Risk capital markets and job creation: implementation of the action plan RCAP

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This Communication reports on progress in the implementation of the RCAP for the year 2001 and, in some aspects, for the first half of 2002. It is the fourth since the adoption of the RCAP in 1998. Market analysis suggests that the last 18 months has been a period of adjustment for the European risk capital industry. The severe correction, which started in mid-2000, still continuous and was particularly significant in the Accession Countries due to, among other things, their sensitivity to global trends. In spite of the negative trend, however, the year 2001 was, for the European industry, the second highest both in terms of funds invested and of funds raised. The decline in Europe has been less pronounced than in the US - although there is a long way to go to match their industry. The medium term prospects for EU venture capital investment seem to be relatively favourable, with significant scope to continue financing viable projects due to the high level of non-invested funds. Inflows of EUR 15 billion were recorded in 2001 - the second highest amount ever- for future venture capital investment and EUR 22 billion for buy-outs. A sign of maturity is the greater diversification of the sources of funding. In 2001, for the second consecutive year, pension funds were the largest single source of private equity capital (27%) in the EU, ahead of banks (24%) and insurance companies (13%). The involvement of endowments, charities, and universities in EU venture capital is also increasing. The problem in Europe is compounded by the presence of a still highly fragmented capital market, which the Financial Services Action Plan is addressing. Furthermore, the weakness and poor performance showed by the EU high-growth stock markets means that the scope for IPOs, an important exit strategy for venture capital investors, remains largely closed at the moment. Improvements to the functioning, regulation and liquidity of these markets is necessary for risk capital to grow and for a sufficient pan-European dimension to emerge, through further and necessary rationalisation. The modernisation of the regulatory framework has continued successfully in a financial environment dominated by the successful introduction of the Euro in physical form. There are important advances in the mandatory introduction of international accounting standards by 2005 and in the forthcoming legislation on supplementary pension funds. As a result those institutions may become important sources of risk capital funds, as it is already the case in the US. On the negative side, difficulties still persists for having an affordable cost-effective European patent. Entrepreneurship policy is also expanding in importance. The forthcoming Green Paper on the subject should raise its profile further and its crucial linkage with risk capital. Projects leading to a better matching of supply and demand of risk capital, as the one already under completion with the help of the Commission, should be encouraged. The objective agreed at the Barcelona European Council to increase EU investment in R&D (approaching 3% of GDP by 2010, of which two-thirds from the private sector) requires increased investment by the private sector and reinforces the role of risk capital, either private or public, to finance promising innovative projects and initiatives. Concerning public funding, the adoption by the Commission of its Communication on state aid and risk capital has clarified the question of compatibility of public funding of risk capital measures with the state aid articles of the Treaty. The EIF has embarked upon a phase of rapid expansion and has been able to attract, under difficult market conditions, private investors to early stage funds. Finally, the share of Structural Funds for financing venture capital investments has been noticeably increased. All these recent policy changes show that the accompany measures to develop European risk capital have undergone profound and positive change in the last 4 years. Compared with 1998, risk capital markets have not only grown but also matured. The current effort to improve the environment for risk capital investment should be maintained, and be seen from a long-term perspective, regardless of cyclical considerations.