

LEADER II



# Local financing in rural areas



LIAISON ENTRE ACTIONS  
DE DÉVELOPPEMENT  
DE L'ÉCONOMIE RURALE

LINKS BETWEEN ACTIONS  
FOR THE DEVELOPMENT  
OF THE RURAL ECONOMY



COMMISSION EUROPÉENNE  
DIRECTION GÉNÉRALE  
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# **Local financing in rural areas**

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# Introduction

**Access to funding is a key local development issue. Indeed, difficulties in securing finance may seriously hamper the emergence of projects – especially small-scale ones – and new business creation.**

The ability to grant funding and/or facilitate the search for such funding is the primary lever which LEADER groups are able to use in their area.

However, despite the existence of a wide variety of potential financing instruments, we have noted that virtually all LEADER groups since LEADER I have confined themselves to a sole financial instrument, namely subsidies. Even though this has enabled them to exploit the diverse possibilities afforded by this formula, by focusing on the beneficiaries' levels of co-partnership, LEADER has largely ignored the multiple advantages offered by other forms of financing, including ethical alternatives, guarantee funds, venture capital, etc., as well as a carefully considered combination of these various formulas.

LEADER's lack of experimentation has not been due to insufficient resources or financial engineering possibilities. Indeed, ever since they were created, Community regulations have authorized the use of the European Structural Funds for financial engineering purposes. However, only a few of the 217 LEADER I local action groups (LAGs) and the thousand LEADER II groups have seized this opportunity to create financial engineering structures suited to specific needs that subsidies fail to address.

At a time when we are drawing lessons from LEADER II (1994-1999) in order to prepare the new LEADER+ Initiative (2000-2006), it appears essential to analyse these financing experiments which have been all too isolated and little-publicized. This dossier addresses a number of questions, including: What lessons can be drawn from these interventions today? What are their limitations? And what are the challenges for the future, in particular for LEADER+?

With respect to the limitations encountered by these formulas, have any alternative experiments been conducted in another context which may be of use to rural development and to LEADER LAGs? For example, at present most of the consultations, initiatives and innovations in local financing are emerging in urban areas. In what ways could this proliferation of experiments in the towns interest rural areas? What are the limitations? Which points require further experimentation?

The purpose of this dossier, which results from discussions during the seminar on local financing held in Tarazona (Aragon, Spain) in January 1999, is to sketch out answers to these various questions.

The document has been structured into four chapters:

- > In Chapter One, we seek to ascertain why the issue of local financing is so important to rural development and what this involves. What are the needs and issues at stake? What problems and doubts do they raise?
- > In Chapter Two we attempt to present a brief outline of current funding provision for rural areas from sources other than LEADER. Within this diverse range we distinguish between two types of structure: those based on a purely financial rationale which, in the current globalization context, increasingly tend to diverge from some of the specific needs of rural areas, and "alternative" forms of financing, which obey different rules of a social, ethical, local development or similar nature. This second phase of analysis leads us to evaluate the gap that exists in rural areas between funding needs and funding provision.
- > Chapter Three focuses on the principal financing formulas tested under LEADER I and LEADER II. What characterizes these experiments? In what way are they different and/or complementary? What parallels are there? What are their limitations? What needs do they fail to address? In which fields is further experimentation required?

> Finally, Chapter Four identifies a number of challenges to be taken up in the future: What issues must financial instruments address, especially in the context of the new rural development Regulation and the LEADER+ Initiative? Two factors will be key to this analysis. The first is that after 2006, there is nothing to guarantee continued support from either the Structural Funds or LEADER, and so from now on it is absolutely essential to think in terms of the survival of initiatives after 2006. The second is that the local territorial framework is no longer adequate for long-term solutions and that higher levels of intervention must be considered that span several rural areas and/or are linked in a variety of ways with urban areas.

## **Chapter 1**

# **Local financing – needs and issues**





# Local financing

## – needs and issues

**Financing is a special form of partnership that exists in varying degrees between a number of different players. However, it is common to find a gulf between funding supply and demand.**

### **1.1 Financing, a form of partnership**

“To finance”, means “to furnish with finances or money; to find capital for”, “to conduct or engage in financial operations, to manage monetary affairs; to provide oneself with capital”<sup>1</sup>. It also means to provide someone with the means to access the market for goods and services in order to carry out a project. The matter of financing therefore involves a supplier and a beneficiary.

However, even in its most commercial form of a bank loan, financing differs from an ordinary supplier/customer relationship because the commitment between the two parties generally extends beyond the supplier providing the goods or services and the customer simply paying for them.

By its very nature, financing engages the responsibility of the “customer/beneficiary” to his supplier at other levels, whatever form such financing takes:

- > If it involves a donation or subsidy, the financing can never totally be divorced from its underlying objective and the donor's expectation of a result from the beneficiary: this may include support for a specific project or more general support to participate in a public interest measure (e.g. subsidizing a cultural association);
- > If it involves a loan, the beneficiary is committed to reimbursing this loan and the supplier will certainly guarantee its reimbursement and negotiate the terms and deadlines.
- > If it involves co-partnership in a project, there is a *de facto* joint responsibility between supplier and beneficiary.

In all cases, the fund provider and beneficiary **share an objective**. This is why financing is first and foremost a special form of partnership. This partnership may vary in scale, from a bank that is happy to grant consumer credit, to a partnership between a project promoter and one or more savers pooling together their ideas, know-how and financial resources to implement a project.

Linking financing to a partnership is crucial, because this link makes it possible to grasp the full importance of financing and to turn it into a local development tool in its own right.

By considering financing from this angle, it is also possible to turn financing into a real lever for coordination, rather than merely a management tool. So, in some cases, LEADER subsidies for project promoters may be perceived simply as resource allocations whilst, in others, they trigger mechanisms which engage the beneficiaries in local processes of consultation, shared objectives, collective learning, transfers of experience, etc.

By forging a link between financing and partnership, we also pinpoint the correlation that exists between local financing and social cohesion/democracy. Indeed, financing is easiest in areas with strong social cohesion. By contrast, in areas dominated by conflict and distrust of institutions, people coming forward with ideas and projects are able to count solely on their own resources, which limits their ability to bring their ideas and projects to fruition.

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[1] According to the “*Oxford English Dictionary*”, Compact Edition, Oxford University Press, 1971.

As we shall see, setting up financial engineering structures at local level, and alternative financing solutions more generally, relies primarily on new forms of partnership and of joint commitment between a variety of players (local councils, business firms, financial institutions, project promoters, etc.). Financing is therefore a particularly effective lever, making it possible to progress beyond agreements that may remain superficial and to culminate in concrete undertakings concerning the proportion of each partner's resources that they make available for common objectives.

Financing is therefore not simply a means of advancing projects or of developing ideas. It is also an essential tool for creating new links and new solutions to bridge the gap between an area's people and its institutions, and hence an instrument of social cohesion and democracy.

## **1.2 Gap between funding supply and demand**

The issue of financing arises where, on the one hand, there are promoters of ideas or projects without sufficient funds to carry them out and, on the other hand, holders of financial resources (savers, banks, public administrations, etc.) whose role includes supporting the development of such ideas with the means at their disposal. Financing therefore consists of creating a form of partnership between these two types of player to allow each to benefit: project promoters (funding applicants) are able to implement their ideas and owners of financial resources (suppliers) are able to derive better returns from their funds.

Areas where suppliers make financial resources freely available to project promoters in an opportune manner are described as having a high level of "financial agility"<sup>2</sup>. By contrast, in areas where such links are difficult for one reason or another, there is poor financial agility. Indeed, there is a multitude of reasons why those seeking finance are unable to forge links with those supplying it, e.g.:

- > they do not know one other;
- > they may know one other but do not trust each other enough and may even be at loggerheads;
- > project promoters do not provide sufficient guarantees, especially in the case of small-scale projects;
- > their objectives are not compatible;
- > fund holders find better returns on their money elsewhere;

- > the cost of managing small funding applications is too high;
- > the financing techniques, which have generally shrunk as a result of regulatory constraints, are unsuitable and too formal for the target audience;
- > conventional financing structures (banks) have shed the personnel with the necessary know-how to finance small local projects and replaced them with young employees trained in standardized credit techniques (screening).

There may also be more subjective reasons, such as a fear of losing a degree of power or seeing a potential competitor set up in business, etc.

So there is always a certain discrepancy between funding supply and demand, the reasons for which can be found on both sides:

- > on the demand side, an inability to put forward a project of a large enough size or with sufficient guarantees;
- > on the supply side, a fear of failure, using short-term profitability as the only criterion, a lack of interest in the area, etc.

Such problems of linking funding supply and demand are more acute in rural areas due to the fact that on the demand side, we are generally speaking of:

- > small-scale project promoters;
- > scattered project promoters (geographical dispersion, small and little-known sectors of activity);
- > risky projects (greater uncertainty about the project's viability).

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[2] The term "financial agility" was coined by a number of Portuguese LAGs during the self-evaluation activities conducted by the LEADER National Coordination Unit.

On the funding supply side, the conditions in rural areas are also less advantageous:

- > the trend towards bank mergers that group together geographical areas has resulted in decision-making centres being located in the towns and hence becoming increasingly remote from both the local and rural economies;
- > the vast networks of rural branches are generally still useful for capturing the large mass of rural savings, but are not equipped (particularly in personnel terms) to finance projects: the rate of recycling rural/local savings is therefore extremely low (often less than 25%).

Faced with these limitations, rural promoters often find themselves isolated and experience difficulties in financing their projects. The problem is even more acute for certain groups such as the young, the unemployed, etc.

So, in rural as well as urban areas, the gap between funding supply and demand is becoming a factor of exclusion for certain sections of the population. This is why access to credit may be perceived as a social right, as asserted by the “Community Regeneration” project<sup>3</sup>, which is supported by the British government in Wales. The fight against exclusion is therefore intricately linked with access to credit. In areas where there is a consistent lack of access to credit for certain social groups, social cohesion will inevitably also be lacking.

As an obstacle to the emergence of projects, the gap between funding supply and demand has repercussions on all aspects of rural development. Access to credit is therefore an issue that is closely linked with social integration and the sustainable development of rural areas.

Asserting this right of access to credit forms part of a dual dynamic: the existence or creation of national or European support frameworks and the application of approaches appropriate to the local level. This dual context raises questions concerning the role of the different levels of responsibility and the different players involved (public sector, private financial sector and the community) in building a financing strategy to promote the sustainable development of rural areas.

### **1.3 Possible ways to bridge the gap between funding supply and demand**

In general, there are three ways to bridge the gap between funding supply and demand and to make it easier to match the two:

- > take demand-side measures to match demand more closely with supply requirements;
- > take supply-side measures to match supply more closely with demand requirements;
- > create liaison structures to perform certain functions and to act as the “missing link” between supply and demand.

#### **a) Take demand-side measures to match demand more closely with supply requirements**

In most cases, demand-side funding measures consist of assisting project promoters to develop their project, to present it more persuasively and to provide the best possible guarantees for securing finance.

*What the Tam des Montagnes LEADER group (Midi-Pyrénées, France) refers to in its strategy as “trawling for projects” consists of organizing intensive local coordination activities over a short period of about three months to identify all potential initiatives and projects and provide them with overall coherence and, most importantly, to offer each one customized technical support. Every project in this list, regardless of type or size, is considered. Its feasibility is verified and, if the results are conclusive, a support process is immediately launched.*

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[3] For further information concerning this project, consult:  
<http://www.egroups.com/docvault/crisp-newsletters/?m=1>

## **b) Take supply-side measures to match supply more closely with demand requirements**

Funding provision is often characterized by a bid to earn maximum returns on investment. Therefore, anyone depositing their savings with a financial institution expects an optimum yield from such savings, more often than not without asking exactly how the funds will be invested. This can sometimes lead to an incongruous situation. Cases have been known where workers' savings have been used to finance projects to modernize factories, which has led to mass redundancies among those very workers. Savers share some of the responsibility in that they are increasingly turning from placing their savings in deposit accounts to share investment, either directly, or indirectly via investment funds or (in some countries) pension funds.

By introducing ethical criteria into the issue of funding provision it becomes possible to adapt supply more closely to demand since it takes into account the specific characteristics of certain funding applications. This includes those that are the most "atypical" and are not the most effective in terms of short-term profitability, but that have a particularly important role to play in long-term development: local development, revitalisation of rural areas, social integration and environmental protection.

Ethical criteria can be introduced at the level of:

- > existing structures, such as banks and investment trusts, which provide savers with products that have been designed according to ethical criteria ("ethical ratings") selected for specific products; or
- > directly at the level of savers, who decide individually or collectively to invest their savings in local investment funds, mutual saving funds, etc.

## **c) Create structures to bridge the gap**

Some functions act as real "missing links" between funding supply and demand and can be carried out by special organizations. These may include:

- > information and communication functions (e.g. informing savers about local investment possibilities);
- > setting up funding provision that is complementary to existing provision, to play a leverage role in funding projects where there is insufficient trust or receptiveness between fund providers and project promoters. LEADER has often intervened at this level, acting as an instrument to release funding that would never have been made available without outside support.

*In Portugal, for example, the budgets of the district councils are quite a lot larger than those of the "freguesias", the lower micro-local administrative level, even though it is often precisely at freguesia level, which is closer to the local community, that ideas for projects emerge. To overcome a degree of reluctance on the part of the district councils to finance projects initiated by the freguesias, certain LEADER groups have co-financed the projects concerned, which has made it easier for these projects to secure the financial commitment of the district councils.*

- > Setting up complementary funding provision to the existing provision in order to help project promoters who do not have access to enough capital of their own to invest;
- > creating systems to enable funding applicants to meet suppliers' requirements, which otherwise they would be unable to meet. This applies particularly to guarantee funds which stand as partial surety for project promoters in guaranteeing bank loans;
- > subsidies to bridge the cost gap, such as subsidies to pay for administering small loans, in order to induce banks to take a stake in small projects;
- > schemes to group loan applicants together in order to secure better collective terms.

<b>REASONS FOR GAPS BETWEEN FUNDING SUPPLY AND DEMAND</b>	<b>POSSIBLE WAYS TO BRIDGE THE GAP</b>		
	<b>Matching demand with supply requirements</b>	<b>Matching supply with demand requirements</b>	<b>Matching supply with demand</b>
<b>a) Human-relations issues</b> The two sides do not know one another			Information and coordination structures
Lack of trust	Support for setting up the project and the funding application	Introduction of ethical objectives	Complementary provision with a leverage effect (seed funds)
<b>b) Economic issues</b> Zero or insufficient financial participation from the beneficiary		Establishment of local investment funds, mutual saving funds	Subsidies and seed funds
Insufficient guarantees from the project promoter			Guarantee funds
Management/follow-up costs too high			> Partial payment of management costs > Grouping together loan applicants
Better returns on investment outside the area		Introduction of ethical objectives for an area	

Finally, this analysis raises a question about financing. How is it possible to secure sources of finance where the demand for returns is not inflated by current market trends? The only possible solution is to introduce a strong ethical requirement from savers and intermediation structures.

## 1.4 Choosing the right financial instruments

Another consideration above and beyond the links between funding supply and demand, is that of the form which financing should take. Fundamentally there are four types of financing:

- > subsidies, donations and lost equity finance, i.e. the definitive provision of funds with no reimbursement obligation;
- > credit, i.e. the provision of funds for a given period at a predetermined interest rate;
- > guarantees, i.e. accepting the risk so as to facilitate access to a loan from a conventional financial institution;

- > equity participation, i.e. investing equity capital into a project, the returns on which are determined by the success of the project.

Each of the above types of funding provides for an infinite range of possible financing formulas, depending on the type of application (levels of co-partnership, interest rates, deadlines, forms of monitoring, etc.). And each particular type of application has its advantages and disadvantages, which must be evaluated in order to make the right strategic choices.

The following table briefly summarizes the main advantages and drawbacks of each of the four funding types.

## ADVANTAGES AND DRAWBACKS OF THE FOUR MOST COMMON TYPES OF FUNDING

	Subsidies and lost equity donations	Credit (with/without ethical requirements)	Guarantees	Equity participation
Cases where it is better to use this type of financing Collective	projects with a social or ethical aim; high-risk innovative projects; projects by young people and other groups in difficulty; Third World projects	Projects with a commercial aim; investments in businesses that meet ethical criteria (ethical ratings)	Any investment project by structures belonging to a collective guarantee project	To boost territorial solidarity
Specific advantages	Make it possible to restore the balance in terms of access to resources, even at territorial level	Relationship that can be built up over the long term	Ability to negotiate with banks; guaranteed access to credit; collective approach and, in most cases, assured project follow-up	To strengthen local links and confidence in the area's future
Disadvantages	Can sometimes encourage a lack of social responsibility	Terms are ill-matched to the specific needs of applicants; limitations in the case of certain projects, especially those with a social aim	Risk of failure	Time to build up trust and to secure capital for investment and rotation
Fund providers	Public players at various levels, public/private partnerships	Banks (traditional, ethical)	Cooperatives and guarantee funds	Local savers, local business firms

### 1.5 Conclusion

#### The problem of financing is a general one not restricted to rural areas

As we have seen, local financing is not only a fundamental problem for rural areas but it is also an eminently complex one. The gap between supply and demand can vary widely and the ways to overcome it call for the implementation of some highly diverse solutions. However, within this complexity, it is becoming increasingly clear that the solutions must involve the creation of links that go beyond just the local level.

In other words, LEADER-type rural areas do not have enough of a critical mass to resolve all of the problems of local financing. Links must be found in particular with urban areas. This is all the more necessary since a proliferation of alternative financing offerings is now emerging in urban areas, whereas rural areas have remained largely untouched by this trend. The following chapter examines the types of financial provision available today, also taking into account urban offerings that may be accessible to project promoters in rural areas or could help construct new decentralized financial offerings in rural areas.

## **Chapter 2**

# **Current funding provision**





# Current funding provision

## What funding provision already exists to meet the needs of rural areas?

There are three types of funding provision:

- > the “conventional” commercial banking sector, which in volume terms represents by far the largest proportion of overall funding provision. However, this type of offering is often ill-suited to the characteristics of small-scale producers and rural areas;
- > the “facilitator” (or “mediator”) sector, comprised of all those initiatives aimed at improving the liaison between project promoters and commercial banks;
- > finally, the “alternative” sector, which provides various forms of finance.

What has emerged is that the public/private distribution is a feature of all funding formulas, with both sectors intervening in all three types of financing, often in partnership.

## 2.1 Commercial banking sector

The commercial banking sector siphons off the lion's share of the savings available in the market. However, its commercial logic leads it to seek those forms of investment that are the least costly, the most attractive in terms of returns and the least risky. More often than not, the needs of small-scale project promoters, especially from rural areas, come into direct conflict with these criteria.

Access to finance for small-scale project promoters, new businesses and social economy projects has therefore always been difficult. It is liable to become even more difficult in the future due to changes in the banking system and the fact that financial markets are becoming increasingly globalized. Indeed, a number of studies<sup>4</sup> have shown that the banks are engaged in two types of process which have serious consequences on local development: profit taking on speculative markets and a much more rigorous selection of their customers to exclude those that are least profitable.

So we see that the banks are tending increasingly to abandon some of their potential customers, as well as some of their traditional tasks of following up and supporting small-scale funding applications. They usually shun “minor” projects, “small” businessmen and socially responsible investments (environment, culture). This leaves young people, the unemployed and the social economy sector with no financial interlocutor.

Similarly, conventional banks are unwilling to take the risk of supporting business creation or innovation. They consider the management costs and risks to be too high. New business creators therefore often find themselves without an interlocutor who will help them to turn their ideas into reality.

*A survey conducted in three French regions (Central West Brittany, the Brenne Nature Reserve and the northern part of the département of Haute-Saône) showed that, of those business firms with fewer than 50 employees:*

- > *more than 50% of the entrepreneurs questioned believed that the bank had no impact on their company;*
- > *25% used a bank to finance their ongoing operations;*
- > *only 20% said that they felt supported by their financial interlocutor<sup>5</sup>.*

*The study reveals that only a small proportion of small businesses use banks other than for overdraft facilities. If one also considers that, in predominantly rural areas, these are mainly one-person businesses (case of 78% of business firms in France's Brenne regional nature reserve, as compared with the national average of 59%, for example), in actual fact such businesses have access to only the most expensive forms of credit. The study concludes that around 50% of business firms cover their needs by using bank overdrafts. This is therefore an extremely costly short-term financial strategy.*

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[4] Granger Benoît and INAISE, “Banquiers du futur: les nouveaux instruments financiers de l'économie sociale du futur”, Editions Charles Léopold Meyer, 1998.

[5] France Initiative Réseau, “Les entreprises implantées en zone rurale” a study carried out by the French public opinion poll institute, SOFRES, April 1998.

The lack of a financial interlocutor from the banking sector (except for operations that are profitable to the banks but costly to businesses, such as running bank overdrafts) discourages a portion of potential local investment.

Furthermore, the banking system behaves differently, depending on the area in which it operates. For instance, in northern Italy, with its prosperous and dynamic economy, the average interest rate was 4.5% in 1999, compared with 8% to 9% in the more marginal areas of the Mezzogiorno region. Such a discrepancy, which is blamed on the higher level of risk in southern Italy, discriminates against those areas with the greatest problems. Likewise, a study carried out in Germany between February 1998 and January 2000, entitled “Benchmarking in Micro Lending”<sup>6</sup>, showed that no credit at all had been granted to small businesses from the former GDR over the period under analysis and that, in 67% of cases, the loan had been refused without giving any reasons.

This change in the role of banks is happening everywhere. It is the result of globalization, which intensifies competition between financial institutions. Nowadays, thanks mainly to the Internet, any bank is able to offer its services to any potential customer on the planet, in direct competition with local banks, whose survival is therefore automatically placed under threat. So, over the coming ten years, we are likely to see a complete upheaval of banking provision, which will in part be characterized by the disappearance of small local banks.

Even banking institutions that have traditionally been closer to rural project promoters, such as farm credit mutual funds, are increasingly adopting the financial profitability rationale in order to be able to cope with globalization.

## **2.2 Facilitation and mediation systems**

Faced with the developments currently taking place in banking, it is becoming increasingly necessary to find solutions for bridging the gap between the bank provision and local credit needs. Such solutions play a “mediation” role in order to **facilitate access to existing financial institutions**.

The local level plays a primary role in this type of structure, because it is in the local area that links can be forged between financing needs and funding provision. This is why most facilitation structures are set up at local or regional level.

The public administration and private collective organizations play an important role in this sector. In countries like Italy and France, for instance, the national administration and some regional administrations have played a dominant role in supporting measures to facilitate access to credit.

Access to financial services can be facilitated at different levels and in different ways:

- > preliminary analysis of funding applications and support for projects;
- > granting start-up loans and loans on trust to act as a lever for securing bank loans later;
- > creation of guarantee funds.

These are the main possibilities for linking funding supply with demand, as presented in Chapter 1.

### **a) Prior analysis of funding applications and support for projects**

Banks may refuse to deal with small-scale project promoters not only because of their lack of guarantees, but also because they have made no financial analysis or because of the cost involved in following up the project to ascertain its viability and preclude the risk of non-reimbursement.

Facilitation structures have therefore addressed this problem by organizing customized technical support, in addition to other ways of facilitating access to credit.

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[6] For further information about this research project, consult the Internet site of the IFF (Institut Für Finanzdienstleistungen e.V): <http://www.iff-hamburg.de> (texts in English and German and databases in English, French, Italian and German). The IFF is an independent research institute founded in 1987 with the aim of helping to improve financial products and services. Its research priorities are: consumer lending and indebtedness, welfare finance, small business finance, access to financial services, financial documentation and real estate finance.

This is the case with France's "Local Initiative Platforms (PFIL)"<sup>[7]</sup>, which benefit from the support of the public authorities and whose intervention takes place at three levels:

- > Provision of funds, in the form of start-up loans, to finance business creation or development. A portion of these funds comes from public subsidies and a portion from equity participations by business firms, financial institutions and private individuals.
- > Sponsorship of new business creators: the special feature of such sponsorship is to allow a new business creator to benefit from the moral backing and experience of a company manager. Business creators use the support and reputation of their sponsor to gain faster access to their markets.
- > Support for new business creation: in addition to sponsorship, each PFIL provides the new business creator with guaranteed technical follow-up, either on a volunteer basis by salaried or retired employees, or on a contributory basis, by public accountants, technical experts and business-creation support structures.

As non-profit-making associations, the PFILs generally turn to existing institutions for support, which also provide them with premises, such as chambers of commerce. The Platform's Board of Directors appoints an Accreditation Committee, which is responsible for examining the applications of new business creators and deciding on the type of support to be provided. In 2000, this support will total EUR 50 million.

The 180 PFILs all come under the national network, "France Initiative Réseau (FIR)". Supported by several ministries, FIR mobilizes or brings together all of the partners of both the company and the economy.

The first PFILs were created in 1981. By the end of 2000 they will number 250. Their success relies on the 5,600 voluntary workers who support and encourage new business creators. By providing a combination of advice, sponsorship and loans on trust, the Platforms really multiply the new business creators' chances of success. Advice from professionals makes for a sound approach; sponsorship provides valuable support in the event of problems; and loans on trust, with no interest or personal guarantee, increase the personal contribution of the new business creator and exert an undeniable leverage effect on other sources of financing.

## **b) Granting start-up loans and loans on trust to act as a lever for accessing bank loans**

A common reason for banks refusing credit is insufficient equity capital.

To meet this requirement, structures have been created to provide project promoters with equity capital in the form of a loan on trust (loan with no interest and no guarantees) or a start-up loan.

This applies especially to new business creators starting up with no financial resources.

The Italian government has created a structure of this type entitled "Imprenditoria Giovanile" (Young Entrepreneurs) in order to support start-ups in areas with the greatest need.

*Imprenditoria Giovanile (IG) is the name of the public/private agency that helps to promote new businesses, local development and support for existing SMEs. IG operates two schemes to support business creation: one to help young entrepreneurs, by means of technical and financial support measures, and the other to promote self-employment among unemployed people of every age, by means of training, technical assistance and loan provision. The success of these two schemes has led the Italian government to delegate further tasks to this agency, including support for women entrepreneurs and the management of European funds.*

*The beneficiaries of the agency's scheme to promote self-employment are people aged over 18 who have been unemployed for at least six months. The projects supported must lead to business creation in areas where there is a serious imbalance between job supply and demand and the projects may not be transferred to another other area for five years following the granting of the loan. Between 1986 (year of its creation) and the end of 1998, IG received 6,000 business creation proposals, of which 1,000 were approved. The scheme to support self-employment (which started up in 1996) has led to 41,000 applications, of which 17,000 were evaluated. Some 3,100 project promoters have participated in training courses and 790 new ideas have been selected for a total investment of EUR 18 million.*

[7] Les Plates-Formes d'Initiative Locale,  
14 rue Delambre, F-75014 Paris. Tél: +33 1 41666661.

### c) Cooperatives or mutual guarantee funds

Another reason why banks are reluctant to grant loans to small projects is the lack of sufficient guarantees from loan applicants. By setting up guarantee funds it is possible to overcome this problem.

A whole host of regional and local structures exist for this purpose. They include guarantee consortia created at the initiative of the trade and craft associations of northern Italy. The regional administrations helped to constitute their corporate capital.

*In order to meet their financing needs, which the banks had failed to meet, and on the initiative of their trade organizations ("associazioni di categoria"), Italian craft businesses set up a collective guarantee mechanism by creating the "Confidi", collective guarantee consortia. The Confidi take the form of either a consortium or a non-profit-making cooperative. The primary aim of the Confidi is to provide a collective bank guarantee to their members and to negotiate preferential rates from the banks.*

*In the absence of a law to define their status, the Bank of Italy lists the Confidi as "non-banking financial institutions". A capital of EUR 25,000 and a minimum of 50 members are required in order to set up a collective guarantee consortium.*

*The financial participation of the regional or provincial authorities in the capital of the Confidi or their regional organizations varies in scale, depending on the particular policies of each region. For instance, the participation of the Lombardy authorities in "Artigiancredit", which groups together the local Confidi of the Lombardy region, is in the order of 40% but reaches 80% in Emilia-Romagna. Furthermore, Emilia-Romagna and Tuscany were the first two Italian regions to adopt laws endorsing the existence of these regional groupings, which are second-degree guarantee consortia, whilst at the same time granting them extensive financing for providing guarantees to the first-degree cooperatives belonging to the regional consortia. By contrast, in Lombardy, no regional law governed the creation of Artigiancredit, which was an initiative of guarantee consortia, but was immediately recognized by the public authorities as Confidi's representative.*

### d) Importance and impact of facilitation structures

Structures to facilitate access to financial banking services play a very important role for small-scale project promoters.

By way of illustration, a study conducted in Germany – called "Benchmarking in Micro Lending"<sup>8</sup> shows that around 95% of Germany's one-person businesses have recourse to outside finance at one time or another. At the same time, it is the sector of one-person businesses that generally creates the largest number of new jobs. In spite of the employment potential that the sector represents, loans have been granted in only 21% of cases. In 69% of these cases, the existence of public sector guarantees was a prerequisite for obtaining the loan. This finding once again highlights the importance of the sector, as well as that of public funds, as a "lever" or "support" for facilitating the access of small-business people to bank loans.

## 2.3 Alternative financing sector

The aim of alternative financing is not to bridge the gap between the provision of commercial banks and demand for finance, but to provide an alternative offering suited to the specific needs of applicants, especially those that are most atypical. It includes all those organizations that seek to offer financial services to match the needs of people with no access to commercial banking services and at the same time to play an important role in terms of local, social, environmental and other types of development (e.g. small projects, welfare projects and environmental projects).

"Financial alternatives" are all guided – at different levels – by "ethical" or "mutual aid" principles aimed at introducing:

- > Mutual aid practices by supporting projects that are of social and environmental interest, generate jobs, or emanate from vulnerable groups in the community, etc.
- > Transparency regarding the use of savings and the gains from certain stock market investments.

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[8] Op. cit. see note 6.

The movement towards ethical and mutual aid financing, which began in the eighties, has today taken on significant proportions. In France, for example, more than EUR 500 million is invested each year in ethical or mutual aid projects and 4% of France's businesses have been created using mutual saving funds. The various mutual aid financial operators grouped under the "FINANSOL" label have been responsible for creating 25,000 new jobs<sup>9</sup>.

There are three types of initiative in the alternative-funding sector:

- > those initiated by civil society aimed at supporting welfare or public interest initiatives, such as projects created by groups in difficulty. These structures, which often take the form of associations or cooperatives, raise the funding required to plug the gap left by traditional banks;
- > ethical banks: although these are proper banking organizations, they are built around an ethical and non-commercial objective. They therefore have a specific objective of mutual aid that runs right through all of their operations. They have either developed from civil society initiatives that were already at an advanced stage of development, or were created at the initiative of political or trade union movements;
- > ethical products offered by conventional financial institutions – to cater for the growing demand from private individuals and businesses for alternative ethical finance products, investment trusts and certain traditional financial institutions, including commercial banks, have started to offer products of this type. This has led to a branch of the alternative sector emerging within the very heart of the traditional commercial sector.

### **2.3.1 Alternative finance structures and products initiated by civil society**

Alternative initiatives initiated by civil society began to develop in the 1980s, when the first mutual saving funds began to be collected locally, especially in European countries like France and Italy<sup>10</sup>.

In France in 1983, for example, the "Cigale Clubs" (investment clubs for the alternative local management of savings) emerged in the sector of local mutual aid venture capital. In Italy, the movement "monetary objection to the banking system", which led to the creation of the "MAG" (self-managed mutual funds), also emerged in the 1980s to support sectors with insuffi-

cient capital, project promoters needing bank guarantees and projects of community interest.

In the majority of cases, such initiatives have been created locally, because it is at local level that the signs of the growing divide between the actual economy and the financial economy are most apparent. It is therefore at local level, which has the advantages of proximity including mutual knowledge between the parties and social relations, that a "social objective" can be developed for using local savings. Social relations in the community can serve as a basis for developing a strategy to facilitate access to finance for project promoters rejected by the banks.

However, over time, such initiatives develop beyond the local level into far wider-ranging structures.

*In 1981, France's Basque Country set up a venture capital company devoted to business creation: "Herrikoa" (meaning "home-grown" in the Basque language). In 1999, the company had 3,500 shareholders. A total of 11 million francs was collected from the population, creating an estimated 1,561 net jobs. Herrikoa, a financial instrument, works in partnership with other local economic structures, including ADIE (Association pour le Droit à l'Initiative Economique), Accea Lann Berri (Atelier-conseil en création d'entreprises ou d'activités) and Hemen (meaning "here" in the Basque language), an association to support and assist economic initiatives). Hemen receives around 200 project proposals per year<sup>11</sup>.*

[9] FINANSOL was founded by several associations such as the Fondation pour le Progrès de l'Homme, the "Cigale", etc. They were joined by several banking networks. Apart from administering the mutual aid savings label, FINANSOL seeks to publicize the mutual aid financing sector more widely and promotes its products amongst local authorities. FINANSOL, 4, rue Jean Lantier, 75001 Paris. Tel: +33 1 44828012. Web: <http://www.globenet.org/horizon-local/finansol/finansol.html>

[10] See: TRANSRURAL Initiatives, no. 125, 26 February 1999, Feature article: Financer autrement les projets ruraux (pp. I to VIII).

[11] For information on these initiatives: BIE Euskal Herri, Résidence L'Alliance, Centre Jorlis, F-64600 Angelu. Tel: +33 4 95311559.

The objectives of alternative initiatives initiated by civil society are generally mutual aid, economic support for the emergence of projects and long-term financial management:

- > **objective of mutual aid** – to use local savings for supporting initiatives put forward by disadvantaged social groups (including the unemployed) who have no access to conventional credit, by innovation-promoters or by sectors of the social economy;
- > **objective of support for the emergence of projects** – to create mechanisms for coordinating and identifying projects that should receive support to foster the transparent self-management of savings and their utilisation;
- > **objective of autonomy and management control** – to develop project support services during the design, start-up and consolidation stages, in order to support access to credit.

Alternative initiatives launched by social groups involve the creation of private law organizations (cooperatives, associations or limited liability companies) that have a limited scope of intervention in the area and draw their financial resources from the local savings of private individuals and business firms, although they often receive support from public organizations. They are characterized by the fact that:

- > they are local instruments;
- > they play an educational role;
- > they often serve as relays for local development measures.

### **2.3.1.1 Characteristics of alternative finance structures and products initiated by social groups**

#### **a) Local instruments**

The scope of activity of these financial alternatives is localized (the local area and/or for the sole benefit of their members) and these alternatives are replicated from a single model. This is the case with France's Cigale clubs and Local Initiative Platforms, as well as Italy's MAGs. The legal frameworks adopted by such local instruments justify their existence by limiting the field of intervention. In Italy, for example, MAG-type financial cooperatives must limit their interventions to a very specific area.

#### **b) Educational instruments**

Above and beyond the “transparent” management of the funds entrusted to them for “mutual aid”, these structures have a strong educational impact because they all supplement the provision of credit with advisory or skill transfer services. They thereby reinforce the autonomy and project-management ability of sectors of the population cast aside by traditional banks<sup>12</sup>.

For such structures, ethical credit is instrumental in fostering solidarity, combating local unemployment and developing local management expertise.

*Created at the end of the 1970s at Inzago, a local district of 8,500 inhabitants in Lombardy, the ethical finance cooperative “MAG2”<sup>13</sup> was set up to invest local savings to assist projects put forward by economically vulnerable people or by non-profit-making associations that find it difficult to access traditional financial channels. In addition to this task, the cooperative has gradually evolved towards providing integrated forms of support for initiatives, becoming a real “one-stop shop” for local development.*

*In educational terms, MAG2 defines itself as an all-inclusive service for supporting job-creating initiatives, primarily those organized on an associative or mutual-aid basis. Such support may cover all the phases in a project's life:*

- > *for self-employment activities, moving from the idea to the project stage, by evaluating and launching new ideas;*
- > *moving from the project to the start-up stage, by providing technical support for producing feasibility studies, choosing the most appropriate legal form and completing the diverse administrative formalities involved in the start-up;*
- > *the consolidation phase, by providing support for management and for certain specialized fields, in order to enhance the development of a firm's internal dynamics and its contacts with the outside world. The experience of MAG2 demonstrates that this latter type of support is crucial to preventing the failure of new initiatives. Paradoxically, however, no resources are available to defray the costs of this type of support.*

[12] Granger op. cit. pp. 55-61

[13] For more information about this initiative, contact:

Dott. Giovanni Acquati, President – Cooperativa MAG2 Finanze  
Via Pacini 11 – 20131 Milan  
Tel.: +39022665474 – Fax: +390270637335

### c) Local development relays

The development of this type of activity frequently relies on public sector support and on forms of partnership with certain banks.

The public authorities and certain banks (particularly savings banks and ethical banks) have understood the importance of these structures for providing direct support to innovative small businesses, businesses of a social nature, project promoters from vulnerable sectors of society, etc., and support their educational and credit function by turning them into proper “local development relays”<sup>14</sup>.

People’s awareness and involvement in the way their savings are invested are important factors in sustainable endogenous development.

Alternative initiatives created by social groups are therefore increasingly of interest to rural areas, although in Europe such experiments are still more the province of urban places.

#### **2.3.1.2 Typology of alternative finance structures and products initiated by social groups<sup>15</sup>**

##### **Local venture capital companies**

Private individuals and businesses invest in new business creations and support business development within the framework of venture capital companies. This system relies on people’s sense of belonging to a region whose economic potential they wish to safeguard. This is the case with *Herrikoa* mentioned earlier.

##### **Mutual-aid venture capital companies**

Venture capital companies and investment clubs combine local savings with mutual aid, by taking an equity participation in new or expanding businesses. The financial dividends from such investments remain modest. The objective of the exercise is to invest in job creation. France’s Cigale clubs provide an example of this type of financial alternative.

*The investment clubs for the alternative local management of savings (“Cigale”) were created in 1983 in order to help develop business firms that respect man’s role in the environment. Since then, 200 clubs have been set up. Each Cigale club is a jointly owned venture capital company. It is comprised of between five and twenty members. Each member invests between EUR 10 and 600 in the club. The club carries out its activities in the local*

*area, mainly by taking an equity participation in business firms that are either being created or in the process of increasing their capital<sup>16</sup>.*

##### **Financial cooperatives and self-managed mutual funds**

This type of initiative has developed mainly in Northern Italy with self-managed mutual funds (MAG). Currently there are six MAGs, distributed in small towns throughout northern Italy.

*MAG2 was created as an alternative to the conventional financial system, which sets no ethical limits on the use of savings.*

*MAG2 financial support is therefore conditional upon the social quality of projects, the relationship of trust between members (ethical evaluation) and the financial solvency of the funding applications submitted (technical and economic evaluation). Information about where the savings are invested plays a key role in the decision-making process, since no asset-backed guarantees are requested.*

*By 1999, the cooperative had 940 members and had financed 200 projects (some a number of times). The amounts invested totalled EUR 2 million.*

*Over the years a policy has developed of encouraging members to help define the sectors of intervention and to self-manage savings. For example, financing activities are organized by groups (“compensori”) that include a variable number of members who organize themselves on a voluntary basis to develop activities for promoting ethical finance on the basis of “Information Points”.*

[14] Alternatives Economiques et La Vie, Les Placements Ethiques, l’épargne alternative et solidaire en 65 fiches, Hors-Série Pratique, no. 3, First quarter 1999. p. 13

[15] This typology was drawn from ‘Alternatives Economiques et La Vie’, op. cit.

[16] For more information about this experiment, contact: Fédération des Cigale, 61 rue Victor Hugo, F-93500 Pantin  
Tel & Fax: +33 1 49919091. Web: <http://www.cigale.org>



## Shared investments

Shared investments enable financial returns to be made on savings in the normal commercial market, with some of the earnings being donated to associations operating in developing countries, to local or social integration projects, etc. They are generally created by associations working to combat social exclusion, trade unions, etc. However, banking networks and management companies are also interested in them and are also creating this type of investment, as we see below.

## Ethical banks created for a mutual aid objective

Ethical banks have either:

- > developed from alternative initiatives initiated by civil society, or
- > been created on a piecemeal basis by political or trade union organizations.

### **ITALY: "BANCA ETICA", A SPIN-OFF FROM THE MAGS**

*In Italy, in order to overcome the territorial constraints imposed by legislation on financial cooperatives, the six existing MAGs supported the creation of the "Banca Etica" (Ethical Bank) in Padua, whose purpose is to put together a range of ethical finance products.*

*Banca Etica was created following a massive collection of funds (around EUR 8 million) to constitute the corporate capital demanded by Italy's banking legislation. This institution complements and extends the activities of the MAGs by providing conventional financial products: certificates of deposit, current accounts, credit cards for buying ethical and mutual aid products, etc.*

*The launch of Banca Etica (January 1999) enabled the MAGs to direct their energies away from providing financial services and focus on promoting development projects for combating poverty (support for new business initiatives put forward by the weakest social groups; development of a local system of micro-credit, etc.). Note also that, unlike the MAGs, the Ethical Bank is in competition with conventional banks.*

*Banca Etica is a credit instrument that helps to enhance the competitiveness and management skills of non-profit-making organizations and hence improve the quality of their products and services. By 2000, Banca Etica had around 13,000 members, of which 170 are local councils, 20 are provincial administrations and five are regions. In order to guarantee its members and customers clear and complete information on the projects financed<sup>17</sup> and on*

*the criteria for evaluating funding applications, Banca Etica considers that savers and members should be responsible for choosing them. It has also appointed an "Ethics Committee", comprised of important figures known for their social and civil commitment, which has the task of verifying the bank's adherence to, and coherent application of, the ethical criteria described in its statutes.*

## Experiments in other countries

Apart from the example of Italy's *Banca Etica*, there are banks or cooperative financial institutions in several European countries<sup>18</sup> which offer exclusively ethical products allocated to combat exclusion and support business creation.

### **NETHERLANDS AND BELGIUM: TRIODOS BANK<sup>19</sup>**

*Triodos Bank, created in the Netherlands in 1980, was the first bank in Europe to define itself as "different", by making one of its founding principles transparency in the use of financing. Today, the bank has more than 12,000 shareholders in the Netherlands (private individuals, associations and business firms). This ethical bank was set up in Belgium in 1995. Like its Dutch sister company, Triodos Belgium has chosen to finance projects which, whilst financially viable, have added value in environmental, social and/or cultural terms. With its 7,300 shareholders, Triodos Bank also considers itself to be a local development bank.*

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[17] According to the daily newspaper "Il Sole 24 Ore" of 6 March 2000, only 12 months after its creation, Banca Etica had financed 222 projects (41% in health and welfare services, 32% in development cooperation and 19% in improving the quality of life) and had collected EUR 43 million.

[18] Most of these structures are members of the INAISE international network (International Association of Investors in the Social Economy), created in 1989. The role of INAISE is to use its power of promotion to commit savers and banks to practising an innovative loan policy, to ensuring greater transparency in the way money is used and to lobby to change banking legislation so that the way savings are collected becomes more conducive to the development of the social economy and small businesses. Web: <http://www.inaise.org>. The objectives and functions of these organizations are described in the journal "Alternatives Economiques", op. cit. pp. 130-137.

[19] For more information:

Triodos Bank

PO Box 55 NL-3700 AB Zeist. Tel: +31306936500;

Fax: +31306936555; E-mail: [triodos@triodos.nl](mailto:triodos@triodos.nl)

Banque Triodos,

rue des Brasseurs 115, B-5000 Namur. Tel: +3281222209;

Fax: +3281222267; E-mail: [triodos-fr@skynet.be](mailto:triodos-fr@skynet.be)

## **UNITED KINGDOM: COOPERATIVE BANK**

*The objective of the Cooperative Bank, the only major financial institution in the United Kingdom involved in the social economy sector, is to “make the banking system ethical”. Since 1992, it has operated a very rigorous ethical policy, defined in a charter based on a survey carried out among the bank’s customers keen to combine ethical considerations with finance. The principal ethical criteria contained in the charter including safeguarding civil rights, fair trade and opposing the arms trade<sup>20</sup>. With its 2,300 counters dotted throughout the country, the Cooperative Bank has around one-and-a-half million customers, which, as its name would indicate, include numerous cooperatives.*

## **GERMANY: ÖKOBANK<sup>21</sup>**

*Created in 1988, Ökobank (Ecobank) was an offshoot of Germany’s ecologist and pacifist movement. Its first savings and loan products were aimed primarily at the renewable energy sector. Nowadays the bank has extended its fields of intervention, particularly in the social sector.*

### **2.3.2 Alternative financial products created by investment trusts or by traditional banks**

This generally includes two types of product: either equity participation in business firms evaluated according to ethical criteria (job creation, respect for the environment, etc.), or transferring some of the profits from stock market investments to welfare associations.

## **Ethical investments**

Ethical investments are administered by finance companies that buy shares in business firms selected on the basis of ethical criteria, respect for the environment, job creation, etc. Fund subscribers are kept regularly informed about investment strategies.

## **Mutual aid and life insurance banking products**

Mutual aid and life insurance bank products have been created by cooperative banks and friendly societies. Their chief aim is to combat exclusion by granting loans to new business creators. For instance, when they open a mutual aid account providing entitlement to all the traditional banking services, account holders authorize the bank or credit cooperative offering the service to invest 70% of the amount on deposit for use by associations supporting the unemployed, new business creators, organic farmers, etc.

*Since 1996, investment trusts and savings management companies in Italy have created two types of ethical fund: funds that adopt ethical management policies and those that support non-profit-making activities. The former category includes funds belonging to the “ethical system” created by the San Paolo Bank and the latter category includes funds from the various management companies (“Azimut”, “Gestnord”, etc.). In the former case, investments are made in public sector projects or in companies that meet “positive criteria” (safeguarding human rights, the environment, etc.). In the latter case, profits from the funds are used to support non-profit-making organizations. There is also the “Roma Caput Mundi” fund, created jointly by the municipality of Rome and the association Roma Caput Mundi, whose profits are used to develop the artistic and cultural heritage of Italy’s capital city. This public/private collaborative venture has resulted in the restoration of some of Rome’s leading monuments<sup>22</sup>.*

## **2.4 Conclusion**

Whereas the banking sector is distancing itself further and further from the specific needs of small-scale project promoters, especially in rural areas, the intermediary sector is becoming more and more important and the alternative sector is starting to establish itself. Nonetheless, the alternative sector still remains weak and, in general, the gulf between the need for finance and its supply is widening for some types of customer.

[20] For more information: Cooperative Bank, PO Box 101 Balloon Street, Manchester (UK). Tel: +441618295797;

Fax: +441618394220; Web: [www.co-operativebank.co.uk](http://www.co-operativebank.co.uk)

[21] For more information: Ökobank EG, PO Box 1660651, D-60069 Frankfurt. Tel: +496925610163; Fax: +496925610219

[22] Source: La Repubblica, Affari e Finanza, 6 March 2000.



## **Chapter 3**

# **Achievements and limitations of LEADER experiences**



# Achievements and limitations of LEADER experiences

**In what ways have the characteristics and opportunities of the Community's rural development initiative been used to improve the response to project promoters and to the needs of rural areas in terms of funding? What have been the achievements and what are the limitations?**

LEADER has characteristics that stem from the fact that it is a Community Initiative financed from the European Structural Funds, as well as from its own special approach. Some of these characteristics and special features have important implications in financing terms. They include:

- > decentralized financing;
- > local partnerships;
- > the possibility of financial engineering under Structural Fund regulations.

## **3.1 Application of decentralized financial decision-making**

Decentralized financial decision-making is a special feature of LEADER that plays a key role in ensuring proximity to initiatives and project promoters in order to respond to their financial needs. Decentralisation also makes it possible to overcome the constraints of isolation and the difficulties in accessing funding, by allowing more flexibility in the allocation of financial aid to small-scale project promoters.

LEADER subsidies have therefore come to play a leverage role, by encouraging investments using local savings that were formerly unutilized due to lack of support for the emergence of projects and/or of confidence in the future of the area concerned. In addition to identifying projects that have failed to receive any other form of support, LEADER subsidies have a major impact in terms of development education. Successive evaluations have highlighted the growing financial participation of private beneficiaries and even of regional authorities after local subsidies from the LEADER programme have been granted. They have shown that greater "proximity" of the support instrument leads to greater confidence in the area's future.

In certain Member States and regions, decentralized financing has not been applied across the board, especially where project funding decisions were taken by the national or regional administration, which limits the impact of LEADER's bottom-up approach. However, where the power of decision has effectively been left to the LEADER groups themselves, such decentralisation has been exploited to the full.

Certain LEADER groups have even gone so far as to decentralize, at least for some of their activities, right down to micro-local level.

*This was the case with the Argyll & the Islands LEADER group (Scotland, United Kingdom), which, due to the isolation and inaccessibility of certain parts of the area<sup>23</sup>, decided in 1994 to create a pilot micro-financing programme to support local projects of social and community interest<sup>24</sup>. It introduced an important innovation: the programme is managed on a decentralized basis by a network of 13 local working groups (LWG) comprised of representatives from the various interest groups, including entrepreneurs.*

*Following the creation of the LWG network, the Fund for Local Projects (FLP), financed by LEADER I, was set up. The LEADER group was responsible for designing the Fund's eligibility criteria, terms of reimbursement, support systems and procedures. In return, the LWGs, partnerships of representatives from scattered communities, took charge of promoting and administering the Fund.*

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[23] Situated in the Scottish Highlands, Argyll and the Islands is a mountainous area that includes numerous small peninsulas and 26 inhabited islands. The area spans 7,156 km<sup>2</sup> and is home to some 78,000 inhabitants. After decades of emigration, the population has risen slightly in recent years.

[24] For more information about this experiment, contact:  
David Haworth, Argyll and the Islands LEADER II Programme  
The Enterprise Centre, Kilmory Industrial Estate  
Lochgilphead, UK-Argyll PA318RT. Tel: +441546602281;  
Fax: +441546603964.

Each LWG was allocated a portion of the Fund, calculated in accordance with the size of the area, its population and its priority status in terms of intervention. An extra EUR 1,400 was added to cover administrative costs.

For each LWG, objectives were fixed in terms of the number of projects to be supported, but no stipulations were made as to the type of project, the interest groups to be given support or the geographical location. These objectives had to be set by each LWG in line with local needs. The LWGs therefore assumed the tasks of promotion and raising public awareness (distributing questionnaires, application forms, etc.) and helped to develop projects, hence playing a role of primary “filter” for the proposals submitted.

The LWGs do not formally approve projects; this remains the LEADER group’s prerogative. However, the LWGs are responsible for examining applications and issuing recommendations (in practice, the LEADER group almost always follows their recommendations). The projects must be aimed at: establishing further development groups, introducing new activities, creating services or facilities for the local community or cultural development. The maximum funding for each project has been set at EUR 1,500.

An evaluation conducted after the formula had been in application for two years, revealed that:

- > projects had not been concentrated in the hands of a few beneficiaries, demonstrating that the programme had had quite a wide impact throughout the area;
- > projects of general interest represented 24% of applications, followed by artistic and cultural projects (23% each);
- > the programme had led to a high degree of additivity: without the Fund, 59% of the projects would never have been implemented and in 18% of cases, project implementation would have been delayed.

LEADER provides the Fund with an annual EUR 170,000. During the first two years, thanks to local co-financing, projects worth EUR 623,000 were carried out. Apart from the fact that it harnesses local savings and other public funds for implementing projects of social and community interest, the Fund has contributed to the acquisition of expertise at all levels. It has enabled local communities to further their project planning and management know-how and allowed LWGs to master the skills of managing procedures, establishing priorities, raising local funds and evaluating project impact. Finally, the Fund has enabled the LEADER group to gain a better understanding of its area’s needs.

### **3.2 Local partnership, a lever for securing bank finance**

Apart from getting closer to project promoters by decentralizing financing, LEADER groups have been able to highlight some of their special features and possibilities in order to influence banks and to act as an interface between financial institutions and funding applicants. The local partnership formula intrinsic to LEADER has been instrumental in creating a privileged relationship with financial institutions.

This has led numerous LAGs to include in their partnership representatives from the banking sector, with whom it has been possible to negotiate undertakings to support project promoters.

One particularly interesting case is that of the Presila Krotonese LAG (Calabria, Italy), which included a bank guarantee cooperative in its local partnership, enabling it to have a direct influence on banks to secure bank loans on behalf of its beneficiaries.

“FinCoop” is a collective guarantee cooperative (Cooperativa di garanzia collettiva fidi ar.l.), founded in 1997 by the Christian association of Italian craftsmen (ACAI) to help small and medium-sized businesses in the Calabria region. In addition to being a founder member of the Presila Krotonese LAG, FinCoop has signed agreements with six other LEADER groups in Calabria. The cooperative concludes agreements with the banking sector to provide loans accompanied by either direct guarantees or guarantees conferred by a regional Single Guarantee Consortium.

The agreement concluded between FinCoop and five banks (four national and one regional bank) enables SMEs and farm businesses in the Presila Krotonese area and in six other LEADER areas in Calabria to:

- > increase their bank credit whilst keeping the same guarantee capacity;
- > improve their access to credit in cases where there are insufficient guarantees;
- > secure interest rates equal to those granted to larger enterprises and to good customers;
- > speed up the examination of the funding application and thus get a faster loan;
- > receive advice on the most suitable financing formulas for their specific needs.

Thanks to this agreement, the LEADER groups have succeeded in establishing a dialogue between the banking system and local businesses, channelling homogenous flows of customers (in terms of categories and requirements) towards the banks and facilitating administrative procedures: FinCoop evaluates the viability of projects. Collaboration with the LEADER groups has also made it possible to develop strategies for local public administrations to participate in setting up venture capital funds.

### 3.3 Application of Structural Fund regulations concerning financial engineering

A European regulation provides for the Structural Funds to be used for financial engineering<sup>25</sup>.

Very few LEADER groups have availed themselves of this possibility. However, there are several examples that demonstrate the diverse advantages of this formula. LEADER has funded some of these initiatives, whilst others have been carried out by LEADER groups but with recourse to Structural Funds not related to LEADER.

#### 3.3.1 Three examples of financial engineering by LEADER groups

Below are three examples of financial engineering by LEADER groups. The first two are financed by LEADER, whilst the third is financed from ERDF funds not related to LEADER. They are:

- > **“LEADERFIDI”**, guarantee and credit cooperative, created by the Anglona-Monte Acuto LEADER group (Sardinia, Italy);
- > **“GALCOB Initiative”**, a financial support instrument for business creation, set up by the Central West Brittany LEADER group (Brittany, France);
- > **“FILTARN”**, a local venture capital fund for small and medium-sized enterprises created with the support of Agence AGATE, the management organization of the Tarn des Montagnes LEADER group (Midi-Pyrénées, France).

##### a) “LEADERFIDI”

LEADERFIDI<sup>26</sup> is a collective guarantee fund that supports the granting of loans on trust for local SMEs and new businesses. It was created within a regional context where money is expensive and those seeking loans are unable to provide the required guarantees. The collective guarantee fund covers 50% of the guarantees for the required loans; interest-free loans are provided from an interest fund.

The economy of the Anglona-Monte Acuto LEADER area, in northern Sardinia, is characterized by a multitude of small and very small production units and by a high failure rate among new businesses. Over the past ten years, negative trends, such as a decline in employment rates, migration of the most skilled young people, the deterioration and, in some cases, the closure of basic services, have compounded the area's fragility.

[25] The principles, together with some of the operating rules, are described in two factsheets published in the Official Journal of the European Communities, no. 146/80 of 5 June 1997: factsheet no. 18 (“Financial Engineering: guarantee funds”) and factsheet no. 19 (“Financial Engineering: venture capital funds”).

[26] For more information about this initiative, contact: Angelo Porcheddu or Pietro Brundu, LEADER Anglona-Monte Acuto, Piazza Garibaldi, I-07014 Ozieri (SS). Tel. & Fax: +39079783023.



One of the greatest difficulties facing entrepreneurs stems from Sardinia's banking system, which is virtually a monopoly. Indeed, 70% of savings are channelled through a single financial group, Banca di Sardegna. Moreover, the island's financial institutions generally apply a 2% higher interest rate on loans and around 0.5% lower interest on savings than on the mainland, whilst at the same time demanding guarantees that many entrepreneurs – especially young people – are unable to provide. The banks justify this practice by blaming the high level of investment risk in Sardinia, a practice that mainland banks also adopt when they set up business on the island, thereby perpetuating the existing system.

The LEADER group decided to tackle the problem by launching a call for tenders in November 1996 among specialized companies for a feasibility study on the creation and operation of a guarantee fund and of a scheme of loans on trust accessible to small business people. In parallel, it started intensive coordination activities, which included organizing meetings in 25 local districts in the LEADER area with the aim of creating a financial cooperative to manage the fund. The 25 local councils joined the project as founder members, each making a contribution proportional to the population of their respective district (around one euro per inhabitant). Other public organizations also contributed to the creation of the fund: the Sassari Chamber of Commerce invested EUR 15,000 in the fund.

The LEADERFIDI limited responsibility cooperative was officially constituted in August 1998. It included 29 public and private founder members, all from the Anglona-Monte Acuto area. By the first quarter of 1999, LEADERFIDI had around 100 associate members, allowing it to comply with the regulations of the UIC, Italy's organization for monitoring financial institutions.

In early 1999, an agreement was signed between Banca di Sardegna and LEADERFIDI. The objective was to create a collective guarantee fund (worth EUR 360,000) to cover 50% of the loans granted to local small and medium-sized enterprises, subject to the approval of the LAG. As a result of the LAG setting up an interest fund (worth EUR 250,000), the bank can now grant loans on trust to local economic operators.

The agreement with the bank provides that:

- > in the event of non-reimbursement, the remaining half of the loan will be paid by the bank;
- > the total amount of funding granted may not exceed the equivalent of four times the sum deposited by LEADERFIDI as a guarantee (i.e. a gearing ratio of 1:4);
- > a loan committee comprising three members – appointed by LEADERFIDI, the Anglona-Monte Acuto LAG and Banca di Sardegna respectively – is responsible for evaluating the suitability of loans.

The LEADERFIDI cooperative will continue its activities after 2001 (end of LEADER II) by becoming a local organization for supporting economic activities and combating the usurious practices so common in the region.

In order to ensure its long-term survival, the cooperative's statutes provide for LEADERFIDI, after 2001, to continue to facilitate access to credit, to provide technical and financial assistance to its members, and so on. Since national contributions (in particular from local councils) are not precluded in the restrictions stipulated in the Structural Funds, they are used to defray a portion of the management costs.

## **b) GALCOB Initiative<sup>27</sup>**

The GALCOB Initiative, created in 1993 by the Central West Brittany LEADER group, is an association that grants loans to local project promoters under highly advantageous terms. These are loans on trust with no guarantee or interest, worth between EUR 3,000 and around 15,000, repayable in five years in quarterly instalments, following a one-year period of grace. Such terms are only possible thanks to the heavy involvement of public entities alongside private individuals and institutions and to a system of sponsorship that closely monitors the beneficiaries. This widespread support has to a large extent been fostered by the existence of a national institutional framework appropriate to this type of initiative.

[27] For more information about this initiative, contact: Monique Le Clezio or Geneviève Le Meur, GALCOB, 14 rue Rosa Le Hénaff, F-22110 Rostrenen. Tel: +33 2 96292653; Fax: +33 2 96290978; E-mail: glemeur@aol.com

In Central West Brittany, employment fell by 19% between 1982 and 1990, dropping by as much as 38% in the farming sector, which is nevertheless still the lynchpin of the local economy. Moreover, the rate of business creation was five points lower than the average for Brittany as a whole. In addition, there was a high business mortality rate in the two years following their creation, mainly because of the project promoters' lack of equity capital.

The launch of the LEADER programme in 1991 provided an opportunity for several players in the area to collectively examine the issue of financial support for new business creators, with a view to reducing the failure rate. The LAG set up an Economic Development Committee comprised of economic players, technical experts from the consular offices (Chamber of Commerce and Industry, Guild Chamber), elected representatives and representatives of local financial institutions. Several solutions were envisaged for boosting the equity capital of project promoters, including venture capital companies. However, because of the characteristics of local firms – most of which are one-person businesses – this solution did not seem very appropriate.

Attention then turned to a solution adopted by other regions that had been the subject of specific national legislation, namely Local Initiative Platforms (PFIL). The LEADER group decided to create a PFIL, linked directly to the LAG. It adopted the name "GALCOB Initiative" and from the outset it included two banks, elected representatives and company heads or executives, in addition to the LAG and the consular offices. Its statutes were registered in 1993, with the technical support of the federation France Initiative Réseau in constituting the initiative.

An agreement protocol was concluded between the LAG and GALCOB Initiative to cover its operation (paying its costs, loan of staff paid for by the LAG).

Furthermore, a fund of approximately EUR 200,000 was set up with the aid of public funds obtained from the three regional councils [Conseils Généraux]<sup>28</sup> of the départements concerned (Finistère, Morbihan and Côtes d'Armor) and from the European Union (participation from LEADER and the ERDF). Additional private funding is provided by local businesses, the two regional banks involved and an insurance group.

Each project promoter must first undergo a phase of technical support, provided by the network of economic coordinators and consular offices that are partners in the initiative. This phase makes it possible to ascertain the suitability of new business creators and their projects, and to define the resources required for running the company during its first three years of operation (investments, need for working capital, etc.). On this basis, project promoters must establish a budget estimate, together with a financial plan detailing the amount of the loan required, which they then send to the GALCOB Initiative. After this they must present their project to an accreditation committee comprised of company heads, public accountants, financial advisers and technical experts from consular offices.

Between 1993 and 1995, the association examined 29 funding applications and granted 20 loans, using all the funds at its disposal. In 1995, due to a lack of resources, GALCOB Initiative could no longer continue to support project promoters financially. It had to seek further funding whilst awaiting reimbursements from the first business firms that had been given support. The status of a PFIL was particularly useful in this respect: the initiative was able to benefit from a national agreement, signed at the instigation of the France Initiative Réseau federation, and to provide a framework for the use of public funds (60% public funding against 40% private funding).

Based on this agreement, new resources were negotiated with private partners (by inviting them to commit funding on the 40% basis) and with public partners (more willing to commit resources under a national agreement). These new funds enabled the association to examine 32 new applications in 1997 and 1998 and to grant 28 loans for a further sum of over EUR 200,000. By the end of 1999, the funding raised exceeded EUR 500,000, making it possible to support between 15 and 20 projects a year.

The launch of the GALCOB Initiative exerted a leverage effect by collectively mobilizing local public and private players that either had financial resources or were able to provide technical support in the form of sponsorship. The existence of a national framework has multiplied this leverage effect, in particular due to the confidence inspired by such a framework. The establishment of a national quality charter in 1996, which the local initiative platforms were invited to sign, reinforced this confidence still further. The GALCOB Initiative signed the charter as soon as it was issued.

[28] In France, the Conseil Général is an elected body operating at Département level.

The business firms concerned cover all sectors: trade, crafts, transport, manufacturing, etc. The 20 businesses that received support between 1993 and 1995 planned to create 65 jobs and invest a total of more than EUR 3 million. Four years after their creation, 16 businesses are still up and running, yielding a success rate of 80% compared with France's average of 50% after the first two years of operation. As for the businesses that have received support since 1997, it is too early to draw conclusions.

### c) "FILTARN"

Unlike the two examples presented above, FILTARN is the initiative of a Local Action Group, carried out without LEADER funding.

"FILTARN"<sup>29</sup> is a local venture capital company that boosts the equity of small and medium-sized enterprises being created or developed. By encouraging local businesses to acquire a stake in other local firms, it exerts an educational and synergetic effect on entrepreneurs. With equity participation in businesses ranging from only EUR 15,000 to 76,000 for a maximum period of seven years, the projects financed by FILTARN are more modest than those supported by most conventional venture capital companies, but they serve as a lever to mobilize further sources of funding.

More densely populated and industrialized than most other départements in south western France (with the exception of the Toulouse conglomeration), the département of Tarn has two large-scale labour pools, organized chiefly around the mining (Carmaux) and textile (Mazamet) industries. In both cases, this generally involves small, highly traditional family businesses. Over the past 15 years, these two labour pools have been hard hit by economic restructuring, which often calls for investment far beyond the means of the businesses concerned. However, such financial resources do exist locally, in particular in certain business firms and financial institutions. This led to the creation of the economic development agency "AGATE" in 1989, whose chief objective is to strengthen the fabric of small and medium-sized enterprises (SMEs) capable of withstanding the crisis. In 1991, the AGATE agency also became administrator of the LEADER I programme for the Tarn des Montagnes region and later, in 1997, of the LEADERII programme for Tarn des Talents.

A study has shown that the needs not covered by existing financial mechanisms are for capital contributions of less than EUR 154,000. It concluded that a local venture capital company was required which would rely on local investors. The project was set up in 1990 in the form of a joint stock company ("FILTARN S.A.") with a capital of EUR 164,600. It had shareholders, five of which were business firms from the Tarn area and four were local financial institutions. The Conseil Général [regional council] provided logistical support, but the venture capital company was created quite independently of the regional authority. By prospecting the target group – local SMEs either under creation or with an innovative development project – FILTARN was able to set up its first financing projects and in 1991 it made its first acquisition of a stake in the capital of an enterprise.

Since then, around 20 applications have been submitted each year. To be eligible, these applications must be from owner-managed firms (in industry or services, but not the trade sector), based in the Tarn region. Their projects must be seen as innovative and coherent from a financial, human and commercial standpoint, as well as creating new jobs over the long term. An investment committee analyses the funding applications. These are then submitted to the board of directors (12 members, including nine shareholding company managers), which considers around 12 projects per year. Seventy per cent of the projects receive a favourable response, culminating in FILTARN acquiring a stake in the business. A guarantee is systematically secured from SOFARIS, a national institution providing sureties for small and medium-sized enterprises. Once the investment decision has been taken, FILTARN provides project support and follow-up from a member of the board of directors.

Since its creation, FILTARN has increased its capital three times, bringing it to around EUR 650,000 by the end of 1999. It currently has 56 shareholders, 42 of which are local businesses. The ERDF contributed a total of EUR 349,692 to the project under Objective 2 (1991-93), plus a further EUR 173,857 (1997-99).

[29] For more information about this initiative, contact:  
FILTARN, 34-36 allées Corbières, Pépinière de Castres,  
F-81100 Castres. Or: AGATE c/o Jean Deneuve, FILTARN project officer,  
4 rue Augustin Malroux, F-81000 Albi. Tel: +33563488740;  
Fax: +33563389750; E-mail: agate@confluent.fr

*Going beyond mere business and employment terms, FILTARN has an educational impact and has raised awareness in the area, among both beneficiaries and the fund's shareholders. After nine years of operation, FILTARN has acquired a stake in 43 business firms for a total of around EUR 1,629,375. Its average stake is no more than 20% of the capital of the business firms concerned. Thirty-eight per cent of these interventions have involved new business start-ups, 9% business firms in operation for less than five years, 47% projects to expand existing businesses and 6% business takeovers. The first proper divestitures took place in 1998 and 1999, with average capital gains of around 18% per year, although one yielded over 30% per year.*

### 3.3.2 Comparative analysis of the three examples

#### 1- STRUCTURE

	LEADERFIDI	GALCOB Initiative	FILTARN
<b>Objectives</b>	To support access to credit by creating a collective guarantee fund (to cover 50% of the guarantees for the loans requested by local entrepreneurs) and an interest fund to cover the interest.	To support business creation, to prevent business mortality in the first two years due to the project promoters' lack of equity.	To boost the equity capital of new or expanding SMEs, by encouraging local businesses to acquire a stake in other firms.
<b>Legal status</b>	Guarantee cooperative	Association	Local limited venture capital company
<b>National support framework</b>	Law on credit cooperatives.	Plate-Formes d'Initiative Locale [ <i>Local Initiative Platforms</i> ]. Statutes registered in 1993, with the technical support of the federation <i>France Initiative Réseau</i> .	Guarantee systematically sought from SOFARIS, a national organization providing sureties for SMEs.
<b>Partners</b>	LEADER group, district councils, Chamber of Commerce.	Apart from the LAG and the consular offices, includes two banks, elected representatives and company heads or executives.	Upon creation: Nine shareholders, including five businesses and four local financial institutions. Logistical support from the <i>Conseil Général</i> . Currently 56 shareholders, 42 of which are local businesses.
<b>Local resources harnessed (financial and human)</b>	Local council funding (one euro per inhabitant/year).	Fund with private partners (40%) and public partners (60%).	Network of local players (consular offices, banks, public accountants, business firms, etc.) and equity participation by local businesses.
<b>Political support framework</b>	Regional authorities and Chamber of Commerce.	Local elected representatives and three <i>Conseils Généraux</i> (Finistère, Morbihan and Côtes d'Armor).	<i>Conseil Général</i> and Chambers of Commerce.

## 2- OPERATION

	<b>LEADERFIDI</b>	<b>GALCOB Initiative</b>	<b>FILTARN</b>
<b>Type of clientele</b>	Young business creators and existing entrepreneurs.	Small local businesses, most of which are owner-managed.	Family-run SMEs little accustomed to the idea of bringing in outside shareholders.
<b>Type of support provided</b>	Loans for a total of four times the amount deposited by LEADERFIDI as a guarantee. Loans limited to EUR 25,822 per business firm. Ceiling for projects of special interest raised to a maximum of EUR 51,645.	Loans free of guarantees and interest, for an amount ranging from EUR 3,000 to around 15,000, reimbursable within five years on a quarterly basis after a one-year grace period.	Average participation of EUR 35,000, up to a maximum of EUR 76,300.
<b>Interest rates</b>	0% on loans on trust (drawn from the fund created by the local action group).	0% on loans on trust.	The first divestiture, which took place in 1998, yielded over 30% per year; average capital gains are around 18% per year.

### 3- MANAGEMENT

	LEADERFIDI	GALCOB Initiative	FILTARN
<b>Management bodies</b>	Independent cooperative. Management costs covered by contributions from the 25 local councils involved.	GALCOB Initiative, an association comprising the LAG, the consular offices, two banks, elected representatives and company managers. Salary of one permanent staff member paid by LEADER, the remainder relying on volunteer work.	Follow-up of business firms by AGATE agency (LEADER administrative agency) financed by the <i>Conseil Général</i> . Three members of staff.
<b>Support and guidance services</b>	Business firms followed up by the local action group.	Technical support by a network of coordinators and consular offices to determine the investments, working capital, etc., required to keep the business firm in operation for the first three years.	Shareholders' agreement stipulating the terms for transferring shares as well as project support and follow-up by a member of the venture capital company's board of directors.
<b>Responsibility for deciding on funding applications</b>	Loan committee comprised of three members: LEADERFIDI, Anglona-Monte Acuto LAG and Banca di Sardegna.	Accreditation committee comprised of company heads, public accountants, financial advisers and technical experts from the consular offices.	Investment committee to study funding applications, which are then submitted to the board of directors (12 members including nine business manager-shareholders).

### 4- IMPACT

	LEADERFIDI	GALCOB Initiative	FILTARN
<b>Multiplier effect</b>	Renewed confidence of young entrepreneurs in local structures; involvement of local councils in economic and social development.	Renewed confidence in the future of the area.	Creation of links between business firms, commitment on collective risk-taking; business attitudes evolving towards bringing in outside capital.
<b>Benefits compared with current funding provision</b>	Loans on trust give young entrepreneurs access to credit.	Loans on trust serve as a lever for securing additional loans from the banks.	Fulfills needs not covered by existing financial mechanisms: equity participations for amounts of less than EUR 154,000.

### **3.3.3 General characteristics of financial engineering under LEADER**

Whilst emphasizing that all three forms of financial engineering presented above make it possible to multiply the use of LEADER funds, this comparative analysis reveals a number of features that distinguish LEADER's intervention in the financing field.

#### **a) The formulas tested are quite new and have yet to be stabilized**

Apart from FILTARN, for which feasibility studies started one year prior to LEADER I, LEADERFIDI and GALCOB Initiative are relatively "young" instruments. The GALCOB Initiative was created in 1993 (LEADER I and II) and LEADERFIDI in 1998 (LEADER II). Both French instruments have been through difficult periods and adjustments have been required, either by negotiating new funds (GALCOB) or by concluding agreements with another company (FILTARN). These difficulties arose chiefly from long reimbursement deadlines reducing the capital available.

After a period of significant growth, FILTARN's business is now declining, due to a drop in available capital and the fact that, for most funding applications, investment is shared with the regional venture capital company, *Midi-Pyrénées Création*. Pending 2001, the date on which the divestitures corresponding to FILTARN's strong growth years are due to occur, an increase in capital, with the financial support of the ERDF, and sharing of certain equity participations with *Midi-Pyrénées Création*, should make it possible for FILTARN to continue to meet demand from businesses in the Tarn region.

#### **b) They are small-scale instruments and will no doubt remain so in view of their local role**

Financing instruments created by LEADER are small-scale and just about meet the needs of a rural area of up to 100,000 inhabitants. They are therefore confined in scope. In any case, many such instruments are subject to legal restrictions regarding their geographical scope (for example, Italy's credit cooperatives are not allowed to extend their activities beyond a well-defined area, i.e. a specific number of local districts).

It is their local nature, and the fact that they act *in situ*, that make these activities and their multiplication so interesting.

#### **c) They are financial instruments and not subsidies (even though, in two cases, they do involve loans on trust)**

All three cases involve credit instruments and not subsidies. Nevertheless, in the case of loans on trust the interest is subsidized.

In the case of FILTARN, the shareholders' agreement defining the terms for the transferral of shareholdings and the calculation of capital gains ensures that the objective of the measure is really to provide local venture capital and not to subsidize business firms on a lost equity basis.

The GALCOB Initiative grants loans on particularly advantageous terms to local businesses during their start-up phase.

As for LEADERFIDI, the interest on the loans on trust granted is automatically drawn from the "interest fund" account opened with the LEADER group at the bank.

We therefore have three types of financial engineering:

- > an instrument of collective guarantees (joint collateral) and loans on trust (LEADERFIDI);
- > a credit/supplementary lever instrument (GALCOB Initiative);
- > a venture capital instrument (FILTARN).

These require three different techniques, adapted to suit the requirements of each context.



**d) The financial service is always accompanied by other types of service (technical assistance, coordination, etc.)**

The GALCOB Initiative is based on a system whereby experienced staff sponsor beneficiary businesses.

More of a local development tool than a speculative fund, FILTARN's objective is to stimulate and consolidate the local economic fabric by fostering the emergence of networks of exchanges, services and activities between business firms.

**e) Their complementary role favours access to other financial resources**

The GALCOB Initiative's system of loans on trust has a financial leverage effect on the banks.

By mutualizing the risks, LEADERFIDI provides access to credit for young business creators and small businessmen who cannot personally assume the guarantees demanded by the banks.

**f) They are instruments anchored firmly in local needs**

The GALCOB Initiative used a national institutional, juridical and legal framework to launch a local structure that truly matches the needs of the Central West Brittany LEADER area.

The labour pools concerned by FILTARN were hard hit by economic restructuring, which often called for investment and injections of capital far beyond the funds available to the business firms concerned. Since such financial resources did exist locally among other players in the area, in particular a number of business firms and financial institutions, FILTARN was created with the primary objective of strengthening the fabric of small and medium-sized enterprises (SMEs) capable of withstanding the crisis.

The LEADERFIDI cooperative guarantee fund was designed to foster the development of small local businesses by facilitating their access to credit in a regional context where money is expensive and would-be borrowers are unable to provide the required guarantees.

**g) They also have an objective of education and harnessing and keeping resources in the area**

These initiatives have a major educational impact; they have helped to raise awareness and foster the economic development of the areas concerned. FILTARN has become a key local development player, stimulating partnerships, encouraging synergies and networking, and helping to train SMEs.

In spite of its as yet limited impact compared with the number of project promoters in the area, the GALCOB Initiative has greatly helped to change local players' perception of their area, because of the large number of people and institutions that it has reached and the image of success that it radiates. Whereas six years earlier the general consensus was that the area had no future, opinions have changed and more young people are now planning to stay in the area.

**h) These instruments are dependent on the support of public institutions...**

In the case of the GALCOB Initiative, a fund of around EUR 200,000 was set up with the aid of public funding secured from three *Conseils Généraux* and from the European Union (participation from LEADER and the ERDF). They were supplemented by private funds raised from local businesses, the two regional banks involved and an insurance group.

In the case of LEADERFIDI, the 25 local councils in the LEADER area are founder members of the cooperative and make a contribution proportional to the population of their respective district (around one euro per inhabitant). Other public structures also contributed to the creation of the fund, including the Sassari Chamber of Commerce.

Since its creation, FILTARN has increased its capital on two occasions. A third increase in capital, to be carried out in one or more phases at the initiative of the Board of Directors, was approved by the meeting of shareholders of 6 May 1999. A first phase was completed before the end of 1999, with the Tarn region's three Chambers of Commerce and the national electricity board, *Electricité de France*, as the new shareholders. The European Union and the French government also assisted with FILTARN's overall funding capacity, in the proportion of 46% from the government, 21% from the European Union, with the remaining 33% from private funding. The ERDF therefore contributed the sum of EUR 349,692 to the project, under Objective 5b (1991-93) plus a further EUR 173,857 (1997-99).

**i) ...and are encompassed  
within the national legal framework**

Each of these initiatives was developed within a specific legal and institutional context. In Italy, cooperatives for collective guarantees and loans on trust are given priority in the tradition of intervention in this domain, in particular that of guarantee cooperatives. By contrast, in France, the initiative is encompassed within the framework of Local Initiative Platforms or of a venture capital fund.

### **3.4 Conclusion**

The LEADER programme has played an important role in triggering the process of risk-taking and harnessing private savings for local investment. However, in areas with highly dispersed production structures, it has proved very difficult to create a multiplier effect based on short-term public interventions. Although public support remains crucial, it is essential to establish long-term solutions.

LEADER II has shown that, in spite of the positive impact they have created, subsidies alone are not enough to support small-scale project promoters, young innovative entrepreneurs, collective schemes in the social economy sector, etc.



## **Chapter 4**

# **Challenges for the future**



# Challenges for the future

## What are the next local financing challenges that LEADER must face?

- In order to answer this question we must first ascertain:
- > which avenues have already been fully explored that provide a sound basis on which to build;
  - > which are the forms of financing where interventions have, by contrast, remained sporadic and still require a great deal of methodological capitalization and transfers of experience;
  - > which financing formulas of importance to rural development have not yet received LEADER support and for which work must start from scratch.

By referring to our summary table on the potential links between funding supply and demand, presented at the end of Chapter 2, we can – in the light of Chapter 3 – briefly outline the various forms of LEADER financial intervention.

## OVERVIEW OF LEADER'S FIELDS OF FINANCIAL INTERVENTION

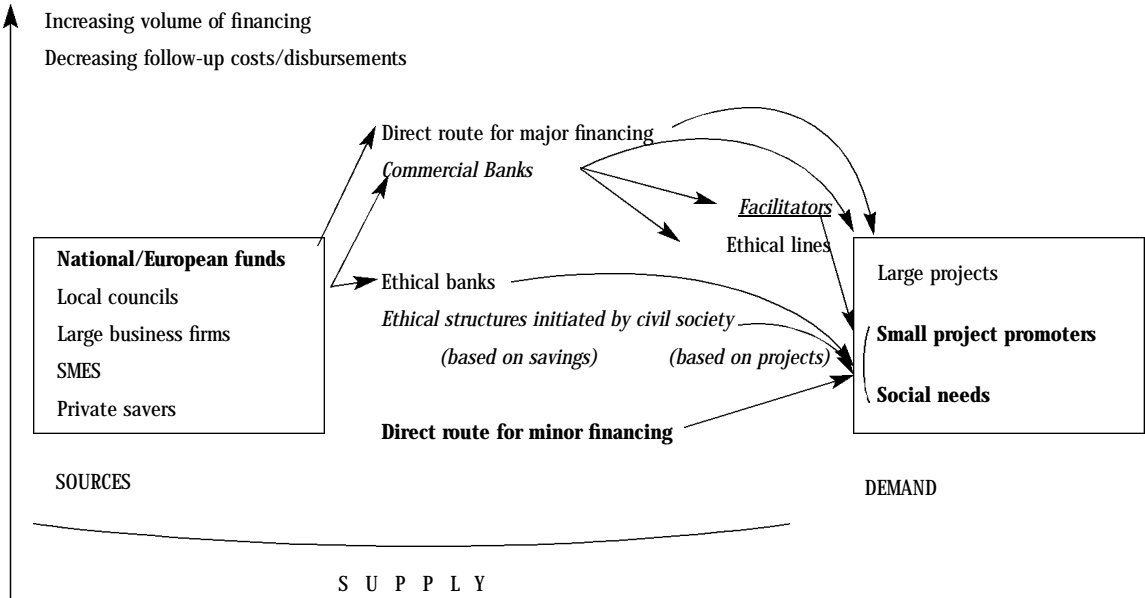
**In bold characters:** major LEADER intervention – Significant and consolidated methodological experience acquired

*In italics:* ad hoc LEADER intervention – Need for methodological capitalization and transfers.

underlined: with LEADER funds;

*not underlined:* without LEADER funds.

In normal characters: no LEADER intervention



There are of course financing formulas, which, by their very nature, escape LEADER's field of intervention. This is the case with "major" financing. However, there are also formulas that LEADER has not yet tried out but which can play a key role in the local development of rural areas. This applies in particular to ethical banks and products.

The future challenges facing LEADER therefore vary from case to case:

- > Where interventions involving new forms of financing have already been practised extensively and have become widespread, the challenge is more to systematize the lessons learned and ensure exchanges of experience in order to achieve excellence. This is the case with "minor financing/levers", in the form of direct subsidies, for which considerable progress has been made and the LEADER groups' know-how is very advanced<sup>30</sup>;
- > With regard to formulas explored by only a few LEADER groups or by a larger number of LAGs in a superficial manner, the problem lies in disseminating and transferring the lessons learned from these experiences, as well as in acquiring skills and setting up collective consultations about the potential of these new avenues and the best methods for getting there. This particularly concerns initiatives involving commercial banks, finance facilitation structures like LEADERFIDI and GALCOB Initiative and structures initiated by civil society, like FILTARN;
- > finally, with regard to financing formulas that have not yet been explored, it is of utmost importance to implement pioneering initiatives, which could play a pilot role at European and national levels.

However, in the latter two cases, many initiatives already exist unrelated to LEADER, particularly in urban areas. It is therefore becoming increasingly necessary to set up exchanges and links with them.

In all three scenarios, inter-territorial cooperation, either among rural areas themselves or between rural and urban areas, is a key element to meeting the challenges that local development financing will pose in the future.

In view of LEADER's varied experience of these three types of initiative, we shall analyse the various challenges posed by each of the three scenarios, stressing the points where further analysis is desirable and on which future efforts could be focused.

## **4.1 Financing formulas that have already been fully explored**

LEADER has amassed plenty of experience in the use of subsidies as a lever for mobilizing and structuring rural areas around pilot and experimental activities. With regard to financing issues, all of this acquired experience can be brought to bear in consultations on: harnessing local savings, regaining the trust of local communities, LEADER's contribution to restoring a fairer balance in terms of access to resources and evaluating projects initiated by disadvantaged groups. Furthermore, issues such as strengthening collaboration, cross-disciplinary measures and raising environmental awareness are all aspects that should be taken into account when the new LEADER+ Initiative is introduced.

## **4.2 Financing formulas cursorily explored by a few LEADER groups**

Three formulas are involved:

- > partnerships with commercial banks;
- > facilitation structures;
- > ethical structures initiated by civil society.

### **4.2.1 Local partnerships with commercial banks**

Two formulas call for special analysis:

- > integrating financial structures into the local partnership and exploiting this partnership to diversify financing possibilities;
- > negotiating benefits to aid territorial development.

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[30] See for example "De la stratégie à l'action: la sélection des projets locaux", 1998, LEADER European Observatory/AEIDL.

### **a) Integrating financial structures into partnerships**

Under LEADER I and II, Local Action Groups often integrated banks or other financial structures into their partnerships. At first sight, such integration has not had much of a serious impact on the attitude of such structures to territorial development or to the conditions for granting loans to the Initiative's final beneficiaries.

A challenge for LEADER+ will be to reflect more deeply on the relationship to be developed between LEADER groups and their partner banks. This should start by examining the intervention rationale in the area, addressing such questions as: Which market "segments" are covered by the banks? Which segments are rejected, and why? How much of the credit granted to local SMEs do banks provide? What support is provided for new business creators?<sup>31</sup>

What is more, partner banks may well be able to introduce new activities into the Local Action Plan. An interesting example of this is the Presila Krotonese LEADER group from Calabria which included FinCoop (a guarantee cooperative) into its partnership. Thanks to the support of this partner, a measure was created within the group's local action plan: business "Information Points" which provide a range of services, including information on access to finance, all in a one-stop shop.

An active partnership with financial organizations should make it possible to integrate measures for: investigating the financial provision for local activities; ascertaining the quality of the products on offer and their suitability for the area's needs; a more detailed identification of the need of rejected segments for financial advice, etc. Some such measures could include a number of LEADER groups as partners within a collective negotiation framework.

### **b) Collective negotiation (by a number of LEADER groups) of territorial development benefits**

Collective negotiations by a number of LEADER groups with financial structures can be useful for securing advantageous credit terms and increasing the local impact of financial resources.

Such collective negotiations can focus on various aspects of the relationship between banks and local areas: processing the funding applications of final beneficiaries of the LEADER Initiative, creating products to match local needs, social investments or investments of community interest, conditions for managing LEADER funds allocated to the groups, etc.

As a result, consultation between several LEADER groups can also create a degree of competitiveness between banks, vying to offer the best benefits to encourage LAGs to open an account with them.

It is chiefly in Spain that we find examples of collective negotiation between LEADERII groups and financial institutions. In all cases, the negotiations, conducted at the level of the autonomous regions, were preceded by the organization of a regional network of all the groups operating in region. The example of Aragon, below, describes this approach and its results.

*In 1996, Aragon's 13 LEADER II groups set up the non-profit-making association, Aragon Rural Development Network (RADER)<sup>32</sup>. The Network immediately launched a series of collective projects involving all of the LAGs.*

*They included the signature of an agreement with the leading regional bank, "Ibercaja", an institution attaching great importance to Aragon's rural development, which had already financed a number of studies and development projects.*

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[31] Greater transparency can be demanded at local level from banks regarding the percentage of savings reinvested in local development activities. Such transparency is important for raising the awareness of the local population about the use of its own resources to serve the needs of the area.

[32] For more information:

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*The agreement contained three types of benefit:*

- > logistical support for the LEADER groups and for RADER, by making available a fund totalling EUR 84,000. Thanks to this fund, RADER was able to finance its own central office and the salary of the net-work coordinator;*
- > the groups belonging to the network gained much more flexibility in managing the LEADER programme (interest on positive balances, overdraft facilities of up to EUR 6,000, an exclusive credit line to cover late payment of the outstanding balance of 20%, free current account transaction and access to the bank's on-line information system);*
- > the project promoters themselves benefited from special terms reserved for the bank's preferential customers (access to credit on advantageous terms, risk management facilities). Based on these minimum terms, project promoters can negotiate further benefits depending on the guarantees that they are able to provide.*

*This agreement has served as a model for other regional Spanish networks, as well as for Spain's Ministry of Agriculture to negotiate a similar agreement with a national bank for the other LEADER groups.*

*The agreement concluded with the bank considerably increased the IAGs' room for manoeuvre and improved the dynamics of the project. However, because of the negotiation terms themselves, the agreement failed to alter the guarantees needed for accessing credit and it did not really increase the possibilities for financing either projects with a strong social, environmental or cultural content, or projects put forward by disadvantaged groups.*

This example illustrates an interesting approach, which has nonetheless had limited impact. The negotiation did not, for example, focus on aspects such as the transparent use of funds or the creation of products appropriate for Aragon's rural SMEs. Nor did the agreement provide for any mechanism for improving the dialogue between project promoters and financial institutions, with LEADER beneficiaries having to organize access to counter-party funds on an individual basis, for example.

#### **4.2.2 Facilitation structures**

Mediation between financial institutions and social project promoters, new business creators and unemployed people seeking credit to set up their own businesses is still a challenge that most rural areas have yet to take up.

Due to their legitimacy, LEADER groups – which generally represent a series of local interests – will be able to play a more effective role in the financial domain, either by creating mediation services (e.g. LEADERFIDI-type guarantee cooperatives) and evaluating project viability and the debt carrying capacity of business firms, or by sticking to existing initiatives that are not very active in rural areas (such as the Presila Krotonese LEADER group's partner, FinCoop).

This mediation function also encourages greater involvement by banks in the development of local initiatives. Its role is therefore to “alert” the banks about projects requiring support and initiatives in progress, about the product needs of small business people (e.g. treasury funds), etc.

In this area, it would be useful to explore a number of issues further in the future, including:

- > an analysis of the obstacles blocking access to credit;*
- > services for providing financial management training/advice and supplying information on the quality and suitability of the various financial products on offer;*
- > measures aimed at local authorities.*

##### **a) Analysing the obstacles blocking access to credit**

Analysing the obstacles blocking access to finance is another future task of the LEADER groups. First this means:

- > Pinpointing individuals or groups that may be potential project promoters but are rejected by the banks in the area (e.g. people who fail to respond to the entrepreneur “profile” demanded by the banks: women, artists, young project promoters with no management experience, young people from ethnic minorities, unemployed people from disadvantaged groups<sup>33</sup>, etc.).*

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[33] See: Granger Benoît & INAISE for the types of people rejected by Europe's banks, *op. cit.* p. 41-45.

- > Identifying the sectors that fail to attract the banks but which do, however, contribute to economic and social development, thereby fostering innovation and the creation of new occupations.
- > Identifying market segments that have been abandoned by the banks.

With regard to small and very small businesses, the analysis should focus on:

- > Adapting financial services to suit micro-businesses requiring easier access to funding, providing loans suitable for the scale of the business, for the players' degree of financial dependence, for their lack of liquid assets, etc.;
- > The adaptation of, and access to, specialized financial advisory services and the ability to react to difficult situations that may arise during the development of the enterprise (rapid growth, credit control, lack of fixed assets);
- > The ability to access venture capital and other sources of funding or a sudden need for large sums in the case of a business start-up.

### **b) Services for providing financial management training/advice and supplying information on the quality and suitability of financial products**

One of the spheres neglected by rural interventions has been the organization of financial information services accessible to entrepreneurs (assistance for the first funding application, advice on the right financial product, etc.). Telephone help lines, for a group of LEADER areas, to provide answers to more or less *ad hoc* questions may be of particular interest.

*In 1993, the British government introduced a mediation service for small businesses ("Ombudsman for Small Firms"), which received 2,600 telephone calls and 1,600 letters from small businesses in 1997 alone.*

The problem of over-indebtedness amongst rural operators appears to be reaching alarming proportions. Due to the fact that they are rooted in the local area, LEADER groups are able to detect this type of problem and attempt to resolve it through mutual aid networks.

*Taking advantage of solidarity, the association "CILDEA" created a system of mentorship in the Loire region (Auvergne, France), to help farmers in difficulty (chiefly due to over-indebtedness) to find solutions for their problems. Farmers who are well established and maybe even hold positions of responsibility in the local area (cooperative chairman, former mayor, etc.) act as the mentors.*

The LEADER groups can therefore take measures to:

- > provide financial management training to potential customers of financial institutions;
- > standardize applications for bank credit and support applicants (in many cases, small businessmen have to contact several financial institutions before they receive a positive response). However, in most LEADER areas, project promoters have been left to deal with this procedure alone;
- > group together credit applications in order to negotiate more advantageous access and reimbursement terms;
- > ascertain real financing needs and the possibilities of accessing the necessary funds. This is a very important activity, given that, in many cases, the funding received by small-scale project promoters (determined on the basis of official bank ratios) falls short of their requirements, which can cause problems for the borrower at a later date;
- > rebuild confidence in official credit mechanisms, especially in areas where distrust, lack of vision or, worse still, systems of usury have become established.

*In rural Calabria (Italy), LEADER groups promote credit access instruments (such as FinCoop and the LEADER subsidies themselves) and the advantages of using them for business creation, by first rebuilding trust and legitimacy. To this end, the LAGs hold information meetings in the presence of the public authorities.*

### c) Measures aimed at local authorities

Local authorities are becoming increasingly involved in job creation, which is the ultimate objective of development initiatives and of numerous public investment measures.

Measures aimed at local authorities may involve using public funds to create and support collective guarantee systems (of the LEADERFIDI type) in order to alter the attitudes of banks in rural areas.

In the case of LEADERFIDI, for example, the local authorities contribute one euro per inhabitant per year, but this contribution may become more substantial as a result of the LEADER groups' efforts to raise people's awareness of how important it is for local project promoters to have access to finance.

#### 4.2.3 Ethical structures initiated by civil society

One of the key aspects on which LEADER groups must focus more in the future is raising people's awareness of the importance of investing local savings in activities based in the area.

Within the context of an integrated approach, based on the creation of local links, it is essential for the local community to understand the social and ethical impact of business creation and the need for combining local savings with mutual aid.

Business and job creation now goes beyond the economic sphere alone: it has become an integral part of a social objective for using human resources and achieving cohesion. Employment, as Europe's governments constantly remind us<sup>34</sup>, has become the cornerstone for building social cohesion and mutual aid. Hence the need for LEADER groups to guarantee access to finance for all those who contribute, or who could contribute, to creating and maintaining jobs.

Lack of access to finance leads to a decline in business activities or to a lack of business creation and hence to greater dependence on state welfare (unemployment benefits, income support, etc.). Furthermore, the large influx of applications from unemployed people wishing to create their own businesses, which *Imprenditoria Giovanile* received under its loan programme for the unemployed (see above), highlights the extent of unsatisfied need in a social group at very great risk of exclusion. Solutions of the *Imprenditoria Giovanile* type help the jobless escape from a situation of dependence and to

build up small businesses for themselves, when they are given favourable finance conditions in terms of cost and reimbursement schedules.

The attitude of local communities to the productive use of local savings for mutual aid is one of the major factors to be taken into account in designing an area-wide awareness/coordination programme.

How can banks be made more transparent with regard to local savings/local investment? How, too, can product quality be improved to meet the needs of rural areas? Meeting such needs is becoming increasingly important to counteract the trend for banks to withdraw from the area in which they are based, in favour of financial speculation operations on international markets.

LEADER groups could play a role in this respect by proposing that banks open up "accounts for local employment" in order to encourage local savers to become involved in job-creating initiatives. The banks themselves would grant the funds collected in such accounts to LEADER beneficiaries or to new business creators in the form of loans.

### 4.3 Financing formulas as yet unexplored by LEADER

First and foremost this involves the LEADER groups' role in the coordination, promotion and local consolidation of ethical and mutual aid financing.

In the Communication from the European Commission "Building an inclusive Europe"<sup>35</sup>, the LEADER Initiative was cited as one of the Union's instruments for actively promoting social integration. LEADER+ groups are invited to play an increasingly active role in supporting and assisting the emergence of collective mutual aid alternatives in rural areas, particularly the areas hardest hit by unemployment.

The territorial coordination approach taken by LEADER groups could be extended to such fields as access to credit, the creation of local ethical and mutual aid alternatives and access to nationally developed alternative formulas.

[34] Commission of the European Communities, COM(2000)79 final, Brussels 1.3.00, Communication from the Commission: Building an inclusive Europe, p. 6

[35] Commission of the European Communities, COM(2000)79 final, op. cit. p. 10

Practices that exist elsewhere, either in the same country or abroad, may inspire local approaches for:

- > opening up access to finance for all project promoters;
- > developing (in partnership with certain banks and appropriate financial structures) products that match the needs of the area concerned;
- > setting up the consulting and knowledge transfer mechanisms required to enhance the management and financial autonomy of vulnerable groups;
- > creating and developing the ability to build projects of public interest that can be financed by ethical and mutual aid financing mechanisms;
- > bringing to the attention of the regional authorities the need to recognize the function of mutual aid financial structures (and of any mechanism that facilitates access to credit for the unemployed, young project promoters, etc.).

By integrating these aspects into the territorial coordination approaches already developed by LEADER groups, the groups will be able to further assert their role as “local development catalysts”. Nonetheless, many rural areas simply do not have enough inhabitants to make local financial structures viable. The cooperation agreements opened up under LEADER+, aimed at securing an appropriate scale of funding, should make it possible to overcome the handicaps so common to rural areas due to their lack of critical mass.

**Leader II** est une Initiative communautaire lancée par la Commission européenne et coordonnée par la Direction générale de l'Agriculture (Unité VI-F.II.3).

Le contenu de ce dossier ne reflète pas nécessairement les opinions de l'Union européenne.

***Leader II** is a Community Initiative launched by the European Commission and coordinated by its Directorate-General for Agriculture (Unit VI-F.II.3).*

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