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# EU Growth Agenda: the Contribution of National Venture Capital Operators

Governments are currently undertaking strong efforts to correct budgetary imbalances on a sustainable basis. This is a necessary condition to put Europe back on track. But it is not in itself sufficient. It has become clear that more must be done to boost growth in Europe.

As expressed by the members of the European Council last 30 January 2012, one of the main pillars of a growth strategy is to improve SME access to finance.

Since the 2007 financial crisis, financing the initial start-up and growth phases of companies has become an increasingly more pressing problem. The poor state of the venture capital (VC) funding market, profoundly affected by the crisis, has strongly contributed to this. Indeed, the total VC-fund investment in SMEs decreased by more than 75% between 2006 and 2011[1].

This situation calls for urgent action at the EU level in order to guarantee the supply of equity finance to SMEs and avoid a long-lasting collapse of this market segment.

This is why 9 EVFIN institutions[2], representing all EU's geographical regions, have been developing a workable financial instrument proposal aimed at complementing existing measures at the EU level and improving access to equity finance for SMEs.

Upon invitation of the European Council on June 28 and 29, our institutions are ready to establish in 2013 a pan-EU venture capital fund of funds (f-o-f) that would be leveraged by remaining budget leeway. Such a project would serve as a pilot project of future financial instruments that are proposed in the Horizon 2020 and the Competitiveness of Enterprises and SMEs Programmes (i.e f-o-f). It would also respond to the European Council call of 4 February 2011 for an EU VC scheme building on the EIF and national operators.

## 1. Why venture capital is vital for growth

Venture capital is vital for thousands of Europe's innovative start-ups and growth-oriented SMEs, providing finance to companies with promising but untested business models. As such, they often face difficulties in accessing traditional bank lending or funding through capital markets. Venture capital therefore helps to drive innovation, economic growth and job creation, and indeed several studies have established the positive correlation between VC investment and economic growth (an increase in investment at the venture capital stage by 0.1% of GDP contributes up to one percentage point increase in real economic growth).

## 2. What are the current challenges?

Since the financial crisis and following new prudential rules in the banking and insurance sectors (Basel 2 and 3, Solvency 2), the VC industry has faced a continuing funding crisis, with fundraising increasingly difficult for VC funds and dropping by more than 40% between 2007 and 2011[3].

[1] Dropping from €17.3 bn in 2006 to €3.5 bn in 2011. Source: EVCA Yearbook 2012.
[2] Namely: *Caixa Capital* (Portugal), *Capital for Enterprise* (UK); *CDC Entreprises* (France), *Enterprise Ireland* (Ireland), *Finnish Industry Investment* (Finland), *KFK* (Poland), *PMV* and *S.R.I.W* (Belgium), and *TANEO* (Greece).
[3] Source: *ibid*

The problem has been compounded by the fact that the European Union's budget allocation as fixed in the 2007-2013 financial perspectives has proved unable to fully meet the financing needs resulting from the crisis.

The survival of a number of successful VC management teams, especially smaller and emerging teams, is therefore jeopardized. Consequently, there are strong indications that early-stage innovative businesses will experience a long-term undersupply of venture capital. Without urgent action, this will result in a loss of business creation and severely undermine the ability of enterprises to grow and create jobs.

This situation is exacerbated by the structural weaknesses of the EU VC market that limit its ability to overcome the crisis by itself: it remains fragmented and dominated by small VC funds which often do not have the critical mass required to operate transnationally. This phenomenon prevents these funds from seizing best investment opportunities across Europe and negatively affects their profitability, keeping investors away.

## 3. What we can offer to boost growth and job creation

### a) In the short term : establishing in 2013 a pan-EU venture capital fund of funds to address the crisis

To address this critical funding gap and offer an intermediary solution before the 2014-2020 financial perspectives, our 9 institutions decided to join forces. They signed in December 2011 a Memorandum of Understanding, which described in general terms a pan-EU venture capital fund of funds project that they could establish in 2013. This was called *Athena Venture Europe.*

Given the nature of the EU VC market (a young industry dominated by small players), national operators have a crucial role to play in promoting its bottom up development. This is today crucially missing.

*Athena Venture Europe* is therefore designed to pool the capital and expertise of our respective institutions in a common investment vehicle. With an aspiration size of €250 million, the funds' objective is primarily to support venture funds with a cross-border investment strategy so as to increase scale and scope in the marketplace. This vehicle would maximize the leverage effect of investments and increase funding for VC funds. In order to strengthen its EU ambition and make it a true EU financial instrument, *Athena Venture* could be leveraged on unused EU monies. A general presentation of this project is outlined in the annex 1 attached to this paper

### b) In the short to medium and long term

In the short to medium and long term, our institutions can:

- Design, structure and manage innovative financial equity instruments in the name of the EU institutions (at the local, regional and EU levels). Such market-oriented instruments would help leverage private sector investment. They would also enable the channelling of EU funding in the most efficient way, by drawing on national operators' expertise of domestic markets.
- Provide long-term finance equity at every stage of the business development cycle, both directly to SMEs and indirectly to VC and expansion funds.
- Offer assistance in designing and structuring equity and guarantee schemes to foster equity-funding activity on the national and EU levels.
- Activate a pan-EU network of investors that are ready to work together on projects that may help to boost Europe's growth.

## <u>Annex 1</u> - General Presentation of "*Athena Venture Europe*": the Pan-EU Venture Capital Fund of Funds Project of 9 major long-term investors

### 1. Investment strategy

The investment objective of the fund of funds (f-o-f) would be to provide equity or quasi equity funding to innovative and high growth SMEs which are in their early stage phase but also in their expansion phase to contribute to their establishment and growth.

This will be made through commitments in venture capital (VC) funds in the European Union, having a cross-border investment strategy or likely to have a strong catalytic role in the development of venture capital markets.

Based on an aspiration size of € 250 million, the f-o-f would aim to build up a portfolio of 15 to 20 funds. The average volume invested per fund would therefore be of € 10 million to € 15 million. The f-o-f would invest pari passu alongside other market-oriented investors, thus leveraging private investment.

#### *a) Scope of intervention*

The fund of funds would aim to invest:

- ✓ Primarily in cross-border VC funds managed by established and newly created management companies;
- ✓ But also in funds managed by new or emerging national VC management companies likely to bring a significant value added to the development of the EU VC market (for a specific technology or a specific region for example).

It would mainly target early stage funds (providing seed and start-up capital), which today face the greatest difficulties in raising capital, but would also include later stage funds (expansion capital).

#### *b) Geographic coverage and balance*

The fund of funds would analyse investment opportunities from all EU venture funds with an emphasis on venture funds with management teams located in countries of participating institutions. That means that all SMEs across the EU, as final beneficiaries, could potentially benefit from funding of the fund of funds.

To ensure a balanced geographic distribution of the selected funds, investments made in any country should not exceed 20 % of the total commitment of the fund of funds.

#### *c) Targeted sectors*

To limit the risk exposure of the f-o-f and seize the best opportunities in domestic markets, a balanced focus across sectors would be sought. Any investment in a venture capital fund should ideally not exceed 10% of the total commitment of the fund of funds.

### 2. Governance

The fund of funds governance will be consistent with the best international practices.

Precise terms of the governance are subject to forthcoming discussions with EU authorities in connection with the project.