

# FIN-URB-ACT

## Thematic Paper

Local Banks within SME support infrastructures



## Summary of the Plenary Session of the FIN-URB-ACT Meeting in Edinburgh on 9 February 2010

### How can cities design a favourable environment, so that local banks are more active?

*“Banks are a large source of institutional finance for local businesses. Thus local authorities should seek to work with local banks. Collaborative arrangements between banks and local development agencies and municipalities offer potential benefits for both parties. (...). Both types of organisation can provide specialised services and expertise”.*

(OECD (2004), Entrepreneurship and Local Economic Development – Programme and Policy Recommendations).

However in many cases, Banks are not attracted to work with Municipalities. The following examples followed shows and summarise possibilities and difficulties and demands to foster cooperation and partnership among public administration and the local support infrastructure with local banks, that were commonly discussed within the FIN-URB-ACT partnerships during its partner meeting in Edinburgh.

#### **Situation in Edinburgh:**

The contribution was presented by Jim Galloway, Head of Enterprise and Innovation within the Economic Development Department at The City of Edinburgh Council. The main issues and shortcomings faced in Edinburgh comprise the low involvement of local banks in the local SME support structure and the insufficient viability of business plans. As in many cases banks simply refuse loans due to insufficient business plans: better and enhanced assistance needs to be provided to entrepreneurs in producing and drafting practicable and sustainable plans that can be accepted and regarded as meaningful to banks. Additionally, there are shortcomings regarding the lending conditions. (e.g. difficult lending rates, inflexibility of SMEs and banks and the problem of asset shrinkage) and generally the capacity lack of businesses to raise sufficient funds to support the plans.

In order to reduce market distortions, and tackle the before mentioned issues, the City of Edinburgh has developed various support policies and instruments on

- business development and start-up support,
- business growth
- the establishment of a new hybrid investment fund.

#### **Business development and start-up support**

##### ***Business Gateway:***

Business Gateway is a national programme, available in the Scottish Enterprise (the regional Economic Development Agency) area as the first point of contact for services to business. It delivers for those interested in setting up in business, or those who are setting out in business a range of business advisory services, business information (e.g. finance, employing people, sales & marketing etc.), start-up courses, business workshops and events (e.g. marketing, accounts, e-business, people and general management) and provides signposting to other public sector services.

With the contact channels through a website and a phone number, there is the possibility to deliver the required advice directly to the client or to refer prospective clients to the various workshops and events. This is to ensure that when clients see business advisers on a “one to one” basis they are already well prepared and can make best use of the time available to them. The Business Gateway service is currently outsourced to a number of contracted suppliers throughout the Scottish

Enterprise area. Locally the delivery of Business Gateway is provided through the Chamber of Commerce. The Website and the contact centre are managed centrally by Scottish Enterprise.

The Business Gateway addresses these markets by meeting three key objectives:

1. Delivering effective information and advisory services to start-ups and small businesses throughout Scotland;
2. Increasing the number of new businesses created – including a proportion of those more likely to produce economic impact, such as those achieving turnover above the VAT threshold and those that subsequently achieve growth and
3. Identifying existing small businesses with potential for development and growth, encouraging additional growth and pointing them to further company growth support from Scottish Enterprise (SE) and Highlands and Islands Enterprise (HIE).

The programme is aiming at robust business plan testing, access to lenders and intermediaries. Additionally there are local incubators for micro-enterprises in areas of multiple deprivations.

The transfer of the Business Gateway to local government took place in 2007 and allows for closer integration with other services such as planning, environmental health, consumer and trading standards to deliver an improved service for Business Gateway customers. It enables local authorities to identify emerging businesses with high growth potential and a key part of the local policy is therefore to ensure that such businesses are referred to the enterprise agencies for further support in their growth.

### **Business Growth**

#### ***Gateway for Growth***

In Edinburgh Business Gateway services may be supplemented by a local add in programme offering additional Growth Advice, free access to business intermediaries and a Business Forum offering peer support, investment intermediaries and potential consortia partners. When businesses are of a particular scale, or are high growth or in key sectors they are referred to the Enterprise Network for specific and targeted support

#### ***Business Gateway Growth Pipeline***

There is a national programme named Business Gateway Growth Pipeline. Businesses are accepted in the Growth Pipeline where they have the potential to achieve sales increase of £400,000 within a period of 3 years and where they may aspire to acceptance into Scottish Enterprise's Account Management arrangements. In the prevailing economic climate, businesses are understandably less ambitious and in most areas the outcomes against the target are below expectations for this point. SMEs consequently need additional assistance for the growth period.

#### ***Scottish Enterprise: Account Management***

For larger scale companies able to make a significant impact to the local or national economy Scottish Enterprise delivers a national programme of individual account management to provide tailored high level support and access to a range of Scottish Enterprise Growth and Development programmes.

### **Hybrid Investment Fund**

#### ***East of Scotland Investment Fund (ESIF)***

The ESIF has been mutually established by an agreement, signed by 12 local authorities from the East of Scotland. It is a new investment loan fund, projected initially over 5 years, for the East of Scotland to benefit new and growing businesses which have good, commercially viable proposals but have experienced difficulty in raising finance from mainstream commercial sources. The fund will be modelled on the successful West of Scotland Loan Fund (WSLF). The project will run from the 1st September 2010 to 31st March 2015. The Loan Funds objectives are job

creation/safeguarding of jobs, business start up, business growth and gap funding by offering loans up to £50,000.

The proposal is being developed by a strategic partnership of Local Authorities in the East of Scotland who are working together to improve the availability of loan finance for SMEs in their area. A formal partnership is being established (the East of Scotland Investment Fund - ESIF) Partnership, which will provide a robust governance and accountability framework for effective management of the fund across the operating area. A detailed ERDF application was submitted by Fife Council Development Services on behalf of the East of Scotland Local Authorities on 9<sup>th</sup> October 2009. Fife Council Development Services has been closely involved with the WSLF over the last year to review options for augmentation of the Fife Investment Fund and have since facilitated a series of meetings of the ESIF partners to explore replicating the WSLF model. These meetings established that there was a strong interest in developing a similar Fund in the east and have developed a cost effective means of taking the proposal forward.

Administration of the Fund will be managed by the WSLF under a contract arrangement with the established ESIF Partnership. This will enable the partnership to operate with minimal overheads and gain from the experience and expertise in the early stages of developing the project. It will also result in greater economies of scale, promote collaboration between regions and accelerate development of the ESIF. There will of course be a requirement to ensure appropriate contractual compliance and monitoring processes are in place.

The funding model consists of investments in the Fund by the subscribing member authorities and the matching ERDF those funds attract. In addition, the revolving nature of the Fund, consisting of capital and interest loan repayments shall ensure that money is recycled and businesses benefit from the continued funding availability.

The Loan Fund is made up from three sources of funding totalling £5 million in year one. Local Authorities are going to contribute £1.8 Million, matched by major banks up to £1.86 million. The initiative is supported by £2 million in European Regional Development Funding.

## Conclusions

Having introduced details of the support instruments provided for SMEs in Edinburgh, Jim Galloway concluded he believed it is necessary to

- involve banks at key stages
- target efforts in the most effective manner (identify good prospects!)
- pool the available resources across agencies
- lever-in additional funding from public and private sources and
- Promote positive messages as widely as possible.

Further Conclusions by Patrick Fourquette:

- Make full use of existing organisations: the Business Gateway is a perfect example of cooperation between Regional level (MA) and a network of local authorities, which themselves can call for expertise from their local partners: Edinburgh involved in the Business Gateway network, calling for expertise from the local Chamber of Commerce: benefits of a regional /national network (quality, visibility, communication, support), reduced costs, improved expertise and action implemented close to the small businesses at local level.
- ESIF, the hybrid investment fund also is a concentrate of good practices: it illustrates:

- a possible cooperation between local authorities and banks;
- the leverage effect of the structural funds obtained through a joint application ,
- use of successful experience in a neighbouring organisation and a transfer of experience,
- use of existing expertise to deliver a better service with reduced administration costs (ESIF funds are managed by WSLF with a management contract)

### **Havva Coskun – AGIT Aachen**

In this short presentation Havva Coskun from AGIT in Aachen gave some ideas from the perspective of a business development agency on what cities can do, to provide a better environment, that banks are more active in the local support infrastructure to SME.

Cities need to follow basic principle of the economy that the offer has to meet the demands. Therefore, cities need to intervene in order to develop a healthy economy. This can be done through the support of new start ups, existing SMEs, support creation of new companies from other regions and to develop a friendly environment in the field of so called „soft requirements“ (infrastructure, family-friendly environment, urban-planning context, high-level education field, attractive tourism etc.). In order to achieve these goals instruments like cluster management, innovative circles, economic development agencies or consulting services should be provided.

If cities can design a favourable environment by way of applying the before mentioned instruments, so that a critical mass of new start-ups, growing existing companies and settling companies can be achieved, local banks become active. Hence, through the investment made by companies more money is needed, that banks can supply. Thus, collaboration between banks and companies can be enhanced.

#### *Short overview of local banks in the region of Aachen*

In the region of Aachen there are different local banks, like the savings bank with more than 100 branches, that is shareholder in technology parks and start-up centres. As part of the savings banks there is the S-UBG which is a group composed by six local savings banks with assets under management of 70 Mio € in total and a current share in 40 partner companies. This group provides targeted services like private equity, mezzanine capital for SME, venture capital for innovative technology companies and seed funds for young entrepreneurs. Besides the Savings Banks there is the State Development of North Rhine Westphalia (NRW Bank) providing targeted services (e.g. decrease of financing cost by low interest loans, risk splitting by bonds or loans with indemnity clause, provision of mezzanine capital) and products for professional persons SMEs and companies with a maximum turnover of 500 Mio € annually. Also the biggest German State Development Bank (Kreditanstalt für Wiederaufbau) offers services locally in Aachen for start-ups and mid-sized businesses.

### **Ostpol Credit Offenbach – Microlending Model in Deprived Neighbourhoods**

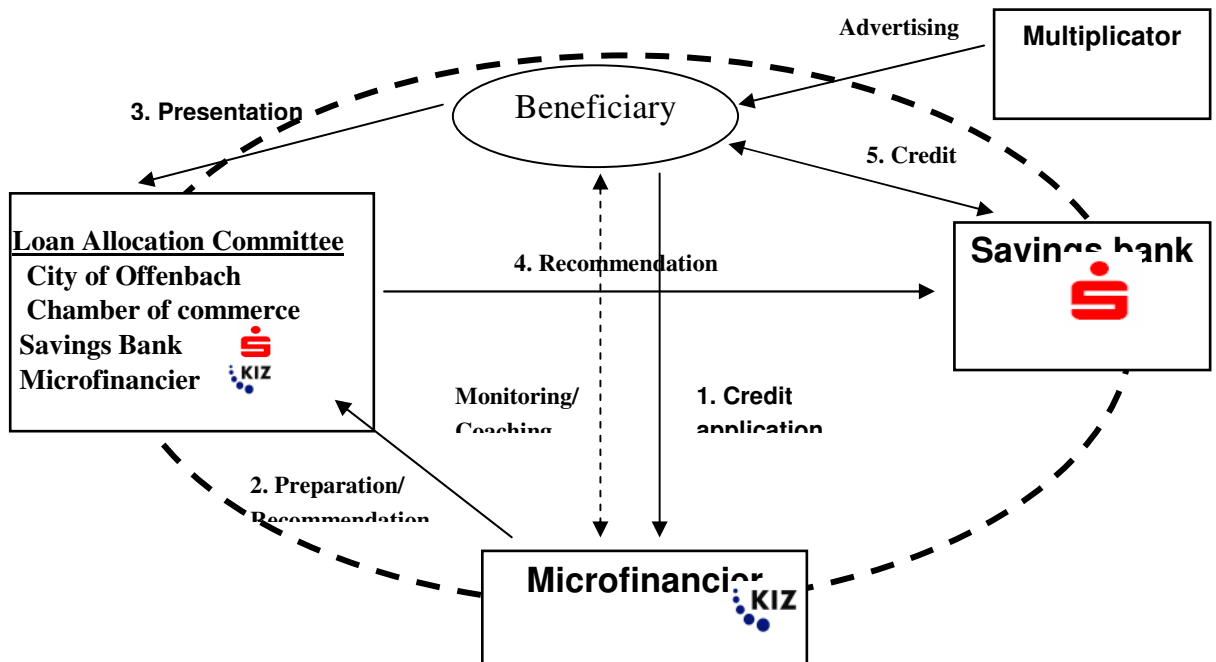
The eastern part of Offenbach's city center has a population of 15.000 inhabitants coming from more than 50 different nations. The neighbourhood has high share of foreigners (app. 50%). The share of citizens with migration background is even higher, with by high unemployment which led to an imbalanced social structure. The local economic structure is dominated by traditional retail businesses with a high share of foreign call- and internet shops as well as one-euro and grocer's shops. In order to upgrade the neighbourhood, diverse initiatives and strong informal networking were established. This includes also the establishment of the creative and start-up center "Ospol" as means to reanimate the local business and cultural sector. The center was conceived as integrated approach, to combine university, start-up center, creativity and businesses in order to attract potential stakeholders from Offenbach, Frankfurt am Main and the surrounding areas. With its facilities, Ospol provides offices and art studios, networking possibilities, coaching and training options, workshops, events, financial resources and contacts.

In order to back-up existing trade sector and to stimulate the formation of new businesses, a new model of an urban micro credit funds was established. The objective was to ease the lending of micro credits by a transparent clear process. It was intended to establish a financial product combining consultation, financing and attending aspects in order to establish microlending as a sustainable instrument which might be adopted by further neighbourhoods with a similar characterisation. The challenge was to find potential partners, and create and implement a financial product which is tailored to the specific needs of the neighbourhood.

#### ***Result of the cooperation model:***

- Microfunds partners are the city of Offenbach (Department Employment Promotion, Statistics and Integration), KIZ GmbH (a non profit project company in this case the microfinancer), Savings bank Offenbach (Business Client Department), IHK Offenbach (chamber of commerce and industry), HfG Offenbach (University of Art and Design), GBO (a non-profit-making building society), DMI (German Microfinance Institute) and the German Microfinance Fund. The partnership among all stakeholders is based on already existing network for economic and employment promotion with a focus on business creation, which is called "Gründerstadt Offenbach ("Founders City Offenbach"). Thus, there was the possibility to involve the classic stakeholders for economic development. Within this model, the local savings bank, the city and the local microfinance institute contribute to form the capital of a guarantee fund applicable to micro-credit..
- A crucial particularity is the "Offenbacher Mikrofinanzfonds" (Microcreditfunds Offenbach), which was particularly founded for the microlending system in Offenbach. This open-ended fund is taking over the first-loss liability and stays at the disposal for the businesses also after the projects end as credit redemption insurance. It was funded by the city, the savings bank Offenbach and KIZ, supported by the local chamber of commerce and industry. Each partner contributed € 46.500. Due to the cooperation with the DMF (German Microcredit Fonds), it was possible to extend the creditportfolio up to € 232.500. A further particularity, which is the involvement of the savings banks, shows that the model is applicable for other cities and regions.

Structure of the micro lending system in the city of Offenbach:



- 
- 
- Prerequisites for beneficiaries to obtain the micro credit are a persuading business concept and a submission of an online application, a voluntary disclosure of confidential information, the latest disclosure of business information and a business location within the inner city of Offenbach (urban development). The beneficiary has to present the business concept to the loan allocation committee which immediately takes a decision on the commitment. Then the savings bank provides the credit to the credit applicant who was recommended by the committee of allocation.
- The product
- The duration of the credit varies between 12 – 24 months without a grace period. The interest rate amounts 10% per year and the bank charges varies between € 90 and € 270 per hour. The first credit must have minimum amounts of minimum € 1.000 and amounts up to € 5.000 at the highest. Additionally, a follow up loan can granted with a maximum of € 10.000. The follow up can be paid, if the lender has repaid successfully the first “Ostpol loan”.
- The liability system = the loan guarantee fund
- In case of a credit default, the Microcreditfonds Offenbach covers 20% (the first loss) default to the German Microcredit Fond who covers the entire default the to the savings bank (the last 80%). Actually it should be the microfinancier KIZ GmbH. However, due to an agreement

with the local microfinancefonds KIZ is exempted from the liability, thus the responsibility has been fully devolved to the local Offenbach fond. In consequence the liability system has four internal relationships: (1) customer – bank; (2) bank – German Microfinance Fond, (3) German Microfinance Fond – microfinancer and (4) microfinancer – Microfinancefond Offenbach.

#### Conclusions advantages – disadvantages on the Offenbach Model

The guarantee system is quite comprehensive, thus the establishment is very complex as for every liability relation among the partners a particular contract has to be elaborated. Additionally the entire system is complex which may lead to a high work expend with potential defects. Moreover, the microfinance who is preparing the credit decision is exempted from the liabilities. However, this disadvantage was balanced by the fact that the microfinancer contributed capital the local fond. A big advantage of the model can be the sustainability. The involvement of local actors by means of financial contribution results in a strong commitment. Moreover, further neighbourhoods can be docked to the existing system. Thus, economies of scale can be achieved and furthermore it is not necessary to establish complex systems in neighbouring city districts.

#### **Micro financing in Leipzig - Wennemar de Weldige**

One of the most important projects for Leipzig support instrument for small scale SMEs as part of the LAP (creation of demanding financing instruments) is the establishment of an urban micro credit fund. As small enterprises in deprived neighbourhoods increasingly have difficulties with access to any forms of finance, the Leipzig microfonds was launched as pilot project until 2012 in order to prove the profitability and self sustainability of such an urban fund. Therefore, the existing partnership between the city, the Leipzig savings bank (Sparkasse Leipzig) and the chamber of Commerce has been employed. Additionally, the ugb as cities start-up agency is being involved as contact and operational point. The ugb is commonly run by the city, the savings bank and the district of northern Saxony. The project is based on the federal support project “Mikrofinanzfonds Deutschland” and the programme “Mikrofinanzierung in Quartieren. (microfinance in neighbourhoods).

Initially the fund is targeting a portfolio of 200.000 € per year allocated to the provision of 50 to 100 micro loans for start-up companies annually. Therefore different funding sources have been pooled. Deriving from this fund microcredits are being provided between 5.000 € and 20.000 €. The overall funding is pooled to 20% by local actors like the city and the savings bank and by 80% directly contributed from the micro finance fund Germany (which in turn is funded by the Federal Ministry of Labour and the European Social Fund).

The model is similar to the before mentioned model in Offenbach. However, additionally a further local deposit bank (GLS-Bank, a non primarily profit orientated cooperative financial institution) is involved into the organisation as loan provider. The GLS Bank has gained already valuable experience on this field. The GLS bank obtains for every loan a credit a 80% credit default security by the micro credit fund Germany (160.000 € in total). The savings bank Leipzig contributes the pooled fund with 15.000 € and also the city of Leipzig contributes one-time with 25.000 € to fill up the overall sum to 200.000 €.

The primary credit is limited to 5.000 € is being paid by the GLS Bank. In case of a redemption in due time, the beneficiary can apply for a follow up credit up to 20.000 €. The interest rate is fixed in both cases with 7.5%. The average lending duration amounts 24 months with a maximum of 36 months. The default security for each lender has to be born up to 50 % by two guarantees. The second 50 % are borne by the microfinancer Leipzig.

The project is characterised by an active assistance of the credit beneficiary like introducing in entrepreneurial and business skills up to common elaboration of solutions in case of possible financial difficulties. This service is provided by the ugb which is also the first contact point for the lender. Having evaluated the credit worthiness, the ugb propose the microloan to the beneficiary and is responsible for the before mentioned guidance. Particular target areas are primarily deprived neighbourhoods in Leipzig ("Leipziger Osten" and "Grünau"). In cooperation with the Leipzig for city development and housing support beneficiaries in these areas receive special assistance.

In order to provide an answer from Leipzig to the question on how to attract banks to be more active Leipzig stated that there is an apparent limited relevance of the local environment for the scope of activities of local banks and a limited local influence on the banking sector's approach to finance SME. Cities can and should develop a favourable environment specifically for micro-finance not merely for local banks but open to any financier who engages in new approaches to financing entrepreneurship.

### **Discussion main points:**

- One leading Question: Is there a market gap for micro-credits, is it a task that local banks have to take, or is it inevitable to create new institutions that micro-lending can be provided?
- Banks needs to be kept on board – no new parallel institutions for micro-lending should not be established
- Banks have a strong competences and high skilled staff, they can provide proper market overviews and can duly evaluate chances and risks of starting a business and local banks can proper evaluate which is a precondition for a successful start-up
- However local banks need to see a ratio between charity tasks and their command for local development and on the other hand to fulfil commercial criteria, thus in many cases micro-lending covers many resources with low turnover for banks
- Example in Leipzig has shown that negotiations with banks is not easy, the willingness to be involved into local structures is limited, that's why it is useful to think about alternative micro-funding institutions and alternative funding opportunities.
- Need of code of conduct for micro lending institutes, capacity building for the staff is needed, to advice unqualified advice for SMEs
- Debate on creating new opportunities of for support facilities for micro-lending or keeping responsibilities on the side of the banks, as they have more competence.

The Leipzig micro-credit fund shows a possible good practice for:

local partnership involving the Municipality, the local savings bank, the CCI and the local development agency.

they pool their financial resources, which guarantees the success for a joint application for complementary funding to the Ministry of Labour (national level) and structural funds (ESF)

they make full use of existing local expertise with UGB helping businesses in preparing micro-credit applications

they can have different approaches to different businesses as micro-credit for social projects cannot be approached exactly the same way as traditional loans to bigger existing businesses, but they secure the financial expertise to manage the fund with the participation of the savings bank

## URBACT II

**URBACT** is a European exchange and learning programme promoting sustainable urban development.

It enables cities to work together to develop solutions to major urban challenges, reaffirming the key role they play in facing increasingly complex societal challenges. It helps them to develop pragmatic solutions that are new and sustainable, and that integrate economic, social and environmental dimensions. It enables cities to share good practices and lessons learned with all professionals involved in urban policy throughout Europe. URBACT is 181 cities, 29 countries, and 5,000 active participants

[www.urbact.eu/project](http://www.urbact.eu/project)



EUROPEAN  
PROGRAMME  
FOR  
SUSTAINABLE  
URBAN  
DEVELOPMENT

