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France Invest's comments on the European Commission's Consultation on a targeted review of the General Block Exemption Regulation (State aid): revised rules for State aid promoting the green and digital transition

Established nearly 40 years ago, France Invest brings together venture capital (VC), private equity (PE), infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts 365 management firms and 180 associate members.

France Invest's members are active contributors to the funding and development of SMEs. During the pandemic, the sector demonstrated its resilience and adaptability, supporting existing portfolio companies as and when needed, while continuing to invest in new businesses that require capital and operational expertise to grow.

For instance, in H2 2020, over half of the capital invested by the French VC industry benefitted ICT and biotech & healthcare.

General comments

Conditions to access State aid are particularly important for EU start-ups, scale-ups and more generally innovative companies to be able to overcome the impact of the pandemic and for Europe to achieve its ambitions in terms of digital transformation and climate change. The opportunity for European SMEs to strengthen their own funds is crucial considering that the support they could benefit during the crisis mainly took the form of loans. **It is of utmost importance to ensure that European innovative companies can find financing in the EU and fully benefit from State aid measures.**

In this context, France Invest welcomes the publication of a targeted review of the General Block Exemption Regulation (State aid): revised rules for State aid promoting the green and digital transition.

In particular, we would like to take the opportunity of this consultation to reiterate **our urgent call for a revision of the current definition of SMEs in the GBER**. Indeed, as recognised by the European Commission (Recommendation 2003/361/EC of 6 May 2003), the current definition of SMEs in the GBER prevents businesses which receive majority ownership from a venture capital company to be eligible to this status. Please find annexed our views on the European definition of SMEs.

We expect that the revised Regulation, together with the updated Guidelines, will provide an opportunity to **simplify the rules and introduce additional flexibility to conditions to access Sate aid**, thus facilitating the deployment of State aid schemes and limiting possible competition distortions to the minimum.

Please note that **France Invest commented on the draft Risk Finance Guidelines** (the Guidelines) which clarify the conditions set out in the General Block Exemption Regulation (GBER), in the context of the consultation launched by the Commission in summer 2021. France Invest also commented on the previous review of the GBER in 2014.

Specific comments on the proposed Regulation

- **Article 2 point 2 on the definition of SMEs**

According to the current definition, non-listed SMEs whose capital is held by Private Equity (PE) and Venture Capital (VC) Alternative Investment Funds (AIFs) are disqualified for SME status for two main reasons:

First, the current definition of SMEs refers to venture capital *companies*. PE and VC AIFs may take the legal form not only of companies but also mutual funds. It means that a SME whose capital is held by a PE and VC *mutual fund* cannot obtain public subsidies.

⇨ **We reiterate our request that the reference to venture capital companies include both legal forms of VC and PE AIFs**.

This is a major point for French PE and VC AIFs, which have essentially been set up as mutual funds.

Second, the concept of autonomous SMEs is difficult to understand for companies owned by private equity vehicles, in particular due to the absence of an obligation to consolidate accounts, justified by the fact that PE and VC AIFs acquire undertakings and divest after a holding period of 5 to 7 years. We believe that, as it is, this criterion applicable to VC and PE AIFs disadvantages SMEs which are funded by PE and VC AIFs and discourages them from seeking private investment.

⇨ **We call for the removal of the thresholds and the application of a full exemption for VC and PE investments to the criteria of SME's definition**.

Further detail on our views on the European definition of SMEs can be found in the annex attached to our contribution.

- **Article 2 point 18 on the definition of undertakings in difficulty**

Due to their business model, most VC/PE backed companies will fail criteria (a) and (b) of the definition of undertakings in difficulty set out in article 2 point 18, as these criteria are not adapted to their specificities.

Indeed, companies under a fund manager's long-term ownership may face losses that represent more than half of their subscribed share capital without being in difficulty. As a consequence, only criteria (c) to (e) should be applicable to VC/PE backed companies.

Alternatively, quasi equity could be deemed as own funds. In such case, rather than applying ratios based on subscribed capital, the sum of equity and quasi equity would be taken into consideration:

where the sum of equity and quasi equity is positive, companies would not be considered as undertakings in difficulty.

- **Article 2 point 72 on the definition of independent private investor**

Current GBER:
'independent private investor' means a private investor who is not a shareholder of the eligible undertaking in which it invests, including business angels and financial institutions, irrespective of their ownership, to the extent that they bear the full risk in respect of their investment. Upon the creation of a new company, private investors, including the founders, are considered to be independent from that company;

Proposed amendment:
'*independent private investor' means an investor who is private and independent, as set out in this point.*
"Private" investors will typically include banks investing at own risk and from own resources, private endowments and foundations, family offices and business angels, corporate investors, insurance companies, pension funds, private individuals, and academic institutions.
[…]
"Independent" means that a private investor is not a shareholder of the eligible undertaking in which it invests. Upon the creation of a new company, private investors, including the founders, are considered to be independent from that company;

The proposed amendment does not specify whether private equity funds are private investors.

⇨ **It should be modified in order to clarify whether private equity funds are private investors.**

- **Article 2 point 80 on the definition of innovative enterprises**

The current EU definition of an "innovative business" includes many VC-backed companies. It however excludes fast-growing start-ups in sectors other than ICT, biotechnology and healthcare (albeit those represent a large proportion of the VC investments). Indeed, it relies on a certain percentage of investment in R&D or in ground-breaking technology, which may not be relevant in some sectors, where innovation is incremental e.g. businesses developing personal protective equipment or applications using existing software to streamline sales in the retail sector.

In this context, we welcome the introduction of an additional criterion based on the award of a label European Innovation Council (EIC) or funding granted by the European Innovation Council Fund. However, in our opinion, this criterion is too restrictive.

⇨ **We suggest enlarging it to labels awarded or funding granted by other European or national public institutions** (e.g. the European Innovation Council (EIC) or, in France, BPIfrance or ADEME) **and to certifications by independent experts** (e.g. auditors).

Indeed, certification by independent experts may prove more affordable (the cost of a BPIFrance label may be quite high for small start-ups), quicker and less burdensome (the administrative process in relation to the EIC may prove complex for some managers which may find it difficult to complete), in other words more efficient.

- **Article 8 on cumulation**

Article 8 paragraph 4 states that "*Aid without identifiable eligible costs exempted under Articles 21, 22 and 23 of this Regulation may be cumulated with any other State aid with identifiable eligible costs. Aid without identifiable eligible costs may be cumulated with any other State aid without identifiable eligible costs, up to the highest relevant total financing threshold fixed in the specific circumstances of each case by this or another block exemption regulation or decision adopted by the Commission.*"

⇨ **We would welcome a clarification that aid towards non-identifiable eligible costs exempted under Article 21 should be cumulated with aid towards non-identifiable eligible costs exempted under Articles 22 and/or 23.**

- **Article 21 on risk finance aid**

  - **Article 21 paragraph 3 on eligible undertakings**

    - **Article 21 paragraph 3 (a)**

Article 21 paragraph 3 (a) states that eligible undertakings "have not been operating in any market".

However, many start-ups generate a low turnover, in the form of minor services, to finance major and priority research and development expenses. It is important in this respect that a company generating a profit and/or turnover from secondary business activities not related to its core business can be an eligible undertaking.

⇨ **We propose specifying this point in the article as follows:**

Eligible undertakings "have not been operating in ~~any~~ **their core** market **as a prime activity**".

- **Article 21 paragraph 3 (b)**

We strongly support the review of the exemption from the "undertakings in difficulty" definition and the introduction of increased flexibility in the definition of eligible SMEs in the new Article 21 paragraph 3 of the GBER. The Commission proposes to modify the eligibility criterion that allows companies to receive risk finance aid from "seven years after their first commercial sale" to "10 years after their registration and/or, in the case of innovative enterprises, seven years after their first commercial sale".

We very much welcome the extension of the period to take into consideration from 7 to 10 years. However, **a 7-year period is definitively too short for innovative companies**, in particular for innovative companies operating in the biotech/medtech sector. A study by BPI France demonstrates that the initiative for encouraging investments in venture companies which are between 7 and 10 years is useful and necessary (venture companies which are between 7 to 10 years represent 52% of enterprises which realised their first commercial sale). This confirms the failure of venture capital market for enterprises aged from 7 to 10 years (SA.55869).

⇨ **We believe that the starting date of this 10-year period should remain unchanged and correspond to the date of the first commercial sale of the company**.

Indeed, the first commercial sale of an innovative company may take place many years after its registration. For example, company Carmat[1], which has developed an artificial heart and aims to

[1] https://www.carmatsa.com/en/about-carmat/#bloc36300

provide cardiologists with innovative technologies that save lives and improve the quality of life for patients with advanced heart failure, was created by Matra Défense (Airbus Group), Truffle Capital and Professor Alain Carpentier in 2008. Carmat obtained CE marking (a prerequisite to market its product in Europe) in December 2020. To this day, it has not started commercialising its solution yet. Changing the start date of the period from first commercial sale to registration would reduce the period taken into consideration and restrict access to State aid.

In order to ascertain the date of the first commercial sale more easily, we propose introducing a threshold of EUR 250,000 of turnover, in line with authorisations granted by the Commission, which considered the 10-year period to be counted from the year following the one when the company's turnover exceeded EUR 250,000 (SA.41265/SA.40725). In any case, a trial sale should not be considered as a first commercial sale, as stated in the Guidelines[2].

⇨ **We propose introducing a threshold of EUR 250,000 of turnover to characterise first commercial sales.**

- **Article 21 paragraph 3 (c)**

Article 21 paragraph 3 (c) states that eligible undertakings are unlisted SMEs which fulfil one of three criteria, including the following: "*require an initial risk finance investment which, based on a business plan prepared in view of a new economic activity, is higher than 50 % of their average annual turnover in the preceding 5 years*."

This criterion is important to help SMEs (in particular SMEs which are older than 7 years) to achieve their green and/or digital transformation, which is a key issue for the next 10 years. Indeed, to do so, companies will have to rely on public financing, and it is crucial that they can benefit from State Aid.

This criterion has been in place for almost 10 years, and we can observe that SMEs cannot fulfil it, as it is too demanding to reflect their actual needs of risk financing.

We remain our previous position. In our view, this criterion does not consider the business reality. Indeed, the requirement of a business plan prepared in view of a new economic activity, higher than 50% of the average annual turnover in the preceding 5 years, is not realistic in practice:

- First, the 50% threshold is too high: it implies huge financing needs, which may not be credible considering the size of the company. Moreover, especially in the current post-crisis context, the increased level of indebtedness of companies should be taken into account;
- Second, the reference period of 5 years is too long: reliable business plans can only cover a 3-year period. Often, SMEs review their business plans an annual basis, and some adjust them at every valuation date.

⇨ For these reasons, **we propose to reduce the percentage of the threshold from 50% to 20% and the reference period from 5 years to 3 years**.

- **Article 21 paragraph 4 on follow-on investments**

  - **Article 21 paragraph 4 (b)**

[2] 'first commercial sale' means the first sale by an undertaking on a product or service market, excluding limited sales to test the market.

The condition for follow-on investments to be "foreseen in the original business plan" is difficult to apply in a Venture Capital context, where business plans are constantly updated as the business and the markets in which it operates evolve. It is not possible to foresee all situations that might require follow-up investments. For instance, the recent Covid-19 crisis forced SMEs to review their original business plans, preventing them from receiving follow-on investments. Furthermore, the reference to the original business plan does not correspond to an economic reality.

⇨ **We believe that follow-on investments should be allowed for businesses which have to update their business plans**.

- **Article 21 paragraph 4 (c)**

Article 21 paragraph 4 (c) states that "*the undertaking receiving the follow-on investments has not become linked, within the meaning of Article 3(3) of Annex I, with another undertaking other than the financial intermediary or the independent private investor providing risk finance under the measure, unless the new entity is an SME."*

⇨ **We propose to clarity this requirement and the reference to a "new entity" as follows:**

*"the undertaking receiving the follow-on investments has not become linked, within the meaning of Article 3(3) of Annex I, with another undertaking other than the financial intermediary or the independent private investor providing risk finance under the measure, unless **the company which benefits from the follow on investments and the company to which it is linked form a new entity complying with the conditions set out in the definition of SMEs set out in annex II***.

- **Article 21 paragraph 5 on risk finance investments**

Article 21 paragraph 5 states that "*risk finance investments into eligible undertakings may take the form of equity, quasi equity investments, loans, guarantees, or a mix thereof*."

In the previous version of the GBER, it was specified that the loans covered by risk financing should be loans granted to financial intermediaries to finance the risks of eligible SMEs.

⇨ **We believe that the loans concerned include only loans granted to financial intermediaries.**

- **Article 21 paragraph 7 on replacement capital**

In our opinion, conditions for the use of "replacement capital" should be reviewed, as they are at odds with broader policy objectives of overcoming market failures in SME finance and encouraging SME job creation. In particular, this rule may penalise minority shareholders (i.e. business angels) who will not be able to transfer their shares to another shareholder and will have to remain in the company's capital. In addition, this measure may lead to a dilution of the founding shareholders in the capital of the company.

⇨ **We suggest removing this measure or, failing that, limiting the percentage of new capital combination to 10% of the capital of the company**.

- **Article 21 paragraph 8 on the total outstanding amount of risk finance investment**

Article 21 paragraph 8 states that "*The total outstanding amount of risk finance investment referred to in paragraph 5 shall not exceed EUR 15 million per eligible undertaking under any risk finance measure*."

We believe that this limit on the total amount of outstanding risk finance investment is too general and propose to specify that it is calculated over a limited period of time.

- ⇨ **We propose that the 15 million EUR amount applies on a limited period of time i.e. 2 years.**

    - **Article 21 paragraph 10 (a) on first loss pieces**

Article 21 paragraph 10 (a) states that "*in the case of asymmetric loss-sharing between public and private investors, the first loss assumed by the public investor shall be capped at 25 % of the risk finance investment*."

- ⇨ In order to better balance the risk-reward sharing arrangements between the Member State or its entrusted entity and the financial intermediary, **we propose that the first loss assumed by the public investor shall be capped at 40%.**

The wording used in the GBER and RFG for the most junior risk tranche that carries the highest risk of loss creates some uncertainty.

- ⇨ **We believe that the definition of "first loss pieces" set out in RFG should be applied in GBER.**

    - **Article 21 paragraph 15 on the remuneration of fund managers**

Article 21 paragraph 15 states that "*their remuneration shall conform to market practices*."

We support that financial intermediaries receiving the public contribution should take profit-driven decisions when providing eligible undertakings with risk finance investment.

We would like to draw the Commission's attention to the fact that private equity and venture capital fund managers are governed by the AIFM Directive which includes provisions on remuneration policies. These policies should be based on 19 principles, including the following: "a remuneration policy shall be consistent with the business strategy, objectives, values and interests of the managers and the AIFs they manage or those of the investors in the AIF, and shall include measures to avoid conflicts of interest". As a consequence, managers covered by the AIFMD already fulfil the obligation set out in article 21 paragraph 15.

- ⇨ **We would like to note that this requirement is complied with by managers covered by the AIFMD.**

- **Article 21a on risk finance aid**

Article 21a states that "*indirect R&D project costs may also be calculated on the basis of a simplified cost approach in the form of a flat-rate of up to [15 %], applied to total eligible direct R&D project costs*."

⇨ **We propose that the percentage of research and development expenses mentioned in the definition of innovative companies is reduced from 15% to 10% of the company's total operating expenses.**

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ANNEX
France Invest's views on
the European definition of SMEs

The European definition of SMEs set out in Recommendation 2003/361/EC contributes to making policies targeting SMEs in Member States and intervention areas more consistent and effective. It is crucial for the application of European policies ensuring that these companies benefit from financial support, reduced costs, reduced administrative burden, etc. In particular, it is included in regulations on state aids, notably in Annex I of the RGEC or for the purpose of obtaining public subsidies.

According to the Recommendation, an SME is a company that employs less than 250 people and whose annual turnover does not exceed EUR 50 million or whose annual balance sheet total does not exceed EUR 43 million.

However, if an enterprise has access to additional resources, it may not qualify for SME status. For instance, in order to only take into account its own workforce, turnover and balance sheet (i.e. not to include data from other enterprises), an enterprise must be considered as autonomous. In particular, according to the Recommendation, enterprises where a venture capital company owns a share exceeding 50% are not considered as autonomous. These enterprises might therefore not be considered as SMEs, even if individually they meet the staff headcount and financial thresholds.

Not obtaining the SME status has serious impacts for companies, including:

- Eligibility to apply for funding support in the context of European programmes applicable to SMEs or public national institutions/programmes aimed at SMEs;
- Social disadvantage compared to similar companies having the SME status, which can benefit from lower social charges. In particular, this creates a significant disadvantage when recruiting key talents in startups;
- Companies which do not qualify as SMEs are also placed at a competitive disadvantage as they cannot benefit from fiscal advantages granted to SMEs;
- Ability to further finance the company through venture capital or capital risk companies when the SME status is a pre-requisite;
- Ability for capital risk funds to deploy financing.

Please see below an example provided by one of our members:

The company "MEDICAL" (3 employees, turnover EUR 3,000, balance sheet EUR 2.4 million) was created in 2017. It was funded by a VC fund which currently owns 83% of its capital. It is at risk of losing its SME status and, as a consequence, of losing the benefit from national aids and subsidies ("Projets Structurants pour la Compétitivité" programme, part of BPI's "Investissements d'Avenirs" Programme). MEDICAL was created to develop a device preventing serious heart failures. It is a very young - and small - company, which develops a solution to a key medical issue.
Due to the fact that a VC fund owns more than 50% of its capital, MEDICAL may not qualify for SME status. This implies dramatic consequences for MEDICAL. Indeed, this may limit or even prohibit its access to aids and subsidies, even though the aim of these programmes is to promote the financing of upcoming technologies and the development of projects which are key for the competitiveness of France and of the EU.

Non listed SMEs whose capital is held by Private Equity (PE) and Venture Capital (VC) Alternative Investment Funds (AIFs) are disqualified for SME status for two main reasons:

- first, the current definition of SMEs refers to venture capital *companies*. As you may know, PE and VC AIFs may take the legal form not only of companies but also mutual funds. It means that a SME whose capital is held by a PE and VC *mutual fund* cannot obtain public subsidies. Notably as we did in the context of the revision of the RGEC, **we reiterate our proposal that the reference to venture capital companies include both legal forms of VC and PE AIFs**. This is a major point for French PE and VC AIFs, which have essentially been set up as mutual funds;

- second, the concept of autonomous SMEs is difficult to understand for companies owned by private equity vehicles, in particular due to the absence of an obligation to consolidate accounts, justified by the fact that PE and VC AIFs acquire undertakings and divest after a holding period of 5 to 7 years. We believe that, as it is, this criterion applicable to VC and PE AIFs disadvantages SMEs which are funded by PE and VC AIFs and discourages them from seeking private investment. Therefore, **we call for the removal of the thresholds and the application of a full exemption for VC and PE investments to the criteria of SME's definition**.

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