

EBAN Position Paper

EU2020: The perspective of early stage venture capital investors

EBAN welcomes the Commission's Communication "**Europe 2020: A strategy for smart, sustainable and inclusive growth**" as a clear and concise European strategy to address the current economic, financial, societal and environmental challenges. In particular, it supports one of the flagship initiatives announced as the "Innovation Union" which will seek to improve framework conditions and access to finance for research and innovation. In the last two years, business angels and early stage venture funds bringing both their financial support and experience/network of contacts to early stage SMEs have been the main source of finance for them, and it is important for European policy makers to support further their involvement in this market.

Nevertheless, EBAN wishes to underline the following caveats and suggest several policy recommendations which, from our early stage venture capital community's perspective, are essential to deliver value to our high growth SMEs in the future and achieve Europe 2020's objectives.

Preliminary remarks

The Communication mentions several times the need to find a "global solution". Whilst we accept that any solution must seek to respond to various objectives, global solutions can also mean adversely affecting parts of the market with measures destined to a specific target group. A case in point is the AIFM (Alternative Investment Fund Managers) proposed directive. While the directive seeks to control systemic risk in the financial markets and improve investor protection, it could also prove highly damageable to the European venture capital industry and therefore be an impediment to funding early stage high growth companies, including across borders. We therefore advocate that through stakeholder consultation, the European authorities should propose **flexible solutions** that are adaptable to different realities. We have seen in recent years after the financial and economic crisis that business angels are **counter-cyclical investors**, who have continued to invest during troubled times. It is therefore important for policy makers to propose mechanisms that can be reactive and adapt to fast changing market conditions.

The document mentions, albeit without naming it, the equity gap and issues related to access to finance. It is important to note that European SMEs do not only suffer from a lack of access to finance, but also from **skills gap in sales and marketing** which should be addressed through strong policies including at a very young age through targeted education programmes. EU research is often rated as world class however our researchers and entrepreneurs are poor at selling what they have to third parties, be it potential customers or financiers. Moreover, the communication mentions the importance of intellectual protection while attention should be paid to **IP commercialization**. Related to this important issue, there needs to be a much **closer link between the research and finance world**. It is important for representatives from the investment community, who are ultimately potential

buyers of the new research and innovation, to sit in technology transfer boards, to participate in the selection of projects which will receive Framework Programme funding, etc.

Attention needs to be given to **policy focus and definitions**. It is not sufficient to create policy for “SMEs” and the “early stage”. There are a number of sub-groups for each definition, which diverts the attention of financial instruments and intermediaries to other activities than those needed to support start-ups. If by early stage one wishes to support the seed/early stage start-up companies that are highly innovative, high risk – but future creators of employment, growth and social value - then there needs to be a clear policy guideline indicating so to the intermediaries. We know that if given the possibility to focus on larger deals with a higher carry and equal due diligence than for smaller projects, intermediaries will not be incentivized to look at the very early stage companies. Therefore, policy makers should strive to create a **better definition of Young Innovative Companies**, i.e. small high growth start-ups in the very early stage that need more attention and support for cross border funding and cross border internationalization of their business.

Policy recommendations

Addressing both supply and demand side issues – Capacity building

It is widely accepted that there exists an **information asymmetry** between entrepreneurs and investors. Investors claim that there is enough money on the market for good projects, which are scarce. On the other hand, entrepreneurs argue that they cannot find investors for their projects. An emphasis should be placed on capacity building of the entrepreneurs and investors through **investment and investor readiness programmes**. This would increase the quality of the deal flow for investors while bringing more educated investors to the market.

To achieve this, it is important to reinforce the structures that link together entrepreneurs and investors, i.e. business angel networks and early stage venture funds that operate at local, regional, national or cross border level.

We recommend as well that entrepreneurship and topics related to investment readiness should be thought in all schools at a very young age in order to raise the entrepreneurship spirit of the EU students.

For the next programming period, instruments such as the “Capacity building scheme”, which aims at improving the financial and technical expertise of financial intermediaries investing in SMEs, should be specifically focused on and extended to business angel network and early stage venture fund managers.

Evolving with the financial market – capacity building of policy makers

The EU Financial instruments do not always necessitate additional funding in order to be effective and create impact. While the communication proposes rightly to “strengthen and further develop the role of EU instruments to support innovation”, one needs to take into account that the main issue with the current lack of **absorption** of finance by early stage investors from instruments such as GIF 1 (High Growth and Innovative SME Facility), for which EBAN had strongly advocated, lies in the **execution**.

There needs to be **sufficient, knowledgeable and dedicated staff** within the different agencies dealing with financial instruments that are in charge of funding early stage projects (including at the European Investment Fund level).

Moreover, it is important **for policy makers to become educated about the new reality of access to finance for early stage high growth companies**. Some 10 years ago, business angels were a small community scattered across Europe, and venture capital funds were the panacea. Today, business angels are organized in groups (over 350 across Europe) and it is widely accepted that they are the main providers of venture capital for the high growth companies at their early stages as VC funds have retreated to less risky investments in later stages. Business angels increasingly co-invest with other angels and with early stage funds in an effort to fill the equity gap in Europe. It is therefore crucial for policy makers in the different EU institutions to become acquainted to the new reality of early stage finance in Europe in order to become more efficient at implementing existing instruments. This is also important given that still today the European angel market only represents one fourth of the angel market in the USA, which is a significant differentiator in terms of financing of innovation.

It is important to reinforce the link between business angels and early stage VC funds with later stage venture funds in order to ensure a healthy innovation finance chain. EBAN would welcome any initiative which would support an **increased dialogue at the regional level between business angels and VC funds with local entrepreneurs**, in order to create well-functioning ecosystems that serve entrepreneurial communities.

Making a difference – critical mass and addressing smaller-end markets

There are two main issues with the financial market in Europe today. The first is that the market is fragmented, and that there are too many small funds operating with no critical mass to grow world class companies. This is particularly true in the biotechnology sector, where promising companies have to go to the US to raise significant amount of capital to grow their business. The EU2020 should therefore not only attract institutional investors to support venture capital funds Europe-wide, but also stimulate the **creation of large cross border venture capital funds**.

On the other hand, if policy places an emphasis on the early stage, then its financial instruments need to be adapted to the reality of the latter. A 15 million€ fund can be a very strong mechanism to leverage funding from private investors at the early stage, even if it is a small fund compared to initiatives needed for different sectors or stages. Again, for these types of funds investing mostly at the seed level, availability of resources is not necessarily the issue. There are two elements lacking:

- to ensure clear objectives and **professional market driven standards** through the training of regional civil servants and the development of guidelines to ensure that the funds are spent on Young Innovative Companies;
- to implement a legislative framework in the form of a single **European small funds management company**, enabling the smooth operation of such funds so that there can be some different administrative and legal requirements to set up smaller funds addressed to early stage high growth companies.

Promoting cross border collaboration and investment by early stage investors

In 2020, for an efficient and competitive Europe, the European authorities should have achieved:

- a single European patent;
- a harmonization of company laws (bankruptcy in particular);
- a harmonization of the fiscal and legal frameworks affecting investors and companies.

The European Union should support initiatives which foster cross border collaboration in the following forms:

- Internationalization of SMEs across Europe
- Cross border investment by investors.

The EU should also strive to reduce barriers that impede the above with the help of early stage investors.

The creation of **co-investment funds** through **public private partnerships** at **European level** is essential to create local financial communities and ecosystems. Moreover, they provide an incentive for investors to remain active in follow-on rounds and continue to make their time and network available to their investee companies. Experience has shown that co-investment funds are an efficient way **to leverage private sector participation in the market.**

It could be envisaged for Member States to create or increase special fiscal incentives for smart investments in Young Innovative Companies, thereby stimulating the participation of a higher number of business angels in the market.

Addressing the link between financing innovation and public procurement

EBAN advocates the creation of an efficient mechanism for Member States to buy a significant portion of their products and services from SMEs. There is also a strong link between the procurement of R&D services and the financing of innovation within companies.

Addressing diversity to solve societal challenges

It is important to achieve the uniformity of “social enterprise” creation. One of the main issues for poor people or minorities is the complexity of setting up a new company and the minimum of equity that might be required to do so. This varies from country to country. A European Social Enterprise would help bring new entrepreneurs and companies to the market, with simpler administrative and financial procedures and distinct company status. Investments in **micro-and social enterprises** in Europe by private investors should be encouraged.

Entrepreneurs and business angels come from a very diverse background. Further support needs to be provided to women-led businesses that are in a period of transition from a long start-up phase to a ready for growth phase. At the moment, there is no support provided on the market for them and there is a risk that these companies may not reach their full potential. By the same token, the European Union should consider supporting the **creation of a European-wide network of women angel investors.** Women are under-represented in the business angel market at under 5% of the total number of investors. Supporting the emergence of a cross-border network would be instrumental in both raising awareness about the potential for women to become investors and ultimately to get more funding for the projects.

About EBAN

EBAN is the unique pan-European representative for the early stage investment community. It gathers over 100 member organizations and individuals from 28 countries. Its members are: business angel networks, early stage venture capital funds, federations of networks, individual angels and associated members. It has five main areas of focus:

- Professionalization of the early stage investment market
- Benchmarking through research and events
- Capacity building
- Dialogue with the European authorities
- Support to co-investment and cross border collaboration