INVEST EUROPE

Invest Europe feedback on the feasibility assessment for a potential EU referral scheme

The Private Equity and Venture Capital industry plays a key role in financing SMEs by connecting providers of capital from across the EU and beyond with companies in search of financing. In 2019 alone, private equity and venture capital funds invested over €94bn into 7,900 European companies, a large majority of which (84%) were SMEs.

The private equity, venture capital and infrastructure sectors, as well as their investors provide an essential source of funding for innovative businesses at key stages of their growth journey, taking a long-term approach to invest in privately-held companies, from start-ups to established firms. They inject not only capital but also dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe’s leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Given the relevance of PE/VC funds in financing SMEs, we wanted to provide a more comprehensive feedback on why we believe an EU referral scheme is not the best solution to address the problems faced by SMEs when accessing financing, at least from a private equity point of view.

Despite the uptake of equity financing instruments by SMEs in the past few years, we acknowledge that SMEs may still face difficulties when accessing this type of financing, particularly in some Member States. Therefore, we fully support initiatives designed to ensure that SMEs have access to the finance they need. However, from a PE/VC point of view, we fear a referral scheme as proposed in the consultation may end up simply being an extra administrative layer for all players involved, referring and receiving entities as well as SMEs. And, consequently, it would end up having very little added value for companies and missing the objective of increasing financing alternatives for SMEs.

We believe in order to understand why the inclusion of PE/VC investors in such a SME referral scheme is not suitable it is essential to comprehend the characteristics that make this type of financing unique and radically different from other finance providers.

First of all, PE and VC investors look for a particular type of companies, mainly start-ups, scale-ups, and innovative companies all of them characterised by having high growth business models. These companies given their characteristics are well aware that venture capital is in many occasions the best option for them. Likewise, these companies know that bank financing is not the type of financing they are looking for, therefore, it is very likely that they will never apply for bank loans. Here we could assume that this also works the other way around and, therefore, companies that at first instance apply for bank financing know that equity financing is not suitable for them.

Secondly, PE and VC investors when investing in companies they also get partial ownership. This is a key difference with the financing banks and other providers offer. Moreover, the success of the venture model is based on the active involvement of managers in the running of the businesses they finance.

Thirdly, the assessment and due diligence that PE/VC investors carry out before deciding to invest in a company is much more complex and differs vastly from the creditworthiness assessment made by banks and other finance providers. This implies that a company that is rejected by a bank has very few chances of being of interest for private equity investors.

For all the above, we believe that a SME referral scheme would risk to direct SMEs to submit applications for a type of funding that is not suited to their needs. This would impose costs in terms of time and resources for SMEs as well as for the referring and receiving entities. More importantly, it will have a very limited impact in improving and facilitating the access to finance for SMEs.

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All in all, while venture and private equity financing is an important and increasingly relevant alternative to bank lending, a SME referral scheme may give companies the impression that it is an interchangeable substitute to it, not acknowledging the above-mentioned differences in credit versus investment decisions. We fear this would not be at the best interest of these businesses.

We think that the European Commission should direct more efforts at improving the venture capital ecosystem as opposed to push the demand for venture or private equity funds through such a scheme. We stand ready to help the European Commission in these efforts. Therefore, we would suggest considering other measures in the context of the CMU Action Plan that could do more in helping SMEs. The EC could for example introduce changes to the current capital requirements regulation for equity investments. Likewise, further development of European fund passports could also help in boosting equity financing. A well-functioning ecosystem would ultimately benefit SMEs as these would end up having access to more financing.

Finally, if the purpose of the referral scheme is to increase awareness for equity financing sources, which is a noble goal in itself, we believe that the informative role of public bodies such as national promotional banks, could be strengthened in order to give companies an ex-ante better overview of the type of financing they may seek depending on their characteristics and needs. This approach would meet the objectives of drawing businesses attention to equity finance without risking to mislead many businesses as to the real options available to them. Private equity should be seen as an option from the start, as opposed to only an alternative option for businesses that failed to get traditional bank financing.

In conclusion, we believe there are more suitable alternatives to increase SMEs access to equity financing than a SME referral Scheme and we would like to support the EC in further exploring these alternatives.

Contact

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About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

For more information please visit www.investeurope.eu.