European Association of Development Agencies
Association Européenne des Agences de Développement

ALL MONEY IS NOT THE SAME!

SME ACCESS TO FINANCE

GUIDEBOOK FOR PUBLIC DECISION-MAKERS AND INTERMEDIARIES

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Disclaimer

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FOREWORD

The present document is aimed at:

1. Public bodies in charge of developing or implementing programmes aiming to provide regional/local SMEs access to funding sources;

2. Businesspersons looking for an insight into the funding source that is best suited to their needs based on their investment readiness, i.e. how ready they are to accommodate or meet with representatives of the SME finance industry.

The scope of this document goes beyond funding sources as such. Indeed, it also seeks to deal with the tools that support these funding sources in promoting the consolidation of companies once they have accessed finance.

The present document is designed to allow intermediaries to easily adapt it to regional contexts as well as to provide speedy links to additional information about the various concepts it examines. A simple click on the URLs appearing in the document will refer readers to the corresponding sites.

This document is based on the following 4 assumptions:

- Entrepreneurs need to realise that any source of finance or any investor is adapted to a phase in the enterprise life cycle;

- Investors are looking for good projects, a good return on investment for the risk taken and need an exit route;

- Public authorities should concentrate their efforts on enabling access to finance for SMEs. The enabling role of the public authorities needs to address both the supply and the demand side;

- Regional markets need to take the form of a supply chain supported by a series of advanced support services.

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INTRODUCTION

These last years, some European regions and then European institutions have realised the importance of SMEs as instruments of development. The action of DG Enterprise and DG Regio of the European Commission has grown to a large extent out of this realisation.

However, 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 US. It is increasingly recognised that SME access to finance is hampered by a number of market failures. But as opposed to the US, the EU does not have a programme equivalent to that operated by the SBA—United States Small Business Administration (http://www.sba.gov).

Europe is characterised by its very diverse cultural context. This diversity is also apparent in the fields both of entrepreneurship and of 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:

- the degree of acceptance among businesspersons of third-party investment in their company;
- the variety of funding sources available in a country;
- the level of maturity of the different market segments that constitute the business finance supply chain.

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 published in the October 2003 issue of *Regional Studies*. Indeed, they argued convincingly that when the UK's DTI and RDAs 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 supply 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 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.

CHAPTER 1: THE MARKET

1.1. DEFINITIONS OF FUNDING SOURCES

- ***Seed capital***: capital 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.
- ***Venture (or risk) capital***: equity invested temporarily in the form of shares of a company by a specialised firm in the hope of a return on investment (ROI) that is both large and speedy, on a par with the level of risk taken. Venture capital firms invest both in start-ups and growing businesses.
- ***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.
- ***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.
- ***Mezzanine***: combination of equity and loans. Applicable interest rates are often comparatively high.
- ***Financial package***: a combination of different funding sources.
- ***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.
- ***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.
- ***Factoring***: a technique whereby SMEs sell invoices to specialised firms.
- ***Leasing***: hire-purchase of capital goods.
- ***Loans and debt***: the main sources of funding for SMEs.

1.2. SME FINANCE PLAYERS

The market of enterprise financing includes many different types of players[1] who fit roughly into three main categories:

I. VENTURE CAPITAL PLAYERS, INCLUDING:

- Business angels and their networks and syndicates;
- Venture capital and private equity firms;
- 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 (the French FCPI, or *Fonds Communs de Placement à l'Innovation*).

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!

III. OTHER SOURCES, INCLUDING:

- Government grants;
- Business competition prizes;
- Factoring;
- Leasing;
- Refundable advances;
- Commercial credit.

1.3. SME FINANCE MARKET SEGMENTATION

I. ENTREPRENEURS' OWN ASSETS AS WELL AS THEIR FAMILIES' AND FRIENDS'

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.

III. FIRST FINANCIAL ROUNDS

- Business Angels;
- Seed capital funds;
- Bank loans/debt;
- Guarantee schemes;
- (Semi-)public investment funds;
- Regional public venture capital;
- Public subsidies;
- Corporate venturing.

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

IV. SECOND FINANCIAL ROUNDS

- Private venture capital;
- Bank loans;
- Stock purchase warrants;
- Mezzanine.

V. OTHER FINANCIAL ROUNDS

- Initial Public Offer (IPO)—listing;
- Bond issues;
- Convertible bonds;
- Leasing;
- Factoring.

NOTE

I. INDIRECT FINANCIAL SUPPORT

- Pre-incubation, incubation;
- Business nurseries and relay workshops;
- Tutoring (coaching, mentoring, hands-on management);
- Obtaining patents and protecting the intellectual right property.

II. INTEGRATED ACTION

- Financial supply chain;
- Intermediation;
- Investment readiness scheme.

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. Such a portal can be found at www.westmidlandsfinance.com
Entrepreneurs need to have an understanding of the type of finance fitting best to the position of the enterprise in its life cycle. If they understand this, they will be able to market themselves to the financial community. According to Philip Kolter[2], the enterprise finance market can be divided in 4 segments:

I Initial and unorthodox sources of fundings;

II Equity;

III Debt finance;

IV Combination of equity and debt.

In Europe we propose to add to these 4 segments public interventions in the form of grants and guarantees.
In paralell to the market segmentation described in point 1.3 here above - which is a supply side approach -, we can draw a new list, which can be defined as a demand side approach and would look like this:

I INITIAL AND UNORTHODOX SOURCES OF FUNDINGS:

- Entrepreneurs savings;
- Profit reinvestments;
- Friends and family savings;

[2] Philip Kotler, Hermawan Kartajaya, S. David Young, *Attracting investors*, Wiley 2004.

- Second mortgage;
- Personal credit cards;
- Customer advance;
- Delay of payments;
- Permices sharing;
- Employing relatives at below market salaries.

II EQUITY:

- Seed and preseed capital;
- Business angels;
- Venture capital;
- Corporate ventures;
- IPO and post IPO.

III DEBT FINANCE:

- Bank credits: short or long term loan, unsecured or micro loans;
- Commercial debt;
- Public/semi-public loans;
- Bonds;
- Factoring – leasing – franchising;

IV COMBINATION OF EQUITY AND DEBT : MEZZANINE.

V PUBLIC FINANCE:

- Grants;
- Reimbursable advances;
- Guarantees.

1.4. WHICH TYPE OF FUNDING IS BEST SUITED TO THE SME LIFECYCLE?

We can split the life cycle of a SME in 3 major phases[3]:

Phase 1: PLANS WHICH COMPRISE 2 STEPS:

- Formulation of the ideas;
- From the idea to the finance of the business plan including the prototype or the proof of the concept phase.

Phase 2: start-up

Phase 3: development and growth with 2 critical steps:

- From 1st customer to initial profit;
- From initial profit to gazelle in 5 years.

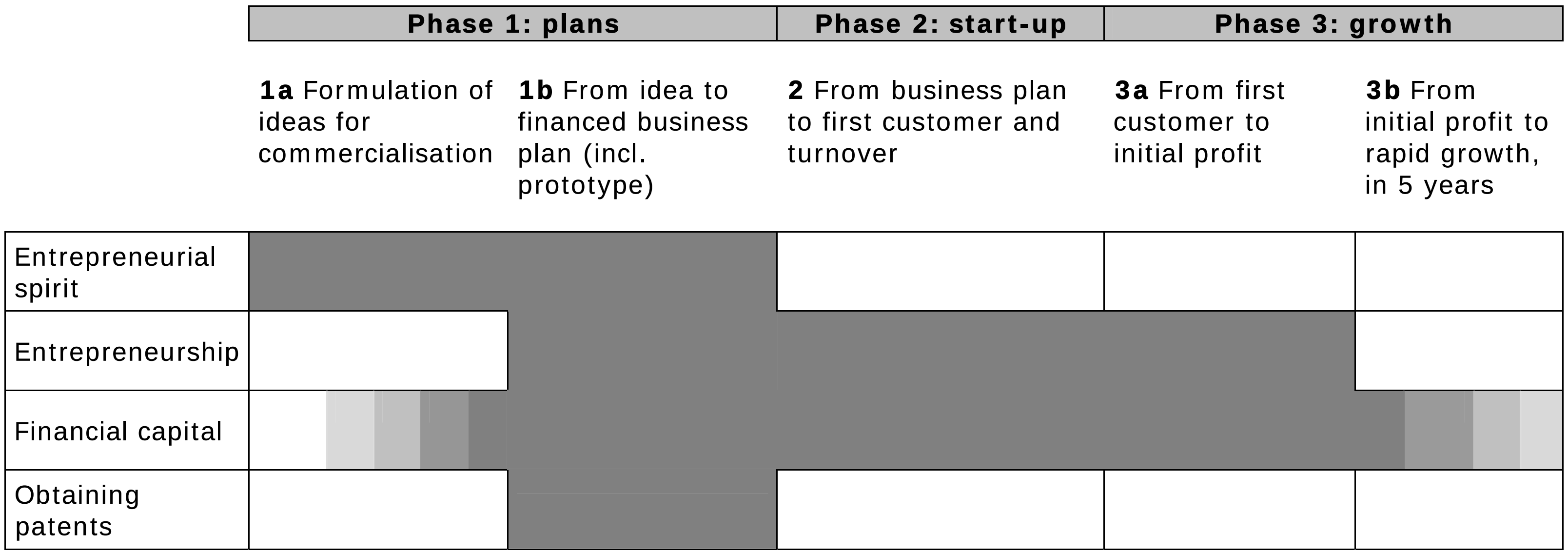
This can be illustrated by the following graph in which the main current bottlenecks are also identified i.e.:

- Entrepreneurial spirit (lack of entrepreneurial scientists);
- Entrepreneurship (lack of management and executives);
- Financial capital (pre-seed, seed, equity, risk capital gaps);
- Patent rights (underdeveloped tech-transfer offices, especially at university level).

[3] Frits van der Have speech given on 14th October 2005 at the *Risk Capital Summit*, London.

Figure 1

Challenges / bottlenecks



Source: Frits van der Have, Risk Capital Summit 4.10.05, London.

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.

Figure 2

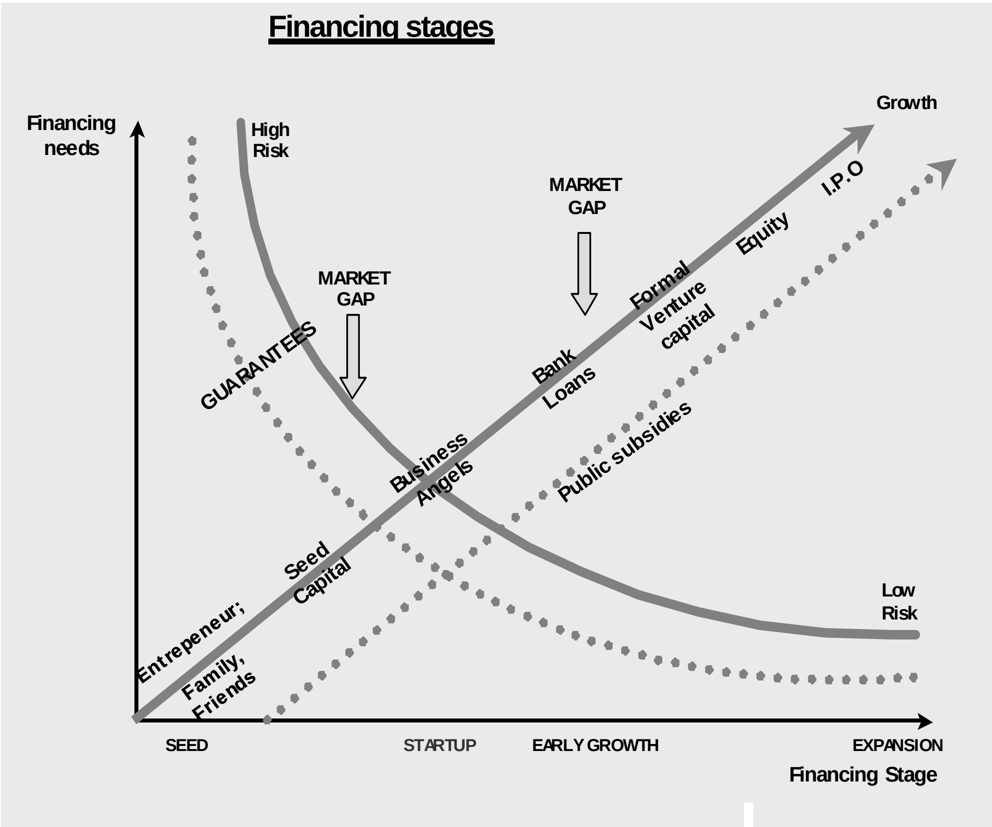
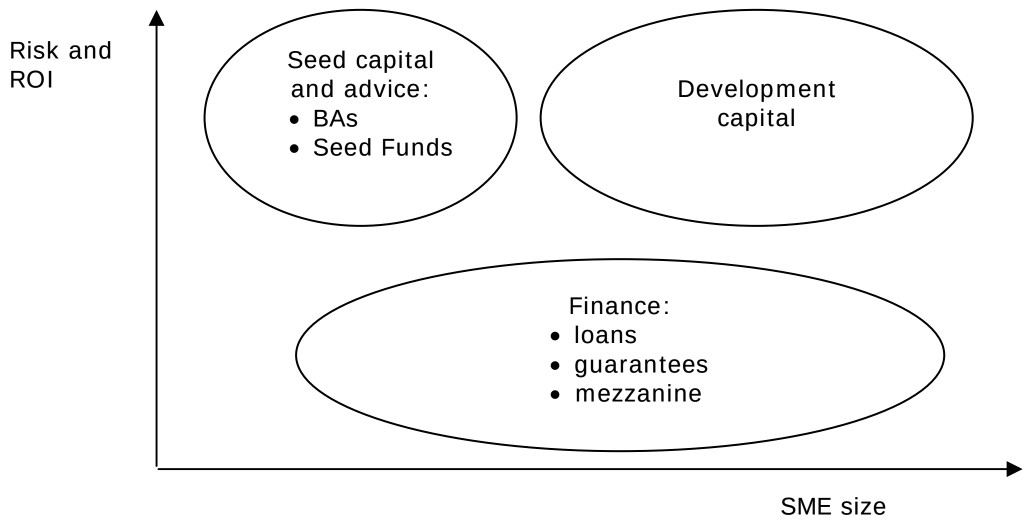
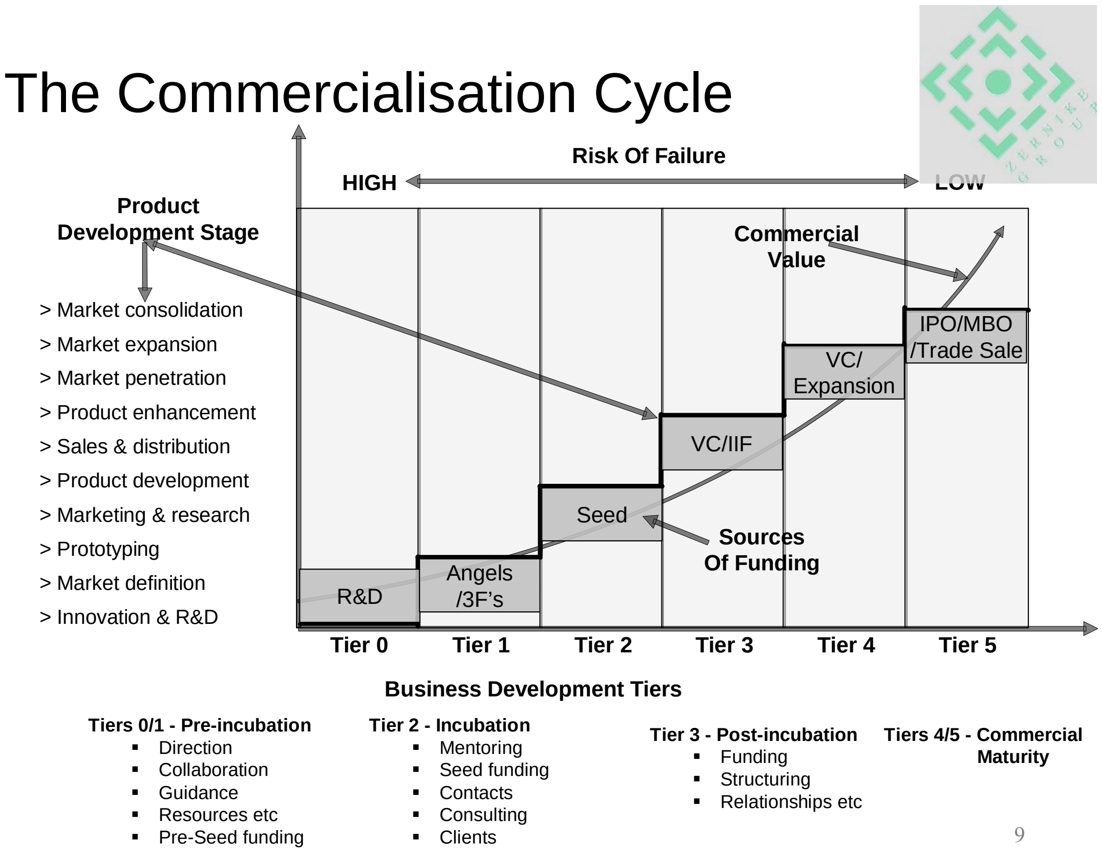


Figure 3. SMEs' three financing circles



Source: Vaeksfonden (DK)

Figure 4



Source: Presentation by Mr Lex de Lange, Managing Director, Zernike Group, made at PARTNER Focus Group in Tartu, Estonia, May 2003

1.5. TYPICAL AMOUNTS INVESTED BY INDIVIDUAL FUNDING SOURCES

As evident from the table n°1 below, the respective amounts that entrepreneurs can expect from the different categories vary according to the type of financial product and player involved:

Table 1.

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[4]
Bond issues	500,000,000-1,500,000,000[2]
Bonds with redeemable share subscription warrants	10,000,000-50,000,000[5]

1.6. 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 annual reports show that in general funds leverage more financial means than they invest. In Germany, a study launched among 40 business angels in the first quarter of 2004 showed that only one quarter of those angels had invested more than 25% of the money they intended to 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. Entrepreneurs may confuse risk capital and credits;
- Inefficient preparation of entrepreneurs willing to meet or meeting investors;
- A different perception of the innovativeness of entrepreneurs project.

The implementation at regional level of specialised support services programmes should be considered as one of the solutions to be looked at in order to solve this paradox.

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[4] World Federation of Exchanges. Average amount of equity raised by newly-listed companies.
[5] Source: *Les Echos*, 17 October 2003.

1.7. 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.

The table below provides a succinct introduction to different types of capital suppliers and their criteria.

Table 2. 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)
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
Public funding	• New jobs • Investment in productive tools
Guarantees	• Stamina as well as technical and financial skills/abilities
Unsecured free of interest loans	• Business plan credibility • Readiness to cooperate with a tutor
Seed capital funds	• Business plan quality • Perception of the innovative nature of the project • 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

1.8. THE EQUITY GAP

In general[6], 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 of supply of funds or to inadequacies on the demand size. The gap can go from an investment size of less than one hundred thousand euros to over a million depending on the region or the country. In the UK the gap has been estimated to be between €0.4 and 3 millions. For Germany, that gap extends to €5 millions.
Some people[7] 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".

[6] DG Entreprise and Industries. Expert group on best practices of public support for early-stage equity finance. April 2005.
[7] 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.

1.9. WHO FINANCES INNOVATIVE START-UPS IN FRANCE?

Analysis of the special report on start-ups published in the January 2005 issue of "L'Usine Nouvelle"

I SOURCE AND SAMPLE

In its issue n° 2948 of 27 January 2005, the French magazine "L'Usine Nouvelle" published a series of articles on 110 start-ups referred to as "the hope of French industry". These SMEs were all established less than five years ago; they are all innovative and promising. They were selected by the magazine's reporters among 250 businesses identified by public and semi-public business development organisations including ANVAR, RDAs, incubators and "technopoles" (science and technology parks).

Selected start-ups were grouped into 11 industrial sectors and presented in standardised format. Information about each business included: location, time of establishment, name of founder, turnover (actual or projected), capitalisation and round(s) of finance, employment and product description.

We focused our analysis on the "initial involvement and subsequent rounds" dimension in order to derive indications on the financial sources of promising French start-ups.

We recognise that the number of companies taken into account is small and not randomly selected. It should be noted and reminded that this analysis is only valid for the few high growth SMEs of the sample.

II LESSONS

It emerges from this sample analysis that:

- The top funding sources of start-ups are their founders and private individuals (the famous "3Fs": Family, Friends and Fools), to which can be added start-up employees in the specific case of spinouts of businesses and research centres;
- Business angels only appeared in six cases. However, all six were involved in start-ups operating in one of just four industries, i.e.: i) telecom, multimedia and networks, ii) mechanical industry, iii) medicine and instrumentation, iv) biotech and pharmaceuticals;
- Venture capital funds appear in 23 instances;
- Regional funds played a role in 11 cases;
- The number of occurrences of the different types of equity suppliers is summarised in the table below.

Table 3. Investor types and shareholders

	No of occurrences	No of cases where data was available	Shareholders			
			100%	75-99%	50-75%	<50%
Founders	59	51	11	14	15	11
Private investors (3Fs)	57	54	14	6	7	27
Business Angels (BAs)	6	3	-	-	-	3
Venture Capitalists (VCs)	23	18	2	2	3	11
Regional funds	11	8	-	1	-	7
Businesses	9	9	-	1	2	6
Research centres	7	5	-	1	0	4
Others (unspecified)	8	0	-	-	-	-
TOTAL	**180**	**148**	**27**	**25**	**27**	**69**

It emerges from this table that:

- The main funding sources of businesses are their founders and the 3Fs and that in the case of 45 businesses. These concentrate more than 75% of initial stock;
- Initial investment ranges between a minimum of €7,630 and a maximum of €5.5 million.

The table below illustrates the distribution of sample businesses across the range of initial investment amounts.

Table 4. Importance of the amount invested

Amount invested	No of businesses
< €10,000	4
€10,000-50,000	28
€50,001-100,000	22
€100,001-250,000	20
€250,001-500,001	9
€500,001-1,000,000	4
> €1,000,000	3
TOTAL	**90**

Total start-up equity supplied to sample businesses amounts to €23,995,000, of which €11 millions were brought by VCs to just two start-ups. This amount does not include €2,920,200 raised by three start-ups during a second round of finance.

The table below presents the amounts invested by the seven main types of investors.

Table 5. Importance of amount invested by type of investors

	Total	**%**	**Minimum**	**Maximum**	**Average**
Founders	€4,609,000	19.2%	€8,000	€448,500	€86,967
3Fs	€4,944,000	20.6%	€1,440	€760,000	€95,088
VCs	€12,920,000	53.8%	€5,000	€5,500,000	€680,005
Regional funds	€441,000	1.8%	€4,400	€287,280	€63,049
Businesses	€452,000	1.9%	€5,155	€242,000	€50,236
Research centres	€42,500	0.2%	€2,145	€29,400	€10,563
BAs	€49,800	0.3%	€13,300	€36,000	€24,900
Others	€480,200	2.0%	-	-	-
TOTAL	**€23,938,500**	**100%**			

Subtracting from the sample the two businesses that raised €11 million from VCs, the above table changes into the table below:

Table 6. Importance of amount invested per investors without taking into account the 2 major VCs investments

Founders	€4,609,000	i.e.	35.5%
3F	€4,944,000	i.e.	38.0%
VCs	€1,920,000	i.e.	14.8%
Regional funds	€441,000	i.e.	3.4%
Other businesses	€452,000	i.e.	3.5%
Research centres	€42,500	i.e.	0.3%
Others	€538,000	i.e.	4.6%
TOTAL	**€12,946,500**		**100%**

This last table confirms that newly-developed businesses have little or no access to any type of seed venture capital. Indeed, nearly 75% of equity investment in our sample of French start-ups is contributed either by founders themselves or by the 3Fs.

Worth noting is that out of 32 business projects for which relatively detailed information is available regarding investment by VCs, BAs, regional funds, other businesses and research centres, at least 12 have had access to a minimum of two different funding sources.

Also noteworthy is that in the case of 39 investors where the size of the investment is known, the majority have invested less than €50,000. Furthermore, their investment accounts for less than 25% of the total shareholding in the company.

Both tables below introduce more detailed information about this type of data:

Table 7. Investment amounts by professional investors

Invested amounts	**No of investors**
< €10,000	10
€10,001-50,000	16
€50,001-100,000	4
> €100,001	9
TOTAL	**39**

Table 8. Relative importance of the stake taken by the professional investors

Share of capital	**No of investors**
< 10.00%	11
10.01-25.00%	13
25.01-50.00%	8
> 50.01%	4
2^{nd} round of finance	3
TOTAL	**39**

1.10. HOW TO FINANCE A TOOL?

Having reviewed the different tools available to support SMEs, we need to look on how the tools themselves access the money they invest in enterprises.
The table below tries to answer this question.

Table 9. Origin of funds by type of tools

TYPE OF FUND	SOURCE OF FUNDINGS
F.F.F. and B.A.	Money of private individuals
Regional seed and V.C.	• Public budget, including EU co-funding[8] • Private individual funding taking the benefits of favourable income/revenue taxation holidays • Private enterprises through a PPP[9]
Loan on trust	• Public budget • Regional enterprises • Banks • Sponsors
Private V.C. and seed capital funds	• Individuals • Corporate investors • Government agencies • Banks • Pension funds • Insurance companies • Funds of funds • Academic institutions • Capital market

In France, funds specialised in innovative enterprises not quoted on any stock market (FCPI – Fonds Communs de Placement dans l'Innovation) are collecting resources from individuals wanting to take advantage from tax holidays. Minimum 60% of the assets of such funds have to be invested in innovative enterprises.
As of 31 December 2003, the managers[10] of these funds had reportedly pooled around €360 million, down from 2002 and 2001 (€480 million and 578 million respectively). Leaders on the French market are:

- *AGF Private Equity*, whose 2003 FCPI is called "AGF innovation 3" (http://www.agfprivatequity.com/connaitr/produits/index.htm);
- *OTC Asset Management*'s "OTC Innovation 3" (http://www.otcam.com/fonds_geres.htm).

In Belgium a similar initiative is known as PRICAF (Société d'investissement privée à capital fixe). Stakeholders of those PRICAF are often Business Angels willing to diversify their portfolios.Such funds are eligible to receive from the national vehicule named "Fonds des participations" a loan of maximum €1,5 million in order to increase their investment capacities.

[8] ERDF allows regions to create such funds.
[9] Barclays Bank is contributing to the capital af all regional venture capital funds set up by UK RDAs in the framework of their ERDF operational programmes.
[10] *Les Echos*, 21 January 2004.

1.11. AVERAGE SIZE OF FUNDS

According to their typology and aim, the size of funds can present big differences. We give hereafter some indications regarding various funds:

Table 10.

Name	Country	Type	Amount €
BIOAM	France	Technology seed fund	44.000.000
CAP DECISIF	France	Technology regional seed fund	20.000.000
INOVAM	France	Technology regional seed fund	5.060.000
Rhône-Alpes Amorçage	France	Technology regional seed fund	6.000.000
Norvatis Venture Fund	Switzerland	Corporate venturing	180.000.000
Genavent 1 (Sangli-Aventis)	France	Corporate venturing	40.000.000
Spinventure	Belgium	University spin out	5.300.000
Alsace Création	France	Regional equity fund	6.600.000
Bretagne Développement	France	Regional equity fund	15.000.000
Finorpa	France	Equity fund of Charbonnages de France	129.000.000
Nord Création	France	Regional equity fund	4.600.000
Nord Innovation	France	Regional equity fund	7.000.000
Amorçage Rhône Alpes	France	Regional equity fund	4.500.000
Up&Up	France	Seed fund	3.000.000
Thalès Corporate Ventures	France	Corporate venture	70.000.000
IRDI Midi-Pyrénées	France	Capital investment	96.500.000
AXA Private Equity Direct Funds	France	Private equity – venture capital	4.500.000.000
GIMV NV	Belgium	Venture capital	1.236.000.000
Apax Europe V	United Kingdom	Private equity – venture capital	4.400.000.000
3i Eurofund IV	United Kingdom	Private equity – venture capital	3.000.000.000
Seed Capital Brandenburg	Germany	Regional seed fund	9.628.284
SITRA	Finland	Early stage and seed	244.100.000
RFI Lodz	Poland	Regional venture capital	2.500.000
Seed Capital de Bizkaia	Spain	Regional seed	10.250.000
BIO Discovery	France	Sectorial seed capital fund	26.400.000
EMERTEC	France	Sectorial seed capital fund	19.500.000
LE LANCEUR	France	Regional seed capital fund	4.200.000
EUREFI	France-Belgium-Luxembourg	Cross-border regional venture capital	22.000.000

1.12. IMPORTANCE OF PUBLIC INTERVENTION TO CREATE OR STRENGTHEN RISK CAPITAL MARKET

As we mentioned in point 1.10 here above, public authorities are “shareholders” of equity funds. Often their contributions are justified by market failures and take the form of “funds of funds”.
Hereafter is a sample of scheme created by national authorities in this field:

Table 11. Provision of funds by national authorities

NAME OF THE SCHEME	COUNTRY	TYPE	AMOUNT €
EIF/ERP – Dachfonds	Germany	Fund of funds	500.000.000
High-Tech Guïnderfonds	Germany	Combination of equity and loans	260.000.000
Seed Capital	France	Fund of funds – link with public research objectives	232.000.000
Fonds de promotion pour le capital risqué	France	Fund of funds	150.000.000
Guarantee Fund	France	Guarantee VCFs	20.000.000
Seed and venture capital risqué	Ireland	Seed capital in high tech high risk start ups	95.000.000
Techno Partner seed capital scheme	The Netherlands	Fund of funds for early stage venture capital	240.000.000
Regional venture capital funds	United Kingdom	Commercial funds acting at regional level	250.000.000
UK High Technology Fund	United Kingdom	Fund of funds	106.100.000
Scottish co-investment fund	United Kingdom	Matching early stage private sector	125.000.000

In the field of demand improvement, it is worth noticing that in the UK six investment readiness demonstration projects were financed between 2002 and 2004. The UK administration provided €1.800.000 in direct grants as a contribution to the running costs of the projects[11].

[11] Cf. www.sbs.gov.uk/sbs_gov_files/researchandstats/investreadi_execsum_sep.pdf

CHAPTER 2: SME PATHWAYS TO FUNDING AND FINANCE SUPPLY 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 supply 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!

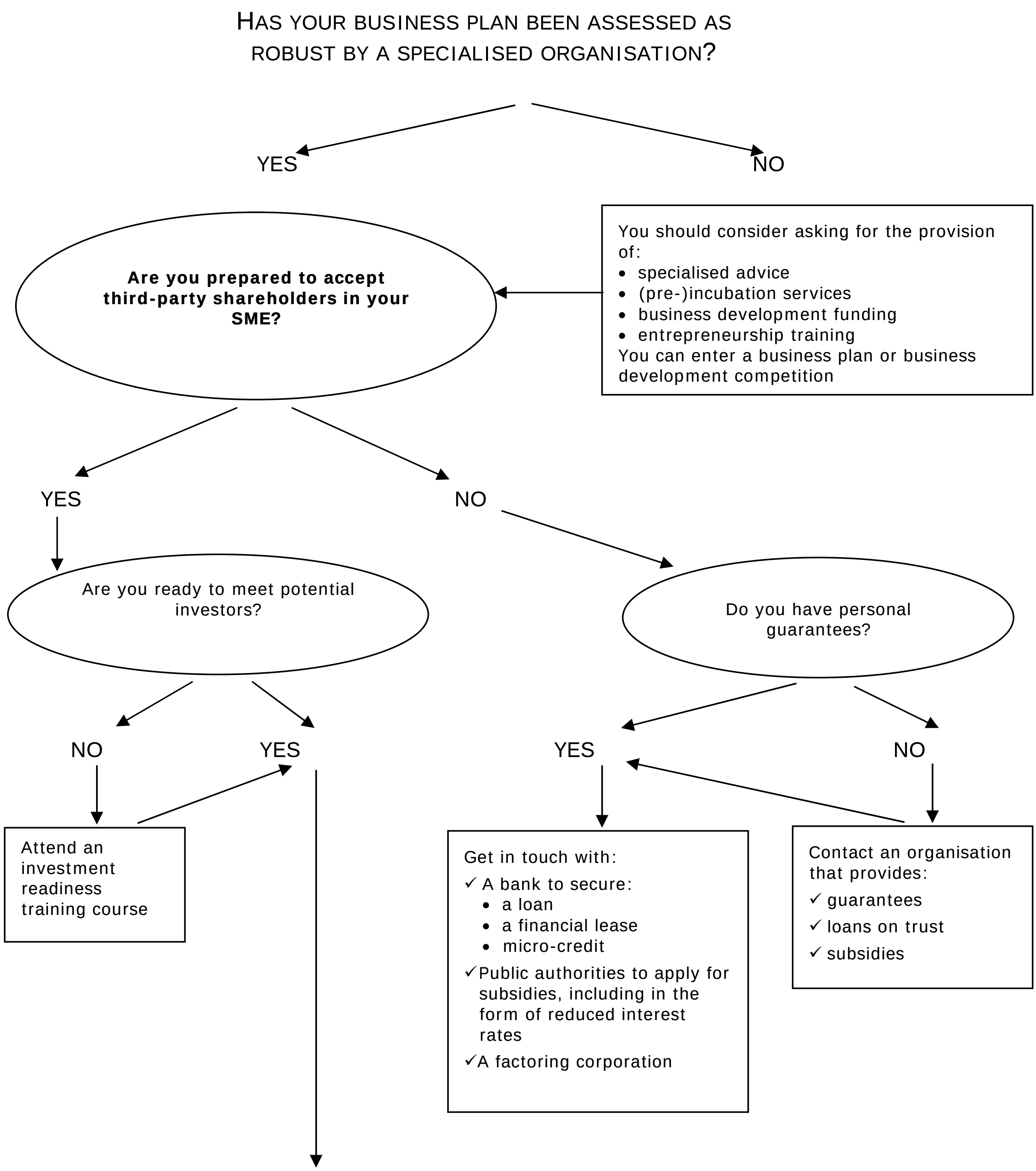
2.1. SME PATHWAYS TO FUNDING SOURCES

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:

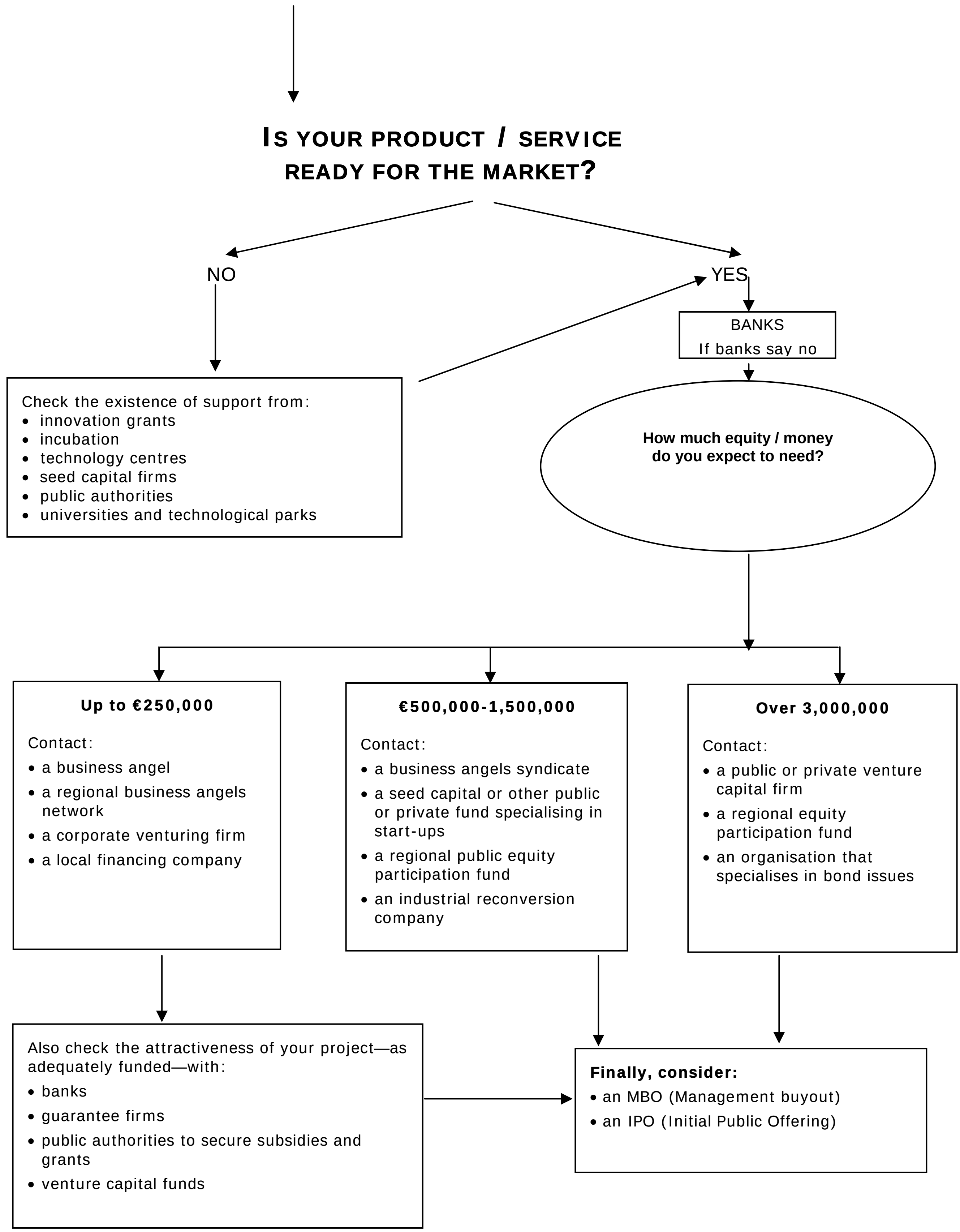
- Business plan robustness;
- Accepting or rejecting new shareholders;
- Availability of personal guarantees;
- Product/service market penetration potential;
- Expected amount of financial sourcing.

Figure 5

SME FUNDING PATHWAYS



Source: EURADA, December 2003



Source: EURADA, December 2003

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 arbitrary. In practice, LIOF (NL, http://www.liof.com) provides funding to SMEs in the Dutch province of Limburg in the following ranges:

- <€25,000;
- €25,000–100,000;
- €100,000–1,000,000;
- €1,000,000–2,500,000.

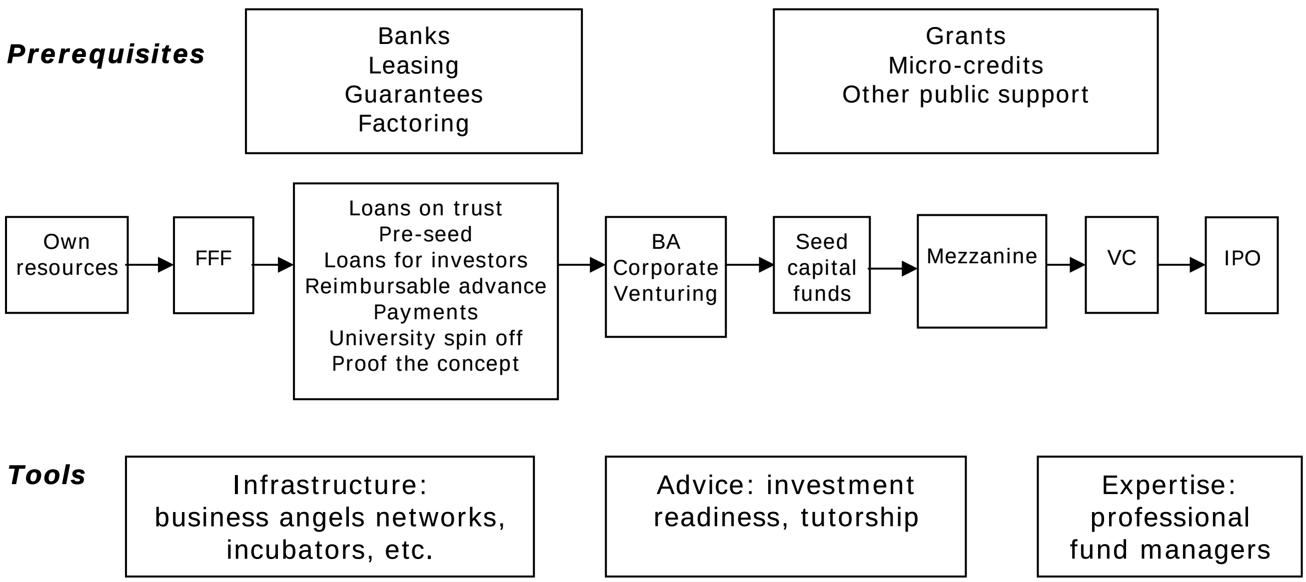
Exceptionally, LIOF's contribution may top €5,000,000.

2.2. THE REGIONAL FINANCE SUPPLY CHAIN

It is increasingly evident that the different SME finance providers act complementarily and should link up to form a regional/local supply chain. As in physics, such a chain can only be as strong as its weakest link. This means that public authorities must monitor and evaluate individual links to ensure that they are all equally strong, that they play their intended role and that there is no missing link. Each link in the supply chain provides the raw material for the next one and an exit route for the previous one. In business finance circles, this approach is known as "integrated finance". It is worth noting that gaps in the chain may change over time and according to economic cycles.

Supply chains can be flowcharted as follows:

Figure 6. An ideal capital provision supply chain



FFF:	Family, Friends, Fools
BA:	Business angels
VC:	Venture capital
IPO:	Initial Public Offering

A number of intermediaries and regional authorities that are not in a position to fully implement the business finance supply chain in their respective regions propose a range of financial products that seek to form a smaller supply 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 supply chain include:

- Adequate funding provision for specialised funds (seed, venture, etc.): when it comes to supply 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 liquidity, 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 supply chain provides the raw material for the next one (Integrated Finance);
- Networking and partnership. This 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"…*;
- Market fluidity supposes that exit opportunities are made available. Exit opportunities are also important to allow investors to materialise its 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.

It is interesting to examine the examples illustrating this below:

I Greater London Enterprise (GLE, UK, http://www.gle.co.uk/) developed a complex scheme integrating financial instruments such as:

- GLE Development Capital;
- One London Business Angels;
- Factoring/Invoice Finance;
- Small Business Loan;
- Mentoring and Investment Readiness Programmes.

II The amounts available from these instruments are:

- €750,000–7,500,000 from GLE Development Capital;
- €140,000–1,000,000 from One London Business Angels.

III In West Midlands (UK), Advantage West Midlands Development Agency also deployed a range of financial services for SMEs (see http://www.westmidlandsfinance.com/Default.aspx).

IV The region of Wales (UK) re-organised all its financial services around a single organisation called Finance Wales (http://www.financewales.co.uk/eng) to provide the following financial services and products:

- Community loans amounting to £5,000–50,000 for the social economy;
- Xenos: its business angels network;
- Spinout: unsecured loans without interest of up to £25,000 for university spinouts;
- Venture capital: up to £750,000 per financial pool and £1,500,000 in total;
- Mezzanine: £10,000–412,500;
- Loans: from micro-credit of £1,000–10,000 to loans of up to £600,000.

Table 12. Finance Wales track record

	Businesses Assisted	Jobs Created or Safeguarded	FW Investment £000s	Private Sector Leverage £000s	Total Investment £000s
	21 months Apr'02 to Dec' 03				
Loans	**181**	**2296**	**5817**	**22346**	**28163**
Equity	**31**	**952**	**4358**	**11951**	**16921**
Mezzanine	**19**	**395**	**1881**	**2992**	**4873**
Spinout	**29**	**107**	**618**	**1446**	**2064**
Xenos	**13**	**108**		**1126**	**1766**
Pre-Investment	**13**	**349**		**2055**	**5774**
Mentoring	**62**	**322**		**3705**	**3705**
Total	**348**	**4529**	**12674**	**45621**	**63266**

Source: *Finance Wales*

V In Finland, SITRA (http://www.sitra.fi/eng/index.asp) provides EGCs (Entrepreneurial Growth Companies) with three complementary growth instruments:

- A network of 200+ business angels;
- A seed capital fund;
- A venture capital fund.

In the SITRA model, the business project submission department that packages projects for submission to business angels is supported by tailored expert advice to remedy human resource weaknesses identified in analysed business projects. SITRA is considering an extension of its provision to include a match fund investing alongside member business angels.

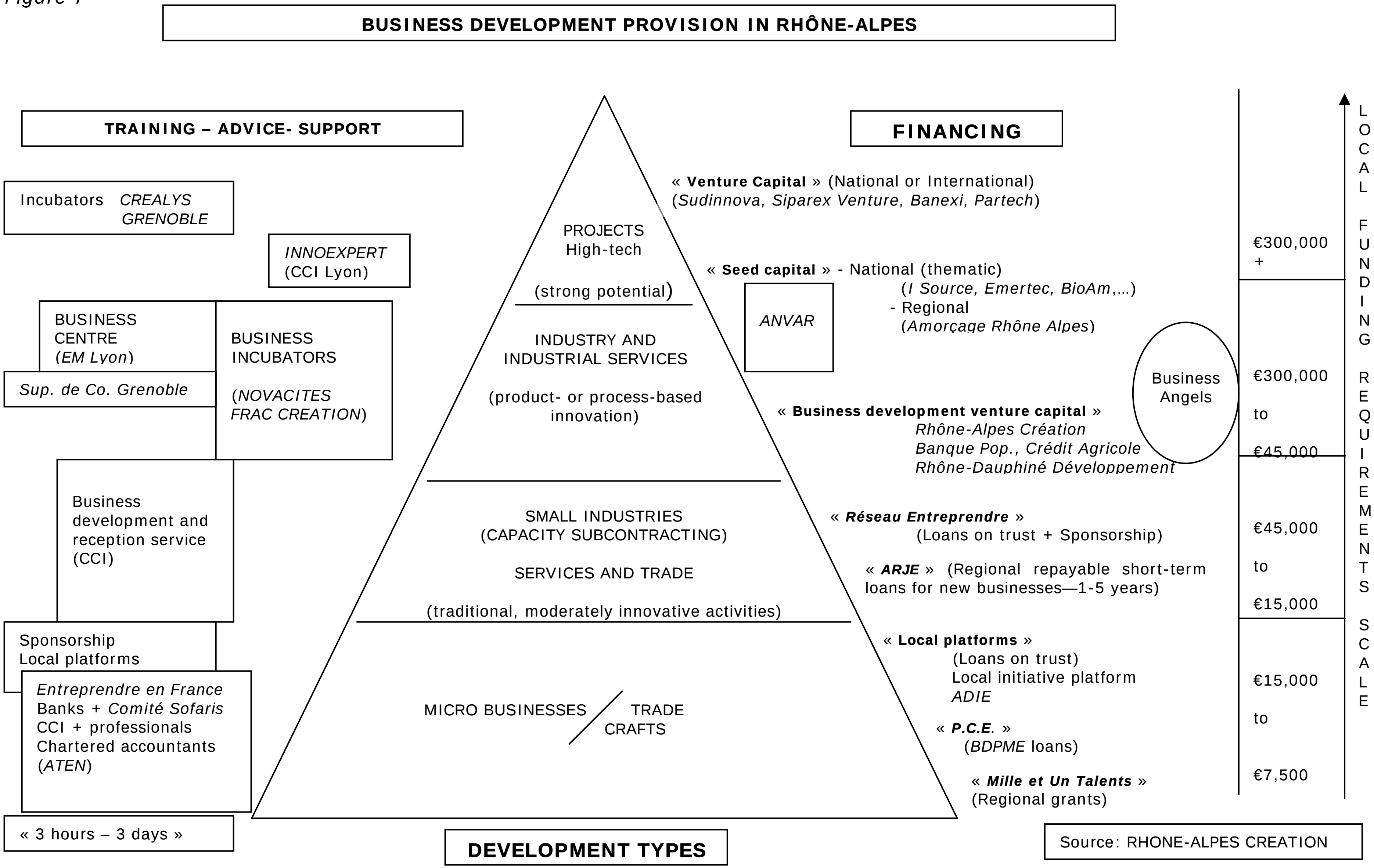
The French Ministry of Research has launched since 1999 a package of support to innovative business comprised of:

- An award system for innovative projects (cf. point 8.6) with a financial envelope of €30 millions;
- A support scheme to university related incubators. 31 incubators have received a total of €26,5 millions and have hosted 964 projects, of which 519 have been turned into a business (figures: end 2003);
- A financial support to 12 seed capital funds (6 are sectorial ones and operate through the whole country and 6 are regional ones) of an amount of €22 millions. Those funds have currently a stake in 51 businesses.

In other Member States, identified examples are diversely integrated, as illustrated by the example of Rhône-Alpes (F) hereafter. While the Anglo-Saxon models presented above are based on the pooling in a single agency of different funding sources available to regional businesses, this particular regional model is organised around a diversity of players. Rhône-Alpes Création's organisational chart (http://perso.wanadoo.fr/aracrea/rac/index.htm) 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.

Figure 7



BUSINESS DEVELOPMENT PROVISION IN RHÔNE-ALPES
TRAINING – ADVICE- SUPPORT
Incubators CREALYS GRENOBLE
INNOEXPERT (CCI Lyon)
BUSINESS CENTRE (EM Lyon)
Sup. de Co. Grenoble
BUSINESS INCUBATORS (NOVACITES FRAC CREATION)
Business development and reception service (CCI)
Sponsorship Local platforms
Entreprendre en France Banks + Comité Sofaris CCI + professionals Chartered accountants (ATEN)
« 3 hours – 3 days »
PROJECTS High-tech (strong potential)
INDUSTRY AND INDUSTRIAL SERVICES (product- or process-based innovation)
SMALL INDUSTRIES (CAPACITY SUBCONTRACTING)
SERVICES AND TRADE
(traditional, moderately innovative activities)
MICRO BUSINESSES / TRADE CRAFTS
DEVELOPMENT TYPES
FINANCING
« Venture Capital » (National or International) (Sudinnova, Siparex Venture, Banexi, Partech)
« Seed capital » - National (thematic) (I Source, Emertec, BioAm,...) - Regional (Amorçage Rhône Alpes)
ANVAR
« Business development venture capital » Rhône-Alpes Création Banque Pop., Crédit Agricole Rhône-Dauphiné Développement
Business Angels
« Réseau Entreprendre » (Loans on trust + Sponsorship)
« ARJE » (Regional repayable short-term loans for new businesses—1-5 years)
« Local platforms » (Loans on trust) Local initiative platform ADIE
« P.C.E. » (BDPME loans)
« Mille et Un Talents » (Regional grants)
€300,000 +
€300,000 to €45,000
€45,000 to €15,000
€15,000 to €7,500
LOCAL FUNDING REQUIREMENTS SCALE
Source: RHONE-ALPES CREATION

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 tract record;
- Investors have not the skill to assess the technology;
- Time to market might be very long;
- Innovation is a risky business.

NEFI[12] conducted a survey among its 10 members in November 2004[13] which shows that, depending on the stage of the life cycle and the innovation intensity of the investment, four main clusters of promotional financing programs can be observed. The four categories of programs are described as follow:

Category 1: programs supporting founders of high-tech companies in their pre-seed and seed stage carrying out top of the art research;

Category 2: programs targeting enterprises which realise R&D projects but are situated in the later stage of their life-cycle;

Category 3: programs targeting SMEs in the early/seed stage of their life-cycle trying to realise an innovative business idea, which does not necessary involve high-tech research;

Category 4: programs targeting the vast majority of innovative projects initiated by companies in their later stage with relatively low innovation intensity.

The table below shows what products NEFI members are offering to SMEs of those 4 categories.

[12] The Network of European Financial Institutions www.nefi.be

[13] Cf. *Financing Innovation and Research investments for SMEs: Challenges and Promotional Approaches*, www.nefi.be

Table 13. NEFI members programs to support innovative SMEs

	FEATURES	PROGRAMMES[14]
Category 1	Top of the art research Pre seed/Seed stage of the company High promotional intensity External tech partner supports screening of applicants and strict company selection →Supply founders on high tech companies with initial funds to make them "investor ready"	**KfW** – Futour **BDPME** Biotech Guarantee
Category 2	Pre-competitive and industrial research in existing SMEs High promotional intensity →Support/motivate existing SMEs to carry out research projects	**MCC** – law 598 research program **MCC** – National Research Facility Fund
Category 3	Innovative business idea Pre seed/seed stage of the company Medium promotional intensity Promotion of networks →Enable initial finance in pre-seed/seed stage and leverage private capital →Increase access to finance →Make company investor ready	**ALMI** – Innovation Loan **KfW** – BTU Early Stage **BDPME** – Equity Guarantee Technology Development
Category 4	Incremental innovation in later stage companies Broad target group Low promotional intensity →Supply existing SMEs with additional funds for innovation (Financing of soft cost e.g. Human Resources)	**ICO** – Innovation Loan **KfW** – Innovation Program – Loan and Equity Variant **BDPME** – Equity Guarantee Capital SME **BDPME** – Innovation Development Contract

NEFI members have identified a clear financing gap in Europe for high potential pre-seed, seed and start-up companies with a strong R&D focus (category 1), especially if these newly founded enterprises are spin-off or private individuals becoming entrepreneurs. As their R&D projects are complex and costly, potential for success can be high, but is difficult to assess and track records or collateral are not available. These elements conduct to a market failure as no funds are available for this target group of SMEs.

[14] KfW: www.kfw.de (D)
ICO: www.ico.es (E)
SOFARIS: www.oseo.fr/OSEO-sofaris.html (F)
ALMI: www.almi.se (S)
MCC: www.mcc.it (I)
MFB: www.mfb.hu (H)

CHAPTER 3: MARKET PROVISION

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.

In 2002, the UK's Department of Trade and Industry (DTI) launched a scheme to co-fund six investment readiness pilot projects (http://www.dti.gov.uk/). The initial results of this pilot scheme should become available in spring 2004.

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 the UK, *Exemplas* (http://www.exemplas.com) 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.

3.2. FROM PROJECT DEVELOPMENT TO FUNDING PROCUREMENT: THE FUNNEL EFFECT

Reasons for implementing investment readiness programmes may include a low rate of access to finance among business developers and companies compared to the number of applications that entrepreneurs submit to investors.

- *France Initiative Réseau* (France Initiative Network, F: http://www.fir.asso.fr) offers the following statistical insight:
  - 28,300 projects submitted;
  - 11,500 projects formally evaluated;
  - 7,400 projects submitted for provision of a loan on trust;
  - 5,700 loans on trust granted.

II *CDC PME* (F: http://www.cdcpme.fr), operating in the field of seed venture capital, submits the following information on the funnel effect:

- 2,200 applications received;
- 99 applications submitted to investment panels;
- 41 projects funded.

The funnel effect[15] is readily apparent in the transition between business concept and incorporation.

III This is how 3,727 business concepts have been submitted to AEE (*Agence de développement de l'Essonne*, F, http://www.ed-partners.org, http://www.ed-partners.org/Expansion/default.htm) over the last ten years, of which around 1,240 have actually become businesses. Ten years down the road, the overall business survival rate is 64%. In 2003 alone, 430 projects were submitted to the Agency, 115 of which eventually became incorporated companies.

IV SITRA (Finland) provides an example of a Business Angels network's experience of the funnel effect. In 2003, it:

- Received 300 projects;
- Submitted 60 to its 200 member angels;
- Secured business angel funding for 20 projects.

3.3. PUBLIC PROVISION AND MARKET FAILURES

The European Commission[16] believes that the role of the public sector should be limited mainly to the improvement of framework financing conditions and should only take limited direct action when justified in the context of market failures. However, it acknowledges the following factors:

- Access to equity and loans is difficult being one of the main obstacles faced by SMEs;
- Inadequate information, investor and credit provider distaste of risk as well as the limited guarantees that SMEs are able to provide;
- Comparatively high due diligence and deal costs compared to funding amounts;

may justify public intervention, as these factors can cause market failures justifying State grants.

As a condition for authorising public measures in support of venture capital, the European Commission requires proof of the existence of a market failure. In addition, the amount of such action is capped at €500,000–750,000 according to regional situations.

Public authorities may act in one or more of the following ways to promote the development of venture capitalism:

- Setting up investment funds, in which they are partners or investors;
- Granting subsidies to existing funds to cover part of their administrative and management overhead costs;
- Promoting other financial instruments to improve the provision and availability of equity for investment;
- Guaranteeing venture capital fund investment;

[15] *Les Echos*, 16 December 2003.
[16] - OJEC C235 (21 August 2001): *State Aids and Investment Capital*, pp. 3-11.
- http://europa.eu.int/comm/enterprise/entrepreneurship/financing/index.htm

- Granting tax incentives to investors in order to encourage them to close venture capital investment deals.

As such, the offer of available finance is not adequate to solve the issue of market failures. Public authorities also need to address the issue of demand, of asymmetric information - which is one of the main causes of poorly performing finance provision markets - and of cracks appearing in the finance supply chain, possibly because of a lack of adequate funding sources or sufficient equity available from some funding sources.

3.4. INFORMATION SOURCES

There is a multiplicity of private, semi-public and public organisations that can, to a certain extent, help business developers and entrepreneurs to find the information they need on access to finance. Some of these organisations apply “touch and go” techniques, while others provide specialised advice or even offer matching services with potential investors. In France, for example, in every city, entrepreneurs might benefit from 120 to 160 different support schemes. In order to help entrepreneurs to find their way, a website has been created with the support of the French State (www.observatoire.ism.asso.fr)

Specialised sources include:

- ***Banks***: they are often the first organisations that entrepreneurs looking for funding to develop their projects turn to. However, bankers more often than never limit their analysis to a credit solution. If the answer is negative, there would be a need for bankers to ensure that business projects are referred to other organisations specialising in SME consulting services and alternative funding sources.

- ***Regional Development Agencies (RDAs):*** These can be considered as the regional and local authorities’ “development arm” and they all provide business advice services. Some of them also manage financial instruments ranging from public grants to sophisticated financial engineering products. The RDA of West Midlands (UK, http://www.advantagewm.co.uk/home-page.html) developed a web portal compiling some 550 different funding sources. EURADA’s website (http://www.eurada.org) lists the coordinates of nearly 150 development agencies operating in Europe. Some RDAs act as intermediates between entrepreneurs and investors. In this particular case, they inform themselves of the investors’ requirements beforehand (amounts, preferred sector of activity,…) and hereby reducing the useless steps that the ignorant entrepreneurs would take normally.

- ***Business incubators and nurseries***: in addition to accommodating businesses at suitably competitive rates with assorted secretarial support services, they offer specialised advice (in matters relating to taxes, regulations, intellectual property, technology transfers, etc.), including to companies looking for finance. Sometimes they even manage to raise funding for the companies that they accommodate or have suitable financial instruments available. According to a survey conducted by the Harvard Business Schools (USA) and published in 2000, 40% of incubators operating worldwide have managed to assist tenant SMEs in securing venture capital.

  The websites below provide an interesting introduction to the concept:

  EU: *EBN-European Bic Network* (http://www.ebn.be);

  F: *France Technopôles Entreprises Innovation* (http://www.reseauftei.com);

  UK: *UK Business Incubation* (http://www.ukbi.co.uk);

NL: Zernike (http://www.zernikegroup.com);

USA: NBIA (National Business Incubation Agency) (http://www.nbia.org).

- ***Incubators linked to universities and other higher technical and technology institutes***:_e.g. the incubator of Franche-Comté (F), linked to both the technology university of Belfort Montbéliard and the *Ecole Nationale Supérieure de la micromécanique* (Higher National School of Micromechanics) in Besançon.

- The importance of entrepreneurship services provided by universities is illustrated by the fact that 150 to 200 university spin-offs emerged in the UK in both 2001 and 2002[17].

- ***Technology parks***: the organisations managing this type of infrastructure may also contribute relevant information on the types of finance that are suited to the development needs of businesses. Useful URL:

  IASP (International Association of Science Parks: http://www.iaspworld.org).

- ***Business development and business plan competitions***: these provide young entrepreneurs with useful access to both expertise and funding sources. Award-winning business projects win prize-money of up to €15,000 or more in Poitou-Charente (F, http://www.creation-transmission.com) and/or a services or equipment package. Some of these competitions are only open to innovative businesses. This is for instance the case of the regional innovation contest of Midi-Pyrénées (http://www.adermip.com/). Competitions of this type or business exhibitions are organised annually in most French departments. Several are mentioned every month in a magazine called “La revue”.

- ***Entrepreneurship training***: its purpose is to improve potential entrepreneurs' awareness of access to different funding sources. Interesting initiatives include:
  - Ecole Solvay (B) and Agence de Développement de l'Aisne (F) as well as the Institut Régional pour la Création et le Développement des Entreprises de PACA (Regional Institute for Business Creation and Development of the Region of Provence-Alpes-Côte d'Azur: http://www.irce-paca.com);
  - In Belgium, BEP-Bureau Economique de la Province de Namur (the Regional Economic Development Office of the Province of Namur) set up NEC-Namur Entrepreneurship Centre in cooperation with two university departments (http://www.bepentreprise.be/nec-presentation.htm). NEC's purpose is to assist business developers by integrating them in a targeted, practical training scheme and providing customised support. Training is provided over five months. The first training session was attended by 20 people.

- ***Cluster management organisations***, a.k.a. *“**industrial districts**”* and *“**local productive systems**”*: they may prove extremely useful for businesses in procuring information or even assistance (general or financial advice). Such organisations exist at regional level in many Member States. Useful URLs include:
  - France: contact:(splinfo@wanadoo.fr);
  - World: The Competitiveness Institute (http://www.competitiveness.org).

[17] *Cordis Focus n°234*, 1 December 2003.

3.5. BUSINESS EXHIBITIONS

A number of countries and regions organise events both to promote entrepreneurship and to access the latest developments in the field of support services for business developers, and possibly on the promotion of family business transfers across generations. Below are a few interesting examples of such fairs:

- Business start-up (UK): London, end November (http://www.bstartup.com);
- Business fair(F): Paris, end January (http://www.salondesentrepreneurs.com);
- Venture capital fair: Louvain-La-Neuve, mid-November (Wallonia, B: (http://www.4x4entreprendre.be).

3.6. HANDS ON MANAGEMENT (COACHING—TUTORING)

It has been established empirically that the life expectancy of businesses that have been accommodated in an incubator or have received some form of advice is dramatically improved compared to businesses that have not benefited from this type of services. Businesspersons therefore need to become aware of the fact that access to finance alone is not adequate to consolidate their business in the long run. Investors are also increasingly sensitive to the quality of human resources available in investee businesses. To remedy any weakness in this field, business finance programmes increasingly include the provision of management or business development consulting services as a (pre)condition of or complement to funding.

3.7. OTHER SHORTCOMINGS OF REGIONAL MARKETS

The efficiency of regional financial markets also depends on:

- The quality and professionalism of managers of existing financial instruments. Management and due diligence (precautionary principle-related) costs grow year by year and their amount is almost identical regardless of the investment size. In outer regions, attracting or retaining skilled fund managers is often difficult;
- Market segment liquidity. In some regions, exit routes for investors are scarce, with the negative consequence that equity is locked up as investment for longer than originally planned or strictly necessary and is therefore not available for reinvestment in other operations;
- The availability of private equity which is capable of maximising the leverage potential of public funds.
- Specialised instruments including guarantees schemes for innovative SMEs. Though some experts considered that the major difference between innovative enterprises and traditional ones is more related to financing the intellectual property rights protection rather than access to finance.
- Lack of instruments to support tha transfert of a SME from one generation of owners to another one.

Below are examples of the kind of leverage provided by a few public instruments:

- Wales Finance's Equity Fund (UK): two private business pools and a public investment pool, representing a sample of 274 investment operations;
- Zukunfsfonds by Investitutionsbank Berlin (D): ten private business pools and a public investment pool, representing a sample of 27 companies;
- Availability of, or access to, specialised consultants or advanced public services capable of improving the quality of business plans and the growth potential of businesses looking for finance.

It appears clearly from the above that the role of the public sector cannot come down to a mere consideration of the different equity market segments: it also needs to invest in their efficiency.

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 when the number of companies attracting the attention and interest of other funding sources is known with a fair degree of certainty not to exceed 25,000? However, bankers seem to be the black sheep in the SME finance cycle.

Significant differences exist across[18] European countries when it comes to the use of bank loans. In some, practically all SMEs have one or more bank credit lines going at any given time, while in others this is true for only 70% of them. According to a survey conducted by the European SME Observatory, 60% of sampled SMEs are up to €100,000 in debt vis-à-vis their bank, 16% are in the red for €100,000–500,000, 1% have more than €1,000,000 in bank debt, and 20% confess not knowing how heavily they are indebted to their bank(s)!

The same survey shows that 60% of European SMEs have applied for a new loan in the last three years. While the vast majority of them obtained the amount they applied for, 13% of SMEs were denied a new loan by their bank because it:

- Considered guarantees to be inadequate;
- Was not satisfied with the overall businesses performance;
- Deemed the information supplied to be insufficient.

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

Bank loans are often linked to tangible guarantees, though bankers themselves insist[19] 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 different types of banks (commercial, cooperative, public, etc.), which are diversely available to listen to SMEs and provide adapted solutions.

Among public banks, the following are worth mentioning:

- BDPME (*Banque du Développement des PME*, SME Development Bank), F: (http://www.bdpme.fr/website/bdpme.nsf) which, in 2002, supplied:
  - €7.3 billion in short-term loans to SMEs with own funds;
  - €4.7 billion to provide government contractor SMEs with short-term finance;
  - €1.2 billion to finance the transfer of SMEs.

In terms of business numbers: 26,300 companies were set up and the transfer of 4,200 more was supported. It is worth noting that on average, 170,000-180,000 new businesses are created annually in France.
In addition to funding activities, BDPME[20] develops regional guarantee schemes. At the end of 2002, 26 such schemes had been set up. With total funds of €55 million, they are able to leverage guarantees for nearly €550 million in equity (SOFARIS REGIONS: http://www.sofaris.com/sofaris/index.htm).

- KFW (D: http://www.kfw.de/DE/Inhalt.jsp).

[18] European SME Observatory, 2003 n°2. SME access to finance: http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/doc/smes_observatory_2003_report2_en.pdf.
[19] See interview of M. J. Thumelaire, manager in charge of SMEs with ING (B), in *l'Echo*, 29 October 2003
[20] See *InterRégions* nr 251, November/December 2003

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

- Soft loans;
- Variable and fixed rate loans;
- Call loans;
- Capital investment loans;
- Factoring;
- Leasing.

Banks can also provide special conditions to support the business transfers. In late 2003, 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. In 2005 this bank 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".

NATWEST (http://www.natwest.com) and HSBC (http://www.ukbusiness.hsbc.com/hsbc) seem most advanced in this kind of provision. 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, North Carolina Triangle, Boston, 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.

In order to improve client awareness of available banking products, HSBC has developed "The Raising Finance Decision Tree" (accessible on its website: http://www.ukbusiness.hsbc.com/hsbc).

4.2. SMALL NON-BANKING LOANS (RISK SHARING) – LOAN ON TRUST[21]

This type of funding is very well developed in France under the name of "fonds de prêts d'honneur" and the network called France Initiative Réseau (www.fir.asso.fr.)

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 20 years, €325,5 millions has been granted to 49 100 individuals which become entrepreneurs and were able to get 1,32 billions of bank loans. They created 110 000 jobs. In 2005, 237 local networks (plates-formes d'initiative locale: PFIL) were in place. The main sources of funding of those PFIL are:

- Local and regional authorities: 48,3 %
- EU and State: 10,0 %
- Caisse des Dépôts et Consignation: 17,8 %

[21] *Les Echos*, 27 May 2005

- Entreprises and banks: 16,1 %
- Other private sources: 7,8 %

In average the loan on trust given to an entrepreneur is €5000.
More recently some "FIRs" are specialising their activities in lending to innovative start-ups.
In the UK many CDFIs (Community Development Finance Institutions) operate to provide between €1500 and 75000 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 the West Midlands region (UK) funds such as:

- 3b
- Black Country Enterprise Fund
- North Staffordshire Risk Capital Fund
- Advantage Community Loan Fund (www.lif.org.uk)

are examples of CDFIs. Useful URLs include:

- FIR (*France Initiative Réseau*, France Initiative Network: http://www.fir.asso.fr/);
- *Réseau Entreprendre* (Entrepreneurs Network: http://www.reseau-entreprendre.org).

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: http://www.eif.org) set up a financial scheme to guarantee operators' micro-credit portfolio. At end 2003, the following organisations had benefited from this type of intervention:

- *Association pour le Droit à l'Initiative Economique* (Association for the Right of Economic Initiative, ADIE, F: http://www.adie.org);
- *Fonds de participation* (Shareholding fund, B: http://www.fonds.org).

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: www.pembrokeshirelottery.co.uk.
In place since 1993, the lottery was able to support 100 enterprises for a total amount of 1.3 million £ UK (approx. €2.1 million) and so create or save 300 jobs.
The lottery runs as follow:

- Each members of the lottery plays 1 £ UK per week. Currently nearly 7000 people are members;
- The winner receives 2000 £ UK;
- The surplus is invested in loans for a 2 to 5 year period paid back monthly. Other regions such as Isle of Wight have developed a similar lottery.

4.3. REGIONAL LOAN FUND

Some regions create special loan funds in order to solve specific problems such as the transfer of ownership of enterprises or to soft the consequences of the failure of a major contractor.
Such investments have been put in place by Advantage West Midlands, for instance in 2005 to avoid a "domino effect" bankruptcy among suppliers of the Rover Car company. That RDA has put in place a special loan fund named Advantage Transition Bridge Fund, www.advantagebridgefund.com. The fund provides loans from €75.000 to 750.000 to enterprises affected by the decline of the MG Rover company. Supported enterprises had more than 15% of their turnover done with MG Rover). They have a viable business plan, but cannot 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, http://www.hoogstarters.nl
In the West Midlands, the Mercia Spinner tool – www.spinner.org.uk – 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, 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 the partnership between the regional development agency of Andalucia (A.I.D.A.) and the universities a grant of €5000 per project is given by A.I.D.A. to the university which has promoted the project 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%. Eleven projects have been funded after 18 months (mid-2005).

4.5. LOANS FOR INNOVATIVE COMPANIES

Oséo Anvar (www.anvar.fr) 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.

CHAPTER 5: VENTURE CAPITAL

5.1. BUSINESS ANGELS (INFORMAL VENTURE CAPITAL)

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[22]. 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 angels networks have emerged at regional level to recruit angels and match them with local entrepreneurs looking for finance and advice.

The number of such Business Angels Networks (BANs) in Europe has grown measurably since 1999. The European Commission[23] and EBAN (European Association of Business Angels Networks: http://www.eban.org) have played an important role in disseminating this concept. In the US, more than 170 such networks have been identified. The total number in Europe is closer to 200, though some BANs have yet to closed their first deal. Because of the informal nature of this sector, it is extremely difficult to collect statistical data. In the US, more than 3 million angels invest roughly $50 billion annually, i.e. twice as much as it is estimated that European venture capitalists invested in 2002.

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 angels networks often find it difficult to become sustainable. A number of regions support a sizeable share of these networks' operating expenses. A few BANs such as BAMS (http://www.bamss.com) and NEBIB (http://www.nebib.nl) are self-financed.

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

- Angel syndication;
- Setting up of dedicated funds that invest alongside angels;
- Provision of easier exit routes for angels;
- Business angels academies;
- Investment readiness programmes;
- Integrated finance;
- Co-investment funds.

Several attempts have been made in Europe and the US to substitute networks with IT tools, the results of which are not convincing. See "Gate2Growth" (http://www.gate2growth.com) or "One London" (http://www.gle.co.uk/onelondon).

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.

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

[23] DG Enterprise cofinanced 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://europa.eu.int/comm/enterprise/library/best-reports/index.htm

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.

Useful URLs include:

EU: EBAN (http://www.eban.org);
UK: BBAA (http://www.bbaa.co.uk)
LINC Scotland (http://www.lincscot.co.uk);
One London (http://www.gle.co.uk/onelondon);
F: France Angels (http://www.franceangels.org);
D: BAND (http://www.business-angels.de);
B: Vlerick Business Angels Netwerk (http://www.ban.be);
BAMS (http://www.bamss.com);
BeBAN (http://www.beban.be);
I: IBAN (http://www.iban.it);
MC: BusinessAngels.Com (http://www.businessangels.com);
US: Angel Capital Association (http://www.angelcapitalassociation.com);

Business Angels 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 angels 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 presentation skills of the team, training in deal agreements (dilution of power, exit route, …).

Since 2004 several business angels networks are trying to set up co-investment funds (some people call this instrument "side-car funds"), which invest "pari passu" with angels. These funds already exist in England, Scotland and Belgium. In 2007[24] the EIF should be able to invest in this co-investment fund.

[24] Cf. draft proposal by the EU Commission under the CIP (Competitiveness and Innovation framework Programme, http://europa.eu.int/comm/enterprise/enterprise_policy/cip/index_en.htm)

5.2. 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: http://www.evca.com), the European venture capital market comprises:

Table 14. Definition of the Venture Capital market segment

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.
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.

Source: EVCA

In Europe, the venture capital market totalled in 2004 €37 billion invested in 6.985 companies. Those figures were 29.1 billion € in 7446 enterprises in 2003, €27.6 billion in 10,229 businesses in 2002, and €24.3 billion in 10,672 businesses in 2001. This market segment breaks down as follows in terms of average size investment in 2003 and 2004:

Table 15. Average size of deals in the Venture Capital industry

	Importance (%)		**Average size/deal (€)**	
	2003	**2004**	**2003**	**2004**
Seed	1.6	0.4	494150	416.250
Replacement	4.6	2.5	6229700	3.156.000
Start-up	11.9	6.0	823300	1.032.500
Expansion	29.4	21.4	1702300	2.379.000
Buyouts	52.4	69.7	16917600	21.03.700
TOTAL	100 %	100%	3907600	5.285.600

Source: EVCA

In 2003, ¾ of the amount investment went to first-time investments and ¼ to follow-up financings.
According to EVCA[25], during the period 2000-2004 the private equity funds raised their sources pf capital as follows:

- Bank: 23%
- Pension funds: 22%
- Funds of funds: 13%
- Insurance companies: 12%
- Corporate investors: 7,5%
- Government agencies: 7%

[25] Ibidem.

- Private individuals: 6,5%
- Academic institutions: 1,5%
- Capital markets: 1%
- Not available: 7%.

The European venture capital industry remains very fragmented, as each country has its own investment culture or tradition. This is how:

- The UK panorama, being the largest market in Europe (37.5% of total), is dominated by buyouts (75%);
- Being the second largest market (21.1%), France invests five times more in seed capital than the UK, while 20% of all investment in Germany focuses on start-ups;
- German public investors alone represent more than 50% of total public investment spending in Europe.
- The vast majority of start-up investment deals are conducted in a limited number of countries including the UK, Sweden, Switzerland, Germany, the Netherlands, Belgium and France. Indeed, the venture capital market segment clears the €100 million mark in every single one of them.

In recent years, the European Commission has become aware of the need to promote the emergence of a genuinely pan-European venture capital market. Between 1998 and 2003, it supported the implementation of a programme called RCAP aimed at removing existing barriers to the creation of such a European market (see: http://europa.eu.int/cgi-bin/eur-lex/udl.pl?GUILANGUAGE=fr&DOCID=503PC0654&LANGUAGE=fr&SERVICE=all&COLLECTION=com&REQUEST=Service-Search&FORMAT=all&CURRENTFORM=Service-Search&switch_en.x=11&switch_en.y=7)

In parallel, DG Regio recommends that ERDF-eligible regions invest in regional venture capital funds and other instruments falling under the generic heading of "financial engineering" as supported in an October 2002 document entitled "Guide to risk capital financing in regional policy" (http://europa.eu.int/comm/regional_policy/sources/docgener/guides/guide_en.htm). While this document is a practical guidebook for managers of regional development programmes subsidised by the European Union, it can also prove useful to other regional stakeholders with an interest in leveraging regional financial engineering tools including venture capital, business angels, loan funds, micro-credits and guarantee schemes.

For further information on European venture capital industry operators, contact the national venture capital associations of your country, such as:

B: VBA (Belgian Venturing Association: http://www.bvassociation.org);

F: AFIC (*Association Française des Investisseurs en Capital*, French Capital Investors' Association: http://www.afic.asso.fr);

UK: BVCA (British Venture Capital Association: http://www.bvca.co.uk).

The biggest European players are:

- 3i (http://www.3i.com);
- Apax Parners (http://www.apax.com).

There are two useful URLs for information on the US context:

- NVCA (National Venture Capital Association: http://www.nvca.org);
- MoneyTree™ Survey (http://www.pwcmoneytree.com/moneytree/index.jsp).

Before launching a quest for the "Holy Grail", entrepreneurs and publics 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, 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"[26].

5.3. 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 (around €150 million in 2004). On average, seed capital funds currently invest around of €400.000 per deal while tickets exceeded €1 million in 2000, i.e. when overenthusiastic investment in NTIC (New Information and Communication Technologies) and internet start-ups was at its strongest.

The activities of seed capital funds vary considerably across the EU. 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*: http://www.cdcpme.fr), manages 15 funds, six of which are industry-specific while the rest are regional. At end 2002, this organisation's portfolio included 113 companies. Notable among dedicated (industry-specific) funds are BIDAM (life sciences), EMERTEC (ICT/industry) as well as I-Source, C-Source and T-Source (all three specialising in ICT). *CDC PME*'s assets under management total €191 million in 113 different businesses.

The data below present the 2004 seed and start up market in Europe, as well as the trends in those two markets between 2000 and 2004. The data show that less and less money is invested in Europe in the seed market:

Table 16. Data concerning the European seed and early stage market in 2004

	Volume in €1000		***N° of companies***	
	SEED	**START UP**	**SEED**	**START UP**
EU	147.771	2.230.233	355	2.160
A	1.876	15.519	3	33
B	3.935	43.228	14	97
CZ	0	173	0	1
DK	15.821	149.866	43	192
FIN	9.063	31.183	31	87
F	36.532	373.752	55	430
D	21.940	351.590	26	330
GR	2976	0	5	0
H	0	0	0	0
IRL	250	27.587	2	41
I	4.378	18.377	6	30

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

NL	1305	37.551	4	67
N	4.699	26.422	6	47
PL	0	0	0	0
P	23	36.104	2	29
SK	1.056	1056	6	6
E	5.738	63.374	15	71
S	25.342	206.826	67	164
CH	768	60.010	3	46
UK	12.069	807.615	67	495

Source: EVCA

The early stage and start up market segments in Europe seems rather small both in volume invested by venture capital funds and in number of companies in which venture capital funds invested in. Trends between 2000 and 2005 for those two markets are shown hereafter:

Table 17. Evolution of the European seed and early stage market

SEED CAPITAL				
Year	**Amount in €1000**	**% of total venture capital market**	**N° of enterprises**	**Deals average**
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
START UP				
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

Source: EVCA

5.4. 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 (*Société d'Encouragement à la Création d'Activités Nouvelles en Technologies*, 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: http://www.esinet.com) 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 has 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 (http://www.jratech.co.uk).

In Wales (UK), Finance Wales: www.financewales.co.uk 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 £UK unsecured free interest loans not repayable during the first 3 months;
- A 7,500 £UK grants 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 (http://www.ost.gov.uk/ enterprise /knowledge /unichal.htm) available in 31 universities and 7 research centres.

The scheme has supported more than 60 businesses in less than 4 years of existence (2000 – 2004).

In Belgium 6 universities have their own venture capital fund specialised in the early or seed capital market segment.
The data below provide information regarding their importance:

I Baeckeland Fonds II Ghent University:

- http://www.techtransfer.ugent.be/topic.asp?sec=industry&id=4&subid=8
- capital: 12,5 mio €
- max investment: 0.5 mio €

II BI³ Fund Brussels University

- http://www.vub.ac.be/downloads/BI+spin-offs_english.pdf
- capital: 6 mio €
- investment scale: between 200 and 600 000 €
- Spinventure: Liège University
- http://www.interface.ulg.ac.be/english/valorisation/spinventure.html
- capital: 5.3 mio €
- investment: 100 000 € (equity + loans)

III Vives: Louvain-la-Neuve University

- www.vivesfund.com
- investment: between 300 000 € and 1 500 000 €
- sectors: ICT and biotech.

IV Gemma Frisius Fonds: Leuven University

- http://www.leuveninc.com/pooled/articles/BF_NEWSART/view.asp?Q=BF_NEWSART_32792

- capital: 6 mio €
- the fund is linked to the IMEC (research centre specialised in the semiconductor sector.

In 1999, the French Ministry for Research, Directorate for Technology 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. Funds such as BIOAM (www.bioam.fr), C-Source (www.isourcegestion.fr/C-Source.htm), Cap Decisif, active in the region Ile de France (www.capdecisif.com) and Le Lanceur in Avergne and Limousin (www.cr-limousin.fr/article.php3?id_article=116), are examples of this initiative. Between 1999 and 2003 51 investments were made.

5.5. 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. In the US, the exclusive aim of corporate venturing is to generate capital gains.

The amount of money raised by the industry of corporate venture at world level has evolved as follows[27]:

Table 18. Importance of the World Corporate Venture Industry

YEAR	NUMBER OF FUNDS	MONEY RAISED IN MIO EUROS
1995	16	2789
1996	8	377
1997	19	1700
1998	22	2156
1999	60	7743
2000	126	15548
2001	55	5213
2002	29	1606
2003	18	1662
2004	11	1371

Source: *Les Echos*

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 millions of euros at their disposal.

In Europe, companies such as Belgacom (B), Thompson (F), Siemens (D) and Innovacom (a subsidiary of France Telecom) are also very active on this market segment. In 2004, Siemens for instance had 19 enterprises in its portfolio. Siemens activities in this field is entitled SMAC (Siemens Mobile Acceleration). The total investment made by SMAC, created in 2001, is worth more than €20 million.

[27] *Les Echos*, 29 June 2005.

Since 2002, the UK's DTI (Department of Trade and Industry: http://www.dti.gov.uk) has 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 (www.corporateventuringuk.org).

Sometimes[28] European based companies develop corporate venture in the US. This is the case of Siemens, which provides seed-stage funds and commercial helps to Berkley (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.

5.6. 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 as:

The communication limits the term « market failure » for case 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 costs29

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.[30]

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: http://www.eif.org) and
- The ERDF (European Regional Development Fund:
- http://www.europa.eu.int/comm/regional_policy/funds/prord/prord_en.htm
- 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;

[28] *The Wall Street Journal*, 14-16 October 2005

[29] Official Journal of the European Communities: State Aid and Risk Capital (2001/C 235/03), VI – Basis for authorising risk capital measures under Article 87(3)(a), (c) and (d) of the Treaty, VI.3

[30] See the Official Journal (OJEC C, 2001/C 235/03:(http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c_235/c_23520010821en00030011.pdf) or the website of DG Competition, accessible through its portal (http://europa.eu.int/comm/competition/index_en.html).

Those three instruments are grouped under the acronym MSIF (Merseyside Special Investment Fund: http://www.msif.co.uk).

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: http://www.eurefi.org) 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: http://www.unicer.asso.fr) unites some 30 regional funds. Investment amounts range between €50,000 and €500,000. The most remarkable are undoubtedly:

- Rhône-Alpes Création (http://perso.wanadoo.fr/aracrea/rac/index.htm);
- Finorpa (http://www.finorpa.fr).

Some regional funds can have a strong sectorial focus and take the advantages of a good public-private partnership. In mid 2005[31] the French regions Aquitaine and Midi-Pyrénées have both invested €1 million in an equity fund named Aerofund (www.aerofund.com) 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.
Advantage West Midlands has created in July 2003 a fund to support the creative industry (www.advantagecreativefund.co.uk).

5.7. 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 (*Sociétés de Développement Régional*, 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: http://www.liof.com/);

In Belgium, such operators exist in every region:

- GIMV (http://www.gimv.be) in Flanders. Remarkably, this firm is listed;
- SRIB (*Société Régionale d'Investissement pour la Région de Bruxelles-Capitale*, Brussels-Capital Regional Development Firm: http://www.srib.be) in the Region of Brussels-Capital;
- SOWALFIN (*Société Wallonne de Financement et de Garantie des Petites et Moyennes Entreprises*, Walloon Small and Medium-Sized Company Funding and Guarantee Firm: http://www.sowalfin.be) pools all financial instruments available to businesses operating in Wallonia.

In France, Regional Development Firms are operating in 13 metropolitan regions.

[31] *Les Echos*, 22 June 2005.

Some of them have joined forces to set up an EEIGs (European Economic Interest Grouping) called "Eurodevelopment". Together, its 36 members weigh more than €600 million in financial assets invested in a portfolio of more than 3,000 client businesses.

A number of French regional organisations have set up venture enterprise investment funds (VEIFs)[32]. This is how in December 2003, Toulouse-based IRDI (*Institut Régional de Développement Industriel*, Regional Industrial Development Institute) of Midi-Pyrénées, France, launched a VEIF called ICSO1 (*investisseur en capital dans le sud ouest*, 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 EIF, CDC and the Regional Council), insurance companies, bank and private firms (EDF and Total).

In Belgium, the Ministry of Finance has issued public bonded loans[33] in order to raise €65 million from private savings to increase the financial resources available to entrepreneurs who wish to set up their own business. Between 1st September 2004 and 31st August 2005 973 loans have been awarded for a total of €60 million[34]

5.8. 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 (http://www.sofirem.fr) and FINORPA (http://www.finorpa.fr) 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. At mid-2003, their total investment was reported to amount to nearly €400 million in nearly 1,300 different user SMEs. In 2003, they joined forces under an umbrella agency called SOWALFIN (http://www.sowalfin.be) controlled by the Walloon region.

5.9. 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 (http://www.love-money.org) operates using a business model that is similar to business angels;
- At European level, INAISE (*Association Internationale des Investisseurs dans l'Économie sociale*, International Association of Investors in the Social economy: http://www.inaise.org) is a grouping of several operators.

Proximity funding[35] may also focus on regional commercial businesses. In December 2003, financial operators of the French department of Nord (*Crédit Mutuel du Nord Europe* - https://www.creditmutuel.fr/cmne/fr/index.html - and *SIGEFI Nord*

[32] *Les Echos*, 2-3 January 2004.
[33] *Les Echos,* 17-19 January 2004.
[34]Les *'Echos,* 7 October 2005.
[35] *Les Echos*, 15 December 2003.

Gestion, FIP - http://www.pme.gouv.fr/actualites/secret/commu/2003/c19122003.htm) jointly launched a proximity investment fund called *FIP Nord Europe PME* to finance unlisted regional SMEs. Maximum stakes in individual companies reach €3,000.

CHAPTER 6: THE STOCK EXCHANGE

6.1. LISTING

It is arguably businesses' noblest path to venture capital as well as the most prestigious and profitable exit route for shareholders. Whereas few businesses will ever enter CAC 40, DJIA, FTSE and other prestigious stock indexes, a number of SMEs can entertain hopes of listing on secondary markets, new markets or even possibly NASDAQ via an IPO (Initial Public Offering). IPOs' most recent moment of glory happened in the last years of the 20th century at the time of what some observers called the "new economy". Fast-growing SMEs generally aim for an IPO on either the *second marché* (second market), new market or NASDAQ, whose respective distinctive features include:

- ***Second marché:*** mid-sized companies with a proven track record of profits and offering the prospect of strong growth looking for up to €50 million in equity. The main second marchés are attached to LSE (London Stock exchange, UK), Euronet (F-B-NL) and Frankfurt (D).

- ***New market:*** companies with a strong potential for growth looking for shareholder's equity. The French new market requires companies applying for an IPO to have own funds amounting to a minimum of €1.3 million prior to listing and to issue at least 100,000 shares for a minimum total value of €1.5 million. Raised equity ranges between €3.2 million and €50 million.

- ***NASDAQ*** (http://www.nasdaq.com)***:*** an automated current quotes market focusing on technology firms with strong growth potential.

According to the International Federation of Stock Exchanges (http://www.fese.be), around 300 companies were listed for the first time in 2002, compared to 375 in 2001. London remains the most dynamic financial centre with 201 listings in 2002 (against 245 in 2001).

In addition to share issues, a number of stock exchanges also allow companies to raise equity by issuing bonds. Luxembourg and London are the most active such financial markets with 5.387 and 1.930 issues respectively.

If an IPO might be considered as the "holy grail" for an entrepreneur and early stage investors, the number of enterprises quoted still remains low in Europe.
At the end of the year 2005[36] the number of enterprises listed on the London Stock Exchange was 3.013, on Euronext this figure was 1.272 and on the Deutsche Börse this number was 777.
Since it was launched in 1995, the London market for mid caps AIM (Alternative Investment Market) some 1.300 enterprises have successfully been listed. Between October 2004 and October 2005 some 400 enterprises were introduced.

6.2. NEW MARKETS

New markets are a specific stock segment that meet the real needs[37] of so-called "mid-cap" (innovative mid-sized) companies looking for equity to fund their growth.

[36] *Les Echos*, 2 November 2005.
[37] See: *L'Entreprise* (F), October 2003, nr°216. Interview with Mrs Amy Antola, Ernst & Young.

After setbacks in the early 2000s, a number of stock exchanges (including EURONEXT, http://www.euronext.com since 15 September 2003) have introduced new rules to restore investor confidence. This is how businesses applying for listing now need to provide the following assurances:

- Three years of existence;
- Positive financial results in the twelve months leading to the application;
- Own funds amounting to a minimum of €1.5 million;
- Implementing a quarterly reporting system;
- Providing reliable guarantees of viability and consolidation.

In 2005, AIM and Euronext have developed specific instruments for SMEs named “Alternext”. This new market segment targets SMEs of the Eurozone employing less than 250 people seeking less than 2,5 millions of euros. During the first months of operation, started on 17.5.05, Alternext will introduce 8 enterprises on this market.

As far as the Irish Stock Exchange in concerned, it started early 2005 a new market dedicated to SMEs named “Irish Enterprise Exchange” (IEX). It should be noted that on this market, the SMEs need to have at least a 5-million-euros capitalisation.

6.3. REGIONAL SME STOCK EXCHANGE

In autumn 2005, Advantage West Midlands 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.

6.4. CONVERTIBLE BONDS (EQUITY LINKED)

This financing technique is often the prerogative of large industrial groups such as Alcatel, AXA and St Microelectronics. Indeed, it is used to raise equity ranging between €250 million to €1.5 billion. Mid-sized companies may nevertheless contemplate bonds with redeemable share subscription warrants, a tool that was recently updated[38] by Europe Offering (http://www.europeoffering.com) for technology-based companies with a strong potential for growth. Equity raised by individual French companies between March 2002 and September 2003 ranged between €1.5 million and €40 million.

In Austria, i2/aws (http://www.aws.at and http://www.innovation.co.at/BA_INDEX.html) offers SMEs a system of micro-corporate bonds with the following characteristics[39]:

- Similar process as listing;
- Enables companies to fund the business development stage with up to €2 million on average;
- Duration: 10 years;
- Possibility to insure nominal subscription with a specialised organisation such as AWS (A, http://www.awsg.at);
- Bonds are listed on the secondary market of the Vienna Stock Exchange (A);
- Businesses’ nominal capital is not diluted across a large body of shareholders;
- Cost of issue is affordable for SMEs.

[38] *Les Echos*, 27 October 2003.
[39] Speech delivered by Mrs R. GRABHERR at the 4th EBAN Congress in Milan, 13-14 November 2003

CHAPTER 7: SUBSIDIES

Among the vast range[40] of public forms of business-oriented intervention, a number provide investment support opportunities.

In general, subsidies are granted in the form of:

- Tax relief;
- Investment subsidies;
- Support for job creations;
- Innovation grants;
- Subsidized advice;
- Business development support.

Pre-competitive grants provided by the Walloon region (B), covering 80-100% of the cost of the business project feasibility and development from the original business concept. Up to €15,500, two and a half years into their existence, these grants have already supported the incorporation of more than 150 businesses (http://www.4x4entreprendre.be).

Many French regions provide business development grants under a variety of names:

- Regional business development grants;
- Regional handicraft business development grants;
- Regional community services business grants;
- Production business development and transfer grants;
- Grants for young business developers;
- Grants for the unemployed developing or taking over businesses;
- Business development project vouchers;
- Grants for innovative projects.

In some regions, subsidies may also take the form of repayable short-term loans.

[40] Employment subsidies, consulting aids, environmental protection grants, RTD subsidies, etc.

CHAPTER 8: OTHER FUNDING SOURCES

8.1. REPAYABLE SUCCESS-LINKED SHORT-TERM LOANS

Such funding is provided by the French ANVAR (*Agence nationale de valorisation de la Recherche*, National Agency for the Leveraging of Research Outcomes: http://www.anvar.fr/agenaccofinaavan.htm). 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.

8.2. STOCK PURCHASE WARRANTS

Since 2001, ANVAR (*Agence nationale de valorisation de la Recherche*, National Agency for the Leveraging of Research Outcomes, F: http://www.anvar.fr/agenaccofinabsa.htm) offers growing businesses a financial product called BSA (*Bons de Souscription d'Actions,* 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.

ANVAR 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[41].

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

8.3. 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 (18%) and capital goods (82%). In the latter segment, the largest market share is represented by cars (33%), followed by industrial machinery and equipment (25%), lorries (19%), computers and business machines (12%) and heavy transport equipment (ships, planes, rolling stock—4%).

[41] See section 8.1: Repayable success-linked short-term loans.

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

Over 1,300 companies are active in this industry in Europe. They invested a total of nearly €2 billion in 2002 (see http://www.leaseurope.org).

8.4. 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[42] 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. For more information on global factoring: visit Factors Chain International (http://www.factors-chain.com).

Factoring costs depend upon a number of elements[43]. Indeed, the fees charged by factors are based on.

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

Commissions[44] vary between 0.5% and 2% and interest rates are 2-3% above the basic rate charged by banks.

Useful URLs in Belgium include:

- DEXIA Factor (http://www.dexia-factors.be/language.asp);
- FORTIS Commercial Finance (http://www.fortiscomfin.co.uk);
- International Factors (http://www.ifb.be).

8.5. COMMERCIAL CREDIT

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 no wish to finance them;
- They want to avoid direct banking costs;
- They are put off by the intricacies of bank credit;
- They lack in-house financial competences.

[42] In Belgium, advances on invoices generally amount to 75-85%.
[43] *L'Echo* (B), 29 October 2003.
[44] European SME Observatory, 2003 n°2. *SME Access to Finance*
http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/doc/smes_observatory_2003_report2_en.pdf

8.6. AWARDS AND SPONSORSHIP

As mentioned in point 3.4 public authorities sometimes reward business development either in kind or with small amounts of money. The French ministry for R & D has made available along with the Anvar (www.anvar.fr) €30 millions in 2004 to reward 182 novative projects. Rewards are given to three types of projects:

- Emerging ideas. Maximum €45.000 of grants. 99 projects supported;
- Ideas in development. Maximum €45.000 of grants. 83 projects supported;
- Special awards.

The funnel effect of this scheme is as follows:

- 1402 fields;
- 333 projects assessed;
- 182 projects awarded.

8.7. MICROLOANS

Microloans 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 UK the South Investment Fund (www.syif.co.uk) is offering loans of €1,600 to €20,000 for existing businesses and up to €16,000 for start ups.

8.8. FRANCHISING

This concept can be a tool to finance the growth of an enterprise. The data reproduced hereafter shows the importance of the franchising activity for several E.U. member States:

Table 19. Importance of EU factoring industry

Country	N° of franchising	N° of franchised
France	765	34.745
Germany	760	41.200
United Kingdom	665	35.600
Italy	654	41.600
Spain	646	29.699
Netherlands	434	18.000

Source: *Franchise magazine* August-September 2004.

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 (www.natexis-pe.fr) has created a specialised fund named SPES. Entreprises such as Intersport, Mr. Bricolage or Optic 2000 benefited from that fund.

CHAPTER 9: GUARANTEES

Guarantees are an important tool to improve businesses' access to credit. According to AECM (European Association of Mutual Guarantee Societies: http://www.aecm.be), 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.

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.

In 2001, AECM's membership operating in the EU granted guarantees to nearly 1.4 million businesses. The largest operators on this market are FEDERCONFIDI (I, more than 600,000 guarantee deals: http://www.federcon.it), SOCAMA (F, over 275,000 guarantee deals: http://www.socama.com), FEDERAS (I), CONFESERCENTI (I, http://www.confesercenti.it) and CESGAR (E: http://www.cesgar.es). A number of guarantee societies have implemented special guarantee schemes aimed at market niches including young entrepreneurs, venture capital, innovation, micro-credits and exports. Guaranteed amounts vary across the range of mutual guarantee societies:

	GUARENTEES	**OUTSTANDING**	**Number of beneficiary SMEs**
D:	Burgschafsbanken:	4952169 €	43754
F:	SOCAMA:	1413685 €	291400
	SIAGI:	713362 €	47000
I:	FEDERCONFIDI:	3249500 €	621887

In Finland, public corporation FINNVERA (http://www.finnvera.fi) 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.

According to AECM (www.aecm.be) in 2002, the total outstanding guarantees offered by the mutual guarantee enterprises reached €40 billions.

CHAPTER 10: WHAT COULD THE PUBLIC SECTOR DO?

10.1. SCOPE OF THE PUBLIC INTERVENTIONS

The scope for public interventions lays at the offer side (provision of finance) 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 nine 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 are not existing for instance: Business angels networks, investment readiness schemes, seed capital funds, …;
- Inefficient functioning of markets: due to the lack of competitions, 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 supply 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 focus on a component of the supply chain or on the improvement of the market;
- Equity gaps;
- Insufficient number of private investors.

10.2. 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;
- Business plan competition;
- Financial intermediation;
- Investment readiness schemes;
- Support the cost of "hands on" management systems;
- Reviewing blockages in distribution channels to specific entrepreneurs: disadvantaged groups or communities.

10.3. IMPROVING THE SUPPLY SIDE

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

- 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 supply chain;
- Providing guarantees or grants to reduce the level of risk taken by investors.

10.4. NETWORKING

Networking is a very useful tool to act as a facilitation process between entrepreneurs and investors. In point 3.1 we have described the benefits that investment readiness schemes can provide to improve the demand side. In point 5.1 we have stressed the advantages of Business Angels Networks 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 Midlands (east and west) a non profit network named Connect Midlands (www.connectmidlands.com) act 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, …
It provides also several benefits to its membership.