

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 6 June 2001

on the aid scheme Regional Venture Capital Funds

(notified under document number C(2001) 1547)

(Only the English text is authentic)

(Text with EEA relevance)

(2001/712/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to those provisions⁽¹⁾, and having regard to their comments,

Whereas:

1. PROCEDURE

- (1) By letter dated 26 May 2000, registered on 7 June 2000, the United Kingdom notified the Commission of the scheme 'Regional Venture Capital Funds'. It provided the Commission with further information by letter dated 21 August 2000, registered on 24 August 2000.
- (2) By letter dated 7 November 2000, the Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the scheme. The United Kingdom authorities answered by letter dated 29 November 2000, registered on 1 December 2000.
- (3) The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities*⁽²⁾. The Commission called on interested parties to submit their comments.

- (4) The Commission received comments from interested parties. It forwarded them to the United Kingdom, which was given the opportunity to react; its comments were received by letters dated 23 March 2001, registered on 26 March 2001, and 2 May 2001, registered the same day.

2. DETAILED DESCRIPTION OF THE SCHEME

- (5) The purpose of the scheme is to address a lack of provision of equity funding at regional level for investment in the 'equity gap' range of GBP 100 000 to GBP 500 000 (about EUR 160 640 to EUR 800 000) for small and medium-sized enterprises (SMEs).
- (6) According to the United Kingdom authorities, the existence of this 'equity gap' is due to the relatively high fixed costs for the remuneration of investment executives. This cost and the direct costs for due diligence and legal documentation do not fall proportionately with smaller sizes of investment and may rise. Consequently, there is an incentive for venture capital firms to pursue larger investments in more mature companies, so that costs can be reduced relative to investment value, enhancing returns and lowering management charges to investors. Investors therefore seek to identify investments where growth is likely to be so exceptional that the capital gain more than compensates for the very high early costs. Consequently, the United Kingdom authorities claim, private investors demonstrate a reluctance to invest in businesses that need equity-based financing in amounts below GBP 500 000 (about EUR 800 000) and are not in leading-edge technology sectors. It has also proved more difficult for SMEs far from London to obtain risk capital, which explains the regional approach.

⁽¹⁾ OJ C 27, 27.1.2001, p. 20.

⁽²⁾ See footnote 1.

- (7) The Regional Venture Capital Funds scheme is based on the Industrial Development Act 1982, Section 8.
- (8) The United Kingdom authorities are planning to establish at least one Regional Venture Capital Fund in each of the English regions.
- (9) The duration of the scheme is four years initially, while the life expectancy of the Regional Funds is 10 to 12 years.
- (10) The budget foreseen for the first three years is GBP 50 million (about EUR 80 million). It is expected that private investors will contribute up to five times that amount. The Government will be a minority investor in each fund.

The selection of a fund manager and the establishment of a fund

- (11) A person who wants to set up a fund in a particular region is called a sponsor. It can be a natural or legal person including a regional development agency. The sponsor will appoint a manager for the fund based on a Community-wide public tender⁽³⁾. All of those entering the competition will be expected to have authorisation from the Financial Services Authority and to operate according to British Venture Capital Association guidelines. The main criterion for appointment will be experience of, and success in, fund management in the 'equity gap' part of the market. A track record in the particular region may be one of the criteria that prospective sponsors may wish to take into account but lack of experience in a particular region will not, on its own, prevent a prospective fund manager from entering a competition in that region. The United Kingdom authorities believe that to insist on a proven track record in any region prior to appointment would restrict the open competition for the process of appointment of fund managers. However, prospective fund managers will have to demonstrate that they have strategies in place to ensure that their expertise could be transferred and utilised in the region.
- (12) The Regional Venture Capital Funds will be commercially managed by professional fund managers, regulated under the auspices of the Financial Services Authority, the Investment Management Regulatory Organisation and the British Venture Capital Association.
- (13) The appointed fund manager will proceed to tender for private investors for the fund. The sponsor, the fund manager and prospective private investors negotiate the terms of the private sector investment. The next step is a public tender, in which the sponsors in England submit to the State the bids they have agreed with their investors. One of the selection criteria in the tender procedure will be the extent of the subordination of State returns that potential investors request. Sponsors have to explain in their bids why they believe that the degree and type of subordination they propose is the minimum necessary to attract private investors.

⁽³⁾ Those prospective sponsors for the creation of a fund who are already authorised fund managers will not be required to undertake a competitive process to appoint themselves.

- (14) The winning bids are selected by an Independent Appraisal Board, which is a subcommittee of the newly created Small Business Investment Taskforce (SBIT). It will consist of members from venture capital academics, experienced institutional investors, financial institutions, the Regional Development Agencies and venture capitalists. The final decision to make a commitment to invest Government money in any fund will remain with the State. In practice, the decision to commit to invest will generally follow the advice of the Board.

The investments

- (15) All investments will be equity-based, i.e. take the form of ordinary shares, preference shares or cumulative preference shares, etc. In principle, the maximum amount that may be invested in any one company is GBP 500 000 (about EUR 800 000) (see also point 5 second indent below).
- (16) The Regional Funds may only invest in small and medium-sized enterprises that fulfil the Community definition⁽⁴⁾ and are not in difficulty. Furthermore, the funds may not invest in SMEs that do not meet legal, moral or ethical standards, nor in companies active in the production, processing or marketing of products listed in Annex I of the Treaty.
- (17) A rough estimate is that about 300 SMEs will be able to benefit from investment each year. The funds may not invest in certain sectors⁽⁵⁾ considered to be low-risk and not requesting public stimulation.

The return on investments

- (18) The fund managers will invest on commercial terms. It is expected that the internal rate of return will be at least 12 %, which the United Kingdom authorities claim would be in line with data currently available on investments in this area. The State will seek a commercial return on its investment, although this return may be

⁽⁴⁾ Commission recommendation of 3 April 1996, concerning the definition of small and medium-sized enterprises (OJ L 107, 30.4.1996, p. 4).

⁽⁵⁾ Dealing in land, commodities futures, shares, securities or other financial instruments; dealing in goods (other than in normal wholesale or retail trades); banking, insurance, money lending, debt factoring, hire-purchase financing and other financial activities; leasing or letting assets on hire, except in the case of certain ship-chartering activities; providing legal or accountancy services; property development; farming, forestry or market gardening.

subordinated to that of private investors at the minimum level required in order to stimulate the creation of any fund. The type of subordination will depend on the individual bids brought forward in the tender, and may include State guarantees to other investors.

- (19) The Regional Funds will take the form of limited partnerships. Limited-partnership agreements normally contain a clause concerning carried interest, setting a profitability 'hurdle' which the manager has to exceed in order to get an extra bonus. This clause will be negotiated from the sponsor's and investors' point of view, so that the hurdle rate is attainable, yet stretching, thus giving an incentive to the fund managers to reach and exceed their hurdles.

Commitments

- (20) The United Kingdom authorities have undertaken to apply the Commission notice on the application of Articles 87 and 88 on State aid in the form of guarantees ⁽⁶⁾, should a regional fund choose a State guarantee as a form of subordination of the State return.
- (21) The United Kingdom authorities have set a formal limit of 50 % Government investment in each regional venture capital fund.
- (22) The United Kingdom authorities have undertaken to ensure that the Regional Venture Capital Funds will not invest in companies active in sensitive sectors for which special Community rules governing State aid have been laid down. The Regional Funds will not invest in companies active in the production, processing or marketing of products listed in Annex I of the EC Treaty.

3. GROUNDS FOR INITIATING THE PROCEDURE

Weak proof of market failure

- (23) The Commission expressed a general doubt concerning the incentive effect of the notified scheme. Among other things, the United Kingdom authorities stated in the notification that the British Venture Capital Association had 15 members in England who invested under GBP 250 000 (about EUR 400 000) and had an average investment size of GBP 500 000 or under (excluding technology specialists). The Commission therefore had doubts whether there was a market failure or not.

Possible presence of incompatible aid to the private investors

- (24) The State expects to have to subordinate its returns on investment in one way or another. These are not terms that are present in a purely commercial investment situation, so the Commission considered that the State would not be acting as a private investor in a market economy. As the financial markets are international, the Commission considered that the benefits granted to the private investors could distort competition and affect trade between Member States.
- (25) The scheme does not foresee a link between the aid provided to private investors and any expenditure that can be considered to constitute eligible costs. Moreover, although the development of SMEs and regional development are Community objectives, the Commission doubted whether the scheme really ensured that the aid was the minimum necessary to attain these objectives. The reason was that it appeared from the notification that the call for tenders for investors would be limited to England. Consequently, the Commission also doubted that any aid to the investors would be compatible with the State aid rules of the EC Treaty. A regional limit to the call for tenders could also have constituted an infringement of Article 43 of the EC Treaty on the freedom of establishment and/or Article 56 of the EC Treaty on the free movement of capital.

Possible presence of incompatible aid to the SMEs receiving investments

- (26) The SMEs in which the Regional Funds invest will receive equity capital that they would not have had access to otherwise, at least not if there is a true equity gap. The resources have partly been invested by the State and the private capital of each fund has been raised thanks to the State aid provided to the private investors. This could also imply that the capital might be provided on terms that would not be acceptable to a private investor, and that fund managers would not invest on commercial terms. Recipient SMEs will be able to strengthen their competitive position, which threatens to distort competition and can have an affect on intra-Community trade, since the beneficiaries can be active in international trade.
- (27) The scheme does not foresee an explicit commitment to link the equity-based investments to initial investments by the beneficiary companies. Therefore, it was neither in line with the Community guidelines on State aid to SMEs in force at the time, nor with the Community guidelines on national regional aid, and the Commission had doubts as to its compatibility with the EC Treaty.

⁽⁶⁾ OJ C 71, 11.3.2000, p. 14.

Possible presence of incompatible aid to the Regional Funds

- (28) The United Kingdom authorities stated in the notification that the British Venture Capital Association has 15 members in England who invest under GBP 250 000 (about EUR 400 000) and have an average investment size of GBP 500 000 or under (excluding technology specialists). These venture capitalists are active in the same segment as the Regional Funds, as are other venture capitalists in other Member States. Therefore, if the Regional Funds were to be seen as undertakings, the fact that they operate with the aid of public resources could distort competition on the venture capital market.
- (29) The compatibility problems of any aid to the Regional Funds would be the same as for the other potential aid recipients.

4. COMMENTS FROM INTERESTED PARTIES

- (30) The Commission received comments from 39 interested parties within the time limits specified in Article 6(1) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty (7). Of these, 37 were from the United Kingdom, and the other two from the Italian and German Governments. The comments from the United Kingdom were submitted by various regional authorities, venture capital companies, advisory bodies, a trade association and a university. There were also comments from three United Kingdom MPs and from two United Kingdom MEPs. Prospective sponsors of funds, fund managers and private investors and investee companies were represented.

On market failure

- (31) All interested parties who addressed the question of market failure agreed that there was one for amounts below GBP 500 000 (about EUR 800 000). There were also several mentions of an equity gap below GBP 1 million (about EUR 1,6 million), at least for sectors other than high technology. The gap was mainly due to the high costs of due diligence, and old data showing disproportionately high risks and low returns from this segment, so that there was a gap between perceived and real risk. At the same time successes in larger investments created a drive for even larger ones. Another remark was that the business angel network did not fill the gap.

- (32) Regarding the 15 members of the BVCA supposedly active in the equity gap segment, several interested parties stated that these venture capitalists may be registered as active in the segment, but there was no actual activity going on. One reason for this may be that the funds were already fully invested. However, it also appeared from the comments that although there may be some funds available, they were nowhere near satisfying market demand. It was also stated that although major United Kingdom venture capital companies may have regional offices, they serviced deals at the larger end of the market.

- (33) The London Development Agency quoted a BVCA report (8) finding that 'London is the main European centre for venture capital but that does not mean that London SMEs see the benefit of this. An equity gap exists in London up to GBP 500 000 and may extend beyond this given the greater cost pressures that tend to push London-based firms more rapidly towards larger investments.'

- (34) Finally, all interested parties claimed that there was an equity gap for small as well as for medium-sized enterprises, as the problem was not linked to the number of employees. One venture capital company proposed defining an eligible company as one that sought to raise less than GBP 500 000 (about EUR 800 000) a year. Several interested parties mentioned that a restriction to small companies would increase the risk of the fund and the private investors' requirements on return and, consequently, the need for subordination of the State's return.

On aid to the investors

- (35) Here the general opinion was that since there was no offer in the equity gap, i.e. in the high risk/low return quadrant of the market, there was no competition to distort, and so there was no aid to investors. At the same time several parties stressed that the possibility to invest had to be widely advertised in order to eliminate any discrimination between investors and to minimise the subordination needed. One party mentioned that even though the incentive might be granted to the investors, they were only a vehicle for passing the benefit on to the SMEs.

- (36) Another comment was that risk capital investments were usually a very small part of investors' portfolios, so that a slightly higher return from the regional venture capital funds would not have an impact on the overall performance of investors.

(7) OJ L 83, 27.3.1999, p. 1.

(8) BVCA Report on Business Angel Investment Activity 1998/99.

On aid to the SMEs

- (37) The overall impression is that interested parties did not think that there was aid to the SMEs invested in, since the investments were made on commercial terms. The only element of aid acknowledged by interested parties was the very availability of the funds. As for the compatibility of any such aid, they referred to the fact that the recipients had to undertake some 'eligible' investments in order to grow.

On aid to the regional funds

- (38) Many interested parties mentioned that there was no basis for the Regional Funds being in receipt of aid, since the standard limited partnership structure in the industry that will be used did not create any separate legal entity. A Regional Fund would not earn profits in its own right and all assets and liabilities would be held by its partners in proportion to their investment.
- (39) A number of parties explained that if more funds began to be offered in the market segment concerned, there might be a danger of distortion of competition between funds. In that case the policy would have accomplished its aim and the problem of distortion would have to be addressed.

- The United Kingdom authorities undertake to ensure that fund managers advertise widely for investors in appropriate trade journals and in the *Official Journal of the European Communities*. There will be no restrictions placed on the location or nationality of investors.
- The United Kingdom authorities undertake to prescribe the need for incentives for the fund managers to maximise the performance of funds.
- In principle, an investor is committed for the life of the fund, i.e. for 10 to 12 years. The only way an investor can be released from this commitment is to sell the investment. If an investor wishes to do this, he must have the fund manager's and other investors' consent for any transfer of ownership. The Government does not intend to offer to purchase any share of the partnership that is being sold by a private sector investor, even if the Government's share of the Regional Fund is below 50 %. On the other hand, the Government would be willing to sell its share of the partnership to any private sector investor who is willing to take on board the subordinated terms.

- (41) In addition, the following comments have been made on each of the issues raised in the Commission decision to open the procedure.

5. COMMENTS FROM THE UNITED KINGDOM

On market failure

- (40) First of all, the United Kingdom authorities have clarified the following technical details of the scheme:
- There may well be an equity gap in London, and the scheme will not only operate outside London. There will probably be between 10 and 15 Regional Funds in total.
 - Each tranche of investment in a company is strictly limited to GBP 250 000 (about EUR 400 000), and there must be at least six months between tranches. In principle, the amount of investment per company is limited to GBP 500 000 (about EUR 800 000). The only exception to the GBP 500 000 limit will be where further investment is required in order to maintain the Regional Fund's percentage holding in a company, and making such investment is in the judgement of the fund manager in the best commercial interests of the fund. Such further investments will be subject to an overall limit of 10 % of any fund being invested in one company. The United Kingdom authorities point out that as investments above GBP 500 000 (about EUR 800 000) can only happen where there is a risk of dilution of shareholding, they will only happen alongside other private sector investments. The further investments will be on terms at least as good as those offered to the private sector investments.

- (42) The United Kingdom authorities state that there is strong evidence of market failure caused by investors' over-reliance on historic aggregate performance data. As the average deal size in the venture capital market has increased, SMEs have found it more difficult to access the type and size of finance most suited to their needs. In establishing these funds the United Kingdom Government is seeking to stimulate the market to provide funding in this area and demonstrate to the wider venture capital industry that good commercial returns can be made from this sector. The scheme is not intended to be a long-term public support programme.
- (43) Moreover, the United Kingdom authorities agree with several interested parties that the equity gap in England has been widened lately, so that it now covers amounts below GBP 1 million (about EUR 1,6 million). While a number of funds do currently exist which make investments in the equity gap, most are nearly fully invested. The United Kingdom authorities believe that there are currently no new private funds being raised for investment in the equity gap. The only funds proposed are those with support from either the ERDF or the Regional Venture Capital Funds Scheme.

On aid to the investors

- (44) The United Kingdom authorities stress that investors in the Regional Funds will be attracted by wide dissemination of an invitation. They are neither limited by number nor geography nor predetermined. Those who operate the Regional Venture Capital Funds will be commercial fund managers, chosen following a rigorous competitive process to ensure that any aid is the minimum required for funds to be created.

On aid to the SMEs

- (45) The United Kingdom authorities claim that the funds will operate in accordance with the market economy investor principle, since there are performance incentives for the fund managers and the private investors would not commit to a fund which did not offer them the highest possible return. There are no mechanisms in the scheme which allow for, or encourage, 'soft' investments to be made. Therefore, they think that the scope for aid to the SMEs is negligible.
- (46) As returns to the investors can only be generated by growth in the investee companies and as growth without initial investment is virtually impossible, it would seem inconceivable to the United Kingdom authorities that investments by the funds would not lead directly to investments by the SMEs.
- (47) Private investors are likely to consider that a restriction on investments to small companies would limit the Regional Funds' ability to secure the highest possible rates of return. Consequently, investors would require an even higher level of public support.

On aid to the regional funds

- (48) The United Kingdom authorities explain that it is not possible to distinguish between a fund and its investors. The fund does not have a separate taxation status and does not have the ability to make profits or losses in its own right. Any profits or losses are attributable to the investors in line with the legal agreement.

6. ASSESSMENT OF THE SCHEME

- (49) At the time of opening the procedure, the Commission did not yet have any State aid rules dealing specifically with the particular form of State aid that may be contained in measures providing risk capital to enterprises. The present assessment is based on Article 87 of

the EC Treaty, with particular reference to the new Commission Communication on State aid and risk capital⁽⁹⁾.

Presence of State aid under Article 87(1) of the EC Treaty

- (50) Point IV.3 of the Communication lists the criteria for a risk capital measure to constitute State aid.

At the level of the investors

- (51) Since the State participates directly in the Regional Funds, State resources are involved. The State expects to have to subordinate its returns on investment in one way or another. These are not terms that are present in a purely commercial investment situation, so the State cannot be said to be acting as a private investor in a market economy. Consequently, there is an advantage to the private investors. Although the private investors are found through an EU-wide call for tenders, the measure is selective in that not all applicants can finally participate. There is discretion at two points, i.e. firstly, when the fund manager selects offers from prospective private investors and, secondly, when the State decides in which proposed Regional Funds it will invest. These selections will be based on qualitative as well as quantitative criteria. Investment of capital is an activity which is the subject of very large trade between Member States. Consequently, the scheme threatens to distort competition and affect trade between Member States. The private investors are only covered by Article 87(1) of the EC Treaty to the extent that they constitute undertakings.
- (52) It is clearly stated in point IV.5(I) of the Communication that the fact that due to a market failure no investors would otherwise make such investments, is not in itself sufficient to rebut the presumption of an advantage.

At the level of the SMEs

- (53) As much as 50 % of the resources made available to the SMEs may constitute State resources. On the issue of whether there is an advantage, the aim of the measure is to give the SMEs access to capital to which they would not otherwise have had access. The existence of advantage depends on whether the terms on which this capital is made available would be acceptable to a private investor in a market economy. This is discussed in the following paragraph. At this level the measure is clearly selective as the Regional Funds may only invest in SMEs in certain regions of the United Kingdom. Recipient SMEs will be able to strengthen their position in relation to their competitors, which threatens to distort competition and have an effect on trade between Member States, since the beneficiaries can be active in international trade.

⁽⁹⁾ Adopted by the Commission on 23 May 2001 (not yet published in the Official Journal).

(54) It is stated in point IV.5(III) of the Communication that the fact that the investment decisions are being taken by commercial managers of risk capital funds, or by representatives of investors, with an interest to ensure a maximum return for the fund is an important indicator that the company has received the investment on terms acceptable to a private investor in a market economy, but it is not in itself conclusive. If a risk capital measure has reduced the risks and/or increased the rewards which investors will obtain from making a particular investment then they may be said no longer to be operating as a normal economic operator. The Commission has already found, and the Court of Justice has agreed, that advantages granted to investors to persuade them to invest in a certain class of enterprise may constitute advantages to those enterprises ⁽¹⁰⁾. In accordance with point IV.5(III) of the Communication the Commission must take into account the possibility that any advantages accorded to investors in the funds are passed on to the enterprises invested in, when the investments are not made by the fund *pari passu*, with a private investor in a market economy. It may be that the typical investments of the funds are not made *pari passu* in this way, and the Commission cannot therefore conclude that the enterprises will receive the investment on terms which would be acceptable to a private investor in a market economy. The Commission therefore considers that the existence of an advantage and therefore of State aid at this level cannot be excluded.

At the level of the regional funds

(55) As the Regional Venture Capital Funds will be limited partnerships, the Commission does not consider them to be separate aid beneficiaries. This principle was established in the Commission decision on another United Kingdom venture capital scheme, namely the Viridian Growth Fund ⁽¹¹⁾.

Exemption under Article 87(3)(c) of the EC Treaty

(56) According to point VI.5 of the Communication, the Commission will require provision of evidence of market failure before proceeding to authorise risk capital measures. It may be prepared to accept that there is a market failure where each tranche ⁽¹²⁾ of finance for an enterprise from risk capital measures which are in turn

wholly or partially financed through State aid will contain a maximum of EUR 500 000 (about GBP 312 700). This criterion is fulfilled in the case under examination. In addition, the United Kingdom authorities and interested parties have stated that the majority of funds present in the equity gap segment are fully invested and that there is no evidence that new private funds are being established. There is also agreement on the fact that the available funds are far from sufficient to cover demand. Finally, there are indications that the equity gap is actually increasing to amounts below GBP 1 million (about EUR 1,6 million), rather than GBP 500 000 (about EUR 800 000).

(57) In point VII.1 on the form of the aid measure, it is stated that one form of aid which the Commission will be prepared to view favourably under the compatibility criteria is that of schemes in which the State is an investor in Venture Capital Funds, even if on less advantageous terms than other investors.

(58) In section VIII.3 of the Communication seven compatibility criteria are listed in order of importance.

1. Target enterprises and size of transactions

(59) The scheme is not limited to small enterprises and to medium-sized enterprises in their start-up or other early stages, or in assisted areas. However, as there is a restriction on the total funding available through the measure, the inclusion of later stage medium-sized enterprises can be accepted. The Commission notes that any investments made in excess of GBP 500 000 (about EUR 800 000) in one enterprise will be made on terms at least as good as those of the other private investors investing at the same time.

(60) It is a positive element that the ceiling for each tranche of financing provided is far below the stipulated thresholds of EUR 500 000 for non-assisted regions, EUR 750 000 for regions qualifying for assistance under Article 87(3)(c) of the EC Treaty or EUR 1 million in regions qualifying for assistance under Article 87(3)(a) of the EC Treaty.

2. Focus on risk capital market failure

(61) It is a positive element that the measure is limited to the provision of equity-based investments.

⁽¹⁰⁾ Case C 16/97, OJ L 212, 30.7.1998, p. 50. This case was the subject of the judgment of the Court in Case C-156/98, 19 September 2000.

⁽¹¹⁾ Decision adopted by the Commission on 13 February 2001 (not yet published in the Official Journal).

⁽¹²⁾ Separate injections of capital within six months of each other would be considered to be part of the same tranche, as would different instalments, even over a longer period, to which a commitment is made simultaneously as part of a single transaction.

3. Profit-driven investment decisions

- (62) It is a positive element that the United Kingdom authorities have undertaken to ensure that there will be a link between investment performance and the remuneration of those responsible for investment decisions. In any case, this is common practice for funds established as limited partnerships.
- (63) Given the undertaking by the United Kingdom authorities, the Commission is confident that the investments in the equity of SMEs will be made on a commercial basis. Market economy investors will provide at least 50 % of each Regional Fund's capital, which can be considered a significant involvement. For funds operating in assisted areas the Commission would consider a private capital share of 30 % to be significant.

4. Minimised distortion of competition between investors and between investment funds

- (64) It is a positive element that the extent of subordination of the return on the public resources is determined through a series of calls for tender. First of all the invitation to invest in the funds will be published in the *Official Journal of the European Communities* and in appropriate trade journals. Secondly, each sponsor of a fund will present the Government with a bid containing an explanation of why the subordination proposed is the least necessary to attract private investors.
- (65) This should ensure that there is no overcompensation to the private investors.

5. Sectoral focus

- (66) It is a positive element that there is no sectoral focus, and that particularly low-risk sectors which should manage without State intervention have even been excluded.
- (67) The United Kingdom authorities have undertaken to ensure that the Regional Venture Capital Funds will not invest in companies active in sensitive sectors for which special Community rules governing State aid have been laid down. In particular, they will not invest in companies active in the production, processing or marketing of products listed in Annex I to the EC Treaty.

6. Investment on the basis of standard commercial practice in fund management

- (68) It is a positive element that the Regional Funds will be commercially managed by a professional fund manager, regulated under the auspices of the Financial Services Authority, the Investment Management Regulatory Organisation and the British Venture Capital Associa-

tion. This ensures that the fund managers will make professional judgements as to whether an expected return from a proposed equity injection into any SME will be a good commercial proposition.

- (69) The communication mentions the lack of an 'exit mechanism' for the State's involvement in individual enterprises as a negative element, since an exit mechanism would be a safeguard against schemes providing long-term financing to companies which will never be viable on their own. However, it is in the nature of a scheme taking the form of a Venture Capital Fund like this one that the individual investors, including the State, cannot withdraw from individual investments made by the fund. The exit mechanism is built into a Venture Capital Fund's design in that the State exits at the same time as the other investors when the fund is wound up. Moreover, the Regional Funds are operating on commercial terms. They will therefore withdraw from companies that will never be viable on their own and will seek to realise the value of successful investments when it is most advantageous to do so, leading ultimately to the withdrawal of the fund (and therefore of the State participation) from all of the companies invested in.

7. Avoidance of cumulation of aid measures to single enterprises

- (70) According to the Communication, the Commission may request commitments by a Member State to assess and set limits to other forms of State aid to enterprises funded by the risk capital measure, including under authorised schemes, if a measure provides aid to the enterprises invested in. In this particular case the Commission has decided not to exercise this right owing to the small size of the total investments and the individual tranches.

7. CONCLUSION

- (71) The Commission takes note of the comments received from interested parties and of the explanations given and further commitments made by the United Kingdom authorities since the opening of the procedure. It also notes that the scheme contains positive elements under each of the seven criteria stipulated in the Communication. Therefore, the Commission is able to take an overall favourable view of the scheme and to conclude that the aid granted to the private investors and to the small and medium-sized enterprises is compatible with the State aid rules. The doubts regarding a possible infringement of Articles 43 and 56 of the EC Treaty have also been allayed.

(72) The Commission concludes that there is no aid at the level of each Regional Fund, as the funds will not be legal entities and the resources of the funds belong to the investors. However, the United Kingdom authorities are invited to monitor the development of the equity gap situation and to ensure that there is no crowding-out of prospective fully private venture capital funds,

HAS ADOPTED THIS DECISION:

Article 1

The notified State aid scheme Regional Venture Capital Funds, as completed by the comments made by the United Kingdom authorities since the opening of the procedure, which the United Kingdom is planning to implement based on the Indus-

trial Development Act 1982, Section 8, is compatible with the common market within the meaning of Article 87(3)(c) of the EC Treaty.

Implementation of the aid is accordingly authorised.

Article 2

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 6 June 2001.

For the Commission

Mario MONTI

Member of the Commission
