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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE  
EUROPEAN PARLIAMENT**

**ON IMPLEMENTATION OF THE RISK CAPITAL ACTION PLAN (RCAP)**

## **EXECUTIVE SUMMARY**

This communication reports on progress in the implementation of the RCAP for the year 2000 and for early 2001. It is the third of this type since the adoption of the RCAP in 1998 and comes at the midpoint of the RCAP which is due to be completed by 2003.

The performance of the risk capital markets in Europe in 2000 was spectacular, and more so in the seed and start-up phases which have, traditionally, been the weakest links of the financing cycle. The European industry has become not only bigger but also more sophisticated and better organised. Growth was shared by all Member States even though important differences persist, reflecting the presence of a fairly fragmented pan-European market. In spite of the strong development, when compared with the US, the size of the European market is still small implying that Europe has still a long way to go. The fall in stock markets, which started in 2000 and accelerated in 2001, the downturn in economic growth and the surrounding climate of uncertainty exacerbated by the events of 11 of September 2001 in the USA, will impact negatively on the growth path of the risk capital industry. This may affect disproportionately investment in the seed and start-up segments. The current market difficulties together with the wide gap with the US should represent additional stimuli to reinforce efforts to complete the RCAP.

Progress in the setting-up of a proper regulatory framework for the development of risk capital has continued, particularly in relation to financial measures where the centre of gravity of decision taking has shifted from the Commission towards Member States and European Parliament. Many difficulties still subsist in important areas such as the absence of an affordable single patent or the whole array of fiscal barriers, often of a discriminatory nature, with the potential to delay even further the establishment of a true single risk capital market. The introduction in the near future of Euro-notes and coins will add supplementary pressure to eliminate remaining cross-border barriers.

The development and promotion of European entrepreneurship, a key priority area, has been pursued primarily through conferences, workshops, training schemes and exchange of best practices. Cultural barriers are difficult to erase and, in spite of the positive evolution of recent years, programmes need to continue for longer. A sector where efforts to develop entrepreneurship could prove to be the most cost-effective is that of R&D. The Lisbon Summit envisaged the creation of the most dynamic economy in the world by the end of this decade. This will require the creation, diffusion, and commercialisation of sophisticated technologies and related applications, results of effective and dynamic R&D programmes. In order to exploit fully the work of researchers, encouraging them to develop an innovation and commercial reflex will be important. In this regard, the rapid adoption of the New Framework Programme for R&D should be a top political priority.

In the area of public funding important steps have been taken to improve the overall efficiency of Community risk capital markets: the Commission has clarified its policy towards state aid; the EIF has strengthened and fully defined its role as the risk capital arm of the EIB Group; the EIB Group and the Commission have signed a joint memorandum to co-finance R&D activities; risk capital is becoming more involved in regional development; and some Community instruments have been redirected toward early stage finance.

In conclusion, there has been some progress in all the RCAP areas. However, for Europe to become a world leader, as foreseen in Lisbon, much more sustained activity has to continue on a wide range of risk capital fronts.

## 1. INTRODUCTION

Since the adoption of the Risk Capital Action Plan (RCAP) in June 1998 by the Cardiff Summit<sup>1</sup>, there have been two annual progress reports<sup>2</sup>. The present document concentrates on **developments in the year 2000 and in early 2001**. Building on the results of the ECOFIN of 7.11.2000 and on the conclusions of the Stockholm and Göteborgh Summits, it provides an evaluation (mostly qualitative) of the degree of progress already achieved, including a comparison with the main competitor, the USA. As the RCAP should be implemented by 2003, this document **completes a mid-term review** for the RCAP.

*Mid-term review of the RCAP completed*

Actions taken to eliminate the risk capital barriers, as foreseen in the RCAP, are part of the on-going structural reforms and will contribute to the improvement of the efficiency of Community's product and capital markets. Following on from the conclusions of last year's RCAP progress report, the BEPG (Broad Economic Policy Guidelines) 2001-2002 includes recommendations on the development of the EU risk capital markets. Later this year, Member States will report on progress on implementing general and country-specific recommendations when they present their national progress reports on structural reform in the context of the Cardiff process.

*The RCAP is part of the EU's on-going structural economic reforms*

This Communication has been prepared by an Ad-Hoc Commission Inter-Service Group where the EIB and the EIF were also represented, and in consultation with the industry (EVCA).

*Ad-hoc inter-service group*

Section 2 describes and analyses relevant market developments including prospects for the immediate future. Section 3 concentrates on on-going legislative work both of financial and non-financial nature. Section 4 refers to tax issues relevant for risk capital. Section 5 describes developments related to entrepreneurship with special attention to R&D issues. Section 6 refers to the important steps taken in the area of public funding. Finally, section 7 contains some general conclusions on the degree of progress achieved.

*2. Market Dev.  
3. Framework  
4. Tax issues  
5. Entrepren.  
6. Public Funds  
7. Conclusions*

## 2. MARKET DEVELOPMENTS

### 2.1. Venture Capital in 2000

The total volume of venture capital investments in Europe<sup>3</sup>, covering seed, start-up, expansion and replacement phases of company development, grew spectacularly from about €10 billion (0.14% of GDP) in 1999 to over **€19.6 billion (0.23% of GDP)** in 2000, continuing the trend of the last few

*Continuing rapid*

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<sup>1</sup> Based on Commission Communication "*Risk Capital : A key to Job Creation in the European Union*", SEC(1998) 522, April 1998

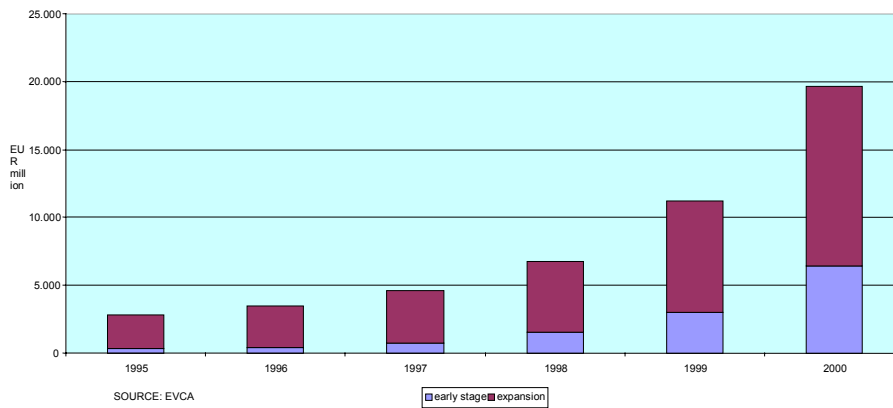
<sup>2</sup> COM(1999) 493 of 20.10.1999 and COM(2000) 658 of 18.10.2000

<sup>3</sup> The year 2000 has been an *uneven period* which started with an overheated market and ended in a sluggish fashion, opening a (possibly lengthy) period of uncertainty. The numbers here are based on total amounts and therefore do not reflect the *changing mood in the market* during the year. Figures are derived from the survey conducted by PWC (PriceWaterhouseCoopers) for EVCA and published in EVCA's 2001 Yearbook.

years (Fig.1). This reflected both an increase in the average size of individual investments (up from €1.6 million in 1999 to €2.3 million in 2000) and increases of 30% and 35% in, respectively, the number of investments and invested companies.

*growth of venture capital investment*

**Fig.1: Venture Capital Investments in EUR-14 1995-2000**



Growth in total **seed and start-up** investment was even more striking, up by nearly 115% at **€6.4 billion**, a figure equivalent to the total volume of venture capital investments only two years earlier. Start-up investments, moreover, more than doubled in volume, representing 29% of the total venture capital invested (Fig.2) and 38% of the total number of investments. Here the increase was due more to a doubling of the number of transactions (a record 1121) rather than to larger transaction sizes.

*More focus on early-stage investment*

Most investee companies were small (less than 100 employees), with 45% of all private equity investments (i.e. including buy-outs, which tend to be larger) in companies employing fewer than 20 people at the time of investment.

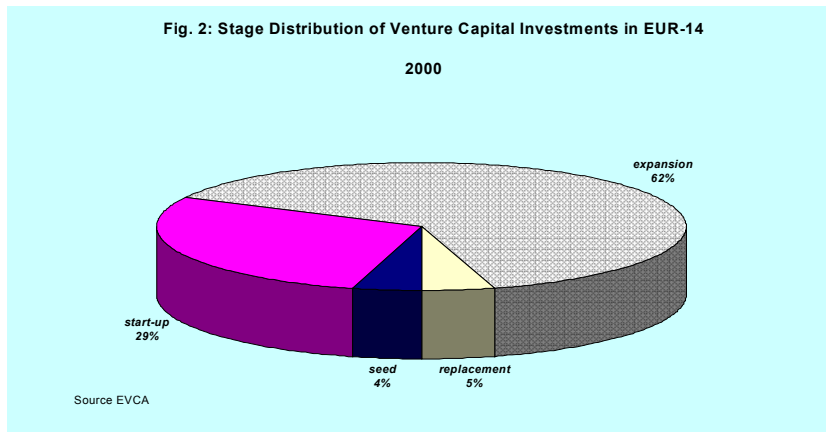
*Mostly small investee companies*

On the funding side, nearly **€20 billion was raised** in 2000 for future venture capital investments, compared with around €11.5 billion in 1999. Of this total, nearly €9 billion was expected by fund managers to be directed towards early-stage investments (compared with less than €5.5 billion in 1999) and some €14 billion for high-tech investments (early-stage and expansion).

*Funding nearly doubled in 2000*

On the sources of funds, there is a growing involvement of institutional investors. In 2000 pension funds more than doubled their contribution from the previous year, providing for the first time the largest single source of private equity capital (24%), supplanting banks (22%), while insurance companies added a further 13%. It should be noted, however, that a significant share of this pension fund investment is accounted for by US pension funds investing in, notably, the UK private equity industry.

*Growing institutional investment*



The European risk capital market is now less focussed on buy-out investments and provides greater coverage of the different stages of company development. But, despite its growth, the European market is still small compared with that of the US where investment rose to over €74 billion in 2000 (up 120% over the previous year), equivalent to 0.7% of GDP. Of this total some €28 billion (37%) went to early-stage investments. This is more than total European venture capital investment as a whole and more than 4 times European investment in early-stage.

*More matured and sophisticated market*

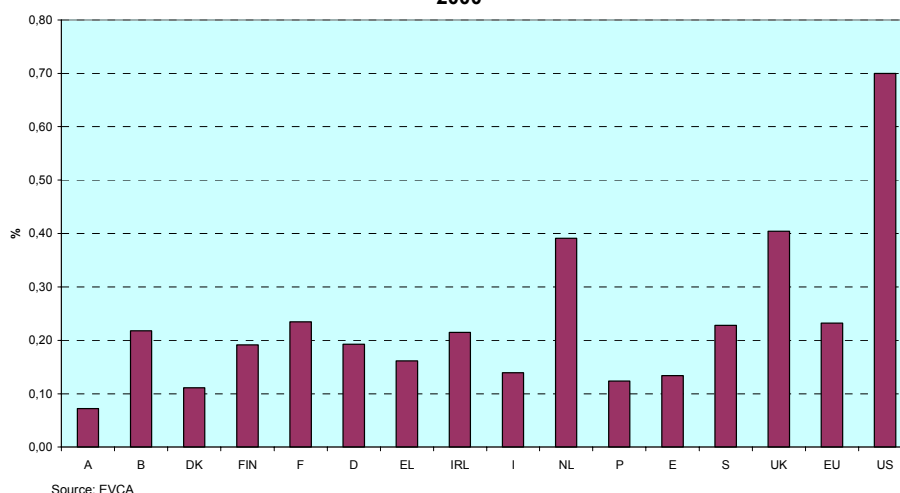
*Gap with the US remains*

The aggregate figures for **the EU reflect a pattern of substantial growth** in the volume of venture capital investment in 2000 across the Member States. In Belgium there was also a substantial growth in seed and start-up investments but not in the total due to exceptionally high growth of the previous year. Funds in the single biggest national market (the UK) more than doubled their venture capital investments to over €6 billion<sup>4</sup> and, strikingly, there was a seven-fold increase in start-up investments and a substantial increase in seed-capital, thus reducing relatively the traditional focus on buy-out finance. German funds consolidated the growth of venture capital to €3.9 billion, an increase of nearly 50%, with a doubling of seed and a substantial increase in start-up investments. In France too there was nearly a doubling of venture capital investments (up to €3.3 billion), including a similar increase in start-up investments. The other major contributors by volume were the Netherlands (venture capital investment of over €1.5 billion), representing 0.39% of GDP which is almost on a par with the share the UK, and Italy with €1.6 billion (nearly a tripling over 1999), including a four-fold increase in start-ups, although the share of venture capital in GDP remains modest at 0.14%. The Finnish and Swedish markets, which have been developing significantly over the past few years, continued to grow, although the most striking growth in Sweden in 2000 came in the buy-out market (75% of the volume of new investments). In the remaining Member States both volumes of venture capital and shares in GDP, though growing, remain low (Figure 3).

*Differences among European Countries persist*

<sup>4</sup> These figures, like those for all the Member States, represent investments made by funds in their home market. They exclude investments actually carried out in other European countries as well as in third countries (notably the USA). While pan-European and extra-European investments have been growing, **over four-fifths of the number and some three-quarters of the total volume of private equity investments continue to be made domestically.**

**Graph 3: Venture Capital Investments as % of GDP  
2000**



All this against the backdrop of a European private equity and venture capital industry which is now bigger, more sophisticated, and more mature than ever in the past, with a substantial core of weathered professional managers, more experienced investors and diversified support services (specialised lawyers, accountants, consultants etc) with a stake in its successful development.

*The Industry has become more professional and better organised*

## **2.2. The Stock Markets for High-Growth Companies**

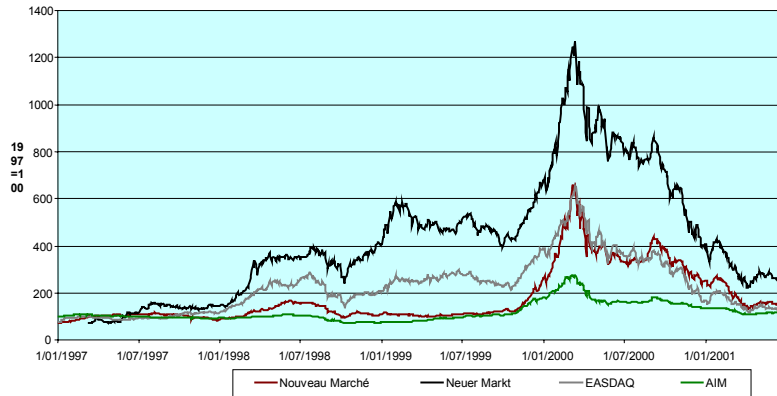
Prices on the German Neuer Markt fell by 40% during 2000 (or by 68% from their March peak), those on the French Nouveau Marché by 2% (or by 61% from their peak) and those on the pan-European stock exchange EASDAQ by 57% (Fig. 4). The **downward momentum** intensified in the second half of 2000 and has accelerated in 2001 amid a series of profits warnings from technology companies (especially internet companies) and market concern about the levels of indebtedness of telecommunications companies, as well as general uncertainty on the back of poor company results.

*Strong stock market correction in 2000, which continuous in 2001*

The first half of 2000 witnessed a continuing growth in new listings on the new exchanges. AIM in London saw more than 250 listings last year, the Neuer Markt 130, the Nouveau Marché 50, the Nuovo Mercato in Italy 35. Companies newly listed on the high-growth exchanges raised some €22 billion as against €8 billion in 1999, although the growth in capital raised was even higher on the traditional exchanges. 2000 also saw the launch of new exchanges in Ireland and Spain. Most IPOs were completed in the first half of 2000. Moreover the fall in prices and in new flotations was faster and steeper on the high-growth markets than on the main stock markets. The main exception to this trend was AIM which saw a continuing flow of companies applying for listing throughout the year, reflecting the fact that it is less focussed on technology stocks and quotes companies across a wide range of sectors.

*Most IPOs completed in the first half 2000*

Fig.4: New growth stock price indices 1997-2001



At the same time the pressures for consolidation and integration among European stock exchanges have remained and may even have been reinforced by the turmoil on the markets. Following the creation of EURONEXT<sup>5</sup>, which includes a high tech segment, in April 2001 the American NASDAQ acquired majority ownership in EASDAQ, the pan-European exchange for growth companies to become **NASDAQ-Europe**.

*Pressure for stock market consolidation remains*

### 2.3. The Outlook for 2001

Figures are not yet available on European venture capital investment and fund-raising for the first half of 2001. But the trends and the prospects for the near- and medium-term have been intensively discussed among participants in the industry. Access to all forms of external finance has become more difficult and more costly. There has been an appreciable widening of spreads for non-investment grade borrowers, a slowdown in loan approvals and, as discussed above, a drying up of the IPO market<sup>6</sup>, particularly on the new exchanges.

*A year of adjustment in European venture capital markets*

With exits more problematical and against a background of a general slowdown in economic growth and a **climate of uncertainty** exacerbated by the events of 11 of September 2001 in the USA, many venture capital funds now face the prospect of holding less profitable investments, nurturing them for longer periods and having to inject more cash into them through several funding rounds which may lead to a consolidation of the industry. On the other hand, as there is a considerable amount of money already raised (and not yet committed) for new investments, downward valuations have created new opportunities for liquid venture capital funds which could produce very high returns over the next 2-3 years.

*Exit has become more difficult*

*Consolidation may become inevitable*

<sup>5</sup> EURONEXT was created in September 2000 by the Paris, Brussels and Amsterdam Bourses. Other exchanges, such as Lisbon, are being attracted to the project.

<sup>6</sup> It has been reported that in the period January-August 2001 only 7 IPOs have taken place in the high-tech sector in the whole Europe.

In 2001 the growth of both investment and fund-raising in Europe can be expected to fall back. The same is true of the US market which could be even more sharply affected because of its greater exposure to the IT industry. Figures for the US market for Q1 2001 already show a sharp downturn. Investment in US venture-backed companies dropped by 39% in Q1 2001 compared with Q4 2000, the biggest single quarter-on-quarter fall in the history of the industry, while venture capital investment in the IT industry fell by more than 50%<sup>7</sup>. In spite of the **retrenchment in Europe**, which could impact negatively on the welcome shift in 2000 towards the financing of early-stage investments, the European industry being more experienced, bigger and stronger than ever before should be expected to emerge successful from current difficulties.

*Downturn in Europe expected to be weathered successfully*

### **3. REGULATORY FRAMEWORK**

As already envisaged in the RCAP, and continuously requested by the industry<sup>8</sup>, the setting-up of an appropriate regulatory framework at both Community and National levels remains a **top political priority** for public authorities. Therefore, a modern, flexible and cost-effective regulatory system comprising legal and administrative measures, and which takes fully into account the needs of efficient risk capital markets (both supply and demand), should be introduced without delay. This section analyses the most relevant of those measures, both financial and non-financial. Tax related measures are discussed in the next section.

*An adequate regulatory framework should be in place without delay*

#### **3.1. Introduction of the EURO**

The introduction of the Euro in physical form in 12 Member States and the corresponding disappearance of national currencies will further highlight the EU, and the Euro-area in particular, as a truly single market. In this dynamic scenario<sup>9</sup>, towards integration, the presence of regulatory barriers will become more visible and the need for their removal more pressing.

*The Euro makes barriers more visible*

The special Stockholm European Council (23/24 March 2001) makes this need clear. Paragraph 18 of the Presidency conclusions states that : “*Rapid implementation of the Financial Services Action Plan (FSAP) is of utmost importance*”. Paragraph 19, second indent, is more specific and asks, as in Lisbon, for full implementation of the FSAP by 2005. In addition, it requires that securities markets legislation provided in the FSAP should be given a priority and that an integrated securities market should be completed by 2003. As for well functioning risk capital markets, the Lisbon **deadline of 2003 is reconfirmed** in paragraph 19. The fact that securities markets legislation and the completion of the RCAP share the same deadline implicitly recognises their inter-related nature. Accordingly,

*Securities market legislation should be completed by 2003*

*Close inter-relation between the RCAP and Securities markets*

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<sup>7</sup> PriceWaterhouseCoopers and VentureOne MoneyTree Survey May 2001

<sup>8</sup> See for instance “*White Paper : Priorities for Private Equity-Fostering Long-Term Economic Growth*”, EVCA, June 2001. This document was the basis of the *4<sup>th</sup> EVCA Policy Meeting* which took place in Brussels on 11 September 2001 with the participation of industry and Commission representatives.

<sup>9</sup> Institutional investors increasingly view Europe’s securities markets as a single entity and there is some evidence of the extension of this trend to retail investors. Moreover, *several public offerings in the last 18 months have included a pan-European retail element.*

a seamless pan-European financial system should be in place soon, able to cater for the needs of enterprises during their whole life cycle, from start-up to stock market flotation and for any subsequent capital raising.

*confirmed at the European Council*

Furthermore, the Stockholm Council adopted a Resolution endorsing the final report<sup>10</sup>, published on 15 February 2001, of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Baron Alexandre Lamfalussy. As a result the Commission has adopted, on 6 June 2001, two decisions to create the **European Securities Committee (ESC)** and a **Committee of European Securities Regulators (CESR)**<sup>11</sup>. These new arrangements should ensure not only that European Securities legislation would be adopted faster and through more transparent procedures, but also that, by distinguishing framework principles from implementing technical details, the new rules would become more effective and flexible enough to respond to unforeseen market developments and to financial innovation. The essence of the new Lamfalussy approach has already been introduced in the proposed directives on Collateral (adopted by the Commission on 27 March 2001), on Prospectuses (see below), and on Market Abuse (adopted on 30 May 2001).

*Lamfalussy procedures need to be implemented for faster and more effective legislation*

**Figure 5 : Implementation of Financial Services Legislation<sup>12</sup>**

	<b>Banks</b>	<b>Insurance</b>	<b>Securities</b>	<b>Payment systems</b>	<b>Company law</b>	<b>Total</b>	<b>Position</b>
<b>B</b>	8/8	23/24	14/14	2/2	15/15	62/63	9
<b>DK</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>D</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>EL</b>	6/8	23/24	14/14	2/2	15/15	60/63	15
<b>E</b>	6/8	24/24	14/14	2/2	15/15	61/63	11
<b>F</b>	8/8	23/24	14/14	1/2	15/15	61/63	11
<b>IRL</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>I</b>	8/8	23/24	14/14	1/2	15/15	61/63	11
<b>L</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>NL</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>A</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>P</b>	7/8	23/24	14/14	2/2	15/15	61/63	11
<b>FIN</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>S</b>	8/8	24/24	14/14	2/2	15/15	63/63	1
<b>UK</b>	8/8	23/24	14/14	2/2	15/15	62/63	9
<b>EU</b>	95.8%	98.3%	100%	93.3%	100%	98.6%	/

<sup>10</sup> See [http://europa.eu.int/comm/internal\\_market](http://europa.eu.int/comm/internal_market) (financial services, general matters section)

<sup>11</sup> See [http://europa.eu.int/comm/internal\\_market](http://europa.eu.int/comm/internal_market) (financial services, securities section)

<sup>12</sup> As of May 2001. On the other hand, the number of banking directives has diminished drastically, comprising with previous years, due to the adoption of Directive 2000/12/EC (Codification of Banking Directives) which has abolished 20 directives.

According to the 4<sup>th</sup> FSAP progress report<sup>13</sup> approved by the Commission on 1<sup>st</sup> June 2001 and endorsed by the ECOFIN Council of 5 June 2001 : “Overall progress is at present reasonably satisfactory although care must be taken to avoid any complacency to emerge” (pp7). On the other hand, as the Commission moves towards a situation at the beginning of next year when it will have tabled nearly all its major proposals, the centre of gravity of decision taking will have shifted from the Commission to the Council and European Parliament.

*Political center of gravity shifting towards Member States and European Parliament*

### **3.2. Measures included in the FSAP<sup>14</sup>**

For the legislative measures included in both the FSAP and the RCAP there is some progress to report :

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

The Commission adopted on 30 May 2001 a proposal for a directive that would introduce a truly “single passport for issuers”. The new procedures are simpler and would make it easier and cheaper to raise capital all over the EU. In particular, this would facilitate pan-European IPOs (Initial Public Offerings) and admission to trading to specialised stock markets for fast-growing SMEs.

*Prospectuses : IPOs procedures will be streamlined*

- **Measure : “Adoption of prudential rules to allow institutional investors to invest in venture capital”**

Regarding legislation on investment funds (UCITS) substantial progress has already been attained. The two common positions on the two Commission proposals have been adopted by the Council on 5 June 2001. Regarding the Commission proposal on supplementary pension funds<sup>15</sup> negotiations continue. There are still, in the Council, divergent views on several critical issues. The debate is, basically, split between those countries already having “second pillar” funded pensions and those Member States considering the introduction of such schemes.

*UCITS close to adoption, but Commission pension fund proposals threatened*

- **Measure : “Assess of existing accounting and auditing requirements”**

On 13 February 2001, the Commission adopted a proposal for a Regulation on the application of International Accounting Standards (IAS) in the EU. It will introduce the requirement for all listed EU companies to prepare their consolidated financial statements in accordance with IAS as of 2005. Member States will be granted the option to extend this requirement to unlisted companies. Concerning statutory audit, the Commission adopted on 21 November 2000 a Recommendation setting minimum standards for external quality assurance systems for statutory audits in the EU. A further recommendation on auditor independence may be issued before end-2001.

*IAS will favour pan-European and international markets*

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<sup>13</sup> See [http://europa.eu.int/comm/internal\\_market](http://europa.eu.int/comm/internal_market) (financial services, action plan section)

<sup>14</sup> The measures, in the RCAP, of *financial nature* were included in the FSAP and affect primarily the *supply side* of risk capital.

<sup>15</sup> COM(2000) 507 of 11 October 2000

- Measure : “*Dissemination of best practices in corporate governance*”

The Commission launched<sup>16</sup> a comparative review of existing codes of corporate governance with a view to identifying any legal or administrative barriers which could frustrate the development of a single capital market. The results are expected for December 2001 at the latest, and their analysis will allow to determine to what extent any intervention at EU level in this debate is desirable or not.

*Best practices in Corporate Governance should be encouraged*

### 3.3. Measures outside the FSAP<sup>17</sup>

For the RCAP legislative measures not included in the FSAP some progress is also been reported :

- Measure : “*Reform of the legislation on insolvency and bankruptcy*”

A *Seminar on Business Failure* was held on 10/11.5.2001 in Noordwijk (the Netherlands). Its conclusions included helping failed entrepreneurs to make a fresh start by addressing the problem of stigma. A comprehensive report on the event will be drawn up and disseminated in Autumn 2001. On the other hand, the Commission is going to launch before end-2001 a study on “*Bankruptcy and a Fresh start*” which will include relevant indicators on bankruptcy laws and the stigma of failure, as well as recommendations.

*The problem of stigma linked to failure should be addressed*

- Measure : “*Reform of the European Patent System*”

On 1 August 2000, the Commission adopted a proposal for a Regulation on the Community patent<sup>18</sup>. The Regulation would give inventors the option of obtaining a single patent to be issued by the European Patent Office which would be both affordable and legally certain. It is expected that a Community patent would significantly reduce translation and related costs, which are today a major element of cost of the European patent and deterrent for patenting especially for SMEs.

*An affordable single patent should be adopted*

## 4. TAX ISSUES

The taxation of the collection and provision of risk capital, as well as the taxation of risk capital income, play clearly a key role in the development of both domestic and international risk capital activities. Generally, different forms of investment or different sources of financing may be subject to different tax treatment, thus leading to different effective tax rates and influencing business decisions. These issues are analysed in depth in a **comprehensive Commission study**<sup>19</sup>.

*Tax barriers are analysed in a Commission study*

Whereas risk capital cannot form the single most important element to take

*Risk capital should also be*

<sup>16</sup> The open invitation to tender has been published in the Official Journal in March 2000, and the contract has been signed in December 2000.

<sup>17</sup> The measures outside the FSAP affect primarily the *demand side* of risk capital.

<sup>18</sup> JO C 337 E of 28.11.2000

<sup>19</sup> Report by the Commission Services on “*Company Taxation in the Internal Market*”. See [http://europa.eu.int/taxation\\_customs](http://europa.eu.int/taxation_customs)

into account while designing the structure of tax systems care must be taken to avoid unintentional negative effects on this type of activity. Thus, the structure of any national tax system should not hamper the positive aims of risk capital, innovation and R&D. On the contrary, special tax regimes have been, and should continue to be, used to encourage these activities.

*taken into account*

#### **4.1. Tax obstacles to cross-border and international risk capital activities**

Both general and more specific tax obstacles still persist. The divergence of national tax rules can act as a barrier and there are also still instances of discriminatory treatment.

As regards **company taxation**, the existing general tax obstacles to cross-border economic activity in the Internal Market are all also important for risk capital activities. Indeed, the study finds (see part III) that the underlying cause of almost all the obstacles is the existence within the Internal Market of 15 separate tax systems which also influences negatively the development of a pan-European risk capital market in a number of ways. For instance, Member States are reluctant to allow relief for losses incurred by associated companies whose profits fall outside the scope of their taxing rights. Moreover, cross-border reorganisations entailing a loss of taxing rights for a Member State are liable to give rise to capital gains taxation and other charges. Finally, double taxation may occur as a result of conflicting taxing rights. The lack of co-ordination of Member States' policies concerning double taxation conventions is a major source of complexities and difficulties for cross-border and international risk capital activities. Furthermore, certain systems of company taxation have an in-built bias in favour of domestic investment. For example, under imputation systems applied in a number of Member States, whereas a tax credit is granted to resident shareholders (individual or corporate) for the tax paid on a company, that credit is usually not available to non-resident shareholders and is not normally granted in respect of foreign dividends. On the basis of the study the Commission has developed a strategy for action to address the various obstacles<sup>20</sup>.

*The main barrier is the existence of 15 different jurisdictions*

*A strategy for action has been developed by the Commission*

In the field of **personal income taxation**, the risk capital market, as part of the broader financial market, also suffers still from a number of tax problems. These concern, for instance, the taxation of stock options where the divergence of rules between Member States may easily lead to double taxation. Moreover, in many cases, Member States' income tax laws (personal and corporate) grant tax relief, either on the level of the individual investor or on the level of the collective fund, only for certain, mostly domestic, investments or investment funds. It is likely that such discriminatory arrangements would not stand a challenge before the ECJ<sup>21</sup>.

*Some barriers affect all financial markets*

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<sup>20</sup> Communication on “*Towards an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities*”. See <http://europa.eu.int/taxation> customs.

<sup>21</sup> For a more detailed overview about potential discriminatory rules in Member States see : *Price Waterhouse Coopers and Fédération Européenne des Fonds et Sociétés d'investissement (FEFSI)*,

The Commission has begun to raise such issues with the Member States. It may be noted that the ECJ has found unlawful laws concerning the taxation of foreign dividends derived from shares in companies established in other Member States due to their discriminatory character<sup>22</sup>. The Commission will devote increasing attention to these issues (including the development of guidance on important ECJ ruling and co-ordination of their implementation via “soft law” instruments) and insist on the respect of the basic Treaty freedoms in this area.

*The basic Treaty freedoms must be respected*

#### **4.2. Tax measures to foster risk capital activities in Member States**

As illustrated in the last year’s progress report, several Member States have introduced specific or general tax measures for fostering, sometimes along with other issues, risk capital. In so doing, Member States should fully respect Treaty obligations, notably those concerning State Aid, as well as other commitments taken in the EU tax area. In this context, it is also noteworthy that many Member States have recourse to specific tax incentives for encouraging R&D activities. For instance, in the majority of Member States R&D activities can benefit from favourable depreciation rules and in some (e.g. in Spain, France, Italy, the Netherlands, Portugal, UK) of specific tax credits. Such tax incentives have to meet the same conditions as regards state aid and regulatory commitments in the tax area as for risk capital. The Netherlands and the UK are currently leading an exercise which is looking more broadly at EU research and innovation incentives. The results of this work are due to be presented to the Economic Policy Committee in December before being forwarded to the Council in January 2002. In view of these developments, and in order to identify good practices, the Commission is launching an exercise in relation to the use of **fiscal incentives to promote investment in R&D**. This is intended to identify ways of improving the effectiveness of such measures and to enhance their complementarily with other incentives for research and technological development. National research and tax administrations will be associated to the initiative.

*Tax incentives for R&D already in place in many Member States*

*The Commission is launching an exercise on R&D fiscal policy to determine good practice*

The following measures and reforms in Member States are of particular importance with a view to risk capital activities. Germany has reduced its corporate (in stages until 2005) and income tax rates and will eliminate taxation of sales of shares by corporations as from 2002. France has also reduced its corporate and income tax and increased tax benefits granted to reinvesting business angels. Italy has granted favourable tax treatment to closed-end investment funds. Spain has granted tax incentives to registered venture capital investors. Several Member States have reduced the tax disincentives to business creation. Several Member States (Ireland, UK, Belgium, Denmark, Germany, France, Italy, the Netherlands, Finland, Sweden) have laid down specific rules, or clarified the application of general rules, on the taxation of stock options which are, however, not always compatible in cross-border situations. In France, the application

*A variety of measures already taken*

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*Discriminatory Tax Barriers in the Single European Investment Funds Market: a discussion paper*, London, June 2001

<sup>22</sup> Cases C-35/98 (**Verkooijen**), OJ C 247 26.08.2000, p.5 ; and C-251/98 (**Baars**), OJ C 192, 8.7.2000, p.4

requirements for the BSPCE system have been expanded and extended up to end-2001.

## **5. ENTREPRENEURSHIP**

If anything, the RCAP is about entrepreneurship<sup>23</sup>. There are still too few innovative projects in Europe with a profile as to become the target of risk capital providers (i.e. the demand side of risk capital is still weak<sup>24</sup>). The RCAP will not be a success unless, because of its influence, there is a substantial increase, in the short/medium term, in the number of innovative fast-growing companies in Europe. Equally, the Lisbon objectives<sup>25</sup> will not become attainable. Therefore, the promotion, at all levels, of entrepreneurship remains a **political objective of prime importance**.

*The RCAP is about entrepreneurship*

*Boosting entrepreneurship, a prime political objective*

Innovative fast-growing companies are also affected by horizontal initiatives affecting the SME industry as a whole. The Commission has recently published a report<sup>26</sup> providing an overall view of the relevant Community activities affecting them. Of particular interest are *the BEST Action Plan to promote Entrepreneurship and competitiveness* and the *Benchmarking Exercise*<sup>27</sup>. Discussed below are some aspects and measures, where progress is reported, relevant for the promotion and diffusion of entrepreneurship, with special attention to R&D initiatives.

### **5.1. Access to finance for entrepreneurs**

Recourse to “non-formal” equity capital for entrepreneurs setting up innovative businesses has improved in Europe. Some proof of increased funding from **Business Angels** in Europe stems from the fact that the number of Business Angels networks has increased to around 130 spread over almost all EU countries. Several thousand Business Angels are organised in such networks, and there are often close links to local or regional venture capital funds which could then take promising start-up companies further upstream by providing subsequent rounds of financing. The Commission has supported the setting up of Business Angels networks successfully and 20 new networks received financial support from the

*Increased funding from Business Angels is taken place*

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<sup>23</sup> This is also the understanding of the industry. See, for instance, the *EVCA White Paper (Opus Cit.)*

<sup>24</sup> Until the demand side for risk capital reaches a minimum stable critical mass, it would be difficult to satisfy the industry desire for *risk capital to become a recognised distinct asset class* (i.e. an asset class of its own).

<sup>25</sup> The Lisbon objectives go well beyond the RCAP’s initial aim of fostering growth and job creation. Indeed, the ambitious goal of transforming the EU, in a decade, into the most competitive and dynamic, knowledge-based society require a more solid, stable, influential and ever expanding innovative industry segment capable of diffusing their output, on a continuous fashion, into the whole economy and society at large.

<sup>26</sup> Commission report “*Creating an Entrepreneurial Europe : The Activities of the European Union for Small and Medium-Sized Enterprises (SMEs)*”, COM(2001) 98 of 1.3.2001. This is the latest report drawn up in accordance with the Third Multi-annual Programme for Enterprise and Entrepreneurship. A *new Multi-Annual Programme (MAP) (2001-2005) for Enterprise and Entrepreneurship* has been adopted by the Council at the end-2000 (see *Council Decision 2000/819/EC* of 20.12.2000, OJ L 333, 29.12.2000, p. 84)

<sup>27</sup> See [http://europa.eu.int/comm\(enterprise\)](http://europa.eu.int/comm(enterprise))

Community budget since the action was launched at the end of 1998.

Business Angel's contribution to the overall seed and early stage finance in Europe is reckoned, by some estimates, to have reached the same level as funding from the « formal » venture capital industry whereas in the US it is estimated to exceed four times “formal” VC investment.

*But big gap with the US still persist*

**Corporate venturing** in Europe is becoming an increasingly important source of financing for entrepreneurs. Exact figures are not available, but it is estimated that around € 1,2 billion are invested each year. This figure is expected to grow according to the general pattern of risk capital, but it is still small in relation to the USA where the figure is estimated to be 5 times larger. This type of investment would greatly benefit in Europe from a regulatory framework favourable to cross-border investment<sup>28</sup>.

*Corporate venturing is becoming more relevant*

## 5.2. Entrepreneurship promotion and entrepreneurial training

A BEST procedure project aiming to promote enterprise culture, from primary school to university, has been launched. It will focus on best practice and benchmarking. The first meeting with experts took place on 14 June 2001. Final results are expected in September 2002.

*A BEST procedure project has been launched*

The Commission, in close co-operation with National authorities and also within the BEST framework, has continued to promote an exchange of good practice in enterprise policy by organising fora and workshops with the participation of officials and practitioners. Two fora (in addition to the seminar on “*Business failure*” mentioned in section 3), each with 300-400 participants, have particularly addressed the theme of **promoting entrepreneurship**. In October 2000 in Nice, Sophia Antipolis, a forum on “*Training for Entrepreneurship*” aimed to provide concrete evidence on how to promote entrepreneurship in schools and universities, in vocational training and within companies (“*Intrapreneurship*”). At the Växjö Forum in Sweden (March 2001) “*Entrepreneurship for the Future*” was the theme and good practice in response to the emerging issues of the ‘new economy’ was examined, specifically in relation to new forms of entrepreneurship<sup>29</sup>.

*Successful fora have been organised in the last 12 months*

Under the Commission FITO3 initiative, Madrid hosted in March 2001 the “*FITO3 European Workshop on Entrepreneurship Training Curriculum*”. The workshop addressed the training needs for Europe's technology entrepreneurs and aimed to provide good practice on how to adapt a general training model to specific conditions.

*Workshop for high-tech entrepreneurs*

The « *Seed-Capital Action* »<sup>30</sup>, to be managed by the EIF, will be designed in a way to support the recruitment of junior investment managers in VC funds (including seed-capital funds ; small funds ; regional funds ; and

*Recruitment of young*

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<sup>28</sup> See Commission publication “*Corporate Venturing in Europe*”, 2001 (EUR 17029)

<sup>29</sup> The good practice identified in these events is being publicised in paper and on the Commission's web site

<sup>30</sup> Foreseen within the *new MAP (2001-2005) (Opus Cit.)*. It will replace the CREA Scheme.

incubators) in which it participates. It will take the form of a grant of 100 000 EUR for each junior investment manager remaining at least 3 years in the funds or incubators concerned. This will substantially ease the recruitment and training of young professionals by European VC operators.

*professionals will be supported*

Finally, as part of the policy to improve the availability and motivation of human resources and to encourage their effectiveness, the Commission has launched in July 2001 a consultation<sup>31</sup>, to be completed by 30.10.2001, which would be the basis for a subsequent Communication, together with an Action Plan, on *Financial Participation*.

*Financial participation should be encouraged*

### **5.3. European Area of Research and Innovation**

The research sector is an increasingly important source of new opportunities for risk capital investment. These arise from projects developed directly by researchers, as a result of university-industry co-operation and through high technology spin-offs<sup>32</sup>. The European Area of Research and Innovation initiative and the new Framework Programme, described below, aim to increase these opportunities by focusing, in particular, on the need to strengthen innovation performance<sup>33</sup>.

*R&D has become an increasingly important source of projects to be financed by risk capital*

In January 2000, the Commission adopted a Communication proposing the creation of a **European Research Area**<sup>34</sup>. In setting out the priorities the document stressed the need for more dynamic private investment in research and innovation. In this regard, it drew attention to the potential role of indirect support instruments such as **fiscal measures (see section 4.2.)**. It also emphasised the need for action to encourage researchers to set up companies, notably in high tech sectors, and to increase the flow of risk capital investment to such companies.

*More dynamic private investment in R&D is needed*

The Lisbon European Council endorsed the objective of achieving a *European Area of Research and Innovation*<sup>35</sup> and emphasised the need to improve the environment for private research investment, R&D partnerships and high-tech start-ups and proposed the use of tax policies, venture capital and **EIB support (see section 6.4.)**. It also called for an open method of co-ordination for benchmarking national research and development policies. As a result, the Commission launched a number of benchmarking exercises in relation to national research policy, including a project addressing the issues around public and private investment in R&D. Later on, the Stockholm European Council invited the Council to consider ways in which Member States' ideas for, and experiences of, boosting R&D through economic incentives could be shared.

*The Lisbon and Stockholm Summits paved the way for more risk capital involvement*

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<sup>31</sup> Commission Working Paper on "*The Financial Participation of Employees in the European Union*", July 2001, addressed primarily to Member States, social partners, companies, and associations dealing with financial participation. See [http://europa.eu.int/comm\(employment and social affairs\)](http://europa.eu.int/comm(employment and social affairs))

<sup>32</sup> For current Community programmes see [www.cordis.lu](http://www.cordis.lu)

<sup>33</sup> In other words, researchers would be encouraged to *develop an innovation/commercial "reflex"*  
<sup>34</sup> COM(2000) 6 of 18.01.2000, "*Towards a European Research Area*"

<sup>35</sup> Lisbon European Council of 23-24 March 2000, Presidency Conclusions, page 4

A proposal for a **New (the Sixth) Framework Programme (2002-2006)**<sup>36</sup> for R&D has been submitted to the Council and the European Parliament. It includes a number of novel features. Central to these is that innovation has been made an integral part of the overall design of the Programme. This reflects the principle that innovation does not start where research ends but is embodied in the conception of a project and accompanies its development. As an example, the Programme will facilitate networking activities to encourage improved interfaces between researchers, enterprises and the financial world. In this regard, exchanges of good practice and implementation of transnational co-operation involving universities, incubators and risk capital funds will be a priority. Organisation of investment fora is an example of the type of networking activity envisaged under this action. The “*Biotechnology and Finance Forum*”, active since end-1997, can be a role model. A rapid adoption of the new Framework Programme would be of paramount importance to achieve the Lisbon and Stockholm objectives.

*Innovation should be an integral part of R&D programmes*

*Rapid adoption would be of paramount importance*

## **6. PUBLIC FUNDING**

Described below are some important steps taken in the last 12 months in order to clarify, rationalise or refocus the provision of risk capital through European public funds. It should be expected that these decisions will increase significantly the overall efficiency of the risk capital markets in the EU in the future.

### **6.1. State aid in the field of risk capital**

Public support for venture capital in Europe has been given, for years, in various forms and through a number of schemes, playing often a key role in its development. Last year’s progress report, while noting the risks of market distortion and of displacing private funds, and pointing out the obligation to respect the state aid rules, recognised a role for public funding limited to “**addressing identifiable market failures**”<sup>37</sup>.

*Public funds only to address market failures*

With these considerations in mind, the Commission has developed its policy on the issue of public funding for risk capital, and has adopted a communication on the subject<sup>38</sup>. The Commission intends to apply the terms of the communication for five years<sup>39</sup>. However, as the approach of this communication represents a departure from previous methods of state aid control, and that it deals with an area of rapid developments, the Commission reserves the right to adjust its approach in the light of experience.

*A communication on state aid and risk capital has been published*

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<sup>36</sup> COM(2001) 94 of 21.02.2001. For proposals on *Specific Programmes* see COM(2001) 279 of 30.05.2001

<sup>37</sup> See Section 3.4 of COM(2000) 658 of 18.10.2000 (*Opus Cit.*)

<sup>38</sup> Communication on “*State Aid and Risk Capital*”, 23 May 2001. See OJ C235 of 21.08.2001, p. 3, and [http://europa.eu.int/comm\(competition\)](http://europa.eu.int/comm(competition))

<sup>39</sup> Drawing on the policy set in the new communication, the Commission authorised in June 2001 the *Regional Venture Capital Funds* due to operate in England (case C 52/2000), and in July 2001 the framework scheme for risk capital funds in France (N 448/2000).

## 6.2. The European Investment Fund

The reform of the EIB Group, approved in June 2000, resulting in the rationalisation and streamlining of the organisation, gave the **EIF control over all venture capital operations of the Group**. This has resulted in a sharp acceleration of EIF investments<sup>40</sup> and has allowed the EIF to achieve a sufficient critical mass as to become a significant participant in the European VC market. It has already a portfolio (committed as of 30.6.2001) in excess of EUR 1.6 billion invested in 124 VC funds, and an investment capacity of EUR 800 million p.a. over the next years.

*EIF has become the venture capital arm of the EIB Group*

This new dimension will allow the EIF to fulfil better the pursuit of traditional Community objectives which has been confirmed as its core mission. The EIF primary task now consists of enhancing the competitive strength of small enterprises, developing VC know-how (see Section 5.2.), fostering innovation and technology, promoting growth, high-quality jobs and balanced regional development, while continuing to generate an “**appropriate return**”<sup>41</sup>. Moreover, the EIF gives priority to investing in “early stage” funds. In particular: (i) funds focused on specific industries or technologies<sup>42</sup> (i.e. biotechnologies, content industries, nano-technologies, “enabling technologies” etc) ; (ii) regional VC funds, with a view to facilitating the balanced development among European regions; (iii) funds financing the exploitation of R&D results; and (iv) pan-European funds.

*Appropriate returns should be generated*

*EIF gives priority to early stage funds*

Finally, an important aspect of the EIF investment policy is not to crowd out private investors. Moreover, the EIF acts as a catalyst to and not as a substitute for private investors. As a strategic fund-of-funds, the EIF is well placed to sustain this catalytic role and take a lead in encouraging other co-investors to continue to invest despite the present uncertainty in the markets.

## 6.3. “Innovation 2000 Initiative”

*Innovation 2000 Initiative (“i2i”)* was launched by EIB in 2000, in response to the Lisbon EU Summit and as EIB’s contribution to the emergence of a more innovative and knowledge-based society. i2i comprises finance for : (i) education/e-learning ; (ii) information and communication technologies ; (iii) R&D ; and (iv) diffusion of innovation, including the audio-visual sector. EIB expects to lend under i2i, EUR 12 to 15 billion in the 3 years following its official launch in May 2000. EIF, also part of i2i, will play a significant role in the programme. With i2i, EIB's role in R&D finance has greatly increased.

*The “i2i” initiative is well underway*

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<sup>40</sup> More than 40 investments in venture capital funds were approved by the EIF Board between September 2000 and June 2001, for EUR 700 million, 80% of them being first time funds.

<sup>41</sup> This **dual approach is unique** among European financial institutions

<sup>42</sup> The EIF has pioneered investment in so-called **frontier technologies** and is considering supporting a range of **emerging technologies** which are expected to underpin the next generation of VC funds.

#### 6.4. Co-operation between the Commission and the EIB

On 7 June 2001, the Commission and the EIB signed a Joint Memorandum in the field of research. This establishes a framework for co-operation between the Community Framework Programme for research and *i2i*. It aims to increase the overall impact of the instruments of the two institutions by enhancing their complementarily and facilitating their combined use by industry and public research organisation across the various stages of the research and technological innovation investment cycle. The memorandum encompasses strategic co-ordination, coherent information actions and sharing of expertise. By enlarging the global envelope available to Community research and innovation financing, it will give Community research and innovation a boost by providing access to funding sources not traditionally available.

*A joint memorandum for R&D activities has been signed*

#### 6.5. Refocusing of Community funds

For **regional development**, the *Council Structural Funds Regulations* and the *Commission Guidelines for implementing Structural Funds in the period 2000-2006*<sup>43</sup> stress the need to achieve the best leverage from operations funded from the Community budget by favouring as far as possible recourse to private sources of financing, namely risk and venture capital and Public-Private Partnerships (PPP). The new forms of financing are particularly foreseen to encourage start-ups, spin-offs and innovative developments, specialised business services, technology transfer and related services. The Commission is currently preparing a *Guide for Financial Engineering under the Structural Funds* accompanied by an evaluation of the negotiation results and of a benchmarking exercise.

*Risk capital becoming more involved in regional development*

On the other hand, following the **invitation of the ECOFIN Council** of 7 November 2000<sup>44</sup> to reorientate Community instruments managed by the EIF, in order to address continuing market failures, the *New Multi-Annual Programme For Enterprise and Entrepreneurship*<sup>45</sup>, adopted in December 2000, foresees that the *EFT Start-up Scheme* will be adapted as to support the financing of incubators and seed capital, and the *SME Guarantee Facility* will add new “windows” to provide **guarantees for equity**, micro-credit and investments in ICT<sup>46</sup>.

*Existing schemes and facilities have been reorientated*

Finally, the examples above show that the range and characteristics of the financial instruments made available by public authorities should continue to evolve as to properly fulfil their intended policy purpose. To achieve the same policy objectives in the future different means may become necessary in a new market climate. The Commission will continue to **creatively** use its financial instruments with the aim of **stimulating** even further private sector investment. In this respect the Commission considers that, for

*Reflection on further development of financial*

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<sup>43</sup> See [http://europa.eu.int/comm/regional\\_policy](http://europa.eu.int/comm/regional_policy)

<sup>44</sup> Based on Commission Communication “*Review of Specific Community Financial Instruments for SMEs*”, COM(2000) 653 of 18.10.2000.

<sup>45</sup> *New MAP (2001-2005) (Opus Cit.)*

<sup>46</sup> This is in addition to the *Seed-Capital Action* (replacing the CREA scheme), mentioned in Section 5.2, which has become an integral part of the new MAP. For details of all these programmes see [www.eif.org](http://www.eif.org).

instance, financial instruments producing a leverage effect on existing private VC funds<sup>47</sup> could be seen as the natural evolution of equity guarantees (already in operation in several Member States and contemplated in the new windows of the SME guarantee Facility). They may provide, in specific cases, an optimal mix of public/private co-operation and, due to their multiplier effects, may avoid the risk of the private sector being crowded out.

*instruments will continue.*

## **7. CONCLUSIONS**

The figures for risk capital investment in Europe in 2000 show spectacular growth comparing with previous years. Since the mid-90s, the combination of improving economic conditions in Europe, the control of government deficits as a result of EMU, rapidly raising stock market valuations, the positive influence of the thriving US economy, and the abundance of investment opportunities in new promising technologies and applications, pushed the risk capital markets into exponential growth. This has also allowed the European risk capital industry to become stronger and more mature. Since the adoption of the RCAP (1998) venture capital investments in Europe has **multiplied by three** and investment in “early stage” by **four**. As a result, investment in “early stage” in 2000 has been equivalent to the total venture capital investment in 1998. From that point of view the mid-term point of the RCAP shows real progress. This optimistic valuation, however, should be tempered when comparing with the USA. Indeed, in 1998 investment by the US venture capital industry was approximately twice that of Europe, in 1999 triple, and in 2000 four times bigger. The gap, therefore, seems to be widening. The size of the US industry is not only much bigger but their larger investments have been growing at a faster rate. If this trend continuous, the ambitious objectives set in Lisbon, which go well beyond those in the RCAP (to foster economic growth and job creation), would become unattainable.

*Still a long way to go to be on track for 2010*

The figures above imply that, in spite of the progress in recent years, there are not, at present, enough entrepreneurs in Europe with the capacity to create and propose a world class flow of innovative projects and companies, which could become the target of risk capital financing. Therefore, for Europe to become much more entrepreneurial, the completion of RCAP, regardless of cyclical considerations, should be a **top political priority**. The emphasis now should be on the “demand” side (e.g. developing and consolidating innovations, with commercial potential, from R&D). Moreover, risk capital considerations should continue to be fully embedded in all Community and national policies. In this regard, to properly track the degree of implementation of the RCAP by Member States<sup>48</sup> much more detailed information is required from them, on an on-

*More information from Member States is needed*

*The new situation requires a*

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<sup>47</sup> An example along those lines, often cited and generally regarded as successful, is the American programme known as *SBIC (Small Business Investment Programme)* which is administered and supported through a guarantee by the *SBA (Small Business Administration)* of the US Federal Government.

<sup>48</sup> Belgium sent to the Commission, in early 2001, a full report on the RCAP implementation : “*Contribution(s) de la Belgique à la Mise en Oeuvre du Plan d’Action Capital-Investissement*”, December 2000

going basis. The incoming national **progress reports on structural reform** should be the first important step of that process. *rethinking of strategy*

Finally, the current difficult market conditions and the surrounding climate of uncertainty, exacerbated by the dramatic events of 11 of September 2001 in the USA, may certainly provoke consolidation in the industry, as well as a rethinking of their strategy.

**LIST OF ANNEXES**

**Annex 2. - RCAP – Layout by type of barrier**

**Annex 3. - Acronyms used in the RCAP**

**Annex 4. - Glossary of terms used in the RCAP**

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

LAYOUT BY TYPE OF BARRIER – SITUATION IN OCTOBER 2001

**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***

<b>Measure</b>	<b>Objective</b>	<b>Responsibility/Participation</b>	<b>Situation</b>
Develop networks of business angels at regional, national and Community levels		<i>Private sector Member States Commission</i>	<i>Action started in 1998 and finished in 2000. 20 Networks have been supported by the Commission. Evaluation of the results launched in August 2001.</i>
Market monitoring and development of information and statistics on all levels of venture capital in the EU		<i>EVCA Commission Market players</i>	<i>On-going</i>
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	<i>Commission Member States Market players (regulatory bodies, new capital markets, venture-capital funds, banks, etc.)</i>	<i>The round table took place on 24 October 1998 in Brussels</i>
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	<i>Commission Market players (banks, venture-capital funds, capital markets, etc..)</i>	<ul style="list-style-type: none"> <li><i>• The Commission has launched in July 2001 a study on Corporate Financing</i></li> <li><i>• For tax related impact see Commission study referenced in Chapter 4</i></li> </ul>

**INSTITUTIONAL AND REGULATORY BARRIERS**

<b>Measure</b>	<b>Objective</b>	<b>Responsibility/Participation</b>	<b>Situation</b>
Transposal and implementation of all financial services directives - monitoring via single market scoreboard		<i>Member States Commission</i>	<i>See scoreboard in Figure 5 (section 3)</i>
Simplification of administrative formalities for company formations (including minimum capital requirements)		<i>Member States Commission (disseminating best practice)</i>	<i>Figures and evolution will be made available by the end-2001 through the Benchmarking Exercise (see section 5)</i>
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	<i>Commission Council EP  Industry : - EFIFC - EVCA - Small business</i>	<i>UCITS Contact Committee and industry representatives met on 18 November 1998 in Brussels. Consensus that an ad-hoc directive was not needed.</i>
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	<i>Commission Council EP  Capital markets (competent authorities and small businesses)</i>	<i>Commission proposal adopted on 30 May 2001</i>

***INSTITUTIONAL AND REGULATORY BARRIERS (Continuation)***

<b>Measure</b>	<b>Objective</b>	<b>Responsibility/Participation</b>	<b>Situation</b>
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	<b>Member States</b> <b>Commission (follow-up to the Green Paper on supplementary pensions)</b>	<ul style="list-style-type: none"> <li>• <i>UCITS common positions adopted on 5 June 2001</i></li> <li>• <i>Commission proposal on pension funds adopted on 11 October 2000</i></li> </ul>
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)	<b>Member States</b> <b>Commission</b> <b>Accounting Bodies</b>	<i>Commission proposal on international accounting standards adopted on 13 February 2000</i>
Reduction of the capital requirements for setting up firms	Facilitate the setting up of firms	<b>Member States</b>	<i>Figures and evolution will be made available by the end-2001 through the Benchmarking Exercise (see section 5)</i>
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	<b>Member States</b> <b>Commission (dissemination of best practice)</b>	<i>A Seminar on “Business Failures” was organised in May 2001. A report will be made available in Autumn 2001. A study on “Bankruptcy and a Fresh Start” expected to be launched by the Commission before end-2001.</i>

*BARRIER : TAXATION*

<b>Themes</b>	<b>Issues to consider</b>	<b>Responsibility/Participation</b>	<b>Situation</b>
Taxation of venture capital funds	Double taxation	<i>Member States</i>	<i>Several measures have already been taken by a number of Member States (See Commission study referenced in section 4)</i>
Capital gains tax	Impact on venture capital	<i>Member States</i>	
Tax arrangements for new firms	Fiscal environment for start-ups	<i>Member States</i>	
Taxation of low-risk capital (e.g. bank deposits, bonds compared with venture capital)	Situation in Member States	<i>Member States</i>	
Stock options	Impact on recruitment and company performance	<i>Member States</i>	<i>Study to be launched by the Commission before end-2001</i>

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

<b>Measure</b>	<b>Objective</b>	<b>Responsibility/Participation</b>	<b>Situation</b>
Development of networking and clustering between universities, research centres, financial backers, lawyers, human resources specialists, etc. and link them at European level		<i>Private sector</i> <i>Member States</i> <i>Commission (pilot schemes, disseminating best practice, Fifth Framework Research Programme)</i>	<i>Envisaged in the Commission's new R&amp;D Framework Programme proposal of February 2001. The "Biotechnology &amp; Finance Forum" active since end-1997 would provide a role model</i>
Development of customised electronic commerce modules for small businesses to ease their access to electronic commerce and the internal market		<i>Private sector</i> <i>Member States</i> <i>Commission (pilot schemes)</i>	<i>Commission adopted a Communication on "GoDigital" on 13.03.2001</i>
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	<i>Market players (small businesses, venture-capital funds, etc.)</i> <i>Commission</i>	<i>The European Federation of High Tech Enterprises was created in 1999</i>
Reform of the European patent system	Following on from the Green Paper, simplify procedures and create a genuine Community patent	<i>Commission</i> <i>Member States</i> <i>EP</i>	<i>Commission proposal adopted on 5 July 2000</i>

**BARRIER : HUMAN RESOURCES**

Measure	Objective	Responsibility/Participation	Situation
Promotion of entrepreneurship and innovation within educational and training systems		<b>Member States Commission (disseminating best practice)</b>	<i>A BEST procedure project aiming to the promotion of an enterprise culture, from primary school to university, has been launched. First meeting with experts took place in June 2001. Final results are expected in September 2002. For other initiatives see Section 5.</i>
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	<b>Commission Market players</b>	<ul style="list-style-type: none"> <li>• <i>Training schemes have been set up by EVCA. Courses are regularly offered to market participants</i></li> <li>• <i>“Seed-Capital Action”, to be managed by the EIF, would concentrate on junior investment managers</i></li> </ul>
Assessment of benefits of equity pay and employee ownership schemes	Begin study of future at European level	<b>Member States Commission Social partners</b>	<i>A Commission consultative document was released in July 2001 (see section 5)</i>

***CULTURAL BARRIERS***

<b>Measure</b>	<b>Objective</b>	<b>Responsibility/Participation</b>	<b>Situation</b>
Demonstration of the advantages of venture capital and promotion of entrepreneurship		<i>Private sector</i> <i>Member States</i> <i>Commission</i>	<i>A number of conferences at national and international level have been organised with the participation of Commission officials (see section 5)</i>
Dissemination of best practices in corporate governance	Facilitate the dissemination of corporate governance practices demanded by investors	<i>Private sector</i> <i>International bodies</i> <i>Commission</i> <i>Member States</i>	<i>Commission call for tender for a comparative study was published on 21 March 2000. Results expected before end-2001.</i>

**ACRONYMS USED IN THE RCAP**

<b>AIM :</b>	Alternative Investment Market ( <a href="http://www.londonstockexchange.com/aim">www.londonstockexchange.com/aim</a> )
<b>BEPG</b>	Broad Economic Policy Guidelines
<b>BEST :</b>	Business Environment Simplification Task Force. Established by the Commission in September 1997
<b>BSPCE :</b>	The French “ <i>Bons de Souscription des Parts et Créateurs d’Entreprises</i> ”
<b>CSER :</b>	Committee of European Securities Regulators
<b>CVC :</b>	Corporate Venture Capital
<b>EASDAQ :</b>	European Association of Securities Dealer Automated Quotation. Renamed “NASDAQ-Europe” ( <a href="http://www.nasdaqeurope.com">www.nasdaqeurope.com</a> )
<b>EIB :</b>	European Investment Bank ( <a href="http://www.eib.org">www.eib.org</a> )
<b>EIF :</b>	European Investment Fund ( <a href="http://www.eif.org">www.eif.org</a> )
<b>EJC :</b>	The European Court of Justice ( <a href="http://www.curia.eu.int">www.curia.eu.int</a> )
<b>ESC :</b>	European Securities Committee. It replaces the High Level Securities Supervisors Committee
<b>EURO. NM :</b>	Nouveau Marché (Paris) + Neuer Markt (Frankfurt) + Nouveau Marché (Brussels) + Nieuwe Markt (Amsterdam) + Nuovo Mercato (Milan)
<b>EVCA :</b>	European Private Equity and Venture Capital Association ( <a href="http://www.evca.com">www.evca.com</a> )
<b>FESCO :</b>	Forum of European Securities Commissions ( <a href="http://www.europefesco.org">www.europefesco.org</a> ). See also the CSER*

<b>FIBV:</b>	Federation Européenne des Bourses de Valeurs/International Federation of Stock Exchanges ( <a href="http://www.fibv.com">www.fibv.com</a> )
<b>FSAP</b>	Financial Services Action Plan
<b>IAS :</b>	International Accounting Standards
<b>ICT:</b>	Information and Communication Technology
<b>ISD :</b>	Investment Services Directive (93/22/EEC)
<b>IT :</b>	Information Technology
<b>MAP</b>	Multi-annual Programme for Enterprise and Entrepreneurship
<b>NASDAQ :</b>	The American National Association of Securities Dealers Automated Quotation system ( <a href="http://www.nasdaq.com">www.nasdaq.com</a> )
<b>R&amp;D</b>	Research and Development
<b>RTD :</b>	Research and Technological Development
<b>SME :</b>	Small and Medium sized Enterprise
<b>UCITS :</b>	Undertakings for Collective Investment in Transferable Securities (Investment Funds)
<b>US GAAP :</b>	The American Generally Accepted Accounting Principles
<b>VC</b>	Venture Capital

## ANNEX 4

### 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 many cases they also facilitate 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 reasons. Predominantly used by large corporates to support external technology development.
- Development capital:*** Financing provided for the growth and expansion of a company.

<b><i>Early stage capital:</i></b>	Financing to companies before they initiate commercial manufacturing and sales, before they be generating a profit. Includes seed* and start-up* financing.
<b><i>Equity:</i></b>	The ordinary share capital of a company.
<b><i>High level Securities Supervisors Committee :</i></b>	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*)
<b><i>Institutional investors:</i></b>	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).
<b><i>Investment Services Directive:</i></b>	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.
<b><i>IPO:</i></b>	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.
<b><i>Management buy-out:</i></b>	Financing provided to enable current operating management and investors to acquire an existing product line or business. Also known as MBO.
<b><i>Market capitalisation:</i></b>	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.
<b><i>Primary market:</i></b>	Market into which a new issue of securities is launched.
<b><i>Private equity:</i></b>	As opposed to public equity, equity investment in companies not listed on a stock market. It includes venture capital and buy-out investments.

<b><i>Prospectus:</i></b>	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.
<b><i>Prospectus Directive:</i></b>	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)
<b><i>Prudent-man regulation:</i></b>	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.
<b><i>Regulated markets:</i></b>	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.*
<b><i>Replacement capital:</i></b>	Purchase of existing shares in a company from another venture capital investment organisation or from another shareholder or shareholders.
<b><i>Risk capital markets:</i></b>	Markets providing equity financing to a company during its early growth stages (start-up* and development*). In the framework of this communication, it covers three sorts of financing: <ul style="list-style-type: none"> <li>• Informal investment by Business Angels* and corporates (“Corporate Venturing”*)</li> <li>• Venture capital.</li> <li>• Stock markets specialised in SMEs and high growth companies.</li> </ul>
<b><i>Secondary market:</i></b>	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.
<b><i>Security:</i></b>	A financial asset, including shares, government stocks, debentures, bonds, unit trusts and right to money lent or deposited.

<b><i>Seed capital:</i></b>	Financing provided to research, assess and develop an initial concept.
<b><i>Start-up capital:</i></b>	Provided to companies for product development and initial marketing.
<b><i>Stock exchange or Stock Market:</i></b>	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.
<b><i>Stock option:</i></b>	Option given to employees and/or managers to buy shares at a fixed price.
<b><i>Venture capital:</i></b>	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*.
<b><i>Venture capital funds</i></b>	Closed-end funds, created to provide venture capital.

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