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Addressing the financing and investment gap in CESEE

Most CESEE countries are modest or moderate innovators (EC classification), even if there is substantial heterogeneity in the evolution of innovation performance across countries and some hot spots of innovation hubs. Low innovation performance is associated to relatively low investment in intangible assets that remains very dependent on European Structural and Investment Funds and foreign R&D investors, skills shortages, a low smart-digital penetration and an operating environment that prevents scaling up of technological advancement.

As a result, a stronger role for innovation to increase productivity is a key element of the new growth model for CESEE, to escape a middle-income trap. To this end, stronger investment, skill development and a system of financial intermediation that supports investment and innovation are crucial.

Launched 10 years ago, the Vienna Initiative is a private-public coordination platform to address macro-financial issues in the CESEE region. In this context, two new working groups have been looking at markets gaps and priority policy areas for investment and innovation in the CESEE region. The working groups have looked at the role of private and public sector, as well as the shaping of IFIs intervention for the purpose.

In the context of the new Multi Annual Financial Framework, the recommendations from those working groups aim to provide a contribution to shape the next generation of IFI products, leveraging on the financial instruments concept, assessing the needs and characteristics of the local investor base and strengthening the cooperation among IFIs.

IFIs have been playing an important role in supporting access to finance of the private sector in CESEE. Looking ahead, IFIs can continue to play a catalytic role in the transition of the region's economies towards a new growth model, based on productivity growth through human capital development and home-grown innovation. A proper tailoring of IFIs product in this direction is crucial.

The new reports identify the key policy priorities for action in this context:

1. To support lending to SMEs and MidCaps, capital relief products are at the moment more in need than liquidity. Impact Finance Products covering first loss risks (e.g. COSME, PF4EE, SME-Initiative, etc) or pre-bankable finance (e.g. EDP, IDFF, Future Mobility) are particularly relevant.
2. Compliance with the minimum requirement for own funds and eligible liabilities (MREL) targets will pose challenges for the banks operating in the region in the coming years.
3. Due to a shift in demand towards local currency products, IFIs should consider further broadening their domestic currency-denominated product palette.
4. EU-funded venture capital programmes boosted the entire VC ecosystem and start up world in the region. Similar initiatives in the future would bring further benefits by focusing increasingly on qualitative results.
5. Venture Debt (VD) is a product offered by banks and specialised funds as a complementary source of later stage risk financing, alongside existing VC funding or equity solutions. The Venture Debt market is relatively underdeveloped in Europe and in nascent stage in CESEE region. There is further potential to develop commercial banks' offering of Venture Debt, with the support of IFIs.
6. IFIs could provide a more targeted financing option for the corporates of the region by adapting their product offers to the specificities of CESEE, potentially by providing smaller ticket sizes, more flexibility in the loan structures, quicker decision-making etc.
7. Using grants in combination with financial instruments is an efficient way to support investments with high socio-economic impact, and such combinations have a high potential for use in CESEE.

The framework for financial instruments proposed by the EC for the next MFF (InvestEU) addresses a number of issues. It is important that the fruitful regular dialogue between the private and public sector parties continue, to maximise the benefits and impact of financial instruments in the market. Better and more accessible data on IFI product supply could help to maximise overall impact and could promote better coordination among IFIs. ●

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