EQUITY FUNDING

MARIO NAVA

Director General, DG for Structural Reform Support, European Commission

Equity or debt? Last time we needed trust, now we need future perspective!

The financial crisis of 2008 was a crisis of debt – triggered by debt handed out by banks as loans, fuelled by repackaged debt, wreaking havoc on interbank debt markets and culminating in the sovereign debt crisis. 2008 and the following years we also experienced a crisis of trust: banks, supervisors, even governments did not trust each other. So, one might say debt is very much about trust – the trust that someone honours his promise to pay back. The evidence seems to suggest that we have fixed our trust-issues over the last decade: the banking sector is stable, reinforced by better EU level regulation and strengthened pan-European supervision. Governments agreed to have the European Commission issue debt for the first time in history to fund a recovery program macroeconomic significance.

Unlike debt, equity is about future perspective: when you buy a share, contrary to debt, there is no promise that you get your money back, there is only a (hopefully well-grounded) perspective that the company succeeds. Looking at the current stock-market, future perspectives do not seem to be the issue. Here of course the low interest environment helps. But the stock-market is not the economy, and while companies associated with the digital economy may have profited, many brick-and-mortar business have suffered and piled on debt. Should we help them to convert their debt into equity?

As you will read in any economist's article at some point: It depends.
First, what is clear is that the future will be green and digital. Therefore, subsidising carbon-heavy businesses of the past will not help. Investors know that and are seeking green investment opportunities. Therefore, one important measure is to help investors identify green investments, as the European Commission recently did by developing the EU taxonomy for sustainable activities. Another measure is to actively support reforms in Member States to carry out reforms to develop green finance ecosystems or green bond markets. The Commission does that through the Technical Support Instrument.

Second, equity is most important for start-ups and innovative companies and difficult to access especially for SMEs. Therefore, the European Commission has launched several initiatives to foster access to equity: the Capital Markets Union to unlock more investments, also for SMEs.

The Single EU Equity Financial Instrument to support European businesses' growth, research and innovation. Venture EU, the Pan-European Venture Capital (VC) Fund-of-Funds programme to further address Europe's equity gap by investing in VC Funds-of-Funds. The European Innovation Council Fund which just provided a first equity investment of EUR 178 million in breakthrough innovation.

Third, if the economic outlook brightens, equity becomes more attractive, debt more sustainable. This is the real solution for which we have to work, and the European Commission does: The Recovery and Resilience Facility, making €672.5 billion in loans and grants available, gives perspectives that the EU will emerge stronger and more resilient from the current crisis.

ELKE KALLENBACH

Deputy Director for International Financial Market Policy, Federal Ministry of Finance, Germany

Boosting the German VC Ecosystem

Start-ups are a key driver of structural change. They put new, innovative ideas into practice, create jobs and safeguard the foundations for future prosperity and growth in Germany and Europe. People who start new businesses can be valuable innovators, and they play a tremendously important role in the development of the German economy.

The Federal Government has therefore set itself the objective of improving legislation and tax rules for venture capital and of making Germany more attractive to venture capital.

In recent years, Germany's venture capital market has advanced significantly. In particular, Germany is doing comparatively well in the area of early-stage financing for start-ups, thanks in part to the many public funding programmes in place at the federal and state (*Bundesländer*) levels.

However, despite the international attention directed towards Germany's start-up scene, the venture capital market in Germany remains too small, especially when compared internationally or when viewed in relation to the size of the German economy. In some countries, venture capital investment is many times higher

than in Germany. Start-ups in Germany have inadequate access to capital especially when it comes to second-stage and third-stage financing.

For this reason, the German government has already adopted a number of instruments to promote financing for innovative start-ups.

This support is provided both (a) indirectly via funds such as the ERP/EIF Fund of Funds and KfW Capital's ERP Venture Capital Fund Investment programme, which invest in private venture capital funds and (b) directly via public funds such as the High-Tech Gründerfonds (HTGF) and coparion, which invest directly in start-ups. In addition, the German government set up a €2 billion programme to help start-ups during the coronavirus pandemic. For regulatory reasons, and to ensure consistency with EU competition and state aid law, funding from these instruments is typically contingent upon significant contributions from private investors. In this way, such funding expands the amount of financing available on the German venture capital market.

Germany is committed to improve financing opportunities during the capital-intensive scale-up stage.

Closing remaining gaps: Germany is committed to improve financing opportunities during the capital-intensive scale-up stage. To this end the German government is currently setting up an €10 billion equity fund for emerging technologies (*Beteiligungsfonds* für Zukunftstechnologien, or *Zukunftsfonds* ("Future Fund") for short), which will be set up at KfW. With this Future Fund the German government will multiply its existing funding structure both quantitatively and qualitatively.

Moreover, the German government proposed several regulatory and tax-related measures to increase Germany's attractiveness for investment funds (VAT exclusion to management fees of VC funds, new tax regulations for employee investment schemes, less red tape and more flexibility for investment fund managers).

SEBASTIEN RASPILLER

Director, French Treasury,
Ministry of the Economy,
Finance and the Recovery Plan,
France

Developing equity funding is much needed and should rely on a result-driven strategy

As the world slowly emerges from a challenging year, the outlines of the post-Covid era begin to take shape, calling for new ways to repair the damage done by the crisis to the corporate sector.

Most of the emergency support schemes have focused, and rightly so, on keeping the economy afloat by providing liquidity to companies, through direct subsidies, furlough schemes, tax and loans moratoria and state guaranteed loans. An unavoidable side effect has been an increase in corporate debt. In France, it has risen by €217bn in 2020. Cash holdings by companies have also increased dramatically (€200bn). This big picture hides very different situations across companies, some faring fairly well, and others emerging badly bruised from the crisis.

A severe economic downturn automatically decreases the levels of equity capital in the economy, via reduced profits, higher debt and the use of cash holdings to meet payment deadlines. These equity losses act as shock absorbers and help businesses go through crises. However, a sustained lack of equity is damaging to the economy, by increasing the risk of viable companies going bankrupt and of debt overhang situations, in which companies prioritize debt reduction strategies over investment and employment plans.

Boosting equity financing is critical now, with government intervention if necessary, especially for SMEs which do not have access to capital markets.

Boosting equity financing is therefore critical now, with government intervention if necessary, especially for SMEs that do not have access to capital markets or professional investors. This support should come with terms and conditions: assistance has to be targeted towards viable firms and to involve the private sector. The aim is to use the resources, information and incentives of the private actors to ensure a good use of taxpayers' money.

The situation calls for a comprehensive strategy. This is what France is trying to do, with a mix of horizontal policies (such as cuts in production and corporate income taxes), and specific measures addressing different situations. For instance, the recently announced *"prêts participatifs et obligations Relance"* scheme targets companies affected by the crisis but with manageable levels of debt and investment plans to finance.

The scheme rests on up to €20bn of "equity loans" (subordinated long-term debt) and subordinated bonds, with a public guarantee of up to 30% of first losses at the portfolio level. For viable firms struggling to meet their debt repayment deadlines, a clear debt restructuring plan is needed. France has reinforced public restructuring committees that help devise solutions with all stakeholders of struggling companies and is reforming bankruptcy procedures to make them more effective.

The European Commission's decision to prolong and expand the scope of the Temporary Framework has freed up some policy space to implement new instruments to help companies rebound from the crisis. The involvement of financial actors will be critical in ensuring that these schemes are a success. Beyond public support to the financing of our economy, we should lift the barriers to investments in equity by the private sector: the Solvency II review is a not-to-be missed opportunity in this regard.

JESÚS GONZÁLEZ NIETO-MÁRQUEZ
Managing Director BME Growth, Bolsas y Mercados Españoles (BME)

Equity financing in the post-Covid reality

A year after the pandemic hit our systems we are still speaking about recovery and rebuilding from a crisis that is still peaking. Measures have been established to counter the devastating effects of the Covid-19, but we must not forget the overarching goal of building a resilient and robust financial system capable of absorbing shocks and generating growth.

SMEs are at the core of growth generation: they increase the productive fabric, allow for larger investor participation, and provide for solutions to demands in new fields, such as ESG. In certain ways, the recovery measures put in place in the second half of 2020 have alleviated some of the most acuciating concerns for SMEs, but we need to consider a change in paradigm to fully unleash their potential.

Equity funding is based on investor trust and capability to invest, their access to equity issuing procedures is paramount to create value. Investors must be given the tools to access the financial system in effective ways: they must be able to understand and decide amongst the different investment options available, and that stems, inevitably, from a more comprehensive financial culture and education. Investors with a deeper knowledge will better understand their risk profile and widen the investment base, to fund SMEs.

Investor participation at the heart of SME funding.

Capital raising can certainly stem from different sources and making use of already established channels needs to be taken a starting point to give visibility to SMEs while providing investors (and their intermediaries) for a trampoline to consider these investments an option when drafting their portfolios.

At the same time, companies need to be able to raise capital without having to deal with excessive burdens that drive investment away from their projects. Policy makers need to understand and assess carefully the impact that current regulation may have in discouraging investments. The EU is rightly proud of taking investor protection with the relevance it merits, but there is still room for allowing companies to approach a wider and more diversified base of investors while preserving their rights.

Easing the requirements for SMEs to be listed, to open secondary issuances and to be rightly covered in research, as well as a carefully dimensioned tax regime, paired with tax incentives, need to be assessed to level the playing field for SMEs vis-à-vis the rest of companies.

Finding the balance on these measures should be considered as a means to grant SMEs access to financing in aims of continuing towards the funding chain: allowing for growth and for moving on the next step of the regulated markets.

We cannot ignore the opportunity window offered by the review of MiFID II, and furthermore, we need to understand it as a chance to make our financial system more dynamic and inclusive, taking one decisive step forward in the completion of the CMU.