European Association of Development Agencies
Association Européenne des Agences de Développement

ALL MONEY IS NOT THE SAME!

What for whom ?

Christian SAUBLENS
March 2013 – Rev. 5

EURADA – Avenue des Arts, 12 – B-1210 Bruxelles
Tel. +32 2 218 43 13 – Fax. +32 2 218 45 83
info@eurada.org www.eurada.org

Table of Contents

List of Tables

List of Graphs

eurada

Preface

Promoting Funding Source Diversity

Public subsidies have long been associated with sink grants rather than loan and guarantee schemes and venture capital supply. Such grants are used to help certain industries finance infrastructure or businesses (under so-called industrial policies), to attract FDI ("regional policies") or as recruitment or training subsidies ("social policies"). However, several public decision-makers at regional, national and EU level alike have come to realise that as an instrument and compared to traditional grants, financial engineering provides much better value for money. Unfortunately, it also remains relatively unknown. This document seeks to clarify the concept and practice of financial engineering and to outline a tentative analysis of its effectiveness as a tool for regional development and also possibly against unemployment.

Indeed, multiple studies have shown – in a rare display of academic consensus – that there is a strong positive correlation between the availability of sources of finance for newly-established businesses in a given region or country and the number of start-ups with growth ambitions there. Furthermore, adequately-funded businesses are better able to deliver their growth strategy. Giving companies with growth ambitions access to financial resources helps kick-start economic growth and hence creates jobs.

The defining feature *par excellence* of dynamic regions is the existence of a varied supply of financial sources, of adequate demand for finance among entrepreneurs and of an efficient platform to match funding supply and demand. It is in the interest of regional dynamism to ensure that all financial instruments complement each other and are adequately available and accessible to businesses. Such instruments include all types of external capital (bank loans), own capital (equity from family and friends, formal venture capital and business angels) as well as subordinated loans. Besides, entrepreneurs also need to be aware of the fact that every type of finance has a specific role to play during the business lifecycle.

This being said, access to finance is still a key obstacle to business development and fast growth. Entrepreneurs have an affinity for debt to finance the start-up and growth stages of their businesses. On the other hand, bank loans are obviously secured only by businesses providing adequate guarantees of reimbursement. To limit the risk taken by banks, collateral is required. The amounts demanded by banks as collateral varies considerably depending on the risk rating of their clients. The ability of businesses to provide such guarantees varies according to the industry in which they operate and to the distinctive nature of their specific assets. In other words, the younger and the smaller a company, the less likely it is to provide adequate guarantees. Bank reluctance when it comes to ensuring business access to loans is further complicated by the internationalisation of the banking industry, by the stigma of the financial crisis and by the enforcement of the Basel III Agreement. A very high risk of default among start-ups put bank customer savings at "illegitimate" risk. Due to inadequate guarantee requirements, loans are not granted and the growth ambitions of many companies never materialise.

So for years now, there has been a chorus extolling the virtues of further developing venture capital – all the while not neglecting the role that banks *can* play in support of start-ups. The term "(formal) venture capital" refers to funds that make (quasi-)own equity temporarily available to businesses through investment funds. Actually, there is no shortage of venture capital. The problem – as illustrated by the figures presented in this document – is that while this type of capital is accessible to growing businesses, it is not readily available for start-ups or early-growth businesses. In fact, as global VC market figures grow, the share of funds available at the seed stage of the business lifecycle becomes smaller.

However, this is a gap that cannot be bridged substituting the public for the private sector but rather by stimulating the private sector through provision of complementary funding under preferential conditions reducing the cost of equity. Europe is reluctant to meddle with this eminently private market and often either opts for "laissez faire" or sets up public funds. Public intervention on this market, at the seed stage, seems desirable.

Besides, studies have shown that 70% of all seed capital investors in the US are somehow government-backed. The biggest US scheme in this context are Small Business Investment Companies (SBICs), venture capital funds recognised by the SBA (Small Business Administration) and empowered to raise money on financial markets up to a share of their own assets. This way, subscribers investing into SBICs enjoy the SBA guarantee. This scheme is particularly clever in that the government guarantee extends to the whole asset portfolio, thereby providing leverage. This concept differs from venture capital-backed guarantee schemes as set up in Europe, which are specifically project-based, thus not only encouraging projects of doubtful profitability (a negative selection bias) but also breeding the inevitable bureaucracy associated with such provision. In budget terms, it is little surprising to find out that the US SBIC scheme is self-supported. In economic terms, an estimated 70% of all seed investment deals (i.e. infusions of venture capital in start-ups) happen through SBICs, creating roughly 200,000 jobs a year. In designing the European objectives of the EU 2020 strategy, why was no hard target specified for venture capital investment and in particular for seed capital?

Reading the above, it is little surprising that Christian Saublens, Director General of EURADA, the European Association of Development Agencies, developed a keen interest for business finance. In his document entitled "All Money is Not the Same", he takes stock of all existing financial instruments. This document, which is updated and supplemented almost yearly, has become a tool for many regional development stakeholders.

First and foremost, this document should be the tool used by all regions to assess instruments and platforms and determine which are lacking or insufficiently developed. It can then become a checklist to audit financial instruments. It should also enable more synergies to emerge between different financial instruments, as simply lining them up at regional level often causes them to be ineffective.
Then, this document is an ideal tool to benchmark and exchange best practices within Europe and beyond. This way, it can make regional interventions more efficient and possibly improve the effectiveness of structural funding in Europe.

This document may also inspire public decision makers at EU level to expedite the transition from a subsidy-based policy to one that is more geared toward financial engineering.

And finally, this document is a very good tool for anyone who wants to learn about financial instruments in a practical way. When my students have to make a presentation about the Miller-Modigliani theorem, it seems to me that learning how things are done in the real world is so important that Christian's document has been on my "must read" list for years.

As far as I am concerned, this document should be read by anyone involved in regional development or with a general interest in economics or in business finance in particular.

I hope you enjoy reading this document and especially applying its lessons.

Rudy Aernoudt
Professor, Corporate finance
Universities of Ghent and Nancy
Head of Cabinet of the President of the European Economic and Social Committee

Foreword

Access to finance often remains one of the key factors in setting up and developing SMEs. It is an issue that is common to all European Union Member States, and possibly one that also affects a number of States in the USA. It is increasingly recognised that SME access to finance is hampered by a number of market failures. In the document entitled "EU 2020 Flagship Initiative: The Innovation Union"[1], EU Commission services indicate that the US invest €15 billion more than Europeans annually.

Europe is characterised by its very diverse cultural context. This diversity is also apparent in the fields both of entrepreneurship and corporate finance. Clearly, the European Union can currently be described as a dual world with an Anglo-Saxon and a Latin component. Differences are measurable in terms of:

- a preference for subsidies;
- the degree of acceptance among businesspersons of third-party investment in their company;
- the variety of funding sources available;
- the level of maturity of the different market segments that constitute the business finance value chain;
- the physical and cultural proximity of investors and entrepreneurs;
- the absence of public schemes helping innovative SMEs secure their first order (SBIR, public procurement, etc.).

Public authorities in Europe also share issues relating to the formulation of programmes that actually address genuine equity gaps, and the lack of sufficiently varied funding procurement channels available to SMEs. This was highlighted by Professors C. Mason and Harrison in a paper already published in the October 2003 issue of *Regional Studies*. Indeed, they argued convincingly that when the UK's DTI (Department of Trade and Industry) and RDAs (Regional Development Agencies) set up regional public venture capital firms using a supply-based approach, they did not manage to address the very real equity gap issue because they overlooked a number of aspects relating both to the demand side and to value chains. To be really effective, the programme should also have considered:

> "initiatives to improve the demand side of the market, including a programme which helps business to become investment ready, better funding of the present system of business angels networks to enable them to more effectively address the inefficiencies in the informal venture capital market and extending eligibility for co-funding to organized angel syndicates in order to access classic venture capital skills*".*

For entrepreneurs, it is important to understand that all forms of finance do not have the same aims. Similarly, the motivations and criteria of different funding parties will vary according both to the type of product presented and the level of risk linked to it. Therefore, business plan quality and content, as well as its presentation to potential investors need to be adjusted to their respective specific requirements. This explains the Anglo-Saxon expression "all money is not the same".
Appropriate ways of addressing potential investors' expectations is something would-be investees can prepare for by attending an investment readiness programme or by passing through an incubator, hoping that some of them will one day become SME growth accelerators

To mention but a few recent "overnight" SME success stories, one may wonder whether developers such as Andrew Mason (Groupon), Mark Zuckerberg (Facebook), Jack Dorsey (Twitter) and Mark Pinkus (Zynga) would have met with the same degree of success if they had been financed by EU venture capital firms. It is doubtful since[2] that the top three French e-commerce hits (Vente Privée, Price Minister and Meetic) did not!

---

[1] Doc. COM(2010) 546 final, 6.10.2010
[2] Les Echos, 11.12.2010

Early lessons learned from the financial crisis that started in 2008 show that businesses that manage to innovate and/or export enjoy positive growth, contrary to those who do not.

Worth underscoring is the importance of equity and the ability of businesses to reinvest profits to succeed. It is useful to readily highlight the differences that exist between companies in different Member States when it comes to the ability to reinvest profits. For instance, German businesses have more available cash flow (107%) than French companies (67%). The total outstanding debt of French businesses equals 103% of GDP v. 77%, 85% and 135% respectively in the case of German, Italian and Spanish businesses.[3] This no doubt explains the size and dynamism of German SMEs in spite of the crisis.

Despite many reports underscoring the structural weakness of the European venture capital industry and the lack of financial resources for start-ups trying to market innovative ideas, national public policies still support traditional businesses in crisis rather than investing in financial engineering.

France and the UK for instance, each spent more than €1 billion in 2 years on old car scrapping premiums, i.e. the same as CIP spent in 7 years financing seed capital under instruments MIC1 & 2!

Worth recalling finally is that the number of businesses that can claim to access the most sophisticated forms of external finance is comparatively low. Indeed, only 30,000 businesses at most, secure formal or informal (business angel) venture capital or launch an IPO annually. As for the sums invested by business angels and venture capitalists in the EU, they totalled €9 billion (50-50%) in 2011.

[3] Coface: Panorama – Défaillances d'entreprises. Automne 2012 http://www.coface.fr/CofacePortal/ShowBinary/BEA%20Repository/FR_fr_FR/documents/Panorama/panorama-defaillances-entreprises.pdf

Introduction

1. The Stakes

Access to funding sources is an issue that for years now has featured regularly among business managers' top three or four concerns or obstacles to SME growth.

Without questioning the findings of surveys and research, it is useful to recall that each source of funding corresponds to a precise stage in the business life cycle – hence the title of this document – and that granting SMEs funding remains a source of risk for investors.

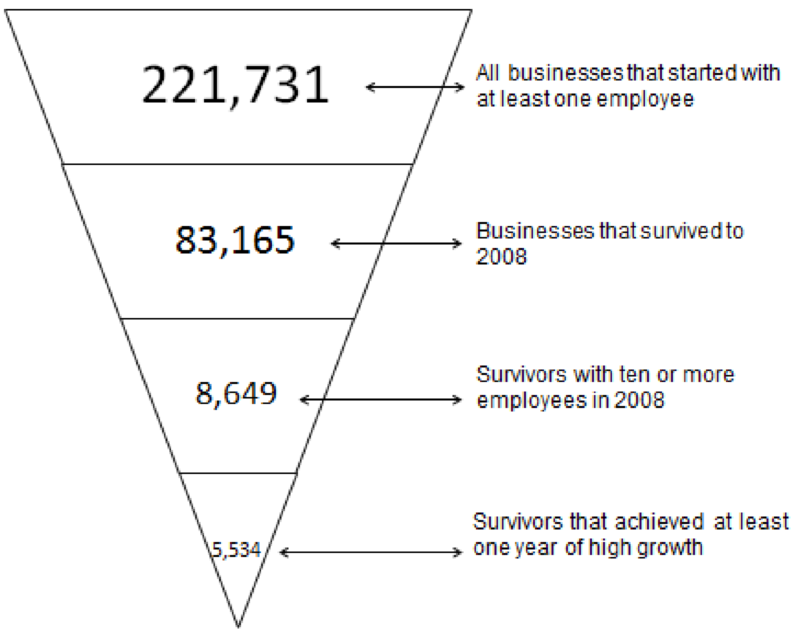
The two realisations above are illustrated by the data below:

a) A wide variety of funding sources are leveraged more or less intensely by SMEs. Indeed, according to an Oxford Economics study,[4] it appears that SMEs mostly finance their growth as follows:

→ owner's aquity	45%
→ reinvestment	40%
→ loans (3+ years)	35%
→ bank loans	35%
→ supplier credit	30%
→ loans (up to 3 years)	25%
→ venture capital	20%
→ factoring	10%

Source: Oxford Economics / EFG

b) NESTA notes that 40% of UK start-ups still exist 10 years later. Among them, less than 10% employ more than 10 people.



Source: (2011) 'Vital Growth: the importance of high-growth businesses to the recovery". London: NESTA

4 Oxford Economics, The Use of Leasing Among European SMEs, November 2011

2. Community Support in the Field of Financial Engineering

In the field of financial engineering, the EU mainly acts through five instruments: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Competitiveness and Innovation Framework Programme (CIP), the 7th Research and Technological Development Framework Programme (FP7) and the European Investment Bank (EIB) and European Investment Fund (EIF).

The Table below characterises each of those instruments.

Table 1 Community Instruments

Instrument	Tools	Delivery	Target Groups
ERDF / ESF	All types: loans, venture capital, guarantees, micro credit, etc.[5]	Regional Operational Programmes or JEREMIE Operational Programmes[6]	Businesses (primarily SMEs)
CIP	Venture capital loans and equity MIC1 & 2	Support through EIF-accredited intermediary bodies	Financial intermediaries
FP7	Subsidies and RSFF (risk Sharing Finance Facility)	Businesses, direct contacts or through financial intermediaries	Businesses, research centres, universities
EIB / EIF	Loans, venture capital and guarantees	Direct contacts or through financial intermediaries	Businesses, universities, research centres, financial organisations, investment funds

There are two formats of EU intervention on behalf of businesses: direct through subsidies or loans and indirect through allocation of resources to intermediary financial organisations that in turn finance SMEs through loans and venture capital or loan guarantees.

The nature and positioning of EIB and EIF intervention are summarised in the graph below.

Worth underscoring is that the cohesion policy does not monitor in detail how regions invest in financial engineering as this investment is aggregated under the "Other investment into SMEs" heading of the list of priority intervention categories (earmarking). Worth noting however is that the amount of this category totalled €14 billion for the 2007-2013 period.

5 Cf. http://ec.europa.eu/regional_policy/archive/funds/2007/jjj/doc/pdf/cocof_guidance_note3_en.pdf
6 JEREMIE O.P. can be either at national or at regional level

Graph 1 The Risk Sharing Finance Facility (EIB and EIF)

1 Risk Capital	2 CIP Resources (SME)	3 RSFF (SME / MidCap)
• Facility: High Growth Innovative SME Scheme (GIF), Ecotech • Purpose: IP financing, technology transfer, seed financing, investment readiness • Target Group: VC Funds, Business Angels • EIF Product: Fund-of-Funds	• Facility: CIP Guarantee schemes • Purpose: Growth financing for SMEs • Target Group: Formal VC Funds, CLOs • EIF Product: SME guarantees (loans, microcredit, equity/ mezzanine, securitization)	• Facillilty: RSFF • Purpose: RDI financing • Target Group: SMEs/MidCaps, Banks, PE Investors • EIB/EIF Product: Loans (incl. Mezzanine), Funded Risk Sharing Facilities with Banks (Investors)

A few examples of projects financed with the different Community instruments are to be found below.

JEREMIE

In mid-2012, more than 30 holding funds were being implemented in 15 Member States as part of the JEREMIE initiative, 14 of which decided to entrust management of their funds to the EIF while other funds have their own managers (see examples in the table). 3.5 billion Euros are legally committed in these 30 holding funds.

The table below presents the geographical breakdown of these projects.

Table 2 JEREMIE projects

EIF Management		**Other institutions**	
Member States	Greece Romania Latvia Lituania Slovakia Cyprus Bulgaria Malta	Member States	Hungary Lituania Spain Poland
Regions	Languedoc-Roussillon (F) Campania (I) Sicilia (I) Calabria (I) Sicilia (I)[7] Provence-Alpes-Côte d'Azur (F)	Regions	Wales (UK) North East of England (UK) North West of England (UK) Yorkshire & Humberside (UK) Andalucia (E) Cataluña (E) Auvergne (F) Lombardia (I) Wielkopolska (PL) Pomerania (PL) Lower Silesia (PL) Lodzkie (PL) Western Pomerania (PL) Eastern Poland (PL)

When it comes to national funds, the amounts managed by the EIF vary between €10 million in the case of Malta and €290 million in Lithuania and between €30 million and €90 million respectively in Languedoc-Roussillon and Campania when it comes to regional funds.

7 European Social Fund

JASMINE

JASMINE, Joint Action to Support Micro-finance Institutions in Europe, is a joint initiative of the Commission and the EIB group to support non-bank micro-credit providers in the EU. JASMINE seeks to help non-bank micro-credit providers improve their governance, information systems, risk management and strategic planning with a view to have a better access to the private capital markets, to expand and to become sustainable.
More information on http://ec.europa.eu/regional_policy/thefunds/instruments/index_en.cfm

14 non-banking organisations were selected under the first stage of delivery of this joint EIB / DG Regio initiative. Worth noting are for instance:

- ✓ Créasol (F)
- ✓ The Prince's Youth Scottish Business Trust (PSYBT) (UK)
- ✓ Premico (I)
- ✓ Foundation for regional enterprise promotion of the town of Székesfehérvar (FREPS/FEA) (H)
- ✓ NACHAZA (BG).

Risk Sharing Finance Facility

The largest amounts of finance granted under the Risk Sharing Finance Facility were allocated to:

- Nokia Siemens Networks single RAN RDI
- Car efficiency and safety RDI – Valéo (F)
- Autoliv Safety Systems R&D (S)
- Alphasat
- Advanced Lithography: Carl Zeiss (D)
- Thyssen Krupp Technologies RDI (D)

European Investment Bank / European Investment Fund

→ Research Infrastructures

- IMEC's Nanotechnology R&D Centre – Leuven (B)
- Free Electron Laser – Trieste (I)
- European Molecular Bi0logy Laboratory (EMBL) – Heidelberg (D)

→ Education and innovation

- Knowledge-based economy in the UK: £500 million for the Royal Bank of Scotland, Lloyds TSB, Santander UK. The funds will be used to modernise the campus and build dedicated technology centres and business incubators.

→ Technology transfer funds

- UNIP Premier Fund, University of Manchester (UK)
- Chalmers Innovation Seed Fund (S)
- KUL Leuven (B)
- Karolinska Development (S)
- IP Group (UK): a consortium of ten British universities, of which the universities of Glasgow, Bath, Southampton, Surrey,…

→ Action on behalf of the climate

The EIB plans to invest 20% of its loan arm into action on behalf of the climate. Notable among funded projects are:

- The programme of the Provincial Council of Barcelona (E) in favour of energy and climate change;
- The joint programme of KfW and the EIB to buy carbon quotas.

→ **Joint investment & co-investment alongside business angels networks: European Angels Fund (EAF)**

In 2012, the European investment fund supported two business angels network co-investment funds: the first one in Germany in partnership with BAND (the national business angels network) and the second one in Spain in cooperation with Axis, a subsidiary of *Instituto Crédito Oficial* (ICO). This fund is called *European Angels Fund – Fondo Isabel La Catolica*; its interventions on behalf of SMEs will range between €250,000 and €5 million. The agreement between the EIF and Axis is for €20 million.

Horizon 2020

For the period 2014-2020, DG Research & Innovation wants to develop a new financial instrument for SMEs with the features described below.

Table 3 Characteristics of the SME finance facility of Horizon 2020

	Phase 1: Concept and feasibility assessment	**Phase 2: R&D, demonstration, market replication**	**Phase 3: Commercialisation**
Idea / Concept = Business plan I	Feasibility of concept Risk assessment IP regime Partner search Design study Pilot application intention Business plan II **Lump sum: around €50,000** **Approx. 6 months**	Development, prototyping, testing Piloting innovative processes, products and services Miniaturisation, design of products Planning and developing scaling-up (market segments, process) Market replication Business plan III **Output based payments: 1 to 3 million € EC funding** **12 to 24 months**	Quality label for successful projects Facilitate access to private finance Support via networking, training, coaching, information, addressing i.a. IP management, knowledge sharing, dissemination SME window in the EU financial facilities (debt facility and equity facility) **No direct funding**
	Mentoring and coaching services accompanying the grant		

Source: European Commission

Chapter 1 The Market

1.1 Definitions of Funding Sources

- **Business angels (informal venture capital)**: private individuals who invest part of their estate in start-ups in the form of venture capital and also contribute their personal managerial expertise.
- **Business Angels Networks (BANs)**: standing regional platforms that promote the matching of business angels with potential investees.
- **Buyouts**: existing investors' shares in a business are bought by the latter's own management team (MBO – Management Buy Out) or by another management team supported by a venture capital fund.
- **Corporate venturing**: venture capital invested by existing firms for the purpose of funding innovative businesses set up by their own staff or active in industries considered of strategic importance.
- **Crowdfunding:** a process whereby a large number of individuals – generally web users – fund a project via a personal contribution in the form of equity or a loan.
- **Development or expansion capital**: financing provided for the growth and expansion of a company, which may or may not break even or trade profitably. Capital may be used to: finance increased production capacity; market or product development; provide additional working capital.
- **Early stage (or start-up) finance**: equity invested in businesses that are past research and development but need additional funding to market their products and services.
- **Equity**: ownership interest in a company, represented by the shares issued to investors.
- **Expansion**: growth, bridging or restructuring capital.
- **Factoring**: a technique whereby SMEs sell invoices to specialised firms.
- **Financial package**: a combination of different funding sources.
- **Grants**: subsidies paid—without an obligation to refund—by public authorities to companies investing in a region for the purpose of facilitating their establishment or expansion.
- **Growth accelerator:** an advisory and matching platform where tech start-ups and investors meet to allow businesses to access financial resources, new markets and specialist expertise.
- **Investment readiness**: set of advice given to to entrepreneurs in order to better prepare them to meet with potential investors.
- **Leasing**: hire-purchase of capital goods.
- **Loans and debt**: the main sources of funding for SMEs.
- **Mezzanine**: combination of equity and loans. Applicable interest rates are often comparatively high.
- **Proof of concept**: finance provided to a researcher's team to support the validation of their business ideas. Often, the financial instrument takes the form of a grants and subortinated loans.
- **Quasi-equity investment instruments**: instruments whise return for the holder (investor/lender) is predominantly based on the profits or losses of the underlying target company, are unsecured in the event of default and/or can be convertible into ordinary equity.
- **Replacement capital** (also called **secondary purchase**): Purchase of existing shares in a company from another private equity investment organisation or from another shareholder or shareholders - an investor buys another's stake.
- **Risk capital**: Equity and quasi-equity financing to companies during their early-growth stages (seed, start-up and expansion phases) in the hope of a return on investment (ROI) that is both large and speedy, on a par with the level of risk taken.. It includes: (1) informal investment by

business angels; (2) venture capital; (3) alternative stock markets specialised in SMEs and high-growth companies.

- **Seed capital**: Financing provided to study, assess and develop an initial concept. It precedes the start-up phase. Seed capital is required to fund a business project before the product or service is marketed. Seed capital is often pivotal in high-tech projects to allow businesspersons to conduct surveys as well as research and development on prototypes that will become companies' core business.
- **Start-up capital**: Financing provided to companies for product development and initial marketing. Companies may be in the process of being set up or may already exist, but have not sold their product or service commercially and are not yet generating a profit.
- **Venture capital**: Investment in unquoted companies by investment funds (venture capital funds) that, acting as principals, manage individual, institutional or in-house money. It includes early-stage and expansion financing, but does not include replacement finance and buy-outs.

1.2 SME Finance Players

The market of enterprise financing includes many different types of players[8] who fit roughly into three main categories:

I. Venture capital players, including:

- business angels and their networks and syndicates;
- regional venture capital funds;
- corporate venturing firms;
- match funds (as set up by DTI's Small Business Service);
- incubators;
- clusters;
- stock exchanges;
- open-end innovation investment funds;
- crowdfunding platforms.

II. Loans and debt with:

- banks and other financial organisations;
- suppliers – the cheapest source of finance are the easy terms of payment they may grant!
- peers through P2P platforms (peer to peer)

III. Other sources, including:

- government grants;
- business competition prizes;
- factoring;
- leasing;
- refundable advances;
- commercial credit;
- crowdfunding;
- sale and lease back;
- research tax credit.

IV. Advantages in kind

- coworking;
- enterprise hotels;
- incubators;
- clusters.

[8] Source (among others): *Investors – A simple Guide to raising finance up to £1m*, www.envestors.co.uk

V. Support to commercialisation of new ideas

- export credit;
- precommercial procurement;
- technology showcase.

1.3 SME Finance Market Segmentation

I. Entrepreneurs' own assets as well as their families' and friends'

- entrepreneur's assets,
- profit reinvestment,
- friends and family savings,
- mortgage,
- credit cards,
- pre-payment of clients' orders,
- terms of payment,
- sharing enterprise real estate,
- employing family members with wages below the market price.

II. Start-up

- seed capital fund;
- loan on trust (i.e. without interest and/or guarantee);
- university and research centre spin-off funds;
- micro-credits;
- (semi-)public start-up and innovation funds;
- public subsidies;
- repayable short-term loans;
- proof of concept
- crowdfunding.

III. First financial Round

- business Angels;
- seed capital funds;
- bank loans/debt;
- guarantee schemes;
- (semi-)public investment funds;
- regional public venture capital;
- public subsidies;
- corporate venturing.

IV. Second financial Round

- private venture capital;
- bank loans;
- stock purchase warrants;
- mezzanine.

V. Other financial rounds

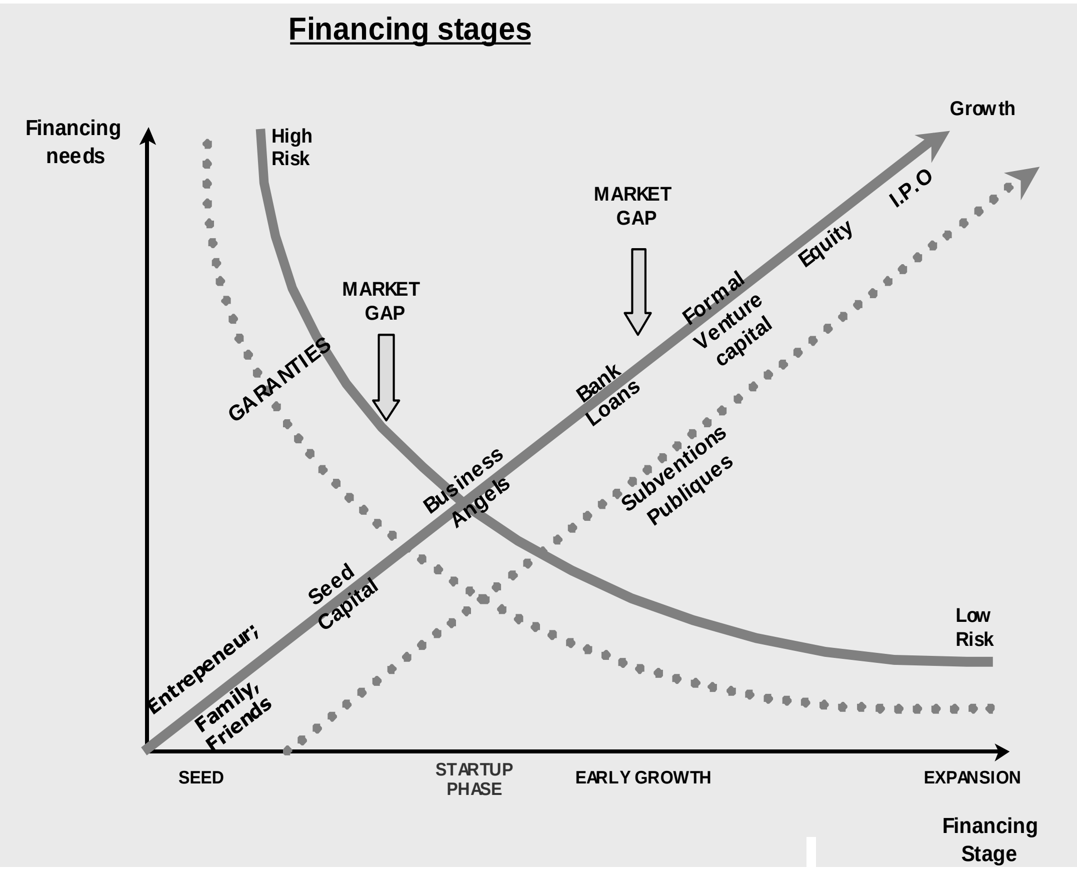
- initial Public Offer (IPO)—listing;
- bond issues;
- convertible bonds;
- leasing;
- factoring
- franchising.

If we cross the two above mentioned datas (providers and tools), we can notice that in a region there might be either a fragmentation of the market, or an overlapping of competences which give entrepreneurs the feeling that they are lost in a jungle. Some agencies try to overcome the situation by providing intermediation services or by developing an e-portal website aiming at helping SMEs to access useful information about the market segments. More recently, platforms that match innovative businesses with investors have been set up, mostly by the private sector – though sometimes with public sector support. Worthy examples include European TechTours[9], PwC's Accelerator[10] and the Plug and Play initiative in Silicon Valley, which is a growth accelerator comprising 300 start-ups. Such platforms can also be dematerialised, as in the case of Oséo INVESTnet[11].

Many experts have tried to link the sources of capital needed by SMEs according to their stage of development. The following figure illustrates that:

- the different funding sources available on the market are often tailored to a specific stage in the business lifecycle;
- individual funding sources are often adjusted to the development cycle of businesses, which needs to be based on individual SMEs optimum turnover potential.

Graph 2 Financing stages



Source : Rudy Aernoudt & Christian SAUBLENS

9 www.techtour.com
10 www.pwcaccelerator.com
11 http://investnet.capitalpme.oseo.fr

1.4 Typical amounts invested by individual funding sources

As evident from the Table below, the respective amounts that entrepreneurs can expect from the different categories vary according to the type of financial product and player involved.

Table 4 Amounts invested by funding sources

Products	***Venture capital investment range (in €)***
Loans without guarantee or interest	5.000 – 15.000
Micro-credits	3.000 – 30.000
Business angels	25.000 – 250.000
Seed capital	300.000 – 1.500.000
Early-stage finance—Start up	500.000 – 2.000.000
Venture capital	2.000.000 – 50.000.000
IPO	35.000.000 - 329.000.000[12]
Crowdfunding	< 100.000
Business angels side car funds	250.000 – 5.000.000
Corporate venturing	500.000 – 5.000.000

1.5 The equity paradox

We often hear and read that on the one hand, investors have money but don't find enough good projects, and, on the other hand, that entrepreneurs don't find enough funding sources to finance their project (which by essence are good ones).

Who is right?

It seems that the offer of risk capital is there but that not enough equity is dedicated to seed or early stage. EVCA (European Venture Capital Association) annual reports show that in general funds leverage more financial means than they invest.

If the supply of capital is not considered as the main obstacle of that market, the problem may come from the quality of the demand.

The demand problem can be classified in 3 fields:

- asymmetric information between the entrepreneurs' and investors' worlds;
- inefficient preparation of entrepreneurs willing to meet or meeting investors;
- a different perception of the innovativeness of entrepreneurs project.

1.6 Tailoring business plans to investor requirements

Once it is accepted that not all funding sources are equivalent in nature, it must also be recognised that it is essential for entrepreneurs to fully grasp the criteria whereby investors decide to invest or not. The table below seeks to list major criteria used by different types of investors as part of due diligence, i.e. the process of evaluating prospective deals.

[12] World Federation of Exchanges. Average amount of equity raised by newly-listed companies

Table 5 Priorities of SME equity/loan suppliers

Suppliers of capital	Criteria for accessing funding sources
Family, Friends and Fools	• Personal relationship based on trust
Business angels or informal investors and spin-off corporate venturing	• Meeting or matching of individual entrepreneurs with business angels • Atmosphere of trust between individuals • Credible business plan in the eyes of the Business Angel • Good management team • Fiscal incentives • Market knowledge of the entrepreneur • Availability of exit route • Return on investment (capital gain) • Share of total capital offered to investors
Banks	• Availability of guarantees or collateral • Perceived ability to repay the loan • Company track record • Rating • Good management
Repayable short-term loans	• Innovative nature of business projects • Business plan quality • Management team
Venture capital and Financial corporate venturing	• Business plan credibility • Business plan with patent technology • Track record (over previous years) • Ability to grow fast and deliver quick ROI • Management team quality • Share of total capital offered to investors • Shared management responsibility • Ability to report regularly on financial outcomes
Public funding	• New jobs • Investment in productive tools
Guarantees	• Stamina as well as technical and financial skills/abilities
Unsecured free of interest loans (loans on trust)	• Business plan credibility • Readiness to cooperate with a tutor
Seed capital funds	• Business plan quality • Perception of the innovative nature of the project • Good management • Intellectual property • High growth potential • Government tax policies
Corporate venturing	• Innovative nature of the project in relation to the company's core business • Industry-specific usefulness of the project, in particular from a technological standpoint • Business plan quality • Good management • Tax incentives
Institutional investors	• Business plan • Intellectual Property (IP) • High growth • Good management • Tax incentives from government

New capital markets	• Viability and consolidation • At least three years in existence • Positive results at least once within twelve months prior to application • More than €1.5 million in shareholder's equity • Ability to publish quarterly results • Public recommendation by analyst • Positive media attention • Government tax policies • Capable and experienced management team • Prominent Board • Experienced team of financial, legal and underwriter advisers • New business concept • Large market share • Record of high growth or high growth potential
Proof of concept	• Innovation • Management team • Entrepreneurship • Commercialisation / exploitation of intellectual property
Crowdfunding	• Interest in the project among the internet community • The amount to be raised • The investor's emotion • Possibility of dialogue with the entrepreneur through social networks

1.7 The equity gap

In general[13], a financial gap refers to a situation where firms that would merit financing cannot get it due to market imperfections. A specific case of financing gap is the equity gap, the lack of provision of private equity investments in the early stage of a firm's growth. The reasons for the existence of finance gaps can be linked either to the insufficient supply of funds or to inadequacies on the demand size. The gap can go from an investment size of less than €100.000 to over a million depending on the region or the country. In the UK the gap has been estimated to be between €400.000 and €3.000.000. For Germany, that gap extends to €5.000.000.
Some people[14] suggest that the equity gap is not a market failure as "SMEs find it hard to raise capital because capital markets understand only too well that many SMEs go bust and the survivors do not provide an adequate return for this risk. This is not market failure, this is the market working efficiently".

Regardless of the opinion of these experts, it is generally accepted at EU level that there are four types of structural gaps in the SME finance cycle:

- insufficient operators in the seed capital segment;
- insufficient investors to finance the seed stage of SME development;
- excessively fragmented venture capital markets;
- insufficiently fluid SME stock markets.[15]

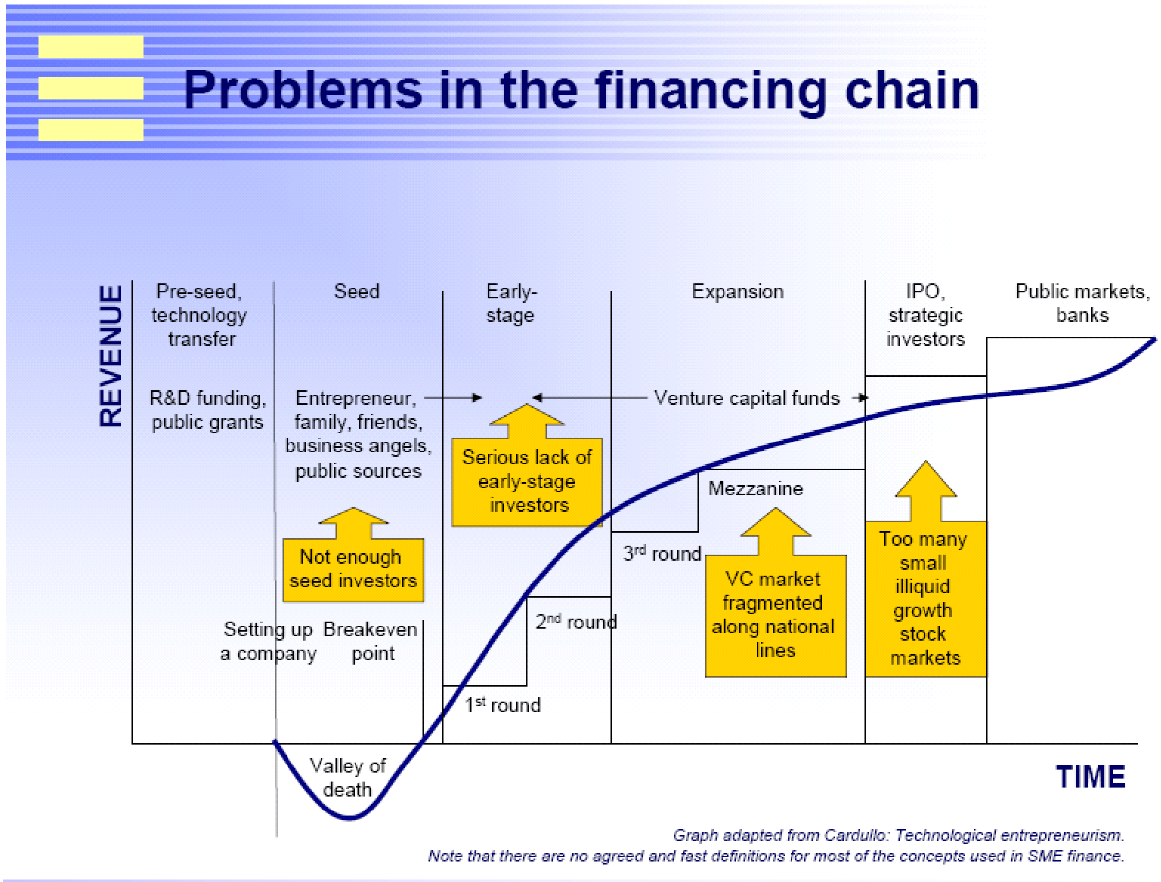
This phenomenon is illustrated in the graph below.

[13] DG Entreprise and Industriy, Expert group on best practices of public support for early-stage equity finance, April 2005

[14] Cf. Andrew Carter and David Walburn : *A case for excluding public policy programmes in support of SMEs from European Union State Aids controls*, September 2005

[15] Presentation by Vesa Vanhanen (DG Enterprise and Industry) at the EASY Seminar in Ljubljana on 19 May 2008.

Graph 3 Problems in the financing chain



Source : Presentation by Vesa Vanhanen (DG Enterprise and Industry) at the EASY Seminar in Ljubljana on 19.5.08

Following the 2008 financial crisis, the EU Commission acknowledged the existence of a venture equity gap for amounts below €2.5 million and adjusted its state aid rules accordingly.

The sovereign debt crisis and the solvency ratios imposed under the so-called Basel 3 agreements have increasingly complicated access to bank loans for businesses and venture capital funds alike. This situation is worrisome on two counts because:

- bank loans are the number one source of finance for SMEs (92% in France in 2011 v. 7% in the case of venture capital and 1% for financial markets);
- banks are one of the main equity suppliers of the venture capital funds industry (15% of funding raised between 2003 and 2007).

Chapter 2 SMEs Pathways to Funding and Finance Value Chain

As indicated in Chapter 1, not all funding sources have the same objectives, nor do they all address the same situations and stages in the business development cycle.

This realisation should guide both business developers' efforts and the formulation of policy that promotes SME access to finance.

Mastering funding pathways and/or the finance value chain evidently facilitates SME access to funds, as it tends to either reduce the asymmetry between information available respectively to entrepreneurs and investors, or tends to ensure that the most suitable funding sources are available to regional SMEs in a given area. Of course, "facilitating" does not necessarily mean that it becomes easy!

2.1 SME pathways to funding sources

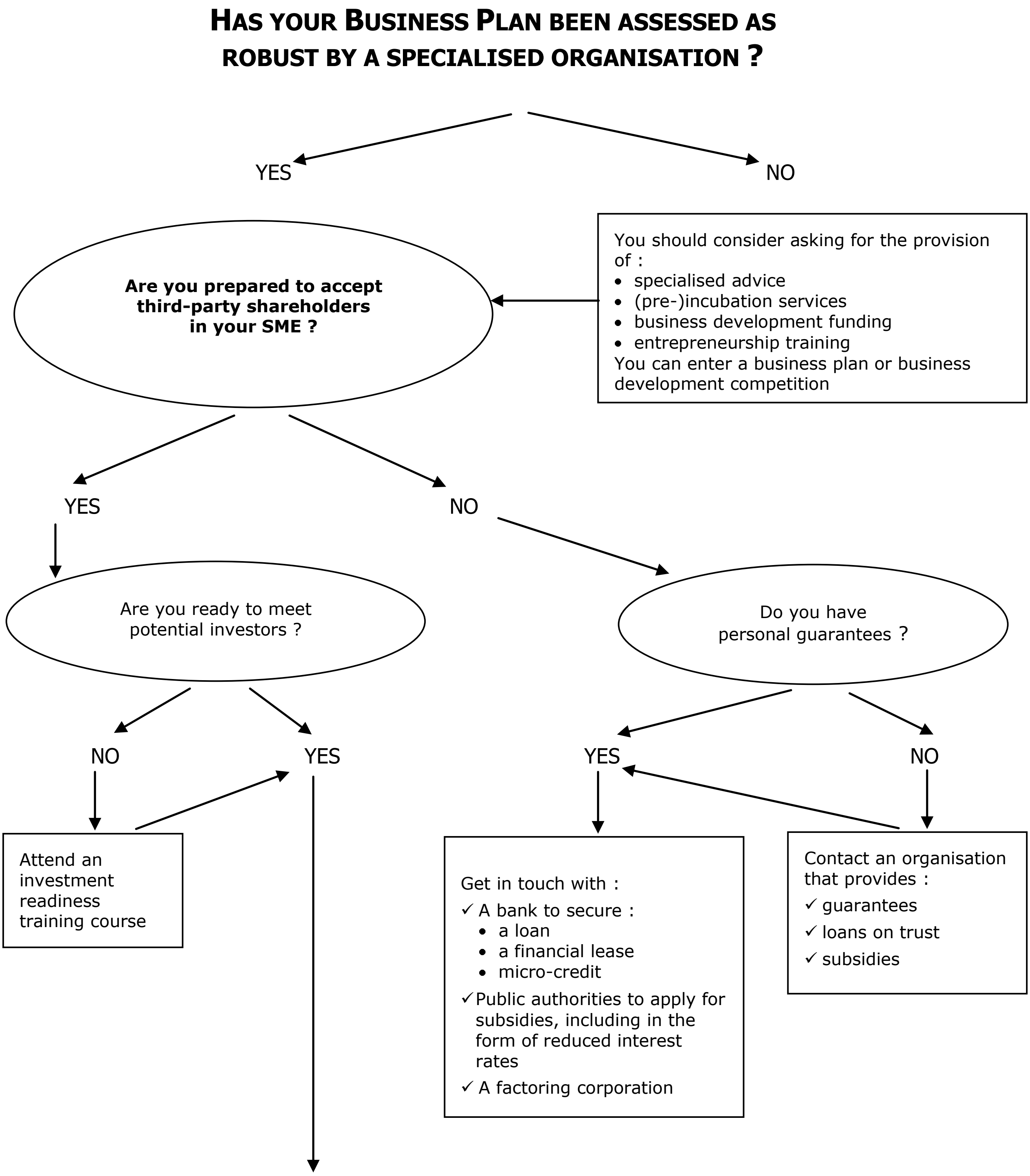
The following pages illustrate the decision path that businesspersons looking for the most appropriate funding sources should follow. It includes five key parameters in the quest for third-party finance:

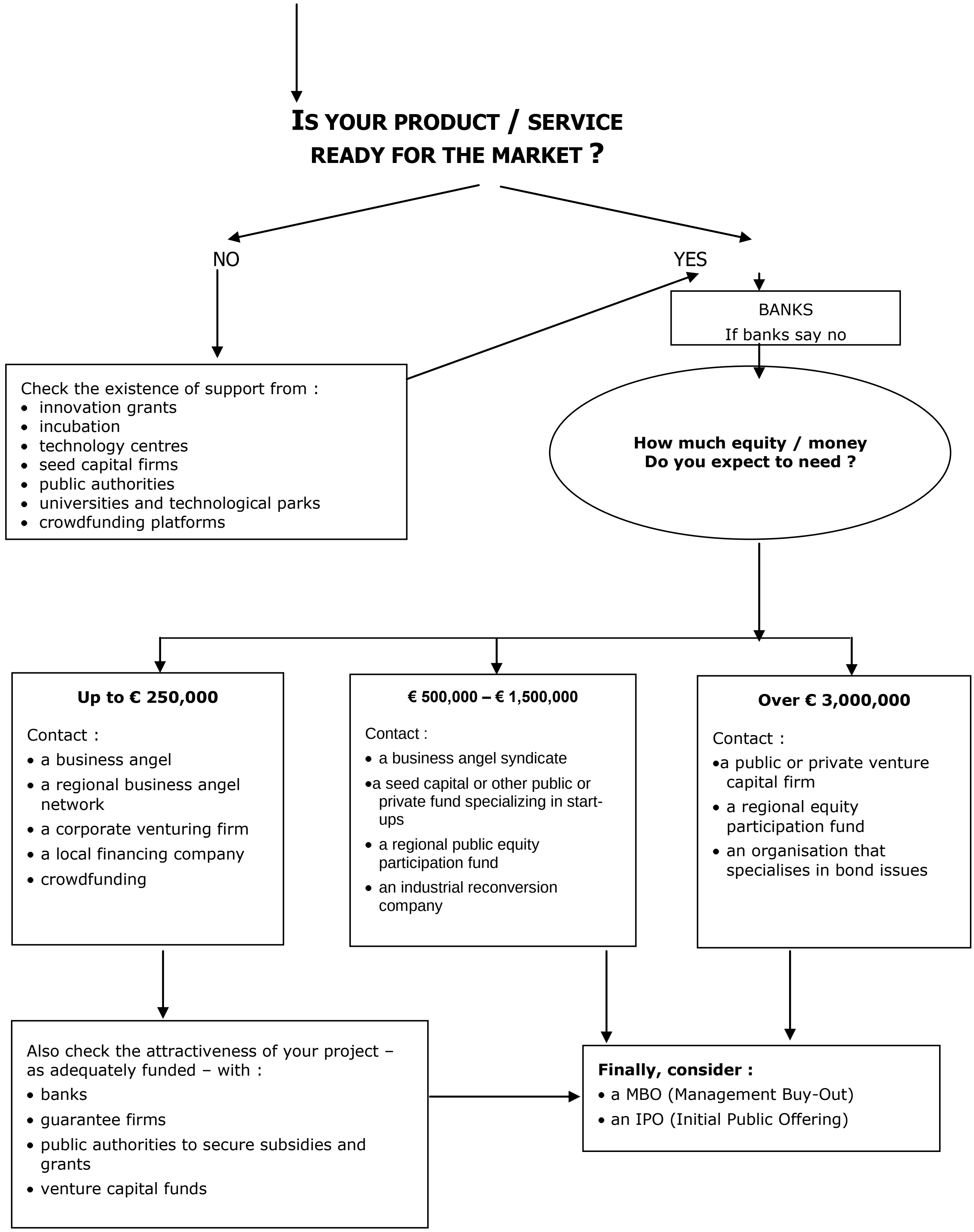
- business plan robustness;
- accepting or rejecting new shareholders;
- availability of personal guarantees;
- product/service market penetration potential;
- expected amount of financial sourcing.

This access pathway can be tailored to a variety of business need categories including mainly:

- business development;
- business transmission;
- innovation;
- internationalisation;
- owner's equity increases;
- financing of current needs;
- solving difficulties

Graph 4 SME funding patways





Source : EURADA

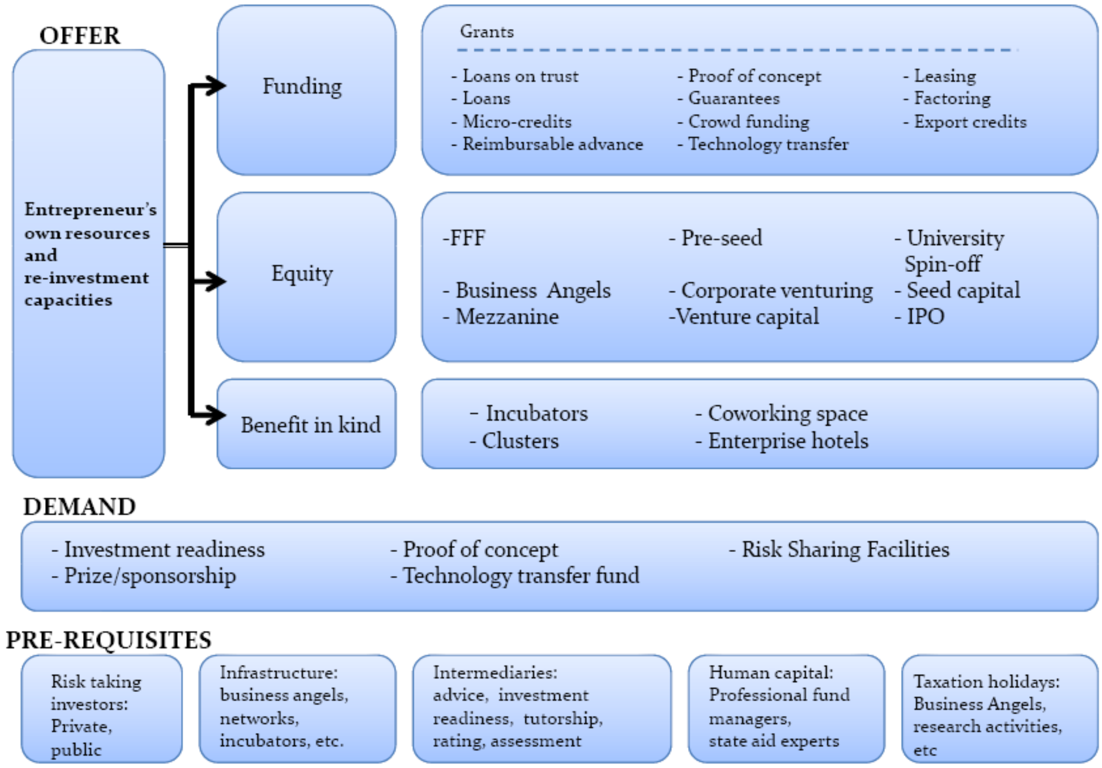
Ranges included in the box answering the question "How much venture capital do you expect to need?" (<€250,000, €250,000–1,500,000 and >€3,000,000), are of course arbitrary.

2.2 The regional finance value chain

It is increasingly evident that the different SME finance providers act complementarily and should link up to form a regional/local value chain.

Value chains can be flowcharted as follows:

Graph 5 Regional financial and equity value chain



Source : EURADA

A number of intermediaries and regional authorities that are not in a position to fully implement the business finance value chain in their respective regions propose a range of financial products that seek to form a smaller value chain to meet one or more of the types of needs expressed by SMEs, or to specialise in niche markets that are not targeted by private finance operators.

The challenges facing the management of such a value chain include:

- adequate funding provision for specialised funds (seed, venture, etc.): when it comes to value chains, critical mass is a key success factor;
- the availability of professional fund managers: their wages are generally substantially higher in large urban centres than in remote areas, which means that some regions may find it difficult to attract talented managers;
- market fluidity, i.e. the possibility for individual investors to sell their stake whenever they want at an affordable cost: this means ensuring that each link in the value chain provides the raw material for the next one. Exit opportunities are also important to allow investors to materialise their return on investment through capital gain for instance and then to reinvest in new projects. The worst situation for an investor is to be stuck for an unexpected amount of time in a single investment.

- networking and partnership. This is needed both between the fund providers but also between those organisations and SME support organisations. SME support organisations have an important role to play in the investment readiness of entrepreneurs' proposals. Managers of the French seed capital fund Cap Decisif claimed in a press interview to Les Echos dated 30.6.04 that: "It's not easy to find good candidates. There are problems of the format in which we receive the projects. This should be the work of incubators, but in practice very few have the competences required. Moreover they are on a quantitative track and not a qualitative one".

An integrated approach is developed by the Berlin Regional Development Bank (D) called *Investitionsbank Berlin*: it offers 20 different products, some of which meet finance needs and others business growth requirements. Invested amounts vary between €5,000 under the *Berlin Start Fonds* and €10,000 under the *KMU Fonds* and *Berlin Kredit* funds. The 20 instruments are listed below:

1. *Berlin Start*: up to €250,000 in seed funding over 6 to 10 years.
2. *Mikrokredite KMU Fonds*: up to €25,000 in microcredit.
3. *Berlin Kredit*: up to €10 million in loans to finance business equipment or takeovers.
4. *Berlin Kredit Innovativ*: €100,000-500,000 in loans for businesses operating in key regional industries investing in innovative initiatives or internationally.
5. *GRW – Gemeinschaftsaufgabe "Verbesserung der regionalen Wirtschaftsstruktur"*: a scheme that provides subsidies according to eligible business size to improve regional economic structures.
6. *KMU Fonds*: a fund supporting SME development with direct loans of up to €250,000.
7. *PROFIT*: a fund that supports research, innovation and technology activities. It provides funding to finance the innovative ideas of businesses. It acts at stages in the cycle including applied research, experimental development and preparation for commercialisation. Its intervention takes the form of subsidised and repayable short-term loans. Funding ranges between €400,000 (applied research stage) and €3 million (all other stages).
8. *VC Fonds Technologie Berlin*: a venture capital fund investing up to €1.5 million in first pooling rounds and up to a total of €3 million per business.
9. *VC Fonds Kreativwirtschaft Berlin*: a venture capital fund dedicated to creative industries and investing under the same terms are the one above.
10. *Zwischenfinanzierung Film*: bridge loan fund for film and television programmes. Amounts vary between a minimum of €100,000 and a maximum of €3.5 million.
11. *Programm Innovationsassistent(in)*: a scheme supporting the employment of innovation assistants by both tech and non tech SMEs with a 50% contribution capped at €20,000 toward the gross wages of an academic. One year project.
12. *Technologie Coaching Center (TCC)*: a technology coaching centre contributing to the fees of accredited experts with amounts ranging between €170 and €665/day depending on business age (more or less than 3 years) and coaching duration (3-8 days or more than 21 days).
13. *Kreativ Coaching Center (KCC)*: a coaching centre for businesses operating in creative industries. Same details as TCC above.
14. *Transfer Bonus*: a €3,000-15,000 premium for transfers of technology to promote contacts between SMES and regional research centres.
15. *Berlin Kapital*: a venture capital fund that can invest up to €5 million over ten years.
16. *IBB – Wachstumsprogramm*: loans of up to ten years to support SME growth with amounts ranging between €500,000 and €15 million. Financing of 100% of eligible costs.
17. *Neue Markt-Erschiessen*: loans to support the development of new markets. 50% subsidies capped differently according to the type of activity involved, e.g. taking part fairs (€15,000), congresses (€5,000) or market surveys (€5,000) or hiring an export assistant (€20,000).
18. *Netzwerkbildung Mittel- und Osteuropa*: support for partnerships in Central and Eastern Europe.
19. *Liquiditätsfonds Berlin*: liquidity fund supporting business restructuring with up to €1 million in five-year loans with a two-year grace period.
20. *Konsolidierungsfonds*: a consolidation fund for East-Berlin businesses. Similar to the liquidity fund above.

Another example of an integrated approach is provided by national administrations such as the UK BIS[16], which promotes the different types of intervention below:

→ Investment readiness. Cf. Mentorsme.co.uk or GrowthAccelerator, a £200 million programme helping SMEs improve their capacity to commercialise innovation, grow their business, access external finance and improve their leadership.

→ Debt financing.

→ Securing finance through venture capital including from the following public sources: Business Angel Co-Investment Fund, Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Venture Capital Trust Scheme.

→ Alternative forms of finance such as leasing and factoring as well as supplier finance (reverse factoring or supplier finance).

→ Specific support formats including Smart support encompassing notions such as proof-of-market (max. £25,000), proof-of-concept (max. £100,000) or prototype development (max. £250,000).

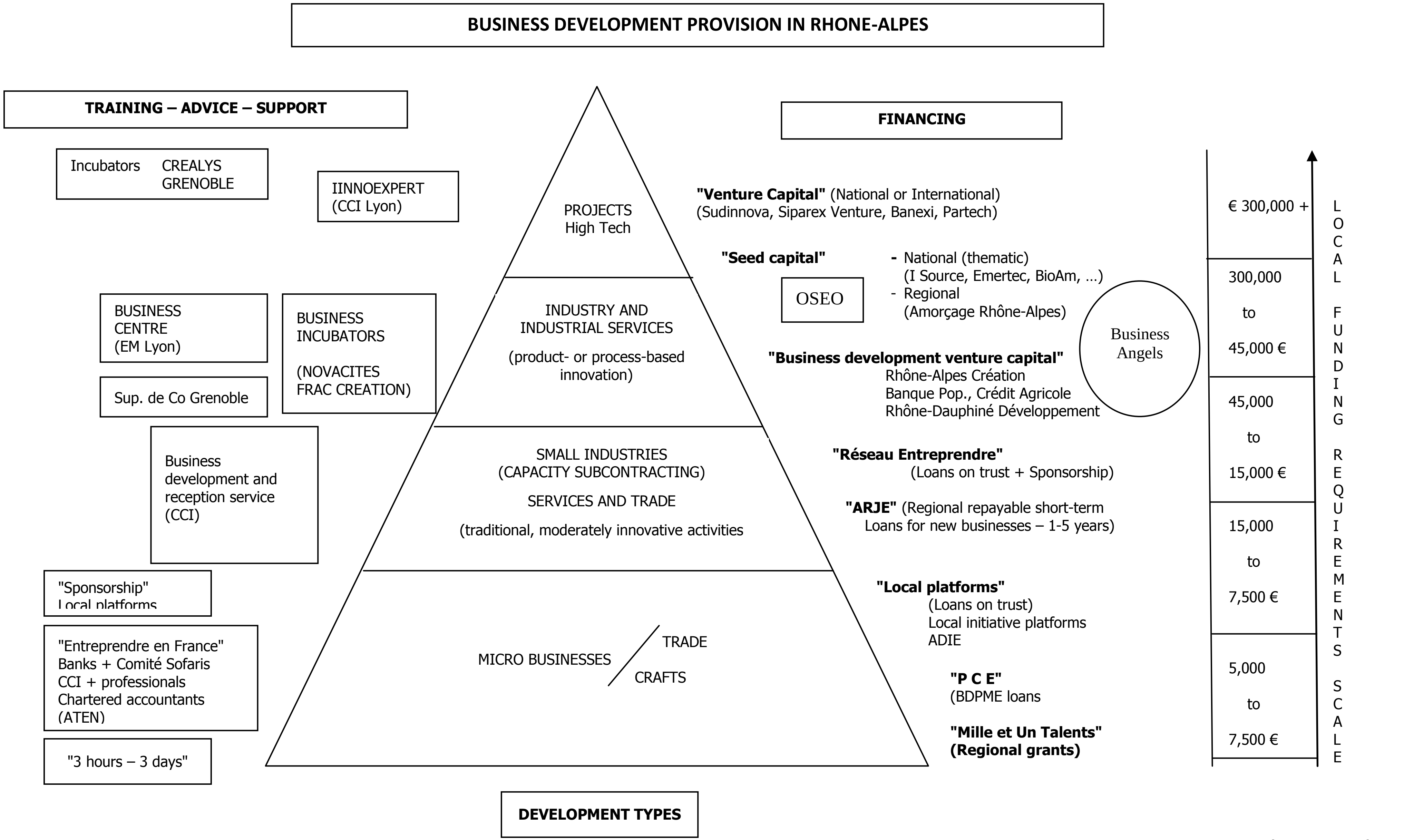
→ Innovative support vehicles such as innovation vouchers, the Small Business Research Initiative (SBRI), Knowledge Transfer Partnerships and UK Export Finance (supporting exports with interventions in the form of guarantees provided by payment default insurance and risk sharing with banks).

The example of Rhône-Alpes (F) below shows how in a region the financial and non financial instruments are complementing one another according to the life cycle of the enterprise and on the type of enterprise. The chart drawn up by Rhône-Alpes Création is interesting in a number of ways as it introduces and draws a parallel between:

- different funding sources available to SMEs;
- average amounts available from individual funding sources;
- advice services tailored to individual funding sources.

[16] Cf. Best Practice Guideline SME Finance, November 2012, Issue 58 http://www.icaew.com/~/media/Files/Technical/Corporate-finance/Guidelines/tecpln11488-cff-guideline-58-2-final.pdf?utm_source=email&utm_medium=shortform&utm_campaign=cffsmefinance

Graph 6



Source : Rhône-Alpes Création

2.3 Financing technology SMEs

In a knowledge economy the support to high-tech start-ups becomes a crucial issue. Most of the financial players have good reasons to be reluctant to provide finance to such enterprises because:

- entrepreneurs have no track record;
- investors have not necessarily the skill to assess the technology;
- time to market might be very long;
- enterprises have difficulties to valorise their intangible assets, i.e. their intellectual property rights, to in order to obtain bank loans;
- innovation is a risky business.

To overcome these difficulties, specific support programmes such as "Proof of Concept", "Reimbursable Advance Payments", growth accelerator, etc. have appeared.

The critical difficulty facing tech SMEs is often convincing a first client to buy their product/service. To help SMEs overcome this barrier, some local authorities have established ad hoc public procurement procedures (negotiated or pre-competitive public procurement). In the US, the SBIR programme has demonstrated its effectiveness when it comes to boosting R&D+I. However, this scheme is not a support factor in the sense that 10 US states monopolise most of the 3,268 individual interventions, including 674 in California, 416 in Massachusetts, 215 in Virginia, 146 in New York, 143 in Texas, etc. And the Canadian Province of Quebec has developed a so-called "technological showcase" project enabling SMEs to test their innovative products or services in real-life conditions at potential customers'.

In mid 2012, the Silicon Valley Bank (US) opened a London branch to offer its services to innovative European SMEs. On the strength of the expertise acquired financing 8,000 US tech businesses, the Silicon Valley Bank expects to sign up some UK tech firms.

Toward the end of 2012, IRDInov was deployed in South-Western France to bridge the equity gap facing innovative SMEs looking for finance in the €500,000-€3 million range. Endowed with €35 million, this fund will specialise in the region's three strategic industries: food & drinks, aerospace and health. The fund managers intend to cooperate with Technology Transfer Accelerators.

Finally, research tax credit schemes have emerged as a powerful incentive for tech SMEs in countries leveraging tax credit as an incentive (see Chapter 11).

2.4 Entrepreneur and investor matching platforms

As underscored above, the business finance market, in particular when it comes to SMEs, is confronted with asymmetric information. One way to overcome this asymmetry is to set up (in)tangible platforms to match finance supply and demand. Some of these platforms provide specialist services to businesses so as to improve their chances of attracting investors. Worth mentioning in particular among these services are coaching and self-evaluation and rating tools.

With the development of web-based social networks, crowdfunding platforms have emerged as providers of a range of different business project financing packages (donations, pre-orders, loans, equity investment, etc) – see Chapter 7.

Chapter 3 Entrepreneur Mentoring

3.1 Investment Readiness

This Anglo-Saxon concept, originally developed by the Department of State and Regional Development of the State of Victoria, Australia, emerged from the realisation that the information submitted by entrepreneurs to investors in the hope of convincing them to finance their project did not necessarily match the data that the latter required and expected.

Typical investment readiness programmes generally include the following five elements:

- critical business plan analysis;
- knowledge of funding sources;
- understanding of the timing of, and amounts to be expected from, funding applications (not all funding is the same);
- perceiving the needs and expectations of different types of investors – business developers need to demonstrate that they are "good risk" and that investors can actually expect a healthy ROI;
- training in submitting business projects to any and all kinds of potential investors.

In addition to the above, investment readiness training also needs to address notions including exit routes and shareholder agreements. The latter should notably discuss items including:

- the balance of power;
- exit clauses;
- release clauses.

In the UK, Exemplas implemented a similar programme called "Fit 4 Finance", focusing around the following three types of action:

- awareness seminars on the concept of "what funding sources exist?"
- "guidance panels" comprising representatives of a bank, venture capitalist, business angel, SME consultant, etc.
- "after sales" services, i.e. advice after seminars as well as before and after guidance panels.

It is incumbent upon public authorities concerned with providing regional SMEs with an access to funding sources to also develop and provide investment readiness services on top of financing tools. This type of service is one of the solutions to increase the quality of projects submitted to investors.

3.2 Proof of Concept

Funding provided to a research team, which has a great potential to become entrepreneurs, in order to help them to develop their business idea.

The funding may take the form of grants, loans, quasi-equity or equity. SITRA (FIN), in partnership with TEKES (FIN), offers a package of grants and equity. The amount provided ranges from €20,000 to €70,000. In this case SITRA invests in subordinated loans and TEKES provides grants.

In Scotland, Scottish Enterprise has put in place a "Proof of concept" scheme which in the first years of implementation (2004-2005) helped the creation of 17 new enterprises. In ten years, more than 1,000 applications have been assessed and the number of supported projects reached 230. Some 50 projects spun off and roughly 20 have led to licensing agreements. This scheme was based on the following tools:

- €300,000 per project of maximum 2 years;
- the entrepreneurial project must include representatives of higher education organisations and a marketing team;
- the university keeps the IPR rights.

The scheme covers the following cost items: wages, patents, outsourcing, travel, market studies, equipment and other running expenses.

Table 6 Examples of proof of concept initiatives

Promoter of the initiative	Amounts of funding provided
Scottish Enterprise	£ 110 000 – 350 000
University of Hull	£ 250 - 1000
Cambridge University	up to £ 25 000
SEEDA	£ 6000 – 35 000
OneNorthEast	£ 10 000 – 60 000
Advantage West Midlands	up to £ 30 000
Creative Seed Fund	up to £ 5000
University of the Arts, London	up to £ 5000
Yorkshire Concept Fund	£ 30 000 – 100 000
Tuli Programme TEKES	up to € 55 000
Campus Andalucia	up to € 200 000 in form of participatory loans
Commercialisation Austria	€ 50 000 - € 250 000
EU ERC Proof of Concept	up to € 150 000
Commercialisation Fund Ireland	€ 80 000 - € 350 000

Source: EURADA Compilation

3.3 Areas for improvement

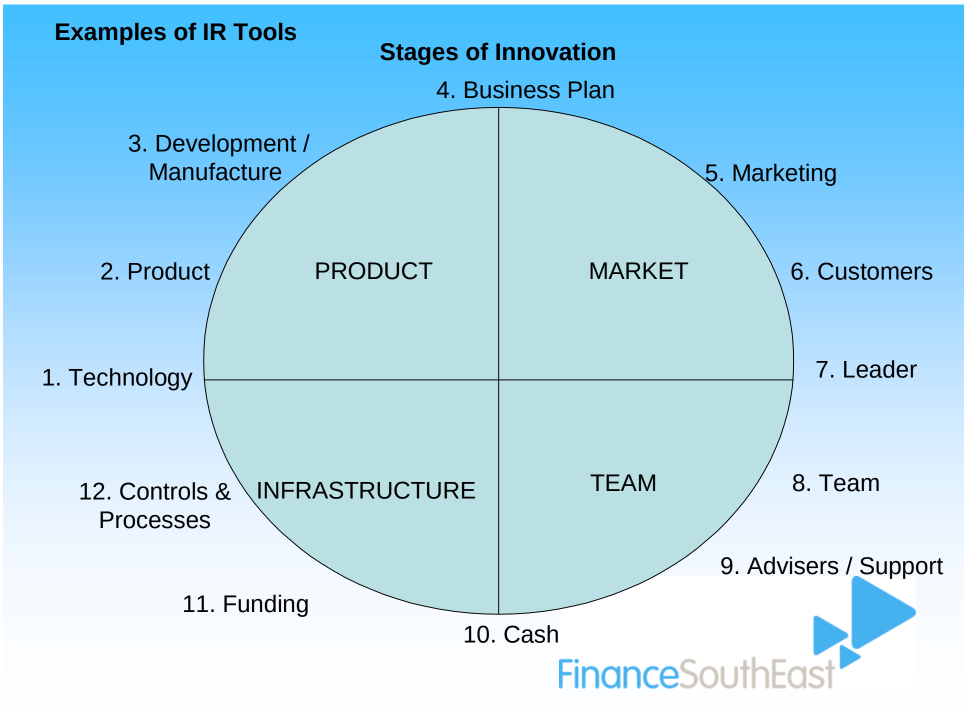
The aim of investment readiness and proof-of-concept schemes is to ensure that all fundamental requirements of future businesses are under control in order to maximise their chances of success and hence their return on investment.

In general, five broad categories of parameters are the subject of attention and advice:

- product or service;
- market;
- management team;
- finance;
- business model.

Some coaches use spider diagrams to visualise areas for improvement. The diagram below is used by Sally Goodsell of Finance South East (UK) in delivering her investment readiness programme.

Graph 7 Progress to be made



3.4 Awards and sponsorship

Public authorities sometimes reward business development either in kind or with small amounts of money. The French ministry for R & D, in partnership with OSEO, organises an annual competition to support the creation of innovative technology enterprises. 182 innovative projects were rewarded in 2004 for an amount of €30 million. In 2010, the 174 projects selected shared €19.8 million.

Rewards were given to three types of projects:

- emerging ideas. Maximum €45,000 of grants.
- ideas in development. Maximum €450,000 of grants.
- special awards.

The funnel effect of this scheme is as follows:

	2004	**2010**
Projects submitted	1 402	1 325
Projects selected of which:emerging ideas Ideas in development	182 99 83	174 101 73

3.5 Growth accelerators

The aim of these initiatives is to enable innovative – even hi-tech – businesses to gain easier access to sources of finance, new markets and specialist expertise than they could individually. These platforms organise meetings in different towns and cities. For instance, the platform called "PwC's Accelerator"[17] has signed a cooperation agreement with "Plug & Play" – another accelerator based in Silicon Valley (USA) – to promote cross meetings between their respective members. These are prepared through training, coaching, critical business plan reviews, communication tool adjustment, strategic market penetration advice, the search for senior executives, services targeting funding procurement and business plan development, etc. At meetings, companies attend a variety of specific or prearranged meetings with potential investors.

[17] Source: Agefi Luxembourg, Juillet/Août 2011

Chapter 4 Loans

4.1 Bank loans

Bankers are undoubtedly the most important link in the business finance chain. How could it possibly be different if we know that the number of companies attracting the attention and interest of other funding sources never exceeded 25,000? However, bankers seem to be the black sheep in the SME finance cycle.

Obviously, the financial crises of 2008 and 2010 have reinforced this feeling. Besides, there is cause to wonder how banks can possibly have perceived the subprime market as less risky compared to investment into SMEs!

In Europe, all specialists agree that the vast majority of SMEs' own funds are inadequate and that undercapitalisation and the lack of growth are the main sources of failures.

Bank loans are often linked to tangible guarantees, though bankers themselves insist[18] that: "loans are never granted on the basis of guarantees. Loans are guaranteed from a company's net assets: capital, reserves, reported results and capital subsidies, as well as the entrepreneur's level of commitment through personal guarantees".

There are several types of banks (commercial, savings, cooperatives, public, ...) which are more or less friendly to SMEs and propose tailored solutions.

This diversity may promote SME finance. In Germany for instance, up to 70% of SME needs are financed by local organisations, i.e. savings banks (24%), Land banks (17.5%), mutual banks (15.5%) and private banks (13%).[19] Thus a strong regional rooting of banks is evident, hence the recycling of locally-collected savings into local SMEs. In their efforts to make banking activities more ethical, EU authorities should consider introducing some sort of "reinvestment act" requiring banks to reinvest locally some of the money raised at regional level.

Since the 2008crisis, businesses – particularly SMEs – have increasingly been confronted banks denying them loans of only granting them against tougher conditions, particularly in the form of (1) higher rates, (2) higher handling fees, (3) tougher collateral requirements, and (4) smaller than expected loans. Conditions applying to overdraft facilities have worsened too.[20]

Commercial (or trade) credit is one of the main sources of short-term finance for categories of businesses including micro businesses, small enterprises and start-ups. It is an instrument available to SMEs when:

- banks do not wish to finance them;
- they want to avoid direct banking costs;
- they are put off by the complexity of bank credit;
- they lack in-house financial competences.

There is an extremely wide range of banking products available to SMEs, namely:

- soft loans;
- variable and fixed rate loans;
- credit line;
- capital investment loans (long term);
- mezzanine.

Banks can also provide special conditions to support the business transfers.

---

[18] See interview of M. J. Thumelaire, manager in charge of SMEs with ING (B), in *l'Echo*, 29 October 2003
[19] Les Echos, 18.10.2012.
[20] For more details, see the "Survey on the access to finance of SME in the Euro Area" on the ECB website.

The French group *Banque Populaire* launched EXPRESS SOCAMA, a scheme granting loans without personal security of up to €25,000, repayable over a maximum of three years. This bank also launched another scheme for the same purpose in the form of a loan of maximum 100.000 € subject to the fact that the entrepreneur has to provide 25% of the loan with a personal guarantee.

Some banks (namely in the UK) are increasingly interested in ways of providing loans for innovative businesses. This is mainly done through training and appointing "technology banking managers". Barclays Bank's Cambridge branch also works very closely with innovative entrepreneurs. HSBC has examined some of the products developed by banks operating in innovative US regions such as the Silicon Valley, the Research Triangle in North Carolina, the Boston region, etc., including "venture leasing" or "intellectual property valuation guarantee" but does not offer them (yet?) to its client businesses in the UK.

Banks generally specialise in the provision of three types of financial business needs:

- cash needs for working capital;
- growth and expansion;
- acquisition of fixed assets.

Halfway through 2012, the French Government announced the establishment by 1 January 2014 of a Public Investment Bank with the aim of financing mid-sized SMEs. A similar initiative called "Business Bank" was launched in the UK in 2013. It will be endowed with £1 billion.

4.2 Small non-banking loans (risk sharing) – Loan on trust

This instrument is very well developed in France and is based on 245 platforms grouped in the "France Initiative" network.

This initiative started in 1985 under the business model: "support the creation of enterprises thanks to free interest loans on trust aiming at helping those enterprises to borrow money from banks".

In average the loan on trust given to an entrepreneur is €8,150. In 2011, 17,750 businesses were assisted thanks to this system. Its leverage ratio was 6. Indeed, €154 million in loans on trust enabled €980 million to be pumped into the economy.

The breakdown of platform intervention formats is as follows:

- business development 10,078 projects
- business takeover 5,187 projects
- business growth 555 projects
- business transmission 133 projects

Note: 428 interventions have been in support of innovative businesses.

These platforms mobilise regional professionals (territorial authorities, enterprises, institutional operators…) willing to contribute to the development of economic initiatives and of new jobs. They aim at mobilising funds in the form of free interest loans without guarantees for financing the creation of local enterprises. The loan is completed by a mentoring and coaching scheme for the entrepreneur. The coaching generally lasts for three years. It is implemented through the mobilisation of the managers of local enterprises. Loans range from €5,000 and €10,000. 15% of loans on trust are completed by a bank loan at the creation stage. In average, €7,165 of loans on trust allow to get €34,900 of bank loans.

In the UK many CDFIs (Community Development Finance Institutions) operate to provide between €1,500 and 75,000 to local enterprises. In general, the cost of such finance is higher than the current interest rate of the market, as the fund takes a higher risk than commercial banks.

In Pembrokeshire (Wales, UK) a lottery has been created in order to collect funds to be invested in the form of loans to local entrepreneurs or enterprises in order to create or maintain jobs. In 17 years, almost £4 million were collected and nearly 300 local firms were supported (as of mid-2011).

In place since 1993, the lottery was able to support 100 enterprises for a total amount of 1.3 million Sterling Pounds (approx. €2.1 million) and so create or save 300 jobs.

The lottery runs as follow:

- each member of the lottery plays £1 per week. Currently nearly 7000 people are members;
- the winner receives £2,000;
- the surplus is invested in loans for a 2 to 5 year period paid back monthly.

4.3 Regional loan funds

Some regions create special loan funds in order to solve specific problems such as the transfer of ownership of enterprises or to soften the consequences of the failure of a major contractor.

Such investments have been put in place by Advantage West Midlands (UK), for instance in 2005 to avoid a "domino effect" bankruptcy among suppliers of the MG Rover Car company. That RDA has put in place a special loan fund named Advantage Transition Bridge Fund. The fund provided loans from €75,000 to 750,000 to enterprises affected by the closure of MG Rover. Supported enterprises had more than 15% of their turnover done with MG Rover. They had a viable business plan, but could not obtain funding from banks.

4.4 Spin-out loans funds

In the Netherlands, Twente University in Overijssel provides interest-free loans of up to €13,600 for teachers and students who want to start a business (more than 425 new businesses created since 1984). In addition to loans, the scheme also provides access to expert advice and university laboratories. A similar system is also taking place in Maastricht in cooperation with LIOF.

In the West Midlands (UK), the Mercia Spinner tool provides grants up to €75,000 towards patenting, market research, business plans, prototyping and interim management for university spin outs. This instrument is managed by a private investment company: Worwich Ventures.

In Andalusia (E), through the Campus project co-financed by ERDF and managed by AIDA (Agencia de Innovacion y Desarrollo de Andulciia), universities are able to provide up to €100,000 of free interest loans without guarantees and not refundable in case of total losses for technology based enterprises created by researchers. As part of a partnership, the agency gives a grant of €5,000 per project to the university that has promoted the project in order to ensure a follow up of the project and coaching system of the entrepreneur. The support can take the form of a participative loan or can be converted into equity finance. There should be an exit after 7 years. The entrepreneurial project must be self-funded in at least 30%.

4.5 Loans for innovative companies

OSEO (F) provides specific loans for enterprises facing problems to finance intangible investments such as: training, marketing and negotiation of a first order, internationalisation costs, commercialisation of an innovation, etc.

The scheme known as "contrat de développement innovation" allows an enterprise to get a loan ranging from €40,000 to 400,.000 for a period up to 6 years. The loan is provided with one year payback holiday and doesn't need to be guaranteed. The interest rate of such loans comprises a fix part of 1.6% and a complementary remuneration based on the Euribor at 3 months. In all cases, a private bank must match at least 20% of the total loan needed by the enterprise.

4.6 Micro-loans

Micro-loans are aimed at small businesses that are unable to raise sufficient (or any) finance from traditional commercial sources. Such loans are available for commercial enterprises as well as for enterprises operating in the so-called social economy sector.

In the UK the South Investment Fund is offering loans of €1,600 to €20,000 for existing businesses and up to €16,000 for start ups.

A number of semi-public organisations have specialised in micro-credit provision. This is namely the case of ALMI (S) and FINNVERA (FIN). ALMI offers loans of up to €27,000. The EIF (European Investment Fund) set up a financial scheme to guarantee the micro-credit portfolios of non-banking operators involved in the segment of micro-credit focusing on support for the development of social reintegration companies. The amount of this type of micro-credit is generally in the area of €3,000.

In order to minimise the entrepreneurial risk – notably in the development of very small businesses – some organisations develop micro-insurance schemes.

For memory, the EU grants micro-credit fund delivery subsidies through technical assistance provided by the JASMINE initiative of the European Investment Fund. At present, this assistance is available to organisations in seven Member States (Bulgaria, France, Hungary, Italy, the United Kingdom [Scotland], Romania and Spain). Since 2010, the EU has also implemented micro-credit facility PROGRESS, delivered in six Member States (Belgium, Bulgaria, Lithuania, Poland, Romania and The Netherlands).

4.7 Loans for industrial reconversion

Some big enterprises, when facing industrial re-conversion, provide sometimes loans in order to create jobs in the region. For instance, Michelin Group (F) has created an ad hoc organisation named Micheli Development to offer loans at reduced rates. The amount of the loan is between €3,000 and €8,000 per job created, according to the type of activity (industry or services to industry), the quality of the project and the invested amount. However, the maximum amount of the loan cannot exceed €175,000.

Michelin Development has provided €49 million of loans between 1990 and 2010. Those loans are without guarantee and have a five-year-life time and they contribute to the running costs of SMEs. Between 35 and 50 files are followed each year.

4.8 Export loans

There are organisations that grant export loans or guarantees to SMEs to help them grow their export markets. Examples of such organisations include Oséo (F) and SOFIWEX (B).

Chapter 5 Venture Capital

5.1 Business Angels

Business angels are individuals — generally experienced entrepreneurs — who invest their money, skills and time in newly created businesses in exchange for a share of their capital. Typical business angel tickets range between €25,000 and €250,000[21]. Many famous companies, including Ford, AT&T, Apple, Amazom.com, Body Shop, etc., managed their initial growth thanks to the contribution of one or more business angels.

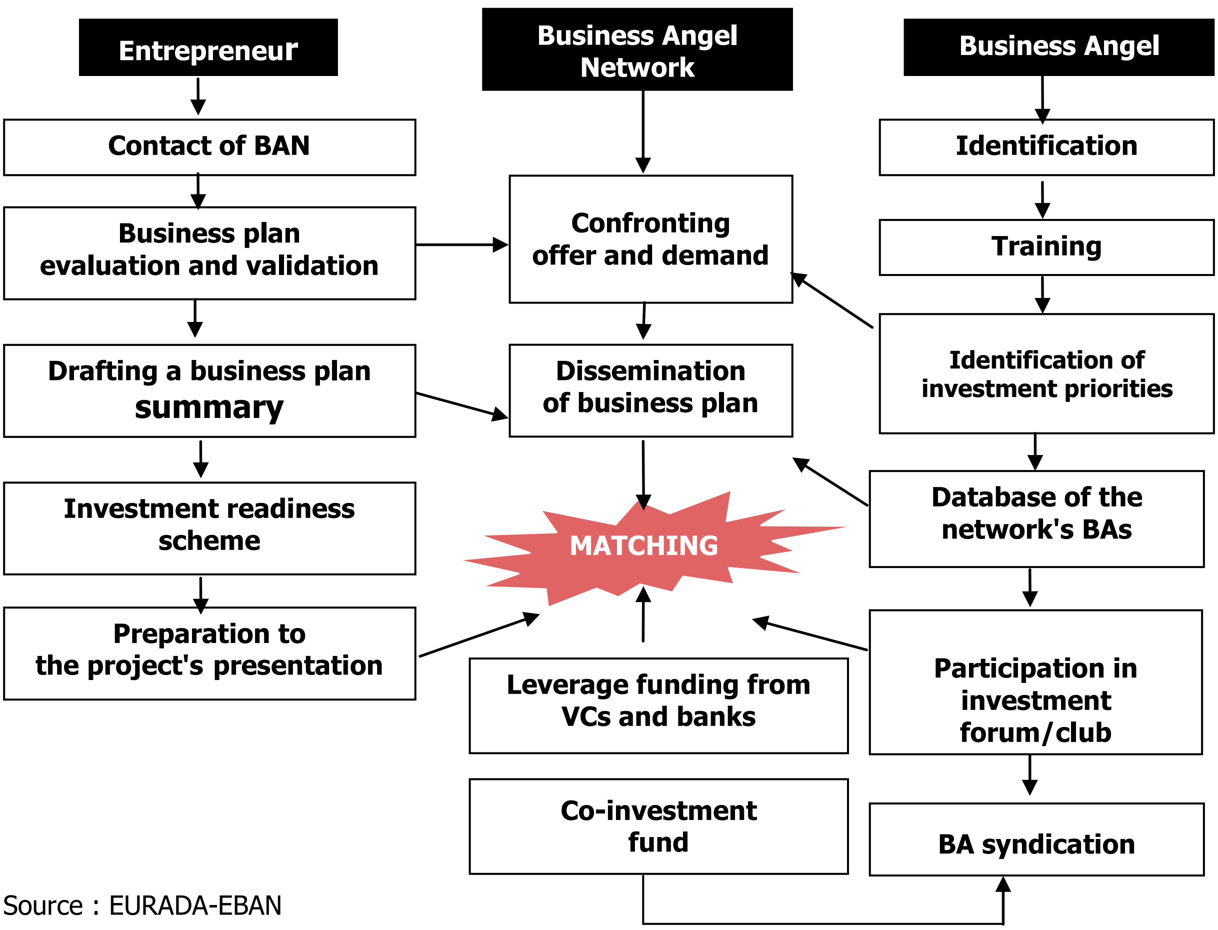
More recently, business angel networks have emerged at regional level to recruit angels and match them with local entrepreneurs looking for finance and advice.

Business angels often develop their own path to make a deal. We can recognize three phases is such process:

- The identification phase. In this phase the business angel gets in contact with the entrepreneur. The angel can find the investment opportunity by himself or through an active engagement in a BAN (Business Angel Network).
- The due diligence phase. The angel screens in detail the business plan and the management team.
- The negotiation phase. The angel and the entrepreneur structure the deal and negotiate the value of the stake as well as the role of the BA or the exit process.

The role of a BAN in the deal flow is illustrated in the following graph:

Graph 8 The role of Business Angel Networks (BANs)



Source : EURADA-EBAN

[21] In some cases, investment may reach as much as €500,000

The number of Business Angel Networks (BANs) in Europe has grown measurably since 1999. The European Commission[22] and EBAN (European Association of Business Angel Networks) have played an important role in disseminating this concept. In the USA, more than 170 such networks have been identified. The total number in Europe is closer to 200, though some BANs have yet to close their first deal. Because of the informal nature of this sector, it is extremely difficult to collect statistical data. In the USA, more than 3 million angels invest roughly $50 billion annually, i.e. twice as much as it is estimated that European venture capitalists invest each year.

EBAN members reported the following data regarding the importance of the industry:

	2007	2009	2010
• Number of active angels in the networks	15,578	6.111	14.785
• Number of deals	1,130	1.385	1.385
• Average amount invested (in Euros)	163,000	275.000	199.000

In 2010, 396 networks were registered. The total amount of investement was €276 million.

Most of the deals were made in France, UK, Belgium and Spain.

The informal venture capital market remains strongly conditioned by:

- taxes on private investment and capital gains or losses;
- regulations on public capital issues.

Because of the very nature of their activities, business angel networks often find it difficult to become sustainable. A number of regions support a sizeable share of these networks' operating expenses.

As they mature, the range of services provided by business angel networks becomes increasingly sophisticated, including:

- angel syndication;
- setting up of dedicated funds that invest alongside angels;
- provision of easier exit routes for angels;
- business angel academies;
- investment readiness programmes;
- integrated finance;
- co-investment funds.

Entrepreneurs need to realise that angels will own a stake of their company. In some countries, this condition constitutes a major obstacle to the development of the informal venture capital market segment.

For entrepreneurs, the advantages of this funding source include:

- investment below the usual minimum amount invested by formal venture capitalists;
- investment in newly-created businesses without necessarily requiring evidence of a positive track-record;
- investment decisions tend to be made on a rather subjective basis—e.g. personal chemistry between angel and entrepreneur—compared to formal venture capitalists;
- angels are geographically closer to entrepreneurs who thereby also benefit from the latter's personal networks. This proximity often leverages other funding sources.

---

22 DG Enterprise co-financed awareness campaigns and pilot projects in 1999-2002. It also published in November 2002 a best report entitled *Benchmarking Business Angels*, Best Reports Nr 1, 2003; Eur-Op catalogue n° NB-AL-02-001-EN-C http://ec.europa.eu/enterprise/library/best-reports/index.htm

Business Angel Networks act as a market place and provide valuable services both to entrepreneurs and investors. Among them it is worth mentioning:

- the project detection process. Projects reach the network by: words to mouth, peers, intermediary organisations, advertising campaigns, business angel academy events, etc.
- the identification of potential angels and the support to help them to start their business angels' activities.
- the matching process. This process can be sometimes complex: first assessment of the business idea or business plan, training of the entrepreneur, improvement of the business plan, strengthening the skills of the team, training in deal agreements (dilution of power, exit route,).

Since 2004 several business angel networks have been trying to set up co-investment funds (some people call this instrument "side-car funds"), which invest "pari passu" with angels. Such funds are already in place in England, Scotland and Belgium. The European Investment Fund (EIF) is now able to invest in such funds and therefore to increased their means of action[23.]

In recent years, business angels have increasingly been supported in their efforts by investment funds. In 2009, EBAN published a compendium of 48 co-investment cases. The average amount invested in these deals was around €570,000.

5.2 Serial investor seed capital funds

Having recognised the importance of seed capital funds as a start-up growth multiplier, and following the example of their Californian counterparts, a number of successful entrepreneurs decided to set up – individually or with peers – investment funds often called "business angels funds". Some of these funds are regional in reach.

This is how some thirty entrepreneurs from the French region of Provence Alpes Côte d'Azur (F) pooled €1.2 million in 2010 to set up *Capital Provence Business Angels* with the aim of investing amounts ranging between €150,000 and €200,000 alongside private investment centres.

As early as 2007 several entrepreneurs from the Nord-Pas-de-Calais Region (F) decided to create a new financial instrument named Re-Sources in order to provide between €100,000 and €800,000 to be invested in local enterprises. The Re-Sources instrument is a mixture of co-investment funds and business angel activities. Their objective is to help up to 6 enterprises per year.

5.3 Venture capital

The venture capital market includes different market segments and venture capital provision streams for businesses with a strong potential for growth. These techniques therefore mainly address businesses already operating for a few years.

According to EVCA (European Private Equity and Venture Capital Association), the European venture capital market comprises:

---

[23] http://www.eif.org

Table 7 Definition of the venture capital market segments

Seed	Seed capital: capital investment serves to allow businesses to proceed with their RTD effort.
Start-up	Start-up funds: investment capital serves product development and early marketing.
Expansion	Growth, bridging or restructuring capital.
Replacement	An investor buys another's stake.
Buy-outs	Existing investors' shares in a business are bought by the latter's own management team (MBO—Management Buy Out) or by another management team supported by a venture capital fund.

Source: EVCA

In 2011, the amounts invested by the venture capital industry totalled €45.5 billion to the benefit of 5,000 companies, compared with €41 billion invested in 4.973 companies in 2010. This market segment breaks down as follows in 2009 and 2011:

Table 8 Importance of and developments in the various segments of the venture capital market

	Importance (%)		**Average size / deal (€)**		**Market size (million €)**	
	2009	**2011**	**2009**	**2011**	**2009**	**2011**
Seed	0.6	0.4	361.200	394.600	139	168
Replacement capital	6.9	1.9	7.466.500	17.472.400	2.006	1.293
Start up	8.7	4.1	1.074.800	1.133.000	1.872	1.972
Expansion	27.5	16.3	3.107.700	3.678.400	6.284	6.963
Buy-outs	53.3	77.3	20.295.700	39.876.600	12.267	34.684

Source: EVCA

Table 9 Evolution of the European seed and early stage market (2000-2009)

SEED CAPITAL				
Year	**Amount in €1000**	**% of total venture capital market**	**Number of enterprises**	**Deals average in €**
2000	819.680	2.3	833	984.000
2001	530.839	2.2	551	963.500
2002	305.135	1.1	535	570.500
2003	150.107	0.5	334	449.500
2004	147.771	0.4	355	416.250
2005	96.847	0.2	362	267.500
2006	197.704	0.3	350	564.900
2007	177.061	0.2	499	354.800
2008	321.385	0.6	569	564.800
2009	139.383	0.6	381	361.200
2010	122.927	0.3	394	312.000
2011	168.871	0.4	428	394.600

START-UP				
Year	**Amount in €1000**	**% of total venture capital market**	**Number of enterprises**	**Deals average in €**
2000	5.843.723	16.7	3.843	1.520.500
2001	3.652.960	15.0	2.755	1.326.000
2002	2.614.436	9.5	2.738	955.000
2003	1.974.248	6.8	2.372	832.500
2004	2.230.233	6.0	2.160	1.032.500
2005	2.334.050	6.0	2.127	1.097.300
2006	5.666.756	8.0	1.905	2.974.600
2007	2.156.693	3.1	1.665	1.359.500
2008	2.538.830	4.7	2.013	1.261.200
2009	2.029.273	8.7	1.888	1.074.800
2010	1.798.070	4.3	1.682	1.069.000
2011	1.794.552	4.1	1.740	1.133.000

Source: EVCA

Before launching a quest for the "Holy Grail", entrepreneurs and public decision-makers need to consider that:

> "Only a small fraction of venture capital firms are interested in providing seed and start-up capital. Fund managers are receptive to the following parameters: proven innovative ideas, market shares, intellectual property and expanding established businesses. Besides, due diligence costs being equal regardless of deal size, venture capital fund managers generally believe that their resources are better spent on sizeable projects. Deal risk and size are both important factors in explaining venture capitalists' increasingly evident lack of interest in seed and start-up investment"[24].

Worth noting is that the industries favoured by investment funds include the internet and ecommerce, health (including biotechnology), software, clean technology and telecoms.[25]

According to EVCA, fund managers invest on average in one file out of 600 received.

5.4 Seed capital funds

This segment of the venture capital industry focuses on the provision of funding to businesses during the process of incorporation. Capital made available in this form is used to fund research and development and possibly field trials of prototypes, i.e. all activities that relate to pre-market stages of the product or service.

Total equity available in Europe for this purpose is somewhat limited (less than €175 million a year between 2009 and 2011). On average, seed capital funds currently invest around €350,000 per deal.

The activities of seed capital funds vary considerably across the European Union. In recent years, funds operating in France, Germany, Denmark, Italy, Finland, Norway and Spain have arguably ranked among the most active. In France, CDC (Caisse des Dépôts et Consignations), manages 15 funds, six of which are industry-specific while the rest are regional.

Developments in the market segment of seed capital (seed and start-up) in Europe between 2005 and 2011 were as follows:

---

[24] See: *When Venture Capitalists say no*, Ron Peterson; Comanche Press M.D.

[25] Source: Les Echos, 21.12.2011.

Table 10 Developments in the seed capital market in Europe

Year	Volume (mio €)	Nb projects (units)	Average per project (€)
2005	2.434	2.485	1.035.800
2006	5.864	2.225	2.635.700
2007	2.433	2.164	1.124.200
2008	2.770	2.582	1.072.900
2009	2.180	2.305	945.700
2010	1.921	2.076	925.300
2011	2.141	2.168	987.550

Table 11 Developments in the seed capital market in the United States

Year	Volume (mio USD)	Nb projects (units)	Average per projet ($)
2005	918	252	3.643.000
2006	1.244	386	3.223.000
2007	1.500	495	3.030.000
2008	1.719	507	3.390.500
2009	1.729	345	5.011.500
2010	1.657	407	4.071.250
2011	1.046	437	2.393.500

Source: PwC Moneytree

One realises that despite definitional differences between EVCA and PwC about concept including 'seed' and 'start-up', while the volume of business is higher in Europe than in the US, the average investment per deal is substantially higher in the US compared to Europe (the ratio is 3:1). This undoubtedly explains the growth differential between businesses on both continents.

In some EU Member States, the number of operators seems to increase but average invested amounts are decreasing. For instance, KPMG France note that while some 288 web-based start-ups managed to raise a total of €830 million between 1 January 2010 and 30 June 2012, most of those deals amounted to less than €500,000.

Even in the US, only a small number of businesses gain access to this type of finance. In addition, most of them are located in just a few regions.

5.5 Mezzanine funding

Mezzanine funding is a hybrid product combining equity and loans. The product is used both by the private sector in LBO deals and by regional public funds.
According to a report from Crédit Suisse[26,] the advantages and disadvantages of mezzanine funding for companies are the following:

[26] Crédit Suisse Economic Research, Economic briefing n°42

Table 12 Advantages and disadvantages of mezzanine funding for companies

Advantages	Disadvantages
▪ Remedies financial shortfalls and provides capital backing ▪ Improves the balance sheet structure and thus credit-worthiness, which can have a positive effect on the company's rating and can widen the room for manoeuvre as regards financing ▪ Strengthens economic equity capital without the need to dilute equity holdings or surrender ownership rights ▪ Tax-deductible interest payments and flexible remuneration structure ▪ Greater entrepreneurial freedom for the company and limited right of mezzanine investor to be consulted	▪ More expensive than conventional loan financing ▪ Capital provided for a limited term only, in contrast to pure equity capital ▪ More stringent transparency requirements

Source : Crédit Suisse

The amounts invested through mezzanine funding vary according to the type of operator. In fact, public investments range from €100.000 to €2.500.000, while private investments range from €20.000.000 to €50.000.000.

5.6 University and research centre venture capital funds

In a number of EU Member States, universities have set up venture capital firms – generally along the same lines as seed capital funds – for the purpose of supporting business projects originating in the university itself or in research centres.

Among such funds are SECANT (Society for the Encouragement of New Technology Activities) set up by the University of Compiègne (F) as early as in 1997 with an initial capital of nearly €700,000 and ESINET (European Space Incubators Network) set up by the European Commission in 2002 to facilitate the development of civil applications from aerospace research outcomes. This fund invests between €50,000 and €300,000 per deal.

Since June 2003, London's Brunel University (UK) has £1 million available to support the seeding of businesses set up within its walls. Maximum investment per business project is £50,000. The University had plans to assist in the creation of 8 new businesses each year for the next five years. The fund is supported by the London Development Agency (LDA) and HSBC, as well as by JRA Technology.

In Wales (UK), Finance Wales manages a programme entitled "Spinout programme" offering a package for people who have a close ongoing relationship with a Higher Education Institution (HEI) wishing to set up a business. These people are graduates, academics and researchers and spin-ins, i.e. entrepreneurs having ideas needing a close relationship with HEI.

The Wales Spinout programme offers a package which may include:

- a 25,000 £ unsecured free interest loans not repayable during the first 3 months;
- a 7,500 £ grant to access business consultants and/or market research experts;
- free space in a HEI incubator;
- use of HEI expertise;
- equipment;
- on-going assistance.

In the UK, there is systematic support for the marketing of university research outcomes through the so-called University Challenge Funds available in 31 universities and 7 research centres.

In Belgium 6 universities have their own venture capital fund specialised in the early or seed capital market segment.

In 1999, the French Ministry for Research, Directorate for Technology, has issued a call for proposals aiming at co-financing technology incubators as well as seed capital funds. 12 funds were awarded State funding. 6 of them have sectorial objectives and the other 6 have regional based funds. 106 deals have been made between 1999 and 2005. It is worth noting that more than 80% of the deals have been made before 2002[27]. Indeed, fund managers experiment difficulties to exit (9 voluntary exits only) and are often obliged to finance subsequent rounds, even if it was not their initial objective. As far as incubation is concerned, thirty incubators were recognized between 2000 and 2010. They have supported more than 2,900 projects.

5.7 Corporate Venturing

This is a particular form of venture capital addressing businesses at the seed or start-up stage of their development. Indeed, in this market segment, capital is supplied by large businesses to finance both innovative spinouts and other companies set up in industries considered of strategic importance. A few major US companies including Motorola, Intel, Microsoft, Cisco and Johnson & Johnson have been active in this particular market segment at one time or another in their corporate history. Intel Capital,[28] for instance, was set up in 1980 and has invested almost $11 billion. They recently invested into French businesses including Sigfox, Movea & Total Immersion.

It should be noted that the most important corporate venture funds are related to pharmaceutical enterprises. Indeed, enterprises such as Eli Illy, GlaxoSmithKline, Novartis, Novo Nordisk A/S or Sanofi-Aventis, manage funds having more than €100 million at their disposal.

In Europe, companies such as Belgacom and Solvay-Rhodia (B), Total, Saint-Gobain, Thompson, Innovacom (a subsidiary of France Telecom) (F), Siemens and BASF (D), as well as Google and Microsoft (USA operating in Europe) are also very active on this market segment.

As early as 2002, the UK's DTI (Department of Trade and Industry) had funded a programme to promote "a formal direct relationship usually between a larger and an independent smaller company in which both contribute to financial management or technical resources sharing risks and rewards equally for mutual growth" through an association called Corporate Venturing UK. Corporate venturing operations in the UK presently enjoy an attractive tax regime.[29]

The EU corporate venturing market has grown steadily in recent years, as shown in the table below:

[27] Les Echos, 25/5/2006
[28] Les Echos, 17.10.2012
[29] Cf. HM Revenue and Customs Corporate Venturing Scheme

Table 13 Developments in the corporate venturing market in Europe

Year	Nb projects (units)	Average per project (mio €)
2005	102	2.500.000
2006	95	4.000.000
2007	129	2.300.000
2008	117	3.200.000
2009	122	3.300.000
2010	132	2.000.000
2011	170	1.300.000

Source: Les Echos, 2.1.13

Sometimes[30] European based companies develop corporate venture in the USA. This is the case of Siemens, which provides seed-stage funds and commercial helps to Berkeley (California) through its programme TTB (technology to business). This programme provides companies – 8 at mid October 2005 – with seed stage financing of about €415.000 and helps commercialisation. In return Siemens gets a percentage of each company and access new technologies.

2011 saw an acceleration of this type of investment. Most remarkable is probably the fact that Sanofi teamed up with two US venture capital firms: Third et Rock Ventures.

5.8 Mergers & Acquisitions

While this growth technique may raise issues with public authorities as to the future of absorbed regional companies, merger & acquisition operations are an important means to fund the growth of new/mid-sized businesses. In 2011, investment by Sanofi in such operations totalled almost €100 million.[31]

5.9 Public venture capital funds

There are market failures in many regions relating to the provision of venture capital for local SMEs. This particular form of market failure has been recognised by European Community institutions.

Indeed, in 2001, DG Competition of the European Commission published guidelines in this field defining the notion of market failure. The Commission limits the term "market failure" for cases where it is believed that a serious misallocation of resources has occurred. There are two main sources of market failure relevant to risk capital markets which particularly affect access to capital by SMEs and companies at the early stages of their development:

- imperfect or asymmetric information;
- transaction costs[32].

This administration allows public authorities to act on the venture capital market provided that:

- the existence of a market failure is clearly established;
- venture capital intervention is limited to €500,000-750,000 depending on the region concerned[33].

---

30 The Wall Street Journal, 14-16 October 2005
31 Source: Le Figaro, 11.1.2012.
32 O.J. C 235, 21.8.2001 – State Aid and Risk Capital – Basis for authorising risk capital measures under Article 87(3)(a), (c) and (d) of the Treaty, VI.3
33 O.J. C 235, 21.8.2001 (http://ec.europa.eu/eur-lex/pri/en/oj/dat/2001/c_235/c_23520010821en00030011.pdf) or website of DG Competition, accessible through its portal (http://ec.europa.eu/competition/index_en.html)

In the European Union, the main regional funds are active in the UK, and in particular in England, where the 9 regional development agencies (RDAs) set up since 2000 have now taken over management of these development instruments. Also worth noting is that the EIF (European Investment Fund) and the ERDF (European Regional Development Fund) contribute to these regional public venture capital funds.

A number of funds such as Merseyside Regional Fund (UK), have developed several specialised schemes including:

Micro-credit:	Individual loan amounts =	£3,000-75,000;
Mezzanine:	Individual investment amounts =	£75,000-250,000;
Venture Capital:	Individual investment amounts =	£100,000-500,000;

Those three instruments are grouped under the acronym MSIF (Merseyside Special Investment Fund).

The UK is not the only country having promoted the emergence of public venture capital funds. It is also worth mentioning that in the *Pôle Européen de Développement* (European Development Pole covering the Belgian province of Luxembourg, the Grand Duchy of Luxembourg and the French region of Lorraine), EUREFI (*Fonds Transfrontalier de Développement*, Cross-border Development Fund) is very active and unique in that it pools the public resources of three regions situated in three different Member States.

In France, UNICER (*Union Nationale des Investisseurs en Capital pour les Entreprises Régionales*, National Union of Capital Investors for Regional Businesses) unites some 30 regional funds. Investment amounts range between €50,000 and €500,000.

Some regional funds can have a strong sectorial focus and take the advantages of a good public-private partnership. In mid 2005, the French regions Aquitaine and Midi-Pyrénées have both invested €1 million in an equity fund named Aerofund aiming at supporting SMEs acting in the aerospace sector. The fund is managed by ACE Management and has already collected money from enterprises such as EADS or SNECMA[34].

Advantage West Midlands has created as early as July 2003 a fund to support the creative industry.

In France ADEME (French Agency for environment and energy management) has set up in 2003 an investment fund named FIDEME specialised in wind energy with several private investors. The fund has €45 million under management.

In 2009, the Walloon Region (B) has set up the Caisse d'Investissement de Wallonie (Walloon investment fund) calling for public savings to create a SME support instrument. €83 million were collected.

5.10 Regional public equity investment firms

These firms had their moment of glory in the sixties. Some of them are still active while others are looking for alternative development channels, and others have disappeared because they failed to innovate or invested too heavily in companies whose death was predictable or inevitable.

They were known under a variety of acronyms in different countries: SDR (Regional Development Firms, in F and B), SODIS (E) and FIN (I).

The same category can be deemed to include regional development agencies operating in the Netherlands, such as LIOF (Province of Limburg).

In Belgium, such operators exist in every region:

- GIMV in Flanders. Remarkably, this firm is listed;
- SRIB (Brussels-Capital Regional Development Firm) in the Region of Brussels-Capital;
- SOWALFIN (Walloon Small and Medium-Sized Company Funding and Guarantee Firm) pools all financial instruments available to businesses operating in Wallonia.

[34] Les Echos, 22 June 2005

In France, Regional Development Firms are operating in several metropolitan regions (Bretagne, Aquitaine, Nord-Pas de Calais).

A number of French regional organisations have set up venture enterprise investment funds (VEIFs)[35.]. This is how in December 2003, Toulouse-based IRDI (Regional Industrial Development Institute) of Midi-Pyrénées (F) launched a VEIF called ICSO'1 (Venture Capital Investor in the South West) with €43 million in funding for company transfer and growth capital operations. The fund is fed by public partners (including the European Investment Fund, Caisse des Dépôts et Consignations, and the Regional Council), insurance companies, banks and private firms (Electricité de France and Total). Due to the success of this fund, a ICSO'2 fund was set up in 2010 with a capital of €63.5 million.

5.11 Industrial reconversion funds

A number of industrial groups facing structural adjustment issues leading either to the closure of production sites or to mass dismissal have set up finance companies that provide venture capital or loans to SMEs against a commitment to create new jobs or hire some of the workforce laid off at or near production sites affected by restructuring. Worth mentioning in this field are the initiatives of *Charbonnages de France* (French Public Coal Company) who set up SOFIREM) and FINORPA to operate in regional coal basins.

In Belgium, regional public authorities have set up a network of "invests", i.e. specialised financial corporations acting at sub-regional level to acquire stakes in new businesses. In 2003, they joined forces under an umbrella agency called SOWALFIN controlled by the Walloon region.

5.12 Proximity funding

The social economy too, developed alternative ways to provide operators of this sector of economic and social life with an access to funding. While the tools are often similar to those of the capitalistic economy, individual deals are often smaller. Worth mentioning among these tools are:

- in France: Lovemoney operates using a business model that is similar to business angels;
- at European level, INAISE (International Association of Investors in the Social economy) is a grouping of several operators.

Proximity funding[36] may also focus on regional commercial businesses. Financial operators of the French North Department (Crédit Mutuel du Nord Europe and SIGEFI Nord Gestion) jointly launched a proximity investment fund called FIP Nord Europe PME to finance unlisted regional SMEs. Maximum stakes in individual companies reach €3,000.

5.13 Transmission funds

Zernike group (NL)), in partnership with the ING Bank, has set up a first transmission venture capital fund in the Netherlands. The fund investment strategy is to take over medium size enterprises facing transmission problems in view of bringing new management team and clustering them around their products and services.

Zernike is planning to create a similar fund in Germany. The size of the Dutch fund is €200 million.

---

[35] Les Echos, 2-3 January 2004
[36] Les Echos, 15 December 2003

Chapter 6 The Stock Exchange

6.1 National Markets for SMEs

For businesses, listing on a stock exchange is the ultimate stage of venture capital finance.

This business financing technique is the province of just a few businesses. In view of the importance of SMEs, most EU stock exchanges have set up a specific segment for them: NYSE Alternext (F, B, NL, P), AIM (UK), Deutsche Börse Entry Standard (D), New/Connect (PL), Nasdaq OMX (S, FIN), AIM Italy (I). Obviously, none of these initiatives even begins to compare with NASDAQ (US).

As illustrated by the data below for the first ten months of 2011, 214 businesses launched IPOs in Europe[37], raising less than €100 million while 32 companies raised more than €100 million:

	Number of businesses		
	Europe and Middle East	North America	Asia
≤€250,000	22	59	0
€250,000-499,999	21	27	1
€500,000-999,999	18	18	4
€1,000,000-1,999,999	17	13	16
€2,000,000-2,999,999	14	5	31
€3,000,000-4,999,999	25	7	52
€5,000,000-14,999,999	45	9	89
€15,000,000-49,999,999	24	49	131
€50,000,000-99,999,999	28	45	116
≥€100,000,000	32	96	114

Worth noting is that in recent years, most IPOs happened on the London and Warsaw exchanges.

As of mid-2011, the breakdown of businesses listed on markets dedicated to SMEs was as follows:

AIM London	1,178
Entry Standard – Deutsche Börse	132
NASDAQ OMX First North	123
NYSE Euronext Alternext	158
New/Connect Warsaw	220

Worth noting is that the conditions businesses need to meet for listing both on the AIM and Alternext are less demanding compared to the traditional stock exchange markets reserved for large companies.

Indeed, companies listed on the London AIM do not need to disclose their financial history, nor is there a minimum share issue requirement. Companies quoted on Alternext have to disclose their financial history for the last two years, issue at least €2.5 million in shares and undertake to make regular financial data disclosures.

Worth adding is that Alternext currently lists companies whose shareholders include at least 5 venture capital firms. And also worth recalling is that the AIM was set up in 1995 and had listed more than 2,900 businesses[38] by mid-2008. As for Alternext, it was launched in mid-2005.

---

[37] Source: Frédérique de Lamine, NYSE Euronext: EBAN Winter University, Brussels 21.10.2011.

[38] Of which at least 500 companies from more than 70 countries in addition to the UK.

The breakdown by sectors of the 1425 listed enterprises on AIM stock exchange in 2005 showed compared with the 1196 listed in August 2011 the following rough picture[39]:

	2005	2011	2012		2005	2011	2012
- Finance:	200	156	129	- Travel and leisure:	70	37	30
- Informatics	130	94	85	- Real estate	50	65	57
- Services:	125	89	105	- Bio & pharmaceutics	50	38	40
- Media:	110	67	60	- Distribution:	30	21	18
- Gas and petrol:	75	109	106	- Alternative energy	na	17	17

Presented below is the regional breakdown of UK businesses listed on the AIM as of 31 December 2010 compared with the one of 1 May 2008:

	2008	2010	2012		2008	2010	2012
East Anglia	98	59	29	South East	117	76	109
London	579	377	192	South West	54	26	11
Midlands	58	47	46	Wales	17	9	8
North West	113	77	99	Yorkshire North East	17	60	8
Scotland	41	29	31	Ireland	2	2	3

Remarkable is that in recent years, the number of listed SMEs has fluctuated considerably. Indeed, in 2011 alone, 22 SMEs launched IPOs in France while 30 left the stock exchange.[40]

En 2013, NYSE-Euronext is expected to launch a business exchange specialising in "PME-ETI" (*entreprise de taille intermédiaire*, mid-cap companies). It will be launched simultaneously on four European stock exchanges (Paris, Lisbon, Brussels & Amsterdam) for businesses with a market capitalisation of up to €1 billion, including 832 companies presently listed on Alternext (183) Euronext B (222 companies with market capitalisations ranging between €150 million and €1 billion) and Euronext C (427 companies with market capitalisations below €150 million).

6.2 Regional electronic SME stock exchange

Ofex, in UK, is an independent market focused on SMEs. Since its launch, Ofex has served over 500 enterprises.

Early 2008, Advantage West Midlands (UK) put in place a regional SME share exchange named "Investbx", aiming at helping SMEs to raise money through a web based in stock exchange. This new instrument will provide a better liquidity of the regional access to finance market.

Investbx was set up to address the difficulties facing SMEs in the Midlands when trying to raise £0.5-2 million. Indeed as of mid-2005, only 57 out of 300,000 businesses in the West Midlands were listed on the AIM and 10 on Ofex[41]. Investbx expects to be able to meet the financial needs of at least 47 SMEs over the first five years of its existence.

As of 31 December 2010, three companies were listed on Investbx, i.e. *Early Equity plc* in financial services, *Logica* in IT software and *Team Works Karting Group* in tourism and leisure. At the time, their shares were valued at 0.35p, 240p and 10p respectively. In 2011, Investbx was "privatised" for the symbolic amount of £1 after having swallowed up £3 million of public funds.

---

[39] Les Echos, 22 March 2006

[40] Les Echos, 19.07.2012

[41] J.O. L 45, 20.2.08

6.3 Listed bonds

In some countries, such as France[42], SMEs prefer bond issues to IPOs. For instance, there were 136 bond issues in 2010. SMEs reportedly raised €2.5 billion in pools ranging between €5-10 million each.

It appears that halfway through 2012, large EU companies had raised more money from bond issues (€90 billion) than bank loans (€76 billion) that year. Worth noting is that as of 30 June 2005, bank loans totalled €128 billion compared to just €48 billion in bond issues that year.

Also worth noting is that the Stuttgart stock exchange has specialised in corporate bond issues while the London and Milan stock exchanges have specific markets for SME bonds respectively called ORB (Orderbook for Retail Bonds) and MOT (*Mercato Telematica delle Obligazioni*).

[42] Les Echos, 31.5.11

Chapter 7 Crowdfunding

Crowdfunding is the use of online communities to raise money from individuals to fund a project or an initiative. The investors/donors are typically not professional financiers. Crowdfunding platforms are infrastructures for people wishing to see that their money goes into well-defined entrepreneurial projects.

Using the emotion and empathy of a target group of citizens to finance ideas, projects or initiatives is not new. Just think about cooperatives, television and radio fund raising programmes[43], etc. The novelty is the use of the power of internet social media to reach donor and investor communities without geographical constraints.

Crowdfunding has demonstrated its ability to reach communities interested in supporting

- businesses
- arts, design
- local projects
- social or societal commitments and engagements

by providing financial means in the form of

- donations / sponsorships
- loans
- in kind rewards
- early stage equity
- pre-ordering.

In all cases crowdfunding provides good pre-market information for the entrepreneurs. Indeed, entrepreneurs can get feedback on their products thanks to believers or early adopters. They can get the attention of people who are project-based and not enterprise-based. Later on, they can get the attention of professional investors.

The following data regarding the activities reported by Kickstarter (USA) illustrate the wide scope of projects receiving funding from the crowd.

Table 14 Volume of money raised by the Top 3 sectorial most successful projects

In USD

Sector	Top 1	Top 2	Top 3
Art	116 270	84 613	77 271
Comics	1 254 120	109 301	84 981
Dance	26 270	25 952	20 616
Design	1 464 706	942 578	938 771
Fashion	64 246	59 132	56 618
Film & Video	352 992	273 725	223 422
Food	257 307	60 409	54 437
Games	3 336 371	2 933 252	1 836 447
Music	207 980	133 341	105 294
Photography	50 015	36 830	35 348
Publishing	140 201	103 538	91 751
Technology	830 827	556 541	262 351
Theater	78 340	67 605	61 250

Source: Kickstarter.com Overview EURADA Secretariat 13.5.12

[43] Téléthon in France or Télévie in Belgium for health research

Table 15 Range of funds raised by some sectors (number of projects)

In units

Sectors	≥ $250,000	$100,000-250,000	$50,000-99,000	$25,000-49,000	≤ $25,000
Food	1	–	2	28	43
Arts	–	1 *	9	27	23
Technology	4	16	23	39	10
Design	18	24	38	28	na

(*) Israel project

Source: Kickstarter.com Overview EURADA Secretariat 13.5.12

Platforms can be funded by cut off of money raised either from entrepreneurs and/or investors or by a lump sum charged to the entrepreneurs.

Project leaders can offer crowd investors one of the following rewards for their investment:

- no return (donation)
- non financial reward (a product, a meeting with the creator,…)
- loan repayment with interest or without interest in case of socially motivated investors
- shares of the company
- collective investment certificate.

According to data published on line by Forbes on 11.5.2012, the world crowdfunding market in 2011 broke down as follows:

- donations 49 %
- loans 22 %
- equity 18 %
- rewards 11 %

The volume of funds raised worldwide by the crowdfunding industry in 2011 is estimated at USD1.5 billion (Source: massolution), of which only 10% in Europe.
In the USA, this volume is estimated at USD920 million in 2011 (Source: MIT).
In France, between 2008 an 2011, 25 platforms have financed 15,000 projects for an amount of EUR6 millions thanks to 35,000 investors[44].

According to crowdfunding.org, the industry's website, there were some 137 platforms operating in Europe early 2012. Their locations are:

UK	32	BE	3	IRL	2
NL	24	I	3	AT	1
FR	25	PL	3	EE	1
DE	16	PT	3	FIN	1
ES	13	CZ	2	LV	1
CH	4	DK	2	RO	1

In comparison, there are 138 platforms in the USA, 12 in Canada and 3 in Japan. No split between loans, equity, donations.

At the level of platforms: Kickstarter, created in 2009. The platform has helped raise USD ±150 million in 2011 and ULULE which financed to date more than 875 projects, often small amounts of money. Investors are rewarded in kind. According to some surveys, 75% of projects funded have faced some delays in delivering the products promised.

[44] La Tribune, 27.3.2012, Meeting of 26.3.12 at the Palais Brongniart

At the level of projects: Trampoline (UK), one of the world first technology business to raise finance, already in 2009, through equity crowdfunding. It raised GBP 1 million in four rounds.

According to Kristof de Buysere[45], the growth of the crowdfunding industry in Europe might face three types of barriers:

- Promotion restrictions with regard to the "Prospectus" directive
- Restrictions in company laws due to the limited number of shareholders
- Restrictions from investment services or banking regulations.

UKIE[46] has identified four hurdles in the current UK regulations. Those hurdles are:

- Requirement by the entrepreneurs to be authorized by the FSA
- Prohibition by the UK Financial Services and Market Act of non authorized firms to promote unregulated collective investment schemes
- Appropriateness of investments. Due diligence costs would be high for crowdfunding operating high volumes of projects having low value investment
- Private companies are not allowed to offer their shares to the public.

Trampoline, a UK enterprise which has successfully raised money through its own crowdfunding portal, made a clear statement regarding the classification between "high net worth individuals", sophisticated investors and self-certified sophisticated investors in order to comply with FSA.

In the USA, the 2012 JOBS Act[47] allows enterprises to raise as much as USD one million without having to manage a public offering. It also allows enterprises to sell up to USD50 million in shares and have up to 1000 shareholders before having to register with the SEC.

It is also worth knowing that in the USA there is a private initiative to establish best practice standards for crowdfunding portals (cf. www.crowdsourcing.org/caps). These standards look at issues such as the transparency of the platform, the quality of the information, the security of the payment, the operational process.

As far as the European market is concerned, there are still discussions around the necessity of adapting or not the legislation. A White Paper has been adopted mid-2012 under the title "A Framework for European Crowdfunding"[48]. As usual, the EU market is very fragmented with more than 550 platforms already operating by end of 2012. With regard to the average amounts collected in Europe, they range from €4,500 for lending between peers, €5,000 for donations, €20,000 for pre-ordering and €50,000 for equity[49].

Some platforms are hybrid ones, mixing crowd investors with professional investors (business angels or venture capitalists)[50].

In 2012, private individuals invested €14 million in 570 projects in The Netherlands.[51] The table below presents a breakdown of this investment per market segment.

45 Tilburg University (NL) and KU Leuven, Campus Kortrijk, Eurada Workshop held on 7.6.2012
46 UKIE = The Association for UK Interactive Entertainment
47 Jumpstarts Our Business Start-ups Act signed by President Obama on 4 May 2012
48 http://www.europecrowdfunding.org/Resources/Documents/FRAMEWORK_EU_CROWDFUNDING.pdf
49 Data quoted by Osman Anwar – SQW, 26.11.2012. Workshop organised by DG Connect and DG Enterprise and Industry
50 Cf. www.mymicroinvest.com
51 Douw & Koren. Crowdfunding in The Netherlands in 2012.

Table 16 Investment per market segment

Project types	Total investment	Number of projects	Average amount per project
International Projects	€700,000	174	€4,000
Creative projects	€1,900,000	262	€7,250
Environment and sport	€300,000	25	€12,000
Businesses	€4,100,000	108	€38,000
Wind energy	€7,000,000	1	€7,000,000

Chapter 8 From the Idea to IPO

The two tables below emphasise the difference – in terms of IPO and new jobs – between US and EU success stories in the NICT (New Information and Communication Technology) industry.

Table 17 Large American NTCI start-ups

LARGE AMERICAN NTCI START-UPSI				
Company	**Creation**	**IPO**	**Capitalisation**	**Employees**
Microsoft	1975	1986	$ 290B	71 000
Cisco	1984	1990	$ 172B	49 900
Google	1998	2004	$ 149B	5 600
Intel	1968	1971	$ 121B	99 900
Oracle	1977	1986	$ 91B	68 400
Apple	1976	1984	$ 73B	17 800
Dell	1984	1988	$ 58B	78 700
eBay	1995	1998	$ 42B	12 300
Yahoo	1994	1996	$ 37B	9 800
Sun Microsystems	1982	1986	$ 19B	38 000
Amazon	1994	1997	$ 15B	13 300
Average	1984	1989	$ 97B	42 000

Source: Hervé Lebret, "Start-up. What we may still learn from Silicon Valley"

Table 18 Large European NTCI start-ups

LARGE EUROPEAN NTCI START-UPS				
Company	**Creation**	**IPO**	**Capitalisation**	**Employees**
SAP	1972	1988	$ 65B	37 700
Dassault Systèmes	1981	1996	$ 6.0B	5 700
Logitech	1981	1988	$ 5.1B	7 200
Business Objects	1990	1994	$ 3.7B	5 100
ARM Holding	1990	1998	$ 3.1B	1 500
Soitec	1992	1999	$ 2.6B	600
CSR	1998	2004	$ 1.5B	810
Autonomy	1996	1998	$ 1.5B	400
Gemplus	1988	2000	$ 1.2B	6 300
Average	1987	1996	$ 10B	7 200

Source : Hervé Lebret, "Start-up. What we may still learn from Silicon Valley "

The graphs below illustrate the venture capital funding cycles of two US companies that have become symbols of the success stories of the Silicon Valley, i.e. Amazon and Google.

Graph 9 A financial chronology of Amazon.com

A financial chronology of AMAZON.COM

Price/Share		
$.001	**1994** July 1994 November 1994	**Founder** Jeff Bezos starts Amazon.com :He invests $10,000 and borrows $44,000
$.1717	**1995** February 1995 July 1995	**Family** Founder's father and mother invest a combined $245,500
$.1287-3333	August 1995 December 1995	**Business Angels** Two angels invest a total of $54,408
$.3333	**1996** December '95 – May '96	**Angel Syndicate** Twenty angels invest$46.850 each on average, for at total of $937.000
$.3333	May 1996	**Family** Founder's siblings invest $20.000
$2.3417	June 1996	**Venture Capitalists** Two venture capital funds invest $8million
$18	**1997** May 1997	**Initial Public Offering** Three million shares are offered on the equity market, raising $49.1 million
$52.11	**1998** December '97 – May '98	**Loan and Bond Issue** $326 million bond issue is used to retire $75 million in loan debt and to finance operations

Source :M.Van Osnabrugge and Robinson : data partially adapted from Smith and Kiholm (forthcoming)

Graph 10 A financial chronology of Google.com

A financial chronology of Google.com

Price/Share (in US $)		
	1995	Larry Page & Sergey Brin@Stanford University
	1997	US$ 15 000 credit cards US$ 100 000 B.A. Andy Bechtolstein (Sun Microsystems) OTL Patent
0.06	end 1998	US$ 960 000 3 B.A. OTL receives 2 % of the shares
0.50	May 1999	US$ 25 000 000 2 V.C. Kleiner Perkins & Sequoia
2.34	2001	US$ 15 000 000 of which Yahoo
85.00	August 2004	US$ 2 718 281 828 I.P.O.
295.00	2005	US$ 4 000 000 000 Capital increase

NB: Turnover US$ 200 000 (1999)
US$ 8 000 000 000 (2006)

Source : Hervé Lebret

Standford University sold later 1.8 million shares for an amount of USD336 million.

Chapter 9 Other Funding Sources

9.1 Repayable success-linked short-term loans

Such funding is provided by the French OSEO. It is targeted at innovative companies and entrepreneurs with a research and development project potentially leading to marketable products or processes. Loans may cover as much as 50% of eligible expenditure incurred as part of project stages including:

- formulation and feasibility;
- development;
- preparation of first production;
- taking out and extension of patents;
- market research;
- search for intermediary partners.

9.2 Stock purchase warrants

Since 2001, OSEO offers growing businesses a financial product called BSA (stock purchase warrants), i.e. securities carrying the right to purchase shares of the issuing body at a fixed price within a specific timeframe.

BSAs have a double advantage for issuing businesses:

- higher equity capital meaning a stronger financial basis;
- improved cash position.

OSEO receives BSAs in exchange for its financial support, either immediately or by instalments as the business project develops, or at the time of calling its claim in the case of a repayable short-term loan.

Worth highlighting is that business developers have pre-emptive rights to buy back OSEO's BSAs if a third party offers to acquire them. As a rule, OSEO avoids keeping BSAs of individual businesses for more than ten years.

9.3 Factoring

Factoring is a fast and flexible way of alleviating businesses' cash flow problems by both providing short-term liquid assets (24 to 48 hours) and protecting them against payments outstanding.

Companies may obtain up to 90% of the full amount of their invoices[52] as soon as products are delivered or services are provided. Factoring applies to both domestic and export bills. Europe accounts for 65% of the global factoring market, estimated at a total of €670 million.

Factoring costs depend upon a number of elements[53]. Indeed, the fees charged by factors are based on:

- the value of assigned claims;
- possible assorted services (administration, management, financing, credit insurance).

Commissions[54] vary between 0.5% and 2% and interest rates are 2-3% above the basic rate charged by banks.

---

[52] In Belgium, advances on invoices generally amount to 75-85%

[53] L'Echo, 29 October 2003

[54] European SME Observatory, 2003 n°2. *SME Access to Finance* http://ec.europa.eu/enterprise/enterprise_policy/analysis/doc/smes_observatory_2003_report2_en.pdf

9.4 Leasing

Leases are an instrument whereby a financial organisation (the lessor) awards a company (the lessee) the right to enjoy an asset for a predetermined period of time against regular "rents".

The leasing market is subdivided into two segments: real estate and capital goods. The types of investment most often financed in the latter segment include transport vehicles (30%), manufacturing equipment (29%), office machinery (23%) and telecom equipment (15%).[55]

Leasing habits differ across EU Member States, with market penetration as a percentage of total business investment being stronger in France, Italy, Germany, Sweden, Poland and the UK.

Over 1,300 companies are active in this industry in Europe.

The strengths of leasing include attractive costs, tax incentives, full financing of purchase price, improved cash flow management and flexibility in setting leasing contract duration.

9.5 Franchising

This concept can be a tool to finance the growth of an enterprise.

The development of a network often needs an important amount of capital both for the brand holder and for the franchised entrepreneurs. Recently this market has been looked at by venture capitalists. In France, Natexis Private Equity has created a specialised fund named SPES. Enterprises such as Intersport, Mr. Bricolage or Optic 2000 benefited from that fund.

9.6 Business transfer/takeover instrument

There are other instruments to promote business transfers in addition to venture capital funds (see section 5.13), such as guarantee funds (see *IDéclic Transmission* in Rhône-Alpes (F), which guarantees bank debt up to €400,000) or loan funds leveraging bank loans (cf. *PRATE*, also in Rhône-Alpes: 7-year loans amounting to €10,000-240,000 with a two year delayed reimbursement clause).

[55] Source: The Use of Leasing amongst European SMEs, Oxford Economics, November 2011.

Chapter 10 Guarantees

Guarantees are an important tool to improve businesses' access to credit. According to AECM (European Association of Mutual Guarantee Societies), there are different types of guarantee schemes:

- mutual or joint-guarantee societies;
- public guarantee schemes, often set up by national or regional public authorities;
- guarantee or counter-guarantee schemes.

While banks are to be the principal source of external capital for small and medium-sized enterprises, guarantee schemes have a complementary role to play by making available guarantees to compensate for SMEs' insufficient collateral. The aim of guarantee societies is to improve the access to professional credit for viable small and medium-sized business projects without the personal collateral required by banks in the hope of building a stable long-term relationship.

Guarantee schemes are formed by a mixture of private and/or public initiatives and usually involve entrepreneurs either directly or indirectly in the action, decision-making and management mechanisms. A special characteristic of the European structure is the existence of national counter guarantees, regional in some cases, and supranational counter guarantee platform organized and financed by the European Commission and handled by the European Investment Fund.

In Finland, public corporation FINNVERA provides both loans and guarantees to SMEs which do not have access to bank loans because they lack adequate guarantees. FINNVERA's activities are deployed under six specific schemes:

- investment finance: mid and long-term loans and guarantees for newly-created SMEs;
- working capital supply: short to mid-term loans and guarantees;
- growth capital: low-rate loans and mid-term guarantees for business growth or environmental protection;
- micro-credit: low-rate, short to long-term loans and guarantees for micro-businesses;
- export credit guarantees;
- internationalisation funds.

The traditional approach is to present the guarantee as a "generic product", guarantee can also be presented in various packages. According to experts of European Commission who launched the project "Expert Group on BEST Practice in the field of Guarantees", guarantee products can be grouped as following:

- **Business start-ups guarantees**

  The German Bürgschaftsbanken launched the "Bürgschaft ohne Bank" system. The entrepreneur contacts the Guarantee Society; its credit file is completed and analyzed with the assistance of experts of the Chamber of Craft/Commerce/Industry. A guarantee bond is provided to successful applications. The bank intervenes at a stage when the file is already completed and the partly coverage ensured. Some guarantee banks add an accompanying service, which enables a follow-up of the starting businesses.

- **Micro-credits guarantees**

  FINNVERA (FIN). A micro-credit guarantee is intended for enterprises being established or employing a maximum of 50 persons. A micro-credit guarantee helps SMEs to obtain a loan and facilitates loan and guarantee decisions. A micro-enterprise guarantee is based on a credit and guarantee facility agreement, concluded between FINNVERA and banks, to enable small credits, generally of maximum €25,000, to be guaranteed by dividing the risk with a bank.

- **Guarantee for growing companies**

  Vaekstkaution (DK) gives support to companies with a high growth potential: the guarantee applies to the development of new products, concepts, production methods or markets. The decision-making process is of less than 5 days for loans from €10,000 to €670,000. The guarantee premium amounts to 3% for the years 1 and 2, than to 1.5% for the next years.

- **Guarantee for business internationalization**

  AWS (A) proposes a guarantee to the Austrian companies, which pursue an objective of internationalization. The premium rate is limited (0,5%/year) and the protection is high (80%).

  FINNVERA's (FIN) internationalization guarantee is intended to serve as collateral for financing the business operations of a Finnish SME abroad. The guarantee may be used when a subsidiary or an affiliated company abroad needs funding for investment, development or growth. The guarantee can also be used to acquire or increase a holding, or to raise the share capital, in a subsidiary or in an affiliated company abroad.

- **Innovation guarantees**

  AWS (A) runs a guarantee programme Innovative Dynamic SMEs to encourage productive investments and high technologies. A guarantee of 80% is attached to loans of a maximum of 1 million Euros. The premium ranges between 0.5% and 1.5% according to the risk. A profit sharing premium can be applied.

  Sofaris (F) manages the "Biotechnology" fund, which is a combination of loan and venture capital guarantee. Sofaris has established contractual partnership with 16 Venture Capital companies and provides them with a 50% guarantee for 10 years.

- **Guarantee for working capital needs**

  Hitelgarancia (H) developed a guarantee linked with a credit card. In full security, cash can be drawn and suppliers can be paid from a guaranteed account.

  RCGF (LT) proposes a guarantee to short-time credits (up to 2 years), which are used by businesses to supplement current assets. The one-off guarantee fee is usually smaller than premium for long-term investment guarantees and accounts to 2% of the guaranteed credit amount.

- **Business transfer guarantees**

  Siagi (F) is a guarantee society specialized in transfer and succession of micro-businesses. Bankers are interested in the professional expertise of Siagi and are satisfied with a guarantee protection negotiated at 35 to 45% of the final loss.

Chapter 11 Tax credit

Tax credit may provide businesses with an interesting funding source. Innovative firms seem to appreciate research tax credit to stimulate this kind of effort.

According to the Innovation Funding Barometer[56] published by *Les Echos* and conducted with 1,000 companies in France, Germany, Spain, Portugal and the United Kingdom in partnership with *Alma Consulting Group*, respondents consider that their growth requires international development and innovation. They indicate having leveraged research tax credit facilities as follows:

74% in France
65% in Spain
61% in the UK
51% in Portugal
0% in Germany because there is no such scheme there.

The rates applied under such tax credit schemes vary across countries: 32.5-82.5% in Portugal, 30% in France, 24-42% in the UK and 8.4-24% in Spain. There are also differences between countries when it comes to ceilings and eligible spending.

In France, companies less than eight years old investing in RTD enjoy a number of additional advantages.

Still in France, tax credit user firms leveraged tax credit as follows in 2011 (by investment type):[57]

- development of new products 37.5%
- overdraft facility 30.0%
- human capital for R&D 14.0%
- innovation marketing costs 8.0%
- patents 3.5%
- others 7.0%

The number of tax credit user companies and eligible amounts vary according to business size, as shown by the data below:

Nb workers	Nb beneficiaries	Total amounts perceived	Average per deal
< 10	4 211	263 000 000 €	62 455 €
Between 10 and 49	4 395	503 000 000 €	114 448 €
Between 50 and 249	2 365	628 000 000 €	265 539 €
Between 250 and 499	563	338 000 000 €	600 355 €
> 500	770	3 175 000 000 €	4 123 377 €

56 Les Echos, 21.12.2010 et www.almacy.com
57 Les Echos, 18.9.1012

Chapter 12 Innovation in the field of financial engineering

12.1 Regional banks

In June 2009, Essex County Council (UK) set up a loan finance organisation for local SMEs called *Banking of Essex* in association with Santander banking group (E). *Banking of Essex* grants 5-year loans with or without guarantee of up to £100,000 as well as (bank) overdraft facilities capped at £100,000. *Banking of Essex* also provides consulting services for its customers.

However, this initiative seems to be faltering. Indeed, over a two year period, *Banking of Essex* apparently only lent £530,000 to 22 different companies (20 loans and 2 overdraft facilities).[58]

12.2 Regional stock exchanges

As indicated in section 6.2, there is a regional exchange initiative for local SMEs in the West Midlands (UK) to help them discover for themselves in a community setting the pros and cons of an IPO.

Other regions – e.g. Rhône-Alpes in France – are contemplating regulated schemes governing regional calls for public savings. The aim of the project is to support 30 to 50 businesses annually with amounts ranging between €200,000 and €800,000. Shares could be exchanged at investors meetings held two or three times a year.

12.3 Matching EGC finance supply and demand

A variety of initiatives including Tech Tour Europe and Europe Unlimited encourage meetings between entrepreneurs and investors through specialist sector investment forums. For user companies, these initiatives act like growth accelerators.

12.4 Regional investment firms

Under the French 'Solidarity and Urban Renewal' Law, regional investment firms can be set up to finance corporate real estate in troubled areas.

The only such project, BATIXIA, is carried out in the Nord department. Notable funded projects include partnerships with a logistics company and a car components manufacturer. The Regional Council is a BATIXIA shareholder.

Since 2010, some regions have leveraged their population's savings to (re)capitalise regional SME investment funds. Worth mentioning are the initiatives of the regions of Auvergne (F), Pays de la Loire (F) and Wallonia (B).

12.5 Corporate real estate sale-and-lease-back

To help businesses face the financial crisis that started in 2008, *Trentino Sviluppo* (I) development agency developed corporate real estate sale-and-lease-back as a tool to support regional SMEs by enabling them to restore their cash flow.

---

[58] The Telegraph, 13.12.10. Le coût de l'étude de faisabilité se serait élevé à 380.000 Livres Sterling.

12.6 Soft Landing Scheme

To help businesses discover or even test their internationalisation potential, free or affordable advice desks and services are available to SMEs for a predetermined period of a few weeks.

12.7 Muslim finance

There are now Muslim finance initiatives aimed at stimulating entrepreneurship among migrants with Muslim backgrounds. Worth mentioning by way of example is the initiative of AWEX (B), which helps Walloon companies improve their attractiveness or supports their exporting endeavours. To do this, AWEX has signed a partnership agreement with the Islamic Bank of Saudi Arabia.

It is worth noting that this financial industry segment may be attractive to finance tangible assets (infrastructures). In 2012, a *sukuks* (Muslim stock resembling bonds) was issued in France to finance the acquisition of solar cell panels. See ORASIS, a Sukuks managed by Legendre Patrimoine. The contractual yield is 7% and individual shares are worth €5,980.

12.8 Coworking space

This recent concept, which had already attracted 140 developers in Europe as of end 2010, is defined as an open space where business developers and self-employed people work in a dynamic community. Users of this space enjoy a number of financial benefits in terms of rental costs and social networks.

A few examples of such initiatives: BetaHaus in Berlin (D); the Cantine, in the Sentier area of Paris (F) or Nomadz in Den Haag (NL).

12.9 Technology transfer and intellectual property funds

The French government has launched "France Brevets" in 2011, an intellectual property investment fund endowed with €50 million based on what is being done in the USA in the field of patent funds (Intellectual Ventures and Ocean Tomo).
Furthermore, the European Investment Bank, Caisse des Dépôts (F), KfW (D), Innovationsbron (S), Veraventure (FIN) CDTI (E) and Cassa Depositi e Prestiti (I) are studying the feasibility of such an instrument in Europe.

The European Investment Fund contributes to the development of technology transfer funds that can support either the emergence of spin-offs leveraging university or research centre IP, or IP licensing.

11.10 Venture capital e-marketplace

Under an Oséo (F) initiative, business developers looking for venture capital have access to an electronic platform where they can meet with investors. Under certain conditions, business developers and start-ups can table equity investment proposals amounting to a minimum of €20,000 and a maximum of €2 million.

This online service provided by Oséo to match businesses with investors went international in 2012, first in cooperation with KfW (D) and then more widely to include other European countries. The platform has since changed its name to Euroquity.[59]

As of 1 November 2012, the website represented 4 302 firms, 7 637 investors and 2 499 potential entrepreneurs looking for start-up finance. Over its first three years of existence on the French market

[59] www.euroquity.com

alone, it enjoyed stable average investment amounts at ±€25,000/project as far as business angel investment was concerned while the average sums invested by venture capital funds increased from €800,000/project in 2009 to €1.5 million/project in 2012.[60]

12.11 Ethical finance

Some ethical savings banks lend money to – or even invest equity in – socially or environmentally responsible businesses that by definition have strong local roots. It may be interesting for development agencies to get in touch with them.

The main EU players on the ethical finance market are[61]: Triodos Bank (NL) with more than €2 billion in loans granted in 2010, GLS Bank (D) with €717 million in loans and Banca Etica (I) with €642 million in loans granted.

12.12 Funds for social purposes

In order to facilitate the reintegration of unemployed people, some initiatives have emerged to provide funding and advice to business creation. Let's mention two cooperative companies with social purposes, *Filstrans* and *Challenge*, in the Belgian province of Luxembourg.

12.13 Regional sectorial funds

A few regions have set up sectorial funds intended to encourage the start-up and expansion of enterprises active in emerging growth sectors. Let's mention ST'ART, the investment fund for creative industries in Wallonia (B) and IBB Beteilgunsgesellschaft – VC Fonds Berlin which invests seed and mezzanine funding in technology companies in Berlin (D).

12.14 Social currencies

Several social currency initiatives have emerged. These currencies are especially useful in stimulating the emergence of (micro-)entrepreneurs in the local socially responsible development industry. Some of them – e.g. in Boulogne-sur-Mer (F) – aim to promote ethical consumption and short distribution channels. In the long run, such currencies could be used to access cultural amenities and soft modes of transport. In France, these currencies are often managed by Crédit Municipal. In Nantes, businesses have an in-house account they can use to pay or receive payments from other participating companies without drawing on their cash flow, thereby paying banks less interest.[62]

Worth noting is that in Switzerland, the WIR is a currency used for payments between companies. More than 60,000 businesses are members of this scheme across the country.

12.15 Peer-to-Peer Loans

Early in 2012, UK administration BIS invested a total of £100,000 into peer-to-peer platforms facilitating loans to SMEs.[63] Funding Circle, a UK platform, has since raised its loan cap to £250,000 from £100,000. Worth noting is that Market Invoice, another platform, operates on the factoring

---

60 Les Echos, 13.11.2012;
61 Source: Les Echos, 23.2.11
62 Les Echos, 27.11.2012.
63 Financial Times, 3.4.2012.

market segment. In this country, a site comparing quotes has been set up.[64] On 10.12.12, it showed that interest on loans varied between 4.88% with RateSetter and 7.65% with Funding Circle – 6.64% with P2P pioneer Zopa. As for lenders, they could expect on the same date to earn interest at a net rate of 2.99% per annum v. 2.2% for deposits of at least one year with traditional banks.

12.16 Incubators set up by tech companies

At the crossroads between pure incubation and corporate venturing, incubators are set up in partnership with businesses to support the development of start-ups in fields close to their core business. Worth mentioning as examples of such incubators are Renault's Paris-based incubator specialising in urban mobility and J.C. Decaux's incubator focusing on Connected Urban Services.

[64] http://2pmoney.co.uk

Chapter 13 What could the Public Sector do?

13.1 Scope of the public interventions

The scope for public interventions lays both at the supply side (provision of finance) and at the demand side (increase the quality of the business plan or reduce the risk to be taken by investors). The public sector can try to solve market failures by helping the demand to match the offer through networking activities.

We have evidences that at least thirteen different types of market failures occur in the field of access to finance by SMEs and start-ups. Those market failures can be:

- information failures: due to the fact that "not all the money is the same" and that the market might be fragmented;
- insufficient infrastructures: due to the fact that some tools do not exist, for instance business angel networks, investment readiness schemes, seed capital funds…;
- inefficient functioning of markets: due to the lack of competition, no exit opportunities for early stage investors, permanent assisted mentality of entrepreneurs used to receiving grants instead of fighting for equity, …;
- limited interaction between actors due to a lack of an integrated approach, the existence of a value chain or a lack of governance;
- institutional mismatch between the infrastructure and the market needs due to lack of understanding by the public sector of the real needs of enterprises and the market failures;
- missing demanding customers due to cultural problems as well as good perception of investors' expectations;
- government failure: due to a lack of coordination and to a focus on a component of the value chain;
- equity gaps;
- insufficient number of private investors;
- lack of risk-taking;
- bad framework conditions (legal, administrative, fiscal, environmental);
- bureaucracy practices;
- lack of public-private partnership.

13.2 Improving the demand side

Public policy should invest in schemes allowing entrepreneurs to become investment ready; this can take different forms, such as:

- support to enterprises wishing to improve their business plan in order to access financial tools;
- business plan competition;
- financial intermediation: filtering the entrepreneurs' steps vis-à-vis investors;
- investment readiness schemes;
- support the cost of "hands on" management systems and the due diligence costs;
- reviewing blockages in distribution channels to specific entrepreneurs: disadvantaged groups or communities;
- support the costs of public rating systems both on the point of view of bank or technology risk in favour of SMEs.
- establishing an interface between enterprises and investors;
- understanding and anticipating changes.

13.3 Improving the supply side

Public authorities can provide different supports in order to add value in the value chain of access to finance for SMEs. The support can take the form of:

- promoting investors' syndication;
- fiscal incentives aiming at improving the environment for business angels and individuals investing either in innovative enterprises or in non-quoted enterprises;
- soft measures such as reducing the costs of financial investors to do the due diligence or support for the recruitment of financial advisors by intermediary organisations;
- stake in funds. Public authorities can contribute to the creation or the sustainability of specific funds responding to regional market failure;
- clustering the main stakeholders in order to organise or strengthen a regional value chain;
- providing guarantees or grants to reduce the level of risk taken by investors
- innovating in the field of providing funding sources: crowdfunding, for example.

13.4 Networking

Networking is a very useful tool to act as a facilitation process between entrepreneurs and investors. Investment readiness schemes can provide good opportunities for entrepreneurs to improve the quality of their demand. Business Angel Networks provide also advantages as matching platform between informal investors and entrepreneurs seeking start-up money.

Public authorities can also support regional networks aiming to secure expertise and equity for early stage companies.

In the French region of Provence-Alpes-Côte d'Azur (PACA), *Fonds PACA Investissement* (PACA Investment Fund) set up in 2011 serves as a one-stop-shop, having formed links between the respective stakeholders of SME finance and incubation and business advisory services, including clusters. It also provides leverage with its €15.5 million matching fund.

In the Midlands (UK) a non-profit network named Connect Midlands acts as facilitator between technology business and investors through a comprehensive programme of events helping young companies to become "investor-ready" and to meet potential investors. The events organised by Connect Midlands are:

- Invoked – an investment readiness programme;
- Connect Springboard – an investment raising platform for enterprises seeking up to €750,000;
- Connect Round Table – an investment raising platform for enterprises seeking between €375,000 and 1,500,000;
- Connect Investment Conferences – an investment raising platform for enterprises seeking from €375,000 to 4,250,000;
- Knowledge and Skill Building – events in the form of technology briefings, enterprise workshops and meetings with the entrepreneurs.

Connect Midlands has a wide range of sponsors such as regional development agencies, universities, business advisors companies, venture capital funds …Of course, Connect Midlands provides also several benefits to its membership.

Among more or less similar networking initiatives, let's mention Oséo Investnet, PwC's Acccelerator, TechTour Europe, for instance.