COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

PROGRESS REPORT ON THE RISK CAPITAL ACTION PLAN
EXECUTIVE SUMMARY

This Communication reviews progress in implementing the strategy for developing the EU risk capital market in light of the conclusions from the Special Lisbon European Council and the deadline of 2003 set for full implementation of the Risk Capital Action Plan (RCAP).

The EU risk capital market performed very well in 1999 but remains small and fragmented in comparison to that of the United States. Although there is no evidence of a generalised market failure, early stage and technology investment remains particularly low. Further development of the EU risk capital market requires accelerated market integration, the easing of country-specific constraints on efficient market functioning and, more generally, the promotion of a more entrepreneurial culture.

Timely implementation of the Financial Services Action Plan (FSAP) will do much to foster a more integrated EU risk capital market. A wide range of measures included in the FSAP and relevant to risk capital have been recently adopted by the Commission or are under preparation by the Commission services. In addition, the Community patent proposed by the Commission will do much to lower costs and increase legal certainty for innovative enterprises wishing to operate outside their own Member State. It is crucial that all relevant parties co-operate to ensure early agreement on the introduction of these measures into Community law.

Structural reform to promote risk capital at the national level is proceeding. In several Member States, regulatory constraints on institutional investment in equity markets have been relaxed and the administrative procedures for establishing a business have been lightened. However, little has been done to address the disincentive effects of bankruptcy and insolvency procedures in most of the Member States. Modest progress is being made in addressing fiscal obstacles to risk capital investment, with adjustments having been made to the taxation of corporate profits and capital gains in some of the Member States. However, tax reforms will need to be accelerated and extended if the RCAP is to be implemented by the deadline.

A series of Community actions to promote a culture of entrepreneurship have been taken. Entrepreneurship is one of the four pillars of the Employment Guidelines. The Guidelines for 2001 proposed by the Commission call for greater entrepreneurship awareness across the society, while the European Social Fund finances a series of educational and training programs in this area. The Commission has also taken actions to promote innovation throughout the Union, for instance, by highlighting the practices employed in the more successful regions. Member States also are taking measures in this area, notably promoting entrepreneurship through funding of relevant disciplines in private and public universities, promoting technology transfers to SMEs, and fostering co-operation between SMEs, academics and large enterprises.

The philosophy underlying the strategy for developing the EU risk capital market attributes primary importance to an environment that is favourable to creating and sustaining a new and innovative business. Consistent with this philosophy, there is a limited role for public funding as a means to address identifiable market failures. However, as with all cases for public funding, the advantages need to be weighed against risks of market distortion and, particularly in the risk capital area, of displacing or crowding out private sector activity.

Much remains to be done if the EU risk capital market is to be brought onto par with that of the United States. To this end, it is essential to implement the RCAP by the deadline of 2003.
1. INTRODUCTION

Although small in relation to other financial markets, the risk capital market\(^1\) is of unique importance in providing a source of equity financing for young and innovative businesses. As indicated in the April 1998 Risk Capital Communication\(^2\), several studies suggest a high employment content in the activities of innovative SMEs, although the employment effects cannot be quantified exactly. Various surveys have also highlighted the role venture capital funding and IPOs can play in the development of high growth companies. In this way, a developed and efficient risk capital market has a significant role to play in stimulating sustainable economic growth and employment creation.

The promotion of entrepreneurship and innovation lies at the heart of the strategy for the creation of a knowledge-based EU economy as set out in the conclusions of the special Lisbon European Council (March 2000). Accordingly, the Council identified the development of a pan-European market for risk capital as a high priority. The Council also called for the implementation of the Risk Capital Action Plan (RCAP), as annexed to the April 1998 Risk Capital Communication, by 2003. The RCAP proposes initiatives to be taken at Community and/or at Member State level in the areas of market fragmentation, institutional and regulatory barriers, taxation, paucity of high-tech SMEs, human resources and cultural barriers. The Commission has presented a first detailed report (October 1999) on the implementation of the RCAP\(^3\). The next implementation report will be based on the monitoring and benchmarking mechanism described in Annex 1\(^4\). This Communication has the more limited objective of reviewing the strategy for developing the EU risk capital market so as to take account of the Lisbon conclusions. In particular, it is proposed to establish the priority areas for action to ensure implementation of the RCAP by the 2003 deadline.

The Communication is structured as follows. Section 2 provides a context for the strategy review by briefly summarising the main developments in the EU risk capital market in 1999. In Section 3, progress in implementing the strategy is examined along three main axes, i.e. measures to foster market integration, structural reform measures and measures to promote a culture of entrepreneurship. The role of public funding is also briefly considered. Section 4 presents

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\(^1\) The risk capital market comprises informal investment by “business angels”, more formal venture capital investment and investment in specialised markets for new and potentially high-growth companies.


\(^4\) The Member State authorities have already been consulted on the monitoring and benchmarking mechanism.
All segments of the EU risk capital market performed well in 1999.

EU venture capital investment grew by 70% relative to 1998.

some general conclusions.

2. MAIN DEVELOPMENTS IN EU RISK CAPITAL MARKET IN 1999

2.1. A clearly improving trend

The EU risk capital market performed strongly in 1999 and now accounts for about 5% of the total capital raised on all EU stock markets. This favourable performance has extended to all segments of the risk capital market, i.e. investment by business angels, venture capital investment and the high-growth equity market. Business angels are individual investors who invest in small and medium-sized business. Data limitations make it difficult to monitor the activity of business angels on a systematic basis, but there is evidence to suggest that the number of active business angels in Europe is increasing. In 1998 and 1999, the number of business angels networks in the EU has almost doubled to a total of 110 active networks. However, 80% of the networks are located in only 3 Member States.

Data on formal venture capital investment are more readily available and indicate an increase of 70% to about €12 billion (0.14% of GDP) in 1999 from about €7 billion (0.09% of GDP) in 1998. This very substantial increase is reflected in the number of investments made (up by 56%), as well as in the number of companies financed (up by 44%, some 7300 companies). Although the EU private equity market has traditionally focused on more profitable later-stage investments such as management buy-outs (MBOs), it is notable that early-stage investment doubled to about €3 billion in 1999 relative to 1998 and was ten times higher than in 1995. An analysis of the expected allocation of funds raised in 1999 confirms this trend, with about €5.5 billion (22% of total funds raised) earmarked for future early-stage investments.

5 These statistics do not include Luxembourg, for which data are not available.
6 Investment in early stage, a key stage in the development of a company, is high-risk and has tended to yield lower returns than MBOs. However, the performance of early-stage investments has improved as the EU venture capital market has matured and the gap relative to returns from MBOs has narrowed.
In reviewing developments in EU risk capital, the performance of the specialised stock markets for high-growth companies must also be considered. These markets, which are closely linked to venture capital activity because they provide an important “exit route” for investors, experienced significant growth world-wide in 1999. Their development has been influential in the progress of a more financial and entrepreneurial culture in the EU. The EU markets for young and high growth companies have performed particularly strongly, continuing a buoyant trend since their creation in the late 1990s. In view of the sharp increase in share prices the preceding months, the decline after March 2000 can largely be seen as a market correction and a step towards growing maturity in this type of investment. As significant as rising share prices has been the sharp increase in the number of companies listed on these markets. The Neuer Markt recently listed its 300th company, while about 140 companies are listed on Le Nouveau Marché and about 430 are listed on AIM. Several new specialised markets were created in 1999 and 2000, e.g. the Nuovo Mercato in Italy and the Nuevo Mercado in Spain. A total of €10 billion was raised on all EU specialised markets (some 80% of this on the Neuer Markt) during the full-year 1999, and a further €13 billion has already been raised in the first six months of 2000.

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7 These markets are likely to be characterised by considerable price volatility due to the high-risk nature of the assets involved, their small size and the limited free float weight on their liquidity.
Table: Main markets specialising in SME financing as at 30 June 2000

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<tr>
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<th>Euro NM</th>
<th>EASDAQ</th>
<th>AIM</th>
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<th>NASDAQ</th>
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<tr>
<td></td>
<td>Le Nouveau Marché (Paris)</td>
<td>Neuer Markt</td>
<td>NMAX</td>
<td>EuroNM Belgium</td>
<td>Nuovo Mercato</td>
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<tr>
<td>Launch</td>
<td>Mar 96</td>
<td>Mar 97</td>
<td>Mar 97</td>
<td>June 97</td>
<td>Nov '96</td>
</tr>
<tr>
<td>Number of companies listed (A)</td>
<td>140</td>
<td>281</td>
<td>15</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>Market capitalisation (billion €) (B)</td>
<td>240</td>
<td>50</td>
<td>22.6</td>
<td>1 006</td>
<td>5818</td>
</tr>
<tr>
<td>Capital raised (current year, billion €)</td>
<td>1.2</td>
<td>0.3</td>
<td>1.6</td>
<td>3.1</td>
<td>33.2</td>
</tr>
<tr>
<td>Average capitalisation per company (million €) (B/A)</td>
<td>513</td>
<td>806</td>
<td>53</td>
<td>4 574</td>
<td>1 201</td>
</tr>
<tr>
<td>Capital exchanged (million €/day)</td>
<td>537</td>
<td>32</td>
<td>48</td>
<td>3 633</td>
<td>76 680</td>
</tr>
<tr>
<td>Performance of index since 30 December 1999</td>
<td>+17%</td>
<td>-8%</td>
<td>-11%</td>
<td>-8%</td>
<td>-3%</td>
</tr>
</tbody>
</table>

Sources: Euro.NM, EASDAQ, LSE, NASDAQ, own calculations.

1 Since launch on 4 November 1999.
2 Average, current month.

2.2 Several forces shaping market developments

The progress achieved in developing the EU risk capital market must be viewed in the context of profound changes in the functioning of the EU financial system as a whole. These changes are, in large part, a response to the wider influence of globalisation. The application of new and advanced technologies to the international financial system has introduced a new dimension of competition by removing geographical barriers and by transforming traditional market structures (e.g. the emergence of automated trading systems). Financial markets and intermediaries have responded to these changes by developing global market strategies which involve achieving greater size through mergers and acquisitions and operating on a world-wide basis. Risk capital markets, although less globalised than other financial markets, have also experienced significant change. Notably, the typical structure of investment projects funded through the financial markets has changed, with an increased tendency for so-called “new economy” enterprises to seek direct financing through the specialised equity markets. These enterprises often need a large capital infusion over a number of years before becoming profitable but their high earnings potential has attracted investors. The most obvious manifestation of this phenomenon has been in the information technology sector, where there has been a surge in the number of stock-market listings fuelled by high investor demand for IT companies’ shares.

Within the European Union, the transformation in financial markets – including risk capital markets – has been intensified by reinforced efforts to complete the single market for financial services and by the

Development of EU risk capital market must be viewed in wider context of globalisation and technological progress.

EU risk capital market also influenced by specific factors such
as financial-market integration and the introduction of the euro. The combined effect of these more EU-specific factors will be to accelerate the emergence of deep, broad and liquid financial markets. More indirectly, the fiscal discipline implied by EMU is releasing additional capital for private-sector investment by reducing public borrowing requirements and stimulating a “crowding in” effect. Privatisation of publicly owned enterprises – often linked to budgetary consolidation strategies - has increased the offering of equities. In many Member States including Germany, France and the United Kingdom, the number of households holding shares has increased sharply in recent years, fuelled by generally buoyant stock prices as well as by the continued withdrawal of the public sector from commercial activities. In this general environment, risk capital activity has also expanded as investors seek out a higher yield on their investments and reduce the relative share of banks deposits in their portfolio.

2.3. Still room for improvement

Despite the progress made in 1999, the EU risk capital market remains small in comparison to that of the United States, particularly in respect of early-stage investment and investment in technology sectors. US venture capital investment rose to €33 billion in 1999, an increase of 150% relative to 1998. Of this total, €13 billion (42%) was in early-stage investment – more than total EU venture capital investment and more than four times EU investment in early-stage companies. The European early-stage venture capital market remains small and lacking in transparency, with a limited correlation between risk and return. This unfavourable comparison puts the recent expansion of the EU risk capital market in perspective and highlights the extent of the challenges still to be overcome. On the other hand, it should be noted that the expansion in US venture capital investment in 1999 was largely due to an increase in the size of individual “deals” rather than to an increase in the number of investments. The relatively large size of deals in the US market can be partly attributed to a higher percentage of technology investment, especially in Internet-based services. In 1999, investments in technology sectors (mainly software industry, telecommunications and Internet-based services) amounted to €18 billion in the United States but to little more than €5 billion in Europe8. However, some commentators have interpreted the increasing size of US deals as evidence of a speculative bubble and have questioned the quality of some recent venture capital investments.

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8 The European and US data are not directly comparable as the European survey includes unsecured debt, whereas the US survey does not include debt and as the US survey includes technology-related investments in other non-technology categories (such as the new media category and IT consulting in the business services category).
The EU risk capital market compares unfavourably with the US market also in that it is highly fragmented with little cross-border activity. This fragmentation is reflected in marked differences in performance between the Member States. In 1999, the level of venture capital investment ranged from 0.32% of GDP in the Netherlands to 0.04% of GDP in Austria. Three groups of Member States can be distinguished: (i) the Netherlands, Belgium, United Kingdom, and Sweden with venture capital investment representing more than 0.2% of GDP and broadly comparable to the US situation a year before; (ii) Finland, Germany, France, Spain and Ireland with a ratio between 0.1% and 0.2% of GDP; and (iii) Greece, Italy, Denmark, Portugal and Austria, where the venture capital market remains smaller than 0.1% of GDP. A similar pattern is observed in respect of early-stage investments with the notable exception of the United Kingdom, where early-stage investment represents less than 0.02% of GDP despite the existence of a relatively large venture capital market. The Member States also differ in relation to investment in the technology sector, with more than 50% of venture capital investment devoted to technology in Belgium, France, Ireland and Sweden but very little technology investment in the less developed markets of Austria, Greece and Portugal.
As with the venture capital market, the EU stock market for young and high-growth companies is fragmented, with marked differences in performance from Member State to Member State. Cross-border comparison is made difficult by the specific characteristics of the national markets. The extent of the differences is illustrated by the contrast between the Neuer Markt and AIM. The Neuer Markt has an average market capitalisation of €680 million, 40 foreign listings\(^9\) and 70% of all listings are in the technology sector, while AIM has an average market capitalisation of only €53 million with listings predominantly UK-based and only 15% in the technology sector. As EU financial integration proceeds, we can expect the creation of a pan-European stock market for high-growth companies. The merger of the Brussels, Amsterdam and Paris exchanges to create Euronext, represents a step in that direction.

3. **The strategy for development of the EU risk capital market**

The favourable performance of the EU risk capital market in 1999 is a cause for optimism. Nevertheless, the EU market continues to underperform that of the United States by a considerable margin. While there is no evidence of a generalised market failure in the European Union, the divergence in performance between Member States points to

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\(^9\) 25% being Austrian, as no such market exists in Austria.
problems of market fragmentation and to the existence of country-specific constraints on more efficient market functioning. More generally, the underperformance of the EU risk capital market would seem attributable also to an inadequate entrepreneurial culture in many of the Member States. All of these factors indicate the need to proceed with the full implementation of the RCAP by the 2003 deadline at the latest.

In this section, the strategy to develop the EU risk capital market is revisited along three main axes. These are: (i) measures to foster market integration; (ii) structural reforms to address country-specific market constraints; and (iii) measures to promote a culture of entrepreneurship within the Member States. Attention is focused both on progress to date and on measures outstanding under the RCAP, while distinguishing between those measures under Community responsibility and those under the responsibility of the Member States. The role of public funding in developing the EU risk capital market is also briefly considered.

### 3.1. Measures to foster market integration

The removal of exchange risk between euro-area countries has made current matching requirements between assets and liabilities obsolete and suggests that portfolio allocation decisions should be increasingly “sector-driven” rather than “country-driven”. The economic policy convergence implied by EMU is further expected to diminish country-specific factors influencing investment decisions. However, evidence from company valuation to date does not indicate a major shift toward sector-specific valuation. A likely explanation for this is the continued fragmentation of EU financial markets. Accordingly, measures to foster an appropriate degree of market integration are a central element of the Lisbon strategy for stimulating more efficient financial markets in general and more efficient risk capital markets in particular.

The Lisbon European Council provided an important impulse to the integration of EU financial markets and EU risk capital markets in particular. Paragraph 20 of the Presidency conclusions states that “it is essential ... to push forward the integration of EU financial markets” and recognises that “efficient risk capital markets play a major role in innovative high-growth SMEs and the creation of new and sustainable jobs”. Paragraph 21 is more specific and requires that steps should be taken to complete the implementation of the Financial Services Action Plan (FSAP) before 2005 and of the RCAP before 2003. Furthermore, the paragraph underlines the importance of some FSAP priority action areas, including two that are highly relevant for the RCAP: (i) facilitating the widest possible access to investment capital on EU-wide basis, including for SMEs by means of a “single passport” for issuers, and (ii) facilitating the successful participation of all investors in an integrated market by eliminating barriers to investment in pension funds.
The implementation by 2005 of the regulatory nature in the RCAP have been integrated) is proceeding at a reasonable pace. Two progress reports have already been presented to the Council (November 1999 and May 2000)\textsuperscript{10}. A third progress report will be presented to the Council of 27 November 2000. Following a request from the Council of 17 July 2000, it will include two new elements: (i) a priority-related "critical path" to achieve the objectives of the FSAP by 2005, and (ii) possible indicators (benchmarks) to measure progress towards realising the economic benefits of an integrated EU financial services sector. The FSAP priority-related critical path will take into account the Lisbon deadline for the implementation of the RCAP (2003). Of particular importance for the development of the EU risk capital market will be the timely adoption of the Directive on the prudential supervision of supplementary pension funds, the two Directives on UCITS, the amendments of the prospectuses Directives and the legislative follow-up to the EU accounting strategy Communication.

The Council of 17 July 2000 took another important decision which should facilitate the integration of EU financial markets. This was to set up a “Committee of Wise Men”\textsuperscript{11}, chaired by Mr. Alexandre Lamfalussy. As a follow-up to the FSAP, this Committee will focus on the practical arrangements for implementing Community rules and will propose scenarios for adapting current practices in order to ensure greater convergence and co-operation between regulators.

Progress on the relevant actions included in both the FSAP and the RCAP includes:

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

The Commission is preparing a proposal in close co-operation with the Member States and, in particular, with FESCO (Forum of European Securities Commissions). The ad-hoc working group of FESCO, where the Commission is an observer, completed its work in mid-2000. The objective of the working group is not only to provide for improved (simpler, cheaper, faster) cross-border procedures but also to facilitate the introduction of modern features such as “shelf registration”\textsuperscript{12}. The Commission intends to table a proposal on this subject before end-2000. In addition, there is a broad consensus that access to cross-border capital by SMEs would be facilitated by agreement at EU level on which investors should qualify as professionals. In this regard, a

\textsuperscript{10} See \url{http://europa.eu.int/comm/internal_market (financial services, action plan section)}

\textsuperscript{11} See \url{http://europa.eu.int/comm/internal_market (financial services, general matters section)}

\textsuperscript{12} ie prospectus prepared in a two-step procedure: a “reduced” prospectus containing everything except for the information concerning the specific securities involved in the issue, which is filed once a year with the competent home authority. Then, when the time is right for an issue, the companies prepare the “issue note” describing the characteristic of the offer and of the securities. Belgium, Spain, France, the UK and Italy already make use of the shelf-registration procedure.
Communication on the distinction between “sophisticated” and “retail” investors is expected to be adopted by the Commission before end-2000 as part of the FSAP.

- Dissemination of best practices in corporate governance

The Commission has launched\(^{13}\) a review of existing codes of corporate governance with a view to identifying any legal or administrative barriers which could frustrate the development of a single market in financial services. The results of this review should be available in the second half of 2001.

- Assessment of existing accounting and auditing requirements

On 14 June 2000, the Commission adopted a Communication on financial reporting strategy. A central feature of the new policy is the introduction of a requirement for all EU-listed companies to prepare their consolidated financial statements in accordance with International Accounting Standards (IAS). This requirement would enter into force at the latest from 2005 onwards. Appropriate legislation will be proposed by the Commission before end-2000. Concerning statutory audit, the Commission will issue before end-2000 a Recommendation on external quality assurance, based on the work of the EU Committee on Auditing.

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

Substantial progress has been made in the year 2000 with regard to investment funds (UCITS). Following the adoption of amended proposals by the Commission (30 May 2000), the Council is expected to reach political agreement on the first proposal in October 2000. Political agreement on the second proposal is expected to be reached before March 2001. This should pave the way for an early adoption of the two new directives. With regard to pension funds, the Commission has adopted (11 October 2000) a proposal for a directive on the prudential supervision of supplementary pension funds\(^{14}\). This proposal takes into account the diversity of pension funds operating in the European Union and covers authorisation, reporting, fit and properness, and rules on liabilities and solvency. Investment rules will be based on the “prudent-man” principle and ensure that pension funds can invest in risk capital markets.

- Reform of the European Patent System\(^{15}\)

On 5 July 2000, the Commission adopted a proposal for a Regulation for a Community patent to give inventors the option of obtaining a

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\(^{13}\) call for tender published on 21 March 2000
\(^{14}\) COM(2000)507prov
\(^{15}\) This measure is not part of the FSAP but is highly relevant to risk capital markets.
single patent legally valid throughout the European Union. Under the Commission proposal, Community patents to be issued by the European Patent Office would be both affordable and legally certain. In particular, it is expected that a Community patent would reduce translation costs to some €2,200 by not requiring any translation beyond that already foreseen in the Munich Convention for the granting of the patent. Concerning legal certainty, the Commission suggests that a new centralised Community tribunal within the framework of the European Court of Justice should be set up to deal with disputes related to the question of infringement and validity of Community patents. This would require an amendment of the Treaty.

3.2. Structural reforms to address country-specific constraints

Efforts to foster a more integrated EU risk capital market need to be supported by appropriate and timely structural reforms to address country-specific constraints on the efficient functioning of risk capital markets. These reforms are mainly the responsibility of Member States and will, of course, vary with national circumstances. However, two main categories of structural reforms - regulatory and fiscal - to develop risk capital markets in the Member States were emphasised in the context of the RCAP.

3.2.1. Easing regulatory constraints

Regulatory constraints on the development of risk capital markets are of two types. The first type relates to legal provisions limiting the scope for institutional investment in risk capital and tend to impact negatively on the supply side of the market. Only four of the Member States (i.e. Finland, Ireland, the Netherlands and the United Kingdom) have no legal restrictions - beyond a general requirement for prudence - on investment in equities by banks, insurance companies and pension funds. Constraints on institutional investment may not be the only barrier to institutional investment in risk capital\(^\text{16}\), but the US experience following the decision to relax the “Prudent Man Regulation” (1978) suggests that the removal of quantitative constraints could provide a major boost to the development of risk capital in the EU.

The proposed EU Directive on occupational retirement provision (see above) addresses this type of barrier in respect of supplementary pension funds, which are among the more important institutional investors. The Directive stresses that national investment rules must ensure that pension funds, inter alia, can invest in risk capital markets in accordance with the “prudent-man” principle. Meanwhile, many of the Member States have already taken actions to allow specific institutional

\(^{16}\) as highlighted by the review of institutional investment launched by the UK Treasury (May 2000) to investigate the factors distorting institutional investor’s decision making.
investors to invest in unquoted companies. In Sweden, a new regulatory framework for pension provision allows insurance companies and pension funds to increase their investment allocation to private equity and these institutional investors are now the main suppliers of venture capital. In France, the introduction of the so-called “DSK” life-insurance contract (1998) provides tax incentives for insurers to invest 50% of their portfolio in equity, including a minimum investment of 5% in unlisted securities, while the regulation applying to the main French venture capital vehicle, the “Fonds Communs de Placement à Risques” has been improved, allowing for the creation of funds of funds and of “light”17 funds for professional investors. In Italy, some limitations on investment rules for closed-end funds have been removed (1998) and domestic mutual funds in Spain have been authorised (1997) to invest up to 10% of their assets in unlisted securities. Denmark is also considering the possibility of raising the proportion of private pension savings which can be invested in non-quoted stocks. Despite these measures, removal of quantitative constraints on investment in equity capital – including risk capital – needs to be given higher priority.

The second type of regulatory barriers to the development of risk capital markets includes administrative procedures for setting up a company, procedures following bankruptcy and insolvency, etc. These barriers tend to impact on the demand side of the market by increasing the cost of business creation. In most of the Member States, significant progress has been made in simplifying administrative procedures, through the creation of one-stop shops for example. The period necessary to register a company has been generally reduced. For example, a company can now be established in 24 hours in France (although a period of 2 to 3 days is more likely), in 5 days in Ireland, in 12 days in Denmark, and 3 weeks in Portugal (3 months previously). In contrast, there has been little progress in improving the application of laws on bankruptcy and insolvency so as to ensure that the consequences of business failure are not so severe as to discourage desirable risk taking.18 Indeed, many of the cultural barriers (see section 3.3) that have been identified as major impediments to entrepreneurship and risk taking within EU Member States continue to be reinforced by the current legal environment. The necessity to reform procedures following bankruptcy and insolvency has been long recognised and should now become a clear priority for the Member States.

3.2.2. Easing fiscal constraints

The structure of taxation can act as barrier to the development of risk capital in several ways.

First, the tax structure can have a negative impact on investment if the

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17 Applying a simplified procedure.
18 The UK government has begun consultation on these matters.
after-tax rate of return to the investor is deemed too low. In this context, the most relevant feature of the tax structure for the development of risk capital markets is the rate of capital gains tax. It is notable that US risk capital investment accelerated in the early 1980s following a reduction in capital gains tax (1978), but decelerated after the 1986 Tax Reform Act in which capital gains tax was increased. Against this background it appears worthwhile examining whether reductions of capital gains taxes could play an equally positive role in promoting the development of EU capital markets. Clearly, the issue of capital gains taxation is related to many other aspects of tax law (e.g. inheritance tax) and of the overall tax structure (e.g. relative weight of labour taxation), so that this assessment needs to take account of the broader implications of capital gains taxes within a given tax system. The taxation of stock options is also an area that can be looked into, inter alia, from this perspective.

Second, the tax structure may hinder investment in equity by granting relatively favourable treatment to debt financing. A study of the EU effective tax burden by Baker & McKenzie (1998)\textsuperscript{19} concluded that debt financing is a more tax-efficient means to develop a company than the use of retained earnings or new equity capital. With the exceptions of Finland and Italy, all of the Member States favour the use of debt over equity financing in their tax structures although it must be recalled that other factors such as availability and cost of financing will play an equally important role in a company’s financing decision. The Finnish tax system affords equal treatment to new equity and debt and Finnish SMEs would seem to have a high and increasing ratio of own funds relative to SMEs in other Member States. The Italian tax system has actually favoured equity financing since 1998 but Italian SMEs remain relatively indebted. The future evolution in the financial structure of Finnish and Italian SMEs should act as a test case in assessing the potential to develop risk capital via a more balanced tax treatment of debt and equity financing. The Commission services are examining these questions indepth in the context of an ongoing comprehensive study on company taxation in the EU. The results of this study will be available early in 2001.

Third, the tax structure may hinder cross-border investment by creating specific tax obstacles or even discriminating against foreign investors. A comprehensive response to such barriers might be achieved most effectively through co-ordinated action on EU-level. In any event, Member States have to make sure that tax treaties and/or other tax law instruments prevent double taxation of dividends in cross-border investments. The above-mentioned Commission company tax study will among other things look into these questions in some depth.

Tax reform was identified as a key priority in the context of the RCAP

reforms but more needs to be done to reduce disincentive effects on entrepreneurship.

Germany is to reduce its corporate and income tax rates and to eliminate corporate tax on the sale of shares of other companies held in the portfolio by corporation from 2002. France is also to reduce its corporate and income tax and has increased tax benefits granted to reinvesting business angels. Italy is to grant favourable tax treatment to closed-end investment funds and Spain has granted tax incentives to registered venture capital investors. Several of the Member States have also made progress in reducing the tax disincentives to business creation. It is also important that Member States design their tax systems so to ensure that the taxation of share ownership and stock options do not act as a disincentive to entrepreneurship. In the United Kingdom and Ireland – where the tax environment is already largely supportive of risk capital investment - taxation of share options has been reformed. In France, the application requirements for the system of "Bons de Souscription des Parts et Créateurs d’Entreprises (BSPCE)" have been expanded and extended to the end of the year 2001 although the reform of stock option plans has still to be completed.

3.3. Promoting a culture of entrepreneurship

Europe still faces a backlog in innovation and innovative companies. In its recent communication “Towards a European research area” the Commission stressed the importance of encouraging and facilitating the creation of new firms by researchers. Both the Commission and the Member States have been strengthening their action to promote technology transfer to SMEs and foster the creation of firms as well as cooperation between SMEs, academics and large enterprises.

The Communication on Innovation in a Knowledge-Driven Economy adopted by the Commission on 20 September presents the current situation of high-tech enterprises and proposes a strategy for innovation in the future. The Trend Chart on Innovation Policy is providing instruments to follow up and design innovation policy initiatives. Three reports to be released in the autumn will contain indicators on human resources, knowledge creation, transmission and application of knowledge, innovation, output and markets. The reports will also examine some 60 measures implemented by the Member States last year to support venture capital, seed capital, incubators, etc. In the

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20 if these shares have been held for at least a year.
21 The Commission staff working paper annexed to the October 1999 Risk Capital Communication (SEC(1999)1725) highlighted the benefits of employee ownership schemes such as stock options, and gave some examples of good practices.
22 i.e. deferral of the tax liabilities until the shares are sold in Ireland, along with a “Save As You Earn” scheme; “All Employee Share Ownership Plan”, and “Enterprise Management Incentive” schemes in the UK.
23 COM(2000)6
24 COM(2000)567
25 (i) the “European Innovation Scoreboard for the Knowledge Economy”; (ii) the monitoring report on “Start-up and technology based companies”, and (iii) the monitoring report on “Innovation Finance”. 

16
framework of Community research programs, various actions have been undertaken and will be pursued to foster the creation of technology-based firms and interfacing between researchers, entrepreneurs and investors. For instance, the “Biotechnology & Finance Forum”, set up jointly by the Commission Life Science programme and the European Association of Security Dealers (EASD), organised two conferences (1998 and 1999) to promote networking between relevant actors in the area of biotechnology. A third conference will take place in November 2000.

Under the PAXIS action, 15 innovative economic areas in Europe have been selected to establish a network promoting best practices. In November 2000, the second forum for innovative enterprise will take place in Lyon, allowing entrepreneurs to give feedback on policies (regional, national or EU-wide) that are to be put in place to help Europe achieve a knowledge and innovation-based society.

As venture capital funds still face difficulties in recruiting skilled investment managers (capable of analysing innovative businesses based on recent R&D findings), the Commission has launched an action under the I-TEC initiative to extend the exchange of experience and good practice between venture capital operators, technology incubators, and industrial liaison offices linked to research institutes and universities across Europe. In addition, through its support to new business angels networks at European, national, and regional level, the Commission facilitates the matching of informal investors and start-up businesses.

The Commission is to publish this autumn the first BEST Implementation report bringing together all aspects of policy affecting entrepreneurship and competitiveness at European and Member State level. Entrepreneurship is one of the four pillars of the Employment Guidelines and the Commission’s proposed Guidelines for 2001 call for greater entrepreneurial awareness across society and in educational curricula. The European Social Fund finances a series of educational and training programs in this area, while some Member States have taken direct measures to overcome cultural barriers to entrepreneurship by introducing the teaching of entrepreneurship in schools and funding (publicly or with the private sector) chairs for entrepreneurship at private and public universities. In addition, award schemes for entrepreneurs now operate in a number of Member States.

### 3.4. The role of public funding

The philosophy underlying the strategy for developing the EU risk capital market attributes primary importance to the creation of an environment favourable to creating and sustaining new and innovative businesses. The measures contained in the RCAP to facilitate market integration, to ease market constraints and to promote a culture of entrepreneurship are in keeping with this philosophy. Consistent with this approach, there is a role for public funding limited to addressing identifiable market failures. However, as with all cases for public funding, the advantages need to be weighed against risks of market
distortion and, particularly in the risk capital area, of displacing or crowding out private sector activity. In the state aid rules, the Community has a mechanism and a procedure to follow which allows this balance to be struck. Member States are obliged to ensure that all measures are consistent with the state aid rules. This may mean notification to the Commission under Article 88(3) of the Treaty so that the Commission can assess the measure’s compatibility with the common market.

A range of financing instruments are available at EU level, managed by the EIB, the EIF and the Commission. It will be recalled that the Lisbon conclusions mandate the Commission to review the coherence of EIB and EIF financing of risk capital activity. This matter is dealt with in a separate Communication.26

4. CONCLUSION

There is increasing evidence to suggest that the long-term performance of an economy is positively related to the level of development of its financial system. More specifically, a growing number of studies point to a relationship between economic growth and the ready availability of innovation financing.27 Thus, access to risk capital can play a key role in sustaining economic growth and employment creation by allowing for the development of new and innovative businesses.

Despite the favourable developments in 1999, the European risk capital market is still lagging behind the US market. In response, action has been taken at EU and Member State level to improve the structural and regulatory environment conditioning the development of risk capital and entrepreneurial firms. The Commission has tabled or is preparing several legislative measures to improve the efficiency of the EU financial market. Timely adoption of the FSAP, especially, will do much to foster a more integrated EU risk capital market. In drafting the Broad Economic Policy Guidelines, it has stressed the importance of structural reforms. Member States have also responded with a series of structural reforms and actions to promote entrepreneurship. However, more needs to be done if the RCAP is to be implemented by the deadline of 2003 set by the special Lisbon European Council.

Implementation of the RCAP requires action on many fronts, but priority should be given to three areas - all of which fall under Member State responsibility. These are (i) the easing of quantitative constraints on institutional investment in equity capital (to be replaced by “prudent

26 See reference.
27 For example, see “How do financial systems affect economic performance ?”, W. Carlin and C. Mayer , July 1999.
man “legislation”\textsuperscript{28}); (ii) the softening of bankruptcy laws to allow failed entrepreneurs a second chance (while affording adequate protection of creditors’ rights); and (iii) the development of a fiscal framework more conducive to investment and entrepreneurship. Substantial progress in these priority areas, combined with accelerated progress of financial integration will do much to ensure the economic and legal environment necessary for a thriving EU risk capital market.

\textsuperscript{28} A principle to be introduced into Community legislation for supplementary pension funds (cf. the Commission proposal of 11 October on supplementary pension funds).
ANNEX 1

BENCHMARKING AND MONITORING OF THE RISK CAPITAL ACTION PLAN

A. BACKGROUND

An efficient market for risk capital plays an important role in the development of innovative, high-growth SMEs and, in this way, contributes significantly to sustainable economic growth and employment creation. Having identified a need to foster the further development of risk capital in the EU, the Commission adopted a Communication and an Action Plan (April 1998) to this end. A first analysis of the implementation of the Risk Capital Action Plan (RCAP) was carried out in October 1999 and revealed that, while some progress had been made, the EU still suffered weaknesses in the availability of risk capital. Further to this analysis, the ECOFIN requested that the Commission should prepare a monitoring and benchmarking mechanism for the RCAP. This mechanism is expected to facilitate implementation of the RCAP before the deadline of 2003 agreed by the Lisbon European Council.

The RCAP proposed a wide range of measures to foster the development of an efficient risk capital market within the EU. These measures, to be taken by the Commission and by the Member States, relate to six different areas i.e. market fragmentation, institutional and regulatory barriers, taxation, paucity of high-tech SMEs, human resources and cultural barriers. Several of the measures contained in the RCAP are also elements of current EU policies to stimulate innovation, to improve the single market in financial services and to promote entrepreneurship and competitiveness. There is, therefore, a substantial overlap between the actions proposed under the RCAP and those included in the Commission’s action plans on innovation, financial services and entrepreneurship. Accordingly, it is intended that the monitoring and benchmarking mechanism for the RCAP should draw upon corresponding mechanisms already in place to follow the implementation of the “Action Plan to Implement the Framework for Financial Markets” (FSAP), the “Action Plan to Promote Entrepreneurship and Competitiveness” (BEST) and the “Innovation Action Plan”. In addition, the mechanism for the RCAP will be closely co-ordinated with the benchmarking exercise - also requested by the Lisbon European Council - to create a friendly environment for starting up and developing innovative business, especially SMEs. Finally, the mechanism should benefit from the work underway in preparing a broader analysis of structural indicators in connection with the BEPG and the Synthesis Report. By exploiting the information

29 Benchmarking is a continuous, systematic process for comparing the performance of organisations, enterprises, economies etc. against a chosen standard. It is a learning process aimed at identifying and implementing best practice. The main steps of a benchmarking process are:
- Identification of a target to be improved;
- Development of a specific performance indicator(s), i.e. benchmark(s), for comparison;
- Comparison of own performance against the benchmark;
- Analysis of best practice and potential for improvement;
- Implementation of best practice;
- Continuous monitoring.

30 COM(99)232
31 COM(98)550
32 COM(96)589
available from these and other sources, it should be possible to limit the number of new indicators required specifically for monitoring the RCAP.

Some of the actions included in the RCAP have now been taken and can be assessed directly. Other actions have a longer-term perspective and their impact on the risk capital market may not be measurable directly. Moreover, any monitoring mechanism for the RCAP must take account of the fact that these markets are evolving rapidly. At this stage, it is proposed that the monitoring and benchmarking mechanism of the RCAP should include:

1. a set of indicators of developments in risk capital markets
2. for each of the actions contained in the RCAP,
   - a summary of progress to date,
   - whenever relevant, an analysis of best practices,
   - whenever possible, the development of specific performance indicators

The mechanism should be designed to allow for regular updating of the RCAP by identification of those actions that are no longer relevant and possibly the inclusion of new actions.

B. DEVELOPMENT AND MONITORING OF INDICATORS OF THE RISK CAPITAL MARKET.

Risk capital is the generic term for a set of equity financing instruments for companies in their early stages of growth. It covers three types of financing: informal investment by business angels, venture capital, and raising of capital on stock markets specialised in high growth companies (the so-called “new markets”). The monitoring of risk capital markets will be based on monitoring of these three main forms of equity financing. It will also refer to indicators of financial structure, as equity financing is to be analysed in relation to other forms of external financing for a company. Special attention will be given to SMEs’ financing. Comparison will be made with the US market.

In May 1997, at the request of the Industry Council, a pilot initiative on benchmarking of framework conditions for European industry was launched jointly by the Commission and the Member States. One of the four projects under this initiative concerned benchmarking the financing of innovation and was co-ordinated by the Danish Ministry of Business and Industry. The RCAP made use of the output from this project and included several of its recommendations. It seems appropriate, therefore that the monitoring mechanism for the RCAP should use, whenever relevant and possible, the indicators proposed in that project.

Proposed indicators of development of the risk capital markets

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Data availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs financial structure</td>
<td>BACH database. Problem: time lag and coverage (the data bank currently covers 11 Member states, the US and Japan). For some countries (mainly, Germany and Austria), the sample is limited only to incorporated businesses.</td>
</tr>
<tr>
<td>- own funds ratio</td>
<td></td>
</tr>
<tr>
<td>- ratio of financial indebtedness</td>
<td></td>
</tr>
</tbody>
</table>
**Indicator Data availability**

<table>
<thead>
<tr>
<th><strong>Indicator</strong></th>
<th><strong>Data availability</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment by business angels</td>
<td><strong>No comprehensive data presently available.</strong> Some fragmented information available from the European Business Angels Network (EBAN)</td>
</tr>
<tr>
<td><strong>Access to venture capital:</strong></td>
<td></td>
</tr>
<tr>
<td>Ratios of VC investments to GDP; breakdown by:</td>
<td>EVCA, yearly; from 2000, will be available twice a year. (PwC for US data).</td>
</tr>
<tr>
<td>- investment stage</td>
<td></td>
</tr>
<tr>
<td>- industry/sector</td>
<td></td>
</tr>
<tr>
<td>Number of companies having received seed and start-up financing; to be compared with number of companies created within the year</td>
<td>The ratio of number of companies having received seed and start-up financing to the number of companies created within the year will not be comparable between Member States as data on business birth rates are not yet harmonised.</td>
</tr>
<tr>
<td><strong>Access to stock markets for high-growth companies:</strong></td>
<td>FIBV, yearly;</td>
</tr>
<tr>
<td>- Capitalisation (relative to GDP)</td>
<td></td>
</tr>
<tr>
<td>- Number of companies quoted (relative to population)</td>
<td></td>
</tr>
<tr>
<td>- Share turnover (value of share trading)</td>
<td></td>
</tr>
<tr>
<td>- Number of IPOs (relative to population)</td>
<td></td>
</tr>
<tr>
<td>- Capital raised (relative to GDP)</td>
<td></td>
</tr>
</tbody>
</table>

C. **MONITORING OF THE MEASURES PUT FORWARD IN THE RISK CAPITAL ACTION PLAN**

C.1. **Market fragmentation**

The structure of risk capital markets is evolving rapidly. Before monitoring the impact of the measures put forward in the RCAP to reduce market fragmentation, it is necessary to analyse the impact of broader developments e.g.: Euronext, ECNs, etc. More specifically in relation to risk capital, a set of indicators on market integration should also be used:

<table>
<thead>
<tr>
<th><strong>Indicator</strong></th>
<th><strong>Data availability</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportion of cross-border VC investments</td>
<td>EVCA</td>
</tr>
<tr>
<td>Proportion of cross-border IPOs on high-growth stock markets</td>
<td>FIBV</td>
</tr>
<tr>
<td>Proportion of VCC exits by IPO</td>
<td>EVCA</td>
</tr>
<tr>
<td>Number of venture-backed IPOs</td>
<td>Stock markets</td>
</tr>
</tbody>
</table>

C.1.1. **Measures under the Commission’s responsibility**

- Market monitoring and development of information and statistics on all levels of venture capital in the EU

The main source of information on venture capital in the EU is EVCA’s yearly private equity survey. In the framework of the implementation of the BEST Action Plan, the Commission has received some complementary information from the Member States. The “trend chart on
innovation” (established in the framework of the Action Plan for Innovation) will also, among other things, gather information on the history and results of national and EU policy measures to support venture capital. Additional sources of information are the study “corporate venturing in Europe” commissioned by the Commission in 1999 to gauge the resurgence in corporate venture capital activity in Europe and the study on the typical growth paths taken by biotechnology and information technology firms and the role that different types of financiers play in this regard.

- Round table on the impact of the fragmentation of the European risk capital market

This action has been completed. The round table was organised at the end of November 1998. It contributed to a better understanding of the role played by risk capital markets in fostering economic growth and job creation. It also highlighted the importance of breaking down cultural barriers to entrepreneurship in Europe and the need for a more integrated EU risk capital market. (Report published in Euro Papers, n° 32, January 1999).

- Detailed examination of the cost to European firms of raising debt and equity finance

A study of this issue has been launched by the Commission and will be completed by end 2000. Based on this study, it may be possible to define some indicators of the cost of debt and equity financing. An indicator of the cost of capital would be very useful, but no such indicator is presently available in the EU.

C.1.2. Measures under the responsibility of the Commission and Member States

- Develop networks of business angels at regional, national and Community levels

Business angel networks have been created in most of the Member States, sometimes with public support. The European Commission supports the development of such networks through its support to EBAN (the European Business Angels Network) as well as through the financing of feasibility studies and specific projects.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Data availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of active business angel networks</td>
<td>The European Business Angels Network (EBAN) database (only limited coverage). The data are available from 1998.</td>
</tr>
</tbody>
</table>

- Public financial support to develop venture capital, innovation finance and improve access to stock exchanges

The Risk Capital Communication from the Commission (April 1998) focused on improving the framework for risk capital financing through the removal of barriers to market access. It did not include any specific recommendation concerning financial support by the State. However, several of the reports sent by Member States (early in 1999) on the implementation of the RCAP included reference to public financial instruments aimed at developing venture capital and innovation finance. Several Member States also made reference to these instruments in their Cardiff reports on product and capital markets. The subsequent Risk Capital Communication (October 1999) highlighted the role of State support as a catalyst to

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33 Measure not specifically included in the April 1998 Risk Capital Communication
the provision of risk capital. While structural reform of the market and the efficient use of public funding can be complementary, it is important that government intervention should not distort the functioning of capital markets and should respect the rules on state aids.

The Commission services are currently preparing a review of the Community financial instruments in support of venture capital. Reference will be made to the results of this review in the context of monitoring the RCAP.

C.2. Institutional and regulatory barriers

C.2.1. Measures under the Commission's responsibility

These are mainly legislative actions that cannot be monitored readily by means of indicators. However, once adopted, the transposition and implementation of legislation by the Member States can be monitored via a scoreboard.

- Venture-capital funds: Assessment of whether there is a need for Community legislation covering specific closed-end funds

The Commission convened the UCITS Contact Committee at the end of 1998 to consider whether it would be appropriate to extend Community legislation on investment funds to cover venture capital funds. Representatives from the venture capital industry, the stock exchanges specialised in fast-growing SMEs, and the SMEs' associations participated in the meeting. The consensus was that such a directive is not desirable.

- Review of implementation and possible amendment of prospectus directive to facilitate companies raising cross-border capital (e.g. IPOs)

A draft proposal for a directive is under preparation, in close co-operation with FESCO. Member States are consulted through various committees, The adoption of the directive is expected to take place before end-2000. The objective is not only to improve cross-border procedures but also to introduce modern features such as “shelf registration”34. Cross-border activity of SMEs would also benefit greatly from a common agreement at EU level on which investors should qualify as professionals. The Commission is co-operating with FESCO on this subject. The ad-hoc working group of FESCO completed its work in May 2000. As part of the FSAP, the Commission will issue a Communication on the distinction between “sophisticated” investors and retail investors before end-2000.

- Assess existing accounting and auditing requirements

In order to accelerate the completion of a single and competitive securities market, the Lisbon European Council requested urgent action in the field of financial reporting in particular to enhance comparability of financial statements. In June 2000, the Commission adopted a

34 Shelf-registration is a prospectus prepared in a two-step procedure. First, companies prepare, at the same time as they prepare their annual reports, a “reduced” prospectus (the RD – Reference document) containing everything except for the information concerning the specific securities involved in the issue. This is filed once a year with the home competent authorities. Then, when the time is right for an issue, the companies prepare the SN (securities or issue note) describing the characteristic of the offer and of the securities. Investors, instead of the classical prospectus receive the RD, the SN and all the information concerning recent relevant news. Belgium, Spain, France, the UK and Italy already make use of self-registration procedures.
A central feature of the new policy is the introduction of a requirement for all EU listed companies to prepare their consolidated financial statements in accordance with International Accounting Standards (IAS). This requirement will enter into force from 2005 onwards. The IAS to be applied by listed companies will be identified by an endorsement mechanism to be set up at EU level. The new policy also puts strong emphasis on the need for proper enforcement of the standards. Main actions in this area will concentrate on disseminating implementation guidance, encouraging high audit quality and reinforcing co-ordinated regulatory oversight. Member States may extend the application of IAS to unlisted companies and to individual accounts.

In order to ensure that the Accounting Directives can remain the basis for financial reporting for all limited liability companies, the Commission will introduce a proposal for the modernisation of the Accounting Directives before the end of 2001.

In order to make it possible for EU companies to apply IAS without coming into conflict with the Accounting Directives, the Commission introduced (24 February 2000) a proposal to amend the Accounting Directives so as to allow the application of fair value accounting for certain financial assets and liabilities.

Concerning statutory audit, the Commission will issue Recommendations on external quality assurance later this year, on the basis of the work of the EU Committee on Auditing. Further Recommendations on auditor independence and auditing standards will follow at a later date. These Recommendations constitute the implementation of actions announced in the 1998 Communication on “statutory audit within the EU” and aim to ensure a harmonised high quality statutory audit practice in the EU.

C.2.2. Measures under the responsibility of Member States

- Transposition and implementation of all financial services directives - monitoring via single market scoreboard

Progress in removing institutional and regulatory barriers to the integration of risk capital markets can be assessed on the basis of the Commission’s single market scoreboard. The situation as of May 2000 is reproduced below:
State of play including the infringement procedures for non-conformity:

<table>
<thead>
<tr>
<th></th>
<th>Banks</th>
<th>Insurance</th>
<th>Securities</th>
<th>Payment systems</th>
<th>Company law</th>
<th>Total</th>
<th>Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>DK</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>D</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>14/15</td>
<td>74/75</td>
<td>12</td>
</tr>
<tr>
<td>EL</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
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</tr>
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<td>E</td>
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<td>22/22</td>
<td>14/14</td>
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<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>F</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>1/2</td>
<td>15/15</td>
<td>74/75</td>
<td>12</td>
</tr>
<tr>
<td>IRL</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>1/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>I</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>0/2</td>
<td>15/15</td>
<td>73/75</td>
<td>14</td>
</tr>
<tr>
<td>L</td>
<td>22/22</td>
<td>22/22</td>
<td>13/14</td>
<td>1/2</td>
<td>15/15</td>
<td>73/75</td>
<td>14</td>
</tr>
<tr>
<td>NL</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>A</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>P</td>
<td>22/22</td>
<td>22/22</td>
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<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>FIN</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>S</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>UK</td>
<td>22/22</td>
<td>22/22</td>
<td>14/14</td>
<td>2/2</td>
<td>15/15</td>
<td>75/75</td>
<td>1</td>
</tr>
<tr>
<td>EU</td>
<td>100%</td>
<td>100%</td>
<td>99.52%</td>
<td>86.66%</td>
<td>99.56%</td>
<td>99.46%</td>
<td>/</td>
</tr>
</tbody>
</table>

- Simplification of administrative formalities for company formations (including minimum capital requirements)

Several Member States have undertaken reforms in this area, but major progress is still necessary as stressed by the Lisbon European Council. Indicators to follow-up on this
progress would be particularly useful. However no comprehensive and up-to-date data is presently available. The Commission continues to work on this issue.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Data availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delays and cost for company registration</td>
<td><strong>No data presently available.</strong> The only data available are from the Logotech study commissioned in 1997 by the European Commission. Data refer to the situation in 1996 and are totally outdated. In the framework of the implementation of the BEST Action Plan, MS have been asked to provide more recent data to the Commission. The Lisbon European Council specifically asked the Commission and the Council to benchmark this issue.</td>
</tr>
<tr>
<td>Capital requirements for setting up firms</td>
<td><strong>No data presently available.</strong> The only comprehensive data available are from the Logotech study commissioned in 1997 by the European Commission. Data refer to the situation in 1996. This indicator is not included in the follow-up to the BEST Action Plan. No updated data is expected from MS.</td>
</tr>
</tbody>
</table>

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

  In the absence of comprehensive data, it is difficult to set up a monitoring mechanism under this heading. However, the Commission services will highlight examples of good practices on the basis of the information to be provided yearly by the Member States in their national reports on products and capital market reforms.

  **C.2.3. Measures of Commission’s and Member States’ responsibility**

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

  In July 1998, the Commission adopted two proposals modifying the UCITS Directive. One proposal would remove barriers to cross-border marketing of units of collective investment funds by widening the scope of assets in which those funds can invest. The other proposal would provide the European passport to management companies and would widen the range of activities that they are allowed to undertake (e.g. they may also be authorised to provide portfolio management services). Technical discussions on these proposals are progressing in the Council, while the European Parliament completed its first reading on 17 February 2000.

  Regarding pension funds, the Commission has proposed on 11 October 2000, a directive on the co-ordination of laws, regulations and administrative provisions relating to institutions for occupational retirement provision. Investment rules will be based on the “prudent-man” principle and ensure that pension funds can invest in risk capital markets.

  Many Member States have taken or plan to take action to remove quantitative restrictions that impede pension funds from using the most efficient and sound investment policies. The importance of this issue has been stressed in the 2000 BEPG. Member States should report on progress made in this area in their national reports on products and capital markets reforms.

  Comparison will be made with institutional investment in the US.
<table>
<thead>
<tr>
<th>Indicator</th>
<th>Data availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional investment as a proportion of GDP</td>
<td>EUROSTAT / OECD.</td>
</tr>
<tr>
<td>Institutional investment in equity as a proportion of GDP</td>
<td></td>
</tr>
<tr>
<td>Ratio of funds raised by VCFs from pension funds and insurance companies to total funds raised</td>
<td>EVCA; whenever possible, a distinction will be made between domestic and non-domestic institutional investors.</td>
</tr>
<tr>
<td>Prudential investment rules for institutional investors</td>
<td><strong>Data to be updated.</strong> The pilot 1998 study “Benchmarking financing of innovation” contained a table listing the main prudential rules and constraints for institutional investors. It will need to be regularly updated through the information to be collected in the yearly national reports on products and capital markets reforms.</td>
</tr>
</tbody>
</table>

C.3. **Taxation**

- Taxation of venture capital funds (issue of transparency to avoid double taxation)
- Capital gains tax
- Stock options
- Tax arrangements for new firms
- Taxation of low-risk capital (e.g. bank deposits, bonds) compared with venture capital

Actions in the fiscal and taxation area are to be taken at national level; however, the Commission can play a role in analysing the situation and highlighting examples of best practice. The fiscal issues are key to the development of risk capital in the EU, but it should be noted that any preferential tax schemes may give rise to state aid issues.

The monitoring of the fiscal framework is difficult, as tax regulations are complex and subject to regular change. No comprehensive indicator could be defined for this section. However, reference could be made to the implicit tax rate on other factors of production: (taxes on self-employed persons + taxes on capital)/net operating surplus of the economy (i.e. capital and entrepreneurial income).

To benchmark fiscal issues, use will be made of existing studies such as

- Taxation of corporate profits, dividends and capital gains, EVCA, 2/99;
- Breaking the barriers, report on multinational share schemes, European Centre for Employee ownership, 4/99 (includes analysis of the taxation);
- Effective tax burden in the EU, study commissioned by the Dutch Minister of Finance, 1/99).
The review of Member State’s national reports on product and capital market reforms should also provide examples of best practices

The work underway in the Commission services on company taxation will also be helpful. Two panels of experts have been set up to review the issues of company taxation in Europe and fiscal barriers to the Single Market. They are expected to report in autumn 2000.

C.4. Paucity of high-tech small businesses

C.4.1. Measures under the Commission’s responsibility

- Creation of a pan-European club for high-tech innovative firms

Progress under this heading will be monitored on the basis of growth in the European Federation of High Tech Enterprises created in 1999.

- Reform of the European patent system

The Commission has proposed on 5 July 2000 a Regulation, to introduce a patent that would be unitary and valid throughout the EU. The court jurisdiction with regard to this EU-wide patent will be centralised both in the first and second instance. Developments in this area could be monitored by using an indicator on world share of European and US patents.

C.4.2. Measures under the responsibility of the Commission and Member States

- Development of networking and clustering between universities, research centres, financial backers, lawyers, human resources specialists etc., and link them at European level

Several actions have been undertaken by Member States and by the Commission in this area. Based on information already transmitted or to be transmitted to the Commission by Member States in the framework of the BEST and Cardiff exercises, examples of best practices will be highlighted.

No indicator is proposed yet to monitor these actions. In the future, use could be made of some of the indicators proposed by the Commission in the framework of the benchmarking of national research policies, especially the indicator proposed on the monitoring the number of spin-offs generated by universities and research centres.

- Development of customised electronic commerce modules for small businesses to ease their access to electronic commerce and the internal market.

It will be impossible to monitor progress under the very specific heading of development of customised electronic commerce modules for SMEs. Member States' reports in 1999 show various initiatives in favour of e-commerce but nothing as specific as the development of customised e-commerce modules. The Commission is to publish a report on electronic commerce and SMEs. Reference could be made to the number of SMEs using the Internet for commercial purposes (data is available for 1998, further surveys are to be launched in the future)
C.5. Human resources

- Promotion of entrepreneurship and innovation within educational and training systems

No indicator can be used in this regard. The Commission will report on progress in projects that it has launched in this area, such as the project (launched in June 1999) on the development of European entrepreneurship training modules, in collaboration with universities, business schools, as well as investors and financiers, and the project to set up a Business Education Network of Europe (BENE) which will bring together training organisations with proven experience in training for entrepreneurship to exchange experiences, identify best practice and adjust the courses and curricula to changing demand. It will also highlight examples of fruitful actions undertaken by the Member States in this area. The Member States' National Action Plans on employment include a presentation of progress made in this area. Although the NAPs do not provide standardised data across all Member States, they may offer input for actions/practices to be further developed.

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

No indicator can be used. The Commission will report on the results of the study it launched to determine training needs for venture-capital fund managers, market makers, and analysts of high-tech firms, as well as on some other initiatives undertaken in this area.

- Assessment of benefits of equity pay and employee ownership schemes

The Commission staff working paper (SEC (1999) 1725) on the implementation of the RCAP included an analysis of the economic and financial impact of employee stock ownership and stock option schemes, as well as the necessary conditions for development of these schemes in the EU. The importance of employee ownership and stock option schemes has been stressed in the BEPG 2000. The Commission will report on the result of a study that it has commissioned on “a company perspective on financial participation in the EU; objectives and obstacles”. In addition, Member States should report on developments in this area within the framework of the yearly national reports on product and capital market reforms.

C.6. Cultural barriers

- Demonstration of the advantages of venture capital and promotion of entrepreneurship

This issue is linked with the above-mentioned actions on promotion of entrepreneurship.

- Dissemination of best practices in corporate governance

Corporate governance has been identified by the Commission as one of the issues to be examined in the context of creating deep and liquid European capital markets. A series of corporate governance codes have been adopted over the past decade with the aim of better protecting the interests of shareholders and/or stakeholders. A number of projects in this area are still in the preparation phase. Differences in corporate governance arrangements may create unnecessary uncertainty and complexity for both cross-border issuers and cross-border investors who might not benefit from the same rights everywhere. Based on these observations, the Commission decided to launch a review of existing codes of corporate governance with a view to identifying any legal or administrative barriers that could frustrate the development of a single market in financial services. The results of this review are expected to be available in the second half of 2001.
D. Conclusion

The Member States authorities, consulted on this mechanism, have expressed their support to the proposed scheme, as well as to the chosen indicators. They have also given some useful data for some indicator for which comprehensive data is presently not available. Likewise, representatives of the industry have welcomed the monitoring and benchmarking of the Risk Capital Action Plan. As the mechanism is set, data will be collected, and will be presented and analysed in the next Risk Capital Action Plan Implementation Report.
ANNEX 2
ACRONYMS USED IN THE RCAP

AIM : Alternative Investment Market [London]
EIB : European Investment Bank
EIF : European Investment Fund
EASDAQ : European Association of Securities Dealer Automated Quotation [Brussels]
EURO. NM: Nouveau Marché (Paris) + Neuer Markt (Frankfort) + Nouveau Marché (Brussels) + Nieuwe Markt (Amsterdam) + Nuovo Mercato (Milan)
EVCA : European Venture Capital Association
FESCO : Forum of European Securities Commissions
FIBV: Federation Européenne des Bourses de Valeurs International Federation of Stock Exchanges
IAS : International Accounting Standards
ICT: Information Communication Technology
ISD : Investment Services Directive (93/22/EEC)
IT : Information Technology
NASDAQ : National Association of Securities Dealers Automated Quotation system
RTD : Research and Technological Development
SOEC : Statistical Office of the European Communities
SME : Small and Medium sized Enterprises
UCITS : Undertakings for Collective Investment in Transferable Securities; (Investment funds)
US GAAP : US Generally Accepted Accounting Principles
Annex 3

GLOSSARY OF TERMS USED IN THE RCAP

Accounting Directive: Directives 78/660/EEC and 83/349/EEC.

Business Angels: Private individuals who invest directly in new and growing unquoted businesses. Business angels usually provide finance in return for an equity stake in the business, but may also provide other long-term finance. This capital can complement the venture capital* industry by providing smaller amounts of finance (generally under EUR 150 000) at an earlier stage than most venture capital firms are able to invest.

Capital market: A market in which long term capital is raised by industry and commerce, the government and local authorities. Stock exchanges are part of the capital market.

Corporate governance: The manner in which organisations, particularly limited companies, are managed and the nature of accountability of the managers to the owners. This topic has been of increased importance since the beginning of the 1990’s, the providers of external finance to a company wanting to ensure management is not acting contrary to their interests.

Corporate venturing: Provision of venture capital by a company for another company.

Development capital: Financing provided for the growth and expansion of a company.

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

Electronic commerce: Direct marketing of trading using a computer or a TV screen.

Equity: The ordinary share capital of a company.
**High level Securities Supervisors Committee:** Informal advisory group created in 1985 by the Commission and the EU Securities Supervisory Regulators with the purpose of dealing with co-operation and cross border matters. It will be replaced by the Securities Committee.

**Institutional investors:** This term refers mainly to insurance companies, pension funds and 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.

**Investment Services Directive:** Directive 93/22/EEC. It provides a European “passport” for investment firms (brokers, dealers, etc.) and gives the right to electronic exchanges to place their terminals in other Member States.

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

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

**Primary market:** Market into which a new issue of securities is launched.

**Private equity:** As opposed to public equity; investment in equity stake by private investors in companies not listed on a stock market.

**Prospectus:** A formal written offer to sell securities that sets forth the plan for a proposed business enterprise, or the facts concerning an existing one that an investor needs to make an informed decision.
**Prospectus Directive:** Documents drawn up according to the rules of Directives 89/298/EEC (public offers) and/or 80/390/EEC (listing particulars).

**Prudent-man regulation:** Obligation of pension managers to invest as a prudent investor would do on his own behalf, in particular by carrying out sensible portfolio diversification, with no limits to portfolio distribution other than on self investment for pension funds financing defined benefit plans. NL, UK, Ireland USA, Canada, Australia have such a legislation.

**Regulated markets:** Organized markets where buyers and sellers meet to trade according to agreed rules and procedures. Markets meeting the conditions set under article 1.13 of the ISD.*

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

**Risk capital markets:** Markets providing equity financing to a company during its early growth stages (start-up* and development*). In the framework of this communication, it covers three sorts of financing:

- Informal investment by Business Angels*
- Venture capital.*
- Stock markets specialized in SMEs and high growth companies.

**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.

* Word defined in the glossary or the acronyms.
Securities Committee: To be created. It will have both consultative and comitology roles and will replace the High Level Securities Supervisors Committee. In the securities area it will have the same role as the Banking Committee in banking and the Insurance Committee in insurance.

Security: A financial asset, including shares, government stocks, debentures, bonds, unit trusts and right to money lent or deposited.

Seed capital: Financing provided to research, assess and develop an initial concept.

Start-up capital: Provided to companies for product development and initial marketing.

Stock exchange (Stock Market): A market in which securities are bought and sold. Its basic function is to enable public companies, governments and local authorities to raise capital by selling securities to investors.

Stock option: Option given to employees and/or managers to buy shares at a fixed price.

Venture capital: Investment in unquoted companies by venture capital firms who, acting as principals, manage individual, institutional or in-house money. Four main financing stages are identified in relation to the stages of development of a venture-backed company: early stage, expansion, replacement and buy-out. In the USA, the word “venture capital” does not include most of the buy-out deals.

Venture capital funds Closed-end funds, created to provide venture capital.

* Word defined in the glossary or the acronyms.