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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Measures on financial assistance for innovative and job creating Small and Medium-Sized Enterprises (1998 Growth and Employment Initiative)

As at 31 December 2002

(SEC(2003) 902)

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1. GENERAL INTRODUCTION

The 2002 annual report on the Growth and Employment Initiative is drawn up in accordance with Article 7(1) of the Council Decision (Decision 98/347/CE) adopted on 19 May 1998.

This Decision requires the Commission to submit an annual report to the European Parliament and Council on the progress achieved on the implementation of three financial instruments-ETF Start-up Facility, JEV and SME Guarantee Facility.

This fourth report is the last report due under the above Council Decision that specifies in article 8 that the programme comes to an end on 31.12.2000. Furthermore the commitment period for both the SME Guarantee Facility and the ETF Start-up ended on 28.05.02.

In December 2000 a successor programme was adopted : MAP, the multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises-SMEs (2001-2005). This programme builds on the Growth and Employment Initiative and further extends it. The next report will be drawn up in the context of this programme, in accordance with the MAP reporting requirements[1].

The annual report is broken down into three parts, one for each of the financial instruments. It is complemented by annexes, referring particularly to statistics on SMEs that are beneficiaries under the ETF Start-up Facility or under the SME Guarantee Facility. These statistics for ETF Start-up and SME Guarantee Facility are based on data as at the latest stage available. Finally, the conclusion describes further developments of the instruments of the Initiative and the context in which they have been implemented.

As at 31.12.02, an amount of EUR 59,82 million out of a total appropriation of EUR 449.56 million[2] was still available for commitments. Under the ETF Start-up Facility, an amount of EUR 17.42 million was available subject to an extension of the reinvestment period. An amount of EUR 42.4 million was also available for JEV.

The activity of the EIF related to the ETF Start-up Facility and the SME Guarantee Facility developed according to plan, although it was affected by the economic situation that resulted in a downturn of risk capital in Europe and the increased reluctance of banks to lend to activities towards SMEs. In this respect, the banks also anticipated consequences, in terms of higher risk exposure, of the Basle II capital accord. As regards JEV, the take-up by the market was lower than expected[3].

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1 Article 5 of Council Decision 2000/819/EC (OJ L 333, 29.12.2000, p. 84)

2 This amount includes the initial budgetary appropriations of the Initiative amounting to EUR 418.56 million and the interest and other income earned amounting to EUR 31 million.

3 The Action Plan "Financing research" launched by the Commission on 30 April 2003 identifies, in particular, two actions to "ensure that Community legislation on capital adequacy, which will be based on the future Basel II capital agreement, properly takes into account the needs of risk capital providers" and to "examine ways to promote the use of rating systems that include technology risk assessment (technology rating) to enable potential investors to appraise the specific risks and rewards associated to investments in technology-based SMEs" (COM(2003) 226 final, Section 6.4 "Financial markets", Actions 2 and 3, p. 24).

In September 2002, European Parliament adopted the Resolution on the Commission's third annual report on the Growth and Employment Initiative, on the basis of the report (A5-0304/2002) submitted by Mr Bushill-Matthews, rapporteur of the European Parliament's "Committee on Employment and Social Affairs".

In 2001 and 2002, the Court of Auditors carried out audits of the financial instruments managed by the EIF, i.e. the ETF Start-up and SME Guarantee Facilities. The Court's observations and the Commission's detailed replies can be found in the annual report of the Court of Auditors (OJ C 295 of 28 November 2002).

2. ETF START-UP FACILITY

2.1. Description of the facility

The objective of the ETF Start-up Facility is to increase the availability of risk capital to innovative SMEs during their creation and their early stage development.

The EIF invests in specialised venture capital funds (below referred to as VC funds) established specifically to provide equity or other forms of risk capital to SMEs. The funds considered under this facility are small or newly established ones, in particular funds operating at a regional level, focusing on specific industries or technologies and funds that finance the exploitation of R&D results.

Investments are made on equal terms with other equity investors. The amended Fiduciary and Management Agreement between the EIF and the EC that entered into force on 18 December 2001 specifies that investments must represent between 10% and 25% of the total capital of a VC fund or business incubator, or 50% in exceptional cases. Investments can be made up to a maximum amount of EUR 10 million. In exceptional, duly substantiated cases the amount committed may be higher, but will not in any case exceed EUR 15 million[4].

The new agreement also foresees the possibility of co-investments in VC funds with other Community facilities, EIF's own resources or other resources under mandate. Co-investments are allowed provided that the aggregate amount does not exceed 50% of the capital of the fund. This option has been used for several investments, in particular in the case of multipurpose funds that include start-up companies in their investment programme.

Venture-capital fund managers are required to maximise private sector participation and will normally be expected to obtain an amount of at least 50% of total fund size from private sources. For funds mainly operating in assisted regions (objectives 1 and 2) or in candidate countries, up to 70% of public funding may be authorised.

Where the investment policy of a VC fund foresees investments outside the participating countries, the EIF's participation is reduced by the corresponding percentage of such investments. However, always taking into account the requirement that the majority of the capital must be invested in the participating countries.

The EIF examines the fund proposals based on criteria which include size, level of involvement from the private sector, investment strategy, target market, deal flow, proposed terms, expected rate of return, management team and the extent to which the EIF investment in the VC fund is expected to have a catalytic effect in raising funds. Attention is also given to achieve an adequate geographical coverage across the European Union (see point 2.2.2).

Following approval by the Commission of a VC fund proposal, the EIF signs contractual agreements with the fund managers and the other equity investors in the fund. Thereafter the EIF progressively disburses the amounts committed to the VC funds for investment in SMEs (see point 2.2.4).

4 Investments approved prior to 18 December 2001 must comply with the provisions of the previous Fiduciary and Management Agreement that foresees investments between 10% and 25% of the total capital of the VC fund, up to a maximum of EUR 10 million.

2.2. Budgetary situation

2.2.1. Overview

As at 31.12.02, the budgetary appropriations of the ETF Start-up Facility amounted to EUR 168 million. In addition, according to the Council Decision 98/347/EC, Annex I, points 7 and 8, proceeds from realised investments may be reinvested during the reinvestment period[5] and the interest earned on the trust account shall be added to the resources of the facility. Therefore, these two income sources shall be added to the budgetary appropriations.

This total budget shall cover the full cost of the facility, including investments in VC funds and any other eligible costs of the facility. The table below shows the breakdown of the budget appropriations, interest and other income as well as their utilisation:

Table 2.1. *Budgetary data*

	(EUR million)
Resources	
Budget appropriations	168.00
Interest & other income	22.02
Total	**190.02**
Utilisation	
EIF signatures to VC funds	110.92
EIF commitments to be signed	46.90
Maximum EIF fees & other	14.78
Available budget to be committed in case of extension of re-investment period	17.42
Total	**190.02**

2.2.2. Geographic distribution

In 2002, the EIF continued receiving a steady flow of enquiries from potential fund managers and sponsors throughout the European Union. As at the end of 2002, following due diligence by the EIF, investment proposals into 28 VC funds had been approved by the EIF and the Commission services, corresponding to a total amount of EUR 207 million. 18 contracts had been signed by the EIF with VC funds. For the remaining 10 approved proposals, negotiations were unsuccessful (see point 2.2.3). The breakdown of the amounts committed to the 18 VC funds by country is shown below:

5 According to this provision, the reinvestment period corresponds to the first four years of operation of the facility. The reinvestment period can be extended by up to three years, subject to a satisfactory evaluation of the facility 48 months after its adoption.

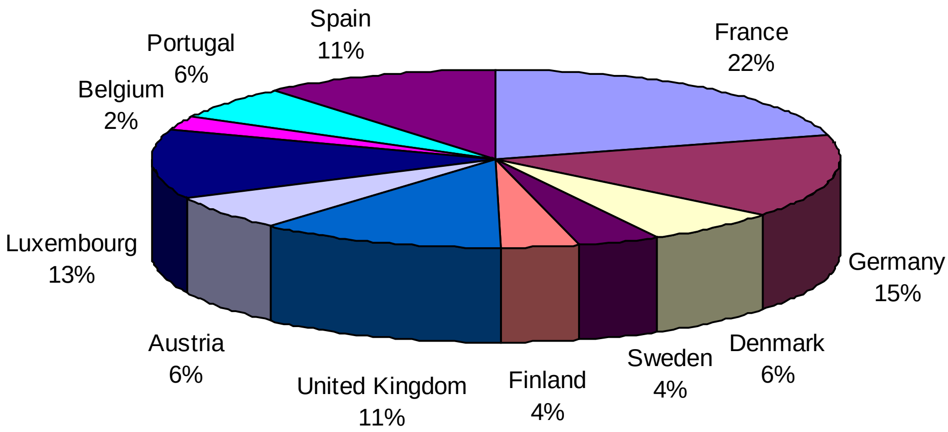

Figure 2.1. Breakdown by country of the VC funds according to the seat of the management company

Geographical distribution as presented in Figure 2.1 is based on the location of the management company of the venture-capital funds. It should be noted that VC funds may choose to have their seat in a given country for legal, operational, market, tax or other reasons, but that their investments are not necessarily limited to this particular country and may extend to other participating countries. In this respect, the Commission suggests considering the merits and the possibility of developing an harmonised European fund legal structure ensuring tax transparency for risk capital operations throughout the Union[6].

Approvals of new funds in the first half of 2002 have resulted in significant changes to the geographical distribution based on amounts committed to VC funds. For example, the share of France has decreased from 28% by the end of 2001 to 22% by the end of 2002.

Another way of examining geographical distribution is on the basis of the location of the SME portfolio companies that have benefited from the facility. This provides a snapshot of a situation at a particular moment in time. However, it does not distinguish between VC funds that are at the beginning of their 5-year investment period and those that have reached the end of this period. A breakdown by country of beneficiary SMEs as at 30.09.02 is provided in Table 2.2.

As already explained in the context of the 2001 discharge procedure, the ETF Start-up facility commenced its activities on a ‘first come, first served’ basis. This resulted in an unevenly balanced absorption for some time. The investment programme of VC funds typically covers 4 to 6 years. It is therefore evident that the French funds which signed at the early stage of the programme are more advanced in their investment programme into final beneficiary SMEs.

[6] COM(2003) 226 final, Section 6.4 "Financial markets", Action 1, p. 24

The following pie chart (figure 2.2.) gives a projection of the estimated number of SMEs by country at the end of the investment programme of the VC funds that are currently in different stages of their investment cycle. The projection takes into account the average investment amount per VC fund and the remaining investment period.

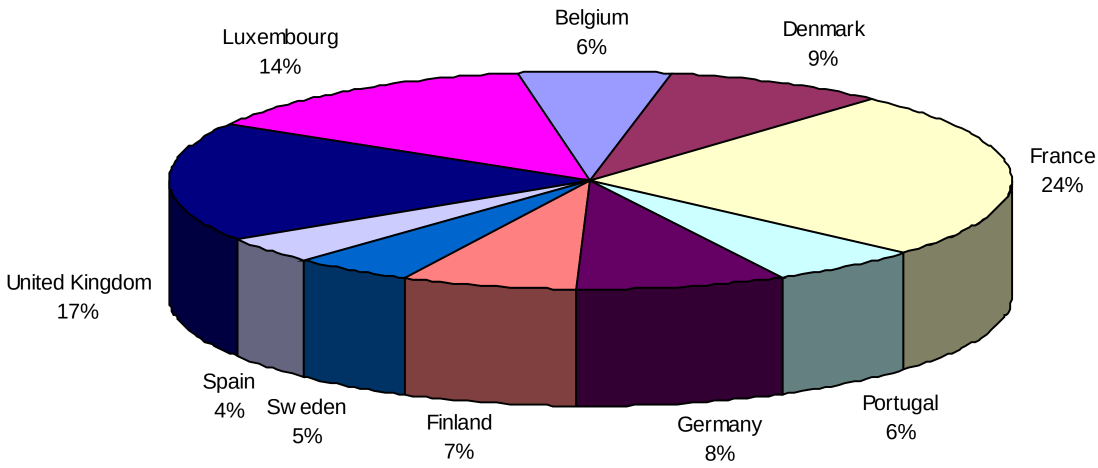

Figure 2.2. *ETF Start-up. Projected number of SMEs by country at termination date of EIF committed amounts as at 31.12.02, weighted by relative investment*

As in the past, the EIF has made significant efforts to achieve a broad geographical coverage[7]. However, it has been difficult to attract private capital in those countries where little venture capital activity exists, for a number of reasons:

– different stages of development of the venture capital market in the various countries;

– requirement that ETF Start-up only invests pari passu with other equity investors;

– at least 50% of capital must be provided by the private sector.

The Commission considers that different needs, market conditions and macro-economic circumstances in the various Member States have an impact on the absorption capacity and the take-up of the various financial instruments. Based on the experience gained in the implementation of the instruments, the new Fiduciary and Management Agreement specifies that appropriate geographical distribution should be achieved across the various SME financial instruments (considered globally) rather than individually for each of them. A breakdown of geographical distribution for ETF Start-up and the SME Guarantee Facility, based on the seat of the intermediaries/VC funds as at 31.12.02, is given in Annex 4.

[7] In 2002, operations in Ireland and Spain, which were not covered in 2001, were approved under the Multiannual Programme for enterprise and entrepreneurship (MAP).

2.2.3. *Commitments*

The investments committed under ETF Start-up in 2002 should be considered against the general development of the venture capital market. The years 2001 and 2002 were characterised by a decrease in investment activity in the European venture capital market compared to the year 2000. According to the statistical data published by the European Private Equity & Venture Capital association (EVCA) [8] the amount invested was reduced by 48% in 2001 while the number of investments decreased by 25% compared to 2000.

Of the 28 operations approved by the EIF and the Commission services and referred to under point 2.2.2 above, corresponding to a net commitment of EUR 157.82 million 18 had resulted in contracts between the EIF and VC funds at the end of 2002. The amount committed to these 18 VC funds is EUR 110.92 million. In addition, 3 out of these 18 funds also received a total amount of EUR 16.6 million from EIF own resources or under the EIB Risk Capital Mandate, thus taking advantage of the possibility to co-invest alongside ETF Start-up resources (see 2.1). The 18 VC funds have raised an amount of EUR 558.1 million[9] from private and public investors, thus providing a substantial leverage to Community funds.

Despite significant efforts made by the EIF, the 10 remaining investment operations did not materialise. This was due to a number of reasons, in particular:

– the adverse market circumstances, as explained above;

– difficulties experienced by the approved VC funds in raising funds within the time limit[10];

– reluctance of private investors to participate in the formal signature (closing) of deals;

– changes by VC funds of their proposed investment policy resulting in ineligibility under the facility.

The graph below shows the quarterly approvals of investments into VC funds. It should be noted that no further commitments under Growth and Employment were made after 28.05.02. ETF Start-up investment proposals submitted by the EIF after that date have been approved under the Multiannual Programme for Enterprise and Entrepreneurship (MAP) (2001-2005), that is subject to a separate reporting in accordance with article 5 of the MAP Council Decision.

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8 Corporate Venturing European Activity Update 2001, EVCA Research Paper, p.4.

9 Indicative total amount based on the EIF report as at 31.12.2002

10 In accordance with the Amended and Restated Fiduciary and Management Agreement of 18 December 2001, the EIF cannot formally commit funds to VC funds after 31.12.2002 under the Growth and Employment Council Decision.

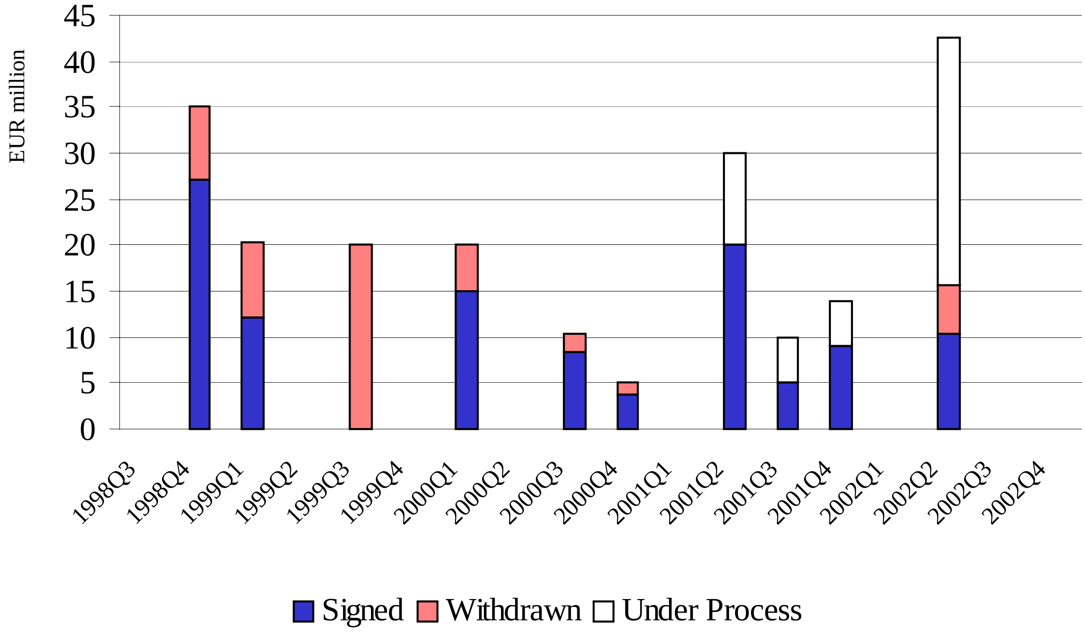

Figure 2.3. *Quarterly approvals of investments in the VC funds*

The graph below shows the cumulative evolution of the total amount committed (i.e. contracts signed plus those still being processed, corresponding to EUR 157.82 million as at the end of 2002) compared to the available budget for commitments to VC funds (EUR 190 million as at the end of 2002).

It also shows the evolution of the amounts signed by the EIF with VC funds (EUR 110.92 million as at the end of 2002).

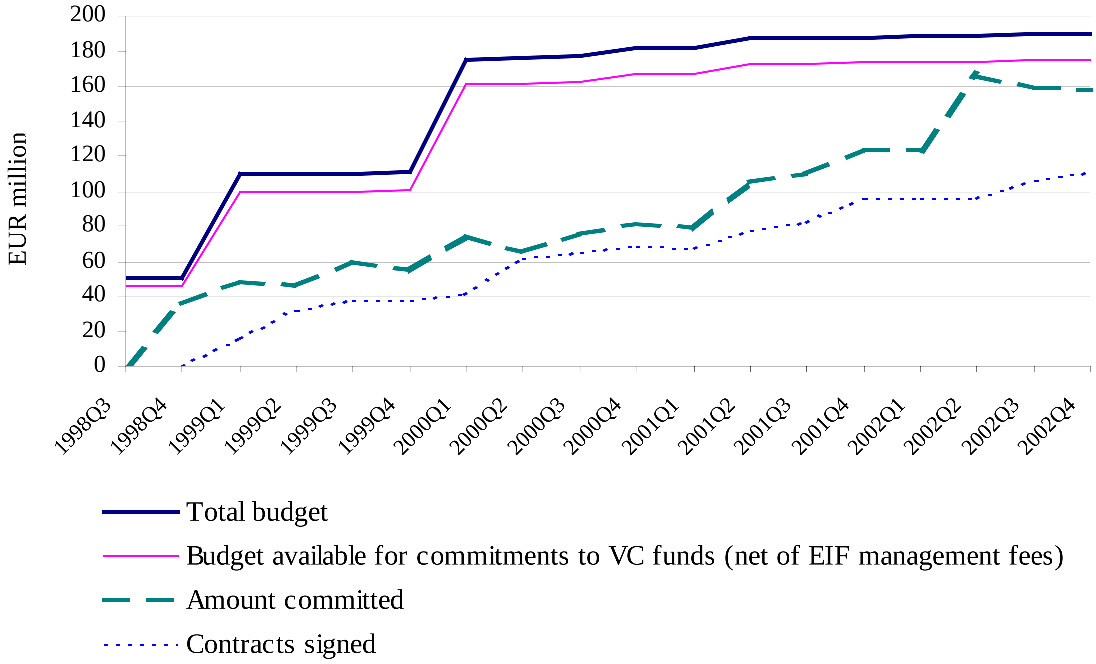

Figure 2.4. *Cumulative evolution of operations*

2.2.4. Disbursements

As at 31.12.02, the total disbursements to VC funds amounted to EUR 63 million, compared to EUR 50 million at the end of 2001 and to EUR 32 million at year end 2000. As a result of the increased pace of investments of VC funds into SMEs, the overall disbursement rate is now 57% of the amounts signed.

It is worth noting that the first ETF Start-up VC funds that signed a contract with the EIF in 1999 show an average disbursement rate of 89%. Those signed in 2000 have reached 59%. Considering the average investment period of VC funds, these disbursement rates can be considered satisfactory.

The following graph shows the progress of the disbursements by the EIF to the VC funds by 31.12.02 in comparison with the amounts of the contracts signed. The disbursements of the EIF are made in parallel with those of all the other investors in the VC funds, pro rata with their investment commitments. The disbursements are used by the VC funds for their investments in SMEs.

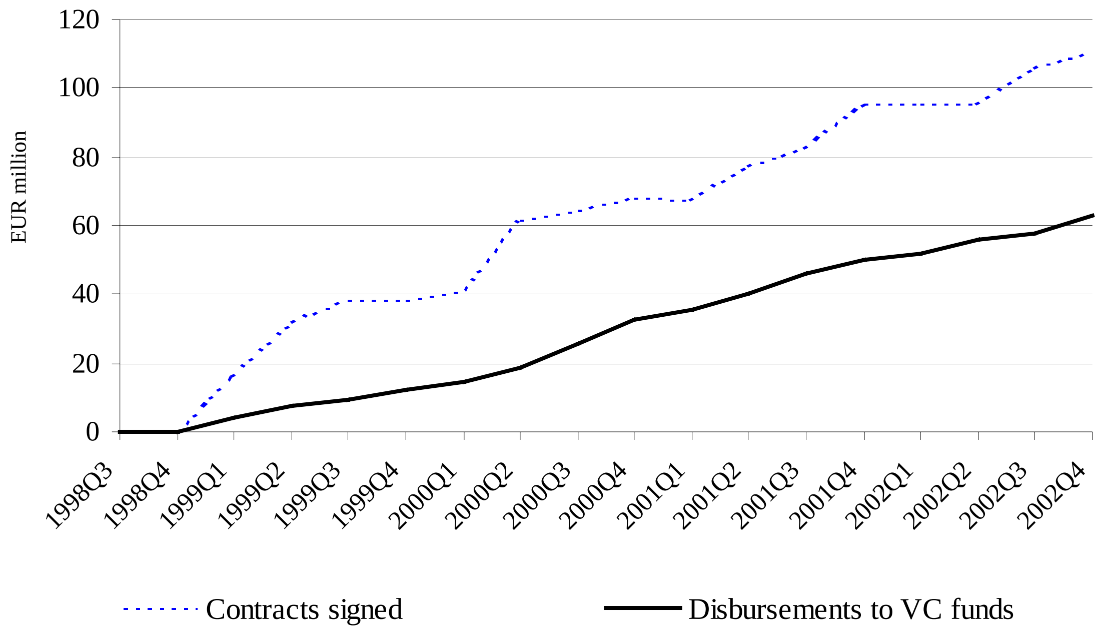

Figure 2.5. *Disbursements to the VC funds*

The graph below shows the investments made by the VC funds in beneficiary SMEs compared to the EIF disbursements to the VC funds. At the end of 2002, the ratio of the facility contribution to the investment of VC funds was 1:4. Taking into account that VC funds have raised a total amount of EUR 558.1 million, the following graph shows that these VC funds have about half of their capital still to be invested in new SMEs or to be used for follow-on investments in SMEs already in their portfolio.

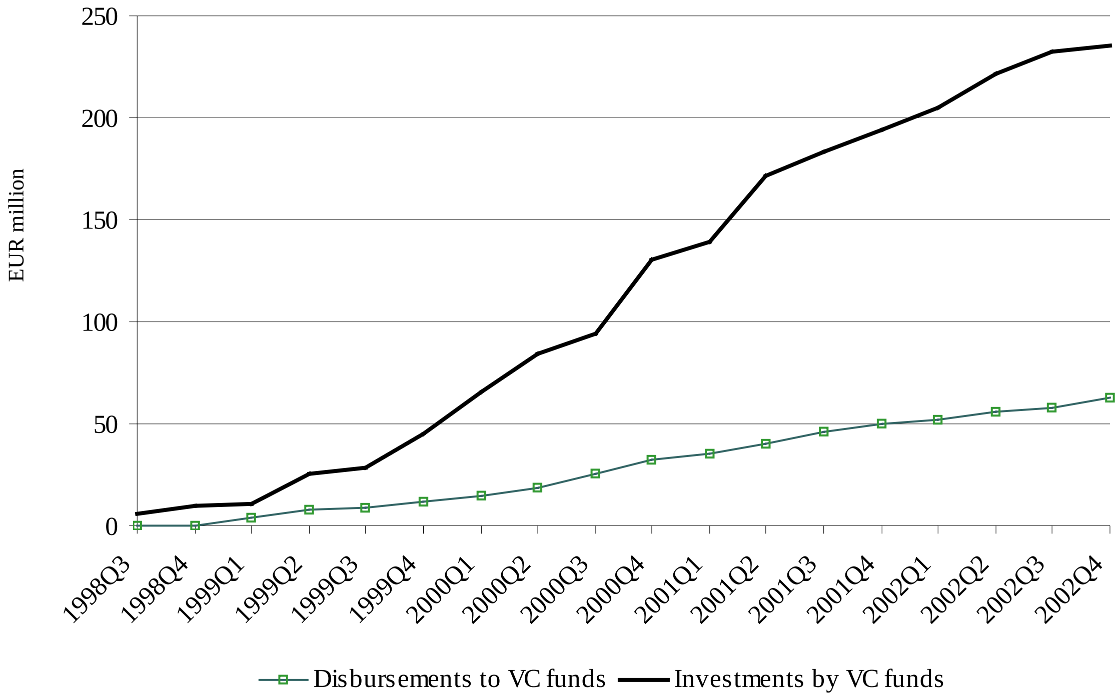

Figure 2.6. *Investments by the VC funds in beneficiary SMEs*

2.2.5. Repayments by the venture capital funds

Some ETF Start-up VC funds have commenced repaying the EIF, following the sale of their equity participation in successful SMEs. More information on the realised investments is given in point 2.4 below.

In the year 2002, a total amount of approximately EUR 446,000 was repaid by the VC funds to the trust account of the facility, resulting in a total amount repaid (including dividends) of EUR 16.1 million as at 31.12.02.

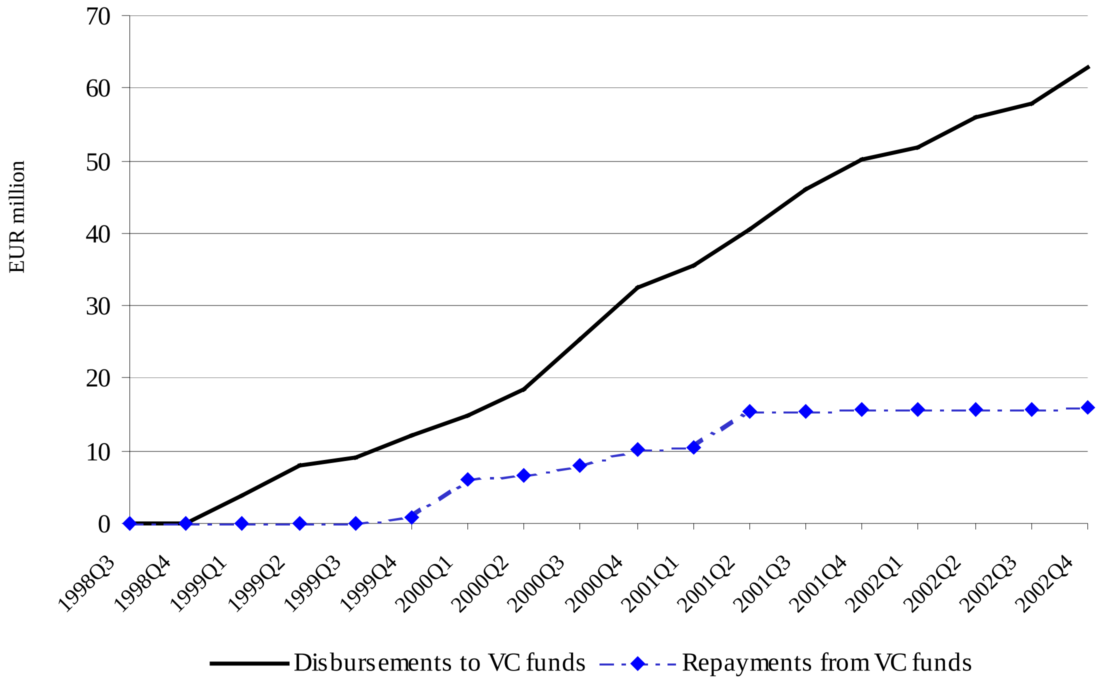

Figure 2.7. *Repayments by the VC funds*

As at 30.09.02 the portfolio was valued at EUR 36 million (see annex 9). The total amount invested (draw downs) was EUR 57.2 million and the capital repayments received amounted to EUR 11.2 million. A further amount of EUR 4.7 million of realised gains was received.

The result is EUR 5.4 million or 11.3% of unrealised losses, after having taken into account the realised gains (details and methodology are given in annex 9). These losses are due to the dramatic deterioration of the VC market in the last two years. It should be noted that the unrealised losses may increase further, given that the deterioration of the VC market continued into 2003. However, the size of any realised losses or gains cannot be known until all investments are exited. Proceeds from realised investments will be returned to the Community budget.

2.2.6. Accounts

The financial statements of the facility are enclosed in annex 8.

2.3. Financial Intermediaries

Most of the VC funds that have contractual agreements with the EIF have a national, or even regional focus, although some of them invest on a pan-European basis. They are mainly oriented towards early stage investments in high technology areas, such as information and communication technologies, Internet, healthcare and life sciences. This is in line with the investment policy of ETF Start-up.

A short description of the VC funds that have contractual agreements with the EIF can be found in annex 1.

2.4. Beneficiary SMEs

As at 30.09.02, the VC funds had invested in 206 SMEs[11]. The total amount invested is EUR 221.2 million, which corresponds to an average investment of EUR 1.1 million per company. This is in line with the statistics provided in the EVCA 2001 yearbook. According to this yearbook in 2000 the average investment in companies in their seed phase amounts to EUR 0.98 million, while the average investment in companies in their start-up phase amounts to EUR 1.52 million.

In line with common venture capital market practice, VC funds under ETF Start-up draw down the money during their investment period, according to their investment opportunities into SME beneficiaries. The timing of these draw-downs is determined by market circumstances and the funds' investment policy, which sometimes foresees setting aside reserves for follow-on investments in promising SME beneficiaries. Furthermore, in accordance with market practice, a small portion of disbursed amounts are used to remunerate the management companies of VC funds, and are therefore not invested in final beneficiaries.

As at 30.09.02, out of EUR 106 million signed at that date (EUR 111 million as at 31.12.02), the VC funds had invested EUR 47.1 million into final beneficiaries, i.e. some 40%. Considering that the existing investments into VC funds have been signed between 1999 and 2002, the disbursement schedule appears to be as expected.

The breakdown by country is as follows:

[11] According to the reporting requirements of the VC funds under ETF Start-up

***Table 2.2**. Breakdown by country of beneficiary SMEs*

Country	**Number of beneficiary SMEs**	**Amounts invested by VC funds (including amounts of other private and public investors)** (EUR million)	**Average investment** (EUR million)
Belgium	3	1.4	0.5
Denmark	15	7.9	0.5
Finland	15	7.7	0.5
France	103	101.7	1.0
Germany	36	43.9	1.2
Luxembourg	3	7.5	2.5
Netherlands	1	0.9	0.9
Sweden	10	19.8	2.0
United Kingdom	11	18.1	1.6
Non-EU (*)	9	12.2	1.4
Total	**206**	**221.2**	**1.1**

(*) US, Canada, Israel and Switzerland (see point 2.1)

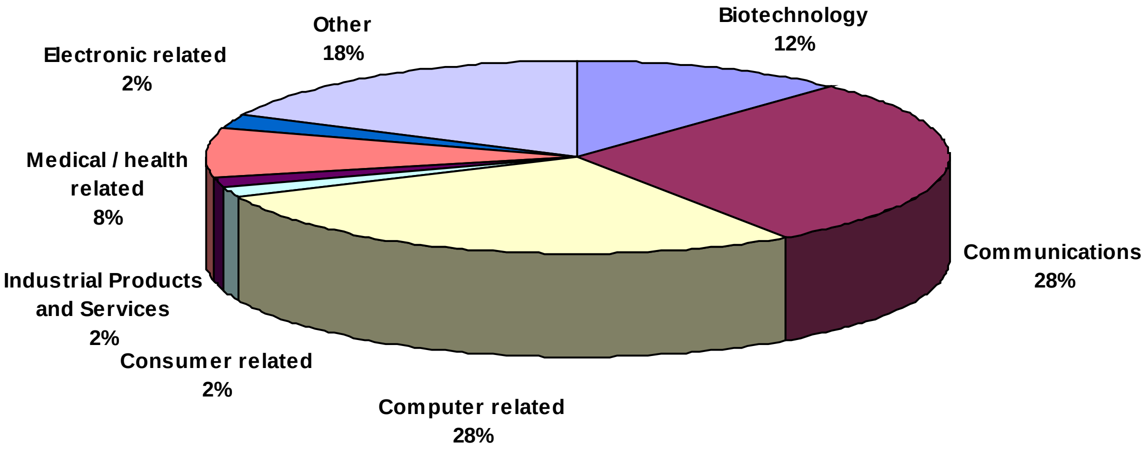

***Figure 2.8**. Investments by VC Funds into SMEs, according to sector*

Out of the 206 companies, 166 are still in the portfolios of the VC funds and 40 investments have been realised. Out of these, 21 have been sold and 19 have been written off. The table below gives details of these 40 investments:

Table 2.3. *Realised investments*

	Number of investee companies	**Cost** (EUR million)	**Final value** (EUR million)	**Gain/Loss** (EUR million)	**Gain/Loss** (%)
Written off	19	22.1	2.2	-19.9	-90%
Sold	21	24.2	88.8	64.6	267%
Total	**40**	**46.3**	**91**	**44.7**	**97%**
ETF Start-up share		**9.3**	**18.5**	**9.2**	**99%**

As far as realised investments are concerned, the final value of the investments represents on average twice the initial capital invested. This contrasts significantly with the situation of the active portfolio companies as explained in section 2.2.5.

The ETF Start-up share is paid back to the trust account of the facility after deduction of the management fees due to the VC funds.

2.5. Employment

Detailed information about employment is included in annex 2.

3. JOINT EUROPEAN VENTURE (JEV)

3.1 Description of the programme

The JEV programme aims to encourage transnational joint ventures between European SMEs in the European Economic Area[12], thereby helping them to benefit from the opportunities offered by the single market.

The contribution is intended to cover some of the expenses related to the setting up of a joint venture (Facility for preparatory work and investment). The amount (maximum EUR 100,000 per project) and the terms of this contribution are as follows:

- The first part of the contribution covers up to 50 % of the eligible expenses with a maximum ceiling of EUR 50,000. Eligible expenses are those related to the conception and setting up of a transnational joint venture created by European SMEs. These include the expenses of the market survey, the preparation of the legal framework and the business plan, the analysis of the environmental impact, and any other expenses that are essential for the setting up of the joint venture.

- The second part of the contribution covers up to 10 % of the total amount of the investment made.

Until autumn 2001, JEV also supported actions promoting the programme (Promotion Facility). The maximum amount of a contribution for the Promotion Facility was EUR 10,000 for promotional action material and EUR 20,000 for events intended to stimulate co-operation. It consisted of 50% of all eligible expenses in the form of a grant. Entities which were eligible to apply for a JEV Promotion Facility contribution were financial intermediaries, European, national or regional associations of SMEs, Chambers of Commerce, Euro-Info-Centres, the Business & Innovation Centres, and all other non-profit entities from European Union, such as trade and industry associations, public agencies and other entities, promoting investments eligible for the JEV Programme. The Commission suspended support for the Promotion Facility In autumn 2001 as the JEV Programme was undergoing a review and internal evaluation.

3.2 Budgetary situation

3.2.1. Overview

The budgetary allocations for the JEV programme totalled EUR 57 million, including EUR 5 million allocated in 1997 for the JEV pilot action.

3.2.2. Geographic distribution

For JEV, as the projects are by definition transnational, geographic distribution of budgetary allocations by Member States is not relevant. The geographic distribution is therefore presented in the context of the review of the projects under point 3.4. hereunder.

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[12] Decision of the EEA Joint Committee n°72/1999 of 15.06.99

3.2.3. *Commitments*

At the end of 2002, the Commission services had committed EUR 14.6 million of the available budgetary resources to final beneficiary SMEs on the basis of approved applications.

3.2.4. *Disbursements*

As at 31.12.02, the total disbursements to beneficiary SMEs amounted to EUR 2.0 million.

3.2.5. *Accounts*

The financial statements of the programme are enclosed in annex 8.

3.3 Financial Intermediaries

The JEV programme is implemented through a network of financial institutions. This network, constituted following a call for expressions of interest (Official Journal S 42 of 28 February 1998), comprised 71 financial intermediaries at 31.12.02 (unchanged from the year before). A complete list of these financial intermediaries is attached (annex 4).

The table below gives an overview of the financial intermediaries by country:

Table 3.1. *Breakdown of financial intermediaries by country*

Country	**Number of financial intermediaries**
Austria	7
Belgium	6
Denmark	2
Finland	1
France	7
Germany	10
Greece	2
Ireland	1
Italy	19
Luxembourg	3
Norway	1
Portugal	2
Spain	8
Sweden	1
UK	1
Total	**71**

An SME that wishes to submit an application under this scheme must contact one of the financial intermediaries in the network. This intermediary is entrusted with evaluating the application and passing it on to the Commission services. The latter will then verify the eligibility of the application and the possible impact on employment.

Out of the 71 financial intermediaries currently remaining in the network, about one third have never submitted an application for a joint venture project. Of the active financial intermediaries, one quarter accounted for more than three-quarters of the joint venture projects.

3.4 Review of the projects

From the start in 1998 until 31.12.02, after an in-depth assessment of potential projects by the financial intermediaries, 273 projects had been received by the Commission services, of which 200 had been approved. Of these, 54 were promotion projects and 146 were preparatory work and investment projects. The table below summarises the evolution of projects:

Table 3.2. *Project status*

(Cumulative figures)	**Projects**				
	31.12.98	**31.12.99**	**31.12.00**	**31.12.01**	**31.12.02**
Projects received					
Joint Venture Projects	23	79	127	173	203
Promotion Facility	-	25	59	70	70
Total	23	104	186	243	273
Projects approved					
Joint Venture Projects	11	53	83	121	146
Promotion Facility	-	12	46	54	54
Total	11	65	129	175	200
Projects rejected	2	5	17	21	30
Projects withdrawn	2	9	25	26	28
Projects under review at year-end	8	25	15	21	15

The first year of the JEV programme (1998) was used by the Commission services to build the network of financial intermediaries and to implement the scheme. By the second year of the programme, 104 projects had been received. In 2000 and in 2001 the number of new applications received remained at about the same level as the year before. This was lower than expected. In 2002 the number of new applications almost halved.

To date, almost one in five projects was refused by the Commission or withdrawn by the financial intermediary. Most refusals were due to non-compliance with the eligibility criteria or to insufficient impact as regards the setting-up of new economic activities involving investment and job creation. Most of the withdrawals were due to the level of administrative requirements related to the processing of the files and the resulting delays.

The table below shows the location of the planned joint ventures:

Table 3.3. *Breakdown by country of the planned joint ventures*

	Planned joint ventures			
	1998-2000	**2001**	**2002**	**Total**
Austria	1	1	3	5
Belgium	8	2	0	10
Denmark	6	2	1	9
Finland	1	0	0	1
France	11	2	0	13
Germany	7	6	6	19
Greece	1	2	2	5
Ireland	1	2	0	3
Italy	10	2	3	15
Luxembourg	1	1	0	2
Netherlands	4	4	1	9
Norway	0	1	1	2
Portugal	8	4	2	14
Spain	16	4	3	23
Sweden	3	2	1	6
United Kingdom	4	3	2	9
Undecided	1	0	0	1
Total	**83**	**38**	**25**	**146**

Nationalities of partners (lead and other) involved in projects are as follows:

Table 3.4. *Breakdown by country of joint ventures' partners*

	Partners			
	1998-2000	**2001**	**2002**	**Total**
Austria	4	2	3	9
Belgium	19	4	0	23
Denmark	12	11	3	26
Finland	3	2	0	5
France	27	3	5	35
Germany	17	12	12	41
Greece	1	2	2	5
Ireland	3	2	0	5
Italy	18	8	12	38
Luxembourg	1	1	0	2
Netherlands	13	7	4	24
Norway	0	3	2	5
Portugal	11	5	3	19
Spain	24	4	2	30
Sweden	6	4	2	12
United Kingdom	21	9	2	32
Other	3	0	0	3
TOTAL	**183**	**79**	**52**	**314**[13]

[13] A minority of projects includes more than two partners.

The number of planned joint ventures by sector of activity is as follows:

Table 3.5. *Sector of activity of planned joint ventures*

	Planned joint ventures			
	1998-2000	**2001**	**2002**	**Total**
Multimedia, software, audio-visual	2	5	1	8
Marketing and commercialisation	13	4	4	21
Manufacturing	14	9	6	29
Waste management	2	0	1	3
Biotechnology	2	1	0	3
Transports, logistics	8	1	1	10
Information technology	20	3	4	27
Energy	4	4	1	9
Construction	4	1	2	7
Industry	5	2	0	7
Telecommunications and data-processing	2	0	0	2
Other services	7	8	5	20
Total	**83**	**38**	**25**	**146**

The size of the SMEs involved in the approved joint venture projects (until 31 December 2002) is as follows:

Table 3.6. *Employment in lead and partner SMEs*

Number of employees	**Number of SMEs** (cumulative figures)			
	31.12.99	**31.12.00**	**31.12.01**	**31.12.02**
< 10	48	97	137	166
10-49	46	56	85	109
50-249	21	28	36	39
Total	**115**	**181**	**258**	**314**

Out of the 314 partner SMEs, 53 % had fewer than 10 employees, while 35 % had between 10 and 49 employees.

3.5 Employment

With only 31 joint ventures created and reported so far (according to the 88 questionnaires returned by SMEs for the evaluation of the Growth and Employment Initiative), the effect on employment has been disappointing. Although first indications seemed positive, by the end of 2002 only 10 applications had been received requesting the investment grant to be awarded on the basis of investments realised in the newly created joint ventures.

The questionnaires returned by SMEs indicate that 31 joint ventures have in fact been created, leading to 252 new jobs. The SMEs anticipate that employment in these joint ventures will increase to 787 in 5 years' time. However, in many of the grant request cases, the actual job creation was significantly less than foreseen in the initial applications forms, so these forecasts may well be rather optimistic. On the other hand, the job creation figures given in the grant application only reflect the current situation - creation of, and investment in a joint venture is often a long process and it may be that further jobs will be created as the business progresses.

The great majority of the joint ventures created and reported so far have opted not to apply for the investment grant. General opinion is that the procedures are too lengthy and complicated. Another reason for not applying for the investment grant is that the joint ventures have invested only limited amounts in fixed assets and therefore, the 10% support has not been considered as incentive enough to justify the administrative effort. It can reasonably be assumed that jobs have been created also in the joint ventures that have decided not to apply for an investment grant, but in view of the actual job creation figures available for the four grants submitted, the numbers are probably rather limited. The actual number of jobs created will only be confirmed when the first reports are received from the joint ventures under their 5-year reporting obligation.

3.6 Take-up of JEV

Demand for JEV from the market has been much lower than originally expected. The programme was originally conceived, partly in response to requests from SME representative organisations, to complement the (then) existing ECIP (European Community Investment Partners) and JOP (Joint Venture Programme – Phare/Tacis) joint venture programmes, which covered the ALAMEDSA and CEEC/NIS countries respectively. ECIP was closed at the end of 1999 and JOP during 2000. One effect of this was that some financial intermediaries who had offered ECIP, JOP and JEV to their SME clients scaled down or ceased their activities, since JEV alone did not provide them with a sufficient volume of projects to justify dedicated staff. The remuneration paid to financial intermediaries for submitting files was regarded by many as insufficient in view of the administrative obligations that the financial intermediaries have assumed when concluding the Framework Agreement with the Commission.

Although the logic behind the JEV programme was considered sound, time has shown that there was in fact relatively little demand from SMEs for support for the creation of transnational joint ventures in the EU. In reality, SMEs investing in other Member States often preferred to create subsidiaries rather than joint ventures, or to enter into looser cooperation agreements without the obligation to create a new legal entity.

Take-up of the programme may also have been affected by the need to impose thorough controls on the processing of applications in order to ensure sound financial management and reduce the risk of irregularities to the minimum. As a result, file-processing times have been longer than expected and the programme has appeared to suffer from bureaucratic inertia. On the other hand, however, there has been no confirmed case of fraud either.

4. SME GUARANTEE FACILITY

4.1. Description of the Facility

The objective of the SME Guarantee Facility is to stimulate job-creation by facilitating the investment activities of SMEs within the European Union, through increased availability of loan finance. This is achieved by increasing the capacity of guarantee schemes operating in the Member States and relates to both new and existing portfolios. This Facility provides higher volumes of guarantees for the existing guarantee products of the financial intermediaries (FIs), access to financing for a larger number of small companies for a wider variety of investments and guarantees for riskier loans. The Facility covers part of the losses incurred under the guarantees up to a pre-determined amount. The Facility is operated by the European Investment Fund (EIF) on a trust basis. The EIF manages the contacts with financial institutions interested in joining the Facility, evaluates and submits the selected proposals to the Commission services for eligibility approval. Appropriate co-operation with Member States is ensured by contacts between the EIF and the relevant national authorities.

The SME Guarantee Facility applies mainly to companies with fewer than 100 employees. The financial intermediaries may have stricter SME eligibility criteria depending on their specific guarantee or loan products. In any case, the approval process, with regard to the final SME beneficiaries, is the full responsibility of the selected financial intermediaries.

4.2. Budgetary situation

4.2.1. Overview

As at 31.12.02, the budgetary appropriations for the SME Guarantee Facility amounted to EUR 198.56 million. In addition, according to the Council Decision 98/347/EC, Annex III, point 7, interest earned on the trust account shall be added to the resources of the Facility. This total budget shall then cover the full cost of the Facility, including guarantee losses and any other eligible costs or expenses under the Facility. The table below shows the breakdown of budget, relevant income and expenditure:

Table 4.1. *Budgetary data as of 31.12.02*

		(EUR million)
Resources		
Budget appropriations		198.56
Interest & other income		8.98
Total		**207.54**
Utilisation		
EIF commitments to FIs (basis: EC approvals)		188.87
Maximum EIF fees[14] and other eligible expenses		18.37
Amount to be returned to the EC budget		0.30
Total		**207.54**

4.2.2. Geographic distribution

The final date for commitments under the Facility was 28.05.02. At the end of 2002 of the EUR 188.87 million approved by the EC, EIF had signed guarantee commitments amounting to EUR 186.95 million. The geographic distribution of guarantee commitments approved by the Commission of EUR 188.87 million is shown below:

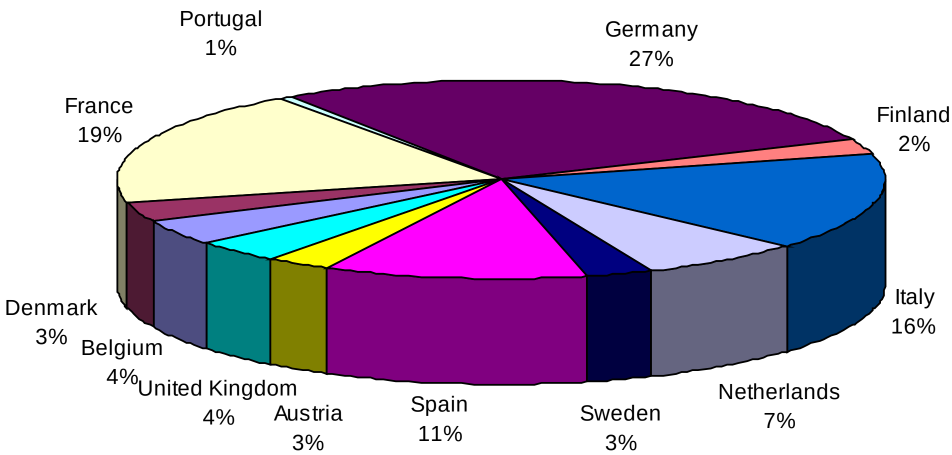

Figure 4.1. *Breakdown by country of the guarantee commitments to financial intermediaries at the end of 2002*

[14] Maximum EIF fees for the full facility period, i.e. until 28 May 2012

4.2.3. *Commitments*

Quarterly EIF commitments to financial intermediaries are shown in the graph below:

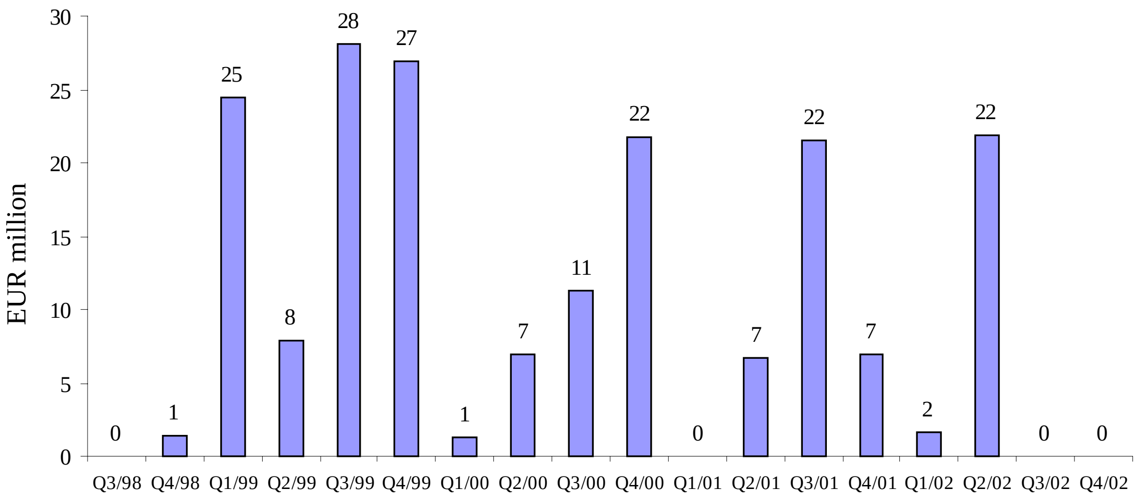

Figure 4.2. *Quarterly EIF commitments to financial intermediaries*

The graph shows the evolution of the EIF guarantee commitments (EUR 188.87 million at 31.12.02) compared to the total available budget (EUR 207.54 million minus EUR 18.37 million for EIF fees[15] and other eligible expenses, at 31.12.02). The graph also indicates the actual utilisation of the budgetary resources by the financial intermediaries. At 31.12.02, average utilisation reached 82.45 %. It should be noted that for certain financial intermediaries the availability period does not end until 31.12.03 and it is expected that this will result in an increased utilisation.

15 Maximum EIF fees for the full facility period, i.e. until 28 May 2012

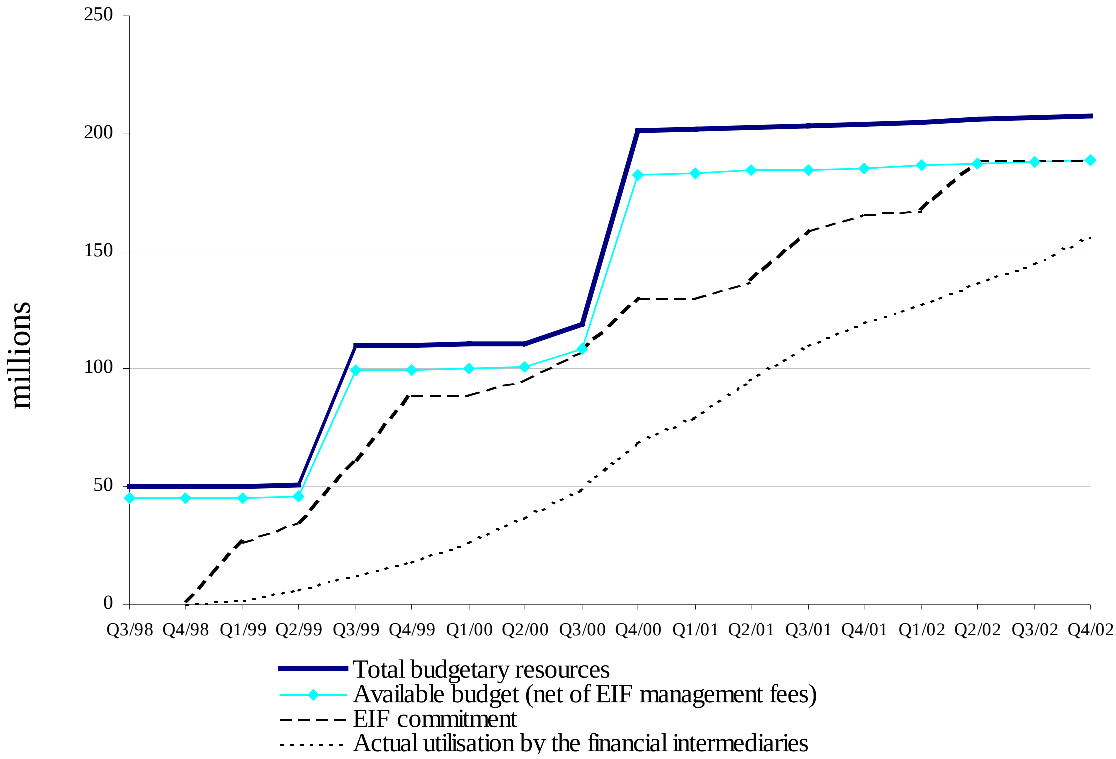

Figure 4.3. *Cumulative evolution of operations*

Guarantee schemes in general have a high leverage effect. As at 31.12.02, the aggregate amount of SME loans guaranteed under the Facility totalled EUR 9.02 billion. At the same time, the utilisation of the budgetary resources by the financial intermediaries amounted to EUR 155.7 million, achieving a leverage effect of 58.

The following graph shows the development of the loans to SMEs and the corresponding amounts that the beneficiary SMEs have declared to have invested so far:

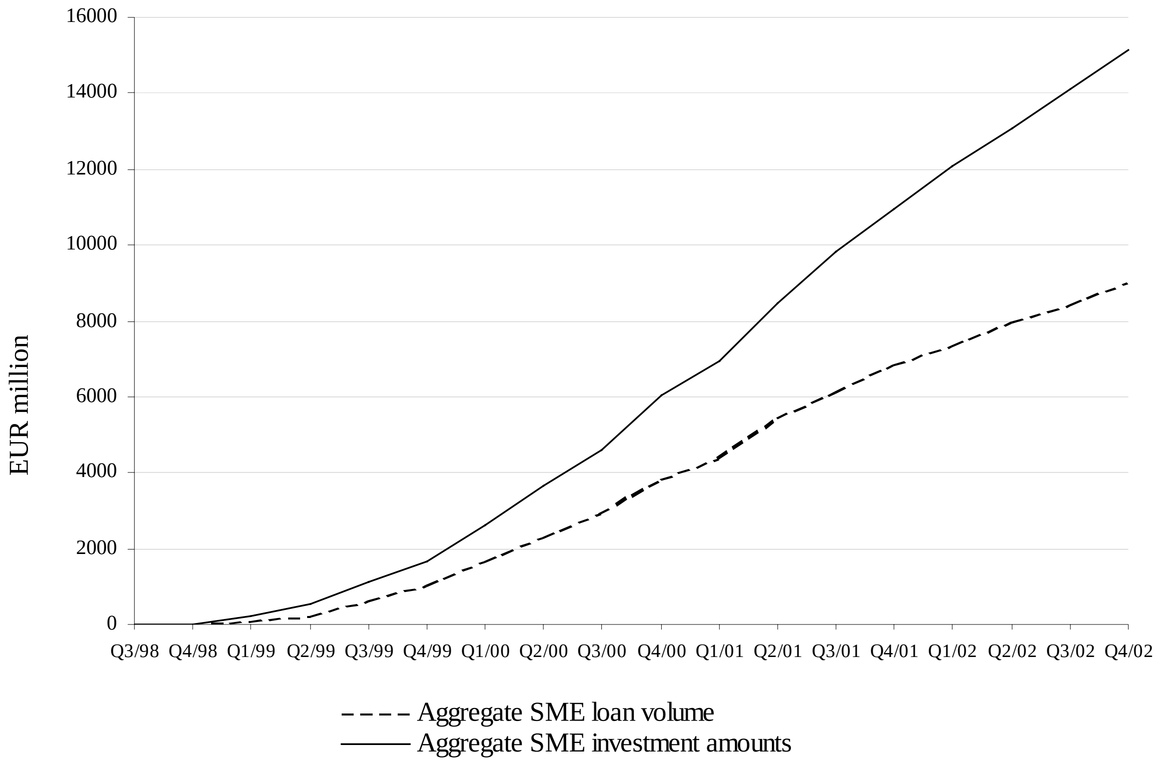

Figure 4.4. *Loans granted to SMEs and corresponding investments*

The EIF has not signed any contracts with new intermediaries in 2002, but amended 9 already existing contracts.

4.2.4. Loss payments

Amount of the EIF's portion in regard to the defaulted loans totals EUR 18.4 million for the year 2002 (EUR 7.2 million in 2001 and EUR 0.4 million in 2000). This represents 9.7 % of the EIF commitment of EUR 188.87 million

A detailed analysis of defaulted loans as of 30.09.02 is provided in Annex 7 following the request in the final report (A5-0304/2002) submitted in September 2002 by Mr Bushill-Matthews, rapporteur of the European Parliament's "Committee on Employment and Social Affairs".

4.2.5. Accounts

The financial statements of the Facility are enclosed in annex 8.

4.3. Financial Intermediaries

4.3.1. Overview

The EIF has signed contracts with 23 financial intermediaries in 12 of the 15 member countries. Although substantial efforts were made by the EIF, no interest was shown from potential intermediaries in Greece, Luxembourg and Ireland.

The commitment period of Community funds under the Growth and Employment budget under the Facility came to an end on 28.05.02 and the amount available has been fully committed to financial intermediaries.

As from 29.05.02, all the future commitments have to be made under the Multiannual Programme for Enterprise and Entrepreneurship (2001-2005), MAP. An amended Fiduciary and Management Agreement between the Commission and the EIF was signed in December 2001. Under this agreement, the coverage of the Facility is extended to other products and countries. Under the MAP, 10 new contracts have been signed so far. The implementation of this facility is the subject of a separate report.

The average utilisation of the financial intermediaries under the Growth and Employment Initiative is 82.45%.

The following graph shows the utilisation[16] of the EIF commitments by country as of 31.12.02.

The graph also takes into account the subsequent amendments to the contracts. The following country description gives more detailed information. Furthermore a detailed description of the different financial intermediaries and their financing products that are guaranteed under the SME Guarantee Facility is to be found in annex 5.

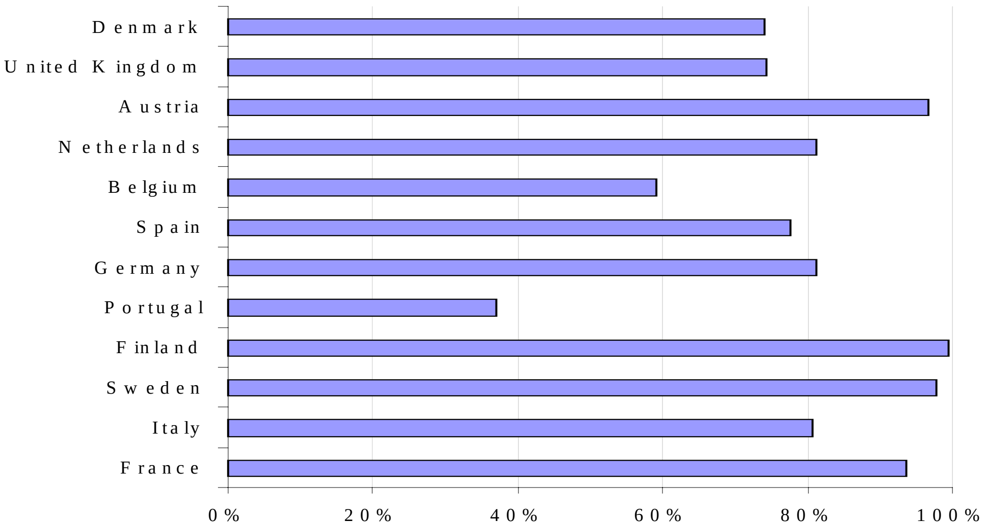

Figure 4.5. *Utilisation by financial intermediaries*

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16 The utilisation is calculated as the ratio between aggregate amount of the guarantees included in the relevant SME Guarantee Facility portfolio of each intermediary and the maximum guarantee portfolio volume contractually agreed for the intermediary.

4.3.2. Countries

Austria

Bürges offers two guarantee products covered under the facility:

“Jungunternehmer-Förderungsaktion” supporting start-ups and ownership transfer ;

“Unternehmensdynamik” supporting innovative SMEs.

Due to the high demand by SMEs, EIF’s contract with Bürges was extended in 2000 and 2001 with subsequent increases of the portfolio volumes and extensions of the availability period until 31.12.02. At the end of the fourth quarter 2002 the actual utilisation rate was 96.6%, and the volumes available under the “Unternehmensdynamik” programme had been fully used.

Belgium

The Facility supports two loan programmes offered by Fonds de Participation (FdP) to start-ups. The utilisation of the FdP programmes has been rapidly growing under the facility. Therefore, the contract was amended in June 2002, the volumes were increased and the availability period extended until 31.12.03. Utilisation reached 58.8% during the fourth quarter 2002.

Denmark

The Growth Fund (Vaekstfonden) offers two different loan guarantee programmes, specifically designed for the Facility: the first is targeted at innovative SMEs with growth potential and designed to support job creation and the second supports potential employees with reduced productivity, i.e. people with some kind of social or physical handicap.

By December 2002 utilisation reached 70.7% The availability period for the intermediary ended 31.12.02. The EIF has signed a new agreement under the MAP Loan Guarantee Window in order to ensure on-going support to SMEs in Denmark.

Finland

Finnvera has made a strong marketing effort resulting in a significant increase in the demand for the facility in 2002. As a result the current utilisation of the Facility reached 99.6%, after the fourth quarter this year. A contract under the MAP Loan Guarantee Window was signed in October 2002 ensuring the continuous support of SMEs.

France

SIAGI offers guarantees to micro enterprises typically artisans and retailers. The utilisation under the Facility is below expectations, 5.9 % as at the end of the availability period on 31.12.02. The low utilisation rate is mainly due to the difficulties that SIAGI had in the promotion of its guarantee activity among the major French banking groups. As for SOFARIS the utilisation rate had reached 100% at the end of 2002.

Germany

As a result of the continued high demand for its “Startgeld” product that supports the establishment of micro enterprises the contract with DtA was amended in May 2002, the volume of the portfolio was increased and the availability period was extended until the 31.12.03. The utilisation rate at the end of 2002 stood at 82.1 %.

The utilisation for the “KfW-Mittelstandsprogramm – Beschäftigung und Qualifizierung” reached 70.8 % at the end of 2002. The availability period for the intermediary ended 31.12.02. KfW decided not to continue the programme beyond that date.

Please note that these two intermediaries merged in 2003.

Italy

The EIF has signed contracts with 10 Intermediaries: 9 operating at a regional level and one at a national level. During the first two quarters of 2002 the EIF has amended 4 operations with existing Italian intermediaries. The performance of the intermediaries under the Facility is in line with expectations with very good results in terms of utilisation, which reached 80.8 % at the end of 2002.

Netherlands

BBMKB’s contract was amended in June 2002 because of the continued success of the facility in the Netherlands. The volume of the portfolio was increased and the availability period was extended until 31.12.03. As at 31.12.02 the utilisation reached already 81.1%.

Portugal

SPGM planned to set up and manage a national guarantee fund to support the mutual guarantee system in the country. However, due to a delay in the change of the national legislation, the process of setting up the mutual guarantee societies was put on hold for more than 1 year. Therefore, the contract has been extended by one year, without changing volumes. As at 31.12.02 utilisation was 37 %.

Spain

CERSA offers counter guarantees to regional mutual guarantee funds and to loans granted by the Ministry of Science and Technology. In June 2002, CERSA’s contract was amended for the second time, because of the high utilisation and the high demand by the SMEs. The availability period was extended until 31.12.03 and the volume of the portfolio was increased. Utilisation reached 77.6 % at the end of 2002.

Sweden

ALMI is a development agency and provides loans to SMEs with growth and job creation potential. It provides financing to SMEs that are excluded from financing by commercial banks due to the high risk involved. In order to reflect the change in market demand the portfolio volumes for ALMI were revised in May 2002 and the availability period was extended until 31.12.02. The utilisation rate reached 97.8% at the end of 2002. In order to meet the high demand and ensure on-going support, a contract under the MAP Loan Window was signed on 21.11.02.

United Kingdom

The Prince's Trust supports disadvantaged young people who want to set up small enterprises but are unable to have access to bank finance.

No other organisation in the UK offers nation-wide micro lending programmes including mentoring services to support young people in the age between 18 and 30.

As of December 2002, utilisation reached approximately 74.1%. The Prince's Trust did not achieve full utilisation by the year end mainly due to an increasingly difficult environment to find suitable young entrepreneurs.

4.4. Beneficiary SMEs

At the end of 2002 the number of SMEs benefiting from the Facility was 125,164, compared with 112,581 at 30.06.02 and 92,408 at 31.12.01 The following table shows the breakdown by country and the corresponding average loan amounts according to the latest available data.

Table 4.2. *Breakdown by country of beneficiary SMEs*

Country	**Number of beneficiary SMEs**	**Average loan amount** (EUR 000)
Austria	3,827	108
Belgium	918	42
Denmark	683	162
Finland	1,768	227
France	30,592	53
Germany	18,465	33
Italy	35,592	61
Netherlands	3,563	160
Portugal *)	45	612
Spain	7,498	113
Sweden	4,355	42
UK	5,275	4
Total	**112,581**	**62**

*) SPGM is in the process of establishing a mutual guarantee system in Portugal. As the mutual guarantee funds are not yet operational, SPGM has issued guarantees under its normal activities to SMEs. The high average loan amount is explained by the fact that this intermediary guarantees up to EUR 1.25 million per SME loan and that about 40% of the client companies were medium-sized requiring larger loans.

Final beneficiaries with up to 10 employees made up 93% of the total number of SMEs. It is interesting to compare the distribution of SMEs by size under the Facility with that of the EU in general. According to the 2002 Observatory of European SMEs, 93% of SMEs are micro-enterprises (0-9 employees), 6% are small enterprises (10-49) and less than 1% are medium-sized enterprises (50-249). This clearly demonstrates that the SME Guarantee Facility is firmly focused on the target population of the European Union “Charter for small enterprises”.

The following table shows the classification by country of the SMEs in terms of the number of employees at the date of the loan agreement**:**

Table 4.3. *Beneficiary SMEs per size class as at 30.06.02*

Country	**Number of SMEs per size class**					**Total**
	0-5	**6-10**	**11-20**	**21-50**	**51-100**	
Austria	3,229	289	182	102	25	3,827
Belgium	917	1	0	0	0	918
Denmark	651	16	8	8	0	683
Germany	17,732	493	149	68	23	18,465
France	27,800	2,791	1	0	0	30,592
Finland	1,066	274	190	171	67	1,768
Italy	28,710	3,242	2,148	1,153	339	35,592
Netherlands	1,921	615	537	391	99	3,563
Portugal	7	3	4	14	17	45
Spain	4,829	1,080	832	591	166	7,498
Sweden	3,430	443	271	175	36	4,355
UK	5,273	2	0	0	0	5,275
Total	95,565	9,249	4,322	2,673	772	112,581
	85%	8%	4%	2%	1%	100%

The above table shows that the SME Guarantee Facility mainly helps the financing of start-ups and the development of young enterprises. 93% of the SMEs that have benefited from the SME Guarantee Facility are smaller companies that have up to 10 employees. When the number of employees is not reported the existence of only one employee is assumed.

Table 4.4. *Breakdown of beneficiary SMEs by year of establishment as at 30.06.02*

Country	Year of establishment							
	2002	2001	2000	1999	1998	< 1998	Not available	Total
Austria	131	471	847	992	505	862	19	3,827
Belgium	84	512	316	0	1	1	4	918
Denmark	44	187	234	60	21	128	9	683
Germany	1,314	5,721	7,217	3,914	36	211	52	18,465
France *)	2	93	934	1,015	634	3,450	24,464	30,592
Finland	130	303	208	118	93	913	3	1,768
Italy	903	3,837	4,489	2,622	1,723	21,850	168	35,592
Netherlands	297	691	704	661	184	1,025	1	3,563
Portugal	0	1	1	5	4	34	0	45
Spain	269	831	1,045	681	538	4,134	0	7,498
Sweden	430	902	1,138	560	169	1,155	1	4,355
UK	1,890	3,385	0	0	0	0	0	5,275
Total	5,494	16,934	17,133	10,628	3,908	33,763	24,721	112,581
	5%	15%	15%	9%	3%	30%	22%	100%

*) This data mainly concerns Sofaris. Approximately 52% of Sofaris' guarantee portfolio relates to its start-up programme. Therefore, out of the 24,721 SMEs for which data on the year of establishment is not available, some are start-ups.

Purpose of financing

The table below shows the main finance purpose of the SME loans guaranteed under the Facility:

Table 4.5. *Purpose of financing as at 30.06.02 expressed as a percentage*

Purpose of financing	**Country**										
	A	**B**	**DK**	**D**	**F**	**FIN**	**I**	**NL**	**P**	**E**	**S**	**Average**
Tangible assets	83.7	100	35.6	63.7	38.7	47.3	87.9	64.7	64.9	91.5	61.5	68.0
Intangible assets	6.9	0	22.0	0.3	51.7	13.1	4.3	16.4	4.6	2.9	18.0	12.0
Working capital	9.4	0	42.4	36.0	9.5	39.5	7.8	18.9	30.6	5.6	20.5	20.0

This table is based on a sample of 80,678 cases for which complete investment breakdown has been provided.

Sector coverage

The following graph shows the main sectors of the beneficiary SMEs:

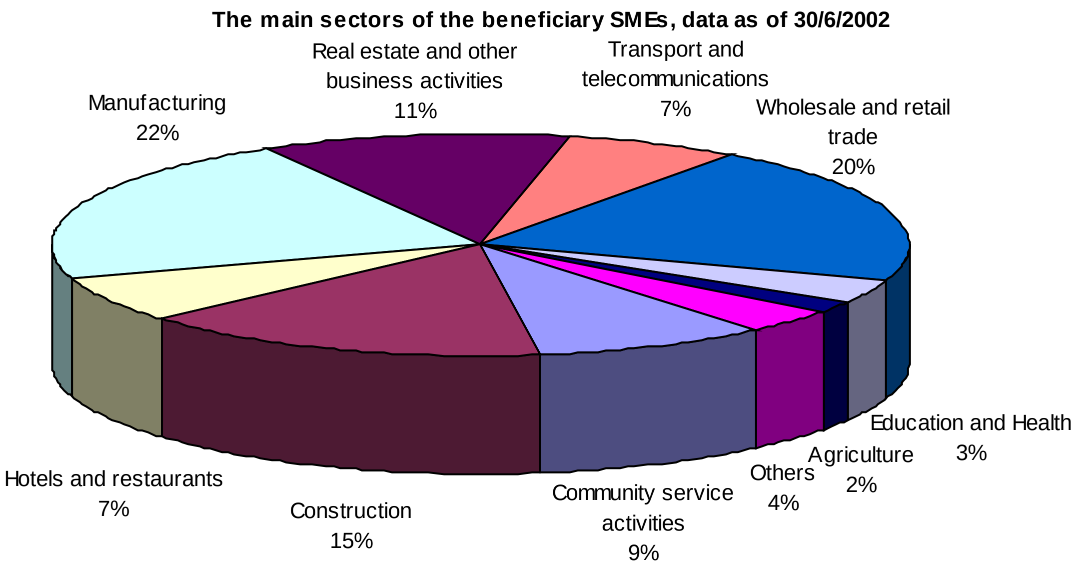

Figure 4.6. *The main sectors of the beneficiary SMEs, data as of 30.06.2002*

4.5. Employment

The 112,581 SMEs benefiting from the SME Guarantee Facility have declared that they have 464,839 employees as at 30.06.02. They have also indicated that they expect an increase of 59,477 employees within one year and a further increase of 38,961. Hence it is estimated that the SMEs that have benefited from the Facility will create a total of around 98,438 new jobs within two years. This is substantial, if one takes into account that approximately 85% of the beneficiary SMEs are very small companies with up to 5 employees.

Detailed information on job creation is contained in Annex 6 of this report.

5. CONCLUSIONS

5.1. Growth and Employment Initiative

2002 was a difficult year for the European venture capital industry as demonstrated by the sharp decline of 49.2 % in fundraising, with EUR 19.4 billion raised, compared with EUR 38.2 billion in 2001[17]. In this context, the progress made during the year under review in the implementation of the ETF Start up facility is satisfactory and shows that the facility worked in a complementary way to fill the gap created by the relative absence of private funding.

It should be noted that the worsening economic climate may have a significant impact on the expected returns of venture capital funds.

In 2002, the SME Guarantee Facility showed its strength in supporting SMEs. Against a worsening and unstable economic climate, participating banks and other guarantee institutions relied on it to provide them with an extra cushion of assurance to continue financing SMEs and thus to maintain job creation opportunities that might otherwise suffer from lack of finance. Compared with 2001, guarantee commitments by the EIF to participating financial intermediaries increased by 14.2%.

As far as JEV was concerned, the take-up by the market was far below expectations. The employment creation impact was minimal and the cost-effectiveness was very low, as already reported last year. An evaluation of the various financial instruments has been carried out by the Commission services. The Commission will present this evaluation in a separate document that will include a proposal on the future of JEV.

5.2. Multiannual programme for enterprise and entrepreneurship (MAP)

On 20 December 2000, the Council decided[18] to extend the financial instruments of the Growth and Employment Initiative under a new legal basis, the multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (2001-2005) (MAP). The MAP proposes modifications and extensions of the ETF Start-up Facility and the SME Guarantee Facility and introduces a new action, the Seed Capital Action. All three actions are managed by the EIF and aim to address recognised market failures in order to improve SMEs' access to finance.

The Commission proposal on the implementation of these measures received a positive opinion on 4 October 2001 from the Enterprise Programme Management Committee, as required under Article 3 of the above-mentioned Council decision.

On 10 December 2001, the Commission adopted its Decision C(2001) 3973 on the implementation of the financial instruments of MAP. Following this, on 18 December 2001 the EC signed with the EIF the fiduciary and management agreements for the ETF Start-up Facility, SME Guarantee Facility and Seed Capital Action.

Within the MAP, the ETF Start-up Facility has been adapted to support the establishment and financing of SMEs in their start-up phase, by investing in specialised VC funds and incubators.

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17 EVCA data
18 Decision 2000/819/EC

Three new sub-windows have been added to the SME Guarantee Facility in order to expand the range of available guarantee instruments:

- micro-credits;
- equity investments;
- loans to cover IT equipment, software and training in the area of internet and e-commerce.

The Seed Capital Action is intended to support seed funds, incubators or similar in which the EIF participates. The support is aimed at the long-term recruitment of additional investment managers to reinforce the capacity of the venture capital industry to cater for investments in seed capital.

In May 2002, the first commitments were made for the MAP budget, ensuring a smooth transition from Growth and Employment. Formalities to allow the candidate countries to participate in the financial instruments were largely completed in 2002. The formal implementation notice for candidate countries was published on 25.02.03. Performance information on the SME Guarantee Facility, the ETF Start-up Facility and JEV will be provided in the context of the MAP.