Capital Markets Union: delivering new opportunities for SMEs through venture capital

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DRAFT REPORT

On 14 July, ACCA (the Association of Chartered Certified Accountants), Barclays & UEAPME organised a conference to discuss how to create the right environment for the provision of private capital to SMEs and what role it can play in moving us towards our Capital Markets Union. Participants also heard some insights regarding the newly published EuVECA Commission proposal to boost venture capital markets.

Rebecca McNeil, Head of SME lending, Barclays, **Othmar Karas**, MEP, and **Niall Bohan**, Head of Capital Markets Union, DG FISMA, European Commission, gave keynote speeches. The roundtable was moderated by **Rosana Mirkovic**, Head of Small Business Affairs, ACCA, and comprised of **Irmfried Schwimann**, Deputy Director General, DG GROW, **Dörte Höppner**, Chief Executive, Invest Europe, **Alexander von Preysing**, Head of Sales, Deutsche Börse Venture Network, Pre-IPO & Capital Markets, **Candace Johnson**, President of the EBAN, and **Gerhard Huemer**, Director, Economy Policy at UEAPME.

The debate revealed that the EU is very committed to pursuing the CMU agenda. Access to finance for SMEs seem to be improving but there is still a lot more to do. Venture capital plays a determining role in stimulating entrepreneurship and young companies, but the current EuVECA systems suffer from imperfections, such as barriers to use the European passport for venture capital funds introduced by certain Member States -like taxing registration charges- , a too rigid and prescriptive definition of what is an eligible SMEs, or a too narrow list of possible fund managers.

Panellists hoped that these issues would be addressed in the new proposal. It is important to develop an “equity culture” in Europe, and to ensure funding for start-ups, scale-up and high-growth companies to really foster growth in Europe. A better allocation of growth capital can be key for more successful IPOs of young, innovative growth companies in Europe.

Participants also heard that businesses should be kept in Europe where possible, but also that foreign investment could be a valuable opportunity. Entrepreneurs and investors need to think European and Global and not only national. The EU has already put in place several tools such as the EU Single equity financial instrument, Horizon 2020 and COSME, the European Fund for Strategic Investments and the pan-European VC Fund-of-Funds. But to optimise their use, it is also crucial to engage with entrepreneurs running businesses and to understand their needs. It is not just about finance, it is also about skills, mentoring, and education. It was stressed that we need to help SMEs to help themselves, decision-makers, banks and alternative finance providers accountants, we all have the duty of care.

Main highlights

Rebecca McNeil, Head of SME lending, Barclays

- We are in unchartered political waters. Now more than ever we need to keep debating the common economic issues that we face in order to find the best way forward for all of our businesses and our people.
- While the situation differs in every European country, debt finance is available to those with the appropriate risk profile. In the UK, there is normally around £100bn of bank funding in the market and that varies up and down by only around 4%. Even during the last recession, that was true. There was a contraction in the availability of debt at the higher risk end of the market. Some overseas and peripheral lenders pulled out of the market as they retrenched post-crisis. The gap these lenders previously filled would, in certain cases, have been more appropriately addressed by equity or risk capital. Where the companies were higher risk because they were ambitious, potential high growth companies, a stronger venture capital market and better access to private equity can help make the difference. As is much more widely understood now, these companies require equity and other finance solutions to absorb start-up and scale-up risks.
- A diverse funding ecosystem is emerging, widening borrowing options for SMEs. This includes crowdfunding, business angels, start-up loans, investment firms such as UK Business Growth Fund and venture capital.
- Banks like Barclays are learning from, and working with, these new lenders introducing them to clients where they offer the right funding option. An example is Barclays' partnership with Bluebay Asset Management to provide blended funding, or unitranche loans, of up to £120m, designed to fill a gap in the market, targeting businesses that are not yet big enough to access the capital markets. As another example, Barclays introduces direct lenders, such as pension funds, into deals where they can provide longer term capital than the bank. Barclays also has an agreement with the European Investment Fund to finance lending to innovative SMEs in the UK up to €140m (£100m) over the next 2 years.
- Policy-makers also have a role to play in ensuring that businesses that are high growth potential have access to risk finance.
- Europe's lack of recent high growth firms is partially the result of its equity financing gap. At the moment it is very difficult for a European business to raise their first round of financing in one Member State, and the second elsewhere in Europe. Businesses looking to scale up significantly often look outside of Europe, increasing the likelihood of the knowledge and potential being lost to Europe.
- Barclays supports the opening of European venture capital funds to a wider range of investors (including foreign investors) as part of a future legislative review and would also welcome a wider range of SME/start up/corporates that these funds can invest in. In parallel, Barclays welcomes scaling up the size of investment funds through a European Funds of Funds proposal.

- Member States should encourage a more entrepreneurial and risk-taking culture. Capital markets will not flourish across Europe unless SME's and other investors are willing to embrace non-debt finance and be comfortable with the risks in doing so.
- Barclays looks forward to the European Commission's forthcoming initiatives in this area.
- The situation does seem to be improving but we are all very conscious that there is lot more to do to make sure we have improved access to finance and better alternative sources to finance. It is important to educate SMEs how to reach that finance.
- We need to make sure that funding and schemes are complementary and aren't creating things which are running in different directions. There needs to be funding for scale-up and high-growth companies so we really can foster growth within Europe.
- SMEs are not homogenous – there are all sorts of businesses. We hear that banks don't take risks often, although they are trying to expand their risk appetites.
- We need to keep businesses in Europe where possible, but we need to be cautious about American investment and realise that it could be an opportunity. It is important to talk to the people that are running businesses and understand their needs.
- It is not just about finance, it is also about skills and mentoring. When it comes to technology and resources, SMEs have bigger challenges now in order to survive. We need to help SMEs to help themselves. We all have the duty of care.

Niall Bohan, Head of Capital Markets Union, DG FISMA, European Commission

- The European Commission underlines the commitment of going forward with the Capital Markets Union and improving access to finance for companies. We also need to develop alternatives to the bank loans.
- The issue of access to finance for small businesses struck the strongest political chord in governments across the EU. They do see a policy failure in this area, especially when it comes to growing companies. We need to make sure that we build enough alternatives for these businesses.
- Venture capital has a critical role to play. There is a pan-European reach that is currently absent in this market. 90% of the venture capital money is concentrated in 8 member states. There is a lot we can do and the reform of the existing legislation aims to improve the situation. We need to broaden the population of managers that can run these structures. The passporting arrangements need to be strengthened.
- The next step will be the venture capital fund-of-funds. The fragmentation has been identified in terms of public support for the venture capital industry. We need to create a structure that will blend public and private money, make it available to private managers and support venture capital projects on a pan-European basis.
- A call expression of interest is being finalised and will be published in September. It could be a game-changer in venture capital funding.
- The European Commission is also looking into tax incentives and trying to create more dynamics in order to make Europe more attractive for investors. One of the steps is revisiting Solvency II.
- The EC is setting up a technical assistance programme through the Structural Reform Support Service. The budget is already agreed with the member states.

Rosana Mirkovic, Head of Small Business Affairs, ACCA, who moderated the debate

- We should all encourage a more entrepreneurial and risk-taking culture. Capital markets will not flourish across Europe unless SMEs and other investors are willing to embrace non-debt finance and be comfortable with the risks in doing so. A pan-European venture capital fund could have a positive impact and send the right signal. We need to lower the barriers for SMEs for venture capital funding. Therefore we need to enhance the free flow of capital within the single market. We also need the political action and will to achieve this goal

Irmfried Schwimann, Deputy Director General, DG GROW

- SMEs are still facing troubles when accessing finance. It is the European culture that bank loans are the preferred source of finance for the majority of SMEs. Other sources remain less relevant and that is the big difference with the US.
- Various alternative ways of funding exist beyond the traditional bank lending. That depends very much on the size of the investment and the stage of a company's growth. There is a huge overleveraging of the banking and corporate sectors and there is a lot of efforts to be taken to deleverage our economy.
- Private institutional investors, such as pension funds, banks, insurance companies, have traditionally been very important sources of funds for venture capital investment but regulatory or self-imposed constraints on their asset allocation may prevent institutional investors from scaling up their investments in this asset class
- European venture capital funds are very small and fragmented compared to the US.
- The European Commission has started a lot of initiatives to address this issue and to look into alternative sources of finance. It is essential for SMEs to diversify their sources of finance and to get better access to finance. This includes not only venture capital, but also business angels, crowdfunding and other sources. When we look at bigger SMEs, the financing options are even broader. The review of the EU Venture Capital Regulation will help to improve the situation by broadening the eligibility of the passport to more VC funds.
- The Commission offers many financial instruments, such as COSME and Horizon 2020. The EC is trying to support the enterprises and their growth from an early stage. It is working on the pan-European venture capital Fund-of-Funds. It is important to note that all the Commission can do is creating an environment; it is up to the companies to make use of it.
- A new equity product will be launched within the European Fund for Strategic Investments (EFSI). There should be more complementarity between EFSI and structural funds so it can boost financing even more.

Dörte Höppner, Chief Executive, Invest Europe

- Venture capital does not happen nationally or regionally – It is a global business. Here in Europe we are trying to create an ecosystem where the US investors could invest in European venture capital and the other way around.
- We constantly compare ourselves to the US venture capital market but not in a competitive sense, rather in looking for things that work or doesn't work there. The system in the US is way more mature. With the Brexit happening, it makes so much sense to drive the Capital Markets Union forward. We need to make sure that this flow of capital within Europe can continue event if the UK leaves. The flow of capital doesn't stop at the European borders; it has to go across the EU.
- The EC venture capital Fund-of-Funds initiative is very important. It is not based on the principle that every member state gets the same amount of money because this is not how the venture capital works. We need to focus on the best performing venture capital funds that then need to invest in the scale-ups. It is all about driving the champions of tomorrow.
- One of the reasons why the EuVECA regime wasn't successful so far is the fees and charges in some member states that make the passport less attractive. Hopefully that will be addressed by the European Commission.
- Another problem was that you were only able to qualify for the EuVECA passport when you invested in SMEs. Many venture capitalists said the regulation wasn't for them because they could miss out on better opportunities in great companies.
- There are also other proposals that could improve venture capital, such as Solvency II. If you get right the regulation on how insurance companies as big institutional investors can invest in the asset class venture capital, then you don't need to worry about public funding anymore. Right now these institutional investors have extremely high risk

ratings. If you regulate the market in the way it functions well, you don't need any additional public spending to fix the market.

- It is often heard that if you create a successful business in Europe, you can make it anywhere. Dealing with all the regulation makes entrepreneurs fit for life. However, it is very important to conclude the single market project. Otherwise, if you have a product and you want it to succeed globally, you have to go to the US market. Hopefully, one day it will be sufficient to succeed in the European market because we have the potential to be bigger than the US market.
- On the equity side, if an entrepreneur doesn't approach venture capital, it probably doesn't seek the funding. Companies should do their homework and build a network – that's what makes a great entrepreneur.

Alexander von Preysing, Head of Sales, Deutsche Börse Venture Network, Pre-IPO & Capital Markets

- It is important to emphasise what big role the capital markets play in developing growth and jobs in Europe. We need to focus on creating an ecosystem in Europe which develops a development of successful IPOs of young, innovative growth companies.
- In todays globalised economies companies are facing many challenges. At very early stages they have to internationalise. They have to invest a lot into innovation, research and intellectual property protection.
- By fostering successful IPOs we automatically foster the whole value chain of growth financing.
- Successful IPOs also signal the strength of the economy. It helps developing equity culture and helps improving the sentiment of young talents towards entrepreneurship.
- Deutsche Börse started an initiative more than one year ago designed to foster the development of growth financing and to foster more successful IPOs. It is a private market initiative.
- The initiative is a digital platform connecting growth companies with a global pool of investors. 50% of them are venture capital investors. It is a very international group of investors. Since the start there have been 20 financing rounds and it has surpassed 800 mln eur. The aim is to make it a European initiative.
- We need not only better allocate the European capital but also the global capital which is available to European companies.
- Closing the gap in growth financing in terms of Europe versus the US is very important. It is very difficult to generate funds overnight. Not only capital is needed, also experience and management of funds.

Candace Johnson, President of the EBAN

- What we really need in Europe is passion, vision, sales and success. We are building European success stories. We need to spend capital on a "Nation of Investors". Europe has so much innovation and research. There are many technologies that we can turn into innovation.
- When you are a business angel, you're close to entrepreneurs. Business angel brings network, experience, expertise and money. Business angels can create opportunities for companies with great potential.
- Corporations play a very important role. They are the missing link in Europe. In the US corporations give transformational deals to SMEs and start-ups. They do not ask them if they have enough private equity of their own. They put trust and value in companies' innovative vision.
- We all have to work together and be part of the ecosystem. Entrepreneurs need to help governments otherwise it's not going to work.
- Europe has amazing opportunities. With the Brexit happening, we need to go even more forward and make our cooperation even stronger. Private people need to work with governments and make it happen.

- The best business angels are serial entrepreneurs. Because they know all the aspects and stages of a company. You need to have that knowledge in order to help other entrepreneurs.
- The whole service economy that is provided by SMEs is so important in the innovation society. Every high-tech job generates many more jobs.
- If business angels are investing their own money, they do need to have a return on investment. However, if there is a long-term vision, it needs to be kept. Experience business angels don't want companies to give up control of their business because it is entrepreneur who has the spirit that must be kept in order for company to be successful.
- We are going away from the culture and mentality of subsidies. We need to let people know that we now have the sales mentality.
- EBAN has joined together EBN, BAE, the London Stock Exchange Group, etc. to create the "E-Zone" - a barrierless market for entrepreneurs and investors in Europe. They doing this together with the "e-Residency" program started by Estonia and now spreading across not only Europe but the world.

Gerhard Huemer, Director, Economy Policy UEAPME

- There are all sorts of businesses, with different equity needs. The majority of SMEs have less than 10 employees; some of them have non employees. Not all are fast growing companies willing to be listed, some SMEs may need equity or quasi-equity for issues such as innovation or business transfer.
- The idea of the capital markets union needs to be fully supported. However, we need to bring in order the lending side and the banking side; otherwise it will not work for the majority of SMEs.
- All types of SMEs end up in situations where bank lending is not available because it is too risky. It is often made clear that the lending is available if there is low risk profile. We need to find ways how to finance companies that are taking more risk.
- A very linear approach is often taken – we talk about high-tech fast growing start-ups. It is very important and we would like to see more of these companies in Europe, however, there are many other situations where SMEs need equity finance. We should keep traditional SMEs in mind.
- Many companies leave Europe because finance is not available. It is not irrelevant if they go to the US or not. The problem in Europe is not only access to finance but also that companies cannot grow fast enough because of different regulations. It becomes costly to grow fast in Europe. If we won't get this right, we will lose companies that will use European research and innovation and make money somewhere else.
- The appetite of SMEs for equity also depends on tax systems, which can be biased towards debt financing, with low equity rates, as it can be the case in some Member States.
- It would be useful if the banks would have an obligation to direct companies to other financing sources if a loan is declined.

Othmar Karas, MEP

- It still seems that different stakeholders are afraid when they hear the words Capital Markets Union. We need a common definition and a common understanding of what we mean when we're talking about the CMU. However, if we do it the right way, everybody can be a winner.
- CMU has to be a financing union for the real economy. There are many talented men and women in all regions and sectors. Our challenge is to provide them the necessary economic framework so they can accomplish their visions. Besides the reduction of the red tape and regulatory burdens, we need to focus on attracting more investment.
- Venture capital is one of the areas where Europe is in danger of falling behind. It is clear that we need to develop broader venture capital culture that could help SMEs and start-ups. A pan-European venture capital fund could have a positive impact and send the right signal. We need to lower the barriers for SMEs for venture capital funding.

Therefore we need to enhance the free flow of capital within the single market. We also need the political action and will to achieve this goal.

- We need reassure young entrepreneurs that Europe is the continent where they will have the best chances for their future. We need a Europe which believes in itself and its economy.
- Brexit must be a warning sign for us. We have to go forward and implement what we decided, showing people the positive aspects of Europe and the single market. Let's not get trapped in speeches or legal steps about more integration. Let's speak about concrete projects, investments, competitiveness, jobs and innovation, not only about money.