

**Ex-ante assessment of a microcredit fund
envisaged in the operational programme
of the Free State of Saxony
for the European Social Fund (ESF)
in the 2014-2020 programming period**

– Management summary –

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Background and research methodology

The Operational Programme of the Free State of Saxony for the European Social Fund in the funding period 2014-2020 (ESF OP) envisages to allocate funds for a micro-loan fund. This funding opportunity is intended to help to meet the capital requirements for start-ups or for the development of young micro-enterprises.

According to Article 37(2) of VO (EU) 1303/2013 (ESIF-VO), it is necessary to conduct an ex-ante assessment for the support of such financial instruments. To clarify the requirements for the ex-ante assessment of financial instruments, the European Commission and European Investment Bank have published a comprehensive methodological guideline in April 2014.

The ex-ante assessment follows this guideline. In addition to the analysis of relevant data it is based on document analysis and expert assessments of the supply and demand aspect of the market segment as well as other relevant issues.

Assessment of consistency

An examination of the relevant documents has shown that the planned support for the Micro Loan Fund of the Free State of Saxony from the OP ESF is consistent with the definitions and ratings of the partnership agreement, the OP ESF and the ex-ante assessment of the Operational Programme.

Analysis of market failures and investment needs

The number of enterprises has grown in Saxony during recent years. Nevertheless, this number is still below the national average. The number of business start-ups has been undergoing a downwards trend and the number of start-ups per capita is also significantly below the national average. With the goal of building stable, competitive companies, a higher number of start-ups appears economically desirable. Analyses have shown that market failures exist with regard to entrepreneurs' and young micro-enterprises' access to start-up financing.

Under the current conditions (corporate holdings, start-up dynamics, financing conditions), the deficit of external financing options for start-ups and young companies generally recognised as promising is estimated to be about 20 to 30 million € p.a. This deficit consists of market failures and less than optimal conditions for investment. Of this amount, about 4 to 6 million € is related to start-ups and approximately 16 to 24 million € to young micro-enterprises.

The main causes for the funding gap thus identified within the private banking and savings bank sector are information issues pertaining to risk assessment of start-up projects, the competence assessment of founders and the lack of profitability of lending for projects with low credit demands.

In addition, aspects such as founders' lack of a 'credit history' with relevant credit institutions and loan applicants' insufficient collateral play a role.

Assessment of the value added of financial instruments and consistency with other public interventions as well as the proportionality of the intervention

At the level of the individual borrower, the value added consists of the fact that the fund provides an additional opportunity of finance, which is difficult to attain on the capital market. Besides, the founders establish a credit history through their funding loan repayments, which can facilitate future access to regular banking financing.

Another important aspect is the fact that loans can reduce the risks of market distortions, as they require fewer subsidies than grant supports. Existing portfolio companies find this a particularly important aspect with regard to business activities which are largely focussed on local markets subject to high competition, such as the ESF microloan borrowers do.

Compared to promoting business start-ups through grants, the proposed use of loan instruments can therefore be regarded as proportionate.

In contrast to lost subsidies, the fund's activities generate re-investment capital. In accordance with the rules for the EU Structural Funds, these returns are to be used for similar purposes, thus multiplying the effects of funding. At the same time, the Free State of Saxony retains its ability to substantially support further measure of economic funding despite declining/ reduced budget transfers.

At a regional level, the value added of the fund can also be seen in the fact that the Free State's existing instruments for promoting competitiveness in the business sector are being usefully supplemented. An examination of existing funding initiatives with similar purposes has shown that the proposed microloan has no significant overlaps.

Finally, it is important to emphasise the job creation effect of the proposed loan fund with a view to the objectives of the strategy Europe 2020. According to the experiences of the 2007-2013 programme period, an average of approx. 0.7 - 0.8 new jobs are created per start-up. This is in addition to the employment opportunities of the founders themselves.

Estimate of the additional public and private resources required of the financial instrument (leverage effect)

After taking into account the national public co-financing of the proposed fund as well as mobilising additional external resources at the borrowers' level, the fund's leverage effect can be estimated as approx. 1.3.

Review of experiences with similar instruments

Extensive data is available from the Free State Saxony's promotion of microloans from the ESF, which started in 2006. These can be referred to for the design of the proposed fund. The results and experiences with regard to the accuracy and effectiveness of the subsidies reflect favourably on a continuation of Saxony's microloan fund.

However, initiatives requiring less administrative effort should be examined as a possible alternative. This is particularly relevant to the question of whether ESF funds should also be

used to further develop the micro finance infrastructure to promote business start-ups in Saxony with lower financial needs.

Assessment of the investment strategy

Analysis of previous experience has shown that providing micro loans for business start-ups and young micro-enterprises carries specific risks and does not constitute a profitable business model which would be able to sustain itself in the long term. In this respect, there is no incentive for private investors to participate in the proposed micro-loan funds.

With a view to the objective of the financial instrument, the proposed funding conditions as a whole are attractive and well suited to the needs of the target group. Reducing the equity share to 20% in general could serve to further increase the appeal/ attractiveness of the funding opportunity/initiative. No significant negative effects are to be expected from this course of action.

With regard to the funding process, a continuous, ongoing implementation of the funding initiative is recommended rather than a competitive process with key dates. The projects should be selected on the basis of mandatory minimum requirements.

The proposed financial allocation of the fund is significantly larger than the average need that would be established as a result of a stabilization of the funding results from 2014 for the entire duration of the programming period. From today's perspective, the financial allocation for the planned financial instrument thus contains a buffer that ensures sufficient availability of funds even in the prospect of unfavourable conditions on the employment market and fiscal policies.

Retaining such a stabilisation reserve appears entirely justified. However, plans should be synchronised regularly with the actual state of implementation in order to allow timely adjustments to the budget if required.

Specification of expected results

The fund's plans provide support for 1.800 start-ups or enterprises during the duration of the programme. At least 80% of the beneficiaries are expected to remain self-employed one year after the funding initiative's beginning.

According to the available data on start-ups' average survival rates and failure probabilities in Saxony's ESF Microloans Fund it is expected that the intended level of subsidised enterprises' and start ups' persistence is indeed achievable.

Regarding the target of 1.800 business start-ups, the target presupposes a significant increase in the scope of the support by about a third as compared to the level of 2014. This seems generally possible.

Provisions for the review and possible updating of the ex-ante assessment

Significant changes in the market situation for start-ups or micro-credit financing in Saxony as well as to funding programmes with a similar objectives could give rise to a change in orientation of the proposed financial instrument.

The same applies to potential difficulties in the implementation of the proposed funds.

As to whether a substantial re-orientation of the fund is indicated:

- should be assessed in the event of considerable changes to the conditions or significant difficulties to the implementation of the fund. If these do not arise:
- be assessed referring to the implementation reports in accordance with Article 50(4) and (5) ESIF-VO

If the assessment indicates a substantial need for re-orientation of the fund, a review and possible update of the ex-ante assessment should be undertaken.
