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FINANCIAL PRODUCT EVALUATION IN LITHUANIAN MARKET CREATING A PRODUCT SUPPLY MAP

SUMMARY OF EVALUATION REPORT

November 27, 2017

Evaluation was performed in accordance with the service provision contract No. 14P-56 „Referring to Financial Product Evaluation in Lithuanian Market Creating a Product Supply Map“ signed on August 01, 2017 between Ministry of Finance of the Republic of Lithuania and LLC „VG CONSULT“.



CONTENTS

INTRODUCTION.....	3
1. ANALYSIS OF LITHUANIAN FINANCIAL PRODUCT SUPPLY	4
2. STATISTICAL ANALYSIS OF FINANCIAL PRODUCT MARKET	6
3. METHODOLOGY OF LITHUANIAN FINANCE PRODUCT MAP CREATION	7
4. ANALYSIS OF FINANCIAL PRODUCT MARKET AND EVALUATION OF FINANCIAL PRODUCT MAP CONCEPTION.....	8
RECOMMENDATIONS	12
RECOMMENDATIONS FOR FINANCIAL PRODUCT MONITORING	12

INTRODUCTION

The following financial products are currently available in Lithuanian financial market: loans, guarantees, investment to a private capital or quasi-equity capital and other products related to risk sharing. Their rapid growth was caused by an increasing market demand and financial products of the European Union (hereinafter – EU) during the programming period of 2007-2013 which still remains during the financing period of 2014-2020.

The aim of the evaluation¹ is to assure integrity of the created/expected to be created financial instruments established by the EU structural funds with other measures active in the market, and increase their efficiency.

Suggested financial products were reviewed and analysed, a map of Lithuanian financial products was created during the evaluation procedure. Recommendations for further monitoring of financial products implemented in Lithuania are provided.

The object of evaluation is financial products in Lithuania. This work analyses financial products designated for expansion of business, public infrastructure and increase of energy efficiency.

The map of financial products is the entirety of financial products which is systematised and classified according to various aspects (e.g. according to groups of financial products, suppliers, financed area or expedience, etc.)

A map of financial products has not been created in Lithuania so far. It is possible to find only individual examples illustrating the structure of financial measures, such as EU Funds map².

Evaluation report consists of four main parts:

Part I. Analysis of Lithuanian financial product supply. It presents the existing financial products and their suppliers in Lithuanian financial market concisely.

Part II. Statistical analysis of financial product market. This part presents statistical data and dynamics on loans, leasing, factoring, guarantees, private and venture capital markets.

Part III. Methodology of Lithuanian finance product map creation. This part describes methodology of financial product map creation which encompasses access to quantitative survey and qualitative research methodology.

Part IV. Analysis of financial product market and evaluation of financial product map concept. This part provides the summarised results of analysis of financial product market and evaluation results of financial product map concept.

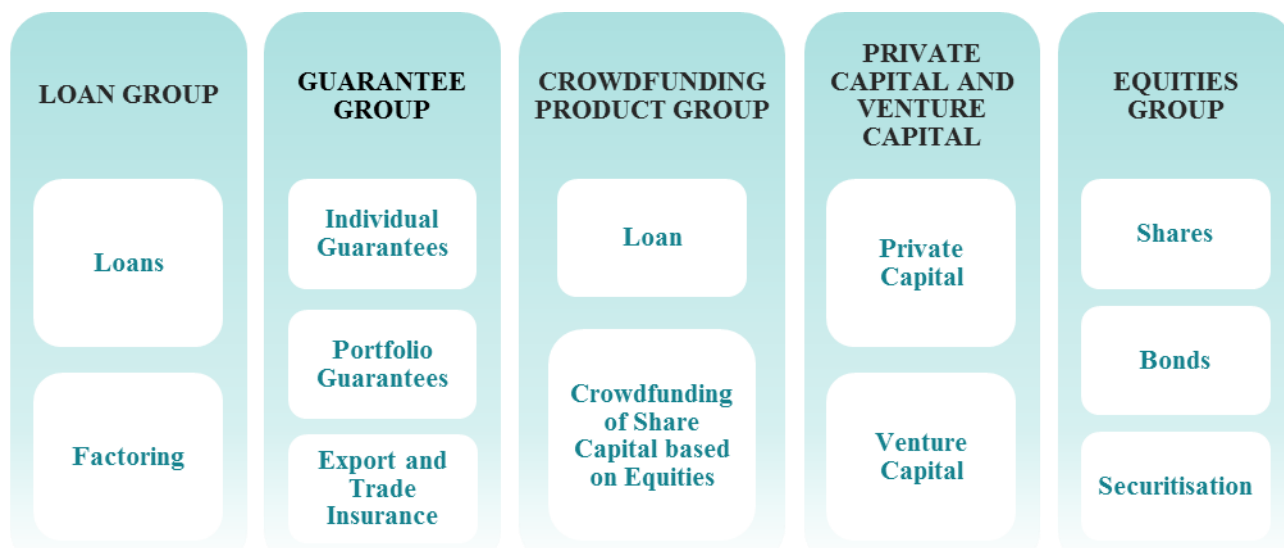
¹ Evaluation was performed in accordance with the service provision contract No. 14P-56 „Referring to Evaluation of Financial Products in Lithuanian Market Creating a Product Supply Map“ signed on August 01, 2017 between Ministry of Finance of the Republic of Lithuania and LLC „VG CONSULT“.

² EU Funds map. Internet access: <http://equinoxadvisory.com/services/eu-funding/eu-financial-instruments/>

1. ANALYSIS OF LITHUANIAN FINANCIAL PRODUCT SUPPLY

Numerous financial products are offered in Lithuanian market which can be used by business. This evaluation encompasses products of credit and payment market as well as alternative financial measures. Product classification into groups is presented in Pic. 1.

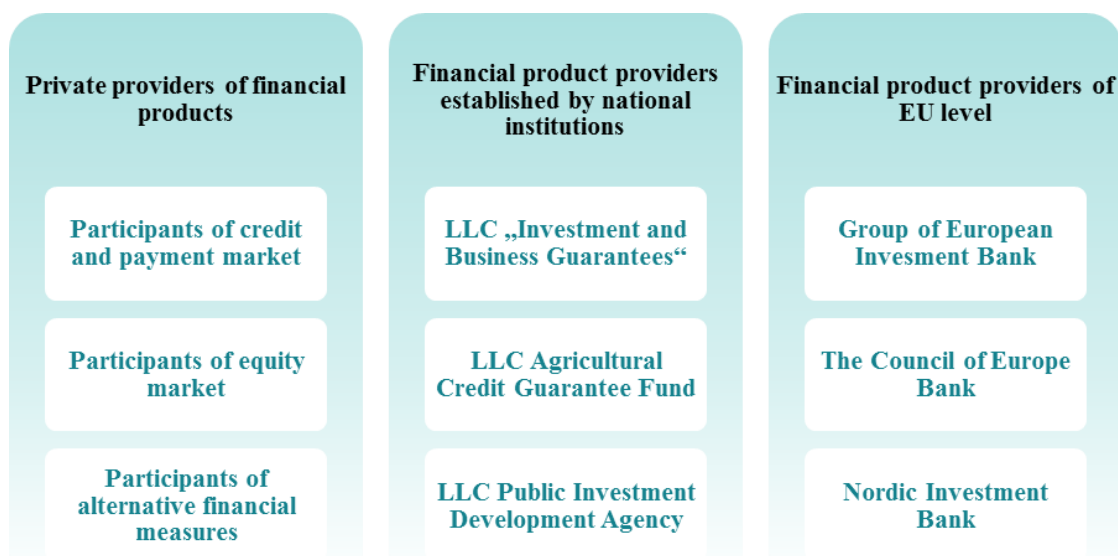
Pic. 1. Financial product groups analysed in the evaluation



Source: Compiled by authors

According to the data of Bank of Lithuania, 1034 participants of financial markets functioned in credit and payment market in August 2017, i.e. credit unions, credit mediators related to real property, mediators of payment institutions, central credit union, banks, crowdfunding platform operators, operators of peer-to-peer lending platform, crowdfunding operator. In addition to the aforementioned participants of the market, various financial products are provided by national and EU institutions, i.e. LLC „Investment and Business Guarantees“, LLC Public Investment Development Agency, Group of European Investment Bank, LLC Agricultural Credit Guarantee Fund, etc. Classification of financial product providers analysed in this evaluation is presented in Pic. 2.

Pic. 2. Classification of financial product providers.



Source: Compiled by authors

LLC Agricultural Credit Guarantee Fund provides loans, guarantees for credit institutions (banks and credit unions) and leasing companies. Fund activity is orientated towards support to agricultural entities, business entities engaged in alternative activities in the countryside or towns with a population not exceeding 6 thousand inhabitants and whose agricultural estate is registered at the Register of Agricultural and Rural Business of the Republic of Lithuania, for establishing processing and fishing enterprises and expanding their business creating favourable crediting conditions.

The aim of **INVEGA** is to promote expansion of Lithuanian business and competitiveness, thus its main activities are as follow³:

- provision of individual and portfolio guarantees;
- provision of soft loans for small and medium business entities or loan administration;
- implementation of venture capital investment measures;
- partial interest reimbursement;
- function performance of intermediary institution in the area administration of EU structural fund management and control;
- management and (or) implementation of finance engineering and financial measures for business entity financing including controlling funds and funds of funds;
- reimbursement and subsidization of state-sponsored expenditures (establishment, training, consultation, scientific research, certification, conformity assessment, guarantee fees, etc.) of business entities;
- provision of grants and (or) subsidies for creating and (or) maintaining jobs, increasing of competitiveness.

INVEGA administers measures financed by EU structural and investment funds and national funds due to which SVV can obtain the necessary funding for business start or business development.

LLC Public Investment Development Agency (hereinafter – VIPA) provides guarantees for projects of street lightning modernisation, soft loans for renovation of multi-apartment buildings, dormitories, central government buildings. VIPA manages Energy Efficiency Fund (hereinafter – ENEF), Fund of Multi-Apartment Building Modernisation (hereinafter – DNMF), Cultural Heritage Fund and Municipality Building Fund.

European Investment Bank (hereinafter – EIB) finances projects which have a positive impact on development and job creation in the EU. The priority is given for the following areas:

- investment to innovation and skills development;
- possibilities for small and medium businesses to get financing for improvement;
- projects to combat climate change;
- projects of strategic development of infrastructure.

EIB funding is orientated towards development and partnership of innovative products facilitating access to financial sources and improving conditions for small and medium capital entities in any stage of their development⁴.

European Council Development Bank (hereinafter – ETVB) is the only bank of European development orientating its activity to exclusively social area: projects financed by bank loans are pursued to decrease social exclusion, protect the residents of the most vulnerable public groups, strive for sustainable development and improve living conditions.

Nordic Investment Bank (hereinafter – ŠIB) provides long-term loans and guarantees for investment projects which strengthen competitiveness of the North and Baltic States and environment protection.

³ <http://invega.lt/lt/apie-invega/veiklos-tikslai/>

⁴ <http://www.eib.org/projects/priorities/sme/index.htm>

2. STATISTICAL ANALYSIS OF FINANCIAL PRODUCT MARKET

Lithuanian finance institutions had granted **loans** worth of 8345,8 mln EUR for country enterprises in the end of July of 2017. More than half of them (53,1%) were loans from 1 to 5 years, almost a third (32,5%) – loans from 5 years and only 14,4% were short-termed loans till 1 year. During the first half of 2017 financial institutions granted new loans worth of 238,85 mln EUR for Lithuanian enterprises. More than a third of them (34,6%) were loans from 1 to 5 years, 38,9% were loans from 5 years, whereas 26,6% were short-termed loans till 1 year.

The main debtors of financial institutions are enterprises functioning in the following areas:

- real property operations (they constituted 25,6% of loan portfolio during the second quarter of 2017);
- retail and wholesale trade; repair of motor vehicles and motorcycles (they constituted 20,8% of loan portfolio during the second quarter of 2017);
- manufacturing (it constituted 14,5% of loan portfolio during the second quarter of 2017).

According to the data of Bank of Lithuania, **leasing** portfolio constituted 2130,516 mln EUR in the end of the first quarter of 2017. 89,4% constituted financial leasing, the rest part – activity leasing. Private sector leasing (eliminating a part of national sector leasing, individual and non-resident leasing) made up 77,3%. 74,6% of leasing portfolio belonging to a private sector was given for service sector enterprises whereas 15,3% - for manufacturing industry and building enterprises, the rest part (10,3%) – for enterprises of agriculture, forestry and fishing.

According to the data of the Bank of Lithuania, **factoring** portfolio was equal to 502 mln EUR in the end of the first quarter of 2017, whereas turnover was 765 mln EUR. 53,6% of the portfolio were international factoring, the rest part was for local factoring.

Private and venture capital in the market of financial products is quite a new area although its role is increasing. In 2017, INVEGA announced a sampling for management of 4 new venture capital funds. A part of finances to newly created venture capital funds will be allocated from EU structural funds which will constitute 58,8 mln EUR. A similar part of financing will have to be raised by selected managers of the funds. The funds are established implementing new **venture** capital financial measures of Ministry of Economy: Venture Capital Fund II financed by European Regional Development Fund, Business Angels Co-Investment Fund financed by European Regional Development Fund, Development Fund I financed by European Regional Development Fund and Development Fund II financed by European Regional Development Fund.

Share emission is not popular in attracting capital in Lithuania. According to the data of Lithuanian Central Securities Depositorium, 10 share emissions were registered during eight months of 2017, and counting from 2000 – just 110. According to the data of Lithuanian Central Securities Depositorium, only one emission of enterprise bonds was registered in 2014 and 2015 each (issuers – Joint Stock Company „Ukmergės gelžbetonis“ and Joint Stock Company „Baltic Mill“), whereas during eight months of 2017 – already three (issuers - Steponkus&Co FM Joint Stock Company and two emissions belonged to Joint Stock Company BNP Finance).

During the period from 2002 till the end of January, 2016, **INVEGA** had granted 5741 individual guarantees. During the first half of 2017, INVEGA received 395 applications for granting individual state guarantees for debt obligations of small and medium businesses and individual persons functioning with business license or having individual activity. It makes 36% more than during the period of January – June of 2016. During the first half of 2017, portfolio guarantee measures were used by 163 business entities, which were granted 12 mln EUR worth of guarantees which assumed financial liabilities exceeding the sum of 15 mln EUR. It indicates that financial institutions are prone to lend for business with state guarantees whereas businessmen sure of their ideas are more courageous to establish or develop their activity and strengthen competitiveness. Increased activity of businessmen and knowledge of the state granted support products enable them to use the benefits of the most appropriate financial products.

During the first half of 2017, **Agricultural Credit Guarantee Fund** granted 93 guarantees worth of 7,8 mln EUR for credit enterprises for credit and leasing services provided for farm workers, rural businessmen and processors for the sum of 13,1 mln EUR. During all the period of Fund activity (since 1997), 5101 guarantees worth of 845 mln EUR were granted, credit enterprises lent 1,1 bil EUR for the sector of agriculture and rural business.

DNMF (VIPA is responsible) granted 237 soft loans till October 2017, whereas **ENEF** granted 3 loans.

EIB invested 255 mln EUR into Lithuanian economy in 2016. The major part of the investment – 90% - is allocated for environment protection financing, 9% for infrastructure and 1% for innovation project financing. During the period of five years (2012-2016), Lithuania was granted 1,08 bil EUR worth of EIB loans. EIB group (European Investment Bank and European Investment Fund) invested 280 mln EUR in total in Lithuania in 2016.

ETVB financed a programme of accommodation provision for the returning exiles, establishment of rehabilitation centers for senior persons, disabled citizens and homeless children, renovation of educational purpose buildings and higher educational schools and provision of the basic tools in Lithuania. ETVB granted Lithuania a 130 mln EUR worth loan in 2009 for financing projects of state investment to social infrastructure development, in 2015 Lithuania was granted a 100 mln EUR worth loan for financing construction and renovation of buildings of cultural, health protection, education, sports⁵.

ŠIB granted 755 mln EUR worth of loans for public and private sectors in Lithuania during 2007-2015. ŠIB granted loans for Lithuania (each loan is worth 100 mln EUR) in 2009 and 2015 for improvement of energy consumption efficiency in public buildings and residential houses⁶. ŠIB granted Lithuania 625,2 mln EUR worth of loans till the end of 2016 including 78% for environmental projects⁷.

3. METHODOLOGY OF LITHUANIAN FINANCE PRODUCT MAP CREATION

Financial product consumer research was initiated to perform the analysis of Lithuanian financial product market. The objectives of the research are as follows:

- to determine if business development and expansion problems are relevant for enterprises and how enterprises evaluate business promotion measures and accessibility of financial sources in Lithuania;
- to identify what financial products are the most frequently used (or intended to be used) by enterprises and what factors stipulate the choice of financial products;
- to ascertain what enterprises (according to age, area of activity, etc.) use financial products the most frequently and where they usually apply for financial product granting;
- to determine how the impact of the employed financial product on the enterprise or organisation is evaluated;
- to provide recommendations how to increase financial product demand and efficiency.

Product evaluation properties and criteria were distinguished for creation Lithuanian financial product map. A qualitative research was performed for property and criteria approval. It was performed organising two group discussions of the experts. The objectives of the discussions were as follow:

- to find out essential tendencies of finance market development;
- to discover criteria by which financial product is described in the map;
- to find out the main components of financial product map;

⁵ <https://finmin.lrv.lt/lt/es-ir-tarptautinis-bendradarbiavimas/tarptautines-finansu-institucijos/europos-tarybos-vystymo-bankas>

⁶ <https://finmin.lrv.lt/lt/naujienos/siaures-investiciju-bankas-lietuvoje-finansavo-projektu-uz-daugiau-nei-755-mln-euru>

⁷ <https://www.15min.lt/verslas/naujiena/bendroves/siaures-investiciju-bankas-baltijos-salyse-isdave-paskolu-uz-1-1-mlrd-euru-663-769348>

- to determine priority areas which are essential to be included into the provision of financial product map.

Referring to the results of the analysis of financial product market and evaluation of financial product map concept, a financial product map was prepared.

4. ANALYSIS OF FINANCIAL PRODUCT MARKET AND EVALUATION OF FINANCIAL PRODUCT MAP CONCEPTION

Results of financial product market survey and their analysis. 310 enterprises and organisations participated in the survey on financial product supply and demand in Lithuania. 5,2% of the enterprises were from the public sector and 94.8% from the private sector.

A questionnaire of enterprise survey comprised 14 problems of business development and expansion and the majority of them were named as essential. The most significant problems were considered to be shortage of financial means for business development (lack of working capital), high taxes for business and increasing expenditure for personnel retainment. A big part of the respondents specified other problems, i.e. shortage of financial means for business start (expenses for business start up), employee (specialist) attraction and retainment, huge competition, low profitability of an enterprise, insolvent or delaying customers, instability of taxes increasing business risk, and unfavourable business laws. A moderately important factor for enterprises is lack of knowledge in business development, problems of product creation and development, shortage of information on possibilities of business development. Investment attraction problem (for scientific research and experimental development) was considered as insignificant or almost irrelevant for many enterprises. Both business promotion means (they were evaluated only by private enterprises) and accessibility of financial sources in general (it was evaluated by both private and public sectors) are evaluated satisfactorily.

Enterprises of private and public sectors use their own financial means most frequently. This financial source was indicated by 60,6% of all the respondents. However, in accordance with the results of the survey, private financial sources are scarce and only 11% of the respondents intend to use them in the future. The most popular external financing sources were considered as leasing (47.4% of the respondents use it), EU funding (unsubstantiated subsidy) (24.5%), credits (22.6%), credit limit (22.3%), soft loan and loan for working capital (19.4% each). Less than a tenth of all the respondents use alternative financial means. Together with a portfolio guarantee these means are considered as irrelevant. Nevertheless, an interest in alternative financial means is observed and more than 10% of the respondents intend to use them in the future. Preference is given for EU funding (34.8%) and various loans, i.e. soft loan (29.0%), loan for working capital (27.4%), investment loan (25.2%) and loan for new / small enterprises (22.9%). Leasing remains attractive enough, approximately every the fourth respondent (25.8%) intends to use it.

The choice of financial products determines institutions where enterprises and organisations will apply to. 68.7% of the respondents applied to banks in order to be provided with the financial product, 67.4% applied to INVEGA and almost every the fourth surveyed enterprise applied to a credit union, EU structural funds or even friends.

Financial products were beneficial for enterprises in general. Almost a half of the respondents claimed that reputation of the enterprise improved, its value increased. 30-40% of the enterprises stated that their client circle increased with the improved financial situation, the enterprise situation in the market and the quality of the provided products. Almost a half of the respondents representing a public sector confirmed that enterprise reputation, the quality of provided services and public attitude improved significantly. Every the third respondent affirmed that it helped to save energy expenses and improve energy efficiency while every the fourth public organisation succeeded in increasing location attractiveness.

Evaluation of financial product map conception. Generalising the expressed opinion of two fokus group participants five tendencies of financial product market development were distinguished:

1. Intention to abandon subsidisation;
2. Orientation to income generation;
3. The need for attitude change to financing/subsidies;
4. Bureaucratic and transparency uncertainties;
5. Popularity of alternative financing.

Experts agree that there are numerous financial products in the market. Therefore, a greater choice of financial products for business is an advantage, it can choose a product which is the most appropriate. Nevertheless, experts emphasize that financial products in the public sector should not be duplicated. It is appropriate to analyse the supply of the current financial products, identify the areas in the market where financing accessibility is restricted. Creating products of public sector a financial mediator plays the most significant role. According to the experts, synchronising conditions for the provision of financial products is a complex task as financial benefit expectation of the banking sector has to be coordinated without making a product too expensive for the customer. However, experts acknowledge that monitoring the risk of banking sector speculations has to be performed. It is important to create conditions for the ultimate consumer to choose the most appropriate financial product (related to its needs) from their abundance. Yet education of the ultimate consumer is equally relevant. Having such a choice of financial products the ultimate consumer must have sufficient knowledge to make the right decision.

With reference to the opinion expressed by the fokus group participants, five groups of financial products were distinguished: a group of loans, a group of guarantees, a group of private and venture capital, a group of crowdfunding and a group of equities.

Referring to the results of financial product market analysis and evaluation results of financial product map conception, a financial product map was prepared which is presented as an appendix to the evaluation report.

CONCLUSIONS

Summarising the performed analysis of Lithuanian financial product market the following conclusions are to be made:

1. Dominating products of Lithuanian financial product market can be divided into five groups: a group of loans, a group of guarantees, a group of crowdfunding, a group of private and venture capital, and a group of equities. Suppliers of these products can be distinguished into private enterprises, enterprises established by state institutions, and financial product suppliers of EU level.
2. After performing statistical analysis of financial product market it was determined that:
 - 2.1. Financial product markets undergo growth tendencies. Loan portfolio increased about 15% from the middle of 2013 till the middle of 2017. The most popular loans were loans from 1 to 5 years during the last three years. Recently the tendencies have slightly changed, i.e. priority is given for long-term loans (more than 5 years). It indicates that business evaluates market recovery more reliably and takes loans for a longer period.
 - 2.2. Not only do traditional financial product markets grow, i.e. loan, leasing, factoring, but also alternative financing sources become more popular, establishment of venture capital funds is accelerated.
 - 2.3. Market of equities is not developed in Lithuania. Emission of bonds and shares in order to attract capital is not popular in Lithuania, a part of publicly distributed shares is very low. Only 13 publicly distributed transactions took place during the period of 2000-2016.
 - 2.4. Guarantee market is characterised by rapid growth. Currently, both guarantee sum and the sum of guaranteed loans exceed pre-crisis level.
 - 2.5. Financial products offered by EU institutions expand the choice of financial means. EIB granted Lithuania loans worth of 1.08 bil EUR during the period from 2012 till 2016. A confirmed project financing by ESIF constitutes 39 bil EUR. Loan portfolio of ETVB for financing social projects decreased: 130 mln EUR worth of loans were granted in 2009 whereas 100 mln EUR of loans were granted in 2015. ŠIB granted loans in Lithuania for 625.2 mln EUR till the end of 2016 including 78% for environment protection projects.
3. A quantitative survey was performed to identify expectations and needs of financial product consumers. Its results revealed that:
 - 3.1. A majority of the researched enterprises identify a shortage of financial means for business development and its start and unfavourable legal environment as the most significant problems.
 - 3.2. Almost 60.6% of the respondents in private and public sectors use their personal financial means as a financing source. But only 11% of the respondents tend to use them in the future.
 - 3.3. The respondents specified that they use leasing together with their private financial means, also EU finding (unsubstantiated subsidy), credit line, credit limit, soft loans and loan for working capital. Less than a tenth of the respondents use alternative financial means. Besides, alternative financing means with a portfolio guarantee are identified as irrelevant financial products. Nevertheless, an interest in alternative financial products is observed and more than 10% of the respondents tend to use them in the future. More attention is paid for EU funding and various loans, i.e. soft loans, loans for working capital, investment loans and loans for new / small enterprises.
 - 3.4. The following aspects determine the choice of financial products: expenses (e.g. interest, deposit, administration taxes), product accessibility (e.g. information

explicitness, product provision speed, complexity of administration and tender and other document preparation) and other conditions related to the product (e.g. repayment terms, restrictions for the use of funds).

- 3.5. The respondents most frequently apply to banks and credit unions regarding financial products as well as to EU structural funds and friends. The latter fact reveals that every the fourth enterprise applies to their friends for financial product provision. It shows that financial product accessibility is complicated in terms of possibilities to be provided with it and expenses.
 - 3.6. The representatives of the majority of enterprises in private sector experienced the benefit of a financial product, i.e. enterprise situation improved, reputation and value increased. Almost a half of the respondents representing a public sector confirmed that enterprise reputation, the quality of the provided services and public attitude improved. Besides, financial products enabled to save energy expenses, increase energy efficiency and location attractiveness.
 - 3.7. The respondents claimed that private financing is the most frequently used in all stages of enterprise development. Leasing becomes more relevant in case of growth and a mature enterprise. The most prevailing alternative financing products are venture capital and crowdfunding. Venture capital is more popular in stages of creation and start whereas crowdfunding prevails in start and development stages. Business angels financing is employed only in enterprise development stage.
5. Evaluation results of financial product map conception revealed that:
- 5.1. According to the experts, there are many financial products in the market although their variety is beneficial for the ultimate consumer as he can use the most appropriate. Moreover, popularity of alternative financial products, such as private and venture capital and crowdfunding is observed. In accordance with the experts, export insurance and securitisation are identified as new and essential financial products for Lithuanian market.
 - 5.2. Financial mediators play a significant role in implementation of products supported by the state and institutions of EU level. However, as the experts claim, financial mediators such as banks are problematic to be motivated to participate in provision of a financial product. Consequently, evaluation of expectations and needs of these institutions is appropriate in pursuance to coordinate interests of state and financial mediators (respectively benefit for business-public and benefit for a financial institution).

RECOMMENDATIONS

STRATEGIC SUGGESTIONS „KNOW IT“

Referring to the results of quantitative and qualitative surveys the following recommendations are formulated:

- **Increase sustainability-efficiency of financial products.** Perform periodic and systematic monitoring of financial product market evaluating expectations of ultimate consumers and their satisfaction in financial products.
- **Increase stability of financial product planning and implementation.** From the point of view of the state, it is appropriate to create practise of financial product planning and implementation as well as impact evaluation on the region.
- Take the good practices of foreign countries into account and **refer to the most up-to-date tendencies of financial products.** Involve the opinion of financial mediators into creation of financial products (with regard to their expectations and needs).
- **Review the portfolio of current financial products** optimising their number in order to avoid financial product duplications. For instance, with regard to the survey, majority of the enterprises take loans from their friends for the start of their business, this presupposes the restrictiveness of financial resources for early business start.
- **Publicise information on financial products** in popular social networks or business platforms. The results of the survey indicate that a part of enterprises lack concentrated information on financing possibilities and learning tools how to start business .
- **Decrease bureaucratic requirements** that more and more diverse products are available for all enterprises or organisations regardless their size, development stage, activity, etc. Put extensive effort that expenses of a financial product do not exceed its benefit.

RECOMMENDATIONS FOR FINANCIAL PRODUCT MONITORING

In order to ensure sustainability of financial product market, it is appropriate to execute permanent monitoring. It provides presumptions to determine changes on time and react to them appropriately and immediately, to evaluate and maintain quality and efficiency.

The following measures are recommended for monitoring:

- Identify monitoring indicators in accordance with recommendation area and implementation measure.
- Select appropriate methods of information collection.
- Determine how often information is collected.
- A responsible institution is determined.

With regard to the results of quantitative and qualitative surveys and document analysis, a plan of financial product monitoring measures is designed.