JEREMIE

JOINT EUROPEAN RESOURCES FOR MICRO TO MEDIUM ENTERPRISES

SME Access to Finance in Slovakia

GAP ANALYSIS

January 2007

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1. Executive Summary

1.1. Statement of Position

The Slovak economy is experiencing strong growth, to which small and medium enterprises (SMEs) are a very important contributor, creating almost 50% of the added value and providing 70% of all jobs. However, a major part of them indicates having insufficient financing to grow, notwithstanding increased activities of commercial banks.

In the context of the JEREMIE initiative, the European Investment Fund (EIF) has analysed in this report the access to finance for SMEs in Slovakia and has identified major gaps between potential demand and existing supply in the main financial instruments facilitating access to finance for SMEs, hampering their creation and development. EIF can act as a catalyst in closing these gaps through its know-how in setting up adequate market-oriented instruments and attracting private lenders and risk capital providers in the framework of JEREMIE (see chapter 1.4).

The portfolio of financial instruments is to be set up in a Jeremie Holding Fund structure, providing an important opportunity to the Slovak government to lay the foundations for continued high economic growth, strong development and increased competitiveness compared with other European countries, in the coming years.

1.2. Major Market Failures & Recommended Actions

EIF has identified the following major market failures in the context of access to finance for SMEs in Slovakia justifing the use of public support measures according to EU State Aid rules:

- **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 factoring-to-GDP ratio compared to EU-25 average;**
- **Low VC activities compared to GDP and other Central European EU member states;**
- **Low R&D-GDP ratio, poor technology transfer record;**
- **No business angels network existing.**

At this stage, in order to diminish or fill these financing gaps, the following revolving instruments are proposed to be set up in 2007-2013 in the JEREMIE framework:

- **Micro Loan Guarantee Scheme targeting start up companies: EUR 180 m;**
- **Social Micro Loan Scheme: EUR 5 m;**
- **Portfolio Loan Guarantee Scheme to SMEs: EUR 110 m;**
- **Slovak Seed Capital Fund; Slovak Emerging Growth Fund, smaller investments in quality private VC fund initiatives: EUR 150 m;**
- **Factoring supporting scheme of EUR 50 m;**
- **Intellectual Property Fund: 10 m;**
- **Capacity-building and Pool Fund to stimulate investment readiness: EUR 5 m.**

Details of the supply and demand analysis of each financial instrument evidencing these market failures and the JEREMIE proposals are given in chapter 3 of this report.

Given the flexibility of the JEREMIE structure, these instruments can be further developed and adapted and new instruments can be introduced, in line with market developments

in Slovakia in the coming years, in order to best correspond to the needs of the SMEs and thus strengthen the Slovakian economy.

1.3. Strategic Priorities and Policies

The Competitiveness Strategy for the Slovak Republic until 2010 ('Lisbon Strategy') aiming to strengthen economic competitiveness with more and better jobs and social cohesion, lists four priority development areas:

- **Information society;**
- **Science, R&D, innovation;**
- **Business environment;**
- **Education and employment.**

This has been reflected in the National Strategic Reference Framework 2007-2013 (total EU Structural Funds to be received more than EUR 11 bn), which includes Operational Programmes in the areas of:

- **Information society (EUR 993 m);**
- **Research and Development (EUR 883 m);**
- **Competitiveness and Economic Growth (EUR 772 m);**
- **Employment and Social Inclusion (EUR 864 m);**
- **Environment (EUR 180 m);**
- **Bratislava region (EUR 87 m);**

apart from the more traditional areas for EU Structural Fund support such as transport, environment and regional (infrastructure) development.

1.4. Why JEREMIE

The contribution that SMEs deliver to the EU economy is well documented. Across the EU, Member States appreciate this fact and have focused many policy initiatives at this sector. This is further recognised in a recent communication by the European Commission[1] which states that 'the partnership for growth and jobs depends on Europe's SMEs achieving their potential, as they prove to be crucial in fostering the entrepreneurship, competition and innovation that leads to sustainable growth and development.' Recent data shows that Europe needs to work on the availability of risk capital to SMEs with high growth potential. After a decrease from EUR 4.2 bn in 2001 as a result of the bursting of the technology bubble, European venture capital investment in early stage firms has stagnated at around EUR 2 bn. A recent survey[2] has shown that 14 % of the 23 m SMEs registered in the European Union need better access to finance.

It is for these reasons that the Commission has created two main EU instruments to promote entrepreneurship and innovation, and to improve SMEs' access to finance, being the *Competitiveness and Innovation Framework Programme (CIP)* and the *Joint European Resources for Micro to Medium Enterprises (JEREMIE)* of the structural funds[3]. The future of European competitiveness depends on an integrated, open, and competitive financial market that covers risk capital and debt finance instruments and as part of the JEREMIE initiative, the European Investment Fund has been asked to evaluate the specific needs

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[1] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. 'Implementing the Community Lisbon Programme: Financing SME Growth – Adding European Value' - Brussels, 29.6.2006 - COM(2006) 349 final

[2] 'SME Access to Finance' Flash Eurobarometer survey, October 2005

[3] The Competitiveness and Innovation Framework Programme (CIP) and the Joint European Resources for Micro to Medium Enterprises (JEREMIE) are complementary in nature and the European Investment Fund will be the key implementation institution ensuring that this is the case for each Member State.

of each EU market to identify market failures and to propose a series of appropriate financially engineered instruments.

The JEREMIE initiative will combine grants from the European Regional Development Fund (ERDF) and the European Social Fund (ESF) with loan capital and other sources of finance to support the creation and expansion of micro, small and medium-sized enterprises as part of EU regional policy. Using the concept of a 'Holding Fund', JEREMIE enables each Member State to support the development of business angels[4], technology transfer funds to link business, universities and research centres, and to improve the availability of micro-credits targeted at those who may not have access to commercial credit. Funding from instruments established through JEREMIE may also be combined with business support and institution-building measures financed by Structural Funds.

In previous periods, difficulties with the administrative processes have led to sub-optimal levels of fund utilisation. Time-consuming processes have led in certain cases to significant levels of funds earmarked for SMEs, being left unused. Understanding the problems this causes, the Commission foresees that significant improvements can be made via the creation of JEREMIE Holding funds within the Member States and with full delegation to the appropriate Managing Authority to oversee the implementation of JEREMIE programmes aimed at delivering sustainable financially engineered instruments that improve access to finance for SMEs.

Importantly, each programme will be individually tailored to the needs of each Member State following on from the combined efforts of the EIF and the Member State to evaluate market failures and the appropriate remedies in the context of its Operational Programme. The proposed instruments will efficiently engage the private sector and seek to maximise the leverage effect. The flexibility within the portfolio of JEREMIE instruments in each programme enables a full range of instruments varying from equity and quasi-equity to venture capital, loans or guarantees for SMEs' benefit in the Member State. Furthermore, the portfolio of instruments used and financial commitments made is flexible enabling alterations in positional allocations to be made during the period.

The benefits to Member States from JEREMIE include:

- **Immediate disbursement of the funds to a 'Holding Fund' within the Member State. JEREMIE is designed to optimise the use of ERDF funding and to simplify the management of financial engineering by the Managing Authority.**
- **Contributions from the national or regional operational programmes to the JEREMIE fund will be eligible for interim up-front payment by the ERDF/ESF, which will facilitate the financial programme management.**
- **A highly adaptable toolbox of financial instruments that can be managed flexibly over a period of time: during the financial period 2007-2013. In consultation and cooperation with the Managing Authorities of operational programmes, the JEREMIE holding Fund Manager will be able to re-allocate the resources to one or other financial instrument and product, depending on the effective demand.**
- **The revolving nature of the portfolio of instruments and the partnership approach with the private market will maximise the long-term impact of the Fund and invested JEREMIE resources that are repaid become available for reinvestment. This is applicable, for example, when returns are received on venture capital investments, or micro-loans are reimbursed to micro-finance institutions. Resources are reinvested into the JEREMIE instruments and are used again in favour of SMEs.**

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[4] To give just one example, for growth-seeking entrepreneurs, external financing becomes necessary when their initial funds have been exhausted. Knowledgeable private investors are critical for the launching of entrepreneurial businesses, but there is a serious and persistent lack of business angels and other seed investors in Europe. To illustrate, Business Angel investments in Europe are estimated to be less than 10% of those in the United States for a similarly-sized economy.

- JEREMIE will principally enhance the supply of SME finance in the regions, by bringing product expertise and decision on investment schemes at a local level. It will also contribute to improve the regional financial conditions targeting areas of need. The EIF's international experience will be available to all Member States.

2. Background Information

2.1. Characteristics of the Economy and Demographics[5]

Since 2001, the Slovak economy has grown at a fairly robust pace. In the framework of EU accession, there have been high increases in GDP, labour productivity and real wages as well as moderation of inflation, unemployment rates and fiscal imbalances. In general, Slovakia is a small and open economy, to a great extent dependent on foreign trade. Although it may have an educated labour force, its main competitive advantage is low labour costs which makes it more a processing economy than a knowledge-based one. The following table shows the development in key macro-economic indicators during the last years according to the Slovak Statistical Institute and IMF:

	2003	2004	2005	2006	2007
GDP Growth	4.2%	5.4%	6.1%	6.6%	7.1%
CPI Inflation	8.5%	7.5%	2.7%	4.2%	2.0%
Current Account Balance in % of GDP	-0.8%	-3.6%	-8.6%	-7.7%	-5.9%
Unemployment Rate (ILO)	17.4%	18.1%	16.2%	13.8%	13.2%

The real GDP growth rate is expected to decrease to 5.5% in 2008 and from then on to 4% in the following years according to the Ministry of Finance. The current account deficit is supposed to decline as a percentage of GDP as from 2007, helped by strong automotive exports.

The population stood at about 5.4 m inhabitants at 31 December 2005, of which 3 m between the age of 25 to 64 and 2.65 economically active. Birth and death rates are quite stable, a major migration cannot be observed. The share of population at risk of poverty, which is defined according to Eurostat as having an income below 60% of the median of equivalent income (i.e. less than SKK 5,631 monthly income), stood at 13.3% in 2004. The unemployment rate is decreasing but includes a growing share of long-term unemployed[6] (68.2% in 2005).

According to the European Trend Chart on Innovation, Slovakia is ranked as one of the poorest performers in the EU-25, mainly because of low R&D spending. The Appraisal Report 2004/2005 talks about a dual economy which explains the low level of knowledge transmission and application in the country: Foreign-owned companies generate a significant proportion of the total output and high-tech manufacturing exports, but carry out activities like R&D at their headquarters. Domestic enterprises are mostly small and have limited access to human and financial resources.

Turnover statistics by sector show a positive development in all sectors, mainly industry (manufacturing), construction and transport. The biggest rises in output continue to be concentrated in the key industries underpinning Slovakia's overall manufacturing performance. Nearly all of the automobile output is exported. Germany is Slovakia's most significant trade partner accounting for one-quarter of exports and one-fifth of imports.

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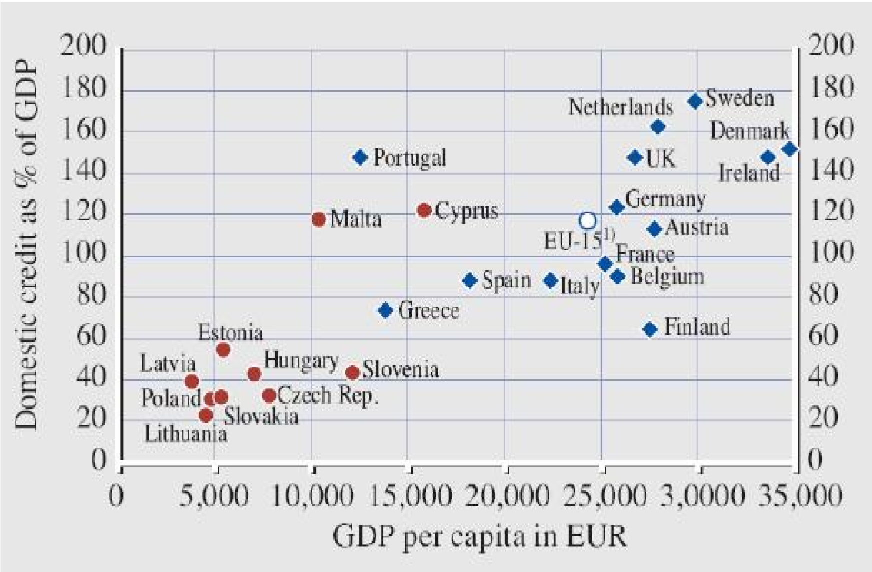
[5] Supporting data in Annex 5.1

[6] > 12 months

Comparing the financial and economic development of Slovakia with other European countries shows a clear demand for increased banking activities in countries with rising GDP[7]. This is evidenced by the chart below, on the basis of which a strong correlation between the level of GDP and the extent of financial intermediation in the country can be assumed. The chart particularly reflects the balance between the standards of the market economy, the density of the entrepreneurial fabric and the extent of intervention from the banks in financing the economy. It shows the amount of progress that is possible in the EU's new member states and the path that their private economy can still envisage.



Source: **AECM: European SMEs and the way they are financed – Loan guarantee schemes", 2006**

2.2. SME Characteristics and Environment[8]

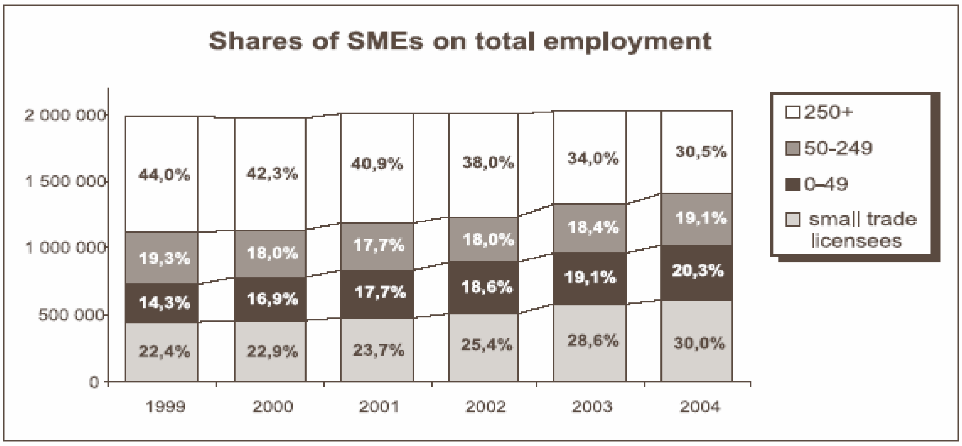
The table below shows the development in the number of SMEs according to the categorisation of the European SME definition:

		2003	2004	2005
Micro enterprises (0-9 employees)	**N° of enterprises**	**353,597**	**390,728**	**409,112**
	Share of total	*95.5%*	*95.3%*	*95.6%*
	Employees	628,125	644,983	671,744
	Contribution to employment	*31.0%*	*31.80%*	*32.40%*
Small enterprises (10-49)	**N° of enterprises**	**13,722**	**16,139**	**15,735**
	Share of total	*3.7%*	*3.9%*	*3.7%*
	Employees	323,833	359,692	371,921
	Contribution to employment	*16.0%*	*17.70%*	*17.90%*
Medium-sized enterprises (50-249	**N° of enterprises**	**2,871**	**3,321**	**3,106**
	Share of total	*0.8%*	*0.8%*	*0.7%*
	Employees	383,059	403,973	422,656
	Contribution to employment	*18.9%*	*19.90%*	*20.40%*
All SMEs	**Total number**	**370,190**	**410,188**	**427,953**
	Total employees	1,335,017	1,408,648	1,466,321
	Total share of contribution to employment	*65.9%*	*69.40%*	*70.70%*

Source: NADSME[9]: State of small and medium enterprises in the Slovak Republic

[7] Chart source: AECM: European SMEs and the way they are financed – Loan guarantee schemes", 2006
[8] Supporting data in Annex 5.1
[9] NADSME = Slovak National Agency for Development of Small and Medium Enterprises

In general the number of SMEs is increasing as well as their overall contribution to employment in Slovakia. Most of the SMEs are micro enterprises with less than 9 employees. Most of the SMEs registered as legal entities exist in the trade and trade services sectors, as well as the industry and construction sectors. In 2004, micro and large companies comprised the biggest shares to overall employment in Slovakia (30% and 30.5% respectively):



The following table shows that only a part of the enterprises registered as legal persons and natural persons working as small traders are actually active[10] in business.

Legal persons (enterprises)	Active	Active (%)	Inactive	Inactive (%)	Registered
micro (0-9)	72,945	68%	34,514	32%	107,459
small (10-49)	11,181	82%	2,439	18%	13,620
medium (50-249)	3,154	78%	902	22%	4,056
Natural persons (small traders)	**Active**	**Active (%)**	**Inactive**	**Inactive (%)**	**Registered**
	496,758	88%	70,613	12%	567,371

According to NADSME, the number of small traders created decreased and the number of those dissolved rose sharply in 2005. In general, a much higher number of small traders is established than SMEs:

	2003		2004		2005	
	Births	Deaths	Births	Deaths	Births	Deaths
Small traders	54,658	17,100	56,716	18,812	50,302	26,172
Enterprises	1,502	534	1,704	670	1,994	990
TOTAL	**56,160**	**17,634**	**58,420**	**19,482**	**52,296**	**27,162**

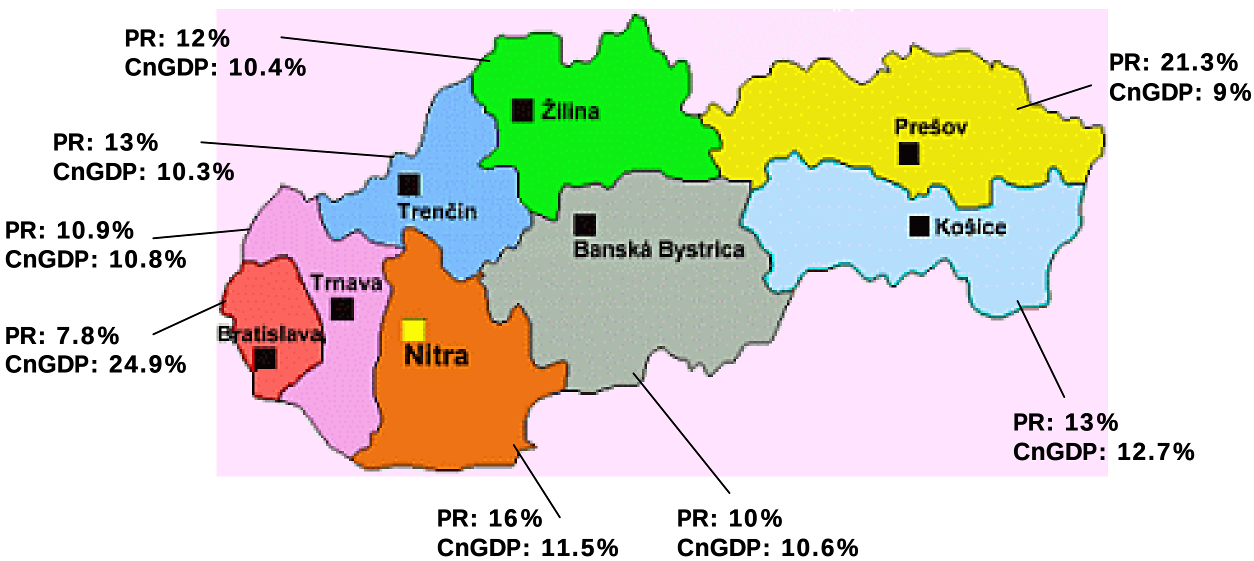
Most of the SMEs were established in 2005 in the sectors "real estate, rental business and commercial activities" as well as "wholesale, retail and repairs". In the small traders category (natural persons as entrepreneurs), the peak lies in "wholesale, retail and repairs" and the construction sector. Compared to 2000, the numbers of small trade licensees doing business in building industry, services and industry increased by 68%, 31% and 21% respectively.

[10] The National Statistical Office considers a company as "active" if it has employees, turnover or regularly sends statistical reports (over 20 employees). "Inactive" companies are registered but have a licencse on hold, wait for exclusion from the business register, are in liquidation, do not respond to requests for filling in statistical questionnaires, have their business activities temporarily interrupted or cannot be contacted through the company address.

2.3. Regional Characteristics

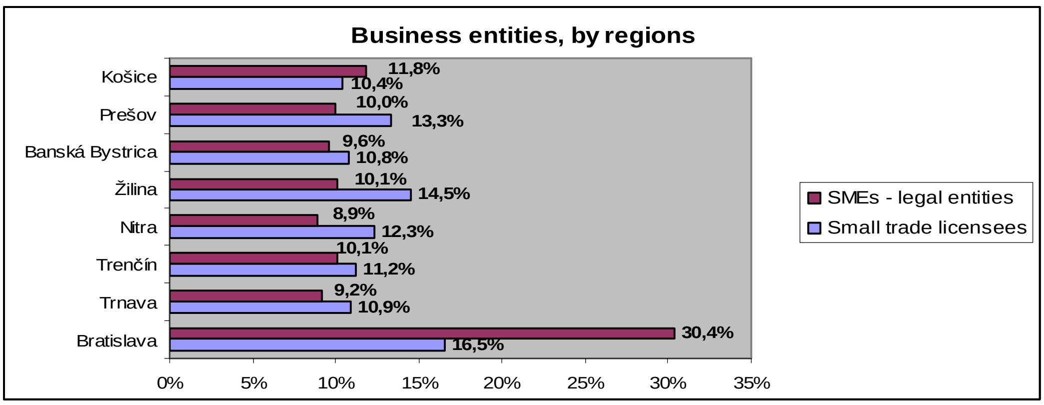
The EU Regional Policy classifies the European countries in regions eligible for Structural Funds. According to this categorisation, the Bratislava region is the only Slovak region classified as "Objective 2" (Competitiveness & Employment), all other regions are "Objective 1" (Convergence), thus receiving Structural Funds as least favoured regions with a GDP of less than 75% of the European average.

There are quite significant regional differences existing in Slovakia, for example shown by the share of population at risk of poverty (PR – 2004 figures) and the contribution to national GDP (CnGDP – 2003 figures). Obviously, Bratislava is the most successful Slovak region and its opposite is Presov in the North-East:

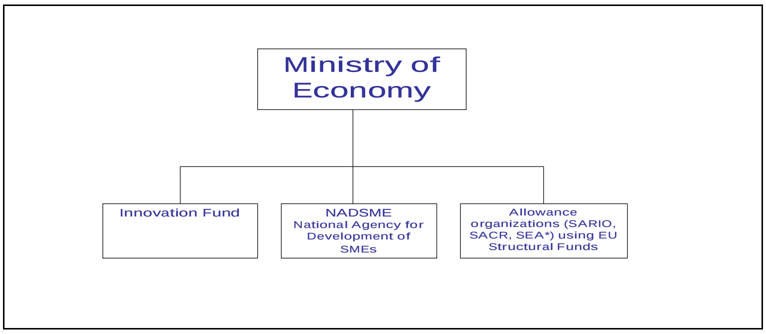


The highest number of SMEs (legal entities) was registered in the Bratislava Region (25,505) in December 2005. In other regions, the number ranged between 7,453 (Nitra Region) and 9,841 (Kosice Region). The number of companies across all regions increased year-on-year, whereby the most substantial increase was reported in Prešov Region (14.9%) and the increase was at its lowest in Trenčin Region (9.2%).

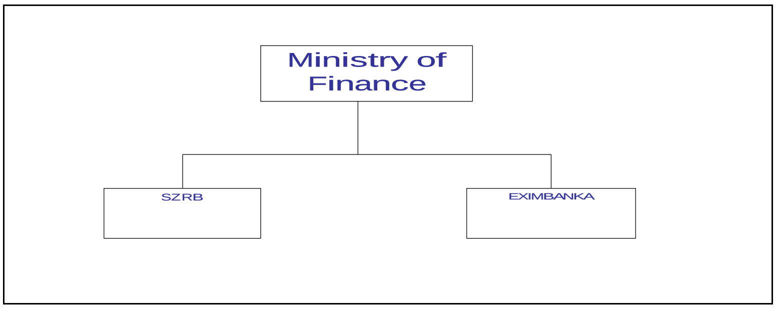
The highest number of natural persons operating as entrepreneurs was registered in Bratislava Region (59,890) and Žilina Region (52,761), whereby the fewest operated in Košice Region (39,189). The relatively highest increase in the number of business operators was reported by Banska Bystrica Region (4.1%), whereby the lowest figures were reported in Trenčin Region (0.7%).



2.4. SME-Supporting Institutions



***SARIO (Slovak Investment and Trade Development Agency), SACR (Slovak Tourist Board), SEA (Slovak Energy Agency)**



The Ministry of Construction & Regional Development is also implementing EU Structural Funds for SME support, through the Operational Programme for Bratislava Region.

Ministry of Economy

The support of the SME development mainly focused on improving competitiveness during the last years, in particular in connection with Slovakia's EU accession. In 2005, the Ministry of Economy supported SMEs especially through the Sectoral Operation Programme Industry and Services (SOP IS) and the Grant Schemes PHARE FM 2002 and 2003. Significant attention was also attached to the development of the supporting business infrastructure, through the construction and operation of incubators and of First Contact Points and Euro Info Centres.

Innovation Fund

This non-profit fund, administered by the Ministry of Economy, is directed towards supporting research and development (R&D) in industrial sectors aiming at providing for an expedient transfer of knowledge of research and development into practical life and at creating conditions for expedient innovative growth of industrial production, improved competitiveness and export of domestic production.

National Agency for Development of SMEs - NADSME

NADSME was established in 1993 as a joint initiative of the EU and the Slovak government and changed its legal form to an interest association with as members the Ministry of Economy, the Ministry of Finance, the Association of Slovakian Entrepreneurs and the Slovak Union of Traders. Its overall mission is to promote SME development and growth, taking account of the state structural, industrial, technological, regional and social policies. The Agency co-ordinates activities, including financial activities, at various

levels, geared towards SME promotion and development. In this context, it is for example involved in the preparation of the state policy and strategy for SME support, the technical implementation of projects and programmes in the framework of EU pre-accession aid and Structural Funds (SOP Industry and Services) and the establishment of SME credit and guarantee systems in cooperation with financial institutions.

Ministry of Finance

The Ministry of Finance sets the framework for the development of the financial sector and supports SMEs through its full subsidiary SZRB and Eximbanka, in which it has the major say.

SZRB - Slovenská Záručná a Rozvojová Banka, a.s.

The Slovak Guarantee and Development Bank is a specialized state-owned commercial bank focused on supporting business activities of mostly SMEs. The Bank applies financial instruments which contribute to the stabilisation of SMEs (including start-ups) as well as to the further development of existing companies. The bank extends loans directly to SMEs or via on-lending banks and issues guarantees to commercial banks in order that business entities can create sufficient security over their assets and can apply for loans with commercial banks. In addition to general financial instruments applied in the business sector, the SZRB is also carrying out some development programmes with specific aims, based on cooperation with foreign financial institutions or ministries, e.g. contributing to financing the renewal of housing development and providing banking products to towns and municipalities.

EXIMBANKA SR

The Export-Import Bank is part of the system of the government's pro-export policy. It supports activities of exporters and importers by financing export credit, insuring export credit and financing import credit in order to support the growth of foreign trade and increase the competitiveness of Slovak products. As government entity, the first criterion for the bank's activity is not to maximise profit, but to maximise the volume of exports supported while ensuring return on investment through the minimisation of risks arising from credit, finance and insurance activities. In 2005, total activities amounted to SKK 70.2 bn, which represents an increase of 4.9% compared to 2004. The stated amount includes banking activities of SKK 51.1 bn and insurance activities of SKK 19.1 bn.

Main International Financing Institutions

European Investment Bank

EIB has been financing projects fostering EU integration since 1990, with a total lending of over EUR 2.1 bn. Operations cover all economic sectors, ranging from industry, health, education and services (24%), transports (29%, energy and telecommunications (24%), water and environment (3%) to SME support through local financial intermediaries via credit lines (global loans – 20%). These global loans for financing small and medium-scale ventures amount in total to about EUR 422 m in cooperation with the major banks active in the country: HVB Bank Slovakia, Dexia Banka Slovensko, Slovenska Sporitel'na a.s., Tatra Banka, CSOB Leasing Slovakia a.s. and SG Equipment Finance. For example, SLSP has access to an EIB credit line offering credits of at least EUR 20,000 with a repayment period of 4-20 years to private and public institutions, SMEs, cities and municipalities to realise projects in eligible areas. The EIB credit line to HVB is targeted to SMEs, cities and municipalities offering maximum loan amounts of EUR 12.5 m with a maturity period of 4 – 15 years.

EIB global loans have become an important tool to channel funds to SMEs and stimulate long-term lending in Slovakia and were often accompanied by the European Commission's SME Finance Facility intended to strenghten the financial intermediaries' capacity to target small SMEs. According to EIB, the global loan activity is expected to continue playing an important role in EIB's business in Slovakia over the coming years.

European Investment Fund

In the framework of its trust activity, EIF has signed guarantees agreements in Slovakia amounting to EUR 50 m. The first agreement was signed with Tatra Banka in 2004, enabling the bank to provide long-term investment loans with less stringent collateral requirements to SMEs. The initial guarantee amount of EUR 25 m was increased to EUR 45m after one year, due to the good results achieved. A second agreement for a guarantee amount of EUR 5 m was signed with VUB in 2006 and the bank is in the implementation phase. Both agreements are provided under the Loan Guarantee Facility of the European Commission's Multi-Annual Programme for Enterprises 2001-2006.

European Bank for Reconstruction and Development

In 2005, EBRD signed projects totalling EUR 60 m. Up to the end of 2005, it had committed about EUR 1.2 bn leading to a transition impact. By 2010, the new EU member states will have "graduated" from the EBRD. In the context of SME support, the EBRD and the European Commission launched a SME Finance Facility for the Central and Eastern European EU Accession countries in 1999 channelling EUR 846 m to SMEs through loans to local banks, leasing companies and investments in private equity funds. EBRD commitments amount to EUR 113 m, consisting of ten loans to seven participating financial intermediaries, four participating banks and three participating leasing companies. The credit lines had some technical assistance features for a total value of EUR 4.6 m plus a performance fee for the participating banks, paid out of EU subsidies, and were succesful in getting banks interested in SME lending. The SME Facility in the Slovak Republic is complete and no new projects will be presented. The EBRD has also set up a venture capital fund (Value Growth Fund), which was quite unsuccessful. It only made one investment not performing well and it is the intention to close the fund. According to EBRD, the main reason for the failure of the fund was a bad choice of manager.

3. Supply and Demand Analysis – Market Failures and Recommendations

3.1. Methodological Framework

There are many difficulties involved in the task of understanding the areas of market weaknesses or gaps in the access to finance to SMEs. The primary challenges are in the form of data availability and the feasibility of measuring the gap between current supply and potential demand for financially engineered instruments. In fact, some respected Academics have even concluded that the task is unachievable in that demand is immeasurable until the supply appears or on the basis that 'laissez-faire economics' implies that supply always equals demand. Nevertheless, a practical methodological framework has been adopted to assess the overall issues in any marketplace which is captured in the graphical model at the end of this sub-chapter.

The approach seeks to understand whether gaps or market weaknesses exist based upon the following principles:

1. Demographic trends within the SME environment and in each market segment[11] are used to estimate the future potential size of market space and potential demand.
2. The variety of sources of supply are measured or estimated using the latest available statistical data from industry sources such as EVCA and national data sources as appropriate.

[11] The standard EU definitions of SME market segments have been adopted.

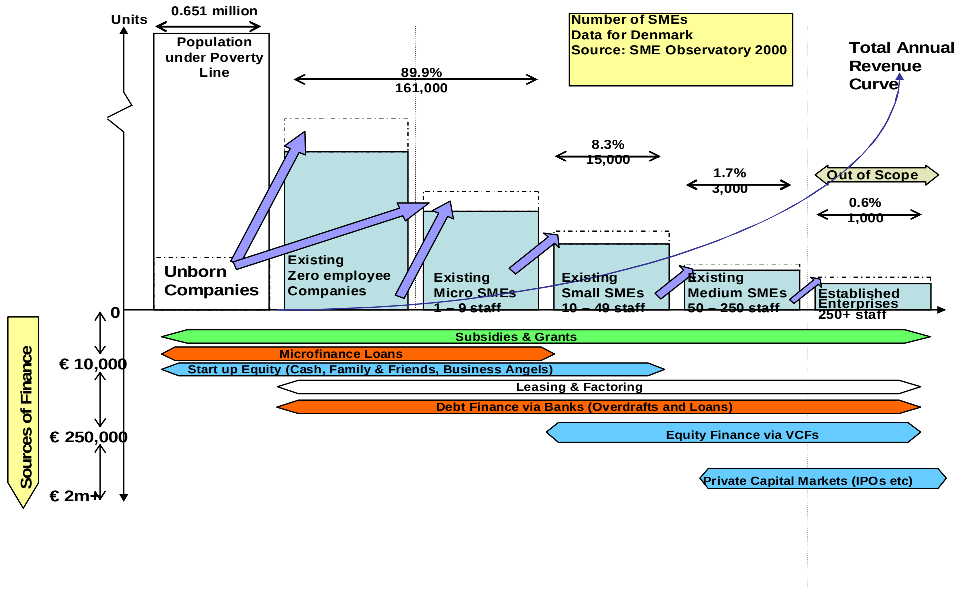
3. Trends/shifts in these supply sources are then reviewed together with the current levels of public support to identify evidence of market failures, gaps or absences.
4. From this, proposals are made for generic financial engineering instruments that comply with the rules of JEREMIE and specifically target the identified market weaknesses or failures with the justification of the size of the funding based upon either a macro (top down) view of the market or the bottom-up, practical view of the instrument in question. These proposals are made on the basis of the European Investment Fund's wide experience of guarantee and equity instruments across Europe and reflect the standards of best practice in the market.
5. An estimation of the sensible 'tranche approach' is then given to provide initial estimation of the size of the Holding Fund with proposed management structures.
6. The total Holding Fund size is estimated for budgetary planning purposes.

The approach adopted follows a set of practical principles to understand whether gaps or market weaknesses exist in each segment of the SME market in each country. It is worth to note as an example that for the first market segment (microfinance) in the area of the 'socially excluded population', the method used is as follows: The latest available data for the section of the overall population regarded as 'at risk of poverty' is taken as the base population for the segment. Then using historical information for the number of people that have created an enterprise per 1,000 inhabitants, this percentage rate is applied to the segment population. This gives an overall estimate of the potential demand size in this sub-segment of microfinance.

For the three other groupings (micro, small and medium SMEs) overall statistics for each segment is presented with a review of factors affecting demand in each case. For these segments, an analysis of the trends in the provision of key sources of supply of finance is undertaken at macro-level before deeper analysis of the main elements of supply in each individual segment is undertaken to understand the key aspects of market weakness or failure that may exist.

From this point, practical proposals are made targeting known weaknesses whilst respecting the aspects of financial engineering and self-sustainability at the core of the JEREMIE initiative. The proposals need to be viewed as a flexible portfolio of instruments that combine to address the weaknesses in the economy but may be varied according to the dynamics of the situation across a period.

General illustrating model:



3.2. Micro Finance

Micro lending is an important tool to create incentives for the set up and development of SMEs, especially in the micro segment. In essence, the programmes should respond to the need for financial products and services which are either not available from commercial banks or provided under terms which the loan applicant can hardly accept.

Supply

According to a report of June 2006 from the Microfinance Centre for Central and Eastern Europe and the New Independent States[12], Micro Finance is provided in Slovakia by NGOs, through public funds and commercial funds. The following tables give some details on the scale of lending activities of the NGOs and public loan funds:

	2004 total gross loan portfolio (EUR)	2005 total gross loan portfolio (EUR)	% change
NGOs	270,505	312,338	15%
Public Loan Funds (NADSME)	3,420,871	n.a.	n.a.

NGOs

The NGOs are two institutions implementing micro lending projects as part of their broader enterprise-support agenda which includes training, market access facilitation, community development activities.

One of these is Integra Venture, a grant scheme[13] and network of Community Economic agencies in Central and Eastern Europe with the mission to alleviate poverty, reduce unemployment and help transform communities by supporting the development of hundreds of small businesses in the depressed and developing areas of Central and Eastern Europe. Their programmes include training, consulting and small loans for socially responsible SMEs; micro enterprise development for socially excluded and at-risk groups, specifically women at risk and under-skilled youth. The latter was set up in 1999 and loan clients act as mutual loan guarantors and form trust groups. Maximum loan amount is EUR 2,813[14]. As at 30 June 2006, 161 loans were disbursed for a total amount of EUR 345,120. About 500 work places have been created and sustained.

Public funds

The loan funds financed from EU Phare sources, Slovak state budget and other public sources are operated by regional advisory centres (RAIC) business innovation centres (BIC) within the framework of NADSME SME support and by SZRB.

NADSME

In 1997, NADSME launched a pilot project Micro Loan Programme with the help of three RAICs in Považská Bystrica, Zvolen and Prešov to improve access to small loans for small entrepreneurs with less than 50 employees in the regions. At present, there are 15 centres operating under the programme covering the whole country.

Loan sizes range from EUR 14,000 – 28,000 in case it is invested into the production, crafts or services including the purchase of materials for production. Given this average loan amount, the activity is more targeted to existing small companies, then to micro

[12] „2005 Microfinance Sector Map in EU New Member States and Pre-Accession Countries"
[13] funded by various corporate donors and multilateral and government agencies, private agencies and foundations; active in Slovakia, Romania, Bulgaria, Croatia, Russia, Serbia
[14] Exchange rate: SKK 100 = EUR 2.81

enterprises. The interest rate is set at 7.55%[15] for periods from 6 months up to 4 years. During 2005, 203 applications were received out of which 194 loans were provided for a total amount of EUR 2.7 m. In total, from the start of the programme, 1,219 micro loans have been provided amounting to EUR 12 m. The average amount of the loans was about EUR 10,500. All in all, 1,664 jobs have been created and 2,215 maintained from the start of the facility. The table in Annex 6.2 gives details on loans granted by regional centre.

Since the regios of Bratislava and Trnava did not dispose a of RAIC, the management of the Micro Loan Programme for these regions was given to the Seed Capital Company (see Chapter 4.5 on details) and renamed Micro Loan Fund. Since 1999, loans were provided for a total amount of EUR 1.4 m. The loans range from EUR 1,400 to EUR 42,200 for purchases of tangible and intangible assets, materials and goods.

SZRB

SZRB offers the Micro Loan and Young Entrepreneur Programme in the form of direct loans on the basis of business plans for business to be conducted in the Slovak Republic. The activities aim at supporting the development of micro and small entrepreneurs (newly established and existing) by access to credit resources. The loan amounts lie between EUR 2,800 and 42,200. In 2004 and 2005, 430 loans were accepted to an amount of EUR 11.2 m, mainly in the agriculture and retail sector, as well as hotel & restaurant business, which leads to an average loan size of about EUR 26,000. In the first nine months of 2006 this total more than doubled.

SZRB also offers "Podnikatel'ka" loans, financed with support of EU, KfW and CEB, in the form of a direct loan to enable existing and starting female entrepreneurs to have access to credit resources to help developing business activities and to reduce the time necessary for processing and executing the application. The loan amount ranges from EUR 2,800 to 28,000 with a maximum maturity of five years. In 2005 and 2006, about 120 loans were granted by SZRB with a total amount of about EUR 1.58 m, thus average loan size is about EUR 13,000.

Furthermore, SZRB issues portfolio bank guarantees (50%) for micro loans (e.g. to Tatra banka since 2004; for loans between EUR 14,000 and 140,000 of max. five years), to extend the possibilities for SME financing by flexible loans without tangible security or without purpose tracing in case of an overdraft current account. A similar cooperation is conducted with OTP Banka Slovensko a.s. and Istrobanka, a.s.. In the latter case, guarantees are granted for investment or operating loans for a maximum maturity of six years. Until the end of 2005, 232 guarantees were issued to an amount of EUR 4 m. These facilities, whereby SZRB does not handle itself loan applications, but guarantees a whole loan portfolio of an involved bank, have appeared to be quite successful: In the first three quarters of 2006 the number of issued guarantees almost doubled to 437 and total outstandings almost tripled to EUR 11 m.

Commercial funds

The following commercial banks provide loans for micro entrepreneurs: Istrobanka, OTP Bank Slovakia, Tatra Banka, VUB, UniBanka. Details on debt financing by commercial banks to SMEs in general are provided in chapter 3.3. It is difficult to quantify the existing supply of financing from commercial banks to micro enterprises or potential entrepreneurs, as SME statistics are not broken down by category micro, small, medium.

When comparing the activities of different players in the micro finance segment, it has to be taken into account that all apply different definitions with regards to micro financing. Furthermore, default rates do not seem to be available, although close management of default rates is critical to any player seeking to benefit from JEREMIE investment.

[15] Basic interest rate of the Slovak National Bank is 4.75%

Demand

Self-employment is an important way of getting out of social welfare dependency. Based on the number of population aged 25-64 (3 m) at risk of poverty, estimated in chapter 2.1 at 13.3% (2004 figure), being 400,000 people, we can estimate the potential demand for micro loans devoted to self-employment business creation. Through consultation with international experts in the field of microfinance, it is assumed that about 60% of this population can be considered as potential business creators. Within this subgroup, around 3% can be expected to start entrepreneurial activity if suitable sources of finance are available. Therefore, the number of at-risk-of-poverty people classified as likely entrepreneurs stands at 7,200 people. Assuming that an average loan size in the micro finance sector to start being self-employed could stand at EUR 10,000[16] a total demand of EUR 72 m is theoretically possible.

About 410,000 micro enterprises exist in Slovakia, comparing birth and death rates in 2005, a positive balance of about 25,000 newly created micro enterprises was recorded. The share of those investing and the average investment size does not seem to be recorded by the Slovak Statistical Office. Comparing to other Central European EU member states, the share of newly crealted investing micro enterprises could be assumed to stand at approx. 10%, with an average investment size of EUR 15,000, totalling EUR 37.5 m.

In general, a developing economy, requiring higher investment levels from companies, will have growing demand for capital by SMEs (see the table on bank credit compared to GDP on page 19), thus micro lending activities to existing enterprises can be expected to expand. Another strong indicator for a potential demand is the high death rate of small traders in 2005, as stated in the table comparing birth and death rates of SMEs on page 8. It can be assumed that at least a certain part of these small traders would not have closed their business last year with appropriate access to finance at their disposal.

Market failure & JEREMIE Recommendations

Comparing the existing supply and theoretical demand of self-employed and start-up micro companies as well as potential self-employed shows a market failure in both segments, leading to a financing gap. Furthermore, the existing state-supported guarantee volumes for micro and start-up financing are very small compared to the potential of the country (232 guarantees, EUR 4 m). In order to address these market failures, it is proposed to implement two schemes in the framework of the JEREMIE portfolio:

1. Micro Loan Guarantee Scheme targeting start-up companies

The new guarantee instrument would be ideally linked to a brand new start up loan programme designed in cooperation with commercial banks and with characteristics tailor made to better address the needs of start up companies such as low collateral requirements, possibility of grace period, advantageous interest and costs.

The commercial banks participating in the programme would dispose of an interesting marketing tool to address new clients. The lenders would manage the client relation and retain a portion of the risk, the remainder to be covered by the guarantee scheme (e.g. on a 20:80 basis). In order to increase the uptake of the start up loan and to ensure lean procedures for the granting of the guarantee, the guarantee scheme could be implemented as a portfolio guarantee, i.e. all the start up loans granted by the participating and in compliance with certain pre-agreed eligibility criteria would be "automatically" covered. Assuming that about 25,000 new micro companies are created per year, a target of 15,000 loans with an average value of EUR 15,000 over the period 2007-2013 would lead to a maximum capital commitment of approx. EUR 225 m.

[16] Compared to micro loans offered, which are more targeting existing small enterprises

Assuming a guarantee rate of 80% the capital required for the guarantee scheme would amount to about EUR 180 m[17].

2. Social Micro Loan Scheme

Support to self-employment making the beneficiaries gain independence from social welfare subsidies. While open to all the population, the programme would specifically target individuals within socio-economic groups that have less access to mainstream banking services (e.g. ethnic minorities, specific segments of the unemployed). EIF's proposal would be to start the programme with a pilot project amounting to EUR 5 m.

3.3. Debt Financing

Supply

The restructuring of the Slovak banking sector has created a competitive market for loans to large companies and the larger SMEs. Margins on these loans are low, security requirements have decreased and loan applications are being handled ever faster in order to acquire or maintain market share. This led to a reduced interest in some of the government-supported loan and guarantee programmes, which are seen as out of line with the requirements of the financial market, as they are still based on lower interest rates and require a relative long application period.

Public funds

NADSME Loan Programme

The government, PHARE and commercial banks provided funds during the last years amounting to EUR 67.5 m for a revolving loan programme. Entrusted to NADSME as coordinator and executor, 1,192 loans were provided in the total amount of about EUR 110 m from the start in 1994 until 30th March 2005 with an average loan amount of EUR 92,000. However, according to NADSME the programme has been closed for new entrants and will be wound down in the next years as the official onlending rate is not interesting anymore to the banks.

SZRB

In terms of branch structure in 2005 the SZRB supported through guarantees and loans provided the highest number of projects in the area of production (27%) and agriculture (25%). The majority of supported projects were of an investment nature (81%).

Loans supported through the Bank's business activities (of the amount of loans supported) for granted guarantees and loans					
Nature of loan	**2005**	**2004**	**2003**	**2002**	**1991-2005**
	Proportion	Proportion	Proportion	Proportion	Proportion
Investment	81%	79%	93%	89%	81%
Working capital	18%	20%	5%	11%	17%
Combined	1%	1%	2%	0%	2%
Total	**100%**	**100**	**100%**	**100%**	**100%**

a.) Guarantee Programmes

In order to facilitate access to finance for entrepreneurs with insufficient own resources to secure a bank loan but good business plans, the portfolio at the end of 2005 contained

[17] This amount represents capital commitment required in case of 100% default rate. Naturally, such figure is highly unlikely and will not be used for provisioning.

among others bank guarantees for financial loans and for micro loans (see chapter 3.2). The table below gives an overview of all guarantees:

Indicator	2005	2004	2003	2002	1991-2005
N° of delivered applications for guarantees	273	439	341	505	5 053
N° of provided guarantees	276	412	270	424	3 894
Amount of provided guarantees in EUR	34 m	44 m	30 m	60 m	385 m
Amount of supported loans with provided guarantees in EUR	54 m	61 m	46 m	76 m	560 m
Average amount of guarantees per project in EUR	124,000	107,000	113,000	141,000	99,000

b.) Lending Programmes

Direct loans are provided to SMEs, to towns and municipalities, housing cooperatives, farmers and food companies. The portfolio at December 2005 contained among others two SME loan programmes.

The following table gives an overview of all direct loans:

Indicator	2005	2004	2003	2002	1991-2005
N° of delivered loan applications	909	645	261	209	2 270
N° of loans accepted by SZRB	751	506	204	129	1,711
Amount of loans accepted by the SZRB in EUR	101 m	59 m	56 m	15.7 m	240 m
Average amount of loan accepted by the SZRB in EUR	134,000	116,000	276,000	121,000	140,000
Number of new job positions	1,517	501	1,145	425	3,947

Indirect loan programmes are implemented through selected commercial banks and financed via a KfW credit line and partially through EU grant participation. The table below illustrates indirect loan activities:

Indicator	2005	2004	2003	2002	1991-2005
N° of delivered loan applications	24	108	66	28	689
N° of loans accepted by SZRB	22	99	55	21	536
Amount of loans accepted by the SZRB in EUR	8.9 m	31.7 m	12.6 m	1.96 m	109 m
Average amount of loan accepted by the SZRB in EUR	404,000	320,000	228,000	93,600	204,000

In 2005, cooperating banks did not seem to show particular interest in this latter type of product since they had sufficient funds of their own and preferred their own credit lines, despite the very stimulating interest rate set by the SZRB.

EXIMBANKA SR

Eximbanka provides, under favourable conditions, buyers credits, including a preshipment funding for exports. These credits can be short-, medium or long-term.

Commercial banks

Commercial banks are the main source of finance for enterprises. The following table lists all commercial banks active in Slovakia; those marked in yellow have SME programmes:

Slovenská sporiteľňa		Citibank (Slovakia)
Všeobecná úverová banka		Istrobanka
Tatra banka		ING Bank
Československá obchodná banka		Wüstenrot stavebná sporiteľňa (building society)
UniBanka		HSBC Bank (since June 2005)
Dexia banka Slovensko		Privatbanka
Prvá stavebná sporiteľňa (building society)		ČSOB stavebná sporiteľňa
HVB Bank Slovakia		Calyon Bank
OTP Banka Slovensko		Komerční banka Bratislava
Ľudová banka		J&T Banka (since March 2006)
Poštová banka		Commerzbank
		Banco Mais (since September 2005)

The special programmes for the SME segment have the following tendencies[18]:

- **More flexible conditions and faster review procedure;**
- **Security requirements simplified, sometimes decreased;**
- **Credit terms increased – most of banks offer repayment periods of up to 8 years (for EIB credit lines, SLSP offers up to 20, HVB up to 15, CSOB up to 12 years);**
- **Packages of additional services offered together with the credit;**
- **Interest rates decreasing.**

In general, Slovakia has a universal banking system and commercial banks offer a wide range of products and services and have no restrictions towards borrowers, economic sectors and/or regions. The Slovak banking system is characterized by high concentration and the four largest banks have more than 60% of total assets. As at 30 June 2006, the overall loan volume of all commercial banks stood at EUR 17.2 bn (SKK 611 bn), according to the Slovak National Bank distributed as follows:

- **34% retail[19] (EUR 5.9 bn), thereof 2% to sole traders and NGOs;**
- **49% enterprises (non-financial companies) (EUR 8.5 bn);**
- **10% non-bank financial companies[20] (EUR 1.7 bn);**
- **4% general government (central and local government bodies) (EUR 648 m).**

The SME segment of the commercial banks is defined as enterprises with a turnover of EUR 845,000 – 42 m (SKK 30 m - 1.5 bn). This clearly targets small to medium-sized enterprises. Interviews with some of the commercial banks active in Slovakia tell that VUB is concentrating on enterprises with a turnover higher than EUR 2.8 m, so medium and large companies. HVB and Tatrabanka mainly give loans to companies which are in business for at least two years. Tatrabanka does not finance start-ups, in HVB it makes 13% of their total SME financing (as per August 2006). Tatrabanka targets an SME business loans share of 16% and has a decreasing rejection rate (in 2003 17%, in 2004 12%, in 2005 9%).

Statistics on the SME activities of five major banks active in Slovakia (VUB, Tatrabanka, Slovenska Sporitelna, HVB, CSOB) show that the general share of SME business loans in the total business financing has increased from 14% in 2004 to 19% in 2005. SLSP and VUB indicate an average SME loan size of about EUR 125,000. Most of the SME financing goes to the wholesale and retail sector as well as manufacturing SMEs, mainly via long-term loans, overdrafts and short-term loans. SME financing by commercial banks is concentrated in the Bratislava and Trencin region. The table below gives the SME loan loan amounts of HVB, CSOB, SLSP and VUB:

[18] Report "Access to finance for SMEs in Slovakia", Ehsal-K.U. Brussels for NADSME and Ecorys-Nei, May 2004
[19] To households, sole traders and non-profit companies serving prevailingly households
[20] other financial companies, financial intermediaries, pension and mutual funds, insurance companies

SME loans		
m EUR (EUR/SKK 36,0)	**2004**	**2005**
HVB	**161.1**	**205.6**
ČSOB	**91.7**	**194.4**
SLSP	**230.6**	**366.7**
VUB	**n.a.**	**408.3**

Demand

In the context of a Eurobarometer survey published in July 2006 on "SME Access to Finance in the New Member States", about 100 companies were interviewed in Slovakia on their access to finance situation. The amounts of loan applications seem much higher in Slovakia than in the other new EU member states: 26% of the SMEs interviewed in Slovakia already applied for a loan of more than EUR 100,000 (compared to only 15% on average in all new member states), 39% for loans between EUR 25,000 and EUR 100,000 (24% on average) and only 32% applied for a loan of less than EUR 25,000, compared to 53% on average in the new member states. However, only 45% indicate to have sufficient financing to see projects through. Compared to other new member states, the financial situation for Slovakian SMEs seems to be quite unfavourable although they see an easy access to finance as important for their successful conduction of business.

The total number of SMEs in Slovakia stands at about 470,000 and an increase can be assumed according to the economic growth in the country. In general, banking activities remain the major source of external financing for SMEs. Comparing the financial and economic development of Slovakia with other European countries shows a clear demand for increased activities in countries with rising GDP, as described in chapter 2.1.

The share of those investing and the average investment size does not seem to be recorded by the Slovak Statistical Office. Compared to other Central European EU member states, the share of investing small and medium-sized enterprises could be assumed to stand at approx. 60% and 80% respectively with average investment sizes between EUR 80,000 and EUR 400,000. Resulting from this assumption, a substantial theoretical demand seems obvious in the coming years. Another strong indicator for a potential demand is the increasing death rate of enterprises in 2005, as stated in the table comparing birth and death rates of SMEs on page 8.

Market failure & JEREMIE Recommendations

Although a high overall amount of total loan funds exists in the country, 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 on par level with some surrounding countries, but behind some of the best performing new EU member states. With such an impressive growth ratio, Slovakia is clearly in need of more credit facilities. The supply-demand gap analysis above shows a certain market failure in the debt financing sector and the existing guarantee volumes in the country are very low compared to the amount of debt financing provided to SMEs.

A solution could be the implementation of a portfolio guarantee scheme. It reflects the "revolving" aspect of the JEREMIE portfolio and has a high potential in terms of leverage as well as visibility for the Slovak government. It also presents a lean structure allowing for the outsourcing of certain activities, such as the monitoring of the guaranteed loans. More in particular, a Portfolio Loan Guarantee Scheme would increase and strengthen the co-operation with the financial institutions operating in the Slovak Republic as they would maintain the main contact with the final beneficiaries and could use the guarantee also to expand their activities in the SME segment; furthermore, it would enhance SME access to finance and lower the overall cost of financing and it would permit to reach a high number of final beneficiaries throughout the country.

Assuming that about 10% of the SMEs operating in the country (about 430,000) are investing, a target of 43,000 loans of an average value of EUR 50,000[21] over the period 2007-2013 could therefore be envisaged. Assuming an average guarantee rate of 50% and a loss rate of 10%, the capital required for the guarantee scheme would amount to about EUR 110 m.

It will be of paramount importance to involve the major SME-oriented banks operating in Slovakia during the structuring phase in order to set up a structure that on one hand enhances SME access to debt finance and on the other corresponds to the expectations of the lenders in terms of quality of the guarantee and procedures required, and provides an appropriate return to the JEREMIE Holding Fund.

Depending on the envisaged portfolio composition in terms of final beneficiaries and operations covered, as well as the estimated absorption capacity, typically a leverage of 10-15 is possible for an SME guarantee fund.

3.4. Leasing

Supply

The Slovakian Association of Leasing Companies has 38 members, of which 35 were active in 2005. The association cannot give a figure on the total number of leasing companies in Slovakia. In 2005, the market of leasing of movable assets grew faster than expected, by 22%. This growth was mainly due to advantageous taxation of leasing in comparison to standard credit sources, as well as by the increased activity of the leasing market in the process of acquisition of sales channels, as well as final customers in comparison to other financing sources. The five strongest market players are CAC Leasing, CSOB Leasing, VB Leasing, VWFS Leasing and Tatra Leasing, which were covering two thirds of the market over the last three years.

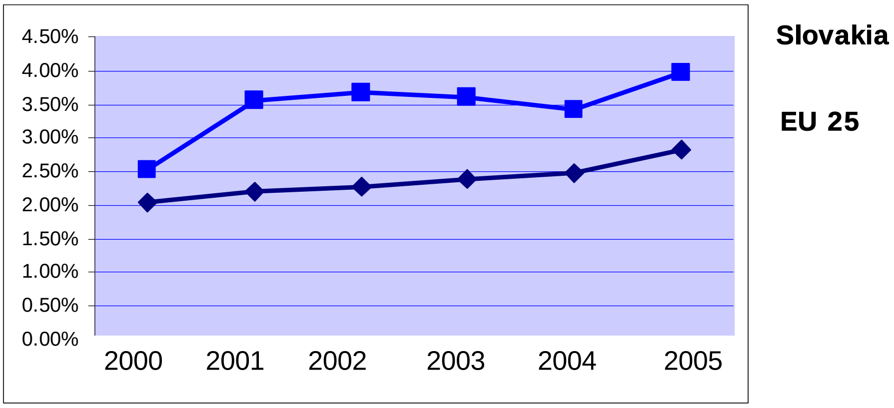
According to the Association of Leasing Companies (ALC) and Leaseurope, the total volume of leased movable and immovable objects in Slovakia reached about EUR 1.5 bn in 2005. The financing of movable and immovable assets by financial and operating leasing, hire purchase and consumer loans saw continued fast growth at the end of 2005; total market growth reached 24.4%. For the entire year of 2005, shares of the individual forms of financing of the movable market were: Financial leasing 81.2%, operating leasing 4.5%, hire purchase 3.0% and consumer loans 10.4%. A total of 75,521 contracts were concluded in the leasing market in 2005; of those, 71 were related to immovable assets.

Product Structure of Leased Movable Assets			
Type of Financing	**Acquisition Price (SKK million)**	**Acquisition Price (EUR million)**	**Share (%)**
Financial Lease	44 368	1 232	81%
Operative Lease	2 959	82	6%
Hire - purchase plans	1 656	46	3%
Consumer loans	5 688	158	10%
Movable assets total	**54 671**	**1 519**	**100%**

The reason for the high growth of financing through leasing contracts is the continued investment attractiveness of Slovakia for foreign and local investors, relatively low tax and fund contributions, growth of wages (thereby also increasing the living standard of inhabitants), private demand, less expensive and more affordable loans, decreasing unemployment, a favourable law for the financing of used vehicles and real estate, and the EU subsidy policy in the agricultural sector. The leasing-to-GDP ratio lies at about

[21] Given the country's characteristics, this programme would mainly target micro and small enterprises

4%, compared to 3.4% in Czech Republic (2005 figures) and well above the European average, as illustrated by the chart below:



Source: Leaseurope Annual Statistics

The penetration rate (proportion of assets financed by leasing out of the total amount of investments) in 2003 amounted to 14%, according to Leaseurope, which corresponds to the European average, compared to 19.1% in Czech Republic.

Demand

As identified in the Eurobarometer survey n° 174 on "SME access to finance", leasing is the preferred type of financing used by SMEs in EU-15, gradually replacing traditional debt financing. Its presently limited share of the market in Slovakia suggests that continued growth in demand for this instrument can be expected in the coming years.

Market failure & JEREMIE Recommendations

Given a strong absolute volume growth expected to continue, with growth levels and a penetration rate ahead of EU-25 average, no evidence of market failure can be observed. Therefore, no public policy action is recommended.

3.5. Factoring

The National Association of Factoring Companies was established in Slovakia in 2003. It does not conduct special activities, but members give information about their activities and turnover for information purposes. According to a study specially commissioned by EIF to the International Factors Group[22], currently 8 factoring companies are established in the country and the market is still growing. The biggest market share is held by Factoring Slovenskej sporitel'ne a.s. with Erste Bank as major shareholder, furthermore CSOB Factoring a.s., VUB Factoring a.s. and Tatra banka a.s.. In 2005, EUR 837.4 m factoring turnover was made, of which 63% with SME factoring clients. The penetration ratio (ratio factoring turnover 2005 / GDP of the country) stands at 2.19%, compared to 6% in EU-25. Comparing domestic with international factoring, Slovakia lies above the European average of international factoring activities.

Substantial space for development can be observed, especially in the management of receivables that clients apparently do not consider as value added for them. In many cases, factoring is considered as financing of last resort. There will be a big pressure from clients on the risk side of the factoring service; that is why growth of non-recourse factoring is expected, currently about 72% of the activities are with recourse. Furthermore, there are signs of growing export in Slovakia – export factoring will

[22] http://www.ifgroup.com; international factoring association with around 84 factoring members & 15 sponsors in 50 countries

increase its shares. The National Bank of Slovakia is preparing regulations for the factoring market; most of the factoring companies are part of bank groups.

Demand

The International Factors Group assesses the development in the number of factoring players in Slovakia during the last five years as lying above the European average (from 5 to 8) and the average growth of activities during the last five years stands at 35.37%, compared to 27.96% in the new EU Member States and 12.17% in EU-25. Thus, Slovakia can be considered as emerging market for factoring activities with a current turnover of EUR 837 m.

Market Failure & JEREMIE Recommendation

The average growth of the factoring market in Slovakia during the last five years stands at about 35% compared to 28% in EU-10+2 and the penetration ratio is 2.19% compared to 2.34% in EU-10+2 and 5% in EU-25.

Although the penetration ratio lies at a good level, it is a bit lower than the EU-10+2 average and about half of the EU-25 average only. Therefore, a factoring supporting scheme of EUR 50 m could be envisaged in the context of JEREMIE. Discussions with major market players would help to better assess the current situation. A financial instrument supporting the factoring activities in Slovakia could be elaborated according to these needs, e.g. a guarantee fund for 'without recourse' and 'reverse factoring' transactions or a master trust securitisation at a later stage.

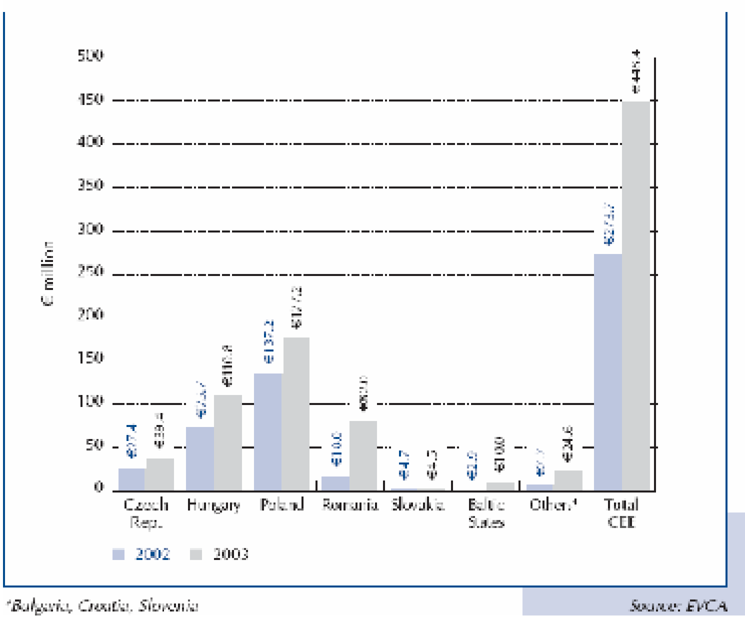
3.6. Venture Capital

In general, VC targets companies with high growth potential. Despite the high growth rates of their economies, Slovakia, and other Central European countries currently still attract a relatively low level of venture capital investment. The main causes for this can be found both on the demand and on the supply side.

Supply

There is a strong dependence in post-’89 transition years on Multilateral Development Institutions for financing of VC funds – players which are in good part pulling out of the region as it enters into the EU “mainstream”. Furthermore, investment teams with strong regional track records are still rare and little history of successful exists is achieved. The legal/fiscal/institutional frameworks for VC and SMEs are still not very favourable – although some progress has been made in this respect in recent years.

According to EVCA, EUR 5.3 m private equity funds were raised in Slovakia in 2004, the majority coming from government and multilateral agencies. About 25% of funds and number of investments went to the seed stage of companies, compared to 25% for start-ups and 50% for expansion. This is approx. the same amount as in the Czech Republic, but much less than in Poland, Hungary or even Romania. Although these numbers probably underestimate the actual market (not all investments are reported to EVCA), Slovakia’s VC sector clearly lags not only the European average, but also the level of other Central and Eastern European member states: private equity investment as percentage of GDP shows a ratio of 0.013% in 2004, compared to a European average of approx. 0.354%. With this ratio, the Slovak Republic lies together with the Czech Republic far behind the other Central European EU Member States. These data suggest that there is a lot of scope for potential growth. The following chart illustrates fund raising activities in Central and Eastern Europe in 2002 and 2003:



Source: EVCA – Central and Eastern European Success Stories 2004

VC players in the Slovak Republic include:

The Slovak American Enterprise Fund[23], established in 1991; its products help financing activities related to expansion and development, management buy-outs/buy-ins and mergers and acquisitions. Since the beginning of its existence until the end of September 2004, SAEF invested approx. USD 41 m in total, of which USD 37 m went into 45 Slovak companies in the form of equity (USD 20m) or loan (USD 17m) under the programme of Direct Investments. The Small Loan Programme has provided USD 4m to 51 companies. In 2008, SAEF will close its programmes for further investments;

Gcp[24], an independent technology VC investment firm with offices in Vienna (A), Lindenberg (D) and Bratislava (SK). It currently manages two funds in the early and expansion stage technology sector – iLab24 and gamma II – with committed capital close to EUR 40 m. Both are backed by a broad base of institutional and private investors. Geographically, Gcp focuses on D, A, CH and EU-countries bordering Austria. To date, it did not make any investments in Slovak companies;

Vencorp Slovakia[25], a.s., a subsidiary of Vencorp UK, Ltd. and has been active on the Slovak market since 2003. The size of investment into individual projects fluctuates between EUR 0.5 m and 4 m. Vencorp is exclusively focused on the quickly developing markets in Central Europe ("emerging markets"); managing at present projects in Slovakia and the Czech Republic. The company provides financing for projects on greenfield areas, but it does not deal with financial requirements for initial start-up financing. To date, no investments were made in Slovak companies;

Genesis Capital Ltd[26], manager of the Genesis Private Equity Fund (GPEF). The size of GPEF is EUR 30 m and the investors to the Fund are EIF, Česká sporitelna, EBRD and Letterkenny Holdings Ltd. The Fund seeks to make investments into dynamic companies with high growth potential domiciled in the Czech Republic and Slovakia. Genesis Capital is a member of CVCA[27] and SLOVCA[28]. It provides equity financing for acquisitions, management buy-outs, buy-ins and leveraged buy-outs, as well as for development capital. In 2006, Genesis has invested EUR 1.5 m in one Slovak company;

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23 www.saef.sk
24 www.gamma-capital.com
25 www.vencorp.sk
26 www.genesiscapital.sk
27 Czech Venture Capital Association
28 Slovak Venture Capital Association

Slovenský Rozvojový Fond, a.s (Slovak Development Fund), founded in June 2006 at the initiative of SLSP (Slovak Savings Bank), with a capital contribution of EUR 5.5 m from SLSP and EUR 14 m from NADSME. A third (institutional) investor is still being sought. Maximum investment per company EUR 1.1 m; suitable financing stages are start-up (i.e. companies with an operating track record of at least 3 years) and further stages. Its management consists of an experienced ex-banker and two experienced ex-industrialists;

Fond Fondov[29], s.r.o. (from December 1994 until April 2006 named "Seed Capital Company, s.r.o."), established by NADSME to manage the Start-up Capital Fund financed by the National PHARE Programme. The fund's resources facilitated the foundation and development of many SMEs. In 1995, the company was one of the founding members of SLOVCA and became a member of EVCA. During its existence the company has provided financial support to more than 140 companies and have realised investments up to EUR 8.5 m, indirectly contributing to the creation over 1,000 jobs. Currently, it includes 5 risk capital funds (see table below and further details in Annex 5.2); all were established from public funds, i.e. PHARE programme funds and state budget resources:

- **Start-up capital fund, established in 1995, transformed into a revolving fund, focusing on SMEs all over Slovakia, with a priority to start-up and expansion, but MBO/MBI not excluded. Investments range from EUR 0.3 m to 1.13 m with a preferred investment of EUR 0.28-0.56 m**
- **Regional Start-up Capital Fund established in 2003 to finance the development of small and medium-sized undertakings in the Banska Bystrica, Zilina, Kosice and Presov regions.**
- **INTEG Fund and SISME Fund established in 2005. INTEG fund is designed to support innovative projects of companies involved in the technological InQb STU incubators in Bratislava and Inova Tech incubator in Sládkovičovo. Financing of innovative firms from all over Slovakia is provided through the intermediation of SISME Fund.**
- **Seed Capital Fund invests in the pre-seed and seed investment stages of young and innovative SMEs. It covers the entire territory of Slovakia. Investments range from EUR 5,600 to 280,000, with a preferred investment of EUR 85,000 – 140,000. Total capital about EUR 14 m.**

In EUR (EUR/SKK 36,0)	Capital contributions (PHARE and SR Government)
Start-up capital fund	4.5 m
Regional Start-up Capital Fund	1.5 m
INTEG Fund	0.8 m
SISME Fund	1.1 m
Seed Capital Fund	14 m

The current manager of the Fond Fondov is the Slovak law firm Baducci Partners, which has VC experience and which took over the former Seed Capital Company employees.

Demand

In general, development of entrepreneurial spirit and of management skills at SME level will build up progressively.

The current level of venture capital investment represents just 0.013% of GDP or EUR 210,000 per thousand non-micro SMEs – less than 10% of the European average. Relevantly, this level is lower than the levels observed in other new EU members, such as Poland (5x higher rate to GDP) and Hungary (9x higher rate to GDP).

[29] www.fondfondov.sk

Demand could be reasonably expected to reach levels of the latter member states – which would place potential demand to EUR 20-36 m per annuum, at current levels of GDP – to grow in the course of the 2007-2013 through the double effect of GDP growth and the expansion of the financial system expressed as a share of GDP. We estimate that an annual level of EUR 50-70 m of risk capital investments could be attained by 2013.

Market Failure & JEREMIE Recommendations

Gaps between potential and realised demand cannot be filled simply by additional supply of capital, as the gap also includes a structural component (e.g. improved institutional environment and/or need to build demand by entrepreneurs through better knowledge of risk capital). However, it appears to us that there would be scope to establish a number of initiatives, in particular in the early/development stages of the financing cycles of enterprises. It will be critical in this phase to ensure an effective cooperation with the governmental agencies that provide support for SMEs as well as the entities responsible for supporting the realisation of scientific research.

JEREMIE resources could be deployed in two distinct and parallel manners in this sector:

1. **The establishment of two JEREMIE "sponsored" funds, in which the Slovak government would take a larger stake (50 to 70% of the funds' total commitments) and which would cooperate closely with the relevant government agencies:**
    - **A multi-sector Slovak Seed Capital Fund, which would provide seed equity and pre-seed participating loans to very early-stage businesses. The participating loans could, in most cases, favourably replace the R&D subsidy programs being contemplated. Such a facility would importantly benefit from a formal close cooperation (possibly presenting a single "umbrella brand" to the market) with Start-up/SME business support, R&D institutions and technology transfer services. Estimated target size (total): EUR 50 m, to be leveraged with a further EUR 30 m of capital from other investors.**
    - **A multi-sector Slovak Emerging Growth Fund, which would target early- and development-stage investments in SMEs through equity or hybrid equity/loan financing, with a set split per investment stage. The objective of this fund would be to ensure a financing continuum for growing/successful Slovak SMEs beyond the seed stage. The investment scope could include the automotive supply chain, as well as energy & environment-related businesses. Estimated target size: EUR 50 m, to be leveraged with a further EUR 30 m of capital from other investors.**
2. **Smaller investments (10-25% of the funds' of total commitments) in 10-15 quality private VC fund initiatives targeting Slovak SMEs. Estimated target size (total): EUR 50-60 m.**

These risk capital schemes would have to be established in accordance with good practices of the private venture capital sector, in particular with regard to ensuring the independence of management, the economic self-sustainability and the alignment (and adequacy) of incentives between all investors and management.

The management of the Seed Capital Fund, should, as mentioned above, be coordinated as much as possible with Slovak institutions/agencies involved in the development/promotion of output from Research and Development. In addition to this VC fund, and in order to attempt to realise a larger portion the potential of Slovak R&D, the Seed Capital Fund could also establish a synergetic relationship with possible technology transfer vehicles – e.g. patent fund (see Section 3.7 hereafter).

3.7. Technology Transfer

Supply

According to the European Trend Chart on Innovation[30], the Slovak R&D sector produces very few scientific publications and makes a low number of patent applications. In general the share of high-tech products in total exports is low. The 2004-2005 Global Competitiveness Survey states that the contribution of R&D and innovation to competitiveness growth was fairly limited. In terms of education, the Slovak Statistical Office reports that the number of higher and secondary education graduates is increasing in the country, compared to basic school leavers. The gross domestic expenditure on R&D as a percentage of GDP lies at 0.53% in Slovakia, compared to 1.86% in EU-25, and seems even to have decreased through the last four years. Slovakia is importing double the share of high-tech goods than exporting. However, according to the Eurobarometer survey on “Population Innovation Readiness”, published in August 2005, Slovakia is one of the EU Member States with the highest portion of pro-innovation citizens, seeing innovation as “improvement of existing products and services” and thus “being more inclined to purchase innovative products or services”.

Business and technological incubators provide starting entrepreneurs with suitable starting conditions for the operation of their enterprise during the period of at least 3 years. At present, 13 incubators are in the operation and support newly established enterprises in individual regions and 6 others are under construction. The incubators were supported by the funds from the Phare, state programme or European funds.

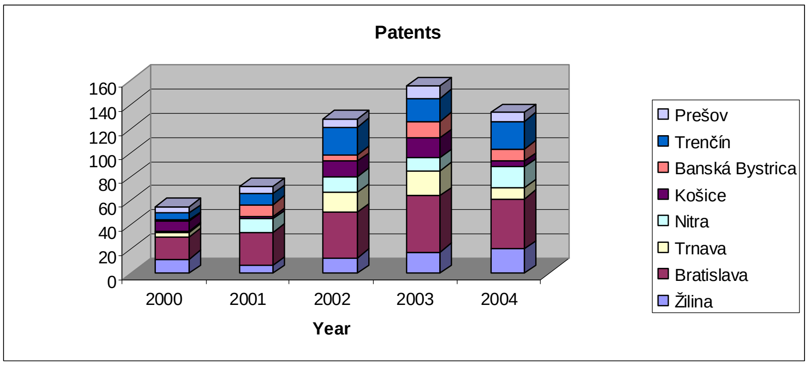
The Slovak Research and Development Agency is a government entity supporting R&D in all science disciplines and technology. It provides new forms of research support with increased interaction between different factors and society-awareness. It develops programmes in the context of international cooperation. Its main role is to provide earmarked funding of science and technology in line with the government science and technology policy. In 2005, about EUR 12 m of funds were allocated to 377 R&D projects, mainly for physical and technical sciences. Apart from Bratislava universities and colleges, their counterparts in Kosice and Zilina are also among successful applicants.

The Innovation Fund, administered by the Ministry of Economy is directed towards supporting R&D in industrial sectors. In 2004, the Fund supported three innovative projects through about EUR 205,000. The funding of the projects approved will continue by releasing additional EUR 352,000 in 2005 and EUR 70,000 in 2006. The Fund provided EUR 660,000 to assist the R&D part of projects in 2005.

SARIO (Slovak business development agency) records 18 existing **industrial parks** and some 45 sites to be completed. State-run industrial parks are eligible to receive state aid if located in an under-developed area with high unemployment and established by a municipality (SOP Industry and Services, measure 1.2).

The number of **patents** issued in Slovakia increased from 55 in 2000 to 155 in 2003, with a decrease in the following year – 133 in 2004, according to the Slovak R&D Agency. In 2003, the number of patent applications to the European Patent Office per million inhabitants lay at about 8,100 compared to 137,000 in EU-25. Obviously, most of the patents are issued in the Bratislava region, followed by Trencin and Zilina:

[30] Annual Innovation Policy Trends and Appraisal Report Slovakia 2005/6, http://trendchart.cordis.lu/reports/documents/Country_Report_Slovak%20Republic_2006.pdf



Source: Slovak R&D Agency

A support scheme for the purchase of innovative technologies and for the setting up of quality management systems is the outcome of the transformation of government programmes entitled Technology Transfer programme and Implementation Programme of Quality Management Systems. In 2005, grants totalling about EUR 31,000 were disbursed to 13 companies to implement quality management systems and EUR 365,000 to companies for the purchase of innovative technologies.

Demand

Demand for strengthening R&D non-grant measures exists in all European countries, given its proven impact on performance and competitiveness. In the context of patent activities, according to the Slovak Industrial Property Office's (SIPO) Annual Report 2005, the number of applications submitted by Slovak applicants in 2005 was extremely low. The causes identified by SIPO are a generally passive approach to support innovation activities (absence of pro-active and networked patent offices) and a low priority given to R&D in Slovakia.

Market failure & JEREMIE Recommendations

Effective management of technology transfer is key to improve an economy's innovation level, which is a major priority of the EU Lisbon Strategy. The R&D-to-GDP ratio mentioned above is very low compared in Slovakia compared to EU-25 which proves insufficient supply in this field. In this context, a recurrent challenge faced by institutions and corporations conducting R&D across Europe is the low ratio of realisation of intellectual property (IP).

To support a more fruitful realisation of IP produced by Slovak research institutions, technology transfer offices (TOs) would need to be established/reinforced in key research institutions to aid the creation of and promote the realisation of intellectual property produced by Slovak Research and Development. These TOs would need to be networked nationally (and possibly internationally), thus enabling an overview of R&D in the country (or part thereof) and the exchange of best practives between TOs.

Once a sufficient nucleus of functional TOs is in place, the establishment of an Intellectual Property ("IP") Fund in the framework of JEREMIE could be envisaged. The IP fund would acquire the rights to selected individual patents (and/or patent portfolios) from research institutions and corporations, and seek to realise the value through licensing out, sale or creation a spin-off into a new business. There is potential for dramatically improving the effectiveness of the technology transfer process in the country and it can substitute non-repayable aid, like pre-seed grants with a self-sustaining financial instrument that could benefit from external/private leverage.

Such a pilot fund could initially amount to EUR 10 m, structured to acquire rights to c. 150-200 patents. The Fund would need to be managed by appropriately qualified investment professionals, combining legal (IP) and investment expertise.

3.8. Business Angels

A Business Angel is a private individual who invests part of his personal assets in a start-up and also shares his personal business management experience with the entrepreneur. A Business Angel network is an organisation whose aim is to facilitate the matching of entrepreneurs (looking for venture capital) with business angels. Business Angel networks tend to remain neutral and generally refrain from formally evaluating business plans or angels. BANs make a market place for matching services. The majority of Business Angel networks operating in the EU are legally set up as not-for-profit organisations, private entities, or possibly foundations. Most of them receive public support and very few are commercially oriented. Main activities are: Raising awareness, training, creation of investment-readiness, financing through public support. The number of networks has strongly evolved in the past few years. In Europe, they are particularly active in Germany, France, UK, Sweden and Spain. [31]

Supply

According to the European Business Angels Network (www.eban.org), an official business angels network does not exist in Slovakia.

NADSME has been coordinating with the UK firm Exemplas the activities of several individual business angels, but lacks adequate financial means to continue this.

In discussions with SLOVCA, it was indicated that there might be interest from within the group of succesful young IT entrepreneurs to act as business angels. SLOVCA would be interested to manage the secretariat of such a network, but does not have the capacity to set it up.

Demand

Business financing through informal, individual investors is strongly needed in every country. Absence or limited activities restricts significantly the number of new enterprises created, especially the most innovative ones which, at their early stages, are very often financed by business angels. Strenghtened technology transfer activities and the potential deal flow coming from this development will result in an even increased demand for this type of financing in the coming years.

Market Failure & JEREMIE Recommendation

The market failure in the Business Angels segment in Slovakia seems obvious due to strong potential demand and a practical absence of existing supply.

As business angels tend to operate within limited geographical and sectoral areas, the existence of a well-functioning and efficient network is an important condition preparing the ground for increasing activities.

It is thus recommended to help enhancing Business Angels activities in Slovakia through the JEREMIE Programme with a total amount of EUR 5m for:

1. **Capacity-building:**

   Establishment of a fund to stimulate the development of a Business Angel network in wide geographical and industry areas. Operational costs which are beyond the JEREMIE scope could be financed by grants.

[31] European Business Angels Network, www.eban.org

After some years of capacity-building to establish a network, a pilot project is recommended:

2. **Pilot project: "Pool Fund" to stimulate investment readiness**

   Limited investment provided by business angels stems from aversion to taking risk by individual investors. Based on EIF's experience, it is expected that such reluctance can be overcome by setting up a fund, supported by private contributions from business angels as well as JEREMIE contribution, which will pool the expected risk among limited partners. Alternatively, a pilot co-investment facility can be established. Such a fund would provide matching investments at a fixed proportion, alongside selected networks if Business Angels.

4. Next Steps

4.1 Proposed Actions and Responsibilities

In order to finalize the process of analysis and preparation for the implementation of the JEREMIE Holding Fund, the following actions are to be undertaken:

№	Action	Responsibility	Due Date
1	Approval of Gap Analysis	SR	Jan 07
2	Decisions on allocations to JEREMIE	SR	Jan 07
3	Appointment of JEREMIE Holding Fund Manager	SR	Feb 07
4	Establishment of JEREMIE Investment Board	SR	Q1 07
5	Drafting of JEREMIE Business Plan	HF Manager	May 07
6	Investment Board decision on Business Plan, first round of instruments, incl. budget	IB (SR)	June 07
7	Setting-up of first round of instruments	HF Manager	Q3 + Q4 07

4.2 Conclusions on the Role of JEREMIE

As a result of this gap analysis on SME access to finance supply and demand in Slovakia, EIF comes to the conclusion that the Slovak Republic can draw substantial benefits from the implementation of the JEREMIE Programme during the next EU budgetary period 2007-2013.

The programme should adopt an appropriate portfolio of financial instruments, identified in this report and should implement them together with all local institutions involved with maximum participation from the private sector. In order for the portfolio to be constantly updated, it should be balanced in nature and should not shift balance to the benefit of one specific instrument. Moreover, the JEREMIE Holding Fund should have a range of flexibility to meet the dynamic market conditions throughout the implementation phase and thus bring substantial advantages to the Slovakian SMEs by facilitiating access to finance.

5. Annexes

5.1. Tables Supporting Chapter 1 and 2

Age	Total		
	Total	Male	Female
Total	**5,389,180**	**2,615,872**	**2,773,308**
0 - 19	1,302,414	666,421	635,993
20 - 24	447,529	228,466	219,063
25 - 64	3,006,599	1,484,679	1,521,920
65 +	632,638	236,306	396,332

SOURCE: Statistical Office

	2000	2001	2002	2003	2004	2005
Economically active persons	2,608.20	2,652.50	2,628.20	2,634.30	2,658.60	2,645.70
Employed	2,101.70	2,123.70	2,127.00	2,164.60	2,170.40	2,216.20
Unemployed	485.2	508	486.9	459.2	480.7	427.5
Economic activity rate (%)	60.3	60.7	60.2	60.3	60.2	59.5
Unemployment rate (%)	18.6	19.2	18.5	17.4	18.1	16.2

Source: SLOVSTAT

	2002	2003	2004	2005	2006	2007	2008
CPI inflation (average)	3.3	8.5	7.5	2.7	4,2*	2,0*	2,0*

** forecast*

Source: SLOVSTAT, NBS

5.2. Tables Supporting Chapter 3

<u>Micro finance</u>

Overview of micro-loans granted, by centres (NADSME loan programme)				
Centre	**N° of micro loans granted in 2005**	**Amount of micro loans granted in 2005, in SKK**	**N° of micro loans granted in total**	**Total amount of micro loans granted, in SKK**
RAIC Dunajská Streda	0	0	7	18 050 420
RAIC Komárno	12	8 070 000	81	31 075 000
RAIC Martin	12	7 643 500	53	23 027 000
RAIC Nitra	8	4 786 090	49	22 557 909
RAIC Považská Bystrica	10	7 357 410	57	48 067 191
RAIC Prešov	18	6 654 460	173	48 867 000
RAIC Prievidza	8	4 830 000	142	43 440 000
RAIC Spišská Nová Ves	31	8 470 000	98	19 495 000
RAIC Trenčín	11	3 633 000	52	24 607 464
RAIC Trebišov	3	2 800 000	27	24 841 000
RAIC Zvolen	13	6 315 000	98	45 621 810

Seed Capital Company, s.r.o.	4	2 473 860	68	40 775 000
RAIC Lučenec	16	8 310 000	148	16 977 725
RAIC Poprad	17	7 425 000	38	6 462 066
RAIC Košice	31	18 200 000	128	10 596 464
Total	**194**	**96 968 320**	**1219**	**424 461 049**

Venture Capital

Funds managed by Fond Fondov, s.r.o.

Start-up capital fund

Investment target	**SME – small and medium enterprises**
Form of financing	**capital participation**
	combination of capital participation/loan
Investment volume	**minimum amount: SKK 0.2 m**
	maximum amount: SKK 20.0 m
	preferred amount: SKK 6.0 – 8.0 m
Investment period	**according to contract; flexible 1-5 years**
Scope of financing	**minority stakes, preferably in the range 10 – 40 %**
Geographical eligibility	**Slovak republic**
Suitable financing stages	**initial (seed)**
	start-up
	development
Eligible sectors	**industry production**
	production services (transport, construction activities, maintenance and repair services)
	innovative enterprises
	active travel industry (support of tourist travel to Slovakia, operation of hotels and family hotels)
Non-eligible sectors	**agricultural basic industry, farming**
	production of weapons, alcoholic beverages, provision of erotic services, operation of gambling houses
	passive travel industry
	whole sale and retail sale
Expenses eligible for financing	**only expenses logically and materially associated with the realisation of business plan and the stage of company life cycle**
Investment criteria	**return on investment**
	management quality
	security of demand
	creation/maintenance of work positions
	no negative impact on environment
	project innovativeness

Regional start-up capital fund

Investment target	**SME – small and medium enterprises**
Form of financing	**capital participation**
	combination of capital participation/loan
Investment volume	**minimum amount: SKK 0.2 m**
	maximum amount: SKK 5.0 m
	preferred amount: SKK 2.0 – 3.0 m
Investment period	**according to contract; flexible 1-5 years**
Scope of financing	**minority stakes, preferably in the range 10 – 40 %**

Geographical eligibility	**Slovak republic - Banska Bystrica, Zilina, Presov and Kosice regions**
Suitable financing stages	**initial (seed)**
	start-up
	development
Eligible sectors	**industry production**
	production services (transport, construction activities, maintenance and repair services)
	services of trade
	active travel industry (support of tourist travel to Slovakia, operation of hotels and family hotels)
Non-eligible sectors	**agricultural basic industry, farming**
	production of weapons, alcoholic beverages, provision of erotic services, operation of gambling houses
	passive travel industry
	retail sale – counter sale
Expenses eligible for financing	**only expenses logically and materially associated with the realisation of business plan and the stage of company life cycle**
Investment criteria	**return on investment**
	management quality
	security of demand
	creation/maintenance of work positions
	no negative impact on environment
	project innovativeness

INTEG fund

Investment target	**SME – small and medium enterprises**
Form of financing	**capital participation**
	combination of capital participation/loan
Investment volume	**minimum amount: undetermined**
	maximum amount: SKK 4.0 m
	preferred amount: SKK 0.5 – 1.0 m
Investment period	**according to contract; flexible 1-5 years**
Scope of financing	**minority stakes, preferably in the range 10 – 40 %, majority stake not excluded**
Geographical eligibility	**Slovak republic – Bratislava county, Trnava county * company must be involved in the InQb or Inova Tech incubators**
Suitable financing stages	**initial (seed)**
	start-up
Eligible sectors	**innovative projects from the area of industry production, production and trade services and new technologies**
Non-eligible sectors	**agricultural basic industry, farming**
	production of weapons, alcoholic beverages, provision of erotic services, operation of gambling houses
Expenses eligible for financing	**only expenses logically and materially associated with the realisation of business plan and the stage of company life cycle**
Investment criteria	**return on investment**
	management quality
	innovativeness of business plan
	commerciability of product and services
	no negative impact on environment

SISME fund

Investment target	SME – small and medium enterprises
Form of financing	capital participation
	combination of capital participation/loan
Investment volume	minimum amount: undetermined
	maximum amount: SKK 5.0 m
	preferred amount: SKK 2.0 – 3.0 m
Investment period	according to contract; flexible 1-5 years
Scope of financing	minority stakes, preferably in the range 10 – 40 %, majority stake not excluded
Geographical eligibility	Slovak republic
Suitable financing stages	initial (seed)
	start-up
Eligible sectors	innovative projects from the area of industry production, production and trade services and new technologies
Non-eligible sectors	agricultural basic industry, farming
	production of weapons, alcoholic beverages, provision of erotic services, operation of gambling houses
Expenses eligible for financing	only expenses logically and materially associated with the realisation of business plan and the stage of company life cycle
Investment criteria	return on investment
	management quality
	innovativeness of business plan
	commerciability of product and services
	no negative impact on environment

Seed Capital Fund

Investment target	SME – small and medium enterprises
Form of financing	capital participation
	combination of capital participation/loan
Investment volume	minimum amount: SKK 0.2 m
	maximum amount: SKK 10.0 m
	preferred amount: SKK 3.0 – 5.0 m
Investment period	according to contract; flexible 1-5 years
Scope of financing	minority stakes, preferably in the range 10 – 40 %, majority stake not excluded
Geographical eligibility	Slovak republic
Suitable financing stages	initial (seed)
Eligible sectors	without limitation
Non-eligible sectors	agricultural basic industry, farming
	production of weapons, alcoholic beverages, provision of erotic services, operation of gambling houses
	passive travel industry
Expenses eligible for financing	only expenses logically and materially associated with the realisation of business plan and the stage of company life cycle
Investment criteria	return on investment
	management quality
	innovativeness of business plan
	higher share of added value
	commerciability of product and services
	value growth

Micro-loan fund

Eligibility criteria	**entrepreneur, legal or natural person with less than 50 employees**
	holder of trade license, concession or other authorisation to undertake business activities
	citizen of European Union
	registered seat on the territory of the Slovak republic
	clean criminal record
	registered seat in the following districts: Bratislava, Senec, Pezinok, Malacky, Trnava, Senica, Skalica
Loan conditions	**micro-loan amount: SKK 50 000 - 1 500 000,-**
	interest rate is fixed within the duration of loan contract
	actual interest rate is based on Basic interest rate of the NBS + 2%
	loan repayment period is from 6 months to 4 years (upon entrepreneur's request the instalment payments of principal sum can be postponed by maximum 6 months)
Use of loan	**purchase of tangible and intangible investment assets**
	reconstruction and repair of operation premises
	purchase of material
	purchase of goods
Required guarantees	**In order to be provided a loan a guarantee in the value of at least the amount of provided funds is required; the subject of financing can also serve as a guarantee (in the case of tangible and intangible investment assets) The entrepreneur may provide a personal guarantee or a third party guarantee may be accepted.**

Private sector Fund with public sector contribution

Slovenský Rozvojový Fond, a.s. - Slovak Development Fund

Investment target	**SME – small and medium enterprises**
Form of financing	**capital participation**
	combination of capital participation/loan
Investment volume	**minimum amount: undetermined**
	maximum amount: SKK 40,0 mil.
Investment period	**according to contract; flexible 1-5 years**
Scope of financing	**minority stakes, preferably above 25%**
Geographical eligibility	**Slovak republic**
Suitable financing stages	**start-up**
	development
Eligible sectors	**SME – small and medium enterprises**
Non-eligible sectors	**agricultural basic industry, farming**
	production of weapons, alcoholic beverages, provision of erotic services, operation of gambling houses
	passive travel industry
	whole sale and retail sale
Expenses eligible for financing	**only expenses logically and materially associated with the realisation of business plan and the stage of company life cycle**
Investment criteria	**return on investment**
	management quality
	security of demand
	creation/maintenance of work positions
	no negative impact on environment
	project innovativeness

5.3. Historical Use of EU Pre-Accession and Structural Funds

Structural Funds 2004-2006

Between 2004 and 2006, EU Structural Funds allocations to Slovakia amounted to about EUR 1.54 bn, of which EUR 838 m for Objective 1 regions (whole country except Bratislava region) and EUR 564 m from the Cohesion Fund[32]. Slovakia has so far drawn down only 27.6% of this allocation[33]. This is slightly above the average recorded in the ten new EU Member States and the government expects that the share will rise sharply by end of 2006 owing to back-loading of funds. The low utilisation rate for EU funds also reflects the national co-financing requirement which would place an unsustainable burden on expenditure it if were met in full. Furthermore, according to EIU, weak administrative capacity represents a serious impediment to the absorption of EU funds.

NADSME has been serving as the implementing agency for Structural Funds since 2004, focusing on SME support through direct support and/or indirect support provided by setting up of infrastructure to secure development of business activities on the part of the public sector. It has been in charge of the implementation of two measures of the Sectoral Operational Programme Industry and Services: Measure 1.1 „Development Support of New and Existing Enterprises and Services“ intended for the private sector, and measure 1.2 „Support of the Construction and Rehabilitation of Infrastructure“, reserved to applicants from the public sector. Both measures are part of Priority 1 „Improved Competitiveness of the Industry and Services Taking Advantage of the Development of the Domestic Growth Potential“.

In general, the SOP IS regards regions corresponding to NUTS II level, i.e. those with purchasing power parity-based GDP per capita less then 75% of the Community’s average over the last few years. From the geographic point of view, this covers Slovakia’s entire territory except for the Bratislava Region. SOP IS is funded from the ERDF, EUR 133.76 m were allocated for the programming period 2004-2006.

The Management Authority of SOP IS, (Ministry of Economy) is responsible for effective and correct management, provision and use of the funds in compliance with EU regulations and institutional, legal and financial systems and provisions of the Slovak Republic. MoE SR uses a network of existing implementation agencies in its competence to appoint Mediating Authorities under the Management Authority:

- **NADSME**
- **SEA (Slovak energy agency)**
- **SARIO (Slovak Investment and Trade Development Agency)**
- **SACR (Slovak Tourist Board)**

NADSME - Measure 1.1 - Support of New and Existing Enterprises and Services

It is aimed to support business development in the sphere of industry and services, increase the employment rate and the living standard in regions via the public sector and to facilitate SME assertion in the international cooperation and EU accession, i.e. the goal is to contribute to the development of regions by means of the development of SMEs. The following table shows the number of contracted projects by region:

Region	Number of projects	Amount of NFC
Banská Bystrica	3	47 517 568,48 SKK
Košice	6	106 893 296,80 SKK
Nitra	8	112 704 719,00 SKK
Prešov	11	404 864 973,90 SKK
Trnava	8	228 701 156,70 SKK

32 DG Regio Factsheet: http://ec.europa.eu/regional_policy/atlas2007/fiche/sk_en.pdf
33 Economist Intelligence Unit, Slovakia Report November 2006, p. 20

Trenčín	7	185 245 058,50 SKK
Žilina	7	116 007 519,80 SKK
TOTAL	**50**	**1 201 934 293,60 SKK**

As at 31st December 2005, 13 projects that were executed according to contracts on the provision of NFC were accomplished in the total amount of SK 87,128 m, i.e. 26% of all projects in the Measure 1.1 with the drawing of contracted funds at 7,2%.

NADSME - Measure 1.2 - Support of the Construction and Rehabilitation of Infrastructure

It is aimed at the support in the area of industry and services, the increase of the employment rate and living standard in regions via the public sector. Within the measure, eligible activities that are under the patronage of NADSME, are directed at the support of building incubators, technological parks and research and development centres. They represent a support mechanism through which the public sector enables SMEs to start up business, expand their production, stabilize their market positions and innovate production and production processes and thus improve their competitiveness. Among others, national projects focus on set-up of a craft institute.

As at 31st December 2005, 7 signed contracts came into effect, in one case the public procurement is in the process and thus the contract cannot be valid before the procurement has been finished. By the end of 2005, 7 projects were carried out. The following table shows the number and amount of contracted projects by regions:

Region	Number of projects	Amount of NFC
Banská Bystrica	2	95 509 169,60
Košice	4	112 307 933,90
Nitra	0	0
Prešov	0	0
Trnava	0	0
Trenčín	1	37 571 930,00
Žilina	1	21 306 634,20
TOTAL	**8**	**266 695 667,70**

Use of structural funds for the implementation of support programmes:

PRIORITY / STRUCTURAL FUNDS MEASURES	Amount in Thousand SK
I. Improvement of the competitiveness of SMEs	**245,790**
Measure 1.1 Support of Development of New and Existing Enterprises and Services	242,123
Measure 1.2 Construction and Rehabilitation of Infrastructure	3,667

Pre-Accession Aid before 2004

Before 2004, the Slovak Republic received pre-accession aid under PHARE, ISPA and SAPARD. The EU committed EUR 434.8 m under the Phare programme until the end of 2000 and EUR 106 m of pre-accession aid for 2000-2004.

NADSME has been acting, since 2001, as the implementing agency of PHARE Programmes of SME support. In 2005, NADSME was implementing 3 grant schemes under the Financial Memorandum 2002: Industrial Development Grant Scheme (IDGS), Tourism Development Grant Scheme (TDGS 2002), and Innovations and Technologies Grant Scheme (INTEG). Two grant schemes under Financial Memorandum 2003 started to be implemented, namely Support of Innovative SMEs Grant Scheme (SISME) and

Tourism Development Grant Scheme (TDGS 2003). The following table shows the drawing of funds from PHARE programmes in 2005:

USE OF FUNDS	In thousand EUR	In thousand SK
I. Facilitation of access of SMEs to capital	1 900,00	71 911,20
- Seed Capital Company (SCC)	1 900,00	71 911,20
II. Improvement of the competitiveness of SMEs	10 794,3	408 542,42
- First Contact Points	91,1	3447,8
- IDGS Grants	3 635,00	137 577,48
- Technical assistance for IDGS	86,20	3 262,49
- TDGS 2002 Grants	3 789,00	143 406
- Technical assistance for TDGS 2002	0,00	0,00
- Business incubators under INTEG	2 335,00	88 375,08
- Technical assistance for INTEG	376,00	14 230,84
- SISME Grants	0,00	0,00
- Technical assistance for SISME	210,00	7 948,08
- TGDS 2003 Grants	153,00	5 790,74
- Technical assistance for TDGS 2003	119,00	4 503,91
Total I. - II.	**12 694,3**	**480 453,62**

In the context of the ISPA programme, Slovakia received a total commitment allocation of € 50.6 m in 2003 - € 17.6 m for the transport sector and € 32.7 m for the environment sector. Technical assistance accounted for € 0.3 m; the total allocation for Slovakia represented 4.5% of the overall ISPA budget in 2003.

In the environment sector, projects included an upgrading of a heating plant in Žilina, Košice City Sewerage and Waste Water Treatment as well as waste water disposal system of the Šaľa region. In the transport sector, no further projects were decided, but projects allocated were implemented, e.g. modernisation of the rail track between Rača and Šenkvice and the motorway project in Bratislava (D 61).

Projects Decided 2003 Slovakia - €						
Sector	**N° of Projects**	**Total Cost**	**Total Eligible Cost**	**Total ISPA Contribution**	**Commitments**	**Payments**
Environment						
Air Pollution	1	12,000,000	12,000,000	9,000,000	2,600,000	-
Drinking Water and Sewage	1	6,660,000	6,660,000	9,782,500	5,830,000	1,017,950
Drinking Water, Sewage and Solid Waste	1	820,000	820,000	615,000	245,000	-
Sewage Network/ Treatment Plant	6	119,217,462	103,416,953	61,854,163	11,399,466	-
Sector Total	**9**	**138,697,462**	**127,846,953**	**81,251,663**	**20,074,466**	**1,017,950**
Transport						
Rail and Road	1	1,600,000	1,600,000	1,200,000	480,000	-
Sector Total	**1**	**1,600,000**	**1,600,000**	**1,200,000**	**480,000**	**-**
TOTAL	**10**	**18,951,760**	**18,951,760**	**15,651,320**	**6,845,000**	**1,017,950**