POLAND CATCHING-UP REGIONS

SETTING UP REGIONAL FINANCIAL INSTRUMENTS AND THEIR DISTRIBUTION MECHANISM

European Commission
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POLAND CATCHING-UP REGIONS

Financial Instruments – Podkarpackie Region

Investment strategy in relation to financial instruments created based on the support funds returned from financial engineering instruments of the Podkarpackie Regional Operational Programme for 2007-2013

20 March 2017

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The report was completed in March 2017.

What is the Lagging Regions Initiative

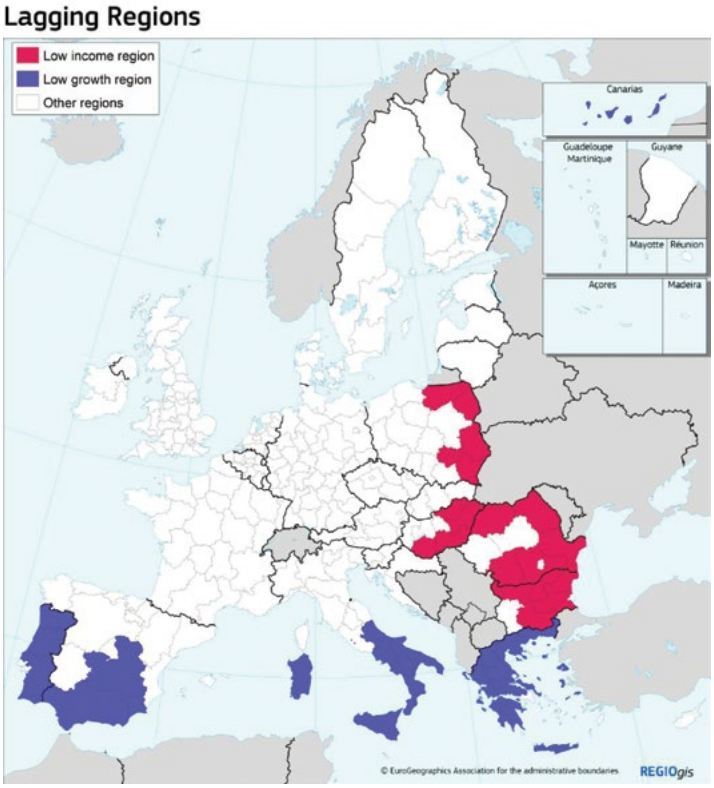
The scope of the EU Cohesion Policy is to narrow development gaps and reduce disparities between Member Countries and regions. To this extent, around €454 billion of ESI (European Structural and Investment) Funds have been allocated to help EU regions become more competitive. However, not all EU regions have been able to fully take advantage of the benefits of EU growth, due to the effects of the 2008 economic crisis and due to a host of structural problems.

To this end, Corina Crețu, the Commissioner for Regional Policy, together with the Task Force for Better Implementation has started the Lagging Regions Initiative. The aim of the Initiative is to identify what holds back growth in less developed regions, and to provide targeted actions for unlocking their growth potential. Thus, these lagging regions will be assisted to involve a broad range of stakeholders (regional and local administrations, educational institutions, business support institutions, SMEs, entrepreneurs, investors, NGOs, IFIs) to help respond to concrete needs they have and to maximize the impact of regional investments. Two types of lagging regions have been identified:

- LOW GROWTH REGIONS, which cover the less developed and transition regions that did not converge to the EU average between the years 2000 and 2013 in Member States with a GDP per Capita (PPS) below the EU average in 2013. These include almost all the less developed and transition regions in Greece, Italy, Spain and Portugal

- LOW INCOME REGIONS, covering all the regions with a GDP per Capita (PPS) below 50% of the EU average in 2013. This group covers the less developed regions of Bulgaria, Hungary, Poland and Romania.

Lagging Regions in the EU



Source: DG REGIO

Poland and Romania are the first countries to pilot this initiative, with two regions each – Swietokrzyskie and Podkarpackie in Poland, and North-West and North-East in Romania. In April 2016, Commissioner Crețu together with Marshal Adam Jarubas in Swietokrzyskie and Marshal Wladyslaw Ortyl in Podkarpackie have officially launched the Polish part of the Lagging Regions Initiative called „Catching-up Regions Poland". The „Catching-up Regions Poland" is an implementation-focused program that aims at providing tailored support to the two Polish regions to boost the impact of EU and private investments in specific areas selected by the two regions.

Over a year of joint work, the World Bank provided hands-on technical assistance and helped coordinate five activities that were selected by the Podkarpackie and Swietokrzyskie regions in coordination with the European Commission, Ministry of Economic Development, and the Bank. The five selected activities were:

- Improving the commercialization of Research & Development (R&D) results generated by public research facilities and enabling better utilization of existing technology transfer centers in the Podkarpackie region.

- Strengthening the vocational education and training system in the Swietokrzyskie region, using best practice examples from around the world and tailoring them to the regional context.

- Activating entrepreneurship in deprived areas in the Podkarpackie and Swietokrzyskie regions.

- Identifying ways to improve conditions for starting a business in the Podkarpackie and Swietokrzyskie regions.

- Supporting the creation of in-house financial instruments in the Podkarpackie region.

This report constitutes one of the outputs of the "Catching-up Regions Poland" work. More outputs, including an overview report and reports for individual activities in both English and Polish can be accessed on the World Bank's website.

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Overview

This Report has been prepared as part of the pilot project of the European Commission titled: Catching-up Regions Initiative, implemented in 2016-2017 in selected regions of two European Union states, i.e. Poland and Romania. In Poland, the pilot project included Świętokrzyskie and Podkarpackie regions.[1]

The initiative objective is the identification of economic growth restrains in lagging regions of Europe and – on that basis – provision of advisory assistance consisting of individualised activities (specific for each region), contributing to the reduction of those restrains to improve conditions for investment and economic growth. The scope of advisory activities was determined with participation of the European Commission, regional and central government (in Poland: Marshal Offices of both regions and the Ministry of Economic Development) and the World Bank which also played the role of an entity implementing advisory services.

One of the intervention areas, agreed for the action plan for Podkarpackie, were matters related to the development of regional mechanism of supporting micro, small and medium enterprises in accessing financing (Task no. 4). The subject of advisory services performed by the World Bank experts specifically concerned management of funds allocated in the region under the Regional Operational Programme for 2007-2013 (Podkarpackie ROP 2007-2013) to financial engineering instruments, subject to return following project implementation by financial intermediaries (approximately PLN 135 million). The objective was, therefore, to develop a strategy for this and to choose organisational form and to design operational model of re-engagement of funds, also considering the next programming perspective of EU aid (European Structural and Investment Funds) for 2014-2020, which also includes support of financial instruments.

As part of advisory services, activities leading to incorporation of a limited liability company in Podkarpackie have been taken already. The company is to be called Podkarpacki Fundusz Rozwoju *[Podkarpacki Development Fund - PDF]*[2] and it will take over tasks related to the organisation and management of financial instruments based on funds returned from Podkarpackie ROP 2007-2013 financial instruments and (like in the past) other financing sources.

This document constitutes final report on advisory services performed from November 2016 to March 2017 in the scope described above.

Warsaw, March 2017

[1] http://ec.europa.eu/regional_policy/pl/policy/how/improving-investment/lagging_regions/

[2] Resolution of Podkarpackie Voivodeship Self-government (Sejmik) as of 27 February 2017 on consent to creation of a company under the name: Podkarpacki Fundusz Rozwoju Spółka z ograniczoną odpowiedzialnością *[Podkarpackie Development Fund Limited Liability Company]*.

Summary

It is very important to design **the rules of return of the funds** allocated previously to the implementation of financial instruments under Podkarpackie ROP 2007-2013 (which will be the subject of separate "exit policy" developed by the representatives of the Marshal Office supported by WB consultants) and **their further use in a way that would not compete with the funds of Podkarpackie ROP 2014-2020**. This document contains an analysis of various aspects of regulating this last issue in the context of targeting financial instrument implementation under current programming perspective for 2014-2020.

In Podkarpackie region the **demand for loan instruments, and to a certain degree also guarantees, should be considerable**, regardless of the financial instruments available in the current programming period. This thesis is supported by the estimated financing gap. Additionally, purely working capital loans may raise special interest. In the longer term, **offering equity instruments** may be considered.

Possibility to freely design instruments, without restrictions of the EU fund application rules, is very important (and it is also a chance to ensure new instruments' success), obviously maintaining compliance with applicable laws and regulations, including in particular regulations on eligibility for public aid. This also enables **testing of new innovative instruments** – previously very rare or non-existent on the regional financing market.

The financial intermediaries interviewed are **comparatively open to accept new solutions**, although they are also rather cautious, indicating very limited cooperation between financial intermediaries in the region, and also between financial intermediaries and the Marshal Office. It is a common opinion that the capacity and experience of local financial intermediaries should be utilised.

At this stage, we propose designing **two types of working capital loans and loans for pre-financing and co-financing** of projects implemented by SMEs under Cohesion Policy 2014-2020. Obviously, in a longer term, the range of financial instruments should be developed and expanded based on the needs analysis and sufficient demarcation between 2014-2020 funds.

In terms of instrument implementation models, we propose three models for consideration, each based on a different level of involvement of the institution created at the regional level (*Podkarpackie Development Fund*).

1) Model 1 is the most traditional and is based on purely **coordinating and accounting role of the regional fund** (*Podkarpacki Development Fund*). It is very similar to the model previously used in Podkarpackie ROP 2007-2013, where virtually all lending activities were performed by local financial intermediaries.
2) Model 2 assumes **execution of all lending activities at the regional level** (by the regional fund). Financial intermediaries and their employees deal exclusively with identification and preliminary analysis of potential borrowers and support in the loan repayment monitoring process.
3) In turn, the model **recommended by us – Model 3**, is to a certain degree a combination of the first two models; it provides for **loans to be granted by local financial intermediaries**, they are fully liable for their repayment (obviously with certain loss ratio limits), a**nd the loans are granted from a sub-account of Podkarpackie Development Fund** to which financial intermediaries are authorised. Loans are also repaid to the account of *Podkarpackie Development Fund*.

   PDF is also responsible for determining the parameters of individual financial products offered by local intermediaries. The types and parameters of individual products should be determined with consideration given to the identified needs of regional micro, small and medium enterprises.

Application of each model of financial instruments implementation, in particular of Models 2 and 3, will require ensuring specific **organisational capacity** (managerial) of the regional fund, **provision of capital** and **other necessary assets**, including knowledge of its staff and access to advisory services. We have specified those issues in the final part of this Report, underlining also their immense importance.

1

Financial instruments in Podkarpackie ROP 2014–2020

In Podkarpackie ROP 2014-2020, using financial instruments as a form of support to micro, small and medium enterprises and entrepreneurship is planned in two priority axes of the Programme, i.e. in:

- Priority Axis I (titled: ***Competitive and Innovative Economy***) in Measure 1.4 SME Support (Sub-measure 1.4.2 ***Financial Instruments***) and
- Priority Axis VII (titled: ***Regional Labour Market***) in Measure 7.3 ***Entrepreneurship Development Support*** (Project Type 2).

General scheme of instruments programmed in Podkarpackie ROP is presented in the table below.The investment strategy contained in the Ex-ante evaluation for Podkarpackie ROP financial instruments considers various recommendations concerning the design of the products planned under individual financial instruments. The tables below contain a summary of determinations of the Ex-ante evaluation in this regard.[5]

Table 1. Financial instruments in Podkarpackie ROP 2014-2020

Measure / Sub-measure	Beneficiary	Target group	Allocation[3]	Financial instrument	Source for parameter setting
Sub-measure 1.4.2	BGK as implementing entity of the fund of funds	Micro, small and medium enterprises	EUR 44.72 million ≈ PLN 192.3 million	• Standard loan • Innovation loan • Guarantee	Recommendations of the Ex-ante evaluation of financial instruments[4]
Measure 7.3		Persons at least 29 years old who are unemployed or economically inactive, including farmers and their family members, running individual farms up to 2 ha, intending to abandon agricultural activities.	EUR 5.73 million ≈ PLN 24.6 million	• Loan	

Source: Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020 (version as of 07.02.2017)

[3] Conversion to Polish zloty at the EUR 1 = PLN 4.3 rate. In further parts of this Report, making estimations related to the planned use of the allocation, we considered only its value arising from the support from European Union funds (on the basis of values set out in Detailed Description of Priority Axes of Podkarpackie ROP for 2014-2020). We do not consider additional amounts which will be contributed to the instruments by the implementing institution. In accordance with the Detailed Description of Priority Axes of Podkarpackie ROP, maximum percentage level of total co-financing of eligible expenditure at the project level (EU funds + potential co-financing from the state budget or other sources granted to beneficiaries by relevant institution) amounts to 95%. This means that the results of the estimations are slightly distorted – in reality, following allocation supplementation, they will be slightly higher. The calculations also do not consider allowances for costs and charges related to instrument management (those issues are also not considered in the Ex-ante evaluation for Podkarpackie ROP financial instruments which is our main reference here – so in general, results of all calculations are indicative only).

[4] *Ocena ex-ante instrumentów inżynierii finansowej w ramach RPO WP 2014-2020,* Rzeszów 2014 *(Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020).*

[5] The Ex-ante evaluation is in many places rather general and some of its findings / recommendations are controversial, often their description is unclear (for the present analysis the document is not that useful – this in fact means that it must be verified and updated when the implementation of financial instruments would be started; considering the purpose of the present Report, we do not analyse here those defects). However, in our opinion some general description of the products planned is useful from the point of view of designing products / instruments provided from funds returned from Podkarpackie ROP 2007-2013 financial instruments and re-engaged. We consider those parts of the analysis that refer to measures/sub-measures of the Programme where (in the current Programme version) the premise of the financial instruments application was maintained.

1.1 **Priority Axis I** (Thematic Objective 3, Investment Priority 3c)

Table 2. Parameters of the products planned as part of financial instruments in Podkarpackie ROP 2014-2020 – ***standard loan*** in Sub-measure 1.4.2. of Podkarpackie ROP – based on Ex-ante evaluation of financial instruments

Financial instrument product parameters		Remarks
Maximum loan value	Up to PLN 120,000	-
Maturity	Up to 5 years	-
Interest rate	Variation depending on loan value	• Loans up to PLN 20,000 – 2% p.a. • PLN 20,000 to PLN 60,000 – 6% p.a. • PLN 60,000 to PLN 120,000 – 10% p.a.
Grace period	6 months	One-time or flexible (3 months per annual repayment period)
Security	Any legal form (material and non-material)	-
Purpose	Undefined	General focus on "enterprise development support"
Specific requirements	-	

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020

Table 3. Parameters of the products planned as part of financial instruments in Podkarpackie ROP 2014-2020 – ***innovative loan*** in Sub-measure 1.4.2. of Podkarpackie ROP – based on Ex-ante evaluation of financial instruments

Financial instrument product parameters		Remarks
Maximum loan value	Up to PLN 400,000	-
Maturity	Up to 5 years	-
Interest rate	Depending on loan value	• Loans up to PLN 60,000 – 2% p.a. • PLN 60,000 and more – 6% p.a.
Grace period	6 months	One-time or flexible (3 months per twelve-month period)
Security	Any legal form (material and non-material)	-
Purpose	Innovative undertakings, including purchase of assets based on technologies known on the domestic market not longer than for 2 years, supporting "launch of new products in new markets"	This assumption indicates the investment purpose of financing
Specific requirements	-	-

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020

Table 4. Parameters of the products planned as part of financial instruments in Podkarpackie ROP 2014-2020 – *guarantee* in Sub-measure 1.4.2. of Podkarpackie ROP – based on Ex-ante assessment of financial instruments

Financial instrument product parameters		Remarks
Maximum loan value	Up to PLN 500,000	Maximum share of guarantee in secured liabilities is not defined
Maturity	Up to 6 years	-
Interest rate	Up to 2% of guarantee value per annum	No details defined (one-time, for each year on current value of guarantee)
Grace period	6 months	One-time or flexible (3 months within twelve-month repayment period)
Security	Non-material, as an exception – all legal forms	Blank bill of exchange with bill of exchange declaration; other forms in case of identification of higher risk of undertaking
Purpose	All types of projects	Enterprises without appropriate security for liabilities incurred
Specific requirements	-	-

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020

In case of loans and guarantees, included in Sub-measure 1.4.2 of Podkarpackie ROP, the Ex-ante evaluation contains recommendations concerning: (1) division of the allocation between individual types of financial instruments (and in case of loans – also products), (2) directing financing to investment and working capital purposes, and (3) recommendations related to territorial de-limitation of final recipients of financial instruments, indicating the need to focus some instruments on the so-called marginalised areas. As follows[6]:

- in terms of the assumptions concerning allocation division to individual types of financial instruments/products:also a conclusion was formed (with reference to other studies) that general distribution of financial instruments, due to their investment vs. working capital purposes, should follow 3:1 ratio of intended use for investment and working capital purposes:

Table 5. Division of allocations between the types of financial instruments/products in Sub-measure 1.4.2 of Podkarpackie ROP 2014-2020 based on the recommendations of the Ex-ante evaluation of financial instruments in Podkarpackie ROP and currently programmed allocation

	Value	Standard loans	Innovation loans	Guarantees
Allocation – Sub-measure 1.4.2 Podkarpackie ROP 2014-2020	PLN 192.3 million according to the Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020	PLN 128.8 mln	PLN 26.9 mln	PLN 36.6 mln
Share	100%	67%	14%	19%

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020 and Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020 (version of 07/02/2017)

[6] The distribution scheme of support allocation in Sub-measure 1.4.2 of Podkarpackie ROP presented in the tables below constitutes fairly specific recommendations for the entity implementing the fund of funds in Podkarpackie, however, the entity managing the fund of funds, i.e. BGK, will have – as we assume – certain freedom in verification of those assumptions to better adjust them to the current situation in the region in terms of financial instrument supply and demand and the scale of the financing gap (it is justified even just considering the time that has passed since the issue of Ex-ante evaluation of financial instruments).

Table 6. Division of allocation in Sub-measure 1.4.2 of Podkarpackie ROP 2014-2020 based on recommendations of Ex-ante evaluation of financial instruments in Podkarpackie ROP and currently programmed allocation

	Value	Investment purposes	Working capital purposes
Allocation – Sub-measure 1.4.2 Podkarpackie ROP 2014-2020	PLN 192.3 million according to the Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020	PLN 144.2 mln	PLN 48.1 mln
Share	100%	75%	25%

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020 and Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020 (version of 07/02/2017)

- it was proposed that 25% of the allocation of support under the Programme should be reserved for debt financing intended for low-value (up to PLN 20,000) loans for micro enterprises[7]:it was proposed that contracts with financial intermediaries should contain solutions ensuring more extensive penetration into economically and socially marginalised areas – it was decided that 25% of loans/guarantees should be received by micro and small enterprises based in villages and towns of populations not exceeding 20,000 – estimation of this value, i.e. the number of loans/guarantees granted in marginalised areas, in a simplest way possible (i.e. considering the allocation value and assuming that individual loans and guarantees will be granted at their maximum value) gives the following result:

Table 7. Division of the allocation in Sub-measure 1.4.2 of Podkarpackie ROP 2014-2020 according to the instrument value and size category of final recipient based on the recommendations of the Ex-ante evaluation of financial instruments in Podkarpackie ROP and currently programmed allocation

	Allocation for loans (standard and innovation)	Loans up to PLN 20,000	Other loans (up to PLN 400,000)
Allocation – Sub-measure 1.4.2 Podkarpackie ROP 2014-2020	PLN 155.7 million	PLN 32.2 mln	PLN 123.5 mln
Share	100%	20.7%	79.3%
Category (size) of final recipient		Micro enterprise	SME

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020 and Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020 (version of 07/02/2017

Table 8. Estimation of the minimum number of loans/guarantees provided in Sub-measure 1.4.2 of Podkarpackie ROP 2014-2020 based on the recommendations of Ex-ante evaluation of financial instruments in Podkarpackie ROP and currently programmed allocation[8]

Financial instrument/product	Allocation	Maximum value	Number	25%
Standard loans up to PLN 20,000	PLN 32.2 mln	PLN 20,000	1 610	403
Standard loans up to PLN 120,000	PLN 96.6 mln	PLN 120,000	805	202
Innovation loans	PLN 96.6 mln	PLN 400,000	68	17
Guarantees	PLN 36.6 mln	PLN 500,000	74	19
Total	PLN 192.3 mln according to the Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020	-	641	641

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020 and Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020 (version of 07/02/2017)

[7] In the table, the allocation value for those products is calculated based on the allocation value for standard loans (25% * PLN 128.8 mln). This means that the share of such products in the total allocation for debt instruments (standard and innovation loans) will be about 20.7%.

[8] To simplify, it was assumed that the average value of financing will be equal to the maximum value, which obviously will not be the case. It may be therefore assumed that the number of loans and guarantees will be in reality higher than those indicated, even by 30-40%.

1.2 **Priority Axis VII** (Thematic Objective 8, Investment Priority 8iii)

Ex-ante evaluation of financial instruments provides also for a loan structured as a typical instrument supporting undertaking business activity and at the same time playing the role of a labour market intervention instrument (in the area of supporting self-employment processes among the unemployed). The investment strategy in the Ex-ante evaluation of financial instruments proposes the following configuration of that type of loans:Eventually, with reference to the current version of Detailed Description of Priority Axes of Podkarpackie ROP 2014-2020, it was determined, for the purposes of implementation of Measure 7.3, that the loans offered out of its funds will be allotted for persons at least 29 years old, unemployed or economically inactive, including farmers and their family members, running individual farms up to 2 ha, who intend to abandon agricultural activities. Currently, no other, more specific determinations on configuration of such loans are available.

Table 9. Parameters of the products planned as part of the financial instruments in Podkarpackie ROP 2014-2020 – loan in Measure 7.3 of Podkarpackie ROP

Financial instrument product parameters		Remarks
Maximum loan value	Up to PLN 60,000	-
Maturity	Up to 5 years	-
Interest rate	From 0.7% to 7%	Depending on the loan value – interest rate growing with the loan value (no details provided)
Grace period	12 months	To be used throughout maturity period
Security	Non-material	Loans up to PLN 10,000 secured by guarantee by natural person(s)
Purpose	Undefined	No limits – financing for investment and working capital purposes ("mixed" purpose possible)
Specific requirements	Maintaining business activity for at least 18 months	This requirement seems to suggest that this is a product for newly created entities

Source: Ex-ante evaluation of financial engineering instruments under Podkarpackie ROP 2014-2020

1.3 **The size of financing gap in Podkarpackie**

The estimation of the financing gap in the regional SME sector made in the Ex-ante evaluation of financial instruments for Podkarpackie ROP 2014-2020 has led to a finding that the size of the gap per annum is from PLN 235 to 305 million[9].

[9] Ex-ante evaluation of financial instruments..., op. cit., p. 24.

Finally, estimation at the level of about PLN 300 million per annum was accepted as justified. At the same time, the authors of the Ex-ante evaluation assumed, considering the specificity of the methods used to estimate the gap, that thanks to them it is possible to assume the lack of any trend changing the value of the annual financing gap determined[10]. As a result of such assumption, the Ex-ante evaluation determined the total value of financing gap for 2014-2020. It was assumed that in Podkarpackie, the size of financing gap in SME sector is at the level of about PLN 2 billion.

Table 10. Financing gap in SME sector in Podkarpackie based on the Ex-ante evaluation of financial instruments of Podkarpackie ROP 2014-2020 and currently programmed allocation

Enterprise size category	Model approach (AFN) (PLN mln)			Statistical approach (PLN mln)	Start-ups (PLN mln)	
	Total	Equity gap	Debt gap		Annually	Bi-annually
Micro				604 563	293 265	485 180
Small	528 969	406 546	122 423	558 046		
Medium	1 115 681	886 396	229 285	978 781		
SME Total:	**1 644 650**	**1 292 942**	**351 708**	**2 141 390**		

Source: Ex-ante evaluation of financial engineering instruments for Podkarpackie ROP 2014-2020, p. 24-25.

1.4 Conclusions for development of financial instruments strategy beyond Podkarpackie ROP 2014–2020

Characteristics of the proposed financial instruments/products outlined in the investment strategy in the Ex-ante evaluation of financial instruments for Podkarpackie ROP 2014-2020, and estimations concerning the size of financing gap in Podkarpackie in the upcoming years constitute a context to plan instruments created from funds returned from financial instruments distributed in Podkarpackie under Podkarpackie ROP 2007-2013.

[10] This assumption is not fully convincing. Disregarding changes occurring in the financing market and also more general changes – in the whole economic system – is a little reckless (in the gap calculations – in some of the methods used – the Ex-ante evaluation uses data from 2012). However, for the purposes of this Report that estimation is not without use. In our opinion, it may determine the initial size of the gap. Its potential growth does not matter as it will (even more so) confirm justification of the use of financial instruments as a form of supporting enterprises (for example, in relation to access to financing sources or creation of incentives to invest). On the other hand, there are no obvious reasons which would justify a thesis that the gap will significantly decrease (for example, the cost of financing was not deemed in the Ex-ante evaluation a condition significantly affecting the gap size – therefore, the recent decline in the market level of interest rate of debt instruments should not play an important role). Naturally, cyclical study of the financing gap would greatly facilitate financial instrument programming.

Below, we present 10 most important conclusions crucial for development of financial instruments based on funds returned from financial instruments invested under Podkarpackie ROP 2007-2013:

1 Existence of a gap in access to economic activity financing sources justifies further deployment/provision of financial instruments.

The size of anticipated financial gap for SME sector in the region **justifies the need for further deployment/provision of financial instruments** based on public funds and targeted at improvement of economic activity financing source availability in the region.

2 Financing gap – its size means that there is no risk of internal competition among financial instruments supported by various sources (instruments created basing on funds returned from Podkarpackie ROP 2007-2013 vs. deployed under Podkarpackie ROP 2014-2020).

The scale of the financial gap in the region suggests that **there is no special risk of excessive (unreasonable) scale of financial instrument support.** The sum of allocation for financial instruments in Podkarpackie ROP 2014-2020 and the volume of funds to be returned from financial instruments of Podkarpackie ROP 2007-2013 is about PLN 350 million (although that amount will not be available at one time, and Podkarpackie ROP 2007-2013 funds will be returned during a period of a few years), in comparison to the estimated annual gap at the level only slightly lower (PLN 235-305 million) than the total allocation (under both programming perspectives). The claim that the value of public support is excessive and it may consequently lead to mutual competition between individual instruments is therefore unjustified. Obviously, the form of individual financial products will also be of certain significance (this means that variation is still desirable).

3 There is demand for non-bank debt financing.

Reporting information of the *Polish Association of Loan Funds* shows that **interest in debt financing for business purposes**, offered by non-bank institutions (traditional financial intermediaries distributing financial instruments based on allocations under aid programmes), **is at a stable and – according to evaluation – high level** ("Each year, loan funds are becoming more important in ensuring access to external financing to SME sector"[11]). The loans offered are largely preferential instruments – with low interest rates, and that naturally raises the level of interest in them.

4 There is demand for non-bank guarantee instruments.

The range of financial instruments of Podkarpackie ROP 2014-2020 includes programming of funds intended for guarantees (Measure 1.4.2 provides for that purpose about 19% of the allocation – according to Ex-ante evaluation assumptions). It should be noted that the situation in guarantee sector (local and regional non-bank guarantee funds) has improved recently. This is supported by the reporting data of the ***National Association of Guarantee Funds***. In

[11] Rynek funduszy pożyczkowych w Polsce - Raport 2015 [Loan fund market in Poland: 2015 Report], PZFP, Warszawa 2015, p. 21.

2015 both the number and the value of guarantees provided increased (while 2014 was the worst period in this regard in the last few years). Inclusion in Podkarpackie ROP support for guarantee provision is therefore **justified – but rather to limited extent** (it has been programmed that way in terms of financial instruments under ROP 2014-2020).

5 Financial instruments in Podkarpackie ROP 2014-2020 – majority of financial products directed for investment financing.

Details of allocation for financial instruments under Podkarpackie ROP 2014-2020 show that financing will be in majority used for **investment instruments** (in accordance with Ex-ante evaluation, in Measure 1.4.2 of Podkarpackie ROP 2014-2020, it will be probably about 75% of the allocation). It may be therefore assumed that in the practice of implementing financial instruments under Podkarpackie ROP 2014-2020, investment instruments will dominate, although it is not ruled out that part of the allocation will be used for working capital products[12].

6 There is demand for non-bank debt instruments used for working capital financing (products – working capital loans).

Activities of loan funds (throughout Poland, and also in Podkarpackie) are focused mainly on **development – investment capital financing.** "The number of investment loans provided in 2015 was almost two times higher than the number of working capital loans or working capital and investment loans; it was the same in terms of their value[13]". At the same time, however, the Polish Association of Loan Funds stresses that regulatory framework for provision of loans by funds limited the possibility of their use in products for working capital financing. On the other hand, however, **interest in working capital loans is significant** – such targeting of a part of financing would allow even more comprehensive support of enterprise development[14] by non-bank institutions and would constitute an important element of reducing the financing gap[15].

[12] In the 2014-2020 programming period for EU financing, the possibility of directing funds to financial instruments used for working capital purposes has been finally clarified and – in accordance with the latest interpretation – is allowed (in the previous programming period there were many ambiguities in this regard). Currently, possibilities (and rules) of financing working capital are described in relevant guidance of the European Commission of 27 March 2015. (EGESIF_14_0041-1), see Guidance for Member States on Article 37(4) CPR – Support to enterprises/ working capital, [https://www.fi-compass.eu/publication/ec-regulatory-guidance/ec-regulatory-guidance-guidance-member-states-article-374-cpr]. This means that instruments for financing of working capital needs may be present as part of Podkarpackie ROP 2014-2020 funds. However, we assume that instruments will eventually be diversified in such way that funds from 2014-2020 perspective will serve mainly for financing of investment, as determinations of the Ex-ante evaluation indicate such scenario. Moreover, it should be added that to finance working capital from funds of 2014-2020 perspective, although allowed, will be subject to the requirement to justify a given undertaking in the business plan (which will constitute certain burden on the part of final recipient, and also financial intermediary who will analyse such document). So, we would like to stress that a business plan is also required when the purpose of financing is "delivery of capital for the strengthening of the general activities of an enterprise (such as activities aimed at stabilising and defending the existing market position, strengthening of capacity utilisation)" – conclusion on the basis of the answer to questions related to the presentation of financing issues + EGESIF of 17 December 2014. Therefore, for example, making a decision on provision of financing for general working capital purposes cannot be limited to a justification based on historic data. To sum up, working capital financing based on funds from 2014-2020 perspective is allowed, but it requires certain level of documentation justifying that type of financing.

[13] Loan Fund Market..., op. cit., p. 35.

[14] Op. cit.

[15] For example, this assumption is very strongly reflected in the offer of *Dolnośląski Fundusz Rozwoju (Dolnośląski Development Fund* – regional institution managing financial instruments funded from funds returned from Dolnośląskie ROP 2007-2013), under which funds are provided to intermediaries to grant two types of working capital loans: (1) to fund ongoing expenditure and (2) to fund current expenses related to the needs of manufacturing operations.

7

(1) Podkarpackie ROP 2014-2020 – mainly financial instruments for investment purposes;

(2) Funds returned from Podkarpackie ROP 2007-2013 – mainly financial instruments for working capital financing.

Current allocation of funds with a division into orientations of financing provided in Podkarpackie ROP 2014-2020 leads to programming solutions where financial instruments supported by **funds returned from ROP 2007-2013 would be focused on working capital financing**, and **funds from current perspective (Podkarpackie ROP 2014-2020) would be used mainly for investment purposes**. Moreover, instruments realised based on "returned" funds from Podkarpackie ROP 2007-2013 could also be allotted to financing less common (unconventional) instruments, in terms of previous practices and experiences of non-bank financial intermediaries in Podkarpackie (for example, loans connected with lease transactions for financing of own contributions, factoring service provision or also – in the sphere of guarantee services – guarantees to secure liabilities arising from tendering security deposits, and also guarantees to lease liabilities). Also, note that financing under financial instruments based on the funds from 2007-2013 will not be subject to time restrictions related to achievement of specific indicators and limited period of eligibility of expenditure within 2014-2020 period. As a result, more balanced and in-depth preparation of specific scope of proposed financial instruments will be possible.

8

As clear and specific demarcation of financial instruments as possible, depending on the financing source.

Demarcation proposed above, **due to the purpose of the financing, should be – as much as possible – clear and specific**[16]. At the same time, it would be reflected in varied preferentiality. We therefore assume that instruments realised based on funds from 2014-2020 perspective would contain a strong incentive element (for example, zero or low interest rate, higher amount of financing for the client), boosting interest in obtaining such financing for investment purposes. In case of financial instruments funded from returned funds (Podkarpackie ROP 2007-2013), **their preferentiality would be lower (higher interest rates – at market level or slightly lower), and they would be instruments intended for working capital financing**. Such solution would guarantee complementarity of the whole scheme of financial instruments in Podkarpackie. Promotional activities should also be planned appropriately, to indicate such complementarity. Also, as was indicated above, instruments based on funds returned from Podkarpackie ROP 2007-2013 could include unconventional instruments/ products.

9

An expansion of the range of financial instruments by equity instruments (to target early stages of enterprise development) is recommended.

Also, establishment **of support for equity instruments in Podkarpackie should be assumed**, to target early development stages of innovative undertakings. This argument seems to be justified due to comparatively extensive capacity of universities in Rzeszów (students/ graduates as the main group of idea originators) and the fact that **financing of such financial instruments is not planned**

[16] We should remember, however, our previous conclusion which indicates that significant level of the financing gap means that some overlap of the purpose of financial instruments/products should not pose special risk of internal competition between instruments/products funded from various sources (funds returned from Podkarpackie ROP 2007-2013 vs. Podkarpackie ROP 2014-2020).

within Podkarpackie ROP 2014-2020 funds[17], and also practices/experiences of other regions in deployment of this type of instruments[18]. Preparation and deployment of this type of financial instruments justifies also (and in particular), on the one hand, their lack in Podkarpackie (very limited local sources[19]), on the other hand, interest in obtaining such type of financing by potential final recipients (idea originators, start-up initiators[20]). It is also not without significance that Podkarpackie today hosts manufacturing specialisations, especially predisposed to generate innovative solutions (in particular, aviation and related industries).

10 There is a possibility of unconstrained development of financial instruments created basing on the funds returned from financial instruments of Podkarpackie ROP 2007-2013, to design instruments simple in terms of procedure for financial intermediaries, and also instruments varied in terms of the type and method of financing of the needs of final recipients.

Financial instruments created basing on funds from 2007-2013 perspective may be designed rather freely. Their engagement is not subject to legal regulations usually applicable to European structural financing (and, depending on approach, its consequences). Therefore, **the aim is to design instruments in such a way that they are not bound by many restrictions/ difficulties of formal/bureaucratic nature.** As indicated by interviews held with financial intermediaries, it was one of the factors attracting numerous critical opinions on the support of financial instruments in Podkarpackie in 2007-2013 perspective. The criticism is usually justified by the presence of several difficulties related to accounting for the use of funds (also too rigorous parameters of allowed loss ratio).

The possibility of flexible design of financial instruments based on funds returned from Podkarpackie ROP 2007-2013 also enables **designing instruments that had not been available before in the range offered by regional financial intermediaries.** This means instruments mentioned above described as "unconventional". Without a doubt, considering this kind of solutions will contribute to diversification of non-bank financing products, which in turn would give the possibility of better, more universal reaction in relation to the attempts to reduce the financing gap in the region.

[17] This aspect is not considered in the Ex-ante evaluation of financial instruments for Podkarpackie ROP 2014-2020.

[18] We can again look at the example of *Dolnośląski Development Fund* that is planning to invest some of the funds in equity instruments, targeted at financing seed and start-up phases of enterprises (innovative projects, including those based on the results of research and development activities).

[19] In Podkarpackie, availability of "indigenous" (regional) investment vehicles specialising in financing early phases of development, is very limited. For example, in Measure 3.1 of the Operational Programme Innovative Economy (2007-2013), among 70 supported investment incubators only one was located in Rzeszów (based on: PAG Uniconsult and Imapp Analiza zasadności zastosowania poszczególnych form finansowania projektów I osi priorytetowej Przedsiębiorcza Polska Wschodnia, Etap 1 - Raport końcowy, Warszawa 2016, p. 75-79). In another report, in turn, (M. Gajewski, J. Szczucki, J. Witkowska, R. Kubajek Ewaluacja ex-post projektu systemowego <Utworzenie i dokapitalizowanie Funduszu Pożyczkowego Innowacji w ramach pilotażu w III osi priorytetowej PO IG>, PAG Uniconsult, Warszawa 2015), one small private investment fund based in Rzeszów was identified.

[20] We refer here to the experiences and conclusions related to the execution of another advisory component under the Catching up Regions Initiative, i.e. Activity 1, concerning the creation of a Regional Technology Transfer Office (RTTO). At the early stages of advisory works under Activity 1, it was discussed that one of the operational components of RTTO would be some financing mechanism for early development stages of ideas generated in RTTO. Those discussions were supported by identified interest of potential beneficiaries. In the end, however, that component was not included, assuming correctly that this may be realised (and would be more appropriate) within the component dedicated to financial instruments. In the future, development of equity instruments in Podkarpackie should be realised in connection with tasks/support offered as part of RTTO. It should be added here that the context of supporting equity instruments in Podkarpackie contains also another support instrument, executed as a pilot project under Operational Programme Eastern Poland 2014-2020 (OPEP). These are the so called Start-up Platforms (in Rzeszów some of the undertakings of Kielce Start-up Platform - Technopark Business Hub - are animated), developed under Sub-measure 1.1.1 OPEP (titled: Starting Platforms for New Ideas) and their accompanying instrument (Sub-measure 1.1.2 OPEP titled Start-up Development in Eastern Poland), in which the start-ups created in the Platforms may be capitalised through development subsidies (granted in competitions through the Polish Agency for Enterprise Development) of up to PLN 800,000. Without a doubt, the functioning of the Platforms and capitalisation support could be appropriately connected with the future offer of equity instrument support in Podkarpackie (provided that the pilot project brings positive results and consequently both measures are continued – which should be known at the latest by mid-2018).

2

Findings from field research in the scope of assessing the interest and formulating conditions concerning financial instruments

As part of preparation of this strategy, direct interviews were successfully conducted with representatives of almost all financial intermediaries implementing financial instruments under Podkarpackie ROP 2007-2013.

Based on the interviews, certain conclusions and recommendations may be indicated as regards the implementation of financial instruments under Podkarpackie ROP 2014-2020, but also (which is most important from the point of view of this Report) as regards the potential design of financial instruments to be implemented on the basis of funds deriving from financial instruments implemented in the 2007-2013 period.

2.1 The overall situation regarding financial instruments and the demand for them

According to the respondents, the demand for financial instruments remains at a relatively stable level, although it is obviously influenced by various factors. The following issues are the most important:

- The interest in financial instruments offered on the basis of public funds increases during periods when non-repayable financing is already unavailable, both under regional and national operational programmes. Such tendency is observed in 2007-2013, and 2014-2020 will probably be similar.
- The interest in financial instruments also depends on the investment plans of enterprises, and obviously decreases (at least as far as investment financing is concerned) during periods of downturns in the country's economic situation, whereas it increases during good economic times.
- For many sectors, demand is seasonal, although this concerns to a greater extent the financing provided for working capital purposes, which – as a rule – was not offered under Podkarpackie ROP 2007-2013 or under OP DEP 2007-2013.

As indicated by some respondents, very limited cooperation and exchange of information between individual institutions of the business environment implementing financial instruments remains a serious problem for financial intermediaries. As recently as a few years ago, when there was the National System of Services for SMEs coordinated by the Polish Agency for Enterprise Development and when meetings and training sessions were organised, the things looked much better, whereas now, individual institutions are practically left to themselves. According to the respondents, the Marshal Office also does not make any visible effort leading to a better integration and cooperation between financial intermediaries.

As a result, in most cases smaller institutions find it rather difficult to monitor the current situation on the refundable financing market or to exchange experiences[21]. Furthermore, no training is offered to those institutions with quite specific needs. Perhaps, this will change thanks to initiating the implementation of financial instruments as part of the 2014-2020 period and the role of Bank Gospodarstwa Krajowego as the manager of the fund of funds. On the other hand, also knowledge of the principles of implementing financial instruments in 2014-2020 and of the financial intermediary selection mode is very limited.

[21] On a national scale, though, a positive role is played by the activity of the *Polish Association of Loan Funds* and the *National Association of Guarantee Funds*.

2.2 The models of financial instruments implementation based on funds from 2007–2013

According to most respondents, an ideal solution from their point of view would be an extension of the existing contracts and at the same time waiver of the requirement to document management expenditure and its settlement on a flat-rate basis. However, such solution is relatively difficult to implement due to legal doubts as to its acceptability (the issue of extending the existing contracts) as well as due to the serious challenge of demarcating the financing offered in relation to the allocation of funds under Podkarpackie ROP 2014-2020; yet, these issues are not actually known or comprehensible to the representatives of financial intermediaries (which is quite understandable, taking into account the different perspectives).

The implementation of funds deriving from Podkarpackie ROP 2007-2013 was assessed relatively positively, even though serious problems with the clearance of management expenditure were commonly indicated, as well as the very long time of accepting the clearance by the Marshal Office. The institutions that had the opportunity to carry out projects under the Operational Programme Development of Eastern Poland[22], assessed cooperation with BGK very positively. It is worth emphasising here that projects under OP DEP were of repayable type and the funds gradually returned to BGK as the loans were repaid.

The respondents demonstrated a rather cautious (and sometimes definitely critical) attitude to the little known and so far rarely applied (although some exceptions may be found in this context) model of implementation based on financial intermediation, under which intermediaries acting at the local level would intermediate in providing loans offered by an entity acting at the regional level. It seems that more well-thought-out opinions could be obtained if a specific offer of cooperation were presented to the intermediaries, including also information on the detailed principles of dividing tasks and the rules of remuneration. The intermediaries emphasised that (which is of great interest to them) it would be very important (and objectively justified) to use the capacity of financial intermediaries acting at the local level.

According to some opinions, version based on the financial intermediation model would still be markedly better than the model adopted for 2014-2020 in which the selection of intermediaries will be carried out through public procurement, and that makes many intermediaries concerned due to the lack of relevant experience and (possibly) the necessity to establish consortia composed of a greater number of entities.

Majority of respondents also pointed to the fact that – regardless of the finally adopted solutions – the financing offered and information about it should be easily available at the local level. In addition, it was pointed out that the requirement to document the costs incurred should be definitely waived.

According to the majority of respondents, using the capacity of local financial intermediaries should make it possible, on the one hand, to effectively reach potential borrowers, and on the other hand, to mitigate the risks related to providing a loan, thanks to the better

[22] i.e. the *Regional Development Agency in Mielec* and the *Regional Chamber of Commerce in Stalowa Wola*.

knowledge of at least some potential clients. It was further emphasised that – at least for a considerable part of financial intermediaries – providing a loan is very often correlated with advisory provided by the financial intermediary's staff concerning such aspects as financing business development or obtaining external funds, including those non-repayable. Not only does such advisory minimise the risks related to the project financed with the loan, but it may also have a positive impact on other areas of activity of a given enterprise.

In turn, in the event of establishment of an institution to manage financial instruments in the whole region (or using an existing institution for that purpose), some respondents pointed out that it was very important for its head (management board president) to be a person possessing experience in the implementation or management of financial instruments or at least to have very good knowledge of the principles of SME support.

2.3 Financial products

The respondents had in general very limited ideas as regards financial products that may be implemented on the basis of funds in the 2014-2020 perspective. The majority of them pointed out that most of the products offered so far have been designed properly, with several minor changes suggested, i.e.:

- The majority of respondents indicated that loans should be offered for relatively longer periods, even up to 10 years, while the decisions on the maturity of specific loans should be made by financial intermediaries. Extending the maturity of products will facilitate access to financing due to enhanced creditworthiness of borrowers, whereas it will obviously increase the risk borne by financial intermediaries.
- The validity of maintaining (or possibly even developing) the support for persons starting business activity, including young people, as the ones having the most difficulty in obtaining commercial financing, was also highlighted. Nevertheless, it must be remembered that such products are offered thanks to the financing provided from national funds ("First Business – Support at the Start" programme, implemented, among others, by the Regional Development Agency in Mielec), and they will presumably be offered as part of Podkarpackie ROP 2014-2020.
- The validity of extending the product range with working capital financing was also indicated; according to the respondents such products would be in high demand.
- None of the intermediaries interviewed mentioned validity of deployment of financial products targeted at a specific sector/group of enterprises. According to the respondents, "general" products principally targeted at a broad group of SMEs have proven the most effective and there is no need to build specialised products. Such attitude, even if not necessarily legitimate, is perfectly understandable as most financial intermediaries are small entities with neither the experience nor the means to analyse the market in depth, which leads to the obvious preference for general products.

- According to the respondents, working capital products related to EU financing in 2014-2020, i.e. loans to ensure an own contribution or to pre-finance a project, should also be of interest to entrepreneurs and numerous intermediaries. If it was possible to provide such loans, many would be interested in incorporating them into their offer.
- Some intermediaries pointed out that part of their clients are companies with hindered access to commercial financing, not only due to a short duration of the business, but also due to the fact that sometimes some portion of their revenues is not properly recorded in their official financial documents. It is possible to finance such companies only at a local level thanks to the knowledge of the specific ways they function and the ability to obtain additional information of an informal nature regarding their actual profitability.

It remains a rather evident issue that some financial intermediaries fail to notice (or refuse to notice) that the interest of the financing offered by them is based, to a considerable extent, on its preferential interest rates, which would have to be much higher under normal market conditions. As a result, most institutions have a rather limited experience in promoting its products and designing them in such way that they are attractive also for reasons other than purely financial benefit.

Demarcation between the funds of 2007-2013 and 2014-2020 period is a complex issue which goes practically unnoticed by financial intermediaries, for obvious reasons. Naturally, from the point of view of the Marshal Office, it is essential to quickly spend the funds of the current programming period provided for financial instruments, which process (both in the Podkarpackie and in other Polish regions) has been dramatically delayed. which is also caused by the fact that some of the implementation arrangements are quite new for the regions.

The restrictions concerning the acceptable level of loss ratio for the loans remains a immensely important issue. According to the respondents, it should be at least 15% of the portfolio value, and even 20-25% for higher risk products (for example, loans for persons starting a business or companies with short existence on the market). Lower loss ratio limits will lead to a more conservative lending policy under which loans will be provided mainly to companies with longer duration of existence (i.e. to those that already have relatively easy access to commercial financing), and additionally intermediaries will require very extensive collateral.

In turn, guarantee instruments offered by intermediaries at the local or regional level, similar to other regions of Poland, have been moderately popular for some time now, which is caused by a range of factors, especially the limited capital endowment (and thus, the ability to provide guarantees of greater value), the competition of programmes offered at the national level (especially de minimis guarantees), and also the preference among chain banks for guarantors capable of collaborating with a network of banks across the country (offering country-wide unified guarantee offer).

One respondent also pointed to the fact that the offer of so-called bid guarantees (profitable and entailing minimum risk at the same time), which has been developing quite rapidly on a national scale, also has its limitations since it is usually not linked to a wider range of services, such as that provided by insurance companies which usually offer contract performance guarantees too.

3

Investment strategy – financial instruments created on the basis of funds returned from financial instruments of Podkarpackie ROP 2007-2013

3.1 Assumptions concerning financial instruments deployed as part of funds returned from financial instruments of Podkarpackie ROP 2007-2013

Taking into account the suggestions resulting from the Ex-ante evaluation of financial instruments as part of Podkarpackie ROP 2014-2020, and also due to the new opportunity for supporting financial instruments as part of the funds returned from Podkarpackie ROP 2007-2013, and additionally taking into account the conclusions from interviews with non-banking financial intermediaries in Podkarpackie, leads to the design of the following distribution of financial instruments and the accompanying sources of financing from public funds, as follows: from allocation provided under Podkarpackie ROP 2014-2020 and funds returned from financial instruments distributed under Podkarpackie ROP 2007-2013.Summing up, the logic in demarcating financial instruments in Podkarpackie is based on the assumption that on the basis of funds returned from instruments financed under Podkarpackie ROP 2007-2013, the following instruments will be deployed in the first place:

- debt instruments used for the financing of working capital, and
- equity instruments, used for the financing of early development stages of innovative enterprises (business undertakings), regardless of or in connection with the functioning of the *Regional Technology Transfer Office* (RTTO) (in the event that it is launched) as well as in cooperation

Table 11. Map of financial instruments according to the type and source of financing

Instrument target	Financial instrument type	Source of financing (public funds)	
		Funds returned from financial instruments of Podkarpackie ROP 2007-2013	Funds allocated to financial instruments of Podkarpackie ROP 2014-2020
Working capital financing	Debt	✱✱✱	✱ or ✱✱
	Guarantee		✱✱✱
	Unconventional	✱	
Grace period Security Purpose	Debt		✱✱✱
	Guarantee		✱✱✱
	Unconventional	✱/✱✱	
Development financing	Equity – stock	✱✱✱	

Priority: ✱✱✱ – high importance, ✱✱ – medium importance, ✱ – low importance.

Source: own elaboration.

with *Start-up Platforms for New Ideas* developed under the Operational Programme Eastern Poland 2014-2020 (Sub-measure 1.1.1 of OP EP) (if the pilot project carried out in 2016 and 2017 is evaluated positively and - therefore - the measure continued).

Due to the greater complexity of implementing equity instruments as well as the lack of regional experience in this scope, **the short-term implementation priority will be attributed to debt instruments.**

Deployment of support for equity instruments will have to be preceded by the *Podkarpacki Development Fund* (the entity implementing financial instruments based on the funds of Podkarpackie ROP 2007-2013, and subsequently also based on other sources) obtaining knowledge and advisory services leading to the design of an equity support mechanism, probably including the involvement of equity investment funds in the process of implementing it (seed/start-up capital) as well as taking into account potential cooperation with other related instruments (Start-up Platforms). Detailed operational solutions concerning equity instruments should be elaborated gradually and simultaneously with the implementation of debt instruments intended to finance working capital needs. Therefore, we assume that this will be one of the tasks of the *Podkarpacki Development Fund*.

Funds returned from financial instruments of Podkarpackie ROP 2007-2013 should also serve for deployment of unconventional instruments, both in the group covering the financing of working capital purposes as well as investment projects. In this scope, the financing of intermediaries will be used to "experiment" with new instruments that had not been offered by the regional non-banking sector thus far. In this manner, in parallel to developing standard (debt) instruments, new financing solutions and mechanisms may be tested. With time and as the financial capability increases, according to testing results, it will be possible to launch completely new instruments on the regional market, adjusted to the specific needs of the regional SME sector.

At the current planning stage, the following unconventional instruments may be indicated:

- factoring (micro-factoring – the financing of low-value current liabilities) – in the scope of financing the needs for working capital, especially in the segment of micro (mainly) and small enterprises,

- financing of deposits (own contribution) in lease transactions (analogously – to micro and small enterprises – in the scope of selected capital goods).

The unconventional instruments mentioned above do not constitute the entire catalogue of potential solutions. The task of the authority managing the funds returned from financial instruments of Podkarpackie ROP 2007-2013 should be the identification of the needs of the regional SME sector in the scope of access to sources of financing and – according to the results of such identification – designing and testing new instruments/solutions in this scope. We consider this "open" element of experimenting to be an important part of the tasks of the authority managing the support funds (naturally, it is also complemented by ongoing observation/monitoring of the financing gap on the regional financial market).

Table 12. General structure of financial instruments deployed from funds returned from financial instruments of Podkarpackie ROP 2007-2013

Purpose of financing	Financial instrument type	Products	Final recipient types	Importance[23]
Working capital financing	Debt	• General purpose working capital loan • Working capital loan for the financing of supplies and services related to enterprise development	Micro, small and medium enterprises	✷✷✷
	Unconventional	• Micro-factoring • Possibly other	Micro and small enterprises	✷
Investment financing	Unconventional	• Micro-factoring • Possibly other	Micro and small enterprises	✷
Development financing	Equity	• Capital contributions/ investments for the financing of the Proof-of-Principle (PoP) phase[24] • Capital contributions in exchange for shares (financing of the Proof-of-Concept phase - PoC)[25] • Capital co-investment contributions (with business angels)	Micro-companies – start-ups (a portfolio created, among other things, based on projects generated in RTTO) and with potential cooperation with Start-up Platforms in Eastern Poland (Lublin, Kielce)	✷✷✷

Priority: ✷✷✷ – high importance, ✷✷ – medium importance, ✷ – low importance

Source: own elaboration

The range of financial instruments presented in the above table is correlated with financial instruments planned for implementation under the allocation of Podkarpackie ROP 2014-2020 (in accordance with the classification presented in the introduction – Table 11). In this way, financial instruments from various sources will complement each other.

"Overlapping" of financial instruments occurs only to a certain extent as regards the working capital financing. It may be assumed that some of the instruments (lesser part of them, actually) supported under Podkarpackie ROP 2014-2020 will also cover working capital financing – however, most probably, these will be working capital instruments related to enterprise development. They may especially be expected in the case of loans provided for in Measure 7.3 of Podkarpackie ROP 2014-2020; yet, the allocation for these loans is relatively small – it amounts to approximately PLN 24.6 million – see Table 1 and additionally Table 9; instruments of this type may also be present in the case of some standard loans in Sub-measure 1.4.2 of Podkarpackie ROP 2014-2020. In both cases, however, these will be "working capital" instruments for which justification will be required in relevant business plans[26], and therefore, they

[23] Operational importance in the support offered by *Podkarpackie Development Fund*.

[24] The *Proof-of-Principle* is usually defined as a R&D&I project phase, consisting of early verification of an idea, during which industrial testing is conducted as well as experimental development work, preliminary evaluation of the R&D&I project potential, analysis of the competitive environment, definition of the research plan and the first milestones in project development. This phase may be carried out, for example, at research centres or by individuals or special project teams (inventors, originators). Conducting it is not principally related to a legally separated entity intended for the implementation of the project.

[25] The *Proof-of-Concept* phase is a R&D&I project phase consisting of the proper verification of an idea, during which industrial testing is conducted as well as experimental development works whose results (if positive) will typically enable full patent application or transition to the international phase of claiming priority in the PCT mode or commercial use of the project outcome. It is usually carried out by a legally separated entity intended for the implementation of the R&D&I project.

[26] The requirement resulting from EU guidance on working capital financing in the current period of structural fund programming (2014-2020).

will be naturally targeting working capital needs simultaneously applying to development purposes. Naturally, the above considerations may be of no importance in the event of making a decision on targeting the financing of debt instruments under Podkarpackie ROP 2014-2020 strictly to investment purposes in exchange for a high degree of instrument preferentiality[27].

3.2 Financial instruments in a long-term perspective

In a long-term perspective, the problem of appropriate demarcation of financial instruments will become limited due to the concentration of instruments management in one regional entity (***Podkarpacki Development Fund***). From this point of view, the decision on entrusting such role (financial instruments managing authority) to ***Podkarpacki Development Fund*** is completely justified. The funds from financial instruments implemented under Podkarpackie ROP 2014-2020 – in analogy to the 2007-2013 perspective – will be managed by this institution, which will allow it to design instruments in such manner as to reflect as much as possible the current and future needs of the regional sector of micro, small and medium enterprises. Concentrating the function of managing financial instruments will enable designing and implementing them as complementary and non-competitive instruments reflecting a broad spectrum of needs and the regional economic sphere specificity. Also for that purpose, ***Podkarpacki Development Fund*** should monitor the situation on the regional financing market.

3.3 Financial products

In this part of the Report, we present the suggested parameters/specification of three financial products whose deployment will constitute a **starting point** for the activity of the entity managing financial instruments in the region. According to the previous conclusions, these are the products concerning the financing of working capital needs of enterprises.

[27] Decisions in this scope will be made by BGK as the entity implementing the fund of funds in Podkarpackie based on the resources of Podkarpackie ROP 2014-2020. We assume that such decisions will be made in consultation with the Programme Managing Authority and with proper consideration of the suggestions included in this Report.

Table 13. Financial product 1 – general purpose working capital loan

No.	Loan parameters – Type 1	
A. General parameters		
A 1	Final recipient	Micro, small and medium enterprises residing or conducting business activity in Podkarpackie region
A 2	Loan amount	Up to PLN 100,000
A 3	Target (purpose of financing)	Capital for the financing of general needs of the enterprise related to its current activity (financing current expenditures)
A 4	Repayment period	Up to 12 months
A 5	Other	-
B. Cost parameters and repayment terms		
B 1	Interest rate	On market terms – considering the reference rate determined by the financial intermediary in accordance with the risk assessment methodology applied by the intermediary and considering the recommendations of the Commission Communication on the revision of the method for setting the reference and discount rates[28] – increased by 1 percentage point
B 2	Commissions charged by the financial intermediary	1-4%
B 3	Repayment terms	At financial intermediary's discretion
B 4	Other	-
C. Documentation parameters		
C 1	Confirmation of payment of the borrower's statutory liabilities	At the financial intermediary's discretion (declaration or another form(s) of confirmation)
C 2	Restrictions – ban on the repayment of statutory liabilities out of the loan	Acceptance by the borrower by a declaration
C 3	Restrictions concerning the loan purpose	Specified within the loan contract
C 4	Other	-
D. Securities		
D 1	Basic	Blank promissory note
D 2	Additional	At the financial intermediary's discretion – in line with the loan security methodology applied
E. Other – organisational		
E 1	Involvement	Maximum one loan per borrower (further loans must not be provided during the repayment period)
E 2	Deadline for portfolio development by financial intermediary	From 9 to 18 months (finally determined in the agreement with the financial intermediary) Alternatively: no deadline
E 3	Loss ratio limit	10-15% of the amount of funds disbursed from the loan financing account (used limit for Type 1 loans), to be finally determined and settled
E 4	Debt collection costs	The cost of debt collection is reimbursed by PDF in whole or in part (e.g. 80%)
E 5	Provision of capital for the disbursement of loans	From the limit awarded – disbursements from the account: each loan upon conclusion of loan contract
E 6	Other	-

Source: own elaboration

[28] OJ L C 14 as of 19.1.2008, p. 6.

Table 14. Financial product 2 – working capital loan for development purposes

No.	Loan parameters – Type 2	
A. General parameters		
A 1	Final recipient	Micro, small and medium enterprises residing or conducting business activity in Podkarpackie
A 2	Loan amount	Up to PLN 200,000
A 3	Target (purpose of financing)	Financing the expenditure related to developing manufacturing activity: materials and raw materials, services, and other – as indicated
A 4	Repayment period	Up to 12 months (with the possibility of one extension maximum by further 12 months based on a simplified analysis/ verification of the borrower's financial standing) – loan extension if sales increase at 25% of the loan value is documented (benchmark – sales at the date of concluding the loan contract)
A 5	Other	-
B. Cost parameters and repayment terms		
B 1	Interest rate	On market terms – considering the reference rate determined by the financial intermediary in accordance with the risk assessment methodology applied by the intermediary and considering the recommendations of the Commission Communication on the revision of the method for setting the reference and discount rates[29]
B 2	Commissions charged by the financial intermediary	1-4%
B 3	Repayment terms	At financial intermediary's discretion
B 4	Other	-
C. Documentation parameters		
C 1	Confirmation of payment of the borrower's statutory liabilities	At the financial intermediary's discretion (declaration or another form(s) of confirmation)
C 2	Restrictions – ban on the repayment of statutory liabilities out of the loan	Acceptance by the borrower by a declaration
C 3	Restrictions concerning the loan purpose	Specified within the loan contract – for the indicated types of expenditure/ expense group Loan clearance based on invoices (in full or at least 70-80% of loan value, to be determined)
C 4	Other	-
D. Securities		
D 1	Basic	Blank promissory note
D 2	Additional	At the financial intermediary's discretion – in line with the loan security methodology applied
D 3	Other	-
E. Other – organisational		
E 1	Involvement	Maximum one loan per borrower (further loans must not be provided during the repayment period; one type 1 loan may be provided)
E 2	Deadline for portfolio development by financial intermediary	From 9 to 18 months (finally determined in the financial intermediary agreement) Alternatively: no deadline
E 3	Loss ratio limit	10-15% of the amount of funds paid from the loan financing account (used limit for Type 2 loans)
E 4	Debt collection costs	The cost of debt collection is reimbursed by PDF in whole or in part (e.g. 80%)
E 5	Provision of capital for the disbursement of loans	From the limit awarded – disbursements from the account: each loan upon conclusion of loan contract
E 6	Other	-

Source: own elaboration

[29] OJ L C 14 as of 19.1.2008, p. 6.

Table 15. Financial product 3 – working capital loan, co-financing or pre-financing of EU projects

No.	Loan parameters – Type 3	
A. General parameters		
A 1	Final recipient	Micro, small and medium enterprises residing or conducting business activity in Podkarpackie and carrying out projects under Cohesion Policy 2014-2020
A 2	Loan amount	Up to PLN 1 million
A 3	Target (purpose of financing)	Pre-financing or financing of own contribution in a project financed by EU funds
A 4	Repayment period	For the project implementation period, possibly + maximum 12 months
A 5	Other	-
B. Cost parameters and repayment terms		
B 1	Interest rate	On market terms – considering the reference rate determined by the financial intermediary in accordance with the risk assessment methodology applied by the intermediary and considering the recommendations of the Commission Communication on the revision of the method for setting the reference and discount rates[30]+ 0.5 percentage point
B 2	Commissions charged by the financial intermediary	1-4%
B 3	Repayment terms	At financial intermediary's discretion
C. Documentation parameters		
C 1	Confirmation of payment of the borrower's statutory liabilities	At the financial intermediary's discretion (declaration or another form(s) of confirmation)
C 2	Restrictions – ban on the repayment of statutory liabilities out of the loan	Acceptance by the borrower by a declaration
C 3	Restrictions concerning the loan purpose	Specified within the loan contract – for the indicated types of expenditure/ expense group Loan clearance based on invoices (in full or at least 70-80% of loan value, to be determined)
C 4	Other	-
D. Securities		
D 1	Basic	Blank promissory note
D 2	Additional	At the financial intermediary's discretion – in line with the loan security methodology applied, especially assignment of grant agreement
D 3	Other	-
E. Other – organisational		
E 1	Involvement	Maximum one loan per borrower
E 2	Deadline for portfolio development by financial intermediary	From 9 to 18 months (finally determined in the financial intermediary agreement) Alternatively: no deadline
E 3	Loss ratio limit	10-15% of the amount of funds paid from the loan financing account
E 4	Debt collection cost	The cost of debt collection is reimbursed by PDF in whole or in part (e.g. 80%)
E 5	Provision of capital for the disbursement of loans	From the limit awarded – disbursements from the account: each loan upon conclusion of loan contract
E 6	Other	-

Source: own elaboration

[30] OJ L C 14 as of 19.1.2008, p. 6.

4

Model of implementation of financial instruments deployed from the funds returned from financial instruments of Podkarpackie ROP 2007–2013[31]

When lending activity is financed from public resources and in circumstances where the institution organising procurement or competition for loan granting may also grant loans independently[32], three basic implementation models may be identified. Two of them are more traditional and the third one is less common – it is based on the experiences of *Dolnośląski Development Fund*. Below, we discuss each model with indication of their strengths and weaknesses.

4.1 Model 1

In the first model, which is most common, as a result of competition procedure, financial intermediaries are selected to grant loans. At the same time, the institution which provides financing, usually sets certain conditions relating to such issues as:

- Maximum permissible share of loans with significant repayment delays and bad loans (uncollectible) and the consequences of possible exceeding of the limits agreed. In case when such limits are exceeded, various sanctions may be applied. For example, if the outcomes of lending activity are worse than it was assumed, the financial intermediary is obliged to cover losses (above agreed limit) out of its own funds and is subject to other "penalties", such as for example, reduction of allocation for financing of management costs.
- The structure of loan portfolio in the form of certain territorial distribution of final recipients (by setting a minimum level of financial intermediary loans in portfolio that were granted to the borrowers residing or conducting business activities in a specific territory) or in the form of certain characteristics of the loans granted (such as value, maturity).
- Characteristics of final recipients – enterprise size, industry, allocation of the loan to financing of specific expenses, etc.

In this model, the institution selecting financial intermediaries is not involved in the process of granting loans at all. Financial intermediaries selected only handle that and the institution only monitors the process of project execution, verifies if the assumed outcomes have been achieved, and performs clearance of expenses incurred by individual institutions. The intermediaries are therefore accountable for the outcomes achieved only. At the same time, the institution transferring funds to them has virtually no influence on operational implementation of projects and the whole process of loan granting and settlement. These issues, according to the terms of the contract with the funds provider, fall under the responsibilities of financial intermediaries.

The table on the opposite page summarizes strengths and weaknesses of this model.

[31] The models presented and discussed in this section provide solutions that may be used by the entity implementing financial instruments in Podkarpackie (*Podkarpackie Development Fund*), based on the funds returned from the financial instruments under Podkarpackie ROP 2007-2013, and in the future also with the use of different sources. Due to the implementation priority which has been assigned to debt financial instruments, these solutions refer to such instruments.

[32] As we expect, we will be dealing with such situation in the case of funds returned from Podkarpackie ROP 2007-2013.

Table 16. The outline of key strengths and weaknesses – MODEL 1

Strengths	Importance	Weaknesses	Importance
The high level of task delegation, no requirement to involve the donor in the technical aspect of the lending process.	✱✱✱	When loans are granted by many fairly small financial intermediaries, it usually results in limited effectiveness of activities and the lack of the economics of scale.	✱✱✱
Implementation model well known among financial intermediaries in the region (and beyond). The possibility of obtaining information from financial intermediaries on possible modifications leading to its improvement. The model is relatively easy to implement.	✱✱✱	Deployment of new loan products is always time-consuming and organizationally complex. It usually requires new procurement procedure and contract award to select financial intermediaries.	✱✱
Limited level of market disruption thanks to the diversification of implementation structure – it is possible to involve various entities, both from non-banking sector and banks (e.g. cooperative bank sector), to act as financial intermediaries.	✱✱	Transfer of risk to financial intermediaries usually does not take place in a fully flexible manner – with a given (excessive) level of risk to intermediaries (permissible low level of bad loans – for example, a few percentage points), they may not be interested in using loan funds. This may, potentially, lead to the expectation/demand of higher remuneration or, during the implementation stage, result in intermediaries' behaviours aimed at elimination (substantial limitation) of high risk undertakings in their portfolio (which eventually may be contradictory to the intervention logic).	✱✱
When the function of financial intermediaries is performed by various entities residing in various parts of the region, it is easy to access final recipients (better penetration of territory targeted for loans), and consequently, it is easier to get better knowledge of final recipients; this also creates the possibility to use such information in the process of feasibility evaluation of undertakings and borrower reliability.	✱✱	Following contract award in regard to the selection of financial intermediaries and contract execution, the possibility of adjustment of the rules of loan provision is very limited (definitely more difficult, however, a lot depends on relevant contractual provisions – for example, providing for the possibility to require intermediaries to implement certain adjustments).	✱
It is practically possible to transfer full risk of lending activity to individual financial intermediaries.	✱✱	When financial products offered by financial intermediaries are not identical (in terms of value, maturity, and other parameters), any promotional and informational activities are a bit more difficult at the regional level. Centralized promotion is more difficult – it cannot contain details of the products offered.	✱
The transfer of lending activity risk to the intermediaries will in general motivate them to professional and responsible behaviours, especially when it is possible to add relevant financial incentives.	✱✱		
A model which results in the creation (development) of local community of financial intermediaries who are well located and have good knowledge of the needs of local enterprises, and who are motivated to develop their own loan products.	✱		
Implementation period is relatively short due to the experiences connected with the mode of distribution of support to financial intermediaries at the regional level in this/similar model.	✱		

Source: own elaboration

Analysing strengths and weaknesses of this model, it seems that its pivotal benefit is the fact that in this solution the institution responsible for the supervision of financial instruments implementation, as of the moment when the procedure for selection of financial intermediaries is finished, does not have to be materially involved in the whole lending process. It suffices that the institution focuses on the monitoring of implementation progress only, and in the case of material problems it takes steps upon consultation with the intermediaries to find a solution.

On the other hand, relatively low effectiveness is a serious weakness of this model. When loans are granted by a significant number of financial intermediaries, fixed costs (mainly resulting from the requirement to maintain staff by each intermediary and provide software supporting management of the lending process) seem to be too high in comparison to the value of the loans (excessive fixed costs per loan). So, this model may cause less effective allocation of resources.

Moreover, when a certain number of financial intermediaries grants loans as a result of finished competitive procedures, it is very difficult (in case of changing economic conditions or a change of the strategy applied by the managing entity/ local authorities) to launch a new loan product based on the same funds, as it would demand a different manner of using the funds which have already been transferred to intermediaries (probably through negotiations of contract amendment, which is not easy when the public procurement regulations are applied and it always requires mutual agreement of the parties). Possible withdrawal of funds is also very difficult (it is highly unlikely it would be possible at all).

4.2 Model 2

In another model, comparatively less common, loans are granted by the institution offering financing to final recipients, at the same time using the support of a network of institutions or individuals throughout the region who, however, play auxiliary role only – they conduct promotional and informational activities, search for potential clients, assist in collection of appropriate documents and (depending on the arrangements with the donor) perform full or simplified loan application assessment (hereafter those institutions are referred to as local representatives or LRs)[33].

The basic difference in relation to Model 1 is the fact that funds remain in full at the disposal of the donor who directly disburses the loans and then monitors their repayment. The donor plays in fact the role of a regional financial instrument (regional loan fund), operating independently and with intermediation of the appointed representatives, aiming this way to direct its services to the whole region.

On the opposite page, we present main strengths and weaknesses of this model.

[33] Such model is used, for example, in the process of implementation of the First Business - "Support at the Start" programme (delivered by the Agency of Enterprise Development in Mielec, playing the role of implementing entity of this programme in several regions of Poland).

Table 17. The outline of main strengths and weaknesses – MODEL 2

Strengths	Importance	Weaknesses	Importance
The use of the economics of scale and other positive consequences of concentrating funds in one institution. All lending operations are executed by one entity at the regional level, local entities play auxiliary role only.	✶✶✶	When the majority of risk is borne by the regional fund, the significance of risk resulting from the lack of (or limited) accountability of intermediaries for the loans granted increases greatly.	✶✶✶
Concentration of capital and activities in one entity (regional fund) will result in positive effects in relation to the assessment of financial and operational capacity of the fund by third party entities. This in turn will cause improved ability to effectively obtain capital from external sources (for example, sources preferring to fund undertakings on a large scale and in a wide extent – e.g. programmes offered from the European level by the *European Investment Fund*). The scale and capacity of the fund may bring various outcomes in the scope of collaboration with major financial (and other) institutions from the environment[34].	✶✶✶	The need to fundamentally strengthen the regional fund in terms of staff and infrastructure, for example, provide software for application processing, management of loan portfolio, monitoring of loan repayments, information exchange with LRs, and collaboration within the network (network management), etc.	✶✶✶
Freedom, flexibility and ease of deployment of new loan products. Each deployment of a new loan product is relatively simple, requires mainly design of a new product, development of the rules of its implementation, training of own staff and local representatives, and potentially execution of new contracts or amendment of the existing contracts (for handling the new products) with LRs.	✶✶	Fund distribution model not very common, in general unknown among the financial intermediaries in the region (and outside the region). This may lead to cautious approach to the participation in the system (or even no interest in the participation, in particular, when support for financial instruments under Podkarpackie ROP 2014-2020 is available). Consequently, new solution will have to be promoted[35] without guarantee that it will be accepted at the expected scale. Significant time factor – establishment of the model and interest in it may require time which is difficult to estimate. Promotion of the model will also give rise to costs.	✶✶✶
The possibility to conduct common, independently targeted promotional strategy at the scale of the whole region (with positive consequences in terms of costs of this type of activities). Easy launch of concentrated informational and promotional activities.	✶✶	Depending on specific organisational solutions, the risk of not using some of the capacity of the existing local financial intermediaries (on the part of LRs, there will be some doubling effect – own products vs. distribution of regional fund products – with difficult to anticipate consequences for the regional fund, for example, we may expect that undertakings funded by the regional fund, proposed by LRs, will be on average burdened with a greater risk).	✶✶
Impact on the development of positive image of the region (and regional authorities, as the author/co-author/participant of the undertaking), resulting from the existence of financially significant and long-lasting regional entity, specialising in financing the economy sphere.	✶	The need to design the system of LRs selection and the rules of their remuneration; additional analysis will be needed to establish the extent of applicability of the public procurement law to the whole system.	✶✶

Source: own elaboration

[34] A lot will depend, however, on the objectives set for the regional fund and the action strategy developed for the fund, as well as determination in its implementation, leading (in the long-term) to the development of regional fund as the key financial institution of the region, active in the particularly deficient areas of the financial market.

[35] It is recommended that this type of activities are preceded by deeper research of attitudes/positions of financial intermediaries as to their perception of this type of solution. If a decision is made to implement this solution, it will be necessary to consider potential promotional activities, including identified attitudes and the level of readiness, and also terms of potential collaboration.

Table 17. The outline of main strengths and weaknesses – MODEL 2 (continued from previous page)

Strengths	Importance	Weaknesses	Importance
		Potentially significant level of market disruption caused by the activity of a major size entity (in particular, domination in relation to non-bank lending institution sector), operating throughout the region. There will be a risk of blocking development and marginalisation of previously growing non-bank financial intermediaries.	*
		Very difficult to connect the final quality of loan portfolio with remuneration of local representatives. This problem will grow in proportion to the number of LRs collaborating with the regional fund.	*
		Time – relatively long, due to no experience in the execution of that type of mechanism, and also due to the need to undertake further analytical activities (development of business plan of the undertaking/ estimation of the financial effect + implementation strategy, ensuring relevant human and technical resources by the regional fund).	*

Source: own elaboration

As may be expected, key strengths of this model are to some extent symmetrical to the weaknesses of Model 1. First of all, with proper design of the implementation mechanism, identification of appropriately active and competent local representatives, and also with design of appropriate mechanism of remuneration for local representatives, considering not just the assistance in the provision of a high number of loans of certain value, but also (possibly) specific diversification of loans and final recipients (in terms of territory, sector and enterprise size), the system may be highly effective in this sphere and exceed the benefits of Model 1.

On the other hand, the main downsides of this solution are related to the fact of direct involvement of the fund in lending activity, resulting in the need to design and implement (and maintain) high-quality selection mechanism of investment targets in terms of risk of the undertakings being funded[36]. Some limitation (understood rather as a challenge in the organisation and management) will also arise from the need of involvement in management of the whole network of LRs (especially at the start) and its management, including resolving potential disputes that may (and probably will) arise at the level of network participants (for example, in relation to competing for customers, etc.). Competences and experience in this scope will be invaluable – the question is, however, how fast they will become available or how long it will take to develop them (and what the consequences will be until the whole distribution network is developed and stabilised).

[36] We cannot really expect that those functions may be "safely" (from the point of view of the interest of the regional fund, in particular in relation to the credit risk control) assigned to the level of LRs, without the need to create very restrictive solutions burdening the local representatives with risk. However, even assuming that this could succeed, it would still be necessary to establish, at the level of the regional fund, the final verification function in relation to investment decisions (and not just approval of the formal aspect of investment decisions made by LRs).

Also, issues related to the uncertainty as to the functioning of the new solutions should be considered, as they will most likely arise among financial intermediaries in the region as this new mechanism will be very different from the schemes of supporting financial instruments known to them. This specific innovation of the model may give rise to various reservations and consequently little willingness (or even unwillingness) to cooperate as a local representative of the regional fund. More so, that almost simultaneously the financial intermediaries will be able to apply for capital under financial instrument implementation under Podkarpackie ROP 2014-2020. It is also true that the extent of this kind of attitudes may be reduced by two factors:

- uncertainty as to the effectiveness of obtaining support under Podkarpackie ROP 2014-2020 (and potential failure to obtain capital for loans) and

- potential conducting of lending activities directly by the regional fund, without the use of local representatives (reducing this problem at least for some time, i.e. until achievement of better understanding of the new solution and its establishment as an efficient mechanism of loan distribution in the region)[37].

On the other hand, the expectation that the regional fund might be able to make its offer easily accessible in the whole region, maintaining the standards of acceptable risk and conducting proper risk management in comparatively short time is not realistic. Therefore, there are several important restricting factors here that arise from the attempt to change common (established) mechanisms of financial instrument support used by financial intermediaries before.

Moreover – and this is without a doubt a very important factor, crucial for the stability of the whole network – design of appropriate scheme of LR remunerations, depending on the loan portfolio, will be a great challenge. For sure, sufficiently attractive remuneration scheme may trigger great interest and more willingness to participate. We should, however, remember that in this case major restriction is related to the postponement in time, from the moment of granting a loan, of potential problems with repayment, and also the question to what extent activities of a local representative may be connected with the loan repayment – in this case certain role may be played by activities of the entity granting the loan (such as: conducting appropriate monitoring, review of expenses covered by the loan, and also consent or lack thereof to amend the loan contract, for example, to change the repayment schedule and allow temporary grace periods in repayment of the principal), over which the local representative will have no control.

[37] However, this solution will be burdened with a major risk.

4.3 Model 3

The third proposed model is based on the solution following the model used by the *Dolnośląski Development Fund*. It is founded on the combination of lending activity based on a regional fund (in this case: *Podkarpacki Development Fund*), however, using the capacity and at the risk of local financial intermediaries. The basic characteristics of this model are as follows:

- All funds for provision of loans remain at the disposal of the *Podkarpacki Development Fund*.

- Financial intermediaries who are to provide loans are selected in a competition mode, i.e. in a procurement procedure or competition – final legal form should be consulted with the Legal Department of the Podkarpackie Marshal Office or other experts, considering rather unusual method of financing the costs borne by financial intermediaries. As a result, a group of about 3-7 financial intermediaries in the region is selected.

- Financial intermediaries are responsible for the identification of potential borrowers and evaluation of their financial standing, creditworthiness, and potential collateral. In case of positive evaluation, intermediaries sign appropriate loan contract, at the same time notifying *Podkarpacki Development Fund* accordingly.

- Loans are granted by a financial intermediary but based on funds located with PDF. Intermediary holds an authorisation to separate and periodically credited sub-account of PDF from which the loan capital is provided (PDF places in that sub-account funds up to the limit granted to a given intermediary). Loan repayment also occurs through another separate PDF's account which financial intermediary may access to monitor if the loan is repaid as scheduled.

- The risk related to granting a loan is borne in full by the financial intermediary above the permissible limit of bad loans. Enforcement activities are conducted by financial intermediaries and the cost thereof are covered in full or in part by PDF.

- Interest on the loans granted constitutes PDF's income in full, and the interest rate is regulated in the contract between PDF and financial intermediaries. PDF does not cover the management cost. Financial intermediaries fund their activities only from commissions charged to enterprises the limits of which are determined in the contract executed by financial intermediaries and PDF. Intermediaries do not charge any other fees to borrowers (variant: they charge only additional fees set out in the contract with PDF).

- This model is useful in case of debt financing. In case of equity instruments and guarantee instruments, Model 1 or Model 2 should be used.

Table 18. The outline of main strengths and weaknesses – MODEL 3

Strengths	Importance	Weaknesses	Importance
Combination of both models discussed above, thanks to the use of the economics of scale and competences of the regional fund with the experience of staff and market knowledge of local financial intermediaries (FIs).	***	Novelty of the model and the related need for precise regulation of technical, legal and organisational details. Possibly very cautious approach to this type of solutions by financial intermediaries (due to innovativeness), and also unwillingness to implement such model.	***
Stimulation of activity of financial intermediaries thanks to making them completely dependent on income on the value of loans granted.	***	The need to fundamentally strengthen the staff and infrastructure of the regional fund, although to a clearly lesser extent than it would be necessary in Model 2.	***
Laying foundations for development of region-wide system using the capacity of the regional fund and local financial intermediaries that could in the future also manage funds from 2014-2020 period, after they are used.	***	The need to design and implement several detailed legal and organisational solutions of fairly high level of complexity (sub-account system for financial intermediaries, rules of selecting financial intermediaries, contents of the contract between PDF and financial intermediaries).	***
Similar to Model 2, freedom, flexibility and ease of deployment of new loan products. Conditions of deployment of a new product are virtually identical.	**	The need to train representatives of financial intermediaries in the rules of functioning of the new model.	**
Similar to Model 2, the possibility to conduct common, independently targeted promotional strategy at the scale of the whole region (with positive consequences in terms of costs of this type of activities). Easy launch of concentrated informational and promotional activities.	**		
Impact on the development of positive image of the region (and regional authorities, as the author/co-author/participant of the undertaking), resulting from the existence of financially significant regional entity, specialising in financing the economy sphere. Facilitation of the ability to obtain funds from other institutions.	*		

Source: own elaboration

4.4 Main conclusions and recommendations

All three models presented above seem possible to use in Podkarpackie and the decision on applying one of them (or their compilation, depending on the type of financial instrument) should be made after consultations with representatives of key financial intermediaries operating in the region, and also following extensive analysis of arguments for and against each of the models described above (and potentially also other). In the opinion of the authors of this Report, Model 3 is the best as it combines the strengths of Models 1 and 2.

Additionally, it should be kept in mind that in the case of funds allocated to financial instruments under Podkarpackie ROP 2014-2020, solutions rather similar to Model 1 will be used – financial intermediaries selected in a procurement procedure will grant loans and the institution playing the role of the fund of funds (Bank Gospodarstwa Krajowego) will only supervise the whole process, monitor accounting for eligible expenditure and the level of achievement of the anticipated indicators. This means that most likely the majority of intermediaries active in the region should be able to realise projects under Podkarpackie ROP 2014-2020 funds, and as a result maintain their human resources capacity required for this purpose. A lot, however, depends on the actual form of procurement conducted by BGK and how willing financial intermediaries will be to establish consortia. In theory, we cannot rule out a situation where all key parts of procurement procedures for 2014-2020 will be awarded to one or two strongest intermediaries and then continuation of operations at appropriate level will be a serious challenge for the others (due to lack of capital limiting their operational capacity). This in turn may (and probably will) force them to accept other solutions (innovative – in comparison to their previous practices), for example, solutions based on Models 2 and 3 described in this Report. Obviously, this tendency will be affected by subjective assessment of proposed terms of collaboration, including in particular the assessment of the terms of remuneration for participation and operation in the network of local representatives, and also the prospects arising from such collaboration.

Ensuring appropriate, professional staff of the *Podkarpacki Development Fund* is a particularly important issue, vital to its success. Other various assets will also be important. As follows:

1		PDF must have appropriate human resources – here, we list people possessing the following experience and qualifications:
	a	Person(s) managing the whole institution, with at least a few years of experience in a managerial role with an institution providing repayable financing (bank, loan or guarantee fund, equity investment funds).
	b	People designing loan products and managing ongoing collaboration with financial intermediaries (2 or 3 persons). They should have experience in specific matters related to lending activities.
	c	Person responsible for promotional and informational activities implemented directly and through the network of financial intermediaries.
	d	Person (external company) responsible for the functioning of monitoring system for the transfer of funds to financial intermediaries and loan repayment.
2		The fund must be equipped with hardware (computer network, server, work stations), software, remote connectivity devices, and vehicles relevant to the activities conducted.
3		The provision of consultancy services for the regional fund, in particular in relation to the design of strategic solutions and selected operational issues: in the area of design of the model of cooperation with intermediaries, independent monitoring of its functioning, verification of adequacy of the financial products offered, evaluation of the needs of enterprises in relation to access to external financing sources, evaluation of financial intermediaries, forming recommendations in relation to improvement of the functioning of the whole mechanism (in terms of its capacity and efficiency), and also obtaining funds from external sources. An important aspect of consultancy services is also related to the assistance in designing regional fund organisational solutions in the scope of financial management, credit risk management, reporting system, public information on the effects of lending activities, in accordance with the *European Code of Good Conduct for Microcredit Provision*[38] – it's an important factor in the context of the ability to obtain financial support from funds provided at the European level (by the *European Investment Fund*[39]).

[38] http://ec.europa.eu/regional_policy/sources/thefunds/doc/code_bonne_conduite_pl.pdf

[39] For example, the latest initiative of support for financial institutions under European programme EaSI (EaSI Capacity Building Investments Window), see http://ec.europa.eu/regional_policy/sources/thefunds/doc/cod _bonne_conduite_pl.pdf

Below, we present recommendations concerning the adoption of the model of financial instruments implementation based on Podkarpackie ROP 2007-2013 funds.

1	All activities related to the selection of one out of the three models described above (in our opinion, Model 3 if most relevant), should be executed after appointment of the institution responsible for funds management at the region-wide level and after commencement of activities described above aimed at reinforcement (provision) of that institution's capacity. Ideally, this would occur by the end of Q2 2017. Until then, talks need to be conducted with financial intermediaries to establish the rules of return of funds from financial instruments of Podkarpackie ROP 2007-2013 and (in general) the terms of collaboration between the regional fund and financial intermediaries.
2	When the *Podkarpacki Development Fund* is ready to conduct operations or it is realistically anticipated that such readiness would be achieved in relatively short time, the decision on the use of selected implementation model must be made (and implemented)[40].
3	The decision on the implementation model selection should be accompanied by the preparation of PDF's business plan considering the cost of implementation of the model selected (and also – PDF activities as a whole). The business plan should be based on a realistic prognosis of the rate and volume of funds obtained (returned) from financial instruments of Podkarpackie ROP 2007-2013. The rate and scale of returns will determine the actual operational capacity of PDF[41].
4	The decisions on the demarcation of products offered in the region by PDF and – on the other hand – by BGK as the fund of funds for the purposes of financial instruments distribution under Podkarpackie ROP 2014-2020 should be made as soon as possible. Those decisions should refer to the recommendations made in this Report, although they obviously may lead to slightly different development of financial instruments/products distribution (it is an opinion of the authors of this Report, however, that the proposal presented herein is close to the optimal solution).
5	During the initial period of PDF existence, it should focus on offering support to financial intermediaries that will enable them to implement a limited number of financial products – this should be appropriately correlated with the planned volume of funds to be managed by the PDF (the starting point for those determinations should be proposals presented in this Report – two debt financing products for working capital needs of enterprises).

[40] A solution anticipating the use of a "mixed" mechanism, combining different implementation models, should not be ruled out. Although this is perfectly viable, in our opinion, the use of a "mixed" variant is not advisable already at the initial stages of PDF functioning. During the "start up" stage, the Fund should not overly complicate its proposal or its operating mechanism. This type of organisational activities/modifications will be reasonable after full operational stability and capacity is achieved.

[41] Those matters will be agreed with financial intermediaries who are currently managing the funds invested in the financial instruments distributed under Podkarpackie ROP 2007-2013.

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Appendices

List of people/institutions with whom extended individual interviews were conducted

Individual extended interviews were conducted in January 2017

No.	Name	Title	Institution	GF/LF/ BEI*
1	Krzysztof Staszewski	Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o. *[Podkarpacki Loan Guarantee Fund]*	Board President	GF
		Stowarzyszenie na Rzecz Promocji i rozwoju Podkarpacia „Pro Carpathia" *[Association for Promotion and Development of Podkarpacie]*		BSI
2	Janusz Fudała	Rzeszowska Agencja Rozwoju Regionalnego *[Regional Development Agency in Rzeszów]*	Board President	LF
3 & 4	Józef Twardowski	Mielecka Agencja Rozwoju Regionalnego „MARR" S.A. *[Regional Development Agency in Mielec]*	Board President	LF
	Michał Pękalski		Fund Manager	
5	Elżbieta Mroszczyk	Poręczenia Kredytowe Sp. z o.o. *[Loan Guarantees Ltd - Branch in Łańcut]*	Branch Manager	GF
6	Marek Jagusiak	Leżajskie Stowarzyszenie Rozwoju *[Leżajsk Development Association]*	Fund Director	LF
	Krzysztof Rogowski		Fund Expert	
7	Witold Pycior	Tarnobrzeska Agencja Rozwoju Regionalnego S.A. [Regional Development Agency in Tarnobrzeg]	Manager	LF
8	Grzegorz Kubal	Podkarpacka Izba Gospodarcza w Krośnie *[Podkarpackie Chamber of Commerce in Krosno]*	Chamber President	LF
9	Ryszard Kapusta	Regionalna Izba Gospodarcza w Stalowej Woli *[Regional Chamber of Commerce in Stalowa Wola]*	President of the Chamber's Management Board	LF
	Jolanta Budkowska		Fund Director	

* GF – guarantee fund, LF – loan fund, BSI – business support institution