FRANCE INVEST
Investors for growth

10 January 2023

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

France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. **We are a member of Invest Europe and we share and support the comments Invest Europe has made in respect of this consultation**.

We would like to use the opportunity of this Consultation to alert the European Commission about the consequences of the current drafting of the definition of a "single undertaking" (Art 2.2) on venture-backed businesses and to propose a modification of the SME Recommendation.

We would also like to share some additional comments on the level of the ceilings and on the introduction of a mandatory public register at national or EU level.

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

Our membership includes venture capital fund managers supporting French and EU start-ups and scale-ups. Given the innovative nature of these businesses, it is not rare that they benefit from State aid and, given their small size, it is possible that the amount of aid they will receive will be below the de minimis threshold.

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 receives equity support from venture funds will be deemed, on the basis of the proposed criteria, to be an entity within a "group".

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, irrespective of whether it is marketed under a venture or growth label;
- any other businesses the fund has supported through equity capital;
- any other business that is supported through equity capital by any other funds managed by the management company;
- the management company itself.

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 venture capital market and may be detrimental to start-ups and scale-ups which receive equity support (as opposed to those receiving bank loans).

As such, one of the effects of the proposed approach has been to undermine the Capital Markets Union objectives of developing private equity investments in innovative SMEs. This ironically ultimately has an impact… on the amount of public funding that is required to support these businesses through funds backed by public institutions (such as the European Investment Fund or national promotional banks).

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

We do not question that it is essential that a distinction must be made between small businesses and subsidiaries of larger corporates groups. We also do not question that the proposed definition is appropriate to cover situations other than those faced by venture-capital backed businesses.

The point of this section is to describe to the reader why any venture-capital backed business should be carved out from the definition. There are indeed fundamental differences between business links that form a trade group – which the definition of a “single undertaking” rightly wants to tackle – and the relationship between a venture fund and the businesses it supports.

These 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 **desire of the venture capital 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**: 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**

Venture capital- backed companies (the same is true of all private equity backed businesses) 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**

Venture capital 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 venture capital support that, irrespective of the level of ownership (majority or not), are worth being recognised within EU law.

III. Proposed change to the SME Recommendation

To acknowledge differences between private equity ownership and trade groups, it is crucial 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 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].

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*". There is therefore ***already a clear policy rationale*** to modify the specific definition in separate legislation, such as this specific note.

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 not be deemed linked to that fund or to other enterprises in which that fund has invested 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.

IV. Additional comments

1. Level of the ceilings

The Commission proposes to cap to the de minimis aid that a single undertaking may receive per Member Sates over any period of three years at a level of 275,000 EUR. Some of our members think that this ceiling is too low. Indeed, in their opinion, the proposed ceiling does not take into account neither the impact of events

[1] SWD (2021) 279 final.

on the international scene when calculating future inflation and of the sanitary crisis nor the fact that SMEs are in need for financing for working capital.

2. Introduction of a mandatory public register a national or EU level

While we share the need to ensure transparency on all de minimis aid granted by any authority within the Member States, some of our members highlight that the maintenance and update of public registers would imply additional costs and red tape, in particular in terms of IT development and human resources (training). They point out the difficulty to aggregate data from multiple participants on different types of aid (subsidies, tax reliefs….). They insist on the need for all actors to be involved for the register to be useful and request a longer transitional period.

Established nearly 40 years ago, France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts roughly 400 management firms and 180 associate members.

Private equity supports unlisted companies for a fixed period of time and provides them with the equity capital, through the acquisition of minority or majority stakes in their capital, needed to finance growth and transformation projects. It supports the creation of start-ups (venture capital), participates in the growth and transformation of many regional SMEs and mid-caps (growth capital) and contributes to the transfer of companies (replacement capital).

France Invest's members represent one of the main growth drivers for the French and European economy and support a significant portion of employment in France and Europe. In 2021, French private equity and infrastructure players invested €36 billion in 2,500 companies and infrastructure projects. They raised €42 billion from investors, half of which abroad (one third at EU level excluding France), which will be invested over the next 5 years2. In addition to that, in 2021, private debt players (structures financing companies and infrastructure projects) invested €14.7 billion in 293 transactions and raised €9.3 billion that will finance new transactions in the coming years3. European companies, in particular start-ups and SMEs, are the main recipients of these investments. Over the 2015-2020 period, over 244 237 jobs were created in companies backed by French venture capital and private equity4.

In particular, during the pandemic, the venture capital and private equity industry has demonstrated its adaptability, supporting existing portfolio companies as and when needed, while continuing to invest in new businesses that require capital and operational expertise to grow.

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2 https://www.franceinvest.eu/wp-content/uploads/2022/04/France-Invest-Etudes-2022_Activite-2021_VDEF.pdf
3 https://www.franceinvest.eu/wp-content/uploads/2022/04/France-Invest-Etudes-2022_Dette-privee-2021.pdf
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