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Ex-ante-Bewertung eines Finanzinstrumentes des Operationellen Programms des Saarlandes für den Europäischen Fonds für regionale Entwicklung (EFRE) in der Förderperiode 2014 bis 2020

Executive Summary (English Version)

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EXECUTIVE SUMMARY

The EFRE-Nachrangdarlehensfonds at a glance

To pursue the specific objective of increasing the investment activities of SMEs by improving access to finance within the framework of the ERDF-program, the Saarland plans to use a revolving financial instrument to provide mezzanine capital in the form of subordinated loans under the investment priority 3 d (supporting the capacity of SMEs to grow in regional, national and international markets, and to engage in innovation processes). The so called “EFRE-Nachrangdarlehensfonds” aims to support a specific target group of SMEs that do not (yet) have sufficient equity and bank-specific collateral, but which nevertheless wish to make sound investments which are expected to be financially viable. To this end, the EFRE-Nachrangdarlehensfonds may grant subordinated loans to SMEs for the financing of investments and equipment. The main characteristics of the funding loans are

- their subordination to the claims of other creditors in the event of insolvency,
- the waiver of the provision of (real) collateral for the loan and
- a comparatively higher interest rate than for traditional loans, which reflects the higher risk costs.

A total volume of € 16.0 million is planned for the fund over the entire term until the end of 2023. The ERDF accounts for € 8.0 million. The subordinated loans can be granted up to an amount of € 1.0 million. The interest rate will depend on the development of the capital market and be determined according to the creditworthiness of the companies. The interest rate is designed free of state aid.

According to current plans, the fund management is to be entrusted with Saarland Investkreditbank AG (in short SIKB), the public development bank of the Saarland.

Market failure, suboptimal investment situations, and consistency

The central purpose of the ex-ante evaluation is to assess the gap in financial market supply that justifies the use of the planned public loan instrument. To this end,

- the existence of a suboptimal investment situation and the special needs for the promotion of SMEs by subordinated loans in the Saarland with regard to the specific target groups of the fund were derived theoretically and empirically,
- the existing investment and support needs in the Saarland, the concrete, expected market demand for subordinated loans and the existing public support for the target group(s) were examined.

In summary, the study led to the following assessments:

- A large body of theoretically oriented studies shows the possibilities and effects of inefficient allocation on credit markets due to credit risks and information asymmetries. These market imperfections manifest themselves in credit rationing (i.e. a demand surplus) even if the credit market is brought in equilibrium by prices. In principle, there are market options to correct for this market failure (creditworthiness check, loan securities).

However, it is not completely ruled out that individual financing projects, firms or certain groups of firms do not receive credit, even if they are willing to pay (at least) the risk-adjusted interest rate prevailing in market equilibrium. Thus, it is highly probable that firms with low equity and / or low loan securities, small and young, fast-growing firms with predominantly intangible assets and firms with particularly high-risk projects (e.g. innovation projects) are affected by a market failure according to theoretical considerations.

- A derivation of the general need for subordinated loans through representative statistical data or empirical studies is not possible for the specific instrument at hand. However, some general and region-specific facts point to a considerable need, especially in the Saarland. This includes firm's possibilities to supply loan securities as a key financing problem, a high proportion of firms with low equity in the Saarland and the special financing problems for innovative projects. Thus, from a general empirical point of view, there is a need for subordinated loans in the above mentioned target group.
- Subordinated loans represent a niche product in the financing possibilities for firms. Accordingly, the expected number of loans in the Saarland is relatively low and difficult to predict. In order to derive the expected demand, the predecessor program "Nachrangdarlehensprogramm Saarland" was examined. In addition, a survey on the expected demand was conducted based on expert interviews. The different estimation methods yield different results and were interpreted cautiously. In a cautious estimate, 4 to 15 cases per year with an average volume of € 300,000 to € 500,000 are assumed. This results in an expected demand for subordinated loans of € 1.2 million to € 7.5 million per year. The broad margin reflects the high uncertainties in the estimation.
- According to the plans of the Ministry of Economy and the SIKB, the investment phase of the fund from mid-2017 to the end of 2023 will involve 6 loans for SMEs per year (€ 16 million fund volume, average loan size of around € 400,000 per SME). If these target values for the EFRE-Nachrangdarlehensfonds are placed in a comparative context with the above estimation of credit demand, the overall budgetary approach seems to be cautious and not too high.
- If demand develops more strongly than planned in the future, the financial instrument is either to be equipped with additional resources or has to restrict lending. In the opposite case, that is if demand lags behind the expectations, means of governance should first be exploited which apply to the terms of the subordinated loan. In this case, a greater interest rate subsidy should be granted in view of the great importance of the interest rate in the comparison of terms and conditions from the borrower's point of view – even though the loans would no longer be granted free of state aid.
- In any case, the wide range of demand estimates and the lack of long experience with subordinated loans make it seem advisable to continuously monitor the implementation of the EFRE-Nachrangdarlehensfonds and the outflow of payments to the final recipients during the fund's lifetime. At the same time, the intensification of marketing and public relations activities planned by SIKB is explicitly recommended for the EFRE-Nachrangdarlehensfonds.
- The coherence analysis has shown that there is currently no directly competing or overriding supply in the area of SME financing for the EFRE-Nachrangdarlehensfonds. Both at the level of the federal state and the national level, there are individual programs in the area of (subordinated) loan and equity financing, for which amounts of intersection can be determined to varying degrees. However, the ERDF Subordinated Loan Fund has specific unique selling characteristics in comparison. The defining feature is the lack of formalized but rather strategic orientation of the target groups and the wider possibilities to offer subordinated loans for SMEs, which are restricted from financing because of their weak creditworthiness and low level of collateral. The EFRE-

Nachrangdarlehensfonds is coherently integrated into the existing landscape of public funding schemes.

Expected results, leverage effects, and value added

At the onset of discussing expected results, the outputs of the EFRE-Nachrangdarlehensfonds were estimated. Assuming full spending of the planned budget during the investment phase the financial means of the fund can be used to finance subordinated loans to about 30 to 50 SMEs. In addition, additional funds for investments are to be expected through the participation of private and public investors. The leverage effects determined in accordance with the requirements of the European Commission and, thus, taking into account the ERDF resources can be found in a range of 1.4 to 3.8.

At the commercial level of the final recipient, successful investment projects lead to effects such as sales growth, cost reductions and employment growth. The successful realization of projects can also stimulate cash flow financing in the following investment and growth stages of the firm. This also takes precaution for tightening requirements from firm's private banks ("Hausbanken") and the requirements for suppliers in some industries (for example in the automotive industry). Due to the high uncertainties that exist for the survival of start-ups or the development of innovative projects up to market maturity or up to the first sales, these effects can ex-ante only be sketched broadly.

Beyond these direct outputs and outcomes, medium-term effects are to be expected: investments and innovations are essential requirements for improving the productivity of firms. This, in turn, is the central prerequisite for the sustainable competitiveness of the regional economy, for the development of new growth areas and for additional jobs. However, these structural effects should not be overemphasized in view of the relatively small number of cases. They also depend on the successful implementation of the new instrument.

Investment strategy

The investment strategy of the EFRE-Nachrangdarlehensfonds is to be assessed as conclusive and adequate as far as it is developed and known so far. In its core elements (target group, concept, type of supported activity, conditions and terms), the financial instrument is designed in such a way that the needs in the region can be met, sufficient demand will be created and consistency with other forms of public funding is provided.

Against the background of the financing requirements of the target group (SMEs with low credit ratings and collateralisation) other forms of public intervention are not appropriate. The EFRE-Nachrangdarlehensfonds fits well into the regional system of public support schemes.

With regard to the institutional setting as an important element of the investment strategy under Article 38 of the ESIF-Regulation, the following points can be maintained:

- As regards the possible options for implementation arrangements within the meaning of Article 38, it is to be recommended to continue the already established governance structures. For this reason, the entrustment of SIKB appears advisable, taking into account state aid rules and obligations in the area of public procurement.
- The subordinated loans from the EFRE-Nachrangdarlehensfonds are aimed at promoting firms out of a specific target group, i.e. SMEs who are otherwise affected by credit constraints due to lack of equity and lack of collateral (business start-ups in their later investment stages, young innovative firms, self-employed persons, successor companies). In view of these target groups and the scope of supported investment activities (real capital investments and operating supplies), financing through subordinated loans seems to be obvious and meaningful. As alternative financial products, guarantees and venture capital are far less suitable.

- The strategic and non-formalized delineation of the target groups is plausible. The selection of final recipients in compliance with the promotion objectives and the purpose of the funding scheme does not take place through an a priori restriction to the eligibility of applicants but via a case-specific examination and assessment of the investment projects.

Conclusion

To sum up, the existence of a suboptimal investment situation and financial gap in the Saarland and thus the need for the EFRE-Nachrangdarlehensfonds is clearly identified by the ex-ante assessment. The subordinated loans from the fund are a valuable contribution to the financing possibilities for SMEs and they support the realization of investment projects which are desirable from a regional policy point of view. The EFRE-Nachrangdarlehensfonds fits well into the existing total public supply of funding for the different target groups and closes an important gap in the credit supply of private SME financing.

The fund's financial approach and moderate budget are duly justified. It seems very likely that the planned financial amount will be fully spent by the end of 2023. Nevertheless, the implementation of the EFRE-Nachrangdarlehensfonds and the outflow of eligible payments from the financial instrument to final recipients should be monitored continuously during the fund's term. In addition, an intensification of marketing and public relations work for the EFRE-Nachrangdarlehensfonds is highly recommended. The funding agreement should include clear provisions in this respect. If introduced in a timely manner and successfully implemented, the EFRE-Nachrangdarlehensfonds can become a key building block for SME support under the Operational Program for the ERDF during the funding period 2014 to 2020 in the Saarland and can make a substantial contribution to the relevant specific objective.