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USAID ESP CROATIA, SETTING UP OF A REGIONAL LOAN GUARANTEE SCHEME IN ŠIBENIK-KNIN COUNTY

Final report

APRIL 2007

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Draft Final Report

Table of Contents

IMPLEMENTED ACTIVITIES	4
ACTIVITY 1: GATHERING BACKGROUND INFORMATION ON THE BANKING SECTOR IN CROATIA	4
ACTIVITY 2: GATHERING BACKGROUND INFORMATION ON THE COUNTY'S ECONOMIC SITUATION	4
ACTIVITY 3: COORDINATION WITH THE REPRESENTATIVES OF THE COUNTY AND MINISTRY OF THE ECONOMY, LABOUR AND ENTREPRENEURSHIP IN CROATIA	5
ACTIVITY 4: PREPARATION OF THE GS MODEL	5
ACTIVITY 5: PREPARATION OF DOCUMENTS AND MATERIALS	6
ACTIVITY 6: TRAINING OF HUMAN RESOURCES	7
LIST OF ANNEXES	8

BACKGROUND

All 3 Consultants were members of the “Business incubator Mandalina” (BIM) project team, co-financed by the Delegation of the European Commission in Croatia, CARDS 2002 Grant scheme. The aim of this project was the transfer of know-how to the newly established business incubator and capacity building of its staff. The project started with 1st of July 2005 and has finished on the 11th of April 2007.

Experiences and contacts gathered during the implementation of the above-mentioned project have been valuable to the implementation of the STTA for setting up the GS in Šibenik-Knin County. On the other hand, during the implementation of the BIM project we have identified, that lack of adequate financial instruments is one of key problems in the County. The GS will fill the gap and make especially for start-up companies possible to receive loans from banks.

The STTA has started with a delay due to difficulties by signing the Technical Assistance Partnership Agreement (TAPA) between USAID and Šibenik-Knin County (County).

IMPLEMENTED ACTIVITIES

After the County signed the TAPA, the Consultants began the STTA. During the technical support duration following activities have been implemented:

ACTIVITY 1: GATHERING BACKGROUND INFORMATION ON THE BANKING SECTOR IN CROATIA

With the support of USAID ESP Finance team the Consultants gathered information on the Croatian banking sector and analyzed these in order to be able to adapt the Guarantee scheme (GS) model to banks as one of key partners of the GS.

Very helpful was the round table on the December 17 2006 in Zagreb at Privredna Banka Zagreb, organized by ESP, where the Consultants could get an impression of the bank's interest to cooperate as well as under which conditions they are willing to work with regional GS's. We have exchanged ideas and points of views with other GS managers from counties which have already started with their GS. All this is incorporated into the GS model for the Šibenik-Knin County, although the basic parameters of the GS will comply with USAID ESP's recommended guidelines. Very important information from this round table was that if the guarantees will not be more then 100.000 EUR, then there is no need for special approval from.Croatian Competition Agency. Most of the GS already operating have contracts with more then one bank, some even with 10 banks. Some GS charge membership fees; besides this they also charge the lenders either 1 % of the loan or 2 % of the guarantee. This amount goes into the GS fund as increase of gurantee potential. Most of the existing GS limit loans up to 50.000 EUR (with the exception of DAN, which approves up to 100.000 EUR) with a maximum guarantee of 50 %.

ACTIVITY 2: GATHERING BACKGROUND INFORMATION ON THE COUNTY'S ECONOMIC SITUATION

It was a clear advantage that all 3 Consultants have been involved in the "Business incubator Mandalina" project, co-financed by the Delegation of the European Commission in Croatia. During the implementation of this project the Consultants have got to know the County's economy very well. By this we refer to the "Analysis of Business environment" document, prepared during the "Business incubator Mandalina" project and to the experiences, contacts and personal communications with representatives of key business support institutions in Šibenik-Knin County. All this know-how is incorporated into the GS model.

ACTIVITY 3: COORDINATION WITH THE REPRESENTATIVES OF THE COUNTY AND MINISTRY OF THE ECONOMY, LABOUR AND ENTREPRENEURSHIP IN CROATIA

Although not a direct part of the STTA the Consultants had to get involved also into raising commitment by the County itself. Initially we had the impression that the County appeared committed to the GS, but didn't really know how to approach the project and finalize it.

Therefore, consultants had meetings with the County as well as with the representatives of the Ministry of the Economy, Labour and Entrepreneurship in Croatia (Deputy Minister Mr. Bračić, who also visited consultants in Slovenia) in order to facilitate the communication between them. The result of these activities is, that the County reserved 1 mil Kuna in its budget for 2007 (also a result of a new County prefect being elected, Mr. Goran Pauk) and that the Ministry of the Economy, Labour and Entrepreneurship has promised (although not yet in writing) additional 1 mil Kuna for the County GS. This means, that at least the 1 mil Kuna from the County can already be used for the GS in 2007.

ACTIVITY 4: PREPARATION OF THE GS MODEL

During the preparation of the GS Model, meetings with Mr. Drago Matić (Director of Regional Development Agency of the Šibenik-Knin County) were held. These meetings have been very important, because we have identified that the best organization for the GS management is the Regional Development Agency (RDA) in the name of the County. The reason for decision for the GS management comes from the fact that the GS is the County's project and they already are the majority owner of the RDA. Taking into consideration, that the RDA is financed by the County and in 2007 will employ 6 new employees as well as the fact that the GS will be RDA's complementary service to the County's economy the RDA is the best option for the GS management organization. A new management company would only create unnecessary costs.

One of the difficulties for defining the GS model was the model, developed by the Croatian Ministry of the Economy, Labour and Entrepreneurship. The Model that the Consultants have defended and supported also by USAID had some important differences to the Ministry's model. Therefore, we have arranged a meeting with the County and the Deputy Minister Mr. Bračić in order to clear these differences and come to a common point. This process was very important, even though it was time consuming, in order to get the Ministry's support and funds.

Based on the meetings on the 7th of December, the Consultants prepared the draft GS model and presented it to USAID and County, which in turn presented it also to the Ministry of Economy, Labour and Entrepreneurship. All involved parties accepted the final GS Model.

The GS model adhered to ESP requirements:

- the Guarantee Scheme will check whether the projects have the attributes which were defined initially as necessary for approving the guarantee, but it will rely on the participating banks to do the due diligence on loan applications.
- the portion of loan guaranteed should not be more than 60%
- the scheme should work with several (not just one) participating banks
- the scheme should guarantee only loans that provide "new money" (no refinancing of existing loans)
- the scheme should place prudent limits as to maximum exposure to a single borrower and to a single industry
- in exchange for the scheme's unconditional guarantees, the participating banks should be willing to reduce their normal collateral requirements

ACTIVITY 5: PREPARATION OF DOCUMENTS AND MATERIALS

Parallel to the above described activities the Consultants have prepared basic documents and materials (templates), which will be used in the day-to day work of the GS. Following draft documents and materials are finished:

- General conditions for GS members
- Rules of the Guarantee committee's work
- Contract for investors
- Contract for Guarantee users
- Codex of members
- Tender sample
- Guarantee sample
- GS member ID
- Invitation to Guarantee Committee meeting
- Guarantee committee meeting report
- Leaflet "How to become a GS member"
- Application form
- Application sheet
- Business plan template
- Evaluation sheet

All these documents and materials have been adapted to the GS Model.

ACTIVITY 6: TRAINING OF HUMAN RESOURCES

The reason for the late conclusion of the STTA was recruitment of Šibenik-Knin RDA staff. However, on the end Mr. Drago Matić, director of RDA Šibenik-Knin County, has decided not to wait for newly recruited staff but to hold the training program with him only and he will implement the training of staff alone. Nevertheless, the STTA Consultants have agreed with Mr. Matić to support him at this training of staff if the need for this will be present. Ms. Tatjana Horvath from USAID ESP Croatia has also attended.

The training was implemented on the 11th of April 2007 in Murska Sobota. STTA Consultants have explained the GS Model in detail as well as all GS materials. For the negotiations with banks, guidelines have been given together with marketing approaches for promoting the GS in the County among entrepreneurs.

Following the training program and based on good previous cooperation with the Šibenik-Knin County, the STTA Consultants and Mr. Matić agreed that the Consultants will support the first tender for Guarantees with advises when possible in Šibenik.

LIST OF ANNEXES

- Annex 1. Guarantee Scheme Model
- Annex 2. General Terms and Conditions for Memberships
- Annex 3. Guarantee Scheme Rules and Regulations
- Annex 4. Agreement on Investment of Funds
- Annex 5. Agreement on Membership in Guarantee Scheme
- Annex 6. Guarantee Scheme Members Code
- Annex 7. Tender Sample
- Annex 8. Guarantee Sample
- Annex 9. Member ID
- Annex 10. Invitation to Guarantee Scheme
- Annex 11. Guarantee Scheme Meeting Report
- Annex 12. How to Became the Guarantee Scheme Member
- Annex 13. Application Form
- Annex 14. Application Sheet
- Annex 15. Business Plan Template
- Annex 16. Evaluation Sheet

Annex 1

REGIONAL LOAN GUARANTEE SCHEME MODEL PROPOSAL

ŠIBENIK-KNIN COUNTY

May 2007

INDEX

GUARANTEE SCHEME MODEL PROPOSAL	ERROR! BOOKMARK NOT DEFINED.
FOR ŠIBENIK-KNIN COUNTY	ERROR! BOOKMARK NOT DEFINED.
INDEX	ERROR! BOOKMARK NOT DEFINED.
1. DESCRIPTION AND OBJECTIVES OF THE GUARANTEE SCHEME PROJECT - RGI	ERROR! BOOKMARK NOT DEFINED.
2. IMPLEMENTATION	ERROR! BOOKMARK NOT DEFINED.
2.1. OFFER TO ENTREPRENEURS	ERROR! BOOKMARK NOT DEFINED.
2.2. GUARANTEES	ERROR! BOOKMARK NOT DEFINED.
2.3. TRAINING FOR ENTREPRENEURS	ERROR! BOOKMARK NOT DEFINED.
3. SWOT ANALYSIS OF THE PROJECT AND DEVELOPMENT STRATEGY	ERROR! BOOKMARK NOT DEFINED.
4. PROJECT DEVELOPMENT STRATEGY	ERROR! BOOKMARK NOT DEFINED.
5. PROJECT PARTNERS	ERROR! BOOKMARK NOT DEFINED.
5.1. INTERESTS AND EXPECTATIONS	ERROR! BOOKMARK NOT DEFINED.
5.2. BENEFITS	ERROR! BOOKMARK NOT DEFINED.
5.3. LOAN AND GUARANTEE POTENTIAL SCHEME	ERROR! BOOKMARK NOT DEFINED.
5.4. THE ROLE OF PARTNERS	ERROR! BOOKMARK NOT DEFINED.
5.4.1. BANKS	ERROR! BOOKMARK NOT DEFINED.
5.4.2. NATIONAL LEVEL	ERROR! BOOKMARK NOT DEFINED.
5.4.3. CHAMBERS OF CRAFTS CHAMBER OF ECONOMY	ERROR! BOOKMARK NOT DEFINED.
5.4.4. LOCAL COMMUNITIES	ERROR! BOOKMARK NOT DEFINED.
5.4.5. ENTREPRENEURS	ERROR! BOOKMARK NOT DEFINED.
5.4.6. INSURANCE COMPANIES	ERROR! BOOKMARK NOT DEFINED.
5.4.7. LOAN SECURITY TECHNIQUES	ERROR! BOOKMARK NOT DEFINED.
6. MODEL IMPLEMENTATION ORGANIZATION AND NECESSARY STAFF	ERROR! BOOKMARK NOT DEFINED.
6.1. GUARANTEE SCHEME WORKFLOW	ERROR! BOOKMARK NOT DEFINED.
6.2. RESOURCES NEEDED FOR PROJECT IMPLEMENTATION	ERROR! BOOKMARK NOT DEFINED.
6.2.1. HUMAN RESOURCES	ERROR! BOOKMARK NOT DEFINED.
6.2.2. OTHER RESOURCES	ERROR! BOOKMARK NOT DEFINED.
6.2.3. REQUIRED INVESTMENTS	ERROR! BOOKMARK NOT DEFINED.
6.3. BASIC CRITERIA FOR GUARANTEE APPROVAL	ERROR! BOOKMARK NOT DEFINED.
6.4. MODEL SENSITIVITY	ERROR! BOOKMARK NOT DEFINED.
6.5. CRITICAL POINTS OF THE MODEL AND NECESSARY MEASURES	ERROR! BOOKMARK NOT DEFINED.
7. Conclusion	ERROR! BOOKMARK NOT DEFINED.

1. GUARANTEE SCHEME PROJECT (RGI) DESCRIPTION AND OBJECTIVES

Guarantee scheme is one of the tools or instruments for the development of the SME sector and the entire Šibenik-Knin County. RGI is not a typical and profit oriented financial organization. It is a development project with which the national government, the County and other partners will try to stimulate economic development.

Pomurje Guarantee Scheme, which has been successfully operating for the past ten years, served as the model. It took more than two years for the scheme to be ready to issue guarantees, and that time was used to study the following systems of guarantee funds:

- Germany (visits and reading);
- Italy (study tour and consultants);
- Hungary (operations in practice);
- Spain (through EU consultant).

Comparisons have shown that it is not possible to take over the entire model from one system, as well as that it is not possible to use the Pomurje Guarantee Scheme and plant it into Croatian environment without thorough adaptation. Hungarian and German examples are cases of systematic financing from the government or banks (this is not defined in Slovenia and Croatia). Spanish and Italian systems function on the basis of big membership (not enough critical mass in Slovenia and Croatia). This example requires a combination of public and entrepreneurial sources. In an economically underdeveloped area such as the Šibenik-Knin County, it will be necessary to rely mostly on public funds. In areas with developed entrepreneurship, their funds could have a more significant role.

The presented model is intended as a project with an aim to find solutions for open issues, establish a system which will be able to operate in Croatian conditions (legislation, licenses, funding).

From a conversation held with the Ministry of Economy, Labor, and Entrepreneurship (Dec. 07, 2006), on the subject of establishing a pilot guarantee scheme in Croatia, conclusions could be drawn that allocated funds could be transferred to the Regional Development Agency (RDA) based on the original contract between the Ministry, the County, and deposit banks. The RDA will be trained to perform the technical activities and will manage the implementation of the project in the entire County.

The following are the objectives of the project:

1. Faster access to loan potential (shorter procedures, non-mortgage loans, **increased confidence of banks**, dispersed risk)
2. Access to softer loans (lower interest rates, the same as with usual loans)
3. Systematic transfer of financial know-to SMEs, and ensured greater volume of technical assistance to entrepreneurship.
4. Consolidation of different financial sources (local, national, entrepreneurial) and dispersed risk
5. SMEs more efficient in investment and in operations.
6. Combination of different forms of financing for SMEs.
7. Development of the SME sector would result in faster development of the County and better living standards for the public.

2. IMPLEMENTATION

The project has **two** (three) levels, with the following expectations and roles:

a) National level (MELE, HAMAG, HBOR)

- Project management and building a unified operations system with government support;
- Ensure HRK 1 mil. necessary to form the guarantee potential
- Project monitoring
- Negotiate and cooperate with banks on national level
- Award „concessions“ for project implementation
- Co-financing of specialist consultants

b) Regional level

- Cooperation in the creation, management and implementation of the project and of the guarantee scheme policy
- Coordinate regional activities
- Attracting partners
- Joint management of the funds

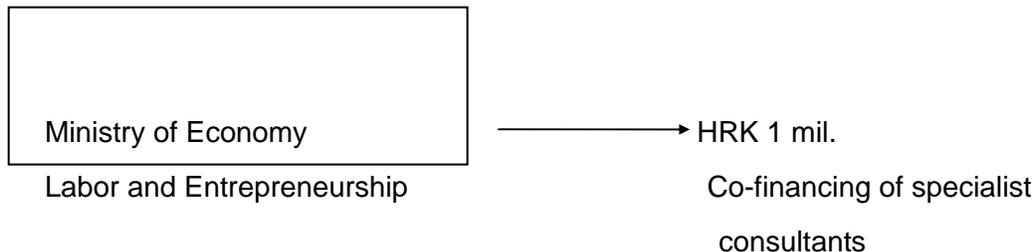
- Agreements with implementing organizations and contractual partners
- Manage the operations of the credit board and other bodies of the RGI
- Training for regional implementers
- Define guarantee quotas and planned performance

c) Local level: **OPTION!**

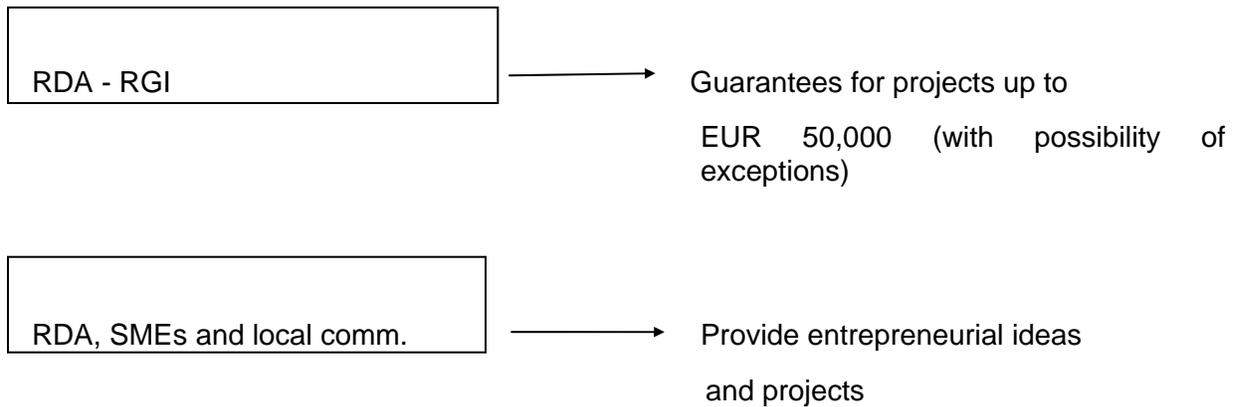
- Joint management and implementation of the project
- Collect application, evaluate them and prepare proposals for granting guarantees
- Organize technical assistance for entrepreneurs
- Training, operations and territorial coverage of services in the region (local chambers of crafts in cooperation with banks, local centers and licensed consultants)

2.1. SERVICES PROVIDED TO ENTREPRENEURS

a) NATIONAL LEVEL:

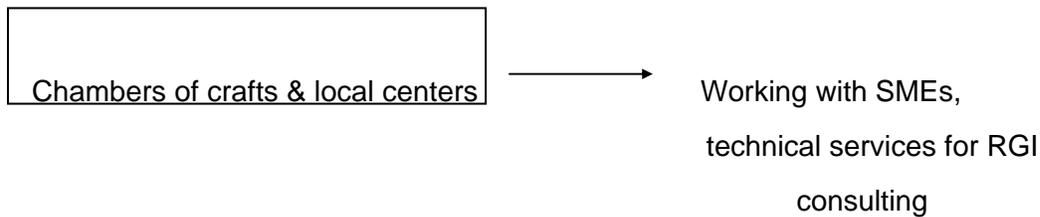


b) REGIONAL LEVEL



OPTION!

c) LOCAL LEVEL (local development initiatives)



2.2. GUARANTEES

As presented above in Services Provided to SMEs, guarantees would be processed for loans up to EUR 50,000 (with possibility of exceptions). Projects requiring larger amounts would be referred to HAMAG to find a joint solution where HAMAG would take on the risk. RGI is one of the pilot-projects. This means that, through its operations, any errors that occur would be corrected and better solutions found.

This proposal is based on the cooperation with USAID, chambers, banks and RDA.

Adopting MELE's proposal, the government is going to supply HRK 1 mil. to the RGI early in 2007. The County also allocated HRK 1mil. for the project. MELE stipulated the actions that

need to be implemented before starting operations (consent from the government - license, guarantee status)

2.3. TRAINING FOR SMES

Transfer of financial know-how to SMEs is one of the important elements of the project. This involves different forms of specialist consultations and training in financing. It is necessary to organize (and certify by RDA/RGI) consultants for financing, and ensure funding for monitoring and supporting SMEs. Only then will their performance be improved. This part of the project requires a special approach, organization and funds, which have already be secured by the government by co-financing consulting services.

3. SWOT ANALYSIS OF THE PROJECT AND DEVELOPMENT STRATEGY

In the SWOT analysis, we start with the possibilities to implement and develop the project. In this, we considered the situation and needs of the SME sector in the County, the organization of the support environment, the size of the environment and recommendations from MELE and USAID regarding project implementation.

STRENGTHS:

- Experience in financing SMEs in Pomurje, Slovenia
- Experience in evaluating entrepreneurial projects
- Familiarization with SMEs and developed support environment
- Current cooperation between municipalities and cities in financing SMEs
- Experience with joint tenders for national funds of the Republic of Slovenia
- Registered for performing “guarantee work” with the EU

WEAKNESSES:

- Unbalanced development of the support environment in the County
- Municipalities and cities in the County have different approach to SME development
- Small concentration of SMEs
- Small competition among banks
- Currently limited human resources of RDA

OPPORTUNITIES:

- Status of the pilot-project
- Great interest from SMEs in the County
- Allocated government funds
- Local communities ready to invest
- Possibility of combining with existing micro-loans on the local level
- Development of consulting activities in financing and transfer of know-how to SMEs
- Cooperation with banks
- Transfer of know-how and experience to other areas of the country

THREATS:

- Politicization of RGI
- Complicated operations and decision making system and undefined organizational structure,
- Entrepreneurs have a passive approach regarding further project development,
- Concerns from the government and commercial banks,
- Investment risk too high and inadequate monitoring of approved projects

4. PROJECT DEVELOPMENT STRATEGY

- Among the Strengths, the experience in financing SMEs in Pomurje, Slovenia is the most significant
- The greatest weakness is the unbalanced development of the support environment in the County
- Among opportunities, the best results could be achieved by the pilot phase, in combination with the transfer of financial know-how to SMEs.
- The greatest threats are the complicated operations system and undefined organizational structure. This threat can be avoided by efficient management of the project and continual search for better solutions. Reservations of the banks could decrease the efficiency of the project, which could, in turn, influence its further development.

The following are further strategic actions:

- a) Find an organizational form which will efficiently cover the entire County. It should be as simple as possible and should enable professional and proficient performance.
- b) Training for staff in project implementation
- c) Combining and developing different forms of financing for SMEs so that the needs of all target groups are met
- d) Apart from financial support and grants, ensure transfer of financial know-how to SMEs.
- e) Cooperation in finding the most suitable technical solutions and sources of financing.
- f) Establish cooperation with banks and insurance companies.
- g) Establish continuity of investment into RGI**

5. PROJECT PARTNERS

5.1. INTERESTS AND EXPECTATIONS

No.	Partners	Contribution	Interests	Expectations
1	Cities and municipalities	Project support	Quotas for local area	New jobs, development
2	National level	Investment, knowledge system, co-financing	Establish system, monitoring, development of entrepreneurship	Taxes, smaller social transfers, efficient MELE
3	RDA	Policy, management and creation of project, training for implementers	Create policy, development of RGI	Development of SMEs in the region
4	Chambers	Investment, part of services, information, co-management	Perform a part of services and new services for members	Member benefits, guarantees
5	Selected professional institutions	Micro-loans, knowledge, services, information	Implement and organize technical activities, cooperation in creating policies	Concession, influence in the area, development of services, market
6	SMEs	Membership fees, dues and co-management	Guarantees and more favorable sources of financing	Greater efficiency, smaller costs and technical assistance
7	Banks and insurance companies	Taking on a part of the risk, knowledge, create services for SMEs	Smaller risk and market development	Smaller expenses, efficiency, more clients
8	Large companies	Participation in the form of donation	Development of SMEs, cooperation and relationships with the environment	Cooperative partners in the area and lower costs

Note:

All of the above partners are interested in project development and implementation. Expected contributions vary, as do interests and expected benefits of joining the project.

5.2. BENEFITS

Benefits can be divided into three categories:

- a) General contribution to the development of the SME sector and the County
- b) Benefits for and financial impact on entrepreneurs
- b) Benefits for and financial impact on the support environment and RDA
- d) Benefits for banks and insurance companies

General impact

General contribution to development of the SME sector and the County will be evaluated and measured by different criteria. The basic criteria include new jobs, number of SMEs, their growth and growth of the living standards in the County. Another measurable criteria is the fact that the government will participate with HRK 1 mil. allocated to the region.

Benefits for entrepreneurs

With entrepreneurs, too, not all benefits are measurable. One of such benefits is greater confidence of banks and easier access to different types of financing.

Measurable benefits include the following:

- Guaranteed loans will be approved by banks. Cost of collateral will be lower, procedures faster. It is estimated that financing cost for an individual loan will be 0.8 % (bank) + 0.5 % (RGI) = 1.3 %.
- Maximal reduction of risk in financing SMEs. 5% annually could bring significant cost savings to entrepreneurs and reduce the number of bad investments.

- Transfer of financial know-how to SMEs would increase their efficiency and reduce risks.

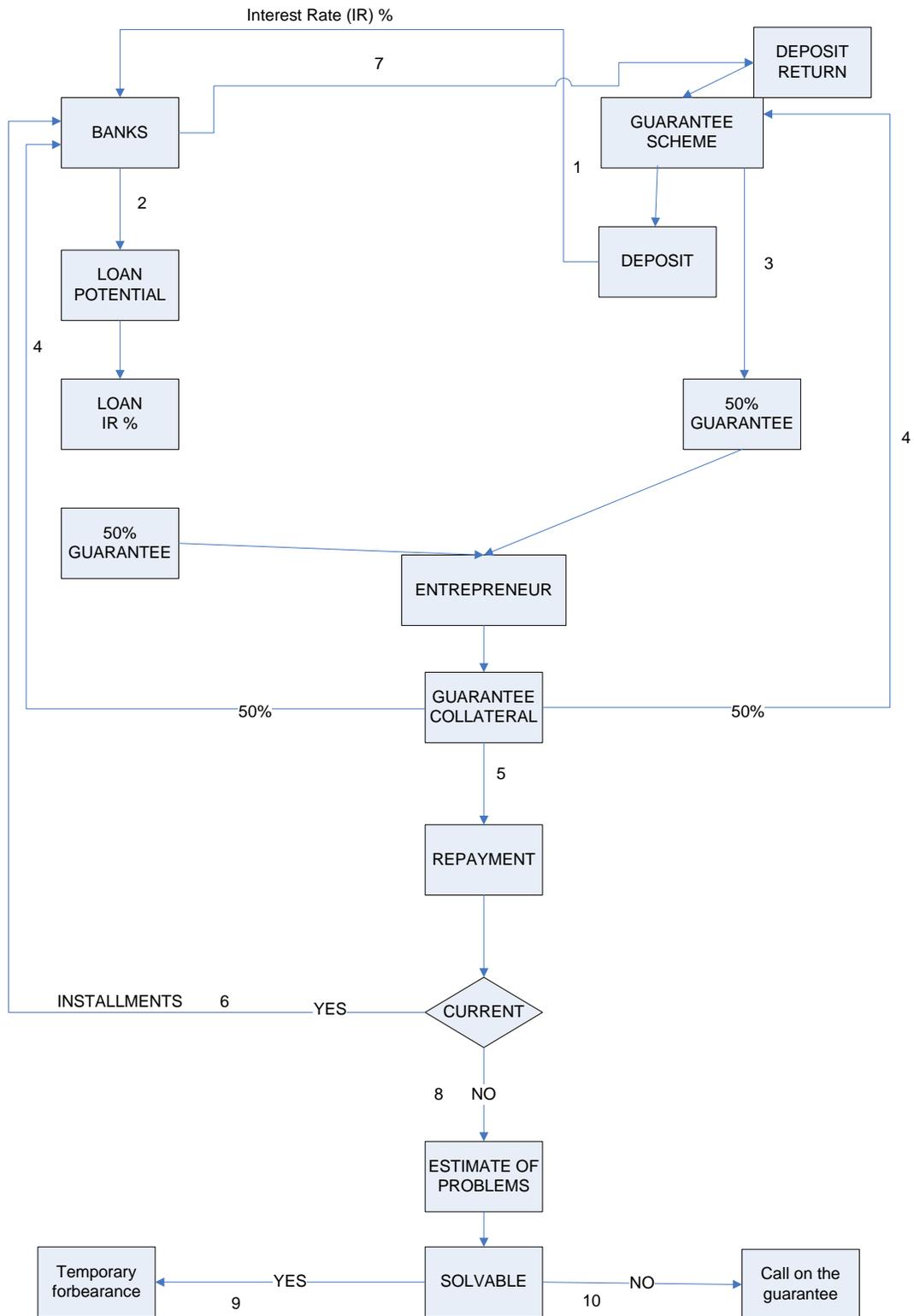
Benefits for the support environment

Support environment will become recognizable, useful, and efficient. Consulting market will gradually develop. Quality of services will improve. Good consultants will have more work in their respective areas and will assume more responsibility for consulting services delivered. Benefits for RDA and project partners are evident in financial projections. It is important to note that the project is not “profit-oriented“ but development oriented.

Benefits for banks and insurance companies

Smaller risk in approving loans and greater client satisfaction. Stronger SMEs mean bigger market for banks and insurance companies. Access to funding at more favorable terms than usual cost of capital. Wider range of financial arrangements and other services offered by these organizations. Cooperation with government institutions.

5.3. LOAN AND GUARANTEE POTENTIAL SCHEME



RDA will form the “guarantee potential” from the funds supplied by different partners. Cooperation will be offered to banks operating in the County. Banks that agree on the terms will sign a Cooperation Agreement.

RDA/RGI will deposit funds with partner banks at + 0% with the bank approving loans to entrepreneurs. The amount of the loans extended will be determined by multiplying the deposit. The Credit Board of RDA will approve guarantees to selected projects. 50% of the approved loan will be guaranteed (with possibility for exceptions), with the bank taking collateral for the remaining portion. SMEs will secure the guarantee by faster and more affordable collateral, such as mortgage. A special agreement will be made with insurance companies to reduce the cost of insurance (life insurance, benefits for guarantee scheme members, mutual guarantees among members etc.).

5.4. THE ROLE OF PARTNERS

5.4.1. BANKS

Banks will be offered cooperation in the following areas:

- a) Creation and operational management of the project
 - Finding applicable solutions
 - Professional assistance to implementers
 - Part of implementation activities (agreement signing, technical assistance to SMEs, taking care of collection, consultant training)

- b) participate in the credit board and project council.

- c) take on a part of the risks (50%).

- d) Form a favorable loan potential for SMEs (based on the fixed-term deposit)

- e) Cooperation in venture investments (equity position)

Most of the banks operating in the County will be invited to cooperate. It would be best to establish cooperation with those banks that have the largest client base and influence.

Banks will be presented with the basic conditions defined by RGI founders. Agreements on Cooperation will be signed with banks.

Guarantees

RDA/RGI will participate in securing loans up to the amount of the kuna equivalent of €50,000. 50 % of the risk will be assumed with the purpose of:

- Ensuring the most favorable loan potential to SMEs,
- Reducing collateral costs
- Improving access to favorable loans for SMEs
- Assisting SMEs in implementing projects and reducing risks

This is a dissemination of the financial support to SMEs on regional/county level, implemented at national level.

Proposal:

- RDA/RGI will guarantee up to 50% of loans for SME projects, where loan amount does not exceed the kuna equivalent of €50,000.
- The bank will assume 50% of risk and cooperate in the operations of the joint credit board.
- Loans will be approved with maturity of 3-5 years
- Multiplier of the guarantee deposit will be up to 5.
- The bank will collaborate with the RDA/RGI in implementation of the project (signing agreements, monitoring SMEs) and prepare the calculation of all expenses for SMEs taking loans (all conditions and expenses must be known).

Short term deposits and loans for SMEs

RDA and the County will also make fixed-term deposits in banks under the defined interest rates which will result in more favorable financing for SMEs in the region.

5.4.2. NATIONAL LEVEL

Stimulating the development of SMEs in the Šibenik-Knin County should be one of the government's tools for stimulating the development of economy in other regions. Incentive measures should be coordinated, specific and such to produce synergy effects. Financial incentives are an efficient way to stimulate the development of SMEs. The government initiated the development of new forms of financial support to small businesses and enabled their use in the County.

Proposal:

- The government should ensure the continuity of project implementation and development
- The same amount of funding that is allocated by the government will probably be ensured from the local and regional levels.
- RDA/RGI can contribute to the supply of national financial instruments.
- Participation in guarantees for loans larger than those included in the scheme
- Training for quality (licensed) financial consultants
- Investments of short-term deposits in the banks in the County indirectly support regional development.
- Financial instrument is decentralized, costs are lowered and efficiency increased
- Interests of financial institutions in the County are taken into consideration
- The range of services provided to the SME sector is increased, which will contribute to their growth and competitiveness.

5.4.3. CHAMBERS OF CRAFTS AND CHAMBER OF ECONOMY

Members of the chamber of crafts will be the largest loan and guarantee users. All surveys have indicated that access to funding constitutes one of the greatest problems that crafts and SMEs are faced with. This can be at least partially remedied by RGI.

Due to assistance from the national level with concrete financial contribution and the possibility that the guarantee scheme will be one of the first in Croatia..Chambers are actively approaching the project and by investing, contributing to the funds. In this, they work closely with local communities and donors. The wish of all project partners is, in the long run, to make the RGI a "fund" for crafts and SMEs. This will happen when crafts and SMEs become majority investors and gain majority for the decision making process. The Chamber of Crafts and the Chamber of Economy have the following roles in the project:

- Partner role
- representatives in the project council and/or the credit board;
- Possible implementers in collecting and processing applications and monitoring financed projects;
- Control of the use of invested funds.

5.4.4. LOCAL COMMUNITIES

Economic development and job creation are important for local communities. This can be ensured primarily by developing the SME sector, widening the base of entrepreneurs and developing entrepreneurship in rural areas. For small business development it is the individual, as the carrier of the idea and implementer of business opportunities, and funding, which is necessary to start and develop a business, that are the most important.

Financial incentives, transfer of financial know-how to SMEs and development of currently unavailable forms of financing, such as seed capital, start-up capital, venture capital and guarantees, these are some of the specific measures for faster development of the SME sector. To these, we could also add conditions for investments which will create new jobs.

Šibenik-Knin County, with the help from the central government, was one of the first in the country to start forming the guarantee potential in the amount of HRK 1 mil. The central government also allocated HRK 1 mil. for the pilot-phase of the project. RDA and partners need to attract local communities to collect at least that much funding from within the County. It would be good if local communities would work together on local development initiatives, some of which have already been formed. Direct connections between communities should not constitute obstacles for cooperation on the project. The recommendation for municipalities and cities is to allocate some funds from their budget for incentives to the SME sector. This should result in the government's stimulation by allowing other benefits. One of such benefits would be funding for guarantees which individual areas of the County will be able to use based on their own participation in the project. These funds should not be collected only from municipalities and cities, but also from entrepreneurs, chambers of crafts and donor organizations from certain area.

Municipalities and cities could have the following roles in the project:

- Partners;
- representatives in the project council and joint representatives in the credit board;
- help form the guarantee quota for their area and criteria for the award of guarantees (general criteria)
- Control the use of invested funds.

RDA offers assistance to partner municipalities and cities (co-founders of the RGI and project participants) in forming the system for local financing of the SME sector and creation of new jobs.

5.4.5. ENTREPRENEURS

The County is one of the less developed areas of the country, as far as entrepreneurship is concerned. Development of the SME sector in the County is far behind the national average, which causes problems in restructuring of the economy, its efficiency, adaptability and employment possibilities.

Faster creation of new businesses, sustainability and further growth of the existing businesses therefore in many aspects depends on more favorable financing options. This does not mean only lower interest rates. It is important to develop financial instruments such as seed, start-up and venture capital. The issues of guarantees for loans and financial know-how in SMEs, which would decrease business risks are especially significant.

The government has recognized the needs of small businesses. In cooperation with the County, they offered the RGI project. This project would meet the needs of SMEs in the County, regarding guarantees for loans. At the same time, easier and more affordable access to financing would be ensured (lower interest rates). Partners in this project are all those interested in faster development of the SME sector: Government, chambers of crafts, chamber of economy, municipalities, cities and banks. Cooperation of different donor organizations is also requested.

The envisioned future development of the RGI is for it to become an Enterprise Fund. This means that entrepreneurs will be the ones to manage it. This will only occur once entrepreneurs and their associations become majority investors. It is not realistic to expect this to happen now, but could be realized in the future.

RGI will offer the following to start-up entrepreneurs and SMEs less than 3 years in business:

- A substantial loan potential with the banks (interest rate to be determined, for loans up to €50,000, maturity of 3 to 5 years)
- RDA/RGI will guarantee up to 50% of the loan
- Additional collateral for the remainder portion of the loan from the SME.
- Technical assistance in implementing projects and specialist financial consulting

Role of entrepreneurs:

- Co-founders in the RGI with participation of €100.
- Membership in the guarantee scheme and a one-time fee in the amount of €150 (with recommendations from two fund members).
- Influence the relevant chambers, municipalities, cities and banks to join the project.
- Use of guarantees and technical assistance.
- Participation in scheme management through representatives.

.4.7. LOAN SECURITY TECHNIQUES

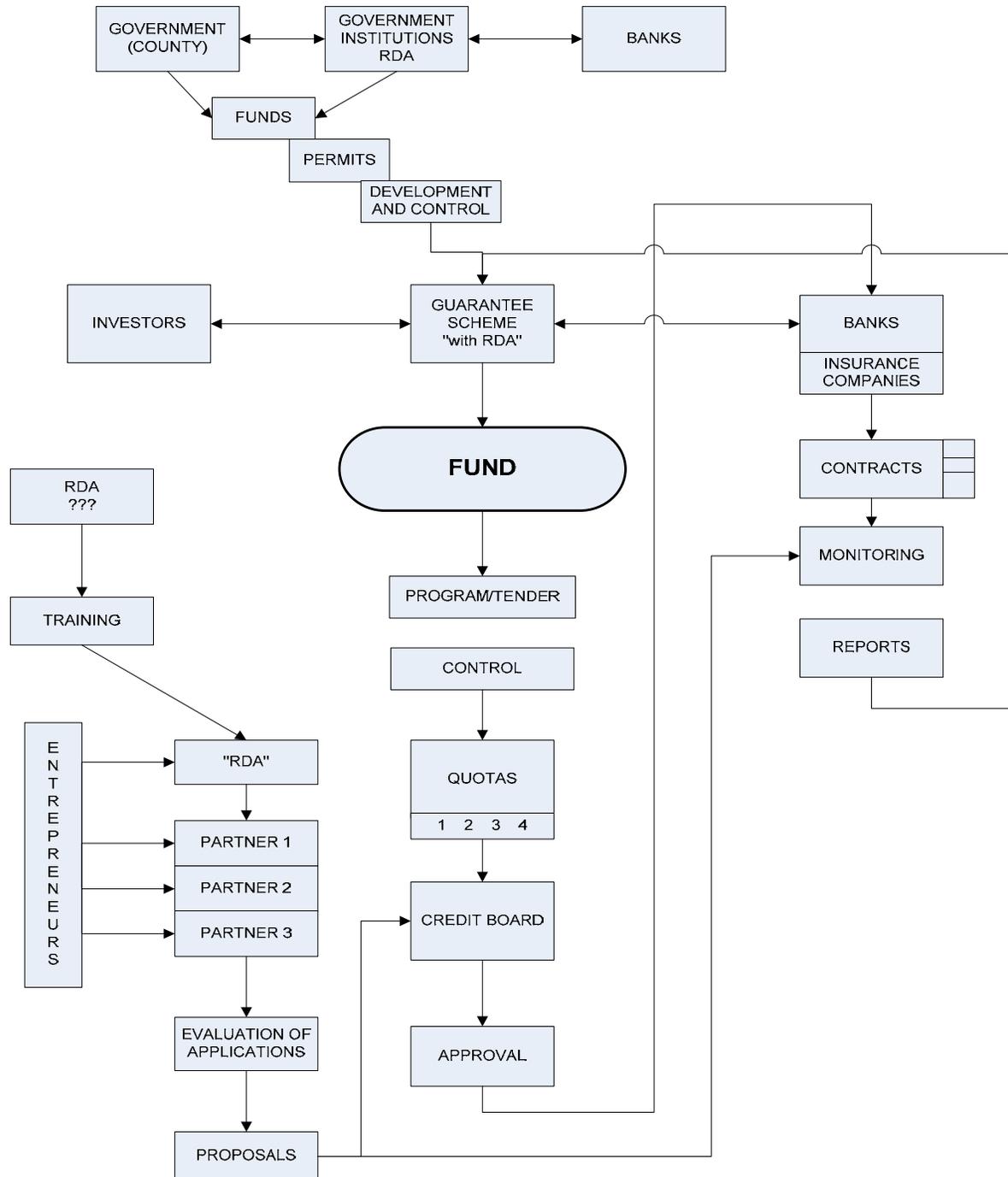
When securing the approved loan, special attention needs to be paid to reduce the risk as much as possible, while taking care that the collateral is acceptable both to the lender and to SMEs (loan security cost to be as low as possible) – connecting collateral demanded in the past with a combination of long-term deposits from different sources. Loans would additionally be secured by an agreement on loan collateral, own bonds, cosigners, lombard loans, and securities (both for companies with public offering, and for those without it, whose market value can be established), security by restricted share transfer in life and rent insurance.

THE FOLLOWING LOAN SECURITY WOULD PRIMARILY BE USED

- a) acceptance order
- b) Bonds (restricted share transfer)
- c) Securities

6. MODEL IMPLEMENTATION ORGANIZATION AND NECESSARY STAFF

6.1. FUNCTIONING OF THE GUARANTEE SCHEME



The diagram clearly shows the following:

- This is a national project which will be continuously developed and monitored
- RDA forms the guarantee potential with interested investors investing in it
- RDA prepares the work program for RGI, rules of procedure and agreements, which are based on consultations with the government, investors banks and insurance companies.
- Guarantee quotas are prepared for each area. Quotas are based on real investments of specific areas.
- RDA Board appoints the credit board and confirms its rules of procedure, manages the policy and monitors performance.
- Capacities are built in RDA to perform technical activities. Technical activities include collection and processing of applications, evaluation of applicability of applications, preparing proposals for the credit board, informing entrepreneurs and monitoring financed projects.
- Proposals are reviewed by the credit board. Approved applications are sent to banks, which make loan agreements. At the same time, all agreements between the SME and RDA/RGI are prepared.
- Banks and licensed consultants monitor financed projects. They provide technical assistance to SMEs and are in charge of reporting.
- RDA reports to Scheme Investors and controls project implementation and development.
- Board of Investors is formed within RDA, to which necessary authorities are transferred from management bodies.

RGI will function as an RDA project.

RDA board will name the Project Council of the RGI, proposed by project partners. The Project Council will have one representative of:

- Each municipality and city investing in the fund
- Each chamber of crafts investing in the fund
- Chamber of Economy, if it will participate in the project
- Association of entrepreneurs representing the share of guarantee scheme members (entrepreneurs)

The Government will be represented by a MELE representative and a HAMAG representative

Project Council's approval will be required for:

- Work plan and investment policy
- Appointing the credit board
- Accepting performance reports
- Confirming rules of procedure for the project council and the credit board,
- Confirming rules and criteria for approving guarantees
- Preparing proposals for creating business policies and work program

Credit board will have a 5-member technical body appointed by the RDA Board, suggested and approved by the project council. It will consist of:

- 3 entrepreneurs
- 1 County representative
- 1 representative of the local community

In the process of forming the credit board, territorial coverage of the County will be considered. The credit board will work under the management of the RDA director, who is not a member of the credit board.

Credit board, in cooperation with RDA director, will guide and monitor the work of implementing organizations and licensed consultants.

Finances of RGI will be managed separate from other RDA finances, as a special unit.

Work plan and investment policies will be adopted with consent of the project council (the right to veto until the contents of the documents are harmonized with the project council)

The RDA board has the final word in the decision making process, or other bodies authorized by it.

RDA board, in cooperation with the project council, will monitor the performance of RGI.

6.2. RESOURCES NEEDED FOR PROJECT IMPLEMENTATION

6.2.1. HUMAN RESOURCES

Standards, based on experience, on time needed for the approval of a single guarantee.

	ACTIVITY	Time for one project (hours)
a)	General consulting	0,5
b)	Consulting for preparing the application	0,5
c)	Collecting the application	0,5
d)	Processing and evaluation	4
f)	Preparing the proposal for the credit board	1
g)	Guarantee approval (4 x 0.25 =1)	1
	TOTAL	7.5 hours

RDA will manage the work of the credit board (variable expenses). The expenses for managing and developing projects will be presented as fixed expenses. We estimate that, on average, one RDA employee will be engaged in this (mostly, the director and business secretary).

The possibility that the RDA transfers some of the activities to local partners (chambers, initiatives), consultants and banks must also be considered.

The estimate of capacities needed includes only operations regarding the issue of guarantees. Apart from operations, there will be a need to develop numerous tools, ICT system, and manage further development of the project. Therefore, financial projections and planned project development need to consider these facts, too. We expect that all partners, and primarily the government, will be involved in further development of the project, since the government was the one to initiate the project and the funds for project development do not directly influence the project budget.

Project implementation is a demanding task since working with money is a very sensitive issue. Since the money involved here are public funds, special monitoring and transparency need to be assured.

The project demands experienced staff.

We also expect cooperation from technical departments of banks, government funds, foreign and domestic consultants in the field of guarantee instruments.

6.2.2. OTHER RESOURCES

It is projected that no more than 5% of approved loans will be high-risk projects. Bad loans will reduce the financial quota.

Based on called guarantees, risk will be assessed annually.

Current project expenses depend on potential and number of approvals.

Project expenses include:

- Project management and development,
- RDA material expenses
- Marketing and promotional activities
- Project Council operations

6.2.3. REQUIRED INVESTMENTS

For successful operations of RGI within RDA, we are recommending:

- to equip office premises
- purchase ICT equipment
- train the staff
- develop recognizable image and marketing
- other

6.3. BASIC CRITERIA FOR GUARANTEE APPROVAL

I.	Project evaluation	In line with development programs Market HR Economy Technology Ecology
II.	Investment security evaluation (thorough analysis done by the banks)	Assets and security Investment amount, financing structure Period of return and economic cycle Investment profitability
III.	Available potential guarantee	

IV.	Risk of current investments	
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6.4. MODEL SENSITIVITY

From the functioning overview, it is clear that the project is “sensitive” in the following points:

a) Projected investments

It is necessary to achieve the projected investment volume for the project to start functioning. In this, it is important to satisfy at least 10% of enquiries from entrepreneurs.

Dispersion of risk will be achieved only if all projected partners participate with their share.

b) Diversification of services

Good operations of the RGI largely depends on the loan system on the local level and additional services provided to entrepreneurs from the national level.

c) Risk of approved loans

Risk should not exceed the projected 5%. Low risk is important for investors' trust.

d) Simple operations

Numerous interests can cause complicated system of operations. This could endanger efficiency, reputation and cause unnecessary expenses. If roles and obligations are not clearly defined among project implementers and their management bodies, this could cause a lot of problems.

e) Security costs

Security costs should not exceed current "mortgage security", but can vary from case to case.

f) Support activities of the project

Success of the project (risk, efficiency) largely depends on the quality of the system and the implementation of technical consulting. This involves additions to the project.

g) Licenses for implementing activities and staff

It is necessary to acquire licenses and adequately train the staff.

6.5. CRITICAL POINTS OF THE MODEL AND NECESSARY MEASURES

Lack of projected investments	Smaller scope of activities
The projected offering not complete	Gradual development
High risk of approved projects	Set more difficult criteria for approving guarantees and intensify project monitoring

Complicated decision making and implementation system	Gradual simplification
Incomplete system for guarantee security	Finding the most suitable forms of securing guarantees
Delays in acquiring licenses for issuing guarantees	Acquiring temporary licenses until all conditions are met
Partners force unacceptable procedures into operations	Narrow the circle of partners
No cooperation from banks	Work with banks that are ready to cooperate
Different concepts in the country	Select the best solutions
Lack of additional services with development of technical consulting	Find sources of funding, greater attention to guarantee approval
Lack of interest among entrepreneurs	Smaller volume of operations or cancel the project

CONFIRMATION OF MODEL JUSTIFICATION:

- a) Objectives can be achieved**
- b) transfer of know-how to SMEs**
- c) lower costs for financing SMEs**
- d) meeting SME needs for different forms of financing**
- e) Similar model functioning in another country**

7. Conclusion

Development of the SME sector has a positive impact on the development of a region. The same is expected in Šibenik-Knin County, one of the least developed counties in Croatia needing additional development incentives. To stimulate the development of the SME sector, new approach needs to be taken. One of the tools for this are guarantee schemes which have been proven as efficient in the European Union and in other countries.

RGI could be one of the pilot-projects in Croatia. It opens the possibility for gradual development into an efficient system for financial support to small and medium-sized enterprises. The readiness of the national government and the County to invest HRK 1 mil. each into the project, could stimulate local sources, which are smaller due to smaller entrepreneurial resources in the County. The share of entrepreneurs will increase in time, which will ensure the sustainability of RGI. Regional Development Agency of the County, acting as the owner, will manage the project. This will ensure objectivity in the decision making process, and monitoring of public funds. RGI will not present competition to existing instruments/institutions engaged in loan security. It will, nevertheless, generate substantial volumes to test the model in practice and develop it in line with the objectives.

Even though it has a development mission, the project is sensitive to potential changes and risk factors.

The project requires efficient management, exchange of know-how, selection of best solutions and adaptation to realistic possibilities of its environment.

