INVEST EUROPE

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Response to Public Consultation on review of State aid – exemptions for small amounts of aid ("de minimis aid")

Executive Summary

In this paper, we describe:

- the negative impact of the current definition of a single financial undertaking (Art 2.2) on the financing of start-ups and scale-ups by venture, growth, and private equity capital
- the economic rationale for making a distinction between venture and trade group ownership
- a targeted and narrow amendment that could solve the issue

We do not have any comments on the numerical amounts of ceilings proposed as part of this review but would like to use the opportunity of the consultation to alert the European Commission about the consequences of the current drafting of the definition of a "single undertaking" (Art 2.2) on any type of business which receive equity support.

In this response, we refer to "private equity funds" as all types of equity funds investing in private businesses, from venture capital to growth, buy-out and infrastructure funds. While points made below are valid for all types of private equity support, the vast majority of businesses receiving EU state aid are in practice either backed by venture or growth funds.

I. Impact of the existing "single undertaking" definition on private equity-backed businesses

As a way of background, Invest Europe represents the whole European private equity industry, including venture capital fund managers supporting EU start-ups and scale-ups. In 2021 private equity funds supported 8895 businesses, 84% of which were SMEs, in sectors such as deep-tech, energy transition tech and hardware or decarbonisation of transport.

Given the innovative nature of businesses backed by venture and growth funds, they typically have the features of businesses that could benefit from state aid and, given their small size, it is possible that the amount of aid they receive will be below the *de minimis* threshold, especially at the venture end of the market.

Our concern with the existing definition – and more broadly with the concept of a "linked enterprise" as set out in the "SME Definition" Recommendation - relates to the fact that any start-up or scale-up which receive equity capital from private equity funds will be deemed, on the basis of the proposed criteria, to be an entity within a "group" as long as the firm has a majority ownership of the company.

Effectively, such a "group" will comprise:

- the business itself (in 98% of the cases an SME in the context of venture capital funding)
- the fund manager, irrespective of whether it is marketed under a venture or growth label
- any other businesses the fund has supported through equity capital.

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Obviously, this will have consequences on the maximum aid that can be given to that specific business under the proposed rules as other innovative start-ups (and the venture fund itself) may also have received state aid.

We have long argued that such an approach is not coherent with the realities of the market and is discriminating - for no objective reasons - against start-ups and scale-ups which receive equity support (as opposed to those receiving bank loans or other types of financing).

As such, the proposed approach perpetuates a general misconception about the nature of equity financing and undermines European Commission objectives to facilitate this type of financing. Most specifically, it goes counter to the Capital Markets Union project, whose key goal is to increase the ability of innovative SMEs to also finance themselves through equity.

Arguably, one could even point out that the very logic of EU state aid is to support businesses that, although facing *temporary* destructive market conditions, will ultimately overcome them at a later stage. As such, EU state aid to innovation should primarily go to a) businesses at their infancy which have the potential to grow; b) businesses that already passed considerable due diligence and market tests. Venture capital and growth funds' backed companies are those that best fit this description – and creating hurdles to promote their support will be especially detrimental to the efficiency of EU State Aid.

Conclusion: The definition has a very tangible negative impact on the ability of innovative small and midsized businesses to attain financing (either because state aid prevents them to receive venture support, or because venture support prevents them to receive state aid). This makes it harder for these businesses to participate in the EU transition towards a greener and more competitive EU economy.

II. Our case: venture ownership is not trade group ownership

We call for small businesses to no longer lose their status of "single undertaking" once backed by private equity funds (and in particular by venture capital and growth funds).

We do not question that it is essential to make a distinction between small businesses and subsidiaries of larger corporates groups but find that such a distinction is not sophisticated enough to separate trade group ownership from the temporary equity support that is granted by equity funds, irrespective of the percentage of ownership the fund has on the company.

What must drive the ability of a business to receive state aid is indeed the level of interconnection with a potential "parent" company, and not the ability of a business to receive financial support. Given this level of interconnection fundamentally differs when a business receives private equity support and when a company is part of a group, it is essential for the Commission Regulation to acknowledge these differences.

These ultimately relate to:

- the **lack of ability**, for a private equity backed SME, **to rely on the success of the fund or of other companies within the fund**
- the **incentives for the private equity manager**, as of the start of the investment, **to exit the company** in the foreseeable future
- the **lack of integration of different portfolio companies / businesses within or across funds**

Overall, these three specificities amount to the same basic principle: there is an **absence of strategic interest** at the private equity manager level: portfolio companies owned by a private equity fund are not at all linked to each other in the way an industrial group is, and the private equity firm does <u>not have an overarching plan for all of them</u>.

This translates into the following *modus operandi*:

1. **Separate accounts**

A manager will maintain separate accounts between its firm and the company it invests in, as documented in the financial contract between the private equity firm and its investees.

2. **No centralised management**

Private equity backed companies do not enjoy joint administration of services or joint legal advice and are treated completely separately.

3. **No right to receive aid from its investors**

Private equity backed companies which suffer economic loss generally do not receive financial aid from the manager or other portfolio companies. Because of the separate accounts maintained by the manager, the companies will generally also not have access to portfolio-wide funds, such as cash pool.

4. **No involvement in day-to-day management**

While active, the manager typically does not get involved in the day-to-day management of the firm. It usually gets involved at the level of the board, with the objective of increasing the value of the company.

5. **Number of investors in the entity**

Private equity firms function as intermediaries for the investors into the fund. The investors typically participate as limited partners in investment funds and normally do not have the ability to exercise control.

6. **Absence of consolidated financial statements**

Typically, no consolidated financial statements exist for the various portfolio companies held by different investment funds that are part of the same private equity firm.

Conclusion: There are fundamental differences between trade group ownership and private equity (including venture capital) support that, irrespective of the level of ownership (majority or not), are worth being recognised within EU law.

III. Proposed changes

To acknowledge differences between private equity ownership and trade groups, we call for the regulator to amend the definition so that companies owned by firms described above continue to be considered as what they effectively are: **single undertakings which, although benefitting from a level of financial support, should not be differentiated from entities which finance themselves through bank loans.**

This objective could have been achieved through a change to the SME Recommendation, and of the “linked enterprise” concept, which the definition copies. Although such a change was once envisaged by the Commission, the recent SME Definition Evaluation clarified that no modification of the Recommendation was to take place in the medium-term[1].

[1] SWD (2021) 279 final.

While closing the door to a modification of the definition, the Evaluation did however point out that companies that are backed by venture firms with a majority ownership would "*lose the possibility to access EU funding and other benefits reserved for SMEs*" due to the way the current definition is drafted. It then pointed out that "*issues of a specific nature could be better examined within their particular policy context, while recognising the need to ensure consistency and equal treatment in view of the horizontal SME Definition*".

Conclusion: There is already a **clear policy rationale** to modify the specific definition in separate legislation.

Our proposed solution

To ensure consistency, we propose for such to a modification be restricted to the private equity model meeting the criteria defined above. Such a caveat could be introduced in an additional paragraph of Art 2.2 or in a recital:

Enterprises which received capital from a venture or private equity fund shall be considered single undertakings for the purpose of this Regulation provided that the fund can show that it has had an exit strategy since the time it acquired its interest the enterprise in question, there are separate accounts between the manager and the enterprise in question, and the enterprise in question has no ability to receive financial aid from that fund or the other enterprises in which that fund has invested.

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About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation, and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance, and transparency from our members.

Invest Europe is a non-profit organisation with twenty-five employees in Brussels, Belgium.

For more information, please visit www.investeurope.eu.