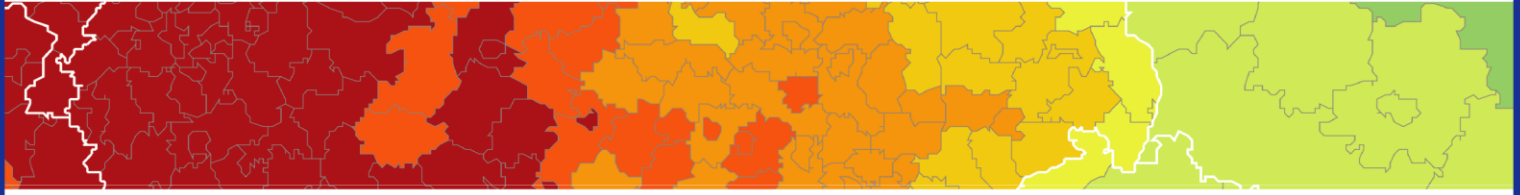


**Inspire policy making by territorial evidence**



# **Financial Instruments and Territorial Cohesion**

Norway – Regional Risk Loan

**Case Study Report**

30/08/2019

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# Financial Instruments and Territorial Cohesion

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## Abstract

The Regional Risk Loan is an important and long-standing instrument of regional policy in Norway. For 2017 some NOK 396 million (c€40 million) was allocated to the Regional Risk Loan loss fund and the associated Regional Investment Grant - almost 30 percent of the regional policy budget. The loan scheme is restricted to designated regional aid areas (the *distrikts*), these cover most of Norway, but only around a quarter of the population. The aim of the scheme is to facilitate access to finance in rural and remote areas as part of the wider economic development strategy for the sparsely-populated regions.

Norway is outside the EU, so the Regional Risk Loan is financed wholly from domestic resources. Unlike financial instruments typically operated under Cohesion policy, the Regional Risk Loan is neither a fund, as such, nor does it have a specified lifespan. The ministry responsible for regional development (KMD) contributes funds from its annual budget, through the county councils, to a loss fund. The loan scheme (alongside a large number of other instruments) is operated by Innovation Norway, essentially a national promotional bank, through its regional/county offices. These offices work with the county councils to determine investment strategies for the areas they cover.

The Regional Risk Loan is aimed at viable projects located in designated *distrikts* which are unable to fully finance planned investments either from their own resources or from commercial banks. Within the designated areas, the scheme has an explicit territorial dimension insofar as Innovation Norway seeks to support projects outside the main population centres where the private banking presence is limited. Innovation Norway is an important player in these areas and assembles funding packages including commercial finance of its own or from private sources, alongside public schemes. Innovation Norway is well-regarded among stakeholders for its financial and sectoral expertise, but is also a high profile organisation that attracts political attention.

Norway has a strong culture of policy evaluation. Econometric impact analyses suggest that the Regional Risk Loan has had a significant impact on sales, value creation and employment. Survey research suggests the loan has high 'additionality' – two-thirds of projects would not have gone ahead on the same basis without it. There is also evidence that the Regional Risk Loan has had a positive impact on capabilities and capacity-building among supported firms, including areas such as new product development and development of new markets.

The Regional Risk Loan has a number of key strengths, notably: its longevity and capacity to respond to changing conditions; the regional structure of Innovation Norway and its ability to respond to local needs; and the absence of annual or multiannual spending targets which can distort investment priorities. Nevertheless, the scheme and its operation are also subject to threats and weaknesses, especially from declining budgets and the tension between maintaining a presence in the remote regions and having sufficient critical mass.

## Abbreviations

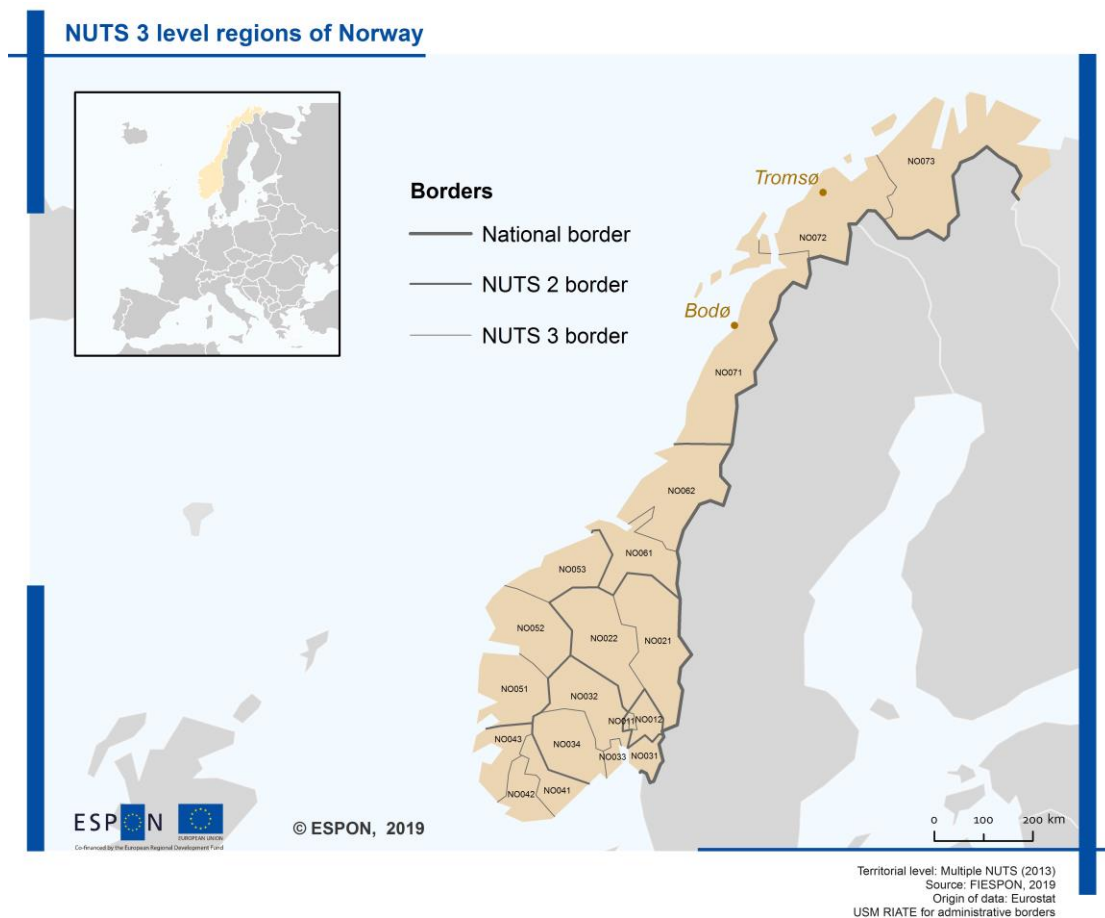
EEA	European Economic Area
ESA	EFTA Surveillance Authority
EU	European Union
GDP	Gross Domestic Product
IN	Innovation Norway
KMD	Kommunal- og moderniseringsdepartementet (Ministry of Local Government and Modernisation)
NUTS	Nomenclature of Territorial Units for Statistics

# 1 Background

## 1.1 Economic and regional context

Norway is a small open economy with a strong export base, particularly related to resource-based industries (oil and gas, fisheries), the maritime sector, other knowledge-intensive activities and tourism. In employment terms, Norway is a service economy (80 percent of employment), but much less so in terms of GDP. Norway is split between export-intensive areas on the coast (from Telemark (NO034) to Møre og Romsdal (NO053)) and the rest of the country (Menon, 2012) –see Map 1-1). Industrial structure varies considerably by region. Agriculture and forestry is important in Hedmark (NO021) and Oppland (NO022) and fishing and fish farming in the coastal area north of Hordaland (NO051) and Sogn Fjordane (NO052); the oil and gas sector dominates in Rogaland (NO043), but is also important in Møre og Romsdal and Agder (NO041 and NO042). Smaller towns and sparsely-populated areas rely on public sector jobs, while Oslo (NO011) dominates in financial and business services.

Map 1-1: Regional breakdown in Norway



Source: authors



Territorial disparities in Norway are characterised by very large distances, a complex topography, extensive mountainous and remote areas and wide variations in climate. This in turn means that there are considerable differences in accessibility and large parts of the country have extremely low population density. In addition, secondary population centres (i.e. after Oslo) are small in international terms.

Economic and social disparities within Norway are rather modest. Norway does not have wide differences in regional income or unemployment, but it does face some specific challenges including labour shortages, the perceived need for a more coordinated approach to skills and the development of an economy rooted principally in natural resources, and therefore comprising a strong spatial component.

Norwegian regional policy has two elements – *distrikt* and regional policy. The *distrikt* element is focused on the far north and other peripheral, or difficult to access, sparsely-populated areas.<sup>1</sup> The regional element concerns the economic development in *all* regions, with policy implemented primarily by the counties.

The focus of this case study is the Regional Risk Loan (*distriktsrettede risikolån*) which is available only in designated regional aid areas (i.e. the *distrikts*). As well as providing an overview of the Regional Risk Loan, this case study offers some insights from its implementation in two counties – Nordland (NO071) and Troms (NO072), both wholly covered by the assisted areas map and located in northern Norway. Although these counties are neighbours, they differ considerably in industrial structure with Nordland having a relatively diverse economy and Troms being focused on fewer activities, notably fisheries and related marine activities, though tourism is an emerging sector and Tromsø University is an important teaching and research centre. Also, as elsewhere in the *distrikts*, the public sector accounts for a significant share of employment.

As Norway is outside the EU, the Regional Risk Loan is, unlike the other case study instruments, financed wholly from domestic resources rather than involving European Structural and Investment Funds. However, because Norway is in the EEA, such instruments are subject to the State aid rules in much the same way as in the EU, except that the rules related to agriculture and fisheries do not apply.<sup>2</sup>

## 1.2 Background summary of the FI

The Regional Risk Loan aims to promote economic development in the designated *distrikts*. The Regional Risk Loan is an important and long-standing instrument of regional policy in Norway. For 2017 some NOK 396 million (about €40 million) was allocated to the Regional Risk Loan loss fund and the associated Regional Investment Grant - almost 30 percent of the

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<sup>1</sup> It is sometimes referred to as 'rural' policy.

<sup>2</sup> As Norway is outside the Common Agricultural and Common Fisheries Policies.

regional policy budget. The scheme is one of a large portfolio of measures operated by Innovation Norway,<sup>3</sup> most of which are available nationwide and on the same terms across the country. The Regional Risk Loan may be offered in tandem with the Regional Investment Grant, also restricted to the *distrikts* and operated by Innovation Norway, as well as alongside other Innovation Norway instruments (i.e. advisory support and other financial products, including commercial loans). The Regional Risk Loan is, in principle, available to firms of all sizes, although in practice the main focus is on SMEs.

Like all of the Innovation Norway portfolio, the Regional Risk Loan is mainly implemented at the subnational level by the regional offices of Innovation Norway. The Regional Risk Loan involves quite complex arrangements involving transfers of funds from the Ministry of Local Government (*Kommunal-og moderniseringsdepartementet*, KMD) to the county councils. The county councils in turn allocate these funds to the county offices of Innovation Norway.

Importantly, the annual budget for the scheme allocated by KMD is a *loss* fund (rather than a *loan* fund); as such, the fund covers defaults on loans made by Innovation Norway, but not the loan principal. Funding for Regional Investment Grants comes from the same budget as the Regional Risk Loan, so that Innovation Norway and the county councils must decide which to prioritise. Clearly grants involve a much more significant – and non-repayable – call on resources than do potential defaults on loans; therefore, grants tend to be used sparingly. Counties can outline priorities for expenditure within their jurisdictions; Innovation Norway is guided by these priorities as well as the multiannual county development plans in implementing the Regional Risk Loan within the relevant county boundaries.

### **1.3 Scope and objectives of the FI**

The Regional Risk Loan is aimed at viable business projects located in designated *distrikts* which are unable to fully finance planned investments either from their own resources or from commercial banks. The aim of the scheme is to facilitate access to finance in remote regions and thereby promote regional economic development.

The designated regional aid areas (*distrikts*) were approved for 2014-20 by the EFTA Surveillance Authority (ESA) on the basis of the EEA State aid rules, which broadly reflect the EU regime.<sup>4</sup> The *distrikts* cover 25.48 percent of the national population (but the vast majority of the national territory) and are areas of low population density (fewer than 12.5 inhabitants

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<sup>3</sup> Innovation Norway is a publicly-owned company (51 percent Ministry of Industry, Trade and Fisheries and 49 per cent county councils) and national development bank. For the portfolio of instruments see: <https://www.innovasjon Norge.no/no/finansiering/> (accessed November 2018).

<sup>4</sup> EFTA Surveillance Authority Decision on the Norwegian Regional Aid map, see: <http://www.eftasurv.int/media/decisions/91-14-COL-with-map.pdf> (accessed November 2018).

per km<sup>2</sup>). The counties of Finnmark, Troms, Nordland and Sogn og Fjordane are eligible in their entirety. Parts of a further 12 of Norway's (current) 19 counties<sup>5</sup> are also eligible.

The Regional Risk Loan is primarily for initial investment in material and non-material assets (land, buildings, plant and equipment). Large firms are not excluded from eligibility, but the main focus tends to be on SMEs.

## 1.4 Operational and Implementation issues

The governance and implementation of the Regional Risk Loan and the associated Regional Grant involves several elements.

- Business development finance is allocated in annual 'assignment letters' by KMD to the county councils as part of the distribution of the annual regional policy budget; this funding is essentially earmarked for the county councils to allocate for spending by Innovation Norway. In principle, county councils can decide that such funds are not to be allocated to Innovation Norway in their entirety but used for business development in other ways.
- Each county council in turn issues its own 'assignment letter' to the relevant regional office of Innovation Norway, allocating monies to Innovation Norway for the loss fund and indicating any priorities to be taken into account in implementing the Regional Risk Loan.
- Innovation Norway implements the Regional Risk Loan (and the associated Regional Grant and Guarantee schemes, which draw on the same budget).

## 1.5 Scale and budget

The annual budget for the loss component of the Regional Risk Loan and the Regional Investment Grant is determined by the counties which decide how much to allocate from the budgets allocated to them under *distrikt* policy by the Ministry (KMD).

The amounts allocated by the counties are illustrated in Table 1-1. This shows that the allocations are higher in the northernmost counties of Finnmark, Troms and Nordland (because of their higher allocations from KMD reflecting the fact that policy favours the least densely-populated areas), but especially so in per capita terms where they average over NOK 260<sup>6</sup> (€27) per head, compared with the national average NOK 99 (€10.3) per head (excluding Oslo and Akerhus which do not contain any *distrikts*).

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<sup>5</sup> The county structure is currently being reformed. This will reduce their number to 10.

<sup>6</sup> Exchange rate Infoeuro (average of the monthly rates: 100 NOK = €9.62): [http://ec.europa.eu/budget/contracts\\_grants/info\\_contracts/infoeuro/index\\_en.cfm](http://ec.europa.eu/budget/contracts_grants/info_contracts/infoeuro/index_en.cfm)

Table 1-1: Annual budget allocations to the Regional Risk Loan (loss fund) and Regional Investment Grant by county (NOK million)

	2010	2011	2012	2013	2014	2015	2016	2017
Finnmark	63	61	58	54	39	38	35	36
Troms	69	66	62	58	47	46	40	42
Nordland	104	76	94	96	65	65	61	50
Nord-Trøndelag	62	51	50	49	41	38	36	39
Sør-Trøndelag	37	37	34	34	27	27	23	25
Møre og Romsdal	65	66	60	60	45	43	38	34
Sogn og Fjordane	48	42	42	40	33	26	31	36
Hordaland	41	40	36	35	30	28	15	23
Rogaland	16	14	9	10	5	6	4	6
Vest-Agder	9	10	9	8	7	7	4	7
Aust-Agder	12	11	10	10	8	6	6	6
Telemark	27	28	14	14	10	9	11	20
Vestfold	3	3	3	3	3	3	2	2
Buskerud	13	11	10	10	8	7	6	10
Oppland	33	34	30	30	28	30	29	28
Hedmark	37	34	30	30	27	28	33	30
Oslo og Akershus	10	8	8	0	0	0	0	0
Østfold	4	5	5	5	4	3	3	2
<b>Total</b>	<b>652</b>	<b>596</b>	<b>562</b>	<b>544</b>	<b>425</b>	<b>408</b>	<b>377</b>	<b>396</b>

Source: Data kindly provided by Innovation Norway.

## 1.6 Existing evaluation results

Both Norwegian regional development policy and the instruments operated by Innovation Norway are evaluated on a regular basis in different ways.

First, there are annual surveys of recipients of Innovation Norway support and finance, including assessments of the 'additionality' of support (Oxford Research, 2018).

Second, Statistics Norway conducts regular research for Innovation Norway using panel studies to compare the performance of firms supported by Innovation Norway against those that do not receive support (Cappelen et al, 2015).

In addition, there are other relevant assessments of different types, including an evaluation of the loans and guarantees operated by Innovation Norway (Menon, 2012), and a recent assessment of the working of the capital market in Norway (NOU, 2018). This included a chapter on the role of public intervention, but several interviewees for this study considered that the report had neglected the spatial dimension of access to finance.

Insights from these studies are included in the discussion in Section 2 below.

## 1.7 Other relevant information

As mentioned, Innovation Norway operates a number of instruments which are frequently used as part of a package of support for firms. These include (but are not limited to):

- A Nationwide Risk Loan scheme, with more demanding innovation scores required in order to qualify than under the Regional Risk Loan.
- Commercial loans, where conditions are on market terms.

In the discussion below, these instruments provide a useful reference point for the use of the Regional Risk Loan. These measures are relevant because their uptake reflects the two-fold challenges prevalent in remote areas. First, in general, projects located in the *distrikts* are less likely to be able to meet the criteria for the Nationwide Risk Loan as these relate to levels of innovation and whether an investment is innovative in national or international terms. As a result, the regional distribution of the nationwide scheme implicitly “favours” the more densely populated areas. Second, in remote areas, access to finance from commercial banks is less assured; the branch network and relationship banking has tended to decline, with the result that, in sparsely-populated areas, Innovation Norway may in effect, substitute for commercial banks through its commercial loan scheme. As a result, the uptake of the Innovation Norway’s commercial loans is comparatively high in the remote regions, but low in the main agglomerations where commercial banking is stronger.

Innovation Norway also operates a large number of other instruments, including other loan schemes, grants, guarantees and advisory and support services. Most of these are available on a nationwide basis, but some may implicitly favour certain areas due to their sectoral focus (such as fisheries). These instruments are not covered in any detail in the discussion that follows, but it is important to acknowledge them in the wider context and the role of Innovation Norway in the implementation of economic development policy more generally.

## 2 Main results and findings

### 2.1 Impact of the Financial Instrument

Some measure of the importance of Innovation Norway in financing business in remote areas can be gleaned from the fact that use of its commercial loans is much higher in the *distrikts* than in the more populous regions. In addition, uptake of the Nationwide Risk Loan (a similar scheme to the Regional Risk Loan, but with more demanding innovation criteria) is much lower in the *distrikts*. This partly reflects the fact that projects in the remote areas are: (i) much less likely to be able to access finance from a commercial bank; and (ii) much less likely to score sufficiently well in innovation terms to qualify for the Nationwide Risk Loan. This is reflected in Table 2-1, which shows that (comparing these three instruments) the three northernmost counties (Finnmark, Troms and Nordland) secure a substantial proportion of Innovation Norway loan finance from commercial loans and the Regional Risk Loan, but very little from the Nationwide Risk Loan; the reverse is true in Oslo and Akershus, more populous regions in the south.

Table 2-1: Distribution of key Innovation Norway loans between regions (2017)

	Share of total loan values and total loans			
	Regional risk loans	Nationwide risk loans	Commercial loans	Total NOK million
Finnmark	58%	-	42%	115
Troms	52%	2%	46%	150
Nordland	69%	15%	15%	130
Oslo	-	100%	-	153
Akershus	-	79%	21%	50
Other regions	14%	30%	56%	2,344
Total Norway	19%	32%	50%	2,943
Total Norway NOK million	555	928	1460	
	Number of loans			
	Regional risk loans	Nationwide-wide risk loans	Commercial loans	Number of loans
Finnmark	25		23	48
Troms	28	2	38	68
Nordland	19	1	4	24
Oslo		51		51
Akershus		19	3	22
Other regions	97	234	255	586
Total Norway	169	307	323	799

Source: Calculations from Innovation Norway data available at: <https://www.innovasjon Norge.no/no/finansiering/tildeling/> (accessed 2 December 2018).

The importance of the Regional Risk Loan (and Innovation Norway products more generally) varies with geography, even *within* designated *distrikts*. In the remoter parts of the northern regions, Innovation Norway is often the only player, while in the main urban centres even in northern Norway – such as Bodø and Tromsø – commercial banks have most of the market. As such, the Regional Risk Loan is not only important to the sparsely-populated regions when viewed from a *national* perspective, but *also from an intra-regional perspective*.

Statistics Norway reports annually to Innovation Norway on the **impact** of its instruments, based on comparing assisted firms with a control group. Table 2-2 shows the impact analysis for the Regional Risk Loans. The method involves matching all firms that have received a loan in a given year, with firms that have not received public support and comparing their development over the three years before and after the loan was given.<sup>7</sup> In the table below, the difference in average annual growth rates between the two groups is reported. All firms which received loans between 2000 and 2013 are included in the assessment. The results are significant for three of the five indicators, namely sales income, value creation and job creation.

Table 2-2: Impact of the Regional Risk Loan compared to non-assisted firms

Indicator	Effect 2000-2016	
Sales income	14.7	***
Value creation	7.2	***
Productivity	1.7	
Employees	4.7	***
Profitability	0.2	
***: 99% significant    **: 95% significant    *: 90% significant		

Source: Data kindly provided by innovation Norway.

In addition to the assessment of impacts using econometric modelling, regular client surveys are undertaken on behalf of Innovation Norway. The discussion below presents a selection of results for the Regional Risk Loan alongside those for the Nationwide Risk Loan and Innovation Norway commercial loans.

Applications for the Regional Risk Loan are assessed according to their **innovation** content, but as mentioned, the criteria used are less demanding than under the Nationwide Risk Loan scheme, and overall Regional Risk Loan supported projects appear significantly less innovative (see Table 2-3). However, their contribution to innovation is *considerably higher* than those supported under Innovation Norway commercial loans.

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<sup>7</sup> See Capellen et al, 2015 for more details of the methodology.

Table 2-3: Percentage of supported projects that contribute to innovation

	New product	Improve of exiting product	New service	Improve existing service	New process	Improve existing process	New methods of storage or delivery	New sales channels	New geographical markets	New product launches	New needs of existing customers
Commercial loan	40	40	40	33	17	54	62	38	62	50	69
Regional risk loan	60	77	65	76	42	76	42	78	69	57	67
Nationwide risk loan	77	77	71	79	55	78	61	74	83	56	71

Source: Oxford Research 2018, Table 25.

Regular research for Innovation Norway also assesses the impact of the products and services offered across a range of **firm-level performance indicators** (Table 2-4) These suggest more positive outcomes for the Regional Risk Loan than for commercial loans, though less positive outcomes than under the Nationwide Risk Loan.

Table 2-4: Percentage of supported projects that contribute significantly to firm-level performance

	Revenue	Exports	Competitiveness	Profitability	Likelihood of survival	Employment
Commercial loan	57	10	57	48	57	45
Regional Risk Loan	69	37	72	72	73	63
Nationwide Risk Loan	87	70	86	73	88	70

Source: Oxford Research 2018, Chapter 10.

There is also evidence that the Regional Risk Loan has had a positive impact on **capabilities and capacity-building** among supported firms (Oxford Research, 2018). These include areas such as new product development, development of new markets, international cooperation, and so on. Overall, the Regional Risk Loan appears to have had a greater impact on such capacities (on average, 47 percent of respondents) than Innovation Norway commercial loans (40 percent), though not as significant as the National Risk Loan (58 percent), which, as mentioned, has more demanding innovation criteria.

A final point to stress in considering these impact data is that care should be taken in comparing the Regional Risk Loan with other measures. This is partly because the *objectives* of the Regional Risk Loan scheme differ from the Nationwide Risk Loan – its aim is to secure investment and development in the *distrikts*, and is not an innovation-related measure *per se* – but also because the context for businesses in the *distrikts* is quite distinctive.



## 2.2 Value-added of the Financial Instrument

An important element of value-added - so-called **additionality** – is measured in research conducted for Innovation Norway (Oxford, 2018). The concept of additionality is used to assess the need for the use of public instruments, i.e. what difference have the funds made?

*Table 2-5: Measuring additionality: What would have happened if Innovation Norway had not provided this support?*

Low 1	Completed development / activity without changes, same scale and time schedule
Medium 2	Completed the development process / activity on the same scale, but at a later date
Medium 3	Completed the development process / activity on a more limited scale, but with the same time schedule
High 4	Completed development / activity at a later date and on a more limited scale
High 5	The development process / activity would not be completed
	Do not know

*Source: Oxford 2018.*

For the Regional Risk Loan, 67 percent of recipients report high levels of additionality, and just 7 percent report that the investment would have gone ahead on the same basis anyway. These data are not necessarily easy to interpret insofar as respondents may be unlikely to admit that the finance was not really needed. However, it is notable that some other Innovation Norway products have much lower levels of additionality, in particular its commercial loans (27 percent reporting 'low' additionality), especially those for the fishing fleet (44 percent reporting low additionality) and Horizon 2020 support (23 percent reporting low additionality).

Innovation Norway can also offer support in the form of **grants** alongside Regional Risk Loans. As Regional Investment Grants are funded from the same budget as the loss fund for the Regional Risk Loan, careful consideration is given to how grants are used, and when they can add value because many more firms can be supported at much lower budget cost with loans rather than grants. Interviewees in Innovation Norway noted that applicants often sought grants in preference to loans. However, these are rarely awarded for large investment projects and for all project sizes the level of grant offered is almost always lower than sought, if offered at all. Sometimes grants are offered as part of the package if it can help to bring a private bank on board - for example, if a bank is concerned that risk of default is too high because financing is wholly in the form of debt. There is also a perception that the psychological impact of having borrowed money is important for project quality. In general, there is a strong shift away from grants and the notion of a subsidy culture towards instruments that are more market-led, and this trend is favoured by interviewees in Innovation Norway.

**Administration costs** for the Regional Risk Loan (and the Regional Investment Grant) are paid by KMD. Innovation Norway interviewees considered that the systems for offering grants are less complex and less expensive to run; however, loan schemes are considered better

value for money overall, partly because of the extent to which funds are recycled, partly because project quality is higher and partly because of the scope for Innovation Norway to develop a longer-term relationship with local firms and offer advice when things are going less well.

The Regional Risk Loan is considered **to address a financing gap and to provide an incentive to fulfil public policy objectives**. From a regional policy perspective it is considered key to establish and develop economic activities in the sparsely-populated regions in order to maintain population settlements and deliver on wider policy objectives, namely: 'regional balance, through growth capacity, equal living conditions and sustainable regions across the country' (KMD, 2017). At the same time, potential investments are both more risky and less able to provide collateral because of their remote location, as well as less able to access finance without intervention because of declining number of bank branches in remote locations.

The Regional Risk Loan is viewed as important in **attracting external finance**. Innovation Norway is not regarded as a 'first port of call' for entrepreneurs who are encouraged instead to exhaust commercial opportunities to access finance first. This may be very difficult where the entrepreneur has little or no own funds or collateral, the location is remote and/or for certain sectors. In such circumstances the involvement of Innovation Norway can act as a catalyst to secure commercial bank financing for some of the investment. This may involve crafting a package of finance involving the Regional Risk Loan, Innovation Norway commercial loans, and possibly small scale grant funding. On occasion, the involvement of Innovation Norway in projects in which commercial banks had been disinterested initially can lead to banks financing projects in their entirety. Even though there is ultimately no loan transaction with Innovation Norway; this is regarded as a success in policy terms. Across the board, the vast majority of Innovation Norway supported projects involve own funds (over 90 percent) – see Table 2-6 - but the type of other funding varies, with bank loans more important under the Regional Risk Loan and external investment more significant for projects part-financed under the Nationwide Risk Loan.

*Table 2-6: Sources of funding other than Innovation Norway (share of firms citing these sources)*

	<b>Own funds/equity</b>	<b>Loans from banks or other financial institutions</b>	<b>Non-IN public funding</b>	<b>External investors</b>
Commercial loan	91%	43%	14%	9%
Regional Risk Loan	91%	54%	23%	22%
Nationwide Risk Loan	93%	28%	26%	61%

*Source: Oxford Research 2018.*

The **impact on access to finance** of the Regional Risk Loan varies considerably by sector in northern Norway, and over time. As mentioned earlier, Nordland has a relatively diverse

economy, while activities in Troms and Finnmark are heavily concentrated on the fisheries and aquaculture sectors, though tourism is emerging as important and there are specific activities related to ocean technology, space, clean energy, also linked to the Arctic strategy (Norwegian Ministries, 2017). From the early 2000s, commercial banks lost interest in the fisheries sector, partly owing to uncertainties over fish quotas. As a result, the sector has tended to be heavily reliant on Innovation Norway financing, for most of the last two decades. This has started to change as a predictable quota scheme based on scientific advice has been agreed with Russia, enabling a more accurate valuation of fishing businesses and in turn making the sector more attractive to commercial banks. The tourism sector is another example. This is quite new and commercial banks have limited interest in it at present. This is partly due to the high risk of business failure in fragile remote areas, but also to the lack of collateral. This is more acute in such regions because land prices are low, but construction costs are the same (or even higher) than in more populous areas so that the land constitutes a smaller share of the investment and is of less value in the case of project failure.

Expected **defaults** are calculated on a case-by-case basis under the Regional Risk Loan in order to determine how much is to be drawn from the loss fund. This is an important change from the system in place around 20 years ago when the scheme ran on the basis of a presumed loss of 30 percent. This was perceived to be too high and resulted in two changes. First, KMD monitors the scale of defaults and expects that these should remain in the 10-20 percent range of the loan portfolio on an ongoing basis; and second, risks are calculated individually, as mentioned above. In practice, the **level of risk** which *should* be taken is the subject of some debate among policymakers – if defaults are low, this may indicate that the Regional Risk Loan is not taking enough risk and is financing projects which could and should be funded by commercial banks; if the defaults are high, then funds available for future lending are quickly depleted and questions are raised about the appropriate use of public funds. This has become more of a live issue of late since Norwegian regional policy has seen significant budget cuts in recent years, following a period in which policy was well funded. A particularity of the Regional Risk Loan loss fund is that unused funds are *not* returned to KMD at the budget year-end. Until now, this has provided a 'buffer' of funds to roll over, but budget cuts are beginning to bite and it remains to be seen what the consequences will be for the level of risk taken by Innovation Norway.

### **2.3 Territorial dimensions of the Financial Instrument**

The Regional Risk Loan **explicitly discriminates in favour of disadvantaged areas at two levels**. First, as noted earlier, it is only available to firms located in the designated *distrikts*. Second, and less explicit, but no less important, there is also discrimination *within* the designated *distrikts*. This second strand of discrimination is more discretionary and arises from the mandates given to the regional offices of Innovation Norway by the county councils as well as Innovation Norway's own aim to avoid financing investments which could be

undertaken by commercial banks. For example, in Troms the county council is keen for Innovation Norway to focus the Regional Risk Loan away from the main town, Tromsø,<sup>8</sup> where commercial banks are represented. Instead, because the number of bank branches has dwindled, and businesses have fewer opportunities to develop banking relationships, it has become increasingly important for Innovation Norway to maintain a presence in the more remote areas. Although Tromsø accounts for around 45 percent of the county population, businesses there received just 11 percent of the loans offered in 2017.

## 2.4 Governance dimension of the Financial Instrument

At a **strategic level**, KMD sets the overall framework for regional development policy. The ministry sends assignment letters to the county councils informing them of their financial allocations and the overarching priorities to pursue; these guide the county councils in determining how to spend their allocations and the priorities they choose for spending by Innovation Norway within the county. KMD also sends an assignment letter to Innovation Norway, setting out the broad policy priorities for the coming year. The management and administration costs for the Regional Risk Loan are paid by KMD; these amount to 10 percent of the budget for *distrikt* loan and grant schemes, which was NOK 772.5 million (€80.3 million) in 2017.<sup>9</sup>

Decisions about the scale of funds for the Regional Risk Loan (or rather the size of the loss fund) reflect wider government priorities - in recent years regional policy spending has been reoriented toward spending on roads, leading to a reduction in business development finance. The distribution of Regional Risk Loan funds between the eligible counties is partly based on historical patterns, but also on the '*distrikt* index' – a detailed formula driven mainly by demographic indicators which determines the intensity of regional development funding across Norway (KMD, 2018).

At the **county level**, individual councils allocate to Innovation Norway the funds devolved to them by KMD. The county councils together own 49 percent of Innovation Norway, and this was intended to increase their overall influence on the activities of Innovation Norway. In practice, this has not really happened at this level – perhaps due to coordination issues or to differences in priorities between counties. However, through their assignment letters to the local offices of Innovation Norway, county councils can *individually* influence how Regional Risk Loans (and Regional Grants) are used within their area. The extent to which they actually do this varies. In Troms, for instance, the county council emphasises that Innovation Norway should concentrate on firms in remote areas of the county, rather than the urban centre of Tromsø where commercial banks are more active; however, in Nordland and

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<sup>8</sup> Though in a wider European context it is a small centre with a population of around 70,000.

<sup>9</sup> The management costs therefore being NOK 77.25 million (€8.03 million) for 2017.

Trøndelag, the county councils have more detailed sectoral and other objectives, such as an emphasis on smart specialisation. The pursuit of prescriptive strategies can be a source of tension with Innovation Norway, which also has financial criteria to fulfil. Most counties appear not to impose detailed strategies on Innovation Norway, but KMD, having devolved responsibility to the counties, does not actively monitor this or collate such information, so there is no comprehensive overview of the approaches taken by the counties.

The Regional Risk Loan is implemented by **Innovation Norway** using budgets allocated by the counties containing designated *distrikts*. Innovation Norway has offices in all 19 counties. Reflecting the forthcoming county reform which will reduce their number to 10, some offices will come under joint management broadly in line with new county structure, but the overall number of offices will remain unchanged. This is considered important in view of the role of Innovation Norway in the *distrikts* and the regionalised structure of Innovation Norway is regarded as a key strength.

The Regional Risk Loan is aimed at risky projects, which are nonetheless considered viable; this segment of the market is perceived to be avoided by commercial banks, and the loan is intended to complement commercial banking activities. Indeed, applicants are normally required to have approached a commercial bank for funding first, but be unable to cover their planned investment from purely commercial sources alone. Applicants often approach Innovation Norway accompanied by commercial banks with the aim of assembling a funding package and securing the involvement of private banks through risk-sharing.

Each application undergoes a thorough analysis of the business case, analysis of the track record and collateral of the applicant and of the risks. Decisions are made at different levels depending on the size of the loan. Loans of up to NOK 5 million (c€0.5 million) are decided by the relevant county office of Innovation Norway – this accounts for 95 percent of all decisions on the Regional Risk Loan. Above this level, decisions are made by a regional credit committee, composed of senior Innovation Norway credit managers from groups of counties; there are five regional credit committees.

The risk assessment, appraisal of project quality and the level of collateral for each project / applicant are used to quantify the amount to be drawn from the loss fund; this uses a grid broadly similar to that for the calculation of the reference and discount rates under the EU State aid rules.<sup>10</sup> However, the interest rate under the Regional Risk Loan is fixed for all projects – currently at 5.25 percent.

Regional Risk Loans typically have a duration of three to eight years, and may cover up to 50 percent of eligible investment. The maximum loan is NOK 25 million (c€2.6 million), but the average considerably smaller. Regional Risk Loans are often provided as part of a financing package which may also comprise commercial bank loans and Innovation Norway

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<sup>10</sup> Communication from the Commission on the revision of the method for setting the reference and discount rates, OJEU C14/6; 19.1.2008.

commercial loans, as well as other loan (and sometimes grant) finance provided through mandates from KMD (via the counties), the Ministry of Industry, Fisheries and Trade or the Ministry of Agriculture.

A **key feature of the overall structure is the regional presence** of Innovation Norway. For many businesses in remote areas, Innovation Norway is the main source of finance and advisory services. An advantage of the regional structure is that a presence is maintained in circumstances that the private sector is unable to sustain for commercial reasons.

Another feature is the combination of rigorous professional approaches to financial appraisal of loan applications coupled with detailed knowledge of the local economy. The assignment letters from KMD and the counties set the parameters for operating the Regional Risk Loan, but in practice, Innovation Norway has considerable autonomy to exercise judgement in assembling financing packages for local businesses. Some counties appear to be more prescriptive than others (e.g. in seeking to pursue a smart specialisation agenda), but in Troms, for example, the Regional Risk Loan is managed on the basis of a high degree of trust by the county council in Innovation Norway's technical capacity to implement the Regional Risk Loan in the interests of the local economy. Indeed, interviewees from the county council indicated that periodic strategy meetings with Innovation Norway to agree priorities were more important than the assignment letter, which focused on reporting requirements rather than on strategic orientation.

## 2.5 Strengths, weaknesses, opportunities and threats

A number strengths, weaknesses, opportunities and threats emerge both from the literature and from discussions with stakeholders.

Key **strengths** of the overall system for the Regional Risk Loan include:

- *Longevity*, which has enabled the measure to be adjusted over time to meet economic development needs and means that the scheme and its workings are well-known among firms or would-be entrepreneurs.
- The *regional structure of Innovation Norway*, which is able to maintain a presence in remote areas that purely commercial intermediaries could not, and which has a detailed understanding of the local economy and close links with county councils.
- *Competence and flexibility* of Innovation Norway regional offices to address the needs of local businesses (with sector specialists), including through advice and soft support, as well as finance.

A number of **weaknesses** also emerge, though not necessarily linked directly to the Regional Risk Loan itself, for example:

- Regional development *budgets are in decline*. This may reach the point at which different decisions have to be taken about levels of risk in order to maintain the viability of the loss fund – i.e. ‘safer’ projects may be favoured over riskier ones for budgetary reasons, partially undermining the rationale for Innovation Norway (that it should intervene where commercial investors are unwilling to do so).
- The *number of measures offered has proliferated*. The range of instruments operated through Innovation Norway (and other agencies) is large, with numerous mandates from different sources (KMD, Ministry of Industry, Fish and Trade, Ministry of Agriculture, county councils, etc.). Over 70 measures, funds, and budget lines are recorded in Innovation Norway’s database of support – some are short-lived, some overlap with others, some are well-known, others less so. Overall, the number of measures and mandates and the variety of terms and conditions is complex to administer and confusing for potential applicants.
- Implementation is *resource intensive*. Some stakeholders argue that grants are simpler and cheaper to administer (though they also have a higher budget cost); there is also an ongoing debate about whether it would be preferable to have lower tax rates across the board than targeted intervention (though this would run counter to wider regional policy objectives and the maintenance of settlement structures in sparsely-populated areas).

There are also potential **opportunities** to facilitate the contribution of the Regional Risk Loan and other financial instruments to territorial development, including:

- The fact that financial instruments involve *a longer-term relationship with entrepreneurs* and the scope to offer a range of advisory and support services. This can help improve project quality and help anticipate issues arising because Innovation Norway becomes aware more quickly that a business is facing challenges than it would in the case of grant recipients.
- The *scope to draw from the national and internal network* of Innovation Norway offices, drawing in a wide range of contacts and expertise beyond Innovation Norway.
- *Developments in new technologies* (bioeconomy, marine technology, satellite and other communications) and/or sectors that are relatively new to sparsely-populated areas (such as tourism) and wider developments such as those under the Arctic Strategy.

Potential **threats** to the implementation of the Regional Risk Loan and its contribution to territorial cohesion include:

- The *politicisation* of intervention in different ways and at different levels. For example, in the past county representatives were present on boards that made decisions about applications over a certain value; one Innovation Norway interviewee noted that the

county representatives never questioned positive decisions on loan applications, but did sometimes overturn Innovation Norway proposals to reject loan applications. At a national level, Innovation Norway was described by one interviewee as a ‘political hot potato’ and whilst its budget lines are not considered huge, they are sometimes considered to vary on grounds that do not seem entirely rational from a market failure perspective.

- A further threat is the *tension between maintaining a presence in the remote regions and having sufficient critical mass*. Considerable expertise, not only of financial issues, but also sectoral dynamics, is needed and it is not always easy to staff Innovation Norway offices in the remote regions.

## 2.6 Typical / flagship projects

The Regional Risk Loan supports a wide range of projects – there is no ‘typical’ project as such. Moreover, the composition of the loan portfolio varies widely between the counties reflecting the sectoral make-up of the area. In particular, in regions with significant coastal areas within the *distrikts*, fishing and aquaculture activities account for a large proportion of lending. This is the case for the three northernmost counties of Finnmark, Troms and Nordland, but even so there are significant differences between them, with over half of all lending by value to the fishing sector in Finnmark, while most loans in Nordland are to industry (though in practice often to fish-processing activities).

Table 2-7: Regional Risk Loan by Sector in Northern Norway 2010-2017

	Number of loans			Share of loan amounts		
	Finnmark	Nordland	Troms	Finnmark	Nordland	Troms
<b>Agriculture/ forestry</b>	434	491	863	15.0%	9.0%	19.1%
<b>Industry</b>	304	632	535	10.4%	21.2%	22.6%
<b>Fishing/ aquaculture</b>	497	336	316	51.3%	42.5%	30.8%
<b>Business services</b>	201	209	443	3.9%	2.8%	4.5%
<b>Professional &amp; technical services</b>	151	306	267	2.7%	7.7%	5.6%
<b>Culture &amp; leisure</b>	212	120	166	3.8%	1.0%	1.4%
<b>Information &amp; communication</b>	116	103	216	1.5%	1.0%	2.9%
<b>Accommodation &amp; catering services</b>	126	178	121	2.9%	3.1%	2.4%
<b>Other</b>	329	499	569	8.5%	11.7%	10.7%
<b>Total</b>	<b>2370</b>	<b>2874</b>	<b>3496</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Loan amount (NOK million)</b>				<b>2307.5</b>	<b>3622.4</b>	<b>3385.3</b>

Source: Calculations from Innovation Norway data available at: <https://www.innovasjon Norge.no/no/finansiering/tildelinger/> (accessed 2 December 2018).

Three ‘flagship’ projects highlighted by respondents are described briefly in Annex 2. To some extent these are all somewhat atypical of applicants under the Regional Risk Loan, but rather reflect the aspiration to diversify activities in regions where this is challenging.



Two of the projects (the Lyngen Experience and Haihuset) are in Troms and linked to the tourism sector. This is considered quite difficult to develop in remote regions, though the abundance of natural resources, the topography and location also provide significant opportunities (such as the northern lights, coastal location, scope to develop outdoor activities). The Lyngen Experience provides high-end tourist accommodation and activities in a remote location, also accessible by helicopter. Haihuset aims to take advantage of tourist and scientific interest in the local shark population. In both cases Innovation Norway was involved in providing a package of support to complement commercial bank and/or own capital to enable the projects to proceed.

A further project (TAG Sensors) in Nordland is rather different in scale and ambition. This has involved the development of so-called cold chain management systems, mainly aimed at the food and pharmaceutical sectors. The technology evolved by the firm (which has also been supported through Horizon 2020) enables the continuous monitoring and logging of the temperature of goods in transit. Initial development work was supported with grants through Innovation Norway, as well as Regional Risk Loan support; the support received through Innovation Norway attracted the interest of commercial banks which then also sought to invest.

## **2.7 Summary assessment**

Overall, the Regional Risk Loan is a mature instrument that is a well-regarded tool among stakeholders in the policy community at both national and county levels. The operation of the scheme benefits from a number of features:

- Long-standing experience which has informed adjustments to the instrument over time.
- The importance of the regional presence of Innovation Norway, reaching into areas which are increasingly abandoned by the market.
- High quality of government and high level of trust between the organisations involved in implementation – KMD devolves budgets for the loss fund and responsibility for defining regional priorities to the counties; the counties in turn devolve funds and responsibility for implementing their priorities to the regional offices of Innovation Norway. There are sound reporting and monitoring mechanisms in place, and transparency in the grants and loans offered (which are recorded on a public database).
- Until recently the budgets allocated have been sufficiently high not to constrain the operation of policy – e.g. to have to prioritise viable projects over more risky ones because of insufficient budget allocations (though this may change).

- The operation of the measure is not driven by annual or even multiannual budgetary timelines that create pressure to spend or distort priorities. Indeed, unspent KMD allocations to the loss fund are retained at a county level so that spending decisions are driven by policy needs rather than concerns about possible underspending and losing the allocation.
- There is an explicit territorial cohesion dimension to policy both at a national level, to the extent that the Regional Risk Loan is restricted to the *distrikts*, and at an infraregional level, where the investment policy aims to counter the tendency for access to finance to be easier in urban centres where commercial banks are present.

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## **List of Annexes**

Annex 1: Case study elaboration

Annex 2: Flagship projects

## Annex 1: Case study elaboration


This case study was based on a combination of desk research and interviews with key stakeholders. The following people contributed to or were interviewed for the case study and their input is gratefully acknowledged. All errors of omission or interpretation remain with the author, of course.

Bjørn Kymre	Innovation Norway, Bodø
Øystein Sjølie	Innovation Norway, Oslo
Axel Rød	KMD, Oslo
Senior Official	KMD, Oslo
Gunnar Kvernenes	Innovation Norway, Tromsø
Senior Official	Troms County Council
Senior Official	Troms County Council
Kristian Bysheim	Innovation Norway, Oslo
Eva Camerer	Innovation Norway, Oslo

## Annex 2: Flagship projects


The summaries below are examples of 'flagship' investments using the Regional Risk Loan which were mentioned by Innovation Norway in Nordland and Troms.

### *TAG Sensors AS*

Location of the project	Rana, Nordland										
Beneficiary name and type	TAG Sensors AS										
Brief description of the project	<p>Tag Sensors was established in 2012. It has developed a product for so-called "cold chain management", especially for the food and pharmaceutical sectors where temperature monitoring is key. The product comprises a label incorporating a temperature sensor that can be attached to a package, a mobile app which reads the temperature log from the sensor label and a database which stores all the temperature logs.</p> <p>This is an innovative product that is also being supported through Horizon 2020. TAG Sensors currently employees around 25 people.</p> <p>Innovation Norway has supported the investment using various financial products – see below.</p>										
Outcome of FI policy intervention	<p><b>2015</b></p> <table> <tr> <td>Enterprise Development Grants</td> <td>188,000</td> </tr> <tr> <td>National start-up grant</td> <td>500,000</td> </tr> </table> <p><b>2016</b></p> <table> <tr> <td>Enterprise Development Grants</td> <td>1,020,000</td> </tr> </table> <p><b>2017</b></p> <table> <tr> <td>District risk loans</td> <td>10,000,000</td> </tr> <tr> <td>Investment grants</td> <td>10,000,000</td> </tr> </table> <p><i>Source: Innovation Norway database.</i></p>	Enterprise Development Grants	188,000	National start-up grant	500,000	Enterprise Development Grants	1,020,000	District risk loans	10,000,000	Investment grants	10,000,000
Enterprise Development Grants	188,000										
National start-up grant	500,000										
Enterprise Development Grants	1,020,000										
District risk loans	10,000,000										
Investment grants	10,000,000										
Other relevant information	This project was cited by Innovation Norway as an example of a 'flagship' investment, partly on account of its innovation content, and because the involvement of Innovation Norway helped to secure interest from the commercial banking sector.										
References	<a href="http://tag-sensors.com/">http://tag-sensors.com/</a>										
Photographic material	 <p>Source: <a href="http://tag-sensors.com/">http://tag-sensors.com/</a></p>										

### *Lyngen Experience AS*

Location of the project	Nordlangen, Troms
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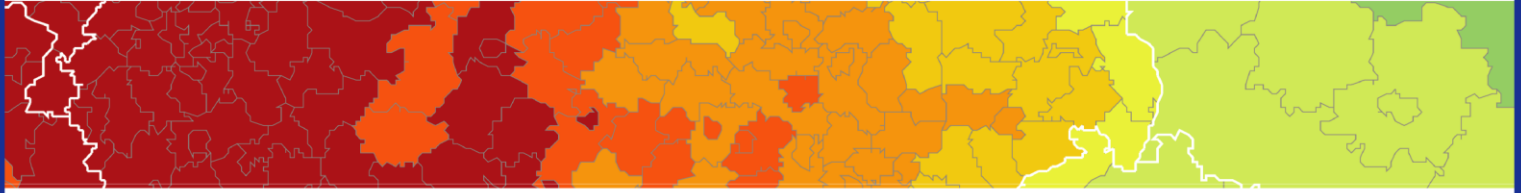
Beneficiary name and type	Lyngen Experience AS, Tourism.												
Brief description of the project	The Lyngen Experience offer high-end tourist accommodation and activities in Nordlenangen, Troms. The location is some two hours by road from Tromsø, but accessible also by helicopter. It offers access to a wide range of summer and winter activities – including northern lights, whale safari, reindeer sledding, walking, climbing, fishing and other marine activities.												
Outcome of FI policy intervention	<p><b>2016</b></p> <table> <tr> <td>National measures for regional development</td> <td>31,500</td> </tr> <tr> <td>Start-up Grants</td> <td>100,000</td> </tr> </table> <p><b>2017</b></p> <table> <tr> <td>Commercial loans</td> <td>2,500,000</td> </tr> <tr> <td>District risk loans</td> <td>5,000,000</td> </tr> <tr> <td>investment grants</td> <td>1,000,000</td> </tr> <tr> <td>Start-up Grants</td> <td>400,000</td> </tr> </table>	National measures for regional development	31,500	Start-up Grants	100,000	Commercial loans	2,500,000	District risk loans	5,000,000	investment grants	1,000,000	Start-up Grants	400,000
National measures for regional development	31,500												
Start-up Grants	100,000												
Commercial loans	2,500,000												
District risk loans	5,000,000												
investment grants	1,000,000												
Start-up Grants	400,000												
Other relevant information	This project was highlighted as a 'flagship' project by Innovation Norway in Tromsø. This is partly because tourism is a comparatively new sector in the region. Consumer feedback on experience has sometimes been mixed with, for example, limited use made of local foods and 'international' cuisines offered instead. As a result there is an emphasis on promoting 'high end' tourist offers that make the most of local resources. Nevertheless, it remains challenging to develop the sector in remote areas – land costs are low, so offer little collateral, but building and other costs remain the same or higher than in the more central areas, increasing the risk and fragility of such investments.												
References	<a href="https://www.lyngenexperience.no/">https://www.lyngenexperience.no/</a>												
Photographic material	 <p>Source: <a href="https://www.lyngenexperience.no/">https://www.lyngenexperience.no/</a></p>												

#### *Haihuset AS*

Location of the project	Ibestad						
Beneficiary name and type	Haihuset AS						
Brief description of the project	Haihuset was established to develop small nature-based tourist activities, centred around the presence of sharks in the area.						
Outcome of FI policy	<table> <tr> <td>2018</td> <td>4,260,000</td> <td></td> </tr> <tr> <td>District risk loans</td> <td></td> <td>2,500,000</td> </tr> </table>	2018	4,260,000		District risk loans		2,500,000
2018	4,260,000						
District risk loans		2,500,000					

intervention	Enterprise Development Grants 260,000 investment grants 1,500,000
Other relevant information	<p>This project was highlighted as a flagship project mainly because it highlights the limited opportunities for development in many parts of northern Norway. The project is in a remote location in Troms (Ibestad island) some four hours by road from Tromsø and over two hours from Narvik.</p> <p>The project involves developing a visitors centre and associated tourism activities to take advantage of interest in the shark population of the area, which is also attracting attention from scientists and researchers. The location is characterised by declining population, especially amongst young people. Distance from main centres means that access to finance is more difficult. However, there was interest from the private banking sector, albeit not sufficient to cover project costs.</p>





### **ESPON 2020 – More information**

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