Outcome of the product development projects supported by the Enterprise Estonia Foundation

Audit Report No 2-5/04/109 of October 11, 2004

Executive summary

The State Audit Office (SAO) has audited the results of the product development projects supported by the Enterprise Estonia Foundation (EEF) up to now and how the EEF activity conduces to the attainment of the programme's objectives.

In the period from 2001 to 2003, EEK 133.5 million were appropriated for product development, whereof EEK 100.9 million were allocated for aid. In the said period, product development aid was sought through the EEF for 60 projects, of which 42 projects were granted funding.

Relevant observations

- **Successful sales of products developed under the project or entrance into export markets have not been realized**. The gap between estimated and actual turnover has been increasing from year to year, and that is why successful progress towards the attainment of the programme's final objectives is highly doubtful. In 2003, for instance, the lag had amounted to EEK 93 million in terms of total sales and to EEK 48 million in terms of export sales. Major reasons for poor outcome are the delays in project implementation, the lack of financial and human resources necessary for the marketing and sales, failure by the EEF to act as a part of the value chain, shortage of venture capital in Estonia needed for quick expansion as well as the utopian forecasts made by businesses.
- **There is no acceptable failure rate established for the implementation of economic benefit forecasts**. Because of the high risk rate of product development activity it cannot be assumed that all projects fully meet the economic benefit estimates. At the same time, neither the government nor the EEF are able, due to the lack of an established acceptable failure rate, to appraise the quality of the results achieved so far.
- **No information has been gathered about the subsequent development of the supported businesses**. Thus the EEF does not command accurate data about how these businesses and projects have progressed after the EEF has deemed the projects completed. Similarly, no information has been systematically gathered about the obstacles and problems that businesses have to face when marketing the innovative products. It has not been possible to rely on relevant information for improving the existing measures and envisaging the new ones, because there is no corresponding information available.
- **The projects fall behind schedule because of the slow procedural and decision-making processes at the EEF**. The submission of correct documents and information required for application in the manner accepted by the EEF is rather time consuming. According to the EEF, the application processing time (i.e., the evaluation and decision-making process) does not violate the three-month time limit, but in reality the period from the submission of application to the notification of the funding decision covers, on the average, nearly six months. The long time for making funding decisions may delay the start of projects and pose problems in the implementation of the project stages.
- **The EEF evaluation and decision-making processes are not transparent**. Project evaluations appear in different forms. Evaluations differ by volume, thoroughness and the use or non-use of numerical grades. The relevance of the project manager's opinion, technical expert's evaluation or the numerical grades assigned to the project upon making a funding decision is not known. Therefore, it is not possible to make an objective comparison between the projects. The adopted funding decision is not sufficiently substantiated to business operators.

Main proposals by the SAO

In order to further elaborate the support schemes and promote the activities of the EEF, the SAO recommends that the Minister of Economic Affairs and Communications, in cooperation with the EEF:

- Gather and consider information about the results achieved so far and analyse the reasons for the difference between the forecasts and the actual situation.

- Upon the establishment of the venture capital fund, take account of the poor outcome of the product development projects and carefully analyse the absorption capacity of the Estonian innovative businesses with a view to planning the financial volume of the fund.

For the purpose of achieving better results in the field of product development, the SAO recommends that the Minister of Economic Affairs and Communications, in cooperation with the EEF:

- Focus on the proper functioning of the value chain based on the measures provided by the EEF where businesses are supported according to their development needs.
- Define clearly to what extent the project may fall short of its economic benefit targets.

In order to faster process the applications and reduce delays in project implementation, the SAO recommends that the EEF:

- Develop, and make available to business operators, clear guidelines regarding the preparation of documents required by an application; offer routine consultations in the course of the application preparation and receipt.

In order to make the project evaluation and decision-making processes more transparent for business operators, the SAO recommends that the EEF:

- Consider the actual amount of time spent on processing the projects and setting deadlines for decision.
- Give justified reasons for both positive and negative funding decisions.

Responses from the Minister of Economic Affairs and Communications and the EEF Board, and the SAO comments on the responses

The Ministry of Economic Affairs and Communications as well as the EEF agreed to most proposals by the SAO and developed a scheme for their implementation.

The SAO proposal about the determination of the failure rate needs, according to both the Ministry of Economic Affairs and Communications and the EEF, a separate analysis for the identification of its application methods. The final position on this issue will be adopted in 2004.

As regards the effectiveness and the evaluation of the outcome of the projects, the SAO wants to underline the importance of making correct forecasts. In the EEF estimation, the number of businesses, who submitted the estimated turnover in products, is smaller than calculated by the SAO. This confirms the seriousness of the problem of the submission of inaccurate data and their use in evaluation.

The data of the audit concerning the implementation of turnover forecasts are estimated to be inaccurate by the EEF. According to the SAO, this estimation stems from the different calculation basis. The EEF has taken into account the data of all product development projects that were granted funding in the years 200l-2003. In the audit calculations, the SAO excluded the forecasts made in discontinued projects and the forecasts on turnover growth made for the year 2004 or beyond. Further, in case of some projects it was debatable whether the forecasts were made for the overall turnover of the enterprise or only the turnover in the innovative product.

The full text of the responses from the Minister of Economic Affairs and Communications and the EEF Board to the observations and proposals of the SAO have been appended to the report.

Märt Kivine
Chief Auditor of the Performance Audit Department