

Review of the State aid regime to support SME access to risk capital

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## Advantages and shortcomings of the current State aid policy in the area of risk capital

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# EIF: The specialist provider of SME risk finance across Europe

Section One

# EIF – a European Union body



“ We’ re the leading developer of risk financing for entrepreneurship and innovation across the EU ”



## Helping

SMEs, micro-enterprises and European regions innovate and grow by **making finance more accessible**

## Fulfilling

our **dual** goal and pursue **EU policy objectives** as well as **financial sustainability**

## Addressing

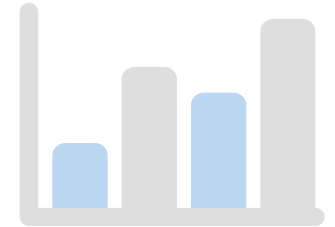
market needs by acting as a **countercyclical** investor in tough economic times

## Working

with financial intermediaries across the **27 EU countries, EFTA** and all **Accession countries**

# Our objectives

“ To support smart, sustainable and inclusive growth ”



**Working with** a broad range of financial intermediaries to provide **credit enhancement** and invest in **venture and growth capital**

Being **Europe's** cornerstone **venture** and **growth** capital investor, leading **catalyst** to promote SME lending and **microfinance**

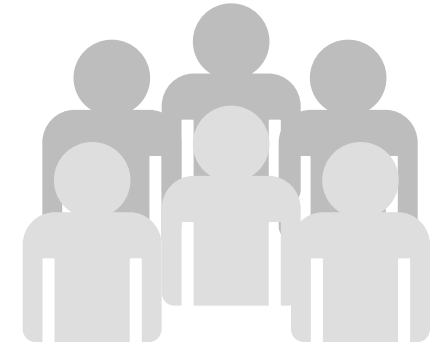
**Promoting cohesion** and regional and social development

**Bringing together** national public and private partners to **support innovation and entrepreneurship**

**Filling the financing gaps** in Europe's economy

# Our counterparts

“ We work with a **wide range of counterparts** to support SMEs ”



## Fund providers and Mandators

- European Investment Bank
- European Commission
- Member States
- Managing Authorities
- Funds of Funds
- Corporates/private
- Public institutes



## Intermediaries and counterparts

- Commercial Banks
- Development & Promotional Banks
- Guarantee Institutions
- Leasing Companies
- Fund Managers
- Microfinance Institutions



micro-  
enterprises,  
SMEs  
and small  
mid-caps

# Our resources

“ We manage resources  
from different stakeholders ”



## European Investment Bank

- Risk Capital Mandate (RCM) **EUR 5bn**
- Mezzanine Facility for Growth (MFG) **EUR 1bn**

## European Commission

- Competitiveness and Innovation Framework Progr. (CIP) **EUR 1bn** equally allocated to equity and guarantees
- Risk-Sharing Instrument (RSI) **EUR 120m**
- Progress Microfinance **EUR 200m**

## National & Regional Funds

- **20** European and regional Funds-of-Funds including Germany, Portugal, Spain, Turkey, UK
- **13** Holding Funds supported by structural funds **EUR 1.2bn**

# Our impact

“ Over 1 Million SMEs supported in **30 different countries.** ”

“ **EUR 11bn in equity and guarantees** commitments have mobilised over **EUR 60bn** from partner banks, investors and other market players. ”

“ **Broad European coverage,**

- 20 Funds-of-Funds/Holding funds,
- 400 Venture and Growth Capital Funds,
- 150 banks, guarantee and promotional institutions ”

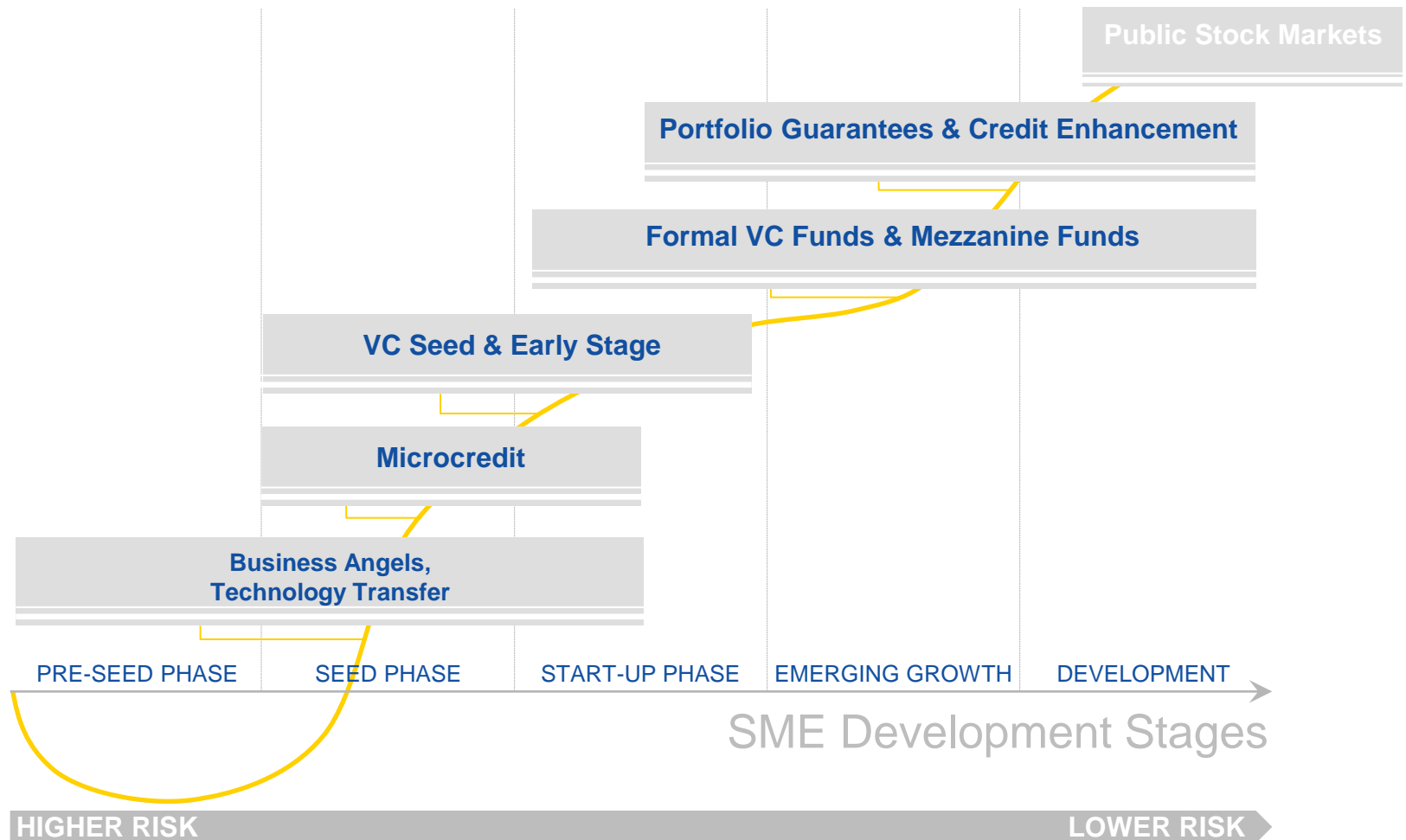


# How does EIF help small and medium-sized enterprises?

## Section Two



# Helping businesses at every stage through risk finance





How does ELF perceive the State aid policy in the area of risk capital?

Section Three

# The revision of the State Aid rules for risk capital

“ Should allow State aid in order to ... ”

- Enhance SME access to risk finance - a priority of the Europe 2020 Strategy
- Provide effective support to SMEs and “good aid”, particularly in the persisting financial crisis
- Provide aid through financial instruments, which are, *a priori*, less distortive and more growth-enhancing than grants
- Make effective use of public funds
- Stimulate and leverage of private investments

# The revision of the State Aid rules for risk capital

“ Should be guided by basic principles ... ”

- **Market economy investor principle (MEIP)**
  - An investment compliant with the MEIP is deemed free of aid
  - A debt, equity or quasi-equity investment complies with the MEIP, if an experienced investor, operating under normal market conditions in the respective market would, all other elements being equal, be prepared to commit to a specific investment in the absence of any public assistance or advantage in the meaning of Article 107(1) TFEU
- **No crowding out of private investors / no substitution of private financing**
  - An investment can comply with MEIP and be market conform but can still be undesirable if it would crowd out private investors
- **Clear compatibility criteria** (e.g. balancing test, priority of pursued objectives)
- **Efficiency and legal certainty**

# The revision of the State Aid rules for risk capital

“ Should be guided by MEIP and no crowding out principles and focus on avoiding market distortions ”

Does the investment confer an **advantage** to a certain undertaking that **distorts or risks to distort competition** within the EU internal market?

Does the investment comply with MEIP or is otherwise compatible?

Does it comply with no crowding out principle?

Incompatible investment

Does the investment comply with no crowding out principle?

Compatible investment

Incompatible investment

Compatible investment

Incompatible investment

# General remarks on the review of risk capital rules

“ Sensible approach to leverage on the risk capital guidelines and to ... ”

- **Revise the scope of the rules** to extend application from
  - risk capital market interventions - VC and PE investments to
  - debt market interventions - loan and guarantee products
- **Revise the compatibility criteria** to
  - extend and simplify the safe-harbour rules, and
  - clarify the substantive assessment
- **Clarify aid (notion and intensity) and compatibility criteria** on all levels of the delivery chain

# General remarks on the review of risk capital rules

## “ Extension of the scope of the rules ”

- **A single state aid framework for risk financing to SMEs**
  - consolidating various other rules, and
  - offering one reference set of rules
- **Observing the structural and technical differences** between
  - risk capital market interventions - VC and PE investments to
  - debt market interventions - loan and guarantee products
- **Providing separate rules risk capital and debt instruments**
  - certain common rules
  - But different “windows” for different financial instruments

# General remarks on the review of risk capital rules

## “ Revision of the compatibility criteria ”

- **Safe-harbour rules**
  - simplification
  - extension
  - considering structural and technical differences between financial instruments
- **Substantive assessment**
  - further clarification of compatibility criteria
  - also considering structural and technical differences between financial instruments



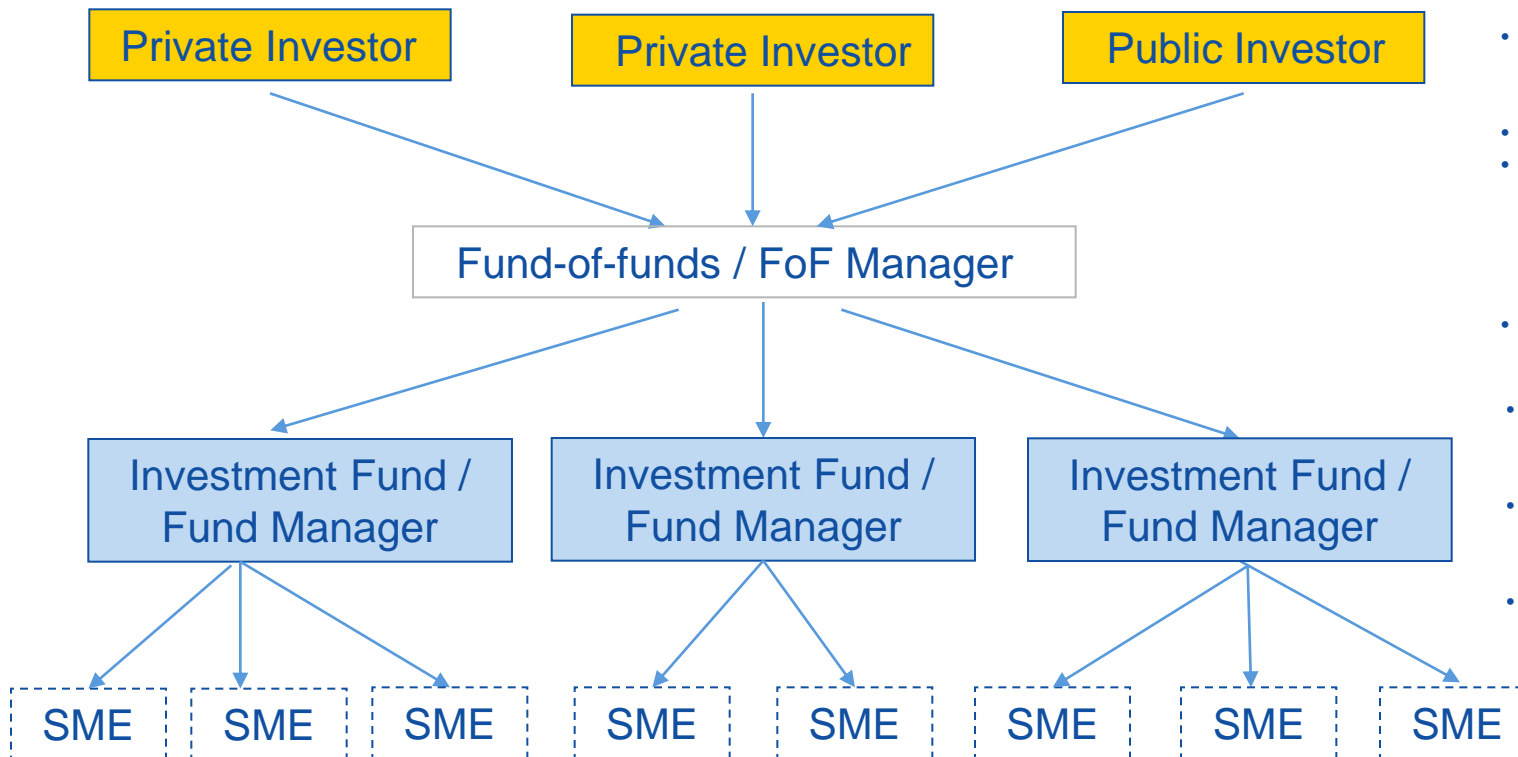
# General remarks on the review of risk capital rules

“ Clarification of **aid (notion and intensity)** and **compatibility** criteria on all levels of the delivery chain ”

- **Clarification of the notion and intensity**
  - e.g. in case of an indirect advantage to a SME due to the mere fact that investors were incentivized to join the fund-of-funds
- **Clarification of compatibility criteria**
  - e.g. different ceilings and thresholds
  - e.g. evidence of passing of benefits
- **On all levels of the delivery chain**
  - e.g. fund-of-funds, fund / fund manager, investee company
  - e.g. guarantee institution, guaranteed bank originating loans, borrowing SME

# General remarks on the review of risk capital rules

“ Difference between advantage and market distortion to be considered throughout the delivery chain ”



- Subordination of public investor without adequate remuneration
- Increased fund raising
- Possible **market distortion** and aid to :
  - private Investors
  - FoF
  - FoF Manager
- Compatibility test
  
- Market conform investments:
  - from FoF in funds
  - from funds in SMEs
- **No** market distortion on:
  - investment fund level
  - SME level
- But **indirect advantage** through additionally mobilised funds to:
  - investment funds
  - SMEs

# Specific remarks on the review of risk capital rules

“ Improving access to risk finance for **young and innovative SMEs** with **high-growth potential** ”

- **Concepts of “innovation” & “high-growth” potential**
  - Vague, potential problems of interpretation
  - EU objectives are not limited to concept of innovation (e.g. social inclusion)
  - Funding gap for SMEs is broader
- **Concept of “viable business plans” instead**
  - Appropriate to limit scope to SMEs with viable business plans showing potential return

# Specific remarks on the review of risk capital rules

“ Selection of **investors and intermediaries** through **competitive process**, where possible through **public tenders**”

- **Concept of competitive selection procedure**
  - Not always compatible with the financial markets and market practice
  - Not always appropriate
  - Clarify minimum requirements to comply with openness, transparency and non-discrimination principles
  - Only one of the compatibility criteria if notion of aid is inherent
- **Alternatives**
  - e.g. safe-harbour rates of remuneration of intermediaries if not selected through competitive procedure

# Specific remarks on the review of risk capital rules

“ private investors ”

- **Notion of “private investor”**
  - Clarify that “market economy investor principle” and “market oriented investor test” prevail
  - So that also public investors or public-private investors can act as “private investors”

# Specific remarks on the review of risk capital rules

## “ Overall investments cap of EUR 10-15m on the level of the SME ”

- Reflects need to increase the limits of single investment tranches
- Reflects need to include follow-on investments as limitations on follow-on investments:
  - may discourage investment in early stages
  - may give an advantage to late stage investors which do not need to compensate early losses through higher returns late
- However, instead of / or in addition to pre-defined ceiling, investments addressing the funding gap should be allowed
  - Based on guidance on the evidence required to demonstrate a funding gap of any size

# Specific remarks on the review of risk capital rules

“ SMEs which have not exceeded a 5-year period since their first sale on a market or since the first entry in a new product market ”

- Eligibility criteria for “state-aid-worthy” final beneficiaries desirable to be set on basis criteria of substance, not of form
- Lifetime, sales figures etc. are arbitrary eligibility criteria that may apply to sectors but are not suitable for standardization across sectors
- Focus should be on development stages of companies and their prospects for future development rather than company history
- Financial instruments that seek to catalyze private sector market forces will necessarily have some degree of haziness that needs to be weighed against policy benefits