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Risk capital: a key to job creation. Implementation of the Action Plan

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SUMMARY AND CONCLUSIONS

1. ***Risk capital is an essential element of growth and job creation.***
   Efficient risk capital markets can play a major role in the support of economic growth, the creation of new and sustainable jobs and the promotion of entrepreneurship and innovation. But their development is hindered in Europe by a number of barriers. For this reason the European Commission adopted, in April 1998, the Communication Risk Capital: a key to job creation in the European Union [1]*analysing the importance of pan–European risk capital markets for the European Union, highlighting the barriers to their development, and proposing an Action Plan to remove these barriers. The measures put forward in this Action Plan are part of the structural reforms needed to improve the overall functioning of the Community's product and capital markets. On this account, the importance of their swift implementation was stressed by both the 1999 Broad Economic Policy Guidelines (BEPG) and the Cardiff report.*

2. ***Progress has been made but there is need for greater effort.***
   In 1999, at the request of the Council, Member States reported on how they are implementing the Risk Capital Action Plan. These reports provided some of the necessary information for the present report Risk Capital: a key to job creation. Implementation of the Action Plan*, analysing policy changes made use of to promote risk capital. The report presents recent developments in risk capital markets, describes how the Member States and the Community are implementing the Risk Capital Action Plan and points towards those areas which need particular attention in the future. It shows that, while some progress is being made towards the construction of an integrated, pan–European risk capital market, it is very uneven among the Member States and EU still suffers some major weaknesses.*

3. ***Risk capital is developing in Europe, but not fast enough and its allocation remains sub–optimal.***
   While venture capital investment more than doubled in Europe over the last four years, only €7 billion was invested in Europe in 1998, compared with €12 billion in the USA, and the difference is even stronger in early stage investments: €1.6 billion compared with €4.5 billion in the USA. The European stock markets for high growth companies have grown strongly, but they remain dwarfs compared to the American Nasdaq.

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[1] SEC(98)552.

4. ***Various actions have been taken by the Community as well as by the Member States.***

The Commission has taken actions in favour of business angels, analysed the economic and financial impact of employee stock ownership and stock option schemes, launched several projects to facilitate the financing of innovation, and has integrated the financial regulatory issues raised in the Risk Capital Action Plan into the Financial Services Action Plan[2].

The Member States have taken very positive measures to support the earliest stages of financing, simplify administrative formalities for setting up a company or promote networking between universities, financial backers and other actors, as well as entrepreneurship and innovation.

5. ***Some major challenges remain****.*

Political recognition of the importance of the issue is emerging at European level, but the scale of the challenge should not be underestimated and major progress is still required in many different areas to ensure an integrated financing chain that will support the growth of fast–growing small and medium–sized enterprises in the Union. Barriers remain outside the financing system per se that seriously discourage risk taking and entrepreneurship: cultural barriers, excessive bureaucracy, and unnecessary complex or poorly designed tax systems are sources of concern. Entrepreneurial Europe also needs systems of reward and opportunity that benefit all levels of society; for this reason this document particularly emphasises the importance of employee ownership schemes.

Europe needs:

(i) a profusion of experienced professionals willing to take risks and act quickly;

(ii) an active angel network and early–stage venture capital;

(iii) a wellspring of technology and new business ideas;

(iv) a base comprising lawyers, banks, accountants, marketing consultants and government administrators who understand entrepreneurial companies;

(v) stock markets that welcome entrepreneurs;

(vi) regulatory, supervisory and tax policies that encourage small business formation and growth and that are favourable to the development of capital markets, investment and risk taking;

(vii) strong priority to the pursuit of microeconomic structural change linking with the broad macroeconomic guidelines to ensure that markets work more efficiently.

Risk capital is an integral part of this equation, a complex, multipolicy equation, which, if solved at European level, would undoubtedly create tremendous market dynamism, jobs and growth. For this reason it is essential that the Member States and the Union speed up the implementation of the Risk Capital Action Plan.

6. ***The Commission's proposals for moving forward.***

In October 1999, the Commission adopted the Communication Risk Capital : Implementation of the Action Plan. Proposals for moving forward[3]. *On the basis of the present report, this Communication makes proposals to take forward the work. It proposes to proceed next year with actions in those areas requiring major structural reform (these include investment rules for institutional investors; prospectus directives to facilitate companies raising cross–border capital; and a European patent system) and calls on the Member States to act in their areas of responsibility, notably taxation of investment, insolvency and bankruptcy legislation, and employee ownership schemes. Beginning of November, this Communication was presented to the Council who welcomed it, stressed the need to promote risk capital, for instance by including specific recommendations in the Broad Economic Policy Guidelines whenever relevant, and invited the Commission to prepare a monitoring and benchmarking mechanism to identify clear priorities and set objectives.*

The Commission will review progress regularly. Failure here would represent a serious missed opportunity for the EU, in terms of investment and job creation.

[2] *Financial Services: Implementing the framework for financial markets : Action Plan*. COM(1999)232.

[3] COM(1999)493.

INTRODUCTION

In April 1998, the European Commission proposed a communication to the Council and the European Parliament on *Risk Capital : a key to job creation in the European Union.*

This document was well–received by both institutions – and also among market practitioners and experts. The basic message of the April 1998 risk capital paper was that successful job creation in Europe requires much more efficient and integrated European risk capital markets throughout the whole enterprise financing chain from seed to start up to initial public offering (IPO). This means breaking down the fragmentation barriers and encouraging market integration.

This premise has made significant political ground in the last 12 months in the European Union. On its own merit. But also because it is now recognised that it forms an essential part of the creation of a dynamic entrepreneurial European space in the future.

Political endorsement has been evident in numerous statements and policy reflections by the Member States at the highest levels of government; by the growing importance being attached to creating a more entrepreneurial Europe; by recognising the key role of microeconomic policy change for innovation and growth; by risk capital market expansion in the EU; by the significant new policy orientations of the European Investment Bank (EIB) and the European Investment Fund (EIF) in these domains; by the creation, within the new Commission, of a special enterprise department; by the emerging business opportunities due to effective supply side opening, particularly in the telecommunications, transport and energy sectors; by the rapid take up of e–commerce and internet trading; by the clear registration and recognition of these concepts within the broad economic and employment guidelines process; and by the inclusion of a number of key financial market legislative changes in the Financial Services Action Plan, adopted by the Commission in May 1999.

It has also been endorsed by successive European Councils – and the European Parliament's opinion and resolution were also supportive, yielding some useful new ideas in the process. The Cardiff European Council (June 1998) underlined the importance of these concepts and at the Vienna European Council in December 1998[4] the importance of the development of a functioning European market for risk capital was recognised, as well as the development of new forms of financing, within the private as well as the public sector. Member States were invited to report on how they are implementing the Risk Capital Action Plan that was attached to the April 1998 Communication.

This working document has a triple purpose. Firstly to present the recent risk capital market developments. Secondly, to report on how the Member States and the Community are implementing the Risk Capital Action Plan taking into account the responses of the Member States to the European Council's Vienna invitation. And thirdly, to point towards those areas which, in the view of the Commission, need particular attention in the future. It is an annex of the communication *Risk Capital: Implementation of the Action Plan. Proposals for moving forward* adopted by the Commission end of October 1999.

The general conclusion is that whilst some progress is being made in the EU, it is still insufficient and too slow to generate and develop the quantity of fast growing small and medium sized companies which the Union needs. Companies that need to be embedded in the Union. Companies rich in employment growth. Indeed, without such growth – without these entrepreneurial dynamics – without the creation of a large number of these fast growing companies, in many different sectors of the European economy – it is difficult, if not impossible, to see how Europe's unemployment levels will decline to acceptable levels in the near term.

The challenge still remains therefore for the European institutions, Member States, regional and local bodies to act together to create these favourable financial and entrepreneurial conditions. At all levels of society. This means working together in a wide number of domains, and coherently. In line with the subsidiarity principles of the Treaty. It requires implementing the Risk Capital Action Plan – as one essential part of the construction of a European entrepreneurial and enterprise culture. For the future benefit and prosperity of all the Union's citizens.

CHAPTER 1: MARKET DEVELOPMENTS

Since the publication of the Commission's communication *Risk capital, a key to job creation in the European Union*, risk capital markets have experienced some positive developments. There is more risk capital available in Europe. However, its allocation remains sub–optimal, due to the persistence of enduring constraints and barriers. It is also on a quite different, lower scale compared to the US. The major recent market developments are summarised below:

Business Angels

Business angels, also known as "informal private investors", are individuals who invest capital in companies and are willing to share their know–how or experience in company management. Business angels invest early in companies, filling the chasm between family, founders, or bank financing and venture capital. They invest in general between € 20 000 and € 250 000 and mainly at start–up or very early–stage (during the first year) of the company. The concept originated in the US where they are considered as playing a major role in the American economic growth. According to a European study, there could be some 125 000 business angels operating in Europe (it is impossible to get any precise figure, this type of investment being informal by definition) and a potential of 1 million business angels. It is widespread in the UK, the Netherlands and Finland but still underdeveloped in most other member states. As will be described further in chapter 2 on the implementation of the Risk Capital Action Plan, several actions have been taken at Community and Member States level to develop this crucial stage of the risk capital financing chain.

[4] Conclusions para 40.

Venture capital

European venture capital has grown rapidly over the past five years, but remains significantly smaller than in the US and insufficiently oriented towards young and innovative companies.

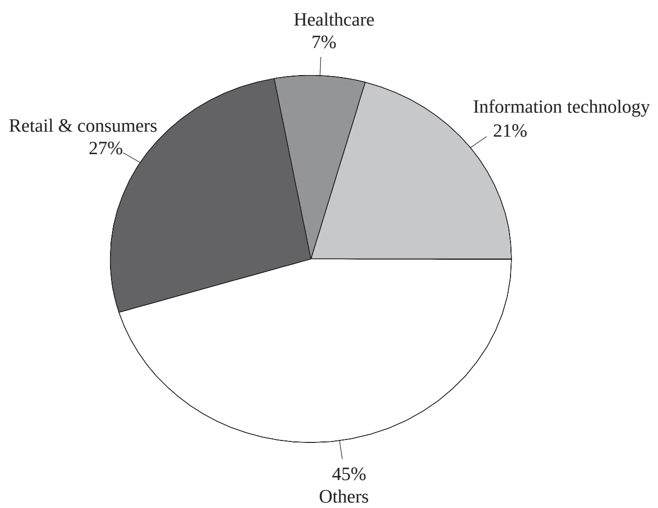
Venture capital is a subset of private equity and refers to equity investments made for the launch, early development or expansion of a business. In Europe, the term venture capital is often used for private equity, therefore including management buy–outs and buy–ins (MBO/MBIs), in contrast to the US where venture capital is used in its restricted sense and does not include MBO and MBI operations. Figures referring to venture capital in this document refer to the restricted definition of venture capital (excluding MBO/ MBIs).

In 1998, for the second year in a row, € 20 billion was raised for private equity investments in Europe (compared with € 3 to 8 billion between 1988 and 1996) and about € 14.5 billion was invested (a 40% increase compared to the 9.6 billion invested in 1997[5]). In the mean time, in the US, almost € 80 billion was raised in private equity and over € 60 billion invested, more than four times the amounts raised and invested in Europe.

In Europe, less than 50% of these € 14.5 billion (€ 7 billion) was invested in venture capital in 1998, compared to € 12 billion in the US. And only € 1.6 billion was invested in early stage, to compare with € 4.5 billion in the US in 1998. This remains a major weakness in the EU.

Investment in high–tech has almost doubled in Europe between 1997 and 1998 (from € 2.3 billion in 1997 to € 4 billion in 1998). But, in the US, over 80% of the venture capital investments are in Information Technology (IT) and healthcare while in Europe, it is less than 28% of the private equity investments. This is another major weakness in the EU.

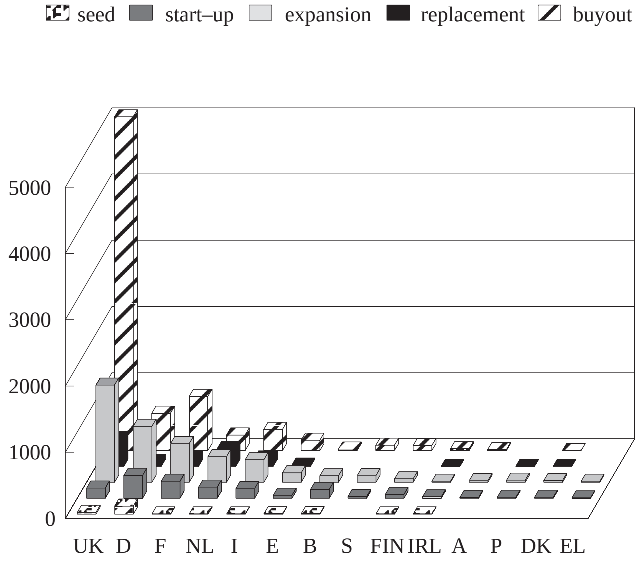
GRAPH 1: **Sectorial distribution of private equity investments in Europe in 1998**



Source: EVCA 1999 Yearbook.

GRAPH 2: **Private equity investments in Europe in 1998**

(in euro million)

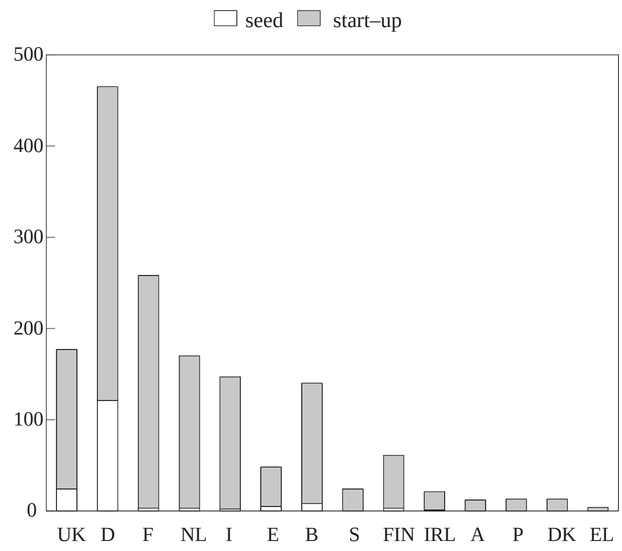


Source: EVCA 1999 Yearbook.

There are also considerable differences within Europe: UK represents almost half of the European investments in private equity, over 3 times the German and French investments. But 70% of the UK investments are in buy–out operations and UK funds invest 3 times less in early stage than German funds.

GRAPH 3: **Early stage investments in Europe in 1998**

(in euro million)



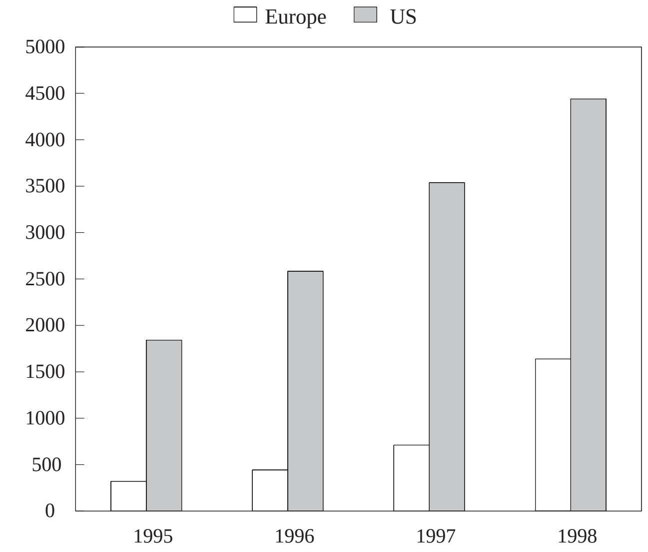
Source: EVCA 1999 Yearbook.

Investment in early stage is much smaller in Europe than in the US, but beginning to increase. It is important that this trend accelerates in the years to come as the performance of the European venture capital funds improves (according to a 1998 study from Venture Economics and Bannock Consulting, early–stage venture funds demonstrate strong performance improvements and, since 1997, their rolling 5 year internal rate of return is comparable with buyout funds). The European and the US market are at different stages of development and, as the European market starts to mature, the performance of early–stage funds should increase, attracting more investments.

5 The 1997 figures include only equity, while the 1998 include 13.5 billion in equity and 0.9 in unsecured debt).

GRAPH 4: **Early stage investments EU vs. US**

(in euro million)



Source: EVCA, Venture One.

Public and private markets are highly intertwined, the public markets being a key for private market performance as they represent exit opportunities and a basis for valuations. The development of pan–European stock markets will help boost European venture capital.

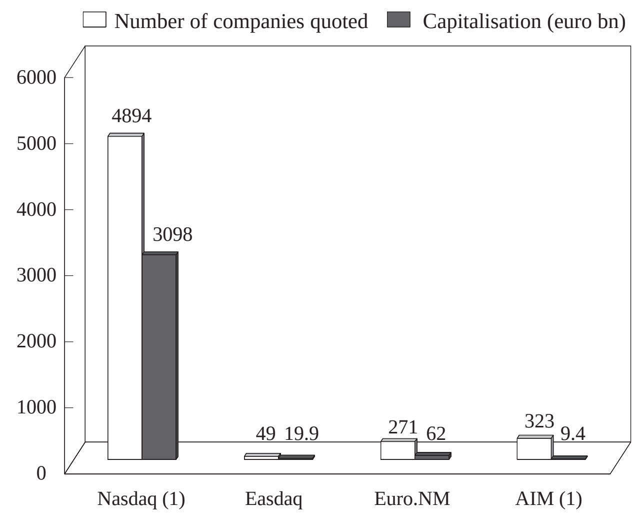
Stock markets

The European stock markets dedicated to high growth companies, created some 3 years ago, are still dwarfs compared to the American Nasdaq: they quote no less than 8 times fewer companies; their total market capitalisation is a staggering 33 times lower than Nasdaq's and they remain extremely fragmented.

Nevertheless, they have grown strongly in 1998 and the first half of 1999 has shown some very positive developments. There are now over 650 companies quoted on the main European markets for high growth companies: Euro.NM, EASDAQ and AIM. Furthermore, for small–cap

GRAPH 5: **Comparison, as of 30/07/99, of Nasdaq and the European growth–company stock markets**

(in euro million)



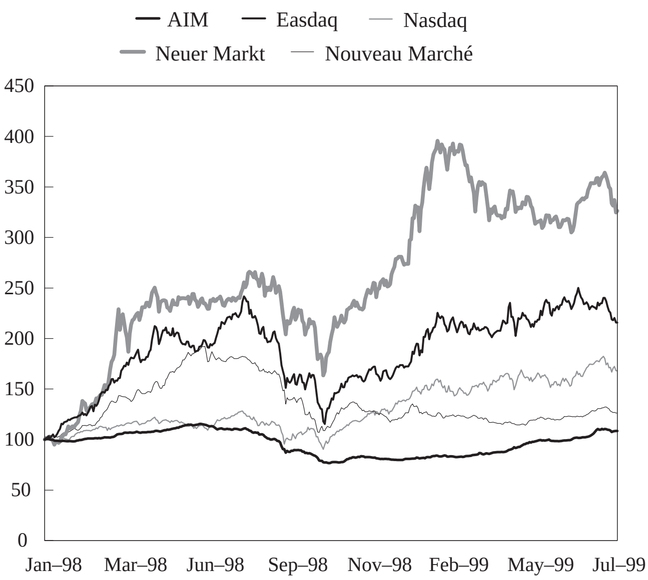
Source: Statistics Nasdaq, Easdaq, AIM, Euro NM, own calculations.

(1) As of 30/06/99.

companies with moderate growth, the Deutsche Börse has recently launched the SMAX and Italy is considering a similar move.

The Neuer Markt in Frankfurt (the main market of the Euro.NM network and accounting for 88% of the network's market capitalisation) experienced the highest growth: created in March 1997, it listed its 100th company mid May 1999 and end of July 1999 quoted 143 companies. Over the last twenty months, its value increased by 180%. The fall back in its stock prices since mid–February 1999 was to be expected after the very rapid growth in 1998 and the first weeks of 1999. EASDAQ has remained a small market, quoting only 49 high–tech international companies end of July 1999. Like the Neuer Markt, its index grew strongly in 1998 (+72%) and the first weeks of 1999, to fall back since July 1999. Mid–1999, EASDAQ announced some fresh investment through a private placement of its shares, including the participation of some significant US investment houses (which are beyond the leading market makers of Nasdaq and whose shares amount to more than 25% of the capital of EASDAQ). AIM on the other hand has not yet fulfilled its expectation: its liquidity is thin and several UK companies have preferred to get listed on EASDAQ rather than on AIM. However, after a fall in its stock prices in 1998 (–20%), it has shown a good performance in the first half of 1999, its index increasing by more than 40%. To cater specifically for high tech companies, the London Stock Exchange announced in September the creation of Techmark, a market segment for technology companies.

GRAPH 6: **Indices 01/01/1998 – 31/07/1999**



Source: Datastream, own calculations.

Severe fragmentation is one of the main barriers to the development of these stock markets for fast growing companies. The more fragmented they are, the more they will remain small and lacking liquidity. Over the last months, the main markets have signed several agreements featuring various degrees of co–operation: a market linkage between Stockholm and Copenhagen (to be joined by Oslo); an agreement between Netherlands, Belgium and Luxembourg stock exchanges; a partnership agreement between the Swiss Exchange and SBF Paris Bourse. The strategic alliance between the London Stock Exchange and the Deutsche Börse announced in July 1998 was completed beginning of May 1999 by the signature of a memorandum of understanding (MoU) between the London, Frankfurt, Paris, Amsterdam, Brussels, Madrid, Milan and Zurich stock exchanges; however, the plan to create a single stock market for trading the shares of Europe's blue chips companies was abandoned in September for a web of connections among the eight bourses through a single electronic interface.

In the meantime, Euro.NM has continued its expansion: the Nuovo Mercato (Milan) joined Le Nouveau Marché (Paris), the Neuer Markt (Frankfurt), Euro.NM Brussels and NMAX (Amsterdam) beginning of 1999; Stockholm, Copenhagen and Zurich are poised to join the alliance within a few months while Irish, Portuguese, Norwegian, Spanish and Finnish membership are also expected within a short time frame and discussions are going on with the London Stock Exchange. These markets are at various stages of development: Le Nouveau Marché and the Neuer Markt quote each over 100 companies, while Milan had its first quotation in June 1999. Listing requirements are now harmonised (with some derogation for the newcomers). However, some quotation rules still differ and the alliance is still not fully integrated technologically. The Nouveau Marché, NMAX and Euro.NM Brussels platforms are interconnected but the link with the Neuer Markt is still to be completed. Through this alliance progressively extended to most of the European growth–company stock exchanges, Euro.NM is attempting to build a competitive and true pan–European market. However, major progress are still needed in harmonisation of the regulations and technology integration in order to reduce market fragmentation and increase market liquidity.

Electronic share trading : the new phenomenon

Among the major recent developments is also the growth of electronic share trading, through electronic communication networks (ECNs). So rapid has been the expansion of these platforms in the last 12 months – that the Commission's April 1998 Communication said little about them. The use of the internet is now widely used for on–line trading of stocks listed on a stock exchange (e–broking / e–trading). It is also used for on–line IPOs. It is estimated that already 5% of European equity trading is now carried out through new electronic share trading organizations. The figure in the US is 5 times higher.

On–line trading has shown astounding growth: there are now more than 5 million on–line brokerage accounts in the US (in 1994 there were none) and ECNs already account for nearly 30% of trading volume on Nasdaq. The emergence of e–broking has had a huge impact on the cost of trading: the average commission for on–line trades is about 10 times lower than for full–service brokerage ($15 to $30, compared to $100 to $300). This growth has led several stock markets to seek alliances with ECNs. In order to attract private investors with internet access, EASDAQ is to launch a new trading platform to trade growth and high tech stock whose main listing is elsewhere. The development of ECNs has also lead stock exchanges to extend their trading hours, in a move to compete both across the Atlantic and with electronic trading. This step, already taken by Nasdaq and the New York Stock Exchange, is under consideration from European markets like Milan, the Deutsche Börse and the London Stock Exchange.

The world's first digital IPO took place in 1996. Since then, several banks have launched their own direct offering services.

The internet technology minimises the expense of underwriting and commissioning and of legal advice. The development of ECNs and electronic stock exchanges will help companies list and trade their shares globally and round the clock and will contribute to a decrease in the cost of raising capital. In theory, exit opportunities for the venture capitalist should improve as liquidity deepens. But it also raises regulators' concerns on safety and investor protection. The Commission, in its communication "Financial services: implementing the framework for financial markets: Action Plan" recommends a common approach to the authorisation and supervision of these "alternative trading systems". The strategic implication and structural impact of the development of ECNs will require further analysis by the Commission.

Europe's need for a single capital market extends beyond stock exchanges

Currently, Europe has 31 different national and cross border central securities depositories (CSDs), the clearing and settlement systems. Most national CSDs serve only their domestic securities markets while two, Euroclear and Cedelbank, have an international scope. Due to the increasing integration of European capital markets, the development of powerful technologies and the growing pressure of investors who require access to securities deposited in multiple CSDs, the European settlement infrastructure will have to consolidate. Various initiatives are taking place to respond to these changes. National CSDs are developing links between themselves. Euroclear has recently advocated a model: the setting up of a "hub and spoke" system where a single hub would settle cross–border transactions while the spokes (based on the national CSDs) would settle domestic transactions and be linked through the hub. The objective would be to provide a single point of entry to all clearing and settlement services for investors, issuers and intermediaries in all European capital markets. Meanwhile, Cedelbank announced a different proposal under which it is to merge clearing, settlement and custody activities with Deutsche Börse Clearing. Sicovam will join the new venture once it will have been legally established. This initiative will imply the creation of an integrated IT platform.

A rationalisation of the clearing and settlement European infrastructure that would decrease costs and benefit investors by providing an appropriate balance between risks and efficiency is crucial for the development of a true pan–European capital market.

Institutional investors play a crucial role in the development of risk capital

The term "institutional investors" includes insurance companies, investment funds and pension funds. As collectors of savings, suppliers of funds, and participants in the various securities markets, they have an important impact on the functioning of the financial markets. They also play an increasingly predominant role in providing risk capital.

They have been gaining in importance in the last decade due to four main factors :

– the ageing of the population producing a rising need for retirement products ;

– the technological progress in communications and information processing giving rise to a new breed of sophisticated investment products;

– the deregulation of the banking and securities industries since the beginning of the 80's heightening competition between and among banks and other financial institutions;

– the disintermediation from banks resulting in a shift in favour of more performance–oriented instruments.

According to the 1998 OECD study "Institutional investors in the new financial landscape", in 1994 US pension funds accounted for just over half of private equity capital and provided 47% of venture capital. It is just a very small fraction of their total assets: from an analysis of the investment strategies of the largest 200 pension funds, it was concluded that only 0.3% was invested in venture capital, 0.5% in LBOs and 1.5% in private placements[6]. Such a small percentage nevertheless amounted to an investment pool of \$32.2 billion. This vast figure derives from the fact that the 200 pension funds' total holdings were already at that time of the order of \$ 1.4 trillion.

However, some American pension funds seem to follow an increasingly cautious trend in investing. Getting bigger, they become less specialised and tend to favour index tracking investments and to concentrate their investments in very large companies in order to keep their management costs as low as possible, whilst maintaining predictable returns. An NBER study from Sept. 1998 showed that large institutions, when compared with other investors, prefer stocks that have greater market capitalisation and are more liquid.

Nevertheless, the role of US pension funds in venture capital has kept increasing: in 1998, pension funds represented almost 80% of new commitments in private equity and more than half of the amounts invested in venture capital. This growth is linked to the growth in pension funds assets: \$2.5 trillion in 1990, \$4.8 trillion in 1996. It is also perhaps partly due to the fact that during the 1990's venture capital backed companies that list on the major US exchanges have outperformed the Russell, S&P and Nasdaq industrial indices.

Institutional investors in Europe seem to be less willing (or legally able) to provide equity investment in start–up companies than those in the US. Total funds invested by pension funds and life companies went up sharply in recent years and their investment in equities increased even sharper. In 1998 European pension funds and insurance companies invested respectively € 5 billion and € 2 in private equity compared with the \$ 32 billion invested by American pension funds some four years before. The asset structure of EU pension funds differs significantly across countries, with the highest percentage of investments in equities prevailing in the UK, followed by Ireland and Belgium. However, even in the UK, a country with large funded pension schemes, highly developed securities markets, a significant venture capital industry and pension funds portfolio regulations based on the prudent man concept, less than one third of the private equity is raised from pension funds. American pension funds are currently the largest investor in the UK venture capital industry.

Recent evidence confirms the strong link between the availability of risk capital and job creation

As the Commission's April 1998 communication on risk capital underlined, by offering high growth companies the access to appropriate financing instruments necessary for their development, efficient risk capital markets have a significant impact on job creation. A recent study from W. Brock "The job destruction and creation models" highlights the linkage between the IPO market and the labour market. Discussions W. Brock had with US venture capitalists, investment bankers and entrepreneurs suggest that between 80% and 90% of funds raised might go towards hiring people. The US Bureau of Labour Statistics could not confirm such a high figure, but they were ready to give W. Brock an estimate of 50%. Such a high "job multiplier" is understandable in a service economy where labour costs dominate the GDP cost structure. Since 1982, the United States has created some 40 million net new jobs, net of restructured lost jobs.

According to a study done in the UK in 1998 by Bannock Consulting for the British Venture Capital Association, over the four years to 1998, venture backed companies increased their staff levels at a rate over three times that of FTSE 100 companies and almost 60% faster than companies in the FTSE Mid–250. The number of people employed in venture backed companies increased by 24% p.a., against a national growth rate of 1.3% p.a.. Over two million people in the UK are estimated to be employed by companies backed by investment from British venture capital.

If the total number of jobs created by companies quoted on the European growth–company markets is not yet impressive (the number of companies quoted being still very small), the growth rate is amazing: the 63 companies quoted end 1998 on the Neuer Markt created some 21 000 jobs between 1996 and 1998 due to an average employment growth of 40% per year. Among companies quoted on the Nouveau Marché, the average employment growth rate over the last three years was of 47% (the companies quoted on the Nouveau Marché being smaller than those quoted on the Neuer Markt, only some 3 600 jobs were created).

Another significant figure is the number of jobs created by the 500 fastest growth and job creating companies as defined by the association Europe's 500. 181 371 jobs have been created by these companies between 1992 and 1997.[7]

The still weak European employment creation can also be seen from the following facts.

Eight US companies in just one sector of the US economy (information technology) – most of whom did not exist in

[6] Other studies give a higher percentage of investment in venture capital and private equity.

[7] Europe's 500. Europe's most dynamic entrepreneurs. The 1998 job creators. The main selection criterion is a job creation index. Additional criteria are also used such as at least 50% increase in growth turnover between 1992 and 1997.

the middle of the 1980's – or else were minnows – but all of whom were financed by venture capital – have a market capitalisation greater than the whole of the Paris Stock Exchange. The companies are Microsoft, Intel, Cisco, America on Line, Sun Microsystems, Dell, Company, and Oracle. And these companies alone have created over ¼ million direct jobs. Furthermore, it is estimated that the indirect job multiplier could be 3 or 4 times as many throughout the US economy.

Finally, EIF evidence from its investee companies indicates a heartening 32% increase in employment in the companies concerned, simply as a result of the first round of investments.

CHAPTER 2: IMPLEMENTATION OF THE RISK CAPITAL ACTION PLAN

PART I: ACTION AT COMMUNITY LEVEL

In the framework of the Risk Capital Action Plan, the Community has undertaken several actions to promote risk capital, the creation and growth of young companies, and to reduce the barriers to their development in Europe. These issues are now considered as major components in the definition of several policies like "building a framework for action for financial services[8]", "The first action plan for innovation in Europe[9]" or "the Action Plan to promote entrepreneurship and competitivness[10]". As for the actions taken at Member State level, this chapter lists some of the most promising measures undertaken at community level. A more exhaustive list of measures is included in the table Annex 1.

The European Parliament's opinion and resolution issued in 1999 were strongly supportive of the Risk Capital Action Plan. In addition, the European Parliament stressed the importance of enhancing measures to change risk culture and to mobilise savings into investment in high growth innovative companies (in particular SMEs), such as: (i) to promote appropriate financing in particular for technical innovation and job creating projects; (ii) to encourage the development of capital markets; (iii) to remove excessive restrictions on the type of investments permitted to pension funds; (iv) to revise insolvency and bankruptcy laws.

Market fragmentation

- ***Business Angels***

  Pursuant to a European study on a Business Angels network, the Commission launched in September 1998 a pilot action in favour of business angels with 3 main goals: to spread and disseminate the idea of business angels networks, to conduct feasibility studies on creating business angels networks and to actually set up and co–ordinate such networks. The European Association of Development Agencies (EURADA), which acts as an umbrella organisation for European regional development agencies, and EBAN (the European Business Angels Network, formally created in June 1999), were charged to disseminate and develop the concept in each member state.

  The Commission is financing a small number of feasibility studies and supporting the creation and co–ordination of networks in various regions of Europe.

- ***Market monitoring and development of information on venture capital***

  Under the Innovation/SMEs programme, a "trend chart for innovation in Europe" has been established. It will gather and analyse information, in co–operation with member states, on national and EU policy measures to promote innovation, among others those in support of venture capital and the financing of innovation, their history and results. The information gathered in that database will be made available to researchers and policy makers.

  In the framework of the Innovation/SMEs programme, the Commission launched two surveys in March 1999: one to gauge the resurging corporate venturing activity in Europe and the other to identify the activities, services and products developed by EU commercial banks to finance new technology based firms (NTBFs).

- ***Impact of the fragmentation of the European market on risk capital financing***

  As proposed in the Action Plan, the Commission organised end November 1998 a round table on the impact of the fragmentation of the European markets on the provision of risk finance. The speakers were major actors in the field: representatives of the main high growth stock markets, venture capital funds, institutional investors, companies listed on these markets and regulatory bodies. The aim of the conference was to compare the situation of stock markets dedicated to innovative high–growth companies in Europe to the situation in the US and to draw some lessons on what should be done to create an appropriate framework for the development of a true European market.

  The key issues discussed were:

– Which reforms are necessary at European and Member State level to assist the creation of a large transparent and liquid European capital market able to provide financing to SMEs, in particular high growth SMEs?

– What are the main barriers to be removed?

– What should be the priorities for action at the European level?

Among the main conclusions of the conference were:

(i) The euro will be a catalyst for the creation of a really pan–European market.

(ii) That information, research and expertise on high growth SMEs are lacking in Europe.

(iii) That there is an urgent need for:
- Harmonization of accounting and taxation rules, as well as of market platforms.
- Fiscal transparency for venture capital funds.

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8 COM(1998)625.

9 COM(1996)589.

10 COM(1998)550.

- Lightening the taxation on stock options.
- And the need to modify bankruptcy rules to give a second chance to entrepreneurs.

Overall, the conference contributed to helping better understand the crucial role risk capital markets play in growth and job creation, the importance of breaking down cultural barriers hindering entrepreneurship in Europe and the need for more integrated European capital markets.

Institutional and regulatory barriers

In June 1998, the Cardiff Summit not only endorsed the Risk–Capital Action Plan. It also invited the Commission to table a framework for action in order to *"improve the single market in financial services"* against the backdrop of the introduction of the euro on 1 January 1999.

In response to this, the Commission, after extensive consultation with market practitioners, industry federations and supervisors, and the assistance of a Financial Services Policy Group (FSPG) made up of personal representatives of the Ecofin ministers adopted a Communication in May 1999[11], later endorsed by the Ecofin of 25 May 1999 and by the Cologne Summit of June 1999. This Communication contains a detailed action plan made up of 43 measures which would constitute the main Commission work programme for the next five years in the financial services area.

The programme in the Financial Services Action Plan would improve the general financial conditions under which companies, irrespective of their field of activity or of their size, would operate. An immediate consequence of this would be a reduction in their cost of capital.

In order to have a coherent package of measures with a coherent approach all [12] measures of financial nature in the Risk Capital Action Plan have been integrated into the Financial Services Action Plan. Through this integration *"the pressure for change will be maintained"[13]*. As a result, the wider exercise should cater for the needs of both large companies and SMEs.

Transposition and implementation of financial services directives

The single market score board shows a very good rate of transposition and implementation of existing financial services directives. However, if we take into account the infringement procedures for non–conformity, it also shows that only six member states (Denmark, Greece, Spain, Ireland, the Netherlands and Sweden) have totally transposed and implemented all the financial services directives (see Tables 1 and 2).

Assessment of the need for a Community legislation on venture capital funds

The members of the UCITS (Undertakings for Collective Investment in Transferable Securities (Investment funds)) Contact Committee (created by Directive 85/611/EEC) and representatives from the venture capital industry, the stock exchanges specialised in fast–growing SMEs, and the SMEs' associations, consider it is not urgent to extend Community legislation on investment funds to cover also venture capital funds. They also wish the Commission to clarify which investors should be considered professionals.

Review of implementation and possible amendment of prospectus directive to facilitate companies raising cross–border capital (e.g. IPO's)

On 3 November 1998 the Commission convened the Stock Exchanges Contact Committee[14], in order to discuss means,

[11] COM(1999)232; 11.05.99: "Financial Services Action Plan".

[12] The only measure of financial nature not integrated in the Financial Services Action Plan is the possible adoption of Community legislation covering venture capital funds. The reason for this is that at a meeting of the UCITS Contact Committee convened by the Commission on 18 November 1998 none of the parties concerned, including the industry representatives, considered urgent to have an EU directive on this field.

[13] Page 6 of the Communication on the Financial Services Action Plan.

[14] At the meeting were also invited representatives from the venture capital industry, the stock exchanges specialised in fast–growing SMEs and the SMEs' associations.

TABLE 1: **Transposition of financial services directives, situation as of June 1999**

	Banks	Insurance	Securities	Company law	Total	Position
B	22/22	19/19	13/13	15/15	69/69	1
DK	22/22	19/19	13/13	15/15	69/69	1
D	22/22	19/19	13/13	14/15	68/69	10
EL	22/22	19/19	13/13	15/15	69/69	1
E	22/22	19/19	13/13	15/15	69/69	1
F	21/22	19/19	12/13	15/15	67/69	15
IRL	22/22	19/19	13/13	15/15	69/69	1
I	21/22	19/19	13/13	15/15	68/69	10
L	22/22	19/19	12/13	15/15	68/69	10
NL	22/22	19/19	13/13	15/15	69/69	1
A	22/22	19/19	12/13	15/15	68/69	10
P	22/22	19/19	12/13	15/15	68/69	10
FIN	22/22	19/19	13/13	15/15	69/69	1
S	22/22	19/19	13/13	15/15	69/69	1
UK	22/22	19/19	13/13	15/15	69/69	1
EU	99.39%	100%	97.95%	99.56%	99.23%	/

TABLE 2: **Transposition of financial services directives, state of play including the infringement procedures for non–conformity**

	Banks	Insurance	Securities	Company law	Total	Position
B	22/22	17/19	13/13	15/15	67/69	13
DK	22/22	19/19	13/13	15/15	69/69	1
D	22/22	19/19	13/13	14/15	68/69	7
EL	22/22	19/19	13/13	15/15	69/69	1
E	22/22	19/19	13/13	15/15	69/69	1
F	21/22	17/19	12/13	15/15	65/69	15
IRL	22/22	19/19	13/13	15/15	69/69	1
I	21/22	19/19	13/13	15/15	68/69	7
L	22/22	19/19	12/13	15/15	68/69	7
NL	22/22	19/19	13/13	15/15	69/69	1
A	21/22	19/19	12/13	15/15	67/69	13
P	22/22	19/19	12/13	15/15	68/69	7
FIN	22/22	18/19	13/13	15/15	68/69	7
S	22/22	19/19	13/13	15/15	69/69	1
UK	22/22	18/19	13/13	15/15	68/69	7
EU	99.09%	97.89%	97.95%	99.56%	98.62%	/

whether legislative or not, to improve the situation concerning cross–border capital raising. As a result it seemed more fruitful for all parties concerned to concentrate in the short–run in clarifying and harmonising, at practical level, the requirements and procedures involved in cross–border activity.

In addition, there was a consensus on the fact that cross–border activity for the SMEs would benefit enormously if a common agreement at European level could be achieved on which investors should qualify as professionals.

The Commission is also co–operating with FESCO on this same subject. The objective is not only to improve cross–border procedures but also to introduce modern features such as “shelf registration”[15]. This may entail modifications to the existing directives.

In line with the Financial Services Action Plan, the Commission intends to move forward on these issues by mid–2000.

Adoption of prudential rules to allow institutional investors to invest in venture capital

Concerning institutional investors, Community legislation is advancing in two fronts: investment funds (UCITS) and pension funds.

- On 17 July 1998 the Commission adopted two proposals modifying Directive 85/611/EEC. One proposal will remove barriers to cross–border marketing of units of collective investment funds by widening the scope of assets in which those funds can invest. The other proposal would provide the European passport to management companies and it will widen the type of activities which they are allowed to undertake (e.g. they may also be authorised to provide portfolio management services).

- Regarding pension funds, the Commission published in May 1999 a Communication drawing policy conclusions from the consultation process launched by the June 1997 Green Paper on “Supplementary Pensions in the Single Market”. The Communication looks at appropriate investment and prudential rules for pension funds in the context of the euro. It also makes proposals for the removal of obstacles to labour mobility and for the co–ordination of Member States’ tax systems. As a follow–up of this Communication, the Commission will propose by mid–2000 a directive on the prudential supervision of pension funds taking into account the diversity of pension funds operating in the EU and covering authorisation, reporting, fit and properness, as well as rules on liabilities and investments which would relax existing rules in some Member States concerning investments in unlisted SMEs.

Assess existing accounting and auditing requirements

Building on the 1995 Communication on a New Accounting Strategy the Commission is working with the Member States in order to examine to what extent more weight can be given to International Accounting Standards (IAS) in the context of the EU. In a Communication which should be published before end–1999 the Commission will map out the strategy for enhancing comparability of financial reports issued by listed EU companies based on combination of EU accounting directives and financial statements issued with agreed international accounting standards. Strategy should prefigure mechanism for vetting international benchmark standards so that these can be used, with no national variations, by EU listed companies.

At a more specific level, the Commission will table before end–1999 an amendment to the 4th and 7th Company Law Directives in order to allow EU companies to account for certain financial assets at fair value, in accordance with In-

[15] Shelf–registration is a prospectus prepared in a two–step procedure. First, companies prepare, at the same time as they prepare their annual reports, an “incomplete” or “reduced” prospectus containing everything except for the information concerning the specific securities involved in the issue. This is filed once a year with the home competent authorities. Then, when the time is right for an issue, the companies prepare the “issue note” describing the characteristic of the offer and of the securities. Investors, instead of the classical prospectus receive the “reduced” prospectus, the “issue note” and all the information concerning recent relevant elements. Belgium, Spain, France, the UK and Italy already make use of shelf–registration procedures.

ternational Accounting Standards. The proposal will not apply to banks and insurance companies.

Paucity of high–tech SMEs

Development of networking and clustering between universities, research centres, financial backers,...

– The Innovation Programme and the Joint Research Centre (JRC) have organised jointly a workshop in March 1998, involving 15 research centres and universities having set up or aiming to set up exploitation companies and dedicated investment funds. This exchange of experience and best practice is to be continued. To this effect, a project has been launched in June 1999 to develop long term durable interaction between sources of finance and sources of technology in the area of spin–off and spin–out from research institutions and universities.

– The LIFT Help Desk for Financing Innovation has been established in January 1999. LIFT helps participants in Community funded research and technological development programs to target and approach appropriate sources of finance. LIFT is co–operating closely with the I–TEC network[16] of venture capital operators.

– Regional Innovation Strategies (RIS) and Regional Infrastructures and Strategies for Technology Transfer (RITTS), involving more than 60 regions, have been developed in order to create a strategic framework for the integration of innovation into regional production structures, establish co–operation networks between companies and the public sector and to bolster the capacity for research and technological development and innovation in the region.

– In June 1999, the Commission launched a pilot action aimed at granting a European label of excellence to economic areas/regions with excellent scientific and technical potential and infrastructures and capabilities to facilitate the creation and development of innovative companies. These areas will join into networks to facilitate dissemination of good practices.

Creation of a pan–European club of high–tech innovative firms

Further to the wide ranging consultation on creation, development and growth of NTBFs launched in response to the Amsterdam (1997) and the Luxembourg(1997) summits, conferences were organised to bring together the main actors involved. The third one took place in Vienna in November 1998, bringing together financiers, innovators and Europe's most successful technology start–ups. One of the outcomes was the creation of the European Federation of High Tech Enterprises providing Europe's high growth innovative companies with a platform for communication with policy makers and others.

Reform of the European Patent System

On 24 June 1997 the Commission published a Green Paper (COM(97)314 final) entitled *"Promoting innovation through patents"*. On 5 February 1999 the Commission (COM(99) 42 final) adopted a Communication on the follow–up to the Green Paper. This Communication is the "operational" dimension of the Green Paper. It defines a number of important actions which the Commission has the intention to undertake by the end of 1999 or early 2000:

– A proposal for a regulation concerning the creation of a Community patent system (Article 308 of the Treaty)

– A proposal for a directive concerning the patentability of computer programmes (Article 95 of the Treaty)

– Interpretative communication concerning patent agents particularly in relation to Articles 43 (right of establishment) and 49 (free provision of services) of the Treaty.

On the other hand, the Commission considers that a pilot action should be launched by national patent offices in order to explore how patent information can be more comprehensible, accessible and practical to SMEs. Finally, the Commission considers that the special needs of SMEs in particular in relation to cost and for simpler and less expensive legal proceedings should be taken into account.

Human resources and cultural barriers

- ***Promotion of entrepreneurship and innovation within educational and training systems***

The Commission launched a project in June 1999 on the development of European entrepreneurship training modules, in collaboration with universities, business schools, as well as investors and financiers.

- ***Determination of training needs for venture–capital fund managers, market makers, analysts of high–tech firms***

A study is being carried out under the framework of the European Innovation Monitoring System, in order to determine training needs for venture–capital fund managers, market makers, analysts of high–tech firms. Results are expected by November 1999.

- ***Assessment of benefits of equity pay and employee ownership schemes***

The Commission has done an analysis of the economic and financial impact of employee stock ownership and stock option schemes and the necessary conditions to the development of these schemes in Europe. A broad initiative on the issue of employee ownership within "the new organisation of work" framework is under preparation.

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16 The I–TEC network of venture capital operators was established by the Innovation Programme in 1998. Currently 28 venture capital operators committed to investing in technologically innovative young companies belong to I–TEC, with a total investment capacity of €1.3 billion.

Box 1: The benefits of employee ownership schemes such as stock options; some key political considerations to encourage the widespread development of stock option/employee ownership schemes in the Union

Granting stock options: what for?

Stock options give employees the right (not the obligation) to purchase a set amount of shares of the company they work for, at a fixed price, for a specified period of time. By linking the worth of the benefit received by the employee to the enterprise's results, such schemes can increase motivation and productivity, contribute to decrease labour–management conflicts and encourage co–operation and information sharing. Over time, employees with a stake in the business have an incentive to contribute more to the development of the company. *Stock option and employee ownership schemes can play a role in the social dialogue in Europe through the development of more participatory forms of work organisation.*

The current situation

According to some studies at the end of 1998 some 7 million US employees benefited from one of the 3 000 broad[17] stock options plans, representing an asset value of approximately $250 billion. Broad–based stock options are widely used in high–technology companies and by an increasing number of non–high tech. A 1997 survey[18] of 1 100 public companies found that 53% of the respondents provide option to all employees. In the UK, currently around 1 million employees are given shares and a similar number are granted stock options each year through the tax–advantaged schemes designed to promote employee share ownership[19]. In France, at the beginning of the 90's, some 600 large quoted companies already operated selective[20] stock options plans, while an increasing number of young high growth companies grant stock options on a broad basis.

Impact on economic growth

There is considerable theoretical as well as empirical evidence pointing towards the strong contribution of employee share ownership schemes to economic growth.

Through wage flexibility

Innovative companies' growth is often based on the quality of their staff. For young high growth companies, stock options are a tool to attract talents they need, but cannot afford paying the high salaries large companies can offer. Granting stock options helps young companies preserve start–up capital for expenditures other than high salaries. It increasingly is a prerequisite for hiring and keeping the most innovative and entrepreneurial employees.

Through employees' motivation and productivity

The studies done on the search for a link between employee ownership and firm performance confirm the correlation between employee ownership and firm performance. An NBER working paper "*Employee ownership, employee attitudes, and firm performance*", 1995, by D. Kruse and J. Blasi, reviews and provides some analyses on the evidence concerning the prevalence, causes, and effects of employee ownership[21] accumulated in 25 studies of employee attitudes and behaviours and 27 studies of productivity and profitability. Attitudinal and behavioural studies tend to find higher employee commitment among employee–owners but mixed results on satisfaction and motivation. Studies also show a positive association between employee stock ownership plans (ESOPs) and firm performance (higher productivity and profitability), but without automatic connection. The relationship depends upon the circumstances in which employee ownership is implemented; several studies show a higher association between employee ownership and economic performance in companies with some form of employee participation in decision. Another indication of the correlation between employee ownership and firm performance is the performance of the Employee Ownership Index, developed by American Capital Strategies since 1992. This index tracks the performance of some 350 stocks in companies with 10% or more broad–based employee ownership schemes. *For the last 5 years, this index has outperformed the majority of stock market averages, including both the Dow Jones Industrial Average and the S&P 500.*

There is considerable evidence of a relationship between employee stock ownership and firm performance. Unfortunately such work still needs to be done on stock options.

Firms granting stocks to their employees grow faster and create more jobs.

There isn't any broad and complete study on the impact of employee ownership plans on firm's employment, however, studies performed by the National Centre for Employee Ownership (NCEO) concluded that companies that combined ownership and participation in the workplace showed a higher employment growth than expected in the industry. For example, a study done in 1986 in the State of Washington among companies with ownership schemes, showed an employment creation higher by 10% on average than among companies without.

Impact on entrepreneurship

Employee share ownership and stock options schemes create an added wealth for employees, contribute to the development of household investments in equities and have contributed to the development of entrepreneurship.

Granted to an increasing number of employees, stock options create, along with other share schemes, the basis of a wide private share ownership. As mentioned above, end 1998 some 7 million US employees benefited from stock options plans, representing an asset value of approximately $250 billion, while some 7.7 million employees benefited from ESOPs and stock bonus plans representing an asset value of $400 billion. In the US, many business angels are former employees who became wealthy by cashing their stock options.

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[17] «broad stock option plans » : plans granting options to 50% or more of full–time employees.

[18] Conducted by Share Data Inc and the American Electronics Association.

[19] *UK Treasury consultation on employee share ownership.*

[20] «selective stock options plans » : plans granting options to a limited number of key people, usually top executives.

[21] Defined as ownership of common stock exceeding 5% of the total market value of the equity held by a group that includes substantially more employees than the senior executive team and key middle managers.

Box 1** (continued): **The benefits of employee ownership schemes such as stock options; some key political considerations to encourage the widespread development of stock option/employee ownership schemes in the Union

Conditions to the development of stock options in Europe

Stock options are underdeveloped in Europe. There are several reasons for this. Unfavourable taxation; an undeveloped equity culture; ownership resistance – particularly in family enterprises. Particularly important is the timing of taxation of stock options as well as the complexity of the regulations and the uncertainty it creates.In some countries the moment of tax charge on stock options or the recognition of trusts (vehicle holding shares allocated to employees through share ownership plans) is not clear. In others, the formula (the mix of income tax, social security contributions, personal wealth tax, capital gains tax) is rather complex and the overall taxation can be very high. Taxes on stock options can be payable on the grant of the option, on the exercise of the option and/or on the sale of the underlying shares. Taxation before the sale of the underlying share will mean that the beneficiary becomes liable to tax before receiving any disposable proceed. Taxation at granting is particularly harmful for the employee who will have to fund the tax charges while it can be several years until he is authorised to exercise the option, sell the shares and generate a revenue. *The most attractive taxation regime on stock options is when beneficiaries are only liable to capital gain tax (tax rate usually lower than for income tax) at the sale of the underlying shares.* It is for example the case of the incentive stock option (ISO) schemes in the US, schemes receiving positive tax treatment (the employees incur tax only when they sell the stock, at which time the gain (difference between the sale price and the exercise price) will be taxed as a capital gain), provided certain requirements are met. By granting employees positive tax treatment, the US government has partially compensated the risk that equity pay can represent to employees, making it more attractive to them, whilst preventing companies from using this scheme only for tax avoidance purposes.

Companies can play a major role in the development of stock options in Europe by setting up transparent as well as diversified schemes. A transparent allocation of options will avoid using them as a tool to avoid paying taxes on high salaries, while combining different schemes (share ownership, stock options, selective, broad,…) will help cater for the different needs of the various employees and attract broader support.

Considering the benefits stock options and other share ownership schemes can bring to the employees, the firms, and the economy, it is crucial to develop in Europe a more favourable environment for these schemes, first and foremost through the reduction of fiscal barriers.

Financial assistance

Launched in 1997 and extended in November 1998, the Innovation and Technology Equity Capital (I–TEC) pilot project is now fully operational. Its aim is to encourage early stage investment in technology innovative companies and help build, within venture capital fund management companies, a lasting capability to appraise and manage such projects. Supported by the Commission's Innovation Programme, it is implemented in collaboration with the EIF. Currently, 28 venture capital operators have committed € 500 million (of a total investment capacity of € 1.3 billion) to investing in technology innovative companies less than three years old.

In November 1998, the Commission launched a new Seed Capital action, called CREA (Capital Risque pour les Entreprises en phase d'amorçage). It will support the creation of innovative small businesses and the transfer of existing businesses to new owners by making advances to new or recently established commercial seed and venture capital funds (between 20 and 30 funds will be selected). These funds make major contributions to the creation of innovative, fast–growing companies, delivering cost–effective job creation for the community, especially when compared with traditional investment subsidies.

Several of the programmes co–financed by the EU Structural Funds, and in particular by the European Regional Development Fund (ERDF), contain financial engineering measures designed to help SMEs in the least developed regions of the Community to have easier access to risk capital. While under the current programming period (1994–99) such actions have been relatively modest in number and in amount of funding allocated, the Commission considers that they have considerable potential in both regional development terms and in helping to achieve better leverage in the use of the Structural Funds' resources deployed: for the new programming period (2000–2006) the Structural Funds' Regulations therefore explicitly encourage greater recourse to such instruments.

EIF

The EIF has been active since early 1997 as a catalyst in the financing of venture capital funds focussed on early–stage and technology investments. In that time it has committed nearly 180 million euro to 31 funds located in 10 of the Member States, partly from its own resources, partly on the basis of funds entrusted to it by the EIB (the European Technology Facility) and, most recently, using EU budget resources earmarked under the Growth and Employment initiative (the ETF Start–Up programme).

The EIF has a further 175 million euro to commit under its present mandates; an additional 125 million is likely to be added shortly following the call from the European Council in Cologne for the European Technology Facility to be doubled in size. With a potential investment capacity of close to 500 million euro under management the EIF has the scope to play a leading role in promoting venture funds across the Union, often acting as a reference investor for other external investors in national funds and consistently promoting good commercial and legal practice. The Fund is actively exploring investment opportunities in all the Member States, with a clear mandate to spread the venture capital culture on a sound basis across the Union.

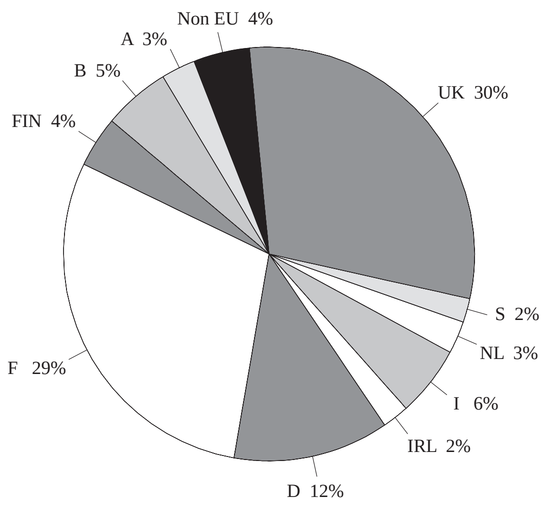
The 31 funds in which the EIF has invested on a minority basis have already raised in total over 1.6 billion euro, predominantly from the private sector. Although many are still in the very early stages of their investment cycles they have already invested 200 million euro in 190 companies, more than 95% of them hi–tech (with over 35% by value in the information technology sector and nearly 20% in biotechnology). Although many of the funds intend to invest on a purely national and, in some cases, regional basis, a significant number are already investing in companies in other EU Member States and there is a growing network of cross–border contacts among early–stage and technology fund managers. It is clearly premature to judge the employment effects of these investments. But figures collected by the EIF from its investee companies point to a heartening increase of 32% in employment in the companies concerned, simply as a result of the first round of investments.

The EIF's role is to act as a catalyst in the provision of equity capital to independent venture funds and, more generally, to help stimulate the early–stage and technology sector of the private equity market. The European Investment Bank has a wider remit under the Amsterdam Special Action Programme to provide risk capital in various forms to small and medium–sized companies, channelling this in large part through its extensive network of partner banks and their affiliates in the Member States. It is thus active as a provider of mezzanine debt as well as equity to a wide range of SMEs, both more and less–established.

EIB

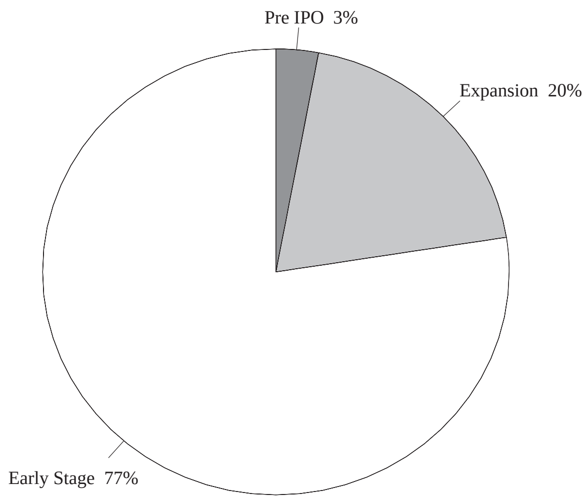
To date the EIB has signed 26 risk capital contracts with a total commitment of over 400 million euro and has approved a further 200 million. These amounts include monies entrusted to the EIF for investment in venture funds. In total the EIB has the authority to use up to 1 billion euro from its surpluses to back up this risk activity. The European Council in Cologne has called for a further 1 billion to be set aside for the period 2000–2003.

GRAPH 7: **Commited capital: Breakdown by country of management location**



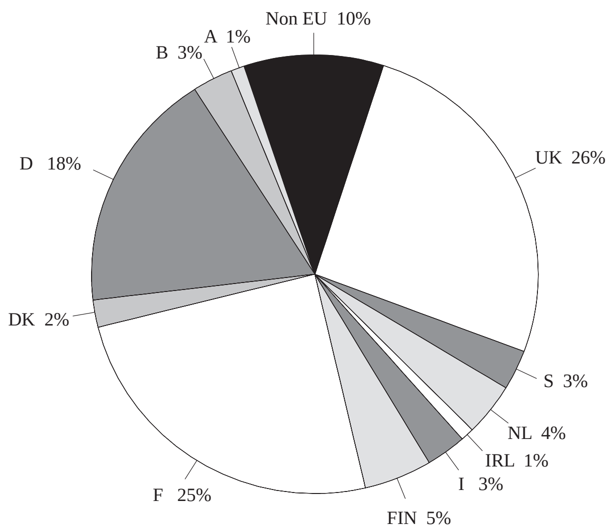
Source: EIF/ETF, mid '99.

GRAPH 8: **Commited capital: Breakdown by targeted stage**



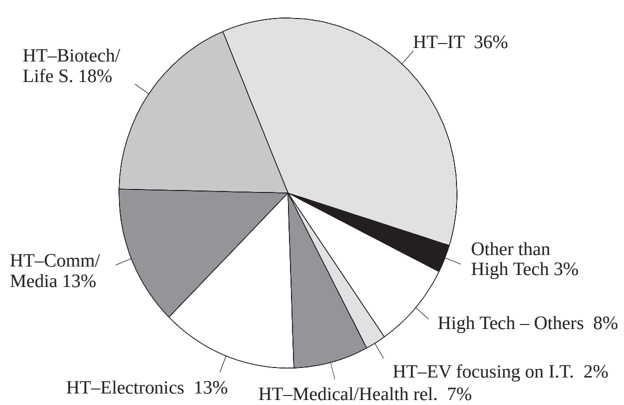
Source: EIF/ETF, mid '99.

GRAPH 9: **Investee company location: Breakdown by cost**



Source: EIF/ETF, mid '99.

GRAPH 10: **Investee company: Sectorial breakdown by cost**



High Tech – Information Technology
High Tech – Biotechnology / Life Sciences
High Tech – Communication / Media
High Tech – Electronics
High Tech – Medical / Health related
High Tech – EV focusing on I.T.
High Tech – Others
Other than High Tech

Source: EIF/ETF, mid '99.

PART II: THE MEMBER STATES RESPONSES

Further to the European Council's invitation to the Member States to report on how they are implementing the Risk Capital action plan, the European Commission received 14 answers[22].

All Member States expressed deep interest for the development of risk capital. Many Member States also expressed interest in learning from what has been done in the other countries. However, a detailed examination of the answers shows that if interesting measures have been taken in some Member States (Finland, France, Ireland, the Netherlands, Denmark, Italy, the UK), little been done in others.

A presentation of the answers from the Member States under the format of the Action Plan (market fragmentation, institutional and regulatory barriers, …) is annexed (see Annex 1).

The analysis presented hereafter contains two sections. The first section deals with the most interesting actions which may provide a reference for further developments. Section II points out areas where developments are still very marginal and insufficient.

I. Some of the most interesting reports, actions and measures, taken or under consideration:

This section lists some of the measures most likely to help successfully develop risk capital. These measures have been selected on the basis of the following criteria: they are innovative actions, measures already implemented or with a precise time table. It is based on the answers provided by the Member States and whenever possible, was completed with other relevant schemes (e.g. with schemes that were announced after the answers were sent or schemes implemented at regional level). The list does not pretend to be exhaustive.

Complementing these actions on the risk capital environment, Member States (as well as the Community), are implementing a number of financial programmes to stimulate the mobilisation of capital for innovative SMEs. Funds channel the financing via financial instruments like equity investments, equity guarantees, loans and loan guarantees. These funds are not the subject of the analysis below, although some of them, dedicated to the financing of young companies, are also mentioned here.

Market fragmentation

Support to business angels

Several member states have been supporting the development of business angels networks: the UK government has supported the creation of the National Business Angel Network (NBAN); it is complemented by the newly–formed Business Angels Networks Association (BANA) which should improve co–operation and links between networks.

[22] The only missing answer is the one from Luxembourg. Most follow the headings of the Risk Capital action plan, except Belgium that sent a 2 pages letter stating general intentions (Annex 2), and Spain that sent a copy of 5 laws (a summary of these laws is presented in Annex 3).

In April 1999, IBAN, the Italian Business Angels Network, was established with headquarters in Milan; it will operate as part of the broader structure of EBAN, the European Business Angels Network. In Germany, the Federal Government initiated the Business Angels Network Germany (BAND). In France, several Business Angels networks have been created by private or public organisations, some with the support of the Chambers of Commerce and Industry and of regional authorities.

In Finland, Sitra, a foundation under the authority of the Parliament, provides a complementary service matching business angels and SMEs. In Ireland, the business angels program of Enterprise Ireland, the industrial development agency, was recently revitalised to involve banks and EU support.

The ”I^2 – the business angels exchange”, established in Austria in December 1996, is an innovative formula, the success of which still needs to be assessed. It is a platform similar to a stock exchange which brings together investors who have capital and experience and SMEs with growth potential looking for external investors. In Sweden, the Innovation Market (IM), privately operated as a kind of local stock market, sees about 14 000 individuals trading SMEs stocks.

Improving access to stock markets

Improving access to stock markets can be done through financial help to cover the costs of developing new financial tools, for example by giving grants to help cover the costs of IPO or of creating a market dedicated to small caps. Such grants, should be limited to the initial development period when the costs are the highest. Improving the general environment is another tool and often a very necessary measure.

The Danish parliament has decided to set aside DKK 5 million for 1999 to be split between companies aspiring to become listed and the new markets. Each small company that achieves a listing is eligible, under defined conditions, for a grant of DKK 85,000 in order to cover costs related to the IPO such as writing a prospectus. The marketplace, where the listing occurs, similarly is eligible for DKK 40 000 per new listing. This scheme was inspired by a similar scheme the Swedish government dropped recently considering it had achieved its aim of supporting the creation of stock markets dedicated to SMEs.

In Italy, a Strategic Steering Committee for the Italian Financial Markets has been created, one of whose tasks is to draw up proposals for facilitating the access of unlisted companies to the regulated risk capital markets.

In the UK, a November 1998 report to the Paymaster General has identified barriers to growth facing smaller quoted companies (SQCs) and brought forward proposals to help address those barriers (development by the Stock Exchange of a more favourable environment for nurturing SQCs as they come to market; improve the partnership between companies and their investors, improve information and communication, extension of the existing fiscal incentives aimed at the very smallest companies in order to encourage private investors to participate more fully in both new equity issues by SQCs and secondary market liquidity in these shares,….)

Institutional and regulatory barriers

Simplification of administrative formalities

In 1998, France took some 37 measures to simplify administrative formalities. Registration of a company should now be possible within 24 hours.

Beginning of June 1999, the French government presented a law in favour of innovation and research. This law includes the extension to innovative companies of a simplified regulatory regime for limited companies ("société par actions simplifiée"). This regime allows for more flexibility in the set up and the functioning of the companies.

In Portugal, the network of Business Formality Centers that help to set up companies, amend articles of association, etc…, has been expanded.

In certain Austrian provinces a "simplified" procedure is available to business start–ups.

In Italy, the Bassani Law (March 1997) requires one–stop help desks to be established in all Italian municipalities to help and accelerate administrative procedures.

Beginning of July 1999, the UK government announced its intention to set up a Small Business Service (SBS), loosely based on the American Small Business Administration (SBA), to act as a voice of small firms, simplify and improve government support and monitor regulations.

Pension funds investment rules

In Finland, in May 1998, a working party, made of representatives of pension funds, investment funds and trade unions and chaired by the ministries of Trade and of Social Affairs, presented to the Ministry of Trade and Industry a report on Pension funds and capital management of SMEs. The purpose of the report was to investigate the means of promoting investing a larger proportion of pension funds in the SME sector without compromising investment protection. Its main proposal with regard to risk capital was that pension funds make it their objective to invest a certain proportion of their investment in risk capital; it also recommended to take into account the capital market developments in the definition of solvency requirements and improve the co–operation between pension funds and capital investment corporations as well as information on risk capital. Further to the publication of that report, several Finish pension funds increased their investment in venture capital.

In Denmark, the quantitative investment controls on pension funds and insurance companies have been relaxed so that they can now invest up to 50% in equity and property (10% in unlisted equity).

Taxation

– Both the UK and Ireland have developed interesting tax relief schemes to encourage individuals to develop existing businesses or set up a company: the Irish schemes include the Business Expansion Scheme (BES) whereby an individual who invests in new ordinary shares of a company can obtain tax relieves and the BES Seed Capital Scheme which provides a refund of income tax already paid to individuals who are interested in starting up a qualifying business. UK schemes combine fiscal incentives for individuals to invest directly in early–stage companies (Enterprise Investment Scheme (EIS)[23]) and to invest indirectly via pooled investment funds (Venture Capital Trusts[24]–).The UK government is also introducing R&D tax credits for SMEs and intends to introduce a new tax incentive to encourage corporate venturing.

– In France, to support investment in risk capital, tax relief is granted since 1998 to new Life Insurance contracts (DSK contracts) that invest a minimum of 50% of their assets in equities and a minimum of 5% in risk capital.

– Concerning employee ownership schemes and stock options, the UK is preparing 2 schemes to support employee ownership and equity remuneration: the Employees Share Ownership Scheme (granted to all employees) and the Enterprise Management Incentives (tax relief on equity remuneration given by smaller companies to a few key individuals). The aim of the government is, with these two schemes, to increase productivity by giving all employees a stake in the business and to help small high growth companies recruit and retain high calibre managers and thereby enhance their growth prospects. The two schemes are complementary and will be developed alongside each other.

The French law proposal in favour of innovation and research (mentioned above) will relax the rules for granting the equity warrants called "bons de souscription de parts de créateurs d'entreprises (BSPCE)" (very similar to stock options). These equity warrants can be issued by start–ups and young companies (less than 15 years old, private or quoted on Le Nouveau Marché) and are granted various tax incentives (no social security contribution, 16% capital gains tax).

Paucity of high–tech small business

Promotion of networking between universities, financial backers,...:

Regions and local agencies play a major role in the development of clusters, although the Commission has received little precise information.

In Finland, a consortium has been established in the Tampere Technology Centre between a local bank, a nation–wide venture capital company, a state–owned venture capital company and a public guarantee company; it mixes public and private capital (2/3 private, 1/3 public) and

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[23] The EIS, introduced in 1993–1994, is designed to help higher risk, unlisted trading companies to raise start–up and expansion finance by the issue of ordinary shares to individual investors previously unconnected with that company. In recent Budgets, the Government has introduced further technical amendments to make the EIS more attractive to potential investors while retaining the focus of the scheme on smaller higher risk enterprises engaged in productive activities. Qualifying investors may claim a range of income tax and capital gains tax reliefs, some conditional on holding the shares for at least 5 years. Over £ 200 million (€ 296 m) has been invested via the EIS in enterprises between 1993–94 and 1997–1998, with £ 54 million (€ 80 m) in 1997–1998.

[24] Whereas the EIS encourages individuals to invest directly in early stage companies with growth potential, VCTs, established in 1995, provide tax incentives for individuals to invest indirectly via pooled investment funds. VCTs are structured as investment trust companies, themselves listed on the stock exchange, which invest at least 70 per cent of their capital in small, higher risk unlisted companies. There are around 26 VCT funds in operation, which have raised around £ 520 million (€ 770 m) and have invested around £ 135 million (€ 200 m) so far in over 180 companies.

invests in genuine seed capital presented by the technology centre. The concept will be adopted by other technology centres in Finland in 1999. Moreover, the Mentor scheme helps young innovative companies to start–up and increase entrepreneurial skills.

In the Netherlands, through the “Twinning concept”, the government mixes coaching and financing mechanism. It also sponsors the creation of business incubator centres, a start–up fund, a coinvestment fund and a international network of experts.

In Spain, the Bilbao Bizkaia Kutxa, a saving loan institution, set up in 1998 a foundation to finance the creation of new enterprises by young people; it reached an agreement with the University of the Basque Country in order to launch a new incubator for the university community (not only for researchers but also for students) and with the Technology Park of Zamudio to create an incubator within the Park.

The French law proposal in favour of innovation and research will make it possible from now on, for university professors and researchers to create or take part to the creation of a company that will market their research.

In the United Kingdom – the university challenge fund is designed to stimulate these activities.

Human resources and cultural barriers

Most Member States have developed programs of promotion of entrepreneurship and innovation within educational and training systems as well as through conferences, the diffusion of information, the work of governmental agencies, venture capital bodies, etc… But too often they lack focus, priorities, dates and deadlines.

Financial assistance for innovative SMEs

All member states have set financial programs channelled through various funds to support the development of innovative SMEs. These are the ICC Software Fund investing in the software industry (Ireland), the National Venture Capital Fund for very early–stage, high–tech businesses (UK), the University Challenge Fund to fund seed–corn early–stage collaborations between university scientists, venture–capital and industry to commercialise scientific discoveries (UK), the Finnish National Fund for Research and Development (SITRA), the KfW/BMFT Technology Participation Programme providing equity finance to small technology based firms on a cofinancing basis with private equity capital providers in Germany etc….

These are only a few examples of the financial assistance by Member States; many answers, following the outline of the Action Plan, focused on the actions to be taken to reduce the barriers to the development of a pan–European risk capital market and did not mention the financial instruments. When well designed, these funds, like the EIB and EIF financing at community level, can act as a catalyst in the provision of risk capital to innovative SMEs, in areas where the provision of private venture capital is not sufficient.

It should however be noted that issues of distortion of competition can arise under certain measures and that some may need to be assessed under the Community’s state aid rules. In this respect it is useful to distinguish between three types of measure:

– measures, such as the EIF, where public funds are invested alongside and on the same terms as market investors’ capital. In these circumstances the Commission considers that no issues of distortion arise;

– measures where there is public participation alongside genuine market investors’ capital but where the participation is not on the same terms. (Possible examples are guarantees against a proportion of any possible loss, or funds where the division of profits is not on a pro rata basis.) In these circumstances the Commission considers that state aid issues can arise. Any concern can be minimised, however, in measures whose design ensures that the distortion is the minimum necessary to achieve the provision of risk capital to the target enterprises. Some Member States have already instituted such arrangements, and certain examples are included in Annex I;

– measures which simply channel public capital into equity investments in small and medium–sized enterprises. While this can be useful in providing capital to such enterprises, it is often much harder for such investments to retain a genuine commercial character, and state aid issues are therefore likely to arise. At worst, there is also a risk of “crowding out” the formation of truly commercial new venture capital funds and of actually discouraging the emergence of the kind of vibrant risk capital markets which Europe needs to develop.

The Commission believes that it is essential to design public measures carefully in order to maximise their utility not only to their immediate beneficiaries but also in the process of promoting the growth of private venture capital markets.

II. Areas where measures taken or under consideration are not sufficient

- ***Reform of the legislation on insolvency and bankruptcy:***

This issue is clearly considered as crucial by many Member States, but few have been able to implement a comprehensive reform giving entrepreneurs a real “second chance”. Austria and Germany, two countries with very stringent bankruptcy legislation (due to the traditional central role of banks in corporate finance) have recently set up some reforms with the view of giving entrepreneurs this “second chance”. However, the discharge of the remaining debt and the possibility of a fresh start is only possible after a long period (seven years in Germany, during which time the obligation to make regular payments must be fully met). In several countries, the issue has been under consideration for some time without the necessary reforms being done due to the complexity of the situation.

Beginning of July 1999, the UK government announced its intention to work on a relaxation of bankruptcy laws to remove the stigma of failure from those whose business fail through no fault of their own. The Department of Trade and Industry (DTI) considers allowing such bankrupts to keep £10 000–20 000 of their assets and to be discharged after six months rather than the present three years. This would be a crucial reform to promote entrepreneurship. However, the DTI intends to discuss it in length before implementing it to find ways to avoid protecting "culpable" bankrupts while giving a second chance to genuine unfortunate entrepreneurs.

- ***Promotion of stock options and innovative employee ownership schemes***

Several member states have been considering developing a more favourable taxation of stock options than the present often complicated and expensive taxation regimes (e.g. taxation at sale of the underlying shares, taxation as capital gains, etc…). However besides the schemes already in place or under consideration in the UK, and the new Belgium law (rather controversial: taxation at issue of the options, but at a low rate), little has been done. Beginning 1999, the French government withdraw its law proposal on this subject (the law proposal in favour of innovation and research is however taking some positive steps in this area); the issue was discussed in Denmark in 1998 but never led to a reform; some steps were taken in Italy, but the situation remains complex. The American example of the Silicon Valley shows the significant role stock options can have in the development of innovative companies.

The Commission considers both these issues as essential elements for encouraging a fresh entrepreneurial culture in the Union.

December 1999

ANNEX 1

RISK CAPITAL ACTION PLAN

The answers from the Member States and the measures undertaken at Community level

This table presents the original answers as provided by the Member States under the format of the Risk Capital Action Plan. It also includes actions undertaken by the European Commission.

The Belgium answer (a two–pages letter) and an summary of the Spanish answer (copy of 5 laws), answers that were not following the format of the Risk Capital Action Plan, are presented in annex 2 and 3.

MARKET FRAGMENTATION

Measures	Develop networks of business angels at regional, national and Community levels
European Commission	In September 1998 the Commission launched a pilot action in favour of business angels with 3 main goals: to spread and disseminate the idea of business angels networks, to conduct feasibility studies on creating business angels networks and to actually set up and coordinate such networks. After a call for proposals, the commission charged the European Association of Development Agencies (EURADA), which acts as an umbrella organisation for European regional development agencies, and EBAN (the European Business Angels Network), to disseminate and develop the concept in each member state. The Commission is financing feasibility studies in Lombardia (Italy), Flanders (Belgium) and for a sector–based (IT) business angels project, based in Belgium but with a European wide coverage and supporting the creation and coordination of networks in Umbria (Italy), Northern Irland (UK), Norrköping (Sweden), Flanders (Belgium), France and Aragon (Spain).
Austria	In December 1996 ”I^2 – the business angels exchange” was established; this is administered by the Innovations Agency, an agency of the Federal Ministry for Economic Affairs and the two sides of industry. I^2 is a market similar to the stock exchange and open to investors who have capital and experience and to SMEs with growth potential. Investors may be either private individuals or firms and equity investment companies. The Austrian Chamber of Commerce (WKÖ) has set up a successor exchange which puts businessmen who are seeking a successor in touch with persons or companies interested in taking over the business. At present, consideration is being given to expanding this to include the I^2 exchange. Lastly, the technology centres also serve as information exchanges between investors and firms. In 1998 an investment fair was organised for the first time at which firms seeking capital could present themselves to interested investors, above all equity investment companies. A follow–up event is being considered.
Denmark	In the wake of an academic study that tried to assess the magnitude of business angels investment in Denmark, the Ministry of Business and Industry decided to initiate a feasibility–study of various ideas for angels' networking. The findings of the academic study were promising and in line with the findings of similar studies in other countries – the Danish market for private investors' direct investment is likely to be at least two times that of the formal venture capital market. The feasibility–study on networks, due in June 1999, is supposed to review the international experience with business angel networks and suggest ways to increase transparency in the market through meeting–places for private investors and firms seeking capital. These meeting–places can be either virtual such as electronic matching–systems or physical places e.g. investor–meetings. The need for government involvement in the process will also be addressed.
Finland	Sitra, a foundation under the authority of the Parliament, provides a complimentary service matching business angels and SMEs. Cooperation networks have been organised with technology centres. Sitra is also involved in founding a market place matching early–stage companies and various types of financiers, including business angels.
France	France considers that it is up to the private sector to develop these networks. Contacts have been made to check that the present rules governing the use of the capital markets do not create serious obstacles to their development.
Germany	In order to promote the linking–up of business angels and business start–ups and to encourage the establishment of regional business–angel networks, the Federal Government initiated in 1998 the Business Angels Network Germany (BAND). Its excellent reception by the press and interested parties in the public arena, together with the first successes in encouraging participation, suggest that BAND will provide an important impetus to this market.
Greece	The Ministry of Development is working with financial institutions to increase the flow of investment finance to small and medium high–tech and innovative companies. Also, it is in the process of examining the feasibility of setting up business angel networks within the program's of the 3rd Community Support Framework.

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Ireland	Enterprise Ireland, the industrial development agency, had in place a Business Angels Program for a number of years. This program was essentially a reactive one. In the latter part of 1998, the Program was revitalised and it was decided that is would be a high profile Proactive National Program involving the banks and EU support. The Irish program will be linked into the European Business Angels network.
Italy	In April IBAN, the Italian Business Angels Network, was established with headquarters in Milan. It will operate as part of the broader structure of EBAN, the European Business Angels Network. IBAN is setting up a closed–end fund, in which the EIF will also participate, for investing in new businesses, particularly in innovative sectors.
Netherlands	Government encourages a number of activities that contribute directly to the awareness of informal capital an coordinates business angel initiatives done by intermediaries.
Portugal	The intention is to promote networks of business angels under the next Economic Support Framework. Steps are being taken to stimulate risk capital, which is regarded as a priority among the next set of measures.
Sweden	Business angels are increasing in numbers in Sweden and are often to be found linking up with each other, for example under the aegis of the Swedish Risk–Capital Association. The Swedish Employers' Association runs a similar scheme. The numbers of both business angels and venture–capital companies have increased sharply during the 1990s. In addition, some public–sector agencies are involved in this area in that they offer capital to SMEs and take a minority shareholding in companies for a limited time. Those agencies try to supplement commercial companies operating in this field and in some cases they are prepared to accept lower returns for their services. The National Board for Industrial and Technical Development (NUTEK) has helped to stimulate the development of official markets and reduce the costs for small businesses wishing to participate. The aim is to promote trading in shares of small businesses and thus encourage private individuals to invest in them. Both NUTEK and some private operators also arrange regulated ”investment forums” where small businesses can be introduced to potential investors.
UK	It is anticipated that recent developments in the UK will help to improve access to business angel finance for many SMEs. The Government has supported the creation of the National Business Angel Network (NBAN). Sponsored by five high street banks and City firms, NBAN aims to stimulate the business angels sector. It is complemented by the newly–formed Business Angel Networks Association (BANA) which will improve cooperation and links between the networks.

Measures	**Market monitoring and development of information and statistics on all levels of venture capital in the EU**
European Commission	In the framework of the Action Plan for Innovation, a "trend chart on innovation" has been established. It will gather information, in co–operation with member states, on national and EU policy measures to promote innovation, among others those in support of venture capital and the financing of innovation, their history and results. The database is currently being extended and will be made available to researchers and policy makers via a dedicated website in the course of 1999. The forthcoming communication on the promotion of innovation in Europe details the progress that has been made in this area. In the framework of the Innovation/SMEs programme, the Commission launched two surveys in March 1999: one to gauge the resurging corporate venturing activity in Europe and the other to identify the activities, services and products developed by EU commercial banks to finance new technology based firms (NTBFs) In addition, under the European Innovation Monitoring System (EIMS), the Commission launched in January 1999 a study on the typical growth paths taken by biotechnology and information technology firms and the role that different types of financiers play in these, in order to help devise approriate support measures for the financing of innovation.
Austria	The Austrian Chamber of Commerce and the equity investment companies are closely monitoring the development of the Austrian venture capital market. Booklets provide information on the state of play on the venture capital market. The Federal Ministry for Economic Affairs is also establishing a ”business founders” department, with two functions – to operate as an information and mediation agency and to carry out qualitative and quantitative analyses.
Finland	As part of its market monitoring activities, Finnish Venture Capital Association collects information for statistical use. Same information is also given to EVCA–Price Waterhouse Coopers European–wide private equity survey.
Greece	The Ministry of National Economy is coordinating with the Bank of Greece the effort to set up a system that will monitor the market of venture financing and of the – to be created – new stock exchange market.
Sweden	In principle the State does not operate in this area in the context of commercial and industrial policy but information on risk–capital operators is available in NUTEK's new financial information database, which is accessible through the Internet. It is understood that the (private) Swedish Risk–Capital Association plays an active part in the EVCA's various activities in this area.

Measures	Round table on the impact of the fragmentation of the European risk capital market
European Commission	As proposed in the Action Plan, the Commission organised end November 1998 a round table on the impact of the fragmentation of the European markets on the provision of risk finance. The conference contributed to helping better understand the crucial role risk capital markets play in growth and job creation, the importance of breaking down cultural barriers hindering entrepreneurship in Europe and the need for more integrated capital markets.
Denmark	In January 1998, the stock exchanges in Copenhagen and Sweden signed an agreement to launch a common market for securities (NOREX). The two exchanges have decided to start using the same trading system and common trading rules for shares. Technically, membership at one exchange will mean automatic access to trading at the other exchange by virtue of reciprocity. The two exchanges will start trading in the common system in May 1999. Other Nordic countries are invited to join in NOREX.
France	The government considers that its role is to provide a framework favourable to the circulation and investment of capital within the Union. It is directly up to the interested parties to develop synergies between the various market participants.
Greece	Based on the study prepared by the Athens Stock exchange SA on market fragmentation for the development of the New Market for small and medium innovative and dynamic businesses, the Ministry for National Economy will establish a round table committee to examine the issue and produce detailed proposals for the legal framework required to established the specialized stock exchange market as well as identify the problems arising from fragmentation.
Italy	The disadvantages of the fragmentation of the European risk capital market will be explored further and measures will be drawn up which will allow new undertakings to have access to savings invested in risk capital throughout Europe.
Portugal	In March 1998 IAPMEI arranged an initial meeting of prominent individuals from the world of finance at which the matter was discussed.
Sweden	The Department of Trade and Industry did not participate in the round–table conference held in autumn 1998 or study the conclusions of the conference.

Measures	Detailed examination of the cost to European firms of raising debt and equity finance
European Commission	In order to make a detailed examination of the cost to European firms of raising debt and equity finance, the Commission has launched two calls for tender: one is a desk research aimed at examining in detail the cost of capital for European firms, in particular SMEs, and to assess whether the cost is one of the reasons of lower use of equity finance by European SMEs. The study should compare the cost of debt finance to the cost of raising equity for European firms, and more specifically for European SMEs and will include the impact of taxation. The second is a survey among European firms, and in particular SMEs and high growth companies, on how they assess the cost of financing and how the cost impacts on their financing as well as investment decision making.
Greece	The Capital Market Commission is to examine the cost to Greek small and medium innovative and dynamic companies of raising financing and in particular the cost of capital in the proposed New Market of the Athens Stock Exchange SA.

Other measures

Measures	Develop venture capital and innovation finance
European Commission and EIB/EIF	The Innovation and Technology Equity Capital (I–TEC) pilot project aims to encourage early stage investments in technology innovative companies. I–TEC aspires to help build, within venture capital fund management companies a lasting capability to appraise and manage such projects, which, in spite of their economic viability and inherent quality 0.5would otherwise be difficult to finance. The pilot project is supported by the Commission's Innovation Programme and has been implemented in collaboration with the EIF (the majority of funds in which the EIF has invested are taking part in the I–TEC pilot project). Launched in July 1997 and extended in November 1998, I–TEC has become fully operational in 1999. Currently, 28 venture capital operators have committed € 500 million of a total investment capacity of € 1.3 billion to investing in technology innovative companies less than three years old. To date, 111 such investments have been made for a total amount of € 94 million, half of them in companies newly created. An important aspect of I–TEC is the networking opportunities it creates, especially for newly established management teams. To date, 14% of investments reported are cross–border. The Commission launched a new Seed Capital action in November 1998 within the Multiannual Programme for SMEs 1997–2000 The objectives of the new action are : – to stimulate the supply of equity finance for the creation and transfer of innovative smaller businesses with growth and job creation potential through support for seed funds or similar organisations in their early years, – to create a Community–wide network for seed capital funds and their managers and to proceed to an exchange of best practices and training. The new action will specifically include equity investment for the transfer of small companies and skilled craft businesses to new owners. Currently almost 1/3 of transfers fail because of the inadequate preparation of the new entrepreneur, the burden of taxation or insufficient financial backing for the new entrepreneur. This would facilitate the continuation of innovative (family) businesses with growth potential and stabilise or create employment, irrespective of whether the new owner comes from the family, the existing management, employees or is an external investor.

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European Commission and EIB/EIF	Therefore the new action, called CREA (Capital Risque pour les Entreprises en phase d'Amorçage) will support the creation of innovative small businesses and the transfer of existing businesses to new owners by making advances to new or recently established commercial seed and venture capital funds (between 20 and 30 funds will be selected). These funds make major contributions to the creation of innovative, fast–growing companies, delivering cost–effective job creation for the community, especially when compared with traditional investment subsidies. Several of the programmes co–financed by the EU Structural Funds, and in particular by the ERDF, contain financial engineering measures designed to help SMEs in the least developed regions of the Community to have easier access to risk capital. While under the current programming period (1994–99) such actions have been relatively modest in number and in amount of funding allocated, the Commission considers that they have considerable potential in both regional development terms and in helping to achieve better leverage in the use of the Structural Funds' resources deployed: for the new programming period (2000–2006) the Structural Funds' Regulations therefore explicitly encourage greater recourse to such instruments, and the Guidelines issued to the Member States for the preparation of their new programmes set out a number of "best practices" which the Commission would wish to see adopted in setting up and operating risk capital operations (Member States will be encouraged to pay particular attention to: monitoring of performance in order to assess with more precision the contribution of financial engineering schemes to regional development; private sector participation to help ensure project sustainability; management by independent professionals with autonomy for day–to– day investment decisions; rigorous project selection criteria which support regional development objectives; financial assistance to be linked to the provision of advisory support/ different financial instruments to SMEs so as to provide them with flexible and sustained assistance at various stages in their development). The Commission encourages national and regional authorities responsible for implementing Structural Funds' co–financed measures in the least developed regions of the Community to make full use of the potential of risk capital and similar financial engineering instruments, as a means of addressing the problems faced by their SMEs The EIF has been active since early 1997 as a catalyst in the financing of venture capital funds focussed on early–stage and technology investments. In that time it has committed nearly 180 million Euro to 31 funds located in 10 of the Member States, partly from its own resources, partly on the basis of funds entrusted to it by the European Investment Bank (the European Technology Facility) and, most recently, using EU budget resources earmarked under the Growth and Employment initiative (the ETF Start–Up programme). The EIF has a further 175 million Euro to commit under its present mandates; an additional 125 million is likely to be added shortly following the call from the European Council in Cologne for the European Technology Facility to be doubled in size. With a potential investment capacity of close to 500 million Euro under management the EIF has the scope to play a leading role in promoting venture funds across the Union, often acting as a reference investor for other external investors in national funds and consistently promoting good commercial and legal practice. The Fund is actively exploring investment opportunities in all the Member States, with a clear mandate to spread the venture capital culture on a sound basis across the Union. The 31 funds in which the EIF has invested on a minority basis have already raised in total over 1.6 billion Euro, predominantly from the private sector. Although many are still in the very early stages of their investment cycles they have already invested 200 million Euro in 190 companies, more than 95% of them hi–tech (with over 35% by value in the information technology sector and nearly 20% in biotechnology). Although many of the funds intend to invest on a purely national and, in some cases, regional basis, a significant number are already investing in companies in other EU Member States and there is a growing network of cross–border contacts among early–stage and technology fund managers. It is clearly premature to judge the employment effects of these investments. But figures collected by the EIF from its investee companies point to a heartening increase of 32% in employment in the companies concerned, simply as a result of the first round of investments. The EIF's role is to act as a catalyst in the provision of equity capital to independent venture funds and, more generally, to help stimulate the early–stage and technology sector of the private equity market. The European Investment Bank has a wider remit under the Amsterdam Special Action Programme to provide risk capital in various forms to small and medium–sized companies, channelling this in large part through its extensive network of partner banks and their affiliates in the Member States. It is thus active as a provider of mezzanine debt as well as equity to a wide range of SMES, both more and less–established. To date the EIB has signed 26 risk capital contracts with a total commitment of over 400 million Euro and has approved a further 200 million. These amounts include monies entrusted to the EIF for investment in venture funds. In total the EIB has the authority to use up to 1 billion Euro from its surpluses to back up this risk activity. The European Council in Cologne has called for a further 1 billion to be set aside for the period 2000–2003.
Denmark	Business Development Finance (www.vaekstfonden.dk), established in 1992, finances risky and innovative enterprises, especially small and medium–sized ones. Loans can be provided for financing research, development and internationalisation. The advantage of such loans is that the fund can extend risk cover on the loan. If the project results in commercialisation, the enterprise must repay the loan with a fixed interest rate. However, if the project falls, the fund writes off the debt and takes over the rights to the project. Recent legislation allows for Business Development Finance to extend loans to development projects, where the risk is even higher than the fund would allow before the change. In exchange, for sharing a higher risk, Business development Finance will require a performance–related return above the fixed rates charged on regular loans. Furthermore, Business Development finance will be allowed to invest alongside private investors in specialised investment vehicles supplying seed–finance – so–called innovation funds. Lastly, Business Development Finance can supply capital or equity guarantees to certified venture capital companies.

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Greece	The Ministry of Development in its Structural Funds' co–financed Operational Program for Industry for the years 1994–1999 (OPI 1994–1999) supported the creation of Venture Capital Companies (OPI action 4.1.2.). For effectiveness in implementing its policies, the Ministry of Development introduced a new legal framework (law 2367/95) that modified and expanded the operational frontiers of the Venture Capital companies from those allowed under law 1775/88. Venture Capital companies that fulfill the requirements of law 2367/95, qualify for support that can reach 20 % of the capital for new companies or 20 % of the capital increase for existing companies. Basic obligation for the Venture Capital companies, is to invest at least one and a half times the received sum in small and medium companies until the end of the support program. The program is currently being implemented and already six new venture capital companies have been created with total capital 13.5 billion drachmas drawing support of 2.7 billion drachmas.
Ireland	Many of the Venture Capital Companies funded under the Seed and Venture Capital Measure of the Structural Funds' co–financed Operational Program for Industry have funded high tech companies, some of which are high growth. The ICC Software Fund is a £ 10 million investment fund specifically investing in the software industry. Investments made by the Fund to June 1998 consisted of investment in start up companies, 3 in early stage companies and 2 in development companies. Another fund set up between Bank of Ireland and Delta Partners has a fund of £ 10 million and to date has invested in software and telecommunication companies in the start up, early and development stages of these companies. Under the Seed/Venture Capital Measure of the Structural Funds' co–financed Operational Program for Industry, the Millennium entrepreneur Fund was set up in 1998 which is an initiative to encourage US based Irish technologists to establish new enterprises in Ireland. The Industrial Development Agencies, a part of their development mandate, are increasingly devoting more of their financial resources to equity investment in developing indigenous companies.
Italy	Establishment of Sviluppo Italia, an industrial development and promotion agency, which will be responsible, among other things, for promoting industry, particularly in the Mezzogiorno and in innovative sectors, and forging the links between the worlds of training, scientific research, finance and industry that are necessary if new businesses in innovative sectors are to be able to develop.
UK	The Government, in partnership with the private sector, is creating an Enterprise Fund, with some £ 180 million (€ 320 m) of public money over three years from 1999. There are four main elements to this fund: • a national venture capital fund with £ 20 million (€ 30 m) of public money to lever in additional private sector contributions, which will support very early–stage, high–technology businesses; • new regional venture capital funds which will specialise in providing small–scale equity to businesses with growth potential, drawing in local expertise from Regional Development Agencies and other; • continuation of the Small Firms Loan Guarantee Scheme (SFLGS) – which provides a guarantee to viable business proposals without collateral or a track record; • public co–financing to support the development of innovative private sector financing ideas to assist growth businesses. The University Challenge Fund, launched in June 1998, provides £ 65 million (€ 96 m) to fund seed–corn early stage collaborations between university scientists, venture capital and industry to commercialise scientific discoveries. Funding is provided jointly by the Government and two private sector trusts. As a complementary measure, the Science Enterprise Challenge, announced in November 1998, will provide £ 25 million (€ 37 m) to endow up to eight new enterprise centres in universities. These centres will help equip scientists and engineers to commercialise their knowledge, and will become centres of excellence for the technology transfer process. The Government is also funding universities for strategies and activities which enhance interaction with business to promote technology and knowledge transfer, strengthen higher skills development and improve student employability. These measures sit alongside increased funding for innovations support activities, including to those promote collaborative partnerships between the knowledge base and business. Government research laboratories are also subject to review, to find ways of making more of the commercial potential of their outputs. The Government's aim through these measures is to increase by 50 per cent the number of businesses spun out each year form the publicly–funded science and engineering base by 2002.

Measures	**Improve access to stock exchanges**
Denmark	Despite legislative changes in 1995, that allowed for regulated second–tier markets, it was not until 1998 that Denmark actually saw a market under the new rules. Following a virtual feasibility–study carried out under the auspices of the ministry of Business and Industry and the Ministry of Economic affairs, one market–place has achieved a concession from the Financial Supervisory while another application is still in process. In recognition of the need for liquidity in new second–tier markets and as part of the on–going effort to improve access to capital for companies, parliament decided to set aside DKK 5 m for 1999 to be split between companies aspiring to become listed and the new markets. Each company that achieves a listing is eligible for a grant of DKK 85 000 provided the market value of its equity not exceed DKK 80 m and the capital raised in the IPO is below DKK 50 m. The grant is intended to cover costs related to the IPO such as writing a prospectus. The marketplace, where the listing occurs, similarly is eligible for DKK 40 000 per new listing.
Greece	The Ministry of National Economy has approved a plan to create a new stock exchange market for small and medium dynamic and innovative companies, using as a model the Euro N.M. and with the intent to joint it in the future and has instructed the Athens Stock Exchange SA to study the feasibility of a such market and its links.

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Italy	Establishment by Borsa Italiana SpA of the New Market, an equities market belonging to the pan–European Euro NM network and with listing requirements tailored to innovative small and medium–sized enterprises. This also fulfils one of the objectives set out by the Government in the Economic and Financial Planning Document 1999–2001; Creation of a Strategic Steering Committee for the Italian Financial Markets, one of whose tasks is to draw up proposals for facilitating the access of unlisted companies to the regulated risk capital markets.
UK	High technology companies often need to raise further capital on public equity markets before they have reached profitability. This is not normally allowed under the Listing Rules of the London Stock Exchange, but the LSE has introduced in recent years a specific provision to allow scientific research based companies to list without the usual three year profit record. This year, the LSE has moved to accept listing applications form a wider range of companies which do not yet meet traditional listing criteria, including other high technology companies seeking an early official listing. Any exemption form the normal rules would be counterbalanced by several alternative investor protection measures.

INSTITUTIONAL AND REGULATORY BARRIERS

Measures	**Transposal and implementation of all financial services directives – monitoring via single market scoreboard**
European Commission	Cf single market scoreboard
Austria	The Banking Law (BWG) amendment transposing the investor compensation Directive (97/9/EC) will shortly be dealt with in cabinet. Another draft Banking Law amendment transposing the finality Directive (98/27/EC) and the Directive on cross–border credit transfers (97/5/EC) is now being prepared. Efforts are being made to reach a decision on the amending law by the second half of 1999. Apart from the money laundering Directive (91/308/EC), where proceedings before the European Court of Justice are pending, Austria has already transposed all the financial services Directives.
Finland	Finland strongly supports action to complete the single market in financial services. Finland believes the implementation of various directives should be monitored more effectively by the Commission. Finland will, if it proves necessary, review its own implementation of various directives where barriers have been identified.
France	France has implemented the Directives on the financial markets, thus removing the obstacles to the mutual recognition of approval for service providers and markets. The Directive on investor compensation schemes is in the process of being transposed (draft law adopted by the Council of Ministers on 2 December 1998 and debated in the National Assembly in March 1999). The post–BCCI Directive is also in the process of being transposed.
Germany	All relevant financial services directives have been transposed into German law and are being implemented.
Greece	Greece is committed to implement all financial services directives in order to complete the single market.
Italy	Italy has pressed ahead resolutely with work on transposing all the Community directives on financial services. Promulgation of the single consolidated text of the rules on financial markets (Legislative Decree 58/1998) in particular means that Directives 93/36 and 93/22 have been transposed in their entirety. Italy is determined to take all the necessary steps for establishing a single market in financial services as quickly as possible.
Netherlands	The Netherlands is committed to complete the single market in financial services and therefore implements directives as soon as possible.
Portugal	Directive 97/9/EC on investor guarantee schemes and Directive 98/29/EC on harmonization of the main provisions concerning export credit insurance with medium– and long–term cover were sent to the Council Presidency for inclusion on the agenda. In the case of the other directives, the transposal deadline has not passed.
Sweden	The directive on investor compensation (97/9/EC) will be brought into force in Sweden on 1 May 1999. Sweden intends to transpose the other capital adequacy directives (98/31/EC, 98/32/EC and 98/33/EC), the settlement finality directive (98/26/EC), the directive on cross–border credit transfers (97/5/EC) and the directive on supplementary supervision of insurance undertakings in an insurance group (98/78/EC) within the prescribed time–limits. Moreover, Sweden has transposed the financial directives and brought them into force.

Measures	Simplification of administrative formalities for company formations (including minimum capital requirements)
Austria	In certain provinces a ”simplified procedure” is used for business start–ups, with all parties involved being invited to a hearing, so as to expedite the administrative procedure. The Federal Ministry for Economic Affairs is also working on a benchmarking study that examines the Austrian conditions for business start–ups and possible improvements.
France	An action plan was launched by the government in autumn 1997, which led to the introduction of 37 practical measures in December of that year, plus new measures in November 1998. Declaration formalities have been reduced (70 million fewer forms). It is now possible to register a company in 24 hours. France considers that minimum capital requirements are at a satisfactory level, given the different legal forms which exist.
Germany	The Federal Government has accepted the importance of this goal in a number of statements, although in practical policy terms there is constant conflict between the goals pursued through regulation and the economic policy goal of easing the burden on small businesses. The minimum capital requirements for incorporated firms in Germany have not been increased for a very long time and were even slightly reduced when re–denominated in euros. A further reduction seems neither necessary nor useful.
Greece	The Ministry of Development is reviewing on an–going process its procedures in order to facilitate an un–bureaucratic regime.
Italy	After having updated the rules on listed companies, Italy intends to overhaul the provisions of company law relating to unlisted companies. To that end, a committee has been set up within the Ministry of Justice with the task of preparing a bill in order to set the ball rolling for the new legislation. One of the subjects to be tackled as part of the reform will be simplification of the procedures for setting up new companies. The minimum capital requirement could also be reviewed, although the current threshold (approximately €10 000 for limited companies) is not generally perceived as a barrier to business start–ups.
Portugal	Decree–Law No 55/97 of 1983 set up two Business Formality Centres, one in Lisbon and one in Porto. Subsequently, Decree–Law No 98/A/98 of 31 March 1998 set up the national network of business formality centres and a further two such centres, one in Coimbra and one in Setubal. The network has thus been expanded and will have to be completed by the end of the present government’s term of office. The objective of these centres is to make it easier for enterprises to set up companies, to amend articles of association, to wind up companies and to carry out related operations. The ministries of finance, justice, economics, and labour and solidarity, and the deputy prime minister are represented as regards the operation of the centres. The euro package set the minimum capital requirements: EUR 5 000 for private limited companies and EUR 50 000 for public limited companies.
Sweden	The Swedish Law on limited companies is being reviewed and proposals have been made to simplify the procedure for setting up limited companies. Work is under way to simplify the registration of enterprises with the tax authorities and the Register of Companies and other enterprises (the Swedish Patent and Registration Office) have been asked to draw up an integrated system.

Measures	Venture–capital funds: Assessment of whether there is a need for Community legislation covering specific closed–end funds
European Commission	On 18 November 1998 the Commission convened the UCITS Contact Committee, created by Directive 85/611/EEC, in order to analyse whether it should be appropriate to extend Community legislation on investment funds to cover also venture capital funds. At the meeting were also invited representatives from the venture capital industry, the stock exchanges specialised in fast–growing SMEs, and the SMEs’ associations. The shared conclusion by all parties concerned was that a directive in this field was not urgent. They also considered of great value added if the Commission could clarify which investors should be considered professionals (N.B. The clarification of the distinction between “sophisticated” investors and “retail” investors is one of the activities included in the Financial Services Action Plan).
Austria	Under the Austrian Investment Fund law, the establishment of ”special funds” or closed–end funds for investors which are not natural persons is permitted. Austria, in principle, welcomes the creation of a European passport for closed–end funds along the lines of Directive 85/611/EEC.
France	Consultation of market participants (French Capital Investors’ Association, French Financial Management Association) suggest that such legislation is unnecessary.
Germany	The Federal Government is in discussion with the German Venture Capital Association (BVK) on this issue.
Netherlands	Following the meeting of the UCITS contact committee of November 1998, where industry representatives strongly argued that venture capital funds can operate well without specific EU–regulation, I would like to stress that there seems to be no needs to create a directive for venture capital funds at an European level.
Sweden	Funds of this type were dealt with in the UCITS Contact Committee in November 1998. The Swedish view expressed then was that there was no need for Community legislation in this area. Such funds should be allowed to develop at national level.

Measures	Review of implementation and possible amendment of prospectus directive to facilitate companies raising cross–border capital (e.g. IPO's)
European Commission	On 3 November 1998 the Commission convened the Stock Exchanges Contact Committee, created by Directive 79/279/EEC, in order to discuss means, whether legislative or not, to improve the situation concerning cross–border capital raising. At the meeting were also invited representatives from the venture capital industry, the stock exchanges specialised in fast–growing SMEs and the SMEs' associations. As a result it seemed more fruitful for all parties concerned to concentrate in the short–run in clarifying and harmonising, at practical level, the requirements and procedures involved in cross–border activity. In addition, there was a consensus on the fact that cross–border activity for the SMEs would benefit enormously if a common agreement at European level could be achieved on which investors should qualify as professionals. (N.B. the clarification of the distinction between "sophisticated" investors and "retail" investors is one of the activities included in the Financial Services Action Plan.) On the other hand, the Commission is co–operating with FESCO on this same subject. Two meetings of an ad–hoc FESCO working group, where the Commission is an observer, have already taken place on 25.2.99 and 17.6.99. Its work will continue until end of 1999. The objective is not only to improve cross–border procedures but also to introduce modern features such as "shelf registration"[25]. This may entail modifications to the existing directives. In line with the Financial Services Action Plan, the Commission intends to table a document on these issues by mid–2000.
Austria	Amendment of the prospectus Directive is, in principle, welcomed. If it is amended, care must, however, be taken to ensure that the protective provisions now in force in Austria, such as the examination of prospectuses by a qualified prospectus examiner, liability of the prospectus examiner, etc., are not undermined.
France	France has called for an amendment along these lines to the prospectus Directive, as it stated in the memorandum on financial services which it sent in November 1998 to its European partners and the Commission. The French government considers that the amendment of the prospectus Directives should cover all financial instruments, and not just growth stocks.
Germany	The Federal Government supports close cooperation between the supervisory authorities for resolving problems which arise with implementing the directive. The Commission's intention of reviewing the directive's implementation in close cooperation with FESCO is welcomed.
Sweden	Those issues were dealt with at an introductory meeting in November 1998 in the Contact Committee set up under Directive 79/279/EEC on stock–exchange listing. It is understood that the Commission will present proposals during 1999. In general, Sweden takes a favorable view of the Commission's work in this area.

[25] Shelf–registration is a prospectus prepared in a two–step procedure. First, companies prepare, at the same time as they prepare their annual reports, an "incomplete" or "reduced" prospectus containing everything except for the information concerning the specific securities involved in the issue. This is filed once a year with the home competent authorities. Then, when the time is right for an issue, the companies prepare the "issue note" describing the characteristic of the offer and of the securities. Investors, instead of the classical prospectus receive the "reduced" prospectus, the "issue note" and all the information concerning recent relevant elements. Belgium, Spain, France, the UK and Italy already make use of shelf–registration procedures.

Measures	Adoption of prudential rules to allow institutional investors to invest in venture capital
European Commission	Concerning institutional investors, Community legislation is advancing in two fronts: investment funds (UCITS) and pension funds. On 17 July 1998 the Commission adopted two proposals modifying Directive 85/611/EEC. One proposal will remove barriers to cross–border marketing of units of collective investment funds by widening the scope of assets in which those funds can invest. The other proposal would provide the European passport to management companies and it will widen the type of activities which they are allowed to undertake (e.g. they may also be authorised to provide portfolio management services). Negotiations in the Council took place under the Austrian and German presidencies. A political agreement may be expected before end 1999 under the Finnish Presidency. The old Parliament was unable to complete the first reading and therefore the new Parliament will have to re–start procedures again. This will delay for several months the adoption of a Council Common Position. Regarding pension funds, the Commission published in May 1999 a Communication drawing policy conclusions from the consultation process launched by the June 1997 Green Paper on "Supplementary Pensions in the Single Market". The Communication looks at appropriate investment and prudential rules for pension funds in the context of the EURO. It also makes proposals for the removal of obstacles to labour mobility and for the co–ordination of Member States' tax systems. As a follow–up of this Communication, the Commission will propose by mid–2000 a directive on the prudential supervision of pension funds taking into account the diversity of pension funds operating in the EU and covering authorisation, reporting, fit and properness, as well as rules on liabilities and investments which would relax existing rules in some MS concerning investments in unlisted SMEs.
Austria	Provided that they comply with the relevant limits of the Banking Law and fulfil the own funds requirements, credit institutions are free to choose how to employ their resources and can therefore also invest in venture capital. Provided that they comply with the provisions of the Investment Fund Law, investment funds can also invest in venture capital by acquiring the appropriate equity securities or through derivatives. On grounds of investor protection, there are no plans at present to extend this possibility to pension investment funds and pension funds.

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Denmark	As part of a more general change in the legislation on unit trusts, it now allows for specialised funds (ervhervsudviklingsforeninger) to invest up to 100 per cent in unlisted stock. Regular unit trusts still have to comply with a maximum of 10 per cent unlisted shares. Starting January 1st 1998 unit trusts have had this new opportunity and though the investment strategy differs – sometimes dramatically – from the usual investment focus of unit trust in Denmark, one fund targeted at bio–tech companies has been set up already. Another regulatory change has relaxed the quantitative investment controls on pension funds and life insurance companies so that they can now invest up to 50 per cent in equity and property, where the ceiling used to be 40 per cent.
Finland	In 1998, the Ministry of Trade and Industry chaired a working group the task of which was to find ways to increase investments of pension funds into SMEs. In the final report it was recommended that pension funds should set a target for their investments in venture capital and start to follow these investments as a separate asset class. The Ministry of Social Affaires and Health monitors the investments of pension funds in venture capital funds in order to determinate the future solidity requirements of these assets.
France	The current prudential rules in France do not constitute an obstacle to risk capital. Share–based life assurance contracts including a minimum investment of 5% in unlisted securities were introduced in the 1998 Finance Law. Furthermore, the UCITS Law of 23 December 1988 was amended recently to allow the creation of UCITSs distributed among qualified investors able to invest up to 50% in unlisted securities.
Germany	The investment provisions of the Insurance Supervision Law do not constitute a significant obstacle to investment in venture capital on the part of insurance companies, including pension funds. The investment rules applying to investment companies, which, for the purposes of venture capital investment, allow acquisition of shares and dormant equity holdings, are tried and tested and should be maintained.
Greece	The Greek regulatory system for insurance companies and pension funds is not a significant barrier to investments in early stage venture businesses. State pension funds have to seek approval of their investments form their supervising ministry.
Italy	The rules implementing the consolidated text of the laws on financial markets have increased flexibility for institutional investors in decisions to invest in open–ended and closed–end securities and real estate funds, thus increasing the opportunities for investing in risk capital. It is possible that the next re–definition of the parameters for types of investment for institutional investors, to be carried out by the Banca d'Italia, will provide for the possibility of more investment in risk capital by institutional investors. Under the laws associated with the finance act for 1999, the Government was empowered to issue one or more legislative decrees on the use of an annual reserve for the "Trattamento di Fine Rapporto" or TFR (end–of–contract payment) to develop forms of supplementary pensions, with a provision whereby the company paying the TFR may, as an alternative to cash payments and under certain conditions, allocate instruments (including risk capital securities) to pension funds.
Portugal	PEDIP II included a measure setting up a system of practical financial engineering incentives in support of risk capital. The establishment of risk capital funds is being stimulated, in conjunction with institutional investors.
Netherlands	The Netherlands have already adopted prudential rules which allow institutional investors to invest in venture capital.
Sweden	The Department of Trade and Industry will issue regulations so that institutional investors can invest in unquoted businesses more easily than at present. The difficulty is that those investors often consider the costs and risks of investing in small businesses to be excessive. It is understood that the Commission will be presenting a draft proposal for a directive on the basis of the Green Paper on supplementary pensions in autumn 1999. The Swedish authorities are looking into the issues involved so that they can present their informed comments on the proposal when it is put forward.

Measures	**Assess existing accounting and auditing requirements**
European Commission	Building on the 1995 Communication on a New Accounting Strategy the Commission is working with the MS in order to examine to what extent more weight can be given to International Accounting Standards (IAS) in the context of the EU. In a Communication which should be published before end–1999 the Commission will map out the strategy for enhancing comparability of financial reports issued by listed EU companies based on combination of EU accounting directives and financial statements issued with agreed international accounting standards. Strategy should prefigure mechanism for vetting international benchmark standards so that these can be used, with no national variations, by EU listed companies. At a more specific level, the Commission will table before end–1999 an amendment to the 4th and 7th Company Law Directives in order to allow EU companies to account for certain financial assets at fair value, in accordance with International Accounting Standards. The proposal will not apply to banks and insurance companies.

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European Commission	In addition to this, the Commission intends to present a proposal by end–2000 to modernise the 4th and 7th Company Law Directives in order to place them in line with the needs of the Single Market by taking into account developments in international accounting standard setting. Concerning auditing, the Commission will issue a recommendation by end–1999, containing specific measures in the areas of quality assurance and auditing standards, in order to upgrade the quality of statutory audits in the EU. The Recommendation will build on the April 1998 Communication on “Statutory Audit within the EU” and on the work of the Committee on Auditing set–up in May 1998.
France	The production of consolidated accounts is now standard practice among SMEs raising funds on the market.
Germany	In 1998 the German legislator allowed on certain conditions parent companies listed on the stock exchange to produce consolidated financial statements, in full discharge of their legal obligations, in accordance with internationally recognized standards, especially the International Accounting Standards (IAS). They do not then need to produce a consolidated financial statement as under German law. These rules will apply until 2004. On the basis of the experience gained with these new rules, the Federal Government will in the next few years undertake a review of the rules on consolidated financial statements with a view to adapting them to international accounting standards. At the same time, the legal conditions were created for the establishment of a national institute that would issue recommendations on consolidated accounting. In the meantime, the German Accounting Standards Committee (DRSC) has begun work on this basis. Also in 1998 new rules were introduced to improve the quality of statutory auditing, with particular emphasis on audit content and the auditors’ report and especially on more risk–oriented auditing. Here too, auditing law is being brought more into line with international standards. This will continue in the next few years in view of the requirements of international stock markets. In Germany, new technology–oriented firms in particular, which are listed on the ”new market”, are using internationally recognized accounting standards. However, before further changes can be made to European balance sheet law, relief’s and derogation’s for SMEs need to be introduced.
Greece	The Ministry of National Economy is taking action on harmonizing accounting requirements by supporting the present strategy of the Commission which is to seek increased harmonisation by greater co–operation between EU standard setters, and by supporting the International Accounting Standards Committee (ISAC).
Italy	The possibility of applying IAS principles to Italian companies, in order to make their economic performance more transparent and comparable, is currently under review. A simplified accounting system may be used by one–person businesses. Finally, accounting principles relating to intangible assets were recently the subject of a review by the Commissione dei Dottori Commercialisti e Ragionieri [committee of commercial consultants and accountants].
Netherlands	The fourth directive on company law offers the possibility to limit the accounting requirements for SMEs. The Netherlands has implemented these exemptions. According to the agreement to modify the directive in the way that these exemptions will be increased the Netherlands will implement the directive as soon as possible. This means that in the near future more SMEs can make use of limited accounting requirements.
Portugal	The active financial engineering program provides for the publication of technical brochures (guides to accountancy and auditing), in collaboration with the official chambers of auditors.
Sweden	A review of Swedish legislation on accounting requirements has been under way for some years. It takes account of simplification and Swedish businesses’ interest that their accounts should be comparable with those of businesses in other countries. Current Swedish legislation on accounting requirements should not prevent Swedish group accounts from being drawn up in accordance with international practice (IAS). However, a more detailed examination of this issue has not been carried out. Current Swedish rules on the form to be taken by auditors’ reports should not prevent Swedish group accounts from being drawn up in accordance with international practice (ISA).

Measures	**Reduction of the capital requirements for setting up firms**
Austria	Since the minimum capital requirement for setting up firms is anyway very low in Austria and does not therefore constitute an obstacle to setting up firms, there are no plans to reduce the statutory minimum capital requirement. A reduction in the minimum level of capitalisation for banks, insurance companies, pension funds and firms providing securities–related services is rejected, mainly on grounds of creditor protection.
Finland	The requirements is at the moment EUR 8 300 and is being assessed in a working group launched by the Minister of Justice.
France	France considers that capital requirements are at a satisfactory level, given the different legal forms which exist.

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Germany	The capital requirements for incorporated firms in Germany have not been increased for a very long time and were even slightly reduced when re–denominated in euro. A further reduction seems neither necessary nor useful.
Greece	Greece has extremely low capital requirements.
Italy	The present minimum level of capital required for setting up companies is not regarded as an obstacle to starting up a business. The subject may be reviewed in the context of the wider reform of company law.
Netherlands	At this stage the Netherlands does not have the intention to reduce the capital requirements for private limited companies.
Portugal	The active business start–up programme involves the setting–up of an exchange for innovative start–up ideas and the provision of technical assistance for new businesses. The establishment of a risk capital fund to assist business start–ups is also being looked into.
Sweden	No work is under way in this area.

Measures	**Reform of the legislation on insolvency and bankruptcy**
European Commission	The Convention on insolvency was completed in 1995 under Article 293 (former 220) of the Treaty. It fixes the rules of jurisdiction, applicable law and enforcement in the field of insolvency proceedings. The Convention was negotiated during 30 years, but it has not yet entered into force due to the lack of signature of the UK (Gibraltar problem). A recent evolution in this field is due to the fact that after the entry into force of the Treaty of Amsterdam (May 1999), MS and the Commission have the right to propose Community acts in the area of civil judicial co–operation (Articles 61 and following). As a result the Council Working Group on Civil Law is discussing a draft regulation that “amsterdamise” (convert it into a Community Act) the 1995 Convention. At this stage is difficult to foresee the outcome of this work. The 1995 Convention does not cover financial services. As a result the Commission tabled proposals for directives on the winding–up and liquidation of banks and insurance companies in 1985 and 1986 respectively. Here also there are some lingering problems related either to their basic principles or to the recognition of a certain jurisdiction (Gibraltar) which makes difficult to predict a timetable for the completion of the negotiations.
Austria	In Austria the legislation on insolvency and bankruptcy has already been reformed to give firms which have gone bankrupt a ”second chance”. Besides the compensation procedure, the aim of which is to keep the firm in operation, the bankruptcy procedure does not necessarily result in the firm being wound up. Firms can opt for forced compensation, under which up to 80% of the claims are discharged from debt. Where such a solution is not possible, e.g. because the entrepreneur cannot satisfy the conditions, because there are grounds for inadmissibility or because the necessary creditor majority was not reached, there is the possibility of keeping the firm in operation by selling it as an entity.
Finland	A total reform that aims at drafting new bankruptcy legislation is pending at the Ministry of Justice. Main objectives concern, for instance, bankruptcy procedure, effects of bankruptcy and administration as well as liquidation of the bankruptcy estate. The working group intends to have the draft of the proposed legislation completed by 1999–2000.
France	French law has undergone many changes in recent years, particularly in 1994. As part of the reform of economic justice and the legal environment for business, the government is now working on improving the practice of collective procedures to achieve greater transparency and efficiency.
Germany	With the entry into force on 1 January 1999 of the insolvency law, the principle of subsequent claims – the principle that, after the closing of insolvency proceedings, creditors may continue to assert their claims against the debtor for the amount not paid off as part of the proceedings – appeared in German law for the first time. Under German law it is now possible to obtain discharge of the remaining debt on condition that, once the insolvency proceedings have run their course, the debtor, in good faith, regularly transfers over a seven–year period the distrainable part of his income or equivalent earnings to a trustee, who then regularly distributes the incoming amounts to the creditors. This procedure is aimed precisely at failed small and medium–sized entrepreneurs who have been operating as sole traders. In the legislator’s view, this procedure for discharge of remaining debt should give this category of people the opportunity for a fresh start.
Greece	The Ministry of Justice will review the legal framework in view of the Commission’s work on bankruptcy.
Italy	The subject may be tackled by the committee set up within the Ministry of Justice, with the aim of preserving the entrepreneurial spirit of those who become insolvent or bankrupt. Furthermore, on the basis of an appropriate legislative mandate, consideration is currently being given to a review of the law on special administration of large companies in difficulty.
Netherlands	The Ministry of Justice is preparing a bill to reform the bankruptcy law.

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Portugal	The purpose of Decree–Law No 316/98 is to revise Decree–Law No 132/93, which relates to bankruptcy. The PEC (procedure for ensuring the recovery of firms) was introduced as part of SIRME (system of incentives for business revitalisation and modernisation).
Sweden	A fair number of major and minor projects are under way in this area. A report (Ju 1997:05) is reviewing the supervision of insolvency and bankruptcy and other issues involving the way these matters are dealt with. The Committee on ranking of claims has recently published its conclusions (SOU 1999:1 *New rules on ranking*). The Committee is continuing its work and reviewing the rules on agreements to reorganise businesses in difficulty.

Other measures

Italy	Approval of a single consolidated text of the laws on financial markets, which has made a substantial contribution to modernising the machinery for corporate governance (protecting minority shareholders and therefore individual savers, who are increasingly investing.
UK	The Government has proposed a specific liberalisation of the financial services regulations on investment promotion to enable those seeking to raise capital to communicate more easily with a specific class of "sophisticated private investor". Subject to consultation and Parliamentary approval, the proposal would reduce the costs for smaller companies seeking to raise informal risk capital and increase the flow of potential investment opportunities to business angels. A key stage in the development of growing enterprises which are backed by external risk capital is the pint at which they start to graduate form early stage venture capital by coming to the public equity markets. EU financial services legislation, in particular the Prospectus Directive, has a direct impact on the legal costs of this process. In March 1999, the Government introduced changes to the Public Offer of Securities regulations to improve the framework for offering securities in the UK, and assist companies – particularly smaller companies – raising capital or operating employee share schemes. By better implementation of the Prospectus Directive, they will also facilitate cross–border offers of securities into the UK form elsewhere within the European Economic Area. This is part of the follow–up to our initiative on cross–border offers of securities during the recent UK Presidency of the EU. The liquidity of the lower end of the stock market is also affected by the quality of the information shared by smaller quoted companies and their investors. The Government has recently worked with representatives form both sides to examine how to improve the quality of this dialogue, and has published practical recommendations on how to achieve this.

TAXATION

Measures	**Taxation of venture capital funds**
Austria	According to the Austrian corporation tax law, both companies financing small and medium–sized businesses and equity investment companies are exempt from corporation tax. The exemption extends to the profits made by these companies during their first five years.
Finland	No double taxation.
France	Venture capital funds enjoy tax transparency in France.
Germany	In Germany special funds within the meaning of the Law on investment companies (investment funds) are tax–exempt. Consequently, double taxation is not possible in this area.
Greece	Venture capital companies established under law 1775/88 have the benefit, in order to determine their taxable profits, to deduce form their revenues three percent (3 %) of the residue amount of 31 of December of each year of their participation in high–tech and innovative businesses as well as of the guarantees they offer.
Ireland	Many venture capital funds in this country are set up as limited partnerships, as capital gains tax arising are assessed not on the partnership but rather on the individual partners. In the case of venture capital funds established as limited companies any gain is liable to capital gains tax in the company and again on distribution to the individual.
Italy	Closed–end securities investment funds are taxed at a rate of 12.5%. Private investors are not liable for any further tax on profits. Corporate investors include profits in their overall income.
Netherlands	In the Netherlands private individuals investing in business start up receive favorable tax treatment.
Portugal	In addition to Decree–Laws Nos 130/98 and 58/99, consideration is being given to a legislative package that will revise the tax framework for venture capital activities. The Decree–Law on tax advantages for SMEs was published.
Sweden	Involves discussion of double taxation See above under venture–capital funds.

Measures	Capital gains tax
Finland	Currently 28 %, no taxation of dividends (avoir fiscal).
France	In France venture capital funds benefit from a favourable capital gains tax regime, subject to certain conditions.
Germany	Until 31 December 1998 it was possible in Germany under Section 6(b) of the Income Tax Law for investment companies to include, without attracting tax, profits from the sale of shares in incorporated firms in the acquisition costs of newly acquired shares in other incorporated firms. This concession was abolished with the extension of the tax base on 1 January 1999 (Tax Relief Law). However, such profits are also exempt from the tax on trade and industry. A capital gains tax on private individuals is not envisaged in Germany at the moment.
Greece	Profits realized by venture capital companies established under law 1775/88 from the sale of shares or stock of high risk businesses, are tax free and appear in a special reserve account available ot off set future losses or to promote and implement investments under law 1775/88 on the condition that it does not exceed fifteen percent (15 %) of total investment.
Ireland	From December 1997 the Capital gains tax rate is reduced to 20 % for gains on disposals other than on development land. Prior to December 1997 a reduced rate of capital gains tax of 26 % applied for chargeable gains on disposals of certain shares by individuals.
Italy	Capital gains realised by closed–end funds are taxed at a rate of 12.5%. Capital gains realised directly by the company on certain ”qualifying” shareholdings (i.e. invested on a long–term basis) are subject to the 27% ”substitutive” tax.
Portugal	This is included in the legislative package mentioned in connection with the above measure.
Sweden	Sweden has a classic double–taxation system whereby income from corporations is first of all taxed at corporate level and subsequently at individual level as dividends or capital gains. Sweden has introduced a degree of relief in its double–taxation system in order to improve the supply of risk capital for unquoted businesses. It is assumed that those businesses do not have the same access to international capital markets as quoted businesses. The owners of unquoted businesses are allowed to retain unearned income corresponding to a previously specified average yield without incurring liability to personal unearned income tax.

Measures	Stock options
Austria	In Austria stock options are, in principle, possible but it is not planned to give them favorable tax treatment.
Finland	Stock options are taxed the same way as ordinary income, at the time when the option is exercised and converted into shares.
France	The government is currently consulting companies and the social partners with a view to improving the system of stock options.
Germany	Under German law an option is not considered for tax purposes as employment income or as a pecuniary benefit at the time it is granted, but only when it is exercised. Exceptions are cases in which the option granted by the employer is tradable at any moment on an open market. In such cases the granting of the option is immediately considered as employment income.
Greece	There are no tax incentives for such new transactions. However, the case is under review.
Italy	The tax treatment of stock options has been the subject of ongoing analysis and modifications aimed at increasing their use. In certain cases specified by the law profits from stock option plans in favour of employees are treated as capital gains and are therefore taxed at 12.5%. Apart from these cases profits constitute profits from employed labour and are therefore taxed at the progressive rate.
Portugal	The Commission arranged for a study to be carried out at European level in which IAPMEI participated and which concluded that the introduction of stock options was one way of helping to improve the operation of SMEs.

Measures	Tax arrangements for new firms
Austria	Newly established firms are exempt from the minimum corporation tax in the first four quarters. In addition, under ”tax reform 2000” young entrepreneurs, in the year in which their company is formed, are exempt from public charges (i.e. court fees for entry in the commercial register, capital duty, license fees, etc.) and pay 7% less in non–wage labour costs in the first three years. Under ”tax reform 2000”, the equity base will also be strengthened for all firms as a result of the rate of return on equity.
Finland	None.
France	New companies are eligible for a temporary exemption from corporation tax in regional development areas and, in certain cases (micro–enterprises), for an exemption from VAT.
Germany	The Government’s objective is to reduce income/earnings tax rates appreciably. Introducing new tax concessions (even for business start–ups) would run counter to that objective and is therefore not being pursued by the Government. As a rule, very little profit is accumulated during the start–up phase in any case.

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Greece	There are no tax incentives for new firms. However the case is under review.
Italy	Losses suffered by companies in the first three years of business may be carried forward indefinitely. Companies in this situation may also benefit from general incentives for capitalisation, investment and recruitment. In particular, as regards the capital levels of companies, in addition to tax benefits (a concessionary substitutive tax for part of the profits in proportion to the net increase in capital) introduced by the ”dual income tax” or ”dit”, for companies which increase their net capital there are further benefits (the so–called ”super dit”) for companies which are listed on any regulated European market.
Sweden	With a view to stimulating the establishment of new firms, Swedish tax legislation permits losses incurred in the first five years of those firms' existence to be set off against individuals' earned income.

Measures	**Taxation of low–risk capital (e.g. bank deposits, bonds) compared with venture capital**
Denmark	In collaboration with the financial sector, industry–and consumer organisations, the Danish government is currently undertaking and exercise to assess the international competitiveness of the financial sector and the financial companies' interaction with industry and consumers as intermediaries. The final report from the exercise is due in June 1999 and likely will contain recommendations on simplification of tax rules on securities in general and stock in particular. Recent tax–changes include Parliaments removal of the trading–tax on stock form 1st October 1999 as a 5 per cent tax on stock–returns to pension funds and other institutional investors handling pension savings.
Finland	The taxation of capital gains is neutral in Finland, with the exception of bank deposits which benefit from non–taxation. A law bill which aims to abolish the tax exemption of bank deposits is currently under discussion in the Finnish Parliament.
Germany	Interest earned on bank deposits and fixed–interest securities is liable for tax. The tax treatment of earnings from venture capital differs according to the type of investment. In the case of capital gains, a saver's tax–free allowance of DEM 3 000/6 000 (single taxpayer/married taxpayer) will apply as from 2000. The sale of privately held shares in an incorporated firm, unless sold speculatively as under Section 23 of the Income Tax Law, is not taxed provided that the shareholding is not more than 10%.
Greece	Without taking into account the point in paragraph 2, overall the returns form low – risk capital are taxed more favorably than the returns from high–risk venture capital. The case is under review.
Italy	For companies low–risk capital is usually taxed by being included in overall income. For the private investor, low–risk capital is generally taxed at a rate of 12.5% or 27% (for bank deposits). For risk capital the comments under points 1 and 2 apply.
Portugal	This is included in the legislative package mentioned in connection with the taxation of venture capital funds.

Other measures

Ireland	Corporation Tax is 28 % from 1 January 1999. A 10 % rate of Corporation Tax applies for manufacturing and International Services Companies. A low rate of Corporation Tax of 25 % applies for profits up to £ 100,000 (£ 50,000 prior to 1 January 1999). The Government has announced a single Corporation Tax rate of 12 ½ per cent form 1 January 2003 along with a rate of 25 per cent on non–trading income. The Government has set out a program of reduction in the standard rate of Corporation Tax for the next five years to achieve the 12 ½ per cent rate. It is proposed to reduce the standard rate for trading income by 4 per cent per annum for the years 2000, 2001, 2002 and by 3 ½ per cent for the year 2003, giving a 12 ½ per cent rate in 2003. Several mechanisms are in place to encourage individuals to develop their existing business to take that first vital step towards entrepreneurship. – The Business Expansion Scheme (BES) whereby an individual who invests in new ordinary shares of a company can obtain tax relief on amounts up to £ 25 000 in any year. – The BES Seed Capital Scheme which provides a refund of income tax already paid to individuals who are interested in starting up a qualifying business. – Significant changes to the tax code in recent years so that investors and entrepreneurs are rewarded for their risk by allowing them to retain more of the profits and gains earned form the business e.g. reduction in corporation tax rates, and reduction in the capital gains tax rate.
Netherlands	In the Dutch tax regulation the main barriers for innovation and the development of risk capital investments, as indicated in the document like the unfavourable treatment of equity income, capital gains tax and the taxation of venture capital funds do not exist. According to the statistics in the document, the Netherlands are scoring very well on the point of taxation of capital income, foreign investors investing in venture capital are not treated different than domestic investors. In the Netherlands we do not have a general capital gains tax, only levy on substantial participation gains. The next in the document on capital gains tax does not apply to the Netherlands. Concerning stock options the Netherlands has the opinion, contrary to the text of the document, that the tax treatment of stock options is not a disincentive to the development of new start up companies. In the Netherlands options are often used as an attractive fiscal reward instrument.

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UK	*Enterprise Investment Scheme (EIS)* The EIS, introduced in 1993–1994, is designed to help higher risk, unlisted trading companies to raise start–up and expansion finance by the issue of ordinary shares to individual investors previously unconnected with that company. In recent Budgets, the Government has introduced further technical amendments to make the EIS more attractive to potential investors while retaining the focus of the scheme on smaller higher risk enterprises engaged in productive activities. Qualifying investors may claim a range of income tax and capital gains tax reliefs, some conditional on holding the shares for at least 5 years. Over £ 200 million (€ 296 m) has been invested via the EIS in enterprises between 1993–94 and 1997–1998, with £ 54 million (€ 80 m) in 1997–1998. *Venture Capital Trusts (VCTs)* Whereas the EIS encourages individuals to invest directly in early stage companies with growth potential, VCTs, established in 1995, provide tax incentives for individuals to invest indirectly via pooled investment funds. VCTs are structured as investment trust companies, themselves listed on the stock exchange, which invest at least 70 per cent of their capital in small, higher risk unlisted companies. There are around 26 VCT funds in operation, which have raised around £ 520 million (€ 770 m) and have invested around £ 135 million (€ 200 m) so far in over 180 companies. *New 10 per cent starting rate of corporation tax* The starting rate of corporation tax will be halved in April 2000 to 10 per cent for the first £ 10 000 of profits (€ 14 800). Companies with profits of up to £ 50 000 (€ 74 000) will also benefit from lower average corporation tax rates, while those with profits from £ 50 k – 300 k (€ 74 k – 444 k) will pay a marginal rate of 20 per cent. Some 85 per cent for the firms gaining from the new 10 per cent rate have less than 10 employees. The new rate will benefit about 270 000 small and growing companies (two thirds of all tax–paying companies) leaving them with more of their profits for retention, reinvestment and growth. *Enterprise Management Incentives (EMIs)* This proposal, announced in the 1999–budget, will enable smaller companies to give tax–advantaged equity remuneration (including share options) to key manager. This measure is designed to enhance the ability of these higher risk trading companies to recruit and retain high calibre personnel to help realise the company's growth potential. Equity rewards up to £ 100 000 (€ 148 000) would benefit from a waiving of income tax on the exercise of options, so that no tax would be paid until the capital gains tax on the eventual sale of shares. EMIs will be introduced in the Finance Bill 2000, following consultation with industry. *R&D Tax Credits* To help stimulate higher levels of R&D and innovation, the Government announced in the 1999 Budget proposals for an R&D tax credit for SMEs. This measure is targeted at SMEs because of the wider economic benefits of fast–growing, innovative enterprise and because these firms face greatest challenges in raising long term finance for R&D. The proposed tax credit will be particularly helpful to early–stage companies that are not yet in profit and which face the most severe cash constraints on their development : they will be able to receive a cash credit based on the value of their annual R&D costs to offset against future profits). Companies in profit will benefit form an enhanced allowance for R&D spending. *Corporate venturing* In the 1999 Budget, the Government announced its intention to introduce a new tax incentive to encourage corporate venturing in next year's Budget. The aim is to accelerate the development in the UK of this specific form of risk capital which can provide both financial benefits to the investee company and a "window on new technology" for the larger investor company. Under the Government's proposal, corporate investors would receive up–front corporation tax relief at 20 per cent on the value of their long term investments in smaller higher risk trading companies.

PAUCITY OF HIGH–TECH SMALL BUSINESSES

Measures	**Development of networking and clustering between universities, research centres, financial backers, lawyers, human resources specialists etc., and link them at European level**
European Commission	The Innovation Programme and the JRC have organised jointly a workshop in March 1998, involving 15 research centres and universities having set up or aiming to set up exploitation companies and dedicated investment funds. This exchange of experience and best practice is to be continued under FP5. To this effect, a FIT project[26] has been launched in June 1999 to develop long term durable interaction between sources of finance and sources of technology in the area of spin–off and spin–out from research institutions and universities. The LIFT Help Desk for Financing Innovation has been established in January 1999. LIFT helps participants in Community funded research and technological development programs to target and approach appropriate sources of finance. LIFT is co–operating closely with the I–TEC network[27] of venture capital operators. In June 1999, the Commission launched a pilot action to facilitate the start–up and development of innovative companies, through which it will grant a European label of excellence to economic areas/regions with excellent scientific and technical potential, and infrastructures and capabilities to facilitate the creation and develoment of innovative companies, and join these areas in thematic networks to identify existing resources and competencies, transfer knowledge and exchange and disseminate good practices. In addition, original instruments and approaches to support the creation of innovative firms and to encourage private investment in these will be validated and their transferability to other contexts tested through transnational pilot projects.

[26] The FIT project has been launched in the context of the Action Plan for Innovation in Europe, with the aim of organising a systematic exchange of good practice in the field of financing innovation between member states, policy makers and market operators.

[27] The I–TEC network of venture capital operators was established by the Innovation Programme in 1998. Currently 28 venture capital operators committed to investing in technologically innovative young companies belong to I–TEC, with a total investment capacity of €1.3 billion.

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European Commission	Regional Innovation Strategies (RIS) and Regional Infrastructures and Strategies for Technology Transfer (RITTS), involving more than 60 regions, have been developed in order to create a strategic framework for the integration of innovation into regional production structures, establish co–operation networks between companies and the public sector and to bolster the capacity for research and technological development and innovation in the region. A study "Clusters – Networking as a tool for SMEs to enhance their access to RTD" was launched in January 1999. The main goal of this study is to provide an in–depth analysis of the means required to set up and develop a network linking up clusters of SMEs with "technology poles".
Austria	The Austrian Federal Government's technology offensive creates the environment and provides public funds to increase private expenditure on research and technological development. Here the intention is to promote, among other things, the establishment and organisation of competence centres and competence networks, the main purpose of which is to serve training and the development of industrial clustering. The objective of this promotion program is the stimulation and sustained increase of private spending on research and development, the use and focussing of the knowledge existing in firms and research establishments (universities, senior technical colleges) for innovation, and stimulation of business start–ups (in particular "spin–offs") in areas closely connected with research and technology. This program will be launched after it has received the Commission's approval.
Denmark	The Ministry of Research and Information Technology and the Ministry of Education will establish a broad, professional IT research and education centre in 1999, in close cooperation with the users, including the IT/Tele/Electronics industry. The Ministry of Business and Industry will in cooperation with the Ministry of Research and Information Technology continue to work on bringing to bear the idea of a combined Growth Centre in the Sound region of IT/Tele/Electronics. The Growth Centre should serve as an incubator for innovative IT–companies as well as a favourable environment for selected research activities in large companies. The centre will have facilities such as access to sophisticated technological infrastructure, "plug n' go" facilities, administrative services and meeting rooms. In order to promote access to venture capital, including capital for pre–competitive research projects, the Growth Centre will seek cooperation with venture capital funds. The Danish government, this year, decided to launch an initiative targeted at strengthening the bio–tech sector in the Sound Region which includes Greater Copenhagen and the southern part of Sweden. The region boasts 60 per cent of the bio–tech industry and research in all of the Nordic countries creating an almost unparalleled opportunity for shaping a bio–tech cluster in the region. The initiative involves the creation of a physical infrastructure allowing access for researchers and entrepreneurs to laboratory facilities, sophisticated research equipment and meeting facilities. The aim of the initiative is to create a window to the world, which is sufficiently favourable that it attracts domestic and foreign research capabilities to unleash the synergies from bringing together companies, universities, research centres and customers. Private involvement should grow as a result, ranging from small bio–tech companies feeling enticed to rent space and labs, to large pharmaceutical companies deciding to invest in development and research activities on the location. Venture capital investors also will have the privilege of accessing a future source of bio–tech inventions and companies.
Finland	A consortium of a local bank, a nation–wide venture capital company, a state–owned venture capital company and a public guarantee company has been established at Tampere Technology Centre. The consortium invests in genuine seed capital (2/3 private, 1/3 public) presented by the technology centre. The concept will be adopted by other technology centres in 1999. Sitra is helping regional venture capitalists to invest in companies in seed stages. Sitra is taking care of many technology transfers in Finland and also internationally.
France	In March 1999 the government launched a call for proposals in respect of "incubators and seed capital funds" directed at universities, research centres and the venture capitalists with a view to encouraging the creation of enterprises linked to public research.
Germany	In order to foster links between research and business, the Federal Government has set up a new support program "Promotion of innovative networks (Innonet)". A competitive tendering procedure is used to select joint projects involving at least five small or medium–sized enterprises (SMEs) and at least two research units from different organisations. The aim is to direct the research carried out in research centres more towards the needs of the market and at the same time to increase the innovation potential of SMEs. The existing network of technology centres needs to be more vigorously developed at European level. With this in view, the Federal Government will be launching an initiative designed to increase the opportunities for SMEs in particular to participate in European research projects.
Greece	The General Secretariat of Research and Technology is mainly preoccupied with the development of networking and clustering on an on–going basis. In addition, it has organized the development and supports the management of intermediary facilities in universities and research centres, aiming at encouraging the economic exploitation of new research. Plans are under consideration for the inclusion for measures such as provision of seed capital within the framework of the operational program for research to be drawn in the 3rd Community Support Framework.
Ireland	The seed and venture capital measure under the operational program for industry 1994–1999 provided approximately £ 33 million EU funds for venture capital investment in Ireland. Together with matching private sector finance a total of £ 66 million has been made available for investing in growing Irish business through venture capital companies established for the purposes of disbursing this facility.

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Ireland	In this context a campus companies venture capital fund was set up with a total fund for investment of £ 6 million. This fund is specially targeted at campus companies, sourcing business proposals form Third Level Colleges. The product or service being supported must be capable of generating an acceptable level of profit and there must be adequate scope for development and achieving capital growth. The Manager of the Fund is actively involved in supporting and bringing business expertise to the development of campus companies. County Enterprise Boards which form a nationwide network encourage the development of local enterprise culture through the provision of financial assistance, advice and information.
Italy	Forging links between the worlds of research and production lies at the heart of the Government's concerns and actions. This is one of the areas in which the newly created industrial promotion and development agency Sviluppo Italia is to focus its efforts. Recently, the company set up by the Treasury, IG SpA, which is to join forces with Sviluppo Italia, and INFM, the National Institute for Materials Physics, have in the meantime launched a pilot project for supporting high–tech business start–ups in the Mezzogiorno by setting up new business activities directly in the field of the research work.
Netherlands	To stimulate new ICT companies the government created and supported the Twinning concept. The Twinning concept is a coaching – and financing mechanism for ICT entrepreneurs. Government sponsored the creation of business incubator centres, a start–up fund, a coinvestment fund and an international network of ICT experts.
Portugal	A similar, voluntary program exists, viz. promotion of business cooperation projects under the aegis of IAPMEI (SME Support Agency).
Sweden	This area is to some degree the responsibility of the private sector. The State has helped to set up ”technical bridging foundations” to establish links with various universities. Those foundations are mainly aimed at stimulating contact between technology–based small businesses and researchers. In at least one case a foundation has taken a holding in a newly established risk–capital company that provides financing for small businesses with growth potential. Operating through NUTEK, the State also provides some support for technology parks in the vicinity of universities, which make premises and networks available to small businesses. It also helps with regional–based industrial development centres.

Measures	**Development of customised electronic commerce modules for small businesses to ease their access to electronic commerce and the internal market**
Austria	As part of the ”EDI (Electronic Data Interchange)–Business Austria” initiative, innovative projects are being promoted for the structured exchange of messages (e.g. orders, accounts, laboratory reports, etc.) between business partners, irrespective of the hardware, software and means of communication used. The purpose of this initiative is to develop EDI solutions which are inexpensive and effective across a broad front, enabling individual firms to use EDI to communicate with different business partners, including those in other countries.
France	The government set up an action plan for the information society in 1997. This included a brief for electronic commerce. A national electronic commerce trophy has been created and an e–commerce ”opportunities shop” Internet site will be set up. A call for proposals on ”collective Internet use by SMEs” aimed at encouraging collective and innovative initiatives has been launched, along with a call for projects on tele–training of very small enterprises in the use of tele–services aimed at raising awareness among such enterprises (fewer than ten employees) of the use of information and communications technology in rural areas (TPPMI–PME).
Germany	It is quite possible that – as in the US – current developments in this area will be intensified in the near future. The Federal Government takes a very positive view of this aspect, seeing in it great potential for competitive job creation. It was for this reason that it launched the Electronic Commerce Initiative in October 1997.
Italy	From 1995 onwards, with coordination of the G7 pilot project ”A Global Marketplace for SMEs”, the Ministry of Industry has been implementing policies for developing information society services and electronic commerce in the firm belief that technological innovation is one of the key instruments for ensuring growth of Italy's productive system, based on small and medium–sized enterprises. Legislative Decree 114/98, which revises the rules relating to the distributive trades, assigns the task of promoting the introduction and use of electronic commerce to the Ministry of Industry. That Ministry has therefore issued a set of industrial policy guidelines for information technology and telecommunications, drawn up in early 1997 following wide–ranging consultations with all public and private operators in the field, and policy guidelines for electronic commerce (in mid–1998). It also set up in early 1999 a permanent Observatory for Electronic Commerce with a view to implementing the policy lines that had been evolved and monitoring the evolution of the relevant market. The initiatives and documents are available on the Observatory's website at: www.minindustria.it/Osservatorio/index.html.
Netherlands	Government will sponsor an initiative to promote more Life Science Start–ups.
Portugal	A study has been published at Community level in which IAPMEI took part. It is based on a survey which the Commission asked the Member States to carry out.
Sweden	The State is not taking any specific measures in this area.

Measure	Creation of a pan–European club for high–tech innovative firms
European Commission	In response to the Amsterdam (1997) and Luxembourg (1997) summits, the Commission launched through its Innovation Programme a wide ranging consultation on the creation, development and growth of NTBFs. To this effect, three major conferences were organised, bringing together the main actors involved, in order to draw up a status of the field in Europe (Paris, December 1997), to devise the most useful measures and actions to be taken (Luxembourg, May 1998) and to present these to the target audience, notably Europe's high growth innovative companies themselves (Vienna, November 1998). One of the outcomes was the creation of the European Federation of High Tech Enterprises, providing for the first time Europe's high growth innovative companies with a European platform for communication with policy makers and others.

Measures	Reform of the European patent system
European Commission	On 24 June 1997 the Commission published a Green Paper (COM(97)314 final) entitled *"Promoting innovation through patents"*. It was the object of many debates by all parties concerned, particularly at the hearing which took place in Luxembourg on 25/26 November 1997. The opinion of the European Parliament was given on 19 November 1998. On 5 February 1999 the Commission (COM(99) 42 final) adopted a Communication on the follow–up to the Green Paper. This Communication is the "operational" dimension of the Green Paper. It defines a number of important actions which the Commission has the intention to undertake by the end of 1999 or early 2000: – A proposal for a regulation concerning the creation of a Community patent system (Article 308 of the Treaty) – A proposal for a directive concerning the patentability of computer programmes (Article 15 of the Treaty) – Interpretative communication concerning patent agents particularly in relation to Articles 43 (right of establishment) and 49 (free provision of services) of the Treaty. On the other hand, the Commission considers that a pilot action should be launched by national patent offices in order to explore how patent information can be more comprehensible, accessible and practical to SMEs. Finally, the Commission considers that the special needs of SMEs in particular in relation to cost and for simpler and less expensive legal proceedings should be taken into account.
Austria	In Austria the fee for filing a patent is ATS 700 or €50.88. Since the national patent offices are of special importance in particular for SMEs and individual applications, the intended reforms at Community level should still leave their position protected.
France	France has taken the initiative of organising an intergovernmental conference of the Member States of the EPO (European Patent Office) with a view to modernising the European patents system so as to make it less costly, more accessible (particularly for SMEs) and more efficient for the exploitation and protection of innovations. The conference will take place on 24 and 25 June 1999 in Paris.
Germany	The Federal Government is open to the plans to create a Community patent.
Greece	Greece is reviewing the Commission's Green Paper on a unitary patent system for the European Union.
Italy	Italy is taking an active part in all work on examining the problems involved and preparing proposals for amending the Munich Convention. In Italy there is no fee for filing the translation of a European patent, by which the patent itself is nationalised, and the renewal fees are among the lowest in Europe (up to the 14th year no more than about EUR 500). With regard to the Community patent, Italy is examining the EU Green Paper, having, however, already ratified the relevant convention.
Netherlands	The Netherlands is looking forward to the proposals of the Commission following the Green Paper and is willing to think with the coming proposals in a constructive way.
Sweden	In Sweden it is planned to review the Law on patents, *inter alia* regarding the obligation of confidentiality for patent agents and the residence of patent agents in 1999. Proposals for reform will be put forward in a departmental note in the course of the year. Reform in this area can result in simpler procedures and create a Community patent. Sweden is following the Commission's work with interest.

HUMAN RESOURCES

Measures	Promotion of entrepreneurship and innovation within educational and training systems
European Commission	A project was launched in June 1999 on the development of European entrepreneurship training modules, in collaboration with universities, business schools, as well as investors and financiers. In June 1999 was launched a project to set up a Business Education Network of Europe (BENE) which will bring together training organisations with proven experience in training for entrepreneurship permitting all the actors including the teachers' professional organisations and the enterprises themselves to exchange experiences, identify best practice and adjust the courses and curricula to changing demand."

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Austria	In Austria entrepreneurship and innovation are promoted in schools providing occupational training, senior technical colleges and universities. Certain universities already have a chair for innovation management and business start–ups. The universities of Vienna, Frankfurt and Berlin are also cooperating within UNIUN (university graduates establish companies), a project jointly financed by the EU which tries out a variety of instruments. The purpose of this project is to provide a ”toolkit” which will subsequently be made available to all universities.
Denmark	As part of an effort to increase the number of IT–graduates in Denmark and thereby lessening the impact of bottlenecks on industry, the government has laid the foundation for a new IT College in Copenhagen that will become a steady source of IT–capable human resources. The IT College is expected to attract individuals with Bachelors degrees or even self–taught individuals by providing research–based IT education at the Masters, Diploma, and Ph. D levels. A selection of short–term courses also means that the IT College soon will be able to provide industry with qualified labour. User–involvement at the managerial level helps set course–supply in accordance with the needs and demands of industry.
Finland	13 university departments or individual units have entrepreneurship in their curricula in Finland at the moment. Altogether 11 professors are working in the field. The most recent example of further developments is a jointly organised course in entrepreneurship for Finnish University personnel. The program started in January 1999 and is funded by the Ministry of Education. The Swedish School of Economics and Business Administration is a member in the organisation “Young enterprise Europe”. Last year more than 600 Finnish high school students participated in the program which promotes entrepreneurship. Education and training of teachers in order to widen their understanding of entrepreneurship. Helsinki University of Technology, Ministry of Trade and Industry, and Culminatum Oy are involved in a 9–country study examining the national entrepreneurial potential of the participating countries (US, UK, FR, DE, FI, JP,IL (Israël), CA, IT). Nine national entrepreneurial factor conditions are studied, and the influence of these on the national start–up rate of new firms as well as on some key indicators of national economic performance is examined. Publication is due in May 1999.
France	Specific modules on setting up a business have been incorporated into the courses of some universities and ”grandes écoles”. A national competition for the creation of innovative technological businesses is also in the process of being launched.
Germany	In 1998 the Federal Government set up the ”School–Business/Working life” initiative with the emphasis on ”Economics in School”. A central goal is to deepen the understanding of economic relationships and the world of work among teachers and pupils. In cooperation with the social partners and other associations, plans for improved collaboration between schools and local businesses are to be drawn up. In addition, entrepreneurship is being promoted in schools and universities through such competitions as ”Junior” and ”EXIST” and through the establishment of industry–funded professorships. The further development of vocational training and lifelong learning is on the agenda for the talks which the Government will be holding the social partners on the ”Alliance for employment, training and competitiveness”. One of the Government’s goals is a clear improvement in the funding conditions for promotion–related training (grants for training as a master craftsman), in order to give young people the opportunity to set up their own businesses and work for themselves. In the last four years more than 70 training regulations have been updated and 34 new professions have been created, including 15 in the service sector. By 1 August 1999 3 more professions requiring training should have been created and 26 existing professions updated.
Greece	The Government has established the Organization for Vocational Training (OEEK) which specializes in preparing, via its Institutes, high school graduates for employment in small and medium businesses based on the needs of local markets identified by the Institutes for Vocational Training. The programs and their contents are continuously adjusted to the market needs. The Organization for the Employment of Human Capital (OAED) has established horizontal programs that are training unemployed on the job at various businesses. Special incentives are provided for capital intensive high–tech companies to provide training as well as employment positions.
Italy	Italy has been active in this area, chiefly through IG SpA, a company operating with the aid of innovative instruments in the fields of business start–ups, local development, support for small and medium–sized enterprises and experiments with new training and employment policies, including in the non–profit sector. IG SpA will join forces with Sviluppo Italia, enabling the latter to step up and supplement the activities it has been carrying out to date. A major vocational training programme called IG Students was launched recently with the aim of stimulating career interest and providing vocational guidance and developing links between the education system and the world of work, by setting up and running businesses ”in the laboratory” involving students in their penultimate year at secondary school and in all the university faculties in Italy. These businesses will produce goods and services that will compete on regional, national and European markets. Italy will also continue to promote business start–ups by providing financial support inter alia under Act 44/86 (now Act 95/95) for those wishing to set up businesses producing goods in agriculture, industry or craft industry or providing business services, under Act 236/93 for those wishing to start up in business as service providers in specific sectors, e.g. tourism, agri–foodstuffs and technological innovation, and under Act 608/96 on self–employed work, for those wishing to set up on their own as a one–person business.

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Netherlands	Government will publish a booklet on risk capital for entrepreneurs.
Sweden	In order to promote entrepreneurship and innovation within educational and training systems with a view to fostering pupils' creativity, sense of responsibility and can–do spirit, teaching in these areas is provided in schools. The Swedish Board of Education provides information on various projects concerning entrepreneurship. In addition, agencies like ALMI and NUTEK that are active in the industrial policy scene help to disseminate the experiences of local authorities and individual educational institutions working with young entrepreneurs in an educational setting. The Nordic Council of Ministers has also adopted initiatives to develop pupils' entrepreneurship.

Measures	**Determination of training needs for venture–capital fund managers, market makers, analysts of high–tech firms**
European Commission	A study is being carried out under the framework of the European Innovation Monitoring System, in order to determine training needs for venture–capital fund managers, market makers, analysts of high–tech firms. Results are expected by November 1999.
Finland	Sitra has launched a training program for mainly venture capital fund managers but also for entrepreneurs.
Greece	The Training Institute of Athens Stock Exchange is in the process of examining the training needs of the market for analysts and market markers in the framework of the New Market for small and medium high–tech companies.
Sweden	This is an issue for market operators and perhaps for the Commission. The Swedish Risk–Capital Association has carried out training for venture–capital operators.

Measures	**Assessment of benefits of equity pay and employee ownership schemes**
European Commission	The Commission services have done an analysis of the economic and financial impact of employee stock ownership and stock option schemes and the necessary conditions to the development of these schemes in Europe. A broad initiative on the issue of employee ownership is under preparation.
Austria	Some firms in Austria have been successfully operating employee ownership schemes for a number of years. A sum of up to ATS 10 000 or €726.73 qualifies for favorable tax treatment.
Finland	The Ministry of Finance will launch a short study of existing employee incentive schemes in Finland. Linking employee compensation to organisational performance has been a challenge, because ownership and control are divided between shareholders and managers in firms. Many firms are using nowadays stock–based compensation, especially stock options. The incentives usually range from the issue of shares to employees to tax–free amounts on distributed profits.
France	In 1967 French law introduced employee share ownership; company savings plans and shareholding schemes allow employees to build up a portfolio of shares with the aid of their company. In 1998 the Government introduced an incentive for start–up businesses to issue equity warrants known as "bons de souscription de parts de créateurs d'entreprise".
Germany	The Federal Ministry for Labour and Social Affairs has produced a brochure on employee ownership of productive wealth, setting out the advantages of individual forms of participation for employees and employers. The Law on corporate control and transparency of 30 April 1998 improved opportunities for issuing "stock options".
Greece	The Ministry of National Economy will encourage employee share ownership and equity pay including equity incentives for managers in high–tech SMEs within the framework of the New Exchange Market.
Italy	The Government has adopted a recent law governing the tax treatment of stock options, recognising the importance of adopting remuneration mechanisms related to company performance and encouraging their use in some cases. Such regimes have been adopted in most privatised companies.
Netherlands	In 1997, there has been a study on this subject called "National rewarding".
Sweden	This does not appear to be an appropriate responsibility for Member States even though some support can be given for research projects.

CULTURAL BARRIERS

Measures	Demonstration of the advantages of venture capital and promotion of entrepreneurship
Austria	The advantages and disadvantages of financing through borrowing and equity financing are explained by means of publications, investment fairs, business plan competitions and individual advice on promotion and financing possibilities for business promotion institutions and banks.
Finland	The Ministry of Trade and Industry is actively involved in promoting entrepreneurship and venture capital in Finland through some governmental agencies and venture capital bodies. The Ministry is currently preparing its financial policy strategy, paying particular attention to well functioning risk–capital markets, companies in the early stage and growth entrepreneurship culture. The Finnish venture capital association is the main body producing information for entrepreneurs and other parties about the Finnish venture capital market. Demonstration of advantages has been communicated to entrepreneurs through publications, articles and seminars. The Confederation of Finnish Industry and Employers puts some efforts to develop attitudes of SMEs towards external equity financing.
France	The government held a ”national innovation forum” in May 1998 which brought together all those active in the creation of innovative businesses, including risk capitalists.
Germany	In its day–to–day work, the Federal Government encourages businesses to take advantage of the opportunities available as a result of improvements to the venture–capital–market environment. The response has been positive. Specifically, the volume of new investments by investment companies in shareholdings below the threshold for stock–exchange listing rose from DEM 1.2 billion in 1996 to DEM 2.4 billion in 1997 and DEM 3.3 billion in 1998. At the end of 1996 the members of the German Venture Capital Association (BVK) had invested only DEM 6.1 billion, but by the end of 1997 the figure was already DEM 7 billion and preliminary data suggests that at 31 December 1998 it was DEM 9.3 billion. Overall, the venture capital market today has changed. Whereas, previously, someone setting up a small technological firm often did not find any willing investor, today the reverse is true: investment companies face the problem of identifying good investment opportunities for the ample amount of capital available. Accordingly, future economic policy will in particular also have to include demand for venture capital in the further development of the venture capital market. Many small businesses are still reluctant to open themselves up to investment capital, fighting shy of the disclosure of traditionally secret company information and of the right of investors to have a say in the firm’s affairs (”master–of–the–house” mentality).
Ireland	To promote an enterprise culture it is essential to provide mechanisms that encourage and help people to go into business for themselves and to encourage them to stay and develop their business through risk reward mechanisms. If that twin strategy is successful the rewards are a greater level of entrepreneurship and innovation in the economy leading to increased job creation.
Italy	The Italian Government has already stressed, in the Economic and Financial Planning Document 1999–2001, the importance of risk capital, particularly for innovative small and medium–sized enterprises, which find it more difficult to finance new ideas by contracting loans. The aim is gradually to break down the barriers which restrict the access to risk capital for small and medium–sized enterprises and to improve the machinery for carrying out capital increases, among other things by extending the available financial instruments. Sviluppo Italia will carry forward the task of promoting entrepreneurship, particularly among young people and in the Mezzogiorno, in keeping with the action taken so far by IG SpA.
Netherlands	Government will publish a booklet on risk capital for entrepreneurs.
Portugal	This has been done via a training/awareness programme concerning financial engineering instruments in the field of risk capital. IAPMEI sent in an application under Measure 5.3 of PEDIP II. There were two series of explanatory meetings held throughout the country, as well as training courses on the spot or via the Internet. The two series of meetings attracted 1 700 individuals, the on–the–spot training courses 150 and the virtual training courses 800 (so far).
Sweden	The State tries in various ways to demonstrate the advantages of venture capital and promotion of entrepreneurship. Those include a wide range of measures aimed at simplifying matters for small businesses, reducing the time the authorities take to deal with their requests and providing improved service. Regarding risk capital, reference is made to the specific measures mentioned above under the heading ”Market fragmentation”.

Measures	Dissemination of best practices in corporate governance
European Commission	The term “corporate governance” covers a wide series of issues with ramifications for the single market in financial services sometimes difficult to evaluate. Furthermore, existing national arrangements spring from long–standing legal and socio–economic traditions. In spite of this, there is an increasing consensus around a number of common principles of good practice which could become a generally accepted code for corporate governance. Given the situation, the Commission involvement in this area would be confined, at a first stage, to identifying any barriers to the development of the single market in financial services which could arise from existing corporate governance arrangements. This will be done through a study which will be launched in early 2000.

(Continued)

Austria	In their advisory activities, the business promotion institutes of the Austrian Chamber of Commerce naturally also concentrate on questions of the corporate governance of SMEs. This includes support in preparing business and financing plans.
Denmark	A government study is under way that looks at corporate governance in Denmark. The study reviews historical trends as well as past and current legislation that potentially can explain the ownership structure in Danish industry. The study also looks at the pros and cons of performance–related pay including relevant tax rules and the scope for changes in business regulation that may improve corporate governance.
Finland	The Helsinki Stock Exchange has, together with three business community organisations, published a recommendation on best practices of corporate governance. Conclusions on improving this recommendation are drawn after the OECD work has been finished.
France	French law has established certain rules which promote the balance of power within a company. In public limited companies, for example, the law protects the independence of the board of directors by stipulating that at least two thirds of directors must not be employees of the company. The preliminary draft of the company law reform, about to be submitted to parliament, includes a section on corporate governance.
Germany	The Law on corporate control and transparency laid down basic standards for corporate governance. The extensive discussions in the context of the legislative process contributed to the shaping of ideas and to a thorough rethink among managers of German companies.
Italy	The adoption of the consolidated text of the laws on financial markets has reformed the corporate governance of listed companies, increasing protection for minority shareholders. Smaller companies which will enter the new market and therefore the pan–European EURO NM network will require mechanisms which further improve communication between the company and investors (quarterly information). The committee set up within the Ministry of Justice will take account of best practice as regards corporate governance in the reform of the law governing unlisted companies.
Netherlands	Corporate governance is presently under discussion within the OECD, with both private parties and government representatives.
Portugal	The above–mentioned training/awareness program also contains a module on best practices in corporate governance.
Sweden	Dissemination of best practices in corporate governance in the venture–capital sector likewise does not appear to be an appropriate responsibility for Member States.

ANNEX 2: BELGIAN REPLY

MINISTER FOR FINANCE

THE MINISTER

Members of the Commission
Mr de Silguy and Mr Monti
Rue de la Loi 200
1049 Brussels

Dear Sirs,

In reply to your letter of 13 January 1999 I am able to inform you that there is no specific plan in Belgium as regards risk capital. However, I would draw your attention to the following points.

Firstly, Belgium has a long tradition of freedom in capital movements, which means that the market has been particularly ”internationalised” for many years. This explains why various international organisations, such as Euroclear, Cedel and EASDAQ have become established in Belgium and there play an active role in the development of the European capital market.

Continuing in this line, the government decided to submit a proposal to Parliament to remove the last formal obstacle, i.e. authorisation from the Ministry of Finance, to the use of the capital markets in Belgium by traders from countries outside the European Union. A draft law including this provision has been submitted to the Council of State for its opinion.

Secondly, measures have already been taken in this area, and in some cases have been in force for several years.

Among these are the securitisation of debt (basically mortgage loans) made possible by the law of 5 August 1992 and a number of implementing decrees incorporating this subject into the system governing undertakings for collective investment and providing that where the shares in a financial vehicle have been the subject of a public issue they must be listed on the stock exchange; and also tax incentives (limited deductibility) attached to pension plans under pillar three.

The share loan system will be set up by a law which has just been adopted by Parliament and which is currently awaiting royal assent and promulgation. This initiative will facilitate the establishment of an efficient settlement and compensation system.

With specific reference to the regulated markets, besides the establishment in Belgium and the recognition of EASDAQ as mentioned above, the Brussels stock market has taken three initiatives: participation in the Euro.NM group, establishment of cross membership among the three Benelux stock exchanges, and the creation of MIM (interprofessional market of unlisted shares). This last initiative, reserved in the first instance for professional investors, nevertheless allows the private individual, interested in venture capital, to buy shares in unit trusts specialising in these high–risk shares, i.e. ”pricafs”. Also, Belfox, the Belgian futures and options Exchange, has envisaged the creation of sectoral indices known as ”insects”, thus giving another dimension to derivatives relating to these indices.

In the privatisation of public undertakings, the sale of government shares has been broadly opened to the public.

I take this opportunity to remind you that requests and suggestions have also been made by the Member States vis–à–vis the Commission, some of which have been tackled within the framework of the Financial Services Policy Group chaired by Mr Monti. I would refer in particular to the request for a Commission legislative initiative making it possible to plan operations aimed at institutional investors in order to reduce fragmentation of the European market, and requests concerning venture capital funds (except for pension funds which, because of their purpose, require great prudence) and on updating the law on prospectuses.

(closing formula and signature)

signed

J. J. Viseur.

ANNEX 3: SUMMARY OF THE SPANISH ANSWER

REPORT ON THE MEASURES ADOPTED IN SPAIN TO DEVELOP THE ACTION PLAN ON CAPITAL INVESTMENT

Several measures aimed at enhancing the development of SMEs, with a view to creating employment, have been taken in Spain since the Action Plan on Capital Investment was passed.

The *regulating Law for Venture Capital Institutions (Law 1/1999, dated 5th January)* is the first and most direct measure. In this regulation, Venture Capital investment is defined as a qualified financial activity since it provides financial resources, especially through capital contributions, which are not intended for indefinite duration. This Law represents a major breakthrough given that the Spanish regulations dating from 1986 had been characterised by continual, partial reforms making the legal and financial–taxation systems provisional and biased in nature. This Law also reinforces the measures taken by the Government on Venture Capital implemented by the Royal Decree Law, dated 7th June 1996, which have already had a very positive effect, with new Venture Capital institutions being created, mostly with private capital, and a few Venture Capital companies now being quoted for the first time on the Spanish Stock Market.

In general terms, the basic lines of the New Law can be summarised as follows:

a) In financial terms:

– A more flexible financial system for investments is required to achieve a greater number of enterprises, limited in all cases by not being allowed to invest in enterprises already quoted on the primary market of the Stock Exchange or in financial enterprises. Thus, as well as typical capital investments, secondary funding is also allowed either through equity loans or through other funding instruments.

– It is now possible to grant permission for Management Companies of Collective Negotiable Securities Investment Institutions to manage Venture Capital Institutions. This new measure aims to attain economies of scale so as to lower costs in Venture Capital Institutions.

b) In terms of administrative intervention:

The responsibility for supervision passes from the Venture Capital Institutions to the National Stock Market Commission, while the Minister for the Economy and Taxation retains responsibility for authorising the creation of new institutions.

c) As regards *investment policy*, and along the lines of the classic principle of diversifying risks, the measures are structured as follows:

1. A compulsory minimum of sixty per cent of the net investment worth in non–financial enterprises not quoted on the primary market of the Stock Exchange is required to support the specific aim of venture capital institutions. However, investment loans of up to thirty per cent may be included in this percentage.

2. The remaining percentage, comprising the freely distributable ratio, covers both fixed and variable income assets traded on secondary markets as well as other loan–based funding formulas.

3. Finally, to avoid risk concentration, the regulations also set a maximum investment limit in any one enterprise (25% of assets) or group (35%).

4. The Law includes two new <u>taxation</u> measures:

- VAT Exemption is extended to include the management of Venture Capital Company assets.

- The exemption period for Company Tax on capital gains arising from the disposal of shares, which generally covers twelve years or may, in exceptional circumstances, stretch to 17 years, is also extended.

To complete the Law, and from the viewpoint of improving business financing, a rule involving partial and specific regulation of factoring has also been included. The aim targeted is to provide greater legal security for factoring operations conducted by credit institutions, thus strengthening this division of business for such institutions. A further salient point is that this rule also affects the granting of future credits arising within one year, provided such credits come from a predetermined legal business.

The *First Draft of the Law on Collective Investment Institutions* currently under negotiation should also be mentioned. Again the aim is to improve SME financing. Indeed, pursuant to current regulations, Security Investment Funds must place 80% of assets in fixed or variable income securities eligible for transaction on the Stock Market or other organised market. In the case of Security Investment Companies, the ratio rises to 90%. This means that only a minimal amount of funds is available for small enterprises.

In general terms, the first draft aims to set more flexible regulations that will improve the efficiency of the C.I.I.

Among other aspects, the draft allows for flexibility in the classification of C.I.I., along the same lines as the reform undertaken by the Reform of the Stock Market Law which has already modified certain aspects of the Law on Collective Investment Institutions currently in force and which highlight Security C.I.I. who may invest in securities not negotiated on organised secondary markets. Such a situation may be considered as fairly similar to venture capital and it is therefore hoped that this measure will also bear some of the benefits.

A third regulation of interest is the *Royal Decree regulating Asset–backed Funds and Securitisation Fund Management Companies* (ROYAL DECREE 14–5–1998, number 926/1998).

Securitisation may be defined as an alternative financial instrument for both public and private economic agents, since it allows funding by granting credits to assets without legal status, which finances this credit by issuing securities onto the markets. Resources are thus immediately raised by the grantor and releases the risk balance.

The assets of these Funds are made up of both financial assets and other rights which allow present and future credits to be granted. As a general rule, liabilities should generally comprise at least 50 % of fixed income securities issued by the fund, while loans from credit institutions are also allowed to cover any possible shortfall arising between payable and receivable cash flows as well as contributions from institutional investors who would be entitled to the residue arising from liquidation of the fund.

The National Stock Market Commission will be responsible for precautionary supervision of both funds and managers.

Without going into further detail, it is clear that this new legal concept will bring a dual benefit to enterprises. On one hand, major investments can be financed against foreseeable future income. Moreover, securitisation of credits from leasing firms and financing and credit institutions will allow enterprises to eliminate a part of assets from their balance sheets. This means that the requirements of own resources to comply with solvency requirements will be less and the availability of new loans for small enterprises will be increased.

In the same way enterprises could be funded directly by credits being granted to securitisation vehicles.

The recent *Reform Law of the Stock Market Law (Law 37/1998, dated 16th November)* is the fourth reference that should be mentioned. In the framework of this law, primary or issuing markets are boosted so as to facilitate access to markets for all kinds of issuers, apart from aiming to improve efficiency and smooth running of our financial markets by adapting them to the DSI and DFGI.

Pursuant to this regulation and its principles, measures for the organising and running of stock markets will be taken to allow for specialisation and enable them to deal with financing small and medium sized enterprises.

Besides these measures that have either already been taken or are currently under negotiation, the following reforms completed over the last two years in the aim of improving financing for the small and medium –sized enterprise should also be highlighted:

Two major provisions have been passed for *Mutual Guarantee Companies,* namely Royal Decree 2345/1996, dated 8th November, (and the Ministerial Order dated 3rd March), and Royal Decree 1644/1997, dated 31st October, on Securitisation Companies.

A fully operational system for guarantees and securities would eliminate the difficulties SMEs have in raising the collateral for loan institutions. In Spain, this system has been implemented through Mutual Guarantee Companies (SGR) which are commerical mutual benefit companies, with varying capital, set up with the main aim of providing guarantee for its members, mostly SMEs.

The guarantee system is backed up by a Securitisation Company, with mainly public–sector capital, which provides separate cover for the risk incurred by SGR when acting as guarantors of small and medium–sized enterprises.

The Royal Decree 1094/1997, dated 4th July is applicable for *investments in securities not quoted* by Investment Companies and Funds.

The aim of this regulation is to ensure that enterprises that are not quoted on the stock markets (most SMEs) may use these institutions as an alternative source of financial resources, thus encouraging the channelling of savings towards the real economy.

The Order dated 19th June 1997 refers to *ensuring flexibility in the requirements* for different companies *to be quoted* on the Stock Exchange.

From the above, it is clear that all these legislative steps are geared to facilitate SME access to financial markets. Overall, these are all different measures which aim to improve business financing.

ANNEX 4: ACRONYMS

AIM:	Alternative Investment Market [London]
EIB:	European Investment Bank
EIF:	European Investment Fund
EASDAQ:	European Association of Securities Dealer Automated Quotation [Brussels]
EURO. NM:	Nouveau Marché (Paris) + Neuer Markt (Frankfort) + Nouveau Marché (Brussels) + Nieuwe Markt (Amsterdam) + Nuovo Mercato (Milan)
EVCA:	European Venture Capital Association
FESCO:	Forum of European Securities Commissions
IAS:	International Accounting Standards
ICT:	Information Communication Technology
ISD:	Investment Services Directive (93/22/EEC)
IT:	Information Technology
NASDAQ:	National Association of Securities Dealers Automated Quotation system
RTD:	Research and Technological Development
SOEC:	Statistical Office of the European Communities
SME:	Small and Medium sized Enterprises
UCITS:	Undertakings for Collective Investment in Transferable Securities; (Investment funds)
US GAAP:	US Generally Accepted Accounting Principles

ANNEX 5: GLOSSARY

Accounting Directive:	Directives 78/660/EEC and 83/349/EEC.
Business Angels:	Private individuals who invest directly in new and growing unquoted businesses. Business angels usually provide finance in return for an equity stake in the business, but may also provide other long–term finance. This capital can complement the venture capital* industry by providing smaller amounts of finance (generally under EUR 150 000) at an earlier stage than most venture capital firms are able to invest.
Capital market:	A market in which long term capital is raised by industry and commerce, the government and local authorities. Stock exchanges are part of the capital market.
Corporate governance:	The manner in which organisations, particularly limited companies, are managed and the nature of accountability of the managers to the owners. This topic has been of increased importance since the beginning of the 1990's, the providers of external finance to a company wanting to ensure management is not acting contrary to their interests.
Corporate venturing:	Provision of venture capital by a company for another company.
Development capital:	Financing provided for the growth and expansion of a company.
Early stage capital:	Financing to companies before they initiate commercial manufacturing and sales, before they be generating a profit. Includes seed* and start–up* financing.
Electronic commerce:	Direct marketing of trading using a computer or a TV screen.
Equity:	The ordinary share capital of a company.
High level Securities Supervisors Committee :	Informal advisory group created in 1985 by the Commission and the EU Securities Supervisory Regulators with the purpose of dealing with co–operation and cross border matters. It will be replaced by the Securities Committee
Institutional investors:	This term refers mainly to insurance companies, pension funds and investmentfunds collecting savings and supplying funds to the markets, but also to other types of institutional wealth (e.g. endowment funds, foundations, etc).
IPO:	Initial Public Offering (flotation, going public) : the process of launching a public company for the first time by inviting the public to subscribe in its shares.
Investment Services Directive:	Directive 93/22/EEC. It provides a European "passport" for investment firms (brokers, dealers, etc.) and gives the right to electronic exchanges to place their terminals in other Member States.
Management buy–out:	Financing provided to enable current operating management and investors to acquire an existing product line or business.
Market capitalization:	The price of a stock multiplied by the total number of shares outstanding. The market's total valuation of a public company. By extension, the total valuation of companies listed on a stock market.
Primary market:	Market into which a new issue of securities is launched.
Private equity:	As opposed to public equity; investment in equity stake by private investors in companies not listed on a stock market.
Prospectus:	A formal written offer to sell securities that sets forth the plan for a proposed business enterprise, or the facts concerning an existing one that an investor needs to make an informed decision.
Prospectus Directive:	Documents drawn up according to the rules of Directives 89/298/EEC (public offers) and/or 80/390/EEC (listing particulars).
Prudent–man regulation:	Obligation of pension managers to invest as a prudent investor would do on his own behalf, in particular by carrying out sensible portfolio diversification, with no limits to portfolio distribution other than on self investment for pension funds financing defined benefit plans. NL, UK, Ireland USA, Canada, Australia have such a legislation.
Regulated markets:	Organized markets where buyers and sellers meet to trade according to agreed rules and procedures. Markets meeting the conditions set under article 1.13 of the ISD.*
Replacement capital:	Purchase of existing shares in a company from another venture capital investment organization or from another shareholder or shareholders.
Risk capital markets:	Markets providing equity financing to a company during its early growth stages (start–up* and development*). In the framework of this communication, it covers three sorts of financing: – Informal investment by Business Angels* – Venture capital.* – Stock markets specialized in SMEs and high growth companies.

* Word defined in the glossary or the acronyms.

(Continued)

Secondary market:	Market where securities are bought and sold subsequent to original issuance. The existence of a flourishing, liquid, secondary market creates the conditions for a healthy primary market.
Securities Committee :	To be created. It will have both consultative and comitology roles and will replace the High Level Securities Supervisors Committee. In the securities area it will have the same role as the Banking Committee in banking and the Insurance Committee in insurance.
Security:	A financial asset, including shares, government stocks, debentures, bonds, unit trusts and right to money lent or deposited.
Seed capital:	Financing provided to research, assess and develop an initial concept.
Start–up capital:	Provided to companies for product development and initial marketing.
Stock exchange (Stock Market):	A market in which securities are bought and sold. Its basic function is to enable public companies, governments and local authorities to raise capital by selling securities to investors.
Stock option:	Option given to employees and/or managers to buy shares at a fixed price.
Venture capital:	Investment in unquoted companies by venture capital firms who, acting as principals, manage individual, institutional or in–house money. Four main financing stages are identified in relation to the stages of development of a venture–backed company : early stage,* expansion*, replacement* and buy–out.* In the USA, the word “venture capital” does not include most of the buy–out deals.
Venture capital funds	Closed–end funds, created to provide venture capital.

* Word defined in the glossary or the acronyms.

Principal economic policy measures – November 1999

Community (EU–15)

4.11 The Governing Council of the ECB increases the interest rate on

- the main refinancing operation by 0.5 percentage points to 3.0 % (effective 10 November);
- the marginal lending facility by 0.5 percentage points to 4.0 % (effective 5 November); and
- the deposit facility by 0.5 percentage points to 2.0 % (effective 5 November).

29.11 The Ecofin Council reaches political agreement on the abrogation of the decision concerning the existence of an excessive deficit in Greece.

Belgium (B)

None.

Denmark (DK)

4.11 Following the interest rate rise of the ECB, the Nationalbank raises its main steering rates to take effect on 5.11; the lending rate by 0.45% to 3.30% and the discount rate by 0.25% to 3.00%.

Germany (D)

11.11 The Bundestag finally adopts the law on ecological tax reform.

12.11 The Bundestag approves some important points of the draft 2000 austerity budget presented by Finance Minister Hans Eichel. The part approved now amounts to a cut of DEM 14.2 billion, DEM 4.2 billion of which are subject to approval by the upper chamber (Bundesrat).

12.11 The Bundestag approves the increase of child benefits for the first and second child from DEM 250 to DEM 270 per month, starting from 1 January 2000. Furthermore, tax breaks for families will be extended.

12.11 The Bundestag approves the taxation of capital–forming life assurance policies. The tax will be applied to new contracts only.

26.11 The Bundestag approves the 2000 austerity budget presented by Finance Minister Hans Eichel. It calls for cuts of DEM 30 billion (€ 15.3 billion).

Greece (EL)

4.11 The budget for 2000 is tabled before parliament. It targets a deficit for the general government of 1.2% of GDP, down from an estimated 1.5% of GDP in 1999.

Spain (E)

15.11 The parliament approves the budget law for 2000. The general government deficit is targeted at 0.8% of GDP for next year. For 1999, the official target for the general government and the state deficit are 1.4% and 1.1% of GDP, respectively. The GDP growth forecast for 2000 is 3.7%, the same figure as in 1999.

France (F)

24.11 The government adopts the supplementary budget for 1999. As expected, it confirms the projections for 1999 – notably a general government deficit of 2.2% of GDP – announced in the draft budget for 2000, which was adopted by the Council of Minister in September.

Ireland (IRL)

15.11 The government announces a new National Development Plan for the years 2000–2006, aimed at improving infrastructure (roads and transport) as well as promoting employment. The total cost is estimated at IEP 40.6 billion, representing about 6% of GDP each year. Government and European Commission officials will discuss the plan in the coming weeks before EU approval is given for the parts it will co–fund (IEP 4.75 billion).

Italy (I)

None.

Luxembourg (L)

None.

Netherlands (NL)

None.

Austria (A)

None.

Portugal (P)

17.11 The government presents a supplementary budget. Both on a national and a public accounts basis the deficit remains unchanged. The central government assumes the debt of the health service.

18.11 The minimum monthly wage is increased by 4.1%, attaining the value of € 318.

Finland (FIN)

None.

Sweden (S)

11.11. The Riksbank decides to raise the repo–rate by 0.35 percentage points to 3.25%, taking effect from 17 November.

12.11 An update of Sweden's convergence programme is presented. The update is based on the forecasts, estimates and proposals presented in the Budget Bill for the year 2000. The direction of economic policy and the budgetary objectives presented in the 1998 convergence programme are maintained. This means that the public finances are aimed at showing a surplus of 2% of GDP on average over the business cycle. The assessment of the prospects for the Swedish economy has improved substantially in comparison with the 1998 convergence programme.

United Kingdom (UK)

4.11 Bank of England raises short–term interest rates by ¼% to 5½%.

9.11 The Pre–Budget Report indicates the government's intentions in a number of fiscal policy areas, notably:

- to shift back from a semi–automatic system of annual real increases in excise duties on fuel and tobacco to annual discretion;
- to reduce capital gains tax on venture companies;
- to increase tax incentives on employee share ownership schemes.

Measures will typically be included in the Finance Bill which will follow the March 2000 Budget.