

Evaluation Study of the Incentive System and Financial Engineering Instruments in force in MADEIRA REGION under the INTERVIR + Programme (2007-2013)

EXECUTIVE SUMMARY



1. Scope, object and objectives of evaluation

2. Evaluation Methodology

3. Key Findings

4. Recommendations

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1. Scope, object and objectives of evaluation

The object of this thematic evaluation are the Aid schemes (Incentive Systems - IS) to investment on business in Madeira financed by Priorities I, II and V of the INTERVIR + Operational Programme and the Financial Engineering Instruments (FEI) available in the regional market and supported by that Programme, covering the period from January 2008 to 30 April 2012.

The evaluation focused particularly on the targets (strategic and operational) and on the modalities of implementation associated with the types of intervention of the Programme, given its nature and heterogeneous levels of implementation of the following policy instruments: *(i)* State aid schemes for companies, namely SMEs; *(ii)* Financial Engineering, and *(iii)* Incentives for companies to compensate for additional costs of remoteness/ultraperipherality.

The structure of the Evaluation Study objectives is presented in the following items.

- ✓ *General objective* - To evaluate the results and effects associated with the implementation of the various incentive schemes and financial engineering instruments in force in Madeira during the INTERVIR + Programme (2007-2013).
- ✓ *Specific objectives* - *(i)* To build the log frame of results and effects related to the nature of IS and FEI in force in Madeira, *(ii)* to characterize the actual and expected contributions of the actions supported by the IS funded by the INTERVIR + Programme to outputs and outcomes, *(iii)* to analyze and interpret the factors that determine the deviations in IS performance until the time of the evaluation, taking into account their expected outputs and results, and *(iv)* to identify and justify any adjustments to be adopted in order to maximize the efficiency and effectiveness of the IS, as well as the improvement of the outcomes and impacts and the sustainability of the investments.

From this logical sequence of objectives tree follows a set of Evaluation Questions delimiting this exercise as an evaluation of results and impacts, dimensions that support responses (descriptive and explanatory), related to the dynamics of IS implementation.

Evaluation Questions

Analytical dimensions	Evaluation Questions
1. Logical framework and dynamics of achievements	QA1. What is the consistency of the IS (internal consistency) in relation to the operational objectives and instruments of the OP? Identification of areas for improvement and possible obstacles implying loss of efficiency and consistency.
	QA2. What profile of achievement is expected given the type of beneficiaries covered and the areas of activity of supported projects? What are the changes on the business profile of departure?
	QA3. What is the nature and type of investments by IS?
	QA4. What is the pattern of project location by geographical area? What is the relevance of the support on the decentralization of business investment?
	QA5. The rhythm of financial progress is as expected given the current position in the OP life cycle? What Actions / Typologies are given more attention?
2. Results and effects-type	QA6. What contributions are already visible to the achievement of the strategic objectives of the NSRF under the Agenda for Competitiveness? What are the actual observed contributions to the achievement of specific objectives of the Axes I, II and V of the INTERVIR + Programme?
	QA7.'s The articulation model between IDE-RAM and the technical/ specialized bodies is appropriate and effective regarding the analysis and decision processes and the monitoring initiatives?
	QA8. What specific effect types are resulting from the use of complementary financing instruments created during the implementation of the Program (ProInvest Credit Line, SMCs Madeira Credit Line, soft Credit Line to micro and small enterprises of Madeira and participation of IDE-RAM on the Counter-Guarantee Mutual Fund) on the demand for aid schemes?
	QA9. What are the needs of regional companies in terms of using FEI? What are the mechanisms to be implemented?
	QA10. What are the results of the IS-Funcionamento (operating aid scheme) regarding the maintenance of businesses and jobs in the context of economic recession?
	QA11. What are the results from access to IS and to FEI, on the entrepreneurial tissue of the region and on the regional economy considering the objectives (employment, productivity, investment, exports, spending on R&D, innovation, etc.) stated in PDES 2007-2013 and in the INTERVIR + Programme?

2. Evaluation Methodology

The methodology designed for this evaluation exercise was based on a multi-method approach, through the use of different methods of collecting information and various sources of information, aiming at maximizing the elements / essential inputs for the proper response to the Evaluation Questions and simultaneously at enhancing the involvement and participation of, namely: the *stakeholders*, entities with responsibility of management and implementation of Incentive Schemes (Technical Support Structures of the Managing Authority and the Intermediate Body), Regional Administration Bodies with intervention in the sphere of business activity, business associations, other relevant entities, consultants and recipients of Aid Schemes and Financial Engineering Instruments.

The methodology adopted sought to develop working complementarities with the *Interim Evaluation Study of INTERVIR + Programme*, whose Final Report devoted a significant part of its contents to the Aid Schemes to Investment in place in Madeira, funded under that Programme. This approach was adopted to enhance the usefulness and value of the work, ensuring greater added value to its Conclusions.

The interviews were semi-directed, based on a template adjusted to the tasks and competencies of respondents and focused on issues relating to the following items: (i) adequacy of aid schemes to regional economic reality and to the needs of business development and its ability to adapt, (ii) adequacy of the articulation model between the IDE-RAM and the technical bodies, (iii) effects on the business profile and pattern of industrial location; (iv) effects on business modernization (areas of projects innovation, new products and services developed, new forms of management, ...), (v) external impacts, namely, of the macroeconomic and financial environment on the dynamics of IS implementation, (vi) contributions to business development and to the development of the regional economy, (vii) impacts on regional economic specialization and on employment, and (viii) needs of companies in terms of the use of financial engineering instruments.

The survey applied to the Entities supported by the Financial Engineering Instruments (the application was *online*) focused on the following subjects: (i) profile of use of complementary instruments of financing, (ii) results boosted by the use of complementary financing instruments; (iii) relationship between Financial Engineering Instruments and the support of the IS, and (iv) standard needs of business financing.

The development of Case Studies was decided in order to undertake a detailed analysis of specific aspects of implementation of each project and to collect empirical data to support the response to the EQ, aiming at deepening the analysis of different dimensions, namely: (i) innovation of products and services (ii) investment in intangible factors of productivity and impact on the operation of the company, (iii) investment in information and communication technologies and, in particular, use of *e-commerce* as a new way to reach the market or reaching new markets, and (iv) access to Financial Engineering, specifically the Credit Lines supported by INTERVIR + Programme.

3. Key Findings

The main results of the Evaluation are presented firstly by systematizing response elements to the Evaluation Questions and, secondly, according to some key analytical dimensions:

Evaluation Questions	Response elements synthesis
<p><i>QA1. What is the consistency of the IS (internal consistency) in relation to the operational objectives and instruments of the OP? Identification of areas for improvement and possible obstacles implying loss of efficiency and consistency.</i></p>	<p>The cross analysis between the specific objectives of the Axes of Intervention and the objectives of the Incentive System (aid schemes) points to a significant consistency of the IS in response to the specific objectives present in the operational tools of the OP (its Priority Axes), which express by the way a heterogeneous vision of business and regional competitiveness.</p> <p>The possibility of this set of IS and the financial planning of public expenditure effectively contribute to the changing of cycle of investment aid and anchor a new stage of the regional development model, is strongly dependent on the dynamics (nature of the project, volume and components of investment initiatives of beneficiaries) and the degree of accuracy in applying the criteria for selecting projects.</p>
<p><i>QA2. What profile of achievement is expected given the type of beneficiaries covered and the areas of activity of supported projects? What are the changes over the business profile of departure?</i></p>	<p>Given the projects supported so far the following conclusions can be drawn: (i) micro and small businesses are underrepresented in number of aid approvals compared with the average of companies in the region while the medium and large capture a higher percentage than their regional weight, (ii) sectors where new firms are more represented correspond to trade and services, strengthening the tertiary sector specialization and (iii) both in medium-high industrial and in high technology services with a high-tech intensive knowledge base, the contribution of IS corresponded, respectively, to 15% and 8.7% of the businesses in these segments in Madeira.</p>
<p><i>QA3. What is the nature and type of investments by IS?</i></p>	<p>The profile of investments supported by various Incentive Schemes shows that almost half of the eligible investment approved focuses on Dynamic Factors of Competitiveness (FDC). This investment concentrates on components related to the introduction of information and communication technologies and improving energy efficiency, particularly in Tourism Aid Scheme (IS Tourism). The areas related to improving the competitiveness of companies have a relatively small importance in the context of the supports (promotion and internationalization - 2.6% of the total eligible investment of 6 projects, and R&D present in 11 projects supported by IS + Conhecimento, where the investments essential to productive activity have a lower weight). In Qualificar + and in SIRE Special Projects the investments in FDC represent more than half of the eligible investment approved.</p>
<p><i>QA4. What is the pattern of project location by geographical area? What is the relevance of the support on the decentralization of business investment?</i></p>	<p>The projects supported by all IS in Madeira are heavily concentrated in the municipality of Funchal (67.9% of approved projects and 77.4% of new business projects), a trend towards a greater concentration of new businesses in the regional capital.</p> <p>This trend reflects a limited influence of the IS in terms of changing the current pattern of regional location.</p> <p>However the IS offering an additional support for locations outside Funchal (IS Qualificar +, IS Tourism and SIRE), present a percentage of projects that are located in Funchal significantly lower than in the other IS (IS Empreendinov and IS + Conhecimento).</p>
<p><i>QA5. The rhythm of financial progress is as expected given the current position in the OP life cycle? What Actions / Typologies are given more attention?</i></p>	<p>The various IS show a weak financial progress (18% of total funding), taking into account the high levels of approvals. The IS + Conhecimento and the IS Tourism are the IS with lower rates of execution. However, noteworthy is the increase in the pace of implementation in 2012, although the levels of performance of IS are still well below the overall implementation rate of INTERVIR + Programme, which stood at 40% (04/30/2012).</p> <p>The projects promoted by medium and large companies with a higher average financial dimension are those where greatest difficulties of realization are perceived, as well as in projects belonging to the service and tourism sectors, as a result of sectoral and economic crisis.</p> <p>The IS-Funcionamento and IEF have acceptable levels of financial performance and major difficulties are not expected in spending the approved amounts.</p>

Evaluation Questions	Response elements synthesis
<p>QA6. What contributions are already visible to the achievement of the strategic objectives of the NSRF under the Agenda for Competitiveness? What are the actual observed contributions to the achievement of specific objectives of the Axes I, II and V of the INTERVIR + Programme?</p>	<p>The anticipated contributions, based on approved projects, to achieve the goals of the Agenda for Competitiveness and Axis I, II and V of the INTERVIR + Programme, can be summarized as follows:</p> <ul style="list-style-type: none"> • the IS to Investment have not revealed clear trends of changing the existing paradigm in regional business, despite some positive signs and examples of innovative projects, access to R&D by firms, investment of FDC and creation of firms in new sectors of activity; • besides the reinforcement of tertiary economy and the limited bet on sectors with a future such as environment and health, the IS haven't induced diversification of the economy; support mechanisms are very open in terms of sectoral scope, not encouraging promoters to economic diversification; • IS-Funcionamento has fully achieved its objectives – reduction of business costs of this ultraperipheral region; reimbursement of current costs of companies induces immediate and effective results.
<p>QA7.'s The articulation model between IDE-RAM and the technical/ specialized bodies is appropriate and effective regarding the analysis and decision processes and the monitoring initiatives?</p>	<p>The articulation model between IDE and technical and specialized bodies is efficient, and the deadlines for issuing opinions are generally met. The articulation model is effective: the decision making process is clearly attributed to a body (IDE); the opinions of technical and specialized agencies are not binding. This model ensures consistency of decisions by the IDE and values the project as a whole, without ties to sectoral logics or investment components.</p>
<p>QA8. What specific effect types are resulting from the use of complementary financing instruments created during the implementation of the Program (ProInvest Credit Line, SMCs Madeira Credit Line, subsidized soft Credit Line to micro and small enterprises of Madeira and participation of IDE-RAM on the Counter-Guarantee Mutual Fund) on the demand for aid schemes?</p>	<p>Four Credit Lines funded by the INTERVIR + Programme were intended mainly to finance working capital of recipient companies (62.6% of the amount borrowed); only 13.1% was devoted to purchase equipment. Since the IS do not fund working capital, it can be inferred that the existence of credit lines secured some financial relief to promoters, namely to develop the projects supported by the IS. However, this conclusion is not supported by factual evidence in the interviews. Working capital is presented in the Beneficiaries' Survey as being the main reason for applying for credit lines (soft loans); funding for construction - very limited in IS - comes in second. These data point to some implicit complementarity between the two types of instruments.</p>
<p>QA9. What are the needs of regional companies in terms of using FEI? What are the mechanisms to be implemented?</p>	<p>Companies that responded to the questionnaire on the use of credit lines funded by INTERVIR + Programme considered that their greatest funding needs are related to working capital (88.5% of total), financing constructions (85.7%) and purchase of equipment (81.4%). This result reflects the current situation in the region where there are severe restrictions on corporate financing both for investment and for the development of its current activity. Only in a context of strong complementarity with IS (both in relation to the same projects as others aimed at similar goals) will be possible to ensure that the Credit lines contribute to the Programme's objectives. Very open instruments may be justified under strong credit restrictions to keep the economy running, but hardly encourage qualitative changes in the pattern of specialization of the region.</p>

Evaluation Questions	Response elements synthesis
<p>QA10. What are the results of the IS-Funcionamento (operating aid) regarding the maintenance of businesses and jobs in the context of economic recession?</p>	<p>The IS-Funcionamento (operation aid scheme) was created in a context of response to additional costs for the exercise of economic activity in ultraperipheral conditions, compounded by the macroeconomic and financial crisis. Although it was not possible to estimate accurately the effects on the maintenance of business and jobs (i.e. not being able to associate directly the results identified to the supports of this IS), it appears that in all projects that have already submitted expense or are completed (488), in addition to the 6428 jobs retained, new 279 jobs were created, thus making a total of 6707, which is an important indicator of results,</p>
<p>QA11. What are the results from access to IS and to FEI, on the entrepreneurial tissue of the region and on the regional economy considering the objectives (employment, productivity, investment, exports, spending on R&D, innovation, etc.) stated in PDES 2007-2013 and in the INTERVIR + Programme?</p>	<p>The estimated results of IS to Investment in Madeira in response to the goals expressed in PDES point to: (i) a positive impact in terms of entrepreneurship, knowledge society (especially in relation to business investment in ICT), sustainable development (especially due to investment in energy efficiency) and job creation, (ii) for positive elements in innovation and R&D; and (iii) for virtually no impact on territorial cohesion and on a more balanced geographical distribution of economic activity across the Region.</p>

The systematization of the Conclusions of the Study is presented in a more aggregated way, by analytical dimension, in order to highlight the most striking elements of the implementation and results, meanwhile, obtained by IS/FEI.

✚ **Contribution to the strategic goals of the development of the region.** Data related to public instruments supporting investment in companies show low performances, jeopardizing an effective contribution of those instruments to a change of paradigm on the horizon 2013. Such levels of performance limit the scope of conclusions, just based on projects' approvals, particularly since the economic and social situation is unfavorable to regional investment and can lead to higher dropouts than usual.

Estimated contributions of support instruments to investment (IS) are:

- positive impact in terms of entrepreneurship and job creation;
- positive impact on economic diversification either via the investment in new sectors (environment, health, ...) or via the use of new processes and products capable of reinforcing business competitiveness and export-oriented activities
- positive impact, although to a small extent, in R&D in collaboration with knowledge producing entities (in particular, mobilization of the University of Madeira) and resulting transfer of technology for businesses.

↵ **Elements of change induced by the Aid Schemes.** Dynamic Factors of Competitiveness ended up having a very significant weight in total eligible expenditure (48.1% of total), which corresponds to an outstanding progress in relation to past and to the standard investment project in the region, where directly productive investments, mainly construction and equipment, have a greater weight. This is an encouraging outcome although it should be relativized because the notion of FDC includes productive investment, when endowed with innovative characteristics, besides covering intangible investment.

The types of investment with greater weight in FDC are ICT and energy efficiency, aggregates with indisputable impact on key areas for development: knowledge society, environment and energy. Indeed, the case studies conducted in hotel industry, retail trade, consulting and computing reveal very interesting effects on cost reduction, environmental sustainability, conquest of new markets outside the region and consolidating market positions in relation to the competition from Mainland enterprises.

The weight of the new companies in all the approved projects is also remarkable: 39.2% of the projects are developed by new companies. This result cannot be disconnected from the political decision to create a specific IS, more favorable for fostering entrepreneurship - IS Empreendinov - which contributed to 73% of new businesses created with the support of IS. Although it is recognized that the component "entrepreneurship" was more decisive in approving projects than "innovation" (where the results were less evident), the IS Empreendinov had impact on the mobilization of new entrepreneurs, especially young people, even if the "need initiatives" (as opposed to the "opportunity initiatives") may have had significant weight.

↵ **Financial Engineering.** Financial engineering can be an effective tool to support investment and, if linked to IS in terms of complementarity, may even contribute not only to the creation, development and modernization of viable companies, but also to support more selective strategic aims.

The fact that only Credit Lines were chosen under this umbrella limited the impact of this instrument. In an area crucial to the strategy of development, the creation of *start-ups*, companies of greatest risk, creativity and innovation, more technology and knowledge-based (where promoters have weaker real guaranties) instruments such as *business angels* and venture capital funds can assume a crucial role.

Not having invested in this area, the impact of Financial Engineering was confined to producing effects in the improvement of the financial situation of companies and the respective treasury,

by strengthening working capital. Although it has not been possible to access relevant data from the Bank sector relative to the projects supported by Credit Lines, the fact that only 13.1% of the funds was allocated to equipment purchase shows the type of projects developed.

↪ **Support to the mainstream business activity.** IS-Funcionamento is a unique IS in ultraperipheral European regions, aiming at compensating (transversely to all companies, as long as they demonstrate a balanced economic and financial situation) the additional costs derived from its ultraperipheral situation and its inherent *handicaps*. It is a model that naturally does not aim at inducing changes in the economic tissue but preserve the existing situation; for this reason, in the long term, it may involve risks associated to the existence of a "rent effect", i.e. discourage the necessary economic and technological adaptations to a changing global market.

The fact that supported costs are mostly salaries (90.6% of total) highlights this potential concern. However, the legislation establishing the IS-Funcionamento binds it to the current financial and economic crisis and therefore it defines, at start, an implicit time limit for its implementation.

Given the objectives and model adopted to reduce the additional costs of ultraperipherality, this IS was quite effective: it retained or created at least 6,700 jobs and reduced by about 13.8% the cost to applicant companies of the current expenditure submitted.

4. Recommendations

↪ **General structure of the incentive model to companies.** The Evaluation Team advocates a simplified model of support tools to companies in relation to the current one and in which financial engineering would play a reinforced role. Thus, in general terms, it is proposed:

- the IS to Investment in companies should be selective, clearly betting on business strategies aimed at reinforcing competitiveness via qualitative changes in the production process, marketing process or of the rationalization of costs, through introduction of new technologies or know-how; directly productive investment would be restricted and supported only in exceptional cases of direct complementarity with FDC;
- the model could work with only two IS: one devoted to R&D (mainly on co-promotion) and another focused on business investment centered on FDC;

- the IS should be based on reimbursable grants, with the exception of aid for the creation of new innovative and qualifying companies which could get a non repayable support;
- the support to projects developed both by new businesses or by the existing ones which do not represent a significant qualitative change for promoting companies or for the competitiveness of the region should have access only to Credit Lines or other FEI that would be transversal to the entrepreneurial tissue;
- Credit Lines should focus more on the goals of business modernization, evolving into complementary instruments of IS in two dimensions:
 - support projects that do not respond to the selective conditions of access to IS but meet the general objectives they pursue;
 - support non eligible costs of projects approved by IS.

✚ **Structural elements of the model.** In terms of conception of new IS, the Evaluation Team provide some recommendations related to options considered less satisfactory in the current model or that in light of expected constraints will justify a structural change:

- *Focus on sectoral specialization of incentives* - a model of incentives more concentrated in sectors that can compete in the global market and export, i.e., marketable goods exposed to external competition; it is expected that the trade services and some other services (namely those that do not address companies) should be excluded from the IS and channeled to soft Credit Lines;
- *Thematic focus of incentives* - a more focused model on the FDC of non directly productive nature, specially immaterial; on the other hand, a more demanding application of concepts and access criteria to the System should be aimed, to ensure that only clear added-value projects in terms of its regional business tissue (innovative investments in new or existing companies) would be supported.
- *Focus of incentives on innovative and qualifying regional tissue entrepreneurship* - a more demanding support to new entrepreneurs based on a decision matrix similar to the existing businesses, and only use repayable grants for projects resulting from opportunity entrepreneurship, which is also characterized by its creativity and for being an added-value for the region; the support aimed at entrepreneurs of “need initiatives” should be channeled to Credit Lines or to active measures for self - employment;
- *Value on the internationalization component* - in spite of the current restrictive Community rules in the Competition area, a creative model of support for the expansion of Madeira’s companies abroad should be recreated, particularly outside the European Union area, more

adapted to the real needs of the entrepreneurs who wish to establish channels for internationalization; in this context, the present rules defined in the IS regarding eligible expenses and conditions of its financing should be reviewed and broadened and its use eased;

- *Reinforcement of the territorial efficiency of incentives* - the issue of territorial cohesion of the region has to be tackled seriously namely because regional imbalances in the concentration of companies, richness, and employment has reached levels that presently are very hard to counteract; there has to be a coordinated and transversal strategy to the regional IS aiming at a positive discrimination outside the Funchal municipality, with bonuses that may lead to considering locating new companies or productive units outside Funchal or maintaining and developing existing companies outside Funchal. This bonus/additional support should be at least 10 percentage points to have some degree of effectiveness.

↳ ***Operation of the Incentive Systems.*** Project monitoring should be valued in all IS, regardless of which organisation plays that role – IDE or IDE in collaboration/cooperation with specialized technical bodies. In Portugal, that function usually does not have the dimension and relevance that it should have in supporting the entrepreneur, detecting and preventing problems being implemented, and is often overshadowed by the duty of checking and controlling. Therefore, the Evaluation Team recommend a more active attitude of the Administration in this domain, particularly since the interviews with the specialized technical bodies often showed a willingness and interest in collaborating and having a more active role in that area; in several cases there is apparently available capacity for this purpose.