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Impact Assessment

Accompanying the document

Communication from the Commission

Guidelines on State aid to promote risk finance investment

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Executive Summary Sheet
Impact assessment on the guidelines on State aid to promote risk finance investments
A. Need for action
Why? What is the problem being addressed?
<p>The main problems are related to :</p> <ul style="list-style-type: none"> - (i) the difficulties SMEs (particularly in their early stages) and some mid-caps face in gaining access to finance and - (ii) the structural weaknesses that affects all main segments of the European venture capital market and constraint the supply of risk finance to these companies. <p>These two issues have been exacerbated by the economic and financial crisis. Due to their historical over-reliance on debt, and with bank loans accounting for about 80% of their financing sources, these companies have been hit particularly hard by the general contraction of the volume of debt funding available from banks. And in this context, the VC industry, which normally provides a mix of equity and debt finance as a complement of an alternative to the traditional bank debt, has been unable to fill the gap.</p> <p>In addition, the basic principles of the current regime for risk capital are well accepted but it emerges from the Commission case practice and the public consultation that, in its practical implementation, the current regime for risk capital has encountered several problems (too restrictive scope, risk of undue-permissiveness, unnecessary administrative costs and inconsistencies with market practices).</p>
What is this initiative expected to achieve?
<p>The revision of the risk capital rules aims at;</p> <ol style="list-style-type: none"> 1. Making European SMEs more competitive in a global marketplace without distorting competition in the internal market 2. Fully addressing the market failure in SMEs' access to finance 3. Enabling efficient functioning of the EU venture capital markets by better reflecting market practices and encouraging the use of new forms of financing 4. Minimising administrative burdens and compliance costs on companies and national administrations 5. Simplifying and rationalising the transparency and reporting requirements for Member States
What is the value added of action at the EU level?
<p>The TFEU gives the competence for assessing the compatibility of State aid to the Commission. Commission guidelines are thus essential to ensure uniform rules throughout Europe for the granting of state aid to promote risk finance investment that could contribute to better competition within the internal market and improved access to finance for SMEs. Commission action is necessary to ensure that SMEs can access finance while aid is limited to the minimum necessary. The Commission also acts as an arbiter by scrutinising in more detail the expected positive effects and potentially negative effects of the most distortive notified aid, in particular by verifying that certain common principles are fulfilled (e.g. incentive effect, proportionality of the aid, etc.).</p>
B. Solutions
What legislative and non-legislative policy options have been considered? Is there a preferred choice or not? Why?
<p>In the absence of compatibility criteria being laid down in the RFG, the Commission would have to assess regional aid notifications on a case-by-case basis in direct application of Article 107(3) (c) of the TFEU. This situation would not ensure equal treatment, legal certainty or predictability, and could lead to subsidy races between MS that would highly damage trade and competition within the internal market. Commission guidelines on risk finance aid are therefore necessary to ensure uniform conditions for the granting of aid in the EU (i.e. a 'do nothing' approach is not conceivable). Other policy instruments than regulation at EU level (e.g. self-regulation, open method of coordination, market-based instruments, etc.) would not be effective. The preferred policy option consists in a more far-reaching reform of the current rules both as regards their scope and the design of the appropriate</p>

<p>compatibility criteria. This would imply to change the scope of the current regime and a shift from a State aid regime for risk capital to a broader framework for SME access to risk finance. This option is consistent with the spirit of the State Aid Modernisation initiative, and in particular with the objective of fostering growth of young innovative SMEs, while focusing the substantive assessment on a more limited number of cases with the biggest impact on the market.</p>
<p>Who supports which option?</p>
<p>Member States and stakeholders, in their replies to the first public consultation indicated that, despite some identified problems, the current risk capital regime worked well and provided provide a sound basis for channelling Member State resources to the right SMEs while limiting risks of crowding out. Nevertheless, the preferred option, which has been publicly presented, first in an Issues Paper, then in the draft Risk Finance Guidelines, is supported by All Member States who made positive comments on the draft Risk Finance Guidelines, welcoming the improvements offered by the proposal compared to the current system.</p>
<p style="text-align: center;">C. Impacts of the preferred option</p>
<p>What are the benefits of the preferred option (if any, otherwise main ones)?</p>
<p>The preferred option addresses inconsistencies with market practices, ensures adequate leverage of private investment into SMEs and mid-caps, has the expected most important positive impact on employment and SMEs' growth and offers the strongest degree of legal certainty. This Option, even if entailing higher adaptation costs than other options, presents the largest achievement of policy objectives.</p>
<p>What are the costs of the preferred option (if any, otherwise main ones)?</p>
<p>The preferred option brings important changes in the regulatory context and the compliance costs for businesses and Member States might be quite high. The notification requirements under the new guidelines would require Member States to provide an <i>ex-ante</i> assessment demonstrating the existence of a funding gap and the absence of market delivery affecting target SMEs in the area concerned. Nevertheless, these compliance costs could be compensated by the fact that more measures would fall under the block exemption and that only the most complex cases would require individual scrutiny.</p>
<p>How will businesses, SMEs and micro-enterprises be affected?</p>
<p>It should be noted that these compliance costs will mainly be supported by national administrations that go through the notification process. At the level of the target undertaking, the administrative burden should be limited to the usual process to access finance.</p>
<p>Will there be significant impacts on national budgets and administrations?</p>
<p>The new RFG, together with the revised GBER, will contribute to avoid excessive administrative burdens for the enforcement of risk finance aid rules.</p>
<p>Will there be other significant impacts?</p>
<p>The application of the revised rules is expected to enhance competition in the internal market by reducing or eliminating undue restrictions to trade and competition and making the control of the effects of risk finance state aid by the Commission more efficient. The new RFG should continue to support MS' policies to stimulate endogenous growth and attract inward investment flow.</p>
<p style="text-align: center;">D. Follow up</p>
<p>When will the policy be reviewed?</p>
<p>DG Competition will carry out a mid-term review of the RFG in S1 2017 to assess the effects of the RFG and determine if adjustments are required. DG Competition will also conduct an ex-post evaluation of the RFG for their revision for the period after 2020. Both tasks will involve consultations of MS and other interested parties.</p>

1. INTRODUCTION: THE SCOPE OF THE IMPACT ASSESSMENT

In its Communication of 8 May 2012 on EU State aid modernisation, the Commission set out an ambitious State aid reform program¹ (“SAM” – State Aid Modernisation). The modernisation has three main interlinked objectives: (i) Foster growth in a strengthened, dynamic and competitive internal market; (ii) Focus enforcement on cases with the biggest impact on the internal market; (iii) Streamlined rules and faster decisions. The various guidelines and frameworks will be revised and streamlined to make them consistent with common compatibility principles.

The review of the Guidelines on State aid to promote risk capital investments in small and medium-sized enterprises² (hereafter the “RCG” or the "Guidelines") and relevant provisions of the General Block Exemption Regulation³ (“GBER”) is guided by the common approach developed in the context of the modernisation of the EU State aid Policy which seeks to support sustainable growth and contribute to the quality of public spending by discouraging aid that does not bring real added value and distorts competition.

More generally this review comes within the overall context of the Commission’s initiatives to enhance SMEs’ access to finance. In particular, one of the key priorities set out in the Europe 2020 Strategy is to ensure a healthy supply of and access to debt and equity finance for growth-oriented SMEs in the EU through actions well designed to stimulate and leverage private capital.

Moreover, the European Parliament and the Council adopted, in April 2013, new rules whereby venture capital funds established in any Member State may freely invest throughout the EU⁴. Member States were also invited to remove tax obstacles so that tax treatment in different jurisdictions would not lead to double taxation and hamper cross-border flows.

This Impact Assessment will explore the need and options to review the existing State Aid rules applicable to risk capital.

2. PROCEDURAL ISSUES AND RESULTS FROM CONSULTATION OF INTERESTED PARTIES

2.1. The current rules and context of the review

The current Guidelines were adopted in 2006 and will expire at the end of 2013. The Guidelines provide guidance on the existence of aid and contain criteria to assess the compatibility of State aid measures with the internal market. The General Block Exemption Regulation adopted in 2008 provides the possibility for Member States to put in place State aid measures to support SMEs' access to risk capital without prior approval by the Commission. The General Block Exemption Regulation is also due to expire at the end of 2013.

¹ COM (2012) 209 final

² OJ C 194, 18.08.2006, p.2

³ OJ L 214, 09.08.2008 Commission Regulation (EC) n° 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation)

⁴ OJ L 115, 25.04.2013 Regulation n° 345/2013 of the European Parliament and the Council of 17 April 2013 on European Venture Capital Funds.

The crisis-related "Temporary Framework"⁵ introduced some additional flexibility by allowing a higher annual investment tranche and lower private investor participation ratios in non-assisted areas. The Commission took the opportunity of the mid-term review of the RCG in 2010⁶ to look at the evolution of venture capital markets and to assess whether the adaptations introduced by the Temporary Framework should be made permanent. It concluded that the upper boundary of the SME equity gap may be wider than had previously been recognised and made the increase to €2.5 million of the annual investment tranche, introduced by the Temporary Framework, permanent as of 2011.

On 16 July 2012, DG Competition launched a public consultation, by publishing a detailed questionnaire in order to gather information on the extent of the market failure affecting access to debt and equity of viable SMEs and the functioning and shortcomings of the current risk capital State aid regime. The public consultation ended on 5 October 2012. 49 contributions were received⁷: 13 from Member States, 11 from public authorities, 24 from other organisations (registered and non-registered, both national and European) and 1 from a citizen.

On this basis, the Commission has carried out a second evaluation of the current regime, the result of which has been published as an Issues Paper. This has been discussed at a workshop with Member States and invited stakeholders on 11 December 2012⁸.

On 8 May 2013, DG Competition launched a public consultation on a draft General Block Exemption Regulation (GBER) that contains a section on aid for SMEs with specific provisions on risk finance aid. The public consultation ended on 28 June 2013.

On 24 July 2013, DG Competition launched a public consultation on the draft Union guidelines on State aid to promote risk finance investments. The public consultation ended on 18 September 2013⁹. This draft has been discussed with Member States in a multilateral meeting held on 13 September 2013¹⁰.

In parallel, the Legal Service, SecGen, ECFIN, ENTR, EMPL, AGRI, MOVE, ENER, ENV, RTD, CNECT, MARE, MARKT REGIO, TAXUD, TRADE, BUDG were invited to be part of the Steering Group for this Impact Assessment and a number of them actively participated at several meetings.

2.2. Impact Assessment Board review and opinion

On 16th October 2013 a meeting of the Impact Assessment Board took place. The overall opinion of the Board on the Impact assessment was positive, with some recommendations for improvement.

⁵ OJ C 6/05, 11.01.2011, Communication of the Commission - Temporary Union framework for State aid measures to support access to finance in the current financial and economic crisis

⁶ http://ec.europa.eu/competition/consultations/2010_temporary_measures/risk_capital_en.pdf

⁷ Non-confidential replies to the public consultation were published at: http://ec.europa.eu/competition/consultations/2012_risk_capital/index_en.html

⁸ Presentations given at the workshop were published at: http://ec.europa.eu/competition/state_aid/legislation/horizontal.html

⁹ The draft report has been transmitted to the board on 18 September 2013. So far DG competition received 6 contributions. Non-confidential replies will be published here :

http://ec.europa.eu/competition/consultations/2013_risk_capital/index_en.html

¹⁰ The main results of the Multilateral meeting are detailed in Annex 3

First, it was recommended to strengthen the problem definition by focusing it more explicitly on the risks and weaknesses of the current framework. Second, it was suggested to set out the substance of the options in more detail, and explain how they relate to other initiatives aiming to improve SMEs' access to finance, while presenting the rationale for changing the threshold in combination with more flexible criteria. Third, it was recommended to give a better indication of the impact of the various options on the amount of private investment leveraged, as well as the expected impacts on competition, growth, employment, administrative costs for market operators, and implementation costs for public authorities. Finally, it was held that the report should give a better overview throughout the report of the input received from different categories of stakeholders, especially on the problem definition, the policy options and the expected impacts.

The recommendations of the Board were taken into account and implemented into the Impact Assessment report.

3. THE PROBLEM AND POLICY CONTEXT

The problem can be divided in two branches: the difficulties SMEs face in their search for finance (point 3.1) and the organisation and functioning of the European venture capital markets that fails in providing adequate finance to those SMEs (point 3.2). Both demand-side and supply-side of the venture capital industry are affected by sub-optimal functioning. The conditions deteriorated under the economic and financial crisis making the situation extremely difficult both for SMEs and for venture capital industries (point 3.3). This is why Member States tried to facilitate access to finance for innovative and growth-oriented SMEs, by encouraging private investors to invest in such companies, sometimes through measures that entail State aid. In this context, public intervention in order to bridge the funding gap needs to be addressed as the design and implementation of the current set of rules on risk capital revealed some weaknesses (point 3.4).

3.1. Market failure for SMEs' access to finance

3.1.1. SME financing needs

Access to finance is the second most pressing problem facing EU SMEs after finding customers¹¹. SMEs are faced with significant challenges in securing the necessary financing, either for investment purposes (at all development stages, but in particular for seed and start-up) or for working capital to maintain their potential growth.

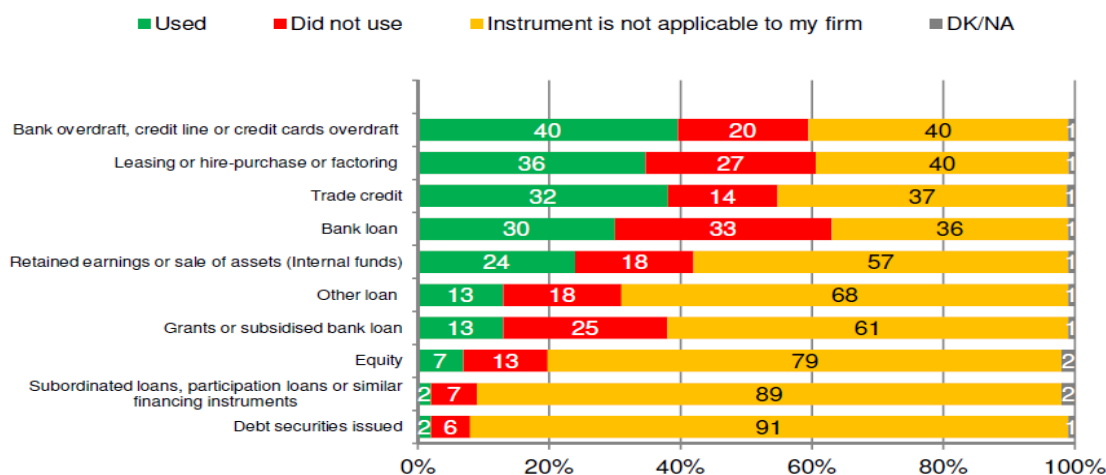
While risk capital is potentially an important source of finance (by tempering the effects of economic downturns that may dry out traditional financing sources and by bringing managerial expertise to start-ups), the diversity of SME characteristics and their finance needs require different types of finance. Risk capital finances only a small fraction of businesses, while SMEs, with regard to external financing, continue being dependent on traditional bank lending, which is itself limited by the banks' refinancing capacity, their risk appetite and capital adequacy. For instance, bank loans account for more than 80%

¹¹ Cited by 15% of business managers (24% for finding customers) in the 2011 Commission - ECB surveys on SME finance, available at http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm

of SME finance, while only 2% of their finance is supplied by venture capital specialists (14% in the US)¹².

The most widely used source of finance in 2011 by SMEs was bank overdrafts (40%), followed by leasing/hire purchase/factoring (36%), trade credit (32%) and bank loans (30%). Equity financing was only used by 7% of SMEs across Europe¹³ (see Table 1). The main challenges concerning this type of investment are the lack of investment readiness or financial knowledge, the traditionally low financial returns and the small size of this asset class.

Table 1: Companies use of internal and external financing in 2011's second semester



Source : 2011 Commission - ECB surveys on SME finance, p.18

This over-reliance on debt has been exacerbated by the financial crisis. In this context, the provision and extension of credit lines by banks to SMEs has decreased. Eurostat data shows that the proportion of unsuccessful loan applications to banks rose between 2007 and 2010 in 19 of the 20 Member States for which data are available¹⁴. Almost two-thirds (63%) of the EU SMEs who applied for a bank loan during the last six months received the whole amount they asked for. However, 11% of the applications were rejected and 17% received less than they applied for. In addition 4% declined the loan offer from the bank because they found the conditions unacceptable. Given that banks are almost the only source of finance for SMEs, this means that approximately one third of the SMEs did not get the finance they required¹⁵.

3.1.2. The root of the problem: asymmetric information

Despite their growth prospects, SMEs may face difficulties, particularly in their early stages, in gaining access to finance. At the heart of these difficulties lies a problem of *asymmetric information*: SMEs, especially when they are young, are often unable to demonstrate their credit-worthiness or the soundness of their business plans to investors. The type of active screening that is undertaken by investors for providing financing to

¹² COM (2011) 860 final, Proposal for a Regulation on European Venture Capital Funds

¹³ Cf. the 2011 Commission - ECB surveys on SME finance, reference above

¹⁴ Eurostat, SME's access to finance survey (2007-2010)

http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics

¹⁵ Cf. the 2011 Commission - ECB surveys on SME finance, available at

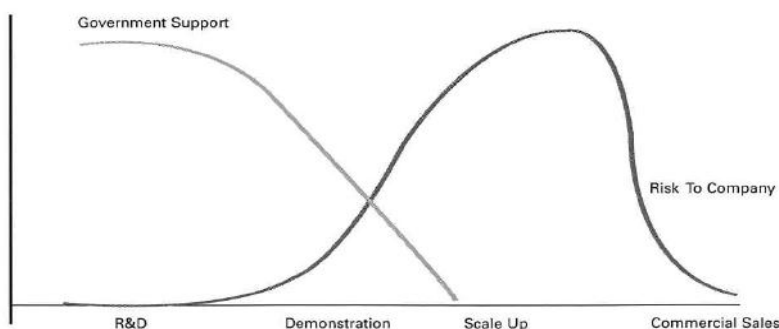
http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm

and http://ec.europa.eu/enterprise/policies/finance/files/2011_safe_summary_en.pdf

larger companies may not be worth the investment in case of transactions involving those SMEs because the screening costs are too large relative to the value of the investment. Imperfect information in new or emerging product markets may act as a deterrent for venture capital investors and may weaken innovative firms' ability to present robust business plans to investors. Independently of the quality of their project and growth potential, these firms are likely to be finance-constrained as long as they lack proven track record and sufficient collaterals.

This problem emerged, for instance, in the context of “clean-tech investing”. The clean-tech investment theme emerged in the early 2000's with a number of fund managers creating investments targeted at making significant investment returns from high-growth companies created by the rise of renewable power and environmental policies based on energy, water, land or material saving¹⁶. Developing new eco-innovations goes through a range of steps from the basic product idea to the final commercial product. Risks associated with early-stage (unproven and proven technologies) and middle stage (pre-commercial) technologies are often seen by private investors as too risky and therefore, often not funded. The problem for the developer is that the technologies at these stages are too advanced in their development to qualify for public research, which leaves the company in a situation where it is neither eligible for start-up assistance nor mature enough to receive private investments¹⁷. The table below underlines the negative correlation between the risk of the companies in the above mentioned sectors and the need of public support in their early stage of development.

Table 2: Model of risk profile for companies of innovation processes



Source: DTI (2006:13).

DTI – Department of Trade and Industry

Therefore, as a result of such information asymmetries, business finance markets may fail to provide the necessary equity or debt finance to newly-created and potentially high-growth firms.

¹⁶ European Cleantech Fundraising 2013-2014, Georgieff capital and Cleantech Group, April 2013. The data provided reflects trends in Cleantech portfolio.

¹⁷ Bridging the Valley of Death : public support for commercialisation of eco-innovation – European Commission, DG Environment – final report May 2009 p.24-25

3.1.3. The nature and scope of the problem: existence and size of an SME financing gap

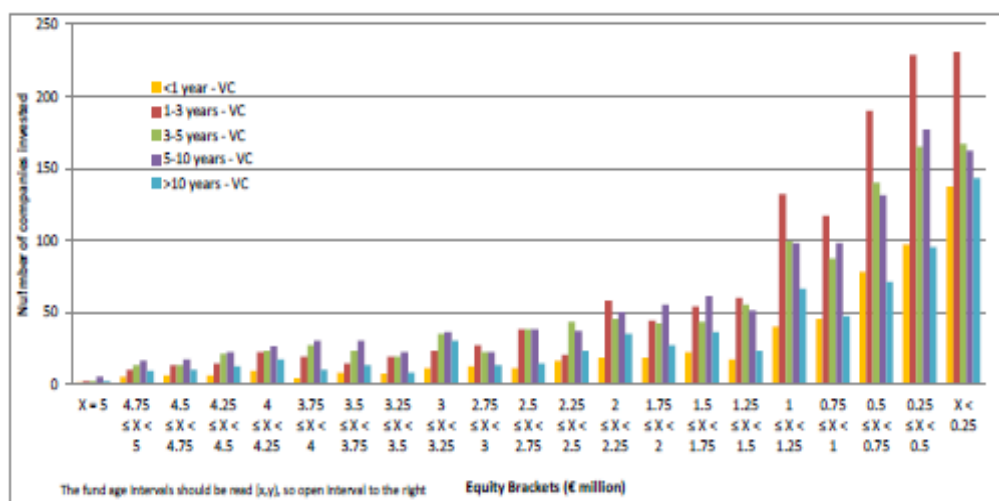
Most comments received during the consultation emphasise that such a failure in business finance markets translates into a "funding gap" which affects SMEs not only at their seed/start up and early expansion stages, but also at later expansion/growth stages. The funding gap is not a specific number, but can be best understood as being a function of many different factors, such as the sector concerned, the business cycle, supply and demand conditions in the given financial market and the characteristics of the company. Hitherto, the Commission has generally acknowledged the existence of a funding gap for equity and quasi-equity investments up to EUR 2.5 million over a year. According to certain stakeholders, however, the funding gap would be significantly higher and generally affect investments of a size of €10 to 15 million, over several years which is considered the level at which private equity providers would normally consider investing. In one specific recent case, the Commission has found, following a detailed assessment, evidence of a funding gap affecting early stage SMEs reaching GBP 5 million per year¹⁸.

3.1.4. Challenges in quantifying the problem

Most comments received during the consultation point out the difficulty of quantifying the equity gap, considering that the gap depends on the age of the investee company and varies from one sector to another.

The European Private Equity and Venture Capital Association (EVCA), both in its response to the public consultation and in study documents¹⁹, provided tables based on compiled data on the SMEs having benefitted from equity financing between 2007 and 2011-2012. For instance, the table below shows that younger companies (in seed/start-up phase, under 1 year old) are in a more difficult position to obtain funding.

Table 3: Repartition of access to equity by company age



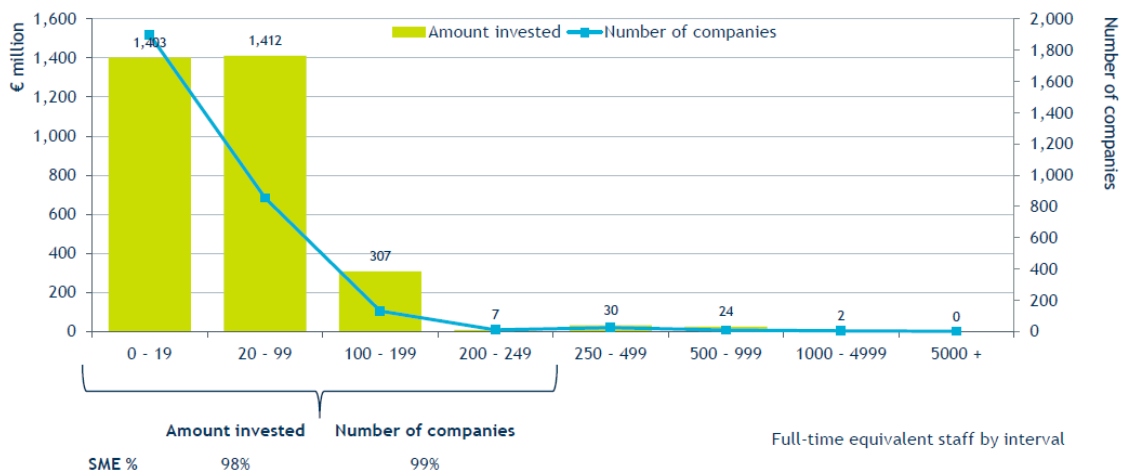
Source: EVCA – response to public consultation

¹⁸ SA.33849 – United Kingdom – Amendments of the Enterprise Investment Scheme and the Venture Capital Trusts Scheme.

¹⁹ EVCA Yearbook 2012 and 2012 Pan-European Private Equity and venture capital Activity. Activity data on fundraising, investments and divestments
http://www.evca.eu/uploadedfiles/home/knowledge_center/evca_research/2012_Pan-European_PE&VC_Activity.pdf

These data can also be linked to the size of the companies invested in. In fact, almost half of the companies that benefited from investments are companies with less than 20 employees and 98% of them are companies employing less than 100 employees (see Table 4)

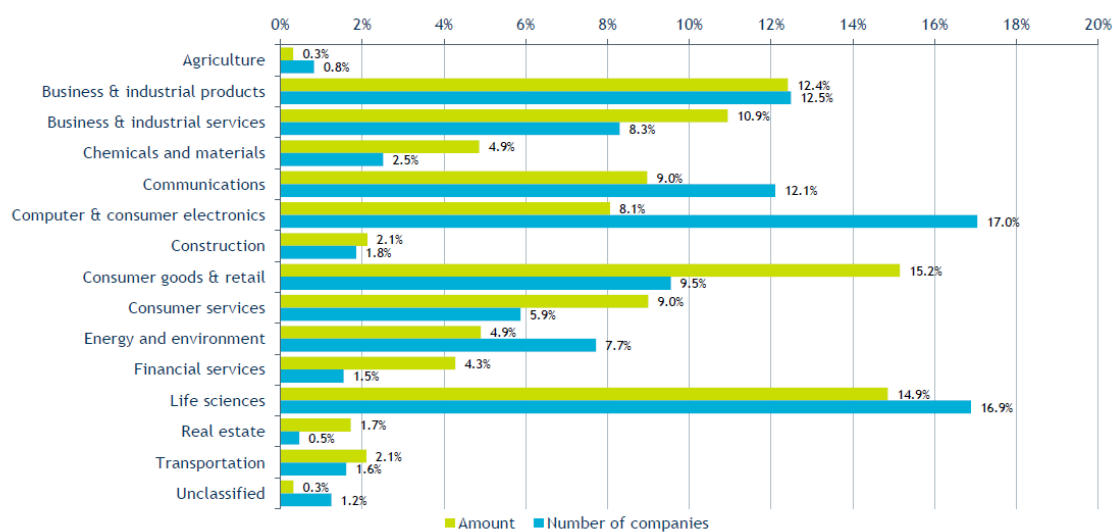
Table 4: Venture capital investments by number of employees (2012)



Source: EVCA/PEREP analytics - 2012 Pan-European Private Equity and venture capital Activity. Activity data on fundraising, investments and divestments, p.52

SMEs' financing need also varies depending on the sector (see Table 5).

Table 5: Repartition of access to equity by sector (% amount & number of companies) – 2012



Source: EVCA/PEREP analytics - 2012 Pan-European Private Equity and venture capital Activity. Activity data on fundraising, investments and divestments

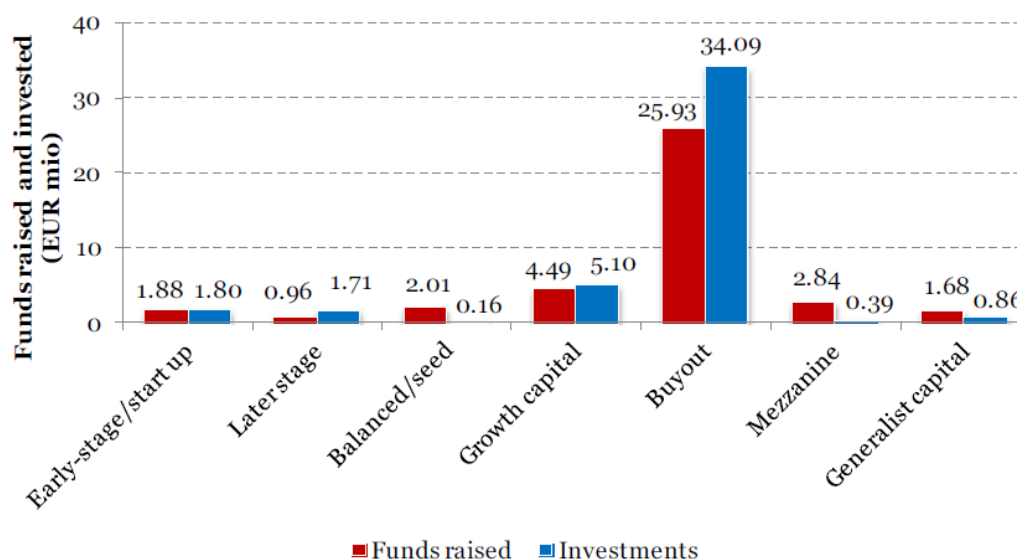
For instance, start-ups in the biomedical and biotech industries require a significant amount of funding upfront, whereas social media companies can be established with a few thousand Euros. Indeed, it is interesting to note that in the ICT sector, investments drop beyond the €2 million range. On the contrary, for industries such as biotech, medical, and pharmaceuticals, alternative sources of financing (business angels) are usually unable to supply the significant amounts of capital needed in the start-up phase (€ 10 million or more).

3.1.5. A market failure that might also affect certain mid-caps

As described above, the identified market failure affects not only SMEs in their early stages but also SMEs in their later growth stages. Some studies intend to show that, in some instances, small midcaps and innovative midcaps may face the same market failure as SMEs²⁰ insofar as they are still at their growth stage. These companies are at a critical stage in their life cycle and have the potential to develop into global players through internationalisation and wider commercialisation of their products and services, which translates into important financing needs.

Due to better awareness and availability, debt financing and bank guarantees are the preferred form of financing for the majority of these companies even if some companies expressed a preference for equity or hybrid financing. However, it seems that bank landing, as well as equity financing, have become more difficult to access for a number of RDI intensive mid-cap companies. The table below provides a detailed breakdown of the gap between funds raised and funds invested by investment strategy in 2011.

Table 6: Funds raised vs. funds invested across investment strategies in 2011



Source: EVCA Yearbook 2012 Activity data on fundraising, investments and divestments by Private Equity and venture capital firms in Europe

The data above underlines that growth capital and investment in the form of buy-outs are the main types of financing for SMEs and mid-caps. It also shows that investments in growth capital and the above mentioned later stage investments are, unlike in the case of the early and mezzanine stages, higher than the fund raised. This indicates that the demand for growth and late stage venture capital to be invested in SMEs and mid-caps was higher than the supply.

3.2. Structural weaknesses of the European venture capital market

The supply of risk capital to SMEs in the EU is constrained by certain structural weaknesses affecting all main segments of this market: the informal venture capital

²⁰ European Investment Bank, Risk Sharing Finance Facility (RSFF), new ways to finance innovative midcaps, 30 November 2012.

(business angels), the formal venture capital (VC funds) and the alternative trading platforms.

3.2.1. *Size of the European VC market*

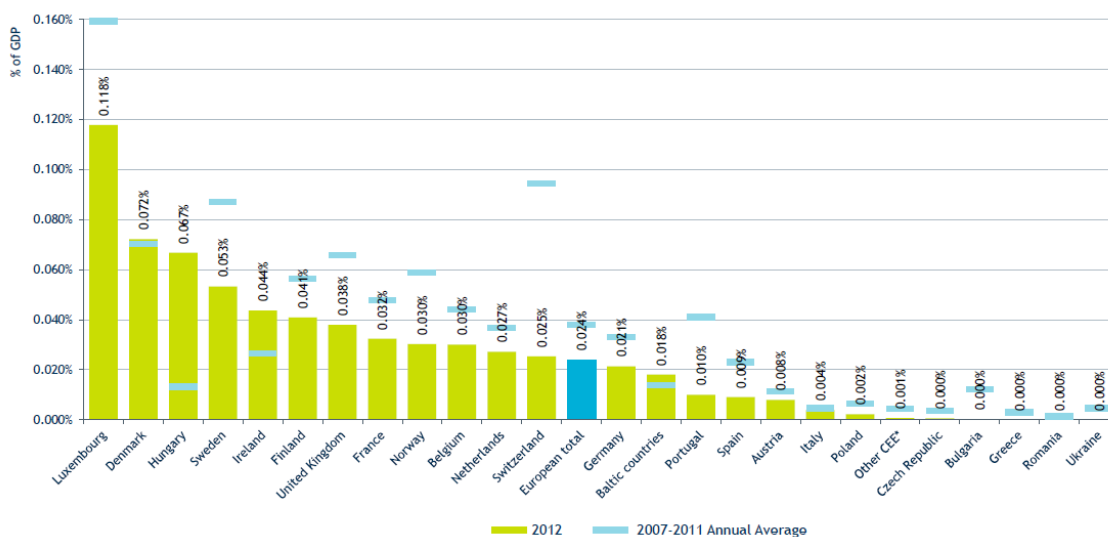
While the informal venture capital market (business angels) remain the main source of risk finance for early stage businesses, there is evidence that this segment is inefficient due to several factors, including the low visibility and scarcity of informal investors who are often confined within a narrow geographic scope, unstructured communication channels between entrepreneurs and business angels resulting in higher transaction costs and restricted choice of investment opportunities, as well as concerns about investment exit routes. Overall, the size of the European informal venture capital market is four times smaller than in the US.

As regards the formal venture capital segment, it is widely acknowledged that the European VC industry lacks critical mass and efficient scale in terms of average fund size. The venture capital sector in Europe is small and not as mature as in the US. In the period 2003-2010, a volume of approximately €131 billion was raised into venture capital funds in the US, against €28 billion in the EU. Moreover, the average US venture capital fund size reaches €130 million of assets under management, against €60 million in the EU²¹.

In 2012 venture capital investments make up only 0.024% of Europe's GDP, a figure which is almost six fold inferior compared to the corresponding US one, which is 0.14% (see Table 7). The above mentioned US figure is superior to the highest one in Europe, *i.e.* 0.118% of GDP in Luxembourg, while countries such as UK, France or Germany invested through venture capital instruments less than 0.04% of their respective GDP (0,038% in UK, 0,026% in France and 0,021 % in Germany). It is also to be noted that the same year the venture capital industry in Europe shrank with more than 25% compared to the annual average of the period 2007-2011. Apart the Hungary, Ireland and the Baltic countries, which recorded increases of this indicator over the analysed period, all other European countries recorded shrinks up to even 45% (UK).

Table 7: 2012 Venture capital investments as % of GDP

²¹ National Venture Capital Association Yearbook 2011.



Source: EVCA/PEREP analytics - 2012 Pan-European Private Equity and venture capital Activity. Activity data on fundraising, investments and divestments

As a result of lack of competitive financial returns, their sub-optimal size and insufficient capitalisation, VC funds may fail to achieve two intertwined aims: on the one hand, building an overall balanced investment portfolio spread across diversified assets and, on the other, supporting individual SMEs with adequate follow-on investments through their development stages.

Finally, as regards alternative trading platforms, it is commonly recognized that, although such alternative exchanges are already in place in several Member States, only a few of them have achieved critical mass. Common problems include insufficient liquidity and a shortage of listings. In addition to possible regulatory failures, this seems to be linked to information asymmetries deterring potential investments via alternative trading platforms²².

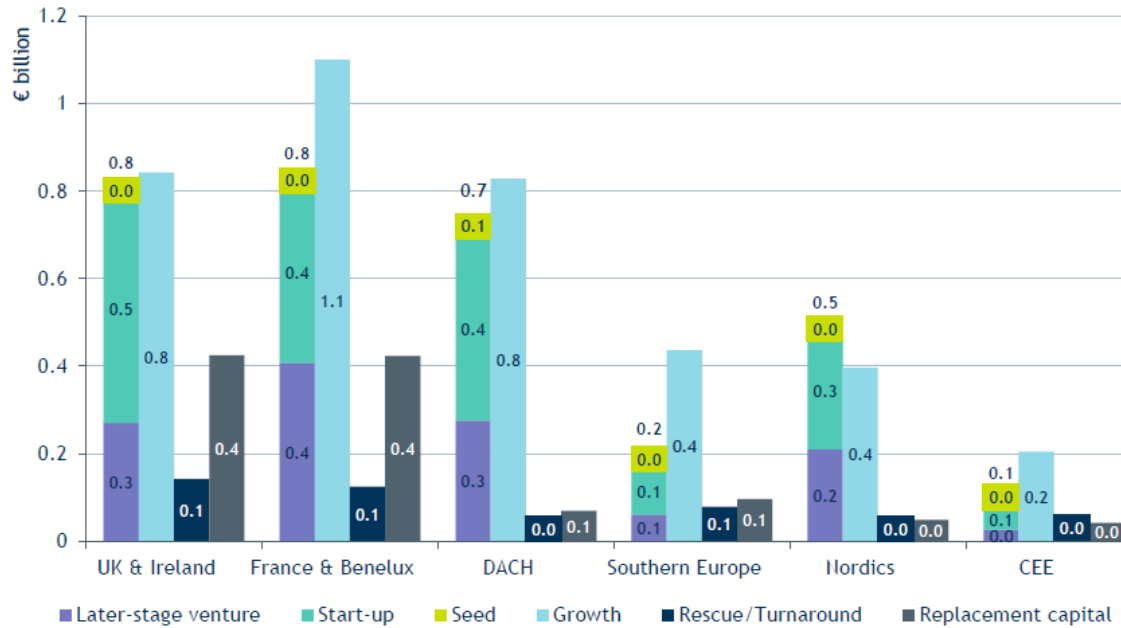
The absence of efficient venture capital sector leads to European innovators and innovative business ventures punching below their commercial potential. This, in turn, is negative for Europe’s global competitiveness.

3.2.2. Fragmentation of the European VC market and regulatory constraints

At present, there is no integrated European venture capital market: venture capital activities are not homogenously spread across the European Union. Around 90% of all venture capital fund managers are concentrated in eight Member States: UK, Germany, Denmark, Finland, Netherlands, France, Sweden and Spain all have venture capital assets under management in excess of €1.5 billion (see Tables 7 and 8).

Table 8: Investments amounts by stage focus and regions (2012)

²² This has been outlined by representants of the London Stock Exchange (AIM) in an informal meeting



DACH: Austria, Germany, Switzerland

Southern Europe: Greece, Italy, Portugal, Spain

Nordics: Denmark, Finland, Norway, Sweden

CEE: Central Eastern Europe

Source: EVCA/PEREP analytics - 2012 Pan-European Private Equity and venture capital Activity. Activity data on fundraising, investments and divestments, p.38

The regulatory situation varies widely from country to country and the market is fragmented along national lines. One of the identified reasons could be the lack of cohesion between the 28 tax systems across the EU that can lead to tax treatment uncertainties and administrative obstacles²³.

Also, the results of the public consultation revealed that prudential regulation has increased investor risk aversion and further constrained fundraising. The levels of capital required by prudential regulation (Basel III, Solvency II) have pushed banks and insurance companies, which were hitherto the main investors, to cut back their allocation to venture capital. It is likely that these regulations will continue to affect, on the long term, the supply of capital of those institutional investors in the venture capital segment.

3.2.3. The European VC market is unattractive compared to other forms of assets

The venture capital sector in Europe is small compared to the broader sector of “private equity”²⁴ (see Table 6). Within the broad range of private equity investors, venture capitalists account for between 10% and 15% (depending on the chosen year of reference). At the end of 2010, there were about 1500 private equity managers headquartered in the European Union. In aggregate, these managers accounted for about

²³ Report of Expert Group on removing tax obstacles to cross-border venture Capital investments, 30 April 2010

²⁴ “private equity” is a form of equity investment into private companies that are not quoted on a stock exchange. Private equity is distinguished by its active investment model, in which it seeks to deliver operation improvements in its companies, over several years.

“venture capital” is a type of private equity focused on early development stages companies. Venture capital funds often back entrepreneurs who have just the germ of a business idea. <http://evca.eu/what-is-private-equity/>

€ 500 billion of assets under management. 10% of this amount, i.e. approximately € 50 billion, can be attributed to the venture capital funds²⁵.

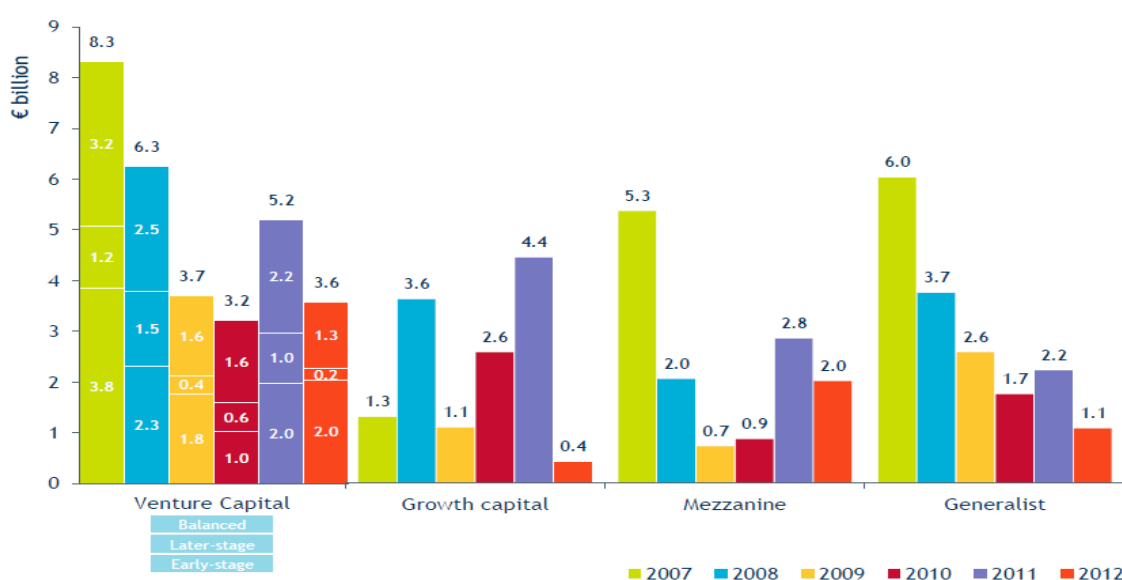
Although strategically important, venture capital is not very significant in comparison to other asset classes: as a comparison, European UCITS and non-UCITS assets under management at the end of 2010 reached € 8 trillion²⁶. Global hedge funds' assets under management reached at the end of 2010 about € 2,5 trillion, with about € 400 billion in Europe²⁷.

Main fundraising constraints of the European VC industry are due to the historically poor returns of the industry, the tightness of this market which makes it illiquid and therefore less attractive than other asset classes, and the fact that there is not really an EU institutional investor community specialising and willing to invest in this segment. Indeed, private institutional investors consider this asset class as unattractive because it does not deliver competitive financial returns and is too risky and illiquid.

3.3. Problems exacerbated by the economic and financial crisis

The economic and financial crisis has exacerbated these structural problems. Due to their historic over-reliance on debt, and with bank loans accounting for about 80% of their financing sources, SMEs have been hit particularly hard by the general contraction of the volume of debt funding available from banks. In this context, the VC industry, which normally provides a mix of equity and debt finance as a complement or an alternative to the traditional bank debt, has been unable to fill the gap (see Table 9). The cause seems to lay in the endemic under-capitalisation of VC funds. The recent Commission/ECB survey on SME financing²⁸ seems to suggest that SMEs with less than 5 years sales history are those that normally encounter more difficulties in obtaining bank loans, which may constitute an indication of the categories of SMEs the most affected by a failure in the overall business financing market.

Table 9: 2007-2012 Funds raised by fund stage focus



²⁵ EVCA answer to public consultation

²⁶ Source : www.efama.org

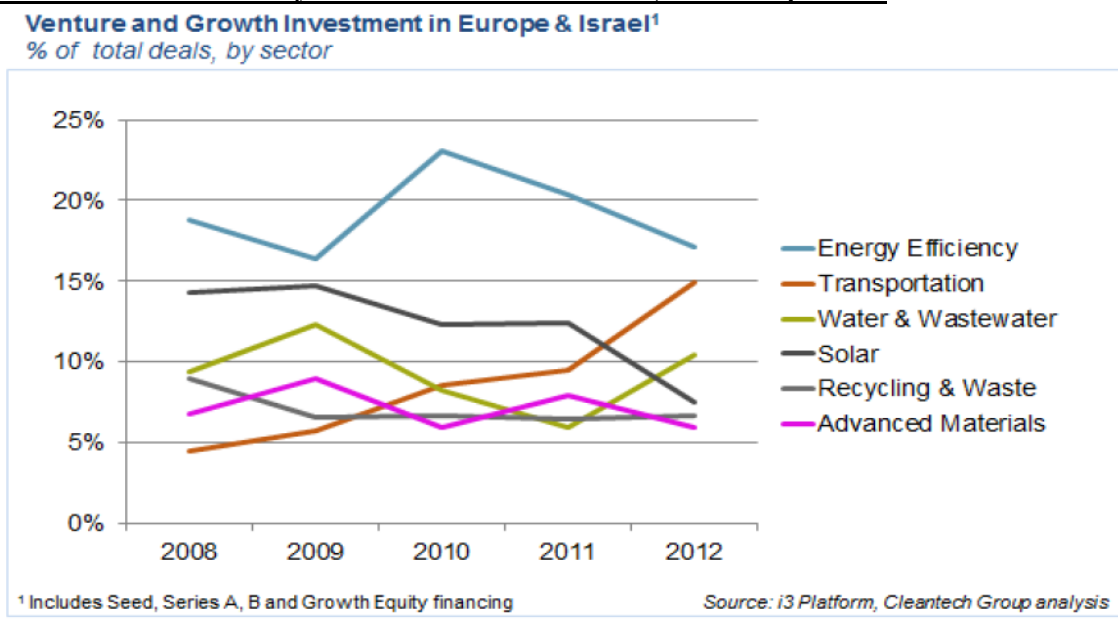
²⁷ Source: www.aima.org

²⁸ See supra footnote n°15

Source: EVCA/PEREP analytics - 2012 Pan-European Private Equity and venture capital Activity. Activity data on fundraising, investments and divestments, p.9

The effects of the crisis have been felt differently in different sectors (see Table10). For instance, it is interesting to note that, clean technologies enterprises, which are considered to be capital intensive industries, whilst affected by the crisis, have been hit differently²⁹. Since 2007, the energy efficiency projects seem to have been financed on a cyclical basis, while the amount invested in solar companies is in constant decline. On the contrary, investments in transportation have constantly increased since 2008 and investments in water and wastewater industries restarted in 2011 after a two-year decrease between 2009 and 2011.

Table10: % of total deals by sector between 2008 and 2012, Cleantech portfolio



Source: European Cleantech Fundraising 2013-2014, Georgieff capital and Cleantech Group, April 2013

In these circumstances, Member States may seek to facilitate access to finance for innovative and growth-oriented SMEs by stimulating and leveraging private investment through an appropriate use of financial and fiscal instruments, which in some cases, may entail the use of State aid.

3.4. Public interventions to bridge the funding gap may distort competition: the need for EU regulation

3.4.1. The EU's right/obligation to act: exclusive competence given by the Treaty

Article 107 and 108 TFEU sets out the rules on State aid control, in particular the obligation of Member States to notify State aid measures to the Commission before they are implemented. Since the TFEU reserves to the Commission the exclusive competence of controlling the conformity of these measures with competition rules, EU action is not subject to a subsidiarity test. Within the European Economic Area, any selective advantage given by a public body to undertakings which has the potential to distort competition and affect trade between Member States is subject to the EU State aid rules.

²⁹ See supra footnote n°16.

However, the Commission currently considers that some public investments do not constitute State aid if they are made *pari passu* between public and private investors and when such investments would be acceptable to a normal economic operator in a market economy. In particular, this is assumed to be the case when public and private investors share exactly the same upside and downside risks and rewards and hold the same level of subordination, and normally where at least 50% of the investment is provided by private investors, which are independent from the companies they invest in (point 3.2 of the Risk Capital Guidelines).

Nevertheless, risk capital measures often involve complex constructions devised to promote risk capital because the public authorities create incentives for one set of economic operators (investors) in order to provide finance to another set (target SMEs). Depending on the design of the measure, and even if the intention of the public authorities may be only to provide benefits to the latter group, enterprises at either or both levels may benefit from State aid.

It is interesting to note that from August 2006 to August 2013, the Commission has adopted 99 decisions under the current RCG (14 decisions per year in average)³⁰.

3.4.2. *Overview of State Aid rules applicable to State interventions supporting SMEs access to finance*

The General Block Exemption Regulation³¹ (GBER) and the Risk Capital Guidelines³² (Guidelines) set out the conditions that Member States should respect when granting State aid to promote access to risk capital for SMEs in their early development stages, particularly with a view to ensuring that such aid targets a proven equity gap and does not crowd out financial markets or distort the valuations of target companies.

The GBER and the Guidelines only cover investments into seed, start-up and early-expansion capital, which excludes SMEs in their growth stage. The GBER covers only risk capital aid provided through private-public funds investing predominantly (70%) in equity/quasi-equity on a non-*pari passu* basis, which leaves most financial instruments (FIs) outside the safe-harbour. Moreover, this requirement leaves only the remaining 30% for debt instruments and liquidity management. Within this narrow scope, it provides for relatively simple compatibility criteria reflecting the need to ensure an adequate incentive effect, while limiting the aid to what is necessary without adverse crowding out effects. In particular, it limits the maximum investment in each target SME to tranches of €1.5 million per successive periods of 12 months and requires compliance with a 50%/ 30% private capital leverage ratios, depending on the assisted/non-assisted status of the regions where the target SMEs have their permanent establishment. Moreover, it requires that aided measures comply with 'profit-driven investment' and 'commercial management' principles.

The Guidelines covers a wider range of risk capital measures, including private-public capital co-investment at SME level, guarantees and fiscal incentives. The Guidelines are structured into two types of assessments: (i) a "standard" assessment relying on the same compatibility criteria as laid down in the GBER, except for a higher threshold for the annual investment tranches (up to €2.5 million); and (ii) a "detailed" assessment mainly

³⁰ See the summary of risk capital decision taken under the 2006 RCG in Annex 1

³¹ OJ L 214, 9.8.2008, p. 3.

³² OJ C 194, 18.8.2006, p. 2.

focused on seven specific measures included in a white list³³. For these measures, the Guidelines aim at providing guidance as to how to evaluate the equity gap and the factors that influence the incentive effect and proportionality, as well as some indications as regards the potential negative effects and the balancing test.

The presence of State aid is therefore scrutinized by the Commission at three levels:

- *aid to investors*: where a measure allows private investors to effect risk capital investments into a company or a set of companies on terms more favorable than public investors, then those private investors will be considered to receive an advantage (non *pari passu* investments);
- *aid to an investment fund/vehicle and/or its manager*: in general, the Commission considers that an investment fund or an investment vehicle is an intermediary vehicle for the transfer of aid to investors and/or enterprises in which the investment is made, rather than being a beneficiary of aid itself. However, measures including direct transfers in favour of an investment vehicle or existing fund may constitute aid, unless the transfer is made on terms which would be acceptable to a normal economic operator in a market economy. (It is to be noted that in general, there is a presumption of no aid to the fund's managers if they were chosen through an open, transparent and non-discriminatory selection procedure or if their remuneration reflects the current market levels in comparable situations);
- *aid to the enterprises in which the investment is made*: where aid is present at the level of the investors, the investment intermediary or its managers, the Commission will normally consider that it is at least partly passed on to the target enterprises. This is the case even where investment decisions are being taken by the manager of the fund with a purely commercial logic.

3.4.3. *Overview of the Commission's experience in implementing the current regime*

The current regime has been thoroughly evaluated through the mid-term review in 2010, a first public consultation in July – October 2012³⁴, the publication of an Issue Paper in November 2012 and the ensuing discussions with Member States and stakeholders. The outcome of the public consultation revealed that the basic principles underpinning the current regime are generally well-accepted as they provide a sound basis for channelling Member State resources to the right SMEs while limiting risks of crowding out. It has provided them with relatively simple safe-harbour rules for SMEs affected by proven market failures and appropriate flexibility to design tailor-made risk capital schemes which do not fulfil the safe-harbour conditions.

³³ These are measures providing for: (i) investment tranches beyond EUR 2.5 million per target SME over each period of twelve months, (ii) expansion capital for medium-sized enterprises in non-assisted areas (iii) follow-on investments beyond the safe-harbour thresholds, (iv) a minimum participation by private investors below 50% in non-assisted areas and 30% in assisted areas, (v) seed capital to micro and small enterprises with less or no private participation by private investors, and/or predominance of debt, (vi) directed to alternative trading platforms or (vii) to scouting costs.

³⁴ See Annex 2

Despite such positive features, it emerges from the Commission case practice and the public consultation that, in its practical implementation, the current regime for risk capital has encountered several problems.

Risks of undue restrictiveness and over-deterrence

In general, the current risk capital regime is considered to be too restrictive both in terms of eligible SMEs and their financing forms, aid instruments and funding structures. The main issue raised in this respect is that at present, the GBER and the Guidelines target only SMEs in their early-growth development stages (seed, start-up and expansion phases). However, there is evidence suggesting that SMEs in their later-growth stages also face market failure when seeking access to a level of finance which is below the level where private equity investors would be interested to enter.

A second main issue stems from the fact that the current rules require that 70% of the total budget of the risk capital measure takes the form of equity or quasi-equity investment, leaving the remaining 30% for possible debt instruments and/or for liquidity management. Case experience shows however that a considerable number of measures use this part of the funds' allocation for the provision of sub-commercial/unsecured loans linked to equity investments³⁵, market-conform loans³⁶ or *de minimis* loans. This requirement could have, therefore, unduly restricted the ability of fund managers to strike the appropriate balance between equity and debt in their deals with target SMEs, thereby deterring potential investors seeking for a balanced mix of fixed returns generating an income stream combined with good prospects for future capital gains, and also SMEs, whose owners may wish to retain a certain part of their equity-holding in the company and therefore, would also favour a balanced equity-debt investment.

Finally, it has also been observed that lack of clarity as to the criteria applicable to, and the evidence required under the detailed assessment for approving aid to alternative trade platforms has discouraged Member States to design proper measures aiming at correcting possible failures in this market segment. In the reference period, the Commission was notified and approved only one measure for an alternative SME marketplace³⁷.

Risk of undue permissiveness and under-deterrence

In some respects, the current rules may also be too permissive. A concern relates to the effectiveness of mechanisms for limiting aid to the investors or to the funds so as to keep it proportionate in view of the objective sought. In essence, aid to investors is presumed to be proportionate if the investments at the level of the target SME are limited to the annual investment tranche, which does not capture the quantum of aid for large investors. Consequently, investors may theoretically invest unlimited amounts under the measure, or benefit from any type of fiscal advantage, entitling them to large and/or unquantifiable amounts of State aid.

A second important concern relates to the effectiveness of the current rules in providing for the necessary safeguards against territorial restrictions (e.g. the requirement to only

³⁵ E.g. N 68/2009; N 136/2010; N 722/2009; SA.32147; SA.32835; SA.32525.

³⁶ E.g. N 355/2008; N 700/2007; N 395/2007; SA.34006. Loans are considered to be market-conform if they respect the reference rates, as indicated in the Commission notice on current State aid recovery interest rates and reference/discount rates for 28 Member States applicable as from 1 July 2013 OJ C 187/12, 29.06.2013.

³⁷ Case C 36/2005, Investbx, OJ L 45, 20.2.2008, p. 1. The positive decision was adopted following the opening of a formal investigation.

invest funds in a particular region) which may contribute to the fragmentation of VC industry and hamper the development of the internal market in this area. This issue is particularly pertinent as a large number of risk capital measures are regional in dimension (about 50% of the decisions in the reference period). The question here is whether too little or too local VC funds may end up financing inefficient firms or ignite subsidy races across regions with increasingly different funding capabilities.

Finally, fully public funds investing seed capital into small companies without any private investment at any level are currently subject to a 'light' detailed assessment³⁸. The question arises whether sufficient safeguards are in place to ensure that the screening of projects is undertaken in a profit-oriented manner, so that only the potentially viable companies are supported. More in general, the current RCG do not specify the type of evidence which should be required to properly balance the positive and negative effects of such measures under detailed assessment. Moreover, as regards the assessment of the negative effects of risk capital measures, the current rules seem insufficiently clear.

Unnecessary administrative and compliance costs

Under the current regime a number of measures which are likely to be unproblematic need nevertheless to be notified and assessed under the RCG.

Firstly, the scope of the GBER only covers public-private funds and excludes other common funding structures (e.g. co-investment of public funds and private capital at the level of each target SME), as well as certain widely used instruments (fiscal incentives, guarantees and other financial instruments), which therefore require notification and individual scrutiny. In particular, they do not provide an adequate legal framework for the assessment of fiscal measures clarifying when such measures are to be considered selective, such as to entail State aid. Pursuant to recent case practice, even if a fiscal incentive is open in principle to all investors and/or funds, irrespective of their forms, it may be de facto selective for instance because it may confer an indirect economic advantage to the target SMEs or because the eligible investments have to comply with the investment restrictions required by the RCG³⁹. For instance, Member States have notified a significant number of fiscal incentives, most often in the form of tax reductions or tax exemptions to investors or funds, which have led the Commission to adopt 17 decisions in this area during the reference period.

Secondly, measures which meet all the conditions of the GBER but foresee annual investment tranches between € 1.5 and 2.5 million require notification and are subject to a standard assessment under the Guidelines. This triggers unnecessary administrative and compliance costs for the assessment of cases for which market failures may be presumed and which are unlikely to raise serious competition concerns.

Finally, the same can be said for measures directly targeting scouting costs which must undergo a detailed assessment pursuant to Section 5 of the RCG⁴⁰.

³⁸ See e.g. N 263/2007 – Germany (Saxony) – Saxon Early Stage Fund (Technology Founder Fund Saxony).

³⁹ For a recent decision, see SA.34582 Italy measures to encourage risk capital investments in newly created enterprises. This measure foresaw a tax exemption for investors investing in SMEs through investment funds, independent of their form.

⁴⁰ The Commission approved only two measures involving scouting costs: N 629/2007 – France Régime cadre d'interventions publiques en capital-investissement régional, amended by N 415/2010; and N 722/2009 – Italy (Region Lazio) – Risk capital aid scheme, amended by SA.32525.

Inconsistencies with market practices and lack of clarity of certain compatibility conditions

In the first place, most stakeholders strongly argue that the regional dimension built in the GBER and RCG does not correspond to market realities and commercial logic. This criticism touches upon several provisions of the current regime, intended to differentiate State aid control to favour investments in assisted regions.⁴¹ It is argued that SMEs' growth potential and ability to access finance would not depend in fact on their location in a particular region, as business finance markets are national in scope or even wider.

In the second place, case experience shows that the use of financial instruments has rapidly developed in recent years and the current rules may not be sufficient to duly cover measures involving these instruments. The GBER covers only the public-private venture capital fund model, excluding other types of financial instruments and funding models. While the current Guidelines foresee a range of financial instruments, they do not specify any key criteria for their design.

Finally, there are a number of concepts in the Guidelines which are open to interpretation or difficult to apply in practice. Thus, it appears that the criterion of commercial management underpinning the safe harbour rules gives rise to divergent interpretations, in particular in the case of public funds managed by public sector bodies. Another question relates to the need for the measure to leverage private capital up to the required minimum ratios and to the weight that 'love money' (i.e. capital invested by the owner of the target firm or his relatives and friends) should have in establishing the proof of the incentive effect of such a measure⁴², as well as the qualification as private capital of market-conform interventions by public entities. More in general, the minimum requirement of 50% or 30% private participation depending on the assisted/ non-assisted status of the investment area is claimed to be particularly difficult to achieve irrespective of location for measures supporting SMEs in their seed stage.

4. OBJECTIVES

This section sets out the general policy objective pursued by the review, along with several more specific underlying objectives.

4.1. General objective: make European SMEs more competitive in a global marketplace without distorting competition in the internal market.

One of the key priorities set out in the Europe 2020 Strategy is to ensure a healthy supply of and access to debt and equity finance for SMEs in Europe through actions well designed to stimulate and leverage private investments. The proposed options for a new State aid regime for risk finance have therefore to be seen in connection with a number of parallel initiatives by the Commission.

⁴¹ In particular, at least 50% private participation is required if the measure targets SMEs located in non-assisted areas, while this ratio is reduced to 30% in assisted areas. Moreover, in non-assisted areas, medium-sized companies in their expansion phase are excluded from the scope of the GBER and require detailed assessment under the RCG. Also, the cumulation rules are different according to the assisted and non-assisted status of the target investment area.

⁴² For recent cases where 'love money' counted towards the required level of private participation, see cases SA.31730 – France – Fonds National d'amorçage; and SA.34006 – Italy – Fondo regionale di Venture Capital.

In particular, within this policy context, the Action plan to improve access to finance for SMEs⁴³ recognises that while the Union's success depends largely on the growth of SMEs, these firms often face significant difficulties in obtaining financing. In order to address this challenge, the Action plan advocates for various policies, including the use of regulation to make SMEs more visible to investors and markets more attractive and accessible for SMEs. Most recently, two regulations relevant to investments funds were adopted: the Regulation on venture capital funds in the Union⁴⁴, which enables venture capital funds in the Union to market their funds and raise capital across the internal market, and the Regulation on European Long-term Investment Funds⁴⁵, which has introduced a new form of investment fund whose successful development requires investors' long-term commitment

In line with these policy orientations, the Commission intends to use the Union budget to facilitate access to finance for SMEs to address key market failures that limit the growth of SMEs and, to this end, has made proposals designed to enhance the use of new financial instruments⁴⁶ under the 2014-2020 Multiannual Financial Framework (MFF). Thus, the implementation of COSME⁴⁷ and Horizon 2020⁴⁸ will endeavour to improve access to equity and debt finance for SMEs and mid-caps in their start-up and growth phases, with a particular emphasis on actions designed to provide seamless support from innovation to market, including the commercial implementation of R&D results. In addition, under the future Common Provisions Regulation for cohesion policy⁴⁹, the use of financial instruments (FIs) (both equity and debt) will be enhanced, by extending their scope and by rendering their implementation frameworks more flexible and effective.

⁴³ Communication from the Commission, An action plan to improve access to finance for SMEs, COM (2011) 870 final, 7.12.2011.

⁴⁴ Regulation (EU) 345/2013 of the European Parliament and the Council of 17 April 2013 on European venture capital funds, OJ L 115, 25.4.2013, p. 1.

⁴⁵ Proposal for a Regulation (EU) of the European Parliament and of the Council on Long-term Investment Funds, COM(2013) 462 final, 2013/0214 (COD).

⁴⁶ Financial Instruments (FIs) cover non-grant financial instruments, which may take the form of debt instruments (loans, guarantees) or equity instruments (pure equity, quasi-equity investments or other risk-sharing instruments).

⁴⁷ http://ec.europa.eu/cip/files/cosme/com_2011_0834_proposition_de_reglement_en.pdf. COSME (Programme for Competitiveness of Enterprises and SMEs 2014-2020) aims at ensuring access to finance for SMEs through dedicated financial instruments and target companies in different development phases: creation, expansion and business transfer. The available instruments are Equity Facility for Growth (providing venture capital for enterprises in particular in their growth phase) and Loan Guarantee Facility (covering loans up to EUR 150 000 available for all types of SMEs). Those instruments will be managed by the European Investment Fund in cooperation with the financial institution of the Member States.

⁴⁸ http://ec.europa.eu/research/horizon2020/pdf/proposals/communication_from_the_commission_-_horizon_2020_-_the_framework_programme_for_research_and_innovation.pdf#view=fit&pagemode=none. The Horizon 2020 Framework Programme for Research and Innovation in the European Union (2014-2020) sets out a number of objectives, each of them supported through a dedicated Specific Programme. The Industrial leadership and competitive frameworks Specific Programme will aim at promoting research and innovation with a business driven agenda and will increase investment *and* facilitate access to risk finance, building on the success of the FP7 Risk Sharing Finance Facility and the CIP financial instruments, so as to provide EU-wide support for innovation in SMEs with high growth potential, as well as small mid-caps and larger innovative mid-caps.

⁴⁹ Amended proposal for a Regulation laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Council Regulation (EC) No 1083/2006, COM(2013) 246 final, 2011/0276 (COD). In particular, the new rules for structural funds aim to provide standard terms and conditions for a set of predefined financial instruments (the so-called "off-the-shelf" instruments) in order to facilitate the design and the management of the most commonly used financial products within the European Structural and Investment Funds (ESIF)⁴⁹. Each "off the shelf" financial instrument must be designed in a way to ensure upfront compliance with State aid rules. The objective here is to design such instruments in such a manner as to be either market-conform, or in line with the *de minimis* Regulation or the General Block Exemption Regulation (GBER).

The policy initiative of reviewing the current risk capital rules has to be seen in this more general context. Its general objective is to ensure that public intervention in this field aims at correcting market failures in the most efficient and effective way while ensuring a level playing field among Member States. Furthermore, it aims at ensuring that public funds complement private capital so that private operators are not crowded out.

4.2. Specific objectives

To allow for a more systematic and thorough assessment, this general objective can be broken down in the following specific objectives.

4.2.1. Fully addressing the market failure in SMES' access to finance

As explained in section 3, market failure is not limited to early stage but affect SMEs beyond their early-growth stages, i.e. in their later expansion/growth stages. In some instances, small midcaps and innovative midcaps may, face the same market failure as SMEs⁵⁰. The aim is to provide straightforward and operational eligibility criteria that would adequately capture companies facing a funding gap (due to their lack of track record/reputation, small scale and/or their inherent business risk) and uncertainty of cash flows for the financing needs of their growth plans (e.g. ramp-up of capacities for the production of new products), while maintaining the necessary safeguards to ensure that competition in the internal market is not distorted.

4.2.2. Enabling efficient functioning of the EU venture capital markets

The policy objective of the current rules is to stimulate risk capital investments predominantly in the form of equity or quasi-equity (70% of the measure), as opposed to standard debt (capped at 30%), so that the investment entails a significant degree of risk associated with potentially high returns. These rules are considered as not being sufficiently flexible and not reflecting normal market practices (VC funds are used to provide variable mix of equity and debt finance). It has been argued that the asymmetry of information problem is to a large extent the same for debt and equity investors and is generally due to the inability of early growth companies to signal themselves as viable business opportunities.

Moreover, the current GBER covers only the classic public-private fund model. This means that a large number of measures involving funds of funds and direct co-investment at company level by a fund entirely endowed with public capital must be assessed pursuant to the Guidelines.

The policy objective is to better reflect market practices and to streamline the assessment of individual measures which can be presumed compatible with the internal market, so as to enhance the development of a more efficient VC industry at the EU level.

4.2.3. Better regulation

EU's better regulation policy aims at simplifying and improving existing regulation, to better design new regulation and to reinforce the respect and the effectiveness of the rules, all this in line with the EU proportionality principle.

⁵⁰ European Investment Bank, Risk Sharing Finance Facility (RSFF), new ways to finance innovative midcaps, 30 November 2012.

Under the current regime, a number of measures which are likely to be unproblematic need nevertheless to be notified and assessed under the Guidelines. Therefore, an important objective is to shift the focus of the Commission enforcement away from cases where market failure may be presumed and which are unlikely to raise serious competition concerns. At the same time, the revised rules should ensure more legal certainty for Member States and companies by clarifying the compatibility criteria both under the GBER and the Guidelines, and by setting out a simple legal framework entailing lower compliance costs.

The better regulation policy objective will first aim at providing simplification. It is acknowledged that simplification produces benefits for market operators and thus enhances competitiveness of the European economy. It is geared to stimulate innovation and reduce administrative burden stemming from regulatory requirements as well as to move towards more flexible regulatory approaches and to bring about change in the regulatory culture.

It will also entail reducing administrative costs, understood as costs linked to the implementation of a new regulation (such as obligation to provide information either to public or private parties).

It is clear that a higher degree of awareness of the EU competition rules contributes to greater compliance with these rules and, hence, to better achievement of their objective to ensure fair competition on the internal market.

5. POLICY OPTIONS

The conditions that Member States should respect when granting State aid to promote access to risk capital for SMEs in their early development stages are set out in the Guidelines and the GBER. In all the four following options the revision of the Guidelines will be combined with revision of block-exemption provisions. The fourth option is the only option that considers abandoning the current architecture by doing away with the Guidelines and keeping only the GBER.

5.1. Option 1 - Baseline scenario: prolonging the existing Guidelines and GBER

After carrying out the revision process of the current rules, the Commission could envisage to continue the current policy, by extending for the next programming period the rules on State aid supporting SME access to risk capital (both the Guidelines and the General Block Exemption Regulation).

No changes would be envisaged in the eligibility criteria for the undertakings and the support would remain focused on the SMEs in their early stages. As far as the compatibility criteria are concerned, the mechanism of annual tranches capped at 1.5 million EUR with no limitations on the number of years in which the intervention is allowed, would be kept in place, without introducing further safeguards designed to limit the risks of overcompensating private investor. The focus of the rules on the forms of finance (on equity mainly) and on the classic forms of investment funds would remain unchanged, and other forms of financial engineering such as those covered by Horizon 2020 and COSME would have to be designed taking only into account the guidance

provided for in the Guidelines and, to the extent that they involve State aid, they would have to be notified and assessed on a case-by-case basis.

5.2. Option 2 - Revising the Guidelines in order to refine the rules on the assessment of compatibility and extend their scope

This option would maintain the structure of the current rules, *i.e.* the GBER, providing for specific safe-harbours conditions, and Guidelines (standard assessment and detailed assessment) for measures that do not comply with such conditions. At the same time, this option would imply a modification of the scope and compatibility criteria for the assessment of notified schemes. The rules could be refined to take into account the evolution of the market with respect to the size of the market failure affecting SMEs' access to risk capital and to address the problems already identified during the mid-term review of 2010.

5.2.1. GBER

The maximum annual investment tranche under the GBER could be increased to EUR 2.5 million, so as to respond to the shortcomings of the current regime, as highlighted in the point 3.1.3 above. While providing for a more realistic approach to risk capital measures, this higher ceiling would only partly address the financing gap faced by SMEs.

The eligibility conditions for SMEs would remain the same as under the current GBER (similar to Option 1) and their qualification for risk capital measure would continue to be linked to their development stages *i.e.* seed, start-up and expansion in relation to their location in assisted or non-assisted areas. The currently required ratio of the private participation, linked to their location (50% in general or 30% in the assisted areas) would also be maintained.

In addition more funding structures, such as funds of funds, or co-investment, could be covered under the GBER.

Under this option, the Commission would not radically change its enforcement practice, as only more simple measures would be covered by the exemption, while more complex measures would continue to fall under both standard and detailed assessment pursuant to the Guidelines.

5.2.2. Guidelines

a) A wider standard assessment

First, Option 2 could envisage broadening the range of eligible SMEs under the standard assessment by covering SMEs beyond expansion stages, irrespective of their location in assisted or non-assisted areas. The option could further increase the maximum annual tranche up to 5 million EUR, in this way responding partially to the stakeholders' views on the size of the funding gap. The approved measures would remain equity-based, however with more flexibility as regards the ratio equity/debt (which is set in Option 1 at 70% equity or quasi equity to 30% debt instruments). Moreover, the current ratio of private/public participation (50% or 30% depending on the location of the companies) would be maintained.

Secondly, Option 2 could consider shifting certain measures for which the Commission has sufficient experience as regards their impacts on competition from detailed

assessment to standard assessment in order to respond to the shortcomings identified in the section 3.2.1 above. This could be for instance the case for measures supporting scouting costs, and measures involving alternative trading platforms.

b) Detailed assessment

While some of the measures previously assessed under detailed assessment would be shifted to the standard assessment, as described above, the Option 2 would maintain the detailed assessment for measures with design parameters not complying with the conditions for standard assessment, and would also extend its scope. In particular, measures including specific downside protection mechanism or measures designed to include certain forms of replacement capital could be expressly dealt with under detailed assessment.

Moreover, for measures subject to detailed assessment, Option 2 could introduce a more flexible approach in respect of the assessment of measures where private capital participation would be below the standard ratios, on the condition the Member States can provide additional evidence regarding the width and depth of the relevant market failure.

The rationale of this option is to limit potential undesirable effects on competition while providing more flexibility to public and private actors in designing their measures, as well as more legal certainty. At the same time, this option does not fully take into account all the concerns expressed by stakeholders who, during the public consultation, have been strongly advocating for less rigid rules, based on a wider safe-harbour and more closely inspired by good market practices.

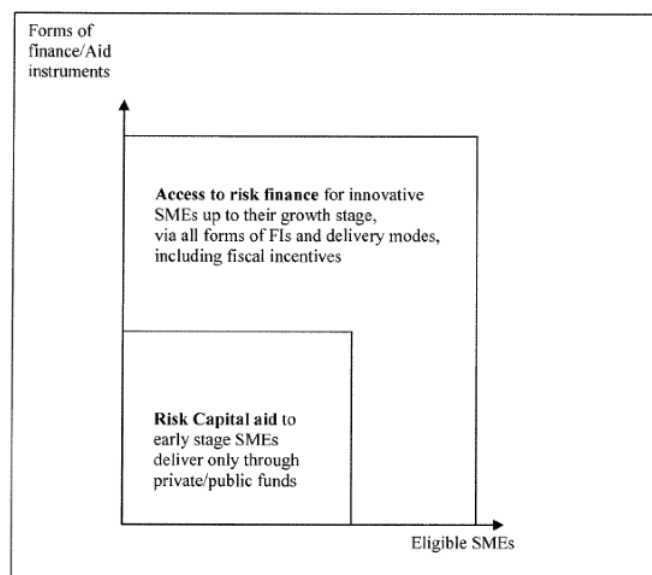
While slightly increasing the scope for exemption of risk finance measures, compared to Option 1, this option would cater only partially for the policy objectives underlying Horizon 2020 and COSME, as it would not cover beneficiaries other than SMEs, to the exclusion of small mid-caps and larger innovative mid-caps.

5.3. Option 3 - Build up a new architecture for the SME access to risk finance

Option 3 consists in a more far-reaching reform of the current rules both as regards their scope and the design of the appropriate compatibility criteria.

This option would go beyond the improvements presented in Option 2. In addition to the refinements considered under Option 2, the appropriate scope of the General Block Exemption Regulation and Guidelines could be revised, so as to examine how best to address the existing market failures as described in points 3.1. to 3.3. above, that hinder (1) the supply of all types of finance (including debt financing) to viable innovative SMEs and certain mid-caps up to their later expansion/growth stage, and (2) different funding structures and delivery modes.

In practice, the review would imply to change the scope of the current regime and a shift from a State aid regime for risk capital to a broader framework for SME access to risk finance as illustrated in the diagram below:



This possibility is consistent with the spirit of the SAM, and in particular with the objective of fostering growth of young innovative SMEs, while focusing the substantive assessment on a more limited number of cases with the biggest impact on the market.

5.3.1. *A wider safe-harbour under the GBER*

The block-exempted risk finance measure could be designed so as to target unlisted SMEs that, at the time of the initial investment round, fulfil one of the following eligibility criteria:

- they have not been operating in any market;
- that have been operating in any market for less than [7 years] following their first commercial sale⁵¹; or
- they require an initial risk finance investment which, based on a business plan prepared in view of entering a new product or geographical market, is higher than 50% of their average annual turnover in the preceding 5 years.

These eligibility criteria would bring within the safe-harbour of the GBER also those SMEs which become mid-caps after the initial investment round, except where such growth is the result of an acquisition by a larger company or of a merger between two SMEs.. Moreover, follow-on investments even beyond the [7-year] period could be eligible, which would encourage more potential investors to participate in investment rounds and provide better exit strategies for public and private investments in venture capital funds.

Acquiring shares from existing investors (e.g. business angels) is a common market practice and many of such operations take place with new/fresh capital being invested into the investee. Those transactions could have a positive effect on an investee and could facilitate the exit of the existing investors, thus enhancing their ex-ante incentives to invest. The GBER could encompass therefore replacement capital, subject to the

⁵¹ This rule could eventually be further refined by referring to the first entry in a new product market.

condition that such transactions would be combined with significant new capital being invested (for instance, 50% of the total investment foreseen into the investee).

It could also be envisaged to extend the scope of the safe-harbour and cover under the GBER any form of risk finance, including guarantees and loans provided via financial intermediaries, besides the currently allowed equity and quasi-equity instruments. The GBER could also provide a larger definition of financial intermediary⁵² so as to cover as many situations as possible. Moreover, the GBER could cover fiscal incentives to independent private investors that are natural persons, considering that, as raised in public consultation and confirmed by case practice, fiscal measures may be very efficient in incentivising investments into the appropriate category of innovative high growth SMEs.

For proportionality purposes, the maximum ceilings of the risk finance measure should also be adjusted to take account of stakeholders view claiming that an overall amount of 15 million EUR would be more in line with current market conditions. Thus, the introduction of an overall cap of €15 million per eligible SME (instead of allowing an unlimited number of annual tranches constrained within a predefined rolling cap of 1.5 million EUR) would safeguard the proportionality of the aid while reflecting the actual dimensions of the relevant market failure.

Aid to alternative trading platforms specialised in SMEs and aid for scouting costs could be, under conditions, block exempted.

5.3.2. *A substantive assessment focused on the more distortive individual cases*

Option 3 aims at simplifying the architecture of the rules by shifting into the scope of the GBER some of the measures previously coming within the standard assessment (see above p. 5.3.1) and by abolishing the distinction between the standard and detailed assessment. Therefore, in principle, any risk finance measure that doesn't fulfil the conditions for exemption, and is not expressly excluded from the scope of the Guidelines, should be notified.

In assessing whether a notified aid measure can be considered compatible with the internal market, the Commission would analyse whether the design of the measure ensures that its positive impact in reaching a common EU policy objective outweighs its potential negative effects on trade between Member States and competition.

In light of the common principles set out in the SAM initiative, in its assessment of the positive effects of the measure, the Commission would examine the following criteria:

- contribution to an objective of common interest,
- absence of market failure of the identified common EU policy objective,
- appropriateness of the aid measure in tackling the identified market failure,

⁵² Financial intermediary means any financial intermediary, regardless of its form of ownership including entrusted entities, fund-of-funds, private investment funds, public investment funds, banks, micro finance institutions and guarantee societies.

- incentive effect of the aid,
- proportionality (aid limited to the minimum),
- avoidance of undue negative effects and transparency.

If at least one on the above criteria is not met, the measure would not be considered to be compatible with the internal market. In all other cases, the Commission should conduct, in a second step, a balancing test of the positive effects in terms of improving access to finance for SMEs in their early development and growth stages against the identified potential undue negative effects.

The Commission would require Member States to carry out an *ex-ante* assessment in order to identify the policy targets of the measure and define the relevant performance indicators. The *ex-ante* assessment should also demonstrate the existence of a funding gap and the absence of market delivery affecting target SMEs in the area concerned. Both structural and cyclical problems leading to sub-optimal levels of private funding should be analysed.

The Risk Finance Guidelines could propose specific guidance as regards the substantial assessment of measures that are likely to be most commonly used. These could be grouped in the three following categories:

- Measures targeting categories of companies falling outside the scope of the GBER:
 - Small midcaps⁵³;
 - Innovative midcaps⁵⁴;
 - Undertakings receiving the initial investment more than 7 years after their first commercial sale;
 - Undertakings requiring higher amount of investment than €15 million;
 - Alternative trading platforms not fulfilling the conditions of the GBER.
- Measures with design parameters not complying with the GBER:
 - Financial instruments with private investors' participation below the ratios provided for in the GBER;
 - Financial instruments with financial design parameters above the ceilings provided for in the GBER;
 - Financial instruments other than guarantees where investors, financial intermediaries and their managers are selected on the basis of criteria giving preference to downside protection over asymmetric profit sharing;
 - Fiscal incentives to corporate investors including financial intermediaries or their manager acting as co-investors.

⁵³ “small midcap” means an undertaking whose number of employees does not exceeded 499, and whose annual turnover does not exceed EUR 100 million or whose annual balance sheet does not exceed EUR 86 million. For the purpose of the application of these Guidelines, entities shall be considered as one undertaking if any of the conditions listed in Article 3(3) of Annex II to the General Block Exemption Regulation is fulfilled ('linked enterprises')

⁵⁴ “innovative midcap” means a midcap (i) that can demonstrate, by means of an evaluation carried out by an external expert that it will in the foreseeable future develop products, services or processes which are new or substantially improved compared to the state of the art in its industry, and which carry a risk of technological or industrial failure or (ii) whose R&D costs represent at least 15% of its total operating costs in at least one of the three years preceding the first investment under the risk finance State aid measure or, in the case of a start-up enterprise without any financial history, in the audit of its current fiscal period, as certified by an external auditor. A “midcap” means an undertaking whose number of employees doesn't exceed 1500 including small midcaps.

- Large schemes falling outside the scope of the GBER by virtue of their large budget.

Option 3's new architecture would provide for additional flexibility and simplification, while, at the same time, the Guidelines should provide sufficient safeguards for the Commission to focus the substantive assessment on a more limited number of cases with the biggest impact on the market.

5.4. Option 4 – Blanket exemption and no more guidelines

The Commission could conclude, after carrying the revision process as envisaged, that the establishment of broad yet precise enough safe harbour under a revised GBER could cover most of the risk capital measures encountered in its case practice as well as new possible situations, thereby remedying the market failure affecting SMEs access to finance.

This Option would envisage not prolonging the Guidelines, meaning that the Commission would only adopt a GBER with a scope as wide as legally possible (based on the criteria developed supra in Option 3). Measures not covered by the GBER would be assessed directly under the Treaty, without any strict guidance as regards the condition to be fulfilled in order to ensure their compatibility. This would make the design of risk finance measures by Member States potentially very open and flexible but, at the same time, exposed to a higher degree of legal uncertainty.

In addition, the Commission would mainly rely on *ex-post* control, which may prove problematic considering the risks of distortions that risk finance measures could create on SME finance market across the EU (for instance in case of crowding out private investments)

Although theoretically possible, this Option risks introducing an unbalanced system based on large exemptions on one side and heavy notification process on the other side that could imply very high administrative cost for the Commission, national authorities, and SMEs.

It should also be noted that this Option has not been supported by any stakeholder during the consultation process.

Therefore, this Option will not be further assessed in the present Report as its shortcomings are very significant and run counter the overall objective of simplification underpinning the State Aid Modernisation.

Table 11: Presentation of Options 1 to 4

	GBER	Standard assessment	Detailed assessment	Treaty
Option 1	<ul style="list-style-type: none"> - €1,5M investment tranche per target undertaking, per 12 months, for an unlimited number of investment rounds - eligible SMEs in seed, start-up and expansion stages depending on geographic location - financing forms : 70% equity 	<ul style="list-style-type: none"> - Same conditions as under GBER but €2,5M€ annual investment tranche 	<ul style="list-style-type: none"> - measures with design parameter going beyond the thresholds and the conditions set out for standard assessment - alternative trading platforms and scouting costs 	All other measures

	quasi-equity / 30% debts - profit driven character of the measure and commercial management - 50%-30% private participation			
Option 2	- increase of exemption threshold to €2,5M - eligible SMEs: same as in option 1 (development stages combined with geographic location) - enlarged coverage of funding structures (funds of funds and co-investment)	- broader range of eligible undertakings: inclusion of SMEs beyond expansion (i.e. growth stages), irrespective of their location - same forms of financing: as in option 1 but more flexibility in the ratio between them; - increase of the threshold up to 5 mln EUR - alternative trading platforms and scouting costs	- measures covered by standard assessment but with different design parameters (for inst. measures providing for more extensive downside protection or certain forms of replacement capital)	All other measures
Option 3	- broader scope of eligible undertakings : SMEs beyond expansion (i.e. growth stage) irrespective of their location and defined through a more rigorous and verifiable eligibility criteria - overall investment cap per eligible undertaking increased (€15M) - all forms of finance – equity/quasi-equity, loans, guarantees or mix thereof and fiscal incentives for physical persons - inclusion of replacement capital at certain conditions and follow-on investments - alternative trading platforms and scouting costs -refined conditions for private participation rate leverage	<i>Discarded</i>	- eligibility: undertakings outside the scope of GBER (small mid-caps, innovative mid-caps) - measures with design parameters not complying with the GBER (private participation below the ratios, different financial parameters) - large schemes falling outside the scope of the GBER by virtue of their large budget	All other measures
Option 4	Same as in Option 3	<i>Discarded</i>	<i>Discarded</i>	All other measures

6. ANALYSIS OF THE IMPACT OF THE OPTIONS

This section presents the most significant elements as regards the impact of the policy options described in the previous section.

6.1. Assessment criteria

The following indicators are used for assessing the impact of each option.

6.1.1. Positive impact on competition in the internal market

This indicator will measure the impact of each option on the functioning of the internal market and competition. Options will score higher to the extent they prevent crowding out of private investors and adverse location effects altering the incentives of firms to establish their activities within the various regions of the EU while fostering growth in EU real economy.

Options will score higher to the extent they provide the right balance between adequate control on the notified measure by the Commission and limited distortions of competition within the internal market. This indicator will hence measure the legal architecture proposed by each option and its effects.

The legal architecture of the options therefore will refer to the limit by which the block-exemption thresholds could be exceeded, in particular in relation to the presumed market gap. In relation to the differences that could exist between the Member States the safe-harbour should be designed in relatively conservative manner so that to enable the Commission to focus on those cases where access to finance measures could be implemented in the countries where the percentage of the affected SMEs is the highest.

6.1.2. Consistency with market practices

This indicator will measure how the proposed new regulation integrates market practices in the design of risk capital/finance measures by Member States.

High scores will be obtained by options that better reflect the market practices. As shown by case experience, a considerable number of measures are designed to provide mixed aid instruments (equity and debt), which reveals the need for fund managers to find the appropriate balance between equity and debt in their deals and demand from the market for those type of mixed instruments and use of innovative financial instruments.

Options will score higher to the extent that they cover different types of finance needed by companies at their different stages of development, meaning they cover different aid instruments (pure debt, guarantees) and funding structures (funds of funds, public funds) while at the same time providing for the necessary safeguards in order to avoid distortions of competition in the internal market.

6.1.3. Leverage of private investment into SMEs

State aid may only be justified if it is targeted at a material market failure affecting the achievement of an identified objective of common interest while effectively providing proportionate incentives to private investors to take part of the risks in the underlying transactions. The Commission considers that there is no general market failure affecting all SMEs without distinction, but markets gaps for some investments at certain stages of SMEs' development due to imperfect information resulting in high transaction and agency costs.

Efficient leverage of private investment into SMEs shall mean that a deeper and more liquid market for fundraising exists and that the overall capital commitments that are channelled towards SME financing increases. Better allocation of capital flows to high growth and innovative sectors like life science, energy and environment or computer and electronics for instance is therefore beneficial for European growth.

This indicator will measure to what extent the proposed new rules encourage the participation by private investors in the designed risk finance measure. Options will score higher if they ensure a maximum leverage with minimum aid while targeting the right market failure.

6.1.4. Positive impact on employment and SMEs' growth

According to a 2005 study⁵⁵, companies backed by venture capital between 1997 and 2004 created about 630.000 new jobs in the EU in the period from 2000 to 2004. Although difficult to predict how the creation of new jobs would be affected by new State aid rules on risk finance, eligible companies have in general a high potential to create employment growth is to be expected.

This indicator will measure the potential impact of each option on job creation, SMEs creation and growth as well as jobs expected to be safeguarded.

Therefore, options will score higher to the extent that, as a result of the measure's investments, more SMEs will have access to finance without entailing undue distortions of competition in the internal market. High scores will be obtained by options that cover the identified funding gap affecting both SMEs and certain mid-caps while excluding, at the same time, investments not affected by this funding gap. It will consequently measure the coverage of eligible undertakings that will receive more finance from private investors.

6.1.5. Positive impact on VC funds' capitalization

The average size of a European venture capital fund is significantly below the optimal size for this type of funding instrument (in comparison with fund's size in the US, see above point 3.2.1). This indicator is to be considered in the light of the Regulation on European Venture Capital Funds that lays down a common framework of rules regarding the qualification of venture capital funds (in particular the composition of the portfolio of funds operating under the new EU qualification, their eligible investment targets, their investment tools and the categories of investors that are eligible to invest in them) as well as the proposal for a regulation on European long-term Investment Funds, which will introduce a new form of investment fund whose successful development requires investors' long-term commitment. The indicators for evaluating the achievement of such an objective could include the overall increase of the funds raised by the VC industry, compared to the GDP of the Member State concerned and to the aggregate EU GDP; the increase in the average size of the VC funds, in comparison to the EU and non-EU VC industry average, as well as the increase in the number of transnational operations.

Options will be evaluated as regards their ability to help VC investors to plan their investments on a pan European basis and on a long-term basis, in light of the general policy goals of the two EU funds regulations mentioned above, such as for instance into infrastructure, transport or energy projects. Options that would not bring forward sufficient safeguards against the current fragmentation and undercapitalization of the VC industry would have negative scores.

6.1.6. Legal certainty

A higher degree of awareness of the EU State aid rules, combined with simplified procedures contributes to greater compliance with these rules and, hence, to better achievement of their objective to ensure fair competition on the internal market.

This indicator will measure to what extent the formal modification proposed in the various options will provide for more legal certainty to Member States and stakeholders.

⁵⁵ Employment contribution of private equity and VC in Europe, EVCA Publication, October 2005

Options will be evaluated in the light of their ability to offer clear rules that cover a large number of applicable situations.

Options will score higher to the extent they provide clear assessment criteria and clear definitions making economic operators and Member States more aware of their rights and obligations under EU competition rules. Clear and simply formulated rules add to such awareness, just as much as they clarify the conditions applicable to aid to risk finance and therefore reduce the interpretation margins for Member States and increase the predictability of the Commission’s decisions. Options will score higher to the extent they also contribute to the simplification of the general architecture of the rules.

6.1.7. *Administrative costs*

This indicator will measure costs incurred by companies and national public authorities in order to meet notification or reporting requirements as well as costs to adapt to new rules (e.g training costs, compliance costs).

Options will score higher to the extent that they ensure a balanced application between block-exempted rules and substantive assessment while providing the necessary safeguards for a level playing field in the EU. Even if they lead to important changes in the regulatory context in which businesses and public authorities currently operate, compliance could be lower due to simpler rules and faster implementation.

Under the current rules, only approximately 1/3 of all risk capital measures were captured by the GBER. Moreover, 66% of the decisions were taken under the standard assessment procedure and 34% under the detailed assessment.

6.1.8. *Sectorial impacts in function of industry’s capital’ requirements*

The current risk capital guidelines are sector-neutral and therefore do not address sector-specific (e.g. environmental) concerns. Nevertheless, the on-going revision might have specific sectorial impacts since SMEs operating in some specific sectors are facing important financing needs (see point 3.1.2) and are also affected by the crisis (see point 3.3 above).

Options will here score higher to the extent they cater in particular for SMEs operating in capital-intensive sectors such as biotechnologies, pharma, green energy, clean technologies, etc.

The following table sum up the relevance of each impact indicator as regards the policy objectives, pursued by the RCG's revision.

Table 12 – Indicators and objectives

	Objectives	Better addressing the market failure in SMEs’ access to finance	Enabling an efficient functioning of the EU venture capital markets	Better regulation
Indicators				
1. Impact on competition in the internal market		✓	✓	
2. Consistency with market practices		✓	✓	
3. Leverage of private investment into SMEs		✓	✓	
4. Impact on employment		✓		

and SMEs' growth (enterprises covered)			
5. Impact on VC industry's capitalization		✓	
6. Legal certainty			✓
7. Administrative costs			✓
8. Sectorial impacts in function of industry's capital requirements	✓		

6.2. Identifying and assessing the impact of each option

This section sets out the conclusions of the Commission's assessment of the likely positive and negative impacts that Options 1 to 3 would have. Each option is assessed on its own merits, including Option 1, which is the baseline "no policy change" scenario.

6.2.1. Positive impact on competition in the internal market

Option 1, by providing a case-by-case analysis (both standard and detailed assessment) is, in principle, less prompt to result in undesirable effects on the internal market because the Commission has a large control on the relevant measures and therefore can detect and prevent distortive measures. However, since this option does not contain specific safeguards for limiting aid to investors, it does not entirely address certain concerns that exist in financial markets in terms of crowding out private investors.

Option 2 provides for a moderate improvement vis-a-vis Option 1 as regards the scope of compatibility rules and assessment criteria, but maintains the existing assessment architecture. Hence, the Commission keeps a large control on the risk finance measures designed by Member States. The scope of its control is slightly enlarged to new measures (replacement capital or screening costs for instance). Nevertheless, this should be balanced by the fact that the coverage of eligible SMEs is the same as in Option 1 and that the regulation of financing instruments and investment tranches are not deeply modified. This does neither affect the current functioning of competition within the internal market, nor does it address more substantially the issue of crowding out.

Option 3 provides for a broader exemption. Therefore, fewer cases would be controlled by the Commission upon notification. The risks of false negatives would be however minimised by the introduction, under this Option, of more safeguards for proportionate aid to investors and more rigorous and verifiable criteria for the identification of the eligible undertakings affected by the market failure.

It can be concluded from the foregoing that Options 1 to 3 rate the same as regards their impact on competition in the internal market.

6.2.2. Consistency with market practices

Option 1 would require that 70% of the total budget of the risk capital measure takes the form of equity or quasi-equity investment, leaving the remaining 30% for possible debt instruments and/or for liquidity management. Moreover, the scope of the GBER would only cover public-private funds and exclude other common funding structures, as well as certain widely used instruments (fiscal incentives, guarantees and other financial instruments), which therefore would continue to require notification and individual scrutiny.

Option 2 aims at better reflecting market practices by covering different models of investment such as funds of funds models but does not offer the possibility to cover under the safe-harbour of the GBER a wider range of financial and fiscal instruments that could be used to address SMEs' financing needs.

Option 3 tries to fully address the inconsistencies with market practices pointed out in the public consultation by introducing more flexibility in designing risk finance measures. For instance, Option 3 puts an end to the current regional distinction between assisted areas and other regions and acknowledges that SMEs' growth potential and ability to access to finance does not depend on their location in a particular region as business finance markets are national in scope or even wider. Moreover, some financial instruments such as guarantees and loans would be covered under the GBER, which would also contain a larger definition of « financial intermediary » that could allow different types of funding structures to invest under a risk finance measure. Moreover, Option 3 intends to better reflect market practices and commercial logic, in relation to capital replacement operations, eligibility of alternative trading platforms, scouting costs, or the increase of the investment cap (up to EUR 15 million) that is allowed under certain measures, etc.

It then can be concluded that Option 3 is the most consistent with market practices and better reflects what the market can offer in terms of investment instruments and funding structures.

6.2.3. *Leverage of private investment into SMEs*

Under the current rules (Option 1), both the GBER and the Guidelines (standard assessment) requires that at least 50% of the investment funds to be provided by private investors (30% when investment targets SMEs located in assisted areas). It is possible for Member States, under detailed assessment, to design measures in which private participation is below those ratios. In this case, the Commission would conduct a balancing test assessing both positive and negative effects of the notified measure. As it has proven difficult to reach these ratios in many cases, stakeholders have objected that the current requirements put an artificial constraint to the operation of VC funds. Therefore, even if this option requires ambitious targets in terms of leverage ratios, it may not deliver the expected results as many measures where such ratios would not correspond to market realities ought to be notified and approved on a case by case basis, which may hamper the efficiency of the measure by delaying the fund raising phase.

Option 2 does not modify the thresholds of private participation, but extends the scope of the safe harbor to encompass measures requiring the participation of private investors (public funds co-investing on a deal-by-deal basis, fund of funds structures). Private investors would be therefore more encouraged to participate in risk-capital measures.

Option 3 provides for more refined criteria as regards private participation at the level of the financial intermediary or the target SME. Under the GBER, private participation should represent at least 10% of the total investment in SMEs prior to their first commercial sale on any market; 40% for SMEs that have conducted commercial operations for less than 7 years and 60% for follow-on investment after such 7-years period. In addition, the Guidelines would introduce an outright prohibition for measures where no private capital participation. Overall, Option 3 sets out more realistic conditions

as regards private investors' participation in risk finance measures⁵⁶ and is therefore designed in a way to optimize the leverage effect in function of the underlying investment strategy of the selected financial intermediary, so as to enable most measures to be captured by the safe harbor of the GBER and reduce, therefore, the legal obstacles to an efficient operation of the fund raising phase.

Moreover, Option 3 provides for a broader coverage of aid to alternative trading platforms specialized in SMEs, both under GBER and the Guidelines. By attracting fresh capital into SME and by facilitating the exit of earlier investors, they can contribute to improve the functioning of SME financing market and stimulate additional leverage.

6.2.4. *Positive impact on employment and SMEs' growth*

In general, the available evidence⁵⁷ suggests that there is a positive correlation between increased supply of venture capital, on the one hand, and an increase in terms of employment and aggregate income in the target region. This seems due to the fact that venture capital allows the investees to create productive activities out of business ideas that otherwise could not be pursued.

In the light of this evidence, and insofar as the current rules have proven relatively effective in channeling finance to SMEs affected by a proven market failure, they have had a positive impact on employment by helping SMEs to start up and hire new employees. Therefore, as Option 1 and 2 cover a similar range of eligible SMEs, it may be assumed that these two options have a similar positive impact on employment and SME's growth.

Option 3 is intended to cover a wider range of eligible undertakings, including SMEs in their seed and startup phase, but also SMEs at later expansion and growth stages. Moreover, under Option 3, and subject to adequate economic evidence being provided by Member States in their *ex-ante* assessment of the measure, the new Guidelines would extend the State aid compatibility conditions to small midcaps and larger innovative midcaps. It is to be noted that the *ex-ante* assessment would require Member States to provide the estimated number of new undertakings created during the implementation of the risk finance measure, as well as the number of jobs created in the final beneficiary undertakings between the date of the first risk finance investment under the measure and the exit. These data could ensure that the measure pursue specific policy objectives such as enhancing employment and growth. In addition, by suppressing the annual investment tranches and setting out an overall investment limit per eligible undertaking, Option 3 would allow investors to better plan their investment strategy in the target companies, which may help the investee to release its full potential in terms of job creation and growth.

Therefore, in the light of the above, it can be assumed that that Option 3 would have the strongest positive impact on employment and SMEs' growth.

⁵⁶ Even if the ratios are lower compared to Option 1 and 2, they are closer to market realities and design to better control excessive aid to investors

⁵⁷ See for instance *Venture capital, entrepreneurship and economic growth report* - <http://martinprosperity.org/media/agrawal/3SorensonSamila.pdf>

6.2.5. *Positive impact on VC funds' capitalization*

As already observed in Section 3.2.1 above, the European VC industry lacks critical mass and efficient scale in terms of average fund size, in particular if compared with the situation in the US.

This indicator is to be considered in the light of the new EU Regulation on Venture Capital Funds that lays down a common framework for funds operating within the internal market, as well as the recent proposal for a regulation on European long-term investment funds. It is to be expected that, once this new legal framework will be fully implemented, the overall structure of the European VC industry should evolve through the development of VC funds of optimal size and with investment strategies based on a wider geographic reach. In this respect, the regime applicable to risk finance aid can be a useful complementary policy tool in as much as it would contain appropriate safeguards against an excessive fragmentation of aided funding structures, both in terms of funds' capitalisation and territorial footprint of their investments.

As shown in Annex 1, about 51% of all decisions take in the area of risk capital aid concerned measures with a regional focus, i.e. funding structures with generally low levels of capitalisation and a narrow geographic scope for investments. Moreover, the current requirements for minimum private participation ratios are based on the distinction between assisted and non-assisted areas of intervention, which constitute an incentive to the set-up of funds with a regional focus. In addition the current rules do not contain any specific safeguards for ensuring that public funding is channelled through funding structures having a sufficient scale to ensure their economic self-sustainability. Therefore, by adopting the same approach as under the current regime, Option 1 would not substantially improve the situation.

By covering under the new GBER different models of investment such as funds of funds and co-investment models, Option 2 would provide certain incentives to Member States to better grasp the efficiencies of different funding structures, thereby helping to improve the operation of regional VC funds. However, while slightly improving the current situation, it would not address the European dimension of this industry.

Option 3 provides for more far reaching safeguards. Firstly, by eliminating the regional divide between assistant and non-assisted areas, it would remove the existing incentives for Member states to continue giving preferential support to funds with a narrow regional focus. Secondly, it would contain under the new GBER specific safeguards aimed at ensuring that, in order to benefit from the safe harbour, the selected financial intermediaries should undergo a due diligence process to ensure a commercially sound investment strategy, including an appropriate risk diversification policy aimed at achieving economic viability and efficient scale in terms of size and territorial scope of its portfolio of investments. Thirdly, as in Option 2, this option would cover under the GBER a wider array of investment models, thereby providing more possibilities for Member States to choose the most efficient funding structure. Lastly, the new Guidelines envisaged under Option 3 would also contain a requirement for ex-post evaluation of regional funds, so as to enable Member States to consider corrective measures to address possible problems of undercapitalisation based on the concrete experience gained through an initial implementation phase of the measure.

In the light of the foregoing, even considering the difficulties in measuring the actual impact of each option, particularly in view of the concomitant deployment of new

regulatory initiatives to improve the functioning of the internal market for VC funds, it could nevertheless be assumed that Option 3 is the most effective in pursuing the objective of enhancing the efficiency of the VC industry.

6.2.6. *Legal certainty*

Option 1 currently ensures a certain degree of legal certainty since the current rules establish criteria and guidance as regards both cases falling within the safe harbour and cases under standard and detailed assessment. Nevertheless, the outcome of the public consultation revealed that Member States and stakeholders consider the scope of the current GBER too narrow and the criteria for individual assessment too complicated and involving too much red tape.

Option 2 provides for a moderate increase in legal certainty as it refines the assessment of compatibility and slightly enlarges the scope of the safe harbour under the new GBER. However, since this option does not significantly modify the current approach to cases subject to either standard or detailed assessment, its purported simplification objective is not fully achieved.

Option 3 can be considered more effective in strengthening legal certainty because it provides a more radical simplification of the architecture of the rules. On one hand a wider array of measures would fall under the GBER. On the other hand, the new Guidelines would provide clearer guidance as regards some category of notifiable measures which may require a closer scrutiny due to their potential distortive effects. Member States and enterprises would also be better informed about the evidence to be submitted in order for their measure to be approved.

Therefore, Option 3 seems to be the most balanced option, considering it provides clear assessment criteria, clear definitions and a simpler legal architecture, making economic operators and Member States fully aware of their rights and obligations under EU competition rules.

6.2.7. *Administrative costs*

Costs incurred in Option 1 by companies and national public authorities in order to meet the notification or reporting requirement are quite high considering the architecture of the current rules (standard and detailed assessment). Member States, in order to go through the notification process, have to provide detailed explanations and economic evidence under standard assessment even more so under detailed assessment

By maintaining the same architecture and the same notification requirements, Option 2 would not materially change the situation compared to Option 1.

By bringing important changes in the regulatory context, Option 3 would imply a moderate increase for Member States in terms of compliance costs, due to the necessary adjustments to the national legal basis for existing schemes. However, since this option would extend the scope of the GBER so that a significant higher number of risk finance measures would be released from the notification requirements, Option 3 would at the same time reduce the administrative burden for Member-States linked to the notification process and undertakings. If the ratio between the block-exempted measures and measures individually assessed under the Guidelines has been approximately of 1/3 to 2/3 under the current regime, Option 3 is expected to reverse this ratio. Moreover, as the

standard assessment of the cases falling under the current Guidelines took 7 months on average, Option 3 would help Member-States to proceed with a faster implementation of many of their risk finance measures.

It should also be noted, however, that Option 3 would also strengthen the standard of proof for cases falling under the new Guidelines by requiring Member States to submit a fully-fledged *ex-ante* assessment with detailed evidence regarding the alleged market failure. Therefore, this (numerically limited) category of cases would entail more efforts from Member States to justify the intended design for their risk finance measures.

On balance, one can conclude that Option 3 scores slightly better than the other two options in terms of administrative costs.

6.2.8. Sectorial impacts in function of industry capital's requirements

Option 1 and 2 provide for the same coverage of eligible SMEs and are sector neutral which means that capital intensive companies are eligible on the same conditions as other SMEs.

Option 3 goes further by covering, subject to substantive assessment under the new Guidelines, also measures targeting small mid-caps and larger innovative midcaps⁵⁸ with higher capital requirements than start up SMEs. In doing so, Option 3 acknowledges that midcaps, especially those heavily investing in R&D and innovation activities, may still have a track record that does not enable potential investors to make relevant assumptions as regards the future market prospects for such activities and may face the same financing constraints as those affecting SMEs. Moreover, as this option would allow investments up to an overall investment cap of EUR 15 million and over a longer period of time, the risk finance regime envisaged under Option 3 would better adapted than the other two options to support companies operating in capital intensive sectors or having longer development cycles. .

7. COMPARISON OF THE OPTIONS

Having presented the impacts of each option, a comparison of the various options can be done by assessing their effectiveness, efficiency and coherence with the objectives identified. Effectiveness refers to the extent to which options achieve the objective. Efficiency refers to the extent to which the objective can be achieved for a given level of resources / at least cost (cost-effectiveness). Coherence refers to the extent to which options are coherent with the overarching objectives of EU policy.

Following the identification and assessment of impact of each option, in light of indicators that corresponds to the policy objectives presented in section 4, this table provides a recapitulative overview of the main features of the options, in achieving the objectives, at the least cost and in coherence with EU policies.

Table 13 – Summary of impacts of Policy Option 1-4

Benefits achieved / problem addressed	Recapitulative overview of the main features of the options
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⁵⁸ See definition footnote n°45

	Option 1	Option 2	Option 3
1. Positive impact on competition in the internal market			
<i>Balanced system between adequate control on the measures designed by the Member states and limited distortion of competition</i>	0	0	0
2. Consistency with market practices			
<i>Aid instruments</i>	0	0	+
<i>Funding structures</i>	0	+	++
3. Leverage of private investment into SMEs			
<i>Minimum private participation</i>	0	+	++
<i>Aid to alternative trading platforms</i>	0	+	++
4. Positive impact on employment and SMEs' growth			
<i>Job creation and support throughout SMEs development cycle</i>	0	0	+
5. Positive impact on VC funds' capitalization			
<i>Regional dimension of funding structures</i>	0	+	++
6. Legal certainty			
<i>Architecture of the rules - simplification</i>	0	+	++
7. Administrative costs			
<i>Adaptation to new rules – compliance costs</i>	0	0	-
<i>Notification requirements – administrative burden on Member States and companies</i>	0	0	++
8. Sectorial impacts in function of industry capital's requirements			
<i>Specific coverage of capital intensive industries</i>	0	0	+

Legend: ++ strong positive impact; + positive impact; 0 no significant impact; - negative impact; -- strong negative impact, all options being assessed against Option 1 which is the baseline scenario.

It should be noted that all Options present similar traits:

- All three Options present positive impact on the internal market although not on the same aspects: Options 1 and 2 ensure a large control to the Commission on the measures designed by Member States and therefore can detect the most distortive ones whilst Option 3 provide more safeguards for aid to investors and ensure a better coverage of SMEs but within the context of a wider block-exemption;
- All three Options present positive impacts on employment and SMEs' growth, although Option 3 has stronger impacts.

Despite these common features, the three options present distinct characteristics as far as the other impact indicators are concerned. In particular, Option 3 presents the strongest positive deviations as regards the indicators capturing

- the relative consistency of each option with the practices prevailing in the SME finance markets, both in terms of types of aid instruments and funding structures

admissible under the alternative regimes, including their alignment with the EU initiatives aimed at enhancing SMEs' access to finance;

- the expected leverage effect , i.e. the ability of each option to provide the right incentives to private investors so as to maximise the additionality of the aid measure;
- the type of safeguards built into the regimes envisaged under each option and aimed at ensuring that Member States avoid an excessive fragmentation of their interventions via financial instruments and regularly monitor the operation of the funding structures put in place under their measures, so as to ensure an appropriate risk diversification at the level of the investees and a sufficient scale at the level of the funds;
- the level of legal certainty;
- the adequacy of the alternative regimes to respond to the challenges of companies operating in capital-intensive sectors

As far as the indicator concerning the impact of each option on administrative costs, Option 1 and 2 would score better than Option 3 only in respect of the specific compliance costs pertaining to adaptation to the new legal framework of the national legal basis for existing schemes. This disadvantage, however, is largely compensated by the strong reduction of red tape and related administrative costs resulting from Option 3 which, in comparison to the other two options, substantially limit the need for notification of risks finance aid measures.

The assessment of the impacts shows that, on the overall, Option 3 dominates as it addresses inconsistencies with market practices, ensures adequate leverage of private investment into SMEs, has the expected most important positive impact on capital intensive industries and offers the strongest degree of legal certainty at lower administrative costs..

8. MONITORING, TRANSPARENCY AND EVALUATION

Monitoring, transparency and evaluation are part of the common principles that lay down the main elements of the compatibility assessment of aid measures and are applicable to all projects covered by the SAM initiative.

8.1. Annual reports and monitoring

In accordance with article 108 TFEU, *“the Commission shall, in cooperation with Member States, keep under constant review all systems of existing aid in those Member States”*.

The current Risk Capital Guidelines are adopted under the State aid rules of the Treaty. As a result, Article 21 in chapter VII (“Monitoring”) of the Council Regulation 659/1999 apply, as amended by Council Regulation 734/2013⁵⁹.

⁵⁹ OJ L 204, 31.7.2013, p.15.

All Member States that adopt aid schemes covered by the current Guidelines must submit annual reports on such schemes to the Commission. Such records must contain all information necessary to establish that the conditions regarding eligibility and maximum investment amounts have been fulfilled. These records must be maintained for 10 years from the date of award of the aid and must be provided to the Commission upon request.

The Commission will continuously monitor the implementation of State aid measures by Member States, through the monitoring exercise regularly launched by the services of Directorate General of Competition. This *ex-post* monitoring exercise involves a check of the legal basis and the list of beneficiaries and an evaluation of the implementation of the scheme for a sample of beneficiaries. It allows to detect and to correct irregularities in the implementation of schemes by Member States.

8.2. Transparency

In the new regime, it is considered to set up a general obligation, under the GBER and the Guidelines, to publish information on all aids granted. Member States would henceforth be required to publish on the internet the summary information about each aid measure; the full text of each aid measure (including its amendments, or a link providing access to it) and the information on each individual aid award.

8.3. Evaluation

The current State aid rules focus little on the actual, measured impact of aid schemes. Rather, schemes are approved *ex-ante* on the basis of pre-defined criteria on the assumption that their overall balance will be positive, without a proper evaluation of their impact on the markets over time. Monitoring focuses on compliance with the pertinent legal provisions in a sample of cases, while annual reports merely provide data related to the on-going implementation of the scheme. *Ex-post* evaluation in contrast has a distinct objective: it provides analysis on the effectiveness and efficiency of an aid measure and suggests improvements and lessons to be learnt.

For these reasons, under the umbrella of SAM, DG COMP has proposed to introduce more systematic *ex-post* evaluations of aid schemes. In the risk finance field, an evaluation may be required for (i) large aid schemes; (ii) schemes with regional focus; (iii) schemes with a narrow sectorial focus; (iv) schemes which are modified, where the modification impacts on the eligibility criteria, the amount of investment or the financial design parameter – the evaluation shall be submitted as a part of the notification; (v) schemes containing novel characteristics in particular with respect to the channel of funding; (vi) schemes where the Commission so requests in the decision approving the measure, in light of its potential negative effects.

These evaluations shall be carried out by independent experts and should be based on common methodology (for which DG COMP will provide guidance).

List of annexes

- Annex 1 – Summary of risk capital decisions taken under the 2006 RCG
- Annex 2 – Main results of the first public consultation (July-October 2012)
- Annex 3 – Main results of the Multilateral meeting with Member States (13 September 2013)
- Annex 4 – Chronology of the impact assessment report

Annex 1 – Summary of risk capital decisions taken under the 2006 RCG

Decisions adopted in the period of 18.08.2006 – 02.08.2013

For 7 years (August 2006 – August 2013), the Commission has adopted 99 decisions on cases, assessed under the Risk Capital Guidelines (RCG). The average annual number of decisions is approx. 14, and the actual number of decisions taken in the relevant calendar year ranges between 7 and 20.

Two thirds (66%) of those decisions were taken under the standard assessment procedure and the remaining one third required detailed assessment. The basic decisions represent the majority of the decisions (61%), and the basic ones requiring detailed assessment were 18%. Accordingly, the amendment decisions represent the other 39% of the all decisions taken, and the amendment decisions taken after detailed assessment of the measure were 16%.

There is no surprise in the fact that the decisions, taken in relation to the EU-15 Member States represent the vast majority of all decisions – 89%, most of which are cases related to Germany, Italy, France, the UK and the Netherlands. The remaining 11% of the decisions were taken in respect with the EU-12 Member States, of which the decisions in respect to Hungary, Slovenia and the Czech Republic are the major part (the data does not include Croatia).

The biggest part of the decisions concern measures regarding investments of a public fund into SMEs with private co-investors (53% of the decisions), followed by the joint public-private funds' investments into SMEs (32%), application of fiscal incentives (19%) and providing guarantees (13%). It should be noted that a scheme, assessed in a decision, may include several different measures, so the percentages sum can exceed 100. In 4 decisions measures for scouting costs (i.e. measures comprising direct grants to investors or financial intermediaries to cover part of their costs to scout new investment business opportunities and to carry out due diligence) were assessed. Only 1 decision regarding measure for alternative trading platforms was adopted, which reflects the fact that this type of platforms seem to have difficulties to emerge. In 8 decisions the Commission found that no aid was present. In 1 case a negative decision was adopted and one conditional decision was taken. The regional schemes represent 51% of all schemes assessed, and 14% of the schemes had a sectorial focus.

The above mentioned four types of measures are obviously the most useful and most commonly used, although there are also other possibilities, which should not be disregarded. The strong presence of regional schemes suggests that the risk finance support could be successfully tailored to the specific necessities of the regions.

Number of decisions

- Number of decisions adopted between 18.08.2006 – 02.08.2013: 99
- Average number of decisions per year: 14 - 15
- Standard assessment: 65 = 66%
- Detailed assessments: 34 = 34%
- Number of basic decisions: 60 = 61%
 - Basic decisions & detailed assessment: 18
- Number of amendment decisions: 39 = 39%
 - Amendment decisions & detailed assessment: 16

Number of decisions in relation to Member States

- Number of decisions taken per MS:
 - DE (33) = 33%
 - IT (12); FR (8); UK (7); NL (7)
 - AT (4+2); ES (3); IRL (3); BE (2); EL (2); HU (4); SLO (2), CZ (2)
 - PL (1); DK (1); LV (1); EST (1); FI (3); MT (1)
 - No decisions: PT, SW, LT, SK, CRO, BG, RO, CY

Number of types of measures (one scheme may include several different measures)

- Public fund invests into SMEs with private co-investors: 52 = 53%
- Public fund invests into SMEs without private co-investors: 13 = 13%
(0% private participation possible)
 - Of which no-aid decisions: 5
 - Of which JEREMIE: 2
- Joint public-private fund invests into SMEs: 32 = 32 %
- Public funds-of-funds invests into other funds that target SMEs: 9
- Guarantee measures: 13 = 13%
- Fiscal incentives: 19 = 19%

- Measures for alternative market places: 1
- Measures for scouting costs: 4
- JEREMIE decisions: 7
 - JEREMIE measures: 4 + 3 amendments
- No aid decisions: 8
- Negative decisions: 1
- Conditional decisions : 1

Features of schemes

- Sectoral focus: 12+1 (no-aid) = 13 %
- Regional schemes: 51= 51 %

Annex 2 – Main results of the first public consultation (July-October 2012)

These main results are to be read complementary to the overview of Commission's experience in implementing the current rules identified in Annex 1 above (which corresponds to part B of the questionnaire).

DG COMP received 49 contributions: 13 from Member States, 11 from public authorities, 24 from other organisations (registered and non-registered, both national (20 replies) and European (4 replies)) and 1 from a citizen.

1. SMEs' financing needs (question A.1)

The responses underline that SME need financing both for investments and working capital (taking into account sectorial differences, as well as development stages – highest investment needs identified in the seed and start-up phases). Regarding the type of investment needed by the SMEs in their different stages of development, the responses point out both equity and debt instruments necessity/preference in the early stages, pointing out also that access to either of these types of financing may depend on the development stage and industry, as well as that the preference for equity financing may be connected to the lack of sufficient assets or higher levels of risk. Business angels and venture capital are mentioned as classical sources of financing for young high-growth, innovative companies. Most of the respondents avoid fixing the exact ration between equity and debt financing, tying it mostly to the risk profile of the company and the type of business, although there are some, which tend to point out 100% equity financing in early stages; still, the predominant part of the responses indicate highest share of equity financing in the start-up phase.

2. Equity financing gap (question A.2.1)

The respondents agree on the existence of SME equity financing gap, although they have no predominant common understanding about its size, as the opinions on this topic vary from "very small" to "big", pointing out as well a considerable amount of money relevant to the size of it (linked specifically to the UK situation which exceeds the current threshold for a detailed assessment of the SA as per the RCG currently in force). There is an opinion that the evaluation of its size as "significant" is made in comparison with the other industrialized countries, e.g. USA. The responses mainly focus on the fact that the size of the equity gap is often linked to the development stages of the companies and level of risks taken. The most commonly used instruments to address the equity financing gap are common shares, but also subordinated loans or third party loans as well as a mix of them, adapted on a case-by-case basis.

2.1 Demand side constraints (question A.3.1)

The replies focused on the fact that SMEs have difficulties to prepare sound business plans, lack of experienced management and do not want to share control / ownership over the enterprise (structural factors). Transitional factors linked to the financial crisis add some difficulties but are not the main reason.

2.2 Supply side constraints (question A.3.2)

The replies here diverge from the difficulties for the investors to analyze and monitor the business strategy and to formulate an exit strategy to their increasing risk awareness, regulatory constraints (both national and EU-wide are mentioned), asymmetry of information and high transaction costs, the size and underdevelopment of the national equity financing market, crisis-related factors such as liquidity shortage... Some respondents also the respondents point out the lack of interest in investors to invest in

equity between EUR 200 000 and EUR 5 000 000, which they consider to form the actual size of the equity gap.

The replies also focus on the fact that the European VC market is fragmented into national market, is small compared to the US (lack of critical mass) and unattractive (low level of returns on such investments, lack of enough liquidity). In addition, the actors on this market are very diverse in nature and actions: European Business Angels are considered to be very selective as to the start-ups they finance, it is mentioned that pension funds should be more active on this market. The respondents also generally consider that alternative stock markets should emerge to stimulate the market.

3. Debt financing gap (question A.2.2)

The replies generally recognize the existence of a debt financing gap that constraint the supply of external debt financing: it is acknowledged that young innovative companies find it challenging to get debt financing and fulfill credit risk assessment due to lack of track record and because they are often loss making in the startup years. This is connected to credit crunch as a consequence of the financial crisis. However, this debt financing gap is not very well estimated in the responses. The most commonly used instruments to address the debt financing gap are standard loans, guarantees and mezzanine debt.

3.1 Demand side constraints (question A.4.1)

The respondents consider most often that the riskiness of the business model can be considered as main challenge, as well as the lack of sound business plan, sufficient collateral and track record. The fact that the amount of the loan needed often is very small also is pointed out.

3.2 Supply side constraints (question A.4.2)

The replies underline that the most important problems creating a potential debt financing gap for SMEs seem to be the lack of credit history of the company, together with the higher risks, lack of qualitative evaluation of companies business potential. Said constraints are believed to have been caused by both structural and transitional factors.

<p style="text-align: center;">Annex 3 – Results of the Multilateral meeting with Member States (13 September 2013)</p>
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All Member States without exception made positive comments on the draft Risk Finance Guidelines, welcoming the improvements offered by the proposal compared to the current system.

Beside this general view, several delegations put forward a number of points for further reflection, which could be grouped, into two categories: (1) comments on specific issues, mainly of technical nature, and (2) a number of horizontal issues cutting across all SAM projects.

As regards the **first category** (which involves risk finance provisions in both the GBER and the Guidelines), the five following aspects seem to deserve special attention:

1. Level of the overall investment cap: general demand to increase the proposed €10M threshold up to €15M.
2. SME status: several delegations strongly argued against the approach proposed under the draft GBER, which consist in covering only those SMEs which fulfill the conditions of the SME definition not only at the moment of the initial investment but also for each of the subsequent investment rounds. It was observed that this approach creates a fundamental legal uncertainty which could deter investors from engaging into the initial investment for fear of being hampered in their follow-on investments, while "punishing" successful SMEs becoming Mid-Caps thanks to the provision of risk finance. Moreover, the proposed solution would entail administrative difficulties linked to the need to notify measures initially covered by the GBER, but which could fall outside the safe-harbour just because one or more of the investees would have successfully progressed in its development ladder following the first investment. It was suggested that the SME status should be checked only at the moment of the first investment round (the follow-on investments being the necessary consequence of the initial decision to invest).
3. Eligibility conditions under the GBER: General demand to cover under the GBER all SMEs which have been operating for less than 7 years (instead of 5) following their first commercial sale
4. Minimum private participation ratios: In this respect, while certain demands seems reasonable and should be addressed (e.g. clarifications about the ratio applicable to funds investing in a portfolio of SMEs at different development stages) other suggestions seem difficult to accommodate (e.g. possibility of 0% of private participation for investments in SMEs at seed stage)
5. Regional Funds: Some Member States were concerned that the Guidelines would imply a negative presumption as to the compatibility of risk finance measures making use of regional funds. We clarified that the aim of the Guidelines was to indicate the need for a careful balancing of the possible inefficiencies resulting from funds operating at suboptimal scale with countervailing advantages resulting from the proximity of the managers to local market realities. In no case however was it the intention of the Guidelines to create a de jure or de facto presumption excluding regional funds from the scope of our proposed compatibility rules.

In addition to these main points, some delegations made constructive proposals for enhancing the clarity of the text.

As regards the **second category** of comments (horizontal issues), several delegations insisted on the following aspects:

1. Transparency: the GBER requirements would go too far. A better balance between ex-ante and ex-post requirements should be found.
2. Cumulation of aid without identifiable eligible costs and de minimis aid: consistency to be checked in the light of the wording used in the *de minimis* Regulation.
3. Evaluation: Delegations were generally unsatisfied with the proposal to make ex post evaluations compulsory in certain cases, as this would interfere with their own prerogatives.
4. Notion of aid: While recognizing that the explanations provided in the draft RFG on the market economy investor test were helpful, some delegations insisted for being consulted as soon as possible on the upcoming draft Notice on the Notion of Aid.
5. Firms in difficulty: many delegations noted a stark contrast between the concept of 'firm in difficulty' as defined in the R&R Guidelines (including the 3-year reference period) and the use of this concept in the context of the RFG (which exclude firms in difficulty from the scope of the eligible SMEs). The contrast stems from the fact that the typical targets for risk finance aid are firms which have not yet reached profitability and would qualify as 'firm in difficulty' under the criteria of the R&R guidelines.
6. Appropriate measures: 6 months is a too short deadline. In addition, the question was raised as to the possibility to use a simplified procedure to extend schemes that end in December 2013 until the entry into force of the new rules in June 2014.

Annex 4 – Chronology of the impact assessment report

12 September 2012: 1st Impact Assessment Steering Group (IASG)

3 December 2012: Transmission of the Roadmap to the members of the IASG

15 February 2013: 2nd Impact Assessment Steering Group

12 June 2013: 3rd Impact Assessment Steering Group

16 September 2013: 4th Impact Assessment Steering Group

18 September 2013: transmission of the Impact assessment report to the Impact Assessment Board (IAB)

16 October 2013: IAB Meeting

November 2013: Integration of IAB comments

December 2013: Inter-service consultation on the Impact Assessment Report followed by the publication of the Impact Assessment Report on the Commission's website