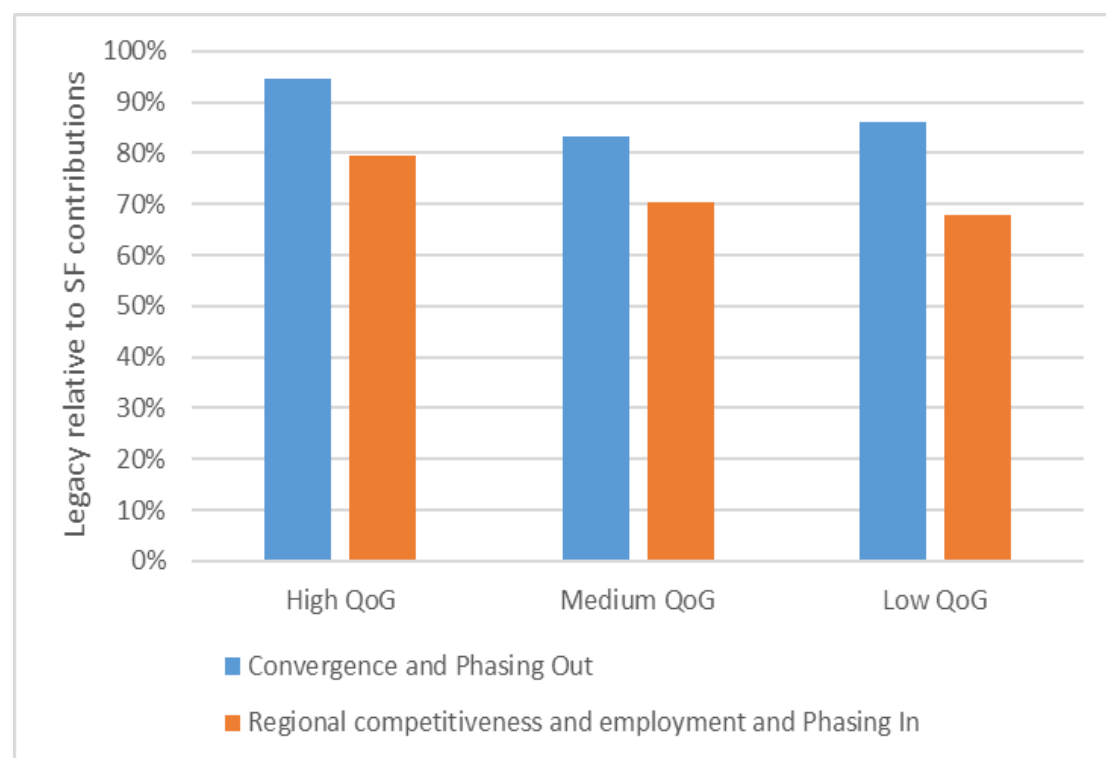
**The legacy generated is larger in NUTS 2 regions eligible for C+PO funding than in RCE+PI regions** (Figure 7-2). The differences in legacy *may* be explained by the way

<sup>25</sup> According to the Commission closure reporting instructions, total amount of ERDF/ESF resources returned to the operation from investments undertaken by financial engineering instruments as defined in Article 44 or left over after all guarantees have been honoured. This amount should be the sum of: 1) gains that have been returned; PLUS 2) resources paid back to FI (and possibly already reused for new loans, or guarantees not called); PLUS 3) the value of resources at final recipient level which have yet to be paid back, which is the amount of potential legacy. Depending on the arrangements of winding up these amounts may be accrued on the level of specific fund or on the level of the managing authority.

<sup>26</sup> This data is based on responses for all Member States except Austria and the CBC OPs.

financial instruments work. These instruments are market instruments and can also be obtained, in most cases, through the market. In high Structural Funds eligibility regions (C+PO regions), markets are more reluctant to step in and so good projects do not get funded. Co-financed FIs are therefore used to fund viable (good) projects which would not otherwise go ahead.

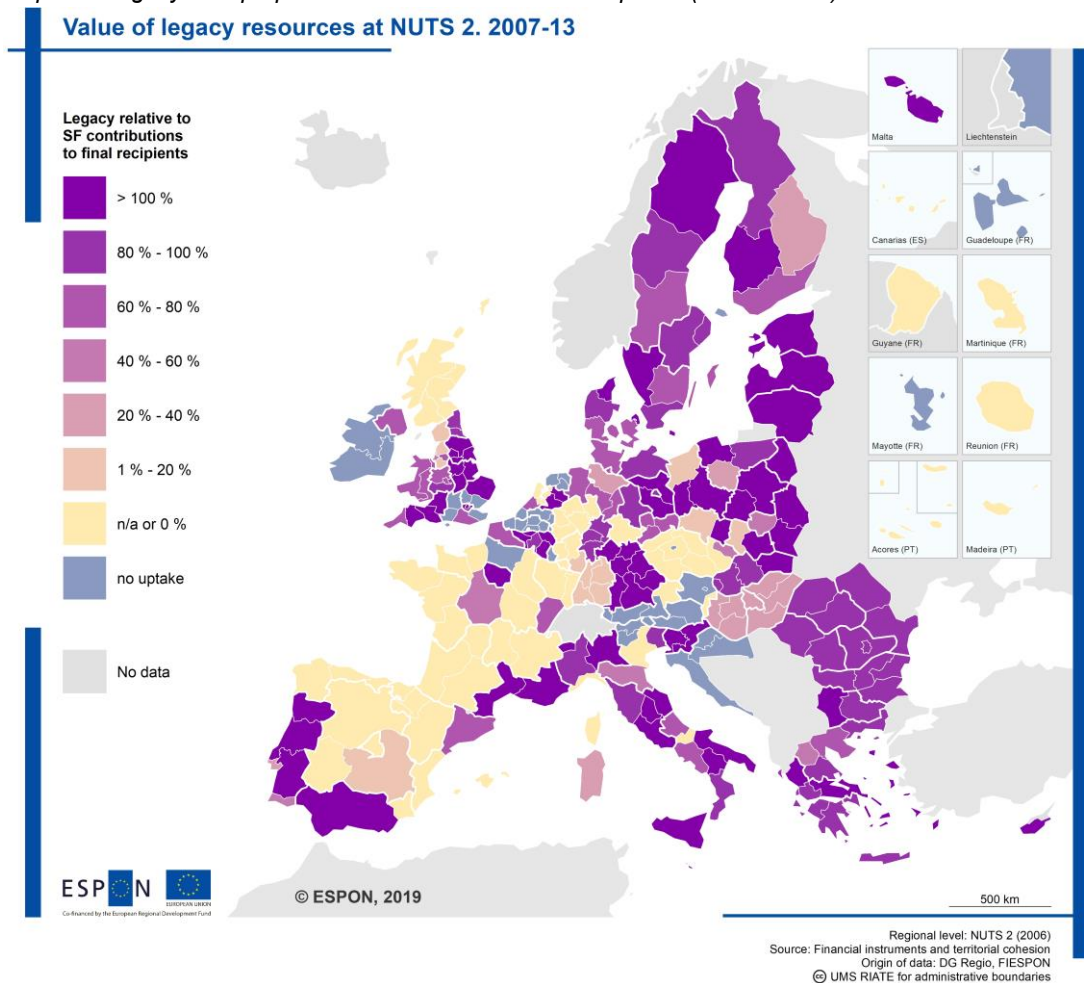
Figure 7-2: Legacy as % of investment in final recipients (SF amounts) by eligibility and QoG



Source: authors based on Member State data

Considerable caution should be exercised in interpreting the data on legacy because the data include *'potential'* legacy, which may not materialise in practice; it is not known to what extent the figures supplied by managing authorities comprise actual or potential legacy. Another factor likely to influence the scale of legacy is the type of product used. For example, equity products may take longer to generate returns since these result from exits or sales of shares, while repayments on loans may begin shortly after they are drawn down. In addition, many holding funds contain different products, and mixed specific funds do not report legacy separately. There is evidence of substantial differences in the rate of legacy achieved or anticipated in different regions (see Map 7-4), but given the comments above it would be unwise to draw firm conclusions from this data.

Map 7-4: Legacy as a proportion of investment in final recipients (EU amounts)



## 7.8 Impact

As mentioned earlier, the available data on the *impact* of FIs is extremely limited, and none of it is comprehensive in coverage. Availability of data on core indicators is discussed further in Chapter 6 of the Scientific Annex. The two most commonly reported impact indicators are number of final recipients and jobs created, but neither were mandatory.

### 7.8.1 Final recipients

The impact of FI can relate to the number of final recipients supported. As discussed earlier, the number of final recipients supported is only known in respect of around 75 percent of investment; in other words, it is not clear how many final recipients were supported with the remaining €2.5 billion. For the FIs where data *is* available, this shows that some 259,889 final recipients were supported, (almost half of which were in Italy alone). The vast majority of final recipients (85 percent) are SMEs and 48 percent of these are microenterprises.

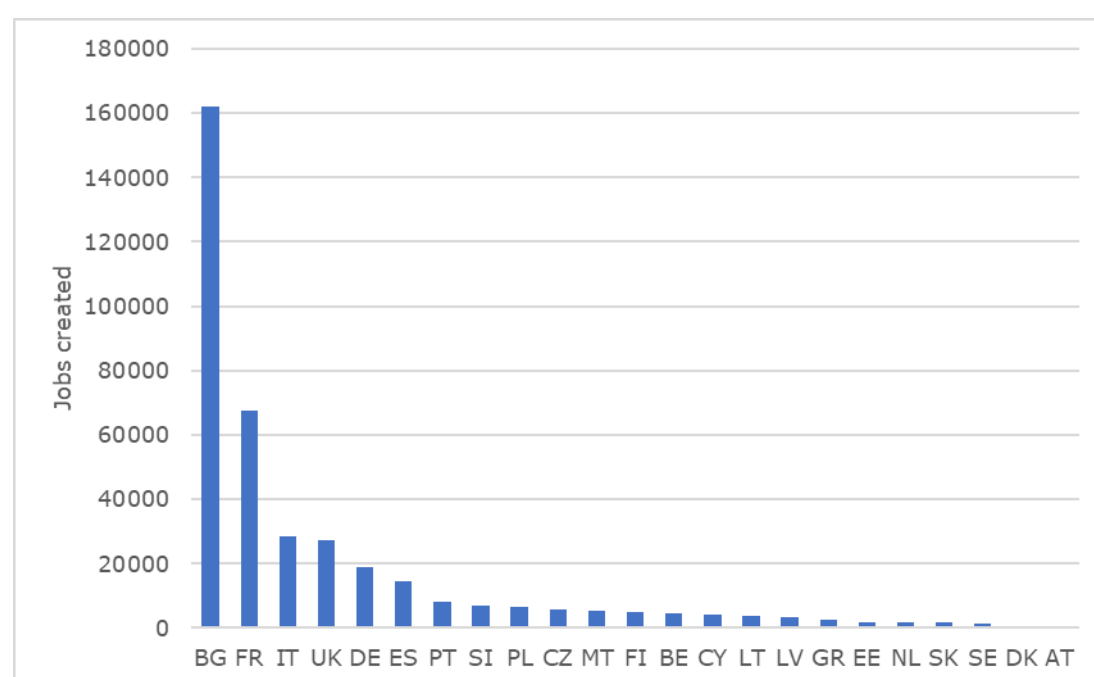
Number of final recipients is a difficult indicator to interpret (higher may not necessarily be 'better') but measured as the number of final recipients for a given amount of OP contributions invested, impact is considerably lower in intermediate regions than in urban or rural regions. More striking is that **impact is much lower in areas with high quality of government;** conversely, **impact is higher in regions with a low quality of government.** This effect is

not related to the Structural Funds eligibility of the regions but results from high QoG regions in Germany and the UK making relatively large investments in relatively few recipients, and low QoG regions in Italy and elsewhere where the number of final recipients related to OP contributions is high.

## 7.8.2 Jobs created

Member States could voluntarily report on jobs created by financial instruments. Reporting of this data was very limited, and available data is unreliable.<sup>27</sup> Available data suggests that 60% of jobs created through ESIF Financial Instruments are in Bulgaria and France (Figure 7-3), which may suggest that these figures predominantly reflect differences in reporting practice rather than differences in impact.

Figure 7-3: Reported jobs created through financial instruments, by Member State (2007-13)



Source: Authors based on information from Member States

Although job creation reported is implausibly high in many Member States, many OPs do not report any data at all on job creation.

## 7.9 Analysing added value and impact based on the regional typology

### 7.9.1 Convergence and Phasing-Out areas

The measures of leverage, legacy, the number of final recipients relative to OP funds and Structural Funds invested in final recipients and the management costs and fees relative to Structural Funds contributions to final recipients differ by type of regions (Table 7-11). Regional types are ranked in order of investment in final recipients. However, as noted before, caution must be exercised in interpreting these results, especially where the use of

<sup>27</sup> See Scientific report for more detail.

financial instruments is relatively low for the regional type as a whole since outcomes may be skewed by the situation in a small number of regions.

In most of the groups, well above 60% legacy is reported. **Legacy of over 80% can be found in some low QoG areas**, this might suggest that FI play an important role in promoting good investment opportunities, such as, in the bank based, rural areas of Calabria (Italy) and in Ipeiros and Thessalia (Greece). The number of final recipients per €1 million of total OP contributions varies widely.<sup>28</sup> Loans and guarantees often involve relatively small OP contributions. On average, these amount to several tens of thousands of euros per final recipient, consistent with the fact that FIs are primarily geared towards supporting SMEs. **In low QoG regions in particular, the number of final recipients that can be supported with one million euro is relatively large.** In bank based, medium QoG areas investment tended to be larger, and, self-evidently fewer recipients are supported for the same sums

Table 7-11: Added value and impact for C+PO regions

Type of NUTS 2 region: quality of government, financial context, geography	Leverage effect	Recipients per 1 million of		Legacy related to OP contributions to final recipients	Management cost and fees relative to SF contributions to final recipients*
		OP contributions	SF contributions		
Low QoG, bank based, urban	1.23	29.70	36.46	68.4%	8.5%
Medium QoG, former socialist, rural	1.25	12.59	15.79	62.6%	8.4%
Medium QoG, former socialist, intermediate	1.43	20.38	29.16	63.4%	8.8%
Medium QoG, bank based, intermediate	1.43	7.20	10.32	61.8%	10.2%
Low QoG, bank based, rural	1.14	53.58	60.84	81.3%	9.4%
Low QoG, bank based, intermediate	1.26	34.51	43.38	73.8%	5.6%
Medium QoG, bank based, urban	1.59	9.81	15.57	61.5%	8.2%
Medium QoG, bank based, rural	1.48	9.62	14.23	37.4%	4.8%
Low QoG, former socialist, rural	1.17	17.81	20.85	80.0%	6.0%
Low QoG, former socialist, intermediate	1.28	16.41	20.96	84.9%	11.5%
Low QoG, former socialist, urban	1.07	7.62	8.17	30.1%	8.9%
Medium QoG, former socialist, urban	1.21	31.86	38.68	83.8%	7.4%
High QoG, bank based, rural	1.45	5.69	8.27	73.2%	8.6%
Medium QoG, market based, intermediate	1.95	4.81	9.41	36.7%	3.9%
High QoG, bank based, intermediate	1.47	11.51	16.90	25.6%	35.2%
Medium QoG, market based, rural	2.50	1.32	3.29	0.0%	3.7%
Total	1.30	20.92	27.22	65.3%	7.7%

Note: Regions are ranked by Structural Funds contributions to final recipients \*Excluding Hungary

Source: Authors based on information Member States

<sup>28</sup> Whether OP funds are from EU or other sources makes no difference to the final recipient.

It is interesting to consider whether high-uptake regions show more added value and more impact and may be more efficient relating to management costs and fees related to Structural Funds contributions.

Impact measured as number of final recipients per € million OP and SF contributions shows a very divergent picture. In some regional types, larger programmes are used to address an even larger number of final recipients. In other, often bank-based regions, larger programmes are used to invest large amounts of money in fewer recipients. Differences in legacy are usually rather small, but they are generally positive. This may be because in regions with more FI, more funds are revolving and become available for reinvestment by the managing authority. Management costs and fees do not differ to a great degree, but are generally a little lower for high-uptake regions. **This may suggest that there are efficiency gains from managing larger regional FI programmes**, but the impact of different financial products is also likely to be a factor, with loans and guarantees attracting lower management costs than equity.

The analysis of model regions with high uptake versus other regions in the C+PO eligibility regions shows a highly diverging picture (see Scientific annex). In some of the model regions, high uptake seems to confirm economies of scale. The NUTS 2 region of Hainaut (BE) has, for example, lower management costs and fees relative to contributions to final recipients than other regions of its type which have a lower uptake of FI. Hainaut also has a higher legacy than low uptake regions and the leverage of guarantees is higher than in other regions. However, this is not the case in all C+PO high uptake regions. In the high uptake region of Sachsen-Anhalt (DE) management costs and fees are remarkably high. In Campania (IT), the region with the highest uptake of FI in the 2007-2013 period, management costs and fees seem to show economies of scale. In the NUTS 2 region of Campania, management costs and fees are lower than in than in the comparable NUTS 2 region of Sicilia. Management costs and fees are even lower in the even larger nationally-managed programme for the Mezzogiorno area (which covers Puglia and Calabria as well as Campania and Sicilia).

The comparative analysis of Campania versus Sicilia shows that the uptake of financial instruments depends on the uptake by local actors as enterprises (i.e. it is demand driven) and that this can differ between regions even if they are addressed by the same programme. These differences are not fully explained by differences in the number of enterprises between the regions. Other factors therefore also play a role.

### **7.9.2 RCE and Phasing In areas**

In RCE and Phasing In areas the amount of Structural Funds provided is significantly lower per region, and there are large differences between regions (Table 7-12). In addition, the Phasing-In regions qualify for a higher co-financing rate, which artificially lowers the leverage effect compared to RCE regions. There are also very large differences in impact measured in the number of recipients per million OP or Structural Funds contributions. RCE+PI, medium

QoG, bank based, rural NUTS 2 regions have the largest amount of recipients per million funds. This relates to a very large number of guarantees in the Italian region of Marche. The use of financial instruments in RCE+PI areas is rather thin, so that one outlier in a region has a direct impact on the scores of a type containing several regions. **Differences between regions largely reflect differences in policy choices between regions.**

Table 7-12: Added value and impact for RCE+PI \*

Type of NUTS 2 region: quality of government, financial context, geography	Leverage effect	Recipients per 1 million of		Legacy related to OP contributions to final recipients	Management cost and fees relative to SF contributions to final recipients*
		OP contributions	SF contributions		
Low QoG, bank based, rural	1.44	18.80	27.12	31.0%	7.6%
Medium QoG, bank based, urban	2.02	31.04	62.83	39.7%	12.6%
High QoG, market based, urban	2.09	3.48	7.25	39.1%	20.7%
Medium QoG, bank based, intermediate	2.43	13.33	32.33	23.7%	7.3%
Medium QoG, market based, urban	2.66	7.50	19.93	26.7%	53.1%
Low QoG, bank based, urban	2.23	67.21	149.70	76.4%	7.9%
High QoG, bank based, rural	2.26	2.72	6.13	30.2%	14.6%
High QoG, bank based, urban	1.99	12.99	25.88	44.9%	15.8%
Medium QoG, bank based, rural	3.25	69.67	226.25	23.4%	9.3%
High QoG, market based, intermediate	2.73	2.03	5.55	36.4%	14.7%
High QoG, bank based, intermediate	2.41	4.85	11.69	22.0%	15.1%
High QoG, market based, rural	2.06	46.18	95.23	41.4%	29.2%
Medium QoG, market based, intermediate	2.39	11.36	27.16	29.0%	21.6%
Total	2.13	20.88	44.49	34.8%	15.3%

Note: Regions are ranked by SF contributions to final recipients \*Excluding low QoG, former socialist, urban

Source: Authors based on information from Member States

Regions with a high *relative* uptake are more common in RCE+PI regions than in C+PO regions. This means that a higher percentage of scarce regional funds are used for FIs (Table 7-12). Although there are, as in the case of C+PO regions, considerable and diverging differences between relatively high-uptake regions, there is more of a common line. **There are generally fewer recipients per €1 million of OP or Structural Funds contributions, legacy is higher and management costs and fees are lower. This suggests that more added value can be created by allocating a higher share of funding to FI in these regions.**

A comparative analysis of high-uptake RCE+PI model regions and regions with a lower uptake of financial instruments (see Scientific Annex) shows that there is a considerable diversity in FI practices in RCE+PI regions. There is a substantial number of low- and even no uptake regions and managing authorities have taken different choices on using the much more scarce ERDF (and ESF) funding. In most of the comparative analysis, economies of scale can be found in management costs and fees. A notable exception are the costs for



**some of the equity/venture capital investments, which has resulted in very high management costs** in several regions. However, in other regions these costs were moderate. The comparative analysis of legacy also shows that in many regional types the high uptake regions showed higher legacy, but exceptions were also found here, showing that there is no **automatic relationship between higher uptake and higher legacy**.

Guarantees were not used in all of the regional types. In the regional types where guarantees were used, it appears that fewer loans can be guaranteed per euro of Structural Funds in higher QoG regions than in areas with low QoG.

## **7.10 Summary**

The added value of financial instruments, such as their sustainability because of the revolving nature of the instruments and the role they may have in the development of local financial markets, may be distinguished from their impact, such as the creation of new jobs. To explore whether differences in added value and impact differ between region types, a typology of European NUTS 2 regions was developed using the criteria of eligibility for regional funding, the national financial system, the regional quality of government and the geography of region as urban, intermediate or rural. Financial instruments are used in 28 types of regions.

The relative share of financial instruments in relation to ERDF and ESF funding is the highest in urban regions with a market based financial system. The lowest share is in rural regions with a market based financial system. This strong urban-rural gradient cannot be found in regions with bank-based or former-socialist financial systems.

Financial instruments can be categorized as loans, guarantees venture capital/equity capital and other financial instruments. Loans are the most often used type of FI, followed by venture capital/equity in areas with a higher quality of government and guarantees in areas with a lower quality of government. This reflects the different context for SMEs in these areas.

A total of 77% of all Structural Fund contributions to final recipients via FIs is allocated in regions with higher eligibility to European regional funding (Convergence and Phasing Out regions). About 9% of all Structural Funds in FI is contributed to final recipients in Campania in Italy. Some 16% of all Structural Funds investment through FIs is accounted for by a single region type comprising Attiki, Sicilia and Campania. Another large group consists of 20 regions in former socialist rural areas with a medium quality of government. There are several other individual regions in which a relatively large share of financial instruments is invested. The uptake of financial instruments therefore differentiates within a single type of region. An even more differentiated picture is shown in the RCE and Phasing-In regions. Here a wide range of levels of uptake of financial instruments can be found, including a number of regions with no uptake at all.

Managing authorities implemented financial instruments either via a holding fund or directly through specific funds. Both holding funds and specific funds have fund managers for which management costs and fees must be paid. The geography of fund managers differs widely

between EU Member States. In some countries they can almost exclusively be found in the national capital region or, as in the case of Germany, in the regional capital. In other countries, such as Poland and Hungary, fund managers can be found in most or even all NUTS 3 regions. A more centralised or decentralised structure of management may have an impact on the way economic decision-making develops in the Member States. More funds are managed in urban areas, and the average amount of funds managed per area in which funds are managed is higher. Thus, there is an urban concentration of fund management services.

An important issue of added value is leverage. The data on leverage shows the impact of EU co-financing rates, which largely determines the calculation of leverage in the regions. Most variance in leverage can be found in regions in which less Structural Funds are provided. There is also variance in the ratio between the size of loan portfolios guaranteed and the amount of SF blocked to guarantee these portfolios. The data suggests that in areas in which the financing situation is more difficult, the leverage of guarantees is much larger. Guarantees are also probably more needed in these areas, as in other areas the loans would be provided without guarantees.

Legacy, the return of funds to the managing authority after being used by the final recipients, is higher in regions with a lower quality of government. This may relate to the fact that in these regions financial markets work less well and financial instruments fund investments that can be financed through regular channels in areas with a higher quality of government.

FI have a different impact in different regions when impact is measured as the number of final recipients supported. In intermediate areas, fewer final recipients are reached by the investment, compared to urban or rural areas. Also, in areas with high quality of government, fewer final recipients are reached by the same investment than in regions with a lower quality of government. The choice of instruments (products) has a major impact on the number of final recipients that can be reached. The amount of Structural Funds used per guarantee is lower than for a loan and much lower than is used to support one enterprise in the form of equity/venture capital. As there are large regional differences in the uptake of different instrument types (products), this suggests that many more recipients are reached in areas with low QoG (where more guarantees are used), than in areas with a high QoG (where more equity/venture capital is used).

Reporting on jobs created was voluntary for managing authorities, and the data shows that there are national differences in reporting. The data reveals more about the variation in national reporting practices than on differences in impact. Data reported on job creation through FI is even higher in some Member States than the total aggregate jobs reported for the programmes as a whole, including both grants and FI.

Comparing high uptake versus average regional outcomes suggests that high uptake regions work more efficiently in relation to management costs and fees. Regions that have spent more than € 20 million in FI also show higher legacy values. More funds are revolving; the fundamental rationale for FI is therefore better accomplished. However, a more refined

analysis of model regions with a specific type of NUTS regions shows that this general principle is not followed in all regions or type of regions. There is a wide variety of practices in the use of FI, resulting in a diverse picture of added value and impact. The number of final recipients per € 1 million invested shows a varied picture. However, in most types of regions high uptake has been used to enable larger investments in relatively fewer final recipients.

## 8 Financial instruments and territorial cohesion: insights from practice

### Key points

- Most case study FIs had a positive impact on the development and diversification of financial markets for SMEs, especially in regions that suffered from financial constraints in the financial crisis. The additional security provided by public sector involvement generated a higher capacity to attract private finance. The multiplier effect was highest for guarantees.
- FIs have supported the development of more sophisticated financial markets, with new supplies of non-traditional sources of SME finance being generated, such as private equity, mezzanine funding and risk finance.
- Demand outstripped the finance supply in most cases, but particularly for loan and guarantee products.
- There is no evidence of cannibalisation effects, either with other public or private sources of finance.
- The relationship with financial intermediaries is key to the success of Financial Instruments, based on their capacity, territorial presence and market interests.
- FIs have enabled skills transfer between actors such as national and local promotional banks and the EIB/EIF.
- The tension between absorption capacity, the need for financial returns and market profitability and regional policy goals has not been resolved. This affects the final effectiveness of FIs in terms of regional policy: in most case study regions, FIs were concentrated in zones with better economic performance, limiting their contribution to overcoming territorial imbalances within that region.
- FIs have generated an innovative and entrepreneurial culture and knowledge transfer among actors in the case study regions; this intangible benefit is difficult to measure, but is valuable for the long-term economic performance of the regions.
- There is an almost unanimous lack of ex post evidence of territorial and economic impact measured with quantitative and systematic methods. Only the Norwegian case carried out continuous econometric impact evaluations.

The case studies examine in more depth the implementation of FIs during 2007-13 within five regions. They thus provide some insight into what might be expected elsewhere in Europe.

The case studies cover the following regions:

- Italy: FI within the ROP Lombardia 2007-13;
- Poland: FI within the ROP Wielkopolskie 2007-13;
- Spain: FI within the ERDF ROP Andalucía 2007-13;
- Sweden: FI within the Mellersta Norrland OP 2007-13;
- Norway: providing a non-EU perspective within the ESPON membership.

This section starts with an introduction to the case studies, and then discusses in turn the common conclusions which have been drawn relating to the impact of FIs on territorial

cohesion. These concern: the added value in the financial market for SMEs and urban projects; governance and administrative challenges; the role of the Financial Intermediary; geographic distribution within regions; and the impact on the entrepreneurial and innovative culture of the SME ecosystem. The section ends with a brief conclusions section.

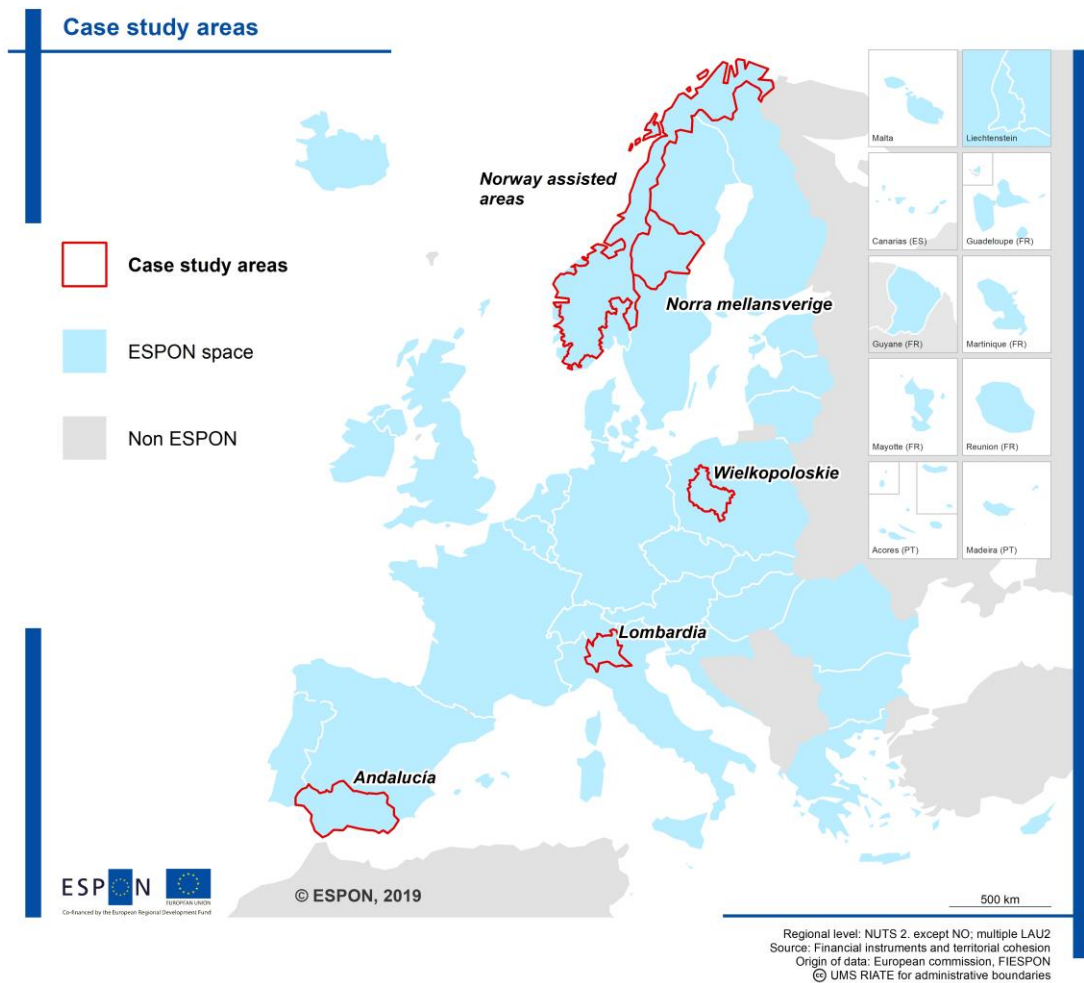
## 8.1 Introduction

The case studies carried out cover a wide range of different regions which are geographically, economically and socially diverse. In spite of this diversity, key issues can be highlighted in order to extract some relevant lessons learned.

As shown in Map 8-1, the case studies have been as follows:

- In **Lombardia**, the FI “Made in Lombardy” Guarantee Fund (MIL), co-funded by the ROP ERDF 2007-2013, was set up in October 2008 to improve the overall rating of the credit portfolio of companies and ameliorate the financial conditions to improve access to the capital market. The MA entrusted implemented of the fund to regional financial agency Finlombarda, which selected the financial intermediary. An initial €33 million was transferred to the fund, guaranteeing a coverage of €500 million with an expected leverage effect of 15. In terms of coverage, while Finlombarda’s financial commitment was €100 million, the financial intermediary assumed a total commitment in the amount of €400 million.
- **Andalucía** was a pioneer in Spain in establishing Financial Instruments during the 2007-2013 period: the JEREMIE Fund aimed at promoting innovation and industrial development through a multi-product strategy and the JESSICA Fund targeted urban development projects. The JEREMIE Andalucía portfolio has an allocation of €398.7 million, which is broken down into €329 million in debt instruments and €63.45 million in risk capital. For the JESSICA Fund, the JHFA invested €72.5 million, or 89.1% of the total amount, in nine projects.
- The **Mellersta Norrland** region in Sweden was the location of one of the first regional venture capital funds implemented under the 2000-06 ERDF programmes. The main reason for the establishment of the co-investment funds, operating *pari passu* to strengthen the availability of private capital, was to reduce the capital-equity gap in the region caused by an imbalance between the private financial resources available and the demand by SMEs for funding and support. In Mellersta Norrland, there are two venture capital funds co-financed by ERDF. The combined assets of the two public co-investment funds are €33 million, and of the €73 million invested in SMEs in the region, €45 million have been attracted from private co-investors.
- **Wielkopolskie** was a leading region implementing FIs in Poland in 2007-13. The main use of FI implementation in Wielkopolskie was through the ROP 2007-13, which specified two instruments for which regional management systems were set up: JESSICA and JEREMIE. The overall sum of loans and credits acquired with the support of FI in the ROP 2007-2013 was PLN 1.8 billion (€422 million).
- In **Norway**, the Regional Risk Loan is an important and long-standing instrument of regional policy. For 2017 some NOK 396 million (c€40 million) was allocated to the Regional Risk Loan loss fund and the associated Regional Investment Grant - almost 30% percent of the regional policy budget. The loan scheme is restricted to designated regional aid areas (the districts); these cover most of Norway, but only around a quarter of the population.

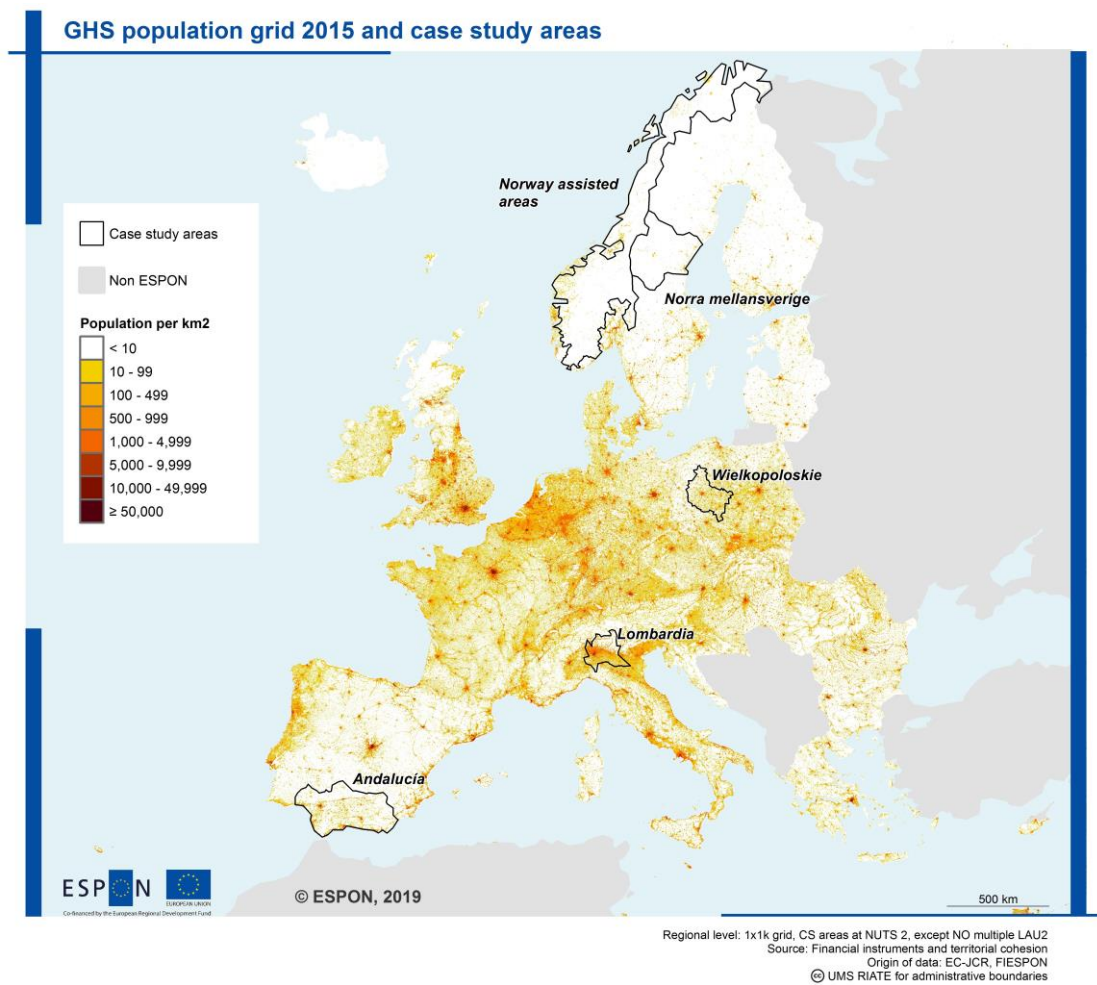
Map 8-1: Case study areas



Source: authors.

According to the geographical distribution of population, as shown in Map 8-2, three of the case studies have been carried out in ‘connectivity’ regions located in the EU’s demographic and economic centre, in particular the area which extends from London to Milan (Lombardia and Wielkopolskie). The other two case study regions are located in the European periphery, with a lower population density – Andalusía and Mellersta Norrland. In order to provide a non-EU perspective within the ESPON membership, the Norway Regional Risk Loan completes the case studies, with special reference to the Nordland region. Moreover, only one of the abovementioned regions can be considered part of the traditionally referred to “blue banana” (Lombardia), while the others surround this area with different degrees of connectivity with the EU economic and demographic centre.

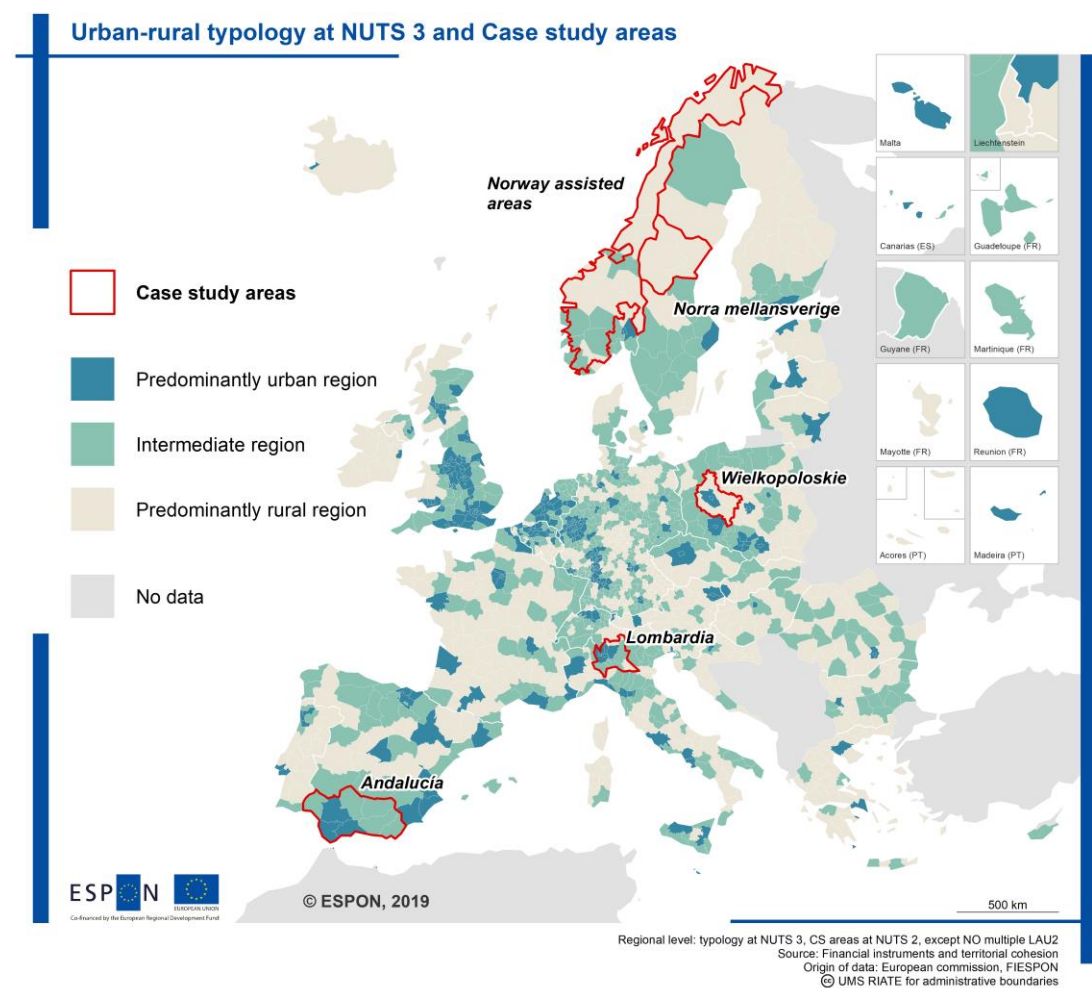
Map 8-2: GHS population grid 2015 and Case Study areas



Source: authors.

As shown in Map 8-3, urban-rural diversity has been also taken into account: while three of the case studies cover urban and intermediate regions, three cover rural areas. The Wielkopolskie case study covers a predominantly rural region with an urban centre (Poznań).

Map 8-3: Urban-rural typology at NUTS 3 and Case study areas



Source: authors.

The classification of these case studies using the regional typology developed as part of this study can be seen in Table 8-1.

Table 8-1: Typology of case study regions

Country	Region	Classification in regional typology (ESIF eligibility, Quality of Government, financial context, geography)
ES	Andalucía	C+PO, low QoG, bank based, urban
IT	Lombardia	RCE+PI, low QoG, bank based, urban
PL	Wielkopolskie	C+PO, low QoG, former socialist, rural
SE	Mellersta Norrland	RCE+PI, medium QoG, market based, rural
NO	N/A	Non-EU ESPON, high QoG, bank based

Source: authors



Table 8-2: Overview of case study financial instruments

Country	Region	FI amount spent 2007-13 (€m)	Product type	Policy Focus
PL	Wielkopolskie	422.00	JESSICA and JEREMIE	Regional economic fabric development and urban development projects
ES	Andalucía	168.52	JESSICA (€72.5 ) and JEREMIE (€398.7 both risk capital and debt)	Promoting innovation and industrial development and urban development projects
SE	Mellersta Norrland	33.00	Co-investment funds	Regional venture capital funds applied to Innovative projects
IT	Lombardia	33.00	"Made in Lombardy" Guarantee Fund (MIL)	Improve the access of companies to the capital market
NO	Norway	40.00	Regional Risk Loan	ICT and innovative projects

Source: authors

Because of this diversity, the FI cannot be assessed under a methodology which solely takes into account the typology of the regions, as they all have different and specific characteristics related to their economic, financial and competitiveness backgrounds.

In spite of this, several common conclusions can be identified, relevant for explaining the impact of Financial Instruments on territorial cohesion. These transversal key elements can be classified as follows:

- the added value in the financial market for SMEs and urban projects;
- governance and administrative challenges;
- the role of the Financial Intermediary;
- geographic distribution within regions; and
- the impact on the entrepreneurial and innovative culture of the SME ecosystem.

In the following sections, each of these aspects is analysed in turn.

## 8.2 Added value in terms of financial markets

Most of the case studies confirm the relevant and positive impact generated by Financial Instruments on the **development and diversification of financial markets for SMEs** within the Case Study regions. While the causes and rationale for implementing FI were similar, the financial constraints generated by the financial crisis evolved in different ways in the regions. Both Andalucía and Lombardia lacked available funds not only for new investments, but also for the regular functioning of firms. In Wielkopolskie, access to commercial finance was difficult for many companies, especially start-ups. The cases of Mellersta Norrland and the target areas for the Regional Risk Loan in Norway are closely related to the particular structural conditions in these remote, very sparsely inhabited territories. Starting from these different contexts, FI achieved a high degree of diversification of financial sources of funding for SMEs, and facilitated the development of new urban development projects.

Multiplier effects of the funds were related to the type of financial product offered, and while venture capital investments and loans tended to generate a lower multiplier effect, **guarantees increased the multiplier effect**. In most cases, SME demand outstripped supply, avoiding any cannibalisation effect with other public support instruments. In Wielkopolskie, for example, both grants and loans for SMEs under the ROP were in very high demand and did not compete with each other, as they responded to different SME needs. The lack of alternative grant-based support for urban regeneration helped avoid this phenomenon in the case of JESSICA, along with the entrepreneurial culture in the region.

In financial terms, therefore, **FIs generated a more sophisticated financial market for SMEs, with a higher capacity to attract private finance**, thanks to the additional security provided by the public sector involvement. Risk sharing schemes have been proven to be effective in attracting private finance to projects and firms which otherwise could not have accessed appropriate sources of funding. For instance, the amount of funding invested in JESSICA and JEREMIE projects in Wielkopolskie, and the additional capital mobilised to fund the investment, generated a substantial leverage effect, making the region a FI leader in Poland. JESSICA supported 37 loans and JEREMIE supported 8,406 projects, accounting for 65% of total employment generated by the ROP (and 13.5% of all jobs created in the region between 2007 and 2015). Similarly, high levels of investment were induced in **Lombardia**, where 116 projects benefited from the MIL guarantee fund, with a confirmed multiplier effect of 11.5.

In some cases, the instruments also **generated a new supply of non-traditional sources of SME finance**, such as private equity, mezzanine funding and risk finance. This supply diversified the sources of finance in the region. This was the case in **Andalucía**, where the multi-instrument fund and venture capital fund portfolios provided funds for 174 projects, allowing firms in the region to access funding in a flexible and tailored way, and generating an induced investment with a multiplier of up to 3.3.

A similar effect was produced in Sweden, where the funds set up in **Mellersta Norrland** had a diverse and substantive impact on the region – a remote region where the availability and utilisation of private risk capital have traditionally been sparse. The co-investment funds have contributed to a more diversified economy by supporting sectors that have few alternative sources of funding, and have helped strengthen the local supply of private capital by attracting private sector partners that would not otherwise have invested. The co-investment funds have substantially strengthened local entrepreneurship and growth potential, particularly among early-stage firms, in a number of sectors where equity investment is a suitable but a regionally scarce source of capital. These are predominantly enterprises that adopt scalable business models for growth and for whom early-stage capital is much easier to raise through equity than by other means such as loans. Co-investment into ICT firms is reported to have contributed in several cases to **keeping ICT employers in the Mellersta Norrland region instead of relocating to capital-rich ICT clusters**. Moreover, because

expected returns are much lower by default in Mellersta Norrland than in metropolitan areas, the co-investment funds have kept an open mind and **invested more diversely** in, for example, the tourism sector, which has clear growth potential in many regions but which often gets outcompeted by high-technology startups with faster growth predictions in larger finance hubs. Additionally, the risk threshold for the co-investment funds' operations is lower than for fully private investments, as the former have no formal profit requirement, thus the intervention has **contributed to the growth of new ventures at an earlier stage** than private investors commonly fund emerging start-ups.

In **Norway**, where a complete and systematic evaluation has been carried out, the **additionality effect has been assessed as very high** - research suggests that two-thirds of projects would not have gone ahead on the same basis without it.

A caveat on the potential impact of ESIF FIs on levels of investment was expressed in several regions. In Wielkopolskie, most of the expenditure in JEREMIE in the region (and across Poland more generally) concerned the **provision of working capital and supporting SMEs' ongoing expenses**, rather than investment. In Andalucía, the crisis caused a change in the type of financing demanded - instead of demanding financing for investment, companies demanded financing for debt refinancing and working capital. Although the FI mitigated the closing of financial markets, the initial scope – investment financing – did not fully respond to companies' real needs.

Added value of FIs was not only aimed at **improving the financial conditions in each region: knowledge transfer and capacity building** was another of the key elements of additionality. For instance, in Norway, the financial support allowed the FI manager to maintain a **long-term relationship** with final recipients, creating the opportunity for a better engagement in the projects, compared to those supported with grants. The Swedish case also confirms the experience of knowledge transfer. In Mellersta Norrland, the co-investments funds' 'active' form of capital investment brought useful support structures to enhance the growth of start-ups and early-stage companies. The **public and private equity investors brought considerable competence and experience** to the board of directors of aspiring businesses and thereby brought crucial insight to development and expansion processes. The co-investment funds also have **extensive business networks** both within and outside the region and helped portfolio companies connect with other investors and businesses for potential future collaboration. There has also been a significant educational role within the region about processes related to risk finance, which has led to **maturing of the local private investment supply** and the establishment of several new private investment stakeholders. For example, the emergence in 2010 of Startkapital I Norr, a consortium of private investors spread around northern Sweden, was inspired by its founders' observation of the opportunities created by the increase in public risk finance in the region. In Andalucía, knowledge transfer with the EIF on setting up the JEREMIE Fund was considered key to its

success. In **Lombardia**, the experience has enabled the MA to improve their understanding of the benefits of FIs and strengthened their competences, and those of the fund manager.

In a further example of added value, repaid JEREMIE funding has provided a financial and institutional basis for the development of Wielkopolskie's own domestic regional policy. This has been initially through the establishment of the **Wielkopolskie Development Fund (WFR)**, set up to manage returning JEREMIE funding and reinvest it in SMEs through loan products which complement existing JEREMIE products, then over the longer-term with the WFR set to develop into a regional investment bank.

### 8.3 Governance and administrative challenges

The regions have used **varying governance arrangements to implement the FIs**. However, a common issue noted was that, even in those regions where there was previous experience in managing Financial Instruments, the administrative burden associated with FIs and the associated governance requirements were found to be challenging. Time dedicated to setting up the instruments was considerable and, in some cases, the initial market assessment was no longer entirely relevant by the time the instrument was operational. For instance, in **Lombardia**, the setting up process took more than eight months for only the selection of the financial intermediary.

Most of the case studies identified the lack of clear interpretation of the 2007-13 implementing regulations as a challenge: in **Andalucía**, the lack of clarity in management and audit rules was identified as a key problem, while Lombardia pointed out that the lack of proper guidelines led to non-eligible applications. Some of the final recipients in Lombardia expressed their concern regarding the administrative burden related to the economic justification of investments.

The loss of absorption has been cause for concern in both Lombardia and Andalucía, where an important proportion of the investments had to be declared as ineligible, as shown in the table below (see Table 8-3). The high number of ineligible applications in Lombardia absorbed the time of the fund manager and financial intermediary, and also had a doubly negative effect on enterprises, by affecting their confidence and willingness to apply for FIs.

*Table 8-3: Investments declared as ineligible*

<b>Case study</b>	<b>Initial ROP allocation</b>	<b>Final eligible execution</b>
<i>Andalucía JEREMIE</i>	€235 million	€113 million
<i>Lombardia JEREMIE</i>	€33 million	€9.6 million

*Source: authors*

This is not just a specific issue for FIs, as it can also be a problem for grant schemes when quality of government is low. In contrast, in terms of administrative burden, loans under JEREMIE were noted to offer an advantage over grants in Wielkopolskie, in that it was possible to apply without waiting for a call for applications, and it was not necessary to factor

in the criteria for that call, offering much more flexibility to entrepreneurs that could not afford a commercial loan.

Some **absorption pressure** has been associated with the constraints imposed by the ESIF programming period. In **Norway**, where these constraints are not relevant as the FI is open-ended and not funded by ERDF, calendar pressures do not affect the implementation of the funds and eligibility has not been an issue. Trust between actors, institutional expertise and long experience in managing the fund has facilitated smooth delivery.

**Governance challenges include aligning the different interests of public and private actors.** As private actors do not have a mandate for territorial policy, and they conduct themselves on a financial returns basis, the alignment of different aims has not always been easy. In **Mellersta Norrland**, for example, there has been some tension over finding the right balance between the main objectives of FI intervention. On one hand, the public funds should work towards the objective of company growth and new job creation, while on the other, they should also aim at more long-term regional growth and enhancing the establishment of a lasting private venture capital presence. While admitting that this two-part objective has prompted questions about how the two ambitions should be prioritised, both co-investment funds in Mellersta Norrland emphasized that this has not hindered to their day-to-day operations nor investment decisions. The assessment of companies in which to invest is made on a purely economic basis and without considering regional policy implications or external factors, in the same way that private venture capital investors operate (although the co-investment funds have no formal profit requirement). The objective of long-term regional stability and growth is understood by the managers of the public funds to already be inherent in the market-complementing intervention itself (and is also pursued through the reinvestment of returns in the region).

**The combination of absorption capacity, the need for financial returns and market profitability and regional policy goals was not as smooth as desired, affecting the final effectiveness of the instruments in terms of regional policy.** In Lombardia, one major reason for the decision to discontinue the FI before the end of the programming period was that the financial intermediary prioritised other commercial interests over the promotion of the Made in Lombardy guarantee fund. The combination of administrative burden, an evolving financial climate and the fact that they could offer other, more profitable, tailor-made financial products dissuaded them from promoting the FI - so much so, that some final recipients observed that the financial intermediary's approach was not very proactive when requesting additional information.

As a result, **long term processes aimed at building confidence between actors, capacity building and previous experience of fund management can be identified as key for success** in the implementation and governance of FI.

## 8.4 The role of the Financial Intermediary

The role of the Financial Intermediaries has been proven to be critical in all the case studies. As the FIs relied on private Financial Intermediaries, their **capacity, territorial presence and market interests have been proven to be one of the key factors for the success** of Financial Instruments.

In the case of **Lombardia**, acting with only one Financial Intermediary seemed to be one of the weaknesses of the instrument. The election of just one Financial Intermediary whose investment strategy was not fully aligned with the ROP and the FI aims became a problem once execution started. While the initial allocation of funding was €33 million, only €9 million was spent, and the FI was discontinued before the end of the programming period. Lessons have been learned, in that in the 2014-20 programming period, the selection of financial intermediaries is no longer restricted to one main player.

In contrast, in **Andalucía**, the MA decided to work with multiple Financial Intermediaries aligned with the overall strategy. In the case of the JESSICA initiative, the European Investment Bank decided to change one of the Financial Intermediaries due to their lack of capacity to guarantee the proper delivery of the funds. In this case, the role of the Financial Intermediary has been much more important, as the final Financial Intermediary acted not only as source of funding, but as an actual fund promoter, providing advisory services to recipients. The Financial Intermediary helped the final recipients to design, calculate and model the projects, and also helped to find additional funding.

Despite initial difficulties, Andalucía fund managers identified that **a strong and diversified network of Financial Intermediaries was one of the keys to success**. This has also been highlighted as one of the strengths in the **Wielkopolskie** case, where the Financial Intermediary was recognised as one of the driving elements to build a culture for the use of the ESIF Funds.

Moreover, in the case of the Mellersta Norrland region, the importance of the Financial Intermediary role is also confirmed. The **extensive personal and professional networks among local authorities, investors, and entrepreneurs in Mellersta Norrland are crucial in helping overcome territorial challenges**. This underlines the importance of the co-investment funds being physically present in the different parts of the region, and the Mellersta Norrland funds have succeeded in this by hosting different kinds of networking events and raising awareness among industry networks about their presence in the region. Private co-financers have also played an **important role in overcoming territorial challenges by creating pan-regional consortia and collaborations between private investors, tackling the critical-mass challenge by ‘pooling’ both the supply of and demand for risk finance capital from the entire region**. Another example can be found in Norway, where the structure of Innovation Norway with **their regional presence has also been a key feature of successful FI implementation**. For many businesses in remote areas, Innovation Norway is the main source of finance and advisory services, and their

presence is maintained in circumstances that the private sector is unable to sustain for commercial reasons. There is a nevertheless even here a **tension noted between maintaining a regional presence in remote regions and having sufficient critical mass.**

*Box 8-1: Two examples of the importance of the Financial Intermediary role : the case of Mellersta Norrland region and Norway.*

The extensive personal and professional networks among local authorities, investors and entrepreneurs in **Mellersta Norrland** are crucial in helping overcome territorial challenges. This underlines the importance of the co-investment funds being physically present in the different parts of the region, and the Mellersta Norrland funds have succeeded in this by hosting different kinds of networking events and raising awareness among industry networks about their presence in the region. Private co-financers have also played an important role in overcoming territorial challenges by creating pan-regional consortia and collaborations between private investors, tackling the critical-mass challenge by 'pooling' both the supply of and demand for risk finance capital from the entire region.

Another example can be found in **Norway**, where the structure of Innovation Norway with their regional presence has also been a key feature of successful FI implementation. For many businesses in remote areas, Innovation Norway is the main source of finance and advisory services, and their presence is maintained in circumstances that the private sector is unable to sustain for commercial reasons. There is a nevertheless even here a tension noted between maintaining a regional presence in remote regions and having sufficient critical mass.

*Source: authors*

## **8.5 Geographical allocation of funds**

While one of the main goals for ESIF co-financed Financial Instruments is supporting territorial cohesion between regions, most of the case studies noted a **lack of territorial focus within the regions. Most of the investments were allocated in the sub-regional areas with highest economic activity.**

In the case of **Wielkopolskie**, the JEREMIE Fund operated in a spatially-blind manner. The MA had considered focusing JEREMIE interventions on counties with higher unemployment and poor socio-economic conditions, however, this **territorial focus was ultimately abandoned**. While loans and guarantees reached all sub-regions of Wielkopolskie, the distribution was skewed towards the region's capital city (Poznań) and its county, where most economic activity is concentrated. For the JESSICA Fund, the territorial focus included broad swathes of cities to ensure maximum eligibility and uptake. It is worth noting that in Wielkopolskie, this concentration has encouraged the managing authority to consider a more targeted approach in 2014-20 to promote loans in the lagging sub-regions, and that the management of the new Wielkopolskie Development Fund, which uses revolved JEREMIE and JESSICA funds, aims to take a more place-based approach.

There was also **geographical concentration** noted in **Andalucía**, where the capital province of Seville accounted for 47% of total JEREMIE allocations. In the case of **Lombardia**, two provinces (Brescia and Milano) received almost 50% of the funds, as most of the manufacturing sector (the target of the Made in Lombardy Fund) is concentrated in these provinces. The **Mellersta Norrland** case also highlighted a degree of concentration in the main urban areas where the demand for risk finance was higher. The focus of investments under the co-investment funds, measured both in the number of beneficiaries and in the volume of the invested capital, was centred in the main urban areas rather than in rural municipalities, and also along the Western Baltic coast rather than in sparsely-populated inland areas. This partly relates to the supply of private co-investors: in some cases there may be promising entrepreneurial activity with high growth potential, but few private co-investors available in that part of the programme area. In addition, part of the regional variation in demand can be explained by the variation in interest and need for risk capital between different sectors.

The concentration in those areas where economic activity is higher is a logical outcome of the agglomeration of firms within the territory. Firms tend to be established in the areas where most of the economic and business services are located, including financial services, utilities, professional services and logistic capacities. **The territorial allocation of demand for Financial Instruments is heavily affected by this agglomeration, and this is even more notable where the sophistication of the financial instrument is higher. While loans and guarantees can be delivered to a wide range of businesses, only a very small group of high growth firms are able to properly absorb risk capital finance, and they tend to be concentrated in urban areas rather than in intermediate or rural ones**, as was found in Andalucía and Mellersta Norrland.

The **existence of an existing ecosystem for this kind of businesses has been highlighted as one of the key elements for Financial Instrument deployment**. The aims of promoting regional innovation and territorial cohesion are not always fully correlated, as innovation requires a proper ecosystem which tends to be territorially concentrated. **Unless there is a clear mandate for investing in the most deprived areas - as in the case of the Regional Investment Fund in Norway - market dynamics tend to promote concentration in specific areas**. The aim of the Norwegian scheme is to facilitate access to finance in rural and remote areas as part of the wider economic development strategy for the sparsely-populated regions, and the scheme has an explicit territorial dimension, insofar as Innovation Norway seeks to support projects outside the main population centres where the private banking presence is limited.

**The drive for absorption also affects territorial focus**. In the case of Wielkopolskie, the territorial focus became a subordinate aim to the drive to ensure absorption and the return and reinvestment of funds. If absorption is in the driving seat of the Financial Instrument, territorial balance can be jeopardized.



It is also important to note that, during the 2007-13 period, ESIF FIs were aimed solely at enterprise support and urban areas/energy efficiency and renewables, and this is reflected in their geographic distribution. In the 2014-20 period, scope to use FIs has been extended to all thematic objectives and all ESI Funds, including EAFRD and EMFF. In theory, this could broaden the scope for FIs to address, for example, the needs of businesses in more rural areas.

## **8.6 Impact on entrepreneurial and innovative culture of the SME ecosystem**

**Most of the case studies reflect the positive effect of FIs on the innovative and entrepreneurial culture in the region.** Financial Instruments provided specific finance for investments which, due to the risk aversion of commercial operators, was not previously being developed. Therefore, firms were able to increase their capacity to undertake complex investment projects in fields such as R&D. At the same time, the provision of funds encouraged the entrepreneurial culture in some areas of the regions. In this way, **Financial Instruments supported the creation of a kind of knowledge transfer among the involved actors: public administrations, Financial Intermediaries, co-investors and firms.**

While it is difficult to measure the contribution of the instruments to this immaterial capital, it has been identified in most of the case studies. The know-how of the Financial Intermediaries was transferred to the Financial Instruments and then to firms and entrepreneurs, thus increasing the sophistication and complexity of the economic and social dynamics at a territorial level. This kind of intellectual capital must not be underestimated, as most modern economic growth theory signals this factor as **one of the key elements for regional competitiveness and performance.**

As an example, the Financial Intermediary in the JESSICA fund in **Andalucía** was committed to advising local authorities and promoters in the structuring and operation of complex infrastructure projects, using Public-Private Partnerships and other project finance modalities, which are far from the more traditional modalities of infrastructure and urban projects. This **generation of knowledge is a valuable outcome** of the JESSICA fund.

Similar experiences can be identified in other case studies. Knowledge transfer - for example from the large national and international banks BGK and EIB, who have a great deal of experience with FI implementation - was also highlighted by the **Wielkopolskie** case study. The **Lombardia** case study noted the importance of the Financial Intermediary in the capacity building of the Financial Instrument, allowing the Managing Authority to achieve a better understanding of the financial industry. This effect was also transmitted to final recipients. In this case, the FI promoted a combination with grants that generated a specific additionality, as the Made in Lombardy initiative was accompanied by a grant in the form of a voucher to assist with business counselling or business plan preparation.

Scope to combine instruments and forms of support in this way is a notable feature of the **Norwegian** case, where grants are sometimes offered as part of the package, if it can help to bring a private bank on board, for example, if a bank is concerned that risk of default is too high because financing is wholly in the form of debt. This may involve putting together a package of finance involving the Regional Risk Loan, Innovation Norway commercial loans, and possibly small scale grant funding. Applicants often approach Innovation Norway accompanied by commercial banks with the aim of **assembling a funding package and securing the involvement of private banks through risk-sharing**. An interesting point to note is that, on occasion, the involvement of Innovation Norway in projects in which commercial banks had been initially uninterested can lead to banks financing projects in their entirety. Even though there is ultimately no loan transaction with Innovation Norway, this is regarded as a success in policy terms.

It is important to note that the level of experience in FI implementation varied widely within the regions. In Lombardia, for example, this was the first time the regional administration or fund manager had managed a fund of such a size, and the FIs were 'pioneer' programmes in Andalucía. In the case of the Swedish and the Norwegian FIs, the learning curve was perhaps less steep, as there was long-term experience to draw upon.

## 8.7 Conclusions

According to the key common elements among the case studies, the following main conclusions can be drawn:

- There is a **trade-off between the different targets of Financial Instruments** - absorption capacity, promotion of innovation and sophistication of economic activity, and territorial cohesion - within the case study regions that does not appear to be fully compatible. The results of most of the case studies noted a lack of territorial focus within the regions, as **most of the instruments placed less emphasis on territorial factors within the region than on other priorities**. The outcome is that in these cases **FIs were concentrated in zones with better economic performance**. It can be concluded that FIs have not contributed (in these cases) to overcoming territorial imbalances.
- Most of the Financial Instruments generated a **positive impact in terms of diversification of sources of financing both for firms and urban projects**. This is particularly relevant in the case of those regions that suffered from strong financial constraints during the financial crisis. Multiplier effects of the funds were related to the type of financial product offered, and while venture capital investments and loans tended to generate a lower multiplier effect, guarantees increased the effect. Demand outstripped the finance supply in most cases, but particularly for loan and guarantee products. The revolving nature of the instruments has also allowed their financial impact to be increased, reaching higher number of firms and supporting the creation of employment and new enterprises.
- Governance and administrative arrangements have been challenging during the implementation and execution phases. **Heavy administrative burdens have eroded the effectiveness of the instruments**, producing a lack of security in the execution and audit phases. In several regions, a significant part of the demand was ineligible. **Lack of**

**legal security on the management of the funds in 2007-13 has been considered as a weakness, especially in those regions with less existing institutional capacity.**

- Furthermore, **aligning the different interests of public and private actors** has been challenging and therefore the combination of absorption capacity, the need for financial returns and market profitability and regional policy goals was not as smooth as desired, affecting the final effectiveness of the instruments in terms of regional policy.
- **The role of Financial Intermediaries is very important especially in regions where there is weak institutional capacity.** The process of selecting, screening and managing the relationship with them has proven to be a key element for the success of Financial Instruments. Financial Instruments appear to be more effective where Financial Intermediaries have a clearly focused investment strategy, in full coherence with the FI targets. There is an opportunity for skills to be transferred between more and less experienced actors, for example, between national promotional banks or the EIB/EIF and local actors.
- One of the key positive outcomes of the instruments is the **generation of innovative and entrepreneurial culture and know-how transfer among the actors.** While this immaterial capital is difficult to measure, the case studies highlighted this effect as one of the most positive ones, which can be relevant to the long-term economic performance of the regions.
- It is notable that there is **an almost universal lack of ex post evidence of territorial and economic impact** measured with quantitative and systematic methods. Only the Norwegian case carried out continuous econometric impact evaluations. Field and econometric impact evaluation practices are crucial in order to continuously improve the performance and impact of FIs.

## 9 Policy proposals for the debate on financial instruments in EU Cohesion policy post-2020

These conclusions and policy proposals draw on the data analysis and the case studies carried out for this project, as well as the wider literature and discussions held during the EWRC events in October 2018. Before turning to these, some general remarks are in order.

A first general point to emphasise is the **heterogeneity of financial instruments**. Financial instruments in Cohesion policy have come to be referred to *en bloc* – largely because specific regulatory arrangements apply to them. In reality, the commonalities across the range of policy tools classed as FIs are few. *The single shared characteristic is that financial instruments involve repayable funds*. Beyond this, the scale of intervention ranges from measures exceeding €500 million and operating over wide geographical areas, to those with budgets as low as €10,000 operating very locally. The instruments discussed in the case studies exemplify this range – from the two co-investment funds in Mellersta Norrland with combined assets of €33 million, to the allocation of nearly €400 million to the JEREMIE fund in Andalucía. Governance arrangements involve diverse institutions and structures, from the EIB group and national promotional banks, to public financial institutions at the regional level, private intermediaries and associations such as chambers of commerce. For enterprises, financial products range from large scale generic business loan schemes, to small-scale equity funds focused on specific activities, sectors or classes of enterprise; urban development and energy efficiency FIs can involve complex integrated financial packages to upgrade particular districts, but also simple householder loan schemes to improve residential insulation. This diversity is featured in the case studies – even within regions FIs funded very different projects: in Andalucía typical JEREMIE projects involved expanding SMEs and improving their performance, with a special focus on start-ups and tech firms, while JESSICA projects mainly involved large-scale public infrastructure facilities.

**Financial instruments are also diverse in territorial terms.** Cohesion policy FIs differ widely in scope, partly linked to the OPs through which they are financed. They may cover a single regional OP corresponding to NUTS 2 and a population of a few hundred thousand, several NUTS 2 regions under a multiregional OP or a national OP covering a population of several tens of millions. Moreover, as the study shows, up to five OPs may offer Cohesion policy FIs in the same region, often for quite similar purposes. These disparate geographies and overlapping jurisdictions complicate any analysis of the distribution of spend.

Another important territorial dimension to the diversity of FIs is the spatial focus. **Most financial instruments are ostensibly spatially neutral**; however, in practice, this means that they are demand-led, with investment tending to be concentrated in the more economically-developed areas within their territory. By contrast, a few FIs explicitly seek to offset regional or local disadvantage, such as the Regional Risk Loan in Norway. From a *national* perspective, the separate regional co-investment funds in Sweden can also be viewed as seeking to address regional disadvantage, by using a regional breakdown to

provide an element of ring-fencing. In the main, however, financial instruments are demanded and a spatial focus is rare.

Financial instruments **differ widely in domestic importance**. In some instances co-financed FIs are an additional credit line in an existing institution so that ESIF essentially reinforces existing domestic budgets for the same purpose (this is the case for some FIs operated by German *Länder*). Elsewhere, they are operated as free-standing new instruments, sometimes on a pilot or experimental basis to maximise the use of modest OP budgets (as in the London Green Fund). Alternatively, cofinanced FIs may account for a significant share of public repayable finance for SMEs, as in Lithuania, for example.

A second key point to highlight is that ***financial instruments are only suitable for some policy objectives and where the investment will generate revenues and cost-savings*** enabling the initial capital advanced to be repaid. The use of financial instruments varies according to the wider economic context – the case studies for Andalucía and Lombardia show how important Cohesion policy FIs were in the aftermath of the financial crisis; similarly, the Norway case study noted how the Regional Risk Loan supported the fishing sector when commercial banks were unwilling to. In this sense, publicly-backed FIs can address a gap in access to finance that may vary over time, as well as (partially) replacing grants as a mechanism to promote investment. The heterogeneity of FIs is therefore a strength since a mix of financial products can respond flexibly to local conditions. That said, even in policy areas such as SME development where financial instruments are prevalent and their role is self-evident, grants often have an essential part to play. The data analysis highlights how small a proportion of Cohesion policy spend FIs represent, even in policy areas where they might be considered most relevant.

A third general point concerns **the quality of the evidence base**. A major challenge for the study has been the collection of relevant data. The data gathering process exposed both the paucity of the data available and its lack of comparability. These shortcomings are a significant obstacle to a fine-grained assessment of the added value and impact of FIs. Moreover, the different 'forms of finance' reported by managing authorities do not map directly to financial instruments, and the policy priority codification in the Implementation Regulation do not correspond to the policy targets addressed by financial instruments in 2007-13. As a result, it is in most cases impossible to assess the complementarity of grants and financial instruments. The role of data gathering and reporting is given further consideration below.

Moving on to **policy recommendations**, a key theme that emerges is that of managing the tensions between potentially conflicting objectives: should the bureaucracy surrounding FIs be 'lighter touch' than for grants given that the sums are (in principle) repayable? Should reporting on FIs be less onerous with a view to encouraging their use, or does data gathering for audit and evaluation take precedence? How important is the performance of an FI in terms of using the funds available and generating returns and how is this balanced with taking risks

that strictly commercial investors will not? And, in the present context, how do these tensions play out in territorial terms?

**There is a need to ensure that administrative requirements are not a disincentive to use FIs rather than grants.**

The regulatory framework for FIs in Cohesion policy has been challenging for the Commission and managing authorities alike. The issues have been documented in detail elsewhere and centre on the complexity of the rules, especially in relation to State aid and public procurement, the status of guidance in the context of audit and wider concerns at the extent of reporting.

There are additional layers in the 'chain of command' for ESIF FIs compared to purely domestic financial instruments *and* compared to ESIF grant schemes. This means that the implementation of ESIF FIs requires a degree of commitment on the part of managing authorities, and/or a conviction that the potential wider benefits of using financial instruments instead of grants will indeed materialise. Research on the uptake of financial instruments in 2014-20 suggests that even in the area of SME support, EU regulatory issues are a significant reason for MAs *not* to use FIs (European Commission, 2017a). It is worth noting, however, that the adoption of the Omnibus Regulation during the 2014-20 period introduced a number of simplifications and the draft regulations for the 2021-27 period propose additional simplifications; both were generally welcomed by managing authorities.<sup>29</sup>

**Care should be taken to ensure that regulatory requirements do not undermine policy objectives.**

Some regulatory requirements have the potential to undermine the effectiveness of financial instruments. The combination of the short programming period and the N+3 requirements can conspire to make managing authorities more risk-averse. In operating ESIF there is considerable emphasis on actually disbursing funds in order to ensure they are not lost. This can result in the prioritisation of "shovel ready" or "safe" projects rather than riskier investments. This may perversely encourage a situation where co-financed financial instruments are more likely to crowd-out private funding because fund managers have an incentive to support 'easy' projects rather than insist that funds be restricted to projects that had been rejected by commercial funders.

The seven-year programming period also impedes the operation of FIs; this timescale is arbitrary and short, especially given the delays involved in the planning and approval of operational programmes – progress in implementing FIs has been slow in 2014-20, even among managing authorities with longstanding experience of operating FIs. From an economic development perspective, there is no logic to the need to close funds at the end of

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<sup>29</sup>Michie R, Mendez C and Gal F (2018) Results, Review and Reform: Delivering programme objectives while preparing for the post-2020 Cohesion policy, IQ-Net Review Paper 43(1), European Policies Research Centre Delft.

the programming period, and retender for fund managers. The management of the Norwegian Regional Risk Loan offers some lessons here. In particular, the loss fund budget provided by the Ministry (KMD) to back the scheme is not reimbursed or clawed back, but rolled over from one year to the next on a continuous basis. As such, there is no incentive to use up year-end monies and because Innovation Norway requires that applicants have exhausted commercial funding options before approaching it for support, this promotes a more policy-focused use of funds, rather than one driven by absorption pressures.

**There is a need to ensure that financial instruments do not reinforce existing disparities in access to finance, with potential negative consequences for territorial cohesion.**

Partly related to the above, financial instruments have the potential simply to reinforce existing spatial disparities in access to finance because of the pressure to disburse budgets and avoid decommitment. Perhaps as a result (and also due to the absence of delineated assisted areas for ESIF since 2000-06), there are few examples of FIs that proactively target disadvantaged areas. In the current ESIF period, the JESSICA programme for Rotterdam is one such example, focused on deprived urban areas through an ITI (Integrated Territorial Investment); in 2007-13 the BRUSOC fund in the Brussels region targeted entrepreneurs in the former Objective 2 areas. Outside the EU, the Norwegian Regional Risk Loan is restricted to designated aid areas, and even within these, seeks explicitly to target funding outside the main population centres. By contrast, the Wielkopolskie case study showed that ambitions to focus on deprived areas can in practice be stymied by wider regulatory complexities and the pressures of short timescales with the result that positive discrimination in favour of disadvantaged areas is diluted or lost.

The ex ante assessment is an important innovation in the 2014-20 Regulations and has generally been welcomed by domestic policymakers for giving greater clarity to policy objectives and better insights into funding requirements. In the context of territorial cohesion there is a need to be clear about what the policy objectives actually are, and potentially accept that there may be a trade-off between a focus on disadvantaged regions and some of the benefits of financial instruments e.g. FIs may be more costly to implement in more remote regions. In short, publicly-backed FIs should not largely replicate what the private sector can do, but rather intervene where it cannot or is unwilling to at the scale required.

It is also worth bearing in mind that during 2007-13, the focus of FIs was restricted to SME support, and to a much lesser degree urban and energy efficiency projects. This may have a bearing on the location of investment. The widening of thematic coverage of FIs in 2014-20 may change investment patterns, though early indications from Commission reporting on the 2014-20 period suggest that implementation in areas other than SME support has been very slow.

**Policymakers point to the importance of policy learning, experience and progressing from simple to more sophisticated financial products.**

Co-financed financial instruments tend to follow one of two models. First, an existing domestic mechanism is provided with an additional block of funding (for instance, a national promotional bank establishes an additional credit line), which is essentially disbursed along the same or similar lines as existing domestic funding. Second, a bespoke fund is established in response to specific identified needs. The first option might be regarded as somewhat mundane since ESIF FIs are simply supplementing domestic funding streams, but this is not only a relatively quick and “safe” route to implementation, it also takes advantage of existing institutional and administrative capacity. The second approach is considerably more risky from the managing authority’s point of view, and more time-consuming, though the outcome might be more innovative. It may also be necessary, since there may not be an existing domestic vehicle to which it can be linked. The Commission's ex post evaluation of 2007-13 FIs found that those which performed best were those that were able to draw extensively on the experience either of existing systems and structures, or past programmes, while committing funding allocations that could realistically be absorbed. In similar vein, policymaker debates at the 2018 EWRC stressed the value of 'starting simple' – beginning with straightforward and standardised financial products that use existing structures and moving to more complex forms of intervention as experience grows.

Since the period under study (2007-13), administrative capacity has been a focus of attention within the debates on Cohesion policy implementation more generally. Specifically relevant to financial instruments, EU level Technical Assistance platforms such as *fi-compass* have been introduced in 2014-20, and made significant efforts to increase capacity within the field of financial instruments.

**Consideration should be given to the role of data collection and reporting for financial instruments to improve the understanding of policy effects and added value.**

The scale and complexity of reporting on financial instruments is a source of frustration to many managing authorities. However, in spite of the administrative burden involved in data collection, it still yields insufficient information to enable an assessment of the effectiveness of financial instruments as a policy instrument.

The quality of the data collected on financial instruments, even in mandatory annual reporting, is poor: the information is often incomplete, error-prone or cannot easily be reconciled with other indicators. Reporting of voluntary information is even more sparse. Few managing authorities collected *any* performance-related data on the operation of financial instruments. The most common indicator collected is job creation, but the definitions vary between countries (sometimes within them) and it is unclear to what extent jobs can *genuinely* be attributed to the FI, thus precluding any credible assessment of impact on employment. This raises the wider issue of the relationship between reporting, accountability and impact. It can be argued that the delegation of implementation to financial intermediaries requires *more and*



*better reporting* of information in order to ensure that investments are made in line with OP priorities. Conversely, as financial instruments are repayable, it can be argued that *reporting should be less onerous* for FIs than for grants, except in cases where the capital advanced is not recovered or guarantees are called in. This is not to suggest that losses *per se* should be a source of concern – if public FIs are targeted appropriately they are likely to incur losses since they are targeting investments rejected by commercial investors – but simply that the loss of public funds should be justified and subject to appropriate audit procedures.

That said, it remains clear that FIs **do have positive effects**. Although frequently used for working capital rather than to fund investment, FIs have helped mitigate the impact of financial crisis in many regions. There is also evidence that they have led to a more sophisticated and diversified financial market for SMEs, generated substantial leverage and legacy for reinvestment and enabled knowledge transfer and capacity building. The wider literature also shows the importance of time and experience in policy evolution, and how that carries through into policy performance (European Commission, 2016).

**Governance structures need to combine financial expertise and local knowledge if they are to address territorial cohesion.**

Implementation of ESIF financial instruments typically involves a steep learning curve for managing authorities. The case studies have emphasised the key role which national and regional promotional banks and financial intermediaries with local knowledge play in successful implementation. However, local expertise may not always be present. In some central and eastern European countries – notably Hungary – there has been an explicit strategy to involve local financial intermediaries in Cohesion policy FIs, contributing to the building-up of local financial markets, but in others, such as Romania and Bulgaria implementation is more centralised. A potentially growing challenge in the centralisation of the commercial banking sector and the decline local branch networks, especially in remote and rural areas. In Norway the regionalised network of Innovation Norway offices seeks in part to compensate for this trend and is testament to the importance of long-term strategies to address access to finance in remote regions. More generally, other case studies also emphasise the building of trust and confidence between actors as key to success in FI implementation.

Given the focus of this report, it is appropriate to reflect on **what can be said about the contribution of Cohesion policy financial instruments to territorial cohesion**. Major complications in addressing this question arise from the heterogeneity of financial instruments described at the start of this chapter. Nevertheless, there are some insights from the territorial distribution of FIs, the analysis of added value and the case studies.

It is clear that most financial instruments are 'spatially-blind', in other words there is generally no geographical focus to intervention within the jurisdiction in which they are available. This means they have the potential to reinforce existing spatial disparities in access to finance within a country or region, which tends to disadvantage rural and remote regions. It may well

be that this is even more likely in the context of financial instruments than grants - if financial intermediaries are risk-averse or have limited incentive to develop markets beyond the main urban centres, investment may be disproportionately concentrated - but there is insufficient data to substantiate this.

Few financial instruments proactively target disadvantaged areas. Such FIs typically involve more effort, more risk and higher costs: it may be more difficult to find financial intermediaries willing and able to target disadvantaged regions, so management costs may be higher; projects may be riskier, leading to poorer returns on the investment and smaller legacies; and it may simply be harder to identify viable projects against the time pressures imposed by the OP schedule, which tends to prioritise absorption of funds. In short, while there is evidence that FIs which target disadvantaged regions can work well, there *may* be a trade-off between a focus on disadvantaged regions and some of the benefits of using FIs in terms of costs and legacy.

Factors such as Cohesion policy eligibility, quality of government, financial context and geography have an impact on the patterns of uptake of financial instruments. However, these factors are interrelated and, fundamentally, are influenced by both the scale of Cohesion policy funding and, related, the presence or absence of domestic FIs.

- In terms of **financial context**, regions in market-based financial systems spend a **higher share** of Structural Funds through FIs than those in bank-based or former socialist countries. However, this pattern is partly a function of lower absolute levels of Cohesion policy funding in these regions and the relative absence of OP priorities (such as basic infrastructure) for which FIs are not suited.
- Uptake of FIs in absolute terms is highest in regions with a **low quality of government**; this is mainly because quality of government is quite closely linked to levels of economic development, and poorer regions qualify for larger Cohesion policy allocations.
- The 'reach' of FIs, measured in terms of numbers of financial recipients, is also greatest in regions with **low quality of government**. This is primarily a function of the choice of product type, which tends to be loans or guarantees rather than equity.

Caution should be exercised in drawing conclusions from these patterns which can easily be influenced by the impact of high spend on FIs in just a few regions; differences between regions often just reflect different policy choices. For example, a managing authority may opt to assign a large part of its budget to FIs, because the budget is small, but will generate a legacy; conversely, a managing authority may eschew the use of FIs because the budget is small, so the administrative effort is considered disproportionate. Of key importance here, this study has only considered Cohesion policy FIs – and these typically represent only a very small part of the overall economic development funding jigsaw.

Last, it is interesting to note that the **relationship between financial instruments and territorial cohesion is very much on the current policy agenda**. Commission proposals for financial instruments in 2021-27<sup>30</sup> do not *substantially* alter the framework for Cohesion policy FIs, but tend in the direction of simplification and continuity, which has broadly been welcomed by managing authorities; however, one innovation is the scope to allocate ESIF funds to the new InvestEU initiative. Proposals for InvestEU involve a significant reshaping of the current EU level FI landscape. The geography of EU level FIs has been a matter of some debate in the past, and in recent negotiations the European Parliament, the Committee of the Regions and some domestic stakeholders have expressed concern at the link between ESIF funds and the new InvestEU programme, and at the spatial targeting of InvestEU itself. This has emphasised the need for newer and smaller promotional banks to play a larger role and for the efforts of more and less experienced financial institutions to be combined in order to improve geographical diversification. It remains to be seen how and whether the scope to allocate ESIF funds to InvestEU will be taken up, and what the territorial implications of this will be.

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<sup>30</sup> See Scientific Annex for discussion of these proposals.

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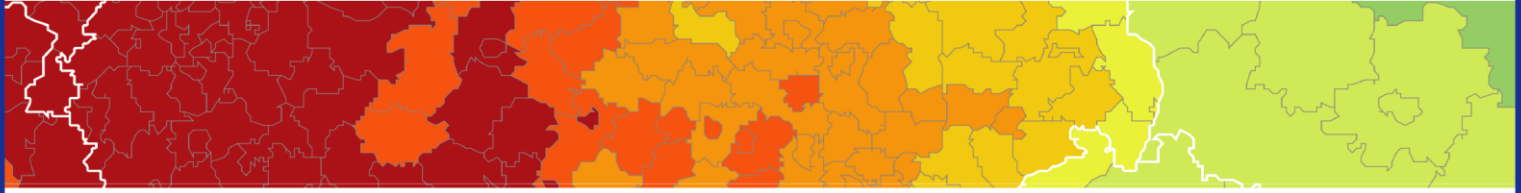
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