European
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Bank

SME CONSULTATION 2007/2008

FINDINGS AND CONCLUSIONS

May 2008

Executive Summary

Support to SMEs has become a key priority for EIB Group, in line with the strategic orientations approved by the board of Governors in 2005. This transversal sector involves both EIB financing through the EU banking sector, and European Investment Fund ("EIF") within Europe for risk capital and guarantee operations.

On 15.05.2007 after close to 2 years of implementation of European Investment Bank Group's (EIB Group's) new strategy, the EIB Management Committee decided to launch a consultation process (the "SME Consultation") with banking partners, public authorities and SME representatives on the modernisation of the Bank's product offering to SMEs in EU-27, with the aim to increase its value added for the final beneficiaries.

At the beginning of the exercise, the general opinion was that in developed financial markets, access to finance is not a major issue for SMEs. The SME Consultation shows that the analysis has to be much more specific, and that indeed, there is a lack of adequate financing tools, in many countries, for a variety of SME segments, e.g. micro-enterprises without business or personal assets to offer as security, young, fast growing, innovative enterprises or those facing the challenge of transmission. This conclusion is essential also because these SME segments are important contributors to growth, competition and innovation and thus employment and the productivity of the European economy as a whole. It is of great importance for future growth in Europe that these segments in particular are not constrained by lack of adequate financing tools. In some European Member States, it is even the scarce availability of long term resources as such which could limit SME development.

The SME Consultation noticed the diversity of situations and interest amongst EU Member States and shows that there is no single European SME market. It will be the challenge for EIB Group to depart from a macroeconomic pan-European perspective and take a more microeconomic one, focussed on the different national markets. It is therefore important that EIB's future activity in favour of SMEs moves away from the "one size fits all approach" and turns towards solutions, which are the result of a deepened knowledge of the various national SME markets.

There is a strong request from the market that in the context of modern SME finance, EIB departs from an eligibility restricted to new fixed asset investment, to expand towards financing of soft investments fostering internationalisation, growth and innovation. Innovation in the context of SME finance has to be seen in a broader context, where investments fostering the development of new products and services, the introduction of new production processes for goods and services, the acquisition of new markets or the financing of company transmission should become eligible for EIB finance beyond their fixed asset components.

SMEs continue to depend mostly on bank debt as a means of finance. Showing a high indebtedness in the balance sheet hampers the chances to obtain further loan financing for expansion phases. This is why, besides maintaining a strong presence in classical loan financing, alternative financing tools have to be developed. Mezzanine finance is a promising instrument, which may in the future not only be reserved to more sophisticated borrowers. In this context, EIB Group could play a specific role in close cooperation with the European Commission. A market for mezzanine financing has to be developed, including appropriate financial tools, but also based on an increased awareness building amongst SMEs through advisory and technical assistance programmes.

EIB's Global Loan product and its underlying principle will continue to have its role to play. However, it needs to evolve, integrating the findings of the SME Consultation on financing gaps and financing needs of today's SMEs. This should include the financing of working capital, investment in (international) expansion and growth, transmission, and a continued focus on R&D. A number of simplifications of the Global Loan product are proposed. These simplifications should not be viewed as a goal in itself. They are a way to reduce the administrative costs to manage EIB's products and therefore increase the financial value added available to SMEs.

Continuity in EIF's support focussed on young, highly innovative, and fast growing SMEs has been secured in 2007 through an increase of the Fund's capital by 50%, ensuring its financial self-sufficiency until 2013. Moreover, the launch in 2007 of the the Competitiveness and Innovation Framework Programme (CIP), in which the EIF acts as manager of European Commission's funds, has confirmed the Fund's business model as European body specialized on venture capital, loan guarantees, micro-credit guarantees, equity and quasi-equity guarantees and securitization.

From the SME Consultation, it could be concluded that EIB Group product offer in SME financing should be strengthened and enlarged notably in the areas of

- Equity finance
- Mezzanine finance
- Senior loan finance,

in whatever structure these products may be used, be it in the form of funds or ABS-structures or simply intermediated loans with or without risk sharing, in order to cover the largest possible spectrum of SME financing needs. The whole spectrum will not be used in each market. Taking into account the view of the respective national government about EIB's presence in SME financing, each geographical team will be able to have recourse to part or the totality of the range of EIB Group's products whenever they see a need in their specific market environment. These initiatives imply a large potential for complementary action by EIB and EIF.

In those areas and markets where strong promotional structures exist, EIB Group should team up constructively with public support institutions, wherever their schemes have proven to be successfully implemented and are in line with EIB Group's priority objectives. Very close cooperation with the Commission and the action of banking and SME associations is necessary. In this context, EIB Group is ready to bring its contribution to the drafting of the Small Business Act currently under preparation by the European Commission.

One final important finding of the SME Consultation has been that there is a lack of information amongst SMEs about the possibilities of EIB Group intervention, independently of the current size of EIB's activity in the respective market. It is worth mentioning however that this lack of information does not only concern EIB Group but is a problem common to many public support schemes. EIB Group will have to reconsider its information policy towards SMEs. It should give a very clear message about its activity, through its intermediaries, but also through other channels with a direct contact to SMEs. One option could be to initiate - for those countries really interested - the creation of national round tables with participants from SME's, banks and public support organisations to regularly evaluate improvements in SME finance and identify problems and solutions. The effectiveness of such increased effort of visibility will however largely depend on the financial value added EIB Group may be able to offer in the future.

1. Introduction

On 15.05.2007 after close to 2 years of implementation of European Investment Bank Group's (EIB Group's) new strategy, the EIB Management Committee decided to launch a consultation process (the "SME Consultation") with banking partners, public authorities and SME representatives on the modernisation of the Bank's product offering to SMEs in EU-27, with the aim to increase its value added for the final beneficiaries. It is worth mentioning that it is the first time that a consultation has been undertaken at such scale. The scope of the SME Consultation was limited to the Member States of the European Union. Reflections on EIB's activity in favour of SMEs outside of these boundaries would require another initiative.

The timing of this re-evaluation exercise of EIB Group's SME financing activity fits well with the reflections of the European Commission. Besides the European Initiative for the Development of Microcredit in Favour of Growth and Employment launched in November 2007, a "Small Business Act for SMEs" should be finalised by June 2008, and will include chapters on how to improve SME's access to finance. At the same time, DG Competition is reviewing the existing range of exceptions on State Aid applicable to SMEs in an effort to improve SMEs' access to public support where it is deemed necessary.

The present report describes how the SME Consultation was implemented and received by the market, presents the results and concludes with a list of proposals for the modernisation of the Bank's SME products.

To give an overview over the whole consultation process, this report has 5 annexes:
- Annex 1 is a statistical summary on the activity of EIB Group in favour of SMEs (pages 18-32);
- Annex 2 provides an analytical report on the SME Consultation (pages 33-47);
- Annex 3 describes financing gaps in the European SME market, as perceived during the SME Consultation and confirmed in recent publications (pages 48-81);
- Annex 4 lists the participants to the SME Consultation (pages 82-84);
- Annex 5 includes the invitation letter to the SME Consultation with its annexes (page 85-95).

2. The SME Consultation

2.1. Background

"Support to SMEs has become a key priority for EIB Group, in line with the strategic orientations approved by the board of Governors in 2005. This transversal sector involves both EIB financing through the EU banking sector, and European Investment Fund ("EIF") within Europe for risk capital and guarantee operations" (COP 2007-2009, § 228).

The EIB Group's current product offering for SMEs (EIB's global loans, EIF's portfolio guarantees, credit enhancement operations and venture capital operations) totalled some 8,6bn EUR in 2006, benefiting to some 209 000 SMEs. This number represents less than 1% of the total amount of some 25 M SMEs existing in Europe (see Annex 1). Comparing the total amount of MLT loans of less than 1M EUR (to any non-financial company) throughout Europe to the volume of SME loans in the EIB loan book, which is a way to approximately compute the market share of SME loans supported by EIB in Europe, one arrives at some 3,6%.

Some European SME markets have benefited more than proportionally from EIB Group support compared to the GDP contribution of the relevant country, some markets less than proportionally. Amongst those having benefited more than proportionally from EIB's SME support are – unsurprisingly - New Member States like Estonia and the Czech Republic, but also some of the "older" EU Members like for instance Portugal, Italy, Spain and – to a lesser extent – France and Finland. To the contrary, in countries like Germany and the UK, the use of EIB Global Loans for SME finance represents less than half of their relative importance in European GDP. In these two specific cases, reasons are of a different nature – in the former country, SMEs benefit from the strong support from the national promotional bank KfW, in the latter, banks and public authorities show a limited interest in an EIB intervention in their SME loan market.

Depending on markets analysed, volumes are not necessarily an appropriate indicator to evaluate EIB's significance in the sector. The crucial element against which EIB's action should be evaluated is the value added its intervention provides to the final beneficiaries, in terms of improving SME's access to the appropriate financial product at attractive conditions. By launching a pan-European consultation, EIB's Management Committee acknowledged the need to evaluate carefully the diversity of market situations throughout Europe, before elaborating an answer to the question where and by which means EIB Group's support to SMEs should be provided in the future. It was decided that for such an in-depth review, the EIB Group should seek advice and input from its intermediary partners, from government agencies and promotional institutions, and from those who should benefit most from its action, the SMEs.

2.2. Context of EIB Group's current position in SME finance

Finding the right balance between efficiency and transparency, the attractiveness of the Bank's product offering – its value added both in terms of pricing and of product characteristics – are keys to the future of EIB's product offering for SMEs. Diversity of financial markets and resulting specificities in the needs of financial intermediaries will continue to require tailor-made solutions for different environments (national or even regional).

Over the years since the introduction of Global Loans in favour of SMEs in 1968, the Bank has built up a network of intermediaries throughout the EU, and supports MLT loans for investments of some 30 000 SMEs every year, with an annual lending volume reaching 6 bn EUR in 2006 and 2007. Over the past years, the Bank's Board of Directors approved some 80 operations per annum with banking partners across Europe. For each operation, the EIB funds may be allocated by the respective banking partner to eligible projects over a period of up to 2 years, in some exceptional cases even up to 4 years. To fully appreciate the extent of the network of intermediaries actively on-lending EIB funds, one thus has to consider the number of operations over an average of several years. More explicitly, the number of intermediaries with which Lines of Credits have been signed over the past three years has increased from 188 to 207 in the EU member states, thereof 35 (41) in the New Member States, where the institution-building element has been of particular importance. Local regional banks have been favoured to increase the degree of penetration of EIB's funds in the local SME market. The success of this strategy is reflected in the average amount per allocation to SMEs achieved for 2006, which came in at EUR 121 500, after reaching EUR 165 000 in 2005. The careful selection of intermediaries which both have to have a renown position in those SME segments the Bank will whish to target in the future, and also are able to satisfy fully EIB's reporting criteria is an ongoing challenge for the Bank.

To respond to the request of more transparency and efficiency, and to strengthen the intermediary's sensitivity to the value-added and EU policy goals ultimately justifying SME Global Loans, several measures were implemented in the last 4 years:

- The concept of dedication was introduced, i.e. eligible projects financed through a Global Loan have to fall for at least 70% under one of the priority objectives of the Bank, be it regional development, i2i, energy, environment or SMEs. This has allowed to refocus the cooperation with financial intermediaries on the top priorities of the Bank's lending activity, notably SMEs. To be noted that the focus on SME lending as one of the priority targets of the Bank per se is simultaneously to the benefit of some of the other targets, as some operations may be dedicated to innovative SMEs and thus benefit the i2i priority at the same time as they promote SMEs. Other Global Loans may be granted to intermediaries with a client base primarily located in a regional development area (e.g. intermediaries in the New Member States), whereby a Global Loan dedicated to SMEs may also benefit the secondary target of regional development. SMEs are often promoters of projects in the energy sector (small wind farms, other forms of renewable energy), in the health and education sector (private schools, hospitals) and also in projects promoting the environment. To reckon the fact that smaller, regional banks may not be able to concentrate the use of EIB funds upon only one of the Bank's priority objectives, exceptions to the principle of dedication have been approved for some limited cases.

- The SME definition used by EIB has been aligned to the one of the European Commission as defined in its Recommendation of May 2003, i.e. the maximum number of employees for a company to be eligible for EIB funding has been reduced from 500 to 250 employees in Global Loan contracts signed as of 01.01.2005[1]. Mid Cap loans have been created to cover medium size companies with up to 3 000 employees. Any evolution in the EC's definition of SMEs would result in a change of EIB's split between the two categories (SMEs and midcap companies), since EIB follows the EC definition for its activity.

- The use of securitisation (ABS, MBS, covered bonds) as a loan substitute, has led to the expansion of the range of financial intermediaries to specialised, regional partners which may have a better reach into the market of SME lending, but which would normally not be considered by the EIB because of their lack of credit quality or due to the small lending amounts involved. SMEs securitisation has been so far the main privileged field of cooperation between EIB and EIF with the finalisation of a number of joint transactions, in which EIB usually invests in the "AAA"-rated tranches whereas EIF guarantees more junior tranches of the same portfolio to attract third-party investors as buyers of theses tranches.

- Each Global Loan operation is today evaluated against three main criteria:
    1. Compliance with the priority objectives of the Bank. Support to SMEs has been reconfirmed as a priority target as such by the Board of Governors of the Bank in 2005. To fully match the European Commission's policy objectives in respect of SMEs, the SME definition used by EIB has been aligned to the one used by the Commission as mentioned above. In the past, a Global Loan transaction could be used to cover a mixture of priority objectives as long as the project financed was within the maximum size allowed of EUR 25 M of project cost. Thus its contribution to one of the priority objectives was difficult to assess and somewhat diluted by the number of objectives. The concept of dedication today allows to clearly identify each operation's compliance with the priority objectives of the Bank. In 2006, 46 out of 77 Global Loan operations approved by EIB's Board of Directors were dedicated to SMEs.
    2. The quality of the intermediary, i.e. the commitment of the intermediary's strategy to SME clients, its market share in SME lending and regional outreach through a dense branch network, the quality of information flow between the intermediary and EIB, the degree of institution building (i.e. contribution to development of the financial markets in case MLT funds are scarce like in emerging markets).
    3. The financial value added, i.e. how EIB's intervention helps improving the access to MLT funds for SMEs, how final beneficiaries are informed about EIB support, what mechanism is used to transfer an adequate financial advantage to the SMEs, and the level of contribution to better market coverage.

The financial value added of EIB's intervention may be measured in different ways. In developing financial markets or financial markets with dynamic growth rates, obtaining MLT funding is an advantage as such for the intermediary, simply because there is no alternative provider of such funding. In turn, having access to EIB funds allows the intermediary to build up a medium long term lending activity in favour of SMEs, which otherwise may not have existed. In other markets, where alternative sources of medium long term funds are

[1] When a global loan is linked to the use of Community funds (e.g. SME Finance Facility or to a national measure involving State Aid, the EIB and the relevant financial intermediary are to apply the full range of criteria, i.e. number of employees less than 250, annual turnover less than EUR 50M or total balance sheet of less than EUR 43M, and the independence criterion.

abundant, the advantage offered by EIB's funds may be measured as the differential between the interest rate to be paid on the EIB loan and the rate to be paid on the alternative source of funding, at the time of disbursement and for the lifetime of the loan. To transfer this advantage to the final beneficiaries, some intermediaries have chosen to offer a rebate on SME loan conditions in the form of a cash refund to each SME of the EIB advantage. In the vast majority of cases though, competition between intermediary banks is considered to be the most reliable transmission mechanism to get the financial advantage offered through EIB's intervention to the final beneficiaries. Indeed, most of European markets show a highly competitive banking environment with dense branch networks. In their efforts to maintain or increase their market share in SME lending, EIB's intermediaries will use any reduction obtained in their funding cost to improve their offer to SMEs and thereby either keep a client or acquire a new one.

In this context, the information of the final beneficiary about the Bank's intervention is considered to be crucial. It is only if the SME is aware of the possibility to obtain an EIB loan that it will actually ask its bank about it. Only if the Bank's intervention is known to the market will the transfer mechanism based on competition actually function. Therefore, EIB has increasingly insisted in the past years that information about its intervention is systematically included either in the finance contract signed between the intermediary institution and the final beneficiary, or in the general conditions on lending operations of the intermediary, or in its commercial brochures and annual reports, or – more recently – in the intermediary's websites specifically dedicated to corporate / SME lending. On these websites, the Bank's eligibility criteria are explained, and it is mentioned that EIB's attractive funding conditions are in principle available to those projects, which fulfil the eligibility criteria.

Combined with different national specificities, the characteristics of Global Loans today vary from one country to the other. Some operations target R&D-intensive SMEs (Germany, Spain), others investments of SMEs in environmental-friendly technologies (Austria, France). In some countries like Poland or Italy, leasing plays an important role in SME finance, and thus, EIB provides value added by supporting the activity of leasing companies. Where smaller, regional banks are targeted to increase the EIB's market penetration, innovative security structures, such as portfolios of "cedulas hipotecarias" or other asset-backed instruments, serve as collateral for EIB's loans (Spain, Italy). In countries like the UK, the use of Global Loans is limited, but the EIB Group is present through an important venture capital activity. In France or Germany, EIB funds are disbursed upfront, reflecting the trust in the relationship between EIB and its intermediaries that the latter will be able to originate sufficient eligible projects in the required time frame. In other countries, particularly some of the New Member States, disbursement of EIB funds is made only after their use has been justified by the presentation of eligible projects by the financial intermediaries.

The activity of the EIF constitutes the second pillar of EIB Group's intervention in favour of SMEs. The EIF is the European body specialised on SME financing. It has a tripartite shareholding, which includes the EIB, the European Union represented by the European Commission, and a number of European banks and financial institutions, from the public or private sector. The fund targets appropriate returns for its shareholders according to Article 24 of its statutes. Complementing EIB's product offering so far focussed on traditional loan financing, EIF intervenes by means of risk capital and guarantee instruments, using either its own funds or those available within the framework of mandates entrusted to it by the EIB, the European Union and other third parties. Like for the EIB, the governing principle of EIF's action is indirect intervention. It will not provide equity to an individual SME, but rather invest in funds which will use EIF's funds to provide equity support to SMEs which are in line with their investment strategy. The bulk of EIF's venture capital investments are carried out using EIB resources. Since the year 2000, EIF has been responsible for all EIB Group equity instruments, investing notably in early stage to mid-stage technology funds that focus on innovative companies in the EU, and generalist funds in Accession Countries, and in the various adjacent countries. By guaranteeing SME loan portfolios, the EIF alleviates banks from part of their regulatory capital requirements, and thus allows them to engage in new SME finance operations. In terms of the development of the markets, by facilitating risk transfer and making illiquid assets such as SME loans more liquid for banks, EIF enhances the access to finance by SMEs and encourages the development of innovative products. In 2007, EIF's venture capital operations totalled EUR 500 m, while guarantee operations amounted to 1.4 bn. EIF's guarantee activity benefited an estimated 100 000 SMEs in 2007.

EIF's activity has been enriched by a number of initiatives in 2007. The European Commission has mandated EIF to manage a EUR 1.1bn facility within the Competitiveness and Innovation Framework Programme (CIP), which will be split between venture capital and guarantees. The CIP SME Guarantee facility will comprise four main business lines: loan guarantees, micro-credit guarantees, equity and quasi-equity guarantees and securitization. During 2006 and 2007, the implementation team of the Joint European Resources for Micro-to-Medium Enterprises (JEREMIE) has focused on evaluating market gaps and weaknesses in the field of SME access to finance in the European Member States and regions and have conducted about 40 national and regional evaluation studies for Member States interested in the initiative. The aim is to help Member States and regions use structural funds available for the period 2007-2013 more efficiently through the creation of sustainable financial instruments in cooperation with local financial intermediaries.

These initiatives are starting to be implemented and will contribute to strengthening the EIF's intervention, particularly focussed on SMEs with high growth potential, micro-companies (particularly start-ups) and the support of ABS structures with innovative features. These initiatives imply a large potential for complementary action by EIB and EIF.

In a changing market environment, the value added of the EIB Group's intervention has to be constantly questioned, both in terms of number of SMEs reached and in terms of amount of measurable financial advantaged passed on to them. The aim of a modernisation of the EIB Group's product offering for SMEs is to increase the traceable value added of its intervention in specific, targeted segments of SMEs, by developing financial products dedicated to these segments. Such new products would be accessible to those financial partners who will accept best practice both in terms of transparency and in terms of mechanism to pass on the financial advantage to the final beneficiaries.

While the Bank was open to any suggestions from the participants to the SME Consultation, there was a consensus that the principle of intermediation through financial partners remains the only means by which EIB may reach the final beneficiaries. Indeed, providing support to SMEs is mainly a question of proximity and day to day client relationship. This equally applies to EIB's loan products as to EIF's venture capital products. EIB will continue to rely on the competence of commercial, cooperative, public banks and other intermediaries in Europe in this area, to channel its support to the final beneficiaries.

2.3. Implementation of the SME Consultation

The SME Consultation took place from June 2007 to January 2008. It was initiated by ways of an invitation letter (attached hereto in Annex 5), sent to 104 counterparts in all EU Member States, thereof 67 banks or banking associations, 14 SME associations (including chambers of commerce or craftsmanship) and 23 government bodies (including DGs of the European Commission). The participants in the SME Consultation were selected by the respective geographical teams within the Bank, and by EIB's office in Brussels as far as European associations and members of European parliament were concerned.

3. Summary of results from the analytical report on the answers received

The response to the SME Consultation has been generally lively, with an overall response rate at 75%. The main results are provided in Annex 2 and may be summarised as follows:

From the variety of responses received, one can conclude first of all that SME finance remains a key topic throughout Europe – for the cooperative and savings banks in Europe because it is part of their traditional mission, for the banking sector in general because it constitutes a reliable and important source of income, for the public support institutions because of the importance of a healthy SME tissue for the national economies, and for the

SME associations because there remains a lot to be done to optimise the access to finance for their members.

Despite of what might be the market share of loans to SMEs supported by EIB (estimated at around 3.6% at European level), EIB Group is considered to be an important partner in the context of SME finance. Most addressees of the letter have prepared detailed written reactions to the invitation letter, many of them were interested in having bi-lateral meetings with EIB to discuss further on the suggestions made. EIB's existing product offering, and more specifically the EIB's Global Loans, is widely appreciated for its flexibility (i.e. the possibility to combine EIB funding with other (national) promotional programmes or to use EIB funding with other banks resources, the flexibility of intermediaries to negotiate freely repayment and interest rate conditions with the final beneficiaries, the flexibility of intermediaries to implement the rules of transfer of financial advantage).

It has to be noted however that the knowledge about EIB's products and intervention was often limited on the SME side. This lack of information concerns not only EIB but also EU instruments and even the available state-supported national schemes which are not fully utilized in many countries. A contribution of EIB to the awareness building on financing tools (EIB products, but also regional and national support schemes) for SMEs would be particularly appreciated by the non-banking respondents to the consultation.

The main criticism expressed about EIB's intervention is the administrative burden which weighs on the management of its programmes. This burden is not adequate in a context of SME finance, which in itself requires a dense (and thus expensive) branch network from the intermediaries. Adding the cost of detailed reporting requirements and complex eligibility criteria is contra productive to the aim of a wide spread use of support schemes in general, and also specifically the use of EIB products. A number of suggestions were made how to improve EIB's current product offering in that sense. A reduction of reporting requirements and abolishing of complex eligibility criteria (complex because not in line with the information the intermediaries require themselves from their clients) is welcomed by all participants to the consultation. It is even seen by many as the main factor which will decide on future use of EIB funds. Standardisation of procedures is key to intermediaries which are focussed on low cost/income ratios. If EIB will follow this road, it will be of paramount importance to link any simplifications made to an increased value added transferred to the final beneficiary.

At the beginning of the exercise, the general opinion was that in developed financial markets, access to finance is not a major issue for SMEs. Such point of view is held in a number of studies of which a survey can be found in Annex 3 to this note. The SME Consultation has shown that when departing from such a global perspective, financing gaps persist in many European SME market segments, asking for more elaborate answers.

In most European markets, risk margins paid by SMEs on loan financing have in the past 4 years converged towards those paid by larger companies, for the benefit of SMEs. Consequently, one could conclude that problems in access to financing currently play a marginal role for SME managers, which could mean that globally there are no financing gaps remaining in the European market, characterised by a competitive banking sector. A similar view may be taken in the case of venture capital. Returns on early stage venture capital investments are persistently negative in Europe, which could lead to the assumption that venture capitalists are actually drawn into investing in firms which do not present thorough business plans because the others are already well served or there is simply no demand. Equally there seems to be no shortage in private equity finance for later-stage financing including management buy outs, as the European market has matured with the arrival of institutional investors such as pension funds and hedge funds.

The SME Consultation shows that the financing gap analysis has to be much more specific, and that indeed, there is a lack of adequate financing tools for a variety of SME segments, e.g. micro-enterprises without business or personal assets to offer as security, young, fast growing, innovative enterprises or those facing the challenge of transmission. This conclusion is essential also because these SME segments are important contributors to growth, competition and innovation and thus employment and the productivity of the European economy as a whole. Their future development will be a contribution to major trends in society – as an example, in line with the spirit of the 6th and 7th Framework Programme of the European Commission, the CIP programme has specific sub-windows for the support to women entrepreneurs. It is of great importance for future growth in Europe that these segments in particular are not constrained by lack of adequate financing tools.

Investments in environmental friendly technology, in R&D and in some country-specific sectors are those for which financing seems also difficult to find.

There is a clear need to foster cross-border investment by SMEs within Europe. However, cross-border investment is not necessarily a question of machinery and equipment, but very often a question of building up a new distribution network or joining forces with another SME abroad. The related financing needs are not eligible for EIB financing so far

In general, there is a strong request from the market that in the context of modern SME finance, EIB departs from an eligibility restricted to new fixed asset investment, to expand towards financing of soft investments fostering internationalisation, growth and innovation. While the Bank has for some years introduced the possibility to finance also R&D programmes including operational costs of researchers and the acquisition of patents and licences, this has so far primarily benefited large groups with significant R&D activity. Innovation in the context of SME finance has to be seen in a broader context, where the development of new products and services, the introduction of new production processes for goods and services and the acquisition of new markets or the financing of company transmission should become eligible for EIB finance beyond their fixed asset components.

SMEs continue to depend mostly on bank debt as a means of finance. Showing a high indebtedness in the balance sheet hampers the chances to obtain further loan financing for expansion phases, company transmission or R&D activities. This is why, besides maintaining a strong presence in classical loan financing, alternative financing tools have to be developed. Amongst these, mezzanine finance seem to be one on which EIB Group should focus. The current offer in venture capital is biased towards larger “tickets”. The low use of venture capital is often a result of the entrepreneurial culture particular for SMEs, as it is more difficult for an individual entrepreneur to accept a financial investor to participate to the decisions about the development of his company than for owners and managers of large companies. In this context mezzanine finance is a promising instrument, which may in the future not only be reserved to more sophisticated borrowers. In this context, EIB Group could play a specific role in close cooperation with the European Commission. A market for mezzanine financing has to be developed, including appropriate financial tools, but also based on an increased awareness building amongst SMEs through advisory and technical assistance programmes.

In a number of European countries, regional and national promotional schemes for SMEs are in place. A substantial part of the consulted non-banking partners and of the banking partners proposes a close co-operation with these schemes in order to avoid any duplication of efforts, definitions and reporting requirements. Some respondents however also suggest in this context an alternative role of EIB’s product offering compared to local support schemes, since parallel schemes may sometimes also benefit from each other.

The SME Consultation reflects the diversity of situations and interest among EU Member States. It shows that, in redefining its SME strategy, EIB will have to face contradictory objectives and constraints:

- There is a strong interest from both, the banking and the government/non banking side, that EIB should maintain its GL activity with its current level. At the same time, there is a suggestion expressed by a number of consulted parties to have a more defined focus in order to avoid dilution of the advantage provided by EIB finance by being too “global”.

- As a result of the politically declared aim to promote a knowledge-based European economy, EIB has decided to give a strong focus of its support to SMEs to highly innovative, research-oriented SMEs and those with high growth potential. However, SMEs falling into these categories represent a minority compared to the large group of SMEs who are neither innovative nor have recently been created, but who nevertheless need financing for their development and have difficulties to obtain it.

- On the one hand, there is a need to provide specific markets with specific solutions able to accommodate national circumstances (presence of public support mechanisms, cultural specificities, structure of the local banking market). On the other hand, tailor-made products would be contrary to simplicity of product offering and low reporting requirements, which should be one of the most important drivers for EIB's future product offering in SME finance.

- To accommodate for specific needs, EIB Global loans will be more dedicated and thus smaller in size. This stands against the interest of EIB to cooperate also with a number of banks, which are ready to work with EIB, but need larger operations to make it worthwhile to consider EIB as alternative source of funding in their centralised treasury departments.

- Cooperation with smaller, regional banks, which are very present in the local SME tissue, is key to reach SMEs. At the same time, as the number of deals per country is limited by EIB's operational capacity, there is an impossibility to serve a growing demand from banks. This means a reduction in market penetration, i.e. a reduction of competition amongst intermediaries for the distribution of EIB funds. Competition is however seen as the main driver for the transfer of a financial advantage from EIB intervention to the SMEs. Any decrease in market competition could give rise to those respondents to the SME Consultation who have feared market distortion as a result of EIB's selective choice of intermediaries.

- One of the clearest messages, coming from the SME Consultation, is the urgent need to limit the administrative burden related to EIB current or future products. At the same time, transparency, traceability and acceptable monitoring are unavoidable.

It will be the challenge for EIB Group to find answers to the topics and contradictions raised by the SME Consultation. Many of these contradictions disappear however when one departs from a macro pan-European perspective and takes a more microeconomic one, focussed on the different national markets. It is therefore important that EIB's future activity in favour of SMEs moves away from the "one size fits all approach" and turns towards solutions which are the result of a deepened knowledge of the various national SME markets.

4. General conclusions on the future role of EIB Group in SME finance

4.1. Make use of the favourable market context

Over the past 5 years, and as a result of fierce competition for market shares throughout European markets, risk margins on corporate loans have reached very low levels, especially for the larger corporates which have easy access to the capital markets and where the banks have to make a special effort to be considered. The effect has also spilled over to the SME lending business. Indeed, some banks have re-discovered SMEs as a profitable and loyal source of income, and many others currently rethink their business model in that sense. As the classical medium long term loan is considered to be the entry point to an SME client relationship, loan conditions have evolved positively for this product.

At the same time, the value added of EIB's intervention – when measured in alternative funding cost terms – was on a downward trend over the past years. The funding advantage between an AAA rated institution and an AA or A rated bank had shrunk to one-digit levels. Such an environment was not favourable for the introduction of specialised EIB products especially when the administrative burden of EIB's programmes would swallow most of the financial advantage.

The recent liquidity crisis has lead (and might lead even more in the future) the banks to be more restrictive on their credit policy. In some cases, EIB was told that this would not be to the detriment of SMEs since it was easier to refuse a large loan to a global player than to frustrate a whole branch network with a more restrictive SME lending policy. The majority of banks – and certainly the SMEs themselves – predict however that the crisis might have an impact on the bank's credit policy – either through an increase in risk margins, or, even worse, through a refusal of new loan requests. This adds to a general fear amongst SMEs that Basle II rules are to the benefit of those SMEs who dispose of sufficient collateral to secure their financing, while the majority will face an increase in lending rates, notably those with a bank exposure exceeding 1M EUR.

The financial value added of EIB has thus come back to higher levels, and the banks look at a close cooperation with EIB with much more interest than at the beginning of 2007. Although the external effects may not persist over a very long period of time, these circumstances seem to be favourable for EIB to rethink its own SME products. The aim is certainly not to prevent a correction in risk pricing towards levels which properly reflect the risk incurred. EIB may rather, at this point of time, benefit from the eagerness of the banks to maintain (or increase) their position in SME lending to be selective in its support, directing the products (which the banks seem eager to allocate) to those SME segments which seem to be most in need of financing, and through those intermediaries which are most ready to cooperate on key issues like transparency and transfer of benefit.

The recent events linked to the sub-prime debacle significantly affected not only the Structured Finance markets, but more generally the capital markets and the interbank markets. A number of securitisation deals that were scheduled for closing in the last quarter of 2007 have been put on hold awaiting a (potentially) better moment to tap the market. Furthermore, it is expected that the medium-term deal pipeline will go down to lower levels and with longer execution time. With this new credit environment, the role of EIF as specialised and stable long-term investor in the SME segment becomes even more crucial.

4.2. Continued verification of EIB's footprint in SME finance is necessary

The SME Consultation has shown that there is no single European SME market. Each national market within the European Union presents its specificities: There are different legal frameworks, different focuses of the SME market both in terms of activity and average size, there are strong or marginal public promotional schemes in place (see country fiches in Annex 3).

The task of SME finance is vast, both in terms of numbers of SMEs to be reached, and financing gaps identified, which range from the provision of seed capital at the very birth of companies, to the lack of financing for the transmission of SMEs to the next owner generation. Compared with this complexity, and with respect for market distortion fears, it is not the goal of EIB to become a dominant market player in European SME finance. To have a footprint in SME finance, EIB Group will have to strengthen and clarify its strategy in this area. It will have to have a more sophisticated approach adapted to the diversity of financial markets and of targeted SME segments. EIB Group's approach should differentiate between different types of constraints leading to problems in access to finance: Those cases where availability of funds is the issue (e.g. least developed financial markets, VC, innovation, mircofinance) versus those cases where financing conditions are the main topic. In the first case, EIB value added should be measured against increase of volume achieved, whereas in the second case, EIB value added should be valued against the improvement in lending conditions transferred to the final beneficiaries. Both approaches could be acceptable but each of them has to be substantiated by an accurate analysis of market circumstances.

As already mentioned, there is a lack of information amongst SMEs about the possibilities of EIB Group intervention, independently of the current size of EIB's activity in the respective market. The SME Consultation showed that this lack of information does not only concern EIB but is a problem common to many public support schemes. EIB Group will have to reconsider its information policy towards SMEs. It should give a very clear message about its activity, through its intermediaries, but also through other channels with a direct contact to SMEs.

4.3. Maintain and modernise the current EIB Group's offer for SMEs

An important result of the SME Consultation has been the repeated interest of the intermediaries and the final beneficiaries in the maintaining of the classical activity of EIB Group in favour of SMEs, including loan financing, venture capital investment and the guarantee instruments. Intermediaries praise the flexibility of the Bank's product and its availability. Final beneficiaries require the classical, medium long term loan for expansion, be it domestic or abroad, but also for the normal course of their investment activity, where finance gaps persist. Although it is limited in a global market context, EIB Group's intervention of more than 8bn EUR in favour of SMEs (thereof EUR 6bn through Global Loans, 2 bn EUR through portfolio guarantees and other credit enhancement, and 0,6bn EUR through venture capital) has its significance. And finally, maintaining the classical product allows for a continuation in business relationships with EIB's intermediaries, which would probably not be as regular with more complex, less frequently repeated operations. Having a good relationship with its intermediaries is certainly key to the success of EIB Group's business model. However, it is worth insisting that there is a chance to maintain a meaningful cooperation based on the classical funding support only if there is an acceptable level of financial value added generated by EIB funding and if the bureaucratic burden attached to such programmes is significantly lightened.

Continuity in EIF's support focussed on young, highly innovative, and fast growing SMEs has been secured in 2007 through an increase of the Fund's capital by 50% to EUR 3bn, ensuring its financial self-sufficiency until 2013. As mentioned before, the launch in 2007 of the CIP programme in which the EIF acts as manager of European Commission's funds is a major event confirming the validity of the Fund's business model.

The scope of the SME Consultation was limited to SMEs and thus does not provide feed back on the need for financing for "mid-cap" companies (up to 3 000 employees). It is however a major market segment towards which EIB will have to strengthen its capacity for support.

At European policy level an initiative for the development of micro-credit in support of growth and employment has recently been launched. The purpose is to identify and overcome the main barriers impeding the development of micro-credit in the European Union. The initiative has four main objectives: improve the legal and institutional environment in the Member States, encourage a favorable climate for entrepreneurship, disseminate best market practices and provide additional capital for Microfinance Institutions through the creation of an investment vehicle (the "MicroFund"). In this context EIF has been mandated to conduct a feasibility study in view of the setting up and management of the MicroFund. This vehicle will mainly target equity investments in newly established and non-bank MFIs, being the ones that face the most difficulties in obtaining funding.

The Global Loan product and its underlying principle will continue to have its role to play. However, it needs to evolve, integrating the findings of the SME Consultation on market gaps and financing needs of today's SMEs. This should include the financing of working capital, investment in (international) expansion and growth, financing of company transmission, and a continued focus on R&D. The support of unsecured lending, and more generally subordinated or mezzanine loan structures seem to be best suited to support SMEs in decisive growth phases. The modernisation of the Global Loan product should also respond to the financing needs of specific market segments, like micro enterprises or SMEs with growth potential (although not necessarily innovative in its strict sense). With the market calling for all these areas to be covered, the question arises whether the total volume of EIB's Global Loan activity should remain unchanged. In fact, the answer will depend on the financial value added transferred to SMEs, that EIB may be able to generate in the future.

4.4. Support SMEs during their entire life cycle

The financial products required to accompany the development of SMEs vary through the life cycle of the company. For a sound development of SMEs, it is important for them to be able to chose the financial product which best suits their actual financing needs. While venture capital is suited for start-up phases, and loans and leasing operations may be best fit to accompany the day to day investment activities of SMEs, mezzanine financing is probably best for post-start up, important growth phases and also for the transmission of companies from one owner generation to the next. The EIB Group covers a large range of these financial products, but there is a need to develop the instruments between classical loan finance and venture capital, i.e. mezzanine financing tools. It will be important that EIB Group continues to accompany SMEs through their whole lifecycle with a large range of product offering, including mezzanine loan structures. Synergies in terms of client acquisition and relationship and in terms of product development will have to be identified between EIB and EIF, each contributing with their core competences towards a clear and unique message to the market.

4.5. Not re-invent the wheel where public support schemes are available

In those areas and markets where strong promotional structures exist, EIB should team up with public support institutions.. Such closer cooperation with public promotional structures could for instance foresee that prior to the deployment of a scheme on a national level through the relevant promotional institution, EIB could propose to develop a simplified scheme with some selected intermediaries to test its acceptance in the market prior to national launch. In this context, the comprehensive studies undertaken by the EIF's JEREMIE team constitute a valuable contribution.

5. Orientations for Product Modernisation and Flexibility for different National Market Environments in the EU

5.1. Simplification

Avoiding bureaucracy and keeping the product as simple as possible when it comes to SME finance was one of the clearest messages received during the consultation. It is thus proposed to analyse the following characteristics for a reviewed Global Loan product:

- Finance up to 100% of the intermediary's intervention, instead of financing up to 50% of project cost.
- No limitation on the purchase of used fixed assets, instead of a limitation of max. 25% of the total global loan amount.
- Simplification of sector eligibility by allowing SME financing in all sectors apart from clearly excluded sectors, e.g. arms, tobacco, gambling etc.
- Generally introduce ex-post reporting on the basis of a list including the following information only: Name and address of final beneficiary, its economic activity, the number of employees, the region where the investment takes place, loan amount granted by the intermediary and the amount requested from EIB. On the other hand, the financial value added passed on to the individual final beneficiaries should be reported by the partner banks explicitly (cf. also item 5.3.2.) More stringent ex-ante reporting requirements should be applied only for the initiation of new intermediaries to the use of EIB funds and for risk-sharing operations.
- For companies with less than 10 employees, reporting requirements should be even more simplified. However, this simplification – to be further elaborated - should be implemented, on a case by case basis, <u>only if an acceptable level of transparency is reached</u>, and each SME customer is informed about EIB's intervention and receives an appropriate share of the financial benefit generated by the operation. This lending activity will complement the EIF's activity in favour of micro credit, and will allow broadening the range of institutions active in micro finance receiving support from EIB Group.
- For those countries where EU directives had been transposed into national law, confirmation from the final beneficiary to the intermediary that they comply with national laws on environment and competition should be sufficient, instead of additional confirmation of compliance with EU directives as currently required

These simplifications should not be viewed as a goal in itself. They are a way to reduce the administrative costs to manage EIB's products and therefore increase the financial value added available to SMEs. Simplifications should be implemented in a package deal with banks with which transparency and transfer of benefits towards the final beneficiaries is reinforced, for instance through labelled EIB products.

5.2. Modernisation of the EIB product

The SME Consultation has shown that there are uncovered financing needs of SMEs not only in the area of MLT loans, but also for working capital needs, for growth phases which do not necessarily imply the purchase of fixed assets, like the entering of a new market by acquisition of a distribution network inside the company's home country, within the European Union or even outside, and also for company transmission. These aspects should be reflected in a modernised Global Loan product, which should allow the usage of EIB funds for the financing of the respective needs. Therefore it is proposed to analyse the following:

- To include effectively working capital into the range of financial needs eligible for EIB finance by reducing the minimum tenor of sub-loans benefiting from EIB finance.
- To render eligible expenses (including fixed asset investment and operational expenses for a period of time) for expansion of SMEs, including for instance the building up or acquisition of distribution networks in domestic or foreign markets (inside the EU). The acquisition of companies should be excluded, unless the purpose of the acquisition is to ensure generation or staff-related company transmission to allow for a continuation in economic activity of the respective company (see below).
- To confirm the eligibility of R&D expenses extending the concept of innovation, including amongst others intellectual property rights (IPR).
- Render eligible financing needs for generation change or staff-related company transmission to allow for a continuation in economic activity of the respective company. As there is a specific financing gap for smaller transactions of this type, it seems appropriate to limit the scope of this measure where buyer and seller are both SMEs, and to amounts not exceeding 1 M EUR.

5.3. A more focussed EIB product offering

European markets for SME finance are divers. Some markets have a strong public scheme with products fitting the specific market's need, channelled through the banking system. On other markets, such public intervention does not exist or only in very limited areas. Sometimes, mutual banking groups and savings banks with their mutual support and guarantee systems are the main players for SME finance, sometimes, this role is rather attributed to large commercial banks. EIB should be able to provide an adequate answer to each situation:

- The SME Consultation has shown that the interest of many intermediaries to work with EIB is either to have EIB as a partner for the provision of liquidity or to have EIB as provider of high value added products (i.e. structured, designed for very specific SME market segments or activities), which allow them to distinguish themselves from their (generalist) competitors or to fulfil specific policy goals in the case of public promotional institutions. One of the options could be that EIB chooses to focus more on high value added products dedicated to specific sectors. This change of approach, if endorsed, has to be progressive and implemented over a two to three year time span. Depending on the justification provided, it will however not be excluded that also in the future, a more general credit line could also persist side by side with more focussed products, granted to the same intermediary.
- For smaller banks in developing markets, or regional banks, which have a specific importance in the context of SME finance, one of the options could be that EIB remains a more general provider of funding, especially if transaction volumes would not allow for highly specialised products. Here, EIB should however be as flexible as reasonably possible with its credit policy. Again depending on the justification provided, maintaining a more general approach towards intermediaries with specific characteristics and requirements will be possible if well-justified.

Whatever strategy is put forward in the context of a specific operation, the ultimate goal for modernisation of the Global loan product is to improve the access to finance for SMEs at attractive conditions. Therefore above proposals will only be implemented with intermediaries who fully accept the Bank's requirements in terms of transparency and transfer of benefit.

Transparency of the Bank's action for the SMEs and adequate transfer of the benefit from EIB funding have repeatedly been subject to discussions. Progress has been made in this respect over the last years, but is not considered sufficient, as stated by the majority of SME associations questioned during the Consultation. The aim therefore is to make a clear and significant step forward on these two topics.

5.3.1. Transparency

There are several formulae, alternative or complementary, which have been used in the past to provide information about EIB's support to the SMEs, depending on the specific marketing and allocation procedure carried out by each intermediary:

- reference to the EIB in the subsidiary contract (signed between the SME beneficiary and intermediary) or in a side letter to the subsidiary contract,
- reference to the EIB in the application form used by the intermediary and filled by the SME beneficiary,
- information in commercial leaflets targeted at SMEs or local authorities,
- information in the marketing section of the web site of intermediaries,
- reference in the annual report of intermediaries to the fact that part of their LMT lending to SMEs and local authorities is funded through EIB global loans,
- information in the web site of the EIB when the operation is under appraisal,
- press release at the time of signature of the global loan.

The SME Consultation showed that diffusion of information on EIB's intervention is a continuous process where there is still progress to be made. Among others, several information channels are proposed:

5.3.1.1. Product labelling – the EIB funds should help to render more attractive a specific product of the intermediary. In order to communicate the partnership between the EIB and the intermediary to the final beneficiaries, either the name of the product or the product documentation should clearly point at EIB.

5.3.1.2. Where the creation of such product does not fit into the sales strategy of the intermediary or is otherwise not acceptable to the intermediary, an alternative could be to inform final beneficiaries individually about EIB support by way of letter or electronic means, sent to each of them, the text of which should be agreed between EIB and the intermediary.

5.3.1.3. Intermediaries should be ready to insert, on their website dedicated to corporate medium long term financing products, an information page on EIB's activity in favour of SMEs, including eligibility criteria and a reference to the advantageous conditions of EIB. Additionally, EIB's intervention would have to be mentioned in an appropriate way in the finance contracts with the SME actually benefiting from EIB support. The contents of both the information page in the internet and the text to be inserted in the agreements with the final beneficiaries should be agreed between EIB and the intermediary.

5.3.2. Transfer of benefit

EIB financial advantage derives from flexibility (for instance, regarding timing of drawdowns), longer maturities, different currencies and lower interest rates. The overall advantage varies according to the type of counterparts and market context and depends also on the administrative costs associated with the operation of the facility (e.g. allocation procedure) and on the cost of the security package requested by the Bank. There will be no single answer and no single mechanism which will be the first best solution, applicable throughout

Europe. But it should be stressed that there is a need to develop mechanisms which provide tangible and quantifiable answers to the question of the EIB's funding advantage that is actually transferred to the SMEs.

Up to now, diverse schemes are used with different intermediaries to pass on that advantage to final beneficiaries, and will be developed in the direction of reporting undertakings of the partner banks:

5.3.2.1. For allocations following closely the back-to-back standard (e.g. because of security consisting of assignment of rights "accrochés" on the final beneficiaries) the rate payable by final beneficiaries is indexed to the EIB lending rate. The EIB has access to the spreads in subsidiary contracts, which include also a premium to cover the risk taken by the intermediaries on the final beneficiaries.

5.3.2.2. Other intermediaries have decided to provide final beneficiaries with an up-front lump sum or a reduction of basis points to interest rate over the life of the loan, upon approval of allocations by the EIB. This rebate is fixed at the time of signature of the global loan and used, by the intermediaries, as a marketing tool. This may entail up-front Global loan disbursement (free quota).

5.3.2.3. Another possibility consists for the intermediary receiving EIB loans to assign a certain financial benefit ("Net Present Value approach") to its commercial network to be used for financing eligible projects. Such a benefit would be derived from the EIB's intervention and previously estimated in aggregate terms by the Treasury of this intermediary (upon each disbursement or for several disbursements over a certain period).

5.3.2.4. In countries with less developed financial markets, where there is no alternative source of long term funding, the availability of EIB funding is as such the financial advantage provided to SMEs. This approach again has to be associated with an identification of all final beneficiaries receiving MLT loans thanks to the Bank's intervention, i.e. a list approach and appropriate information mechanisms for the final beneficiaries should be implemented also in this case to allow for a high degree of transparency of the Bank's action.

The choice of the method should correspond to the specificity of each market. It should be clearly indicated in a side letter to the contractual documentation signed by EIB with each intermediary. Moreover, EIB should receive quantifiable information about the advantage passed to final beneficiaries in an adequate form.

5.4. A unique strategy for SME finance within EIB Group

The SME Consultation has shown that financing needs not totally covered by the market persist at any stage of an SME's life, from its creation to its transfer to the next generation of owners. In which product segment EIB Group may provide most value added depends very much on local market circumstances and on EIB's appetite to take risk. In some cases, the provision of additional volumes of venture capital or loan guarantee schemes priced at market rates or Global Loans with special attention to financial value added transferred to the final beneficiaries may be sufficient to make a large number of SMEs benefit from the EIB Group's intervention. In other markets, financing gaps may be more obvious in areas where returns are mitigated by higher default rates, or by a political goal implying lower financial returns in the short run. Here, EIB might be driven to serve more risky market segments to increase its value added – bearing however in mind that it is no one's interest that bad proposals get financing support. In each product area, from venture capital through mezzanine funds to risk sharing structures on classical medium long term loans, the competences of EIF and EIB should be used at their best, for the benefit of a product offering adapted to the needs of SMEs, independent of their stage of development.

The classical EIB Group product offer should thus be strengthened and enlarged notably in the areas of

- Equity finance
- Mezzanine finance
- Senior loan finance,

in whatever structure these products may be used, be it in the form of funds or ABS-structures or simply intermediated loans with or without risk sharing, in order to cover the largest possible spectrum of SME financing needs.

Demand for mezzanine financing within the smaller end of the SME sector is under scrutiny with intermediaries and final clients. Potential for volume will most likely come from a portfolio approach either through EIF investment in funds, through EIF guarantees/credit enhancement for SME securitisation platforms (even if currently limited to specific markets) perhaps combined also with an EIB participation, or through venture capital operations. Further opportunities in this field are also being explored regarding the Bank's potential assumption of direct subordinated/unsecured lending positions. Structures by which EIB funds are lent to an intermediary which in turn on-lends the funds to other partner banks ("double delegation scheme") developed with experienced bank partners may be pursued as well.

Finally, another mezzanine finance product is being developed by EIB through its concept of grouped loans for a limited number of final beneficiaries (up to 20). It concerns mostly mid-cap companies but also SME. EIB funding and risk coverage is provided to an intermediary on a case by case basis with a risk analysis performed by EIB on each mezzanine finance proposal presented by the intermediary.

The whole spectrum will not be used in each market, but each geographical team in EIB should have these tools at its disposal. Taking into account the view of the respective national government about EIB's presence in SME financing, each team will be able to have recourse to the full range of products whenever they see a need in their specific market environment.

5.5. Get to better know the SME market and make EIB better known to SMEs

EIB's products will not have a more effective and accurate market penetration if EIB does not develop a deeper understanding on SME financing needs and also if SMEs do not know the range of possibilities offered by EIB in SME finance. SME's will not be able to use (standard and sophisticated) financing tools unless they are able to present a "professional" business plan to their bankers, and unless the entrepreneurs have an understanding of the range of possibilities offered to them. In those markets where there is an interest in such activities, EIB should repeat regularly (for instance every 3 years) the experience of market surveys similar to the one undertaken for this consultation. It could also initiate - for those countries really interested - the creation of national round tables with participants from SME's, banks and public support organisations to regularly evaluate improvements in SME finance and identify problems and solutions. Besides this, EIB should not only rely on the banking sector for the dissemination of the information on its products, but use channels of direct communication with the final beneficiaries. The effectiveness of such increased effort of visibility will however largely depend on the financial value added EIB Group may be able to offer in the future. Very close cooperation with the Commission and the action of banking and SME associations is necessary. In this context, EIB Group is ready to bring its contribution to the drafting of the Small Business Act currently under preparation by the European Commission.

ANNEX 1

Statistical review of the EIB Group's support for SMEs

Purpose of this annex

Support for small and medium-sized enterprises in Europe was designated as an operational priority of the EIB Group by its Board of Governors in June 2005. In order to address this objective in the best way, thought is being given within the Bank to modernising the range of financial products offered to SMEs. Hence this annex, which:

- makes a statistical assessment of the EIB's support for SMEs in Europe in recent years (2001-2005[2]), analysing the development of lending to SMEs in the various countries of the 25-member European Union. Several measures of the intensity of the EIB's support for SMEs in the different Member States are also proposed;

- seeks to quantify the EIB's "market share" in the segment of medium and long-term lending to SMEs in Europe and compared with national SME-supporting public entities;

- presents the activity of the EIF over the period 2001-2006 and seeks to assess the overall impact of the EIB Group's assistance for SMEs.

Two main difficulties arise in calculating the impact of the EIB Group's support for SMEs. First, the guarantee and venture-capital activities conducted by the EIF lend themselves less readily than conventional SME loans to detailed statistical capture. For this reason, and because this note is intended to complement the proposal for modernisation of the EIB's SME product offerings, its focus is primarily on the EIB's Global Loans to SMEs, with discussion of the EIF's operations providing supplementary input.

Secondly, the notion of the EIB Group's SME financing "market share" is necessarily imprecise. Should the approach adopted be based on financial flows or stocks, on the number of beneficiary SMEs or on the number of jobs safeguarded? How should the advantage accruing from the different financial products offered by the EIB and the EIF be taken into account? Is it relevant to put all the 25 million European SMEs in the frame of reference when 90% of them are enterprises with fewer than 10 employees, hitherto relatively untouched by the EIB? Posing these questions does not imply having to give up any attempt at comprehensive analysis. But it does mean that varied statistical methods have to be applied to obtain a comprehensive picture, and this is the approach followed in this note. It also requires the reader to treat the results with due care.

[2] As the figures for 2006 were not available at the time this note was written, the analysis stops at end-2005. The preliminary data for 2006 broadly confirm the results presented in this note.

Key results

1. In 2005, credits allocated to SMEs through Global Loans (€4.4bn[3]) were markedly higher than in 2004 (+11%), so that allocations reverted to their medium-term average (€4.5bn on average over the period 2001-2005) following the decline in 2004.

2. At the same time, the estimated number of SMEs receiving EIB funds via Global Loans was around 26 500 in 2005, thereby coming close to the record level reached in 2003 (around 27 500). This reflects both the increase in the total amount of allocations and better EIB targeting of micro and small enterprises, which resulted in a reduction in the average amount of the loans.

3. Over the period 2001-2005, Italy, France and Spain accounted for more than two thirds of the funds allocated to SMEs via Global Loans. However, if the economic weight of each European country is taken into account, the three countries that emerge as the prime beneficiaries over the same period are Estonia, Portugal and Italy. Of the nine countries receiving a greater proportion of Global Loans to SMEs in relation to their share of European GDP are six countries – including three new Member States – in receipt of structural funds under the "convergence" objective for the period 2007-2013.

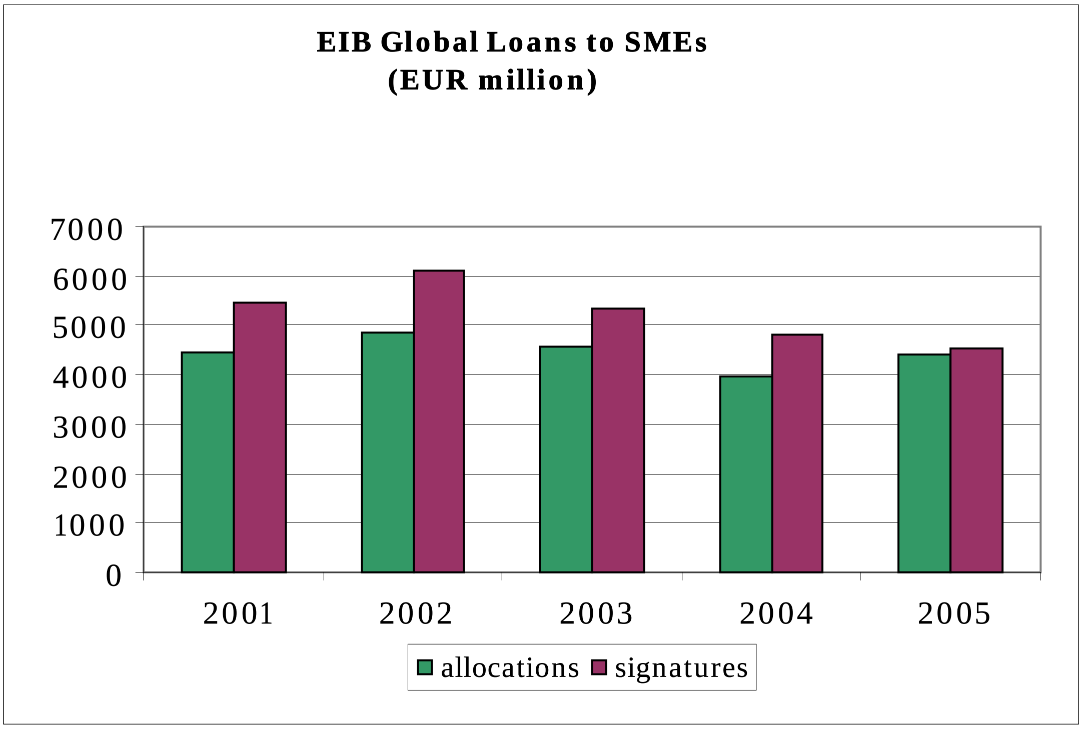
4. The data available at the European Central Bank suggest that the EIB's market share in the segment of medium and long-term lending to SMEs in the Euro area is probably around 4%, with marked variations between countries. Although such lending by the EIB is lower than that recorded on their domestic markets by the majority of public SME-supporting institutions, which benefit from the backing of the authorities and from public subsidies, on average its level is satisfactory and enables the EIB to play an active role in the market for medium and long-term lending to SMEs, while minimising the risks of distorted competition.

5. More than 200 000 SMEs received funds from EIB Group in 2006 if the European Investment Fund's operations in the form of guarantees (€2bn in 2006) and venture capital (€0.7bn) are taken into consideration. The EIF's support for SMEs also contributed to rebalancing the geographical distribution of the EIB Group's financing assistance for SMEs.

[3] Total credits allocated on the basis of the fiche/list approach and the portfolio approach.

1. Recent developments

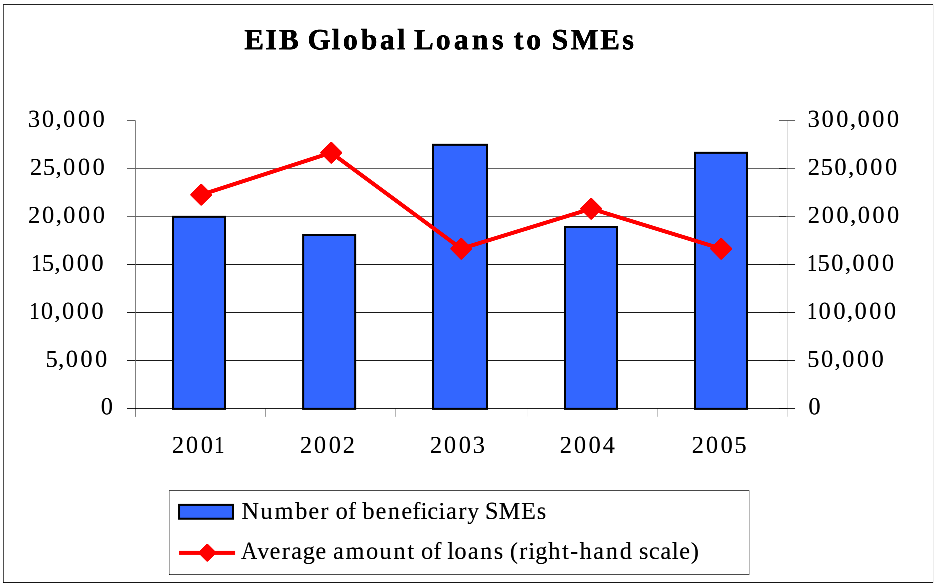
Between 2001 and 2005, the volume of credits allocated to SMEs in Europe by financial intermediaries in receipt of EIB Global Loans was relatively stable, with an annual amount of €4.5 billion[4]. Over this period, signatures of intermediated loans to SMEs accounted for 48% of total Global Loans and for 14% of the Bank's total lending.



In 2005, the amounts allocated to SMEs reached €4.4bn, 11% up on 2004. At the same time, SMEs receiving Global Loans numbered around 26 500, close to the record level of 27 500 attained in 2003. This situation was due to the noticeable fall in the average amount of financial intermediaries' allocations to SMEs from 2002, reflecting the growth of EIB support for enterprises classified as "micro" (fewer than 10 employees) and "small" (10 to 50). For instance, the EIB significantly expanded its lending to leasing companies during those years (13% of total signatures of SME lines of credit during the period 2001-2005). At the same time, the Bank developed its partnerships with regional banks that target "small" SMEs[5]. Finally, the earmarking of a micro-credit tranche in certain SME Global Loans[6] opened the way for increased EIB assistance to very small enterprises.

Signatures of SME Global Loans accounted for 51% of Global Loan signatures in 2005 and 11% of total EIB lending. However, the steady decline in the annual volume of signatures (-25% between 2002 and 2005) should lead to a reduction in the amount of allocations in the years ahead, all other things being equal.

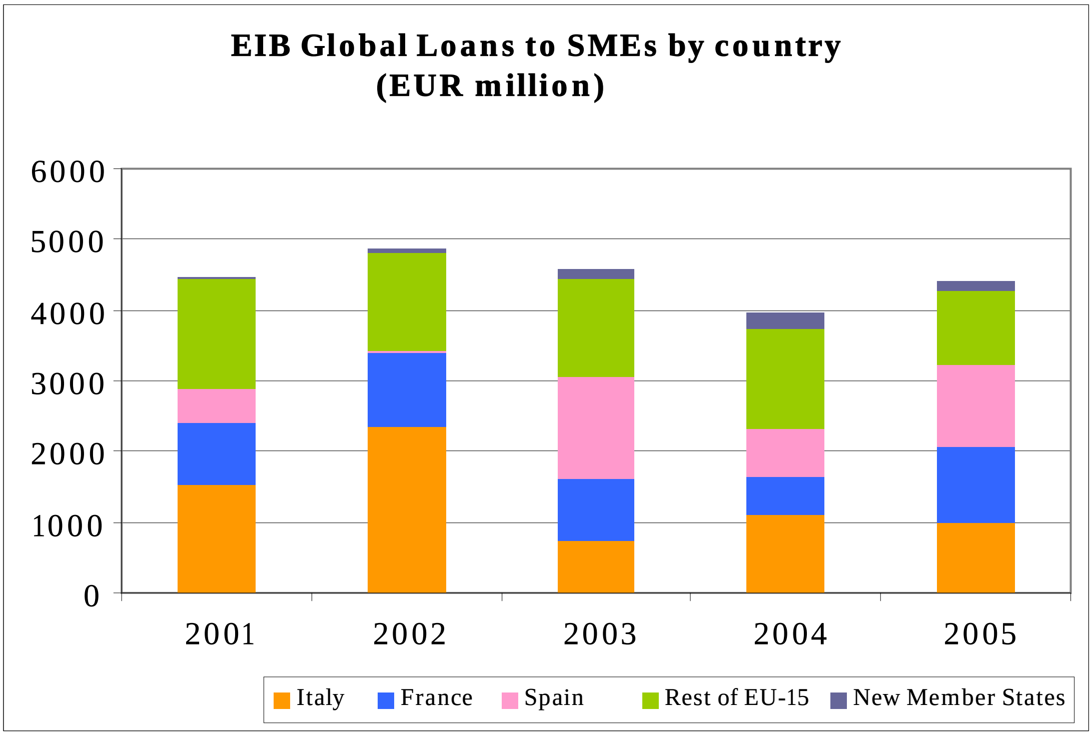
[4] Total credits allocated on the basis of the fiche/list approach and the portfolio approach. The sources of the different figures are detailed in Appendix 3.
[5] In 2005, for example, the Bank carried out its first operation with a grouping of seven Spanish regional banks (Caja Rural Granada, Caja Rural Zamora, Caja Campo, Caja Rural Central de Orihuela, Caixa Popular, Caja Rural Gijon, Caja Rural Albacete).
[6] This was the case with two lines of credit signed with Crédit Coopératif in 2004 and 2006.



2. Geographical distribution of Global Loans to SMEs

2.1 Allocations by country over the period 2001-2005

Historically, Global Loans have been very concentrated in their geographical distribution. This instrument was created at the end of the 1960s to assist SMEs and local authorities in Italy's *Mezzogiorno*. Over the period 2001-2005, three countries (Spain, France and Italy) took two thirds of aggregate EIB Global Loans to SMEs. If Germany and the United Kingdom are added in, the proportion rises to 82%. The other ten countries of the EU-15 make up only 15% of the total, with the new Member States that joined the EU in 2004 receiving the remaining 3%.



This strong concentration of SME Global Loans on a few countries mainly reflects the economic weight of the different members of the European Union. Indeed, the five largest EU-25 economies (France, Germany, Italy, Spain, United Kingdom) produced 75% of the Union's GDP and took 82% of allocations to SMEs over the years 2001-2006. The proportion of SME Global Loans going to the new Member States during the same period (3%) must be seen against the background of these countries' small share in the aggregate GDP of the European Union (5%).

2.2 GDP-adjusted geographical distribution of Global Loans to SMEs

A truer picture of the EIB's relative SME financing input in each EU country emerges when the amount of allocations to SMEs is related to each Member State's economic weight.

Intensity of EIB support for SMEs / GDP (2001-2005)

1	**Estonia**	2.70	14	**Netherlands**	0.51
2	**Portugal**	2.58	15	**United Kingdom**	0.50
3	**Italy**	2.28	16	**Lithuania**	0.49
4	**Spain**	2.17	17	**Germany**	0.31
5	**Ireland**	2.11	18	**Cyprus**	0.26
6	**Latvia**	1.83	19	**Slovakia**	0.18
7	**France**	1.25	20	**Denmark**	0.13
8	**Finland**	1.15	21	**Poland**	0.12
9	**Hungary**	1.03	22	**Sweden**	0.10
10	**Czech Republic**	0.98	23	**Greece**	0.01
11	**Belgium**	0.93	24	**Luxembourg**	0.00
12	**Slovenia**	0.87	25	**Malta**	0.00
13	**Austria**	0.74			

NB: Share of aggregate SME Global Loans / share of European GDP. An index higher than 1 indicates that the share of the EIB's SME Global Loans is more than proportional to GDP and vice versa.
Green denotes the ten Member States that joined the EU in 2004.

Over the period 2001-2005, nine out of 25 EU countries received support for their SMEs exceeding their economic weight in Europe. Spain, Italy and, to a lesser extent, France feature at the upper end of the scale, accompanied by Portugal. Also noteworthy is the presence of three States of north-eastern Europe (Estonia, Latvia and Finland) among the countries that fared best, even if the total volume of loans to these countries (2.1%) remains marginal in relation to aggregate allocations in Europe.

On the other hand, EIB financing for SMEs remains below average in the majority of the countries of the Union. In particular, EIB Global Loans for SMEs are relatively little used in Germany[7] and the United Kingdom. As far as Germany is concerned, this is due to the greater participation by public banks in the SME lending segment. In the United Kingdom, the relatively low level of Global Loans reflects a limited interest on the part of the British banks and public authorities in EIB involvement in the SME lending market.

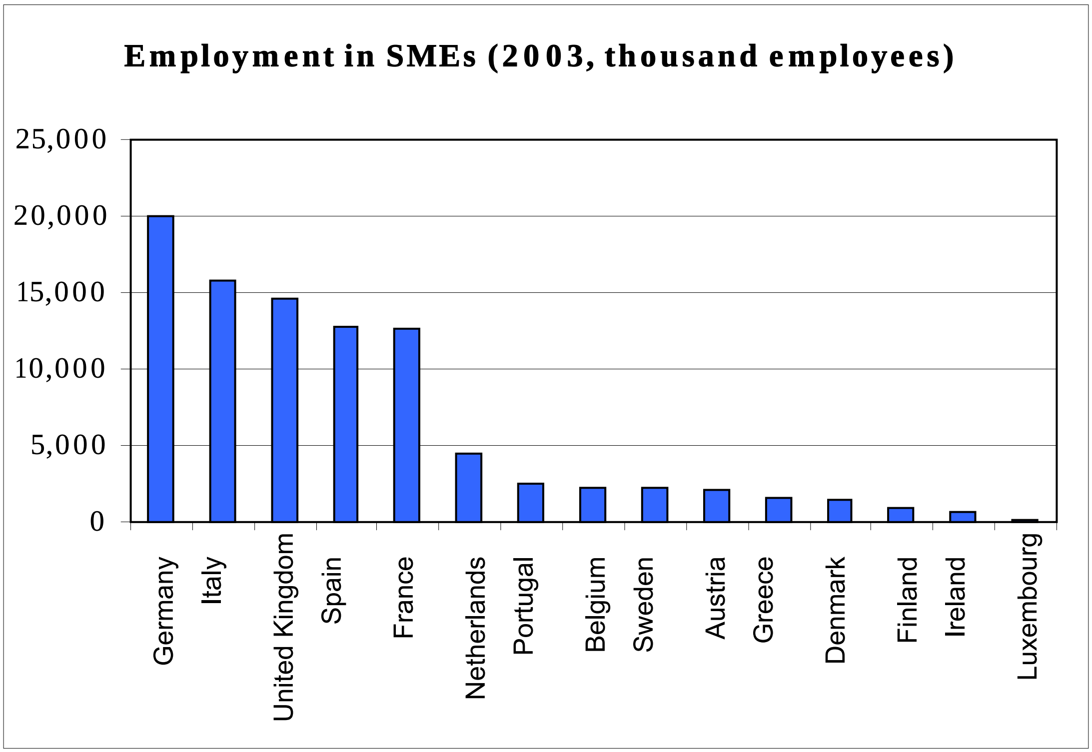
The share of Global Loans allocated to new Member States' SMEs, which had strongly increased between 2001 and 2004 (from 0.6 to 5.8%), has fallen sharply since enlargement, dropping to 3% in 2006 (equal to just a little over half the weight of the 10 new Member States in Europe's GDP). Part of this decline is probably temporary, given that loan signatures under the SME Finance Facility[8] have been rising since 2004.

[7] However, EIB Global Loans are widely used in Germany for infrastructure financing.

[8] A programme managed by the EIB, on behalf of the European Commission, which enables subsidies to be granted to banks in new Member States active in SME finance.

In total, the new Member States that joined in 2004 were the recipients of 7% of the SME Global Loan signatures during the period 2001-2005. The disparity compared with credit allocations over the same period (3% of the total) points to the likelihood of a catch-up process in the years ahead. Nevertheless, the recent trend in the level of allocations remains worrying, since the term and interest-rate advantage conferred by EIB financing is clearest in those countries where modernisation of the banking system is under way. More generally, it has to be acknowledged that the correlation between the intensity of EIB support for SMEs and the level of economic development in the different Member States remains marginal[9].

2.3 Geographical distribution based on the number of employees in SMEs



Another way of assessing EIB support for SMEs in the different countries of the EU is to look at each country's share of total SME employment at the European level. This approach, which owing to the lack of more recent data is limited to the year 2003 and to the EU-15, yields results similar overall to those from the GDP-based approach. It does, however, show that the high volume of Global Loans to SMEs in Spain and Italy is partly explained by the extent of SME employment in these countries[10].

[9] The correlation between the EIB SME support index and per capita GDP of the EU-25 countries is only slightly negative and not very significant (R^2 of 0.04).

[10] Conversely, Ireland fares particularly well relative to its share of total SME employment in Europe, even if the total volume of allocations remains low (1.5%)

Intensity of EIB support for SMEs / number of SME employees

1	**Ireland**	4.33
2	**Italy**	1.86
3	**Finland**	1.66
4	**France**	1.52
5	**Portugal**	1.35
6	**Spain**	1.28
7	**Belgium**	1.10
8	**Austria**	0.77
9	**United Kingdom**	0.55
10	**Netherlands**	0.51
11	**Germany**	0.33
12	**Denmark**	0.16
13	**Sweden**	0.12
14	**Greece**	0.01
15	**Luxembourg**	0.00

NB: The index as calculated expresses the ratio between (a) each country's share of total SME Global Loans opened in the EU-15 between 2001 and 2005 and (b) that country's share of the total number of persons employed in SMEs in the EU-15 in 2003. An index higher than 1 indicates that the country's share of the EIB's SME Global Loans exceeds the European average.

3. EIB market share in Europe and comparison with the national SME-supporting public banks

The statistics published by the European Central Bank and by the national central banks make it difficult to assess accurately the EIB's "market share" of SME financing. A comparison with an estimate – based on ECB data – of outstanding loans to non-financial enterprises of more than 1 year and for less than €1 million indicates that the EIB represented around 3.5% of this market segment in the Euro area in recent years, the percentage holding very steady between 2001 and 2005. There are nevertheless good reasons for thinking that the EIB's true "market share" in the segment of medium and long-term lending to SMEs is higher.

	2001	2002	2003	2004	2005
Estimated outstandings of EIB Global Loans to SMEs (€ area, in €bn)	19.3	21.7	22.7	23.7	25.6
Estimated outstandings of loans <€1mn, more than 1 year (€ area, in €bn)	565.3	595.0	624.9	654.1	711.1
EIB "market share"	**3.42%**	**3.65%**	**3.63%**	**3.63%**	**3.60%**

Sources: Annual Reports of the EIB, "Monthly Bulletin" and "MFI interest rates statistics" of the European Central Bank.

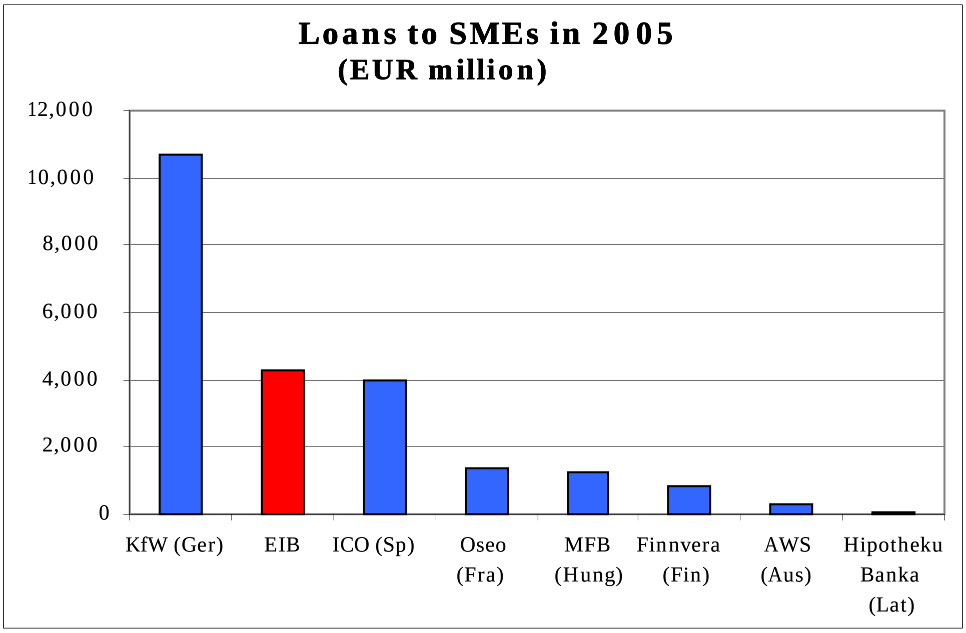
It is true that, through its Global Loans to SMEs, the EIB makes some loans in excess of €1 million. But this proportion remains small, given that the average amount of loans to SMEs over the period 2001-2005 was of the order of €200 000. On the other hand, it is probable that the figure published by the ECB is higher than the volume of medium and long-term loans to SMEs insofar as:

- it covers loans to all enterprises, and not solely to SMEs. Loans for less than €1 million granted to enterprises with more than 250 employees are therefore included;

- it includes a significant share of loans with a maturity of between 1 and 4 years, whereas the EIB is geared to lending for longer terms.

The foregoing would indicate that the EIB's true market share in the Euro area is higher than the figure of 3.5% mentioned above – probably in the region of 4 to 5% of the market, with marked variations between the European countries. The distribution indices previously calculated suggest that the EIB's market share could be close to 10% in countries such as Portugal, Italy or Spain and something like 1 to 2% in Germany and the United Kingdom.

Another way of assessing the extent of the EIB's support for SMEs is to compare the amount of Global Loans granted with lending by SME-supporting national public banks. Within the European market as a whole, the EIB ranked second in 2005, behind KfW Mittelstandsbank. This outcome is all the more remarkable in that the EIB's lending constituency spans the whole of the European market, whereas KfW remains largely focused on the German market.



It should, however, be noted that the gap between KfW and the EIB Group is partly explained by the fact that the German bank classifies firms with fewer than 500 employees as SMEs (against 250 in the case of the EIB). The amount of KfW loans to enterprises with fewer than 250 employees is therefore likely to be appreciably less than the figure of €10.8 billion reported for 2005[11]. Furthermore, part of the loans offered by KfW enjoys public subsidies. Similarly, the figures furnished by MFB, Finnvera and Hipotheku Banka lead to over-estimation of the amount of their SME lending in 2005.

The foregoing does not, however, invalidate the general conclusion regarding the EIB's market share in the different countries studied: the EIB faces keen competition from the SME-financing public banks in Hungary and Germany, whereas its position is stronger in France, Austria and, to a lesser extent, Spain.

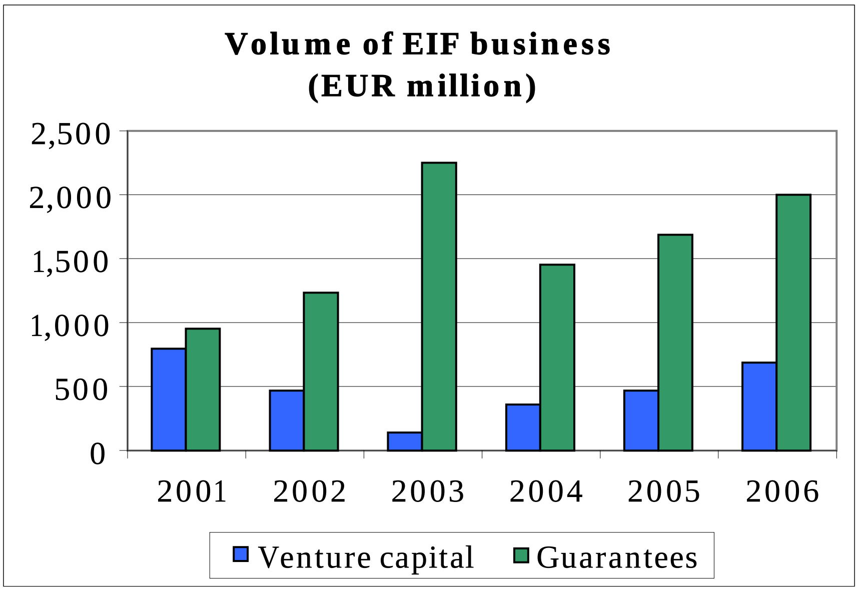
[11] KfW were contacted but said they could not provide figures relating solely to enterprises with fewer than 250 employees.

Loans to SMEs in 2005 in certain countries (€ million)

	EIB	Public bank	% EIB / public bank
Germany (KfW)	203	10 674[12]	1.9%
Austria (AWS)	181	278	65.1%
Spain (ICO)	1 161	4 000	29.0%
Finland (Finnvera)	102	814[13]	12.5%
France (OSEO)	916	1360	67.4%
Hungary (MFB)	23	1242[14]	1.9%
Latvia (Hipotheku Banka)	13	59[15]	22.0%

4. Recent developments in the activity of the European Investment Fund

The European Investment Fund supports European SMEs through two main products: guarantees for SME loan portfolios, and equity participations in venture-capital funds targeted at innovative SMEs. These two activities have been steadily growing since 2004: in 2006, the volume of new guarantees reached €2bn, 18% up on 2005. At the same time, investment in venture-capital funds climbed by 47% to €0.7bn. At the end of 2005, the EIF held venture-capital fund participations totalling €3.2bn and guaranteed a €9.3bn portfolio of SME loans.

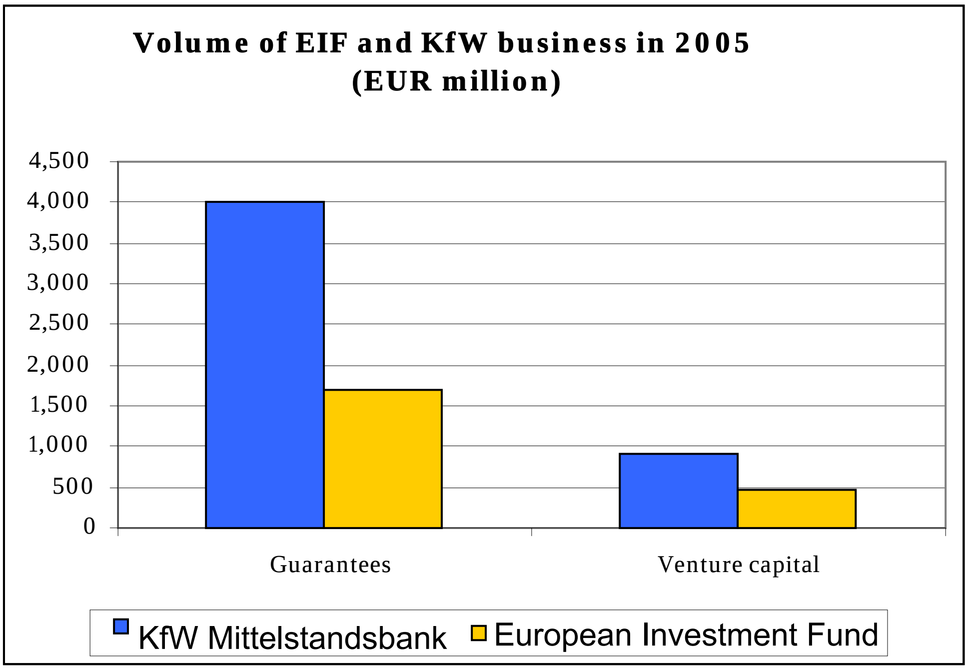


The geographical distribution of EIF participations in venture-capital funds[16] is more balanced than in the case of the EIB's SME Global Loans. France heads the list of beneficiary countries (23% of commitments in 2005), ahead of the United Kingdom (19%), which is followed by Germany, Italy and Spain with some 10% each. In all, the EU's five largest economies account for 73% of commitments, the 10 other EU-15 countries for 20% and the new Member States for 6%. This pattern is very similar to these three groups' share of European GDP, though the Member States that joined the Union in 2004 actually show figures slightly higher than proportionate to their relative economic weight.

[12] Loans to enterprises with fewer than 500 employs (against 250 in the case of the EIB)
[13] Loans + guarantees
[14] Target for outstanding SME loans
[15] Outstanding SME loans
[16] Figures taken from the EIF's Annual Report for 2005, page 17. The amounts corresponding to operations covering several countries (€935 million committed in 2005) are excluded from the analysis, as they cannot be apportioned by Member State. Similarly, the analysis does not take account of the fact that the funds may invest in enterprises based outside their national frontiers.

On the guarantee side[17], Italy is the prime beneficiary country by a wide margin (34% of commitments in 2005), ahead of Germany (14%), Spain (10%) and the Netherlands and France (8% each). The guarantee distribution profile shows that the ten "small" EU-15 countries are over-represented (28%, against a 20% share of the EU's GDP), at the expense of the five largest European economies (68%, against 74%) and the new Member States (3%, against 5%). In particular, Austria, Portugal and the Netherlands emerge as faring especially well in relation to their respective contributions to European GDP.

The EIF's market share is difficult to quantify because of the absence of precise public statistics on guarantees and venture-capital funds as well as the absence of internal studies on the subject. However, a look at the volume of guarantee and venture-capital business generated in 2005 by the EIF and KfW shows a substantial gap between them.



5. Overview of the EIB Group's SME support activity

Two principal conclusions emerge from the joint study of EIF and EIB support for SMEs in the European Union.

First, if guarantee and venture-capital operations are taken into account along with Global Loans to SMEs, this tends to re-balance the distribution of EIB funds among the European countries. The table below sets out the extent of the EIB Group's relative support for SMEs in the 25 countries of the EU, taking into account the stocks of Global Loans, guarantees and venture-capital fund participations as at end-2005.

[17] Figures taken from the EIF's Annual Report for 2005, page 25. The amounts corresponding to operations covering several countries (€155 million committed in 2005) are again excluded from the analysis.

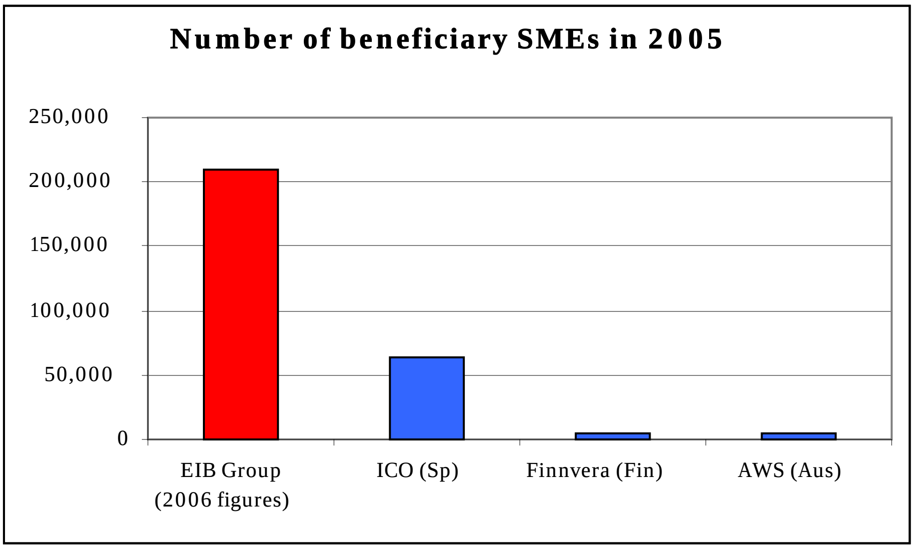
EIB Group support for SMEs / GDP (2005)

1	**Estonia**	2.38	14	**Slovenia**	0.74
2	**Portugal**	2.29	15	**Lithuania**	0.61
3	**Italy**	2.26	16	**Slovakia**	0.55
4	**Spain**	1.89	17	**Sweden**	0.47
5	**Latvia**	1.68	18	**Denmark**	0.47
6	**Ireland**	1.66	19	**Malta**	0.46
7	**Finland**	1.32	20	**United Kingdom**	0.45
8	**France**	1.08	21	**Germany**	0.42
9	**Austria**	1.06	22	**Poland**	0.26
10	**Czech Republic**	1.05	23	**Cyprus**	0.26
11	**Belgium**	1.05	24	**Luxembourg**	0.19
12	**Hungary**	0.96	25	**Greece**	0.06
13	**Netherlands**	0.80			

NB: Share of the estimated total end-2005 stock of EIB SME Global Loans plus EIF guarantees and venture-capital operations / share of European GDP in 2005. An index higher than 1 indicates that the relevant country's share of the EIB Group's operations in support of SMEs is more than proportional to its GDP and vice versa.
Green denotes the 10 Member States that joined the EU in 2004.

While there is little alteration in country ranking, the values calculated for the whole range of the EIB Group's operations are less dispersed than those for Global Loans alone, the standard deviation changing from 0.87 to 0.69. The operations of the EIF and those of the EIB in regard to support for SMEs are thus complementary.

Secondly, the EIF's guarantee and venture-capital activity has contributed to leveraging considerably the impact of the EIB Group's support for SMEs. For example, the EIF's operations made possible participation in the financing of 183 000 SMEs in 2006, on top of the 26 000 SMEs that received EIB Global Loans that year[18]. Hence, when a comparison is made that focuses on the whole spectrum of support for SMEs (loans, guarantees and venture capital) and on the number of beneficiary SMEs, it leads to a significant re-evaluation of the importance of the EIB Group on the European market – even though the absence of data for KfW precludes a comprehensive assessment.



[18] Source: document "Promoting small and medium-sized enterprises (SMEs)", published on the EIB website following the annual press conference on 8 February 2007. http://www.eib.org/Attachments/general/events/briefing2007_04_sme_en.pdf

Appendix 1: allocations in € million (fiche/list + portfolio) of Global Loans to SMEs in the EU-25, from 2001 to 2005

	2001	2002	2003	2004	2005	2001-2005	% 2001-05
Belgium	47	150	149	104	122	572	2.59%
Czech Republic	0	23	45	61	52	181	0.82%
Denmark	12	12	19	12	0	55	0.25%
Germany	655	315	141	409	203	1,723	7.80%
Estonia	4	3	20	20	5	52	0.24%
Ireland	0	100	150	56	35	341	1.54%
Greece	0	2	0	0	0	2	0.01%
Spain	476	21	1,447	668	1,161	3,773	17.07%
France	873	1,068	690	747	916	4,294	19.43%
Italy	1540	2,340	944	892	1,034	6,750	30.54%
Cyprus	0	0	0	0	7	7	0.03%
Latvia	0	1	13	16	13	43	0.19%
Lithuania	0	0	0	18	0	18	0.08%
Luxembourg	0	0	0	0	0	0	0.00%
Hungary	8	23	38	78	23	170	0.77%
Malta	0	0	0	0	0	0	0.00%
Netherlands	122	4	92	135	181	534	2.42%
Austria	105	102	53	52	62	374	1.69%
Poland	16	13	9	7	13	58	0.26%
Portugal	9	236	213	142	189	789	3.57%
Slovenia	0	1	1	29	17	48	0.22%
Slovakia	0	0	9	1	2	12	0.05%
Finland	12	64	121	76	102	375	1.70%
Sweden	1	22	34	5	0	62	0.28%
United Kingdom	589	364	330	431	155	1,869	8.46%
Total	**4,469**	**4,864**	**4,518**	**3,959**	**4,292**	**22,102**	**100.00%**
EU 15	4,441	4,800	4,383	3,729	4,160	21513	97.34%
EU 10	28	64	135	230	132	589	2.66%

Appendix 2: signatures in € million of Global Loans to SMEs in the EU-27 countries, from 2001 to 2005

	2001	2002	2003	2004	2005	2001-2005	% 2001-05
Belgium	249	300	25	100	50	475	2
Bulgaria	11	6	0	13	15	45	0.2
Czech Republic	65	34	39	76	75	289	1
Denmark	45	0	13	20	37	70	0.3
Germany	256	277	412	533	78	1,556	6
Estonia	24	44	24	0	0	92	0.3
Ireland	100	190	150	0	100	540	2
Greece	25	0	65	50	0	140	1
Spain	729	1,056	1,184	677	1,063	4,709	18
France	1,123	961	869	764	867	4,584	17
Italy	2,115	1,943	1,237	1,585	1,238	8,118	31
Cyprus	0	0	0	0	0	0	0
Latvia	0	4	36	31	18	89	0.3
Lithuania	0	0	36	0	5	41	0.2
Luxembourg	0	0	0	0	0	0	0
Hungary	54	53	102	126	68	403	2
Malta	13	0	0	0	0	13	0.1
Netherlands	181	218	150	0	75	624	2
Austria	108	99	95	57	85	443	2
Poland	41	101	49	199	266	656	2
Portugal	0	480	303	113	168	1,063	4
Romania	20	14	15	37	15	101	0.4
Slovenia	5	6	45	45	15	116	0.4
Slovakia	0	10	40	32	16	98	0.4
Finland	50	50	52	56	175	383	1
Sweden	48	19	117	9	0	193	1
United Kingdom	410	290	302	320	111	1,432	5
Total	**5,472**	**6,123**	**5,341**	**4,810**	**4,540**	**26,287**	**100.00%**
EU 15	5,239	5,852	4,955	4,252	4,046	24,344	92.61%
EU 10	202	252	370	509	464	1,796	6.83%
EU 2	32	20	15	49	30	146	0.55%

Appendix 3: Explanation of the tables and charts used in this annex

The percentage of *Global Loans to SMEs signed with leasing companies* over the period 2001-2005 was calculated from the EIB's public data base, leasing companies being identified as all those whose name include the terms "*lease*", "*leasing*" *or* "*crédit-bail*". The high degree of uniformity of company names in this sector[19] reduces the risk of substantial underestimation in the figure arrived at.

Indices of country distribution of SME Global Loans: the statistics regarding allocated amounts are collated with GDP (source: Eurostat) and with the number of employees in SMEs (source: European Commission SMEs Observatory report on *SMEs in Europe 2003*[20]) for each European country. Comparison of each country's share in the European total for these two components makes it possible to calculate an index of the intensity of EIB assistance to SMEs. For example, between 2001 and 2005 Slovenia received 0.22% of aggregate SME Global Loans granted in Europe. Over the same period, Slovenia's economy produced 0.25% of European GDP. The index of EIB support for SMEs in Slovenia as a proportion of the GDP figure is therefore 0.87 (0.215/0.246).

In the case of the *distribution indices for the entire EIB Group* that have been presented, indices were first calculated from the EIF's published figures for guarantees and venture capital. These two indices, along with that for lines of credit, were then aggregated in accordance with a key taking account of the end-2005 stocks of each financial instrument: €25.6bn for lines of credit, €9.1bn for guarantees and €2.2bn for investments in venture-capital funds, equal respectively to 69%, 6% and 25% of the EIB Group's funds used for SMEs. For example, in the case of Finland an index of 1.15 for Global Loans, 2.37 for venture capital and 1.55 for guarantees produces a composite index of 1.32 (0.69*1.15+0.06*2.37+0.25*1.55).

Calculating *the EIB's market share in the segment of medium and long-term financing for SMEs in the Euro area* was more complex.

The initial step was to calculate outstanding SME Global Loans on the basis of the figure for aggregate Global Loan outstandings published each year in the EIB's Financial Report[21]. This figure was first multiplied by an estimate of the share which the EIB's SME Global Loans represented as a proportion of total Global Loans. The figure used was 40% because, while SME Global Loans and infrastructure Global Loans have latterly each constituted around 50% of total GLs, allowance needs to be made for the longer maturity of infrastructure GLs (an estimated average of 7.5 years, against 5 years for SME credit lines). The resulting figure was then multiplied by an estimate of GLs to SMEs in the Euro area as a proportion of total GLs in the European Union. The geographical distribution of SME GL signatures over the period 2001-2005 was taken as the yardstick, giving a figure of 88.7%.

Next, the size of the market for medium and long-term loans to SMEs in Europe was estimated from ECB published statistics. Using the ECB's *Monthly Bulletin*, the outstanding total of loans to non-financial enterprises with an initial maturity exceeding 1 year can first be calculated by adding the columns "1 to 5 years" and "more than 5 years" (section headed "*Euro area statistics*", table 2.4, lines "*outstanding amounts*"). For the purpose of estimating the SME loans share in this outstanding total, it was decided to take the figure for loans of less than €1 million as a proxy. The assumption made here was that the distribution between loans below and above €1 million in total loan outstandings was similar to the distribution observed regarding the signature or renegotiation of loans in the Euro area. The figures published each month by the ECB under the heading "Euro Area MFI Interest Rate Statistics" show that loans below €1 million account for around 30% of total loans to non-financial

[19] See, for example, the member list of the German Leasing Companies Association. http://www.leasing-verband.de/download/bdl_mitglieder_2006_endgueltig.pdf
[20] http://ec.europa.eu/enterprise/enterprise_policy/analysis/doc/smes_observatory_2003_report7_en.pdf (table on p.78).
[21] In the case of the 2005 Financial Report, for example, the table is on page 38.

enterprises. This figure was very stable over the period 2001-2005, and was therefore used to estimate the outstanding total of loans of less than €1 million with an initial maturity exceeding 1 year.

Dividing the outstanding total of EIB Global Loans to SMEs in the Euro area by the outstanding total of medium and long-term loans produces an estimate of the EIB's market share in this segment.

ANNEX 2

Analytical Report on the SME Consultation

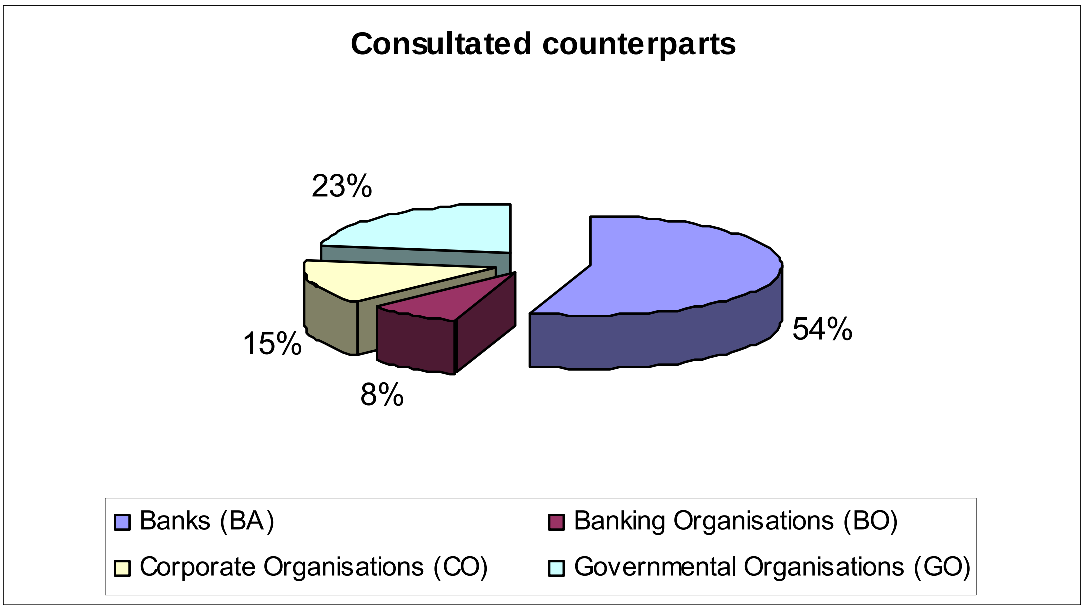
1. Implementation of the SME Consultation

The SME Consultation took place in the second half of 2007. It was initiated by ways of an invitation letter, sent as of June 2007 to 104 counterparts. Beyond the 104 banks, government organisations and SME associations, an information about the SME Consultation, including the full invitation text, was also sent to 15 Members of the European Parliament. All 27 EU Member States were covered by the SME Consultation.

The invitation letter did intentionally not include a detailed and systematic questionnaire. It included only a few questions formulated in a very open way in order to catch a wide range of topics. For the evaluation of this consultation and the conclusions to be drawn, it is therefore important to bear in mind that this exercise is neither an opinion poll nor a market survey. The range of issues raised is very broad and sometimes contradictory, and it is the purpose of this report to present the different views in all their detail.

Amongst the 104 counterparts consulted, there were 58 banks and 9 banking organisations, 14 SME associations (including chambers of commerce or craftsmanship) and 23 government bodies (including promotional institutions and DGs of the European Commission). In the statistics provided, the main distinction will be made between banks (banks and banking associations) and non-banks (SME associations and government bodies), unless otherwise specified.

The participants invited to the consultation were selected by the respective geographical operational departments of the Bank, and by EIB's office in Brussels as far as European associations and members of European parliament were concerned.

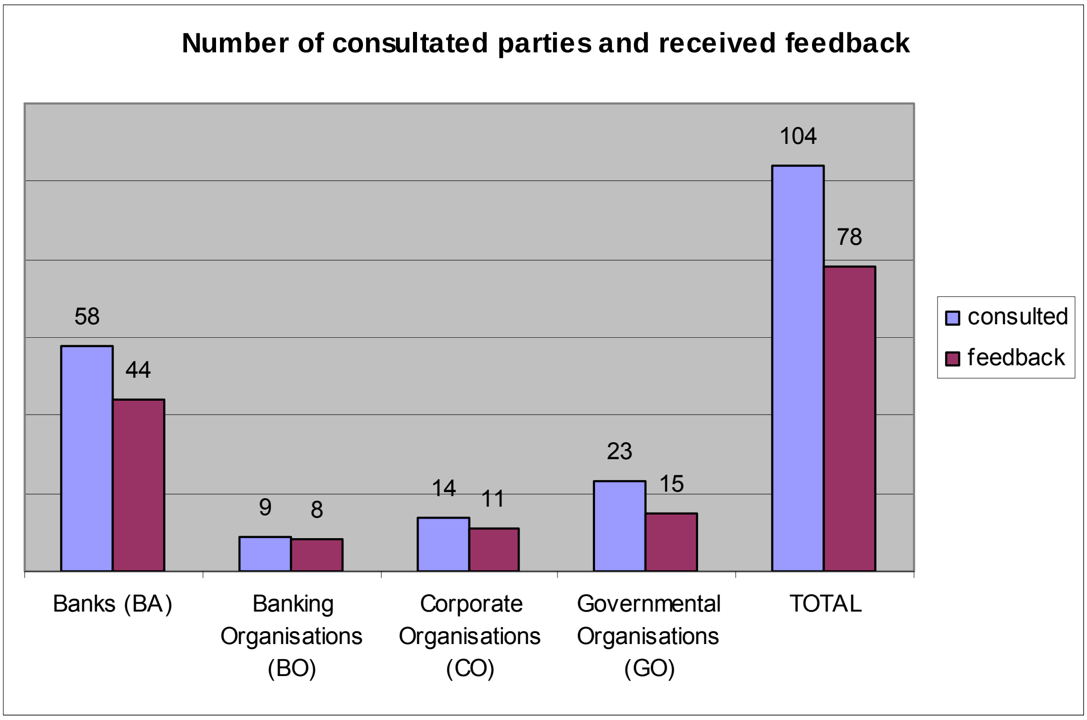


The first group of consulted counterparts is not surprisingly the banks. Dealing with SMEs is a question of proximity and a dense network of branches is a basic condition to cover efficiently the SME's market. As EIB does not and will not have such a network, it relies on its partner banks to convey to final beneficiaries the advantage derived from their cooperation with EIB. Thus the banks are the first concerned when it comes to an evaluation of EIB's products and procedures.

The second largest group of consulted counterparts is to be found amongst the government organisations, including public promotional banks like KfW, Finnvera or OSEO and also government bodies dedicated to SME support like IAPMEI in Portugal or BERR in the UK.

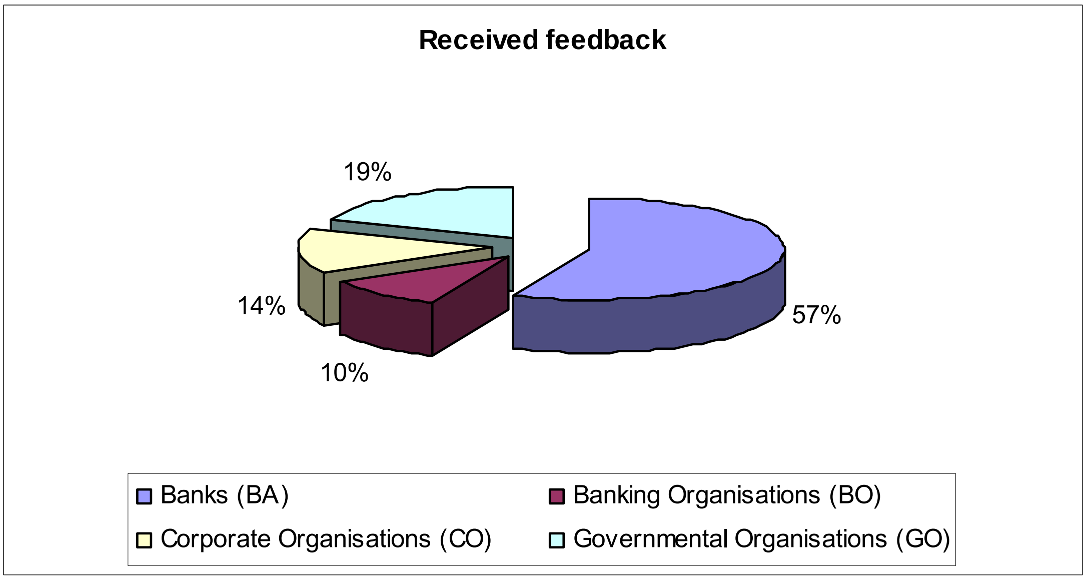
The third group is represented by a number of SME's associations at national and European level. This third group is of high importance because it gives a different perspective coming from the SME market.

The response to the SME Consultation has been generally lively, with responses received from 78 respondents compared to 104 participants (75%). 8 out of 9 banking associations responded in writing or through meetings to which they conveyed EIB and their members. The response from EIB's banking partners was equally high, with a ratio of 76%. 65% of the promotional banks and governmental departments dedicated to SME support which were contacted answered to the invitation with constructive replies. Very importantly, 11 out of 14 SME associations (79%) contributed with their views to the consultation.



This high rate of response, as well as the general tone of the received feedback, shows that EIB's intervention in favour of SMEs is considered relevant in most countries. It is equally appreciated (sometimes for different reasons) in mature as well as in developing financial markets. This positive conclusion has somewhat to be mitigated by the specific circumstances in which the SME Consultation took place (the sub prime crisis with its various consequences on major financial markets). Some doubt have also been raised in at least two countries where EIB's intervention is associated with a risk of market distortion.

Due to the similar response quotas in all categories of participants to the SME Consultation, the split of answers received is very much in line with the choice of contacted counterparts:



2. Statistical overview of the answers to the questions formulated in the invitation to the SME Consultation

The main focus of the SME Consultation was on four topics, as set out in the invitation letter sent to the participants:

- Strengths/weaknesses of the EIB Group's current product offering (target group, eligibility criteria, definition of project cost, reporting, minimum/maximum maturity, pricing etc.)
- Which are the SME segments that are not well covered in terms of financing needs and where the EIB could make a valid contribution?
- Which are the financial products to be developed by the EIB that would be best suited to respond to the needs of these market segments (see also examples of product proposals in the annex to this letter)?
- In your opinion, would the development of risk-sharing mechanisms between the EIB and its financial partners represent a valuable contribution in the context of SME lending?

The following paragraphs will provide a statistical presentation of the answers on the four topics. For the purpose of the analysis, the views of the banks and banking associations are presented separately from the views of governmental organisations and non-banks.

2.1. Strengths/Weaknesses of the existing EIB product

The first objective of the SME Consultation was to receive feedback on the strengths and weaknesses of the existing EIB product, and suggestions for improvement.

2.1.1. Strengths of the existing EIB product offering

One third of respondents to the consultation explicitly mentioned their satisfaction with EIB Group's existing product offering, for various reasons:

The Global Loan product is mainly appreciated for its flexibility. Many participants from the banking side are satisfied with the broadness of the eligibility criteria and the definition of final beneficiaries. They appreciate that the Bank does not interfere with the intermediary's client relationship, i.e. does not impose strict rules on the repayment structure, duration and interest rate conditions applied to the SMEs. A limited number of intermediaries also explicitly appreciated the speed with which EIB approves allocation requests. In CEE, the EIB SME Finance Facility was praised. Under the SME Finance Facility, the EIB grants Global Loans to intermediaries in Central and Eastern Europe, which are combined with a grant element from EU Commission funds. For each MLT loan granted to an SME, the intermediary receives a 3 000 EUR premium out of these funds. Also EIF's portfolio guarantees were mentioned several times for their institution building effect, i.e. encouraging the banks to enhance their (medium long term lending) activity in the SME segment.

The EIF's venture capital activity was appreciated for its support to innovative SMEs.

In the context of the current liquidity crisis, some respondents also praised EIB's role as stable provider of liquidity at attractive conditions.

2.1.2. Weaknesses and areas of improvement of the existing products

2.1.2.1. Comments on the intermediation principle

As it was made clear by the Bank during the SME Consultation, the Bank is not considering any change to the use of the intermediation principle in the context of support to SMEs. When describing the strengths of EIB's current product offering, many banks explicitly supported this view, praising, as mentioned above, amongst others the fact that there was no interference with their client relationship thanks to the intermediation principle. There were however also opposite views on this subject. Although their number is low compared to the overall number of answers received, the negative comments received in this context should not be neglected.

2 out of 10 corporate organisations were of the opinion that the intermediation principle stands against the whish of EIB to pass on its favourable funding conditions to the final beneficiaries.

EIB was also invited in several cases (by one banking association, and 4 government/non-bank organisations) to review its choice of intermediaries. There are SME segments which have created finance institutions outside the banking area. The largest sector which may serve as an example in this context is the cooperative sector. Its members often finance themselves through foundations or through other forms of institutions like mutual guarantee schemes or ethic banks.

Finally, 2 out of 14 corporate organisations stated that their members had a very limited knowledge of EIB's intervention in their favour. They admitted that this was also the case for the public schemes in favour of SME available at national level.

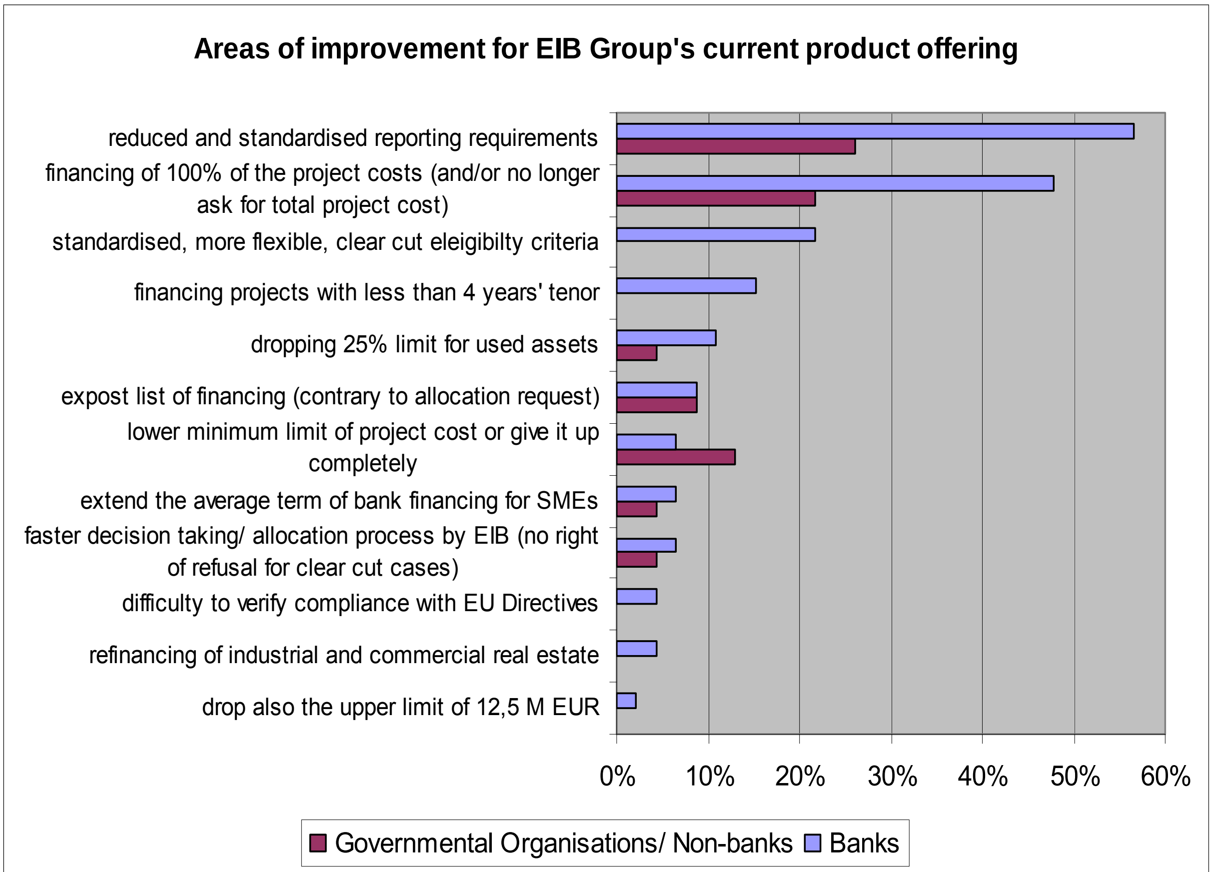
On each point, the overall number of replies remains small. This could be interpreted as a general acceptance of the intermediation principle, and a success of the information policy and transparency which EIB imposes on its counterparts since a number of years. However, discussions lead during the SME Consultation both with banks and non-banking organisations showed that although they knew about EIB, many were not aware of the full scope of EIB's intervention in favour of SMEs. As an example, one bank did not know that a Global Loan may be used for investments in any European Member State, and a corporate organisation thought that the number of 250 employees was too high for the respective national market, apparently ignoring that it was a maximum limit. Thus the effort on transparency and awareness building will have to remain high in EIB's agenda related to its intervention in SME finance.

2.1.2.2. Weaknesses of the existing EIB product offering

The answer to the question as to what would be the main weakness of EIB Group's product offering for SMEs was outstandingly clear: When it comes to SME finance, the reduction of bureaucracy is key. More than half of the respondents across all categories urged the Bank to reduce its reporting requirements in the context of SME finance. Some of them were even categorical in saying that any requirement going beyond data already available in their IT system (like for instance the request to indicate the change in number of employees before and after the implementation of the investment, like required in the context of EIB's SME Finance Facility) would in their view make an EIB product unmarketable. The request to SMEs to confirm that they are in line with EU directives on environment and competition creates an additional uncertainty in so far as SMEs are familiar with national legislation, but not with EU directives.

While commercial banks referred to their efforts to reduce cost/income ratios, public promotional institutions insisted on the fact that EIB should not "reinvent the wheel". They pointed out that their programmes where often very much in line with EIB's goals. If an overlap in strategy between the promotional institution as such or a specific programme of such an institution on the one hand, and EIB's promotional goals on the other, had been identified, EIB should support such institution or programme without imposing its own reporting requirements.

To be noted that the criticism about the level of bureaucracy was mentioned in the context of EIB's Global Loans, including those schemes linked to EU grants, and also repeatedly in the context of EIF portfolio guarantees issued under the EU mandate.



2.1.2.3. Suggestions for improvement of the characteristics of the existing EIB Group products

- The majority of respondents saw the increase of the maximum of project cost financed from 50% to 100% as one of the most suitable improvements of EIB's Global Loan product (bearing in mind that EIB would never refinance more than 100% of the respective intermediary bank loan to the final beneficiary). The 50% rule implies in many cases that banks have to make its SME client sign two separate loan agreements, one with the "EIB conditions", and one with the bank's standard conditions for the remaining amount. Such complication is deemed inappropriate in the context of SME finance.

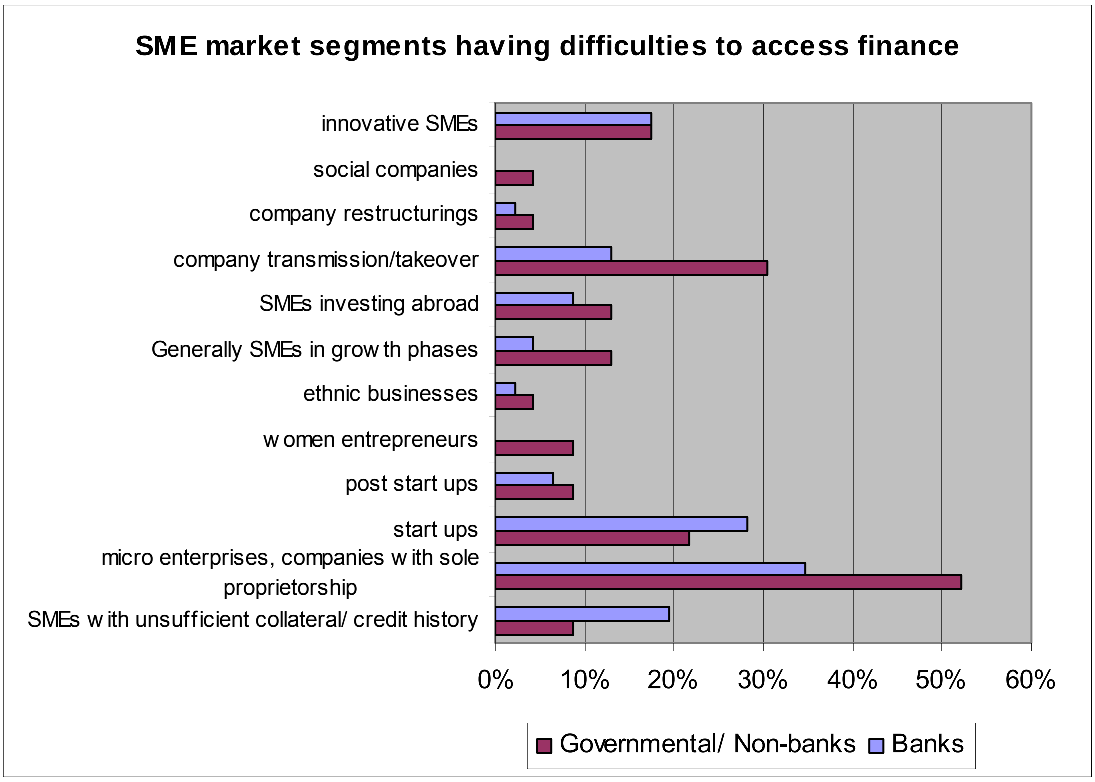
- Simplified and clear eligibility criteria would allow a shortening of approval procedures for individual allocations, or even a more consequent delegation of the decision on eligibility to the intermediaries. It would also render possible the use of modern communication technologies, e.g. an interactive website where an intermediary or even any final beneficiary could enter project details and receive an on-line response on the question of eligibility. Some other promotional institutions already have agreed on such wider delegation of the decision on eligibility, which would constitute a competitive advantage in their favour. In this context, the introduction of an ex-post list reporting system was suggested by respondents from those countries where the "fiche" system[22] is applied.

- It was frequently suggested that EIB should abandon the rule that maximum 25% of an EIB Global Loan may be used for financing projects which include expenditure for used intangible or tangible assets. Such rule would indeed be very difficult to observe. This implies also the larger question raised by one intermediary, i.e. why a company should be penalised by EIB just because it has decided to improve its productivity through the purchase of a used machine rather than through the purchase of a new one.

- The lower limit of project cost or loan amount (currently set at 40 000 EUR / 20 000 EUR) was considered inappropriate with respect to the aim of supporting mostly the smaller amongst the SMEs. Respondents to the SME Consultation suggested abandoning any minimum.

2.2. SME and activity segments facing financing gaps

This chapter focuses on the replies received on the issue of financing gaps, i.e. on the question of segments of the SME market facing problems in term of access to finance.



[22] The "fiche" system implies that each allocation request is provided to EIB on a separate form, which includes details on the project and the final beneficiary, and is signed by the latter one. Alternative systems used by EIB are the "list" approach (the intermediary provides EIB with a list including names of final beneficiaries, number of employees, activity sectors, project description, requested amount and location ex post) and the "portfolio" approach (the intermediary provides EIB with a statistic on its SME medium long term loan production, including a sectorial and a geographical split of loans granted, on an annual basis).

The results displayed above are in line with the global analysis of gaps in SME finance presented in ANNEX 3.

Besides the general topic of lack of security and/or insufficient collateral and credit history, which is common for all SME, the following more specific segments where mentioned:

- Small businesses were mentioned the most frequently, throughout the different categories of respondents and the most widely amongst Europe, as being the SME market segment facing the largest problems to obtain financing. The definition of what is a small company however varies from market to market. It certainly includes the large (in terms of numbers) group of self employed. Other suggestions concentrate on amounts of annual turnover, e.g. a German banking group suggests 5M EUR annual turnover as an upper limit, and the British Federation of Small Businesses defines small businesses as those with an annual turnover between GBP 100,000 and 500,000 (EUR 140,000 and EUR 700,000). The definition used by the European Commission for small companies, i.e. 1-9 employees, corresponding to less than 1M EUR of annual turnover, is probably adequate. To be noted that while the topic is the most frequently mentioned for both categories of respondents, the percentage amongst the government/non-bank respondents is higher and reaches more than 50%. This may be due to the fact that financing micro businesses requires a very dense branch network, and is therefore not put forward as a core topic by those banks focussed most on low cost/income ratios.

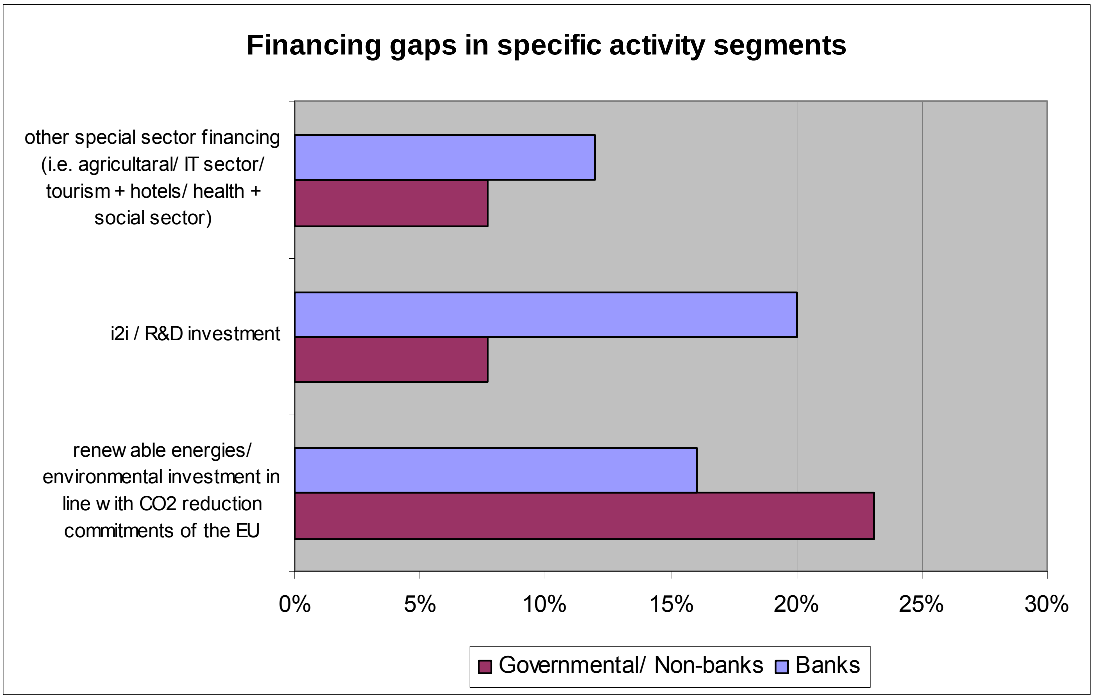
- Unsurprisingly, the second largest number of answers named start-ups and young enterprises in post-start up phases without credit history or track record as having problems to find sufficient financing for their establishment or expansion.

- The third frequently mentioned segment were companies facing the challenge of restructuring or transmission from one generation to the next, followed by innovative SMEs. Again, the proportion of government/non-bank organisations highlighting this topic is significantly higher than the proportion amongst banks. Restructuring and company transmission is a business which requires a high level of individualisation of the products offered. Standardisation is not possible, and credit risks may be high compared to financing of a large number of micro businesses.

- Also SMEs in growth phases, and more specifically SMEs expanding abroad (i.e. in the majority of cases into another EU Member State) seem to face problems to obtain financing for their expansion.

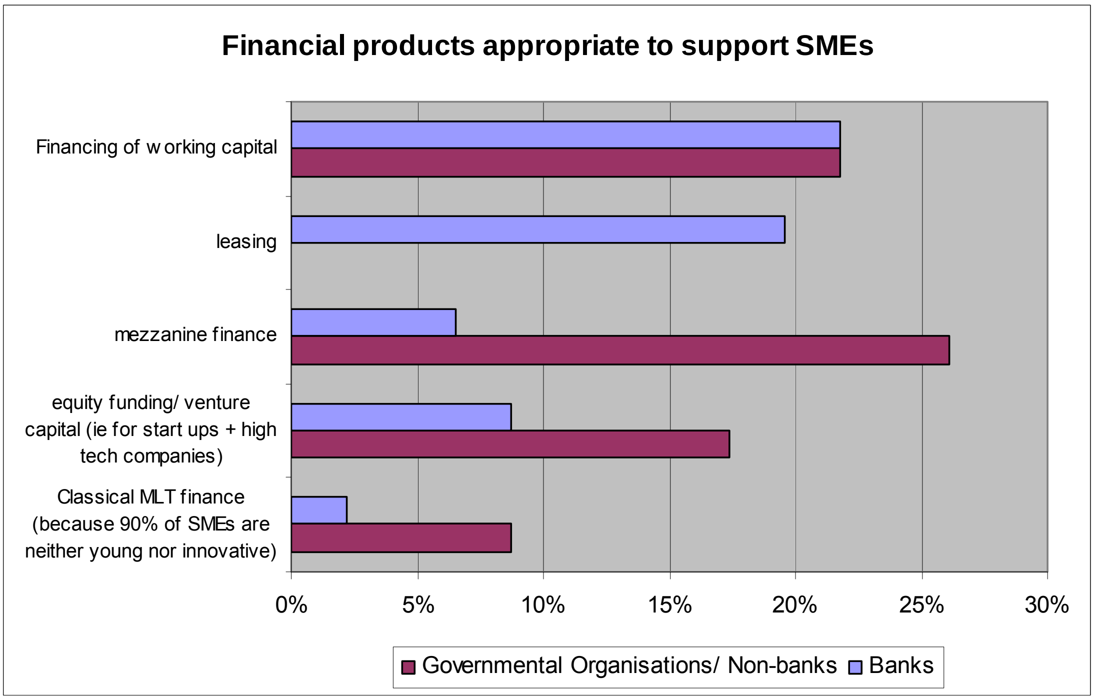
- SME segments like cooperatives companies, ethnic businesses or women entrepreneurs have not been mentioned by many respondents, but may nevertheless be important in numbers (social sector) and in a national context (ethnic businesses).

- The analysis of the answers received during the SME Consultation also shows that besides the size of SMEs and their position in the overall lifecycle of a company, there are specific activities for which obtaining finance represents a problem. Unsurprisingly, R&D is most often mentioned. But across Europe, SMEs also seem to have difficulties in finding finance for investments related to energy efficiency and sustainable development. And finally, there are country-specific activity segments like tourism in Portugal and Spain or Hungary which have been mentioned in this context.



2.3. Financial products deemed appropriate to support SME development

This chapter presents the financial products suited to close the above-mentioned financing gaps according to the responses received during the SME Consultation, and where EIB could make a contribution, including reflections on risk-sharing schemes.



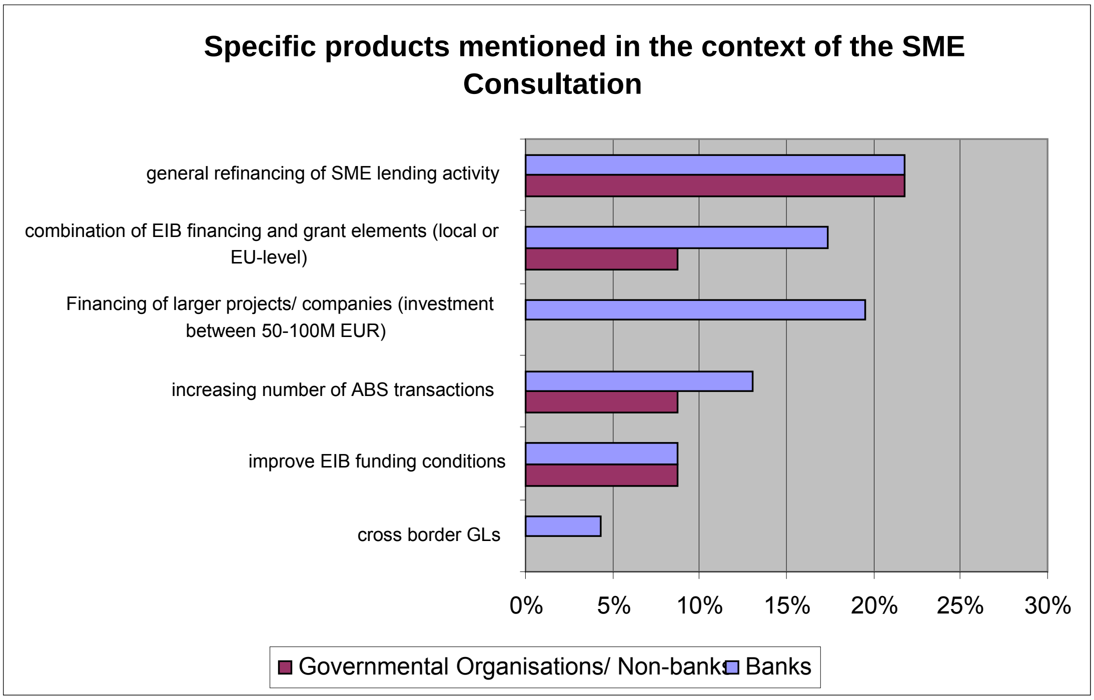
The representatives of the association of European SMEs (UEAPME), which regroups the largest number of SMEs throughout Europe, reminded the Bank very strongly about the fact that 90% of SMEs were neither innovative in the strict sense of carrying out R&D programmes worth more than 4% of their annual turnover (which is the definition used by the OECD to define the "high-tech sector"), nor young, nor even expanding. There was thus a repeated plea to maintain an EIB support for the classical external financing tools used by SMEs. To be noted that leasing was mentioned as particularly important in Central and Eastern European markets, but also in Italy. For many respondents, lack of access to working capital finance is just as important for the development of SMEs as MLT lending, mezzanine or VC financing. The German market, where SMEs are often required to issue bank guarantees in the context of their day to day business[23], in addition to deteriorating payment conditions imposed by their clients, may serve as example in this respect. It may be surprising that these “classical” financing tools come first, when considering that at the same time, the European banking market may be considered as generally very competitive and “over-banked”. But these characteristics apply mostly to those SMEs which are able to present their investment projects in a convincing way to bankers, and which have the necessary track record, profitability and security.

Beyond this, the products mentioned during the SME Consultation as suited to address financing gaps in start-up phases, for company transmission or restructuring or financing R&D and innovation are equity finance (for start ups and high tech companies) and mezzanine finance (for transmission or expansion phases):

- One respondent stated that venture capital was used by 5-6% of micro and small businesses (90% of which are individual companies or partnerships). It was emphasised that take-up would remain negligible if new forms of venture capital which could also apply to individual companies would not be devised. To note that while the British market is considered to be the most developed in Europe in terms of venture capital, the offer of the latter was still considered to be insufficient. In Italy, the Bank was told that equity finance operations are usually not tailored to the needs of local SMEs, due to the large size of the deals.

- Mezzanine finance was generally considered to be a very interesting product to match the cultural difficulties SMEs have to let a financial partner into the own funds of their company on the one side, and the difficulty to provide adequate security for external financing at times of transmission or international expansion on the other side. Mezzanine finance was mentioned much more often by government/non-bank organisations than by the banks as a suitable product to close market gaps in SME finance. Again, this may be related to the fact that mezzanine finance is a highly individualised product. The offer for SMEs has started developing fairly recently, and the ABS market for mezzanine loans is only at its creation stage.

[23] Prepayment guarantees to buy raw material, execution guarantees etc.



- To be noted that a significant proportion of consulted parties (more than 20%) were of the idea that EIB should generally support SME finance as such, without limitation to specific products or even medium long term lending. Such a scheme was seen by many respondents to be the best response to the average size of final beneficiaries and the aim to transfer the largest possible financial advantage to the SMEs.

- In the context of financing of innovative SMEs, and also following the very positive experience of the SME Finance Facility in CEE, there was an interest in the use of EU grants in combination with EIB intervention. Such combination was however almost immediately followed by and combined with the request for adequate reporting requirements.

- Close to 20% of respondents from the banking sector would appreciate if EIB would develop simple, standardised products for larger projects, with investment volumes reaching 50-100M EUR.

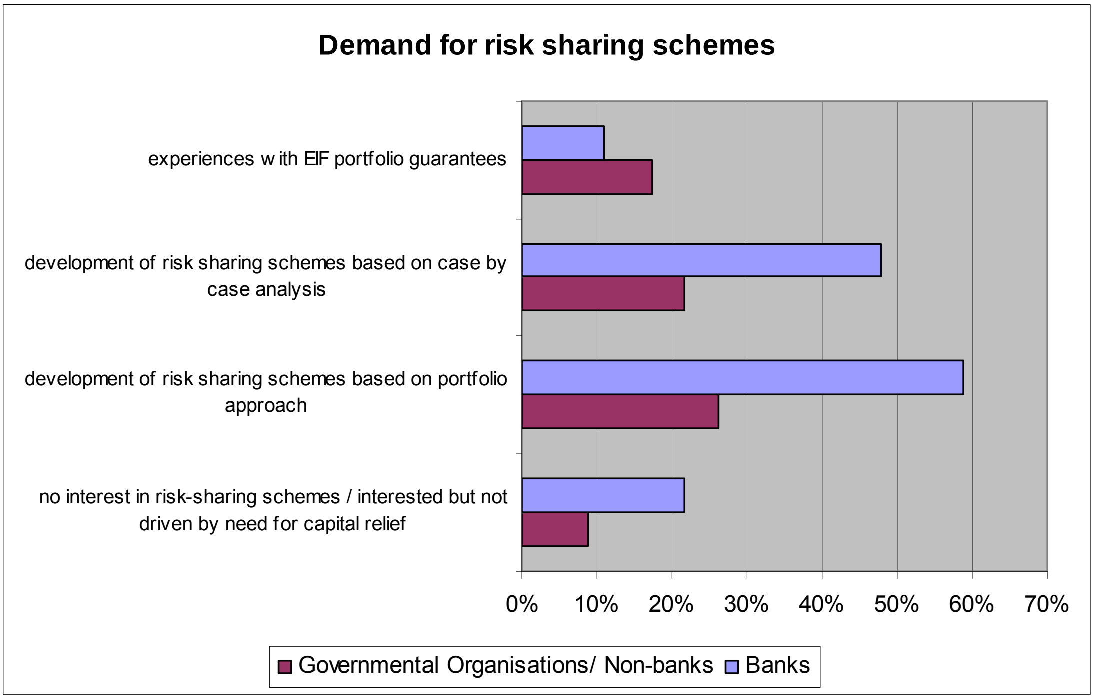
- To contribute to the closing of the financing gaps with respect to “classical” external financing, EIB was encouraged to pursue its activity in ABS operations. In markets like Italy or Portugal, where covered bonds legislations have lately been modernised, the activity could be intensified. The Bank was also invited to contribute to the development of ABS transactions with mezzanine loan portfolios.

- And finally, the improvement of EIB funding conditions was seen by some as another easy-to-implement tool to contribute to the closing of financing gaps in SME finance.

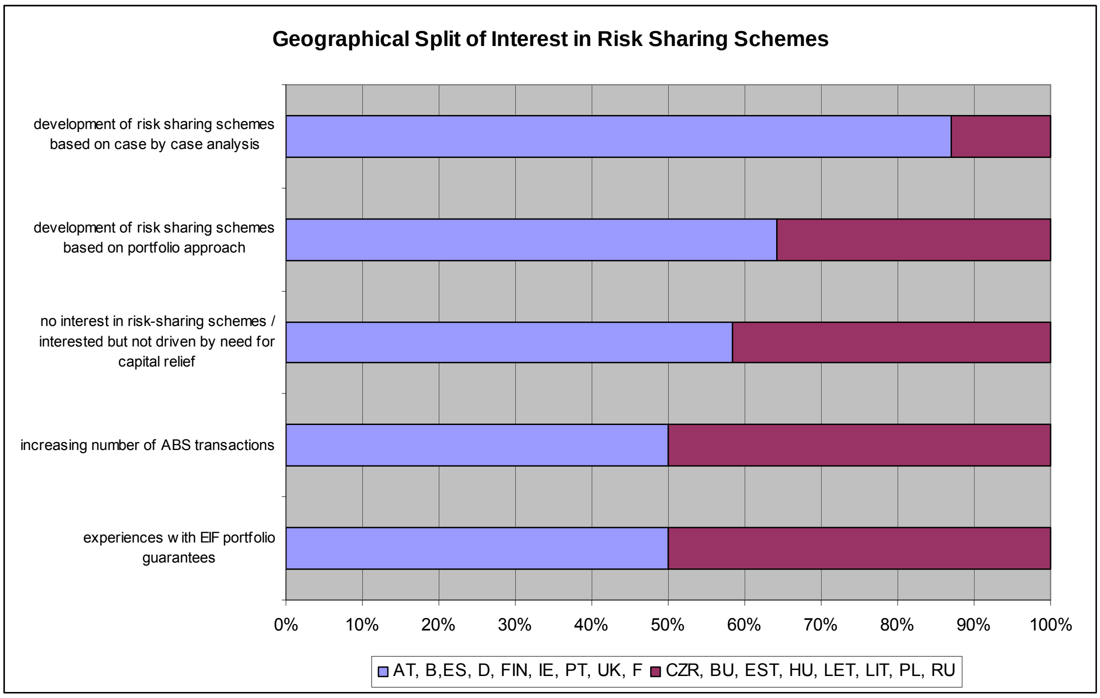
The participants to the SME Consultation were specifically asked to comment on their interest in developing risk-sharing schemes with EIB, and if this could be another interesting alternative to alleviate gaps in SME finance throughout Europe.

The responses received on this last question of the consultation letter show that there is a general interest in developing risk-sharing schemes, especially amongst the banks responding to the consultation. Their motivations are of different nature: In some cases there is an interest to alleviate capital constraints due to dynamically growing loan books or lack of adequate deposit bases. Where capital constraint was an issue, ABS transactions or covered bonds (with recently improved legal frameworks in Portugal and Italy) were praised as existing solutions. Guarantees from promotional banks appear to be more seldomly used so far.

In other cases, the banks claim that (at the time they were consulted) there is no immediate capital constraint weighing on their lending activity, but they would appreciate having a risk-sharing product to distinguish themselves from their competitors (in one case, EIB was even requested to keep exclusivity with one counterpart on a risk-sharing product, to better serve such marketing purpose).



The SME Consultation has not brought a straightforward answer to the question as to which approach to choose between sharing the risk on the basis of a portfolio of SME loans or on a case by case basis, probably because the number of concrete operations in which EIB has entered so far is still very small. A case-by-case approach could be better suited for larger (less numerous) loans, bearing in mind the higher complexity inherent to this concept (notably double due diligence to be performed on each file). The portfolio approach would probably be the better concept when targeting the lower end of the SME market, where individual loan grading systems are still being refined.



The above graph shows the priorities regarding the different types of risk sharing schemes. The answers from the different countries have been divided into two country groups[24] comprising the Western European economies and the countries in Central and Eastern Europe. As a result one could draw the conclusion that the more matured financial markets are the more interest in risk sharing facilities exist (on a case by case basis). In the context of dynamically growing loan books, ABS structures are equally appreciated by old and new Member States to support the development of SME finance.

In this context, it was highlighted by some counterparts that there is an implicit way through which EIB is already now de facto sharing risks with local banks in Central and Eastern Europe. Indeed, several participants to the SME Consultation in CEE mentioned that when requesting funding (or security) from their Western European mother companies, the latter would still apply country risk add-ons for the price of such intra group support. By offering EIB funding at the same conditions for all EU member states, EIB's funding through a standard GL is thus proportionally more attractive in the New Member states.

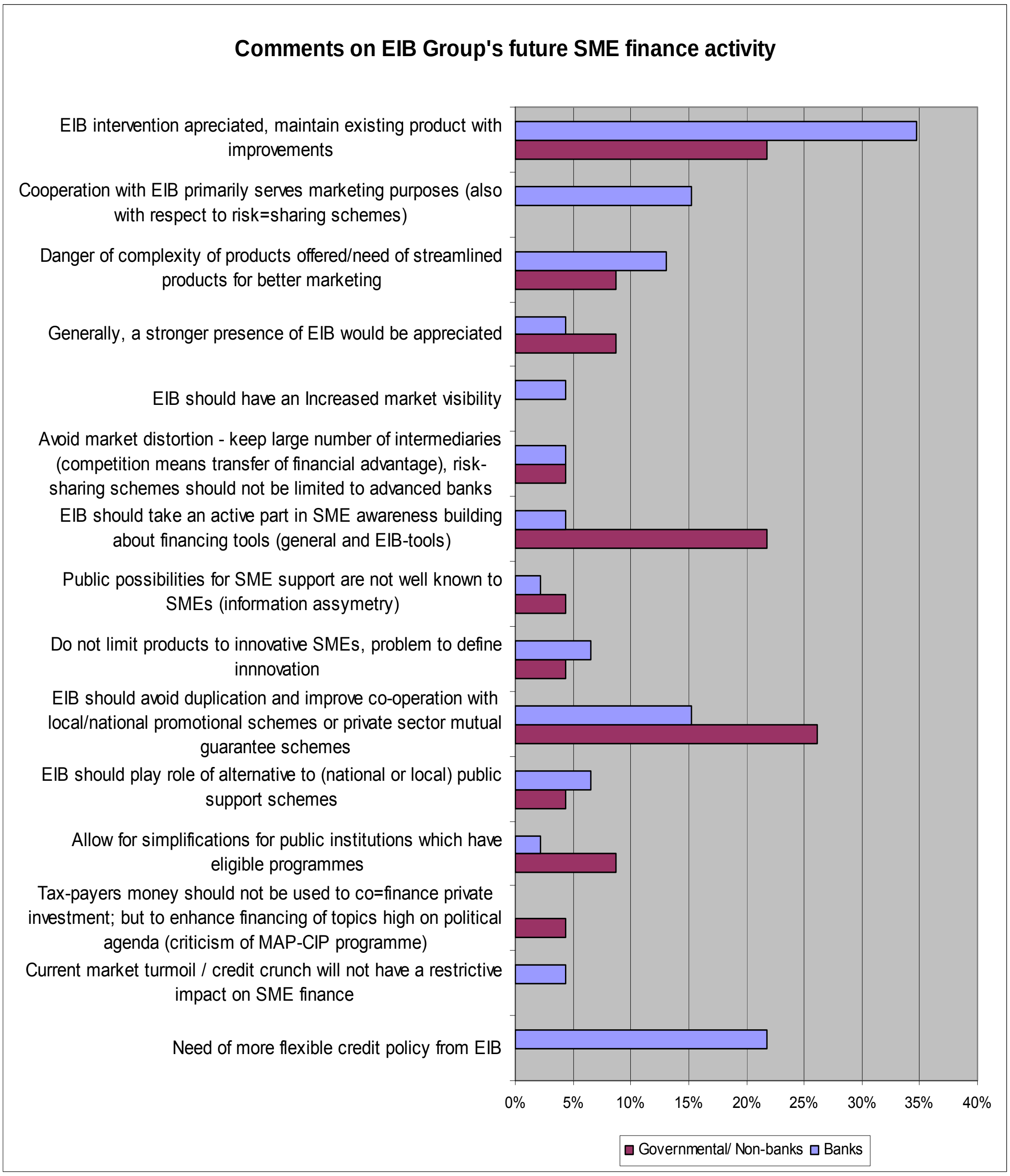
If EIB embarks itself on risk-sharing schemes based on a case by case approach, a precondition for such schemes is clearly that EIB accepts the intermediary's internal loan grading system in terms of information requirements and pricing, and agrees to full delegation of the loan appraisal procedure.

Due to the small number of risk sharing transaction already finalized these comments on risk sharing scheme have to be considered with caution in so far as they are more theoretical than based on experience.

[24] 100% is equal to the total number of replies received on each topic/ only countries which have commented on the relevant issues have been taken into consideration

3. Conclusions[25]

The following chart gives an overview of the drivers which respondents of the SME Consultation have mentioned as those which should impact on EIB's future role in SME finance. Again, the graph cannot be interpreted in the sense that the percentage of participants that have not mentioned a point are automatically of the opposite opinion. The graph simply lists a number of topics and relates the percentage by category of respondents who mentioned the respective topic.



25 To be noted that in several cases, EIB was encouraged to reform its credit policy towards its banking partners and consider whether unsecured lending based on the history of a mutual support mechanism or based on the credit quality of the intermediary could be envisaged. This subject is not further pursued in this note since it is subject to very specific relationship issues which cannot be dealt with in this statistical report. In the case of Romania and Bulgaria, the Bank was also urged to intervene with the respective Central Banks and Governments to alleviate the minimum reserve requirements weighing on SME lending activity of the commercial banks in the respective countries. Also this issue is pursued on a bilateral basis with the Central Banks and Governments of the countries concerned and will not be further developed in this report.

From the variety of responses received, one can conclude first of all that SME finance remains a key topic throughout Europe – for the cooperative and savings banks in Europe because it is part of their traditional mission, for the banking sector in general because it constitutes a reliable and important source of income, for the public support institutions because of the importance of a healthy SME tissue for the national economies, and for the SME associations because there remains a lot to be done to optimise the access to finance for their members.

Despite of what might be the market share of loans supported by EIB (estimated at around 3.6% at European level), EIB Group is considered to be an important partner in the context of SME finance. Most addressees of the letter have prepared detailed written reactions to the invitation letter, many of them were interested in having bi-lateral meetings with EIB to discuss further on the suggestions made. EIB's existing product offering, and more specifically the EIB's Global Loans, is widely appreciated for its flexibility (i.e. the possibility to combine EIB funding with other (national) promotional programmes or to use EIB funding with other banks resources, the flexibility of intermediaries to negotiate freely repayment and interest rate conditions with the final beneficiaries, the flexibility of intermediaries to implement the rules of transfer of financial advantage).

It has to be noted however that the knowledge about EIB's products and intervention was often limited on the SME side. This lack of information concerns not only EIB but also EU instruments and even the available state-supported national schemes which are not fully utilized in many countries. A contribution of EIB to the awareness building on financing tools (EIB products, but also regional and national support schemes) for SMEs would be particularly appreciated by the non-banking respondents to the SME Consultation.

The main criticism expressed about EIB's intervention is the heavy administrative burden which weighs on the management of its programmes. This burden is not adequate in a context of SME finance, which in itself requires a dense (and thus expensive) branch network from the intermediaries. Adding the cost of detailed reporting requirements and complex eligibility criteria is contra productive to the aim of a wide spread use of support schemes in general, and also specifically the use of EIB products. A number of suggestions were made how to improve EIB's current product offering in that sense. A reduction of reporting requirements and abolishing of complex eligibility criteria (complex because not in line with the information the intermediaries require themselves from their clients) is welcomed by all participants to the consultation. It is even seen by many as the main factor which will decide on future use of EIB funds. Standardisation of procedures is key to intermediaries which are focussed on low cost/income ratios. If EIB will follow this road, it will be of paramount importance to link any simplifications made to an increased value added transferred to the final beneficiary.

At the beginning of the exercise, the general opinion was that in developed financial market, access to finance was not a major issue for SMEs. It appears that this view has to be more elaborated[26]. Micro-enterprises, enterprises facing the challenge of growth, and young and innovative enterprises are those segments which seem to face financing gaps across Europe. Investments in environmental friendly technology, in R&D and in country-specific sectors are those for which financing seems difficult to find.

There is a clear need to foster cross-border investment by SMEs within Europe. However, cross-border investment is not necessarily a question of machinery and equipment, but very often a question of building up a new distribution network or joining forces with another SME abroad. The related financing needs are not eligible for EIB financing so far.

[26] In some European Member States, access to finance for SMEs is constrained by external factors such as very high minimum reserve requirements for banks. EIB will continue to intervene in favour of SMEs at a political level to alleviate such constraints, but formulating consequences on EIB's product offering for SMEs in these countries is beyond the scope of this report.

SMEs continue to depend mostly on bank debt as a means of finance. Showing a high indebtedness in the balance sheet hampers the chances to obtain further loan financing for expansion phases, company transmission or R&D activities. This is why, besides maintaining a strong presence in classical loan financing, alternative financing tools have to be developed. Amongst these, mezzanine finance seem to be one on which EIB should focus. The current offer in venture capital is biased towards larger "tickets". The low use of venture capital is also a question of entrepreneurial culture, as it is particularly difficult for an SME entrepreneur to accept a financial investor to participate to the decisions about the development of his company. In this context Mezzanine finance is a promising instrument where EIB group could play a specific role.

26% of the consulted non-banking partners and 15% of the banking partners propose a close co-operation with regional and/or national promotional schemes to avoid any duplication of efforts, definitions and reporting requirements. Some respondents however also suggest in this context an alternative role of EIB's product offering compared to local support schemes, since parallel schemes may sometimes also benefit from each other.

This SME Consultation reflects the diversity of situations and interest among EU Member States. It shows that, in redefining its SME strategy, EIB will have to face contradictory objectives and constraints:

- There is a strong interest from both, the banking and the government/non banking side, that EIB should maintain its GL activity with its current level. At the same time, there is a need to have a more defined and restricted focus in order to avoid dilution of the advantage provided by EIB finance by being too "global".
- As a result of the politically declared aim to promote a knowledge-based European economy, EIB has decided to give a strong focus of its support to SMEs to highly innovative, research-oriented SMEs and those with high growth potential. However, SMEs falling into these categories represent a minority compared to the large group of SMEs who are in neither innovative nor have recently been created, but who nevertheless need financing for their development and have difficulties to obtain it.
- On the one hand, there is a need to provide specific markets with specific solutions able to accommodate national circumstances (presence of public support mechanisms, cultural specificities, structure of the local banking market). On the other hand, tailor-made products would be contrary to simplicity of product offering and low reporting requirements, which should be one of the most important drivers for EIB's future product offering in SME finance.
- To accommodate for specific needs, EIB Global loans will be more dedicated and thus smaller in size. This stands against the interest of EIB to cooperate also with a number of banks, which are ready to work with EIB, but need larger operations to make it worthwhile to consider EIB as alternative source of funding in their centralised treasury departments.
- Cooperation with smaller, regional banks, which are very present in the local SME tissue, is key to reach SMEs. At the same time, as the number of deals per country is limited by EIB's operational capacity, there is an impossibility to serve a growing demand from banks. This means a reduction in market penetration, i.e. a reduction of competition amongst intermediaries for the distribution of EIB funds. Competition is however seen as the main driver for the transfer of a financial advantage from EIB intervention to the SMEs. Any decrease in market competition could give rise to those respondents to the SME Consultation who have feared market distortion as a result of EIB's selective choice of intermediaries.
- One of the clearest messages, coming from the SME Consultation, is the urgent need to limit the administrative burden related to EIB current or future products. At the same time, transparency, traceability and acceptable monitoring are unavoidable.

It will be the challenge for EIB to find answers to the topics and contradictions raised by the SME Consultation. For the choices to be made to modernise EIB's intervention in SME finance, the overall aim of improving transparency and value added for the final beneficiaries will however remain central in EIB's strategy.

ANNEX 3

Financing Gaps in the European SME Market

The purpose of this annex is to highlight a few issues in respect to the topic of “access to finance for SMEs”. There is ample literature on this issue, and the following note refers to some of the most recent publications, without however the ambition to be complete. Firstly, a summary on the ongoing debate on financing gaps for SMEs is provided. This is followed by a presentation of some SME segments facing difficulties in access to finance, and reflections on the financial tools which would be best placed to respond to modern SME’s needs.

1. SME financing in a competitive European banking environment

In most European markets, risk margins paid by SMEs on loan financing have in the past 4 years converged towards those paid by larger companies, for the benefit of SMEs. This trend is primarily observed for medium/long term loans, while it is weaker for (mostly unsecured) short term loans. It can be explained by two main factors: On the one hand, economic growth and increased cost efficiency has allowed SMEs to improve their financial situation and many have used the cash generated by their operations to repay bank debts. On the other hand, banks have been able to reduce their provisioning levels and show an increased appetite for SME lending as an entry point to a profitable client relationship (including high value banking services like LBOs, private wealth management for the CEO of the SME etc.). Consequently, one could conclude that problems in access to financing currently play a marginal role for SME managers.

The French Central Bank dedicated its September 2007 Bulletin to SMEs, describing how their financial situation has on average evolved over the past years in France, and drawing conclusions on the effects on the topic of access to finance. Daniel Gabrielli writes in his contribution on “L’accès des PME aux financements bancaires”:

“… The cost of credit for SMEs is generally higher than that for large companies. The reasons for this are twofold: on the one hand, most SMEs do not have access to direct financing on capital markets; on the other, they carry higher risk premia than large companies. However, (the statistics) show that the rate differential between SMEs and large corporations has narrowed in recent years, more so in France than in the rest of the Euro area. (…) As a result of their easier access to bank loans, SMEs have had increasing recourse to debt financing relative to internal financing to fund their investments (according to the OSEO business surveys, the share of internal financing dropped from 47% in May 2006 to 44% in November 2006 and 37% in May 2007). Debt financing has also replaced factoring operations, long-term rentals and lease with purchase options. At present, financial factors thus represent a relatively minor obstacle to investment. (…)

The major trends described above conceal significant differences across sectors of activity. Thus, loans to enterprises in mining and quarrying as well as manufacturing have remained unchanged since mid-2003 at levels below those observed over the previous three years. (…) An analysis of the financing structures and investment behaviours based on the annual studies of the Banque de France tends to show that enterprises in certain sectors, irrespective of their size, are currently net lenders and prefer to use available funds to reduce their level of debt rather than finance investments.”

Another European issue, to which the SME Consultation has not brought a clear cut answer on whether it will have positive or negative effects on SME finance, is the impact the new Basle II regulations will have on SME lending. There seems to be a widespread fear amongst SMEs that Basle II regulations will widen the spreads between those borrowers which are able to present material collateral to their bankers, and those (innovative, dynamic, young) SMEs which may have very good prospects, but cannot offer adequate assets to back their financing needs. On the opposite, simulations done back in 2004 conclude that the new regulation will not have a restrictive effect on the bank’s attitude towards SME lending. Indeed, under Basle II, an SME loan will have a more favourable risk weighting than a loan to a large corporate. This is a consequence of the importance given to the contribution of SMEs to European economic growth, and of the fact that a default of a large company may have a larger overall impact on the economy, whereas there is usually no correlation amongst defaults of SMEs. As the Basle II framework will lead to the development of credit ratings for SMEs, and will show a stronger relationship between credit ratings and pricing, it will reduce information asymmetries between bankers and SME's, and should thus enable firms to benefit from greater access to finance.

The above may lead to the conclusion that globally there are no financing gaps remaining in the European market, and if SMEs do state the contrary, they are referring to the fact that they perceive the price they have to pay for bank loans as too expensive. This seems to be underpinned by empirical evidence showing that, in the Euro area, only a one-digit percentage of SMEs' loan requests are turned down by lenders. In a competitive European banking landscape, where central banks recurrently warn that loan pricing does not correctly reflect the underlying risk, this scenario would reflect a misperception by the SME of the entrepreneurial risk they represent, rather than a misallocation of resources. A similar view may be taken in the case of venture capital. Returns on early stage venture capital investments are persistently negative in Europe, which could lead to the assumption that venture capitalists are actually drawn into investing in firms which do not present thorough business plans because the others are already well served or there is simply no demand ("Funding growth in a changing world", The UBS UK Venture Backed Report – 2007). There seems to be no shortage neither in private equity finance for later-stage financing including management buy outs, as the European market for buy-outs has matured with the arrival of institutional investors such as pension funds and hedge funds.

Generally, SMEs present specific criteria (e.g. size, shareholding, financial surface, accounting standards, private character of contracts with labour force, suppliers and customers) which limit their access to the financial markets per se, making SMEs more dependent on bank finance than large corporates. Bank finance in turn is most difficult to obtain for those who lack adequate collateral to back their application. The limitations on access to finance resulting from these specificities inherent to SMEs however do not necessarily mean that there are market imperfections in SME finance. As the European Central Bank (ECB) puts it in its article on "The financing of small and medium-sized enterprises in the Euro-area" published in its August 2007 Monthly Bulletin, "to sum up, there is some evidence from surveys to suggest that some Euro area SMEs face binding finance constraints (i.e. have no access to finance despite having borrowing requirements), while the vast majority enjoy appropriate access to finance.(…) All in all, the evidence of a gap in the financing of a minority of SMEs does not per se point to a lack of efficiency in the allocation of credit."

But to conclude from this that financing gaps are basically inexistent in European SME finance is certainly too straightforward. The SME Consultation shows that a much more precise analysis is required and that indeed, there is a lack of adequate financing tools for certain SME segments, e.g. micro-enterprises without business or personal assets to offer as security, young, fast growing, innovative enterprises. These businesses however will drive growth, competition and innovation and thus contribute to employment and the productivity of the European economy as a whole. It is thus of strategic importance that these segments in particular are not constrained by lack of adequate financing tools.

More specifically, the positive trend in credit margins is not applicable to all SMEs: Debt financing is more important in some sectors such as construction and manufacturing than in others. The smaller ones amongst them for instance continue to pay on average higher interest rates than the larger ones, if at all they have access to financing. This is not only because taken individually, they represent a higher risk. It is also because there is a deficit in capacity to present their activity in the form of a "bankable" business plan specifically for the very small companies. Bureaucracy is felt to be another important reason why financing gaps persist especially when it comes to SME finance in Europe. SMEs continue to bear a disproportionate regulatory and administrative burden in comparison with larger businesses – it has been estimated that where large businesses spend one EUR/employee because of regulatory duty, a small business might have to spend on average up to 10 EUR ("Small and medium-sized enterprises – Key for delivering more growth and jobs. A mid-term review of Modern SME policy.", European Commission, 10/2007).

The European Central Bank has analysed the issue of Financing of SMEs in the Euro Area in its August 2007 Monthly Bulletin, focussing specifically on firm size and describing how financing patterns differ across large, medium-sized and small enterprises.

"*Firm size may affect the quality and quantity of information available on a firm's projects and collateral, as well as its relationship with the markets and banks.(…) Unlike large firms, small firms often do not enter into contracts that are publicly visible (contracts with the labour force, suppliers and customers are generally kept private). In addition, small businesses do not normally issue traded securities that are continuously priced in public markets. (…) As a result, small firms often cannot credibly convey their quality and may have difficulty in building up a reputation to signal that they are of high quality or low risk. The resulting asymmetry of information between the two sides of the market may even result in firms being completely unable to obtain external finance. For instance, on the supply (bank) side, the costs involved in assessing and setting appropriate premia for risk and the relatively high monitoring costs may hinder the flow of funds to smaller firms. (…) Differences related to guarantees and the cost of financing may also affect the financing patterns of SMEs. Small firms often have less collateral that could protect creditors from adverse selection or moral hazard effects. In addition, it is plausible that funding costs contain a significant fixed cost component. These fixed costs would make small loans more expensive than larger ones, which are mostly obtained by large firms. (…)*

Secondly, the positive trend in interest margins over the past years is certainly not irreversible, as this summer's market turmoil may indicate. Most of the banking counterparts questioned during the SME Consultation was of the opinion that the credit squeeze would probably not have an immediate impact on the favourable situation SMEs are currently facing when it comes to access to finance, but they also do not exclude medium to long term effects.

Third, the backside of the fact that SMEs have used the buoyant economy of the last 2-3 years to improve their balance sheet situation through decreasing indebtedness may be that investments have been somewhat neglected. This may particularly be true for independent SMEs, i.e. which do not benefit from a group support. It also applies to those investments which show only low one-digit returns, e.g. investments in environmental upgrades of machinery and equipment. This leads to the assumption that when SMEs will enter into a new cycle of investment, financing gaps will show more clearly and will have to be addressed.

2. Financing gaps are not uniform but scattered throughout Europe

The identification of those SME segments which have more difficulties than others to access whatever financial product they may need in the different stages of their existence, requires a microeconomic analysis.

In its "Brasilia Action Statement for SME & Entrepreneurship Financing" published at the occasion of the OECD Global Conference on "Better Financing for Entrepreneurship and SME Growth held on the 27-26th of March in Brasilia, the OECD summarised the situation as follows:

"*Financing gaps (a term for which there is no precise generally accepted definition, but it describes a situation in which a sizable share of economically significant SMEs are unable to obtain adequate financing) may arise due to agency problems, asymmetric information and other market and policy imperfections that can give rise to incomplete financial markets and constrain SMEs access to financing. Analysis reveals not one, but several kinds of financing gaps. Many OECD countries have partial gaps, which tend to be severe especially in early-stage firms. However, financial gaps are more pervasive in emerging, transition and developing economies. Access to appropriate types of financing structures and facilities are especially required to allow SMEs and entrepreneurs to take advantage of the opportunities provided by innovation, notably through the diffusion of information and communications technology (ICT). They are also needed for SMEs with new business models and high growth* *prospects as they make a very important contribution to economic growth accompanied by job creation and social cohesion.* (…)"

There is no single answer to the question of financing gaps in the European SME market. The result of an analysis throughout the main European markets very much depends on the addressee of the question (SMEs, their bankers or government policy and central bank experts), but also on the country or region analysed. As an example, more than nine out of ten SMEs in Finland and Ireland reported having sufficient financing, compared with just two-thirds of SMEs in Portugal and Italy. In Finland, 95% of firms report that access was easy, compared with only 14% in Germany ("SME Access to Finance", Flash Eurobarometer 174/2005).

The reasons for these disparities are several. On the offer side, banking is one of the major European industries with 22 banks listed amongst the top 100 European listed companies, and representing 24% of the market capitalisation of these companies. But banking ranks only 7th when it comes to internationalisation or "Europeanization" rate of its activity (The "internationalisation" or "Europeanization" rate is defined by N. Véron in the march 2007 issue of the breugelpolicybrief in an article on "Is Europe ready for a Major Banking Crisis?" as the amount of sales realised outside the headquarters zone divided by total sales).

The relative parochialism of Europe's banking industry

Sectoral breakdown of Europe's top 100 listed companies	Average internationalisation rate	Average Europeanization rate
Life sciences	91%	84%
Consumer products & services	84%	74%
Manufacturing & business services	80%	66%
Oil, gas & mining	70%	57%
Insurance	66%	53%
Energy & water utilities	46%	31%
Banking	**44%**	**27%**
Telecoms & media	36%	24%
Average all sectors	62%	49%

Source: "Is Europe ready for a major banking crisis?", N. Véron, breugelpolicybrief 2007/03

Other reasons for the disparity in the SME market might be found in the structure of the SME community itself which varies strongly throughout Europe. Within the bracket of 250 employees, there are countries in which the focus is very much on micro-enterprises (Italy, Greece), whereas in other countries, SMEs tend to have employees at the upper end of the scale (e.g. in Germany).

Distribution of enterprises by firm size in manufacturing, 2002

Country	less than 10	10-49	50-249	>250
France	84.0	11.4	3.6	1.0
Germany	62.1	27.3	8.4	2.2
Italy	83.4	14.4	1.9	0.3
Spain	78.4	18.4	2.8	0.5
United Kingdom	71.7	21.0	5.9	1.5

Source: "The SME Financing Gap", Volume I: Theory and Evidence, OECD2006

The variety of legal forms under which SMEs are incorporated and of tax and accounting legislation is large compared with bigger firms. Public support schemes for SMEs are more or less present and show very different patterns throughout Europe, ranging from strongly centralised national support schemes with large players like KfW in Germany to regional support agencies coordinating a diversity of players like in Spanish and certain French regions. And finally, financial markets throughout Europe show different levels of development, which has for instance an impact on access to finance for SMEs in the New

Member States compared with EU-15 (“SME Access to Finance in the New Member States”, Flash Eurobarometer 184/2006).

3. SME segments for which financing gaps persist

The feed back received from the SME Consultation shows that there are certain SME segments which still face problems to access financing for their investment projects. The common denominator of the different segments is a lack of asset-based collaterals at the moment of the investment and a higher than average risk to be taken by the financial institution. This follows the increase in importance in investments in immaterial assets, the whish of SMEs to consolidate their position in a globalizing environment through external and internal growth, and the need for transfer to the next owner generation, which is not a new issue, but which has grown in importance over the last years.

In each national market within the European Union, financing gaps will have different amplitudes, and thereby in fine impact on the economic development of the country. This will depend amongst others on the weight of SMEs and specific sectors in the respective national economy, the structure of the SME market and the development of the respective national financial market, i.e. the ability of the local banking sector to responding to SME needs in a flexible way.

3.1. Micro enterprises

Companies with less than 10 employees are widely considered to be those which have most difficulties to access to finance. There are several reasons which were mentioned by the participants to the SME Consultation. Those important in the context of EIB’s intervention in this segment might be: Dealing with micro enterprises requires a dense (and costly) branch network. High administration and credit assessment costs due to the small size of loans stand against the profitability of micro-credit schemes. Standardising (in some cases automatising) the loan application process for micro companies seems to be one way many banks have chosen to improve the cost coverage for this market segment. Another factor is that on the demand side, managers of micro enterprises have difficulties to apprehend the large spectrum of financing tools available to them, both due to the complexity of the products themselves, and due to a lack of information on alternatives available. And finally, historical data show the highest probabilities of default for micro enterprises compared to other SME segments. While public support is available in the majority of European Member States to bridge – at least partially – this market gap, micro-credit is particularly dependent on the specific circumstances of the local environment and the scope and intensity of subsidies differ considerably between countries (“FinNetSME – Experiences and Practices”, INTERREG IIIC, European Union 2007).

“A European initiative for the development of micro-credit in support of growth and employment”, Commission of the European Communities, 11/2007

(…) “Over recent decades, the EU economy has evolved from one driven by large-scale industrial enterprises to a greater dependence on smaller businesses, including one-person business, mostly in services. This has led to increased demand for micro-credit. (…) Assessing the availability, or supply, of micro-credit in the Member States appears to be quite difficult. In terms of the size of individual loans, estimates suggest the typical micro-loan in Europe is of the order of EUR 7 000 to 8 000. (…) Banks themselves do not keep specific statistics on micro-credit, and what data they have can be ambiguous in that some loans are classified as personal credit, while others form part of a larger category of loans to SMEs or, in some countries, are combined with loans to agriculture. (…) On the whole, micro-credit is developing in many of the new Member States, and a similar trend can be discerned over recent years in the EU-15. However, much remains to be done to exploit its full potential (…).

Micro-credit uses a financial approach to business development, so that the costs of capital, risk and operating expenses are appropriately covered, ensuring the sustainability of the institutions and services provided. However, the problem of suitable access to finance for micro-enterprises and the potential self-employed remains and is recognised as such. (…)

These efforts combined with the efforts of certain Member States are unlikely by themselves to increase the supply of micro-credit on a sufficient scale and within a reasonable time-frame in the absence of deliberate and comprehensive actions devised by the authorities at national and Community level. In spite of their increasing awareness of the future potential of the micro-credit market, the evidence suggests that banks engage in micro-credit activities, (directly or, more often, in partnership with non-bank institutions) where they are encouraged to do so by public support mechanisms (for example, the EU's PHARE programme, the European Investment Fund (EIF) and the European Bank for Reconstruction and Development (EBRD)). (…)"

3.2. SMEs focussed on Research and Development and Innovation

There was a broad consensus amongst the participants in the SME Consultation that when it comes to innovation and R&D, financial support to SMEs is underdeveloped. The financing of research and development undertaken by independent SMEs seems to be very much a problem of lack of collateral caused by the high share of "soft" investments and the tailor-made equipment, and of asymmetric information between the (scientific and highly specialised) "innovator" and his financier about the innovation itself, its future market potential and thus ability to provide cash flows sufficient to repay debt. This is also why the numerous public programmes developed to finance R&D are only scarcely used. Such support programmes must become more accessible for SMEs, through better information and reduced bureaucratic hurdles ("Thinking Big" SME Action Day, 21.11.2007, BUSINESSEUROPE/KPMG).

"Financing Innovation and Research investments for SMEs: Challenges and Promotional Approaches", Network of Financial Institutions promoting SMEs NEFI, June 2005

"The difficulties of early stage finance with its sub-stages pre-seed, seed and start-up are broadly characterised by the inability of an enterprise to provide a sound track record to investors and the inability of an enterprise to provide a sound track record to investors and the inability to provide acceptable collaterals to banks. The lesser advanced the company's position in its lifecycle is, the higher the risks associated are. When a company has entered the growth or expansion stage (or later stage) the circumstances for potential financiers are slightly different. These companies generate revenue streams and cash flow from other products in their portfolio. They have accumulated assets and funds and can provide collateral for their expansion investments. (…) The study shows a clear promotional financing gap in Europe for high potential, pre-seed or start up companies engaging in research."

3.3. SMEs in decisive growth phases

SME's in dynamic growth phases, be it through domestic or international development, continue to face restrictions in access to finance. According to the survey conducted by BUSINESSEUROPE/KPMG in 2007, 66% of 840 consulted companies throughout 14 EU Member States consider lack of financing as the major obstacle for their growth strategy. At present, only 18% of SMEs have international activities and even fewer export their goods outside their home country ("Small and medium-sized enterprises – Key for delivering more growth and jobs. A mid-term review of Modern SME policy.", European Commission, 10/2007). Most SMEs see their future in international development. The support of growth phases of SMEs with adequate financial tools has an important leverage on employment. In France for instance, 2 000 SMEs out of 1.2 million have a growth rate of two to three times the average growth of SMEs, but these 2 000 companies provide more than half of the net creation of jobs by SMEs ("Une stratégie PME pour la France", Rapport de Jean-Paul Betbèze et Christian Saint-Etienne, Résumé dans Conseil d'Analyse Economiques, Nr 3/2006). Providers of finance thus need to stand ready to accompany their clients in these growth phases.

SME Action Day: Thinking BIG – A Study published by BUSINESSEUROPE and KPMG on the 21st of November 2007

How can SMEs become more global?
Facts:

- *SMEs are aware of competitive challenges and increasingly planning to go international. According to the KPMG survey, half of SMEs remain focused on the domestic market, but the other half think that operating within the EU market is very important. One third consider that extending activities beyond the EU is very important.*
- *69% of SMEs operate or intend to operate in the European market. 44% of them believe that more EU instruments and policies are needed to favour SME internationalisation. (…)*

Priorities:

1. *Internationalisation is important for enhancing market shares, strengthening competitiveness and innovation capacity. SMEs will increasingly need to develop their markets within and beyond the EU in order to grow and stay competitive in a globalised world.*

(…)

5. *SMEs need better access to information and qualified advice when they consider going international and developing markets.*

3.4. Company transmission

Financing companies facing the challenge of transmission from one generation to another represents a challenge for Europe. Some 700 000 SMEs are concerned on average every year, and some 2.8M jobs involved throughout Europe on an annual basis. To obtain a bank financing for the transfer is difficult since the appraisal is complex and does not allow for standardised procedures. Smaller transfers (most transferees need less than 120 000 EUR in total for their investment) often do not generate the fees necessary to cover the higher transaction costs incurred by the banks. Equity providers are only interested in high-yield cases which are not the majority. Business transfers do not necessarily involve the acquisition of new fixed assets, but rather the taking over of an existing structure by a new owner. European and Member State support to SMEs has however so far been very much focussed on the creation of new assets.

"Financing SME Transfers: Challenges and Promotional Approaches", NEFI – Network of European Financial Institutions for Small and Medium Sized Enterprises, 2003

In their paper, the NEFI members come to the conclusion that there is an urgent need for improvement of the financial environment to close the gap between the number of companies facing the need for a transfer of ownership on the one hand, and the number of private persons or SMEs which are actually interested in taking over an existing business on the other.

(…) "From the banks' perspective, the reluctance to finance SME transfers is due to the high risks and high transaction costs (…). It is further aggravated by the structure of the M&A (mergers and acquisitions) market. The tendency towards bigger M&A transactions and the rapid development of this market segment have focused the interest of larger banks on theses profitable "big deals". Therefore, banks that are interested in SME take-overs are typically smaller banks, namely the regular business banks of SMEs or private persons (PP, including sole proprietors), such as commercial, savings or co-operative banks. (…)

As a consequence of the comparatively high risks and relatively high transaction costs, the financial market is currently failing to satisfy the demand for SME transfer financing. (…)"

3.5. SMEs investing in sustainable development

There is a lack of financing for investments fostering sustainable development, and notably implementing the CO2 reduction goals to which the EU Commission has committed. It is felt across Europe that while compliance with higher environmental standards is a driver for higher efficiency, also improves the company image and contributes to innovation – but high compliance costs result in a competitive disadvantage compared to non-EU companies. As investments related to reduced environmental impact rather weigh on the profit and loss statements of SMEs than to have positive effects on their profitability and business plan, it is difficult to find financing for them.

SME Action Day: Thinking BIG – A Study published by BUSINESSEUROPE and KPMG on the 21st of November 2007

Facts:

- *Looking at the way environmental legislation affects its business, one in two SMEs believes that compliance with higher standards is a driver for higher energy efficiency and also improves the company image. A similar proportion also considers it a driver for product and process innovation.*
- *At the same time, more than one third of SMEs state they are negatively affected by high-compliance costs and have a competitive disadvantage as compared with companies in non-EU countries.(…)*
- *Two thirds of SMEs strongly call for a reduction of administrative burdens, for financial support and free-of-charge expert advice to support them in their efforts to comply with environmental legislation. (…)*

Priorities:
(…)
2. Both the European and national levels should develop support services for SMEs. In particular, programmes that back SMEs' efforts to become more energy-efficient should be developed.
3. At the same time, in order to sustain their activity, SMEs need security of energy supply and access to energy at a reasonable price.
(…)

4. Financing tools considered to be suited to close the market gaps in European SME finance

The most recurrent criticism about existing financing tools is that these tools are not adapted to the needs of SMEs, either because of the size of deals targeted or because of the small number of (innovative and young) SMEs they are dedicated to.

4.1. ABS finance

To bolster the offer of classical loan financing for SMEs, the support of ABS structures is of particular importance. SME finance remains a local business, in which smaller, regional banks play an important role. These banks are however constrained in their lending capacity due to their smaller size and equity. ABS structures could allow them to free part of their regulatory capital and make it available for additional SME lending. However, securitisation of SME loans implies high market entry costs for the establishment of the legal structures, documentation and reporting requirements to rating agencies. This affects in particular regional banks or smaller credit institutions. The high degree of diversity of loan instruments available to SMEs, the different types of collateral and different legal forms of SMEs are other reasons why the SME securitisation market is currently lagging behind in its development compared to mortgage securitisations. There is a need for public support in this field and it is not surprising that the securitisation of SME loans has developed dynamically in countries where such public schemes have been put in place.

"SME Securitisation: Final Report", Roundtable between bankers and SMEs, European Commission, 2006

"Public support for SME loan securitisation must be made conditional on ensuring "additionality", i.e. extending new loans to SMEs so that SMEs profit from the support given to the transaction. (…)
Public programs should have sufficient size to foster market growth. They should work with the private sector and avoid distorting the market. In particular they should focus:

- *on helping to extend the market to smaller and lower rated SMEs*
- *On helping to broaden the range of financial instruments which can be securitised: with special regard to mezzanine finance as it can strengthen the equity ratio of SMEs, and*
- *On assisting regionally active or smaller banks to get access to securitisation*

4.2. Equity Finance

Besides the classical lending activity, the importance of sophisticated financing tools like VC and mezzanine financing for SMEs is increasing. The use of sophisticated (mezzanine) financing products or even venture capital so far concerns a one-digit percentage of SMEs only. In its written comment to EIB's consultation, the EESC (European Economic and Social Committee) highlights that only 5-6% of micro and small businesses make use of venture capital. Only very few enterprises are able to attract venture capital funding (+/- 7 000 enterprises per year in EU 27) or to be introduced at any type of stock market (a few hundreds a year in the EU 27, according to "FinNetSME – Experiences and Practices", INTERREG IIIC, European Union, 2007). Successful cases are mostly concentrated around urban areas, since in rural, small and less developed areas, private investors fear the lack of a critical mass for obtaining a portfolio effect to buffer the individual risks.

R&D activities and the availability of seed and venture capital are key for the development of innovative SMEs. Current gaps inhibit SME growth. The offer for early- and expansion-stage financing needs to be increased with a view to stimulating creation and growth of innovative and high-tech SMEs. It is thus urgent that cross-border investments of venture capital funds within the EU are facilitated, and new forms of venture capital be developed to include individual companies or partnerships into the range of companies eligible for VC-investment.

"Recent developments in the European private equity markets – is the market at an inflection point?", European Commission, DG Economic and Financial Affairs, 12/2007

(…)

European private equity investment levels continue to vary strongly between Member States (…). In EU-19, the average private equity investment by country of management (i.e. investment made by funds managed from the Member State concerned in both domestic companies and companies domiciled abroad) expressed in % of GDP was 0.61% in 2006. The average conceals significant differences between Member States. In the United Kingdom, the ratio was 2.15%, in Sweden 1.39%, followed by France with 0.56% and the Netherlands with 0.45%.

The increase in the amount of buyout investment was mainly driven by an increase in the number and the average size of the so-called mega-buyouts, i.e. take-over of companies valued at or above EUR 1 000 M, but in terms of transactions they accounted for just 31 out of a total of 1653 companies bought out in 2006 (…). In 2006, the number of small buyouts, i.e. buyouts of companies valued at less than EUR 50M, was 1 286, up by 12% from the 1 151 recorded in 2005, involving private equity investments of EUR 4.8bn or, on average, EUR 3.7M per company. As many of these transactions can be assumed to involve management buyouts concluded with the objective of unlocking growth, the steady increase in the numbers of target companies should be seen as a positive development.

(…) on average European venture investment produces acceptable, if not overly attractive returns in later stage investing, but the average returns of early stage investing are

persistently negative. European buyout investment, on the other hand, has produced good returns.
(…) The completion of leveraged buyouts has become noticeably more difficult in line with the tighter supply of debt, not only because of the lesser capacity of banks to accommodate debt in their balance sheet, but also the reduced appetite of the far and widely dispersed buyers that until recently were happy to purchase packaged LBO-debt. (…) It could be assumed that concerning the smaller end of buyouts, the drying up of debt may not be as dramatic. The immediate consequence should be more costly debt and a negative impact on deal profitability. (…) Venture capital will be less affected by the correction in the credit market.

4.3. Mezzanine Finance

Mezzanine finance is frequently mentioned as a suitable tool to accompany SMEs in stages in their development which do not require asset-based finance, but which are based on "soft" investments. As a consequence, financing these investments cannot base on fixed assets as collateral, and is thus per se subordinated to "classical" asset-based lending. This concerns R&D activity just as well as company transfers or expansion into new markets. There are a multitude of mezzanine financing tools. Mezzanine financing with loan characteristics, like a subordinated loan, is an adequate financing tool for SME in their later stage, engaging in innovation or R&D investments because it does not need collateral, it strengthens the equity base by being subordinated to a senior loan and thus increases the ability for SMEs to access loans in the future. Mezzanine financing tools with characteristics that are closer to equity (like a silent participation) are well suited for SMEs in their early stage. The mezzanine provider would profit from the potential success of the company. The company in turn does not have to give up its ownership rights as it would be the case with open participations.

Mezzanine funds avoid the disadvantages of equity finance, but usually also do not further deteriorate the balance sheet ratios as additional classical bank debt would do. On the offer side, the bank has to be ready to take larger risks than it would take for an asset-based financing, but at the same time, this is compensated by the chance to eventually receive part of the profit generated by a successful investment. As far as public support is concerned, granting quasi-equity thus ensures that funds flow back to the public in case of success of the promoted company. This is why promotional banks have started to introduce mezzanine financing tools to finance, amongst others, R&D and innovation of SMEs. However, the market for mezzanine finance for smaller companies and in small amounts is not yet sufficiently developed in Europe.

"Mezzanine Finance – Final Report" – Fifth Roundtable between Bankers and SMEs: Transparency and Dialogue, Mezzanine Finance, SME Securitisation, European Commission, Enterprise publications, 2007

Mezzanine finance can be a complementary source of finance to debt and equity and can be helpful in financing the start-up, and expansion of SMEs, innovation, and business transfers. (…)
The most common forms of mezzanine finance include the subordinated loan, participating loan, "silent participation", profit participation and convertible bonds; the structuring possibilities are almost endless. (…) The level of control by the finance provider is dependent on the mezzanine product chosen. This gives SME owners the option to retain control of the company, which is one their main concerns. At the same time mezzanine finance is a relatively expensive financing tool and difficult to obtain for most SMEs compared with debt finance. (…)

Following the success of mezzanine finance for upper tier SMEs some financial institutions have started to offer mezzanine products to the group of SMEs below the upper tier. The mezzanine tickets demanded by these SMEs are frequently smaller that those demanded by upper-tier SMEs. (…) Presently there are two main target groups of mezzanine finance in the middle tier SME market. In the first target group there are SMEs striving for further expansion. In the second group there are mature family-owned companies with a requirement for succession planning and a need to plan for the eventual transfer of ownership.

Low-tier SMEs have a much lower rating than upper-tier SMEs and often have a financing need for smaller amounts (less than EUR 250 000). Most of the time they do not fulfil the requirements of the commercial mezzanine market regarding company history, revenues or reporting. Enabling the supply of hybrid finance to this group of companies often involves public support.

It is important to point out that low- and middle-tier SMEs together include the overwhelming majority of SMEs in Europe. The process of "downsizing" (providing smaller tickets of mezzanine finance to lower rated SMEs) is expected to pick up as the mezzanine finance market matures and borrowers become more aware of this type of finance. (…)

The Round Table discussions have identified the following key areas for action:

- *(…)*
- *Promotional financial institutions are invited to develop additional products by using mezzanine instruments with profit sharing elements to finance the start-up, expansion and transfer of SMEs as well as SME innovation projects.*
- *The securitisation of low- and middle-tier mezzanine instruments should be facilitated. In this respect fostering the development of the SME loan securitisation market can make an important contribution (…)*
- *Banks or banking associations in cooperation with financial advisors, such as accountants, Chambers and SME associations should consider introducing information programmes which would educate SMEs about innovative financing tools such as mezzanine finance.*

More particularly addressing the topic of company transmission, the NEFI banks point out in their study on "Financing SME transfers: Challenges and Promotional Approaches" (2003) that "all of their loan schemes directed at company transmission provide risk sharing with the co-financing bank – either in form of an exemption from liability or in form of a separate guarantee." As the lack of sufficient collateral on the part of the buyer seems to be the most important parameter of the high risk, recently launched programmes emphasise the reduction of collateral requirements rather than the pure subsidisation of interest rates when promoting senior debt. As far as mezzanine finance is concerned, it may enable the buyer to obtain access to capital for the envisaged transfer if it is granted "ex ante", and thus helps to create an offer on the market for loan financing for SME transfers. "Ex post" mezzanine finance programmes may in turn secure the competitiveness of the transferred enterprise.

Concerning the scope of financing, most SME transfer programmes offered by public promotional institutions are tailored to the structure of the SME sector in the respective Member State. It is worth noting that programmes focus on the lower end of the spectrum of transfer volumes with private individuals as the target group. Loan amounts vary from 5-digit EUR amounts to several hundred thousand EUR, with some programmes even allowing for loans in the range of several million EUR (as a response to the specific need of the German market).

Mezzanine financing schemes however have to stay simple if they are to be an effective tool for SME finance. If offered by public promotional institutions, the mezzanine financing programmes should be attractive for both, the intermediaries and the final beneficiaries. Additional costs or heavy reporting requirements would greatly hamper the success of the respective schemes.

5. Snapshots of country specificities throughout Europe

Beyond the general topics mentioned above, the below country-specific chapters try to point at differences throughout Europe:

Austria

Economic importance of SMEs

As in all other EU Member States, the importance of SMEs for the Austrian economy is overwhelming. More than 99% of all enterprises are SMEs (with up to 500 employees). Total number of enterprises, and of micro enterprises (less than 10 employees) in particular, shows an increasing trend.

Some 200,000 enterprises employ about 2m people in Austria. Some 500 enterprises are large ones, while more than 195,000 are SMEs which employ more than 75 % of all those employed. Even the sector *industrial manufacturing* is dominated by SMEs, which have a share of 97% of all enterprises. Large enterprises, account for about around 3% or about 200 firms, but employ approximately 40% of industrial manufacturing workers. S*ervices* have become the economic sector with most enterprises (35%) and most employees (30%).

In Austria public promotional entities such Austria Wirtschaftservice ("AWS") and Forschungsgesellschaft ("FFG") are developing for SME several support mechanisms.
The EIB has successfully supported SMEs by its global loans since 1997 in close co-operation with the commercial banking sector. Three of the four largest banks intermediate EIB Global Loans. These three together made some 400 allocations for an amount of EUR 250m over the past five years. A further network with 9 regional partner banks has been set up.

EIB is encouraged both by commercial banking partners and by AWS and FFG to extend its product offering complementary to the one of the commercial banks.

Baltic and Nordic States

Number of people employed by enterprise size (non-financial 2004)

1,000

	DK	%	FI	%	SE	%	EE	%	LT	%	LV		EU-27	%
Micro (1-9)	306	18.7	253	21.1	608	24.8	87	22.9	132	16.7	131	22.3	37,000	29.6
Small (10-49)	412	25.3	225	18.8	507	20.7	106	27.8	209	26.4	154	26.2	26,000	20.8
Medium (50-249)	350	21.5	221	18.5	442	18.0	103	27.0	221	28.0	155	26.4	21,000	16.8
Large (250+)	564	34.6	498	41.6	896	36.5	86	22.4	228	28.8	148	25.2	41,000	32.8
Total	1,633	100.0	1,195	100.0	2,453	100.0	382	100.0	790	100.0	588	100.0	125,000	100.0

Source: Eurostat

Estonia, Latvia and Lithuania

The intermediary banks in the Baltic States appear generally satisfied with the current EIB GL product. So far, the banks have not showed interest in risk-sharing schemes as they are competing for market share and want to increase their loan portfolios. However, this might change due to recent market turbulence.

The main issues that could be improved in the current Baltic States GLs are as follows:

-eligible sectors and restricted/excluded sectors are difficult to define. Shorten/simplify the restricted/eligible sector list.

- sub-project cost definition: this should be simplified in order to be in line with other IFIs. EIB should co-finance all SME lending up to 50% of the intermediary bank's loan and not use the cumbersome rules on sub-project cost definition.
- EIB should move to list-based allocation from the fiche and not require the final beneficiary to sign off the fiche.

Denmark.

The Bank's relationship with Ringkjoebing Landbobank (RL) dates back to 2003 and, to date, four global loans have been signed with this intermediary. RL confirms that the existing EIB global loan product is satisfactory and flexible. Furthermore, it commented that in its opinion there did not appear to be a need in the Danish market for a facility targeted at the micro end of the SME market. Furthermore, the risk-sharing concept was not an attractive option for RL as it might introduce a distortion of competition in the Danish banking market.

The Bank had a long-standing global loan relationship with FIH between 1975 until the mid-1990's; thereafter and until 2007, the relationship was focussed more on treasury operations. A new SME global loan facility of EUR 50m was signed in 2007, marking the resumption of such activity following a period of ten years.

Finland

Finnvera is the Bank's main SME financial intermediary in Finland. It is a not-for-profit public promotional institution offering support for a broad range of SMEs (e.g. micro-enterprises, women in business, SME-promoted climate-change investments and regional development schemes, in many cases, partially supported by government subsidies). Finnvera has also confirmed its satisfaction with the EIB's current global loan product, although any reduction in reporting requirements/procedures would be welcomed. Although it finds the concept of risk-sharing attractive for the Finnish commercial banking sector, it does not consider this option important for itself (given its particular tasks and role endowed by the Finnish State). The principal criterion regarding Finnvera's choice of the EIB for funding is pricing; as long as the Bank can provide attractive sub-EURIBOR funding, it is satisfied with the global loan product.

Other global loan intermediaries in Finland are OKO Bank. and Aktia Savings Bank

Sweden

EIB has GL operations with subsidiaries of three of the big four Swedish banks i.e. SEB, Swedbank and Nordea in the Baltic States and Poland (Nordea only). These banks appreciate this co-operation with EIB outside of their home markets but have confirmed that they are not interested in obtaining GL facilities in respect of their operations in Sweden.

Benelux

Economic importance of SMEs

The Netherlands: Core figures for SMEs and large companies in 2006

	SMEs	Large companies
N° of companies	731 000	2 300
(as at 1/01/2006)	99.7%	0.3%
Jobs	4 133 000	2 844 000
(% of employees)	59%	41%
Turnover	€714bn	€509bn
	58%	42%
Export	€108bn	€112bn
	49%	51%
Profit	€59bn	€39bn
	60%	40%

Belgium: The last statistics available from the Belgian Federal Government indicate that SMEs and midcap companies account for over 70% of GDP with approximately 97% of these companies employing less than 50 people. It is estimated that there were around 15,000 private companies with a turnover of EUR 1 to 25 million. Despite of the small turnover volumes of SMEs and midcap companies in comparison to large corporates in Belgium, they are very active in the export market and play a very important role in their niche sectors where they are often market leaders. Belgium is the only country in Europe where statistical analysis indicate that the profitability of SMEs/midcaps is considerably higher than that of large companies

Luxemburg: SME's account for 99.8% of all enterprises in Luxemburg, with companies with up to 9 employees representing 94.4%. Their contribution to employment is however lower than in the rest of Europe, with only 47.8% of employees working in an SME.

The banking market/ financing of SMEs/ EIB's activities
A developed BNL banking system with a long tradition in SME financing, combined with a long list of SME dedicated programs developed by the national and region promotional public bodies (Senter Novem, les Fonds de Participations, la SRIB, PMV, plan Marshall, SNCI etc) allow to conclude that market is well covered with SME oriented products; support from EIB or EIF (as regards the latter already in place for some schemes) enlarging the capacity of these schemes to intervene in the SME market might well be welcome.

Market gaps in SME finance in the BNL market seem to be limited in number and, if any, are mostly centred around equity or semi-equity products for start-ups (although reasonably well catered for under different public schemes) or growth companies (i.e. parties not exceeding the 'intervention size threshold' to become eligible for the (international) equity or mezzanine investors present in the market). To the extent any considered offering of such equity or semi-equity products would envisage an investment horizon exceeding standards set by abovementioned (international) investors, their attractiveness would only but increase.

Bulgaria

Economic importance of SMEs

According to statistical data for Bulgaria's SME sector referring to 2004, there were 221,000 SMEs; accounting for 99% of total enterprises in Bulgaria. SMEs, which employed 1.2 million persons, represented 37% of total employment in the Bulgarian economy (but this is increasing at a faster pace than larger enterprises in line with new markets and growing entrepreneurial activity). Sector wise, SMEs are strongly represented in trade, repair of vehicles and household goods and manufacturing.

The main weaknesses of the Bulgarian SME sector are the low level of competitiveness, weak innovation capacities (few research companies), technological deficits and the lack of skilled labour force. Most SMEs have a short or non-existent historic track record.

The banking market/ financing of SMEs

Although Bulgaria's level of banking-coverage is still low compared to Western Europe, access to finance is improving and the access of SMEs to financing is getting easier, which among others is due to the fierce competition between Bulgarian banks, mainly owned by Western European institutions. Bureaucratic hurdles often hinder however the access to EU grant financing. The knowledge about the presence of international financial organisations seems to be limited.

The main funding needs of SMEs in Bulgaria refer to the following sectors/activities:

- Investment and technology renewal
- Start-ups of new companies for young people and unemployed with no business history
- training of already employed personnel in new skills and foreign languages
- implementation of international standards
- business cooperation with foreign partners, visits and participation in international fairs, joint business project participation

EIB's activities

EIB is responding to this market demand with a wide range of activities (including Global Loans for leasing companies and secured by local securities). However, its activities are constrained by the existing minimum reserve, which was recently increased from 8% to 12%.

Cyprus

The Cypriot economy is a small, robust and fairly flexible economy and its basic characteristics are the following:

- The dominant role of the private sector and the small size of the domestic market. The population in the Government controlled area is about 750 000 people, a third of which live in rural areas and the remaining two thirds in urban settlements.
- The small size of enterprises. According to the Registration of Establishments, an average enterprise employs about 4.4 persons. "Micro enterprises", that is enterprises employing less than 10 persons constitute some 95% of the total, other "small-sized" enterprises with 10-49 employees represent 4% and "medium-sized" enterprises, with 50-249 employees count for only 0,7% of the total. The large enterprises with a workforce exceeding 250 employees amount to less than 70, representing 0, 1% of the total number of enterprises. The small size of the business units hinders the exploitation of economies of scale and the adoption of advanced technologies and modern methods of management, production design and marketing.
- The small size of the labour force, given the small population base and certain quantitative and qualitative imbalances in the labour market at both at the sectoral and occupational level. These have been partly ameliorated by the employment, to a large extent, of foreign labour.
- The predominance and increasing importance of the services sector, which accounts for some 75% of total employment including the tourism sector, whose total contribution, derived from the value added created, either directly through the purchases of goods and services of tourists in various sectors of economic activity or indirectly amounts to about 25% of GDP.
- Given the small size of the local market, the majority of SME's are in businesses related to the final consumer rather than production and there is also limited financing opportunities for SME's without an established record or collateral etc.

The Bank's traditional GL product has been used extensively in the past in support of the developmental objectives of the, government owned, Cyprus Development Bank. However, the three largest private sector commercial banks – Bank of Cyprus Ltd, Marfin (formerly Cyprus) Popular Bank Ltd and Hellenic Bank Ltd – (accounting for over 60% of total banking assets) have been operating in a highly competitive financial system with moderate local opportunities (within the acceptable risk-reward spectrum) and, following exposures arising from the Cyprus Stock Exchange collapse in 2002-03, they have suffered heavily from weak credit quality and a period of heavy losses including credit rating write downs. This environment has limited the scope for the Bank's traditional GL product during this period.

Over the past couple of years however the above mentioned banks have implemented significant cost cutting and restructuring programmes, have reduced considerably the levels of non-performing loans and have increased earnings capacity, thus, achieving a significant improvement in their financial fundamentals. Total credit to the private sector has accelerated recently, with mortgage lending—including in foreign currencies, mostly in euros—being an important component of the increase.

This more positive context, also supported by EU accession and new market potential, should give a new impetus in the medium term to lending to the local enterprise and SME sectors. This may include, for example, areas such as export oriented SME's, tourism investments, investments for higher value added activities etc.; although this must also take account of the limited size of the local economy and the conservative approach of local banks due to past problems. In this regard, and also taking account of the entry to the EURO zone in 2008, the Bank will endeavour to establish a new strategic collaboration with the main Cyprus commercial banks considering their future needs, essentially through the GL/ABS and Risk sharing product lines.

Czech Republic

Economic importance of SMEs
Small and medium-sized enterprises, defined as enterprises with less than 250 employees, represent 99.85% of all companies in the Czech Republic. Their share in total employment accounts for 62%, they generate 35% of GBP and represent 51% of overall investments in the country.

Like in other countries in the EU, most SMEs (95.6%) are micro enterprises with less than 20 employees. They contribute to 26.3% of total employment, whereas small (20-99 employees) and medium-sized (100-249 employees) enterprises represent 36.2% and 37% respectively of total jobs, although they account only for 3.8% and 0.6% of all businesses.

The banking market/ financing of SMEs
SMEs have access to financing through a well-developed banking system, which provides a wide range of classical banking products like MLT loans and leasing financing. The latter is the preferred form of financing for SMEs and cooperation with leasing companies accounts for an important part of EIB's activity in the Czech Republic.

Alongside the commercial banking sector, public support to SMEs is provided through several channels, mainly state agencies (in particular Czech Invest) and public bank ČMZRB (72% State owned, the remaining portion of capital being held by private banks):

- Czech Invest provides investment incentives to SMEs (grants and some loans) aimed at supporting the competitiveness of Czech businesses and promoting FDI,
- ČMZRB supports SME development mainly by providing guarantees, subordinated and subsidized (or interest-free) loans. The bank has several programmes, aimed at various target groups like start-ups, micro enterprises or developing SMEs.

In total, public support to SMEs in 2006 reached EUR 401m, thereof EUR 225m from the State budget and EUR 139 m from EU structural funds and Phare.

The main issues identified on the Czech market regarding SME financing can be summarized as follows:

- general need to increase the availability of guarantees and loans at preferential rates, in order to encourage the modernization of production tools,
- need to further increase the support to start-up financing and SMEs in early development phase,
- need for capital instruments or equity-type financing (subordinated debt) in order to strengthen SMEs' own funds and increase their ability to borrow,
- need to put a special emphasis on SMEs in the field of R&D and renewable energies / energy savings.

EIB's activities
In this context, EIB's activity in the SME market in the Czech Republic would be aimed at:

- pursuing current global loan activity with banks and leasing companies, incorporating any possible grant component in our product (Commission Facilities contributed substantially to the establishment of relationships with a wide range of intermediaries). Specialisation of global loans on particular topics like R&D or energy savings seems to be difficult given market size,
- further developing risk-sharing schemes with local financial institutions in order to enhance their capacity to lend to SMEs.

Subordinated debt instruments as offered by and in cooperation with ČMZRB would need to be assessed but are probably too risky currently.

France

The economic importance and structure of SMEs

SMEs represent 97.6% of all enterprises in France and generate 68.4% of all turnover generated by French companies. The French SME landscape is characterised by a "missing middle", i.e. a deficit in the number of medium sized enterprises. Indeed, companies with less than 10 employees represent close to 95% of all SMEs, compared to 91.7% on average in Europe. The number of micro-enterprises which do not manage to grow to larger ones thus seems to be higher than in other countries, which is amongst others attributed to regulatory barriers, and to a lack of access to (micro) finance.

The banking market/ financing of SMEs/ EIB's activities

The French market for SME finance is amongst the most competitive in Europe. The French Central Bank concludes in its September 2007 Monthly Bulletin that when analysing the average interest rate (including risk margins) paid by SMEs for loans up to 1M EUR, French SMEs pay on average 35bps less than the average estimated for the European Union. As far as early stage support through venture capital is concerned, the French market has undergone a positive development in the past years, also thanks to several publicly sponsored initiatives (Fonds d'investissement de proximité (2003); support for "gazelles" launched in 2006, France Investissements (2006, 3bn EUR to be spent over 6 years notably through VC investments undertaken by publicly owned CDC Entreprises). The French VC market is currently second in Europe after the British one.

EIB Group's SME financing activities in France encompass VC investments, Global Loans to the large commercial banking groups including their leasing subsidiaries, to the cooperative banking system and savings banks.

Market gaps in SME finance in France may be identified amongst those SME segments mentioned in the introduction to this annex. Company transmission finance and also mezzanine financing tools are areas in which French SMEs ask the commercial banks' offer – so far very much focussed on cost efficiency – to be enlargened. The publicly owned bank dedicated to the support of SMEs, OSEO, has a well-established presence throughout France and its programmes are well-known to bankers and SMEs alike. During the SME Consultation, EIB has repeatedly been encouraged to continue to team up with OSEO and cooperate on its programmes and schemes, rather than to develop own, competing schemes, with one argument being that such schemes would render the task even more complex for the sales forces of the banks.

Greece

The economic importance of SMEs

SMEs in the Greek Economy: In 2003 some 770,000 SMEs were registered in Greece, with enterprises employing less than 50 people accounting for 99.74% of these. SMEs account for about 87% of total employment with micro (1-9 staff) and small (10-49 staff) companies accounting for 74% of these posts. Such small personal or family-owned enterprises, relatively conservative in seeking external finance, usually lack the necessary know how for more sophisticated financial instruments and hence they are often faced with higher borrowing costs. SMEs are also responsible for the creation of 60-80% of new employment annually.

Financing of SMEs

Principal Available Financial Instruments: Since the introduction of the Euro, commercial lending to SMEs has intensified as a result of increased competition among Greek banks and a more stable macroeconomic environment. The Greek financial system for SMEs, however, continues to be characterized by high costs in terms both of collateral (companies not offering adequate collateral cannot be financed by commercial banks) and spreads (for example, in 2006, the average rate for a new corporate loan with a duration more than five years was 6.1% compared to 4.5% in the EU).

In addition to guarantees provided by commercial banks, a guarantee fund (TEMPME) for micro and small companies (staff below 49), co-financed by the EU (67%) and the Greek State (33%), commenced operations in 2004. TEMPME guarantees are typically used to compensate for low collateral levels and applications for these guarantees arrive through commercial and cooperative banks. Some 50% of these concern micro loans. Indicatively, the annual guarantee fee for 3-10 year loan of EUR 50,000-400,000 to a small (staff 10-49 employees) enterprise is in the range of 0.78%-1.25% with tangible collateral or 1.03%-1.50% without such collateral. To date TEMPME seems to have been successful in fulfilling its role, but the capacity for the provision of guarantees needs to be increased in order to cover existing needs.

Venture capital/private equity investment in Greece is below the European average with investments at 0.033% of GDP compared to 0.569% in Europe. In 2005, total funds invested reached EUR 386 m, the majority by foreign private equity houses. This type of financing is not typically used by SMEs, and the financing gap is evident especially at early stage financing (seed and start up capital).

High borrowing costs and limited availability of appropriate financial instruments, coupled with lack of awareness and reluctance to resort to external financing on the part of the entrepreneurs means that a rather high proportion of small and micro enterprises (estimated at about 33%) do not have a loan. It is also estimated that of the 40,000-50,000 new enterprises created each year only about 8,000 resort to the financial system for funding, indicating that the financing gap is significant.

EIB's activities

The EIB has currently 4 ongoing GL for SME financing, with EFG Eurobank, Emporiki Bank, Geniki Bank and Pancretan Cooperative bank. GL activity has traditionally been limited in Greece due to a large part to the low funding cost that Greek banks, with their large deposit base, enjoy. Following the maturing of the financial system, the entry of foreign banks through acquisition and the rapid expansion of lending in recent years, banks have also turned to alternative sources of financing and GL activity has demonstrated notable recovery.

One of the main difficulties partner banks face in Greece relates to EIB eligibility related issues. This is traced to many SMEs financing long-term assets with short-term loans (i.e. capital expenditure with working capital facilities), excluding as a result relevant access to the EIB medium/long-term product. A second hurdle that banks report is the fact that a large part of SME investments concern used assets (typically the purchase of buildings or machinery) which are partially also excluded from eligible cost thus reducing the pool of eligible projects.

Germany

Economic importance of SMEs

SME's account for a substantial part of German businesses and the domestic economy. 3.4 million SME's (Definition: max 500 employees and turnover less than EUR 50m p.a.) account for 99.7% of all registered companies in Germany, 40.8% of taxable income, 70.5% of employment and 84% of all apprentice training (German Federal Statistics 2006). SME's are widely represented through lobbying groups and organisations both on state and regional levels.

The banking market/ financing of SMEs

Kreditanstalt für Wiederaufbau (KfW) is developing SME support mechanisms since 1949. The basic principle is intermediation through the commercial banking sector. KfW offers high coverage in Germany of subsidised lending and a full range of SME support products. In 2003, the so-called "2nd agreement" between the Federal Government and the European Commission led to explicit confirmation of SME support as one of the major responsibilities of KfW and of the regional public support banks. Thus there is a certain level of competition between these banks and KfW. But there has also been cooperation between the two, such as NRW Bank, which optimises existing KfW products by adding its own interest subsidy to SME lending.

The dominating presence of KfW combined with the activities of the regional promotional banks allow to conclude that market is well covered although any improvement in interest rates under EIB global loans is welcome.

EIB’s activities

A non disputed market gap is today seen in the provision of mezzanine loans which, widen the financing potential of the SMEs by reinforcing their own funds and thus increasing their borrowing potential for bank loans. Leading German promotional banks such as KfW and L-Bank have launched highly successful mezzanine programs in the German market. Both banks invited in 2007 the EIB to join forces in order to further extend these programs. Furthermore EIB was encouraged both by banking partners and by SME associations in Germany to maintain a product offering complementary to the one of KfW. The flexibility of the EIB Global Loan is very much appreciated.

When talking about market gaps in SME finance in Germany, one specificity might be the important need for short term working capital and bank guarantees by SMEs. Indeed, a particularity of the German market is that in many professions, SMEs need to provide extensive bank guarantees, e.g. for good execution of the works and for prepayments received. While in other countries like France such commitments are covered through insurances, German SMEs have to use large parts of their credit lines with banks for the issuance of guarantees.

Hungary

Economic importance of SMEs

In Hungary, micro, small and medium sized enterprises play an important role in the economic life of the country, employing 75% of the total number of employees, creating approximately 50% of the gross value added and accounting for 36% of total exports. 99.9% of the enterprises are SMEs, with 95.1% of the enterprises being micro-sized, 4.1% small-sized and 0.7% medium sized.

The banking market/ financing of SMEs

The Hungarian banking sector has started to focus on the SMEs sector since 2001 to a higher extent, as competition for larger corporates became very intense, limiting banks' growth perspectives. In spite of this, the credit to GDP ratio of Hungarian non-financial enterprises is lower than the EU-15 average, and is only slowly increasing from its level of ca. 25%. The reason for this is that the overwhelming majority of SMEs is still not "bankable". State solutions to this problem (the national promotional institution MFB offers HUF-loans in EUR-terms to SMEs through its intermediaries) have so far not been successful in improving the situation. The Government favours public guarantee schemes to improve the access to finance of Hungarian SMEs, and mentions JEREMIE as promising scheme in this respect.

The leasing market has developed a lot in the past years, accounting now 5.4% of the GDP, well above the EU average of 2.3%. However, as 70% of the leasing activity is motor-car lease, that is not connected to actual business activities, while leasing of commercial vehicles, machinery and equipment lease each account for only 0.1-1.0% of the market.

As far as venture capital activities are concerned, the private equity investments to GDP ratio in Hungary (about 0.1-0.15%) is much lower than the EU average of approximately 0.3%. It is a typical market gap that the lower and middle segment of the market is permanently underfinanced, while the number of large-scale transactions has stabilised and the average investment amount is growing.

As pointed out in a development report published in 2007 by the Hungarian government, SMEs in Hungary generally suffer from a backlog in productivity due to low level of technical equipment and limited access to financial resources. They also point at the lack of modern organisational and management methods amongst SMEs.

EIB's activities

EIB has Global Loan relationships with all the major commercial banks in Hungary. Global loans have been generally accompanied by Commission grants, of which MFF/MIF was more popular in Hungary, than SME FF, due to a competitive product on the market from the Hungarian Development Bank.

Italy

Economic importance of SMEs

Almost 99% of businesses in Italy are SMEs (up to 250 employees) and some 95% are micro SMEs (less than 10 employees). Their contribution to the Italian GDP stands at 42%, compared to some 35% on average in Europe. The majority are conservative, very small, family owned, have low own funds and rely on bank loans for finance, and the cultural adversity for the acceptance of venture capital as a means of finance is thus particularly common. Almost all SME financing is carried out through the banking system, notably the saving and co-operative banks with the latter focussing on artisans and micro SMEs. Some SME financing is supported by the mutual guarantee system (confidi). Leasing for both industrial real estate and equipment with several fiscal benefits is a very popular financial tool amongst Italian SMEs. The Italian banking landscape has undergone an important consolidation process in the past years, which is still ongoing. Two large banking groups (Intesa Sanpaolo and Unicredit) have emerged from this process, dominating a few medium sized and a large number of small regional entities. There is no national or regional public financial institution specifically providing finance directly to SMEs.

The banking market/ financing of SMEs

The Cassa Depositi e Prestiti (CDP), majority controlled by the State, manages on behalf of the State national contributions for SMEs and research investments (e.g. Fondo Rotativo per il sostegno alle imprese e gli investimenti alla ricerca, Law 488/92), retroceding national funds (usually interest rate subsidies) to financial intermediaries. CDP does not finance SMEs directly. Several regions have dedicated programmes to support SMEs consisting mainly of interest rate subsidies through the banking system after selection of the banking intermediary by open tendering.

Equity and quasi equity participations, technical assistance, start up finance etc. are provided by Sviluppo Italia, the national development agency, through a network of regional agencies.

EIB's activities

EIB global loans (credit lines) finance SMEs in Italy through more than 20 banking groups, most of which via national/regional subsidiaries and/or specialised product companies (e.g. leasing). EIB funding also contributes, in some cases (e.g. Veneto, Marche) to the Regions' dedicated programmes to support SMEs. The EIF has supported the mutual guarantee system. Over the last five years (2002-2007), the global loan activity of the Bank in Italy amounted to almost EUR 10bn (corresponding to some 35% of the overall financing activity in the country in the same period), of which approximately two thirds has been dedicated to SMEs.

The provision of VC and mezzanine for the micro and smaller SMEs is underdeveloped while existing activity focuses on larger SMEs. However, this may partly be due to the adversity of the smaller SMEs to accept the standard VC terms and other sources of finance such as mezzanine loans may be more suitable.

Ireland

Economic importance of SMEs

Small firms play a dominating role in the Irish economy and account for more than half of the total private sector, non-agricultural workforce[27]. Construction is the single largest sector and accounts for a quarter of all Irish SMEs.

The banking market/ financing of SMEs

Thanks to the improved investment environment of the Irish economy SMEs' access to financing had somewhat eased during the last decade, while bank loans and overdraft facilities remain the main form of finance for SMEs. However, SMEs in the services sector with limited capital assets as well as SMEs that are ineligible for support from the enterprise development agencies (such as e.g. Enterprise Ireland, Department of Finance, Trade&Employment) have continued to face difficulties with the access to financing. According to the Irish Small Business Forum banks operating in Ireland are reluctant to lend money to SMEs that are perceived to be risky or lack of collateral and under the current Irish tax regime Irish investors are more likely to choose an asset backed investment option than take equity stakes in SMEs. Another constraint for Irish SMEs' is the fact that their working capital financing needs are pressed in situations where SMEs supply goods and services to large organizations, when SMEs are often compelled to accept long delays in payment.

In addition to banks, government institutions, such as Enterprise Ireland (Irish State development agency focused on transforming Irish industry) provide Business Expansion ("BES") and Seed Capital Schemes ("SCS") to SMEs.

[27] Small Business Forum Report, 16 May 2006

Malta

The Maltese SME landscape is driven by the characteristics of the market, i.e. a small island state with a high percentage of family-owned micro-businesses amongst SMEs, impossibility to reach a critical mass in some key sectors, and a small domestic market. Moreover, the public support schemes do not seem to be well used due to the lack of information amongst SMEs about the Business Promotion Act which is the main governmental programme providing support to SMEs, and about the programmes of the national Institute for the Promotion of Small and Medium Sized Enterprises (IPSE). The Maltese banking sector provides basic banking services, i.e. finance is limited to loan finance based on local security which is limited. Guarantee schemes and innovative financial products like mezzanine finance will be highly appreciated in a market where international expansion is one of the few possibilities for development, but educational measures will have to accompany such innovative financial instruments to make them accessible to local SMEs.

Poland

Economic importance of SMEs

Poland counts about 3.6 m economic entities, of which 99.8% are SMEs. By far the largest group of enterprises (95% of total) are companies employing up to 9 employees, thus qualifying as micro enterprises. Small companies employing between 10 and 49 staff account for 4% of total and those employing between 50 and 249 for 0,8%. The average size of Polish SMEs is smaller than in the EU-15 and employs about 3.3 people. The largest number of enterprises are firms owned by physical persons.

The SME sector employs about 67.1% of total labour in the national economy (except for agriculture, forestry and fisheries). Despite serious development barriers encountered by SMEs, there was a steady increase in the period of activity in recent years, a proof of improved SME sector stability and favourable development trends.

The banking market/ financing of SMEs

At the end of 2006, there were 51 commercial banks and 584 co-operative banks active in Poland. One of the commercial banks is fully state owned. 60.5% of capital of banks belonged to foreign investors. For a second consecutive year the employment in the banking sector continued to grow, increasing by 4410 persons to 129100.

Poland's banking system is still small by western standards and has a large potential for development. Further economic growth is expected to increase financial services, particularly for SMEs, and many of the banks already seek to increasingly penetrate these sectors. As competition grows, margins are expected to shrink, but this should be offset by increased volumes, higher commission income and more efficient operating structures. The increased competition will contribute to a further consolidation of the banking sector.

The leasing market

In 2006, Polish leasing companies financed PLN 20.9bn (EUR 5.4bn) in assets, which represents an increase by approx. 28.8% compared to 2005. The growth observed in the market in H1 2007 was even more spectacular, with overall volumes growing by some 73% compared to same period of 2006. Leasing is clearly becoming a preferred mode of investment financing for Polish SMEs, and is actively promoted by banking groups.

The market is relatively fragmented with nearly 40 operating companies, usually offering a full range of leasing services. Practically all of them are subsidiaries of banks operating in Poland (RLPL, BRE Leasing etc.), or members of international financial groups (EFL, LHI Leasing PL). With few exceptions, such as LHI Leasing PL (real estate) or SG Equipment Leasing (IT & office equipment), most companies are operating as generalists, including the ones which started as niche players but expanded towards the full range of products.

EIB activities:

The EIB finances projects promoted by Polish small and medium sized enterprises via its financial intermediaries. Whereas mid-cap companies and (larger) SMEs are usually financed via local banks, smaller enterprises are normally served through leasing companies. Therefore, the cooperation of EIB with leasing companies is vital to improve access of micro enterprises to external funding on attractive terms. Innovative operations including ABS structures have recently been implemented by the Bank as a response to the needs of a dynamically developing SME financing market.

Portugal

According to data from 2004, there are around 293 thousand SMEs in Portugal, according to the European definition, employing more than 2 million people. On that date, SMEs represented 99.6% of the total business network of Portugal (97%, if considering only micro and small enterprises), generating 75% of total employment and 57% of total turnover. There is a concentration of SMEs in the Lisbon and Porto regions, with approximately half of the national total, and in the sector of commerce and services (more than half of the national total).

Public support to SMEs is provided by IAPMEI – Instituto de Apoio às Pequenas e Médias Empresas Industriais (Institute for the Support of Small and Medium-sized Enterprises), a specialised public agency within the Portuguese Ministry for the Economy, created to provide technical and financial support to enterprises, in particular to micro, small and medium-sized companies. The SMEs in the tourism sector are not targeted by IAPMEI, as there is another specialized public agency for that sector.

IAPMEI provides financial support to SME investment through various incentive schemes which cover objectives such as plant modernization, R&D and innovation, regional development, energy savings, start-ups and entrepreneurship, company restructurings or internationalization. The incentives consist of capital grants and/or interest rate rebates on bank loans. IAPMEI also supports SMEs through venture capital, guarantees and instruments designed to support securitizations of SME debt portfolios. Recently it has announced an integrated Financial Engineering Programme to encourage SMEs to expand and diversify their sources of finance through Venture Capital, Participating Bonds, Mutual Guarantees, Fixed-Asset Management Funds and access to the “Second Market”.

Technical & Technological Assistance is carried out in partnership with various specialized organizations, such as technological centres, business and innovation centres. IAPMEI is linked to a network of services geared to provide companies with technical and technological support. IAPMEI has a staff of around 350, 14 regional offices in Portugal and 5 in Spain and a wide range of controlling interests in associate organisations (both private and state-owned) involved in SME support schemes in Portugal.

The Portuguese banking market is very competitive, and lending books of the banks have grown quickly in the past 5 years, along with an increase in the average maturity of the loan books. The banks have sought to diversify their sources of medium-long term funding and the use of ABS structures has been frequent (the EIB participated in the two securitisations of SME loans). In addition to off-balance sheet securitisations the banks are now starting to tap the market for mortgage-based covered bonds following favourable new legislation enacted in Portugal in 2006.

Romania

Economic importance of SMEs

Available statistical data for Romania's SME sector refers to 2004. In Romania there were 403,000 small to medium sized enterprises of which 89% were micro-enterprises (2004). The contribution of the Romanian SME sector amounted to 60% of total GDP. Romanian SMEs provided for 51% of total employment in the Romanian economy and are strongly represented in trade and industry.

The main weaknesses of the Romanian SME sector are the low level of competitiveness, technological weaknesses and the lack of a skilled labour force. Most SMEs have a short or non-existent historic track record.

The banking market/ financing of SMEs

Although improving, access to financing is still difficult for Romanian SMEs, in particular in certain sub-sectors. Whereas competition among banks has substantially increased over the last years, the country is still under banked compared to Western European standards.

The main funding needs of SMEs in Romania refer to following sectors/activities/types of SMEs:

- Investment and technology renewal
- Start-up companies (both loans and equity)
- Training of already employed personnel in new skills and foreign languages
- financing needs for micro-enterprises

EIB's activities

The 40% minimum reserve - which is significantly higher than in other countries - has constraining effects on external funding including EIB global loans. This also implies a growing interest in local currency funding and new avenues such as EIB purchase of bonds issued by banks for global loan funding in order to avoid the minimum reserve which also applies to local currency. All banks welcome the existing grant schemes, which play a major role in their decision making for EIB loans given the strong value added.

The Bank is looking to develop its activity with leasing companies in 2007 which so far are excluded from the minimum reserve and where asset based leasing is growing strongly based on higher investment activity. This might be under a framework loan covering several institutions given the relatively smaller size of these operations and the similarity of the leasing businesses.

Slovakia

Economic importance of SMEs

In Slovakia there are about 430 000 SME's employing 1.5 m persons representing 70% of the national employment. The number of SMEs is increasing as well as their overall contribution to employment in the country. Most of the SMEs are micro enterprises with less than 9 employees. Most of the SMEs exist in the trade as well as the industry and construction sectors. Micro companies comprise the biggest share to overall employment in Slovakia (30%). Most of the recently established SMEs are active in real estate, rental business and commercial activities, as well as wholesale, retail and repairs. From 2000 to 2005, the numbers of small trade licensees doing business in building industry, services and industry increased by 68%, 31% and 21% respectively. The significant regional differences existing in Slovakia are equally reflected in the SME segment, with Bratislava being the most advanced and Presov in the North-East the least advanced region.

The banking market/ financing of SMEs

Commercial banks are the main source of finance for enterprises. Statistics of five major banks active in Slovakia (VUB, Tatrabanka, Slovenska Sporitelna, HVB, CSOB) show that the general share of SME and mid cap loans in the total business financing is increasing and is at 19%.

Although a high overall amount of total loan funds exists in the country, it seems that a substantial part of the demand is not being satisfied. This is also visible from the data on domestic credit as percentage of GDP, which show Slovakia at par with some surrounding countries, but behind some of the best performing new EU member states.

Leasing has become an important means of financing in the country mainly due to a quicker and less bureaucratic approach compared to banks, less stringent security requirements, and tax advantages. The leasing-to-GDP ratio lies at about 4%, compared to 3.4% in Czech Republic and is well above the European average. The penetration rate (proportion of assets financed by leasing out of the total amount of investments) has increased considerably from 14% in 2003 and is heading towards 20%. There is still room for further growth in the leasing segment.

Major shortcomings in the context of access to finance for SMEs in Slovakia could be summarised as follows:

- Low provision of micro finance for self-employment and start-ups;
- Low ratio of SME domestic credit and guarantee activities as percentage of GDP;
- Low venture capital activities compared to GDP and other Central European EU member States;
- Low R&D-GDP ratio, poor technology transfer record.

EIB's activities

The EIB group has been implementing Global Loans since a few years in Slovakia. The Global Loans with the leasing companies worked very well. Up to now, the Global Loans were generally accompanied by Commission grant support facilities (SME, MIF, MFF) providing an incentive to use these funds. These are running out now, and some of the commercial banks start to ask for other advantages, i.e. sharing of risk.

Slovenia

Economic importance of SMEs

SMEs are a key segment of the Slovenian economy. In terms of size, 97 000 SMEs represent 99% of all registered companies and 65% of employment in the country. Slovenia recognised the particular importance of the SME sector and in 1996 adopted a National Strategy on SME development, encompassing measures to improve the business environment for these companies.

The banking market/ financing of SMEs

Most of the Bank's SME financing through Global Loans in Slovenia benefited from European Commission's support through the SME Finance Facility. Products offered by financial intermediaries to SMEs have been specially tailored to the needs of the respective sector. As such they have largely covered the needs of SMEs. Global loans supported projects in various sectors, including education, environment, infrastructure, health and tourism.

Spain

The Central State offers support to SMEs through the Ministerio de Industria, Turismo y Comercio, Dirección General de Política de la Pequeña y Mediana Empresa. There are several support programmes offered for SMEs, some of them in the form of loans at 0% interest rates. The Ministry acts through intermediaries such as Instituto de Crédito Oficial, banks and other intermediaries.

The Spanish Development Bank - Instituto de Crédito Oficial – is a 100% State owned entity, under the aegis of the Ministry of Economy and Finance through the Secretariat of State for Economy. ICO has a programme "SME Facility" (7bn EUR of loans to SMEs granted in 2006, mainly for fixed asset investment[28]) through which it provides loans to SMEs at preferential interest rates. Under the terms and conditions set by ICO, loans are granted through private credit institutions (banks, savings banks and credit co-operatives), which assume any insolvency risk. The ICO SME facility is a refinancing line for banks, which obtain funding at EURIBOR ./. 25bps under the condition to on-lend these funds at max EURIBOR + 65bps; ICO funds may be used to refinance up to 80% (90% for micro-companies) of project cost. Only fixed asset investments are eligible, the maximum amount per beneficiary is 1,5M EUR.

Support to SMEs is also provided through regional public institutions like Agencia de Inovación y Desarollo de Andalucía (IDEA), Instituto Valenciano de Finanzas (IVF), Instituto Catalán de Finanzas (ICF), Instituto Gallego de Promoción Economica (IGAPE), Instituto de Finanzas de Castilla La Mancha, Luzaro Establecimiento Financiero de Crédito. Support is provided directly or through the commercial banking sector, by ways of loans at preferential rates, mezzanine finance or venture capital funds.

Some of the above-mentioned programmes are supported by cohesion fund and EIB loans. EIB used to finance ICO until a few years ago. The regional public institutions listed above use EIB loans for some of their programmes.

SMEs in Spain benefit from the fact that the branch network of the banks is one of the most dense in Europe. The SME market is disputed by many banks, of which some have significant market shares (20% are held by Santander Central Hispano, another 15% by La Caixa, the biggest savings bank in Spain). The total market share of all Spanish savings banks in the Spanish lending market is estimated at close to 50% by the savings bank association.

United Kingdom

Economic importance of SMEs

Small firms play a key role in the UK economy, accounting for 37% of private sector turnover and 44% of private sector employment. Of the estimated 4.3 million enterprises in the UK at the start of 2005, 3.8 million are in England. The number of enterprises in England increased by 0.3 million between 2003 and 2005 (a rise of 8.5 per cent). 32 per cent of all UK enterprises are in London and the South East. Both these regions have over 675,000 enterprises each.

In the UK as a whole, SMEs account for over half of employment (58.7%). This is also true for each region and devolved country in the UK except London, where SMEs only account for 47%. For the South West, Wales and Northern Ireland, the proportion exceeds 70%.

The banking market/ financing of SMEs

Bank loans (54%) and overdraft facilities (25%) remain the dominant form of finance for enterprises seeking finance in the UK[29]. Data specific to England obtained from the Annual Survey of Small Businesses (2005) showed that a similar dominance of bank funding with the source of finance most often used as a bank loan (42%), followed by a bank overdraft (26%). It is noticeable that the English figure for bank loans is some 12% lower than that of the UK for the same period. Term lending had risen by 15% over the year (2005). Around 500,000 small businesses had established banking relationships over the year. Some 80% SMEs have used external finance within the last three years. The vast majority of them are satisfied with the availability of external finance – 79% of small businesses seeking finance are successful on their first attempt. Some 25 000 businesses per annum may have had viable propositions for accessing some form of external finance rejected by more than one provider.

Obtaining finance is reported as a major problem at start-up by some 10% of businesses. 38% getting less finance than they need and 10% report difficulties in raising start-up finance. Some groups of potential entrepreneurs cite access to finance as a major problem. The availability of debt finance has improved significantly over the past decade, as a result of increasing economic stability and the development of the business market. Despite this, lenders continue to face uncertainty in assessing credit risk when lending to SMEs and often rely on collateral provided by the borrower to reduce their risk exposure. This approach generally works well but can create difficulties for entrepreneurs who do not have the suitable access to offer as security.

EIB's activities

EIB's lending to financial institutions in UK for the purpose of passing financial advantage to SMEs has declined over the last few years, as the financial benefit available has reduced. As a result, there are now a small number of intermediaries in the market applying EIB's advantage to particular segments of their business. EIB has also explored with a number of intermediaries how to increase the financial advantage available to SMEs, and to secure that objective, EIB has concluded a securitisation deal with one intermediary, significantly increasing the advantage which it can make available to its SME customers.

[29] JEREMIE, JOINT EUROPEAN RESOURCES FOR MICRO TO MEDIUM ENTERPRISES, Final Evaluation Study ENGLAND, June 2007

GLOSSARY OF ABBREVIATIONS AND INSTITUTIONS

BERR	Department for Business Enterprise and Regulatory Reform, UK
BUSINESSEUROPE	Confederation of European Businesses, ex UNICE (Union de l'Industrie des Communautés Européennes)
EUROCHAMBERS	Association of European Chambers of Commerce
EACB	European Association of Cooperative Banks
EBF	European Banking Federation
ECB	European Central Bank
EESC	European Economic and Social Committee
ESBG	European Savings Bank Group
FinNetSME	Network for Regional SME Finance, project part-financed by the European Union
KfW	Kreditanstalt für Wiederaufbau Bankengruppe
LBO	Leveraged buy-out
MFB	Hungarian Development Bank
NEFI	Network of European Financial Institutions for Small and Medium Sized Enterprises, including MFB (HU), Almi (SE), OSEO (FR), Finnvera (SF), ICO (ES), KfW (DE), MCC (I), Slovak Guarantee and Development Bank (SL), Hipoteku banku (LV), SNCI (LUX)
OSEO	Name of the public promotional institution for SMEs in France
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
SME	Small and Medium-sized Enterprises
UEAPME	Union Européenne de l'Artisanat et des PME
VC	Venture Capital

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ANNEX 4

Department	Country	Counterpart
European associations		European Association of Co-operative Banks (EACB)
		Union Européenne de l'Artisanat et des PME (UEAPME)
		BusinessEurope - Union of Industrial and Employer's Confederations in Europe (UNICE)
		Eurochambres - Ass. Of European Chambers of Commerce and Industry
		Coordination Committee of European Cooperative Ass. (CCACE)
		European Ass. of Public Banks (EAPB)
		European Savings Banks Group (ESBG)
		European Banking Federation (EBF)
European commission		DG Enterprise
		DG ECFIN
Other European Institutions		European Economic and Social Committee (EESC)
		Network of European Financial Institutions for SMEs (NEFI)
		SME Intergroup of the European Parliament
Adriatic Sea	**Italy**	Intesa San Paolo SpA
		Assolombarda
		Confindustria
		Mediocredito Capitalia
		Banca Delle Marche S.p.A.
		Cassa di Risparmio di FERRARA
Baltic Sea	**Poland**	Bank PEKAO S.A.
		Bank Millennium
		Polish Association for Leasing Companies
	Estonia	AS Hansapank
	Latvia	Mortgage and Land Bank of Latvia
		DnB NORD Banka AS
	Lithuania	AB DnB NORD Bankas
	Finland	Finnvera plc
		OKO Bank

	Denmark	Ringkjobing Landbobank A/S
		Vaekstfonden
Central Europe	**Germany**	KfW Mittelstandsbank
		Deutsche Bank AG
		DZ Bank/ Volks- und Raiffeisenbanken
		Deutscher Sparkassen- und Giroverband
		Deutscher Handwerkskammertag
		NRW Bank
	Austria	Bank Austria Creditanstalt AG
		Investkredit Bank AG
		Wirtschaftskammer Österreich
		AWS Austria Wirtschaftsservice
	Czech Republic	Czeska Sporitelna a.s.
		Ceskoslovenska obchodni banka, a. s.
	Hungary	Hungarian Development Bank (MFB)
		Kerkeskedelmi Es Hitelbank RT (K& H Bank)
		CIB Bank (Central-European International Bank Ltd.)
		Unicredit Bank (Hungary) RT
South-Eastern Europe	**Romania**	BRD Société Générale
		Banca Commerciala Romana
		Bancpost S.A.
	Bulgaria	Unicredit Bulbank
		DSK Bank Plc
		Encouragement Bank
	Greece	EFG Eurobank
	Slovenia	Nova Ljubljanska banka dd
Spain Portugal	**Spain**	CEOE - Confederación Española de Organizaciones Empresariales
		CECA
		Santander Central Hispano
		La Caixa
	Portugal	BANCO ESPÍRITO SANTO
		BANCO BPI SA
		IAPMEI
		Millenium BCP

		Banco Santander Totta
Western Europe	**UK**	Alliance & Leicester Commercial Finance plc
		Barclays Bank Plc
		Close Brothers Group plc
		Department for Business Enterprise and Regulatory Reform
		Federation of Small Businesses
	Ireland	Bank of Ireland Business Banking
		Bank of Scotland (Ireland) Ltd
		AIB Bank
	France	OSEO
		BNP Paribas S.A.
		Société Générale S.A.
		Groupe Banque Populaire
		Groupe Arkéa
		Confédération Nationale du Crédit Mutuel
		Credit Mutuel Centre Est Europe
		Fédération bancaire francaise (FBF)
		Confédération Générale des Petites et Moyennes Entreprises
	Belgium	Société Régionale d'Investissement de Bruxelles (SRIB)
	Netherlands	SenterNovem

ANNEX 5

- Draft Invitation letter to the SME Consultation -

Dear Sirs,

The European Investment Bank (EIB) is the financing institution of the European Union. Its mission is to support the implementation of investment projects within its priority objectives, including the development of SMEs. The mission is also taken forward by the European Investment Fund (EIF) as part of the EIB Group.

The EIB's AAA credit rating enables it to raise funds on the capital markets at advantageous rates. In order to maximise its support to SMEs and in the absence of a retail network, the EIB works with a range of banking intermediaries to on-lend these funds to SMEs at attractive conditions through a standardised product called a "Global Loan". The EIB has so far developed a network of some 120 intermediaries throughout the EU, which currently pass some EUR 4bn of EIB funding to SMEs on an annual basis, fostering investment projects worth at least EUR 8bn each year. The Global Loan product has evolved considerably, in terms of volumes but also in terms of diversification across a range of partner banks, and across SMEs and industrial sectors.

In support of the EIB Group's SME policies, the EIF promotes entrepreneurship through its venture capital activity, investing in selected venture capital funds. The EIF also provides guarantees for portfolios of SME loans, thereby freeing up regulatory capital at the intermediary level and allowing the latter further to develop its SME lending activity. Global Loans and SME portfolio guarantees can be combined.

Diversity of financial markets and the resulting varying needs of financial intermediaries and final beneficiaries require tailor-made solutions. The EIB product offering has to evolve from its previous focus of universal provider of funding to the role of flexible partner acting with products adapted to local market circumstances and to counterparts' needs.

Important results have already been achieved with Global Loans directed to various groups of clients (micro-credit, innovative SMEs, audiovisual) or with different types of financial structures (leasing, ABS), with or without risk sharing by the EIB Group. Nevertheless, in a changing market environment, the value added of the EIB's presence has to be constantly questioned, both in terms of number of SMEs reached and in terms of amount of measurable financial advantage passed on to them. In the short note attached to this letter, you will find a description of the Global Loan product, the challenges it is facing and different paths which might be followed to address these challenges.

The EIB, acknowledging these challenges, would like to consult representatives of SMEs and major partners in SME financing in Europe, to allow them to express their own views on the EIB's current products and how to develop them to achieve maximum value added for final beneficiaries.

To prepare the consultation, the EIB kindly requests you to outline your own views on the following indicative topics:

- Strengths/weaknesses of the EIB Group's current product offering (target group, eligibility criteria, definition of project cost, reporting, minimum/maximum maturity, pricing etc.)

- Which are the SME segments that are not well covered in terms of financing needs and where the EIB could make a valid contribution?

- Which are the financial products to be developed by the EIB that would be best suited to respond to the needs of these market segments (see also examples of product proposals in the annex to this letter)?

- In your opinion, would the development of risk-sharing mechanisms between the EIB and its financial partners represent a valuable contribution in the context of SME lending?

I would be grateful if you could let us have your views on the above topics either in writing, or by phone or e-mail, to be sent to the contact details shown below. Thereafter, we would like to follow up on these issues with a working-level meeting. Naturally, I would also welcome the opportunity to discuss these issues with you if your diary allowed it in the next three months.

Philippe de Fontaine Vive

Contact in EIB :

Annex: 1

EIB's Global Loan product and how to modernise it to maximise its value added for SMEs

1. Background

Support for SMEs is a key priority for the EIB Group, as has been restated in 2005 in line with the strategic orientations approved by the Board of Governors of the EIB (i.e. the finance ministers of the member states of the EU). This support concerns both the EIB's financings through the EU banking sector, and the EIF's risk capital and guarantee transactions.

There is a consensus that intermediation through financial partners is the only means by which the EIB can reach a significant number of SMEs. Indeed without SME Global Loans, the EIB would have to limit its remit to large projects and larger counterparts.

An SME Global Loan is a medium-term credit line made available to national and regional intermediary banks to finance investment projects undertaken by independent companies with fewer than 250 employees. The project size is currently limited to a minimum of EUR 40 000 and a maximum of EUR 25m. The EIB's participation is limited to 50% of the project cost. The client relationship and the lending decision remain fully with the financial intermediary.

Global Loans have been conceived as an instrument for the support of investments undertaken by SMEs. Each Global Loan operation is evaluated against three main criteria:

1. Compliance with the priority objectives of the Bank. As the support for SMEs is one priority criterion as such, the result of the evaluation is necessarily positive for Global Loans in favour of SMEs.
2. The quality of the intermediary, i.e. its experience in SME lending, quality of information flow between the intermediary and the EIB, and degree of institution building (i.e. contribution to development of financial markets where MLT funds are scarce, as in emerging markets).
3. The financial value added, i.e. improving the SME's access to MLT funds, the financial advantage transferred to SMEs, the contribution to better market coverage and/or enhanced competition amongst intermediaries, notably through the information to the final beneficiaries of the EIB's contribution.

Finding the right balance between efficiency and transparency, and the attractiveness of the Bank's product offering – its value added both in terms of pricing and of product characteristics – are keys to the future of the SME Global Loans. Diversity of financial markets and resulting specific needs of financial intermediaries will continue to require tailor-made solutions.

This is why the original Global Loan product has undergone a number of changes over the past years. In an effort to improve the value added of the Bank's involvement, to the benefit of the final beneficiaries, the characteristics of Global Loans today vary substantially from one country to another. While dedication to one of the Bank's priority objectives has become the standard, innovative security structures help smaller regional intermediaries have access to EIB funds. The focus on specific SME segments such as micro-enterprises with fewer than 10 employees is another example how the Global Loan product may be used to address the financing needs of a specific market segment. In 2006, a number of ABS transactions were concluded, including four operations in cooperation with the EIF.

Over the years since the introduction of Global Loans in favour of SMEs in 1968, the Bank has built up a network of intermediaries throughout the EU and supports MLT loans for investments of some 30,000 SMEs every year, with an annual lending volume reaching an average of EUR 4bn. The number of intermediaries with which Lines of Credits have been signed over the past three years has increased from 188 to 207 in the EU Member States, including 41 in the New Member States, where the institution-building element has been of particular importance. Local regional banks have been favoured so as to increase the degree of penetration of EIB funding in the local SME market. The success of this strategy is reflected in the average amount per allocation to SMEs achieved for 2006, which came in at EUR 121,500, after reaching EUR 165,000 in 2005. The careful selection of intermediaries, which must have a recognised position in those SME segments the Bank wishes to target in the future and are also able to satisfy fully the EIB's reporting criteria, is an ongoing challenge for the geographical teams of the Bank.

A substantial improvement has also been seen over the past few years in the financial value added offered to SMEs,. Informing the final beneficiary about the Bank's involvement is considered to be an important element for the final beneficiary to be able to ask for and obtain an appropriate part of the EIB funding advantage and this aspect is systematically included either in the finance contract signed between the intermediary institution and the final beneficiary, the general conditions on lending operations of the intermediary, its commercial brochures and annual reports, or – more recently – on the intermediary's websites specifically dedicated to corporate/SME lending. On these websites, the Bank's eligibility criteria are explained, and it is mentioned that the EIB's attractive funding conditions are in principle available to those projects that meet the eligibility criteria.

Nevertheless, in a changing market environment the value added of the EIB's intervention has to be constantly questioned, both in terms of the number of SMEs reached and the amount of measurable financial advantage passed on to them. The aim of modernising the EIB Group's product offering for SMEs is to increase the traceable value added of its involvement in specific, targeted segments of SMEs by developing financial products dedicated to those segments. Such new products would be accessible to those financial partners who will accept best practice in terms of both transparency and the mechanism for passing on the financial advantage to the final beneficiaries.

2. Proposals to modernise the standard SME Global Loan

To increase the value added of the EIB's activities in support of SMEs, the EIB proposes to explore three options: simplification, refocusing and risk sharing.

Simplification/streamlining of the existing product will commence with a review of the current process in order to eliminate any unnecessary administrative constraints. Aspects which could be considered include: reduced reporting requirements, shorter minimum tenors (currently set at four years), lower minimum loan amounts (currently set at EUR 20 000), simplification of project definition and calculation of the project cost (for instance, abandoning the rule that the EIB may fund only up to 50% of the total project cost). The challenge is to improve the handling of the Global Loan product without, however, giving up on transparency (informing the final beneficiary of the Bank's involvement) or the eligibility requirements, such as the exclusion of certain sectors and the exclusion of purely financial transactions. Also, it becomes even more crucial, when introducing the above simplifications, that an appropriate share of the financial value added of the Bank's intervention be transferred to the SMEs.

Refocusing means concentrating on targeted segments of SMEs. The Bank probably needs to evolve further from its previous focus of universal provider of funding to the role of flexible partner, acting with more tailor-made products adapted to local market circumstances and to counterparts' and final beneficiaries' needs. As a response to these specific requirements, lines of credits for different purposes (SMEs at large, micro-credit, innovative SMEs, young SMEs, audiovisual) or with different types of financial structure (MLT loans, leasing, ABS), with or without risk-taking, could be further developed, with the aim of maximising the value added of the EIB's involvement.

The third option to be explored is the development of risk-sharing schemes. The intention of the EIB when approaching the subject of increased risk-taking in the SME segment cannot be to replace the commercial bank's role but, on the contrary, to build on a strengthened partnership with a wide range of financial intermediaries (commercial banks as well as promotional banks/institutions). Depending on market circumstances, the EIB has so far followed different approaches to increasing the value added of its SME lending activity through risk-sharing schemes, taking the form of ABS transactions involving the EIB Group investing at different levels of risk or of a combination of standard SME Global Loans, with the EIB sharing the risks pari passu with the financial partner on a "case-by-case" or "portfolio" basis.

On the following pages some examples of potential new EIB products are presented.

Global Loan for loans to SMEs for less than EUR 1m with an EIB label

1. Principle

Each new loan not exceeding EUR 1m and with a term of three years or more granted to an independent SME pursuing an eligible business[30] may be backed by EIB funds and therefore benefit from attractive financial conditions. The EIB loan would no longer be limited to 50% of the cost of the underlying investment project but could be as much as 100% of that cost, provided that the amount lent by the EIB does not exceed the amount supplied by the partner institution. “Project Cost” are all the expenses for tangible and intangible assets directly related to the implementation of a project.

2. Information required

The allocation of the EIB funds will be justified ex post via a list of projects, which must contain the following information:

- the name of the final beneficiary;
- the location of the investment;
- the NACE code (classification of economic activity);
- the total cost of the investment;
- the amount of the loan provided by the intermediary bank; and
- the number of employees of the SME concerned.

3. Transparency

a. Transferring the EIB advantage to the final beneficiary

The advantage deriving from the use of EIB funds must be transmitted to the final beneficiaries in an identifiable and appropriate manner, possibly by creating a specific EIB product that will be distributed as such (under the EIB label).

b. Informing the final beneficiary

The intermediary bank must inform the final beneficiaries of the EIB support by means that are acceptable to the EIB (website, commercial brochures, annual reports, etc.).

c. Rules applicable

The intermediary bank will ensure that the final beneficiaries undertake to comply with current European and national directives and laws concerning the environment, procurement and competition.

[30] The following sectors are excluded: military equipment, tobacco, gambling, the processing of toxic waste and certain agro industries. Other areas that would also be excluded are: holding companies, real estate companies (unless they can demonstrate that their main activity is industrial) and financial restructuring operations.

Global Loan for loans to micro-enterprises with an EIB label

1. Principle

Each new loan not exceeding EUR 50 000 and with a term of three years or more granted to an independent micro-enterprise (fewer than ten employees) pursuing an eligible business[31] may be backed by EIB funds and therefore benefit from attractive financial conditions. The same company may benefit from these advantages only once every 12 months.

2. Information required

The allocation of the EIB funds will be justified via annual MLT lending statistics for loans of less than EUR 50 000 to micro-enterprises[32], to be provided by the intermediary bank. These statistics must include the following information (number of loans and amount involved):

- Breakdown by geographical region
- Breakdown by sector.

Total MLT lending in this category must be at least twice the amount of the loan provided by the EIB.

3. Transparency

a. Transferring the EIB advantage to the final beneficiary

The advantage deriving from the use of EIB funds must be transmitted to the final beneficiaries in an identifiable and appropriate manner, possibly by creating a specific EIB product that will be distributed as such (under the EIB label).

b. Informing the final beneficiary

The intermediary bank must inform the final beneficiaries of the EIB support by means that are acceptable to the EIB (website, commercial brochures, annual reports, etc.).

c. Rules applicable

The intermediary bank will ensure that the final beneficiaries undertake to comply with current European and national directives and laws concerning the environment, procurement and competition.

[31] The following sectors are excluded: military equipment, tobacco, gambling, the processing of toxic waste and certain agri-foodstuffs sectors. Other areas that would also be excluded are: holding companies, real estate companies (unless they can demonstrate that their main activity is industrial) and financial restructuring operations.

[32] Loans to micro-enterprises will thus not be justified by a list of individual operations but through a portfolio.

Global Loan for innovative SMEs
with risk sharing on a case-by-case basis

1. Principle

Each new loan of less than EUR 12.5m (financing a project with a total cost of less than EUR 25m[33]) and with a term of three years or more granted to an innovative independent SME will be eligible for EIB support and therefore may benefit from attractive financial terms. In order to increase the funding advantage deriving from such an operation, the EIB is prepared to share the credit risk with the intermediary bank. Based on a detailed analysis of the internal credit rating system of the intermediary bank, the EIB would delegate the appraisal of SME loans and the administration of EIB's funds to the intermediary. The delegation agreement would specify the maximum risk by operation that would be acceptable to the EIB.

2. Financial terms and conditions

Risk sharing is done on a case-by-case *pari passu* basis with the financial partner. It may take various forms. Thus the EIB could share the credit risk on a senior loan secured by mortgages or assignments of rights etc. Another possibility could be to share the risk on unsecured loans (probably with a loan grading equivalent to BB-/B+). Intermediate scenarios are also possible. The risk borne by the EIB could be covered either in the form of a first demand guarantee or in the form of a subsidiary guarantee.

3. Information required

The list of information below is non-exhaustive and will be adapted to the Bank's risk

assessment requirements.

a. Information on loans on which the risk is to be shared[34]

- the internal loan grading awarded to the project by the financial partner;
- the name of the final beneficiary
- the location of the investment;
- the NACE code (classification of economic activity);
- the loan amount provided by the intermediary bank.

b. Information on operations benefiting from the EIB advantage

- the name of the final beneficiary;
- location of the investment;
- the NACE code (classification of economic activities);
- the loan amount provided by the financial partner; and
- the number of employees of the SME concerned.

4. Transparency

a. Transferring the EIB advantage to the final beneficiary
The advantage deriving from the risk sharing and the use of EIB funds must be transmitted to the final beneficiaries in an identifiable and appropriate manner,

[33] The total cost of the project may include tangible and intangible assets (in the case of R&D projects). Purely financial transactions, the financing of VAT, residential property transactions or transactions where the purchase of the land accounts for more than 50% of the total cost of the project will not be considered.
[34] Loans subject to risk sharing do not necessarily have to be the same as those benefiting from the EIB funding advantage.

possibly by creating a specific EIB product that will be distributed as such (under the EIB label).

b. Informing the final beneficiary

The intermediary bank must inform the final beneficiaries of the EIB support by means that are acceptable to the EIB (website, commercial brochures, annual reports, etc.).

c. Rules applicable

The financial partner will ensure that the final beneficiaries undertake to comply with current European and national directives and laws concerning the environment, procurement and competition.

Global Loan for innovative SMEs
with risk sharing on a portfolio basis

1. Principle

Each new loan of less than EUR 12.5m (financing a project with a total cost of less than EUR 25m) and with a term of three years or more granted to an innovative independent SME may be backed by EIB funds and therefore benefit from attractive financial conditions. In addition, the EIB is prepared to share the credit risk on a portfolio (existing and/or to be established) of SME or other loans by means of a guarantee[35]. Such guarantee will reduce the regulatory capital requirements of the intermediary for the secured loans. The regulatory capital freed up could be used to expand the intermediary's SME lending activities. The guaranteed portfolio must meet certain criteria in terms of average term of loans, granularity and sectoral diversification. Periodic rating (six-monthly or quarterly) in accordance with these criteria will allow to monitor the level of risk of the portfolio, which has to remain acceptable to the EIB throughout the lifetime of the EIB guarantee. The origination of the loans to be included in the portfolio and the administration of the flow of funds would be entirely delegated to the financial partner.

2. Financial terms and conditions

The risk sharing would cover part (up to 50%) of the losses incurred after the underlying loans have been repaid and the underlying guarantees realised. The remuneration of EIB for the risk covered will depend on the risk profile of the guaranteed loans, i.e. portfolio concentration with respect to borrowers, economic activity, geographical location, and average maturity of the outstanding loans, their repayment structure, the level of underlying guarantees, historical default data, etc.

3. Information required (non-exhaustive list)

a. Before signing the risk sharing agreement, the financial intermediary must supply sufficient information on:

- the quality of its SME loan portfolio;
- its internal loan grading system;
- its security evaluation procedures;
- its risk monitoring procedures;
- its procedures for build-up and release of provisions;
- its IT system for loan administration;
- data on the portfolio of existing loans, with information on its historic performance, to enable simulations based on historic default and recovery rates.

b. **Information required on the final beneficiaries benefiting from the EIB advantage:**

The allocation of the EIB funds will be justified ex post via a list of eligible projects, which must contain the following information:

- the name of the final beneficiary;
- the location of the investment;
- the NACE code (classification of economic activities);
- the loan amount provided by the intermediary bank; and
- the number of employees.

[35] Loans subject to risk sharing do not necessarily have to be the same as those benefiting from the EIB funding advantage.

4. Transparency

a. Transferring the EIB advantage to the final beneficiary

The advantage deriving from the risk sharing and the use of EIB funds must be transmitted to the final beneficiaries in an identifiable and appropriate manner, possibly by creating a specific EIB product that will be distributed as such (under the EIB label).

b. Informing the final beneficiary

The intermediary bank must inform the final beneficiaries of the EIB support by means that are acceptable to the EIB (website, commercial brochures, annual reports, etc.).

c. Rules applicable

The financial partner will ensure that the final beneficiaries undertake to comply with current European and national directives and laws concerning the environment, procurement and competition.