COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 4.11.2003
COM(2003) 654 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

ON IMPLEMENTATION OF THE RISK CAPITAL ACTION PLAN (RCAP)

1. EXECUTIVE SUMMARY

This is the fifth and final annual report

This Communication reports on progress in the implementation of the RCAP for the year 2002 and, where possible, for the first three quarters of 2003. It is the fifth since the adoption of the RCAP in 1998. It is also the final one as various European Councils had set, and confirmed, 2003 as the deadline to complete the Risk Capital Action Plan.

Important shift towards buy-outs

The year 2002 has been a period of adjustment to the prolonged downturn. Whereas the total amount of EU private equity investment has slightly increased over 2001, and is the second largest ever, there has been an important shift towards less risky buy-outs and more focus on follow-on investments leaving investment in early stage, particularly for seed investment in a difficult situation.

Highly fragmented market

Important differences between Member States still persist - one illustration of a highly fragmented market in Europe. The same can be said of the Accession Countries where risk capital is clearly underdeveloped.

The investment gap with the USA persists

The gap with the US remains. Investment in the US is still double than that in Europe. However this is better than in 2001 when investments in the USA were more than three times bigger and in 2000 when investments were four times bigger, but still, in accumulated terms, there is a long way to go. In addition, more money is still going in the USA to the (politically sensitive) companies in early stage.

Considerable progress in most areas

The EU regulatory framework has improved considerably. Tax issues being its weakest side. The growing awareness of the importance of entrepreneurship is fuelling a heavy Community agenda for the coming years. The same can be said of R&D where important measures are being developed for the 2010 horizon. Also public funding has been consistently approved, with State aid policy for the risk capital sector proving successful.

Most of the RCAP objectives have been attained.

When taking the RCAP period as a whole considerable progress can be reported, with all political, as well as many technical, objectives attained. The European risk capital industry is now much larger, more mature and professional than in 1998. Awareness by enterprises and public authorities about the strategic importance of this sector and the possibilities provided by this type of financing is now well enshrined in Europe. The RCAP has played a political role in supporting those directly or indirectly involved in risk capital activities. The philosophy behind the RCAP is already permeating other regional, national and Community policies and programmes. There has also been strong support from the European Parliament. This is an important achievement in itself.

A possible follow-up will be analysed

In order to keep up the momentum, the Commission will continue to follow the European risk capital markets closely. It will further analyse the areas where there still remain inefficiencies with a view of putting forward recommendations and proposals, as appropriate, with the Lisbon 2010 deadline in mind.

Of special concern is the situation of specialised stock exchanges for high-growth companies. Once the Accession Countries join the Community in May 2004, the EU will have so many exchanges that their long term commercial survival is unsustainable. In the US for example there are basically 2 large ones (NYSE + NASDAQ) plus a few successful ATSs.

Too many exchanges in the EU

So many exchanges, mostly small, fragments the liquidity available for small growing firms in the EU; driving up the cost of capital ; and reducing exit opportunities for venture capitalists. The time has surely come for the smaller European exchanges to formally link together – creating a common pool of European liquidity for European fast growing companies – based on a common, rigorous set of pan-European trading and corporate governance rules – which are being developed in the FSAP. Regional exchanges could also link to this pan-European specialised network – and hence to the larger exchanges. The Commission would welcome a strategic initiative by the industry in this sense.

The infra-structure for high-growth companies will have to be improved

2. INTRODUCTION

Since the adoption[1] of the **Risk Capital Action Plan (RCAP)** in 1998 the Commission has published *annually* a Communication, addressed to the Council and to the European Parliament, on the degree of progress achieved in its implementation. This **fifth** progress report[2] covers the year 2002 and, where possible, the first three quarters of 2003. It also includes an overall evaluation for the whole RCAP period (1998-2003[3]) as well as a framework for possible further action.

This is the fifth and final RCAP progress report

The RCAP was launched with the objective of eliminating persistent regulatory and administrative barriers, at Community and national levels, which may impede the creation of a truly single market in the risk capital area. In this regard the RCAP is an important component of structural reform as acknowledged at the Lisbon Summit.

The objective is to have a single market in the risk capital area

This Communication has been prepared by the **Commission's Risk Capital Working Group** which includes representatives from the EIF. Close consultation with the industry (EVCA and others) has continued and their opinions have enriched the debates.

Continuous contacts with the industry

Section 3 contains relevant market analysis and the outlook for the medium term. Section 4 reviews regulatory issues. Section 5 refers to tax matters. Section 6 focuses on entrepreneurship developments. Section 7 refers to R&D issues. Section 8 describes different aspects of public funding. Section 9 contains conclusions for the whole RCAP period. Section 10 proposes a framework for possible further action. Finally, the document is enriched with a number of relevant annexes.

The document is made up of 9 sections and the annexes

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1 Based on "***Risk Capital: A key to job creation in the European Union***", SEC(1998)522, April 1998

2 The previous ones were COM(1999)493 of 20 October 1999, COM(2000)658 of 18 October 2000, COM(2001)605 of 25 October 2001 and COM(2002) 563 of 16 October 2002

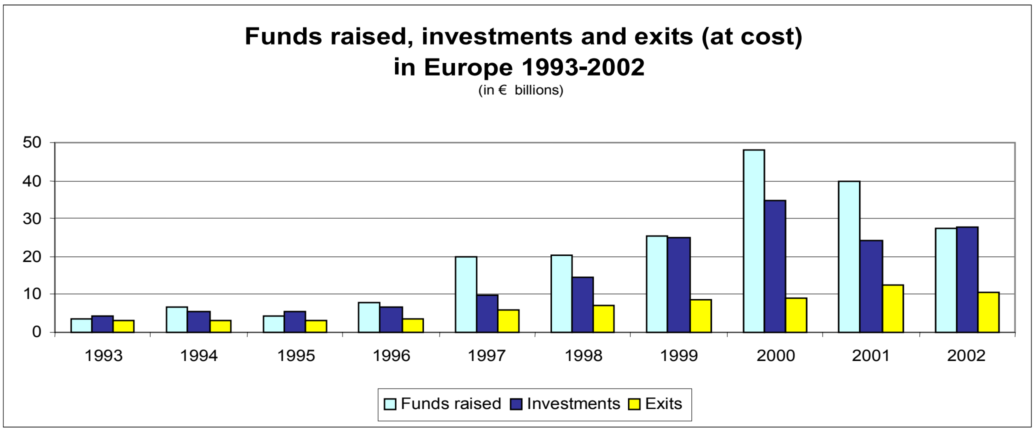
3 This date for the completion of the RCAP was requested at the Lisbon Summit (March 2000) and has been confirmed at subsequent Spring Summits (Stockholm and Barcelona)

3. MARKET DEVELOPMENTS[4]

3.1. The EU private equity industry in 2002

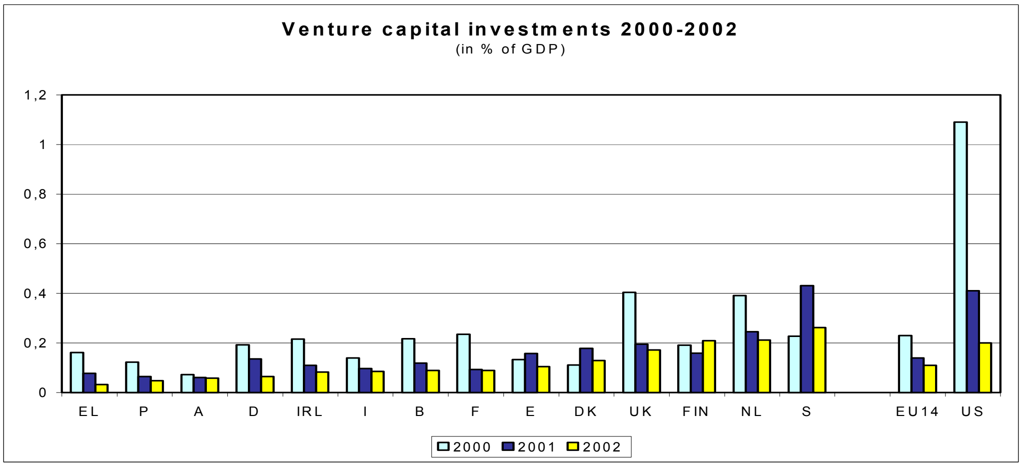
Slight increase in private equity over 2001

In 2002, total EU private equity investment, including both venture capital and buy-out investment, amounted to **€27 billion or 0.29 % of GDP**. A slight increase over 2001. The number of companies that received a private equity investment was approximately 7.800 of which one third were high-technology companies.



Venture capital contracted, buy-out expanded

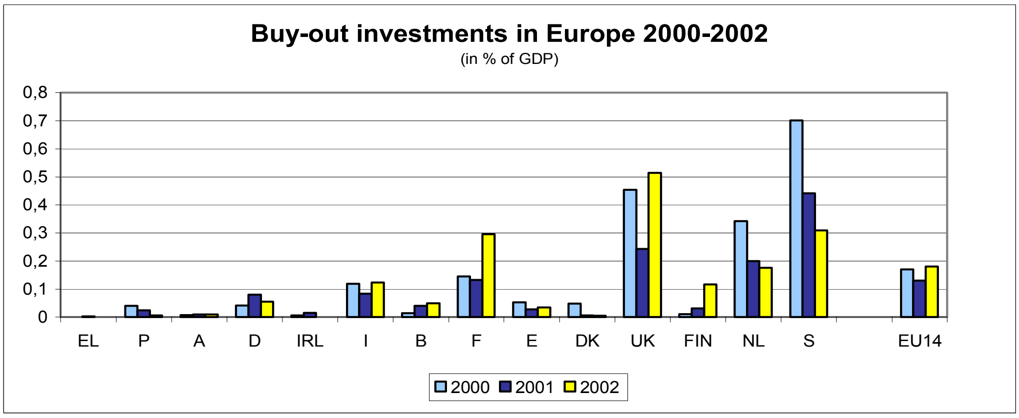
Whilst the investment volume held up well, there was a shift away from venture capital towards buy-outs. More specifically, the overall positive growth in EU private equity investment in 2002 was accounted for by buy-out investment that increased 57% from €10.7 billion to **€16.8 billion or 0.18% of GDP** last year. Venture capital investment contracted from €12.7 billion to **€10.1 billion or 0.11% of GDP**. Venture backed high technology investment (annex 4) was particularly hardly hit, reducing by 41% from €5.7 billion to €3.3 billion.



4 EU figures are derived from the survey conducted by PwC for EVCA and published in **EVCA's 2003 Yearbook**; US figures derive from the survey conducted by PwC and Venture Economics for NVCA (Money Tree Survey). These sources have been preferred to others as they give data consistent across countries (even if EU and US figures are not entirely comparable) for several years.

In 2002, as in previous years, there were significant differences at Member State level in the growth of private equity investment. Growth was strong in France (78%), Finland (78%) and the UK (52%). In contrast, investment activity fell significantly in Greece (-56%), Germany (-43%) and Portugal (-37%). In absolute terms, the UK private equity industry was the largest[5] with total investments amounting to €10.4 billion. The UK also had the highest investment level in private equity, as % of GDP, at 0.63% but was closely followed by Sweden with 0.58% of GDP. Other countries with high investment levels were France (0.39 %), the Netherlands (0.39 %) and Finland (0.33 %).

Differences between Member States persist



Examined further in terms of number of investee companies (annex 5), a more complex picture of private equity investment patterns emerges. The number of buy-outs supported by EU private equity houses grew by 13% suggesting that the 57% growth in investment volume may have been the result of a number of multi-billion euro transactions. The number of companies targeted by for venture capital investment also grew, even if marginally, despite the 26% drop in investment volume in 2002.

The amount of **funds raised** by European private equity houses in 2002 amounted to **€27.5 billion**, just below two thirds of the amount raised the year before, representing a further decline from the peak year of 2000. However, despite the downturn, the funds raised in 2002 still significantly exceeded the amounts raised in 1997-1998, the years corresponding to significant genuine growth of the European private equity market. This seems to suggest that the European private equity industry has reached a certain maturity.

Funds raised decreased

During the past decade, banks, pension funds and insurance companies have provided the bulk of funds raised for private equity investment contributing €50 billion, €40 billion and €25 billion, respectively, in 1993-2002. Combined they have accounted for between 67% (1997) and 56% (2002) of total funds raised. With the exception of government agencies, all investor categories reduced their commitment to private equity in 2001 and 2002, with pension fund investment reducing most sharply. In 2002, pension funds provided €4.3 billion of private equity funding, down from €10.2 billion in 2001. Insurance

Strong reduction of private equity investment

[5] EVCA figures attribute investments to a country on the basis of investments made by local private equity houses irrespective of the location of the investments. Figures for some countries thus include an element of outward investment. In the case of accession countries, significant inward investment has been attributed to the home country of the relevant private equity funds.

companies invested €3.6 billion in private equity in 2002, down from €4.7 billion the year before. The amount of funds allocated by banks to private equity in 2002 amounted to €6.8 billion, when in 2001 the figure was €9.2 billion. It may be assumed that most of the funds provided by banks were, however, for their captive private equity companies.

from pension funds

In 2002, funds raised for venture capital investment amounted to €8.5 billion, sharply down from the €15.0 billion of 2001. Fund raising for buy-out activity fared better, €18.3 billion raised last year, whereas in 2001 €23.3 billion was allocated for this purpose.

In 2002, the total €10.7 billion of European venture capital investment consisted of €3 billion of early stage investment and €8 billion expansion stage investment (annex 6). Early stage investment was broken down to €305 million of seed investment and €2.6 billion start-up investment, down 43 % and 28 %, respectively, in comparison to the year before. In excess of 500 seed companies received an investment which, on average, amounted to €570.000. More than 2.700 start-up companies received funding with average transaction size approaching €1 million. Almost 3.900 companies in the expansion stage received a venture capital investment that averaged €1.8 million.

Seed investment more affected by the downturn

As an indicator of the growth and maturity of the European private equity industry, at the end of 2002, there were just over 5.500 private equity executives in the EU (annex 7), down by 6.6 % from the year before, but 68 % above the 1998 number of 3.275.

Number of executives consolidated

Since 2001, the volume of write-offs (annex 8) calculated on the basis of cost of investment has moved to a different scale from where it was in 1993-2000. In 2002, 31% of exits, calculated at the cost of the original investment, were by write-off.

Write-offs have increased

3.2. The private equity industry in the Accession Countries

The private equity industries of the Accession Countries are at different levels of development. In terms of investment as % of GDP, the Hungarian is the largest. In 2001, the Hungarian private equity investment by local private equity houses amounted to 0.23% of GDP, close to the EU average of 0.27 % of GDP that year. However, in line with the overall European market developments, it contracted severely in 2002 to 0.03% of GDP. In absolute terms, investment contracted by 88% to €17 million from €143 million the year before.

Different levels of development in Accession Countries

The Polish market remains relatively very small in terms of investment in % of GDP, which amounted to 0.06 % in 2002 and 0.08 in 2001. In absolute terms, the 2002 investment volume of €137 million was comparable to some of the small Member States. The Czech and Slovak private equity markets may be considered as having reached critical mass. In 2002, investments amounted to €27 million and €5 million, respectively.

Consistently with the smaller markets in the Member States, the Czech, Hungarian, Polish and Slovak private equity investment was venture capital oriented with buy-out investment playing a minor or no role at all. Overall, in

Absence of

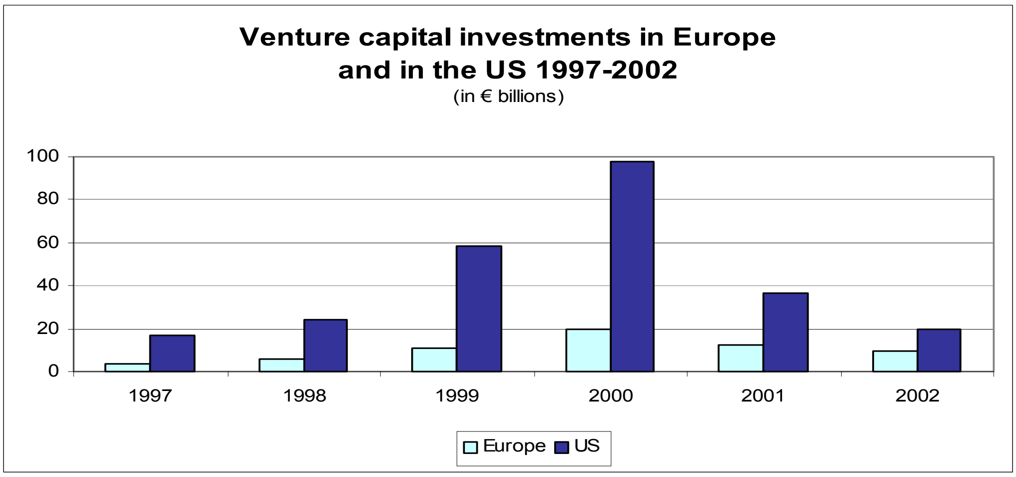
2002, banks were the most important source of funding, although in Slovakia government agencies played a major role. In 2002 private equity investment in Estonia, Latvia, Lithuania and Slovenia, taken together amounted to less than €5 million. No information was available for Cyprus and Malta.

buy-outs

3.3. Private equity in the EU in comparison to the US

The European venture capital investment has contracted less severely than the American one with the result that the difference in the level of venture capital investment is now more balanced. However, the venture capital investment gap is still there. Despite its nearly 50% decline, the US venture capital investment (annex 2) still corresponds 0.2% of GDP, as compared to 0.1% of GDP in the EU. In absolute terms, in 2002, the volume of **US venture capital investment (€20 billion) was twice that of the EU (€10 billion)**.

Stronger contraction in the US



In Europe early stage investment accounts for a slightly higher proportion of venture capital investment than in the US. This appears to contradict the generally held view that in the US it is easier for early stage companies to raise equity than in Europe. However, as the relative volume of venture capital investment in the US has exceeded investment in Europe many times over in the past, the venture capital funding for early stage was higher in the US.

Total early stage funding higher in the US

Moreover, in the US, around 60% of the companies that receive a venture capital investment belong to the early stage category, whereas in Europe the corresponding figure is approximately 40%. In the US around 20% of the volume of venture capital investment goes to companies that receive venture capital for the first time and 80% to companies already backed by venture investment. Inversely, in Europe those figures are 75% and 25% respectively..This may suggest that the US venture capitalist is in general more experienced and more willing to follow a long-term strategy, i.e. to provide investments in many sequential tranches as opposed to just one large capital injection which is more common to the seemingly less experienced one-time venture capital investor in Europe. Given that every disbursement would be subject to a review of the investee company, the US venture capitalist could be more likely to combine his investment with a commitment in terms of monitoring and management support.

The US more focused on follow-on investments

The US market has also experienced a steep downturn in fundraising for private equity. **In 2002, US$ 30.9 billion were raised,** down from US$ 82.6 billion in 2001 and US$ 180.2 in the peak year of 2000. The backlog of funds raised, but not invested is very much in evidence. The funds raised for venture capital amounted to just US$ 6.9 billion in 2002, down from US$ 40.7 billion in 2001 and US$ 106.9 billion in 2000. Concurrently with the low new fund raising for venture capital in 2002, 26 venture capital funds cancelled approximately US$ 5 billion of commitments received, for lack of attractive investments. The 2002 net funds raised for venture capital investment were thus only US$ 1.9 billion, an amount that corresponds to venture capital funds raised as far back as in 1991.

Huge backlog of funds to be invested

3.4. Exits and high-growth stock markets

In 2002, private equity investors in Europe exited 4.911 companies, down from 6.293 in 2001. Trade sales accounted for 821 and 1233 companies, respectively. In terms of investment at cost, trade sales accounted for 17% of total 2002 divestments, down from 34% the year before. In 2002, in terms of investment cost, private equity backed IPOs (including buy-out flotations) amounted to €703 million, up from € 250 million in 2001. In 2002, 41 private equity backed companies were floated in European stock exchanges, down from 47 the year before. In 2003, the markets became even less receptive.

Decreasing number of exits

As seen in annex 9, in the last three years, Frankfurt's *Neuer Markt*, Euronext's *Nouveau Marché*, London's *AIM* and *Nasdaq Europe* have lost most of their value. A loss more severe than that experienced by the main European stock markets. Moreover, none of the high growth markets had yet (mid-2003) reached the starting level from the beginning of 1998. Low trading volume caused by lack of investor appetite in small growth companies resulted in decisions to close the Neuer Markt and Nasdaq Europe. The European growth exchanges are often compared to Nasdaq, which was however established already in 1971 and lists in excess of 4000 companies, including some of the largest global companies that will always figure prominently in the portfolios of investors. This may explain why Nasdaq lost proportionately less of its total market capitalisation after the crash of early 2000 and why its recovery has been stronger.

NASDAQ fares better than EU high-growth markets

In 2002 the number IPOs reduced again. In the *Nouveau Marché*, only 2 new companies were listed in 2002, down from 10 in 2001 and 52 in 2000. One new company was listed on the *Neuer Markt* in 2002, compared to 11 in 2001 and 133 in 2000. On the *Nuovo Mercato* there were no new listing in 2002 against 5 in 2001, down from 30 in 2000. There were no new listings in the *Nuevo Mercado* in 2002, in comparison to 6 in 2001. On *AIM,* there were 60 new listings in 2002, down from 94 and 179 in 2001 and 2000, respectively. At the end of 2002, the *AIM* list included 704 companies (up from 629 at the end of 2001), the *Nouveau Marché* 135 (164), the *Nuovo Mercato* 45 (45), the *Nuevo Mercado* 13 (13) and the *Neuer Markt* 240 companies (down from 326 at the end of 2001). For trading volumes see Annex 10. Available data for 2003 is not encouraging. By midyear there were only one IPO in the *Nuevo Mercado* and 12 new listings in *AIM*.

Even more reduction in the number of IPOs

The on-going integration between the European stock markets, national and regional, will increasingly allow investors to efficiently trade shares cross-

Recovery to

border. The liquidity of the European market will increase. This will improve conditions for the listing of growth companies, but it cannot replace investor confidence in the future prospects of newly listed growth companies as the driving element in investment decisions.

be driven by investor confidence

3.5. Outlook for the European private equity industry

Total private equity investment in 2002 was the second highest level ever recorded (annex 1), and nearly three times that of 1997, the first year of very high growth in Europe market. This suggests that the European private equity has reached a level and a maturity that has allowed it to weather the recent set-backs reasonably well.

2002 second highest year ever recorded

In 1997, both venture capital and buy-out investments amounted to €4.8 billion. In 2002, venture capital investments in the EU amounted to €10.1 billion, down from €12.7 billion the year before, whereas buy-out investment reached €16.8 billion, its highest ever level. It appears that venture capital investment is still contracting, although at a reduced rate, whereas buy-out investment is again expanding.

Shift towards buy-outs

Whereas, during the period 1997-2001, the funds raised for new investment substantially exceeded investments, in 2002 funds raised was equal to investment volume, as it was the case for the period before 1997. In 2003 fund-raising has become progressively more difficult even for well established private equity funds with excellent track records.

Fund raising more difficult

The year 2002 saw a clear trend of banks starting to dispose of their captive private equity operations. During the last five years, banks have, on average, been the source of 26% of all funds raised in Europe. After the severing of ties, the banks' interest in taking care of the future funding of these entities is likely to wane and is it not evident whether the buy-out or venture capital segment would be more adversely affected.

Banks disposing of some of their private equity operations

The share of funding provided by pension funds during the last five years has also remained stable in the growing market, averaging 23%. Diversification to an equity type asset that has a different cycle from quoted equity is seen, generally, as beneficial. However, due to the collapse in quoted equity prices, the proportion of private equity in their portfolios now often exceeds target allocations and in the near term they may be unwilling to allocate additional funds to private equity investment. Whereas, in the medium and long term, the increasing funding of European pension liabilities could increase the supply of private equity considerably, the trend in some Member States towards defined contribution schemes could have the opposite effect.

More balanced investment from pension funds foreseen

There is some evidence that private equity is gaining acceptance as a separate asset class. The necessary benchmarking presents, however, considerable challenges. At industry level encouraging efforts are being made to develop generally accepted conventions and statistics for the measurement of profitability of this type of investment.

Appropriate benchmarks being developed

The lack of exit opportunities is generally perceived as the single most important factor holding back the recovery of the European private equity markets, especially venture capital investment in early-stage and technology companies. The low level of exits is particularly worrying against the back-drop of the high investment levels in 1998-2000 which, in normal circumstances, should be mature for divestment in the very near future. Companies are therefore increasingly dependent on follow-on venture-capital investments, raising temporarily the demand for this type of financing[6].

Lack of exit opportunities seen as the main problem

4. REGULATORY ISSUES

Since the inception of the RCAP in 1998, building an appropriate regulatory framework, both at Community and national levels, has been a top political priority. This acknowledges the fact that without a modern and flexible set of legal and administrative rules reflecting the needs of risk capital operators (the supply side) and enterprises (the demand side) risk capital markets will not flourish in Europe. As described below (see also annex 11) considerable[7] progress, since 1998, has already been achieved in attaining that goal.

Considerable progress in setting-up an appropriate regulatory framework

4.1. Measures included in the FSAP[8]

The completion of the FSAP proceeds relentlessly[9] and is expected to be finished, as requested by the Brussels Spring European Summit, by April 2004. This coincides with the final session of the current European Parliament and allows for enough time (normally 18 months) for transposition of the last adopted measures into national legislations before the end of 2005. Once completed the negotiation of the remaining FSAP measures, the focus of Community action should, logically, move into ensuring common implementation and enforcement at European level, including in the new Member States. Regarding in particular the RCAP measures also included in the FSAP, the progress has been substantial :

The RCAP is on track for its full completion

Measure: ***"Upgrading of directives on prospectuses to facilitate companies raising cross-border capital" (e.g. IPOs)***

The new directive on prospectuses has been adopted on 15 July 2003. As a result, once transposed, it will be easier and cheaper to raise capital all over the EU on the basis of a seal of approval granted by a Member State regulatory authority. This will facilitate risk capital exits (IPOs) and the introduction of companies in high-growth stock markets.

The prospectus directive has been adopted in the Summer 2003

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

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6 This applies in particular to life sciences companies with long product development times and large capital needs

7 In this regard, see point 8 of the Presidency conclusions of the Brussels Spring European Summit (20/21 March 2003)

8 These measures affect primarily the ***supply side*** of risk capital.

9 See "***Eight Report – Financial Services/Nine months left to deliver the FSAP***", 3 June 2003, www.europa.eu.int/comm (internal market, financial services)

The directive on supplementary pension funds was adopted on 13 May 2003. Once transposed (24 months) it will provide additional opportunities to the risk capital industry. In this regard the Brussels Spring European Summit explicitly invites the Council and the Commission to examine obstacles for investment by pension funds in venture capital markets (point 31, second indent, of the Presidency conclusions). On the other hand, the new 2001 UCITS directives should have been transposed by August 2003.

The long awaited directive on pension funds has been finally adopted

Measure: ***"Assess of existing accounting and auditing requirements"***

In addition to the adoption, already reported, of the Council regulation on the application of international Accounting Standards (IAS), the Commission has adopted on 19 May 2003 a directive[10] allowing Member States partially exempting more SMEs from financial reporting rules. Also, the 4th and the 7th accounting directives have been modernised[11]. On the other hand, in view of the recent financial scandals, the Commission has adopted a Communication[12] on 21 May 2003, prioritising actions on statutory audit, necessary for reinforcing the audit quality and the auditor's independence.

The accounting and audit frameworks have been modernised

Measure: ***"Dissemination of best practices in corporate governance"***

In order to avoid the damaging effect on the highly publicised financial scandals the Commission has adopted on 21 May 2003 a Communication[13] on Company Law and Corporate Governance which includes an action plan. After completing a consultation process, specific measures are expected to be proposed by the Commission in the Autumn 2003.

An action plan is already underway

4.2. Measures outside the FSAP[14]

For the RCAP legislative measures not included in the FSAP there has also been some progress.

Measure: ***"Reform of the legislation on insolvency and bankruptcy"[15]***

The fifth and last meeting of the expert group of the Best Project *Restructuring, Bankrupcy and a Fresh Start* took place on 16 May 2003. The Final Report concerning this Best Project will be published in the Autumn 2003 and will provide, based on the work of the expert group, a set of indicators for each of the discussed topics (early warning ; legal system ; fresh start ; stigma of failure) and a strategy for improvement by giving examples of best practices.

A Best Project has been completed

Measure: ***"Reform of the European Patent System"***

After more than three decades of deliberations the Council of Ministers reached

The availability

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10 Directive 2003/38/EC of 13 May 2003, L120, 15/05/2003, p. 22-23
11 Directive 2003/51/EC of 18 June 2003, L178, 17/07/2003, p. 16-22
12 COM(2003) 286 final
13 COM(2003) 284 final
14 These regulatory measures are intended to boost the ***demand side*** of risk capital.
15 For an overview of the subject see "***The European Restructuring and Insolvency Guide 2002/2003***", White Page, 2002 ; and "***Bankrupcy and Insolvency***", EVCA, May 2002

a political agreement on a Community Patent on 3 March 2003. Once in place, the Community Patent is, among other things, expected to, on average, halve the translation costs. Also, a single, centralised Community Court will rule on disputes arising from Community Patents.

of a Community Patent already on track

5. TAX ISSUES

Tax issues are of paramount importance to the development of risk capital markets. That is the case of corporate tax (on dividends and on capital gains) and personal income tax (on dividends, on capital gains, and on stock options). Also important are the conditions for innovation and R&D tax incentives. While the overall picture is still far from satisfactory, important advances can be also reported.

The overall picture is improving

5.1. Developments in Member States

As taxation remains largely a national competence, pan-european operators face a fragmented system : disparity of effective corporate tax rates, many tax inefficiencies and high tax compliance costs. They also find a general pattern of treating worse equity financing than debt financing. The differences in the relevant tax regimes provide an explanation for the different performance of Member States in the field of risk capital, something policy makers are becoming increasingly aware of. In particular, it seems it has become generally acknowledged that both an **appropriately designed general tax policy** and **specific tax incentives** (including those on R&D and innovation) can play an important role in this context. As indicated in previous Communications, many Member States have already enacted appropriate legislation in recent years (e.g. annex 12), a trend that has continued in 2003.

Many Member States has enacted appropriate legislation

5.2. Developments at Community level

Tax initiatives at Community level are necessary for the good functioning of the internal market. As already reported, a Commission study[16] found that industry is often subject to high tax compliance costs and international double taxation in areas such as transactions within multinational groups of companies, cross border flows of dividend, interest and royalty payments, cross-border loss relief and business restructuring. The final policy goal would be to eliminate all these obstacles.

Cross-border obstacles should be eliminated

The tax package adopted by the ECOFIN Council during its June 2003 session included the directive on the tax regime applicable to interest and royalty payments between associated companies which will be applicable from 1st January 2004. Also the tax package included a code of conduct for business taxation in the EU area. The aim is to guarantee a level playing field in order to avoid unfair tax competition, leading to losses in tax revenues, and distort efficient economic decisions.

Unfair tax competition should be avoided

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16 "***Company Taxation in the Internal Market***", SEC(2001) 1681 of 23.10.2001

17 "***Proposal for a Council Directive amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States***", COM(2003) 462 final of 29.07.2003

On the other hand, the Commission has recently adopted a proposal for a Council Directive[17] aiming at the improvement and extension of the scope of the Parent-Subsidiary Directive. It provides for the elimination of international double taxation of dividend payments, which will lead to the reduction of the international cost of capital.

The parent-subsidiary directive is being modernised

As for specific risk capital related initiatives, the Commission idea of developing the concept[18] of "**Home State Taxation**" into a pilot project for **small and medium-sized enterprises** deserves particular attention. Under this approach a business can opt to compute its entire EU tax base, including foreign subsidiaries or permanent establishments, according to the rules of the Member State where its headquarters are based. This project is expected to provide in particular a significant reduction of tax-related compliance cost for the internationalisation of SMEs in the internal market.

A pilot project for SMEs could provide for major benefits

5.3 Tax policy in the international context

The interplay of individual measures, which may be coherent and justifiable at national level, and the different approach when applying international tax principles can lead to situations of **double-taxation** when residents of more than one Member State are involved. This is unfortunately often the case as regards, for instance, stock options when the issuing company and the receiving employee are resident in different countries. In this regard it is encouraging to observe that these issues receive increasing attention, *inter alia* also at OECD level. It is obvious that from a Community perspective, it would be important to show a co-ordinated approach among the Member States in these international fora.

Member States should coordinate their positions in international fora

6. ENTREPRENEURSHIP

Best Procedure projects (based on the identification and exchange between Member States of best practices) have provided the entrepreneurship framework for the RCAP. Project reports are available[19] on the transfer of business, on education and training for entrepreneurship, on benchmarking the management of incubators, on business angels, on bankruptcy and a fresh start, and on other subjects. However, whereas the importance of entrepreneurship for job creation[20], innovation and economic growth is already widely recognised, Europe does not fully yet exploit its entrepreneurial potential.

The entrepreneurial potential in Europe is not yet fully exploited

With a view to launch a wide public debate on the future agenda for entrepreneurship policy, the Commission adopted a *Green Paper* in January 2003[21]. As a follow-up, and at the request of the Brussels European Spring

An action plan is under

18 See the result of the consultation published on 7 July 2003 at : http://europa.eu.int/comm/taxation_customs/taxation/company_tax/index.htm

19 See http://europa.eu.int/comm/enterprise/index_en.htm.

20 In the new employment guideline Nr 2 on job creation and entrepreneurship (see Council Decision 2003/578/EC – OJ L 197, 5.8.2003, p. 13) emphasis is placed on the need for facilitating access to capital for start-ups, new and existing SMEs and enterprises with a high growth and job creation potential

21 "***Green Paper – Entrepreneurship in Europe***", COM(2003) 27 final of 21.01.2003

22 See point 23, first indent of the Presidency conclusions

Summit[22], the Commission is now working on an *Action Plan for Entrepreneurship* to be presented at the end of 2003.

preparation

The 2003 Report[23] on the implementation of the *European Charter for Small Enterprises* concludes that progress is encouraging. Many Member States have put education for entrepreneurship high on the national agendas and efforts to support entrepreneurial skills in schools have been considerably stepped up in 2002. The first Report[24] on the implementation by Accession Countries of the Charter shows that these countries are on the right track. Their main challenge now is to build an entrepreneurial culture. Access to finance for SMEs remains difficult and venture capital is not yet developed enough. Therefore an effort on education in this area would be necessary. At the Thessaloniki Summit in June 2003, the Western Balkans countries endorsed the Charter.

The Charter for small enterprises shows encouraging progress

6.1. Informal investors and community venture capital

The number of business angels networks has continued growing (Annex 3). Of special relevance is the explosion in the number of networks in France and Germany which now match the number of networks in the UK.

Networks of business angels continue growing

As the European risk capital markets mature, wider objectives have started to emerge. In several Member States regional venture capital funds have public participation and pursue the objectives of community development like job creation or local development. E.g. in the UK, the government is participating with 50% *Bridges Community Development Venture Fund*, which will invest in the most deprived areas in England. Such funds also benefit from the UK community investment tax relief.

Venture capital is being used in community development

6.2. Employee financial participation

Following the Commission *Communication on the promotion of employees financial participation*[25], various actions and projects have been financed in the area, (conferences, benchmarking exercises, studies, etc.). Meanwhile, an ad-hoc expert group[26] set up by the Commission examining transnational obstacles to the application of various schemes, is expected to render its report by early Autumn 2003.

Obstacles to employees financial participation are being analysed

Another expert group convened by the Commission has analysed the current provisions for employee stock options and put forward conclusions to improve legal framework[27]. The report finds that effective tax rates on employee stock options (and the subsequent holding of shares) in the EU range from around 15% to over 70% and that, due to the differences in tax systems, considerable

A report on employee stock options has been published

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23 COM(2003) 21 final, 21.1.2003.

24 SEC(2003) 57, 21.1.2003.

25 "***Promoting employee financial participation in the European Union – A framework for Community action***", COM(2002)364 of 5 July 2002

26 The ***"High level Group on transnational obstacles to financial participation of employees for companies having a transfontier dimension***" has met seven times until July 2003

27 "***Employee Stock Options-The legal and administrative environment for Employee Stock Options in the EU***". Final Report of the Expert Group, June 2003 ; www.europa.eu.int/comm (enterprise)

problems can arise for employees who move from one country to another while holding stock options.

7. EUROPEAN AREA OF RESEARCH AND INNOVATION

Activities initiated under the 5th Framework Programme such as those to promote networking and clustering between universities, research centres, entrepreneurs, investors, lawyers at European level will be pursued under the 6th Framework Programme[28]. This includes the "*Gate2Growth Initiative*"[29] and the "*Biotech and Finance Forum*" already reported in past Communications.

A number of initiatives will continue

Moreover, under the 6th Framework Programme, increased emphasis is put on the integration of innovation as an important dimension in the design and implementation of a research project and in the exploitation of research results by the partners themselves, through the creation of spin-offs, or through technology transfer. Participants are therefore encouraged to include in their projects "innovation-related activities", which can be supported at the same rate as research activities, and include feasibility assessment of exploring research through spin-offs. Associations of SMEs are allowed to participate on behalf of their members.

Emphasis on the integration of innovation

Organisations seeking external sources of finance for their project, other research activities, research infrastructures, or for the exploitation of the research results, will receive information on the various financing instruments of the EIB (e.g. the EIB's new **Innovation 2010 Initiative** with an indicative envelope of €20 billion for the period 2003-2006 will provide loan finance for innovation and R&D related initiatives) and the EIF.

Information on financing will be provided

7.1. Towards 3% of GDP

In Spring 2003, the Commission adopted a Communication[30] putting forward an Action Plan to attain the goal set by the Barcelona European Council (March 2002) of increasing EU investment in R&D to approach 3% of GDP by 2010, of which two-thirds should come from the private sector. The Action Plan has been developed in consultation with all the stakeholders concerned, notably industry and the financial community and takes into account the recommendations of 5 expert groups on ways to improve the effectiveness of public financing mechanisms (including risk capital) for research.

A new Communication has been adopted

The Action Plan defines a range of actions involving various policies and instruments that should be undertaken and developed at European and/or national levels to achieve the 3% goal. They include a number of actions to improve access to financing for research and innovation: (i) Support to guarantee mechanisms for research and innovation in SMEs ; (ii) Support to risk capital for research-intensive SMEs, and (iii) Availability of efficient, supportive and integrated financial markets. In addition, the Action Plan defines other measures that will contribute to promote the creation and growth of new

Actions should be undertaken at both European and national levels

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28 "***6th Framework Programme (2002-2006)***", 27 June 2002, www.european.eu.int/comm (research)

29 See www.gate2growth.com

30 ***"Investing in Research: an Action Plan for Europe***", COM(2003) 226 final of 30 April 2003

technology-based firms and therefore to increase the demand for risk capital:

A number of measures will increase the demand for risk capital

Pursue or initiate regulatory and administrative reforms and support measures to enable public research institutions to develop more effective links with industry; issues to address include notably **the establishment of incubators** and seed funds ;

Develop European guidelines for the management and exploitation of intellectual property rights resulting from publicly funded research with the aim of promoting technology transfer to industry and **the creation of spin-offs**; and

Encourage a concerted use of fiscal and other incentives, notably to promote the **creation and early growth of research-intensive firms**.

8. PUBLIC FUNDING

8.1. State aid and risk capital

The Communication on State aid and risk capital is proving successful

The Communication on State aid and risk capital[31] is proving a successful instrument in supporting public intervention in the form of equity in the presence of a market failure while at the same time attracting private capital. Both national authorities and the industry have appreciated the flexibility of this instrument and its innovative approach. In particular, Member States have been keen to resort to innovative risk capital schemes mainly in SMEs located in depressed areas or active in the high-technology or the services sector, or as part of other projects of EU interest. The success of a number of public/private partnerships encouraged by the *pari passu* principle has generated recurring investment by private investors, along with public authorities, and has made it easier to recruit experienced independent managers from the private sector, receiving a remuneration linked to the return on investment and/or the performance of the investment fund.

Some recent examples

Among the schemes approved under the Communication[32] were: the UK *Small and medium enterprise venture capital and loan Fund*[33], focusing on the provision of equity and quasi-equity as well as micro-finance loans to SMEs ; the Greek *TANEO - New economy development Fund*[34], a fund-of-funds intended to provide finance to venture capital funds investing in SMEs active in "new economy" sectors such as telecommunication and biotechnology; the Italian scheme *Risk capital for start-up of innovative enterprises*[35], aimed at supporting innovative enterprises in the start-up phase; and the Austrian *Fund for the participation in the equity of SMEs in Burgenland*[36] and the *Venture capital scheme for the Land of Styria*[37].

8.2. The European Investment Fund

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31 Communication on "***State aid and risk capital***", OJ C235, 21.08.2001, p. 3.

32 See www.europa.eu.int/comm/secretariat_general/sgb/state_aids

33 Case N 620/2002, Commission decision of 4/2/2003

34 Case N 548/2002, Commission decision of 18/9/2002

35 Case N 292/2002, Commission decision of 11/12/2002

36 Case N 677/2002, Commission decision of 4/4/2003

37 Case N 403/2002, Commission decision of 19/2/2003

The EIF aims to support the EU risk capital markets and invests primarily in technology-based regional and pan-European funds. In the technology area EIF's primary target has been early- and mid-stage investments, whilst incorporating later stage investments following a recent assessment of the dearth of financing preventing promising mid- to late- stage European technology opportunities from receiving adequate funding.

The EIF invests in other funds

In 2002, the EIF committed €471.5 million in 36 risk capital funds. This decrease compared to 2001 (€800m in 57 funds) is due to the current downwards market trend, which provides limited appropriate investment opportunities. However, the EIF remains a key player in the early-stage and high tech risk capital market, with a total portfolio of commitments comprising 185 funds and amounting to €2.45bn (as on 30/04/03), of which 73% is dedicated to early-stage and 61% to high-tech.

Decreased in new commitments in 2002

For its investments, the EIF uses either its own funds or those available within the framework of mandates entrusted to it by the EIB or the European Commission. Since the launch of the **Innovation 2000 Initiative**, the EIF has managed all of the EIB's resources devoted to risk capital. In total, 88% of the EIF's risk capital activity stems from EIB resources. In this context and in response to calls for increased action in the area of risk capital, the EIB has initiated the necessary procedures to increase by € 500m the amount made available to the EIF.

A variety of sources of funds

On behalf of the European Commission, the EIF manages the Multiannual Programme for Enterprise and Entrepreneurship 2001/2005, the successor of the Growth & Employment Scheme 1998-2000, under which the *ETF Start-up Facility* for seed and early-stage investments as well as the *Seed Capital Action* scheme of grants are set up. The *ETF Start-up Facility* accounts for 5% of the EIF's cumulative venture capital portfolio (as at 30/04/2003). The EIF investments are made in keeping with best market practice.

The EIF has recently developed independent advisory services as a new and complementary activity, whereby it can provide advice grounded on its expertise as an investor and guarantor. This new, fee-payingactivity conducted in close cooperation with the European Commission, currently focuses on regional entities and authorities but will likely soon apply to other sectors such as research.

Consultancy activities as complement ary tasks

8.3. Regional funds

As already reported last year, the Commission guidelines[38] for the implementation of structural funds for the period 2000-2006 requested that the traditional subsidiaries to SMEs were partially replaced by more modern and dynamic methods of financing, such as risk capital and guarantee funds. This has the advantage that the public contributions to these funds are recuperable (revolving funds) after a few years, once the investment in the SMEs are liquidated.

Traditional subsidies are being replaced by more modern financial instruments

[38] www.europa.eu.int/comm/regional_policy/sources/docoffic/official/guidelines/coord_en.htm

The programming of structural funds shows that the guidelines are being followed and that, as a result, the interventions in risk capital funds and guarantee funds will reach in the period 2000-2006 to about €1,4 billion, i.e. more than double for the 1994-1999 period. Around two thirds in the regions under objective 1 and one third in the regions under objective 2. By countries, the UK is clearly the one making more use of these possibilities.

Risk capital and guarantee funds will more than double their resources

On the other hand, the Commission *Guide to Risk Capital Financing in Regional Policy* is already available in all Community languages[39] what should become a practical document for all those involved, at regional and national levels in risk capital related activities.

The new Guide is already available

9. CONCLUSIONS

The last 18 months has been a period of adjustment in Europe with many players convinced that we are already at the bottom of the prolonged down-cycle. Behind have been left the burst of the bubble and the financial scandals and many in the industry, following a consolidation and a rationalisation process soon be completed, seem to be ready for a recovery.

A new cycle may start soon

When taking the RCAP period as a whole (1998-2003) important progress can be reported. From the political point of view, risk capital issues are now at the top of the agenda in all regional, national and Community institutions. From the technical point of view most of the measures foreseen in the RCAP in 1998 have been completed. There are of course measures which by its own nature (e.g. those linked to cultural barriers) cannot by subject, in practice, to a specific deadline but where qualitative progress can also be reported.

Most of the objectives foreseen in 1998 have been achieved

The European industry has also changed considerably in the last 5 years. It is now much bigger (even though the gap with the USA still persists), more global, mature and professional and, as a result, risk capital is becoming in an increasing number of Member States an asset class of its own. The challenge now would be to extend these positive developments to the whole Community and in particular to the future new Member States.

Risk capital should be an asset class of its own all over Europe

10. WAY FORWARD

The world today, from the economic, financial and political points of view is very different from that of 1998. The risk capital industry has been subject to important transformations, to difficult and proving experiences and to important successes. Therefore, many of the premises and objectives foreseen in the RCAP deserve to be re-examined. Furthermore, to achieve the Lisbon 2010 objectives, Europe will need to develop a modern economy and a powerful innovative sector, something that will require a much more efficient and sophisticated pan-European risk capital market.

The risk capital environment has changed radically in the last 5 years

With these considerations in mind, in order to keep up the momentum, and building on the experience of the last five years, the Commission has the

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39 www.europa.eu.int/comm/regional_policy/sources/docgener/guides/risk/risk_en.pdf

intention of continuing to closely follow developments in the European risk-capital market and carrying out further analysis in 2004 of aspects of the market where inefficiencies remain, taking into the March 2003 Brussels European Council invitation for the Commission : "*to work towards reducing barriers to the creation of a genuine European risk capital market, capable of supporting entrepreneurship, and examine interalia obstacles for investments by institutional investors (pension funds) in venture capital markets*" (point 31, second indent, of the Presidency conclusions.).

Further analysis based on the RCAP experience

Whereas risk capital covers a vast variety of topics and aspects, some important elements, likely to be included in the analysis, could be the following :

Some possible elements

(i) **Obstacles faced by institutional investors to invest in venture capital**

To fulfil the above mentioned European Council invitation.

(ii) **Further improvements in the regulatory framework**

This should be an on-going activity with the main purpose of ensuring that risk capital needs are taken into account during the negotiation (e.g. *Merger Regulation* or new *Capital Adequacy Rules-Basel II*), implementation and enforcement of new rules.

Risk capital should be taken into account in any new initiative

A specific measure repeatedly requested by the industry is the creation of a ***harmonised European fund legal structure*** capable of ensuring transparency, from the fiscal point of view, all over Europe. In the Communication COM(2003) 226 final of 30 April 2003, on "***Investing in research : an action plan for Europe***" page 24, the Commission has already taken the commitment to "consider the merits and the possibility" of such a measure. Even though this was done in the context of R&D, this is a horizontal issue which should be considered for all cases where risk capital is involved.

Transparent structures are needed by the industry

(iii) **Fostering exit mechanisms**

The availability of efficient exit mechanisms is one of the key requirements for having a successful risk capital market. In this regard, the characteristics, structure and **role of specialised stock exchanges and secondary stock exchange lists for high-growth companies** should be re-examined together with factors determining investor appetite for venture backed companies.

A continuous cycle of risk capital should be ensured

(iv)**Close the informational gap between the financial community (the supply side) and the companies and entrepreneurs (the demand side)**. This win-win undertaking has clearly two different aspects :

Availability of matching mechanisms

Risk capital providers need to know, in a readily and cost-effective fashion, which companies and entrepreneurs are looking for funding and viceversa. This should be made available at regional, national and pan-European levels, depending on the size, strategy, and objectives of the different participants (see section 6.2 of COM(2002) 563).

Investors and entrepreneurs should meet easily

Developing ratings of SMEs including technology rating

The financial providers before making their investments need to estimate the risks and rewards associated to them. If that is expensive or difficult they, most likely, would abstain from making such investments. For companies of a certain size, and a number of years in the market, classical methods (e.g. financial history, bank's internal ratings, feasibility studies, due diligence) may be used. The case is more complicated when, as it is often the case in risk capital investment, technology is involved or when the company is new and innovative, possibly relying on a single technology-based product or service, with no history and scarce assets. For all these cases it would be important to develop rating methodologies which are credible, reliable, and cost-effective.

Rating mechanisms able to value technology should be developed

(v)**<u>Strategic</u>** : **<u>closing the gap with the USA</u>**

This will require a thorough analysis of the successful private and/or public policy instruments used in the USA to foster risk capital activities at all stages of capital investment, both formal and informal, and which may explain, for instance, why proportionally less people decide to become in Europe entrepreneur and why new companies in the USA grow faster and become bigger than in Europe.

Successful policies should be transposed into Europe

(vi) **<u>Focusing Community support</u>**

Past Community actions channelling financial support to venture capital funds investing primarily in early stage have been successful in fostering the growth of the European venture capital industry. In order to safeguard the market that has been created, this strategy should remain in place and implemented through the MAP. While the priority should remain seed and early stage investment, Community instruments (notably the EIF) should also play a role in maintaining an adequate availability of later stage financing to potentially successful companies. The aim would be to counterbalance the effects of the present reduced supply of development stage financing as the risk capital markets are still adjusting in the wake of the bursting of the internet bubble.

Community support should cover all stages

The forthcoming accession of the new Member States will merge their financial markets with that of the EU-15. The links with the pan-European market players are already largely established. The widening of the EU market will present increased opportunities for all concerned. Full advantage should be taken of the accumulated experience of the EIF in the establishment of new funds in locations outside the immediate beneficial influence of the largest financial centres.

The EIF should also take care of the new Member States

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LIST OF ANNEXES

ANNEX 1

HISTORICAL DATA FOR RISK CAPITAL in the EU

Value in million € of	1998	1999	2000	2001	2002
Investment in Early stage (seed + start-up)	1 566	2 991	6 405	3 988	2 699
Investment in Development capital (expansion + replacement)	5 172	8 242	13 226	8 758	7 405
Total VENTURE CAPITAL	6 738	11 233	19 632	12 746	10 104
Total VENTURE CAPITAL as of % GDP	**0.09**	**0.14**	**0.23**	**0.14**	**0.11**
Buy-outs	7 333	13 154	13 917	10 743	16 845
Total PRIVATE EQUITY	14 071	24 387	33 549	23 489	26 949
Total PRIVATE EQUITY as of % GDP	**0.19**	**0.30**	**0.40**	**0.27**	**0.29**
Funds Raised for PRIVATE EQUITY Investments	19 663	24 613	45 633	38 708	26 779

ANNEX 2

HISTORICAL DATA FOR VENTURE CAPITAL in the US

Value in million US$ of	1998	1999	2000	2001	2002
Investment in Early stage (seed + start-up)	7 325	15 426	29 297	9 949	4 366
Investment in Expansion and later stage	14 067	39 469	76 834	30 752	16 870
Total VENTURE CAPITAL	21 392	54 895	106 131	40 701	21 236
Total VENTURE CAPITAL as of % GDP	**0.25**	**0.60**	**1.09**	**0.41**	**0.20**

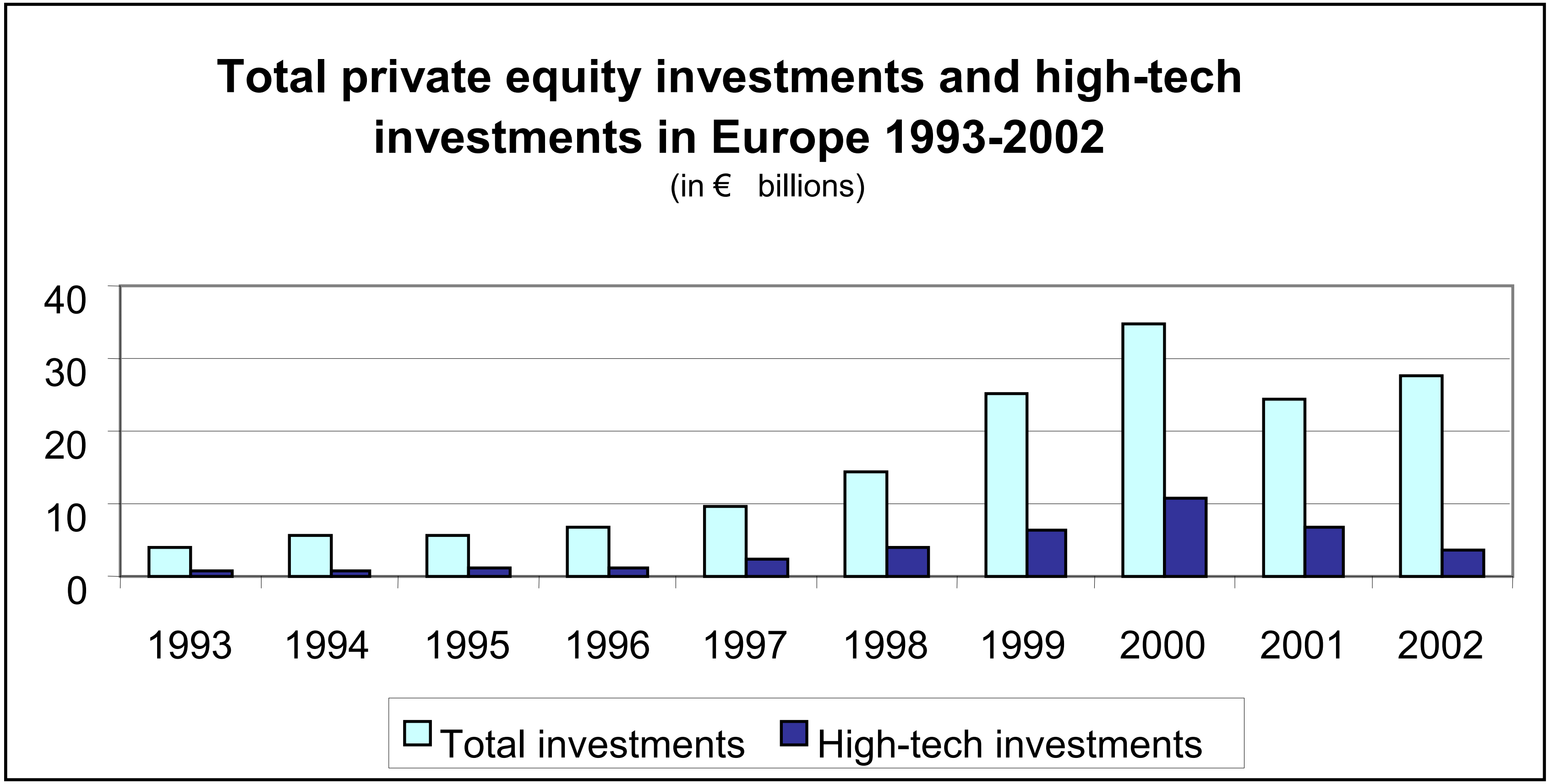
ANNEX 3

BUSINESS ANGEL NETWORKS in the EU

	Year 1999	Year 2001	Year 2002	Year 2003
Belgium	2	6	7	7
Denmark	0	4	6	6
Germany	3	36	40	40
Greece	0	0	0	0
Spain	1	1	2	2
France	3	24	31	49
Ireland	1	1	1	1
Italy	0	6	13	11
Luxembourg	1	1	1	1
Netherlands	1	2	2	3
Austria	1	1	1	1
Portugal	0	1	1	1
Finland	1	1	1	1
Sweden	1	1	1	1
United Kingdom	49	49	50	48
EU	**64 Networks**	**134 Networks**	**158 Networks**	**176 Networks**

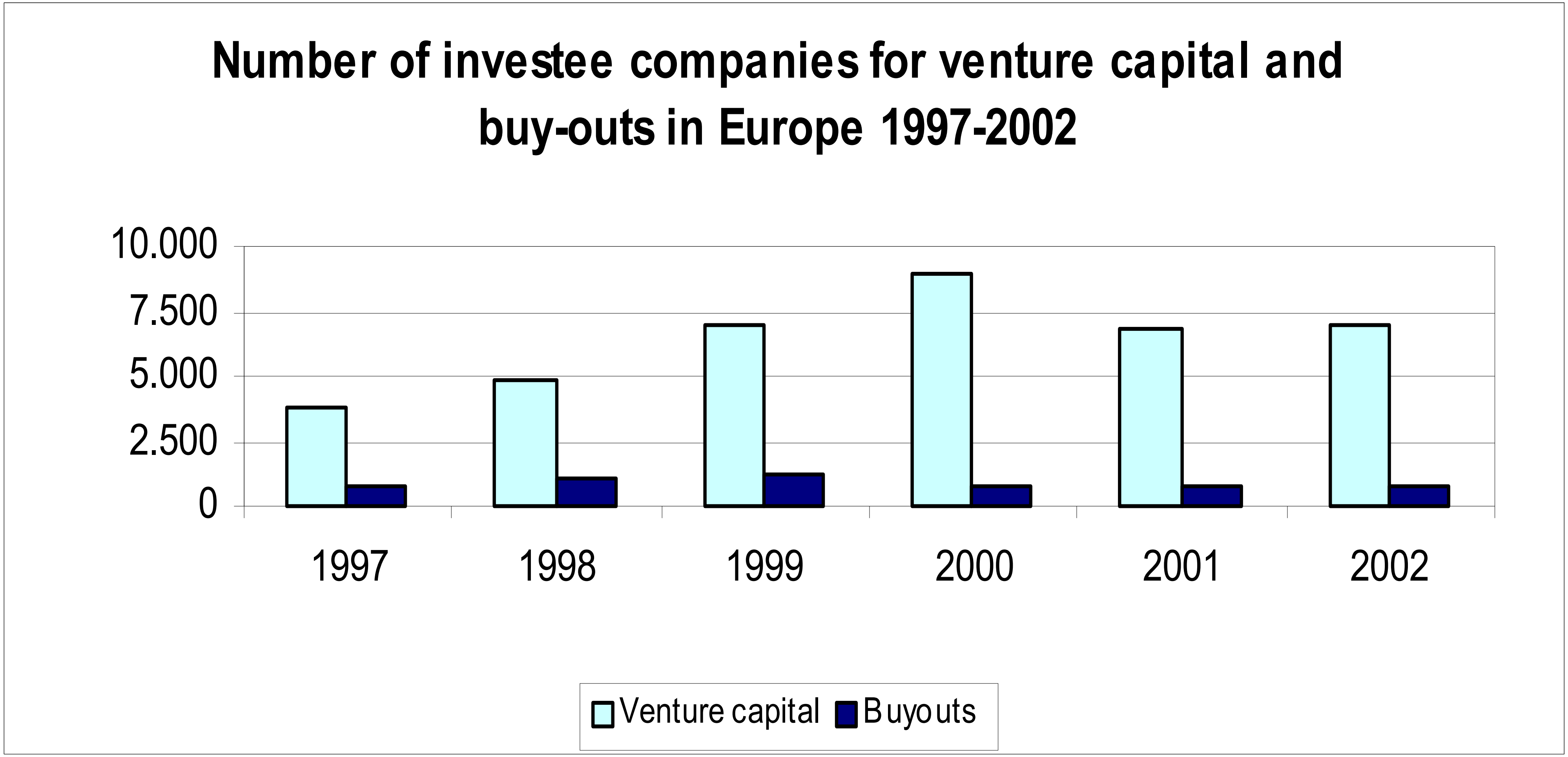
Source : *EBAN*

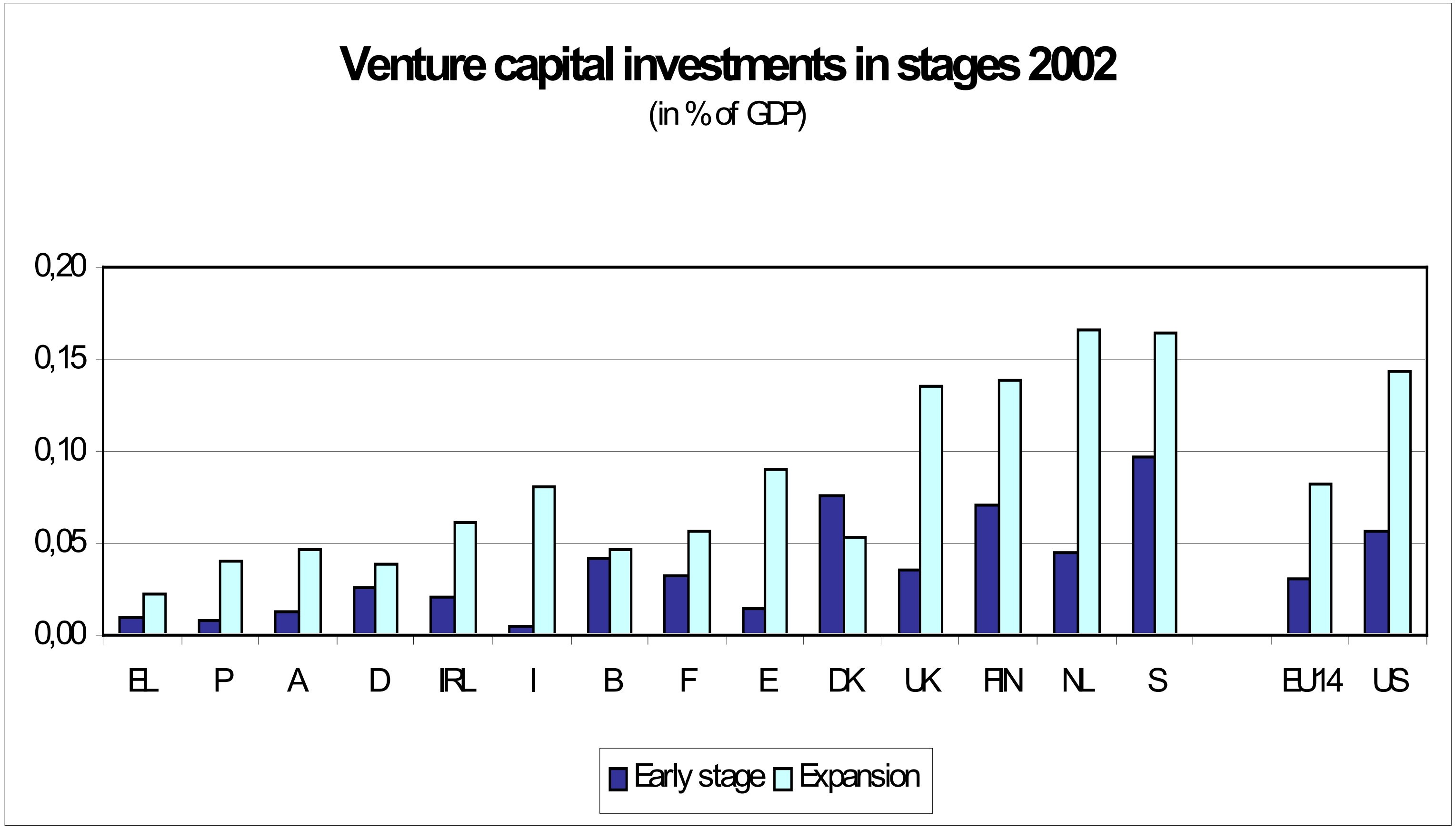
ANNEX 4



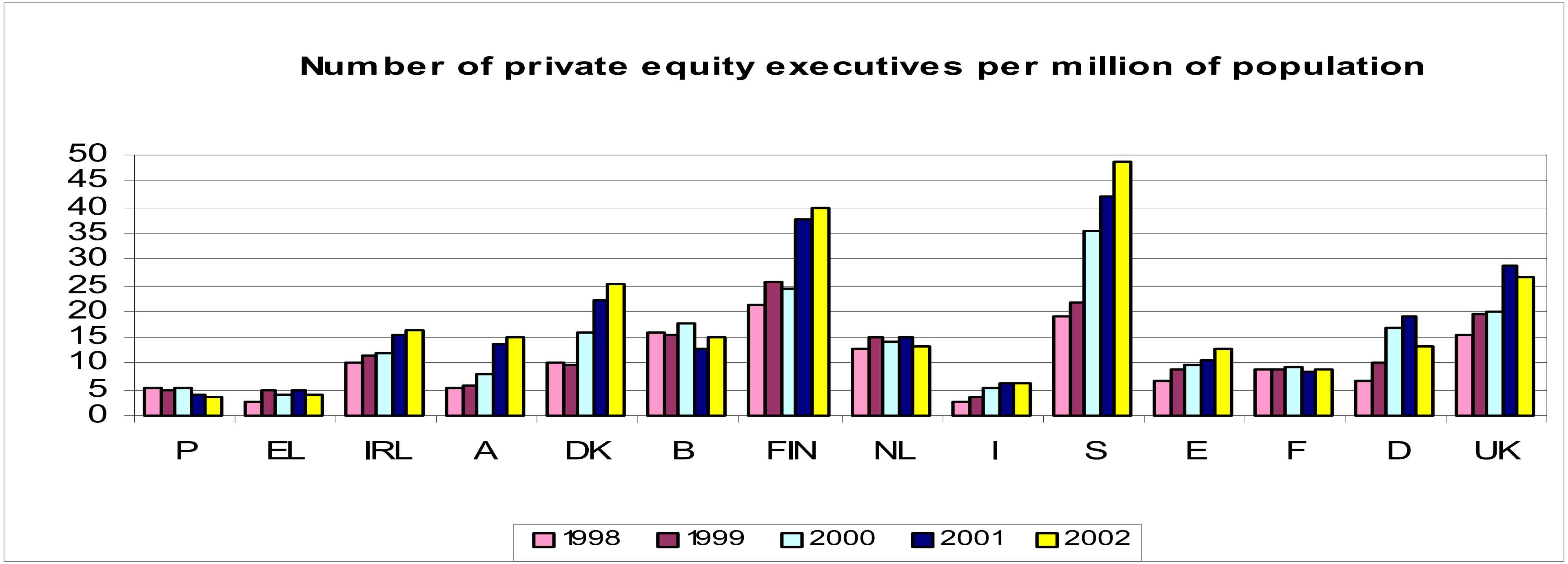
Total private equity investments and high-tech investments in Europe 1993-2002
(in € billions)
40
30
20
10
0
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
Total investments
High-tech investments

ANNEX 5

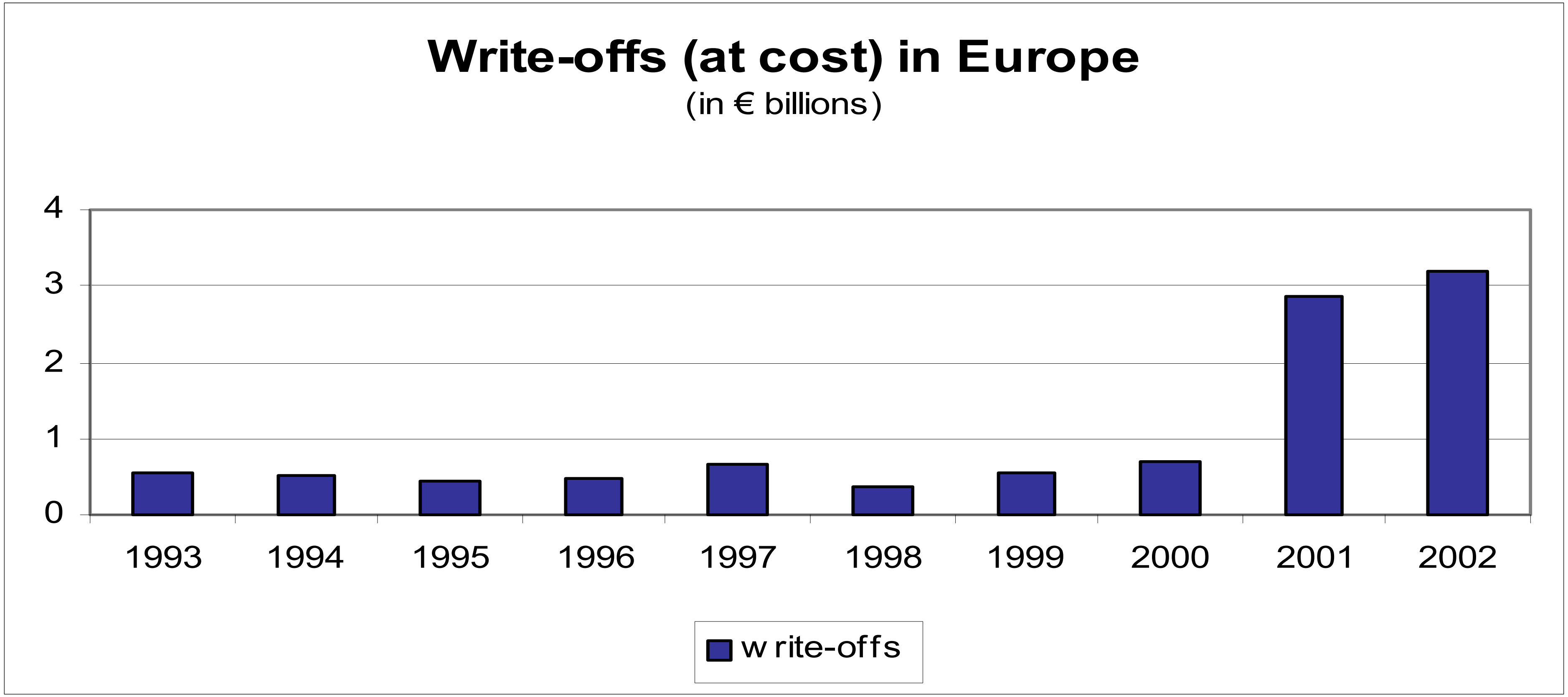

Number of investee companies for venture capital and buy-outs in Europe 1997-2002
10.000
7.500
5.000
2.500
0
1997
1998
1999
2000
2001
2002
Venture capital
Buyouts

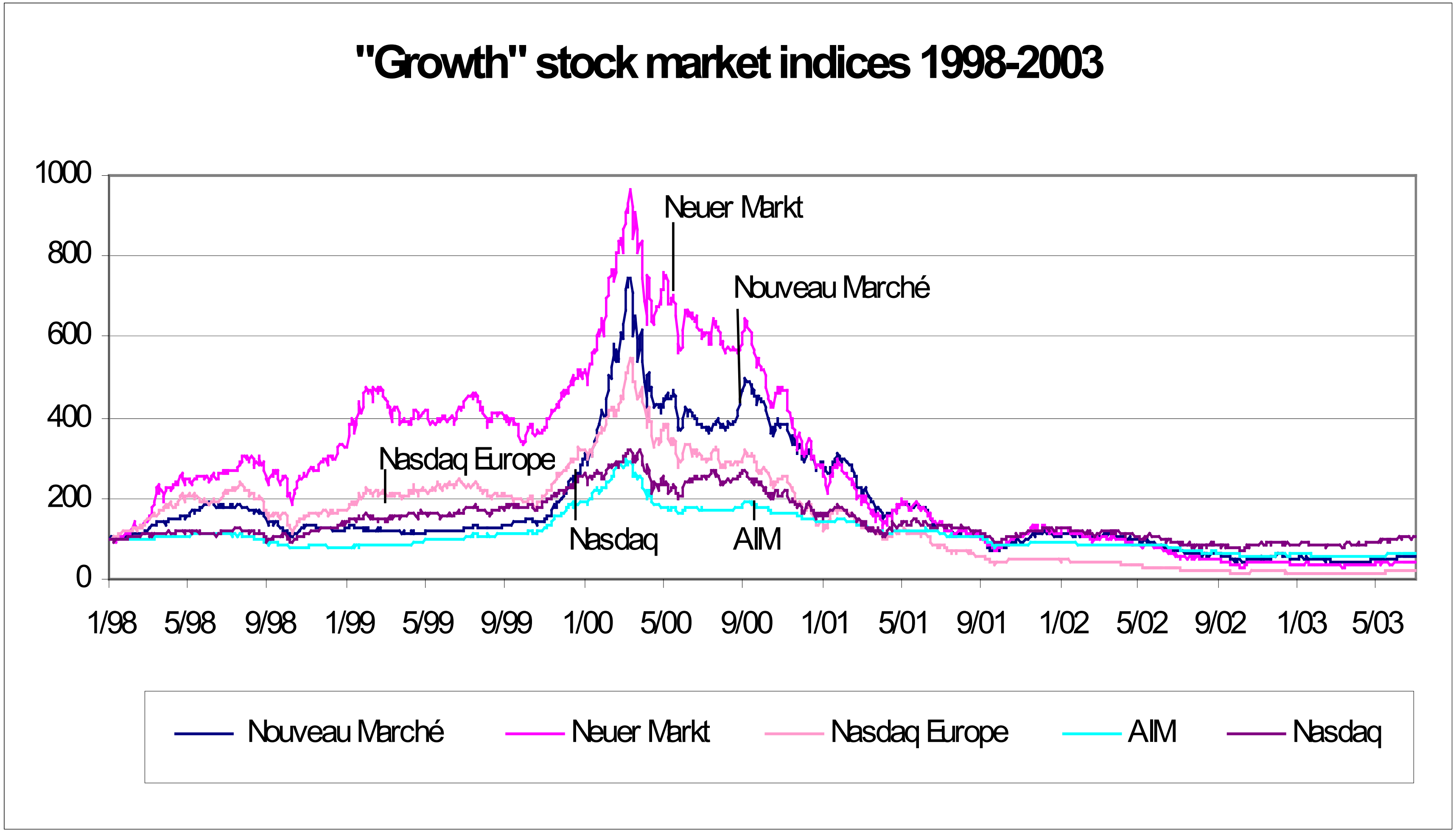

Venture capital investments in stages 2002
(in % of GDP)
0,20
0,15
0,10
0,05
0,00
EL
P
A
D
IRL
I
B
F
E
DK
UK
FIN
NL
S
EU14
US
Early stage
Expansion

ANNEX 7

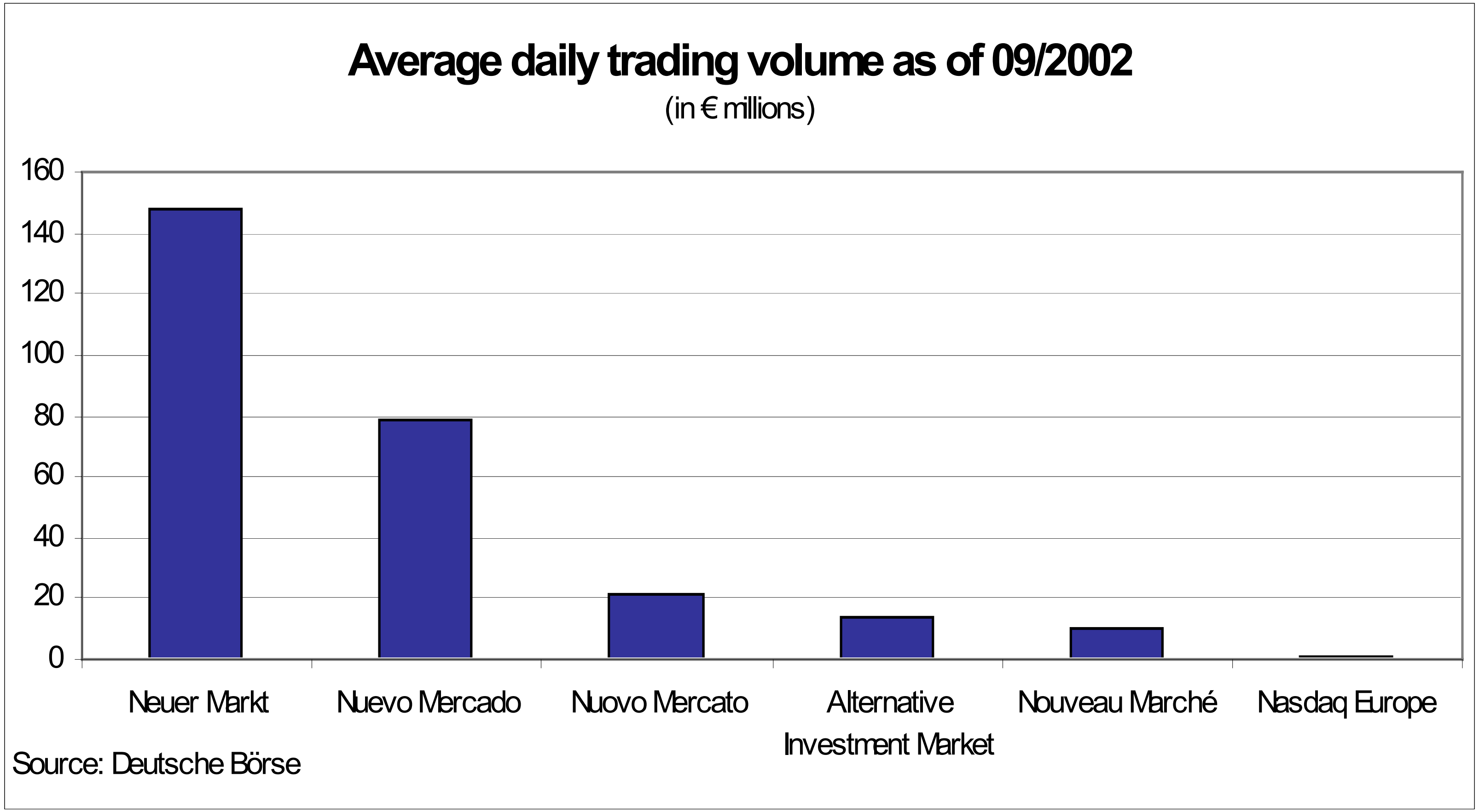


Number of private equity executives per million of population
50
45
40
35
30
25
20
15
10
5
0
P
EL
IRL
A
DK
B
FIN
NL
I
S
E
F
D
UK
1998
1999
2000
2001
2002


Write-offs (at cost) in Europe
(in € billions)
4
3
2
1
0
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
w rite-offs


"Growth" stock market indices 1998-2003
1000
800
600
400
200
0
1/98
5/98
9/98
1/99
5/99
9/99
1/00
5/00
9/00
1/01
5/01
9/01
1/02
5/02
9/02
1/03
5/03
Neuer Markt
Nouveau Marché
Nasdaq Europe
Nasdaq
AIM
Nouveau Marché
Neuer Markt
Nasdaq Europe
AIM
Nasdaq

ANNEX 10



Average daily trading volume as of 09/2002
(in € millions)
160
140
120
100
80
60
40
20
0
Neuer Markt
Nuevo Mercado
Nuovo Mercato
Alternative Investment Market
Nouveau Marché
Nasdaq Europe
Source: Deutsche Börse

ANNEX 11

DEGREE OF TRANSPOSITION OF COMMUNITY LAW ALREADY ADOPTED IN THE FIELD OF FINANCIAL SERVICES

	Banks	Insurance	Securities	Payment Systems	Company law	Total
BE	10/11	23/24	8/10	2/2	15/15	58/62
DK	11/11	24/24	8/10	2/2	15/15	60/62
DE	11/11	23/24	8/10	2/2	15/15	59/62
EL	10/11	23/24	7/10	2/2	15/15	57/62
ES	11/11	23/24	8/10	2/2	15/15	59/62
FR	10/11	22/24	8/10	2/2	15/15	57/62
IE	10/11	23/24	8/10	2/2	15/15	58/62
IT	10/11	24/24	8/10	2/2	15/15	59/62
LU	10/11	22/24	10/10	2/2	15/15	59/62
NL	11/11	23/24	8/10	2/2	15/15	59/62
AT	11/11	24/24	8/10	2/2	15/15	60/62
PT	10/11	24/24	8/10	2/2	15/15	59/62
FI	11/11	23/24	7/10	2/2	15/15	58/62
SE	10/11	23/24	8/10	2/2	15/15	58/62
UK	10/11	23/24	8/10	2/2	15/15	58/62
EU	94,5%	96,4%	80,0%	100%	100%	94,4%

September 2003

ANNEX 12

SUMMARY OF CAPITAL GAINS TAXATION IN THE MEMBER STATES

	Exemption	Requirements
Belgium	Yes	5% or 1,2 m. € and subsidiary subject to tax
Denmark	Yes	3 years, subsidiary without financial activity and subject to tax
Germany	Yes	
Greece	No. 35%	
Spain	Yes	5% during 1 year and subsidiary with business activity
France	Reduced rate: 20.2%	5% or 23 m € and 2 years
Ireland	No. 20%	25%
Italy	Reduced rate: 19%	20% of voting rights; 10% on listed companies and 3 financial statements
Luxembourg	Yes	10% or 1,2 m. € during 1 year and subsidiary subject to tax
Netherlands	Yes	5% and subsidiary subject to tax
Austria	Yes	25% during 2 years and subsidiary without financial activity and subject to tax
Portugal	No. 30%	
Finland	No. 29%	
Sweden	No. 28%	
United Kingdom	Yes	10% during 1 year and subsidiary is a trading company without financial activity

Source :
- *EVCA : Taxation of Corporate Profits, Dividends and Capital gains in Europe*
- *Commission services from data supplied by the Member States*

ANNEX 13

RCAP (RISK CAPITAL ACTION PLAN) APROVED AT THE CARDIFF SUMMIT (JUNE 1998)

LAYOUT BY TYPE OF BARRIER – SITUATION IN OCTOBER 2003

The RCAP comprises six (6) categories of barriers to be removed in the EU:

- **MARKET FRAGMENTATION**
- **INSTITUTIONAL AND REGULATORY**
- **TAXATION**
- **PAUCITY OF HIGH-TECH SMALL BUSINESSES**
- **HUMAN RESOURCES**
- **CULTURAL**

BARRIER : ***MARKET FRAGMENTATION***

Measure	Objective	Responsibility/Participation	Situation
Develop networks of business angels at regional, national and Community levels		***Private sector*** ***Member States*** ***Commission***	*The pilot action (1998-2000) has been completed. The Benchmarking (2001-2002) has been completed*
Market monitoring and development of information and statistics on all levels of venture capital in the EU		***EVCA*** ***Commission*** ***Market players***	*On-going*
Round table on the impact of the fragmentation of the European risk capital market	Prompt all the market players to generate synergy to reduce the effects of fragmentation	***Commission*** ***Member States*** ***Market players*** ***(regulatory bodies, new capital markets, venture-capital funds, banks, etc.)***	*The round table took place on 24 October 1998 in Brussels*
Detailed examination of the cost to European firms of raising debt and equity finance	Obtain a clearer picture of the difficulties and financial needs of firms	***Commission*** ***Market players*** ***(banks, venture-capital funds, capital markets, etc..)***	*For tax related analysis see Commission study referenced in section 5.2.*

INSTITUTIONAL AND REGULATORY BARRIERS

Measure	Objective	Responsibility/Participation	Situation
Transposal and implementation of all financial services directives - monitoring via single market scoreboard		***Member States*** ***Commission***	*See table n Annex 11*
Simplification of administrative formalities for company formations (including minimum capital requirements)		***Member States*** ***Commission*** ***(disseminating best practice)***	*Figures and evolution were made available through a Benchmarking Exercise*
Venture-capital funds : Assessment of whether there is a need for Community legislation covering specific closed-end funds	Create, along the lines of Directive 85/611 on UCITS, a European passport for closed-end funds (including venture-capital funds), enabling them to raise funds and offer their services in all Member States without restriction	***Commission*** ***Council*** ***EP*** ***Industry :*** ***- EFIFC*** ***- EVCA*** ***- Small business***	*UCITS Contact Committee and industry representatives met on 18 November 1998 in Brussels. Consensus that an ad-hoc directive was not needed*
Review of implementation and possible amendment of prospectus directive to facilitate companies raising cross-border capital (e.g. IPO's)	In these areas, a prospectus or offer document approved in one Member State should be available for use in all the Member States	***Commission*** ***Council*** ***EP*** ***Capital markets (competent authorities and small businesses)***	*A new directive was adopted on 15 July 2003*

INSTITUTIONAL AND REGULATORY *BARRIERS (Continuation)*

Measure	Objective	Responsibility/Participation	Situation
Adoption of prudential rules to allow institutional investors to invest in venture capital	Allow institutional investors, acting in accordance with "prudent man" rules, to invest in venture capital	***Member States*** ***Commission (follow-up to the Green Paper on supplementary pensions)***	• *Two UCITS Directives adopted in 2002* • *The Directive on supplementary pension funds adopted on 13 May 2003*
Assess existing accounting and auditing requirements	Allow companies to draw up consolidated accounts to facilitate access to risk capital (for IPO's and listed companies)	***Member States*** ***Commission*** ***Accounting Bodies***	• *Obligation of using international accounting standards adopted in 2002.* • *The 4th and 7th directives have been modernised on 18 June 2003.* • *A Communication on auditing adopted on 21 May 2003*
Reduction of the capital requirements for setting up firms	Facilitate the setting up of firms	***Member States***	*Figures and evolution were made available through the Benchmarking Exercise*
Reform of the legislation on insolvency and bankruptcy	Whilst protecting the interest of creditors and consumers, ensure that entrepreneurs who have gone bankrupt can have a second chance	***Member States*** ***Commission (dissemination of best practice)***	*The Final Report concerning a Best Project will be published in Autumn 2003*

BARRIER : ***TAXATION***

Themes	Issues to consider	Responsibility/Participation	Situation
Taxation of venture capital funds	Double taxation	***Member States***	*Several measures have already been taken by a number of Member States (see, for instance, annex 10)*
Capital gains tax	Impact on venture capital	***Member States***	
Tax arrangements for new firms	Fiscal environment for start-ups	***Member States***	
Taxation of low-risk capital (e.g. bank deposits, bonds compared with venture capital)	Situation in Member States	***Member States***	
Stock options	Impact on recruitment and company performance	***Member States***	*The Final Report of an expert group published in June 2003*

BARRIER : ***PAUCITY OF HIGH-TECH SMALL BUSINESSES***

Measure	Objective	Responsibility/Participation	Situation
Development of networking and clustering between universities, research centres, financial backers, lawyers, human resources specialists, etc. and link them at European level		***Private sector*** ***Member States*** ***Commission (pilot schemes, disseminating best practice, Fifth Framework Research Programme)***	• *The Gate2Growth initiative fosters networks of innovation professionals, entrepreneurs and financiers* • *The "Biotech & Finance" Forum continuous successfully active*
Development of customised electronic commerce modules for small businesses to ease their access to electronic commerce and the internal market		***Private sector*** ***Member States*** ***Commission (pilot schemes)***	*Commission adopted a Communication on "GoDigital" on 13.03.2001*
Creation of a pan-European club of high-tech innovatory firms	Facilitate dissemination at European level of examples of successes and good practice : facilitate contact with investors	***Market players (small businesses, venture-capital funds, etc.)*** ***Commission***	*The European Federation of High Tech Enterprises was created in 1999*
Reform of the European patent system	Following on from the Green Paper, simplify procedures and create a genuine Community patent	***Commission*** ***Member States*** ***EP***	*Political agreement on a Community Patent reached on 3 March 2003*

BARRIER : ***HUMAN RESOURCES***

Measure	Objective	Responsibility/Participation	Situation
Promotion of entrepreuneurship and innovation within educational and training systems		***Member States*** ***Commission (disseminating best practice)***	*With the support of the Commission, EVCA has developed an Entrepreneurship toolkit to be used in universities and institutions of higher education*
Determination of training needs for venture-capital fund managers, market makers, analysts of high-tech firms	Identify training schemes to be set up to make good any shortages of skilled staff in these areas	***Commission*** ***Market players***	• *Training schemes have been set up by EVCA. Courses are regularly offered to market participants* • *"Seed-Capital Action", to be managed by the EIF, would concentrate on junior investment managers*
Assessment of benefits of equity pay and employee ownership schemes	Begin study of future at European level	***Member States*** ***Commission*** ***Social partners***	*The Final Report of an expert group to be published in early Autumn 2003*

CULTURAL BARRIERS

Measure	Objective	Responsibility/Participation	Situation
Demonstration of the advantages of venture capital and promotion of entrepreneurship		***Private sector*** ***Member States*** ***Commission***	*A Best procedure project has been run with the objective of identifying and comparing initiatives across Europe*
Dissemination of best practices in corporate governance	Facilitate the dissemination of corporate governance practices demanded by investors	***Private sector*** ***International bodies*** ***Commission*** ***Member States***	*A Communication which contains an action plan has been adopted by the Commission on 21 May 2003*

ANNEX 14

ACRONYMS USED IN THE COMMUNICATION

AIM :	Alternative Investment Market (www.londonstockexchange.com/aim)
ATS :	Alternative Trading System
BEST :	Business Environment Simplification Task Force. Established by the Commission in September 1997
EIB :	European Investment Bank (www.eib.org)
EIF :	European Investment Fund (www.eif.org)
EVCA :	European Private Equity and Venture Capital Association (www.evca.com)
FSAP :	Financial Services Action Plan
IAS :	International Accounting Standards
MAP :	Multi-Annual Programme for Enterprise and Entrepreneurship implemented by the Commission
NASDAQ :	The American National Association of Securities Dealers Automated Quotation system (www.nasdaq.com)
NYSE :	The New York Stock Exchange
R&D :	Research and Development
SME :	Small and Medium-sized Enterprise
UCITS :	Undertakings for Collective Investment in Transferable Securities (Investment Funds)

ANNEX 15

GLOSSARY OF TERMS USED IN THE COMMUNICATION

Accounting Directive:	Directives 78/660/EEC (the 4th) and 83/349/EEC (the 7th) as amended
***Business Angels*:**	Private individuals who invest directly in young new and growing unquoted businesses (seed finance). In may cases they also facilitates the finance of the next stage of the life cycle of young companies (start-up phase). Business angels usually provide finance in return for an equity stake in the business, but may also provide other long-term finance. This capital can complement the venture capital* industry by providing smaller amounts of finance (generally under EUR 150 000) at an earlier stage than most venture capital firms are able to invest.
Capital market:	A market in which long term capital is raised by industry and commerce, the government and local authorities. Stock exchanges are part of the capital market.
***Corporate governance*:**	The manner in which organisations, particularly limited companies, are managed and the nature of accountability of the managers to the owners. This topic has been of increased importance since the beginning of the 1990's, the providers of external finance to a company wanting to ensure management is not acting contrary to their interests.
Corporate venturing:	Corporate venture capital* whereby a larger company takes a direct minority stake in a smaller unquoted company for strategic, financial or social responsibility reason. Predominantly used by large corporates to support external technology development.
***Development capital*:**	Financing provided for the growth and expansion of a company.

***Early stage capital*:** Financing to companies before they initiate commercial manufacturing and sales, before they be generating a profit. Includes seed* and start-up* financing.

Equity: The ordinary share capital of a company.

***Institutional investors*:** This term refers mainly to insurance companies, pension funds and investment funds collecting savings and supplying funds to the markets, but also to other types of institutional wealth (e.g. endowment funds, foundations, etc).

IPO: Initial Public Offering (flotation, going public) : the process of launching a public company for the first time by inviting the public to subscribe in its shares.

***Management buy-out*:** Financing provided to enable current operating management and investors to acquire an existing product line or business. Also known as MBO.

Market capitalisation: The price of a stock multiplied by the total number of shares outstanding. The market's total valuation of a public company. By extension, the total valuation of companies listed on a stock market.

Private equity: As opposed to public equity, equity investment in companies not listed on a stock market. It includes venture capital and buy-out investments.

Prospectus: A formal written offer to sell securities that sets forth the plan for a proposed business enterprise, or the facts concerning an existing one that an investor needs to make an informed decision.

Prospectus Directive: Documents drawn up according to the rules of Directives 89/298/EEC (public offers) and/or 80/390/EEC (listing particulars).These Directives will be replaced by the new one adopted on 15 July 2003.

Replacement capital: Purchase of existing shares in a company from another venture capital investment organisation or from another shareholder or shareholders.

Risk capital markets:	Markets providing equity financing to a company during its early growth stages (seed*, start-up* and development*). In the framework of this communication, it covers three sorts of financing: • Informal investment by Business Angels* and corporates ("Corporate Venturing"*) • Venture capital. • Stock markets specialised in SMEs and high growth companies.
***Secondary market*:**	Market where securities are bought and sold subsequent to original issuance. The existence of a flourishing, liquid, secondary market creates the conditions for a healthy primary market.
Security:	A financial asset, including shares, government stocks, debentures, bonds, unit trusts and right to money lent or deposited.
***Seed capital*:**	Financing provided to research, assess and develop an initial concept.
***Start-up capital*:**	Provided to companies for product development and initial marketing.
Stock exchange or Stock Market:	A market in which securities are bought and sold. Its basic function is to enable public companies, governments and local authorities to raise capital by selling securities to investors.
***Stock option*:**	Option given to employees and/or managers to buy shares at a fixed price.
***Venture capital*:**	Investment in unquoted companies by venture capital firms managing in-house or third-party funds. It includes early stage*, expansion* and replacement* finance, but excludes the financing of buy-outs*.
Venture capital funds	Closed-end funds, created to provide venture capital.

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(*) *Word defined in the glossary or the acronyms*