COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

ON IMPLEMENTATION OF THE RISK CAPITAL ACTION PLAN (RCAP)

1. EXECUTIVE SUMMARY

This Communication reports on progress in the implementation of the RCAP for the year 2001 and, in some aspects, for the first half of 2002. It is the fourth since the adoption of the RCAP in 1998. Successive European Councils have set 2003 as the deadline to complete the Risk Capital Action Plan.

This is the fourth annual report

Market analysis suggests that the last 18 months has been a period of adjustment for the European risk capital industry. The severe correction, which started in mid-2000, still continuous and was particularly significant in the Accession Countries due to, among other things, their sensibility to global trends. In spite of the negative trend, however, the year 2001 was, for the European industry, the second highest both in terms of funds invested and of funds raised. The decline in Europe has been less pronounced than in the US - although there is a long way to go to match their industry. The problem in Europe is compounded by the presence of a still highly fragmented capital market, which the Financial Services Action Plan is addressing. Furthermore, the weakness and poor performance showed by the EU high-growth stock markets means that the scope for IPOs, an important exit strategy for venture capital investors, remains largely closed at the moment. Improvements to the functioning, regulation and liquidity of these markets is necessary for risk capital to grow and for a sufficient pan-European dimension to emerge, through further and necessary rationalization.

A period of adjustment for the industry

The modernisation of the regulatory framework has continued successfully in a financial environment dominated by the successful introduction of the Euro in physical form. Important advances can be reported in the mandatory introduction of international accounting standards by 2005 and in the forthcoming legislation on supplementary pension funds. As a result those institutions may become important sources of risk capital funds as it is already the case in the US. On the negative side, difficulties still persists for having an affordable cost-effective European patent.

The regulatory framework is being modernised relentlessly

Entrepreneurship policy is also expanding in importance. The forthcoming Green Paper on the subject should raise its profile further and its crucial linkage with risk capital. Projects leading to a better matching of supply and demand of risk capital, as the one already under completion with the help of the Commission, should be encouraged. The objective agreed at the Barcelona European Council to increase EU investment in R&D (approaching 3% of GDP by 2010, of which two thirds from the private sector) requires increased investment by the private sector and reinforces the role of risk capital, either private or public, to finance promising innovative projects and initiatives.

Entrepreneurship is being encouraged from different angles

Concerning public funding, the adoption by the Commission of its Communication on state aid and risk capital has clarified the question of compatibility of public funding of risk capital measures with the state aid articles of the Treaty. The EIF has embarked upon a phase of rapid expansion and has been able to attract, under difficult market conditions,

Community funding of risk capital is proving successful private investors to early stage funds. Finally, the share of Structural Funds for financing venture capital investments has been noticeably increased. All these recent policy changes show that the accompany measures to develop European risk capital have undergone profound and positive change in the last 4 years.

RCAP should be seen from a long-term perspective

Compared with 1998, risk capital markets have not only grown but also matured. The current effort to improve the environment for risk capital investment should be maintained, and be seen from a long-term perspective, regardless of cyclical considerations.

2003 will be the final *"analysis"* year on the RCAP - and a year to reflect whether further measures are necessary to enhance risk capital post-2003.

2. INTRODUCTION

This is the fourth RCAP progress report

Since the adoption of the **Risk Capital Action Plan (RCAP)** in June 1998 by the *Cardiff Summit*[1], the Commission has published *annual reports*, addressed to the Council and to the European Parliament[2], on the degree of progress achieved in its implementation. This **fourth** progress report[3] **covers the last 18 months** (year 2001 and, to some extend, the first half of 2002). Moreover, for the first time, there are some analysis on Accession Countries. Also for the first time there are some figures on buyouts as well as some suggestions to go beyond the RCAP.

Barriers should be eliminated at both Community and National levels

The RCAP is intended to eliminate remaining regulatory and administrative barriers at both Community and national levels which impairs the **full development of risk capital markets[4] in Europe**. The elimination of all these barriers will play a major role in the creation and development of innovative high-growth SMEs and would therefore be important to foster economic growth and job creation. Moreover, the timely completion of the RCAP will be essential for the Community to become, as agreed in Lisbon, by 2010 the most competitive and dynamic, knowledge-based society in the world.

The RCAP should be completed by end-2003

As the 2003 deadline approaches[5], the need to know better the situation in the Member States is more pressing. In view of this the information obtained through the national progress reports in the context of the 2001-2002 Broad Economic Policy Guidelines has been complemented by the answers to an ad-hoc questionnaire sent to Member States in April 2002. They will be presented separately.

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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 European Parliament has adopted favourable resolutions on these reports, the last on 11 April 2002 (Report A5-0020/2002 of MEP Peter William Skinner)

[3]The previous ones were COM(1999)493 of 20 October 1999, COM(2000)658 of 18 October 2000 and COM(2001)605 of 25 October 2001.

[4]As such the ***RCAP is a key component of structural reform*** in Europe and, at the macroeconomic level, the expected increase in efficiency in the overall Community's product and capital markets should translate into ***economic growth and (high-quality) job creation***.

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

This progress report has been prepared by the **Commission Risk Capital Working Group** which includes representatives of the EIB and the EIF. Continuous co-operation and consultation with the industry (EVCA) has ensured that their views are also taken into account.

Close contacts with the industry

3. MARKET DEVELOPMENTS[6]

3.1. The Venture Capital industry in 2001

The EU venture capital market has experienced a severe correction since the second half of 2000. The correction reflects the continuing deflation of the bubble in TMT investment which, together with a global economic slowdown, has depressed equity markets and reduced incentives for venture capital investors. Venture capital investment[7] fell by 35% in 2001 relative to 2000, while there was a corresponding fall of 24% in buy-out investment. Altogether, **€12.7 billion (0.14% of GDP)** were invested in venture capital and **€10.7 billion (0.12% of GDP)** in buy-outs in 2001.

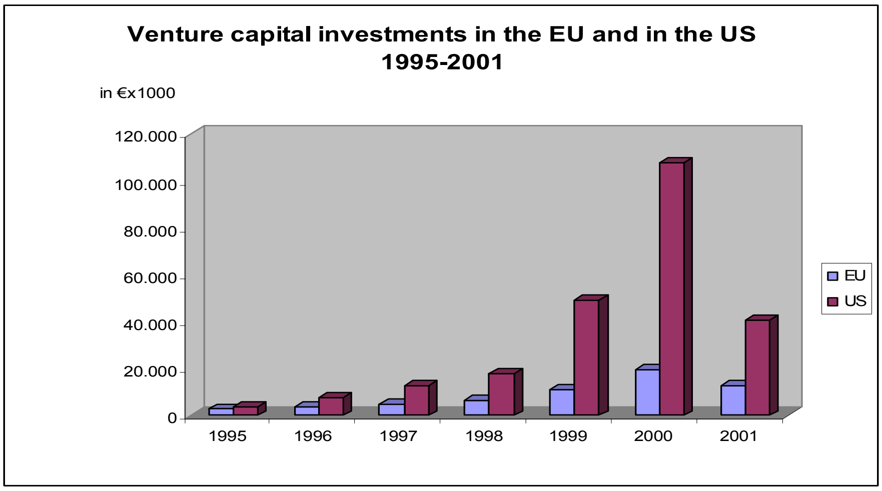
A severe global correction is following earlier excesses

The global venture capital industry is small[8] and very sensitive to changes in the economic environment. The annual flows into US venture capital funds increased by a factor of ten in the 1980s, before returns began to fall and commitments went into steady decline. This pattern was reversed in the 1990s, ending the decade with record inflows. Cumulatively, US venture capital investments were multiplied by 20 between 1995 and 2000.

The US venture capital industry has gone through at least two distinct cycles

As stressed in previous *RCAP Communications*, this striking US expansion was largely due to the development of a speculative bubble in 1999 and 2000. Investment standards slackened amid a rush to build exposure in the technology sectors. When the bubble finally burst, investment collapsed. End 2001, they were down by 62% relative to the previous year.

Development of a speculative bubble



[6] EU figures are derived from the survey conducted by **PwC for the EVCA** and published in EVCA's 2002 Yearbook; US figures derive from the survey conducted by PwC and Venture Economics for the NVCA (MoneyTree Survey). These sources have been preferred to other possible sources as they give data consistent across countries (even if **EU and US figures are not entirely comparable**) and across several years.
[7] Including seed, start-up, expansion, and replacement phases of company development
[8] Venture capital investments represent **only 5% of capital raised on stock markets**

Recent fluctuations have been less pronounced in the EU than in the USA. EU venture capital investments were only multiplied by six in the period 1995-2000. Nevertheless, the correction since the first quarter of 2001 has been sharp and has resulted in a steep decline in investment rates. On the positive side, total EU venture capital investment in 2001 was the second highest level ever recorded. The decline in investment being partly due to a return of deals' valuations to more conservative levels.

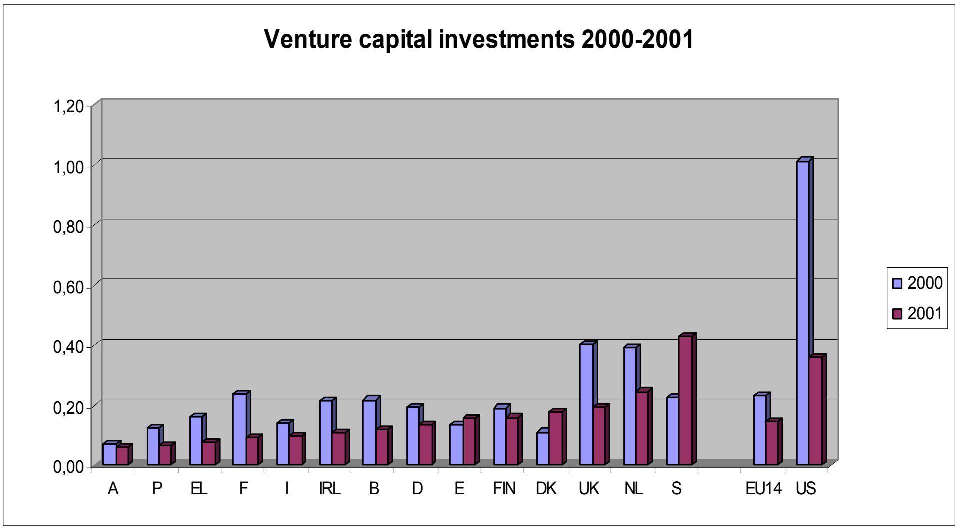
The downturn has been less sharp in Europe than in the US

Although the correction has been less severe than in the USA, the EU venture capital industry remains relatively small. Despite the 62% decline in 2001, the US venture capital industry still represents **0.36% of GDP,** compared to only 0.14% of GDP in the EU. In absolute terms, the US industry remains three times larger (i.e. **€41 billion** vs. €12.7 billion). The contraction has concentrated on start-up and technology, segments that were already relatively under-developed in the EU.

In absolute size the European industry remains dwarfed by the US

The EU venture capital market remains fragmented, with marked differences between countries, in terms of levels and trends. Building on several years of significant growth, investment in 2001 expanded further in Sweden (+80%), Denmark (+67%) and Spain (+26%). In contrast, fell significantly in France (-60%), the United Kingdom (-50%), Greece (-50%), Belgium, Ireland and Portugal (all -40%). Sweden has now the highest level of investment within the EU in terms of GDP (0.43% of GDP), although the UK retains the highest level in absolute terms.

Industry performance varies between Member States



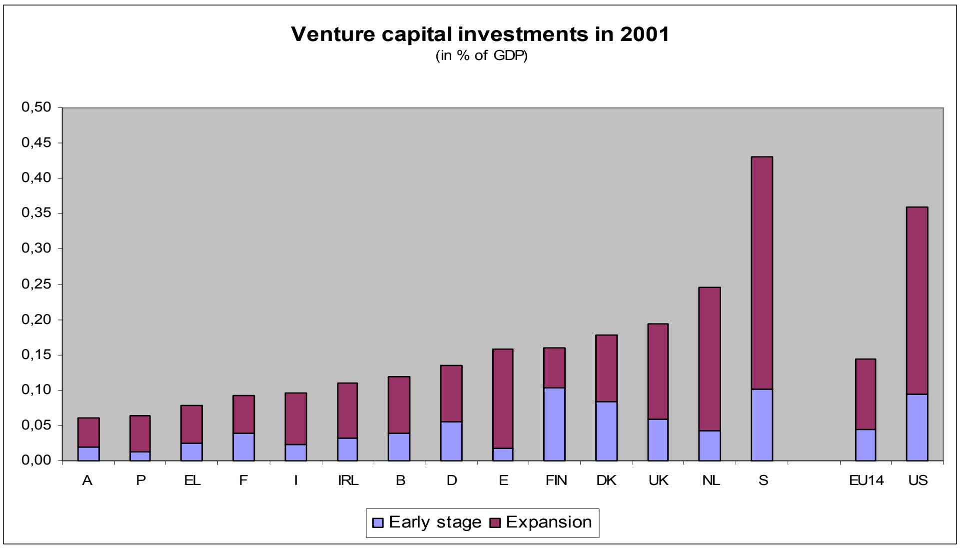
In Sweden, early-stage investment remained slack over the last two years while investment in expansion doubled in 2001, as the focus shifted to developing existing portfolios. A similar trend was evident in the Netherlands where the fall in investments was markedly bigger in early stage. Spain continued to focus on later stage investments, and start-up investments, already small, further declined in relative terms. Belgium, Ireland and Italy experienced a particularly pronounced decline in early-

General decline in early stages

stage investment. In the United Kingdom, start-up investments decreased in a proportion similar to later stage investments. But, although, UK investment has been traditionally focused on later-stage and buy-outs, for the second year in a row, seed investment almost doubled in 2001 and the number of seed capital projects increased tenfold. Finland has continued to invest heavily in early-stage in 2001, joined in this trend this year by Denmark. In Germany and France, all segments were equally affected by a slump in investment, being stronger in France than in Germany.

Important contraction in Accession Countries

The contraction of the venture capital industry was particularly significant in the Accession Countries. Their industry is new and relatively underdeveloped and is especially sensitive to global trends[9]. These countries also suffer from a lack of exit opportunities, as their stock markets rarely offer a realistic possibility of completing an IPO.



Different patterns in different countries

While venture capital data may not be complete for the Accession Countries, some distinct trends can be identified. In the Czech Republic, investment in venture capital fell by 75%, and represented 0.04% of GDP, and funding fell by 90% in 2001. Banks remained the main investors and only 12.5% of total investment was funded domestically. The bulk of funding (63%) came from other EU countries. The decline in investment was less pronounced in Poland (-25%) where venture capital investments represented 0.07% of GDP. Funding declined by 50% and came mainly from corporate investors and banks in other EU countries (79%). In Hungary, venture capital investments remained small (0.05% of GDP), while buy-outs were six times higher than in 2000. Overall private equity was almost entirely funded by other EU countries (99%). In contrast, venture capital investment increased in Slovakia (albeit from a very low level in 2000 and without any significant increase in the number of participants) with over 90% of new funding supplied by non-EU investors.

[9] The majority of funding is raised abroad, mainly in the EU

While the correction in the EU venture capital industry can be seen as a necessary re-adjustment toward sustainable valuations, several aspects give cause for concern. Notably, the disproportionate impact on early-stage and high-tech investment. As venture capital funds have focused on nurturing their existing portfolio companies, the share of investments in very small companies has declined in 2001. The drop in the number of companies financed has been even sharper than the drop in the number of investments (-23% vs. -20%). Investment in seed and start-up projects has fallen by 38%, while replacement investments have increased by 22%. This may lead to a "*credit crunch*" for the early-stage segment, with adverse effects on the viability of start-ups and small firms.

Early-stage investment particularly affected by the correction

Investment in the technology segment has also decreased sharply, by 35%, to **€5.7 billion**. This decline was particularly important in France, Portugal and Spain. In the latter country, technology represented less than 15% of venture capital investments in 2001. Internet-related investments dropped sharply. But computer-related investments remained the single largest category of technology investments (despite a 36% fall) and focused on second-stage funding, for the expansion of established businesses. Compared to the US, the European market for technology remains small (six times lower than **USA investments of €35.4 billion)**. However, as more deals were done in Europe than in the US (4,340 vs. 3,280), the gap is due to the differences in the type of investment[10]. Sustained growth is not to be expected in the short run. Funds raised in 2001 and earmarked for investment in early-stage and expansion high-technology companies decreased by respectively 35% (to €5.6 billion) and 40% (to €4 billion).

Investment in technology also fell sharply

No short run pick-up for technology

3.2. Outlook for the EU venture capital industry

Many investments made late in 1999 and in the first half of 2000 were overvalued and are now weighing, probably for some time, on the performance of venture capital funds. In 2001, 23% of divestments were done by write-off[11], as the industry cleaned-up portfolios. Returns have fallen, with the main drop being seen in early-stage at –9% for the one-year horizon internal rate of return at the end of 2001. Moreover, the continued weakness of high-growth stock markets has led to the near-disappearance of IPOs[12]. The inability for venture capital funds to divest through IPOs will impact on their performance and therefore their ability to raise new capital. This will also limit their capability to invest in new companies as they are forced to stick to their existing portfolio for longer than expected.

Correction probably has some way to go

In the US, investments in 2000(Q2) have been decreasing for the ninth consecutive quarter, and total investments for the year 2002 is expected to be well below 1999, and probably 1998, levels. And as venture capital funds have become very selective in their investments, they handed more capital back[13] to their investors than they raised from them. In Europe,

Investment in USA and Europe continue decreasing

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[10]For instance, deals in the **medical device sector** were 33 times greater in the USA than in Europe
[11]Compared to less than 7% on average over the previous three years
[12]Trade sales have always been much larger than IPOs in volume terms, but **IPOs are key for valuation**
[13]For the first time in US venture capital market history

preliminary figures for 2002(Q1) also show a low level of investment, focused on follow-on investments rather than on supporting new ventures.

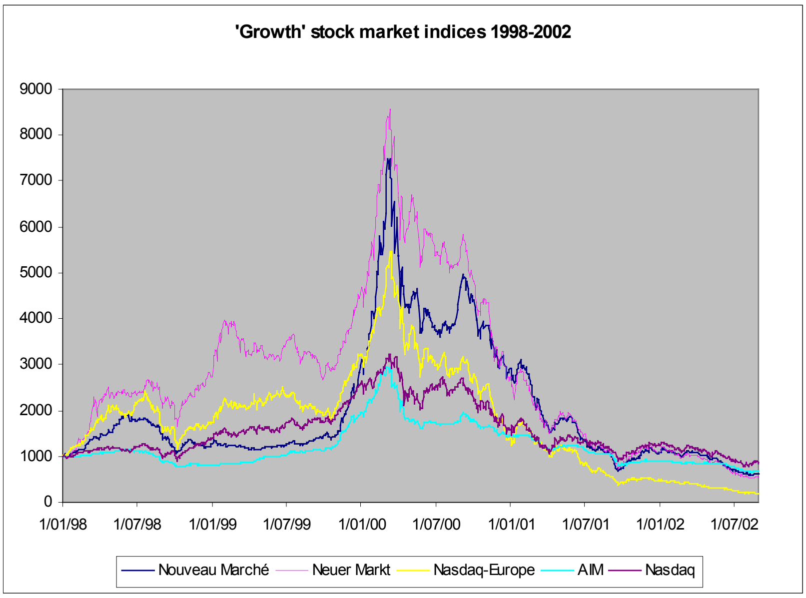
The medium-term prospects for the EU venture capital investment seem to be relatively favourable, with significant scope to continue financing viable projects due to the high level of non-invested funds**.** Inflows of **€15 billion** were recorded in 2001 - again, the second highest amount ever - for future venture capital investment and **€22 billion for buy-outs**. A sign of maturity is the greater diversification in sources of funding. In 2001, for the second consecutive year, pension funds were the largest single source of private equity capital (27%) in the EU, ahead of banks (24%) and insurance companies (13%). Full involvement of pension funds, which have longer investment horizons, is a pre-condition for developing a mature venture capital market. The involvement of endowments, charities, universities, etc, in EU venture capital is also increasing.

Medium-term prospects seem to be more favourable

As the EU venture capital industry has matured, it is now significantly better equipped to weather economic downturns. More reasonable entry valuations offer renewed market opportunities, helped by the progressive development of the industry as a whole and the gradual emergence of a more entrepreneurial spirit in the EU. However, expectations of a quick rebound could be disappointed.

EU industry has matured and is better equipped

3.3. High-growth stock markets



These markets play a major role in financing the development of growth companies and in offering exit routes for investors. Since the burst of the TMT bubble in March 2000, the prices of high-growth stocks have collapsed and primary activity in those markets has come to a standstill.

The events of 11 September further hit already depressed markets. By end September 2001, *Frankfurt's Neuer Markt* had fallen more than 90% from its record highs of March 2000. In the same period, *Euronext's Nouveau Marché* fell 91%, *Italy's Nuovo Mercato* 92%, *Nasdaq Europe* – formerly

EU high-growth stock markets depressed in the aftermath of the TMT bubble

Easdaq – 93%, and *Spain's Nuevo Mercado* "only" 83%, probably benefiting from the fact that it was established sometime after March 2000. After some sort of recovery end of 2001 and beginning 2002, markets experienced a further correction in April – July 2002. Investor concerns reflect four factors: (i) the prospect of lower-than-expected earnings in the coming quarters because of a sluggish global economy ; (ii) perception that price-earning ratios in some equity markets remain unsustainably high; (iii) some loss of confidence in the reliability of the audited accounts (a domino effect from the US); (iv) lack of liquidity in small stocks. This concern is particularly high for TMT stocks.

Current absence of liquidity

For primary activity, EU "high-growth" markets remained virtually closed in 2001. In total, only 10 companies were listed on the *Nouveau Marché* (compared with 52 the previous year), 11 on the *Neuer Markt* (compared with 133 in 2000) and 5 on the *Nuovo Mercato* (compared with 30 in 2000). And in the first six months of 2002, 2 companies were newly listed on the *Nouveau Marché* and one on the *Neuer Markt*. A number of companies have also decided to delist, especially from the *Neuer Markt* and *Nasdaq Europe*. Because of the costs involved, in the case of some foreign companies, to focus on their domestic markets, or, in general, because of the crisis in confidence in the stock market. The exception to this dismal trend was *AIM* (108 new companies were listed in 2001 compared with 250 in 2000) because it includes both traditional small capitalisation companies as well as "high-growth" companies.

Uncertainty remains high

At the end of 2001, 629 companies were quoted on *AIM*, 326 on the *Neuer Markt*, and 164 on *Le Nouveau Marché*. Liquidity has always been low on these markets and volatility high, two major drawbacks that have increased in 2001. Last year, less than €4 million was traded per day on *AIM*, €8 million on *le Nouveau Marché* and €50 million on the *Neuer Markt*. Liquidity improved late 2001, but has remained low. The decision to close the *Neuer Markt* and re-organise the Deutsche Börse into a two-tier structure, as well as the consolidation between the Paris, Amsterdam, Brussels and Lisbon markets into *Euronext*, which includes a high tech segment, may make these markets more attractive to investors and restore confidence. Market practitioners are relatively optimistic but uncertainty on growth, corporate profitability and equity valuation remains high, and therefore the recovery may be delayed. No successful pan-European platforms have yet emerged, which might improve the depth of some markets and widen the pool of investors.

Nasdaq in contrast remains highly liquid

In contrast to the EU markets, there are more than 4000 companies listed on the *Nasdaq*. The *Nasdaq* also suffered significantly from the collapse of the TMT bubble after 2000, losing more than 60% of its value since early 2000. Only 144 new companies were listed in 2001 (compared to more than 800 in 2000) and 815 were delisted. Nevertheless, with an average of €12 billion traded per day, the market still remains highly liquid.

4. REGULATORY ISSUES

The modernisation of the regulatory framework, as required by the RCAP, should lead eventually to a barrier-free, cost-effective regulatory system, encouraging the full development of risk capital markets. In the last year, the modernisation process has advanced relentlessly in a financial environment dominated by the successful introduction of the euro in physical form which will help market stability.

Successful introduction of the euro in physical form

The Barcelona Summit reconfirmed the 2003 deadline for the completion of integrated securities and risk capital markets (point 35, second paragraph of Presidency conclusions). Another important milestone has been the agreement found by the Commission on 5 February 2002 with the Parliament which opened the way for the **deployment of the Lamfalussy procedures**.[14] These procedures, conceived in principle for securities markets regulations, might be extended to other financial sectors.

Agreement with the Parliament on Lamfalussy procedures

Implementation of Financial Services legislation

	Banks	Insurance	Securities	Payment systems	Company law	Total	Position
B	7/9	24/25	8/8	2/2	15/15	56/59	9
DK	9/9	24/25	8/8	2/2	15/15	58/59	3
D	7/9	24/25	8/8	2/2	15/15	56/59	9
EL	7/9	23/25	8/8	2/2	15/15	55/59	15
E	7/9	24/25	8/8	2/2	15/15	56/59	9
F	7/9	24/25	8/8	2/2	15/15	56/59	9
IRL	9/9	24/25	8/8	2/2	15/15	58/59	3
I	9/9	24/25	8/8	2/2	15/15	58/59	3
L	9/9	24/25	8/8	2/2	15/15	58/59	3
NL	7/9	24/25	8/8	2/2	15/15	56/59	9
A	9/9	25/25	8/8	2/2	15/15	59/59	1
P	9/9	24/25	8/8	2/2	15/15	58/59	3
FIN	7/9	24/25	8/8	2/2	15/15	56/59	9
S	9/9	25/25	8/8	2/2	15/15	59/59	1
UK	9/9	24/25	8/8	2/2	15/15	58/59	3
EU	89.6%	96.3%	100%	100%	100%	98.7%	/

September 2002

As for the FSAP[15], the Belgian and Spanish Presidencies have helped create the necessary political momentum and as a result: *"a number of agreements have been struck, but significant challenges remain to complete the Plan by 2003/5" (page 2)*. As the programme advances the center of gravity of Community action, and therefore the priorities, will move forward accordingly.

The FSAP is being completed

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[14] In this context the EP-Economic and Monetary Affairs Committee has created on 24 April 2002 an ***Advisory Panel of Financial Services Experts***. See ECON online. www.europarl.eu.int/committee/econ_home.htm

[15] "***6th FSAP Progress Report***", COM(2002)267 of 3 June 2002.

4.1. Measures included in the FSAP[16]

In most of the regulatory measures included in both the FSAP and the RCAP decisive steps have been completed:

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

The Commission has adopted an amended proposal[17] on prospectuses which takes into account Parliament's opinion on the original proposal. Once adopted the Directive will introduce a truly "*single passport for issuers*". This will facilitate IPOs, including those for listing in the specialised high-growth stock markets. The Commission's new proposal has added additional flexibility for SME IPO's. The Danish Presidency and the European Parliament are striving to find the common ground before the end of 2002.

Measures to open to IPO door are being accelerated

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

Two new directives[18] on harmonised investment funds (UCITS) have been adopted. Regarding the Commission proposal on the activities and supervision of supplementary pension funds, negotiations still continue but important progress is being achieved. As a result, investment by these institutions in risk capital markets will be possible. In the future they should be expected to become important sources of risk capital funds.

UCITS adopted and important advances in pension funds attained

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

On 6 June 2002 a Regulation has been adopted on the application of International Accounting Standards (IAS) in the EU. It requires all EU listed companies, to prepare their consolidated accounts in accordance with IAS from 2005 onwards. Member States may extend this requirement to unlisted companies. In this context, the Commission adopted a proposal on 3 June 2002 for amending the existing EU Accounting Directives. This would allow Member States which do not apply IAS to all companies to move progressively towards similar, high quality financial reporting. Common accounting standards will facilitate comparison of company performance as well as listing in high-growth stock markets. Concerning statutory audit, the Commission adopted on 16 May 2002 a Recommendation on the independence of statutory auditors in the EU. The Commission will issue later this year a general communication on statutory audit outlining priorities for further actions. These measures will favour reliability of accounts.

IAS standards mandatory by 2005 all over Europe

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

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[16]These measures affect primarily the ***supply side*** of risk capital.
[17]COM(2002)460 of 9 August 2002, www.europa.eu.int/comm (internal market)
[18]***Directives 2001/107/EC*** (JO L41, p.20 of 13.02.2002) and ***2001/108/EC*** (JO L41, p. 35 of 13.02.2002)

The comparative study requested by the Commission on corporate governance codes relevant to the EU and the Member States was completed in January 2002. Later this year, and at the request of the ECOFIN Council (April 2002 Oviedo), the *High Level Group of Company Law Experts* will provide a number of recommendations on some key corporate governance issues which have become relevant in the wake of the latest US financial scandals, specially for TMT stocks. Improving transparency, disclosure and corporate governance are all essential components for reviving EU stock markets, including the high growth markets.

Best practices in Corporate Governance have come at the top of the agenda

4.2. Measures outside the FSAP[19]

For the RCAP legislative measures not included in the FSAP only some progress can be reported.

- Measure: ***"Reform of the legislation on insolvency and bankruptcy"***[20]

To enhance effectiveness of the legal systems and to reduce the stigma of failure in Europe, in order to provide a second chance to entrepreneurs, the Commission together with national experts, and following a preparatory study[21], has proceeded to define a set of performance indicators and benchmarks as a support to Member States for shaping their strategy in this field. Furthermore, the Commission has published a guide[22] which includes guidelines for effective insolvency and creditor right systems and case studies on legal issues and support schemes.

The problem of stigma linked to failure is being addressed

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

Following the Commission proposal[23], successive European Councils have requested Member States to agree on a clear and balanced package. However, negotiations still continue. A Community patent which is affordable, simple, cost-efficient and legally certain will be particularly important for innovative high-growth SMEs. This will require satisfactory jurisdictional arrangements of Community nature[24].

An affordable single patent is still pending

4.3. Measures beyond the RCAP

As shown above, the RCAP foresees a number of specific regulatory barriers, which should be overcome. As the RCAP implementation proceeds, other barriers at both Community and national levels, not specifically mentioned in 1998, may become present. Examples are the new *Basle capital adequacy* rules and the new *regulation on mergers*, both

Scope of the RCAP should be

[19] These regulatory measures are intended to boost the ***demand side*** of risk capital.

[20] 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

[21] "***Bankrupcy and a Fresh Start***", www.europa.eu.int/comm(enterprise)

[22] "***Helping Business Overcome Financial Difficulties***", www.europa.eu.int/comm(enterprise)

[23] ***Regulation for a Community Patent*** (JO C 337 of 28.11.2000)

[24] In this regard, the Commission has produced a working document "***On the planned Community Patent Jurisdiction***", COM(2002) 480 of 30.08.2002

closely monitored by the industry which fears that, for instance, banks may reduce their investment in risk capital or that risk capital providers will be forced to send "unnecessary" notifications. The industry in also in favour of having *European fund structures* that avoid current inefficiencies due to prevailing tax rules. The new needs and developments should have also to be appropriately covered in order to achieve the pursued RCAP political objective.

interpreted in a dynamic fashion

5. TAX ISSUES

Importance of tax issues is increasing

The basic importance of tax issues for the development of risk capital is already a well-established fact and has become a common feature in most tax-related publications. Moreover, business sources emphasise that, in relative terms, the importance of tax issues is increasing.

5.1. Tax environment for risk capital

Two sets of constraints

Risk capital operators and investors are facing two important types of tax constraints : structural barriers (e.g. the tax treatment of dividends and capital gains, of retail investment in private equity vehicles, of equity *vs* debt financing and of stock options) and specific obstacles to cross-border activities. A recent **Commission study**[25] found that tax rate differentials in the EU are very high and that, in virtually all countries and situations, debt financing receives a more favourable tax treatment than equity financing[26]. For cross-border obstacles, the study proposes a two pronged strategy. In the short term, enactment of specific legislation targeted at each particular obstacle. In the longer term, development of a systematic, comprehensive solution to all cross-border issues providing companies with a common consolidated tax base for their economic activities within the EU.

Two pronged strategy

Tax laws continue to becoming more friendly to risk capital

As illustrated in previous Commission **Communications**[27], various Member States have enacted tax legislation which is intended to foster risk capital and/or R&D. In 2002, this trend has continued. For instance, the UK has followed the German example and now provides for an exemption of capital gains arising on disposal of company participation. Concerning capital gains of "*business angels*", some Member States such as UK and France either exempt such capital gains or provide targeted relief for long-term investment in companies.

5.2. Specific issues and Commission initiatives under way

Scarce EU legislation

There is no EU legislation providing for the exemption of capital gains derived from the transfer of shares or some other method to eliminate double taxation or for cross-border loses relief. There is also no harmonisation whatsoever concerning transparent entities, including investment institutions such as partnerships or funds.

[25] "***Company Taxation in the Internal Market***", SEC (2001) 1681 of 23.10.2001
[26] See also "***Tax of Corporate Profits, Dividends and Capital Gains in Europe***", EVCA, May 2002
[27] See COM(2000) 658 of 18.10.2000 and COM(2001) 605 of 25.10.2001

Whereas two directives on direct taxation have been adopted, they are subject to several shortcomings. The **Parent-Subsidiary Directive**[28] provides for the exemption of dividend payments between associated companies across the EU, but it does not apply to partnerships and other legal forms often adopted by SMEs. Moreover, the minimum (direct) shareholding requirement of 25% excludes a significant number of holdings from receiving its benefits. The **Merger Directive**[29] is equally not applicable to partnerships and does not include the merger of holding companies. Besides, no rules are provided to avoid double taxation arising from transactions such as exchange of shares or transfer of assets.

Directives on direct taxation have provided limited results

Concerning bilateral tax treaties, the Commission intends, following technical discussions with Member States in 2003, to come forward in 2004 with a **Communication** on the need to adapt certain provisions of double taxation conventions, based on the **OECD model**[30], in order to make them compatible with **Treaty principles**[31].

Bilateral tax treaties should be adapted

Tax treatment of stock options is another important topic for the risk capital industry (see section 6.4). For instance, employees exercising their right of freedom of movement may be overtaxed on this sort of income since Member States follow different tax criteria - tax at granting or at exercising or at vesting - and do not apply double tax treaties consistently.

Stock options are taxed differently

5.3 Tax incentives

Special tax regimes have been, and should continue to be, used to encourage risk capital activities, R&D and innovation, provided they meet the requirements of the Code of Conduct on business taxation, EU State Aid rules and other commitments of Member States in the EU tax arena.

Special tax regimes should be compatible with prevailing rules

As regards *R&D and innovation*, governments have devised a variety of fiscal incentives for the benefit of the business sector[32]. The role of economic incentives in this field has been subject to increasing attention in view of the theoretical and practical developments, with multiplicity of variables coming into play. Governments have a high degree of leverage on a large number of these variables (e.g. the economy's knowledge base, the framework conditions for R&D and innovation, the effectiveness of networking and knowledge transfer mechanisms). As a general rule, the use of economic incentives should concentrate on identified market failures, and on minimising the crowding out of private research efforts and possible

Multiple variables come into play

[28] "***Council Directive on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States***", 90/435/EEC of 23.07.1990

[29] "***Council Directive on the common system of taxation applicable to mergers, divisions, transfer of assets and exchange of shares concerning companies of different Member States***", 90/434/EEC of 23.07.1990

[30] "***Model Tax Convention on Income and on Capital***", OECD November, 2000.

[31] In a longer-term perspective, this Communication may constitute a first step towards the possible elaboration of an EU tax treaty model.

[32] For a detailed analysis see "***Corporation tax and innovation : Issues at stake and review of European Union experiences in the nineties***". EUR 17035 (Commission, Innovation Papers No 19, 2002)

distortions of competition. Therefore, optimising economic incentives calls for a comprehensive strategy building on the perceived interaction between the various economic policy instruments that determine the quality of the innovation system.

6. ENTREPRENEURSHIP

It is already a widely shared view that entrepreneurial dynamism is insufficient in Europe and that there is a great potential for improvement. In order to draw attention on the subject, the Commission intends to publish a **Green Paper** on Entrepreneurship early in 2003[33]. The Green Paper, which will be presented to the 2003 Spring Summit, will highlight the importance of entrepreneurs in the knowledge-based economy and analyse the correlation between entrepreneurship and economic performance.

Great potential for improvement

On the other hand, the 2002 Report[34] on the implementation of the European **Charter for Small Enterprises**[35] concludes that real progress has been made in implementing the Charter, particularly in areas such as start-up procedures and improving legislation. On 23 April 2002, all candidate countries signed in Slovenia the "*Maribor Declaration"*, supporting the Charter recommendations.

The Charter is being implemented

6.1. Informal risk capital financing

The number of business angel networks is increasing rapidly (see annex 4). But, for the time being, only the UK can be considered a mature market. The Commission has been active in developing business angel financing in Europe through a pilot action (1998-2000) and a benchmarking project (2001-2002). The *Business Angel Network pilot programme* was part of the Third MAP[36] and its evaluation shows that the benefits of network building are considerable for both companies and local development[37]. The focus of the *benchmarking project* is on public policies that are beneficial for the development of a mature business angel investment market

Business angel financing continuous developing

Even though precise figures are difficult to obtain, **corporate venturing** has also been hard hit by the downturn in the markets, and many companies have abandoned their risk capital activities altogether. According to surveys, strategic objectives have become more important than financial objectives what is likely to cushion the decrease of corporate venturing investment. To favour this type of activity, some Member States have introduced incentives such as the UK corporate venturing scheme in which, if a company purchases shares in another company, 20 % of the

Increasing importance of strategic objectives

[33]The European Council took note in Barcelona (15/16 March 2002) of the Commission's intentions and added that "*the Council will meet before every Spring European Council to assess progress in this area*" (Point 15 of the Presidency Conclusions)

[34]COM(2002) 68 of 6.02.2002 (This second annual report was presented to the Barcelona Summit)

[35]**The European Charter for Small Enterprises**, adopted by the General Affairs Council on 13 June 2000 and welcomed by the Feira European Council on 19-20 June 2000, called upon Member States and the Commission to take action to support and encourage small enterprises in ten key areas.

[36]Third Multiannual Programme for SMEs (1997-2000), 97/15/EC of 9.12.1996 (OJ L 6, 10.1.1997, p. 25-31)

[37]An evaluation report will be available by the end of 2002.

amount invested can be, under certain conditions, set against the tax bill.

6.2. Matching supply with the demand for risk capital

Investors and entrepreneurs should meet easily

Information on entrepreneurs and investors should be readily available and easy matching of both sides may have considerable added value. Business angel networks are in a crucial position to facilitate that matching. But, to reach a critical mass, sustained awareness-raising campaigns will be needed and modern ICT tools will have to be fully exploited[38]. This will be needed not only at regional or national level, but also at cross-border level, especially in some high-tech areas where the number of companies and knowledgeable investors is limited.

An extensive data base is being constructed

To close existing risk capital matching gaps and provide related services, the Commission is supporting[39] since March 2002 an investor identification and guidance service, **Gate2Growth.com**, for innovative entrepreneurs to complement regional and national initiatives. The service is manned by a team of investment analysts with a venture capital and/or entrepreneurial background. In its first quarter, 900 entrepreneurs have registered and profiles of 3000 investors in Europe have been established so far. It is expected that this pan-European matching database reaches its full critical mass by end 2002.

6.3. Entrepreneurship and training

Entrepreneurial attitudes and skills should be taught

The notion of entrepreneurship as a basic skill that should be provided through lifelong learning is becoming widely recognised. In most EU countries, initiatives already exist. In the framework of the 4th MAP[40] the Commission is running a "*Best Procedure" project* on education and training for entrepreneurship with the objective of identifying and comparing initiatives across Europe that aim to promote teaching of entrepreneurship in the education systems, from primary school to university. Earlier this year, the Commission published[41] the results of a project on entrepreneurship training including the outcome of a conference on the subject held in Madrid in 2001.

An education toolkit has been distributed

EVCA[42] has established in 2002 an *Entrepreneurship Education Toolkit* which is being made available to 500 European universities and institutions of higher education to help them teach a one semester class explaining the basics of, and possibilities provided by, risk capital financing.

6.4. Employee financial participation

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[38] In the same vein, the European Parliament has called for a "**one-stop shop" risk capital website** (point 17 of the EP Resolution of 11.04.2000, Opus Cit.)

[39] Under the **Gate2Growth Initiative** and based on the results of the **LIFT Helpdesk** pilot project (1999-2001) for access to finance (www.gate2growth.com)

[40] "***Multi-Annual Programme (2001-2005) for Enterprise and Entrepreneurship***" (Council Decision 2000/819/EC of 20.12.2000, OJ L 333, 29.12.2000, p. 84)

[41] "***The Development and Implementation of European Entrepreneurship Training Curriculums***", EUR 17047 (Commission, Innovation Papers No 24, 2002)

[42] With the support of the Commission's **Gate2Growth Initiative (**www.cordis.lu/finance/home.html**)**

In order to analyse further the possibilities provided by the different types of employees' financial participation, the Commission has published a Communication[43] on the subject and a working group[44], made of independent experts, have been created. On the other hand, the Commission launched in late 2001 a study[45] on employee stock options to analyse the existing provisions in the Member States and the USA and to evaluate the pros and cons of this form of remuneration, with special focus on SMEs. To help the Commission a group of experts have been created[46]

Stock options and other forms of remuneration are being analysed

7. EUROPEAN AREA OF RESEARCH AND INNOVATION

The Barcelona European Council agreed[47] to increase overall EU spending on R&D with the aim of approaching **3% of GDP by 2010** (up from 1.9% in 2000), two-thirds of which coming from the private sector. The EU is spending much less in R&D than its major trading partners and the gap with the US has been steadily growing[48]. In a recent **Communication**[49], the Commission identifies a range of policy areas and issues that need to be addressed to achieve that goal. It states that efficient and integrated financial markets will be crucial to increase and facilitate access by SMEs to external sources of finance and more effective use of various public financing instruments (direct support, fiscal incentives, guarantee schemes and risk capital) will be needed, in particular, to stimulate and leverage private investment.

3% of GDP for research should be attained by 2010

Expert groups are helping the Commission in identifying how public support could be better used to foster private investment in R&D, in particular by improving access to risk capital and debt instruments. On the basis of the debate with all stakeholders referred to in the above-mentioned Communication, the Commission will consider proposing a focused set of priority actions supported by a process of open coordination in a **second Communication**, in Spring 2003.

A second communication is under preparation

The newly approved[50] **6th Framework Programme (2002-2006***)*, with an overall budget of 17.5 billion euros (+17% compared to the 5th) has been specifically designed to support the creation of the *European Area for Research and Innovation*. New instruments are introduced by the 6th FP to encourage the integration of research capacities, to promote the co-ordination of national programmes, to increase the mobility of researchers and to enhance the impact of research efforts. Horizontal activities under

New instruments are being introduced

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

44 The "***High level Group on transnational obstacles to financial participation of employees for companies having a transfrontier dimension***" has met for the first time on 18 September 2002

45 "***Employee Stock Options in the EU and the USA***", September 2002, www.europa.eu.int/comm (enterprise)

46 The experts have been nominated by the Member States and the Candidate Countries, and the group has met, for the first time, on 22 May 2002.

47 Point 47, first indent, of the Barcelona European Council conclusions, 15 and 16 March 2002.

48 OECD data and Commission estimates value that gap to around 120 billion euros in 2000, of which more than 80% is due to the lower level of business spending

49 "***More Research for Europe : Towards 3% of GDP***", COM(2002) 499 of 11.09.2002)

50 European Parliament and Council Decision of 27 June 2002, www.europa.eu.int/comm(research)

the 5th FP facilitating trans-national technology transfer and the interfacing between researchers, enterprises and investors, will be reinforced. Investment fora, based on the successful *"Biotechnology and Finance Forum",* will be encouraged.

8. PUBLIC FUNDING

8.1. State aid and risk capital

The adoption of the Communication on this subject[51] has proved to be an important development and it has been applied in other cases since last year's report[52], including *Linea de apoyo a la capitalización de empresa de base tecnológica* (Spain), the *Sächsische Beteiligungsgesellschaft* (Germany) and two further UK schemes, one intended to fill the gap in the provision of risk capital in small amounts to SMEs in the coalfield areas of England and another to do the same in other communities suffering particular deprivation. A particular issue arises in assessing measures where all the funds invested are public funds. In such cases it may be harder to establish that investment decisions are profit-driven, which is one of the criteria laid down by the Communication.

The Communication is being applied

8.2. The"i2i" initiative and the European Investment Fund

As explained in last year's Communication[53], **Innovation 2000 Initiative** ("i2i") was launched by the EIB in May 2000, in response to the Lisbon EU Summit and as EIB's contribution to the emergence of a more innovative and knowledge-based society. The EIB Group (including EIF, its equity "arm") is dedicating a significant part of its resources to encourage investment in research and innovation. As of September 2002, loans approved under i2i for projects related to research totalled €4.6 billion, of which €3.2 billion was signed.

i2i is active since May 2000

The largest share of the venture capital resources managed by the EIF is made available by the EIB (including the i2i resources ear-marked for risk capital such as i2i audiovisual), mainly for early stage financing. For the audio-visual industry a number of venture capital funds have received from i2i, as of June 2002, a total of €83.5 million of which €48.5 million relates to investment in content industry and €25 million to high-tech audio-visual SMEs. The EIF also operates the "*ETF Start-up*"[54] Facility and the "*Seed-Capital Action*" of the MAP. The first is targeted towards venture capital funds, particularly seed funds, smaller funds, regional funds and sectorally or technologically specialised funds and incubators. The second supports the investment capacity of those seed capital funds that the EIF invest in through small grants to help the recruitment of additional investment managers.

EIF is the risk capital arm of the EIB and also manages some MAP schemes

[51]Communication on "***State Aid and Risk Capital***", of 23 May 2001 (OJ C235 of 21.08.2001, p. 3)
[52]COM(2001) 605 of 25.10.2002 on the RCAP implementation, section 6.1, footnote 39
[53]Section 6.3 of COM(2001) 605, Opus Cit.
[54]The Agreement between the Commission and the EIF was signed on 18.12.2001

Since its Reform in June 2000, the EIF has embarked upon a phase of rapid expansion. It handles a portfolio in excess of **€2.2 billion**[55], invested in more than **160 funds**. Of them : (i) Funds focused on *specific industries or technologies* (e.g. biotechnologies, agro-business, content industries, nanotechnologies, "enabling technologies", etc) ; (ii) *Regional funds*, with a view to facilitating the balanced development among European regions (in 2001, first operations were signed in Greece and Portugal, substantial commitments representing 9% of EIF activity were signed in Spain, and 5 operations were concluded in the Candidate Countries); (iii) Funds financing the *exploitation of R&D results*; and (iv) *Pan-European funds* (11 *Hi-Tec Pan-European funds* were supported in 2001).

EIF focuses on "early stage" technology funds

8.3. Co-operation between the Commission and the EIB in R&D

This co-operation[56] aims at optimising complementarity and synergy between the Community Framework Programme and the i2i initiative, thereby enhancing their overall impact, and leverage effect, on private investment. Three joint working groups[57] are active in raising awareness in the research community of the new financial opportunities. The new arrangement will also allow to better take into account the specificity of R&D, and the financing needs of different types of companies, in the design and implementation of EIB instruments (e.g. loan facility for the financing of European strategic research projects), including the involvement of national credit and guarantee institutions.

Synergies and complementarities will be exploited

8.4. Regional Policy

The *Commission Guidelines for implementing Structural Funds in the Period 2000-2006*[58] requested to limit direct subsidies to SMEs and to substitute them by more modern and active types of financing such as those provided by venture capital and guarantee funds. Regional funds programming shows that the guidelines are being followed. For instance, while Structural Fund co-financing of SME investment has remained at the same level as for the 1994-1999 period, that is some €17 billions, the amount estimated in the programming documents under risk capital investment has nearly doubled from €600 millions to some €1200 millions.

The new guidelines are being followed

On the other hand, the Commission is about to complete its *New Guide to Risk Capital Financing in Regional Policy*. It will be made available in all Community languages before end-2002 and it is expected to become a useful tool for national and regional operators as well as for final recipients of regional funds.

The New Guide soon available

9. CONCLUSIONS

The RCAP was intended primarily to lay the long-term foundation of the risk capital markets in Europe and therefore short-term cyclical

We should take a long-term view

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[55]Of this, the EIF invested EUR 800 million in 57 funds in 2001 alone.
[56]The Joint Memorandum between the Commission and the EIB was signed on 7 June 2001
[57](i) R&D projects ; (ii) Research infrastructure ; and (iii) Risk capital for start-ups and incubators
[58]Published in 1999, see www.europa.eu.int/comm (regional policy)

considerations should not deter the relevant actors from reinforcing and consolidating risk capital financing. Financial markets, including risk capital markets, have become lately subject to a **string of severe tests** leading to a deteriorating financial climate. The destabilisation effects of the 11 September attacks, the ENRON, Tyco and other corporate scandals, have shaken confidence in financial markets**.** To re-create a new attractive scenario for investors, improvements will be needed in many fronts including the provision of really meaningful accounting figures, net present values based on realistic future cash flows, effective corporate governance, and proper supervision.

A comprehensive package of regulatory improvements will be needed

Professionally organised risk capital financing includes, from the start of a deal, a strategy for exit. The use of the IPO exit door, which is the key link between private and public markets, is often part of those strategies and its availability for flotation, at attractive prices, during the years following the deals should be expected. But the uncertain and volatile markets prevailing following the internet bubble cannot perform well their basic function as providers of finance for promising companies and projects. As a result, the scope for IPOs remains largely closed, a situation which should be addressed by all parties concerned, including the high-growth stock markets. Some pan-European rationalization might be required - as has happened in the blue chip sectors.

The IPO door should be open again

US[59] risk capital investments in 2001 were "**only" three times that of the EU**. This breaks the trend of previous years (in 2000 it was four times bigger). But it does not mean further progress in closing the gap with the US will be automatic. It follows that the EU must continue to use all the means at its disposal to facilitate and encouraged the expansion of European risk capital market. If the EU's employment potential is to be fulfilled particular attention should be paid to R&D. The new ambitious goals for R&D expansion in Europe will require new imaginative financing schemes, in which risk capital should play a primary role. Perhaps the most encouraging message of this report is that a glance since 1998 shows that in almost every policy area there has been significant and positive accompanying policies to support the development or risk capital in the EU. In the EIB, EIF. In research. In entrepreneurship and regional policy. In the regulatory environment as the Financial Services Action Plan is implemented. This augurs well for the future.

Gap with the US still very big

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[59] An economic impact study released in the US in October 2001 by the NVCA (the US National Venture Capital Association) shows that venture capital invested in the US, during the past three decades, created **7.6 million jobs and more than $ 1.3 trillion in revenue** (see www.ncva.org)

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ANNEX 1

HISTORICAL DATA FOR RISK CAPITAL in the EU

Value in million € of	1998	1999	2000	2001
Investment in Early stage (seed + start-up)	1 566	2 991	6 405	3 988
Investment in Development capital (expansion + replacement)	5 172	8 242	13 226	8 758
Total VENTURE CAPITAL	6 738	11 233	19 632	12 746
Total VENTURE CAPITAL as of % GDP	**0.09**	**0,14**	**0,23**	**0,14**
Buy-outs	7 333	13 154	13 917	10 743
Total PRIVATE EQUITY	14 071	24 387	33 549	23 489
Total PRIVATE EQUITY as of % GDP	**0,19**	**0,30**	**0,40**	**0,27**
Funds Raised for PRIVATE EQUITY Investments	19 663	24 613	45 633	36 915

ANNEX 2

HISTORICAL DATA FOR VENTURE CAPITAL INVESTMENT in the US

Value in million € of	1998	1999	2000	2001
Investment in Early stage (seed + start-up)	5 365	12 925	29 340	10 643
Investment in Development capital (expansion + replacement/later stage)	11 742	36 282	78 562	30 158
Total VENTURE CAPITAL	17 107	49 207	107 903	40 800
Total VENTURE CAPITAL as of % GDP	**0,22**	**0,57**	**1,02**	**0,36**

ANNEX 3

BUSINESS ANGEL NETWORKS IN EUROPE

	Year 1999	Year 2002
Belgium	2	7
Denmark	0	6
Germany	1	40
Greece	0	0
Spain	1	2
France	3	31
Ireland	1	1
Italy	0	13
Luxembourg	1	1
Netherlands	1	2
Austria	1	1
Portugal	0	1
Finland	1	1
Sweden	1	1
United Kingdom	49	50
EU	**63 Networks**	**158 Networks**

Source: EBAN, the Member States.

ANNEX 4

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

LAYOUT BY TYPE OF BARRIER – SITUATION IN OCTOBER 2002

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) is being 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 5.1*

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 (Scoreboard) in Section 4*
Simplification of administrative formalities for company formations (including minimum capital requirements)		***Member States*** ***Commission*** ***(disseminating best practice)***	*Figures and evolution were made available through the 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)***	*Commission adopted amended proposal on 9 August 2002*

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* • *Important progress in the negotiations for pension funds*
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*
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)***	*A set of performance indicators and benchmarks has been defined as a support to Member States*

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 Commission Study referenced in section 5)*
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***	*Study launched by the Commission end-2001*

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***	*Commission proposal adopted in 2000*

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***	*A Communication on employees financial participation has been adopted on 5 July 2002*

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 is being 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 comparative study in corporate governance, requested by the Commission, was completed in 2002*

ANNEX 5

ACRONYMS USED IN THE RCAP

AIM : Alternative Investment Market (www.londonstockexchange.com/aim)

BEPG Broad Economic Policy Guidelines

BEST : Business Environment Simplification Task Force. Established by the Commission in September 1997

BSPCE : The French "*Bons de Souscription des Parts et Créateurs d'Entreprises*"

CESR : Committee of European Securities Regulators

CVC : Corporate Venture Capital

EASDAQ : European Association of Securities Dealer Automated Quotation. Renamed "NASDAQ-Europe" (www.nasdaqeurope.com)

EFC : Community Economic and Finance Committee

EIB : European Investment Bank (www.eib.org)

EIF : European Investment Fund (www.eif.org)

EJC : The European Court of Justice (www.curia.eu.int)

ESC : European Securities Committee. It replaces the High Level Securities Supervisors Committee

EURO. NM : Nouveau Marché (Paris) + Neuer Markt (Frankfurt) + Nouveau Marché (Brussels) + Nieuwe Markt (Amsterdam) + Nuovo Mercato (Milan)

EVCA : European Private Equity and Venture Capital Association (www.evca.com)

FIBV:	Federation Européenne des Bourses de Valeurs/International Federation of Stock Exchanges (www.fibv.com)
FSAP	Financial Services Action Plan
IAS :	International Accounting Standards
ICT:	Information and Communication Technology
ISD :	Investment Services Directive (93/22/EEC)
IT :	Information Technology
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)
R&D	Research and Development
RTD :	Research and Technological Development
SME :	Small and Medium sized Enterprise
TMT	Telecom, media and technology
UCITS :	Undertakings for Collective Investment in Transferable Securities (Investment Funds)
US GAAP :	The American Generally Accepted Accounting Principles
VC	Venture Capital

ANNEX 6

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 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.
***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 has been replaced by the European Securities Committee (ESC*)
***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).
Investment Services Directive:	Directive 93/22/EEC (ISD*). 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.
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.
***Primary market*:**	Market into which a new issue of securities is launched.
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 a new one under negotiation (proposal adopted by the Commission on 30 May 2001)

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*:** Organised 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 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*