

# PRACTICAL MANUAL FOR RISK CAPITAL FUNDS IN STRUCTURAL FUND PROGRAMMES

## I. Definition

- Risk Capital Financing can be defined as public funds for SMEs that are made available on a basis where they can be recycled every few years and can achieve a leverage additional private sector finance.
- The main forms of Risk Capital Financing are venture capital including formal equity, micro-credits, revolving loan schemes, mutual guarantees and business angel networks ('informal venture capital').
- The purpose of public intervention is to address a market failure - the reluctance of private sector institutions to provide finance to start-up and SMEs, especially where projects are seen as high risk.
- The Commission, in Regulation 1260/1999 (recital 40, Articles 28(3) and 29(4)) and in its guidance for 2000-06 programmes, has encouraged Member States to co-finance through the programmes interest subsidies and other "financial engineering" products such as venture capital and loan guarantees.

## II. Basic information and figures

- In the current 2000-06 period, support for Risk Capital Financing has increased to €3,292 million with 35% of this coming from the EU Structural Funds. Most EU Member States have or are introducing schemes and Applicant Countries are encouraged to do so too.
- First, Risk Capital Financing schemes work best where there is independent management, clear targets, and financial assistance is combined with more comprehensive business support services.
- Second, while performance indicators should include financial inputs and activity indicators (e.g. number of SMEs to be assisted) more emphasis is needed on financial performance, outputs and the contribution to regional development.
- The 2000-2006 Structural Fund Regulations give Member States the option of providing an additional 10% of assistance to SMEs for investments not involving direct public aid.
- **The new proposed Objective on "Regional competitiveness and employment"** shall focus its assistance amongst other horizontal themes on creating new financial instruments and incubation facilities.

## III. Risk Capital and State Aid Rules

- New schemes have to comply with the rules on State Aid. In March 2000, the Commission published detailed guidelines on the application of Articles 87 and 88 of the EC Treaty on state aid in the form of *guarantees*. A Communication on State Aid and *Risk Capital* was issued in August 2001 setting out the detailed criteria for approval of new schemes. These provide a basis for estimating the amount of any aid and deciding whether it is allowable.

- Under the de minimis rules (Commission Regulation EC No 69/2001 of January 2001), if public aid is €100,000 or less to each enterprise over a three year period, then this is within the limits set by the Regulation.

#### **IV. Guide on Risk Capital**

The new Guide suggests a number of general performance indicators - financial and regional development orientated - for EU-supported Risk Capital Financing schemes. Financial indicators include:

- Leverage of private sector finance.
- In the case of loan schemes, the level of bad debts.
- With equity funds, the rate of return on investments.
- With all instruments, the rate at which there is a reinvestment of funds in new projects.

Website:

[http://europa.eu.int/comm/regional\\_policy/sources/docgener/guides/guide\\_en.htm](http://europa.eu.int/comm/regional_policy/sources/docgener/guides/guide_en.htm)

The guide is now available in all official language versions.

#### **V. Eligibility Rules 8 ("venture capital and loan funds") under Regulation 448/2004 Rules 8 and 9: venture capital, loan and guarantee funds**

**Rule 8 defines:**

*"Venture capital funds and loan funds" as "investment vehicles established specially to provide equity or other forms of risk capital, including loans, to small and medium-sized enterprises as defined in Commission Recommendation 96/280/EC".*

*"Venture capital holding funds" are "funds set up to invest in several venture capital and loan funds".*

*Rule 9 defines "Guarantee funds" as "financing instruments that guarantee capital and loan funds within the meaning of Rule No 8 and other SME financing schemes (including loans) against losses arising from their investments in small and medium-sized enterprises as defined in Commission Recommendation 96/280/EC. The funds may be publicly-supported mutual funds subscribed by SMEs, commercially-run funds with private-sector partners, or wholly publicly-financed funds".*

Rule 8 and Rule 9 also set out a number of conditions under which Structural Funds may co-finance the capital of venture capital and/or loan, venture capital holding funds and guarantee funds. The essential conditions are:

**Business plan:** the funds must be set up on the basis of prudent business plans which specify inter alia the targeted market (or target guarantee portfolio), the criteria, the terms and conditions of financing, operational budget, ownership and co-financing partners, professionalism, competence and

independence of management, fund's by-laws, justification and intended utilisation of Structural Funds' contribution, investment exit policy, and winding-up provisions, including the reutilization of returns attributable to the contribution from the Structural Funds.

**Legal nature:** the funds must be set up as independent legal entities, governed by agreement between the shareholders, or as a separate block of financing within an existing institution.

**Aim :** funds may invest only in SMEs at their establishment, early stages (including seed capital) or expansion. In all cases the funds may invest only in activities judged potentially economically viable.

**Capital:** all participants must make their contributions in cash, and the contribution from Structural Funds is subject to the limits laid down in Article 29(3) and (4) of Regulation 1260/1999.

**Management:** the funds must be managed by professional, competent and independent management.

**Winding-up:** the funds must have an investment exit policy and winding-up provisions, including that the re-utilisation of returns and/or leftovers from Structural Funds' contribution must be reused for SME development activities in the same eligible area.

**State aid:** State aid rules must be respected both at the level of contributions to the funds and at the level of investments/guarantees provided to SMEs.

Rule 8 also sets out certain recommendations as **standards of good practice**, the compliance with which will be regarded as positive element to examine the fund's compatibility with State aid rules. However the recommendations are not binding for the purpose of the eligibility of expenditure, reason for which they will not be examined in this fiche.

Useful links:

*On eligibility questions*

<http://www.cc.cec/REGIO/html/eligibilityquestions/fiches/eli0045.htm>

*Risk Capital Guide*

[http://europa.eu.int/comm/regional\\_policy/sources/docgener/guides/guide\\_en.htm](http://europa.eu.int/comm/regional_policy/sources/docgener/guides/guide_en.htm)