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The Shortage of Risk Capital for Europe's High Growth Businesses

In conjunction with:

Accountancy Europe, BAE Business Angels Europe, BusinessEurope, Deutsche Börse Group, eban, European Investment Fund, Euronext, ecn European Crowdfunding Network, FESE, Invest Europe, London Stock Exchange Group, Nasdaq

Disclaimer

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The content of this report has been discussed with and has greatly benefitted from discussions with the following organisations. The institutions support the objective of addressing the shortage of risk capital while having individual views on particular aspects of certain issues.

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Foreword

The Shortage of Risk Capital for Europe's High Growth Businesses is a collaboration between AFME, the European Investment Fund (EIF), seven trade associations and four stock exchanges representing various stakeholders involved in pre-initial public offering (IPO) finance.

Against a background of improving, but uneven growth, Europe's shortage of risk capital for high-growth businesses is a pressing issue. For public and private stakeholders alike, raising finance and retaining investors for high-growth and innovative companies is a major priority.

The report sets out to explain the state of the financing market for small and mid-size high-growth companies in the European Union and the challenges they face in accessing crucial early stage financing.

While all the associations involved in drafting the report support the objective of addressing the shortage of pre-IPO equity capital, as is to be expected, there are different views on specific issues. Together, we represent businesses, crowdfunding platforms, business angels, venture capital funds, other early-stage investors, stock exchanges, accountants, arrangers and banks involved in financing start-ups, scale-ups, high growth companies and innovative businesses. We all have a key role to play in enabling these businesses to realise their full potential in a EU full of opportunities.

We are keen to play an important role in building a viable funding ecosystem for these high-potential companies, enabling them to benefit from a unified market of more than 510m people[1] and annual GDP of €14.7tn[2].

This pan-European report gathers data and views on key barriers and recommendations for unlocking risk capital for small high growth businesses. Our objective is to improve the potential scalability of Europe's young companies ahead of them accessing the public markets.

Improving access to risk capital is essential for the future competitiveness of Europe's high growth businesses and we hope this report will stimulate an interesting and productive debate on this subject.

Simon Lewis
Chief Executive
Association for Financial Markets in Europe

1 Europa.eu

2 Source: IMF, 2016

The Shortage of Risk Capital for Europe's High Growth Businesses

1. Executive summary

The purpose of this report is to describe the existing sources of risk capital, and to highlight ways in which policymakers might improve its supply. This could happen at both the European Commission and Member State levels.

The availability of risk capital is of utmost importance to finance the start and growth of young and innovative companies. It is not a financing instrument for all types of companies, but in particular for a group of enterprises with very high growth potential. The relevance of risk capital financing, not only for young and innovative companies but also for the economy as a whole, ranks often high in the toolbox of policy recommendations. However, there are impediments to a development of a vibrant risk capital market and still the "[p]resence and accessibility of alternative funding avenues is underdeveloped for SMEs, *e.g.* venture capital & angel investing" (AFME and BCG, 2015).[3]

Europe has a shortage of risk capital for small, early-stage growing businesses. This is holding back the development of high-growth sectors such as technology which are essential for economic competitiveness. While sources of capital such as crowdfunding and business angels are becoming more accessible, the EU is still at a significant disadvantage to the United States.

Europe was home to just 16 unicorns[4] in January 2017. This compared to 91 in the US and 44 in Asia[5]. What's more, while 17 of the world's 50 most valuable companies in 2006 were from the EU, today, only 6 are[6].

The EU's fragmented internal market is partly to blame. **Different rules, taxes and standards across the 28 Member States hamper young businesses seeking to scale up across borders**. Establishing a single EU framework for start-ups, with standardised rules across countries, would help to remove this barrier. The recent survey and "the Start-up and Scale-up Initiative" from the Commission are the first step to improve the start-up ecosystem in Europe[7]. Through their business life cycle, businesses use various sources of financing to grow from a start-up looking for seed funding to 'mid-cap' looking for funding in public capital markets, across the so-called "funding escalator"[8].

This report provides **insights on the financing gaps on the funding escalator, setting out to:**

- **Educating entrepreneurs about the benefits of risk capital, and appropriate structure and governance,** leading to a more flexible start-up universe**.** There is a lack of awareness among Europe's entrepreneurs and "family and friend" investors about the benefits of risk capital[9], at a seed stage of development. European SMEs heavily rely on bank financing[10] and although, many entrepreneurs turn to bank loans when they need cash, in many cases risk capital is more suitable for young businesses without dependable cash flows or assets. The demand side "culture" regarding the (willingness to) use of external risk capital is significantly different in Europe compared to the US. Evidence shows **well-capitalised businesses are more likely to be successful** and able to pivot from their initial product or market[11]. Start-ups with long-term prospects, a relevant business plan and management team should seek large amount of start-up

3 Kraemer-Eis, H., Signore, S. and Prencipe, D. (2016). The European venture capital landscape: an EIF perspective. Volume I: the impact of EIF on the VC ecosystem. EIF Working Paper 2016/34, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_34.pdf

4 High-growth, venture capital (VC)-backed companies with valuations of more than $1bn.

5 Wall Street Journal, http://graphics.wsj.com/billion-dollar-club/

6 The Economist, August 2016.

7 http://ec.europa.eu/growth/tools-databases/newsroom/cf/itemdetail.cfm?item_id=8723 and http://europa.eu/rapid/press-release_IP-16-3882_en.htm

8 European Commission, Communication on Long Term Financing of the European Economy, 27 March 2014.

9 Defined in the document as being equity or venture debt, the latter being defined as non-convertible senior term debt that includes warrants and allow existing investors to avoid dilution from new investors.

10 For details see Kraemer-Eis, H. Lang, F., Torfs, W., Gvetadze, S. (2016) European Small Business Finance Outlook, December 2016. EIF Working Paper 2016/38, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf

11 See section "Family and Friends, page 27. See also "Growth Paths and Survival Chances", Alex Coad, Julian Frankish, Richard G. Roberts, David J. Storey, July 2, 2011

funds, ideally equity, to boost their chances of success. When utilised inappropriately, "family and friends" finance can reduce growth prospects and the chance of additional rounds of professional finance (see "family and friends" section). It is therefore vital for businesses to have access to standardised documentation, widely available on the internet for equity and quasi-equity financing.

- Seed-stage VC investments and equity investments in technology transfer (TT) activities can contribute to reducing early-stage (pre-seed, seed and post-seed) funding gaps and sustain viable TT structures while generating over time financial returns for investors. TT activities, including business incubators encourage collaboration between research organisations and industry, the licensing of intellectual property rights, and the creation of start-up businesses and university spin-out companies, thereby contributing to support innovation and human capital formation[12].

- **Enabling business angels and crowdfunders to play an important part in providing equity funding for young businesses.** Creating a passport for them to invest across Europe would help crowdfunding and business angel networks to grow. Consistent fiscal incentives would also help. Although overall market volumes so far are rather low, equity crowdfunding is expanding, but suffers from inconsistent regulation, as well as varying tax incentives[13]. A common EU regulatory and tax environment would boost growth. With a growing crowdfunding industry, there is a need for independent organisation, at a global or European level, to promote, and create a clear framework and taxonomy for the crowdfunding industry.

- **Facilitating investments in venture capital (VC): there is far less funding available in Europe than in the US**, where it plays an important part in funding high-growth businesses. More favourable tax and regulatory treatment for institutional investors such as pension funds and insurers, respectively, would promote the sector's growth. The European Commission's plan to study discriminatory tax obstacles to pension funds' cross-border investment is a step forward. At the same time, promotion of pension investing would create larger pools of capital for VC investing.

- **Developing the venture debt market** in Europe so it could fill the gap between two equity financing rounds from VC. Venture debt provides customised debt financing for young and innovative companies as an interim financing to grow operations before having another venture capital financing round. Promoting and increasing awareness of the venture debt financing route could help the growth of European innovative businesses.

- **Building a favourable environment for businesses accessing capital markets and reviving the primary equity market activity.** Public markets can provide large amount of capital to more mature high-growth companies. Savings in the EU represent €2.7tn or 20% of GDP (compared to €2.8tn and 27% of GDP in the US[14]) and in 2014 European assets under management from retail stood at €4.9 trillion, representing 26% of the overall assets under management[15]. **Three million EU citizens hold non-real estate assets in excess of €1m[16].** However, very little is invested into corporates, including small listed businesses, through the capital markets. Policy-makers should give investors incentives to allocate funds to both unlisted and listed equity. Moreover, current regulations should be adapted to include a larger spectrum of investors including through the definition of professional investors in MiFID II.

12 Kraemer-Eis, H., Lang, F., Torfs, W., and Gvetadze, S. (2015). European Small Business Finance Outlook, Dec. 2015. EIF Working Paper 2015/32. Dec. 2015. http://www.eif.org/news_centre/publications/eif_wp_32.pdf EIF (2016). Annual Report 2015. Supporting smart, sustainable and inclusive economic growth for SMEs. 02.05.2016. http://www.eif.org/news_centre/publications/eif_annual_report_2015.pdf

13 Throughout the document tax incentives are viewed as tax relief schemes through government guarantees, reductions on tax rates and tax credits.

14 Bank of England.

15 EFAMA, Asset Management in Europe, 8th Annual Review, April 2015, http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/150427_Asset%20Management%20Report%202015.pdf

16 European Commission, Opportunity Now: Europe's mission to innovate, Robert Madelin and David Ringrose.

Background

Among the 23m European small and medium-sized enterprises (SMEs),[17] a fraction are high growth companies quick to grow, invest, create jobs and become leaders in their respective markets (e.g. just 6% of UK companies created half of new jobs between 2002 and 2008[18]). In other words, the high growth companies are mainly responsible for the creation of new jobs[19]. Looked at another way, the 60% of start-ups that survive their first three years may represent only 17% of UK employment but they create 42% of new jobs.[20] With more equity investment, more businesses could survive and potentially create new jobs. But start-ups, scale-ups and high growth companies respectively need seed, early-stage and expansion capital to reach their objectives.

Appropriately, **European policy-makers have launched many constructive initiatives to increase the access of European SMEs to finance**, as highlighted in the European Commission's Capital Markets Union (CMU) Action Plan. Recent examples are the launch and expansion of the Investment Plan for Europe – which also provides significant support in terms of risk capital via the European Investment Fund (EIF) - unlocking €75bn for SMEs, the review of the Prospectus Regulation to improve larger SMEs' access to the capital markets, the review of the securitisation framework and the launch of the European Venture Capital Funds (EuVECA) regulation. The recently launched pan-European Venture Capital Fund of Funds and study of the national tax incentives for venture capital and business angel investments[21] are further steps towards better capitalised start-ups and growth companies.

The CMU Action Plan states that "so far, external equity funding for SMEs is rather limited in Europe", including to finance their growth ambitions. The CMU was jointly supported by a group of major European associations at its announcement in June 2015[22]. In 2015, AFME and BCG in their joint report *Bridging the Growth Gap* showed that although European SMEs had more financing available than their US counterparts. 77% of EU funding for SMEs was in the form of debt vs 40% in the US. US SMEs have greater access to equity finance, which is of crucial importance for their survival. There are many studies regarding SME financing gaps[23], e.g. research[24] shows that the equity gap in some EU Member States[25] is three to five times larger than that of the US, with a large equity financing gap in the smaller countries. Further, 90% of European SMEs either regard equity finance as irrelevant or don't know that equity providers exist.[26]

In November 2016, the European Commission launched the Start-up and Scale-up Initiative[27]. This initiative brings range of existing and new actions to create a more coherent framework to help innovative businesses to grow. This initiative encompasses the creation of the pan-European Venture Capital Fund of Funds with the EIF, the legislative proposal on insolvency law and other initiatives in the domain of taxation. The initiative will also improve innovation supports through reforms to the Horizon 2020 programme, reinforcement of the ecosystems and measures to support the use of Intellectual Property rights by SMEs. Further flagship initiatives to support risk capital – covering various investment stages and sectors – will be necessary.

17 Annual Report on European SMEs, 2016, https://ec.europa.eu/growth/smes/business-friendly-environment/performance-review-2016_en

18 Nesta, The vital 6 per cent, 2009.

19 Kauffman, EU INNOVA, 2014.

20 European Commission, Crowdfunding in the EU Capital Markets Union, May 2016.

21 European Commission, CMU: First Status Report, April 2016.

22 AFME, BAE, EBF, Eurochambres, EBAN, EBN, ECN and European Issuers issued a joint declaration on the Capital Markets Union on May 2015: http://www.eban.org/wp-content/uploads/2015/05/Capital-Market-Union.pdf

23 For an overview see Kraemer-Eis, H. and Lang, F. (2014). Guidelines for SME Access to Finance Market Assessments. EIF Working Paper 2014/22, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_22_gafma_april14_fv.pdf

24 Lopez de Silanes, F, J McCahery, D Schoenmaker, and D Stanisic (2015), "The European Capital Markets Study: The Estimation of the Financing Gap of SMEs", Duisenberg School of Finance, Amsterdam.

25 France, Germany, Netherlands, Poland and Romania.

26 ECB, Survey on the access to finance of enterprises in the Euro Area. October 2015 to March 2016. June 2016.

27 http://europa.eu/rapid/press-release_IP-16-3882_en.htm

2. Overcoming barriers to risk capital financing

The availability of risk capital is of utmost importance to finance the start and growth of young and innovative companies. It is not a financing instrument for all types of companies – i.e. it cannot form a general substitute for traditional bank financing - but in particular for a specific class of enterprises with very high growth potential.[28]

The relevance of risk capital financing, not only for young and innovative companies but also for the economy as a whole, ranks often high in the toolbox of policy recommendations. However, there are impediments to a development of a vibrant risk capital market.

In order to explore the barriers to risk capital finance for Europe's SMEs, we interviewed a wide range of stakeholders involved in pre-initial public offering (IPO) finance, including policy-makers, and conducted extensive background research. We identified a number of barriers to this crucial stage of financing. We also collected a number of recommendations for improvement. This chapter discusses our findings.

1. A fragmented start-up market

At the October 2014 European Parliament of Enterprises (EPE), 84% of the participating entrepreneurs voted "No" to the question: "Is the EU Single Market sufficiently integrated, allowing your company to operate and compete freely?"[29].

The EU has a potential market of 510m customers[30] but European entrepreneurs cannot take full advantage of its potential. This is also due to various fragmentations on the supply and demand side of risk financing across the various member state jurisdictions. Entrepreneurs struggle to scale-up their businesses because of fragmentation in standards, legal frameworks and insolvency laws (see page 72 in Appendix). On the other hand, the providers of risk capital suffer from market fragmentation as well.

Such fragmentation is also observable in reporting standards. SMEs' financial reporting standards vary substantially between Member States, and are often driven by the demands of tax regimes and authorities rather than the information needs of creditors and other providers of finance. High levels of risk, information asymmetry, and significant due diligence and compliance costs result in a shortage of equity finance for businesses trying to raise less than €2m. In the IPO stage specifically, certain compliance, cost and due diligence related barriers may discourage SMEs from accessing public markets although the new rules on prospectuses are exempting the smallest capital raisings and should provide a lighter regime and less complex requirements for some issuances.

Additional barriers may result from tax regimes that have a bias in favour of debt finance, thereby further limiting the number of appealing financing options for smaller companies.

Recommendations

We recommend the establishment of a single legal framework for early stage companies with standard rules across EU countries. This would include a simple legal framework for corporate, labour, tax/fiscal incentives, stock options and bankruptcy issues. There is already momentum for such a transformation.

28 See in particular Signore (2016) for an empirical analysis of start-up growth and growth patterns of VC backed companies. Signore, S. (2016). The European venture capital landscape: an EIF perspective. Volume II: Growth patterns of EIF-backed startups. EIF Working Paper 2016/38, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_38.pdf

29 Eurochambres, Response to the public consultation under the start-up initiative, July 2016

30 In 2016, there were more than 510m people residing in the 28 countries of the EU. The size of the EU market could be reduced as a result of Brexit. However, for the purpose of this document, we continue to reference the size of the EU as it currently stands, prior to Brexit.

Notably, the Commission has surveyed entrepreneurs, start-ups and stakeholders on how to improve the start-up ecosystem in Europe[31], taking into account a company's evolving stages of development. This consultation led to the Commission's Start-up and Scale-up initiative[32] which we hope will help start-ups to take full advantage of the single market. This initiative brings together a range of existing and new programmes including the launch of ta pan-European VC fund of funds, the introduction of a new directive on insolvency law and simplification in taxation, including the creation of a Single VAT Area[33].

Within the private sector, there are two high-level proposals for standardisation, which we endorse in broad terms. The proposals favour a single internal market with, as far as possible: one set of rules, one set of incentives and the removal of cross-border barriers for investors and entrepreneurs. One of the proposals asks for an E-Zone. Such E-Zone is backed by a group of non-financial support organisations such as incubators, accelerators, innovation and entrepreneurship centres, including EBAN[34]. The second proposes the "EU Single Start-up Market" and is backed by a group of 145 entrepreneurs[35].

More specifically, BusinessEurope, which represents businesses from 34 countries at the European level, has made the following proposals:

- The principle of mutual recognition should be better defined and consolidated through a revision of the EU regulation[36] laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State. National technical regulations fragment the single market by applying additional requirements to products that are already being lawfully marketed.

- The introduction and establishment of a "Quick Assessment Procedure" could promote better application of mutual recognition in goods and services and would improve the transparency of national decisions.

- New national technical regulations should be subject to an impact assessment with respect to the principle of free movement, and their justification and proportionality should be documented and based on special conditions of the Member State in question.

The Commission's recent dialogue with entrepreneurs about how to improve the single market for start-ups in Europe is to be welcomed[37]. Similarly, the Commission's Single Market Strategy to reinforce the single market for services and goods, a digital single market and standardisation of products, materials, services and processes is a positive development. **It is time, as far as is possible, to create a single competitive environment to boost entrepreneurship, competitiveness, scalability and job formation**.

Innovations in the use of the blockchain technology, which simplify transaction processing and disintermediate middlemen have potential to improve funding. Crowdfunding transactions have, in some cases, benefited from this technology. Further, stock exchanges in Europe have started to provide investors with an investor voting rights platform thanks to Estonia's unique e-residency system (Nasdaq Tallinn and the Republic of Estonia, see page 73 in Appendix).

Importantly, businesses must be able to deliver the financial information which is necessary to investors, and ensure that it is prepared to widely accepted standards.

31 http://ec.europa.eu/growth/tools-databases/newsroom/cf/itemdetail.cfm?item_id=8723

32 European Commission Communication, Europe's next leaders: the Start-up and Scale-up Initiative, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0733&from=EN

33 https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_148_en.pdf

34 The Creation of an E-Zone for Europe's Innovators, Entrepreneurs and Investors, 2016 http://www.eban.org/wp-content/uploads/2015/05/E-Zone-22-December-20141.pdf

35 http://www.singlestartupmarket.eu/

36 EU-regulation 764/2008. Mutual recognition is the principle of European Union (EU) law under which Member States must allow goods that are legally sold in another member state also to be sold in their own territory.

37 Through the recent public consultation under the Start-up initiative: http://ec.europa.eu/growth/tools-databases/newsroom/cf/itemdetail.cfm?item_id=8723

2. Lack of awareness by businesses of risk capital's benefits at the various development stages and specifically at the seed investment stage[38]

European business culture is far more familiar with debt finance than equity. This is a problem because equity is a far more flexible form of finance, often better suited to young companies than debt. In fact, greater use of equity, or quasi-equity, would reduce business failure rates from inability to meet debt payments.

The probability of survival is influenced by both a start-up's growth path and its initial size. **Therefore, startups with long-term growth prospects, appropriate business plans and sound management teams can raise sufficient funds at early stages, ideally equity, to have a material impact on their success rates.**

Businesses funded by family and friends may take less risks and therefore impact their rate of success and their ability to raise subsequent rounds of finance by other types of external investors. Informal finance has many drawbacks which can have a serious impact on the success of the business.

Many SMEs are skilled in accounting, but not all are skilled in finance management or attracting investment. There is a case for teaching SMEs about finance management and investment readiness. EU funding could be directed towards matchmaking sessions between entrepreneurs and potential investors. This should be done indirectly through improving local capacity to develop such investment readiness services, which requires a long-term approach and continuity. Chambers of commerce can play a pivotal role as trusted intermediaries[39].

Recommendations

Educating entrepreneurs about the benefits of equity finance would lead to a more flexible start-up universe. These businessmen could be taught how **to structure their companies' governance with aligned interests between shareholders and founders, and how to communicate openly with shareholders such as friends and family.** Good relations with shareholders would make them more likely to participate in future financing rounds. AFME and partners plan to publish a guide to help high-growth private companies access and retain investors – from the seed stage to exit.

3. Under-developed business angel capacity

Europe's hubs for innovation and start-ups are getting bigger and act as the beating heart of a complex network of national and international investments[40] and business angels are playing their part.

Yet while business angels frequently provide first round of funding of, for example, €500,000, they rarely deliver a second round of about €2m necessary for businesses to scale-up. In addition, business angels finance are not uniformly keen to fund all sectors and regions. If Europe had **a single market for business angel investors, syndicates and networks,** it would be easier to fund these larger amounts across all sectors. In today's single market, private cross-border investors in innovative companies are often penalised in other countries by national regulations, which do not offer them the same incentives on investments or exit as investors in their own national fiscal framework.

Illustrating the problem, it is estimated that US business angels invest in twice as many US companies as their EU counterparts in EU businesses. Furthermore, the size of US angels-backed transactions is approximately 1.7 times higher than EU transactions[41].

38 See page 54 for an overview of the various stages of development.

39 Best practices and examples of Chambers of commerce help to SMEs can be found in "Access to Finance: Chamber Services to SMEs", September 2016.

40 See Kraemer-Eis, H., Signore, S. and Prencipe, D. (2016). The European venture capital landscape: an EIF perspective. Volume I: the impact of EIF on the VC ecosystem. EIF Working Paper 2016/34, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_34.pdf

41 BAE, EBAN, Halo report, Center for Venture Research, Angel Capital Association. Estimated values, 2015.

Recommendations

We recommend **creating a single market for business angel investors, as well as their syndicates and networks.** A passport would allow them to invest in companies across EU Member States. Such passport granted to angel investors would allow them to follow their investee businesses when they plan to scale-up and expand into other European markets, and would make it easier to identify a syndicate of angels in another EU country willing to co-invest alongside the existing business angels, providing both risk capital and a soft landing in the target country. The introduction of a passport requires the development of a common accreditation or qualification system for business angels, which is already required in some EU countries.

Furthermore, mutual recognition of existing fiscal incentives for business angels is key to ensuring they would invest freely across the EU. We recommend that the various national tax incentives (e.g. Seed Enterprise Investment Schemes (SEIS) and Enterprise Investment Schemes (EIS) in the UK and *Fonds commun de placement dans l'innovation* in France (FCPI)) are reviewed to identify best practices and align incentives. For instance, the UK requires investors under SEIS and EIS schemes can only invest in businesses with a substantial base in the UK, whilst angels in France can invest in companies based in EU countries. By aligning their approaches, EU Member States could foster strong networks of specialist business angels, operating across EU borders.

Public and private stakeholders alike could deliver a further boost by training individual investors about the role of business angels, and promoting the role of syndicates and networks with a European reach. Business angel syndicates and networks are an efficient way to connect investors and entrepreneurs. They should be leveraged.

Existing business angel associations such as Business Angels Europe (BAE), the European Business Angel Network (EBAN) already give strong support, but more assistance is needed. Notably, there is a need for more education, training and certifications for investors and businesses. Education for high-net worth individuals and family offices about the benefits of investing in small private companies and start-ups would also be a good thing.

Business angel associations are working with smaller EU member states and the Commission on initiatives including the *Early Stage Investing Launchpad Pilot (ESIL)*. The ESIL pilot[42], funded by the European Commission, is currently developing business angel activities in three member states. If this initiative were leveraged in other member states it could both develop business angels in smaller EU countries and promote collaboration between regional EU business angel groups, clubs and syndicates.

We also **support private initiatives which improve the availability of early-stage companies' information as well as business plans**[43].

4. Insufficient business angel exit opportunities

If business angels are to invest more they must have better exit opportunities. Business angels may hold their investment for nine years and more without finding an appropriate buyer. Indeed, the lack of exit opportunities can, over time, deter business angels from investing, so undermining market confidence.

The development of expanded networks and training might also increase the exit opportunities for business angel investors. Additionally, further development of Europe's VC industry would provide a bigger community of buyers for these young businesses.

Secondary markets for private shares should be developed in Europe. US markets such as NASDAQ Private Markets/ Second Market offer liquidity for early employees, founders and seed investors with equity in young companies. Transactions on NASDAQ Private Markets reached \$1.6bn in 2015[44]. Similar private initiatives have been launched in Europe but many have failed to prosper. A common EU framework for secondary market platforms for private transactions (disclosure, transparency and tax implications for buyers and sellers) – maybe even creation of a public-private EU platform – would help.

42 http://www.europeanesilpilot.eu/

43 See gust.com which connects start-ups and potential investors in the US, France and Brazil. However, we are not aware of such a platform at a EU28 level.

44 Nasdaq Private Markets, *Private Company Liquidity: a Year in Review, 2016*

A recent initiative has come from Euronext in the shape of the Euronext Expert Market. This market is designed to meet the needs of non-listed companies looking for alternative financial solutions. Issuers do not have to register their securities: share or bondholders can simply sell their securities through a market member. Almost any financial instrument can be eligible for trading on the Expert Market, as long as it is not listed on any regulated market or on Euronext MTF's, and it has an acceptable settlement solution. Trading on Expert Market is easy and its wide base of members reaches a large community of investors. Public auctions take place once a week for shares, bonds and other fixed income instruments.

5. Under-developed crowdfunding capacity

Crowdfunding platforms are playing an increasing role in providing funding to SMEs, innovative start-ups and projects within research and development, creative and cultural sectors, renewable energy and other sectors. Funding amounts are in many cases between €500,000 and €1m for securities-based crowdfunding in the main markets, with average amounts in the UK even higher. However, it is not uncommon to see individual businesses raising more capital on certain crowdfunding platforms, reaching multi-million euro amounts per transaction.

The new Prospectus Regulation enables the development of crowdfunding markets to allow for European harmonisation for seed and early-stage fundraising for SMEs. The new prospectus rules will not apply to issues of securities of less than €1m and Member States would be able to exempt issuers they consider to be small from the obligation to publish a prospectus by setting a higher threshold (up to €8m) for their domestic markets. Adequate oversight of the crowdfunding platforms should be enacted on European or national levels but under the guidance of European Securities and Markets Authority (ESMA) and with involvement of the industry.

Crowdfunding platforms operate from different geographical locations and also with different business models, from special purpose vehicles that pool equity investors into a managed structure, via direct equity investments and quasi-equity structures to tradeable securities on multilateral trading facilities (MTFs). Other financial structures, such as bonds and debt-structures are also being increasingly used.

With a **European single market for retail or semi-professional investors**, including business angels, which allows the use of crowdfunding platforms, it would not only be easier to fund larger amounts, but also for individual investors to make informed investment decisions. For instance, geographic location might have an impact on the financial returns and there would be an opportunity to increase portfolio diversification.

While securities crowdfunding in Europe is ahead of its US equivalent (between €159m and 354m in the EU compared to €149m in the US, see section on equity crowdfunding below), access to finance is not limited to crowdfunding. As such, crowdfunding does not stop innovative businesses relocating to the US or Asia in search of better providers of capital. A well-planned European market for securities, alongside the funding escalator is key for making the European early-stage environment attractive.

Provide more clarity between various national crowdfunding frameworks and make use of existing passporting regimes would increase harmonisation and ensure regulated crowdfunding could effectively address funding gaps in early-stage finance across Europe.

In addition, best practices derived from experience in the market are needed to promote visibility and the security of equity crowdfunding as well as to unlock further cross-border investments. The fledgling equity crowdfunding market has great potential yet it is the legal frameworks and market practices governing it which vary from one Member State to another and are unclear. These bar platforms from scaling up, which would unlock cross-border investments. In some Member States, regulation makes the cost of capital raising higher than in others.

Recommendations

We recommend creating a single market for retail and semi-professional investors. While crowdfunding platforms can theoretically operate across borders under the EU's MiFID regulation, national legislations often prevent a pan-European market. Other barriers include the national differences in interpretation of the prospectus regulation, various fiscal incentives and company laws across the EU member states.

The European Crowdfunding Network (ECN) already provides strong support to the crowdfunding industry, but more assistance is needed. **Notably, there is a need for more education, training and certifications for investors and businesses, as well as professional best practices.** Education for retail investors, high-net worth individuals and family offices about the benefits of investing in small private companies and start-ups would also redirect investments.

The ECN together with BAE and others are working with smaller EU Member States and the Commission on initiatives including the *Early Stage Investing Launchpad Pilot (ESIL)*. Funded by the European Commission, this pilot is currently developing business angel and crowdfunding activities in three Member States. The initiative could be leveraged in other EU member states and include specific aspects on crowdfunding.

Finally, we recommend the promotion of a common EU framework and best practices in crowdfunding activities.

6. No secondary markets for crowdfunding exits

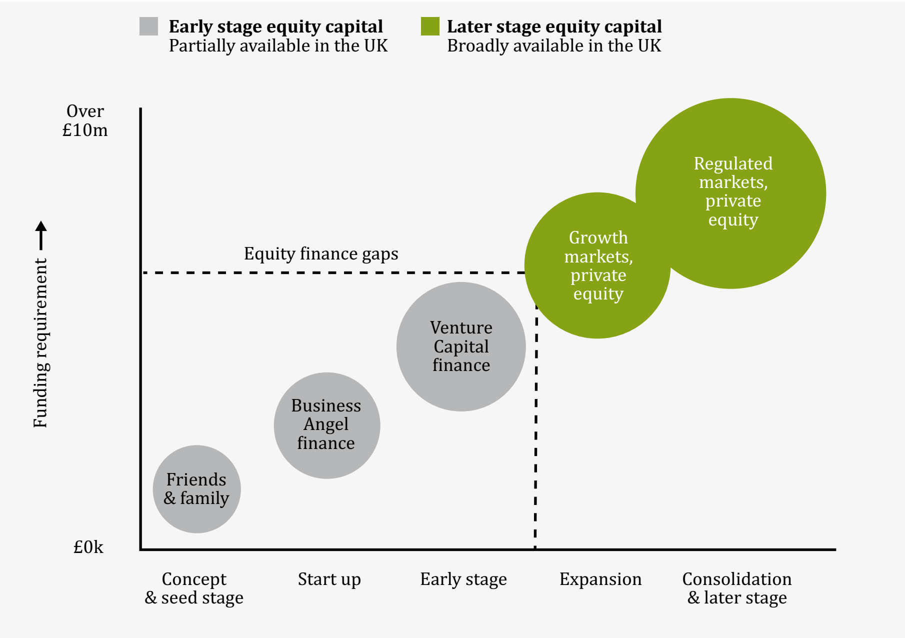
There is an urgent need to create and **improve exit opportunities for security crowdfunders** in Europe. Crowdfunders usually make investments as minority shareholders. Most crowdfunding platforms are simply market places. They do not participate in the transactions and, therefore, are not actively involved in exits. Instead, the business' management is responsible for exits. But due to the relative youth of crowdfunding, and other specificities, relatively few exits have taken place. Those that have include secondary sales to business angels, VC funds and, even IPOs (see case study page 35).

Secondary markets for private shares are already being developed in Europe. Examples of platforms that do or can act as secondary markets include Privanet in Sweden, Euronext's Expert Market in various countries and Alternativa in France (both operating as MTF). While such markets remain very small, Euronext's Expert Market saw the first secondary market trading in crowdfunded securities in Europe in March 2016 when participatory notes in the Belgian company Domobios, issued by the crowdfunding platform MyMicroInvest, were traded on Expert Market. A common EU framework for secondary market platforms for private transactions which would manage disclosures, transparency and tax implications for buyers and sellers, would help the development of the market, including the primary crowdfunding market.

7. Insufficient venture capital funding

European companies receive far less funding from VC funds than their US counterparts. This scarcity of funding limits the options for fast-growing companies seeking sufficient scale to compete globally.

Figure 1: **Equity finance gaps in the UK**



Source: Allen Simpson, Dr. Richard Roberts

Simply speaking, **VC funds are too small and need to increase in size**[45]: Europe's VC funds raised an average of €61m between 2007 and 2012 while US funds raised in average $98m (€72m) in 2005 and $135m (€111m) in 2015. US VC funds have a larger share of the overall private equity (PE) market than their European VC counterparts (20% vs 11%).

The average European VC-backed company receives only €1.3m (€356,000 at seed stages)[46]**, compared to €6.4m in the US (€2.9m at seed stages)**[47]. Investments are relatively small because Europe's VC funds are smaller than their US peers[48].

There is a particular financing gap at the stage when businesses want to scale-up in order to sell into international markets or expand their product ranges[49]. **Broadly speaking, businesses tend to reach this stage when they are two to three years old.** Typically, they received for around €5m or more in equity finance.

For instance, we understand that in Germany there is typically a shortage of VC for rounds of €3m up to €10m. Few German VC investors are able to contribute these ticket sizes[50]. Yet this is a stage when VC funds should play a major part.

45 EU VC funds are too small and re-invest in too few financial rounds, *Scale-up UK*, p45, University of Cambridge, SAID Business School, University of Oxford, Barclays, 2016. See also *The State of European Venture Capital*, BCG, IESE Business School, 2015.

46 Invest Europe, 2007 – 2015 statistics

47 NVCA 2016 Yearbook, 2007 – 2015 statistics

48 Assessing the Potential for EU Investment in Venture Capital and Other Risk Capital fund of funds, Oxford Research and CSES, 2015 and National Venture Capital Association and BCG

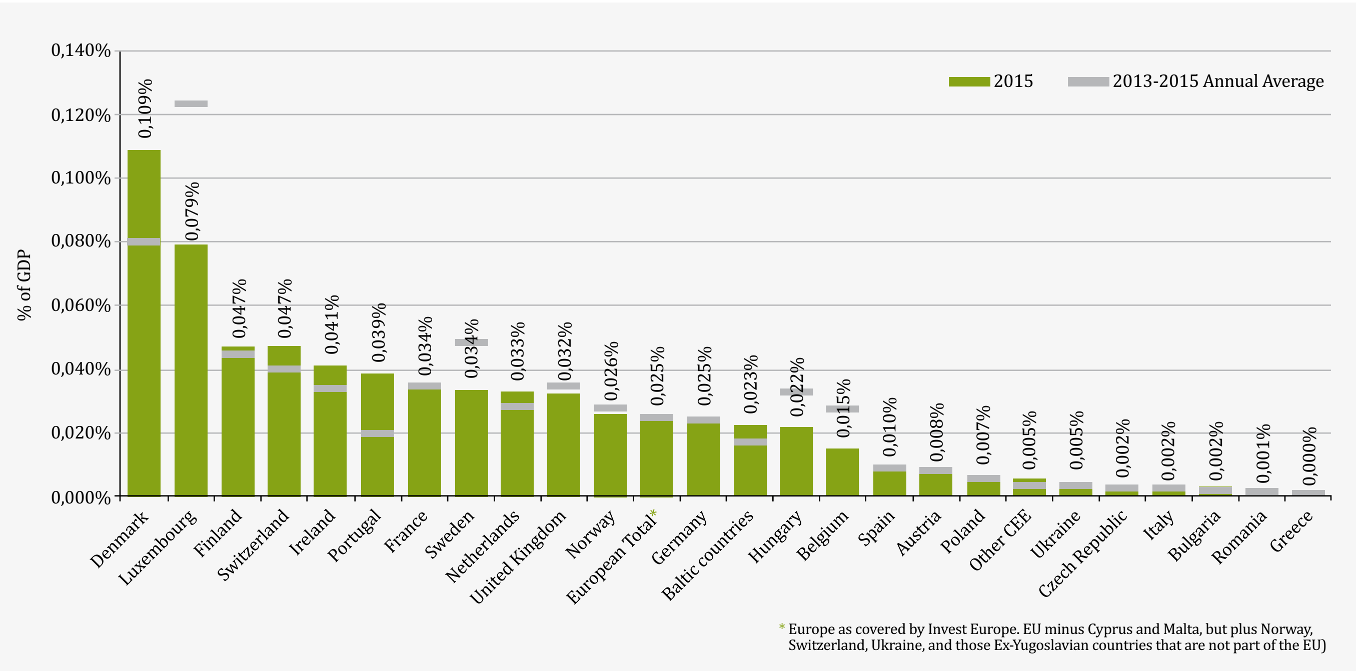
49 See European Small Business Finance Outlook, EIF, December 2016

50 E&Y, Venture Capital and Start-ups in Germany 2015

A quarter of the VC asset class is invested by government agencies. Compared to the US, pension funds, insurance, endowments, fund of funds and family offices invest much less in the EU VC asset class. At early stages, the European Investment Fund (EIF), a public entity, plays an important role. The EIF estimates that the investments activity backed by the EIF represented 41% of total investments in Europe in 2014 (29% in 2007). The share directly attributable to the EIF amounts to 10% (5% in 2007), hinting to the significant leverage that characteristics EIF-backed investments. Moreover, the EIF estimates that fundraising volumes backed by EIF in 2014 amount to 45% of the overall volumes collected by European VC investors (36% in 2007), against a share directly attributable to EIF totalling 12% (5% in 2007). The EIF observes a strong effect of the EIF funding, affecting VC amounts invested the year after and contributing to the VC ecosystem creation. The finding gives proof towards EIF effective crowding-in of VC capital (both from EIF co-investors and non-EIF co-investors) in the analysed period. The estimates show that, on average, a 1% increase in EIF-provided VC capital in a region led to a 1.41% increase in other investors' activity in the same region, one year later. This effect is in additional to the traditionally measured crowding-in by public investors in individual transactions.[51]. Public involvement is even more important for so-called Key Enabling Technology (KET) companies (a group of six technologies that provide the basis for innovation in a range of products across industrial sectors). Some 42% of KET funding comes from the public sector. There is a shortage of early stage finance for KET companies and even more at later stages[52]. The facts, described above, show that public support for risk capital – in order to be efficient - should preferably be indirect and should be able to cover various investment stages and sectors.

Figure 2 shows that venture capital investments is fragmented in Europe. In comparison, the US VC investments represent 0.33% of their GDP. Markets such as the UK, France and the Nordics have seen some recovery since 2008. However, many European countries such as Italy and Spain are struggling to develop their VC market. The fragmentation of the EU's institutional investors market as well as the lack of domestic insurance companies and pension funds may explain the lack investments in the VC asset class. However, VC investors seem to target tech hub rather than specific regions.[53]

Figure 2: **Venture capital investment as % of GDP (industry statistics, location of the VC firm, 2015)**



Source: IMF, World Economic Outlook Database (GDP) / Invest Europe / PEREP_Analytics
Note: *Other CEE consists of Ex-Yugoslavia and Slovakia

51 Kraemer-Eis, H., Signore, S. and Prencipe, D. (2016). The European venture capital landscape: an EIF perspective. Volume I: the impact of EIF on the VC ecosystem. EIF Working Paper 2016/34, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_34.pdf

52 Access to finance conditions for KETs companies, InnovFin Advisory, EIB Advisory Services, March 2016.

53 Kraemer-Eis, H., Lang F., Torfs W. and Gvetadze S. (2016). European Small Business Finance Outlook, EIF Research & Market Analysis. http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf

Recommendations

If Europe's VC industry is to provide more funding, it needs to scale-up. This could be achieved through providing incentives for investing in VC funds, encouraging private sophisticated individuals to invest in the asset class and promoting pension savings generally. The following broad measures would help to achieve these goals:

- **Achieving a workable EU-level marketing passport for VC fund managers** – as part of the review of the EuVECA – is a prerequisite to a well-functioning European venture capital industry. In Europe, too many venture capital funds are reliant on domestic investors (see Figure 37, page 56). The benefits of a Capital Markets Union will not be fully realised if institutional capital does not flow from investors in one Member State to VC firms in another. Action is needed to break down the barriers that lock capital behind national borders.

- **Clarify the involvement of high-net worth individuals, "sophisticated" and "semi-professional" investors**. VC firms want to raise capital from high net worth individuals (or family offices). There is a significant level of demand from this type of investor, which cannot always be fulfilled owing to marketing restrictions. In addition, private equity fund executives will often invest their own money alongside the main fund. This promotes alignment of interests and ensures that the investment team has "skin-in-the-game". In some cases, executives' family members or personal trustees – as well as in some cases the chairmen of the portfolio companies - will also make an investment into the relevant vehicle. Many direct or indirect investments in SMEs come from investors who would not be deemed "elective professional investors" under the MiFID II definition, either because they are high-net-worth individuals, such as family offices, entrepreneurs, wealthy individuals; or managers of venture capital and private equity funds, who are co-investing alongside the fund. As a result, those investors are either not allowed to invest in venture capital funds (unless it is EuVECA). Early-stage investor representatives suggest that MiFID and AIFMD should ensure that "sophisticated "or "semi-professional" investors are recognised as a specific investor category[54].

- **Encouraging investments into private/workplace pensions as appropriate** and **promoting increased allocation at national levels into alternative asset classes** such as VC. Fiscal incentives at a national level would encourage further private pension savings (see page 48 on the deregulation of pension funds in the US and Sweden).

- **Removing regulatory restrictions affecting institutional investors.** For example, insurers have cut their commitments to private equity (PE) and VC funds substantially as they prepare for Solvency II. Again, commitments and allocations to the asset class are far smaller than those in the US. However, we welcome the reduced capital charges for investments in both VC and PE in the final set of the Solvency II Delegated Acts agreed upon in the beginning of 2015. We also welcome the Commission's proposal to assess the prudential treatment of PE in 2018.

- **Providing tax incentives for family offices and private individuals through programmes** such as the UK's Seed Enterprise Investment Scheme and Enterprise Investment Scheme. Some of this equity investment could be provided by **the 3m EU citizens who each hold non-real estate assets in excess of €1m**[55]. This could encourage a change in investment culture in favour of equity. According to the European Central Bank, **U.S. households allocate one-third of their incomes to equity**, while this share **is only one-tenth of savings for German households** and **one-fifth for French and Italian** ones[56].

- Distilling the essence of the success of the UK's **Business Growth Fund**[57] (see page 71), its predecessor ICFC/3i and Germany's High-Tech Gruenderfonds (HTG). Similar initiatives could have an impact at national and European levels.

- Supporting the VC market through pan-European initiatives such as the European Commission's proposal to launch a privately-managed pan-European fund of funds (FoF) which would give institutional investors access to a diversified fund and the Commission's Start-up and Scale-up initiative.

54 For more information see http://www.investeurope.eu/media/516723/Invest-Europe-PAE-Full-Response-to-Consultation-on-Cross-border-Distribution-of-Funds.pdf

55 European Commission, Opportunity Now: Europe's mission to innovate, Robert Madelin and David Ringrose.

56 Politico, 2 May 2016.

57 http://www.businessgrowthfund.co.uk/

VentureUp[58] is an Italian institutional platform, launched by AIFI (the Italian Private Equity, Venture Capital and Private Debt Association) and Fondo Italiano d'Investimento, in cooperation with Cassa depositi e prestiti, Invitalia, BonelliErede and KPMG at the end of 2015. The aim of the initiative is to promote and catalyse contacts between start-ups and VC, seed investors and other players active in the ecosystem (accelerators, incubators, universities, science and technology parks, corporates).

8. Small venture debt market

In a context of subdued investments in the VC asset class, especially in follow-on funding, venture debt is used to fund businesses struggling to scale-up their activities, and allows investors to see a company through to profitability.

Venture debt is a complement to equity financing in a form of debt financing provided to venture equity-backed companies that lack the assets or cash flow for traditional debt financing, or that want greater flexibility. Venture debt is usually senior debt, collaterised by a company's tangible or intangible asset and structured as a term loan which amortise over time, with warrants for company stock.

When used sensibly, venture debt decreases the need for existing VC investors to deploy follow-on funding. The absence of dilution is particularly welcome for equity investors and the management team.

Venture debt is useful for early-stage businesses with high research and development expenditures as it enables more time to the development of new products and hit new milestones which will be essential to attract new equity investors on the next fundraising round. On the other hand, and like any other form of debt finance, venture debt should not be used as a financing of last resort and debt payment should not be too burdensome for the company and discourage future equity investors. Finally, venture debt is not recommended for businesses with stable revenues and receivables, where working capital finance could be more appropriate.

Recommendation

Venture debt is an asset class which requires expertise from investors and awareness from businesses. Promoting and increasing awareness of the venture debt financing route could be useful for innovative businesses to fill the gap between two VC equity rounds. We recommend the promotion of venture debt for innovative companies, especially those with a patent, to fill the gap between two VC equity rounds. The development of the German's Mezannine Fund of Fund by the EIF could be expanded to other Member States in the European Union.

9. Unfavourable environment for businesses accessing public markets

Small businesses often do not have the access of the information necessary to initiate long-term growth financing strategies. They often need help to acquire the financial and organisational skills to make themselves attractive to the widest possible range of investors. In its communication on long term financing, the Commission committed itself to assessing best practices for SMEs accessing capital markets. When published, this report deserves to be acted upon by policy-makers.

Deutsche Börse Venture Network is an initiative bringing together young companies and investors to improve the funding of high growth companies (with compound annual growth rate of 200% yearly). The participating investors are VCs, PE firms, public equity funds, family offices and high net worth individuals. Together, they represent more than €1.3tn of assets under management.

The London Stock Exchange's ELITE programme is designed to help SMEs prepare for and structure the next stage of growth through the access to long term financing. ELITE offers an innovative approach, including a training programme, a working zone supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is "capital neutral" to any financing opportunity, providing access to PE and VC funds, debt products, and others. ELITE's long-term objective is to improve SMEs access to more sophisticated skill-sets, network and a diversified capital pool in order to accelerate growth.

58 www.ventureup.it

EnterNext, the SME-dedicated subsidiary of Euronext, focuses on assisting SMEs to gain greater access to financial markets through proximity across France, Belgium, the Netherlands and Portugal. EnterNext organises over 200 events a year with the objective of explaining to SMEs of all sizes and sectors the role of financial markets and their benefits. Moreover, EnterNext assists listed SMEs in developing and strengthening their relationships with investors via regular meetings and events. Since 2014 EnterNext has also specifically focused on the technology sector to support companies' financing needs in this space. Central to this work has been a partnership with Morningstar to support financial analysis on technology companies as well as the launch of 'Tech Share' – a pre-IPO programme – and Tech 40, a label for 40 chosen Tech stocks enabling access to certain premium services.

The Irish Stock Exchange recently launched the #IPOready programme dedicated to growing companies with turnover above €5 million. The programme aims at enhancing the knowledge and skills of CEOs and CFOs in raising capital, investor relations and business management. It involves expert tuition and insights from advisors, investors, entrepreneurs and leading Irish corporates as well as networking opportunities. The initiative also includes one-on-one coaching from mentors and a live pitch of the company equity story to a panel of investors. The programme is led by the ISE and supported by Enterprise Ireland.

Recommendations

The Capital Markets Union should support the development of SME advisory ecosystems of issuers, investors, advisors, entrepreneurs, academics and European centres of innovation such as science parks. As they grow, SMEs use a combination of bank finance, seed capital, business angel finance, VC and ultimately public markets. Each type of investor is interdependent, as it must be confident of realising its investment at a later stage (and reinvest in the next generation of entrepreneurs).

10. Sluggish primary equity market activity

The importance of capital markets for the EU economy, as well as the need for their development are recognised in the Commission Green Paper on Capital Markets Union: "More integrated capital markets, especially for equity, would enhance the shock-absorption capacity of the European economy and allow for more investment without increasing levels of indebtedness"[59] the paper states.

The IPO process plays a crucial role in Europe's economy. Research has shown that capital market size is positively correlated with economic development: "those countries where capital markets – and especially stock markets – seem to be underdeveloped appear to pay a high price in terms of below average growth"[60]. Specifically, the same report (see previous note) states that: "in Europe it is the capital market, providing access to debt and equity financing, which determines economic development".

Studies from the United States and Europe demonstrate the unique role of equity in providing permanent risk capital[61]. The risk capital financing enabled by IPOs supports innovation, which is crucial for growth in developed economies[62]. Moreover, public equity markets complement and enable other sources of financing in a broad and continuous spectrum of methods available to companies and investors.

Therefore, there is a need to tackle the decline in IPOs. During 1993-2000, the OECD area had an annual average of about 1,170 IPOs. During 2001-2011, this number fell to about 670. During the "recovery" period before the financial crisis, IPO numbers never equalled the highs of the 1990s. Europe is arguably the worst-affected region. While Asia's equity market capitalisation and turnover have grown most rapidly, the US has traditionally made greater use of equity markets.

59 European Commission, "Green Paper: Building a Capital Markets Union".

60 Kaserer C. and Rapp M. S., "Capital Markets and Economic Growth: Long-Term Trends and Policy Challenges", page 10.

61 Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets".

62 Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe", pages 52-53.

A **reason for falling IPO numbers is the decline in smaller companies coming to the market.** From 2005 to 2007, an average of €11bn was raised annually through 300 IPOs on European junior markets while the annual average has fallen to €2.8bn from 2008 to 2015, and €2bn in 2015. While IPO markets continue to function well for larger companies they are becoming less and less accessible to smaller companies.

Therefore, there is a need to promote investor support for IPOs. The EU has a saving rate of 20% of GDP compared to 17% in the US. However, most of the savings are invested in real estate or left in bank deposits. They are barely invested in capital markets.

Recommendations

The Commission could support the creation of new categories of investors in order to support SMEs such as created in Italy through the "Fondo di fondi"[63] or the debt funds which are a rather new investor class[64]. For instance, the Commission could use such instrument to support the investments by new categories of investors in SMEs, with the participation of multiple actors including pension funds, insurance companies and alternative funds. If successful, such initiative would provide growth capital to start-ups, scale-ups and early stage companies, and also more generally to SMEs with clear business models, paths to rapid growth and a strong likelihood of follow-on investments.

Moreover, market practices should be revised and adapted to enlarge the current spectrum of professional investors: if needed regulatory action should be taken in the context of the Capital Market Union plan. In particular, the notion of "professional investors" as set out in MiFID II could be used. As known, MiFID recognises that investors have different levels of knowledge, skill, and expertise. The application of specific regulatory obligations under MiFID depends on a client's regulatory category. MiFID adopts two main categories of client: retail and professional. There is a separate and distinct third category for a limited range of business: eligible counterparty (ECP). MiFID attaches different regulatory protections to each of these categories – with the result that those falling within the retail category - the less experienced, knowledgeable and sophisticated investors will be afforded a higher level of protection than that afforded to investors in the professional or ECP category. "Retail" clients can request treatment as professional clients provided that relevant criteria and procedures are fulfilled. These clients are referred to by MiFID as elective professional clients: they are allowed to waive the Directive's protections in order to access a wider range of investments. Potential changes to the current legal environment to reinforce and smoothen such mechanism can be investigated.

Additionally, the proposed Prospectus Regulation should reduce the costs for small and mid-cap issuers listing on public equity markets. SME prospectuses should be made shorter, simpler, and less costly to produce while increasing their relevance for investors. The new rules on prospectuses propose a lighter prospectus for small and mid-companies (SMEs with up to 499 employees) and small issuances through the EU growth prospectuses. The new rules could also help information to be clearer for the investors. The new category of MTFs under MiFID II, "SME Growth Markets", may provide a useful platform for small and mid-sized businesses looking to raise capital on public markets

63 Launched in the context of the project "piùBorsa" described in the Memorandum signed by Consob and by some of the main representatives of the Italian industry to facilitate capital market access by medium-sized enterprises.

64 Such debt funds can act in a similar way to Private Equity funds; see for more details Kraemer-Eis (2014), http://www.eif.org/news_centre/publications/eif_wp_25.pdf

3. Table of barriers to risk capital investment

The table below provides highlights barriers to pre-IPO equity investment in Europe. It also outlines recommendations that would encourage investment, helping young companies to scale up, and so unlocking growth and jobs.

Finance providers	Key barriers	Recommendations
All	Fragmentation in standards, legal frameworks, insolvency laws and languages is a barrier to investment that stops companies from scaling up.	The principle of mutual recognition should be better defined and consolidated. Introduce a "quick assessment procedure", creating a framework for mutual recognitions for good and services. New national technical regulations could be subject to an impact assessment with respect to the principle of free movement. Educate entrepreneurs about the merits of different financial instruments and funding processes in early stages. **Equip individuals**, starting from a very young age, **with entrepreneurial attitudes and skills**, such as a sense of initiative, self-confidence, creativity, financial literacy, planning skills, teamwork and the ability to manage resources, uncertainty and risk[65]. **Address legal, insolvency and other areas** related to company ownership and investment, which vary between Member States. **Introduce a "disclosures elevator"** to accompany companies step-by-step alongside the "funding escalator" with non-mandatory recommended guidelines and standardised documentation from the start of a company. Create a forum (supported by public or private stakeholders) for entrepreneurs and investors to ask and answer financing-related questions to increase their general knowledge on specific topics (e.g. Quora in the US). **Create an online portal gathering information**, learning about advisory services and exchanging experience on SME access to finance. To be enhanced, explored and facilitated at EU level. **EU funding could be redirected towards the organisation of matchmaking sessions** in order to enable contact between entrepreneurs and potential investors. Existing institutions such as the European Institute of Innovation and Technology (EIT) and chambers of commerce could play a pivotal role as trusted intermediaries.
Family and friends	Although they can be supportive, "family and friends" finance can reduce growth prospects and the chance of additional rounds of professional finance. This finance is often in the form of loans, despite the importance of getting equity finance at an early stage.	Survival of firms is highly dependent on the initial amount of cash a business holds, and the wider scale of the business. **Promotion of best practices for businesses and education of entrepreneurs on how to structure their businesses since their establishment**, including adequate governance structures and financial negotiation skills. AFME plans to publish separately a guide to help businesses throughout the funding elevator. Companies and entrepreneurs looking for informal finance should seek external advice from lawyers and accountants. **Creation of standardised documentation**, widely available on the internet, for equity and quasi-equity financing by family and friends.

65 Eurochambres, Response to the public consultation under the start-up initiative", July 2016

66 European Commission, European's next leaders: the Start-up and Scale-up initiative, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0733&from=EN

67 Guide to Private Equity and Venture Capital for Pension Funds, Invest Europe, 2016.

68 http://www.eif.org/what_we_do/resources/MDD/index.htm

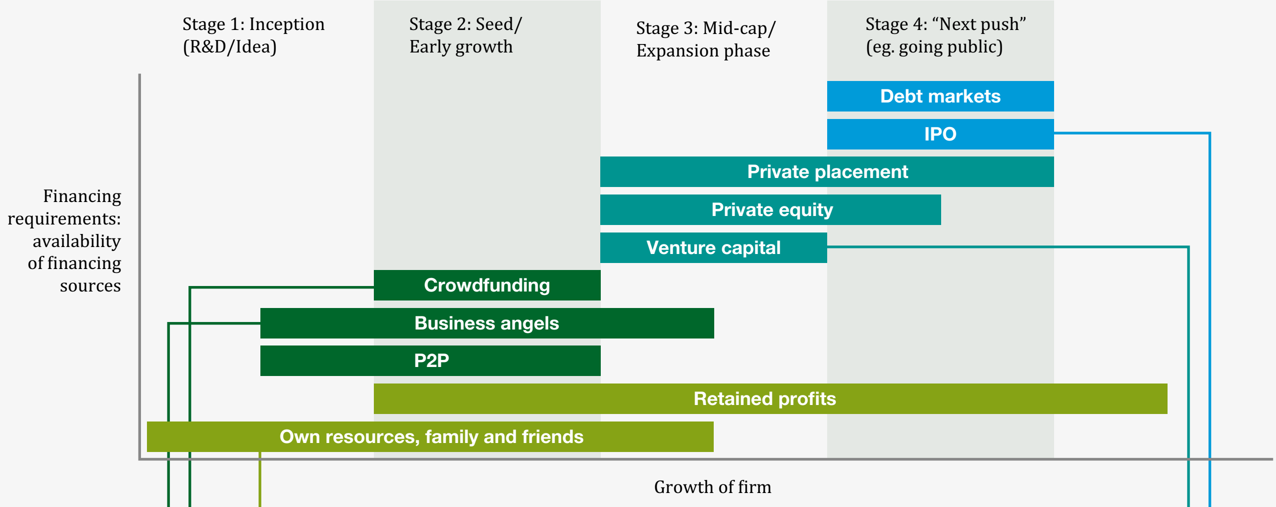
69 https://www.enternext.biz/fr/enternext/analyse-financiere/rapports-morningstar

Table of barriers to risk capital investment

Finance providers	Key barriers	Recommendations
Equity crowdfunding	Inconsistent, unclear and restrictive legal frameworks and market practices in various EU member states, including prospectus rules, making it difficult for platforms to scale-up and unlock cross-border investments and leading to jurisdiction shopping by crowdfunding platforms and their users. Costly regulatory compliance for capital raising in some Member States.	**Promote a common EU framework and best practices in crowdfunding activities** while harmonising equity crowdfunding for SMEs, i.e. through the Prospectus Directive, tax incentives for retail investors and relevant co-investment facilities managed at European level. We welcome the recent announcement of the coordination by the Commission of a pan-European platform where Member States' best practice on crowdfunding can be shared[66]. The **cross-border objective of the CMU should apply to early stage investing** and facilitate cross-border investments below the prospectus threshold while taking into account the specific nature and advantages of crowdfunding. **Support market research** to improve the visibility of the equity crowdfunding market. **Leverage the Early Stage Investing LaunchPad Pilot** (ESIL) across all EU Member States. Promote crowdfunding at national and EU cross-border levels. **Clarify relationship between national crowdfunding frameworks and prospectus rules**, and utilise existing pass-porting regimes for cross-border crowdfunding. **Help establish adequate transparency rules** that can be applied to all early-stage investment forms and foster a more demand driven market for early-stage investments in Europe.
Business angel finance	Small amount of investment to a small number of companies in the EU. Fragmentation of local business angel ecosystems and national or European networks. Lack of business angel capacity in smaller EU Member States.	We recommend the **creation of a single market for business angel investors, syndicates and networks through the establishment of a passport** for them to invest in companies across the EU. A review of fiscal rules and introduction of a common fiscal framework for business angel investments could improve business angel financing substantially. **Increase awareness of business angels' role through Europe-wide campaigns of promotion**, training, certification and recruitment of angels into business angel syndicates and networks. Leverage the *Early Stage Investing LaunchPad Pilot* (ESIL) across all EU Member States, to promote activity at national and EU cross-border levels. Support private initiatives which **improve the availability of early-stage business information** as well as business plans.
	Lack of exit opportunities.	**Increase the size of first time and follow-on business angel investments** in a company by expanding the European Investment Fund's (EIF) co-investment fund, the European Angel Fund (EAF), to cover more Member States. **Increase awareness of the importance of exit strategies** (and legal/accounting advice) before the investment is made, including specific points (e.g. proper valuation, legal diligence on intellectual property, pre-existing agreement with informal investors, valuation, use of specific financial instruments) to be reflected in the term sheet. Ensure understanding of need to give away partial ownership. **Use the European Investment Advisory Hub (EIAH) to help business angels** in assessing investments and potential exit strategies through, for instance, workshops and seminars. **Create a privately or publicly funded platform for secondary transactions** in business angel investments to improve opportunities for exiting companies.
	Lack of business information and data consistency and reliance.	**Promote local, national and European business angel networks**, syndicates and clubs in order to increase reported transactions. **Support market research to improve the visibility of the business angels market,** including the Commission's current data gathering initiative, assisted by BAE and EBAN.
	Limitations to cross-border investments within the EU from business angels.	**Create a single market for business angel investors, syndicates and networks** through a passport for them to invest across the EU. **Align EU-28 tax frameworks and best practices** to incentivising angel investments (e.g. EIS/SEIS in the UK, FIP/FCPI in France). **Allow national tax relief for investments in EU-28 start-ups**, high growth companies and SMEs (e.g. France).

Finance providers	Key barriers	Recommendations
Venture capital (equity)	Lack of VC fund capacity, especially for later-stage investments. Lack of commitments in VC funds by pension funds and insurers. Small average size of VC funds, which deters large institutional investors from investing in the asset class.	**Allow a broader range of fund managers investing in start-ups and scale-ups to benefit from the voluntary EuVECA** passport by extending the list of eligible investments. **Ensure that prudential rules for institutional investors such as Solvency II risk-weights**, do not discourage investment in VC funds. **Increase the availability of private pension funds in Europe** and promote pension fund investment into VC[67]. The UK, Netherlands, Sweden and Denmark represent the vast majority of private pension funds in Europe. **Continue and increase public support** for the various investment stages from seed to growth and sectors on a pan-European level in order to further develop the European VC ecosystem.
Venture debt	Lack of follow-on financing rounds from VC funds.	**Promote the venture debt financing route** to fill the gap between two VC equity rounds. Consider good examples like the German's Mezzanine Fund of Fund by the EIF as well as the EIB's Mid-Cap quasi-equity financing programmes[68].
Public markets	Erosion of the pan-European ecosystem for smaller listed companies.	**We welcome the European Commission, Council and Parliament's active involvement and agreement in the introduction of a Prospectus Regulation**, with an important emphasis on access of small and mid-market companies to the public markets.
	Liquidity costs.	**Improve the 'after-market incentives' for brokers**, such as a pilot programme for tick sizes designed to take into account the needs of smaller companies. Enable investment into less liquid stocks through the **creation of indices with equal weight** per company and not based on market cap.
	Lack of equity culture in Europe.	**Promote the financial education** of both investors and companies as users of capital markets. Encourage direct investment in equity and bonds via the Pan-European Personal Pension Product.
	Lack of tax incentives to encourage long-term investing and to ensure the fair treatment of debt and equity financing.	**End tax discrimination of equity** compared with debt and other forms of investments. The Commission has proposed the introduction of an allowance for corporate equity as part of their CCTB proposal. This would be an effective way of achieving equal tax treatment for debt and equity. **Provide tax incentives to encourage investment** both for the longer-term and in emerging growth companies. Ensure consistent tax treatment and exchange of best practice. Ensure that tax systems are not a barrier to cross-border savings.
	Lack of financial information between businesses and investors.	Help companies connect with the right prospective investors at least one year before the IPO.
	Lack of research in SMEs.	**Improve the provision of analyst research** and /or other third party business information services regarding SMEs. For instance, Euronext's stock exchange Enternext market created a partnership with Morningstar to develop coverage of tech small caps[69]. **Enhance the availability of EU data and research** by standardising and improving data collection, in order to enable both companies and investors to understand the comparative costs and benefits of different services provided by capital markets participants.
	Increase the range of investors in public markets.	**Consider the enlargement of investors**, possibly through regulatory action in the notion of "professional investors" in MiFID II.

Figure 3: **The EU "funding escalator" for high-growth companies**[70]



Family & Friends
- Only 43% of new companies survive after 5 years of business: founders should seek additional initial funding in the form of equity to increase their survival rates.
- Education and availability of non-mandatory standard forms to help building term sheets, negotiation and governance could be available.
- This could avoid future problems with future investors.

Business angels
- There are 33,000 business angel investments reported vs. 71,000 in the US).
- However, countries such as the UK and DE have a well developed and active BA networks numerous active networks and syndicates.
- Incoherence between Member States tax incentives makes difficult for business angels to invest cross-borders. Only 12 Member States have tax incentives for business angels, venture capital and start-ups.
- EU needs more business angels and should consider assisting the development of syndicates and networks through training, certifications, education as well as through additional co-investments with the EAF and other co-investment funds.
- Create a single market for business angels allowing them to invest in any EU MS issuers.
- Promote the development of public or private platforms gathering start-ups information.

Equity crowdfunding
- A growing industry, no longer limited to micro-businesses. But many Member States do not have access to this channel.
- The new Prospectus Regulation needs to be adapted to accommodate the sector, including to facilitate cross-border investments.
- A common framework and taxonomy must be agreed at the EU level.

Venture capital
- VC are also investors in Stage 2 (seed / early growth).
- VC fundraising and investments are worryingly low compared to historic data as well as the US (respectively €5.3bn vs €25.9bn and €3.8bn vs €54.4bn).
- This impacts the investments in EU start-ups, especially late-stage companies with €1.3m invested in average although such companies are looking around €5m to expand and compared to €6.4m in the US.
- Public institutions provide 30-40% of the VC fundraising, compared to 10% for European buy-out firms. VC funds are too small and re-invest in too few financial rounds.
- Accompany the launch of the European VC Fund of Fund with measures to incentivise pension funds (through the creation of a EU common framework), family offices and HNWI (through a common framework for tax schemes).

Venture debt
- Venture debt is underutilised by venture capital-backed firms. 5% of VC-backed companies obtain venture debt financing in the EU compared to 15-20% in the US.
- Venture debt is a great tool to complement VC-backed companies in between rounds of financing while minimising dilution of existing shareholders.

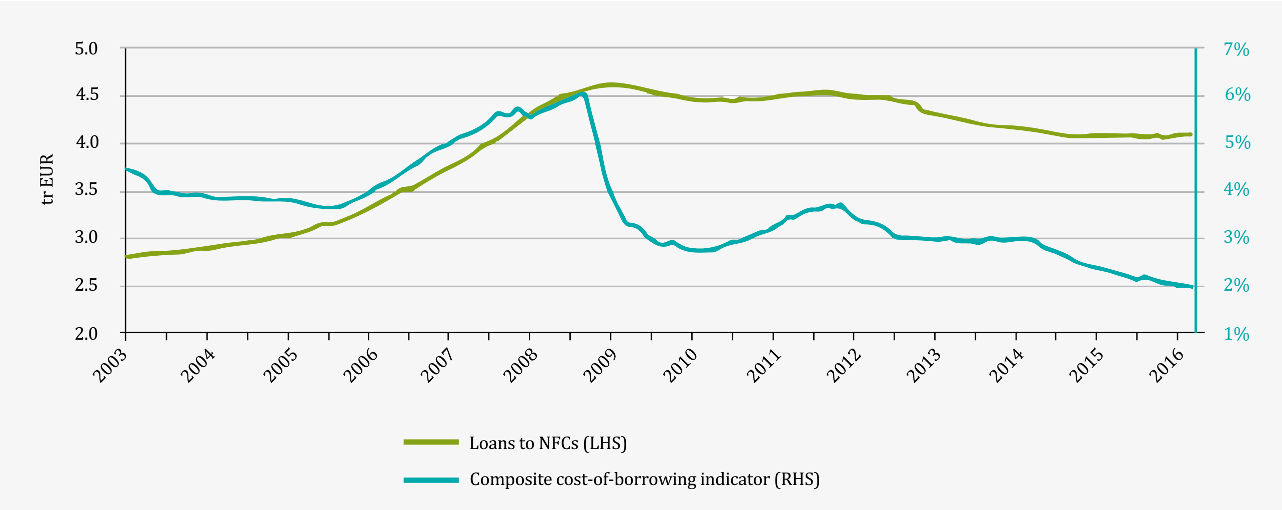
Public equity markets
- In 2012-15, 31 EU companies representing €31.7bn in market capitalisation decided to list in the US.

70 Data on business angels may not represent the whole universe of business angels-backed transactions.

4. The environment for EU high-growth companies

In the context of record low or negative interest rates and the expansion of quantitative easing measures in Europe, borrowing costs have continued to decline. The amount of outstanding loans (to non-financial companies) in the Euro area remains stagnant after 2009's peak.

Figure 4: **Outstanding loans and composite cost-of-borrowing indicator for non-financial corporations in the Euro Area (until April 2016)**



Source: Kraemer-Eis et al (2016), based on data from ECB Data Warehouse

Definitions of SMEs vary widely. The European Commission has a specific definition which includes companies with 10-250 employees, with turnover ranging from less than €2m up to €50m, or with a total balance sheet of between €2m and €43m[71]. In 2015, there were more than 23m SMEs in the EU, employing 90m people[72].

Many of those SMEs are profitable companies or businesses with recurrent stable cash-flows, making bank loans an appropriate source of financing. But high-growth or innovative businesses have different needs. They have higher growth but less stable cashflows. This higher degree of risk makes equity funding more appropriate for this type of business.

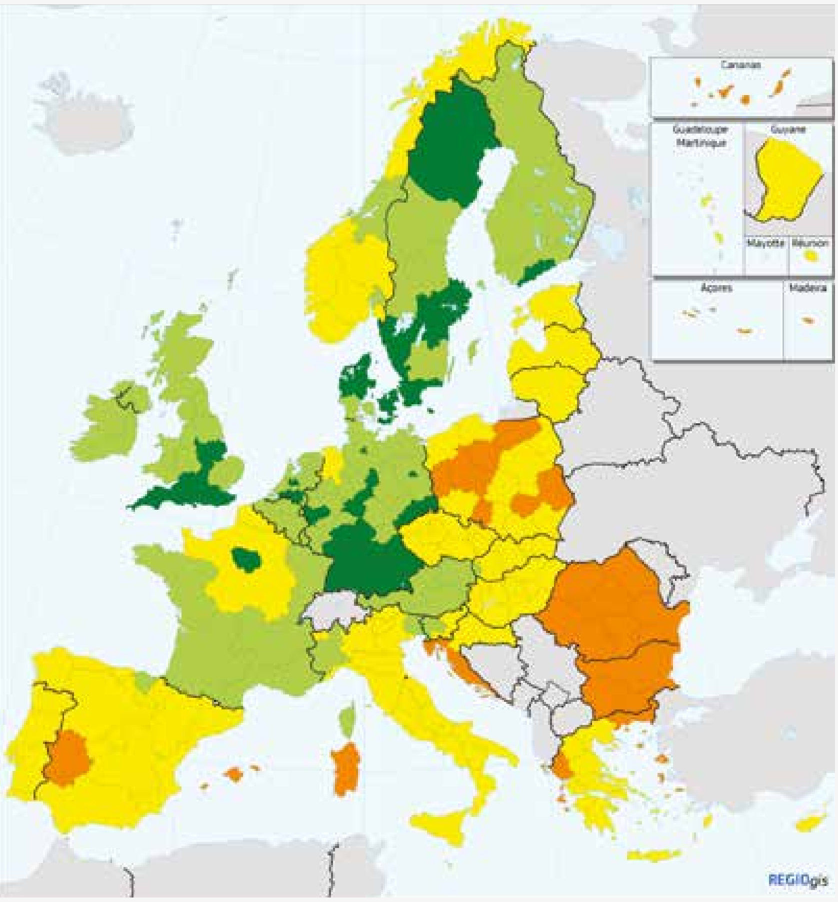
Businesses operate in a fragmented Europe in terms of innovation. There is a huge difference between Europe's most and least innovative regions. As the map below shows, the most innovative regions include southern Germany, southern England and the Nordic region as well as the cities of Paris and Berlin.[73]

71 Many banks have their own specific definitions for commercial purposes. Also, other regulations such as MiFID and the Prospectus Regulation have introduced the concept of the SME Growth Market in which companies should have market capitalisation of less than €200m.

72 European Commission, SME Performance Review, https://ec.europa.eu/growth/smes/business-friendly-environment/performance-review-2016_en

73 Regional Innovation Scoreboard 2016, European Commission, http://ec.europa.eu/DocsRoom/documents/17824

Figure 5: **The most and least innovative regions in Europe**



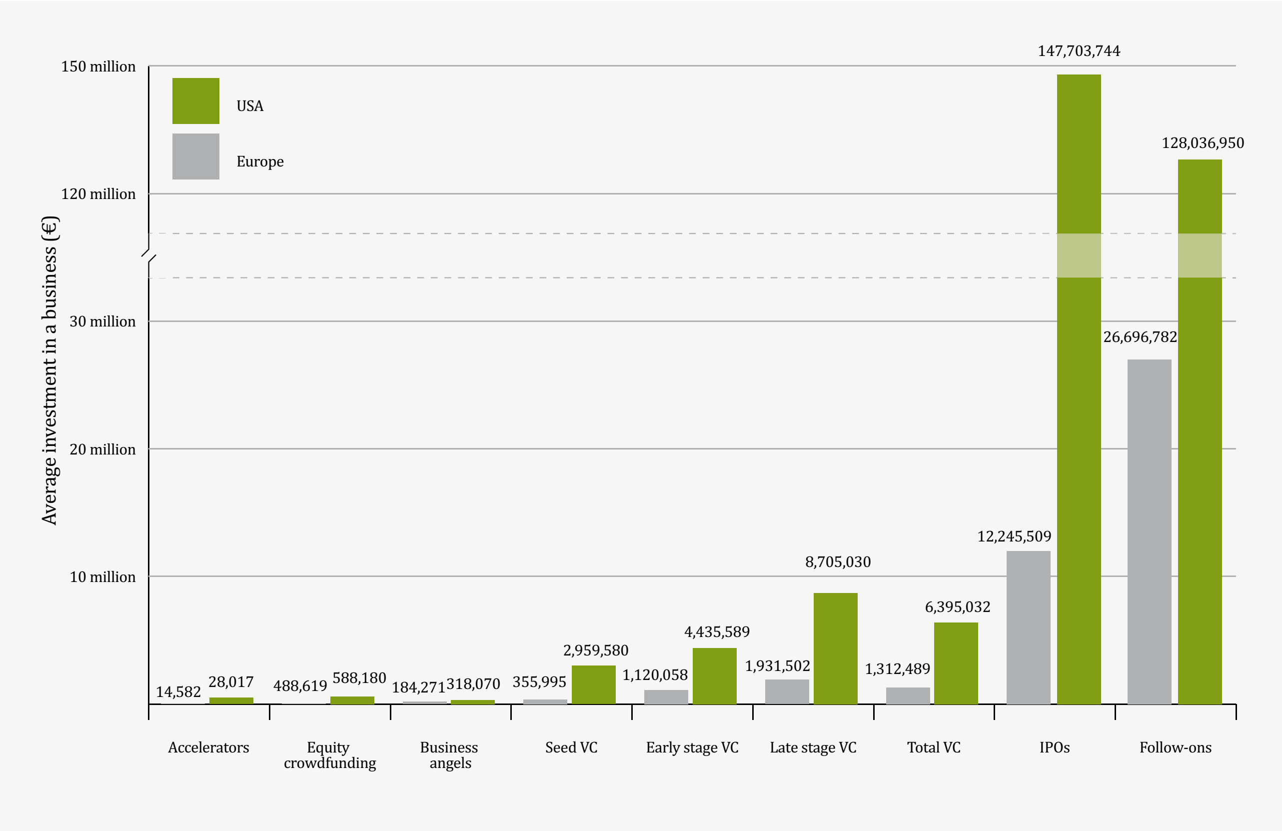
Regional performance groups

- Innovation leaders
- Strong innovators
- Moderate innovators
- Modest innovators

Source: Regional Innovation Scoreboard 2016, European Commission, http://ec.europa.eu/DocsRoom/documents/17824

5. State of the risk capital market and IPO primary market

Figure 6: **Average investment in a business, EU vs US, 2015**



Sources are available in the Appendix. The data below may not represent the whole universe (e.g. only reported transactions), may be estimated (e.g. business angels) or counted multiple times (e.g. between crowdfunding, accelerators and business angels). Consistent, comparable and trusted data across Europe would contribute to the development of the various private markets. The review of the various public private and public initiatives in information availability by the European Commission in 2016 is an important step towards the development of private initiatives on information availability.

Innovative businesses use various sources of risk capital providers to finance their various stages of development, as illustrated in Figures 7 and 8 by a US and EU business.

Figure 7: **Google's financing sequence**

Investor	Year	Volume ($)
Founders	1998	Credit card limit
Business Angel	1998	100,000
Friends and family	1998	900,000
Venture Capital	1999	25,000,000
IPO	2004	1,670,000,000
Today's market capitalisation	2016	499,070,000,000

Source: Deutsche Bank Research, Venture Capital: Bridge between idea and innovation?, Thomas Meyer, 2008

Figure 8: **LaFourchette.com's financing sequence (France)**

Investor	Year	Volume (€)
Founders	2006	Credit card limit
Business Angel	2007	800,000
Venture Capital (Round 1)	2011	3,300,000 (majority share)
Venture Capital (Round 2)	2012	8,000,000 (20%)
Acquisition by TripAdvisor	2014	100,000,000 (100%)

1. Family and friends

The following table describes the characteristics of the "family and friends" investor market:

Market size (2015 investments)	n/a
Type of vendors	Founders, co-founders
Type of investors	Informal, inexperienced
Typical amount (per transaction)	€20,000 - €100,000
Transaction time horizon	Less than 2 months
Investment time horizon	Couple of years
Investment reasons	Trust at least one entrepreneur
Financial instrument	Loans, common shares
Screening process and due diligence	Low
Documentation requirements	Low
Company's stage of development	Seed
Exit opportunities	Business angels
Key considerations	Businesses' survival rates depend on their initial cash positions. Entrepreneurs should align their interests with their family and friend investors by suggesting a formal term-sheet with fair valuation and clauses as well as an experienced board. The creation of standardised documentation could help entrepreneurs and potential future investors.

"Family and friends" (or informal funding) is a common way of financing early stage companies. Their finance usually follows on from the founders' own equity. In Europe, family and friends typically provide finance in the form of loans rather than equity.

Evidence suggests that firms with stronger cash positions have a higher probability of survival (see Figure 10). According to Coad et al[74], a smaller initial size means that there is a smaller buffer protecting firms from exit (e.g. default), which would suggest that firms seeking larger start-up funds have a greater chance of success. Lopez-Garcia and Puente (2006) consider that firms with better long-term growth prospects are more able to raise capital[75], which gives them a better buffer against failure.

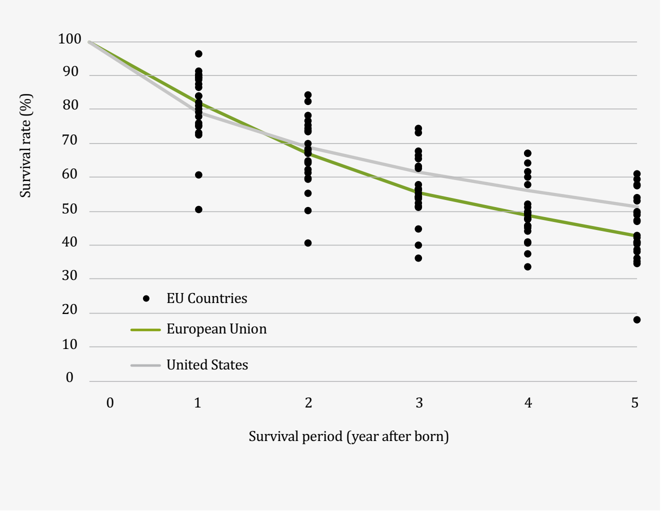
The probability of survival is influenced by both the company's growth path and its initial size. **Therefore, start-ups with long-term prospects, a relevant business plan and management team should seek large amount of start-up funds, ideally equity, to boost their chances of success.** Figure 9 shows the different survival rates between European and US firms, with European survival rates dipping below those in the US after just two years. In Europe, 82 of every 100 new companies survive the first year and 43 survive for five years. The survival rate varies between European countries. For example, in Lithuania just 20 out of 100 companies survive their first five years, while in Belgium 61 out of 100 survive this long.

Several factors explain the country variation in survival rates. According to the OECD, country-specific factors include market conditions (competition environment, access to foreign markets, anti-trust laws, measures of export credits), access to finance (depth of financial markets), regulatory framework, technology and infrastructure framework, and cultural entrepreneurship spirit (education attainment, immigration, attitudes towards entrepreneurs, risk attitude in societies, among others).

74 See Lopez-Garcia and Puente (2006) "Business demography in Spain: determinants of firm survival", Banco de España, Documentos de Trabajo N.° 0608 and "Growth Paths and Survival Chances", Alex Coad, Julian Frankish, Richard G. Roberts, David J Storey, July 2, 2011.

75 According to Lopez-Garcia and Puente, another possible interpretation is that firms with better information about their future success enter at a greater size.

Figure 9: **Business survival rates: European Union (median) and United States**

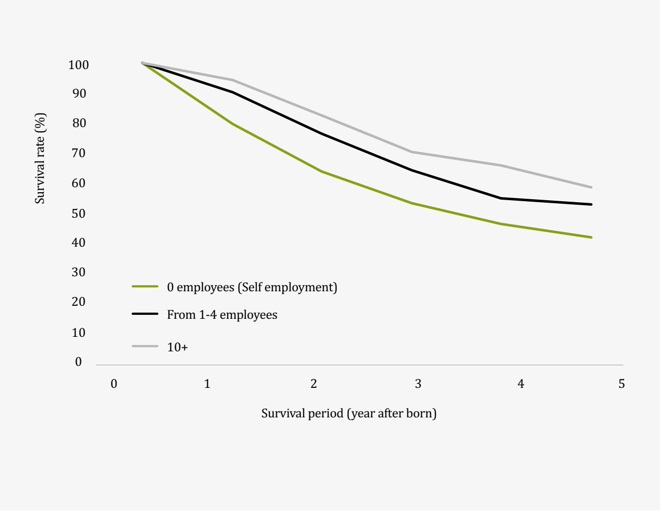


Source: Eurostat and US Bureau of Labor Statistics

Figure 10: **Exit rates by start-up size**

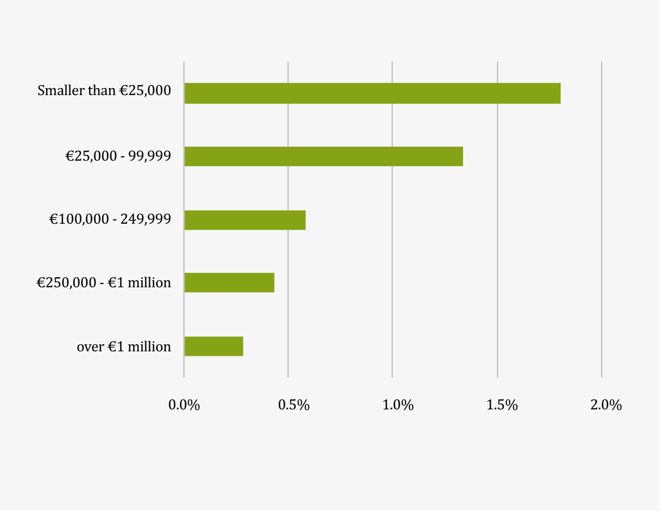
Source: Coad et al. (2011)

Figure 11: **Business survival rates in Europe by size of firm**



Source: Source: Dealogic

Figure 12: **Size of loan from family or friends for SMEs in the Eurozone (% of all SMEs that took a loan in the last two years)**



Source: EC: 2013 SMEs' Access to Finance survey

Using only personal equity and credit at launch could signal a lower chance of survival. Arguably, use of personal resources could indicate that a young firm was unable to raise finance and it might be financially constrained.

Informal (family and friends) finance has many drawbacks which can seriously reduce the chances of success. For instance, studies show that informal finance is often correlated with lower revenue growth and reinvestment rates[76] because of the founder's consequent unwillingness to take risk[77]. In addition, the use of personal credit is negatively associated with revenue level: firms that are not able to secure financing backed only by the firm's balance sheet (i.e., business credit and trade credit) due to poorer future prospects are forced to rely on personal types of credit[78].

In terms of raising capital, having investment from family and friends can impact a company's ability to raise subsequent rounds of finance from professional investors. This is because there is often a conflict of interest between existing family and friend shareholders and additional investors[79]. Problems between existing informal and formal investors "persist after controlling for firm, seed round and management team related information"[80].

It is, therefore, important for entrepreneurs to **structure their companies appropriately, understanding the various available financial instruments** (e.g. common shares/stocks, participating and non-participating preferred shares/stocks, participating preferred subject to a cap, convertible notes). **They should define the respective roles of the founders and shareholders, by aligning their interests and consulting external help at a very early stage. This avoids costly potential external funding in the longer term**, especially from a VC fund which may require substantial control over the company. Many stakeholders provide standardised terms sheets for various financial instruments for early stage companies. For example, EBAN, Invest Europe, Association Française des Investisseurs pour la Croissance, The Galion Project and Gust.com all make term sheets available.

These types of term sheets set out important shareholders and credit-related issues such as fair compensation for the founder, vesting of employee options or shares subject to achieving a certain objective, type of shares and the creation of a board composed of capable members. In France, the Galion Project provides a standard Series A term sheet for negotiation between entrepreneurs and VC firms (although not at earlier stages).

76 Formal versus Informal Finance: Evidence from China, Meghana Ayyagari et al, 2010.

77 Financing from Family and Friends, Samuel Lee and Petra Persson, 2012.

78 See Cole and Sokolyk (2015) "Debt Financing, Survival, and Growth of Start-Up Firms" available in http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2014-Rome/papers/EFMA2014_0612_fullpaper.pdf

79 Are Family and Friends the Wrong Investors? Evidence from U.S. Startups, Luana Zaccaria, November 2015.

80 See note 36.

2. Seed investments through accelerators

Market size (2015 investments)	n/a
Type of vendors	Founders, co-founders
Type of investors	Accelerators, business angels, VC
Typical amount (per transaction)	€10,000 - €150,000
Transaction time horizon	Typically, every year or six months
Investment time horizon	Couple of years
Investment reasons	Close monitoring of entrepreneurs during a limited evaluation period
Financial instrument	Equity, convertible notes
Screening process and due diligence	High
Documentation requirements	High
Company's stage of development	Seed or early stages
Exit opportunities	VC, business angels
Key considerations	Europe has seen many accelerators being created in the past few years. Accelerators are a format that may provide funding coming from business angels or venture capital funds to a small number of start-ups which follow a specific mentoring programme for a few weeks or months. In 2015, 2,574 start-ups received €37.5m in the EU[81].

Accelerators are relatively new structures which invest a small amount of money in a large number of start-ups one or more times a year, sometimes in return for a percentage of equity. In addition to investments, start-ups usually receive mentorship for an intensive few months.

For instance, the first accelerator in the US, Y-Combinator, invests an average of $120,000 in exchange for a 7% equity stake. Since 2005, Y-Combinator has invested more than $7m into almost 1,000 companies, including successful start-ups like Airbnb and Dropbox. In the UK, SeedCamp invests €75,000 in exchange for 7% in equity and may participate in following financing rounds with up to €200,000.

The Lisbon Challenge, a Portugal-based accelerator provides €75,000 in the form of convertible notes and €50,000 in equity for successful global start-ups, in addition to providing hands-on support. This has led to investments from other finance providers (other accelerators, business angels, VCs) of more than €52m for 79 start-ups.

Accelerators are usually a way for serial entrepreneurs, business angels, VC funds, corporates, family offices and funds of funds to invest in very early stage companies.

In 2015, 2,574 start-ups received €37.5m from 113 accelerators in Europe (see figure) compared to $84.2m (€77.5m) in the US[82]. **In the US, during the 10 years from 2005-2015, 5,259 companies received more than $2bn**. In addition, 2,006 of these US companies received a further €17.3bn in capital from VC funds[83].

Exits of start-ups in accelerators in Europe (as trade sale or rarely IPO) are still uncommon, contrary to the US and Canada (see below).

81 Gust.com

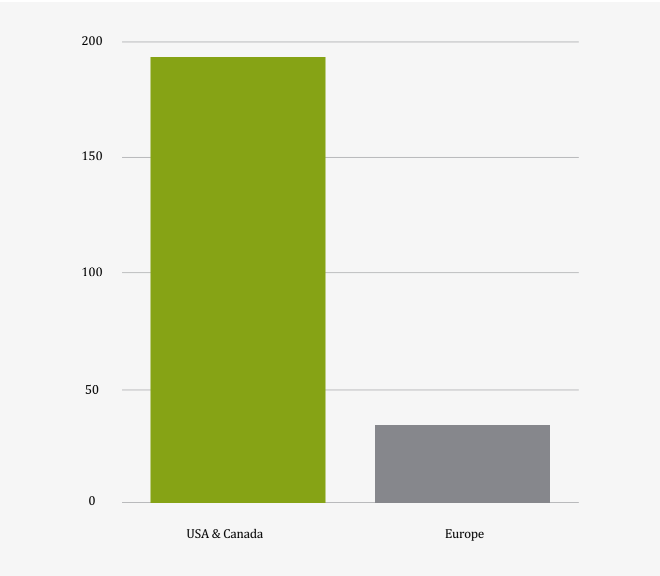
82 Gust.com USA Canada Accelerator Report, 2015

83 Accelerating growth: Startup accelerator programs in the United States, 2016

Figure 13: **Investments through accelerators in Europe, 2015**

Country	Investment (€m)	Number of start-ups
United Kingdom	10	1,124
Denmark	4.8	57
Spain	4.7	263
Germany	3.3	126
Italy	2.3	73
Bulgaria	2	40
Ireland	1.3	59
France	1.3	219
Netherlands	1.2	84
Hungary	1.1	26
Estonia	0.9	23
Sweden	0.5	29
Portugal	0.4	156
TOTAL	37.5	2,574

Figure 14: **Number of accelerator start-up exits, 2015**



Sources: gust.com

3. Equity crowdfunding

Market size (2015 investments)	Between €159m and €354m[84]
Type of vendors	Founders, co-founders
Type of investors	Individuals (but may be restricted in some countries)
Typical amount (per transaction)	€20,000 - €5,000,000
Transaction time horizon	Typically less than six months. Some businesses raise finance in hours
Investment time horizon	Several years
Investment reasons	Financial return, participation in exciting ventures
Financial instrument	Shares and other equitable rights
Screening process and due diligence	Depends on platform
Documentation requirements	Depends on platform. Usually exempted from a prospectus
Company's stage of development	Can apply to all stages of development
Regulation applicable	Being developed at national level
Exit opportunities	Too early to say, can be business angels, trade sale or IPO
Key considerations	Unclear legal framework and market practices; inconsistent across EU Member States

Equity crowdfunding is a growing source of finance for European companies. Most commonly used as early and growth stage financing, it can be tapped throughout companies' funding cycles. Some companies may also have business angels or VC funds as co-investors alongside crowd investors.

Business models vary from one equity crowdfunding platform to another, as follows:

- Matchmaking structure: the online platform connects issuers with potential investors although all aspects of the negotiation and the transaction are performed offline.

- Nominee structure: the online platform represents all investors and invests on their behalf. The platform may hire external lawyers to take care of the paperwork and legal aspects of the transaction. This structure can protect investors against dilution and other potential difficulties. While the nominee model has in some cases similarities with a fund structure, it is sufficiently different to benefit from tax incentives such as those in the UK's Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) programmes.

- Syndicate model: closer to business angel investing. The platform facilitates the investment around a lead investor, who may propose a company to other potential investors.

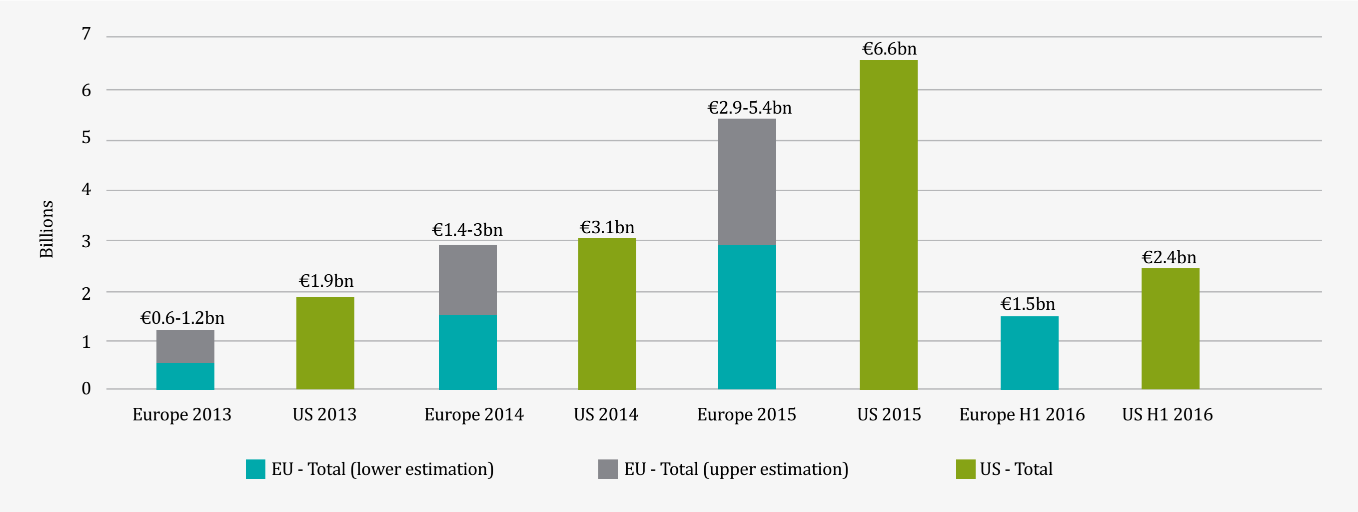
With a growing crowdfunding industry and many platforms expanding across member states, **there is a need for independent organisation, at a global or European level, to promote, and create a clear framework and taxonomy for the crowdfunding industry.**

84 Depending on the source (Cambridge Centre for Alternative Finance and Crowdsurfer.com).

All sources agree that crowdfunding and equity crowdfunding is growing fast in Europe, although there are differing estimates of its exact size. In 2015, Crowdsurfer.com reported that €2.9bn was raised through crowdfunding platforms compared to €1.4bn in 2014 (The Cambridge Alternative Finance Report reports €5.4bn in 2015[85]). Most of the funding was in the form of debt (66%) and was raised in the UK (84%). Between €159m[86] and €354m[87] in equity was raised according to Cambridge centre for Alternative Finance, an increase of between 78% and 92% from 2014, with an average of between €459,000 and €488,619 per campaign in 2015 compared to almost €413,000 in 2014.

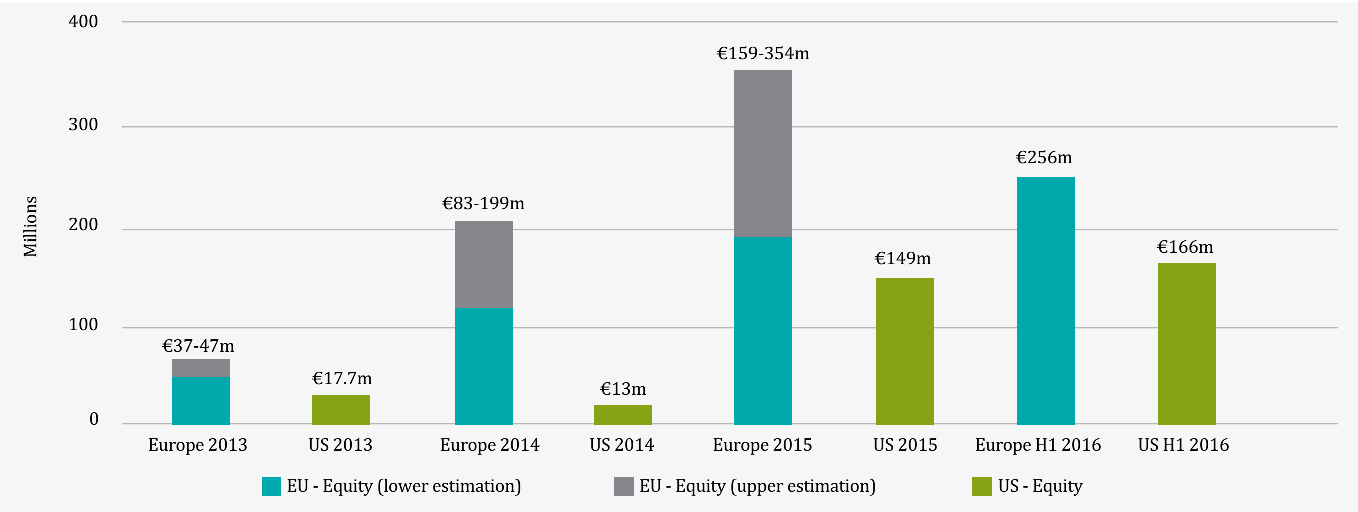
Equity capital raised through crowdfunding platforms varies widely from as little as €30,000 to the national threshold for requiring a prospectus.

Figure 15: **Total crowdfunding flows in Europe and the US, 2013 – H1 2016**



Source: Crowdsurfer.com, *Cambridge Centre for Alternative Finance* European Alternative Finance Report.

Figure 16: **Equity crowdfunding flows in Europe and the US, 2013 – H1 2016**



Source: Crowdsurfer.com, *Cambridge Centre for Alternative Finance* European Alternative Finance Report.

85 Data widely varies between the various sources of data for investments through crowdfunding platforms. Other sources include the Alternative Finance Benchmarking Report (E&Y, KPMG and University of Cambridge), Massolution.com. The data cited in the European Commission's report on Crowdfunding comes from crowdsurfer.com.

86 Cambridge centre for Alternative Finance, 2016.

87 Crowdsurfer.com

Figure 17: **Country-by-country crowdfunding – a fragmented market**

		Equity crowdfunding				
	Total crowdfunding amount invested (EUR)	Total equity capital raised (EUR)	Average raised (EUR)	Number of funded campaigns	Number of platforms	Average number of investors
Austria	7,168,756	4,040,564	192,408	21	3	190
Belgium	4,557,862	1,429,900	95,327	15	2	135
Bulgaria	1,243,329					
Croatia	179,906					
Cyprus	43,899					
Czech Rep	1,051,214					
Denmark	4,350,938					
Estonia	21,344,923	214,520	53,630	4	1	40
Finland	24,619,182	7,695,522	366,453	21	3	237
France	91,473,570	10,638,958	379,963	28	8	184
Germany	108,575,923	35,464,894	347,695	102	15	235
Greece	1,064,308					
Hungary	866,112					
Ireland	16,793,055	198,521	99,261	2	1	109
Italy	13,502,483	408,000	408,000	1	1	22
Lithuania	200,786					
Luxembourg	1,705,337					
Malta	17,113					
Netherlands	81,006,312	2,425,158	110,234	22	2	113
Poland	11,298,109	132,255	26,451	5	2	14
Portugal	546,441	75,008	75,008	1	1	116
Romania	689,798	176,540	176,540	1	1	18
Slovakia	471,298					
Slovenia	1,718,919					
Spain	32,811,437	7,281,822	142,781	51	9	49
Sweden	27,100,415	20,743,886	669,158	31	4	73
UK	2,400,209,446	262,834,396	627,290	419	16	239

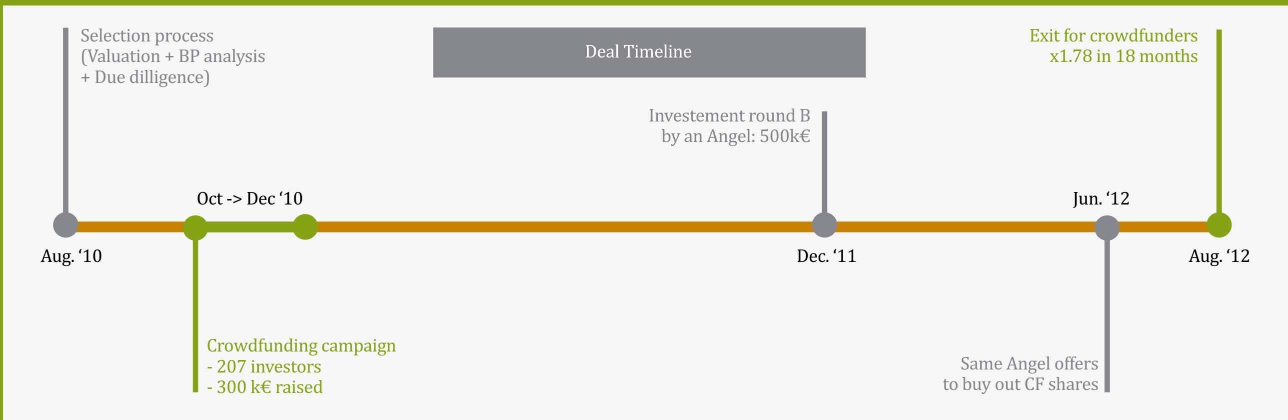
Source: crowdsurfer.com

Tax policies also play an important role in crowd investing. Aligning tax policies for domestic and EU investors would improve crowdfunding, business angel and VC investing into early stage companies. Therefore, we welcome the Commission's recent initiative "to promote best practices in national tax incentives for VC to foster investment in SMEs and start-ups". Additionally, we would support the extension of this initiative to business angels (see Figure 22, Page 43).

Case study: Exit from a crowdfunding investment

At present, few equity crowdfunding investments have reached the exit stage (most platforms have only been in operation for a few years). French biotech company Antabio, founded in 2009, achieved the first exit in France in 2012.

In 2010, a crowd of 208 investors provided €309,000 in less than three months, to complete proof-of-concept studies. They subsequently sold their stake to an angel investor, securing return of over four times their collective investment in the exit process. Later, the biotech received funding from Wellcome Trust, the UK charity, and French public bank Bpifrance, to fund the development of its programme for €5.4m. Antabio is currently raising €15m to be ready to enter phase 2 of its clinical testing in 2019.



Another example of a successful exit is the IPO of Seedrs fundraiser FreeAgent on the London Stock Exchange AIM in November 2016[88].

88 http://www.altfi.com/article/2412_seedrs_delivers_sectors_first_ipo_a_down_round_for_investors.

4. Business angels

Market size (2015 investments)	€6.1bn (estimate)[89]
Type of vendors	Founders, co-founders, family and friends
Type of investors	Ex-entrepreneurs, experienced professionals
Typical amount (per transaction)	€50,000 - €1m
Transaction time horizon	3-6 months
Investment time horizon	8 years
Investment reasons	High financial return with exit plan, interest in playing a role in the next success story
Financial instrument	Common shares, preferred shares, convertible preferred shares, convertible debt with various clauses which will be negotiated in the term sheet during the financing rounds
Screening process and due diligence	High
Documentation requirements	Business angels can ask for any type of document from the company; as such investment is built on trust between the entrepreneur and the investor
Company's stage of development	Start-ups which usually have a working prototype (except for some sectors such as biotechnology). Seed (43%), early stage (40%), later stage (10%)[90]
Regulation applicable	No particular regulation
Exit opportunities	Typically, through a trade sale or management buy-out; more rarely from VC funds
Key considerations	It is easier to raise amounts of about €500,000 than larger sums of up to €2m. Business angels could provide more equity at this latter stage, helping businesses to expand, if the sector increased its financing capacity Tax incentives vary in the different EU Member States. Most incentives are not applicable to cross-border investments in the EU Many business angels do not plan their exits before investing. Business angel associations and networks play an important role in the education of angel investors. Additional education, certification and recruitment of angels need to be promoted by public and private initiatives Successful co-investment funds for business angels in national Member States, and at EU level, should be replicated in other countries

Business angels are private individuals. They invest their personal wealth and provide their experience, expertise and contacts. Business angels usually invest in the earlier stages of development. They do so either individually or in a group (syndicate) where one business angel takes the lead. Business angels usually invest 2-10% of their net wealth in companies over several years. A business angel typically invests €10,000 to €200,000 by round of financing for a deal size from €50,000 to €1m (average of €184,271). The business angel may also want to participate in follow-up rounds. The current data shows that European angels provide less finance to less companies than their US peers (Figure 18).

Broadly speaking, there are four types of business angels:

i. Ex-entrepreneurs
ii. Active professionals with a functional expertise
iii. Executives between jobs who want to join a start-up
iv. Aspiring entrepreneurs who see angel investment as a way to gain expertise and visibility.

Business angels do not usually invest at the beginning of the project. Instead, they tend to do so when founders, family and friends have already done so. Ideally, angel investors like to invest in companies testing and scaling their products or services. European angels tend to invest in companies at an earlier stage of development (e.g. funding and idea at a seed stage) than their US peers, who invest more in later stages to expand companies.

89 EBAN statistics compendium, 2015

90 EBAN statistics compendium, 2015

Angel investors look for FFF investments when deciding where to place their own money. They believe this reveals both the founders' attractiveness as business leaders, as well as their commitment to the venture. Founders with FFF have an incentive to work hard so as not to disappoint the people they are the closest to.

Measuring the size of the business angels market is a difficult task because many of them invest in private companies without reporting to a business angels network or association, which is the current way of gathering data[91]. In Europe, the EBAN uses a multiplier of x10 applied to the "visible" market (the actual reported market) to estimate the overall market while the Centre for Strategy & Evaluation Services (CSES) uses a x7 multiplier. The US Angel Capital Association (ACA) uses the same methodology to estimate the market but applies a x30 multiplier.

Without a consistent and reliable methodology, the market's precise size is unclear. This is why we support the Commission's initiative to build a consistent data framework on business angel investments and investors. Both BAE and EBAN are taking part in this project.

Figure 18: **The market for business angels in Europe and the US**

	Europe	US [92]
Number of angels	303,650	304,930
Total investments	€6.1bn	€22.7bn
Number of companies invested	32,940	71,110
Average individual investment	€19,990	€9 - 23,000
Average deal size	€184,271	€318,000
Average market valuation		€2.1m (€2.5m in 2014)
Mean ownership average		20-25%
Jobs created		270,000
Number of investments by stage	**Europe**	**US**
(a) Seed stage	43%	28%
(b) Early stage investing	40%	45%
(c) Expansion	16%	27%
Investments in first round	n/a	49%
Yield rates: opportunities brought to investors that result in an investment	7%	18%

Source: BAE, EBAN Statistic Compedium (http://www.eban.org/wp-content/uploads/2016/06/Early-Stage-Market-Statistics-2015.pdf), Halo report, Center for Venture Research, Angel Capital Association. Estimated values, 2015.
Due to its nature, the early stage investment market and especially the business angels investment market is difficult to quantify. Please note that currently there is no robust and consistent data available on the business angels market in Europe; published data is typically imprecise and can only be used as indication or very rough estimate.

In the EU, 3m citizens hold non-real estate assets worth more than €1m[93]. If even a small part of this were used for business angel investing it would make a huge difference. **Harmonised and clear tax incentives would be a first step towards building capacity.** This could be done through the development of a common framework for investor protection (the diversity of business angels related investments are summarise in the table below).

91 More information can be found in Kraemer-Eis, H. Lang, F., Torfs, W., Gvetadze, S. (2016) European Small Business Finance Outlook, December 2016. EIF Working Paper 2016/38, EIF Research & Market Analysis, pp. 26ff. http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf

92 Jeffrey Sohl, "The Angel Investor Market in 2015: A Buyers' Market", Center for Venture Research, May 25, 2015.

93 European Commission, Opportunity Now: Europe's mission to innovate, Robert Madelin and David Ringrose

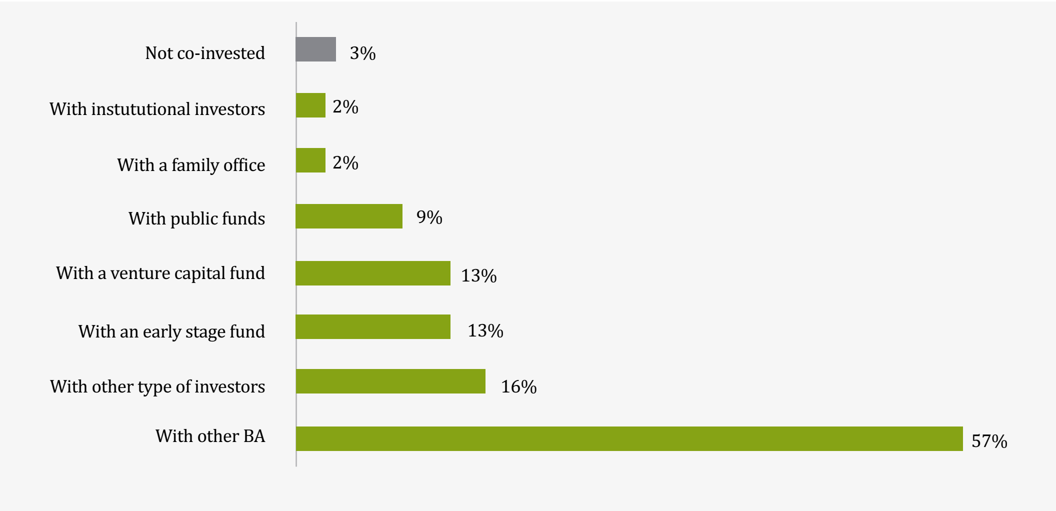
The UK's SEIS and EIS' tax programmes are good examples of tax incentives that could be copied elsewhere. The EIS scheme is considered successful in attracting a critical mass of investments;[94] it is estimated that **24% of EIS investments would not have been made without the EIS scheme[95]. The lack of coordination between EU member states' tax incentives deters business angels from investing across borders.** This results in few business angel investments in cross-border within the EU: 8% in Germany, 2.6% in the UK and 0% in the Netherlands, Spain and Sweden[96] This compares in the US to cross-state business angel investments ranging from 11.3% to 41.5%.[97]

Building business angels' capacity would help them to participate in the follow-on investments that allow companies to scale-up, so that they reach a size where VC funds would consider investing. In Europe, 60% of the deals are first-round deals of about €300,000 (which is an appropriate amount at this stage) and 30-40% are second-round transactions that raise about €500,000. In order to scale up, however, we understand that fund raising should be in the region of €2m. Syndicating is a growing trend for angel investors. This enables them to spread risks, share due diligence and pool their financing. The result is larger deals and more flexibility to invest in follow-on financing rounds.

The introduction of co-investments supported by the public sector is a step forward for syndication. **The success of the UK's AngelCoFund and EIF's European Angel Fund (EAF)[98] that started in Germany are good examples that can be replicated** to improve the capacity of angel investments at first rounds and follow-on rounds. The EAF's expansion into other Member States happened already (Austria, Denmark, Ireland, Netherlands and Spain) and a further expansion is under way.

Such syndication of angels and networks, working with public institutions (e.g. the European Investment Advisory Hub) as well as national and European networks (e.g. BAE, EBAN), **can play a major role in educating, training and certifying investors** in unlisted high growth companies.

Figure 19: **Business angels invest with other business angels or other types of investors**



Source: EBAN Statistics 2014

94 Mason and Harrison, 1999; Boyns et al., 2003

95 Wiltbank, 2009

96 "Evaluation of EU Member States' Business Angel Markets and Policies, Final report", 2012

97 Halo Report, 2015 Annual report.

98 A detailed list of public, private and public-private co-investment funds is available on EBAN's 2015 Compendium of co-investment funds with business angels.

Figure 20: **Information on national networks and public schemes**

Note that data in this table represents the visible market. It is estimated that the vast majority of the transactions are not reported through a business angel network.

Member State	Examples of business angel associations[99]	Number of registered business angels	Number of BA networks	Number of reported deals	Total amount invested	Average amount invested by business angels in a company	Public co-investment initiatives
Austria	Austria Wirtschafts Service, www.business-angels.at	250	4	180		€150,000	European Angels Fund S.C.A. SICAR - aws Business Angel Fonds (Austria) ("EAF Austria") is an €22.5m initiative funded by EIF and AWS.
	Austrian Angel Investor Association	180		50	€15m	€150,000	
Belgium	Wallonia: beangels, www.beangels.eu, Flanders: business angels network vlaanderen, www.ban.be	400		40-50	€10m		NAUSECAA Ventures Fund invests in early stage companies completing their 3rd/4th financing round with a view to raising €3-4m and exit within 3-6 years. Ark-angels Activator Fund (Flanders): co-investment fund in which the Flemish government participates alongside a group of angels and the ING bank, bringing a total of €15m.
Estonia	ESTBAN, www.estban.ee	101	1	63	€6.7m	€105,000	The Estonian Development Fund (Eesti Arengufond) is a €30m fund created by the Parliament
France	France Angels, www.franceangels.org	10,000	76	386	€41m	€143,000	Angel Sources is a collaboration between Bpifrance and France Angels (privately managed by iSource) with €20m and investing €500k – 1,500k.
Finland	Finnish Business Angels Network, www.fiban.org	500	12	434	€37m	€84,000	

99 More comprehensive list of business angel associations, networks and syndicates are available on EBAN website (www.eban.org/about/find-a-member) and Business Angels Europe (www.businessangelseurope.com/Become-A-Member/Pagine/Membership-Directory.aspx)

100 Business Angels Europe, ZEW 2014

101 EIS and SEIS numbers are an estimate for business angel investments although these may not all be angel-type deals and that not all angels use the SEIS/EIS schemes with potentially around 70-90% of deals done through the EIS (NESTA, UK Business Angels Association)

Member State	Examples of business angel associations[99]	Number of registered business angels	Number of BA networks	Number of reported deals	Total amount invested	Average amount invested by business angels in a company	Public co-investment initiatives
Germany	Business Angels Netzwerk Deutschland, BAND, www.business-angels.de	6,000 – 9,000	35-40		€590m[100]		High-Tech Gründerfonds (HTGF): public-private usually investing €500k in convertible loans and acquiring 15% of shares. HTGF can invest further €1.5m in subsequent rounds. European Angels Fund: launched by the EIF in cooperation with the German government and BAND. Instead of granting co-investments on a deal-by-deal basis, the EAF enters long-term contractual relationships with business angels. Co-investment framework agreements (CFAs) are established through which the EAF commits a predefined amount of equity for co-investments upfront to each business angel for future investments. The total volumes available under an individual CFA is typically between €250k and €5m for 10 years.
Ireland	Halo Business Angel Network	10	725	67	€14.4m	€215,000	EIF launched the €22.5m EAF Ireland compartment with Enterprise Ireland in 2015.
Italy	IBAN, http://www.iban.it	279	14	135	€46m	€351,000	Ingenium Sardegna is a €34m public-private fund investing €100k-1.5m with a yearly cap of €3m. The Ingenium Emilia Roagna I is a €10m fund, 70% private and 30% public investing in the Emilia Romagna region. Ingenium Emilia Roagna II is a €14m fund.
Netherlands	Business Angels Netwerken Nederland (www.bannederland.nl)	3,200	13	118	€34m	€290,000	European Angels Fund Netherlands: €45m initiative funded by the Dutch Venture Initiative (DVI), a fund-of-funds initiative advised by EIF.
Poland	PolBAN, polban.pl	411	5	32	€12.4m	€385,000	The Polish Agency for Enterprise Development (www.parp.gov.pl) (PAED) implements support schemes for business angel networks and seed funds (mostly through ERDF and the national budget). Loan for Innovation –€25m Fund; 85% ERDF and 15% National Funds; €4.7m has been so far invested by private investors: BA/VC founds.
Portugal	APBA, www.apba.pt/ FNABA, www.fnaba.org	150	APBA: 2 FNABA: 17	170	€10m		Compete Co-investment Fund: created in 2011, €32m has been co-invested in 133 companies over 3 years.

Member State	Examples of business angel associations[99]	Number of registered business angels	Number of BA networks	Number of reported deals	Total amount invested	Average amount invested by business angels in a company	Public co-investment initiatives
Spain	AEBAN, www.aeban.es	2,732	52	232	€55m	€237,000	Fondo Isabel La Católica European Angels Fund is a €30m initiative funded by the EIF, ICO, Axis and Neotec.
Slovenia	Poslovni Angeli Slovenije, www.poslovniangeli.si	78	3	23	€1.85m	€80,000	Ingenium Slovenia Fund ia a 50/50 public-private fund with €7.5m of AuM. 30% is dedicated to cross-border investments.
Sweden	CONNECT Sweden, www.connectsverige.se	600 – 1,000	22		€200 – 400m	€91,850	Almi Invest is a public fund managing SEK 1,100 and investing in around 70 new companies every year.
United Kingdom	UK Business Angels Association, www.ukbusinessangelsassociation.org.uk	18,000	58	567	EIS: £1.7bn and SEIS: £168m in 2,270 businesses[101]	€170,000	Angel CoFund: £100m fund investing £100k - £1m alongside business angels. Since launch the fund invested £24m alongside £95m from business angels. The Scottish Co-Investment Fund is a £72m fund funded by the European Development Fund and the Scottish government.

Sources: Compilation from authors of EBAN, BAE and local associations

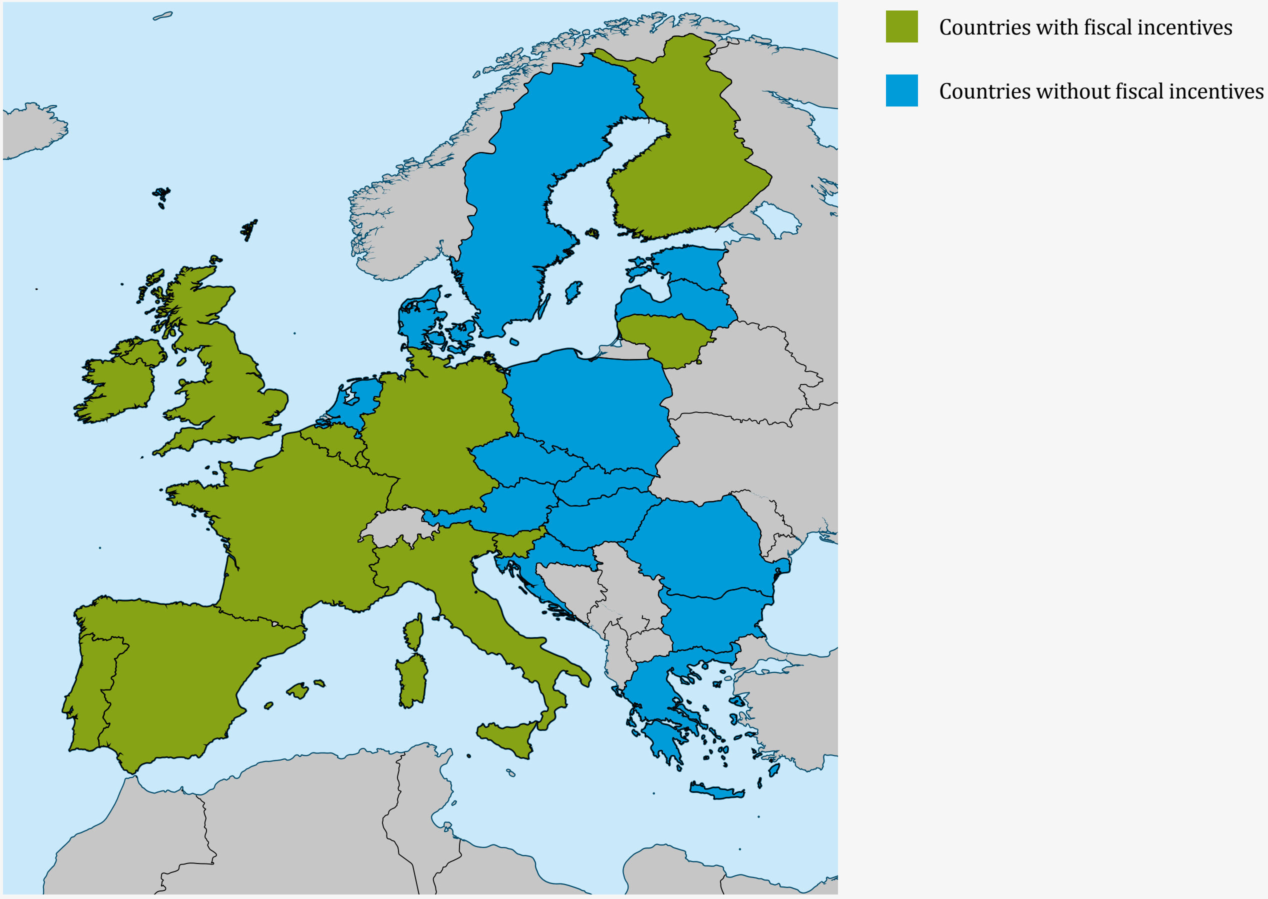
Tax incentives

Tax relief schemes through government guarantees, reductions on tax rates and tax credits are efficient ways to channel business angel investments (also friends and family investments) into early-stage companies.

However, **only 12 EU member states use such fiscal incentives**[102] **and those that do are not necessarily aligned.** For example, some countries have benefits for VC and business angel investors investing directly into the start-up company or via an investment fund, while in other jurisdictions the tax benefits are provided to the company itself (e.g. via tax exemptions on paid salaries). Some countries establish incentives via a tax reduction for investments in shares of start-ups and SMEs (BE, FI, SL, UK, ES, IE, FR, GE, LU). Others levy reduced taxes on dividends, capital gains and taxable profits (PT, IT, LT, UK, FR). A further type of incentive is exemption from withholding taxes (BE, LU), among other instruments.

102 Belgium, Finland, France, Ireland, Italy, Germany, Lithuania, Luxembourg, Portugal, Slovenia, Spain and the UK, 2015 Compedium of fiscal incentives: tax outlook in Europe, Business angels perspective, EBAN, BAE, BOFIDI.

Figure 21: **Countries with and without tax incentives for venture capital, private equity and start-ups**



Source: EBAN, BAE and BOFIDI

Business angel investors and start-ups must meet certain criteria to qualify for tax incentive programmes. The criteria depend on the tax incentive and the jurisdiction. For example, in France business angels must hold the investment for at least five years to benefit from an income tax reduction of 18% when investing in SMEs. Other countries such as Belgium, the United Kingdom and Ireland have similar conditions for business angels who wish to claim tax relief on equity investments.

Other criteria relate to the maximum amount that investors can claim for tax relief, which also varies by jurisdiction and tax benefit programme. In Ireland, for example, the maximum individual investment eligible for tax relief is €150,000. In some instances, eligibility relates to the company itself. It may, for example, depend on the size of the company, its economic sector, or increasing employee numbers (see detail in Figure 22).

The extent to which tax benefits encourage start-ups depends on the incentives and the criteria that beneficiaries have to meet. For example, evidence suggests that UK tax breaks are widely used by VC investors and affect their investment decisions. Research conducted by the UK Business Angels Association (UKBAA)[103] found that about 90% of angel investors have invested through the EIS or SEIS tax benefit programmes. What's more, 75% of UK angel investors said that the EIS/SEIS schemes' benefits affected their decision to invest.

103 A Nation of Angels, UKBAA. Report available in: http://www.enterpriseresearch.ac.uk/wp-content/uploads/2015/01/ERC-Angels-Report..pdf

Although some jurisdictions offer tax incentives for investment in start-up companies, the differences in tax regimes from one to another hampers the European start-up ecosystem. In 2013, the European Parliament and the Council invited member states[104] to remove tax obstacles, in order to remove double taxation and encourage cross-border flows.

Government incentives are also subject to changes in government and the availability of budgets. Uncertainty around the permanence of the different incentive programmes adds an element of risk to start-up companies and VC investing.

Although tax policies are the responsibility of national governments, aligning them would improve business angel and VC investing into early stage companies. This is why we welcome the Commission's recent initiative "to promote best practices in national tax incentives for VC to foster investment in SMEs and start-ups".[105] Additionally, we would support the extension of this initiative to business angels.

Notably, tax relief usually benefits business angels and companies resident in the country where the schemes apply, which deters cross-border investments. An exception is France's tax breaks, which can apply to companies resident in any EU member state.

Figure 22: **Main European tax incentives for investments in SMEs and start-ups**

	Benefit	Criteria
Belgium	Tax reduction of 45% for investment in new shares of start-ups and a tax reduction of 30% for investments in new shares of an SME or start-up fund.	The investor must hold the shares for four years.
	Interest received on loans granted to a start-up through crowdfunding are exempted from withholding taxes and personal income tax.	
	A start-up company can benefit from a 10% wage withholding tax exemption on paid salaries, which is increased to 20% for micro companies.	
Finland	A business angel that invests in the equity of a start-up as an individual can get a deduction of 50% from his/her capital gain income tax.	The underlying company cannot be more than six years old.
France	Business angel investors benefit from an income tax reduction of 18% of the sum invested. They can invest through closed-end funds, Fonds commun de placement dans l'innovation (FCPI) and Fonds d'investissement de proximité (FIP): FCPI: in 2015, 34 funds raised €371m FIP: in 2015, 46 funds raised €490m In 2015, 99,000 individuals invested an average of €8,740 FCPI and FIP funds raised in average around €11m	Investments limit of €12,000 (€24,000 for married couples). The investment must be held for at least five years and the company must be an SME.
	Individual business angel investors eligible for wealth tax can invest up to €90,000 and reduce their wealth tax rate by 50% (thus a maximum wealth tax deduction of €45,000).	The tax break also applies when investing in SMEs across the 27 other EU member states.

104 Commission Staff Working Document, Impact Assessment. Guidelines on State aid to promote risk finance investment. http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2014/swd_2014_0006_en.pdf

105 Press release Capital Markets Union: new rules to support investment in venture capital and social enterprises, 14 July 2016.

	Benefit	Criteria
Germany	A tax refund is granted on capital gains from INVEST financing. INVEST is a fund launched by the Federal Government, which grants angel investors a sum equivalent to 20% of their total investment.	
	If the fund is a corporate entity (GmbH or AG), 95% of the capital gains from selling shares are neither subject to corporate income tax (Körperschaftsteuer) nor trade tax (Gewerbesteuer). The remaining 5% is taxed at a rate of approximately 30%.	
	Potential to reclaim a tax relief of up to 41%: an initial tax relief of 30% with a further 11% possible after a 3-year period.	(i) The 11% additional relief is subject to an increase in employee numbers and neither reducing average salaries, nor R&D expenditure. (ii) The maximum individual investment is €150,000 per year. (iii) The limit, which can be raised over the life time of a company, is €10m with a limit in any one year of €25m. (iv) The company must be resident in the state. (v) The investment must be held for three years.
Ireland	There are various schemes in place to encourage entrepreneurship - in particular – Start Up refunds for Entrepreneurs (SURE), Employment Investment and Incentive (EII) scheme and CGT Entrepreneurial Relief (more information is available on www.revenue.ie).	SURE provides a tax relief of up to 41% of the capital invested in EEA companies of less than two years old. The EII provides a tax relief of up to 40% (max €150,000 per year) for investments in unquoted micro and SMEs.
Italy	Capital gains realised by business angels (resident and non-resident) are exempt of 50% of their amount in taxes.	
Lithuania	Incentive for investment programmes: a company may reduce its taxable profits by 50% for expenses incurred between 2009 and 2018.	
Luxembourg	Investment funds resident in Luxembourg are generally exempt from corporate income tax, municipal business tax and withholding tax on dividends. These investment funds are subject to a subscription tax of up to 0.05% of their NAV.	
	Angels may invest collectively through various vehicles. SICAR (Société d'Investissement en Capital Risque), an investment company in risk capital which benefits from a tax exemption on income and capital gains deriving from investment in securities. SOPARFI (Société de Participation Financière), a fully taxable company that benefits from a large network of double tax treaties and from all the EU directives.	
Portugal	Special tax regime for VC investors, risk capital companies and risk capital funds. Tax reduction of 50% for dividends and for sale of share participation owned for over two years.	These entities have to be registered at the Portuguese Securities Market Commission (CMVM).
	Deduction in the amount of the company tax of the last five years if the profits were invested in a growing business.	
Slovenia	Investments in high-risk companies are tax exempt. Investment funds, VCs, pension funds and insurance companies are taxed at a 0% rate when certain conditions are fulfilled.	

	Benefit	Criteria
Spain	Deduction of 20% on investment income tax up to a maximum of €50,000 if the investment is in a new or recently created company.	(i) The share must be acquired at the time of the incorporation of the company or through a capital increase within three years following its incorporation. (ii) The investment must be in a company in the form of a company. (iii) The company must have the adequate resources to undertake the corporate activity. (iv) The equity of the company may not exceed €400,000.
	Catalonia: a deduction of 30% on the investments in start-ups with a maximum deduction of €6,000.	The shareholding acquired cannot exceed the 35% of the start-up's "social capital".
	Madrid: deduction of 20% of investments in start-ups with maximum deduction of €4,000.	The stockholding acquired cannot exceed the 40% of the start-up's "social capital".
	Balearic Islands: deduction of 20% of the investment in start-ups for investments of up to €600.	
United Kingdom	Entrepreneurs relief: taxation of 10% for the first £10m of lifetime gains on qualifying business, rather than up to 28%. Since 1993, over 24,500 companies have received £14bn and in 2014-15, 3,130 companies raised £1.7bn through the EIS. The majority (58%) raised EIS investments for the first time.	
	Seed Enterprise Investment Scheme (SEIS): income tax relief at 50% of the cost of the shares subscribed for (max annual investment of £100,000). In 2014-15, 2,185 companies received £168m through the SEIS.	If the SEIS shares are sold within 3 years, the SEIS investor receives value or an option is placed over the shares, then the SEIS tax reducer is clawed back.
	Enterprise Investment Scheme (EIS): income tax relief at 30% of the amount invested in subscribing for new shares (max annual investment of £1m).	See above.
	Venture Capital Trust (VCT): income tax relief at 30% of the amount invested in subscribing for new shares (max investment of £200,000). Dividends are exempt from income tax.	If the VCT shares are sold within five years, the VCT tax relief is clawed back. Income tax exemption for dividends is granted, provided that in the year of acquisition the market value of the qualifying shares did not exceed £200,000 or, where the limit is exceeded, the dividends in respect of the first shares acquired up to the limit are exempt.
	Social Investment Tax Relief Scheme (SITR): individuals making an eligible investment can deduct 30% of the cost of their investment from their income tax liability, either for the tax year in which the investment is made or the previous tax year.	Tax relief: applies to organisations with a defined and regulated social purpose including charities, community interest companies or community benefit societies, carrying out a qualifying trade and with fewer than 500 employees and gross assets of up to £15m. The investment must be held for a minimum of three years for the relief to be retained.

Source: Summary from EBAN, BAE, BOFIDI 2015 Compendium of fiscal incentives: tax outlook in Europe Business Angels perspective http://www.eban.org/wp-content/uploads/2015/12/Compendium_FISCAL_2015-17-12-2015FinalV71.pdf

Exits

Angel investors usually hold their investments for an average of eight years before selling. The majority of the companies are written down (56%) whereas more successful companies are sold through a trade sale or a management buy back. VC firms are not always the natural buyers for exiting business angels, although more business angel networks tend to be organised with the capacity to invest €500,000 – €1m alongside VC funds. The main exit strategy for business angels (as well as VC firms) is acquisitions by larger companies.

Exit opportunities are a difficulty for business angels. They are often not considered as a priority by business angels[106] at the time of the investment: one study showed that **business angels considered potential exit routes as the 24th out of 27 investment criteria[107].**

In addition, secondary markets for private shares are underdeveloped in Europe. In the United States, NASDAQ Private Market[108] has launched a secondary platform to facilitate shareholder liquidity.

Certainly, US investors have more opportunities to exit than their European peers. in 2012, California had 455 M&A technology exits compared to 156 in the UK, 52 in Germany and 35 in France[109].

106 (Wetzel, 1981; Gaston, 1989; Harrison and Mason, 1992; Landström, 1993; Mason and Harrison, 1994; Lumme et al, 1998).

107 Van Osnabrugge and Robinson, 2002.

108 https://www.nasdaqprivatemarket.com/

109 CBInsights 2012 Tech M&A Activity Report.

5. Venture capital

Market size (2015 investments, Europe)	€3.8bn[110]
Type of vendors	Founders, co-founders, family and friends, business angels
Type of investors	Professional investors (GPs) investing on the behalf of institutional investors (e.g. pensions funds, insurances, family offices)
Typical amount (per transaction)	€300,000 - €5m depending on the round of financing and the Member State
Transaction time horizon	6 – 9 months or more
Investment time horizon	6 – 8 years
Investment reasons	High financial return with exit plan
Financial instrument	Common shares, preferred shares, convertible preferred shares, convertible debt with various clauses which will be negotiated in the terms sheet during the financing rounds (and in the shareholders agreement)
Screening process and due diligence	High
Company's stage of development	Seed stage (15% of transactions), early-stage (63%), later stage (22%)[111]
Exit opportunities	Trade sale, another VC/PE fund, MBO, public markets
Key considerations	In 2015, VC funds invested €3.8bn in Europe against $59.1bn (app. €54.4bn) in the US The VC industry is concentrated in around 10 EU Member States while in other countries the industry is very small and mostly relies on public funding from national or European developments banks (see Figure 27 below). On the other hand, pension funds are the main contributor to US VC funds Between 2007 and 2015, EU companies received on average €1.3m from VC funds at all stages compared to €€6.4m by US firms EU companies have less access to multiple rounds of financing from VC funds: 60% of transactions are only one round of financing[112] (in the US, 57% of companies have two or more rounds of financing) There is less capital allocated to later stage investing, which is vital for expanding and scaling up

VC and private equity (PE) funds specialise in investing companies usually not listed on stock exchanges. VC funds invest in early-stage companies with high growth potential and high risks. This chapter focuses on VC investors (PE investors are not covered as they tend to invest in more mature companies.)

Obtaining VC capital is crucial to "to find the right product-market fit, since each iteration will bring the product being developed closer to the market needs".[113] VC investors can play a vital role in this iteration process.

There are 840 specialist European VC firms with assets of about €60bn (compared to a total of €564bn in the entire PE market)[114].

In a 2016 survey[115], European chamber of commerce and business representative respondents complained that the EU was not encouraging the PE/VC sector. Consequently, respondents did not view PE/VC as an option when raising finance, with the exception of the UK and Scandinavia.

110 InvestEurope

111 InvestEurope

112 Scale-up UK, p46, University of Cambridge, SAID Business School, University of Oxford, Barclays, 2016

113 "Product iteration in VC funded technology-based start-ups: Pivoting as critical success fact?" Vincent Jocquet, Sven H. De Cleyn, Frank Maene and Johan Braet, 2015.

114 InvestEurope

115 Report on the findings of the pan-European business survey, Council of British Chambers of Commerce in Europe (COBCOE), January 2016.

Fundraising: who are the investors in PE and VC funds?

Within Europe, 98 VC funds raised €5.3bn in 2015 (+8% from 2014 and +3% from 2011) compared to nearly €26bn raised by 236 funds (93 of which were new funds) in the United States.

Figure 23: **Fundraising - Europe and United States PE, VC and Growth funds (€bn)**

Europe	2015	2014	2013	2012	2011
Total private equity market	47.6	48	54.4	24.6	41.6
Venture capital	5.3	4.9	4.6	3.9	5.2
Growth capital[116]	2.9	2.8	1.1	0.5	4.4
United States	**2015**	**2014**	**2013**	**2012**	**2011**
Total private equity market	133.1	123.6	111	97.5	69.1
Venture capital	25.9	25.7	12.9	15.1	14.7
Growth capital	19.0	16.6	10.1	8.0	10.0

Sources: Invest Europe and National Venture Capital Association 2016 Yearbook (NVCA). InvestEurope, NVCA and other provider definitions and methodologies may vary.[117] Moreover, Invest Europe definitions and approaches can differ from those of other data providers. See, for example, European Small Business Finance Outlook (http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf), Box 4 ("Introductory information on Invest Europe data")

This means that **US VC funds represent a larger share of the overall PE market than their European VC counterparts** (20% vs 11%).

Figure 24: **Share of VC fundraising out of the overall PE market**

	2015	2014	2013	2012	2011
Europe	11%	10%	8.5%	16%	12.5%
United States	20%	21%	12%	15%	21%

Sources: Invest Europe and National Venture Capital Association (NVCA)

116 Growth capital is a type of private equity investment - most often a minority investment but not necessarily – in relatively mature companies that are looking for capital to expand or restructure operations or enters new markets.

117 See, for example, OECD's "Entrepreneurship at a Glance 2016", Annex C ("International comparability of venture capital data"): http://www.oecd-ilibrary.org/sites/entrepreneur_aag-2016-en/09/03/index.html?itemId=/content/chapter/entrepreneur_aag-2016-39-en&mimeType=text/html

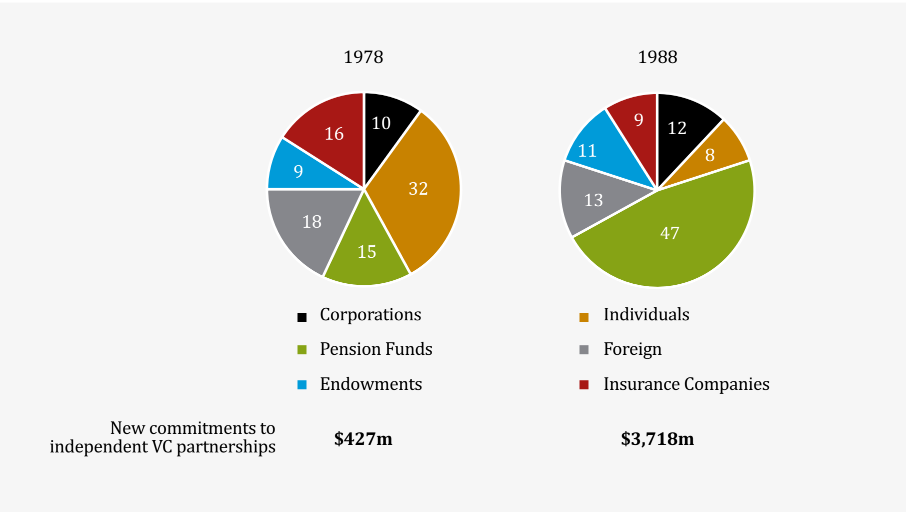
Deregulation of investment activities by public pension funds: US pension funds have an important role in the success of the US VC market and its underlying companies. This resulted from the relaxation of the "prudent man" rule allowing pension funds to invest up to 15% of their assets in riskier investments.

By contrast, in Europe the UK, Netherlands and Sweden are some of the markets which operate contributory schemes where contributions are paid into a fund by employees and/or employees and the funds are invested, as opposed to government schemes in which current workers pay the pensions of retired people. Typically, in countries with fully funded pensions systems where workers save for retirement via public or private pension funds, VC funds benefit from inflows of retirement savings. Likewise, in countries with private pension systems, insurance companies typically invest their annuity reserves in a wide variety long-term investment products, including VC funds.

Figure 26 illustrates this relationship by comparing the size of the pension and insurance industries with the size of the VC industry for countries in Europe. Notably, the larger the size of pension and insurance companies relative to GDP, the larger the size of the VC industry.

In order to promote pension fund financing of small and medium-sized companies, regulators in both Sweden (1996) and the United States (1978) relaxed regulatory regimes by allowing them to invest in VC funds[118]. The regulatory change stimulated the local start-up ecosystem. Figure 25 shows how the mix and size of contributions in the US VC industry changed. The share of funds committed to VC by pension funds increased from 15% in 1978 to 47% in 1988, and the total annual new commitments increased from US$ 427m to US$ 3.7bn.

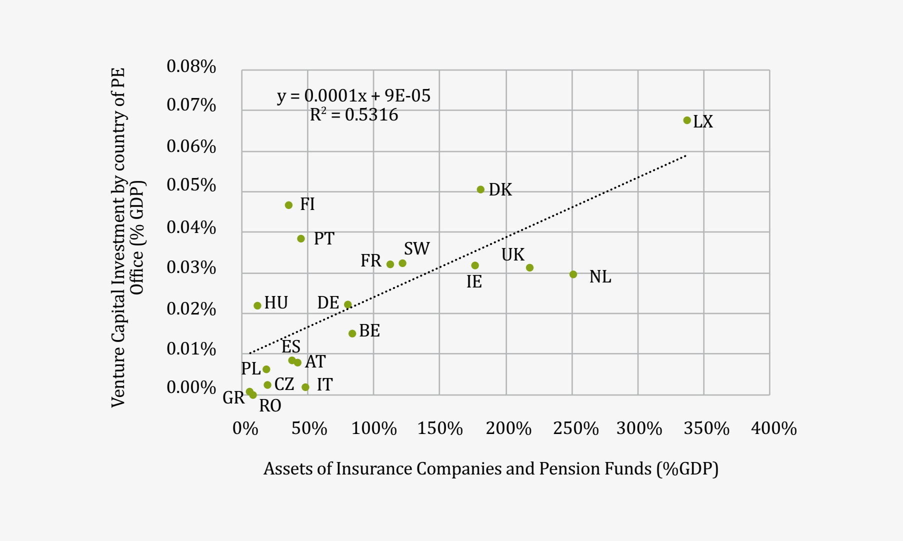
Figure 25: **Evolution of the sources of contributions in the US venture capital industry: 1978 and 1988 (%)**



Source: Gompers and Lerner (1998)

118 As Gompers and Lerner (2001) argue, the US venture capital market benefitted greatly from a large inflow of funds after the US Department of Labor allowed pension fund managers to invest into venture capital funds.

Figure 26: **Source of contributions in the US venture capital industry: 1978 and 1988 (%)**



Source: European Commission and InvestEurope

Geographical drawdown of fundraising

With regards to the types of investors, **government agencies continue to be by far the main investors in European VC funds**, investing 21% of the €5.3bn raised by VC funds in 2015, according to the trade association Invest Europe (25% in 2014 and 0% in the US in 2014). Another source, BCG, estimates that government entities are playing an even bigger part in VC fundraising, with their role doubling between 2008 and 2014, from 14% to 35%. It is estimated that fundraising volumes backed by the EIF in 2014 amounted to 45% of the overall volumes collected by European VC investors (36% in 2007), against a share directly attributable to EIF totalling 12% (5% in 2007).

However, the relatively high share of government agencies activity has to be put in context. For example, the EIF argues that "even if the importance of government agencies is still unsatisfyingly high for the long term, it is noteworthy that government agencies continue to play their role and support the market in a counter-cyclical way, in particular in the times of an economic and financial crisis when total VC fundraising levels came down from EUR 8.3bn in 2007 to EUR 3.2bn in 2010 and EUR 3.9bn in 2012, respectively. This led almost 'naturally' to an increased share of government agency fund investors. Since then, the government share decreased" [119]. Moreover, theoretical evidence suggests that public VC support is relatively well targeted and achieving positive effects in Europe. [120]

The EIF estimates that the investment activity backed by EIF represented 41% of total investments in Europe in 2014 (29% in 2007). The share directly attributable to EIF amounts to 10% (5% in 2007), hinting to the significant leverage that characterises EIF-backed investments and its counter-cyclical role as an investor. Moreover EIF estimate that fundraising volumes backed by EIF in 2014 amount to 45% of the overall volumes collected by European VC investors (36% in 2007), against a share directly attributable to EIF totalling 12% (5% in 2007).

EU and national public agencies play a predominant role in VC fundraising. However, this varies. According to Invest Europe / PEREP_Analytic, government agencies are the main source of VC fund raising in 14 EU member states. Yet in Denmark, Sweden and Italy pension funds are the main source, while in Bulgaria, Poland and the Czech Republic private individuals are (see figure 27).

119 Kraemer-Eis, H., Lang, F., Torfs, W., and Gvetadze, S. (2016). European Small Business Finance Outlook, December 2016. EIF Working Paper 2016/38, EIF Research & Market Analysis, pp. 26ff. http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf

120 See ibidem for further details.

Figure 27: **Type of investors investing in European VC funds, broken down by country of origin (2011 – Q3 2015)**

LP origin/LP Type	Academic institutions	Banks	Capital markets	Corporate investors	Endowments and foundations	Family offices	Fund of funds	Government agencies	GP commitment	Insurance companies	Other asset managers	Pension funds	Private individuals	Sovereign wealth funds	Grand total
Australasia	0%	6%	0%	21%	0%	3%	1%	17%	0%	0%	2%	2%	1%	47%	100%
Austria	0%	18%	0%	0%	0%	0%	7%	53%	0%	1%	0%	5%	17%	0%	100%
Baltics	0%	0%	0%	13%	0%	0%	0%	80%	0%	0%	0%	0%	7%	0%	100%
Belgium	1%	10%	0%	9%	0%	6%	14%	27%	0%	3%	15%	0%	16%	0%	100%
Bulgaria	0%	0%	0%	21%	0%	0%	0%	0%	28%	0%	0%	0%	51%	0%	100%
Canada	0%	0%	0%	46%	0%	0%	19%	0%	0%	0%	0%	35%	0%	0%	100%
CZ	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	0%	100%
Denmark	1%	0%	0%	0%	0%	4%	31%	0%	1%	3%	5%	55%	0%	0%	100%
Ex-Y&SK	0%	51%	0%	11%	0%	0%	0%	9%	0%	6%	2%	22%	0%	0%	100%
Finland	0%	0%	0%	9%	5%	4%	11%	48%	1%	1%	2%	7%	12%	0%	100%
France	2%	3%	0%	13%	0%	2%	3%	50%	0%	4%	2%	1%	20%	0%	100%
Germany	0%	10%	0%	24%	0%	8%	5%	38%	0%	2%	1%	2%	10%	0%	100%
Greece	50%	0%	0%	0%	0%	50%	0%	0%	0%	0%	0%	0%	0%	0%	100%
Hungary	0%	0%	0%	0%	0%	0%	0%	100%	0%	0%	0%	0%	0%	0%	100%
Ireland	17%	15%	0%	6%	0%	2%	0%	42%	1%	0%	0%	12%	4%	0%	100%
Israel	0%	0%	0%	0%	0%	89%	0%	0%	0%	0%	0%	0%	11%	0%	100%
Italy	0%	5%	0%	9%	6%	2%	14%	6%	0%	0%	1%	47%	9%	0%	100%
Luxembourg	0%	2%	0%	2%	0%	1%	9%	85%	0%	0%	0%	1%	0%	0%	100%
Netherlands	0%	3%	0%	10%	1%	12%	9%	29%	1%	14%	3%	13%	6%	0%	100%
Norway	0%	4%	0%	3%	2%	7%	5%	60%	1%	4%	1%	8%	6%	0%	100%
Poland	0%	0%	19%	2%	0%	0%	17%	23%	0%	0%	1%	0%	36%	0%	100%
Portugal	1%	27%	0%	21%	0%	0%	0%	51%	0%	0%	0%	0%	0%	0%	100%
Spain	0%	18%	0%	20%	0%	9%	0%	30%	0%	12%	6%	3%	1%	0%	100%
Sweden	0%	3%	0%	2%	0%	17%	6%	4%	2%	16%	0%	48%	1%	0%	100%
Switzerland	0%	6%	0%	30%	1%	23%	11%	3%	0%	0%	0%	15%	12%	0%	100%
UK	0%	2%	14%	13%	13%	4%	13%	20%	1%	0%	5%	8%	6%	0%	100%
USA	0%	0%	0%	22%	15%	3%	33%	0%	1%	0%	2%	22%	1%	3%	100%
Grand Total	1%	5%	2%	13%	3%	5%	9%	38%	0%	3%	2%	8%	10%	1%	100%

Source: InvestEurope, PEREP_Analytic, European Commission

Although buy-out funds, which invest in larger and often profitable companies, are less dependent in government help, so-called "growth" funds were 50% funded by government agencies in 2015, up from 21% in 2014.

Figure 28: **European VC fundraising by type of investors (000s EUR)**

	2015	2014	2013	2012	2011
Academic institutions	2,520	100,670	10,750	300	8,080
Banks	42,600	138,100	125,030	143,910	403,300
Capital markets	12,170	88,650	28,580	45,850	178,780
Corporate investors	503,750	1,126,250	322,490	522,240	635,360
Endowments and foundations	301,960	148,510	336,260	30,290	26,810
Family offices	153,400	183,680	216,020	227,480	141,800
Fund of funds	415,100	313,980	407,380	307,220	460,200
Government agencies	1,097,680	1,213,840	1,468,880	1,270,700	1,494,100
Insurance companies	95,000	91,200	129,930	229,860	109,530
Other asset managers	373,730	61,280	69,160	159,410	49,340
Pension funds	252,910	489,880	371,700	160,780	338,570
Private individuals	259,860	250,130	746,300	265,970	621,380
Sovereign wealth funds	0	14,100	70,000	14,430	13,060
Unclassified	1,819,800	726,410	305,830	485,400	694,180
New funds raised	**5,330,480**	**4,946,680**	**4,608,310**	**3,863,840**	**5,174,490**

Source: InvestEurope

Figure 29: **Growth fundraising - type of investors (000s EUR)**

	2015	2014	2013	2012	2011
Academic institutions	0	0	350	1,000	1,300
Banks	37,390	159,540	57,280	19,910	2,970,180
Capital markets	0	34,100	32,800	15,030	0
Corporate investors	3,900	31,740	87,640	7,080	44,940
Endowments and foundations	500	79,360	28,820	0	12,500
Family offices	199,900	25,520	54,000	17,730	135,200
Fund of funds	48,400	196,770	236,860	6,820	311,170
Government agencies	1,427,710	572,030	197,270	210,030	193,360
Insurance companies	6,000	334,290	65,720	5,600	141,430
Other asset managers	0	118,460	15,000	22,990	218,280
Pension funds	8,600	388,560	74,890	130,890	203,430
Private individuals	115,010	149,470	16,180	42,010	108,770
Sovereign wealth funds	0	80,140	0	0	12,000
Unclassified	1,028,990	616,410	196,620	61,500	23,500
New funds raised	**2,876,400**	**2,786,390**	**1,063,430**	**540,590**	**4,376,060**

Source: InvestEurope

Figure 30: **EU vs. US VC fund raising by type of investor (2014)**

	Europe 2014	United States 2014
Government agencies	25%	0%
Pension funds	10%	29%
Corporate investors	23%	3%
Fund of funds	6%	13%
Endowment and foundations	3%	17%
Family offices	4%	14%
Individuals	5%	0%
Banks and insurance companies	5%	11%
Others	19%	13%
Total	**€4.9bn**	**€25.7bn**

Sources: BCG, InvestEurope

While **North American investors are among the most active in European PE, they tend to invest much less in European VC** (€7bn in PE funds representing 15% of the market vs. €385m in the VC sub-category, representing 7% of the VC fundraising market, see table below). **The most active investors in both European PE and VC funds are French & Benelux investors** providing, respectively, 15% and 21% of the overall fundraising in 2015 (despite a 34% drop since 2014). Commitments from UK and Irish investors vary widely while VC funds have seen a big drop in commitments from investors in the DACH region (Germany, Austria, Switzerland) (-74% since 2011).

Figure 31: **Geographic breakdown of investor (LPs) sources for European VC funds**

	2015	2014	2013	2012	2011
Asia & Australia	6,000	8,250	92,270	12,930	57,410
CEE	78,050	122,080	40,050	41,770	104,400
DACH	367,090	844,260	372,760	485,610	1,406,000
France & Benelux	1,142,840	1,735,770	1,699,170	1,452,660	1,467,720
Nordics	117,150	241,540	306,580	505,420	375,620
North America	385,170	439,160	459,410	155,200	72,160
Rest of the world	11,800	9,900	4,000	20,960	0
Southern Europe	37,100	238,600	135,210	160,400	216,160
UK & Ireland	702,340	324,080	758,910	323,640	671,290
Others Europe	652,590	213,020	24,550	64,680	65,020
Others	1,830,350	770,020	715,400	640,570	738,710
New funds raised	5,330,480	4,946,680	4,608,310	3,863,840	5,174,490

Source: InvestEurope

Size of VC funds

There are **significant differences in the average size of European and US VC fundraisings.** European VC funds raised an **average €61m** between 2007 and 2012, and 50% of all VC funds were smaller than €27m[121]. On the other hand, in 2014**, US funds raised an average €81m in 2005 and €112m in 2015**[122].

Figure 32: **Number and size of PE funds in Europe reaching their final closing during the year (all private equity market)**

	2015	2014	2013	2012	2011
< €100m	65	79	62	66	77
€100m - €250m	31	27	23	18	37
€250m - €500m	13	17	13	7	10
€500m - €1bn	7	10	4	7	4
> €1bn	13	7	12	3	5

Source: InvestEurope

Investments by VC funds

European VC investments have fallen significantly since 2007-2008 when they were about €6bn per year. In 2015, **European VC funds invested €3.8bn in 2,836 companies** at various stages of development. At the same time, **US VCs invested €54.4bn in 4,380 transactions.**

In addition to VC, "growth equity" funds – which invest in relatively mature companies that are looking for capital to expand operations, restructure operations or enter new markets – represented in 2015 €6.5bn in new investments in Europe compared to €18bn in the US.

Figure 33: **Definitions of various development stages in Europe and the US**

Stages of development	Europe	United States
Seed	Financing is provided to research, assess and develop an initial concept before a business has reached the start-up phase.	The state of a company when it has just been incorporated and its founders are developing their product or service.
Start-up / Early stage	Financing is provided to companies for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold products commercially.	After the seed (formation) stage but before generating revenues. Typically, a company will have a core management team and a proven concept or product, but no positive cash flow.
Later stage / Expansion	**Later stage:** financing is provided for the expansion of an operating company, which may or may not be breaking even or trading profitably. Later-stage venture tends to finance companies already backed by VC firms.	**Expansion:** a company characterised by a complete management team and a substantial increase in revenues. **Later stage:** a company that has proven its concept, achieved significant revenues compared to its competition, and is approaching cash flow break even or positive net income.

Sources: InvestEurope and NVCA

121 Assessing the Potential for EU Investment in Venture Capital and Other Risk Capital fund of funds, Oxford Research and CSES, 2015

122 National Venture Capital Association.

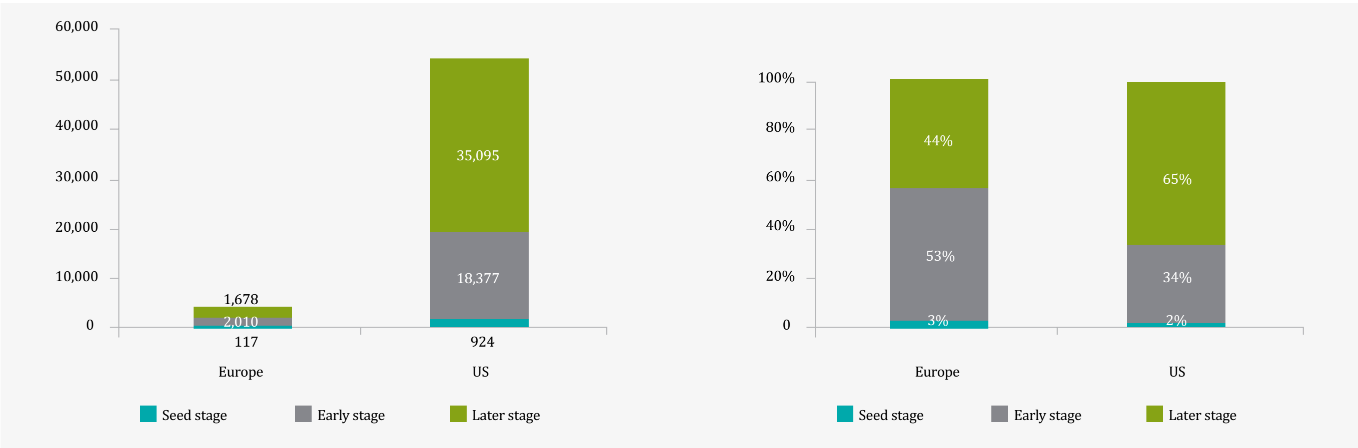
Later-stage European investments are a minority compared to the US*

When comparing the mix of investments by stage of development, European **VC funds allocate almost twice as much of their investments to companies at seed stage than US VCs** (3.1% vs 1.7% of total VC funds in 2015, see figure below). The same can be observed for early stage companies. **However, European companies at later stages, which need capital to expand their product ranges and/or geographically have a lower allocation. Only 44% of the European VC investments went to later stage companies whereas US companies at this stage get almost two-third of all VC investments** (see Figure 34 below). This contrast can be explained by Europe's small amount of committed capital, which limits investments in subsequent rounds.

Europe's companies receive small tickets from VC funds compared to the US

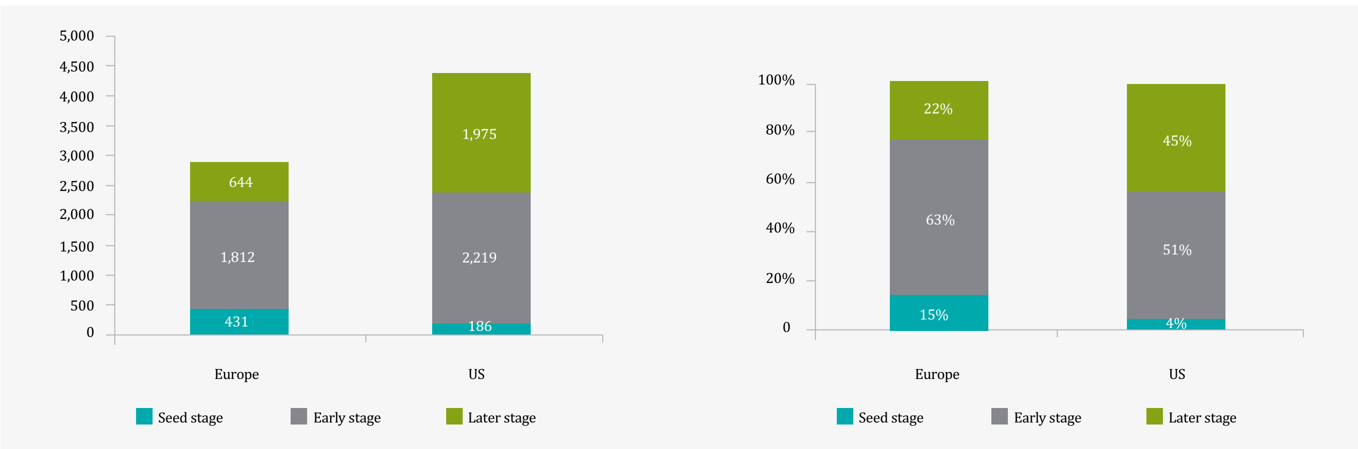
With more US investments into VC funds (notably pension funds, see above), US companies receive much more funding than their European's counterparts at every stage of development. On average, US companies raising seed financing receive eight times more funding (€3m) compared to their European peers (€356,000). US companies have similar advantages at early and later-stage funding, receiving respectively 7.5 times and 6.8 times more funding than their European counterparts (€8.7m in the US compared to €1.9m in Europe, see Figure 35 below).

Figure 34: **Absolute and relative 2015 VC investments in Europe and the US by stage of development (€m)**



Sources: InvestEurope and NVCA

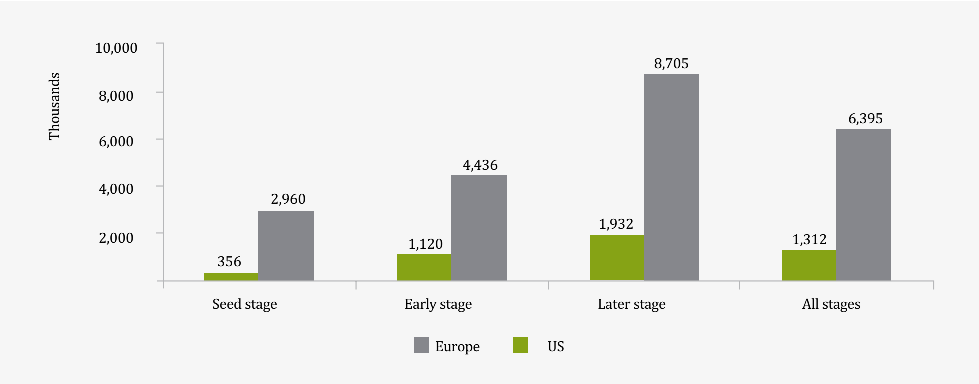
Figure 35: **Absolute and relative 2015 VC-backed companies in Europe and the US by stage of development (number of companies)**



Sources: InvestEurope and NVCA

* The following data and comparisons have been sourced from Invest Europe (Data for Europe) and the NVCA (Data for the US). Because both industry associations use independent data collection processes, the comparability of findings is affected by differences in data coverage and methodologies applied. The respective association should be contacted directly if further advice and guidance how to best use and interpret the data is required.

Figure 36: **Average invested in VC-backed transactions in Europe and the US (2007 - 2015, €000s)**



Sources: InvestEurope and NVCA

When looking into cross-border VC investments within Europe, the UK and Ireland receive the most VC finance from other countries (34%). Most of this finance is from outside Europe. Other regions receive more funding from their own countries (see Figure 37 below).

Figure 37: **Cross-border venture capital investments, 2011 – Q3-2015**

Region of the portfolio company that receives the investment	CEE		DACH		France & Benelux		Nordics		Southern Europe		UK & Ireland		All Europe	
Region of the office that makes the investment	EUR million	% total	EUR million	% total	EUR million	% total	EUR million	% total	EUR million	% total	EUR million	% total	EUR million	% total
CEE	338	80%	26	1%	0	0%	2	0%	0	0%	7	0%	372	2%
DACH	20	5%	3,135	69%	190	5%	88	4%	55	5%	215	6%	3,702	23%
France&Benelux	3	1%	424	9%	3,630	87%	87	4%	108	10%	335	9%	4,586	28%
Nordics	10	2%	139	3%	57	1%	1,928	79%	11%	1%	167%	4%	2,310	14%
Southern Europe	0	0%	18	0%	13	0%	5	0%	730	71%	24	1%	790	5%
UK&Ireland	40	9%	310	7%	148	4%	228	9%	82	8%	2526	66%	3,334	20%
Outside of Europe	10	2%	484	11%	159	4%	113	5%	43	4%	533	14%	1,342	8%
Grand Total	420	100%	4,535	100%	4,196	100%	2,450	100%	1,028	100%	3,806	100%	16,436	100%

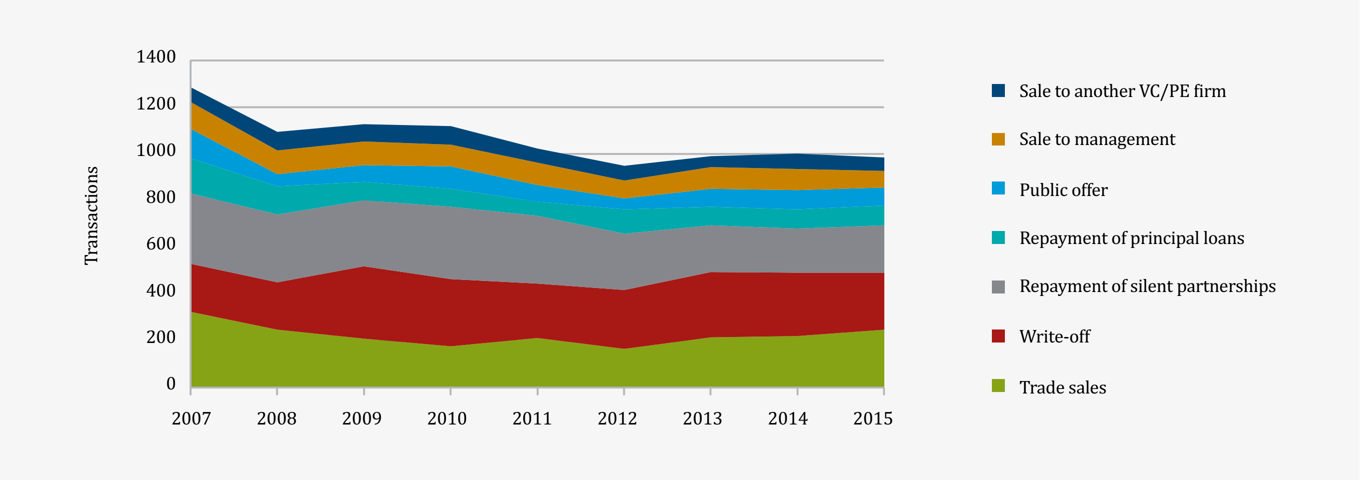
Sources: InvestEurope/PEREP_Analytics, European Commission, 2011 – Q3-2015

When looking into the geographic dispersion of European VC activity in more detail, the picture becomes more complex. It seems that VC investors tend to target tech 'hubs' rather than certain regions, based on the expertise developed in those hubs. Recent EIF research has shown that European hubs, and in particular those backed by EIF investments, act as the beating heart of a complex network of national and international investments. This claim is supported by data on investment amounts originated by hubs: 23% of these remains in the hub, 40% reaches out to other in-country locations and the remaining 37% travels beyond the national frontier. Since higher cross-border investments can be interpreted as signal of deeper integration of the European VC market, EIF may hold a vantage point in fostering the consolidation of a European-wide VC ecosystem.[123]

VC exits

According to Invest Europe, in 2015 funds in the EU sold 1,005 early stage companies representing €2.1bn of the divestment at cost. In 2015, the most common exit route was a trade sale (24% of transactions) while 23.5% of transactions were written-off. Notably, 7.5% of the exits were through the public markets. More mature and less risky companies backed by buy-out funds are naturally less likely to be written-off (4%) and are usually divested by trade sales (29%), sold to another PE firm (24%) or brought to the public markets (11%).

Figure 38: **VC-backed business exits (number of companies invested)**



Source: Invest Europe

123 Kraemer-Eis, H., Lang, F., Torfs, W., and Gvetadze, S. (2016). European Small Business Finance Outlook, December 2016. EIF Working Paper 2016/38, EIF Research & Market Analysis, pp. 26ff. http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf, based on Kraemer-Eis, H.

Family offices and private individuals' investments in venture capital funds

Between 2011 and Q3-2015, more than €2.6bn from family offices and private individuals was allocated to VC funds. The majority of the finance was raised by funds in France and Germany.

Figure 39: **Commitments by family offices and private individuals to European VCs, 2011–Q3 2015**

	Family Offices		Private individuals		Total	
Fund location	**Amount (€m)**	**Number of VC funds**	**Amount (€m)**	**Number of VC funds**	**Amount (€m)**	**Number of VC funds**
CEE			65	6	65	6
Bulgaria			4	1	4	1
Czech Republic			40	2	40	2
Lithuania			2	1	2	1
Poland			19	2	19	2
DACH	196	7	588	26	783	27
Austria			21	5	21	5
Germany	182	6	488	17	670	18
Switzerland	14	1	79	4	93	4
France & Benelux	234	25	918	95	1,152	100
Belgium			2	1	2	1
France	113	17	820	80	933	81
Luxembourg			20	3	20	3
Netherlands	120	8	76	11	197	15
Nordics	101	16	81	15	183	25
Denmark	12	1	14	1	26	2
Finland	12	4	41	8	53	9
Norway	67	10	21	3	88	11
Sweden	11	1	5	3	15	3
Southern Europe	61	5	38	8	100	11
Italy			28	3	28	3
Spain	61	5	11	5	72	8
UK & Ireland	272	12	178	13	450	20
Channel Islands			24	1	24	1
Ireland	9	1	14	3	22	3
United Kingdom	263	11	140	9	403	16
Grand Total	864	65	1,869	163	2,732	189

Sources: Invest Europe/PEREP_Analytics, European Commission

Corporate investments into venture capital

Corporates employ various models for VC investing. Some invest directly from their balance sheets (BP, Bosch) while others act as captive VC funds, investing directly in companies (Unilever Ventures). Finally, others invest as fund of fund limited partners (Siemens Venture Capital).

Corporate VC investment can vary across different stages of the company, providing syndication opportunities with VC and PE funds.

US (€23.4bn) and Chinese (€8.9bn) companies are the most active corporate VCs. In Europe, Germany (€2bn) is the most dynamic country followed by the UK (€847m). In France, corporate VC has grown from €32m in 2008 to €289m in 2013. It represented 5% of investments in start-ups and SMEs in 2013, against 16% in the US[124 125].

124 BusinessEurope, Association Française des Investisseurs pour la Croissance (AFIC)

125 However, direct comparisons of US vs. European data have to be treated carefully, as CVC is to a large extent not part of the InvestEurope statistics describing the European VC market. (See, e.g., Kraemer-Eis, H., Lang, F., Torfs, W., and Gvetadze, S. (2016). European Small Business Finance Outlook, December 2016. EIF Working Paper 2016/38, EIF Research & Market Analysis, p. 21. http://www.eif.org/news_centre/publications/eif_wp_37_esbfo_dec16_final.pdf, according to which "corporate acquisitions outside of dedicated corporate venture programmes are not included in the statistics".

6. Venture debt

Venture debt usually refers to debt finance provided to businesses which have achieved scale already, not necessarily with positive cash flows but stable and close to it, and do not qualify for traditional debt financing or aim for greater flexibility.

Venture debt can take to form of a line of credit linked to account receivables, equipment finance (borrowing for a specific equipment) and vendor finance (borrowing directly from the supplier). Most of the time, venture debt refers to non-convertible senior term debt that includes warrants.

Venture debt providers usually have strong relationships with VC firms or other professional investors, hence allowing to effectively provide loans to companies burning cash.

Unlike typical bank loans, venture debt has no financial covenant. However, like any other form of debt and loan, venture debt needs to be repaid with interest over time.

Most venture debt transactions are for companies with revenues of more than €10m. Typical terms are between three and four years.

Venture debt provides an alternative or complementary source of financing, usually for companies with existing professional investors such as a VC that lack the assets or cash-flows for traditional debt financing[126]. For existing VC investors, raising venture debt allows to reserve additional capital for future rounds and helps existing investors to avoid dilution from new investors by reducing the size of a new equity round or helping reach objectives to raise the next round at higher valuations. Venture debt is used at a stage where equity finance is too dilutive for the existing VC investors or that the amount sought is too little for an equity fundraising. The additional capital finances more growth ahead of the next formal equity capital raising. Venture debt may be preferable to convertible debt which converts into equity, as venture debt funding does not dilute existing shareholdings.

Venture debt is suitable for young and innovative businesses ideally with at least one granted or pending patent.[127]

This type of finance is suited to companies with clear objectives to accelerate growth, finance the purchase of equipment or make an acquisition.

The European market for venture debt is small compared to the US. While it is difficult to get an overview, estimates suggest that 15-20% of all US VC is in the form of venture debt. This compares with 8-10% in the UK and 5% in Europe.[128]

Venture debt in Europe could be a useful financing route to fill the gap between two VC rounds. There is a shortage of VC capital in Europe, especially after the first round of finance. According to Preqin and the "Scale-Up UK" report[129], investors commit on average to 1.7 rounds of financing in a particular European (excluding the UK) portfolio company. By contrast, US investors commit on average to 2.4 rounds and UK companies receive commitments for an average of 2.1 rounds. In addition, European companies (excluding the UK) find that 60% of their investors invest in just one round. In the US, 42% of investors invest in two or more rounds (58%, see Figure 41).

Improving the visibility and access of venture debt instruments and providers could provide extra finance for businesses to reach their next milestone without getting diluted. An important step could be reached for some businesses, allowing future potential fundraising with VC funds allowing businesses to scale-up and grow.

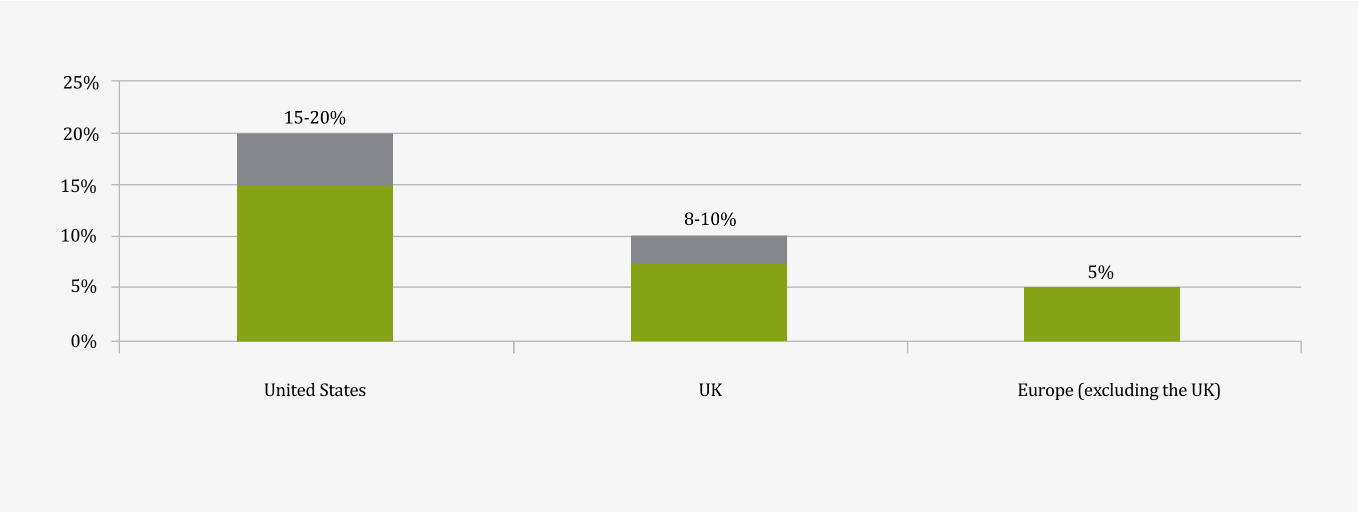
126 "Debt financing of high-growth startups: The venture lending business model", Timo Fischer, Gaetan de Rassenfosse

127 "Patent activity of start-ups and the structuring of venture lending contracts", Mischa Hesse, Eva Lutz, Eli Talmor

128 E&Y and "Scale-up UK" report.

129 Scale-up UK, p45, University of Cambridge, SAID Business School, University of Oxford, Barclays, 2016. See also The State of European Venture Capital, BCG, IESE Business School, 2015.

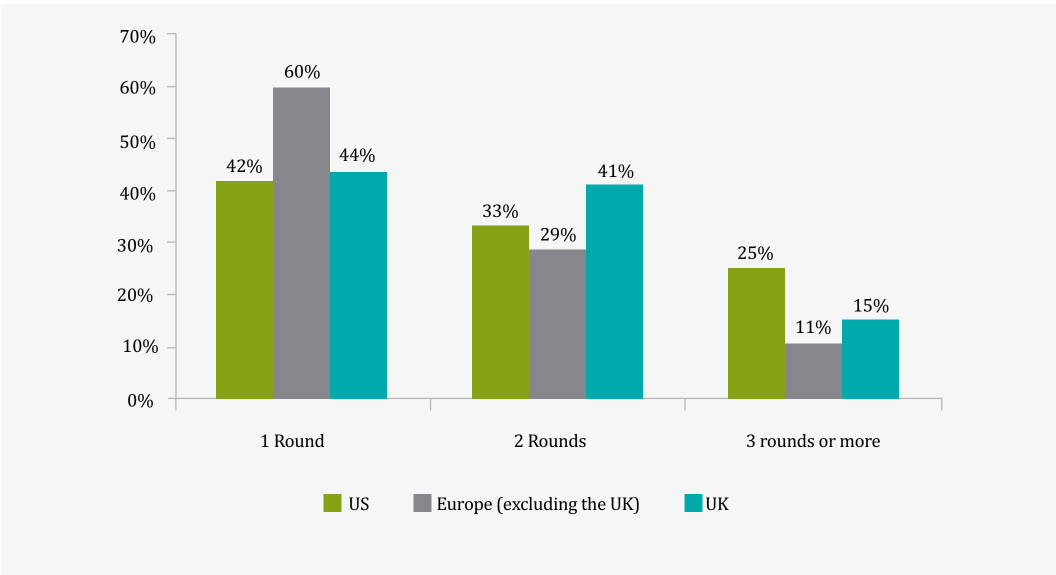
Figure 40: **Percentage of VC-backed companies obtaining venture debt (range from different sources)**



Source: E&Y, Scale-up UK

In Germany, venture loans are due for repayment at the end of the loan period and are usually granted to established growth companies that are already generating substantial revenues. Venture loans are subordinated loans (Nachrangdarlehen), which are granted for three to four years and include semi-annual interest payments.

Figure 41: **Frequency of multiple equity rounds in venture capital funds**



Source: Scale-up UK, Preqin

In the context of the Commission's "Capital Markets Union" initiative, the Commission will work with European supervisory authorities to "assess the need for a coordinated approach to loan origination by funds and the case for a future EU framework". A mapping on national practices for loan origination by funds is provided by ESMA.[130]

Member states have recently clarified rules on debt fund managers. For instance, in 2016, Germany introduced new rules to clarify whether debt fund managers need bank licences, including venture debt managers.[131]

130 https://www.esma.europa.eu/sites/default/files/library/2016-596_opinion_on_loan_origination.pdf

131 http://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Gesetzentwuerfe_Arbeitsfassungen/2015-09-24-OGAW.html

7. Raising equity capital on Europe's "junior" exchanges

Market size (2015)	€2bn on the primary market (IPOs), and €8.5bn on the secondary market (follow-ons)[132]
Type of vendors	Founders, family and friends, business angels, venture capital funds
Type of investors	Institutional investors, retail investors (if public offering)
Typical amount (per transaction)	€10m - €100m
Transaction time horizon	6 months. May take longer depending on market conditions and may take be shorter in case of a private placement.
Investment time horizon	Typically, 5-6 years but depends on investment strategy
Investment reasons	Financial returns, portfolio diversification
Financial instrument	Common share
Screening process and due diligence	High
Documentation requirements	Prospectus required if public offering (or listing on regulated markets which junior markets are usually not), offering circular if private placement
Company's stage of development	Expansion stage
Exit opportunities	Secondary market, follow-on offering, trade sale
Key considerations	€1.7bn on average raised annually in 2008-15 compared to €11bn in 2005-07 Capital raising from both the primary and secondary markets are erratic throughout Europe The typical size of listed companies has grown since 1999 with a median size during the last 10 years of about €20m-€30m From 2012-15, 31 European companies representing €21.7bn in market capitalisation decided to list in the US raising €5.2bn The proposed Prospectus Regulation is expected to include the objective of lowering listing costs for small and mid-sized issuers

"Junior" exchanges are stock markets where companies sell new shares to institutional investors, and sometimes to the public, to raise equity capital. "Junior" exchanges are usually in the form of MTFs and usually have less onerous obligations in terms of financial costs and disclosures, both at admission to trading and throughout the company's public life[133].

Across France, Germany, Spain, Italy, Sweden and the UK, among others, over 1,500 companies are listed on junior exchanges, representing nearly £98bn in market capitalisation. On Euronext Alternext, for example, 48% of the companies have less than €25m in annual turnover.[134]

The depth of the European junior markets varies across jurisdictions. The UK is the most active junior market accumulating a total of 656 IPOs since 2007, representing a total of €21.4bn in fresh capital raised from the public. We also note that First North, in Sweden and other Nordic and Baltic countries, has in recent years added numerous companies to its list of 46 in 2014 and 61 in 2015.

The typical amount raised on junior markets ranges from €4m on the Stockholm First North market to €15m on the UK London Stock Exchange's AIM, with capital raisings as low as €100,000 on AIM and in Spain's Mercado alternative Bursatil. However, these typical amounts hide a high diversity in amounts raised: on Nasdaq First North companies capital raisings in 2016 have varied from €1m to €98m.

132 PwC IPO Watch

133 A detailed comparison of the different requirements during admission and life of a listing for both equities and bonds in the junior markets is available in AFME's "Raising finance for Europe's small & medium-sized businesses" report.

134 AFME "Raising finance for Europe's small & medium-sized businesses".

Figure 42: **Equity raised in Europe's "junior" stock exchanges, 2007- H1 2016**

	As of Q3 - 2016		2015		2014		2013		2012		2011		2010		2009		2008		2007	
Exchange	IPOs	Value (€m)	IPOs	Value	IPOs	Value	IPOs	Value	IPOs	Value	IPOs	Value	IPOs	Value (€m)	IPOs	Value (€m)	IPOs	Value (€m)	IPOs	Value (€m)
LSE AIM	29	1,111	31	730	81	3,159	68	2,079	49	788	48	741	58	1,180	14	655	58	1,423	220	9,537
LSE AIM Italia	9	103	17	265	21	203	15	193	10	3	3	10	6	32	5	32	-	-	-	-
Nasdaq OMX First North	36	448	61	790	46	417	20	21	25	267	9	10	9	22	5	-	16	56	50	837
BME MAB	17	11	17	132	6	57	1	2	9	5	5	9	10	48	2	19	-	-	-	-
Euronext Alternext	7	73	18	113	12	61	7	89	23	8	8	23	21	73	3	-	7	31	39	445
Deutsche Boerse Entry Standard	3	14	4	9	4	1,401	1	-	32	15	15	32	13	116	4	5	10	6	34	250
Warsaw NewConnect	12	7	19	6	22	7	41	11	37	89	89	36	86	40	26	10	61	47	24	41

Source: PwC IPO Watch, 2007 – Q3 2016. Few IPOs are only technical listings which have not necessarily raised capital.

Figure 43: **Follow-on: Equity raised in Europe's "junior" stock exchanges, 2007- H1 2016**

	As of Q3 - 2016		2015		2014		2013		2012		2011		2010		2009		2008		2007	
Exchange	IPOs	Value (€m)	IPOs	Value	IPOs	Value	IPOs	Value	IPOs	Value	IPOs	Value	IPOs	Value (€m)	IPOs	Value (€m)	IPOs	Value (€m)	IPOs	Value (€m)
LSEG AIM	224	3,303	283	7,424	253	4,020	237	3,098	294	2,822	375	3,798	407	5,921	420	4,596	303	3,026	535	11,305
LSEG AIM Italia	2	75	1	0	-	-	-	-	-	-	2	140	-	-	-	-	-	-	-	-
Nasdaq OMX First North	10	120	9	138	5	51	1	2	-	-	-	-	-	-	-	-	-	-	-	-
BME MAB	1	3	1	5	-	-	-	-	1	18	1	4	-	-	-	-	-	-	-	-
Euronext Alternext	27	130	10	58	6	47	4	44	6	18	-	-	7	11	11	88	7	24	9	216
Deutsche Boerse Entry Standard	12	330	16	879	10	101	13	374	9	23	15	60	18	58	7	37	21	265	21	140
Warsaw NewConnect	3	2	6	14	2	3	1	3	2	2	2	1	6	18	8	2	6	3	2	1

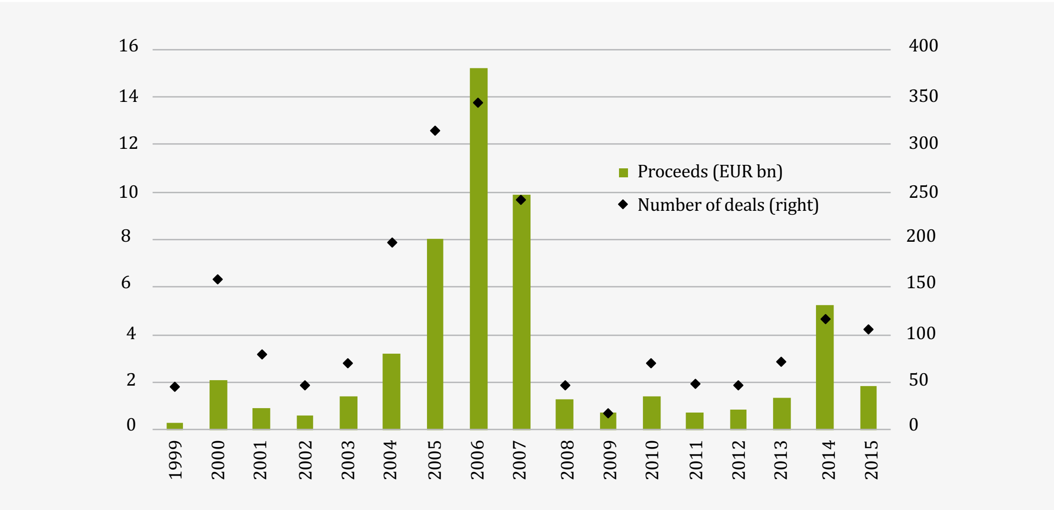
Source: Dealogic

Since 2007, a total of €28.4bn in equity has been raised by companies through IPOs on junior markets and €52.8bn in following transactions in the secondary markets (follow-ons). However, origination activity has remained subdued since the 2007 crisis. For example, from 2005-2007 an average of €11bn was raised annually through about 300 IPOs per year. Since then, the annual average has fallen to €2.8bn from 2008 and 2015, across 161 IPOs per year. In 2015, more than €2bn was raised through 192 transactions in European "junior" exchanges.

The amount of capital raising and the size of issuing firms has varied in recent years (see Figure 44). As market volatility, price spreads and investor appetite fluctuates, so too does the window of opportunity for companies raising finance.

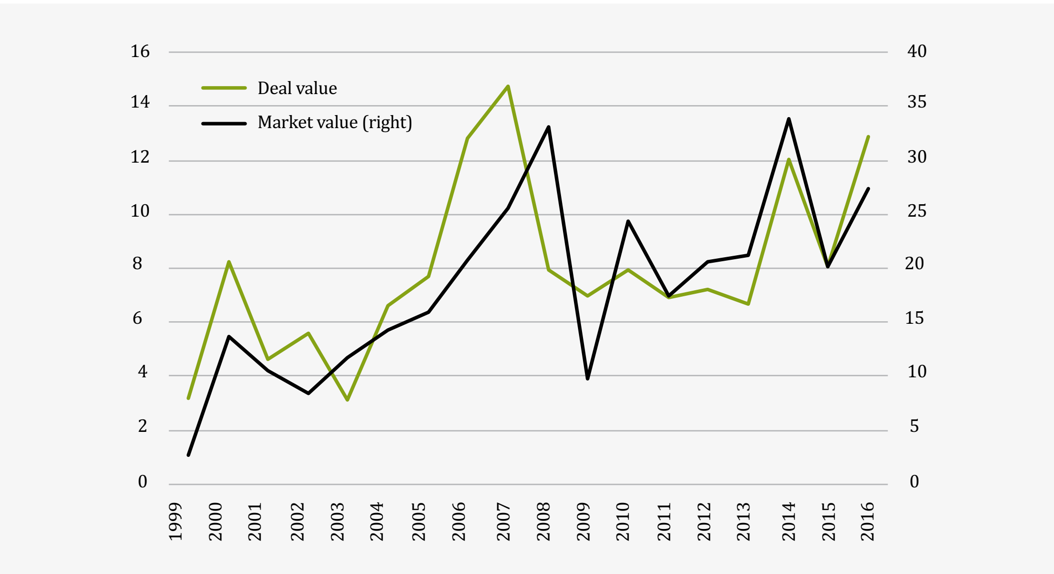
From a long-term perspective, the typical size of listed companies has grown since 1999 with a median size (before capital raising) during the last 10 years of about €20m-€30m, and capital raisings of between 20%-30% of the post-IPO value of the listed company.

Figure 44: **IPO proceeds and number of deals on European Junior markets**



Source: Dealogic

Figure 45: **Median IPO deal value and median size of issuing company on Junior markets (€m)**



Source: Dealogic

Comparison of European and other small- and mid-markets

In the US, the JOBS Act of 2012 introduced the concept of Emerging Growth Companies (EGCs), which are companies with revenues of less than $1bn. The JOBS Act is estimated to have sparked an increase of 25% in IPOs annually (21 per year). Notably, this growth in small firm IPOs has resulted in the post-JOBS period having the highest percentage of low-revenue IPO issuers since 2000. Approximately 45% of issuers conducting IPOs between April 2013 and March 2014 had less than $50m in revenue, compared to an average of 28% between 2001 and 2012. About 82,000 jobs have been added by the companies that completed IPOs under the JOBS Act, an increase of roughly 30% from their pre-IPO head counts.

This increase in IPO volume is mainly driven by the reduction of proprietary disclosure costs as a consequence of confidential filing and testing-the-water provisions of the JOBS Act "IPO On-Ramp" (Title I). Approximately 90% of issuers select the confidential filings provision and over two-thirds select the testing-the-waters provision.

With this mechanism, companies with less than €1bn in revenues would file a draft registration statement for confidential review by the National Competent Authority (NCA) prior to making public filing. The confidential filing and any amendments would be publicly filed with the NCA not later than 21 days before the issuers conducted their roadshows.

In addition, those companies and their representatives would be authorised to communicate with qualified investors before, or after, the filing of a registration document to determine whether investors have an interest in the placing.

The EGC status has also attracted European companies, which have benefited from the related provisions. From 2012-15, 31 European companies representing €21.7bn in market capitalisation decided to list in the US, raising €5.2bn. Of these 31 companies, 26 had market capitalisations at IPO of less than €1bn (see exhibit 10). US EGCs under the JOBS Act usually have a market capitalisation at IPO of less than €1bn. Of the 566 IPOs of US EGC companies studied in 2012-15, 493 (87%) were below €1bn.[135]

On the other hand, in Europe, only 23% of European IPOs had market capitalisation in between €200m and €1bn compared to 48% in the US[136] (103 companies compared to 271), 52% in Shanghai and Shenzhen and 36% in Hong Kong. In Europe, over the same period, non-SME companies have listed seven primary equity issuances on MTFs,[137] with market capitalisations of between €200m and €1bn.

Figure 46: **US and European IPOs drawdown by market capitalisation, 2012-2015**

	US (EGCs)		Europe (Main markets and MTFs)	
Range of market capitalisation at IPO (€m)	**Number of companies**	**% (count)**	**Number of companies**	**% (count)**
0 - 200	222	39%	269	61%
200 - 1,000	271	48%	103	23%
+1,000	73	16%	72	16%
Total	**566**	**100%**	**444**	**100%**

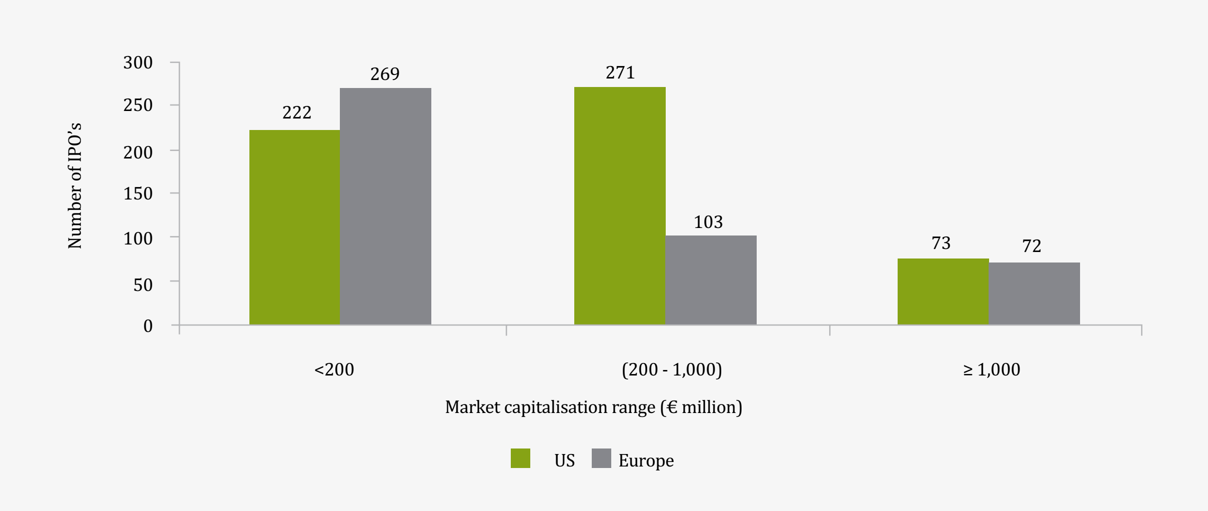
Sources: AFME, Dealogic, 2012-2015

135 Source: Dealogic. Sample of 566 US EGC companies between 1 January 2012 and 31 December 2015.

136 Source: Dealogic. Sample of 444 IPOs in European main markets and MTFs between 1 January 2012 and 31 December 2015.

137 As defined in the first bullet of Article 2(1)(f) of the draft regulation.

Figure 47: **Number of IPOs in European main markets and MTFs and from US EGCs, 2012-2015**



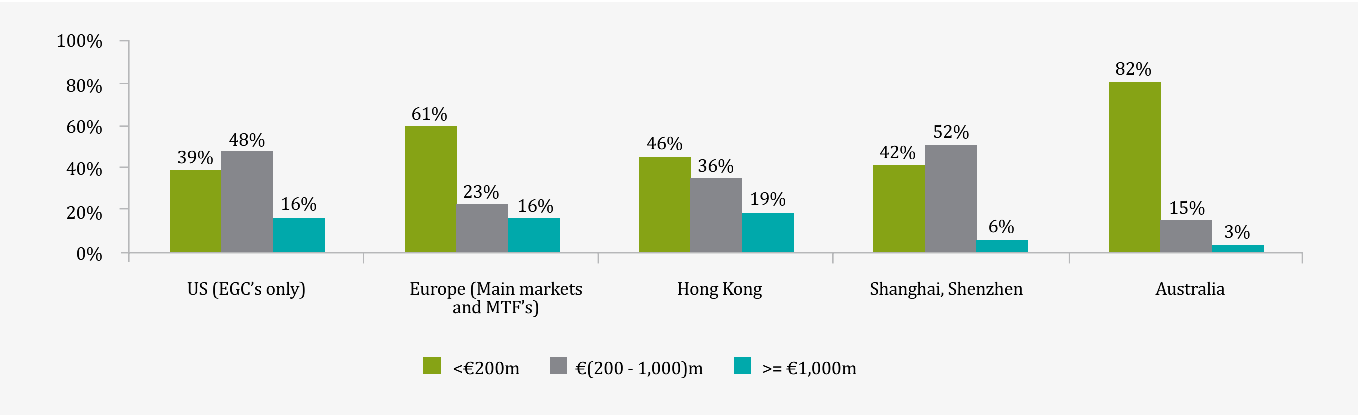
Source: AFME, Dealogic

Figure 48: **IPOs in Hong Kong, China and Australia by market capitalisation, 2012-2015**

Range of market capitalisation at IPO (€m)	Hong Kong	Shanghai, Shenzhen	Australia
<200	134	205	238
200 - 1000	105	252	45
>=1000	55	31	9

Source: AFME, Dealogic

Figure 49: **IPOs in Hong Kong, China and Australia by market capitalisation, 2012-2015**



Source: AFME, Dealogic

Liquidity costs

While the secondary markets are out of scope of this report, it may be useful to understand that the reduced liquidity in MTFs may increase the cost of capital to companies listed on small cap markets. Further, secondary research by Oxera indicates a 'small firm' effect which makes small company stocks more vulnerable to market illiquidity. Research by Amihud (2002) highlights that in times of market stress there is a flight to liquidity.

8. Public funding from EU-wide and national entities

EU financial instruments for risk capital

The EU provides various forms of support to risk capital for innovative businesses.

The 2014-2020 programme has introduced the 'Single EU Equity Financial Instrument' which supports European enterprises' growth, research and innovation (R&I) from the early stage, including seed, up to expansion and growth stage.

The Single EU Equity financial instrument is financially supported by the COSME (Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises) focusing on SMEs and the Horizon 2020 providing equity finance to research companies and larger companies.

The implementation of the Single EU Equity Financial Instrument has been delegated to the EIF by the European Commission.

The new Commission's Start-up and Scale-up Initiative is planning to reform the Horizon 2020 programme. This initiative include the creation of the European Innovation Council in charge of addressing issues to support the EU's most promising innovators[138].

The launch by the Commission and the EIF of the pan-European Venture Capital Fund of Funds should complement the existing programmes. The EU will provide cornerstone investments of up to a maximum budget of €400 million and the fund manager(s) must raise at least three times as much from private sources, triggering a minimum of €1.6bn in venture capital funding. It will be managed by one or more professional and experienced fund managers.

The role of the European Investment Fund

EIF is the **European Investment Bank Group's**[139] **specialist provider of risk finance to benefit small and medium-sized enterprises (SME) across Europe.** Its shareholders are the European Investment Bank (EIB), the European Union, represented by the European Commission, and a wide range of public and private banks and financial institutions.

In general, EIF carries out activities using either own resources or those provided by the European Investment Bank, the European Commission, by EU Member States or other third parties. By developing and offering targeted financial products to financial intermediaries, such as banks, guarantee and leasing companies, micro-credit providers and private equity funds, EIF enhances SMEs' access to finance. By taking SME risk, EIF pursues two main statutory objectives:

- fostering EU objectives, notably in the field of entrepreneurship, growth, innovation, research and development, employment and regional development;

- generating an appropriate return for our shareholders, through a commercial pricing policy and a balance of fee and risk based income

Referring to risk capital, by promoting entrepreneurship and innovation, EIF stimulates private sector involvement and makes European private equity more attractive as an asset class. This helps to close the funding gap many businesses face. EIF typically makes cornerstone investments in funds: the actual amount depends on the segment targeted, the characteristics of the fund, the investment opportunity and the market conditions.

EIF has built a strong equity track record with European SMEs by funding both established and first-time teams. EIF's financial backing has helped companies to innovate and grow into European players and sometimes even global leaders. All stages, from investing in technology transfer to investing in mezzanine, are covered. EIF addresses the market gap in early stage funding by providing risk capital to top tier and first time fund managers and has repeatedly stepped up its commitments in promising and quality-oriented funds to stimulate growth and innovation in Europe.

138 https://ec.europa.eu/research/eic/index.cfm

139 The European Investment Bank Group consists of the European Investment Bank (EIB) and the EIF.

EIF backs a range of growth funds that support established, profitable and growing businesses that need more capital to take advantage of new opportunities. Through these growth funds, tailor-made products, ranging from hybrid debt/equity o pure equity finance, including expansion and replacement, are offered to mature businesses. One product is mezzanine, a hybrid debt/equity tool designed to finance growth.

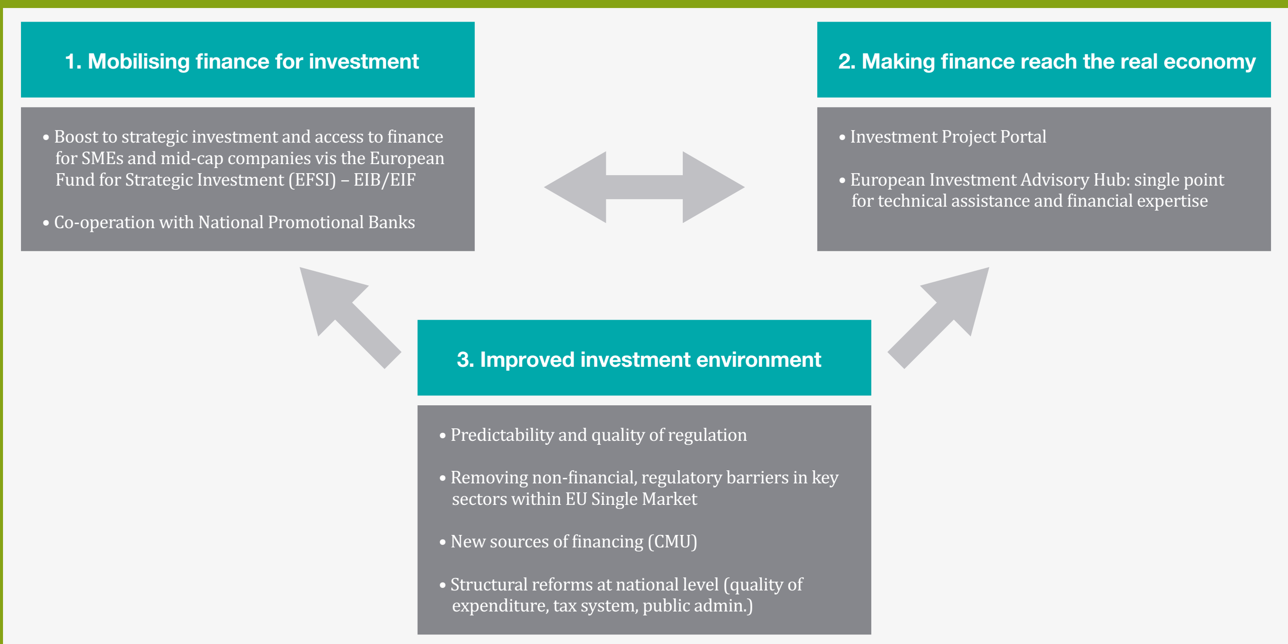
Since 1994 EIF has committed more than €11bn in over 470 SME-focused venture and growth capital funds.

As well as its own funds, EIF invests resources managed on behalf of capital providers under a range of programmes. EIF also manages and advises funds-of-funds and other initiatives for third party investors.

The Investment Plan for Europe

EIF is involved in the implementation of the Investment Plan for Europe (IPE)[140]. The IPE is based on three pillars, mobilising finance for investment, making finance reach the real economy, and improved investment environment, see Figure 50.

Figure 50: **Pillars of the IPE**



Source: European Commission

As part of this investment plan's pillar one, the European Fund for Strategic Investments (EFSI) aims to unlock additional investments of at least €315bn over a three year period by addressing market gaps and mobilising private resources. EFSI is a strategic partnership between the Commission and the EIB Group. The latter contributes €5bn to the initiative alongside a €16bn guarantee from the EU budget. Currently, EFSI has two components (see as well Figure 51):

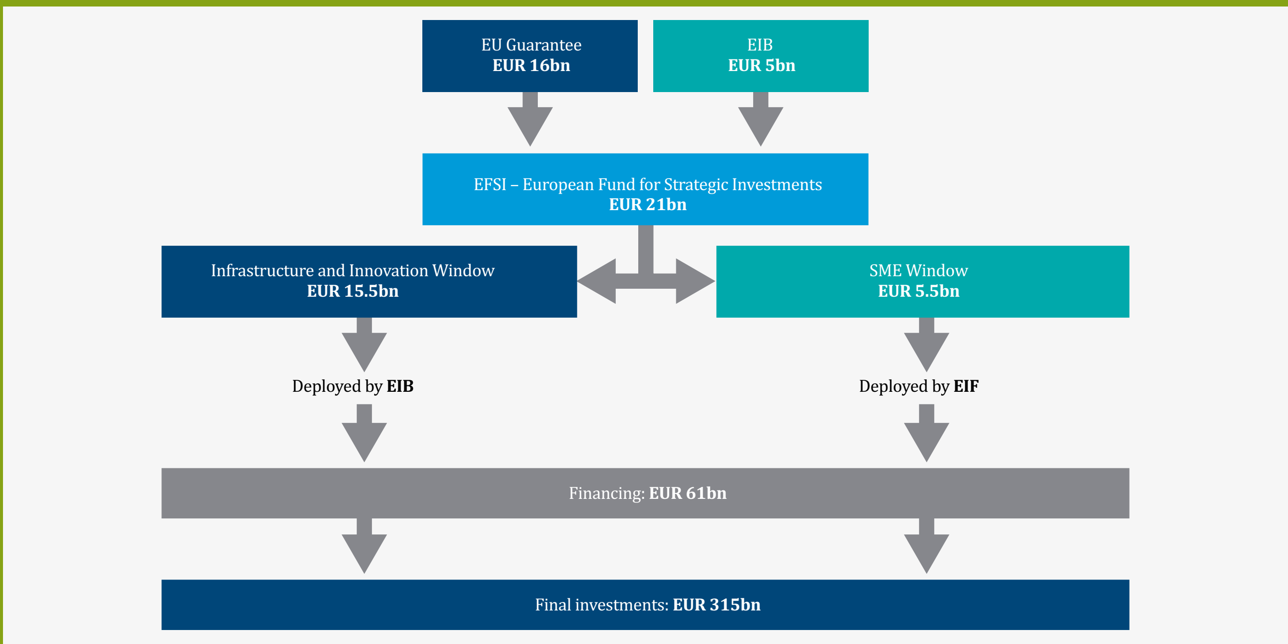
- the Infrastructure and Innovation Window (€15.5bn), deployed through the EIB, and
- the SME Window (€5.5bn), implemented through EIF. The financial instruments used for the purposes of the EFSI SME Window are mainly guarantees and equity investments.

140 See http://www.eib.org/efsi/index.htm and http://www.eif.org/what_we_do/efsi/index.htm.

The resources under EFSI enable EIF to deploy its existing support for SMEs at a higher and faster rate than initially planned to satisfy strong demand of support to SME access to finance. During the first phase, initial EFSI resources under the SME Window are being used to accelerate and enhance the deployment of existing EU flagship programmes which EIF manages – i.e. COSME, InnovFin – and to significantly increase the Risk Capital Resources (RCR) mandate for equity investments, which EIB has entrusted to EIF. Thanks to EFSI, also the RCR equity mandate, which EIF manages on behalf of EIB, has been increased by €2.5bn.

In the second phase of the EFSI SME Window (started in 2016), new products are being rolled out, including a new Pan-European Venture Capital Fund(s)-of-Funds programme[141], products for social impact and microfinance, as well as products in relation to the new equity and securitisation platforms, introduced above.

Figure 51: **EFSI structure**



Source: EIB Group

The implementation of the EFSI SME window is well on track, as per end-2016, 247 transactions have been signed in 28 countries, covering already around 70% of the total foreseen EFSI SME Window contribution, with expected mobilised investments of around €67bn[142]. The demand from intermediaries to finance SMEs remains very high. Based on the success of the EFSI implementation, the European Commission on 14th September 2016 proposed an extension of EFSI by increasing its firepower and duration and to reinforce its strengths[143]. European Union economy and finance ministers approved in principle the extension of the Investment Plan for Europe and EFSI at the Ecofin Council on 6th December 2016, passing the ball to the European Parliament, which must now give its view on the draft legislation before it can be formally adopted.

141 See http://www.eif.org/what_we_do/equity/news/2016/efsi_pan-european_venture_capital_funds_of_funds.htm and http://www.eif.org/what_we_do/equity/paneuropean_venture_capital_fund_of_funds/index.htm for more information. In addition, InnovFin Fund-of-Funds (InnovFin FoF) targets investments into fund of funds holding or targeting to build a portfolio of investments into underlying funds with significant early stage focus. It also provides significant funding to the separately managed Pan-European Venture Capital Fund(s)-of-Fund programme. More information can be found here: http://www.eif.org/news_centre/publications/eif_innovfin_venture_capital_en.pdf. An overview is also given in Kraemer-Eis et al. (2016).

142 Latest EFSI figures can be found at http://ec.europa.eu/priorities/publications/investment-plan-results-so-far_en.

143 European Commission (2016). Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 1316/2013 and (EU) 2015/1017 as regards the extension of the duration of the European Fund for Strategic Investments as well as the introduction of technical enhancements for that Fund and the European Investment Advisory Hub. Brussels, 14.9.2016 COM(2016) 597 final 2016/0276 (COD). https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/1-2016-597-EN-F1-1.PDF

EIF's engagement in the deployment of the Investment Plan for Europe's EFSI SME Window has been anchored in two main objectives. EIF is seeking ways to support the European venture capital and private equity industry in reaching out and providing the financing for high-growth and innovative SMEs in Europe.

In the first phase of implementation of the SME Window, €2.5bn was provided to EIF by the EIB, from its own contribution to EFSI, to increase the firepower of the Risk Capital Resources (RCR) mandate that is managed by EIF. This equity mandate supports in particular private equity and technology transfer investments into innovative SMEs and mid-caps. Under the RCR mandate, EIF increased commitments in investment funds that target early to lower mid-market segments, including the provision of equity as well as hybrid debt/equity financing. 30 new EFSI-backed RCR transactions were signed by the end of 2016, leading to an expected EUR 10.9bn of mobilised investments.

A new EFSI SME Window Equity instrument was developed with a total investment capacity of €2,068m. It is an umbrella structure to:

- Early stage investments under the newly launched InnovFin Equity facility including a focus on technology transfer, business angels and venture capital; and

- Growth stage investments and fund of funds, including a focus on social impact investments.

In addition, this instrument opens up the possibility for other investors to co-invest alongside EIF in both the early- and the growth stage windows, by matching the same amount of investment (pari-passu principle) within the framework of the Pan-European Venture Capital Fund-of-Funds.

EIF also rolled out a collaborative investment platform for national promotional banks and institutions (NPIs) in September 2016. The NPI-Equity Platform provides a flexible, non-binding governance framework enabling NPIs to match the resources invested by EIF under the EFSI SME Window Equity instrument or other equity mandates. More generally, it is an opportunity for EIF and NPIs to establish a closer, more coordinated operational interaction.

In Europe, **the EIF is the main investor in VC funds.** It is estimated that fundraising volumes backed by the EIF in 2014 amounted to 45% of the overall sums raised from European VC investors (36% in 2007), against a share directly attributable to EIF totalling 12% (5% in 2007). The investment activity backed by EIF represented 41% of total investments in Europe in 2014 (29% in 2007)[144]. The EIF invests at every stage of a company's development but this differs from one country to another. For instance, in more mature VC markets such as the UK, the EIF invests in scaling up companies, whereas in other markets it focuses on earlier stages, investing €500,000 to €2m. The EIF prefers not to crowd-out private investors in the VC market. It likes to invest alongside private capital, and does not want to own a disproportionately large share of Europe's VC investments.

The EIF also **co-invests with business angels** at various stages of development through the European Angels Fund (EAF). The EAF has committed €300m in total, with tickets between €250,000 and €10m. The initiative started in Germany in close cooperation with Business Angels Netzwerk Deutschland (BAND) and the ERP-EIF Dachfonds, before expanding into Austria, Spain, Ireland, Denmark and Finland.

The **EIF is also active in the technology transfer** area, supporting the commercialisation of ideas. This includes close cooperation with private stakeholders, universities and research organisations in the field of intellectual property rights and the creation of start-ups or spin-off of companies. In 2014, the EIF invested €111m in technology transfers.

The EIF also provides guarantees and securitisation signatures. In 2015, €4.7bn was invested in such instruments, catalysing €16.7bn in funding. Other EIF initiatives include microfinance in the form of guarantee or loans to microfinance institutions (€86.4m committed in 2015).

144 EIF, The European venture capital landscape: an EIF perspective. Volume I: The impact of EIF on the VC ecosystem, Working Paper 2016/34

Figure 52: **EIF commitments crowd-in private investors**

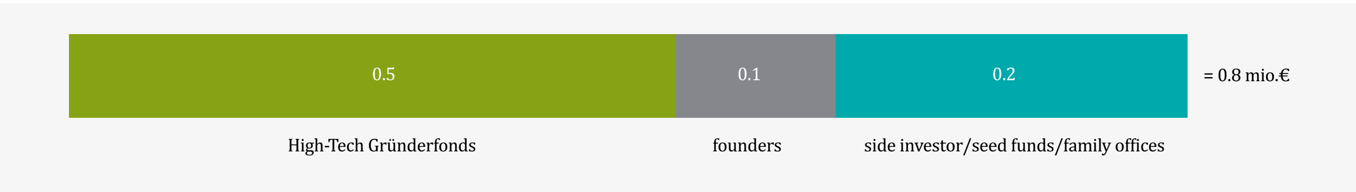
	Commitments	Catalysing
Equity and mezzanine		
2015	€2.2bn, including Early stage: €1bn Growth: €1.2bn	€9.8bn, including Early stage: €3.5bn Growth: €6.3bn
2014	€1.65bn, including Early stage: €723m Growth: €930m	€8.2bn, including Early stage: €1.9bn Growth: €6.4bn
Since inception	€9.9bn, including Early stage: €4.8bn Growth: €5.1bn	€48.6bn, including Early stage: €18.3bn Growth: €30.3bn
Guarantees and securitisation		
2015	€4.7bn	€16.7bn
Since inception	€9.3bn	€62.0bn
Microfinance		
2015	€86.4m	€421m
Since inception	€218m	€923m

National institutions

Public national development banks such as the KfW in Germany and BPIfrance in France usually provide guarantees as well as equity finance. AFME's guide *Raising finance for Europe's small and mid-sized companies* (2015) provides more information on the various national programmes for SMEs in the form of equity, debt, loan or tax incentives. However, many companies in smaller member states do not have access to national development banks, although the Commission's "Investment Plan for Europe" is eager to help develop these institutions.

In addition, some countries have started to promote other initiatives to distribute equity. This is the case of the Business Growth Funds, a private initiative in the UK (see box below) or the German's High-Tech Gruenderfonds (HTG). Since 2005, the HTG has invested in close to 400 companies at a seed stage through its two closed-end funds (€376m of commitment).

Figure 53: **Typical transaction with the involvement of the German's HTG**



Source: High Tech Gruenderfonds

In Ireland, there is the Ireland Strategic Investment Fund[145], managed and controlled by the National Treasury Management Agency (NTMA), which is sovereign development fund with a statutory mandate to invest on a commercial basis in a manner designed to support economic activity and employment in the country. The fund's predecessor was the National Pensions Reserve Fund (NPRF).

With €8 billion available to deploy, the Fund has a long investment time horizon and therefore can act as a permanent or patient source of long-term capital, with its flexibility, it can therefore meet changing capital needs of the capital structure and gaps in the marketplace.Appendix

The Business Growth Fund

The Business Growth Fund (BGF) is a private company whose shareholders are the largest UK-based banks (Barclays, HSBC, Lloyds, RBS and Standard Chartered). With a similar mandate to the ICFC (the predecessor of PE firm 3i), the BGF was established in 2011 to provide equity to high growth companies in the UK.

BGF has €2.5bn in capital and typically invests £2m – £10m in companies with turnover of £5m – £100m. Recently, BGF created BGF Ventures with £200m to invest specifically in early-stage technology companies.

So far, the BGF has provided £900m in funding. It aims to invest £500m per year of new money in early-stage and growth companies.

Similar initiatives at Member State or European level could have an impact.

For more information, see http://www.businessgrowthfund.co.uk/ and http://www.bgfventures.com/

145 www.isif.ie

6. Appendix

Estonia's e-Residency

Estonia is the first member state to offer e-Residency - a transnational digital identity available to everyone in the world. Through its e-Residency program, Estonia is building a borderless digital society and unleashing entrepreneurial potential. After becoming an e-resident, entrepreneurs and freelancers can open and run location independent businesses online, apply for a bank account* and conduct e-banking, get access to international payment service providers, declare taxes, sign all relevant documents and contracts remotely, and get easier access to EU markets. This means a Singaporean entrepreneur could, for example, run a company from the Philippines while serving clients in Germany. The same e-Residency platform allows financial and web service providers, start-ups and developers to avoid country specific solutions and have quick access to international markets by letting clients from anywhere in the world use their services via the clients' secure and government-verified digital identities. E-Residency does not give citizenship or tax residency. Nor does it confer the right to live in or visit Estonia or the European Union. To learn more, visit: e-resident.gov.ee.

The European Institute of Innovation and Technology (EIT)

The EIT inspires highly productive interaction between innovation hubs, stakeholders, start-ups and scale-ups. Thanks to this effective and constructive relationship, access to talent, knowledge and markets and support for new innovative business ventures is continuously fostered. The EIT takes a transdisciplinary approach, crossing the boundaries between disciplines, sectors, research, higher education and business, science and society. It involves all actors in the innovation value chain. The EIT provides thematic expertise in the area of climate change, sustainable energy, raw materials, digitalisation and health.

Advertising would increase the awareness of the EIT among investors such as crowd funders, business angels, VC funds.

Examples of fragmentation within the EU

Fragmentation can be found for instance across specific member states.

Different technical standards

In the case of Spain[146], most trading obstacles for Spanish companies are those related to technical standards. National technical rules represent more than 40% of the total detected single market obstacles, the most noteworthy referring to the failure to standardise relevant products and to the misapplication of mutual recognition for certificates or approvals obtained in Spain. Obstacles related to the functioning of the "single market" are mainly concentrated in the states to which the majority of Spanish products are bound: France, Germany, Italy, United Kingdom and Portugal.

Different packaging requirements for pharmaceutical products

Pharmaceutical products have to be registered in each member state before marketing. Member states have different requirements about the information that is allowed on the packaging. This makes it impossible to introduce common packaging, even where the same languages may be used. For example, Finland requires a triangle in the "blue box", but this is not allowed in Sweden. Belgium requires a barcode sticker on the packaging, which is not permitted on other markets. Italy has a special "bollini sticker", and France requires two red lines on the blister cards. The consequence is reduced product ranges in some markets and a higher amount of waste.

Conflicting regulatory approaches to the environment and energy efficiency result in significant costs and administrative burdens

An SME exports wood burning stoves and accessories to all European countries and ends up being squeezed between optimization of emission targets and energy efficiency – requirements that are going into opposite directions. New labelling requirements addressed to consumers are increasing, e.g. regarding energy efficiency rules in each member state.

What should apply is the recognition by EU state authorities of any EU laboratory that is certified for the needed analysis / non- EU laboratories that conform with EU regulations.

Upholstered furniture

Even if furniture is under the scope of the General Product Safety Directive and covered by European standards, special requirements in the UK for upholstered furniture – even for garden furniture – mean that a special range of products has to be developed for the UK. Due to fire protection, foam and textiles must be treated with flame resistant chemicals, which for environmental reasons are not wanted on other markets. The consequence calculated for one specific company is that it needs to double its stock of furniture. There are extra initial costs for each product, which have forced the company to reduce its UK product range by about 25%.

Spanish furniture companies have similar problems in France and Germany.

Source: BusinessEurope

146 According to the Open Line of the identification of problems of Spanish companies in the European single market Report 2015

Figure 54: **Overall picture of pre-IPO equity and venture debt finance availability, EU vs US**

	Europe	US
Junior markets	PwC IPO Watch, Dealogic, 2015	Dealogic, 2015, Emerging Growth Companies only
Venture Capital	Invest Europe, 2015	National Venture Capital Association, 2015
Business angels	EBAN, 2015	Centre for Venture Research, 2015
Total Crowdfunding platforms	Crowdsurfer.com	Cambridge Centre for Alternative Finance, The Americas Alternative Benchmarking Report, 2015 Crowdsurfer.com
Accelerators	Fundacity, European Accelerator Report 2014	

Resources from contributors

Joint declaration on the CMU: http://www.eban.org/wp-content/uploads/2015/05/Capital-Market-Union.pdf

EBAN contribution to the European Commission's Consultation on the Green Paper "Building a Capital Market Union": http://www.eban.org/wp-content/uploads/2015/05/EBAN-Capital-Market-Union-Response.pdf

Examples of termsheets and other templates:

EBAN knowledge center, including termsheet (item 19): http://www.eban.org/knowledge-center/

Seedsummit (group of European investors): http://seedsummit.org/

BVCA (UK Venture Capital Associations): https://www.bvca.co.uk/Portals/0/library/Files/StandardIndustryDocuments/Guide_to_VC_Termsheets.pdf

AFIC (France Venture Capital Association): http://www.afic.asso.fr/dl.php?table=etude_publication&chemin=uploads/_afic&nom_file=capital-risque-guide-des-bonnes-pratiques-version-2010_1.pdf

"The Creation of an E-Zone for Europe's Innovators, Entrepreneurs and Investors": http://www.eban.org/wp-content/uploads/2015/05/E-Zone-22-December-20141.pdf

Best practices from Chambers of commerce and recommendations, "Access to Finance: Camber Services to SMEs", September 2016: http://bit.ly/2do3UTF and http://bit.ly/2cyh9LG

Eurochambres response to the start-up consultation: http://www.eurochambres.eu/content/default.asp?PageID=1&DocID=7456

Accountancy Europe Roundtable Series 'Access to Finance for SMEs - In Search of Innovative Solutions': http://www.fee.be/images/publications/sme-smp/Rep_of_Disc_Roundtable_Series_1203542012241334.pdf

Accountancy Europe document on Simplified prospectus for SMEs: https://www.accountancyeurope.eu/wp-content/uploads/Prospectus_paper.pdf

PAE-Invest Europe response to the Consultation on the cross-border distribution of funds: http://www.investeurope.eu/media/516723/Invest-Europe-PAE-Full-Response-to-Consultation-on-Cross-border-Distribution-of-Funds.pdf

Invest Europe Guide to Private Equity and Venture Capital for Pension Funds (2016): http://investeurope.eu/media/510671/Invest-Europe-Pension-Fund-Guide-to-Private-Equity-and-Venture-Capital.pdf

Invest Europe response to the Consultation on the cross-border distribution of funds: http://www.investeurope.eu/media/516723/Invest-Europe-PAE-Full-Response-to-Consultation-on-Cross-border-Distribution-of-Funds.pdf

AFME-BCG, Bridging the Growth Gap, 2015: http://www.afme.eu/globalassets/downloads/publications/afme_growth_flagship_cw.pdf

AFME, Raising Finance for Europe's Small & Medium-Sized Businesses (available in Dutch, English, French, German, Italian, Spanish), 2015: http://www.afme.eu/en/reports/publications-and-data/publications/Raising-finance-for-Europe-small-medium-sized-businesses-smes/

AFME, Why Equity Markets Matter, 2015: http://www.afme.eu/globalassets/downloads/publications/afme_whyequity_nov2015_low-res.pdf

European Investment Fund (EIF):
http://www.eif.org/news_centre/publications/index.htm
http://www.eif.org/news_centre/research/index.htm

Figure 55: **European companies issuing IPOs in the US in 2012-15**

Company	Pricing date	Exchange	Issuer nationality	Capital raised (€m)	Market capitalisation at time of offering (€m)
Collabrium Japan Acquisition	Oct-12	Nasdaq	UK	32	32
Acquaistion Corp	Oct-12	Nasdaq	UK	44	51
Quotient Ltd	Apr-14	Nasdaq	UK	29	83
Atlantic Alliance Partnership Corp	Apr-15	Nasdaq	UK	71	89
Egalet Corp	Feb-14	Nasdaq	Denmark	43	130
Affimed NV	Sep-14	Nasdaq	Germany	43	130
Innocoll AG	Jul-14	Nasdaq	Ireland	45	132
Oxford Immunotec Global plc	Nov-13	Nasdaq	UK	55	145
voxeljet AG	Oct-13	New York	Germany	72	150
Nabriva Therapeutics AG	Sep-15	Nasdaq	Austria	94	180
Ardmore Shipping Corp	Jul-13	New York	Ireland	106	191
Luxfer Holdings plc	Oct-12	New York	UK	72	204
UniQure BV	Feb-14	Nasdaq	Netherlands	68	222
ProQR Therapeutics BV	Sep-14	Nasdaq	Netherlands	87	223
Navios Maritime Midstream Partners LP	Nov-14	New York	Greece	98	225
KNOT Offshore Partners LP	Apr-13	New York	UK	138	282
GasLog Partners LP	May-14	New York	Greece	146	297
Prosensa Holding NV	Jun-13	Nasdaq	Netherlands	69	349
Ascendis Pharma A/S	Jan-15	Nasdaq	Denmark	110	366
Dynagas LNG Partners LP	Nov-13	Nasdaq	Greece	193	403
Materialise NV	Jun-14	Nasdaq	Belgium	81	416
Mimecast Ltd	Nov-15	Nasdaq	UK	73	506
Advanced Accelerator Applications SA	Nov-15	Nasdaq	France	80	574
VTTI Energy Partners LP	Jul-14	New York	Netherlands	315	644
Forward Pharma A/S	Oct-14	Nasdaq	Denmark	186	759
Navigator Holdings Ltd	Nov-13	New York	UK	194	778
Adaptimmune Therapeutics plc	May-15	Nasdaq	UK	171	1,077
Criteo SA	Oct-13	Nasdaq	France	209	1,242
Abengoa Yield plc	Jun-14	Nasdaq	Spain	612	1,714
Manchester United plc	Aug-12	New York	UK	189	1,852
Markit Ltd	Jun-14	Nasdaq	UK	1,088	3,135
King Digital Entertainment	Mar-14	New York	UK	362	5,136

Source: AFME, Dealogic

7. Glossary

Buy-out: purchase by a private equity firm of an established and mature company's equity with the objective to gain controlling interest.

Commitment: capital committed by limited partners to a private equity fund. The commitment capital is usually not invested immediately but is invested over a period of time

Early stage: investment stage where financing is provided to businesses for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold products commercially.

Expansion stage: a company characterised by a complete management team and a substantial increase in revenues.

General Partner (GP): refers to the venture capital or private equity fund firm which manages the fund(s).

Growth Capital: strategy of some private equity funds consisting in investing in relatively mature companies that are looking for capital to expand or restructure operations.

Later stage: investment stage where financing is provided for the expansion of an operating company, which may or may not be breaking even or trading profitably. Later-stage venture tends to finance companies already backed by VC firms.

Limited Partner (LP): refers to investors in venture capital or private equity funds. Limited partners may be pension funds, insurance companies, family offices, endowments and high net worth individuals (HNWI).

Market capitalisation: the value of the equity of a company usually calculated at the number of shares outstanding multiplied by the market price of the share.

MBO: a buyout that is led or participated in by the company's management team.

Secondary market: a market or exchange in which securities are bought and sold following their initial sale. Investors in the primary market, by contrast, purchase shares directly from the issuer.

Seed-stage: investment stage where financing is provided to research, assess and develop an initial concept before a business has reached a start-up phase.

Series: venture rounds that typically occur after some objectives are reached. A Series A round is the first significant round once the seed capital has already been provided. The letters refer to the class of shares to investors.

Start-up stage: see early stage.

Term-sheet: agreement between the sellers and buyers of shares. The term-sheet sets the basic terms and conditions under which investment will be made.

Venture Capital: strategy of some private equity funds consisting in investing in start-ups and small businesses that are believed to have long-term growth potential. Risk is typically high for investors as most businesses are usually non-profitable and sometimes without revenues.

Vesting: the process by which an employee is granted ownership of rights such as stock options and warrants. Rights which have not been vested may not be traded.

Warrants: type of security usually issued together with a loan, a bond or preferred stock. Warrants and allow an investor to buy ordinary shares at a pre-determined price.

AFME ‘Growth’ initiatives

The *Shortage of Risk Capital for Europe’s High Growth Businesses* report is part of AFME’s broader ‘Growth’ initiative led by Clare Francis, Board member and Chair of the AFME Growth Working Group and Managing Director, Head of Global Corporate Banking at Lloyds Bank.

Previous AFME reports have highlighted the gaps in equity financing for small and mid-sized companies, such as *Unlocking funding for growth* and more recently, *Bridging the growth gap*. This was followed by the *Raising finance for Europe’s small and mid-sized businesses*, translated in six languages. The AFME SME Finance Working Group and its Chair, Allen Simpson, Head of Public Policy, Corporate Banking at Barclays played a lead role in drafting this report.

Members of the AFME Growth Working Group initiatives include:

Allen & Overy, BBVA, Bank of America Merrill Lynch, Barclays, BlackRock, BNP Paribas, Citigroup, Clifford Chance, Crédit Agricole CIB, Credit Suisse, DBRS, Deutsche Bank, Grupo Santander, HSBC, ING, Investec, JPMorgan, Lloyds Bank, Intesa Sanpaolo, M&G Investments, Moody’s Investors Service, Natixis, RBS, S&P Global Ratings, Société Générale CIB, UBS.

Notes

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/ About AFME

The Association for Financial Markets in Europe (AFME) is the voice of Europe's wholesale financial markets.

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