European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
CREATING LASTING VALUE

On behalf of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

5 October 2012

To **DG Competition, State Aid**

Re **Response to Commission Consultation Paper: State aid to support SME access to risk capital (HT.347)**

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European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
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Questionnaire

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a. Do you object to the disclosure of your identity?

Yes ☐ No ☑

b. Does any of the exceptions foreseen in Article 4 of Regulation 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents[1] apply to your response? If so, please indicate clearly which parts should not be divulged, justify the need for such confidential treatment and provide also a non-confidential version of your response for publication on our website.

Please provide your contact details below:

Name	Dörte Höppner
Organisation represented	European Private Equity and Venture Capital Association
Location (country)	Brussels (BELGIUM)
E-mail address:	doerte.hoeppner@evca.eu

Please describe the main activities of your organisation:

a. Please identify whether you can be considered as being active on the financing supply or demand side or representing public authorities or other stakeholders:

   The European Private Equity and Venture Capital Association (EVCA) is a member-based, non-profit trade association that was established in 1983 in Brussels. EVCA is a member of the Transparency register (ID: 60975211600-74). Our members cover the whole investment spectrum, including the institutional investors investing in a broad range of PE/VC funds, as well as the PE/VC firms raising such funds, who in turn invest in the full life-cycle of unlisted companies, from high-growth technology start-ups, to the largest global buyout funds turning around and growing mature companies. The stakeholders represented are therefore **active on the financing supply side.**

[1] OJ L 145, 31 May 2001, p. 43.

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T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

b. Please indicate the size of your company (in terms of turnover and number of employees) or your organization (in terms of members):

More than 1,200 entities are members of the EVCA. The EVCA's role includes engaging with regulators and politicians on behalf of the industry; developing robust professional standards; providing industry research; providing information for the media; building professional development opportunities; and holding forums to facilitate interaction between members and industry participants, including institutional investors, entrepreneurs, policymakers and academics.

c. If applicable, please provide the NACE[2] code relevant for the activity of your company.

n/a

[2] NACE is the European industry standard classification system.

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Introduction and general remarks

The European Private Equity and Venture Capital Association (EVCA) welcomes the opportunity to respond to the Commission's consultation paper concerning State aid to support SME access to risk capital (the "Consultation paper") and to provide comments on the application of the Community Guidelines on State aid to promote risk capital investments in small and medium-sized enterprises (the "RCG").

As a preliminary remark, please note that most of the data provided in response to the questionnaire relates to the **supply-side** of equity rather than to the demand-side. However, whenever possible and relevant, we have also provided data relating to the general issue of SMEs access to finance, and/or information relating to the demand-side. The data provided comes from various public sources (European Commission, European Central Bank) as well as from private databases (EVCA / PEREP, Bureau van Dijk).[3]

***

Today, many European SMEs struggle because of difficulties in accessing finance markets. As highlighted by the European Commission, the tightening of credit conditions during the crisis has made access to finance difficult, especially for SMEs. Corrective measures have been adopted, but access to finance continues to be difficult.[4]

This is a critical issue for the European economy since among high-growth firms, as measured by employment expansion rates, small firms exhibit higher net job creation rates than larger ones (85% of all new jobs in the EU between 2002 and 2010 were created by SMEs). High-growth firms are found in all industries and in all regions, and tend to be innovative. Venture capital channels the flow of equity into such innovative companies from institutional investors such as pension funds and insurance companies as well as family offices, corporate investors and high net worth individuals; it contributes to the financing of SMEs and to their growth and addresses a significant need of SMEs. For these reasons, venture capital plays a positive role in supporting the real economy in Europe and should be nurtured and grown, particularly in an economic environment characterised by low macro-economic growth.

However, to this day, the European venture capital market remains underdeveloped, in particular when compared with the US venture capital market. The economic crisis has clearly taken its toll on the venture capital market in Europe.

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[3] The EVCA /PEREP and Bureau van Dijk statistics gathered cover over 13,000 SMEs which have been equity backed, between 2007 and 2011.

[4] COM(2011) 642 final, COMMUNICATION FROM THE COMMISSION, Industrial Policy: Reinforcing competitiveness. See also COM(2011) 702 final, COMMUNICATION FROM THE COMMISSION, Small Business, Big World — a new partnership to help SMEs seize global opportunities.

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Venture capital fundraising has decreased; investments have been postponed; investors are withdrawing from the asset class there are fewer exits and returns are lagging behind those possible in other asset classes. Many venture capital funds in Europe are also too small to support the later stage funding rounds required to help innovative companies reach their true potential.

Only a very limited number of European SMEs can be presented today as success stories in which venture capitalists were involved. A comparison of the rates of return or the size of investments by European venture capital funds with their counterparts in the United States clearly demonstrates the European venture capital market is uncompetitive with the United States in the attraction of international capital.

State aid policy and State aid to risk capital can play a positive and supporting role in SMEs access to finance and addressing wider issues in regards to the development of the European venture capital industry. As underlined in the Europe 2020 Communication, "*State aid policy can also actively and positively contribute to the Europe 2020 objectives by prompting and supporting initiatives for innovative, efficient and greener technologies, while facilitating access to public support for investment, risk capital and funding for research and development*".[5]

We believe that the revision of the Risk Capital Guidelines provides an opportunity to ensure that robust State aid rules fully support growth and the Europe 2020 objectives.[6] In order to achieve this, the Risk Capital Guidelines should be viewed as a policy instrument that can be deployed to facilitate the development of an industry that exhibits certain positive externalities in regards to economic growth, yet remains uncompetitive at European level in comparison to the United States.

We believe both SMEs and the risk capital market could benefit from improvements to the Guidelines. Since their implementation in 2006 and their modification following the mid-term review, the Guidelines have played a significant role in encouraging the development of venture capital and in turn investment in European SMEs. In the past the RCG have been positively perceived as an important signal to private investors.[7]

We consider that the Risk Capital Guidelines could be simplified, rationalised and improved. It is important to understand that the success of the venture capital industry and of European SMEs depends not only on the VC funds' ability to invest, but also on their ability and capacity to fundraise and their ability to realise their investment (exit opportunities). All of these elements should be borne in mind when revising the current Guidelines.

Our main request is that the Guidelines provide sufficient flexibility to venture capital firms and investors, as well as predictability in the interpretation and implementation of the Guidelines' principles. EVCA therefore recommends that the increase from EUR 1.5 million to EUR 2.5 million of the safe-harbour threshold following the Temporary Framework must not only be maintained but also increased to EUR 6 million.

[5] COM(2010) 2020, COMMUNICATION FROM THE COMMISSION EUROPE 2020: A strategy for smart, sustainable and inclusive growth, p. 19.

[6] Joaquín Almunia, EP workshop: State Aid Modernisation, Brussels, 25 September 2012.

[7] Annual Report on Competition Policy 2010, p. 40.

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At a time of limited financial liquidity and where small and medium-sized enterprises are faced with a difficult economic climate and continued issues in terms of access to finance, such an increase would contribute to addressing the rigidity of the current Guidelines and the constraints on investments made by VC funds into SMEs.

EVCA calls for the simplification and rationalisation of the RCG and requests the Commission to consider the following amendments to the Risk Capital Guidelines:

- Improve the definition of start-up capital by removing the reference to profits;
- Increase the safe-harbour threshold for tranches of investment from EUR 2.5 million to EUR 6 million for all stages;
- Rationalise the Guidelines regarding the period of evaluation for tranches of investment by better taking into account the acceleration of technology development stages, as well as the long-term nature of venture capital funds;
- Facilitate the use of *non-pari passu* structures;
- Increase the ratio allowed for aid to scouting costs;
- Expand the scope of the block exemption.

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Responses

We have not answered every question, only those which we consider to be relevant to the VC industry.

A. General questions - fact finding

A.1. SME financing needs

a. In your experience, what are ***SMEs' financing needs in their seed, start-up, early expansion and growth stages***?[8] Is financing sought for investment purposes and/or working capital or both? To what extent do financing needs vary according to (i) the size of a business, (ii) the development stage (i. e. seed, start-up, early expansion and growth) and growth prospects of a business, (iii) the sector in which the business is active and/or (iv) the nature of activities for which financing is sought?

As stated in the introduction, innovative companies and those showing higher levels of growth have particular issues around securing the necessary funding. This funding is used by companies either for investment purposes (all stages of development of companies, but in particular for seed and start-up) or for working capital to maintain their high growth (early growth, expansion).

Venture capital funds often provide equity investment which helps high-growth potential companies cross the "valley of death". This is the phase in the life of a company where they have limited quality collateral which would enable them to make use of debt. Given the high risk involved in investing in those stages, combined to the lack of collateral and the limited cash flows, equity financing is almost always the only source of financing to help companies grow. This is where the provision of risk capital can prove particularly useful.

As reported in various Commission – European Central Bank joint studies,[9] challenges in access to finance are among the top concerns of SMEs (15%). A higher proportion of SMEs (those less than 5 years old) actually mentioned "Access to finance" as their most pressing problem (around 20%).

Almost two-thirds (63%) of the EU SMEs who applied for a bank loan during the last six months received the whole amount they asked for. However, 11% of the applications were rejected and 17% received less than they applied for. In addition 4% declined the loan offer from the bank because they found the conditions unacceptable. **This means that approximately one third of the SMEs did not get the finance they required**.

[8] Point 2.2 (g) and (h) of the Risk Capital Guidelines provides the definition of early stage and expansion stage. In general terms, a growth stage refers to expansion operations or entry into new markets by more established businesses.

[9] Cf. the 2011 Commission - ECB surveys on SME finance, available at http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm.

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This is trend has developed in recent years. The economic crisis has made it more difficult for SMEs to access finance. This is corroborated by Eurostat data, which shows that the proportion of unsuccessful loan applications to banks rose between 2007 and 2010 in 19 of the 20 Member States for which data are available.[10]

SME financing needs vary depending on their development stage, as well as by sector. For instance, start-ups in the biomedical and biotech industries require a significant amount of funding, whereas social media companies can be established with a few thousand Euros. This has direct implications for industries such as biotech, medical, and pharmaceuticals where alternative sources of financing (business angels) are usually unable to supply the significant amounts of capital needed in the start-up phase. This can be in the region of EUR 10 million, but often more.

b. In your experience, to what extent do SMEs in their early development and growth stages rely on ***external financing and on what types of financial instruments***, i.e. equity financing, debt financing or a mixture of equity and debt financing? To what extent does the type of financing instruments depend on the development stage and/or the sector in which the SME is active and/or the nature of activities for which external financing is sought?

It is clear that a majority of SMEs will tend to heavily rely on external financing. According to the Commission - ECB studies,[11] over the past 6 months, over 55% of SMEs have only relied on external financing (4% used only internal financing, whereas 20% used both internal and external financing).

According to the ECB,[12] the composition of SMEs' sources of external financing changed little between October 2011 and March 2012. The percentage of euro area SMEs using bank loans (35%, up from 33% in H1 2011) and bank overdrafts or credit lines (42%, up from 40%) increased somewhat in comparison with the previous round, bank financing remaining their most important source of external financing.

In such early stages, SMEs generally face two main hurdles in access to finance: first, it corresponds to a pre-profit phase of a company development, meaning that there will be limited or negative cash-flows for a certain period of time. During these phases, the ability of the entrepreneurs and their young, innovative SMEs to pay back the loans may be quite limited and in some cases it may take up to several years until they are able to do so while being able to sustain their activity.

Second, companies in such early stages will have limited quality collateral which would enable them to make use of debt. Given the high risk involved in investing in those stages, combined to the lack of collateral and the limited cash flows, there are opportunities for equity financing. This is where the provision of risk capital can prove particularly useful.

[10] Eurostat, SMEs' access to finance survey (2007-2010).

[11] Idem.

[12] ECB Access to finance.

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The need to access alternative financing such as equity is particularly acute for companies which, in order to reach their full potential, will need either significant amounts to invest (e.g. manufacture and industrial sectors) or a certain amount over a long period of time (e.g. in biotech, life sciences and some cleantech companies: capital intensive sectors where products take relatively more time to be fully developed and tested before being marketed and resulting in positive cash flows).

As explained above, the need for external financing is particularly critical for SMEs which are in early development stages. In our experience, SMEs in their early development and growth stages rely on a wide range of financial instruments in terms of external financing.

c. In your experience, how does ***the ratio between equity and debt financing instruments*** change over the lifetime of a typical SME from early stage (seed and start-up) to expansion and growth stage? Please specify whether the financial structure depends on the sector in which the SME is active and/or the nature of activities for which external financing is sought.

It is difficult to determine a general equity/debt ratio over the lifetime of a typical SME from early stage to expansion and growth stage. As acknowledged by the European Commission, there is a constant fluctuation of the risk capital market over time. However, the following elements may prove useful in better understanding and apprehending the equity/debt ratio.

First, there is no typical SME lifecycle. Some SMEs may need several rounds of external financing, with a mix of debt and of equity, before being able to achieve sufficient cash-flows and reach the expansion stage, whereas others will only need one round of venture capital investment before the exit via IPO and being able to access capital markets. **One key feature of successful SMEs is flexibility in their financial structure.**

Second, there is no other typical formula for a successful SME, where financing requirements will vary significantly by time, sector, development stage, market location, market maturity and general economic environment.

Third, as underlined by the European Central Bank in its latest *Survey on the access to finance of SMEs*,[13] Euro area SMEs reported a further decline in their leverage (ratio of debt to assets), evidencing not only the continued need to deleverage from substantial levels of debt (predominant when compared with equity), but also a decline in the availability of debt financing in the survey period. This data also confirms the persistence of the "credit crunch".

[13] This April 2012 report presents the main features of the results of the sixth round of the survey on the access to finance of small and medium-sized enterprises in the euro area, conducted between 29 February and 29 March 2012 on behalf of the European Central Bank (ECB). The total sample size for the euro area was 7,511 firms.

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info@evca.eu www.evca.eu

A.2. Existence and size of an SME financing gap

A.2.1. Equity financing gap [14]

a. In your experience, is there an equity financing gap that might constrain the supply of external equity/quasi-equity financing for businesses that have valuable business models and fulfil all standard equity investment criteria[15]?

We would like to first underline that much time was needed to compile, analyse and provide extensive data on SMEs access to finance. In the calculation of such a gap, and given the limited timeframe of the consultation, we faced significant difficulties, including the variations from one sector to another and from one development stage to another, the very high number of companies to screen, and the need to differentiate between private equity and venture capital activities when compiling data. More time would have been useful to provide further information and to assess more precisely the nature of the gap constraining the supply of equity to SMEs in Europe. We are available to undertake further research and are committed to contribute to the Commission's review of the Guidelines beyond this consultation.

We would also like to underline the fact that standard equity investment criteria mentioned by the Commission (and in reference to EVCA documents), albeit useful when attempting to better understand the private equity and venture capital industry, are not sufficient to understand the investment process. In fact, some factors will play a predominant role, whereas others, in particular good business management by the entrepreneurial team, may contribute -but are not critical- to the success of the venture. Typically, the product or the service to be provided, as well as the characteristics of the market and its potential, are the deciding criteria. Venture capital fund managers, as active owners, provide management expertise, if required to the companies they back.

EVCA would contend current thinking that there is no general risk capital market failure in the EU. The equity financing gap is the result of a mismatch between the demand and supply of equity, and this market failure is most often linked to asymmetries of information. VC firms are well equipped to address these asymmetries of information and have developed as a need to address these. In our view, asymmetries of information persist beyond the current safe-harbour threshold found under the Risk Capital Guidelines (as does the SMEs' need for funding).

Venture capital fund managers actively seek out investment opportunities in young, high-growth potential companies. VC fund managers engage in extensive due diligence to overcome information asymmetries. This is the reason why many VC fund managers are former entrepreneurs, scientists, engineers or all three. They have the ability to evaluate

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[14] An equity financing gap is a shortage of external equity/quasi-equity financing that an undertaking might encounter at a particular stage of development which cannot be filled by Venture Capitalists, Business Angels, Private Equity Firms, Banks or any other non-public Investor.

[15] Good Business Management by the entrepreneurial team, patented technology or other valuable intangibles, Existence of an addressable market of sufficient size, potential to produce an attractive financial return (as substantiated by a credible business plan), also VC investment criteria as defined by EVCA.

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T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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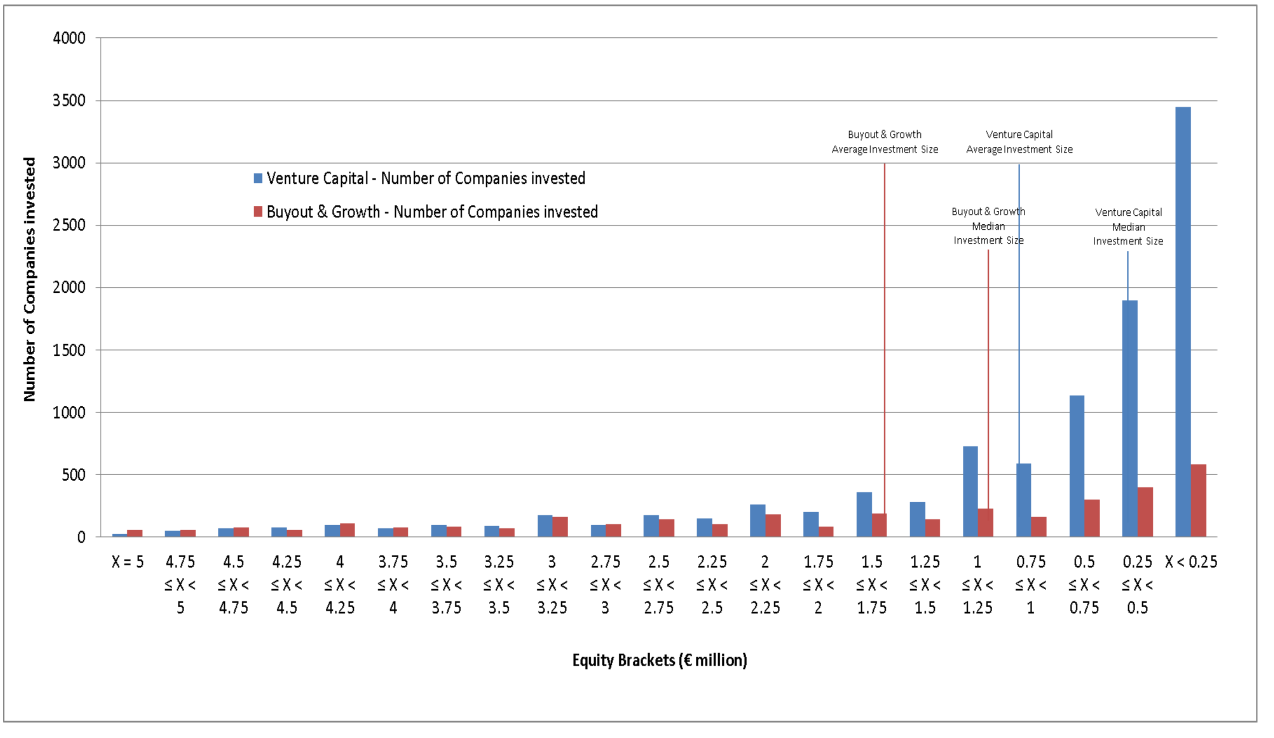
technology, business and market risk and just as importantly to address these risks not only with capital, but also with business and entrepreneurial expertise.

The graph below presents a picture of the number of SMEs which have been equity backed over the 2007-2011 period, taking into account the amounts received. Data is provided by equity brackets. The average investment size for venture capital clearly demonstrates that there is a limited number of SMEs benefitting from more than EUR 1 million equity investments.



Additional graphs are presented further below to highlight the repartition in terms of location, sectors, and age of the investee company (see also Annex 1).

b. What is, in your experience, the size of the equity financing gap (in absolute terms or relative to the size of the company)?

As explained throughout this response to the Consultation, it is extremely difficult and does not reflect market reality to come up with a specific figure. As presented to the European Commission in the context of the assessment of the compatibility of the UK scheme for VCTs,[16] **we estimate that the equity gap exceeds the current safe harbour threshold and goes up to at least EUR 6 million.**

[16] SA.33849 (2012/N) – United Kingdom, Amendments of the Enterprise Investment Scheme and the Venture Capital Trusts Scheme.

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Bastion Tower, Place du Champ de Mars 5
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T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

Indeed, the most recent assessment confirms that even in normal market conditions a structural equity gap remains. In the case of sectors requiring complex R&D or large capital expenditure, often with long investment horizons, the gap may extend up to EUR 15 million and above.

Further, we consider that the equity gap should not only be identified in absolute or relative terms in a strictly European context, but that it should also be analysed taking into account the maturity of the European venture capital market and comparing it to other markets. In particular, the US venture capital market is more developed: the average deal size is much higher than the average European average deal size. We would contend that unintended effects of the EUR 2.5 million safe-harbour threshold may be a scaling down of investments to fit within the framework established by Section 4 of the Risk Capital Guidelines, in spite of the SMEs' need for finance, which goes beyond this threshold.

This scaling down of investments is best seen when comparing the VC industry in Europe and in the United States. The average size of venture deals in the US in 2011 were as follows: USD 4.67 million for seed, USD 4.62 million for early stage, USD 8.38 million for expansion and USD 8.46 million for later stage.[17]

Performance of venture in Europe and in the US (see Annex 2) also demonstrates that there is a gap between both regions, as seen in the table below:[18]

Table 9: Horizon IRRs to 31.12.2011 for Europe and the US

Fund stage	Region	1-year IRR	3-year IRR	5-year IRR	10-year IRR
Venture	Europe	2.68	4.88	-0.14	-0.94
	US	11.59	7.87	3.54	-1.01

Based on recent studies done at national level on mature venture capital markets, such as the United Kingdom,[19] it appears that the equity gap is often quantified as a set of boundaries relating to the amount of equity finance sought in which potentially viable and profitable businesses are unable to raise the finance they need. **In practice the boundaries of the equity gap are not rigid.** It is unrealistic to assume that the supply of equity capital suddenly increases beyond the identified boundaries of the gap and in practice there is likely to be a progressing scale of difficulty. The boundaries of the equity gap are perceived to have increased over time as private sector venture capitalists have drifted towards larger investments (see below).

[17] National Venture Capital Association Yearbook 2011.

[18] 2011 EVCA Pan-European Private Equity Performance Benchmarks Study, June 2012

[19] BIS, Department for business, innovation and skills, SME Access to External Finance, January 2012.

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B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
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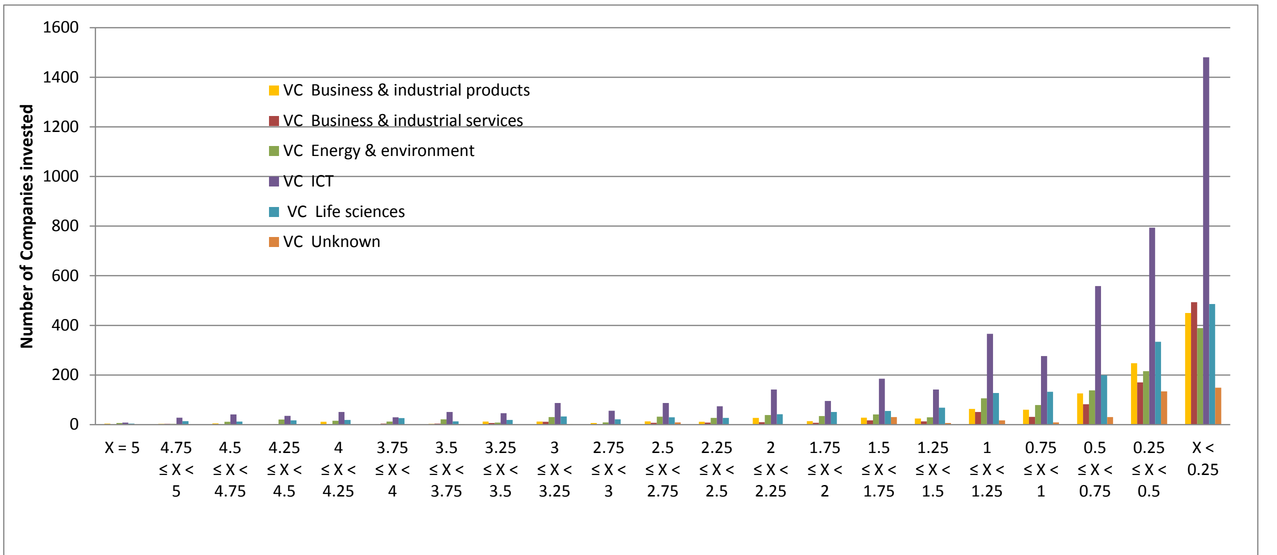
c. In your experience, how does the equity gap depend on the size of a business (SMEs or larger companies[20]), its development stage (seed, start-up, early expansion or growth stage), its "age" (for example, number of years since the start-up, the first commercialisation of a product or service), the sector and regional characteristics (for instance, assisted areas[21])?

As explained above, the equity gap varies significantly depending on various factors. We have compiled the data on SMEs having benefitted from equity financing between 2007 and 2011, and then included another factor, so as to provide a better picture of the characteristics of the SMEs receiving equity, of the number of investments made and the amounts invested.



The first graph (see Annex 1) presents the repartition from a sectorial point of view. It is interesting to note that in the ICT sector, investments drop beyond the EUR 2 million range. EVCA would like to draw the attention of the Commission on the rigidity of the current system, even assuming that the equity gap is actually of EUR 2.5 million.[22] Indeed, if a company in seed or start-up phase needs EUR 2.5 million of funding and runs into unexpected issues in terms of research or prototype development, both the SME and the fund(s) which have invested in the SME will be constrained. The VC fund(s) will not be able to increase its contribution having reached the limit in terms of tranche of investment, and the SME will waste time and energy, having to find more financing outside of its current VC investors.

[20] Larger companies are considered to be companies that do not fulfil the SME definition.

[21] Assisted areas means regions falling within the scope of the derogations contained in Article 107(3)(a) or (c) TFEU.

[22] We believe that the gap is higher: as stated above, it is estimated that the gap that for the life sciences and ICT sectors in particular, goes significantly beyond the EUR 2.5 million limit; the financing needed may reach up to EUR 10-15 million.

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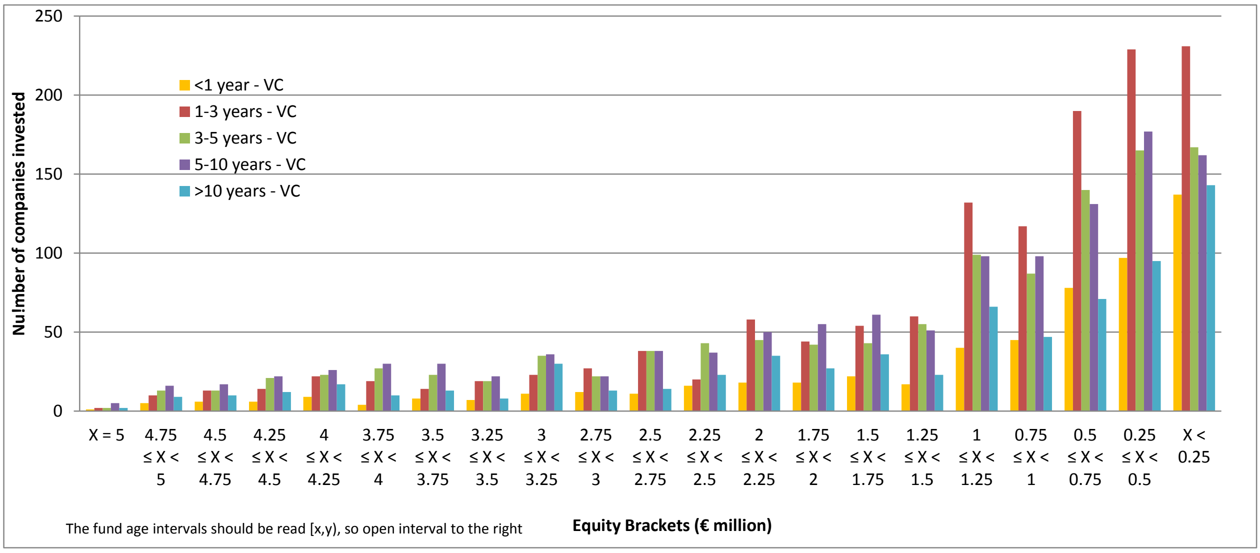
The same lack of flexibility may also affect companies in the expansion stage. If an SME has already used the EUR 2.5 million it can benefit from, and is then faced with additional growth opportunities requiring additional rounds of investment, it may well have to pass such opportunities.

Similar graphs are presented below to underline the role and impact of the age of the investee company, which are in a more difficult position to obtain funding when they are younger (seed/start-up, under 1 year old):



Finally, we have also included data relating to the location of companies. This third set of data is less useful and must also take into account the maturity of the national venture capital market, and second the number of SMEs established in each of these countries.[23] Only the top 5 countries are presented in the graph below.

[23] The results indicate a strong concentration in Germany; however, it could be misleading. It must essentially be interpreted in light of the more efficient reporting of data in Germany compared with other countries.

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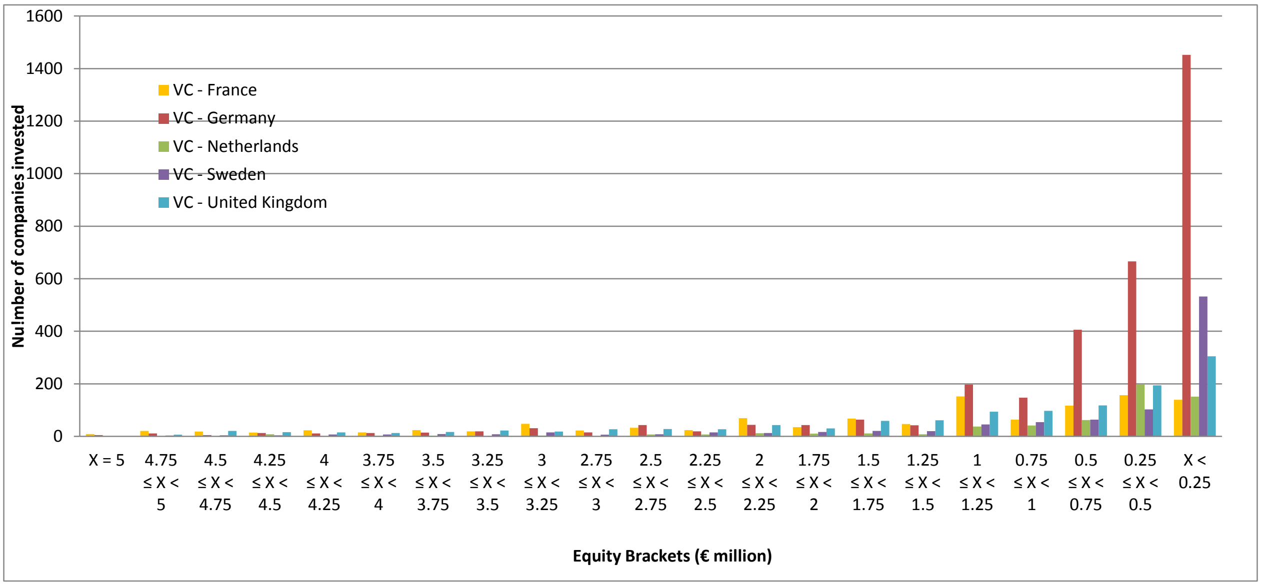

It may be argued that the location of companies is overall a less relevant criterion, as compared with the development stage or the age of the company. In particular, as explained further below in the response to the Consultation, we consider the "assisted" / "non-assisted" categorisation is not relevant for the identification of the equity gap.

d. In your experience, what type of equity/quasi-equity financing instruments are used to address the equity financing gap, notably: common shares, preference shares and cumulative preference shares, convertible bonds, other hybrid structures different from a standard debt (please specify).

As previously discussed under Question A.1.b), there is a wide range of financing instruments used by VC funds. We would like to highlight the importance of providing sufficient flexibility in the equity / quasi-equity financing instruments used to address the financing gap. In our opinion, the Guidelines currently do provide such flexibility as far as the financing instruments are concerned. The 70% proportion and prevalence of equity and quasi-instruments applicable under Section 4.3.3 of the Risk Capital Guidelines do not appear to be problematic.

Further, this 70% proportion is also the figure used in the Venture Capital Regulation proposal[24]. It seems appropriate to maintain the alignment of the Risk Capital Guidelines figure on the regulatory text soon to be adopted; a higher threshold would only introduce discrepancies and have no added value.

Finally, by maintaining the flexibility of instruments that may be used to address the financing gap, it will ensure better negotiations between the VCs and the target SME, resulting into a choice of a combination of instruments adapted and tailored to the need of both the entrepreneur and the SME invested in, and of the VC fund.

[24] COM(2011) 860 final, Proposal for a Regulation on European Venture Capital Funds.

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Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

A.2.2. Debt financing gap[25]

Please note that VC funds are not credit institutions and do not provide debt financing. We are not in a position to answer questions in this Section.

A.3. Underlying reasons for the SME equity financing gap

A.3.1. Demand-side constraints

a. In your experience, to what extent can the equity financing gap be attributed to demand-side problems? In your answer please consider the following challenges faced by enterprises looking for equity financing:

   - The enterprise's understanding of the benefits and risks associated with external equity financing
   - The capacity of the enterprise to prepare sound business plans, including the enterprise's ability to present itself as an investment opportunity to investors
   - The quality of the enterprise's key management
   - The enterprise's (un)willingness to share control with outside investors who usually have an influence over company decisions in addition to providing funding
   - The size of the investment needed
   - Legal, regulatory or fiscal constraints on the side of the enterprise

The demand side for venture capital is not a pressing issue from the perspective of venture capital funds. Anecdotal evidence shows that it was not until after 2005 that the excess of capital raised prior and during the dot com bubble was removed from the system. Conversely, it took very little time for entrepreneurs to exit the market (as opposed to ten year funds) when the bubble crashed. By objective measures (such as patent filings), Europe also has a level of innovative activity similar to that of the US. VC activity is nevertheless comparatively young in comparison to the US, which may influence levels of awareness in regards to share dilution. As the industry matures and develops, investments such as Skype demonstrate that while the founders' initial holding is diluted, the overall increase in valuation of the company greatly compensates for the dilution.

[25] A debt financing gap is shortage of external debt financing that an undertaking might encounter at a particular stage of development which cannot be filled by banks, non-banking lending institutions or any other non-public lender.

As previously discussed, venture capital as an industry has partly evolved to address issues that have arisen due to information asymmetries. Issues such as business plans and management expertise can be overcome, if appropriate with the aid of the VC investor.

b. In your experience, do these demand-side constraints reflect structural or rather transitional factors (due to the financial crisis)? If possible, please provide parameters that delimit the effects of the current economic conditions and contrast them with normal (cyclical) market circumstances and this for each of the company development stages where it is relevant.

n/a

A.3.2. Supply-side constraints

a. In your experience, to what extent can the equity financing gap be attributed to supply-side problems? In your answer please consider the following challenges faced by investors willing to provide equity financing to SMEs in early development and growth stages:

- The (un)attractiveness of investments in risk capital compared to other asset classes.

  As explained below under Question A.3.2.d), risk capital is generally more risky compared to other asset classes and provides lower returns. Given the lower returns and the risks entailed, it is more difficult to attract investors, particularly regarding early development stages, which are currently characterised in the Guidelines as a pre-sale / pre-profit stage.

- The (lack of) interest of investors to invest in a particular investment size or participation ratio

  Venture capital investments are realised following a due diligence process. This process typically includes fixed costs, which means that investment size must be significant enough to compensate those fixed costs. Due to such relatively high costs for investment appraisal and other transaction costs, very small investments are therefore less likely to attract investors.

  Another factor may contribute to the lack of investors' interest: VC funds will often take minority participations in the investee companies. In 2011, it is estimated that around 10% of VC funds took majority participations. Minority participations may appear as less attractive to investors, given the fact that it may be comparatively more difficult to sell a minority stake. This is also a sensitive issue given the fact that VC funds are long-term, closed-ended vehicles: they are constituted for 10-12 years and with no redemption rights for investors.

- Restrictions imposed on cross-border investments

  See our response below under Question A.3.3. b)

- The need for investors to make a careful analysis of the entire business strategy in order to estimate the possibilities of making a profit on the investment and the risks associated with it

- The need for investors to be able to monitor that the business strategy is well implemented by the enterprise's managers

- The need for investors to plan and execute an exit strategy, in order to generate a risk-adjusted return on investment from selling its equity stake in the company in which the investment is made. Please explain if there are constraints related to the absence of an initial public offering (IPO) or secondary market potential.

  VC funds implement a strategy which is agreed upon upfront by the investors in the fund. This strategy includes the investment strategy and the risk associated with it, the relationship between the investors and the manager of the VC fund, and also the exit strategy, designed to maximise returns on investment.

  Venture capitalists will sell off their share in the investee company after it is listed on a stock exchange. However, it may be sometimes difficult to sell shares in a public market. In such a case, the exit may take place through sales to better informed investors (e.g., other firms in the same industry or to the SME's own management or owners). Still, higher returns are usually achieved via initial public offerings, since they concern the better-performing investee companies. If listings are not possible due to important constraints in terms of procedure and preparation (costs), and asymmetries of information remain, it will significantly impact the ability of the fund to achieve return. Such elements will be taken into account in the negotiations with investors, and have a direct impact on the strategy of the VC fund.

b. In your experience, do these supply-side constraints reflect structural or rather transitional factors (due to the financial crisis)? If possible, please provide parameters (such as IPO activity in a particular sector) that delimit the effects of the current economic conditions and contrast them with normal (cyclical) market circumstances and this for each of the company development stages where it is relevant.

   We consider that supply-side constraints do not solely reflect transitional factors due to the financial crisis. Both structural and transitional factors play a role in these constraints, but we believe that structural factors play a long-term and equally important role.

   Any assessment of the financial crisis on the venture capital industry is relatively straightforward in regards to fundraising. It is more challenging in regards to investments made and investments realised. A key reason for this is that VC funds are long-term investors (constituted for 10-12 years), with an average holding period of investment reaching 7 years. It is therefore difficult, if not impossible, to have today a full picture of the impact of the financial crisis on the venture capital market.

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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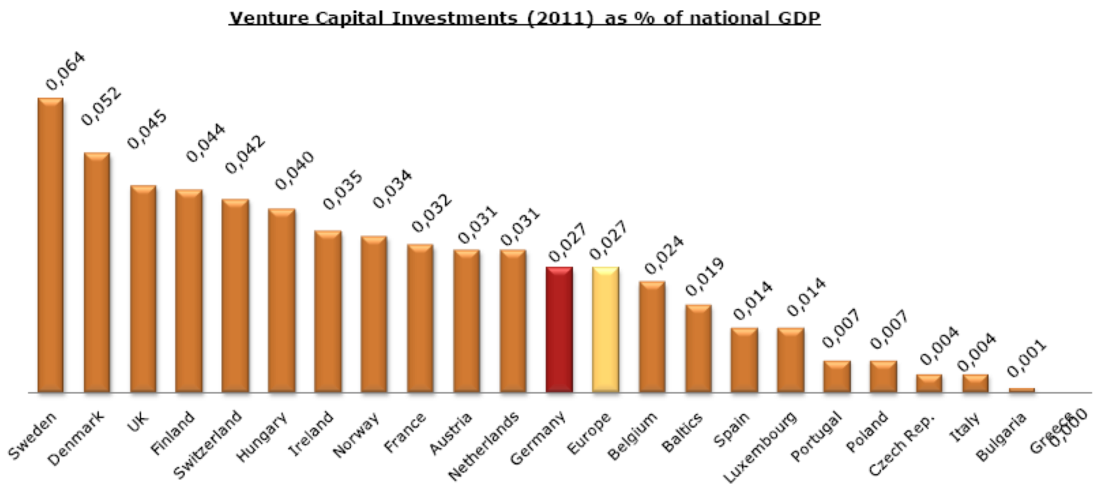
c. In your experience, what are the key characteristics of the European venture capital (VC) market, such as the size of the European VC asset class compared to the European private equity and public equity asset class, average fund size, key VC companies (private VC managers, publicly-owned VC companies) and key investors active in the market?

The venture capital sector in Europe is small compared to the broader sector of 'private equity'. Within the broad range of private equity investors, venture capitalists account for between 10% and 15%, depending on the chosen year of reference. As at the end of 2010 there were about 1,500 private equity managers headquartered in the European Union. In aggregate, these managers accounted for EUR 500 billion of assets under management. Exactly 10% of this amount, approximately EUR 50 billion, can be attributed to the venture capital funds.

Although strategically important, venture capital accounts for only approximately EUR 5 billion on an annual basis. This is not very significant in comparison to other asset classes: as a comparison, European UCITS and non-UCITS assets under management at the end of 2010 reached EUR 8 trillion.[26] Global hedge funds assets under management reached at the end of 2010 about EUR 2.5 trillion, with about EUR 400 billion in Europe.[27]

In terms of equity to GDP ratio, venture capital investments are small: they represented about 0,064% of GDP in Sweden, 0,052% in Denmark, 0,045% in UK, 0,032% in France and 0,027% in Germany; the average in Europe standing at 0,027%:



Moreover, venture capital activities are not homogenously spread across the European Union. Around 90% of all venture capital fund managers are concentrated in eight Member States (UK, Germany Sweden, Denmark, Finland Netherlands, France and Spain all have venture capital assets under management in excess of EUR 1.5 billion).

Venture capital in Europe is now characterised by a reliance on public sector institutions such as the European Investment Fund ("EIF"). It is essential that programmes managed by

[26] Source: www.efama.org
[27] Source: www.aima.org

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
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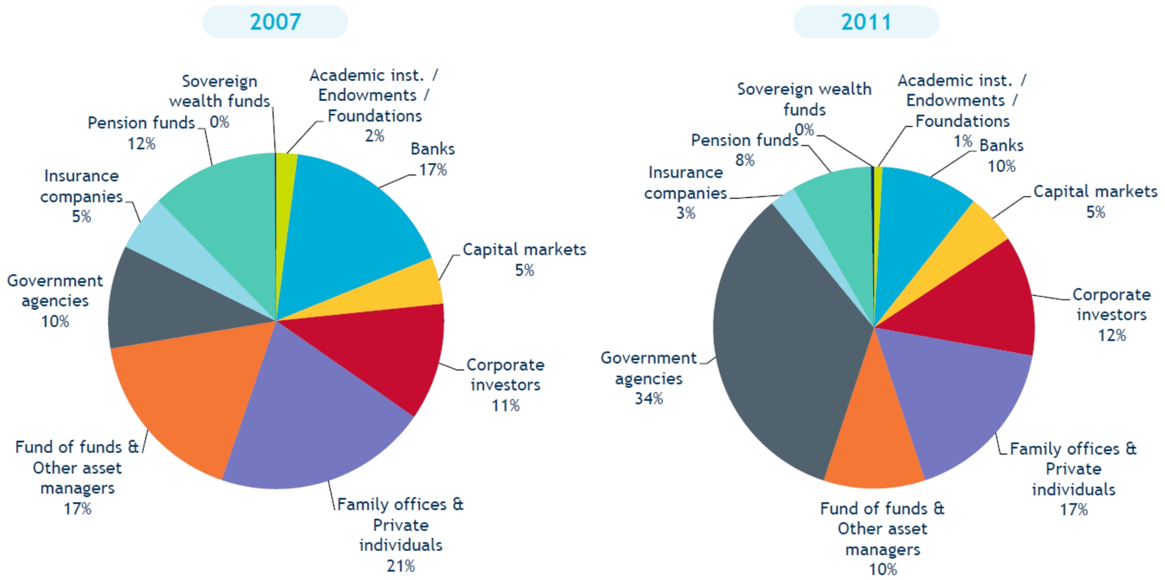
the EIF and other institutions at a national level are continued. It is also crucial they are built upon and complemented. The investor base must be expanded and diversified if in the long-term the European venture capital industry is to become self sustaining.

The graph below demonstrates the shift in the venture capital investor base:

Venture funds raised by type of investor

2007 vs. 2011 - Incremental amount raised during the year - % of total amount



Source: EVCA / PEREP_Analytics

As highlighted by the European Commission in the Impact Assessment on its Venture Capital Regulation proposal,[28] the role and importance of such traditional investors is expected to even increase in response to the newly introduced prudential rules for banks and insurance companies, which will require banks and insurance companies to set aside additional regulatory capital once they invest in venture capital fund (see below answer to Question A.3.2.g)).

d. What has been the performance of the European VC industry in terms of profitability compared to other asset classes, the minimum/average value of deals and the type of capital investment (early stage, expansion or growth capital)?

From inception to 31 December 2011, the net-pooled IRR[29] for the 1,431 independent private equity funds covered was 8.95%. Return for buyout funds reduced to 11.42% (12.7% in 2010) while **return for venture funds increased to 1.51% (0.5 % in 2010).**

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[28] COM(2011) 860 final, Proposal for a Regulation on European Venture Capital Funds.

[29] The IRR is the interim net return earned by investors (limited partners) from the fund from inception to a stated date. The IRR is calculated as an annualised effective compounded rate of return using daily or

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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Regarding the top quartile, private equity funds in the top quartile remained stable at a net pooled IRR of 22.54% (22.81% in 2010). Buyout funds in the top quartile recorded 30.09% (32.2% in 2010) whereas **venture in the top quartile remained constant at 13.2%.**

Regarding the top half, private equity funds in the top half showed a net pooled IRR of 13.95% (14.36% in 2010). Buyout funds in the top half recorded 19.23% (20.2% in 2010) whereas **venture in the top half had 8.04% (8.3% in 2010).**

Therefore, the overall venture capital industry has not delivered competitive financial returns compared to other private equity investment stages. However, venture backed companies performed significantly better in terms of sales and employment growth than other, non-venture backed, high-tech companies.

Comparison with **public market comparators**:[30] the challenging economic conditions are reflected in negative performance of public market comparators such as Morgan Stanley Euro Equity (MSCI) with -9.72% (-3.55% in 2010) and HSBC Small Company Equity with -6.20% (3.47% in 2010). But JP Morgan Eurobonds (EMBI+) capturing emerging markets showed positive performance of 9.91% (7.22% in 2010). These public market indexes show significantly higher performance compared to the VC industry.

Several tables from our 2011 Performance Study (see Annex 2)[31] which relate to the venture capital industry are presented below, and distinguish between fund stages:

Table 1: Annualised net pooled IRR from inception to 31.12.2011

Fund stage*	No. of funds	Pooled IRR	Multiples			Multiples (as % of TVPI)	
			DPI	RVPI	TVPI	DPI	RVPI
Seed/Early-stage	459	-0.98	0.39	0.56	0.95	41%	59%
Later-stage	120	2.82	0.67	0.47	1.14	59%	41%
Balanced	191	3.97	0.36	0.80	1.16	31%	69%
All venture	**770**	**1.51**	**0.41**	**0.66**	**1.07**	**38%**	**62%**

monthly cash flows to and from investors, together with the quarter end valuation of the fund's unliquidated holdings or residual value as a terminal cash flow to investors. The IRR is therefore net (i.e. after deduction of all fees and carried interest).

[30] JP Morgan Euro Bonds (EMBI+), HSBC Small Company Equity and Morgan Stanley Euro (MSCI) indices.

[31] 2011 EVCA Pan-European Private Equity Performance Benchmarks Study, June 2012.

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
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Table 2: Top-quarter / **Top-half**

Fund stage	No. of funds	Top-quarter pooled IRR	*Overall upper quartile IRR	No. of funds	Top-half pooled IRR	**Overall median IRR
Seed/Early-stage	115	12.52	2.15	230	7.02	-3.00
Later-stage	30	17.49	8.20	60	12.65	-0.33
Balanced	48	15.98	6.18	96	7.80	-0.20
All venture	**193**	**13.20**	**4.93**	**385**	**8.04**	**-1.76**

Table 3: Top-quarter funds formed 1980-2011

			Horizon IRR			
Fund stage	No. of Funds	Pooled IRR	1-year IRR	3-year IRR	5-year IRR	10-year IRR
Seed/Early-stage	115	12.52	17.20	9.97	6.05	6.72
Later-stage	30	17.49	20.36	10.28	6.53	6.12
Balanced	48	15.98	2.01	15.55	4.40	5.62
All venture	193	13.20	5.01	13.83	4.97	6.00

It is worth highlighting here the importance of seed and early-stage investment funds, for the top quarter funds (115 funds) as well as for the top half funds (230 funds), but that later stage funds still have better returns.

Table 6: Venture funds performance by fund size to 31.12.2011

Fund Size*	No. of Funds	Pooled IRR	1-year IRR	3-year IRR	5-year IRR	10-year IRR
EUR 0-50m	525	3.30	0.14	0.78	-1.94	-1.60
EUR 50m-100m	115	0.77	-2.00	1.36	-1.93	-2.71
EUR 100m-250m	96	0.77	6.78	1.36	-1.92	-3.24
EUR 250m+	34	1.03	2.74	8.73	1.83	1.39
All venture 2011	**770**	**1.51**	**2.68**	**4.88**	**-0.14**	**-0.94**
All venture 2010	**765**	**1.35**	**17.53**	**-1.38**	**0.05**	**-2.27**

Source: Thomson Reuters

The high figure (3.30) found under "pooled IRR" for small VC funds (EUR 0 to 50 million) should be read carefully, since the data provided covers the 1980-2011 period, and includes therefore extremely high IRRs in the 1990's. The most representative data is found under the 1-, 3- and 5-year IRR columns, according to which larger funds tend to better perform.

e. What are the key characteristics of business angel finance in Europe, such as the nature and geographical profile of investors, the minimum/average value of deals, syndication deals? What are the key barriers hindering business angel financing?

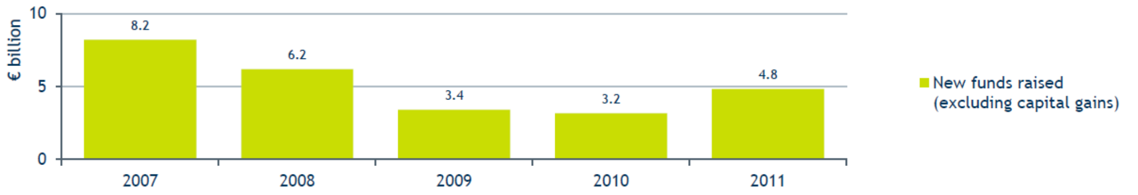
n/a

f. In your experience, what are the key constraints affecting the supply of equity finance to SMEs through alternative stock markets specialised in SMEs?

n/a

g. What are the key fundraising constraints of the European VC industry? What makes a VC fund attractive for investors? Is it important for VC funds to diversify their investments across equity and debt instruments, sectors, regions and/or countries and SMEs and larger companies?

In the wake of the financial crisis, fundraising in the European VC industry has been significantly more difficult. In spite of some improvements and signs of recovery, it has not fully recovered back to its 2007 levels, as seen in the graph below:



Source: EVCA / PEREP_Analytics

Incremental amounts raised by venture capital funds during the year reached over EUR 8 billion in 2007, over EUR 6 billion in 2008, over EUR 3 billion in both 2009 and 2010, and 4.85 billion in 2011 (for 135 new funds).

However, in spite of signs of recovery, fluctuations have been witnessed over the past years regarding the basis of investors (see graphs below), particularly regarding pension funds, banks and insurers, which contribution has significantly decreased.

Many institutional investors such as banks, pension funds and insurance companies generally consider the market too small to allocate expertise or resources. In addition there is a lack of family offices and large university endowments in Europe in comparison to the United States. These institutions have a long established culture of investing in innovation via venture capital. While it is not possible to build out a similar investor base in Europe in the short-term, State aid can be an important instrument to encourage other

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
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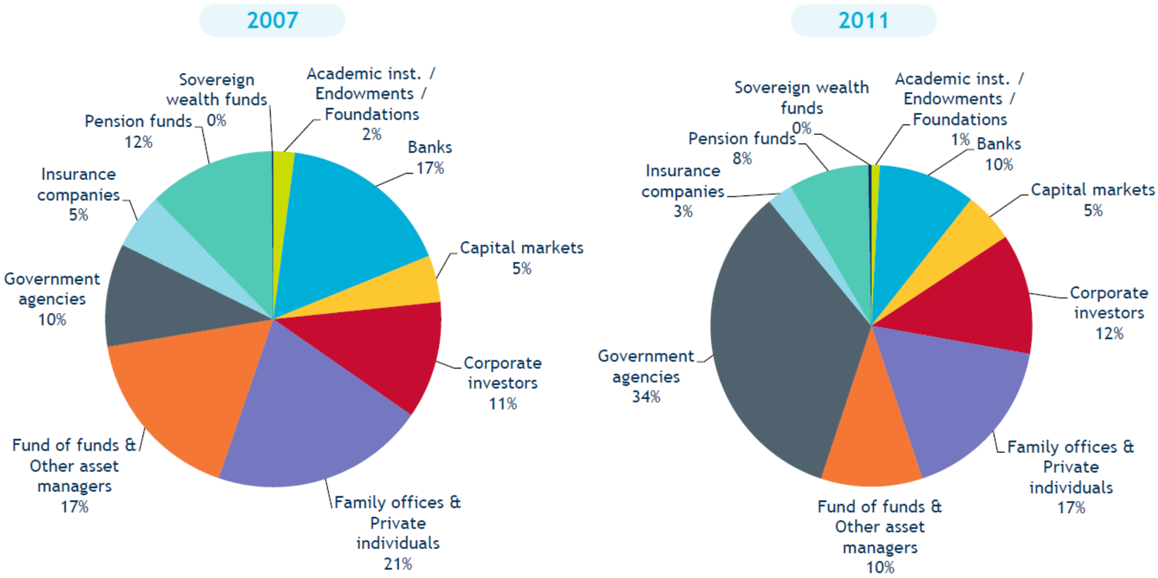
private sector investors to the venture capital market to increase the diversity of the investor base and level the playing field with the United States.

Venture funds raised by type of investor

2007 vs. 2011 - Incremental amount raised during the year - % of total amount



Source: EVCA / PEREP_Analytics

Venture capital funds remain a niche player in the fund industry largely on account of their focus on SMEs at the very riskiest stage of their development. Due to their focus on small and innovative SMEs, it is often challenging for venture capital funds to create returns that would mobilise average investors' interest. Indeed, VC funds' attractiveness to investors depends essentially on the returns achieved and the performance of the funds (cf. above).

Other factors play a significant role on the fundraising of the European VC industry. In particular, the legal environment creates additional difficulties: institutional investors are stepping away from their usual commitments to the venture capital industry, and the tax environment is subject to significant changes affecting private individuals (high net worth individuals investing in VC). Pension funds' representation in the VC investor basis went from over 12% in 2007 to 8% in 2011. The same trend is seen for banks (17% to 10%), and insurance companies (5% to 3%).

This may be interpreted as a result of the financial crisis and the ensuing new regulatory constraints, which risk creating a fundraising straightjacket. The prudential requirements are being revised in the context of Basel III agreements and the Capital Requirements Directive IV / Capital Requirements Regulation proposals (for banks), in Solvency II (for insurers) and soon in the Institutions for occupational retirement provision Directive (IORP). It is foreseen the IORP Directive would apply Solvency II standards to pension funds, which has the potential to massively impair their ability to invest in real economy assets like venture capital. As a result of applying Solvency II standards to pension funds, both the allocation of funds to VC funds and the direct financing of SMEs would be

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

significantly undermined. In particular, banks and insurers already tend to significantly deleverage their activities, in order to compensate the capital shortfall.

Further, it appears that the new provisions also risk favouring short-termism; this would reinforce the current trend affecting the VC investor basis, since VC funds are typically closed-end vehicles, with a 10-12 year lifetime and no redemption rights for investors. For instance, under Solvency II, insurance companies are required to meet a solvency capital ratio (SCR) across a wide variety of risks including property, market, liquidity, life and non-life. It requires insurers to be able to meet a 100% SCR at a 99.5% confidence level over a one year time period. Insurers may then rely on a standard risk weight, which is considerably higher than for other products such as public equities (39%) and government bonds (12%). Such figures and requirements have a direct negative impact on the allocation of insurers to venture capital.

A.3.3. Regulatory constraints

a. To what extent existing regulations restrict investors (for instance because of high capital requirements) from investing in the European VC asset class and how does this contribute to an equity financing gap?

Overall, there is a significant fragmentation of the European venture capital market. As explained above, there are a number of legal and regulatory constraints impacting fundraising in Europe (CRD IV/ CRR, Solvency II, revision of the IORP Directive; cf. above).

This fragmentation is also due to the fact that up to now, funds and investors have only been able to rely on national placement regimes. No European-wide passport existed for venture capital funds, unlike the passport created under the Alternative Investment Manager Fund Directive (AIFMD) for managers managing funds with EUR 500 million of assets under management.

A proposal for a venture capital passport and a venture capital regulation has been put forward, but this has not been adopted yet.

Last but not the least, the EUR 2.5 million limit established by the Risk Capital Guidelines may constrain the strategy used by VC funds, which is an important factor taken into account by investors investing in VC funds.

b. To what extent is the fiscal environment contributing to the equity financing gap? Are specific risk capital investments facing tax hurdles that do not exist or are less relevant for other types of investment?

The fiscal environment is a very significant factor for the venture capital industry, since it can constitute an incentive for private investors. One of the main issues faced by venture capital funds is the fact that there is currently no European-wide tax-neutral vehicle. This means that significant risks of double taxation exist, which investors prefer to avoid. Given the risky nature of venture capital investment, a constraining fiscal environment which gives no guarantee that double taxation will not apply in fact reinforces risk aversion.

Other types of investment or asset classes may partly or entirely escape the double taxation issue, in particular where no intermediate vehicle is used for the purpose of investment. In response to the fragmentation, investors may be tempted to focus on tax-neutral structures, which exist at national level only, or on other asset classes.

c. In your experience, are there regulatory offering / placement restrictions in the retail or wholesale equity capital markets that might contribute to the equity financing gap?

We are not in a position to answer questions in this Section.

A.4. Underlying reasons for the SME debt financing gap

Please note that VC funds are not credit institutions and do not provide debt financing. We are not in a position to answer questions in this Section.

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

B. Experience with the Risk Capital Guidelines

B.1.General comments

This section focuses on your overall experience with the application of the Risk Capital Guidelines.

a. Based on your experience, does ***the current scope*** of the Risk Capital Guidelines appropriately facilitate SME access to risk capital?

The scope of the current Risk Capital Guidelines does not appear problematic in itself. Members have not reported any issues regarding the exclusion of the provision of aid to enterprises in difficulty or specific sectors (shipbuilding, coal, steel industry) from the scope of the Guidelines.

The exclusion of aid to export-related activities (i.e. directly linked to the quantities exported) does not seem problematic in so far as it does not discriminate against SMEs which are more export-oriented. The purpose of the Guidelines is to facilitate access to finance and thus contribute to the growth of European SMEs. It is important to ensure that their ability to export is not constrained.

b. Have you encountered any problems when applying the Risk Capital Guidelines to ***various support forms***, such as capital injection, guarantees and fiscal measures and ***various delivery modes***, such as investment funds (i. e. public funds capital invested in a VC fund), co-investment funds (i. e. public funds co-invested on a deal by deal basis) ?

n/a

c. What has been your overall experience with ***the two-stage assessment architecture*** (a "standard" assessment based on pre-defined eligibility and investment criteria as laid down in section 4.3 of the Risk Capital Guidelines, and a detailed effects-based assessment)?

Most members are not familiar with the detailed effects-based assessment, which in their view provides less predictability than the standard assessment under Section 4.3 of the Risk Capital Guidelines. In particular, as stated above, it is difficult, costly and cumbersome to gather enough data to demonstrate the market failure and the equity gap. Furthermore, it is feared that the notification procedure with a detailed effects-based assessment would take much time. As a consequence, there is a tendency to focus on the standard assessment and to tailor schemes to fit within the limits set under Section 4.3.

d. What has been your experience with the ***cumulation*** of aid for risk capital with other types of aid covering the same costs?

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

No major issues have been reported by members regarding the cumulation of aid for risk capital with other types of aid covering the same costs.

B.2. Presence of State aid

This section seeks your views on the guidance provided by the Risk Capital Guidelines on the existence and absence of State aid within the meaning of Article 107(1) of the TFEU in risk capital measures. [32]

a. In general, have you encountered any difficulties with designing ***market-conform measures aimed at facilitating SME access to risk capital*** e. g. as concerns aid presence at several levels of the funding architecture, the criteria for *pari passu* terms and market-conform management remuneration and their applicability to various forms of aid (capital investment, guarantees, fiscal incentives)?

n/a

b. In your experience, have the Risk Capital Guidelines (possibly together with other Commission's interpretative documents) provided sufficient legal certainty and clarity with regards to the deployment of various market-conform ***financial instruments (e. g. equity, debt, hybrid instruments)*** to support SME access to finance?

As far as the financial instruments allowed under the Risk Capital Guidelines are concerned, EVCA considers that there has been no significant issue regarding the deployment of various financial instruments. It is however important to preserve the flexibility which currently exists, thanks to a wide range of hybrid instruments.

c. In your experience, have the Risk Capital Guidelines provided sufficient legal certainty for the ***presumption of no State aid to private investors***[33]? Have you experienced any difficulties as concerns the notion of "an independent private investor", independence of private investors, risk-sharing investment nature and the notion of private resources?

No major issues have been reported by members regarding this aspect of the Guidelines.

d. As concerns ***State aid at the level of an investment fund,*** when the fund is set up to pool resources from investors and transfer them to investee companies, generally the Risk

[32] See section 3.2 of the Risk Capital Guidelines.

[33] According to point 3.2 of the Risk Capital Guidelines, there is a presumption of no aid to private investors when public and private investments are effected *pari pasu* and *normally where at least 50%* of the funding is provided by independent private investors, which is to ensure significant private participation.

Capital Guidelines consider such funds not to be State aid recipient. In your experience, has this presumption provided sufficient legal certainty for excluding State aid to non-transparent investment companies that are granted special fiscal treatment?

n/a

e. The ***presumption of no State aid to fund managers*** is considered to be fulfilled when fund managers are chosen through an open and transparent tender procedure or do not receive any other advantages granted by the State. In your experience, has this provided sufficient legal safeguards?

To the best of our knowledge, no specific issues have arisen in this respect.

f. In your experience, have the Risk Capital Guidelines provided sufficient legal certainty and safeguards as concerns ***the presumption of no aid to investee companies***[34]?

We consider that more legal certainty regarding the presumption of no aid to investee companies could be provided. In particular, we question the fact that aid at the level of the investor (e.g. tax incentives) is necessarily passed on to the investee company, and we consider that the Guidelines should confirm that investments made on market terms, irrespective of the State measure at investor level (investors being the beneficiary and recipients of the measure), are free of State aid.

B.3. Form of aid

While Member States can choose the form of aid, the Risk Capital Guidelines provide guidance on the type of measures for facilitating risk capital investments in SMEs. [35] *This section focuses on your experience with the various types of risk capital measures and their effectiveness.*

a. In your experience, what has been the main purpose of aid - to share investment risks with private investors and/or to provide liquidity in the form of capital injection? As for sharing investment risk, has the focus been on addressing upside risk by enhancing returns for private investors or on providing downside risk protection against worse than expected investment performance or potential losses?

n/a

[34] According to point 3.2 of the Risk Capital Guidelines, there is a presumption of no aid to investee companies where normally there is no aid to investors or the investment fund/fund manager and where the investment is made on terms which would be acceptable to a private investor in a market economy in the absence of any State intervention.

[35] See section 4.2 of the Risk Capital Guidelines.

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

b. In your experience, what types of State aid measures have been most commonly used (provision of public capital on non-*pari passu* terms, selective fiscal incentive schemes, guarantee schemes and measures targeting fund managers)?

EVCA considers that non-pari passu structures could be used to address both the structural issues (e.g. regarding the investor basis, cf. above) and the conjectural issues (i.e. lower returns) which affect fundraising in the venture capital industry.

Unlike other asset classes such as property or later stage private equity, venture capital investors can not reduce the cost of their equity investment by blending it with cheaper bank financing. This increases the risk to venture capital investors and reduces the equity return. Equity investing is indeed expensive. This means that venture capital firms have to generate a higher return on their equity investment classes in order to be competitive and attractive. This is one factor depressing returns to investors in innovation. The funds of funds could be structured to level the playing field; the public sector should invest on a non-pari passu basis.

c. What has been your experience with ***the provision of public capital on non-pari passu terms***? How often has it been used? What type of profit- and loss-sharing arrangements and level of subordination between public and private investments has been used? What limitations have been introduced to avoid over-compensation of the private investors?

n/a

d. What has been your experience with ***selective fiscal incentives to private investors and/or funds***? Which one has been used the most often? What safeguards have been introduced to minimise fiscal incentives to the minimum necessary to trigger private investments?

n/a

e. What has been your experience with ***guarantee schemes covering downside investment risks***? What type of transactions (e.g. mezzanine, equity transactions) have been covered and how have the risk-sharing instruments been designed to minimise distortions?

n/a

f. Have you implemented ***any measures targeting fund managers***? What has been the objectives of such measures (e.g. to address the problem of costly appraisals of potential investments and/or high fundraising costs) and their overall design (e. g. grant schemes covering certain investment management costs)?

n/a

g. Overall, ***how effective have been the various State aid measures*** in leveraging the private sector financing for risk capital investments and tackling the equity gap? Please provide evidence based on independent studies, if available.

n/a

h. How has each of the different types of measures (the provision of public capital on non-*pari passu* terms, selective fiscal incentive schemes, guarantee schemes and measures targeting fund managers) affected the selection process of target SMEs, i.e. will the measure still lead to the selection of the most promising SMEs – given the amount of information available – or is this selection process distorted?

n/a

B.4. Conditions for compatibility: a standard assessment

The Risk Capital Guidelines set out specific safe-harbour thresholds related to eligible recipients, development stages, the nature of the investment instrument, an annual investment tranche and the level of private investment. [36] *Moreover, they set out a number of conditions to ensure that investment decisions are profit-driven and investments are managed on a commercial basis.*

B.4.1. Safe-harbour investment and eligibility conditions

a. What has been your experience with the application of the Risk Capital Guidelines in view of the identified equity gap as concerns:

- the conditions related to ***business development stages (to seed, start-up and expansion stages) and business size (SMEs***)?

- ***the size of the annual investment tranche of EUR 2.5 million*** ? What has been your experience in applying the annual investment tranche requirement to the various forms of aid (fiscal incentives, guarantees, etc.)?

- the requirement to invest at least ***70% of the fund's capital in the form of equity/quasi-equity in SMEs***? In your experience, has this restriction been applied to the total capital of the fund or for each investment deal?

[36] See section 4.3 of the Risk Capital Guidelines.

As explained previously in our response, the principle and the size of annual investment tranche of investment appear to be problematic.

First, the 12-month period used to assess and calculate the tranches of investment does not seem relevant, given the pace of investments, in particular in seed/start-up stages. This 12-month period simply does not correspond to the typical distance between an initial round of investment in an SME and the follow-on rounds of investments. We understand that the more removal of the time reference would not be feasible; however, we consider it is important for the Guidelines to be rationalised and better reflect in the compatibility assessment the actual demand and pace of investment in companies.

Second, the size of the tranche of investment can constrain the strategy of VC funds, in particular to ensure that it is able to access an investor basis as wide as possible. This is especially important in regard to fiscal incentives to investors.

As explained below, we also believe the definition of start-up capital may be improved.

b. The Risk Capital guidelines require ***a minimum participation of private investors*** according to the "assisted" or "non-assisted" status of the region concerned. In your experience, has it been difficult to attract the required private capital? If yes, please describe the difficulties encountered and explain whether meeting this requirement has proved to be more difficult depending on the development stage of a business and associated risks. Has the requirement been sufficiently clear with regard to the nature of investors operating under the market economy investor principle?

EVCA does not consider that distinguishing between "assisted" or "non-assisted" areas helps addressing the equity gap. The public participation should rather depend on the development stage of the investee company. Since it is more difficult to attract private investors in seed and start-up stages, this is where public participation ratio should be raised, irrespective of the "assisted" / "non-assisted" status of the region concerned.

c. What has been your experience with ***the specific treatment of assisted regions*** where the private participation requirement is lower and support to medium-sized enterprises in expansion stage is allowed?

As explained above, we would tend to consider that the business development stage is more relevant than that of the "assisted" / "non-assisted" status of the region concerned.

Members have also reported that the restriction of risk capital measures of medium enterprises up to start-up phase outside assisted areas is problematic, partly due to the fact that the definition of the start-up development phase is too restrictive.

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

The start-up phase[37] if interpreted as ending at first commercial sale, potentially discriminates between companies depending on the sector in which they are active. From its creation, an Internet companies will be able to engage in commercial sale, which would exclude it from the start-up phase. On the other hand, biotech companies may not do so for years.

Such an approach discriminates between sectors, and as a result, investments in medium-enterprises are not possible, unless a flexible interpretation is adopted. **Therefore we would ask for the definition of start-up capital / stage to be made more coherent and more flexible by removing the reference to profit**.

We would also encourage the Commission to enlarge the benefit of the Risk Capital Guidelines, irrespective of the assisted / non-assisted character of an area in which SMEs are located, but rather to strongly focus on the seed and start-up development phases.

B.4.2. Profit-driven investment decisions

a. What has been your experience with applying the ***conditions for profit-driven investments***[38] in terms of ensuring that publicly-supported risk capital investments are made in viable businesses and do not distort competition in the internal market by supporting inefficient businesses?

n/a

b. In your experience, ***how has the profit-driven requirement been reconciled with the preferential treatment of private investors*** compared to the public investment? In that respect, what incentives have been offered to the private investors to ensure their genuine interest in investment success, i. e. have the incentives focused on improving returns instead of providing downside risk protection?

n/a

B.4.3. Investment management on a commercial basis

a. What has been your experience with applying ***the commercial management conditions*** in terms of ensuring that investments are managed on a commercial basis seeking to optimise investment returns? In your view, is ***the wording sufficiently clear*** to avoid misinterpretations?

n/a

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[37] Start up capital is defined as "*financing provided to companies, which have not sold their product or service commercially and are not yet generating a profit, for product development and initial marketing*."

[38] Each investment decision must be based on a viable business plan with a clearly identified exit strategy and minimum level of private investment. See point 4.3.5 of the Risk Capital Guidelines

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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b. In your experience, have risk capital measures been implemented mainly ***under direct management mode***, i. e. by the public authorities or their executive agencies providing equity finance directly to SMEs/financial intermediaries? If yes, what safeguards have been put in place to ensure that investments are managed on a commercial basis (e. g. relying on investment decisions of qualifying independent investors)?

   n/a

c. In your experience with ***indirect management mode***, i. e. when implementation tasks are delegated to public or private entities that act on behalf of the public authorities and have the necessary technical expertise to carry out investment appraisals, structure investment deals, supervise portfolio and ensure successful exits), have implementation tasks been delegated mainly to private operators or public in-house bodies, acting as entrusted entities? How the entrusted entities have been selected? In your experience, what has been the performance of public in-house management bodies?

   n/a

d. In your experience, which ***management remuneration structure and performance incentives*** (carried interest arrangements or alike) have been used to align the interest of investment managers with those of public and private investors in order to maximise investment performance?

   EVCA would like to remind the Commission of the specificities of remuneration under the VC model. The VC industry uses a risk-sharing and incentive structure, which has been developed jointly over many years between the fund managers and investors, with the specific aim of aligning interests between the fund manager and its investors. This specific model ensures both ex-ante alignment of interests thanks to the co-investment by the sponsors of the private equity partnerships (often via a carried interest vehicle) and ex-post adjustments to protect investors' interest and commitment to the fund.

   Consequently, we strongly believe that the typical carried interest structure which operates in the VC industry is the most efficient remuneration structure which may be used.

e. In your experience, have you encountered any difficulties applying ***the commercial management conditions to various forms of aid***, such as setting up VC funds, co-investment funds, fiscal measures, guarantees?

   n/a

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu

B.5. Conditions for compatibility: a detailed assessment

Risk capital measures that do not fulfil all the standard assessment conditions may nevertheless be authorised after a detailed assessment. [39]

a. In your experience, have the Risk Capital Guidelines provided sufficient ***clarity and predictability*** about the possible outcome of the Commission's assessment of measures subject to a detailed assessment? In your view, are the conditions for the assessment of the positive and negative effects of the aid appropriate and sufficiently clear?

n/a

B.5.1. Market failure and aid necessity

a. What has been your experience concerning ***the burden of proof for substantiating market failure*** and providing relevant evidence?

We are not in a position to comment on most of these questions.

b. In your experience, what ***eligibility criteria and investment restrictions*** have been introduced to ensure that risk capital investments target the identified equity gap?

n/a

c. In your experience, have you set out ***contractual requirements for intermediaries*** to verify the presence of a viability gap (insufficient viability to attract financing on commercial terms) in each deal?

n/a

B.5.2. Incentive effect

a. What has been your overall experience in applying ***the conditions for the incentive effect of the aid*** as set out in the Risk Capital Guidelines?

n/a

[39] See chapter 5 of the Risk Capital Guidelines.

b. In your experience, what ***type of incentives*** (non *pari passu* capital enhancing returns for private investors or sharing downside risk with private investors, fiscal incentives, guarantees, etc.) attracted the most private investors, such as large institutional investors, business angels as well as non-traditional alternative investors, such as sovereign wealth funds, endowment funds and charitable foundations?

n/a

c. In your experience, what has been the appropriate ***balance*** between limiting incentives for the private investors to the minimum necessary and attracting their significant participation?

n/a

B.5.3. Proportionality

a. What has been your experience in applying the conditions for ***the proportionality of the aid*** as set out by the Risk Capital Guidelines?

n/a

b. In your experience, what procedural safeguards and benchmarks have been used to ***avoid overcompensation of the private investors***, i. e. limiting their expected returns on investment to market levels?

n/a

c. In your experience, do you require that measures involving repayable financial instruments are ***financially self-sustainable***, i. e. at least the initial public capital must be repaid to the state?

n/a

d. In addition to the annual investment cap at SME level and a private-public investment deal ratio, what other safeguards have been used to ***limit the aid to investee companies***?

n/a

B.5.4. Delivery mode and decision-making

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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a. In your experience, what ***procedure has been used to select financial intermediaries*** to manage the investments on behalf of public authorities? What minimum selection criteria have been used (skills, track record, a fee level)?

b. In your experience, has ***direct implementation*** (public authorities making investment decisions) been an exception and under what circumstances? How have you ensured that the public authorities undertaking direct implementation have the technical capacity to manage investments on a commercial basis?

c. What ***performance-based incentives for fund managers*** have been used to incentivise them to take investment decisions on a commercial basis to ensure self-sustainability of funds?

d. In your experience, how the ***private investors have been involved in decision-making*** of a public-private fund or a public fund co-investing with the private investors on a deal-by-deal basis?

e. In your experience, has ***the aid for management scouting costs been often used***? If not, why? Are the criteria well-designed to meet the needs of fund managers?

   Members have reported that the aid for management scouting costs, since its introduction, has proved both cost-efficient and effective. Such aid is currently limited to 50% of the costs sustained when the scouting does not result into investment. Scouting costs are inevitable when investing in seed and start-up stages. EVCA would request the increase of the 50% limit on scouting costs.

B.5.5. Minimising competition distortions

a. In your experience, have ***the safeguards*** set out in the Risk Capital Guidelines provided sufficient legal certainty in order to ***minimise potential distortions of competition and trade***?

   n/a

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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C. Experience with the GBER

C.1. GBER: risk capital measures

Aid for risk capital investments is partly covered by the GBER, thereby allowing Member States to support risk capital investments without prior notification to the Commission. [40]

a. In your experience, to what extent have the possibilities provided by the GBER been used? What proportion of aid for risk capital investments was granted under the GBER in comparison to the Risk Capital Guidelines? Please indicate the number of GBER aid measures and GBER aid amount as percentage of total risk capital aid.

To our knowledge, there has been a limited use of the GBER and of the notification exemption provided for under the GBER. Slightly over 35 schemes have been set up pursuant to Article 28 and 29 GBER and have had the opportunity of benefitting from a notification exemption. Further, investment funds are very often not aware of the existence of faster procedures and of the fact that the prior notification requirement does not apply in such cases.

This exemption could be extended: it could be used to clear existing schemes which have already been approved or cleared by the Commission, to avoid the burden of notification procedure by the national authorities.

Members have reported that lengthy procedures had to be undertaken for authorised schemes when the Risk Capital Guidelines were reviewed, e.g. in 2006 or following the adoption of the Temporary Framework. Provided the conditions under which the initial scheme or national measure are not stricter in the new Guidelines, the benefit of the exemption notification should extend to schemes already authorised.

b. What are the main factors that have possibly ***prevented your authorities from granting a larger proportion of risk capital aid through block-exempted measures***? Is it related to the type of measures (capital provision, fiscal incentives, guarantees), the size of the annual investment tranche, delivery mode (a public-private fund, a public fund co-investing with private investors on a deal-by-deal basis) or to other factors?

Currently, the scope of the block exemption only covers the constitution of investment funds in which the State is a partner, investor or participant, even if on less advantageous terms than other investors, provided specific conditions (including the safe-harbour threshold) are complied with.

Given the experience accumulated now by the Member States and by the Commission under the Risk Capital Guidelines, we would suggest an extension of the types of measures which may be block-exempted, provided these measures also comply with specific

[40] See Section 6 of the GBER.

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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conditions aligned with the Risk Capital Guidelines assessment under Section 4 (safe-harbour threshold, financing instruments used, 50% of the funding provided by private investors, etc.).

In this context, the limit on the size of tranches of investment is the most important factor which has restricted the use of the GBER.

c. Have you encountered any difficulties with ***the types of measures*** that are currently exempted, namely the constitution of public-private funds?

n/a

d. What has been your experience with applying ***the investment restrictions*** set out in the GBER (the eligible beneficiaries, the annual investment tranche, the private investment ratio)?

n/a

e. In your experience, have the conditions related to ***profit-driven investment decisions and commercial management*** been sufficiently clear to implement block-exempted measures?

n/a

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5
B-1050 Brussels, Belgium
T +32 2 715 00 20 F +32 2 725 07 04
info@evca.eu www.evca.eu
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D. Miscellaneous

D.1. Questions aiming at all respondents

a. Do you have any other comments on the application of the Risk Capital Guidelines and the GBER (risk capital measures) on issues other than those covered in the previous questions?

   No.

b. Please provide copies of any documents or studies which may be relevant for assessing the application of the Risk Capital Guidelines and the GBER and contributing to the reflection on its future revision.

   See Annexes attached.

c. Please indicate whether the Commission services may contact you for further details on the information submitted, if required.

   Yes ☑ No ☐

About EVCA

The European Private Equity and Venture Capital Association is the voice of European private equity and venture capital, representing more than 1,300 members. In addition to promoting the industry among key stakeholders, such as institutional investors, entrepreneurs and employee representatives, EVCA develops professional standards, research reports and holds professional training and networking events.