Press release

Industry calls for more action on risk capital for Europe's high growth firms

AFME publishes new report on the challenges of raising pre-IPO finance
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AFME has today published a new report examining the specific challenges associated with raising risk capital for small and mid-size high-growth companies in the European Union. The report aims to inform policymakers about the challenges facing Europe's high growth companies in obtaining crucial early stage financing.

"The Shortage of Risk Capital for Europe's High Growth Businesses" was authored by AFME with the support of 12 other European organisations representing all the different stakeholders involved in pre-IPO finance. These include the European Investment Fund (EIF), seven other European trade associations representing business angels (BAE, EBAN), venture capital (Invest Europe), accountants (Accountancy Europe) and crowdfunding (ECN), as well as stock exchanges (FESE, Deutsche Börse, LSE, Euronext, Nasdaq).

Simon Lewis, Chief Executive of AFME, said: "Europe's shortage of risk capital for high-growth businesses is a pressing issue, particularly given the enduring low growth environment. Collectively, we are pleased to present this pan-European report providing data and recommendations on improving access to equity and venture debt financing for high growth companies. The industry looks forward to working with the Commission to help further the Capital Markets Union and growth agenda and boost EU companies' competitiveness."

Olivier Guersent, Director-General at DG FISMA, said: "The European Commission welcomes this new pan-European study on the shortage of risk capital for ambitious firms seeking to expand. This is one of the core challenges that the EU's Capital Markets Union seeks to address. The inadequate supply of risk capital has been a longstanding constraint on European firms with high growth potential. Under CMU, the Commission has tabled several initiatives to improve the functioning of these markets. However, there is no quick fix. European policy-makers need to stay focussed on this structural challenge in the years ahead. This report is very timely as the Commission prepares to refresh the CMU action plan through its mid-term review."

The report identifies the main barriers preventing the creation and growth of businesses in Europe and makes the following recommendations to address them:

1. **Fragmented start-up market**
   Establishing a single EU framework for start-ups with standard rules across EU Member States would enable young businesses to scale-up across borders and facilitate access to 508 million customers. This could be done through the establishment of an EU expert group to focus on the revision of the various EU legal frameworks, insolvency laws and tax incentives for investors. There is already momentum for such a transformation with the recent Commission Start-up and Scale-up Initiative, including the proposal for an Insolvency Directive;
2. **Lack of awareness of risk capital benefits among businesses**
   Improving awareness among entrepreneurs of how to gain and retain risk capital investors would reduce business failure rates. Better business structure and governance from the start would increase the chances of raising subsequent rounds of financing from professional investors. Businesses with stronger cash positions would emerge, leading to higher chances of survival;
3. **Under-developed business angel and crowdfunder capacity**
   Unlocking business angel and crowdfunder capacity would allow them to invest in companies across the EU. Creating a single market for business angel investors by aligning best practices and ensuring

consistent tax incentives in the EU28 could be one way to provide more risk capital to Europe's innovative businesses. Education, training and certification of individual investors, as well as the promotion of the role of syndicates and networks with a European reach, would also increase the number of crowdfunders and business angels;

4. **Insufficient business angel exit opportunities**
   If business angels and crowdfunders are to invest more, they must have access to better exit opportunities. The development of networks and training, as well as the development of secondary markets for private shares at EU level would enable such access;
5. **Insufficient venture capital funding**
   If Europe's VC industry is to provide more funding, it needs to scale up. This could be achieved by providing incentives for investing in VC funds, encouraging investment in the asset class and promoting pension savings in the EU28 generally. Achieving a workable EU-level marketing passport for VC fund managers (as part of the review of the EuVECA) and the launch of the pan-European fund of funds are good steps forward;
6. **Small venture debt market**
   Developing the venture debt market in Europe could provide the necessary funding for VC-backed businesses to reach their next milestone. Venture debt can fill the gap between two VC equity rounds.
7. **Unfavourable environment for businesses to access public markets**
   Building a favourable environment for access to capital markets would help small businesses access the information necessary to initiate long-term growth financing strategies. To do this, the development of SME advisory ecosystems of issuers, advisors, entrepreneurs, academics and European centres of innovation is recommended;
8. **Sluggish primary equity market**
   There is a need to tackle the decline in IPOs, which play a crucial role in Europe's economy. The proposed Prospectus Regulation is a great opportunity and further initiatives should be undertaken, such as supporting new categories of investors to invest in high-growth companies.

The report outlines the various sources of EU financing available to Europe's high-growth businesses, (including family and friends, accelerators, equity crowdfunding, business angels, venture capital, venture debt, public markets and public funding), but highlights that many of these are underused:

- Europe could invest more in risk capital: three million EU citizens hold non-real estate assets in excess of €1m – if even a small part of this were used for **business angel investing**, it would make a huge difference;
- European companies received €1.3m on average from **venture capital** compared to €6.4m in the US;
- **Venture debt** is underused: only 5% of VC-backed EU companies obtain venture debt financing compared to 15-20% in the US and 8-10% in the UK.

The report also includes an analysis of the main providers of risk capital for small innovative companies in Europe, showing that there is room for improvement in the European risk capital landscape:

- **Business angels** invested in half the number of businesses in Europe compared to the US. Only 12 EU Member States have tax incentives for early-stage investments;
- **VC funds** in Europe invested €4.1bn compared to €26.4bn on average in the US between 2007-15;
- Only 44% of **EU VC investments** went to later stage businesses compared to almost two-thirds of all VC investments in the US;
- **Equity crowdfunding** is growing in Europe with €354m invested;
- Origination activity in the EU has remained subdued since the 2007 crisis: in 2005-2007 an average of €11bn was raised annually through 300 IPOs per year. Since then, the annual average has fallen to €2.8bn with 161 IPOs per year between 2008 and 2015.

- A majority (61%) of European listed companies have market capitalisation of less than €200m compared to just 46% in Hong Kong and 39% in US emerging growth companies.

The report is part of AFME's broader growth initiatives and is the third in a series of publications focussing on unlocking growth and jobs in Europe. Earlier publications include *Bridging the growth gap,* which highlighted the gaps in equity financing for small and mid-sized companies. This was followed by *Raising finance for Europe's small and mid-sized businesses* translated in six languages.

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About AFME:

1. AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.
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