# THE ROLE OF EU FUNDS IN ENCOURAGING ENTREPRENEURSHIP

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## Sažetak

Ovisno o zemlji članici EU, sektor malih i srednjih poduzeća (SME) čini i do 99% ukupnog broja poduzeća. Kao takva SME poduzeća znatno doprinose gospodarskom rastu pa većina zemalja podupire razvitak poduzetništva putem agencija za malo gospodarstvo, nacionalnih razvojnih banaka ili izravnim potporama određenim skupinama poduzetnika.
Manje razvijene zemlje članice EU mogu se osloniti i na potporu iz EU fondova iako se uobičajeno smatra da su sredstva EU fondova prvenstveno namijenjena javnom i neprofitnom sektoru. Osim tehničke pomoći i poticaja informacijskoj poduzetničkoj mreži ili određenim skupinama poduzetnika, ostatak sredstava iz EU fondova pretežito završava u rukama središnje ili lokalne države.
Jedan od ciljeva akcijskog plana razvoja poduzetništva 2020 je omogućiti SME sektoru bolji pristup financijskim sredstvima, pa je cilj ovoga rada istražiti na koji je način to moguće postići. Temeljno istraživačko pitanje je mogu li EU fondovi doprinijeti financiranju malih i srednjih poduzeća i pod kojim uvjetima. U radu se također daje osvrt na proceduru koju SME sektor mora poštivati prilikom apliciranja za sredstva EU fondova radi implementacije odabranih projekata.

Ključne riječi: sektor malih i srednjih poduzeća, EU fondovi, podrška razvoju poduzetništva

## Abstract

Depending on the EU country in question, SMEs constitute up to 99% of all enterprises. SMEs contribute substantially to overall economic growth and that is why most countries support development of certain target business groups such as women entrepreneurs' or start-ups through small business agencies, national development banks or even direct subsidies.
Less developed EU member states can benefit from the EU funding support, although the EU funds' support is primarily regarded as reserved for non-profit making beneficiaries. Except for technical assistance, encouraging entrepreneurship networksand certain social groups of entrepreneurs, most EU funds' support is targeted to the central and/or local state-owned or managed institutions.
One of the goals of Entrepreneurship 2020 Action Plan is to enable Europe-wide SMEs better access to finance. The aim of this paper is to investigate how it could be achieved by means of the EU funds. Main research question of this paper is whether EU funds can bridge the funding gap that Croatian SMEs are faced with and under what conditions. This paper also addresses the procedure that SMEs need to follow when applying for the EU funds.


Key words: SMEs, EU funds, entrepreneurship support

# Introduction

The literature on EU funds absorption is rather limited to certain member countries and periods (MarkovičHribernik et al., 2008;Tatar, 2010; Hunya, 2011; Zaman and Cristea, 2011; Goleyewska, 2013). The funding opportunities from the EU funds are commonly divided into targeted programmes of funding such as research, education, innovation, environment, that are set under the broadly defined and commonly agreed objectives. Three broad objectives are defined in the period 2007-2013: Convergence, Regional competitiveness and employment and European territorial cooperation. These objectives are funded from EU taxpayers' money, i.e. the Structural funds that encompass European Regional Development Fund (ERDF) and European Social Fund (ESF), as well as from the Cohesion Fund that is directed to the regions with GDP per capita less than 90% of the EU average. Like it is shown in table 1, The ERDF is used for funding all three objectives, the ESF for funding Convergence and Regional competitiveness and employment objective, while the Cohesion Fund supports only Convergence objective goals.These three funds represent about 35% of the total EU budget (EBRD, EC and IMF, 2011). Most of dedicated funds are directed to less developed EU regions, while almost one fifth of the common budget is used to make well-developed regions even better off and for promoting cross-regional or cross-border cooperation.

| Objective | EU funds' coverage | Goal | No of regions con-cerned | Number of the affected EU citizens | Total allocated budget per objective |
|---|---|---|---|---|---|
| Convergence | ERDF, ESF, Cohesion fund | Reduction of regional disparitiesof the regions whose per capita gross domestic product (GDP) is less than 75% of the EU average by helping them to catch up with the well-devel-oped regions. | 99 | 170 million | 283.6 billion euro (81.3% of the total budget) |
| Regional com-petitiveness and employment | ERDF, ESF | Help create jobs by promoting com-petitiveness and making the well-developed regions even more at-tractive to businesses and investors. This objective covers all regions in Europe notcovered by the conver-gence objective. | 172 | 330 million | 55.3 billion euro (16% of the total budget) |
| European ter-ritorial coopera-tion | ERDF | Encourage cross-border and/or cross-regional cooperation | All | 500 million | 7.9 billion euro (2.5% of the total budget) |
| All objectives | - | - | - | - | 346.7 billion euro (100% of the budget) |

Table 1. EU policy objectives from 2007-2013

Source: Adopted from Regional Policy - Inforegio portal (http://ec.europa.eu/regional_policy/how/policy/index_en.cfm, retrieved: July 2013)

The budget of the structural funds and the rules for its use are decided at the central EU-level, while the priorities of cohesion policy are subject of consultation between the European Commi-ssion and the EU countries. Up to 80% of the EU budget is managed by the member states that cooperate with the European Commission with regard to achieving targeted objectives of the EU funds' spending, while other thematic programmes are managed centrally. EU funds account for 1,7 to 3,5% of the annual GDP of the CEE countries (KPMG, 2011). Each country produces its na-tional strategic reference framework that must be sent to the European Commission within five months following the adoption of the strategic guidelines. After the projects are selected at the regional level, project priorities are decided at the national level. The national strategic reference framework outlines the country's strategy, proposes a list of operational programmes and within them the projects for funding as well as the amount of co-funding available in the national budget for certain operational programmes. They must be approved by the European Commission that commits the funds for operational programmes' execution. Grant programmes funded from the EU funds are tailored and implemented by various departments of the EU Commission or execu-tive agencies in line with the commonly set objectives. The available budget in the multiannual fi-nancial framework is publicly disclosed by theme, objectives and by theme and member states. The same themes can be covered and funded under different objectives as it is shown in table 2.

| Thematic Breakdown Per Objective | Convergence | EuropeanTerritorialCooperation | RegionalCompetitivenessandEmployment | Total |
|---|---|---|---|---|
| Culture | 4.794.816.994 | 490.112.053 | 854.217.820 | 6.139.146.867 |
| Energy | 8.870.361.040 | 344.817.590 | 1.942.788.364 | 11.157.966.994 |
| Environmental protection and risk prevention | 45.098.648.446 | 1.250.880.020 | 3.348.513.158 | 49.698.041.624 |
| Improving access to employment and sustainability | 14.895.606.001 | 174.511.242 | 8.768.669.535 | 23.838.786.777 |
| Improving human capital | 21.914.198.035 | 284.641.848 | 4.489.619.172 | 26.688.459.055 |
| Improving the social inclusion of the disadvantaged | 5.090.617.054 | 55.371.127 | 4.939.099.755 | 10.085.087.936 |
| Increasing the adaptability of workers and firms, enterprises and entrepreneurs | 7.580.559.335 | 131.405.865 | 5.443.967.958 | 13.155.933.158 |
| Information society | 12.076.677.871 | 549.950.999 | 2.324.348.709 | 14.950.977.579 |
| Investment in social infrastructure | 16.430.395.925 | 450.544.790 | 914.152.824 | 17.795.093.539 |
| Mobilisation for reforms in the fields of employment and inclusion | 684.319.753 | 219.923.291 | 365.264.523 | 1.269.507.567 |
| Reduction of additional costs hindering the outermost regions development | 376.466.913 | 5.498.263 | 279.292.174 | 661.257.350 |
| Research and technological development (R&TD), innovation and entrepreneurship | 49.700.600.383 | 1.348.569.984 | 14.659.268.912 | 65.708.439.279 |
| Strengthening institutional capacity at national, regional and local level | 2.531.932.477 | 288.265.908 | 82.769.077 | 2.902.967.462 |
| Technical assistance | 7.930.570.041 | 463.921.176 | 1.694.677.932 | 10.089.169.149 |
| Tourism | 4.636.201.016 | 594.159.469 | 842.397.436 | 6.072.757.921 |
| Transport | 72.113.312.738 | 1.036.659.466 | 2.388.175.237 | 75.538.147.440 |
| Urban and rural regeneration | 8.834.463.550 | 212.661.136 | 1.924.391.477 | 10.971.516.163 |
| Total | 283.559.747.572 | 7.901.894.227 | 55.261.614.061 | 346.723.255.860 |

Table 2. Overview of funded themes summarised in three EU strategicobjectives, 2007-2013

Source: Adopted from http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm, retrieved: July 2013

Although the coverage of programmes might sound self-intuitive, it is often quite difficult to distinguish which programme or theme is suitable for a particular registered entity. Despite the fact that research and technological development (R&TD), innovation and entrepreneurship theme is positioned on the second priority place with regard to the budget allotted, it is at the first sight vague whether it is just one or the only theme under which the entrepreneurs can submit their projects for EU funding.The rest of the paper tries to give some insight into funding programmes and application process for entrepreneurs and to offer a look into future regarding entrepreneurship funding in the programming period 2014-2020 that is to be brought in shortly.

## EU funds for entrepreneurship – present and future

Access to finance of SMEs is one of most important goals of the EU policy that is defined as one of EU priority goals in Small Business Act and Europe 2020 Strategy. A unique definition of small and medium-sized enterprises (SMEs) is applied across all EU institutions as of 2005. All enterprises having less than 250 employees, annual turnover of up to 50 million euro and/or assets of up to 43 million euro are considered SMEs. It is estimated that 99,8% of all business entities in the EU belong to the SME sector, while 91,8% of the total number of enterprises are micro enterprises (ESBA, 2011). The EU uses three instruments to support SME development: grants, loans and guarantees. Most support is given indirectly through programmes managed at the national or regional level. In general, small and medium sized enterprises can apply directly for a grant to the authority that manages the programme if their projects fulfil the criteria of sustainability, value-added and trans-nationality. To fulfil these criteria the SMEs are often gathered into consortia. The ultimate eligibility of certain entity for grant application is evident from the calls for grant. However, ex-post estimate of awarded funds to certain entities is very difficult as there are no central statistical data led by the type of entity whom the funds were awarded for certain purpose/theme.

Structural funds are in charge of funding the SMEs, through different thematic programmes and community initiatives implemented in the regions.Although the beneficiaries of structural funds receive a direct contribution to finance their projects, co-funding of the projects is a general rule. In other words, the EU usually subsidises only a part of the costs of a project while the rest of funds must be ensured from other sources including enterprises' own funds, national subsidies or bank loans. The amount of co-funding varies depending on the member country development, type of the EU fund and policy goals. For member countries with GDP per capita below 85% of the EU average, the maximum grant amount reaches 85% of eligible investment costs of the project (EBRD, EC and IMF, 2011, p. 5). SMEs from "convergence" regions mostly benefit from the ERDF, while local authorities and other public institutions benefit from the Cohesion fund and the ESF. ERDF in particular supports entrepreneurship, innovation and competitiveness of SMEs, improving the regional and local environment for SMEs and their interregional and cross-border co-operation, while the ESF supports investment in human resources covering entrepreneurship programmes for women, the unemployed and the disadvantaged for any reason.

Direct grants to SMEs from the Structural funds are only possible in economically less developed regions, i.e. "convergence" regions that lag behind average EU GDP. In other words, SMEs from the most developed EU countries are not eligible for direct grants from the EU funds. However, SMEs throughout the EU benefit from indirect support such as guarantee schemes.

Three most easily distinguished programmes dedicated to SMEs are CIP – Competitiveness and innovation Programme that consists of EIP – Innovation and Entrepreneurship Programme, ICT-PSP - The Information Communication Technologies Policy Support Programme, and IEE - The Intelligent Energy Europe Programme, RSI – Risk Sharing Instrument for research and development and innovation driven SMEs, and JEREMIE.Some other programmes support SMEs, but are not limited to them.

Apart from the guarantee schemes for loans, microfinance and equity CIP provides business and innovation services support. Although 1,3% of centrally administered EU budget has been allocated to CIPfrom 2007-2012, it manages to mobilize far more funds to SMEs through guarantees. It is estimated that each euro invested into CIP (EIP) guarantee facility SMEG generated at least 17 additional euros of loans to SMEs (EIF, 2011, p. 13). The preliminary estimates show that CIP managed to help 220 thousand SMEs to get access to 13,3 billion euro of loans while CIP-funded investments in venture capital funds supported fast growing SMEs for 2,3 billion euro from 2007 to 2012 (EIBG and EC, 2013).

Compared to other funded programmes CIP is a rather small programme worth 3,6 billion euro in the period 2007-2013. It is heavily used in most developed EU countries such as Belgium (over 300 million euro), Germany (292 million euro), Italy (267 million euro) and Spain (231 million euro) from 2007-2012.1 Committed funds under CIP reached 2,4 billion euro at the end of 2012. Equity financing, loan guarantees and microfinance schemes are managed by the European Investment Fund, an institution in joint ownership of the European Investment Bank (62%), European Commission (30%) and 25 public and private financial institutions. Like its major shareholder – the European Investment Bank, the European Investment Fund is dedicated to SME financing, but its clientele are more risky enterprises. Microfinance facility is targeted to special groups of entrepreneurs such as the young, women, the unemployed and disadvantaged people.

Risk sharing instrument has been financed through FP7 programme – the EU's 7th Framework Programme for Research and managed by the European Investment Fund. It has been designed to support access to debt finance to innovative SMEs and small mid-caps (companies employing up to 499 people) investing in research, development and innovation projects. Under the RSI facility, the SMEs are supported via direct guarantees to financial institutions that provide loans and/or leases to the SMEs and as of 2013 through counter-guarantees offered to guarantors that issue guarantees to banks and other financial institutions for loans or financial leases. FP7 programme is most heavily exploited programme that is managed centrally by the European Commission in all countries. It absorbed two thirds of the centrally managed EU funds so far.2Its operational programmes Co-operation, Ideas, People and Capacities targeted to SMEs are jointly worth 48,5 billion euro.3Table 3 provides information on FP7 and CIP programme commitmentsby countries from 2007-2012.

1 Calculatedfrom: http://ec.europa.eu/budget/fts/index_en.htm, retrievedJuly 2013.

| Thematic Breakdown Per Objective | Convergence | European Territorial Cooperation | Regional Competitiveness and Employment | Total |
|---|---|---|---|---|
| Culture | 4.794.816.994 | 490.112.053 | 854.217.820 | 6.139.146.867 |
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| Improving access to employment and sustainability | 14.895.606.001 | 174.511.242 | 8.768.669.535 | 23.838.786.777 |
| Improving human capital | 21.914.198.035 | 284.641.848 | 4.489.619.172 | 26.688.459.055 |
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| Information society | 12.076.677.871 | 549.950.999 | 2.324.348.709 | 14.950.977.579 |
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| Technical assistance | 7.930.570.041 | 463.921.176 | 1.694.677.932 | 10.089.169.149 |
| Tourism | 4.636.201.016 | 594.159.469 | 842.397.436 | 6.072.757.921 |
| Transport | 72.113.312.738 | 1.036.659.466 | 2.388.175.237 | 75.538.147.440 |
| Urban and rural regeneration | 8.834.463.550 | 212.661.136 | 1.924.391.477 | 10.971.516.163 |
| Total | 283.559.747.572 | 7.901.894.227 | 55.261.614.061 | 346.723.255.860 |

*It is not possible to distinguish which part of FP7 relies to SMEs

Table 3.The allotted amount to the EU countries from the EU budget

Source: Obtained and calculated from: http://ec.europa.eu/budget/fts/index_en.htm

The evaluation report of CIP ICT PSP (2011) revealed that 33% of funds were committed to private companies that accounted for almost 35% of programme participants by the end of 2010. 75% of private companies also participated in FP7 programme. While biggest risks in ICT PSP projects are bound to implementation of new innovative service solutions, FP7 programme is more related to covering technological risks.

JEREMIE - Joint European Resources for Micro to Medium Enterprises is a facility created by the European Investment Fund and the European Commission that enables better access to finance for SMEs. It enables member states to use a part of allocated structural funds for loan guarantees, venture capital and equity financing to SMEs.Contributions from the Structural funds are allocated to loans, guarantees or venture capital funds that are invested into enterprises.Returns from investments are reinvested in enterprises. In this way, a pool of funds can be re-used several times, leveraging capital and increasing the impact of public resources allocated to SMEs.EU funds can also be channelled through holding funds which are set up to invest in several investment funds. This is not compulsory, but does offer the advantage of enabling managing authorities to delegate some of the tasks required to implement JEREMIE to professionals. The highest share, namely EUR 8,902.65 million, went to financial engineering instruments for enterprises (either to holding funds or directly to specific funds) from 2007 to 2011 (EC, 2012). Of this, an aggregated amount of EUR 5.753,16 million was paid from the Structural Funds, out of which more than 96% from the ERDF, while the rest of funds were contributed from the ESF operational programmes.

Financial engineering instruments for enterprises represent the highest percentage (nearly 90%) of all financial engineering instruments implemented in 2007-2011. At the end of 2011 a total of 484 specific funds for enterprises offering all types of financial products, primarily loans and guarantees followed by equity/venture capital and other products, were set up. 341 funds were implemented without a holding fund, while the remaining 143 specific funds were implemented through aholding fund (EC, 2012).

There are some programmes managed at the national level such as business support activities that benefit SMEs indirectly through technical assistance or information database. The latter particularly concerns Enterprise Europe Network that is the largest European business support and innovation network providing integrated high quality services for the benefit of SMEs. One of the network's core activities is informing enterprises about EU legislation, programmesand funding opportunities as well as providing feedback from SMEs to the Commission toensure that future legislation responds to SME needs.

2 Own calculation based on the data available at: http://ec.europa.eu/budget/fts/index_en.htm (retrieved July 2013).

3 Informationobtainedfrom: http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=7264 (retrievedJuly 2013).

The new Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) will run from 2014 to 2020, with 2.03 billion euro at disposal. It is a continuation of the current CIP, i.e. its EIP – Entrepreneurship and Innovation Programme component. Its main beneficiaries would be existing entrepreneurs, prospect entrepreneurs and national (regional, local) authorities. COSME would continue supporting European Enterprise Network, a so called one-stop shop for entrepreneurs that gathers more than 600 business support organisations from 60 countries. As evidenced from the subtotal and programme specific data presented in table 4, COSME is just a part of the programmes SMEs can benefit from. Although the specific calls for project proposals might target different beneficiaries, it general SMEs can pay attention to the group of project proposals evidenced in the table 4.

| **Operational programmes** | **2013** | **2014-2020** |
|---|---|---|
| 1.1. Horizon 2020 | 9.832 | 70.200 |
| 1.2. COSME | 163 | 2.030 |
| 1.3. Erasmus for all | 1.330 | 13.010 |
| 1.4. Energy | 22 | 5.126 |
| 1.5. ICT | 3 | 1.000 |
| 1.a Subtotal Competitiveness for growth and jobs (sum 1.1-1.5.) | 11.350 | 91.366 |
| **I. Total Competitiveness for growth and jobs** | **15.068** | **125.614** |
| 2.1. Youth employment initiative | 0 | 3.000 |
| 2.2. Competitiveness | 6.312 | 49.492,3 |
| 2.a Subtotal Cohesion Policy | 6.312 | 52.492,3 |
| **II. Total Cohesion Policy** | **52.392** | **325.149** |

Source: Pulled from MFF 2014-2020.

Table 4. Operational programmes concerning SMEs proposed funds from 2014-2020

# Application process

The project submission process commences following publication of a call for proposals. The criteria that need to be met by the submitted project are published in the application guidelines. Completed projects are not entitled to financing but projects in the implementation can be eligible under certain conditions despite the fact that their chances for being awarded the funds are smaller compared to the projects in the preparatory phases.

To apply for the EU funds, applicants must have a financially, economically and socially elaborated project idea that in thematically in line with the priorities of operational programmes. Project description must include: overall goal and specific objectives of the project, elaboration of the need for project, description of project activities, action plan, expected results after project implementation, budget estimation and envisaged financial sources. The applicants must also prove that they have cash resource needed for co-financing. Each project proposal is subject to evaluation that consists of: administrative compliance assessment, eligibility assessment and technical and financial assessment.

Evaluation of administrative compliance and eligibility assesses financial stability of applicants. Technical evaluation is most important as it assesses project's compliance with the call for proposal, projects' results, innovativeness and strategic necessity of the project. Refused applications are elaborated in detail, giving the chance to applicants to improve their application in the prospect calls for project proposals.

The more partners there are and the more regions (countries) are involved, the greater the chance to get the funding provided that other tender requirements are fulfilled. A rule of thumb is having at least three partners (regions) that benefit from the project implementation. In the context of SMEs it means that a good combination could be a joint project application of one or more SMEs with a university or a research institute. In other words, public-private partnerships in broad meaning are encouraged. Currently the environmental projects whose investment costs exceed 25 million euro require special evaluation procedure. The same holds for other projects exceeding 50 million euro of investment value. For these large projects cost-benefit analysis that explains the impact of overall social and economic position of the country and not necessarily financial benefits that the project can bring to the region that it should be implemented in as well as to other neighbouring regions. This analysis is required in addition to the feasibility study of the project.

Regulatory framework applicable for the EU funds is defined in the Financial regulation and its implementing rules as well as certain sector specific regulation. As of the beginning of 2013 the new Financial Regulation is accompanied with the new rules of application (RAP). The latter helps simpler, cheaper and faster procedures of awarding the EU funds to the applicants for grants and public contracts, supports more accountable spending of the EU funds as well as the mobilisation of third parties' financial resources in addition to EU grants in various innovation schemes. It is believed that the new regulation would benefit member countries with low absorption rates from the EU funds such as Bulgaria and Romania.

The so-called light documentation encompasses legal status check of the applicant, its financial and operational capacity that is to be proved by a declaration of honour without the necessity to provide supporting documents.

Neither non-profit principle nor guarantees on pre-financing are required as of 2013. An earlier grant threshold for light documentation was 25.000 euro, while it stands at 60.000 euro as of the beginning of 2013. The proof of financial capacity of the applicant organisation is normally required by the European Commission for contracts on purchasing services, supplies and works whose value exceeds 60.000 euro. From 2013 thereon the plans on work programmes would be multi-annual.

The grant award procedure should last up to nine months from the closure of the call. The applicants should receive the notice on the evaluation of their projects within six months from the closure of the call. The grant agreement with successful applicants should be concluded within three months from the communication of the evaluation results of the project. Upon the grant agreement conclusion, the beneficiaries should receive money due within 30, 60 or 90 days after reporting the delivery results according to their contractual obligations. The exact term is subject to contract obligations' fulfilment test. The maximum threshold per lump sum payment to the contractors of 25.000 euro will be abolished and general accounting practice in calculating costs of beneficiaries would be recognised in particular cases. An external audit is generally applicable for grants exceeding 0,5 million euro and for grants above 0,1 million euro that are used for financing operational costs of organisations.

Due to the fact that many potentially good projects have been disregarded in the past if they had some missing documentation, the new rules give applicants an opportunity to submit additional documentation or provide clarifications to project documentation as long as this does not modifies the project proposal or tender.

Due to the fact that commercial banks have expertise in project selection and financing, lots of EU programmes, particularly those targeting the SMEs, are implemented through financial institutions' intermediation. In addition, banks can play big role in project pre-financing. The involvement of private sector helped increase absorption capacity from the EU funds in Italy, Hungary and Greece (EBRD, EC and IMF, 2011).

## Conclusion

Although it might not be evident at the first sight, the opportunities of SME funding at the EU level are broad and will be even broader in the multi-annual financial framework in the 2014-2020 period. It especially concerns innovative, research and development oriented SMEs that collaborate with other research institutions, other SMEs, as well as SME networks. Although the application process of the projects for EU funds and programmes might be time-consuming and exhausting for SMEs, it is a worthwhile experience as it helps enterprises to elaborate its own strategy and goals. The latter is not only crucial for their SMEs' existence but for applying for the numerous guarantee programmes offered to SMEs with or without support of the EU institutions. EU encourages strongly development of SMEs and it is up to the SME sector to make the most of the EU programmes available for their own benefit and for the benefit of regions they operate in.

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