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EIF VC Survey 2019

Fund managers' market sentiment and policy recommendations

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Executive summary[1]

Following the launch of the first *EIF VC Survey* in 2018,[2] this study presents the results of the second *EIF VC Survey*, a survey among venture capital general partner (GP)/management companies headquartered in the EU28 and other European countries (mainly Norway, Switzerland and Turkey). The surveyed population includes both companies in which the EIF has invested as well as companies in which the EIF has not (or not yet) invested.

The *EIF VC Survey 2019* consisted of questions covering five main topics:

- The *VC market sentiment,*
- *Policy recommendations regarding regulatory and tax-related issues in VC business*,
- *The human capital in VC,*
- *ESG (Environmental, Social, Governance) considerations in VC investment decisions, as well as*
- *EIF's product and mandate development*.

This EIF Working Paper summarises the findings of the first two parts, mentioned above. The study provides a detailed overview of the respondents' state of business and market activity as well as their general perception of the European VC market. In doing so, we look at the current situation, developments in the recent past and expectations for the future.

Market sentiment

State of business

- The current **state of business** continues to be perceived positive, with the majority of the fund managers expecting a further improvement in the next 12 months.[3]

Availability of funding and fundraising environment

- The majority of the fund managers perceive positively the **availability of funding** to finance their own portfolio companies' prospects.
- However, only half of the fund managers consider the current **fundraising environment** to be good; with one-third of the respondents expecting a deterioration in the next 12 months.
- The issue of available funding is more acute for VCs investing mainly in seed-stage companies. Moreover, a relatively large share of seed-stage fund managers are likely to

[1] We would like to thank the anonymous respondents to the survey. Without their support and valuable replies this project would not have been possible. This paper benefited from comments and inputs by many EIF colleagues, for which we are very grateful; we would like to express particular thanks to Oscar Farres. We would also like to thank colleagues from Invest Europe and from the Trier University for their support. All errors are of the authors.

[2] The results of this first survey wave were published in two EIF Working Papers, namely "EIF VC Survey 2018: Fund managers' market sentiment and views on public intervention" and "EIF VC Survey 2018: Fund managers' perception of EIF's value added"; both available at http://www.eif.org/news_centre/research/index.htm

[3] For several questions, we report fund managers' responses regarding their expectations for the next 12 months. In this context, it needs to be taken into consideration that the survey was conducted between 7 February and 18 March 2019.

move away from their current stage focus over the next five years, which might further decrease the availability of finance for seed-stage enterprises through VC funds.

- **Finding co-investors to syndicate** is perceived easier compared to a year ago by the majority of the respondents; with expectations remaining largely the same for the next 12 months. Nonetheless, almost one-third of the fund managers did report difficulties in finding co-investors.

Investments and portfolio development

- The number of qualified **investment proposals** received and of **new investments** undertaken are both expected, on balance, to increase in the next 12 months.
- **Portfolio development** during the last year has been at least in line with expectations; with further improvement expected in the next 12 months.
- Trade sales dominated the exit activity in 2018, while improved **exit opportunities** are expected in the next 12 months.

Important challenges in the European VC business

- Exit environment, fundraising and high investee company valuations are perceived as the three **biggest challenges in the European VC business**.
- Recruiting high-quality professionals and securing financing continue to be perceived as the two **biggest challenges faced by investee companies**.

Overall prospects of the European VC market, promising countries and industries for future VC investments

- While **investment activities** in the European VC market are expected, on balance, to improve in the next 12 months, fund managers are relatively less optimistic compared to a year ago.
- Fund managers are rather confident about the **long-term growth prospects** of the VC industry in their market and in Europe altogether.
- Germany, the UK and France continue to be perceived as the three **most promising countries for VC investments** in the next 12 months.
- Alongside traditional VC target industries, the importance of relatively **newer, technology related sectors** (Artificial Intelligence, Digital Health, DeepTech, Fintech, Blockchain and Cybersecurity) is expected to rise in the future. Technology-related areas in the context of Life Sciences (BioTech, MedTech, etc.) may also feature prominently.

Policy recommendations: possible tax-related and regulatory interventions in VC business

The policy recommendations presented in this report reflect the views of the surveyed fund managers and are not necessarily endorsed by the EIF.

- The findings echo the evidence first documented in the previous survey wave that tax and regulatory incentives should be given to make VC a more attractive asset class and encourage other private LPs to invest.

- Fund managers provide concrete recommendations regarding the type of such incentives and offer suggestions regarding how tax systems and legal frameworks could be further simplified and harmonised across Europe.
- These suggestions relate to investors, GPs and portfolio companies alike. Perhaps not surprisingly, a common theme across all three categories is a call to reduce taxation.
- When it comes to other regulations, it seems that simplification is relatively more important than harmonisation. At the same time, fund managers call for measures to overcome the cross-border market fragmentation of the European VC market.
- GPs who undertake cross-border investments are more in favour of harmonisation and simplification in taxation and other regulations, compared to GPs who only invest domestically.
- While there is general consensus across regions that regulations should be simplified, there is greater variation in the responses concerning the element of harmonisation. In particular, GPs in France are most in favour of harmonisation (in both tax and other regulations) contrary to GPs in the UK & Ireland.

The insights from the *EIF VC Survey* will help to further improve EIF's product offer and the European VC ecosystem in line with markets' needs. Moreover, the project forms part of EIF's work to assess the impact of its activities and complements the recent and ongoing quantitative analyses of the **economic effects of EIF's VC operations**. It is envisaged to repeat this study on (at least) an annual basis. Moreover, based on this survey, a **venture capital market sentiment index** (barometer) is in development and will provide the possibility to track the VC market sentiment over time. By improving the availability of information about this important market segment, this project contributes to establishing a sustainable venture capital ecosystem in Europe – a key objective of the EIF.

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1 Introduction

Venture capital is an essential source for start-up and young companies to achieve growth and create value through innovation. The relevance of venture capital financing, not only for young and innovative companies but also for the economy as a whole, is very high.

The European Investment Fund (EIF) is a specialist provider of risk finance to benefit small and medium-sized enterprises (SMEs) across Europe. By developing and offering targeted financial products to its intermediaries (such as banks, guarantee and leasing companies, micro-credit providers and private equity funds), the EIF enhances SMEs' access to finance.

The EIF is a leading institution in the European venture capital (VC) market, focusing on the establishment of a sustainable VC ecosystem in Europe in order to support innovation and entrepreneurship. The EIF concentrates on building the necessary private sector VC infrastructure to address market gaps and opportunities with the aim to further enhance the attractiveness of European venture capital as an alternative asset class.

The EIF works with VC funds, which act as intermediaries and invest into innovative high-tech SMEs in their early and growth phases. The particular focus is on disruptive early-stage technology enterprises that typically face financing challenges but also provide outstanding investment opportunities. The EIF has built a strong expertise in setting-up, managing or advising tailored fund-of-funds, mostly with resources entrusted to the EIF by third parties such as the European Investment Bank (EIB), the European Commission, national and regional authorities as well as institutional investors.

EIF's Research & Market Analysis (RMA) supports EIF's strategic decision-making, product development and mandate management processes through applied research, market analyses and impact assessments. In order to facilitate EIF's activities in European VC and to provide additional benefit for market participants, RMA aims at gathering and providing relevant information that can shed more light on this important but still relatively opaque part of the SME financing market. This EIF Working Paper forms part of that exercise.

Following the launch of the first *EIF VC Survey* in 2018, in this study we present the results of the second *EIF VC Survey*, a survey among venture capital general partner (GP)/management companies headquartered in the EU28 and other European countries (mainly Norway, Switzerland and Turkey). The surveyed population includes both companies in which the EIF has invested as well as companies in which the EIF has not (or not yet) invested. See Chapter 2 for a more detailed overview of the population and the respondents.

The *EIF VC Survey 2019* consisted of questions covering five main topics:

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This EIF Working Paper summarises the findings of the first two parts, mentioned above.

The study provides a detailed overview of the respondents' state of business and market activity as well as their general perception of the European VC market. In doing so, we look at the current situation, developments in the recent past and expectations for the future.

More generally, the insights from the *EIF VC Survey* will help to further improve EIF's product offer in line with markets' needs. Moreover, the project forms part of EIF's work to assess the impact of its activities and complements the recent and ongoing quantitative analyses of the economic effects of EIF's VC operations.[4]

It is envisaged to repeat this study (at least) on an annual basis in order to improve the availability of information about this important market segment. As such, this project contributes to establishing a sustainable venture capital ecosystem in Europe – a key objective of the EIF.

[4] In this context, five studies have been presented so far. See for details Vol I to V of the series "The European venture capital landscape: an EIF perspective"; available at http://www.eif.org/news_centre/research/index.htm

2 Overview of the sample

The second wave of the *EIF VC Survey* was conducted between 7 February and 18 March 2019. We used EIF internal data and PitchBook to derive the contact details of the GPs[5] who are active in the European VC market – our target population. The survey questionnaire was eventually received via e-mail by 4,367 (2018: 2,032) individuals, representing 2,095 (2018: 1,453) distinct VC firms headquartered in the EU28 and other European countries (mainly Norway, Switzerland and Turkey).

We received, on an anonymous basis, 774 (2018: 379) completed responses from 538 (2018: 316) VC firms in Europe, making this, to the best of our knowledge, the largest survey on venture capital to date[6]. This also translated into high response rates, 17.7% at individual revel (2018: 18.7%) and 25.7% at firm level (2018: 21.7%). We targeted and we indeed received responses mainly from senior people within the VC firms (CEOs, CFOs, COOs, managing/investment directors, (managing/general) partners, etc.), meaning that these responses reflect the views of the decision-makers within the respective VC firms.

Not surprisingly, more than half of the responses come from GPs in the UK (N=117), Germany (N=100), the Netherlands (N=90), France (N=63) and Spain (N=51). The response rates range from 10% in the UK to as high as 32% in the Netherlands (see Figure 1).

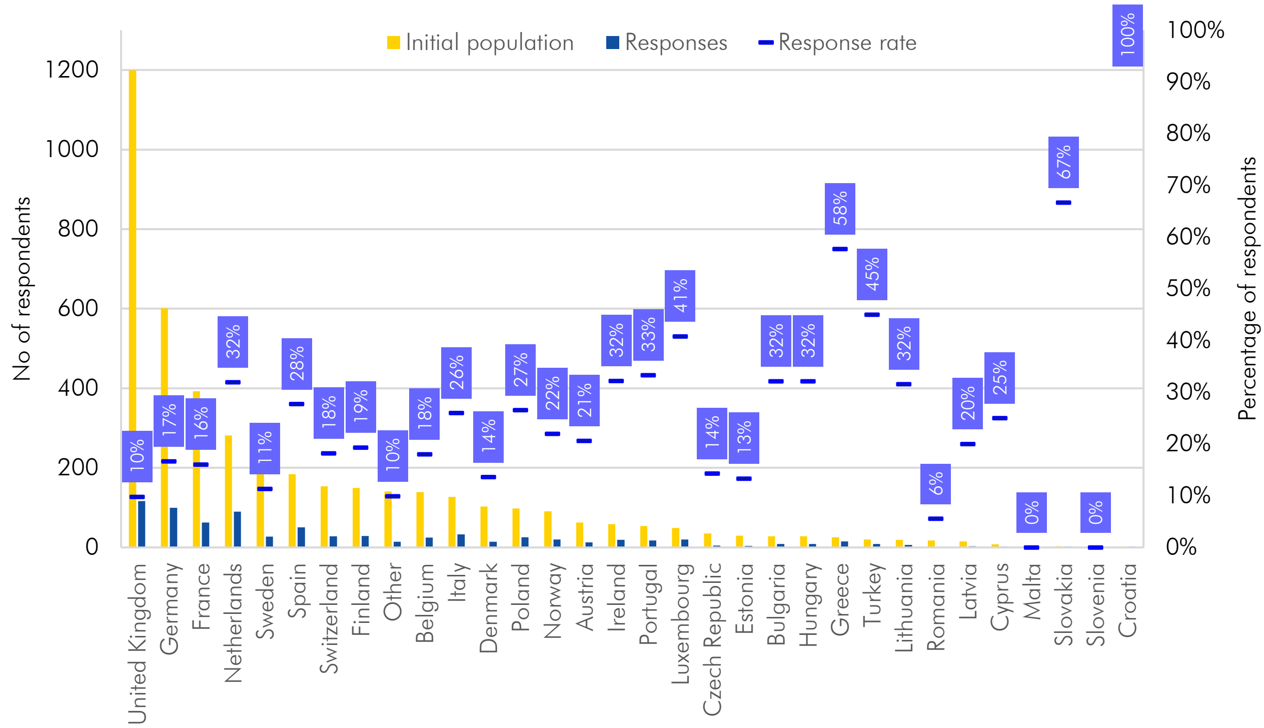
As most of the respondents in the survey state the UK, Germany, the Netherlands and France as the headquarter location of their VC firm, these four countries also constitute the most frequently mentioned target countries for VC investments (see Figure 2). Moreover, 21% of the respondents indicate that they invest only domestically (i.e. only in the country of their VC firm's headquarter location), see Figure 3. The vast majority (60%) invest both domestically and abroad, with the headquarter country also being *the* most important target country for VC investments. Only 10% of the GPs report that they undertake cross-border investments only and do not invest domestically.

There seems to be a strong "home bias" when it comes to choosing the country of the VC firms' headquarter location, since the fact that a large part of the management team has lived in that country is by far the most frequently stated reason (see Figure 4).

[5] The terms "GPs", "VC managers", "fund managers", "VCs" and "respondents" are used interchangeably throughout the report.

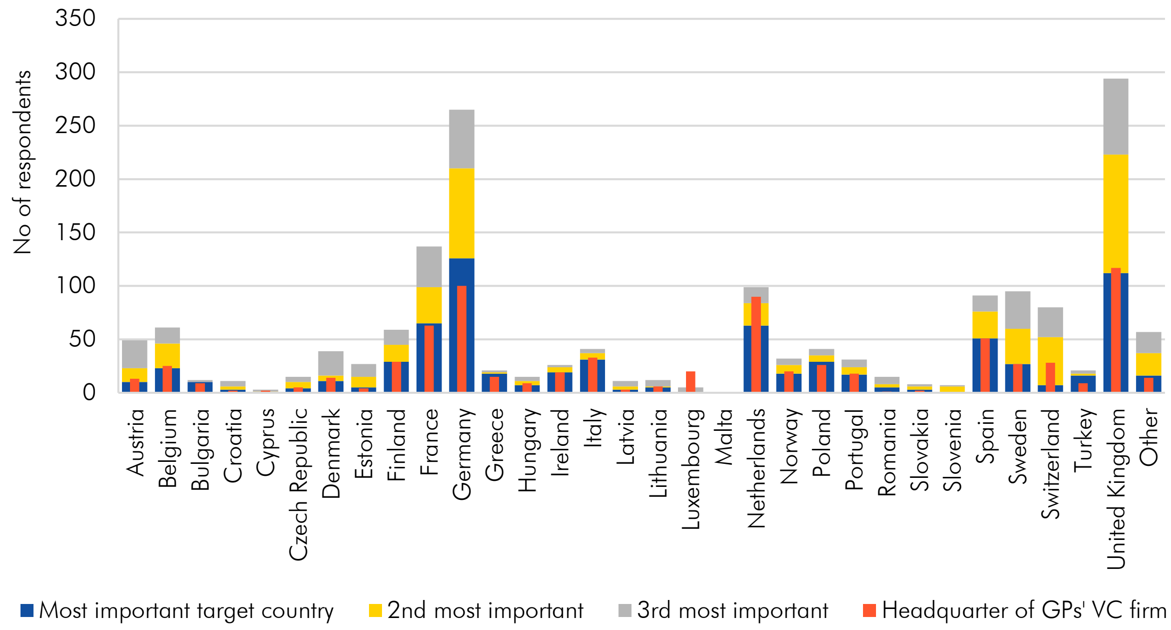
[6] In the initial sample construction process, we also included GPs from VC firms headquartered in the US, Asia or other world region that are nonetheless active in the European VC market. Hence, all in all, the online survey questionnaire was received by 7,121 individuals, representing 4,384 distinct VC firms globally. However, due to the low number of responses received from GPs outside Europe (63) and to concerns regarding the representative nature of these responses, we decided not to include them in our analysis and to only present the results for the 774 completed responses received from European GPs.

Figure 1: Distribution of respondents by VC firm headquarter country



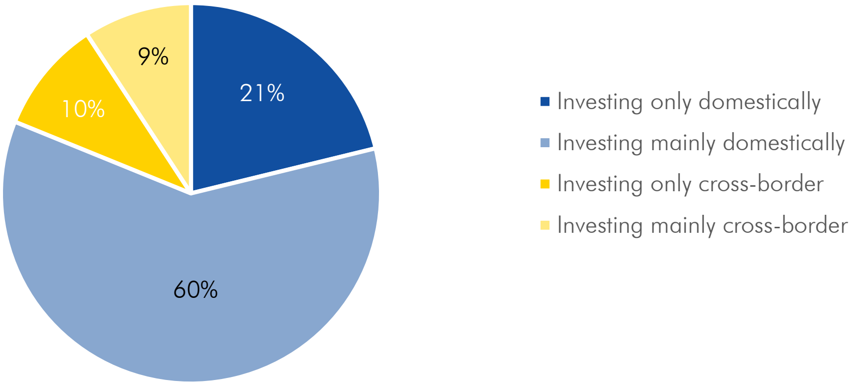
Q. In which country is your firm headquartered?

Figure 2: GPs' most important target countries for VC investments



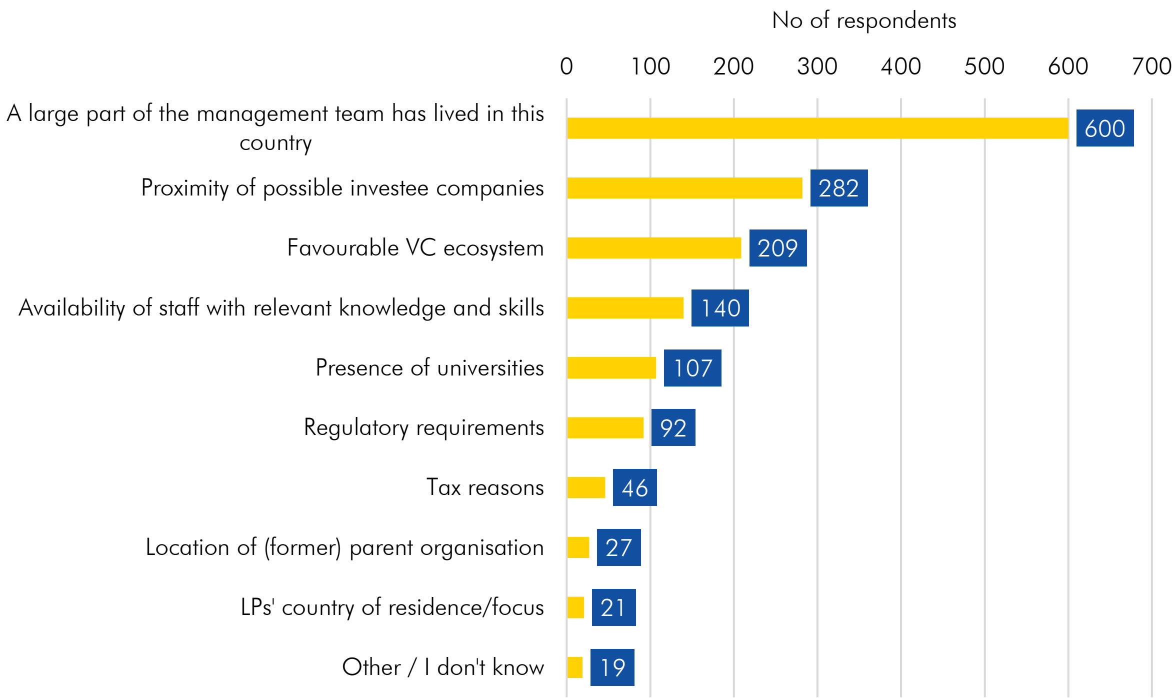
Q. Select up to three of the most important countries in which your firm invests in venture, in order of importance.

Figure 3: GPs' investment activity relative to their VC firm's headquarter location[7]



Note: "Investing only domestically" refers to GPs that only invest in the country of their VC firm's headquarter location; "Investing mainly domestically" refers to GPs that invest both in the country of their VC firm's headquarter location and abroad, but for which the country of the headquarter location constitutes the No1 most important target country for VC investments; "Investing only cross-border" refers to GPs that only invest outside the country of their VC firm's headquarter location; "Investing mainly cross-border" refers to GPs that invest both in the country of their VC firm's headquarter location and abroad, but for which the country of the headquarter location does NOT constitute the No1 most important target country for VC investments .

Figure 4: Reasons for choosing the country of the VC firms' headquarter location



Note: Multiple selection possible.

Q. Why was this country chosen as firm headquarter?

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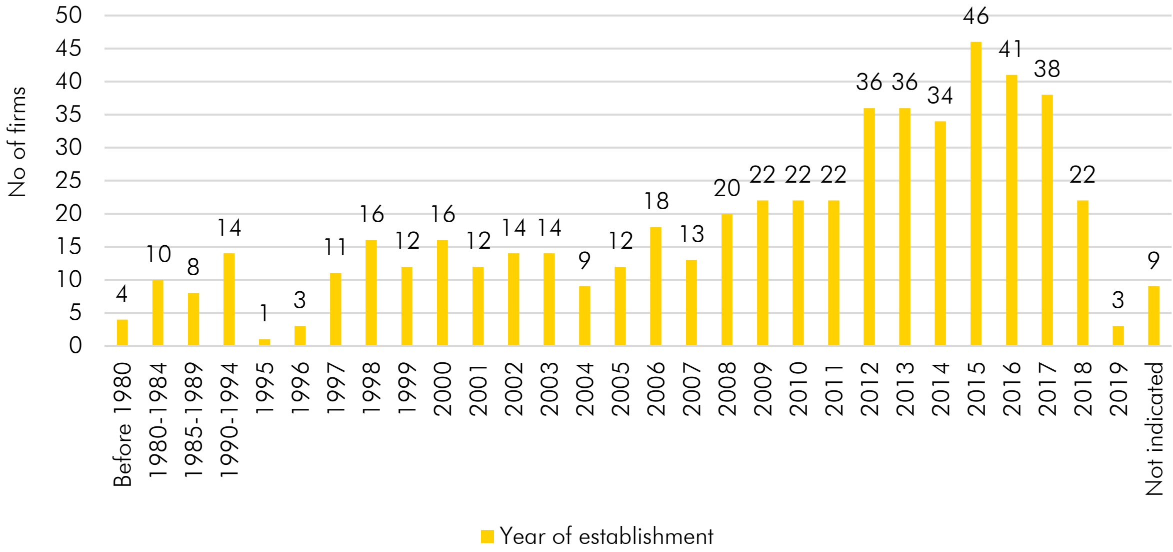
[7] Due to rounding, percentages may not always add up to 100%.

The majority of the VC firms that participated in the survey (approximately 60%) have been founded over the last decade (see Figure 5). Indeed, the average (median) firm age in the sample is 11 (8) years.

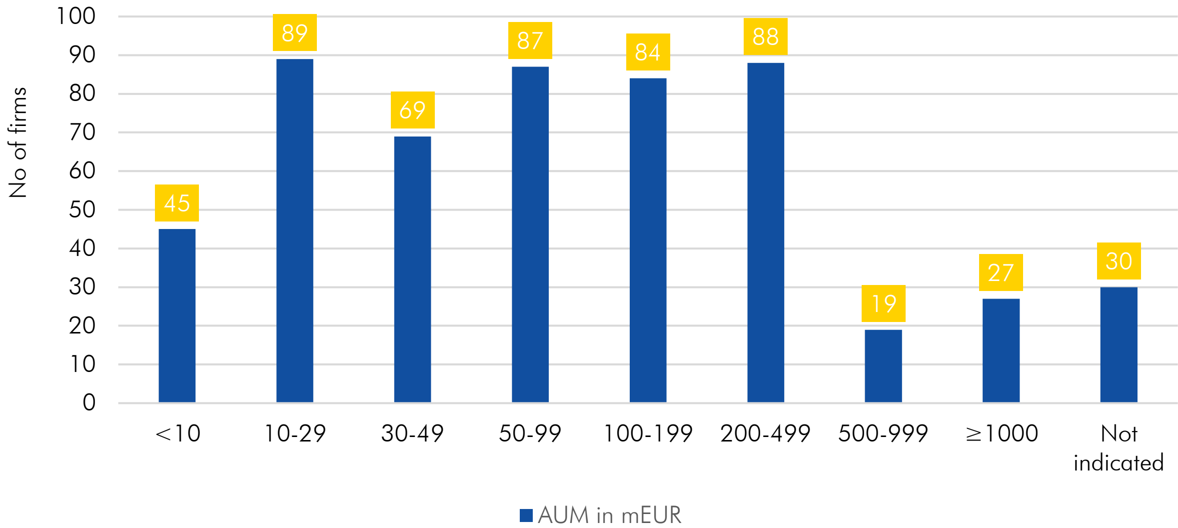
Figure 5: Year of establishment of VC firms in the sample



Q. In what year was your firm established?

The average (median) assets under management of the 538 VC firms represented in the survey is EUR 204m (EUR 70m), with the total value of AUM for all firms exceeding EUR 100bn. At least half of the VC firms that took part in the survey are managing assets under EUR 100m, while for quite a few, AUM are in excess of EUR 1bn (see Figure 6).

Figure 6: Assets under management (AUM) of VC firms in the sample

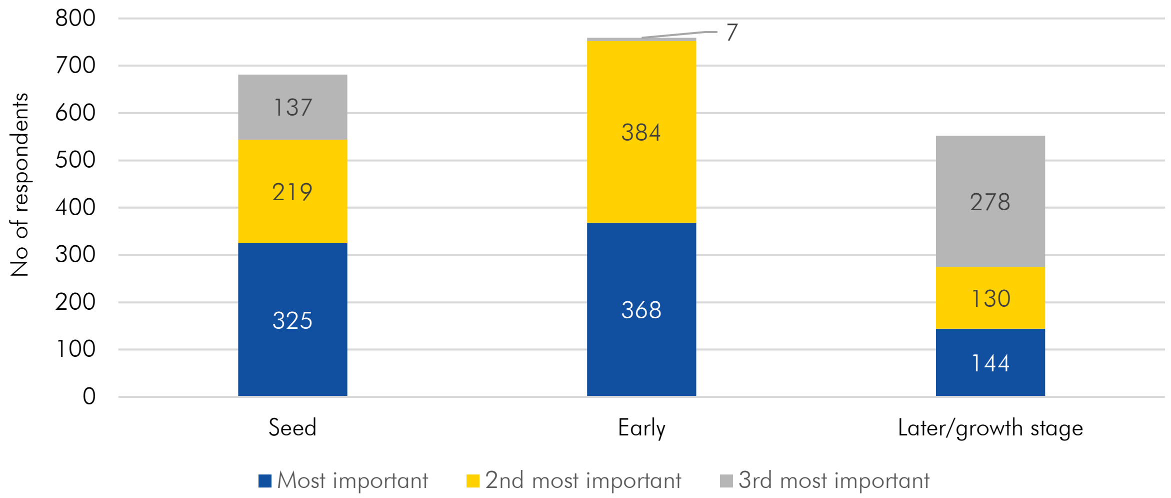


Q. What are your firm's total approximate assets under management (in million EUR)?

Results not presented here for the sake of brevity show that the surveyed GPs have raised, on average, 4 funds in total, while 60% of the respondents have raised up to 2 funds. For two-thirds of the surveyed GPs, the vintage year of their firm's most recent VC fund lies in the last three years.

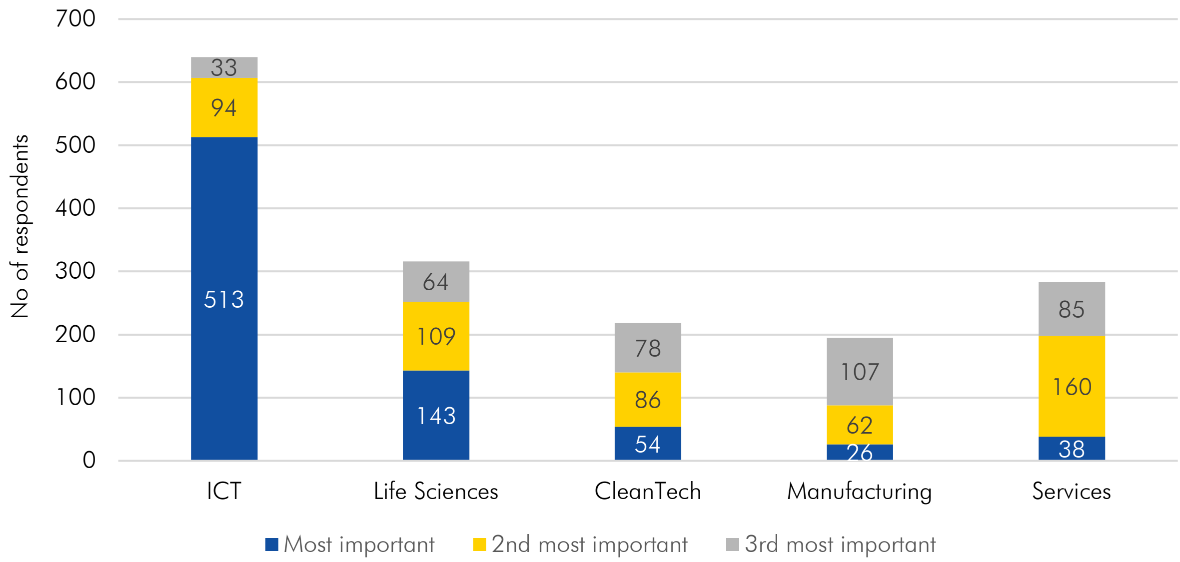
The vast majority of the respondents are early-stage investors (see Figure 7), while ICT is clearly the dominant sector in the sample (see Figure 8), followed by Life Sciences and Services.

Figure 7: GPs' investment stage focus



Q. What is (are) the most important stage(s) in which your firm invests?

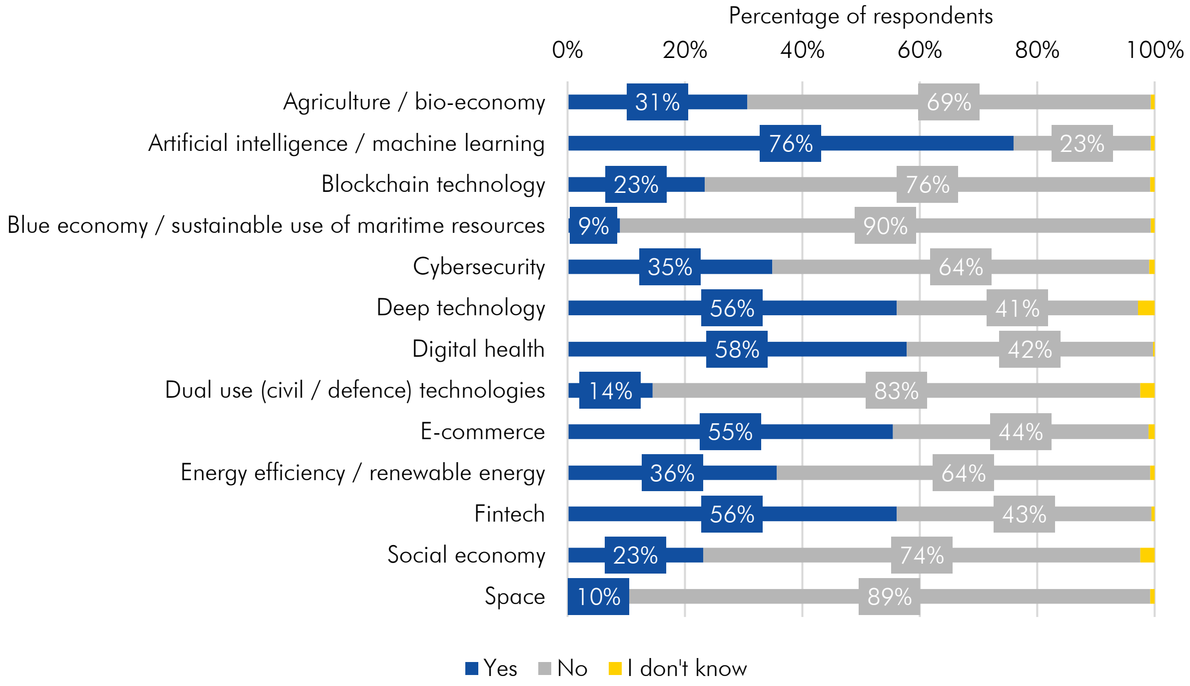
Figure 8: GPs' most important target industries for VC investments



Q. Select up to three of the most important industries in which your firm invests in venture capital.

Apart from the already established technology industries, VC managers were asked about investments in relatively newer sectors that are currently in the public discussion and whose importance is on the rise. Compared to the *EIF VC Survey 2018*, this list of sectors has been significantly enriched to include new topics in the public debate but also to incorporate the feedback received from GPs who participated in the previous survey wave. As shown in Figure 9, Artificial Intelligence (AI), Digital Health, DeepTech, Fintech and E-commerce take leading positions.

Figure 9: Likelihood of current portfolio including an investee in specific industries



Q. Does your current investment portfolio include an investee in the area of …

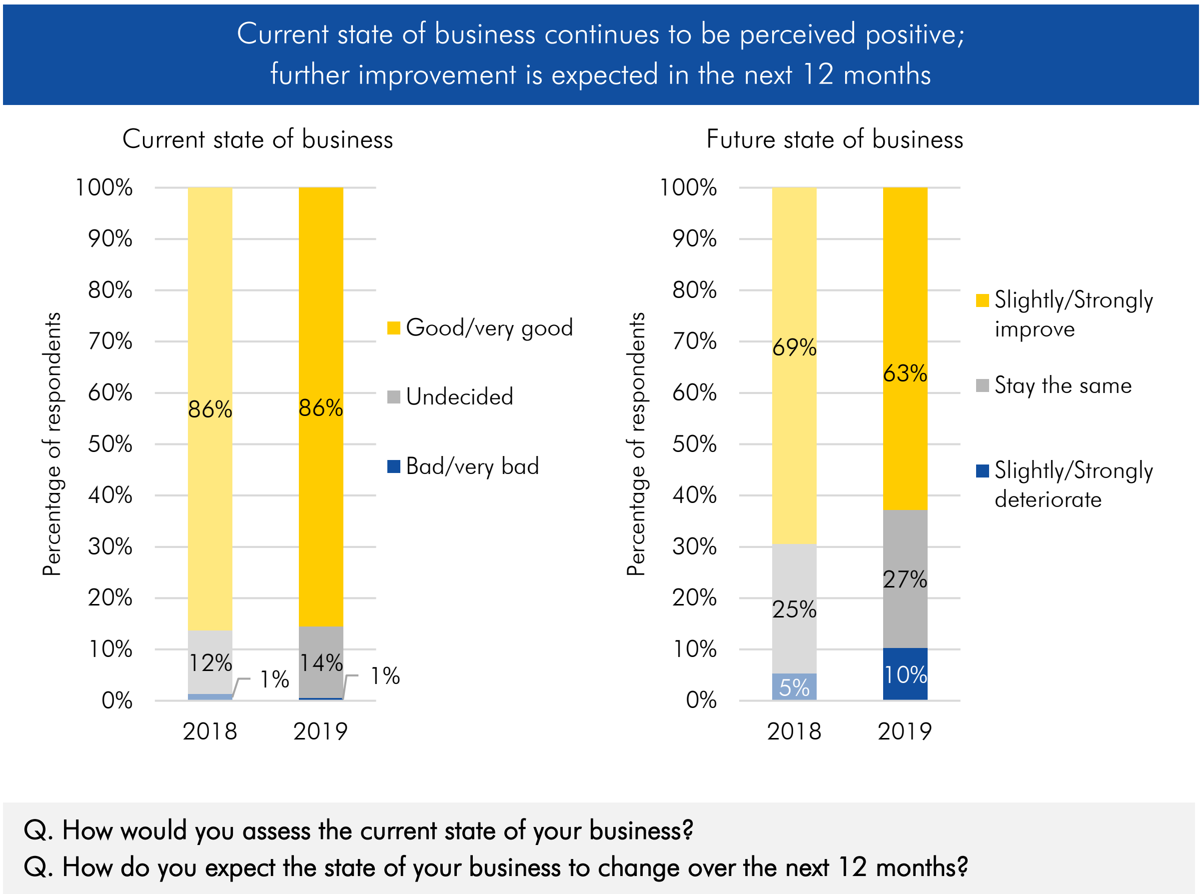
3 Market sentiment

As discussed in the Introduction of this report, one part of the survey focused on market sentiment and aimed at identifying participating VC managers' perception of the current market situation as well as of future outlook. Therefore, a significant number of questions covered a range of topics relating to the state of business, the availability of funding and the fundraising environment, portfolio development, the challenges in the European VC business, the overall prospects of the VC market in Europe as well as countries and industries considered promising for future VC investments.

3.1 State of business

As in the *EIF VC Survey 2018*, in 2019 VC managers continue to appear very positive regarding both the current and the future state of their business. An overwhelming majority of 86% (2018: also 86%) consider their current state of business to be "good" or "very good" (see Figure 10). The outlook for the next 12 months[8] continues to be optimistic, given that almost two thirds (63%; 2018: 69%) of VC managers expect a further improvement in their state of business.

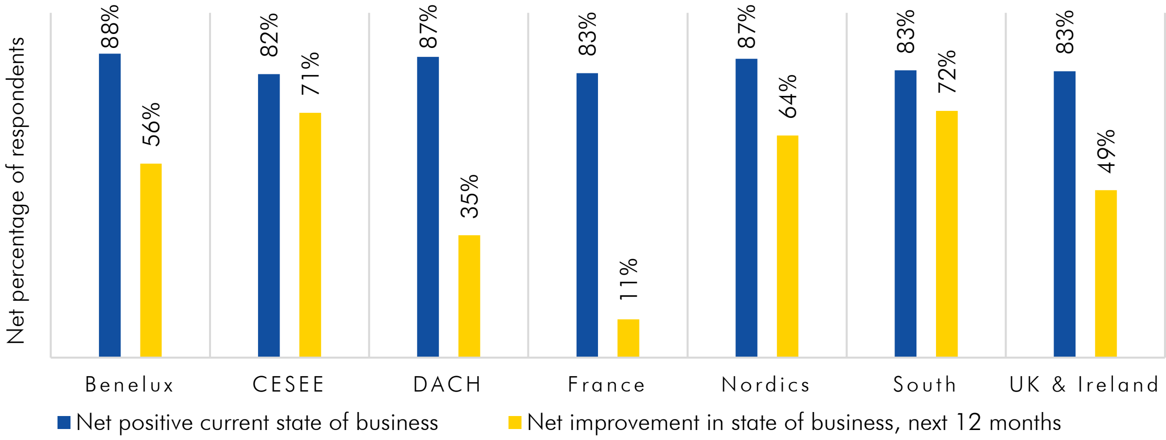
Figure 10: Current and future state of business



[8] For several questions, we report fund managers' responses regarding their expectations for the next 12 months. In this context, it needs to be taken into consideration that the survey was conducted between 7 February and 18 March 2019.

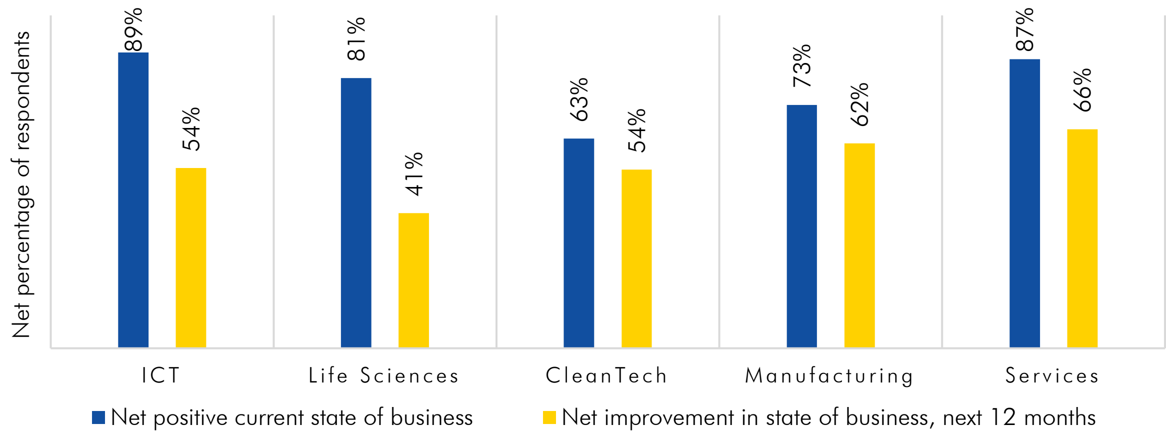
It needs to be noted, however, that a significant degree of heterogeneity does exist across countries, industries and investment stage focus. For example, based on the headquarter location of the VC firm[9] (see Figure 11), we observe that while, on balance, 7 in 10 VC managers in CESEE and the South expect an improvement in their state of business over the next 12 months, the same is true for only 1 in 10 VC managers in France.

Figure 11: Current and future state of business (net balance) – by VC firm headquarter



Note: "Net positive current state of business" reflects the percentage of respondents rating their current state of business as "good" or "very good" minus the percentage of respondents rating their current state of business as "bad" or "very bad". "Net improvement in state of business, next 12 months" reflects the percentage of respondents expecting their state of business to "slightly" or "strongly improve" over the next 12 months minus the percentage of respondents expecting their state of business to "slightly" or "strongly deteriorate" over the next 12 months.

Figure 12: Current and future state of business (net balance) – by VC main target industry



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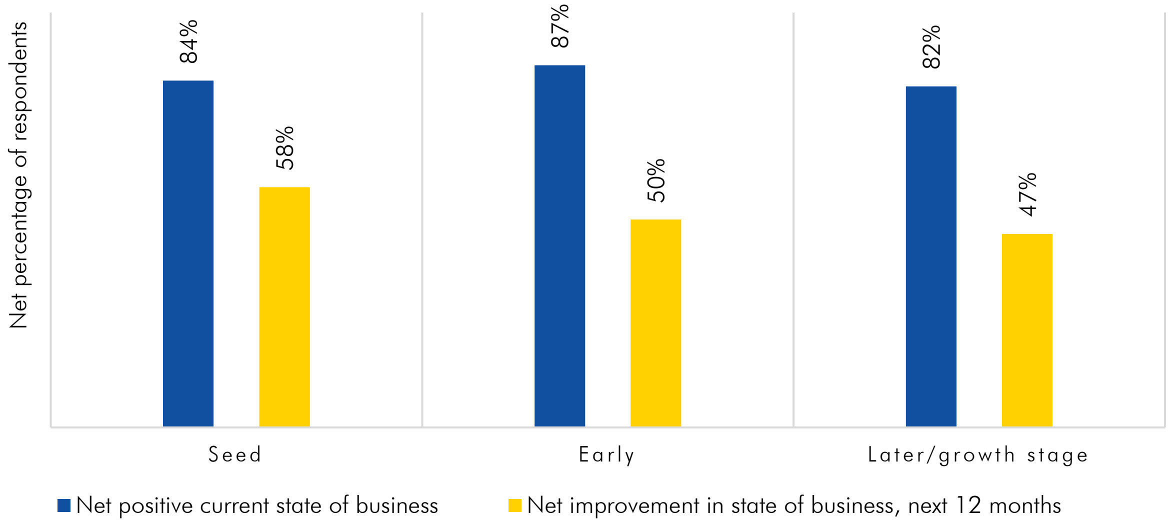
[9] Based on the respondents' distribution by headquarter country, country groupings are as follows: 135 respondents from Benelux (Belgium, Netherlands, Luxembourg); 107 respondents from CESEE (here: Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Turkey, Other); 141 respondents from DACH (Germany, Austria, Switzerland); 63 respondents from France; 90 respondents from the Nordics (Denmark, Finland, Norway, Sweden); 102 respondents from the South (here: Italy, Portugal, Spain); 136 respondents from the UK & Ireland.

When the industry focus is taken into consideration (see Figure 12), GPs investing mainly in CleanTech appear relatively less positive regarding their current state of business, while GPs investing mainly in Life Sciences exhibit the least optimistic outlook for the year ahead. Finally, VC fund managers investing mainly in later/growth-stage companies are relatively less positive regarding both their current state of business as well as future prospects (see Figure 13).

Figure 13: Current and future state of business (net balance) – by VC investment stage focus



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3.2 Availability of funding and fundraising environment

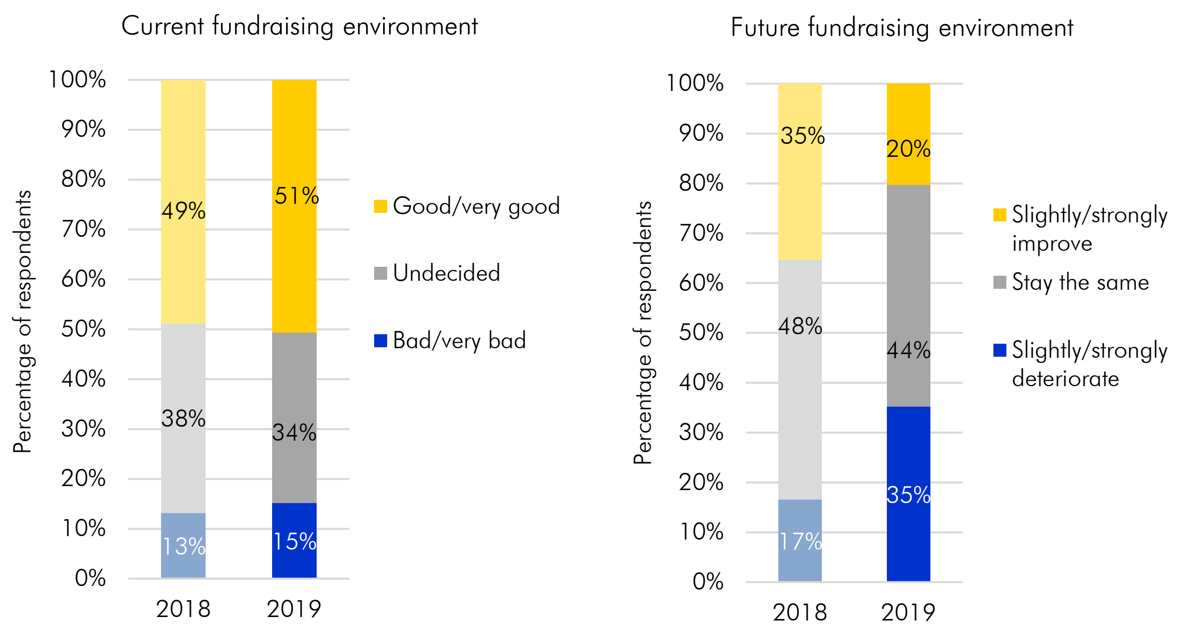
Consistent with the results of the *EIF VC Survey 2018*, this year's findings also suggest that fundraising continues to be perceived as an important issue in the VC business. As seen in Figure 14, 1 in 2 VC fund managers consider the current fundraising environment to be "good" or "very good", but only 1 in 5 anticipate a further improvement in the near future. In fact, 35% of the GPs expect the fundraising environment for VC funds in Europe to deteriorate in the course of the next 12 months (up from 17% the year before).

VC managers in DACH, France and Benelux (see Figure 15) evaluate relatively more positively the current fundraising environment, as opposed to VC managers in CESEE and the South where only 1 in 10, on balance, exhibit a positive perception. Interestingly however, when it comes to future prospects, it is fund managers from the same two regions who demonstrate the most optimistic outlook (VC managers in the South, on balance, even expect an improvement in the fundraising environment over the next 12 months).

The same holds true for VCs investing mainly in Services (see Figure 16), while for VCs investing mainly in Manufacturing and in ICT, a relatively more negative outlook is documented.

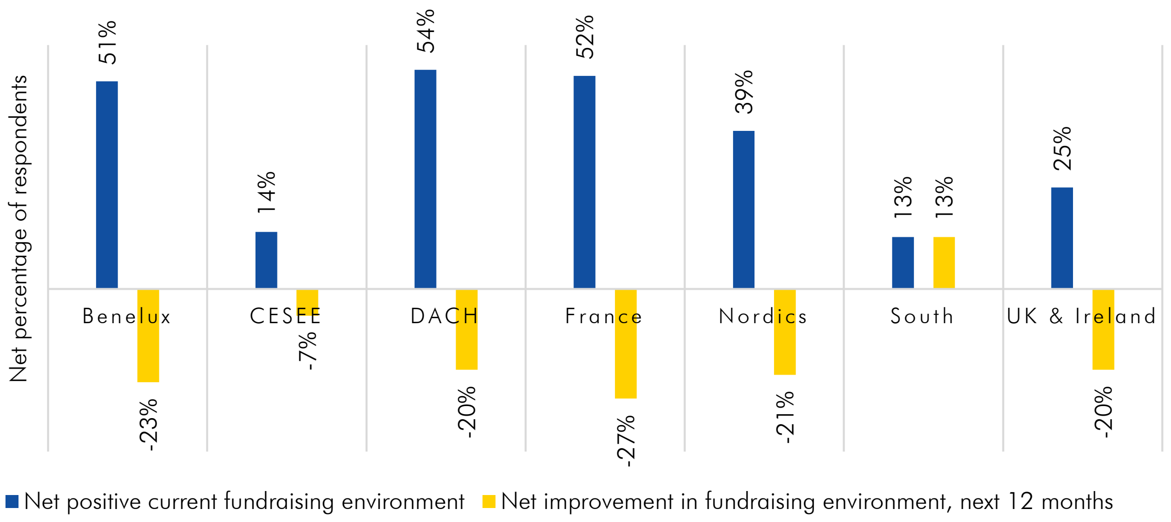
Figure 14: Current and future fundraising environment

1 in 2 GPs evaluate positively the current fundraising environment;
but 1 in 3 expect a deterioration in the next 12 months



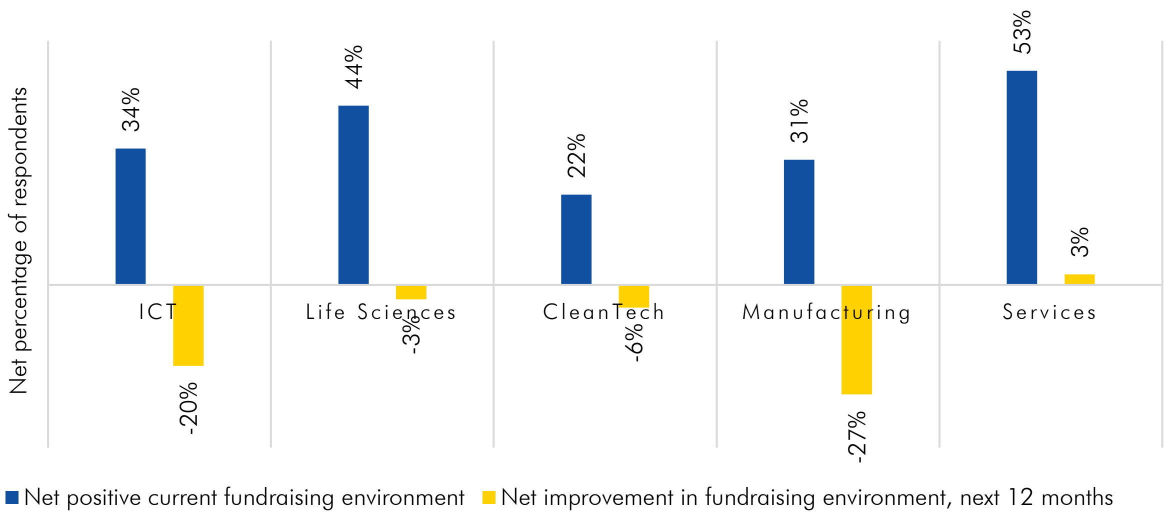
Q. How would you rate the current fundraising environment for VC funds?
Q. Over the next 12 months, how do you expect the fundraising environment to develop?

Figure 15: Current and future fundraising environment (net balance) – by VC firm headquarter



Note: "Net positive current fundraising environment" reflects the percentage of respondents rating the current fundraising environment as "good" or "very good" minus the percentage of respondents rating the current fundraising environment as "bad" or "very bad". "Net improvement in fundraising environment, next 12 months" reflects the percentage of respondents expecting the fundraising environment to "slightly" or "strongly improve" over the next 12 months minus the percentage of respondents expecting the fundraising environment to "slightly" or "strongly deteriorate" over the next 12 months (a negative net value suggests a deterioration).

Figure 16: Current and future fundraising environment (net balance) – by VC main target industry



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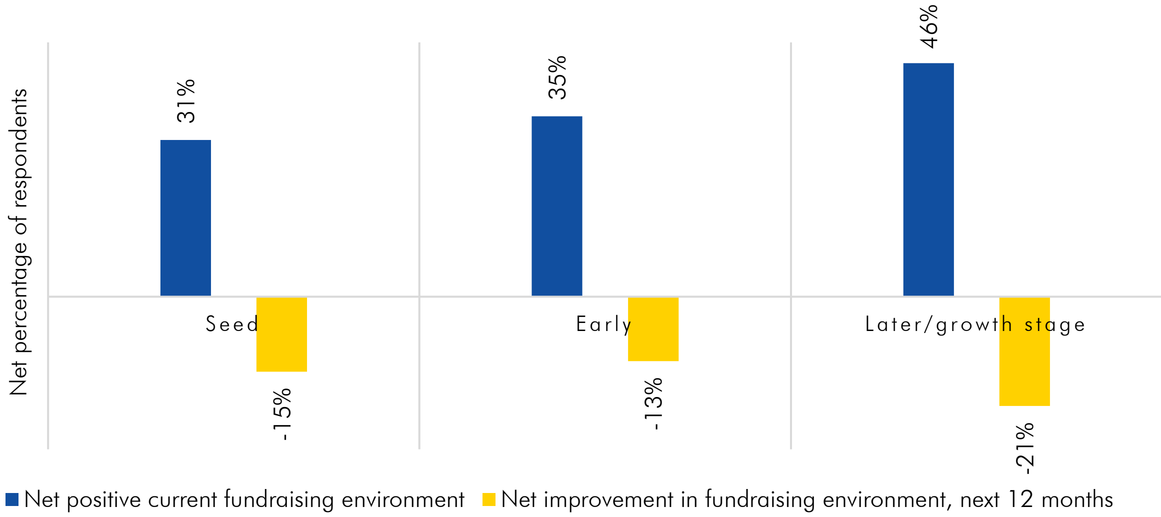
Later/growth-stage VCs (see Figure 17) exhibit the greatest degree of deviation between their current and future perception of the fundraising environment, being the ones who rate relatively more positively the current fundraising environment, but at the same time the ones who expect to a greater extent a deterioration of the fundraising environment in the future.

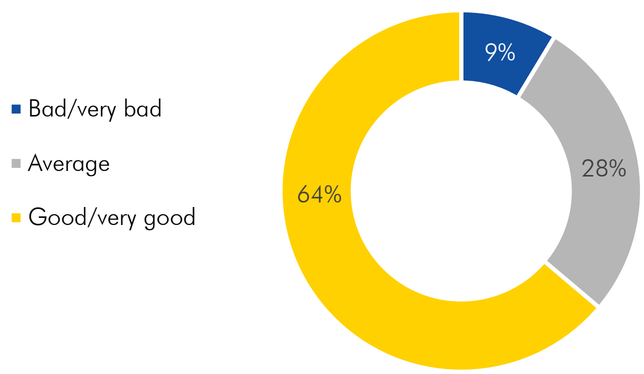
Figure 17: Current and future fundraising environment (net balance) – by VC investment stage focus



Note: "Net positive current fundraising environment" reflects the percentage of respondents rating the current fundraising environment as "good" or "very good" minus the percentage of respondents rating the current fundraising environment as "bad" or "very bad". "Net improvement in fundraising environment, next 12 months" reflects the percentage of respondents expecting the fundraising environment to "slightly" or "strongly improve" over the next 12 months minus the percentage of respondents expecting the fundraising environment to "slightly" or "strongly deteriorate" over the next 12 months (a negative net value suggests a deterioration).

Leaving aside the general market conditions with regard to fundraising, when VC fund managers are asked to evaluate the availability of funding to finance *their own* portfolio companies' prospects, a more favourable picture is portrayed (see Figure 18). In particular, almost two thirds of the respondents rate the availability of funding as "good" or "very good".

Figure 18: Availability of funding to finance own portfolio companies' prospects

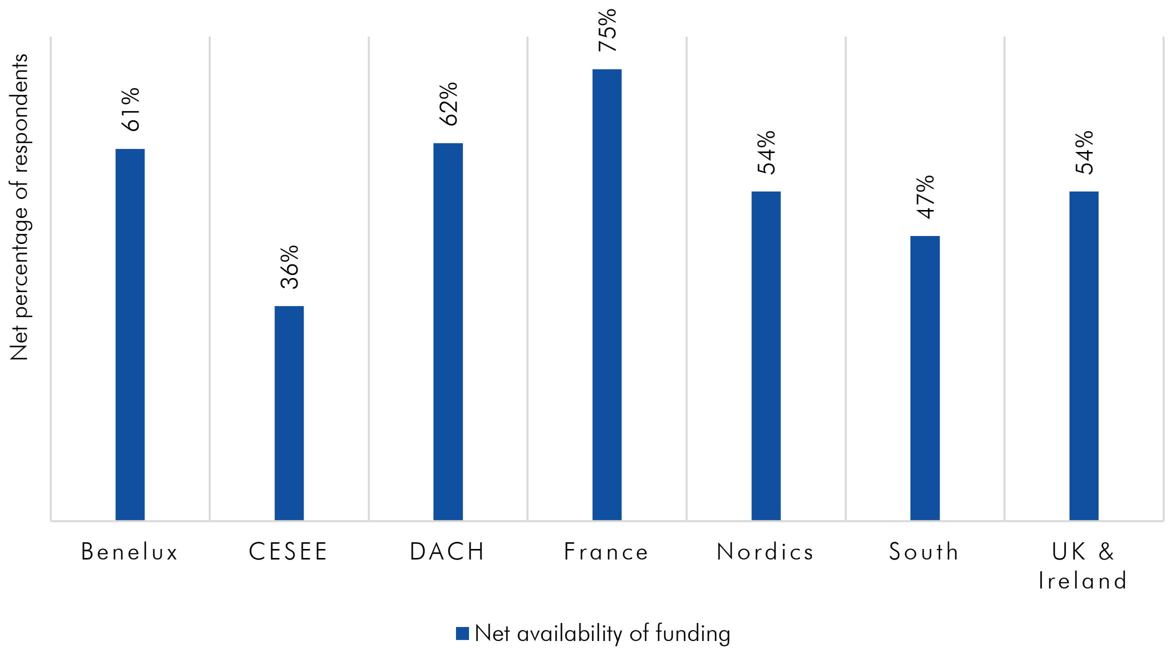


Availability of funding to finance own portfolio companies' prospects is perceived good

Q. How would you rate the availability of funding to finance your portfolio companies' prospects?

However, this finding is not homogeneous across regions, sectors and investment stages.

Figure 19: Availability of funding (net balance) – by VC firm headquarter

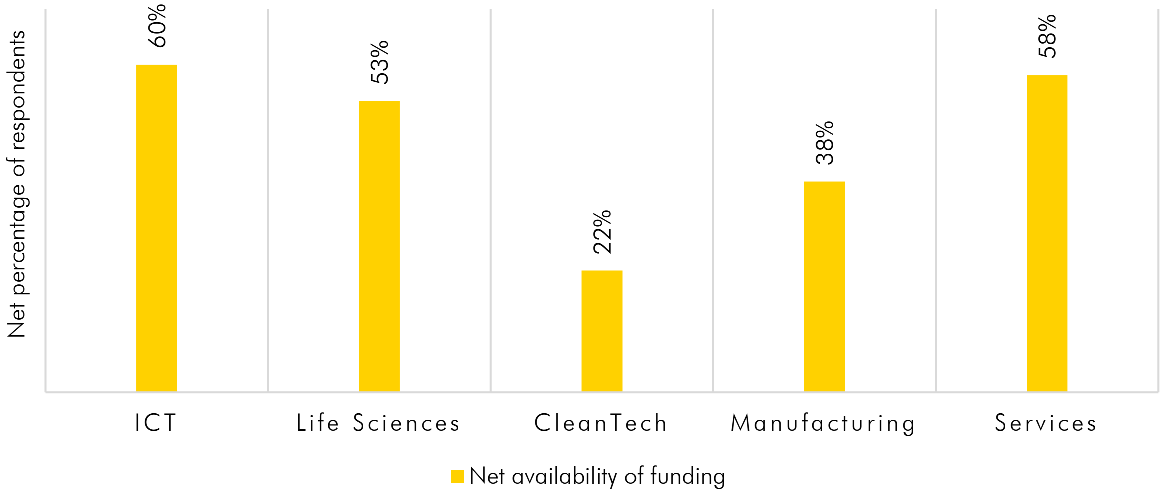


Note: "Net availability of funding" reflects the percentage of respondents rating the availability of funding as "good" or "very good" minus the percentage of respondents rating the availability of funding as "bad" or "very bad".

Similarly to the pattern documented earlier for the current fundraising environment, the availability of funding appears to be better in France, DACH and Benelux (in France, 3 in 4 GPs, on balance, rate positively the availability of funding to finance their portfolio companies' prospects) and worse in CESEE and the South (in CESEE, the availability of funding is perceived positively by only 1 in 3 GPs, on balance), see Figure 19.

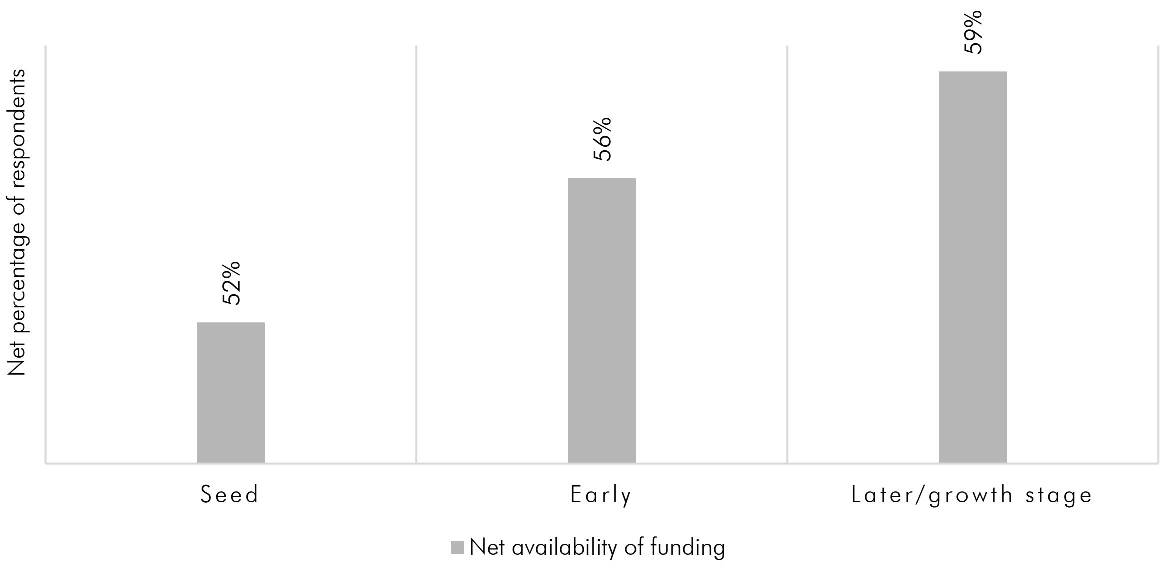
Furthermore, the issue of available funding is more acute for VCs investing mainly in CleanTech and in Manufacturing (see Figure 20) as well as for VCs investing mainly in seed-stage companies (see Figure 21).

Figure 20: Availability of funding (net balance) – by VC main target industry



Note: "Net availability of funding" reflects the percentage of respondents rating the availability of funding as "good" or "very good" minus the percentage of respondents rating the availability of funding as "bad" or "very bad".

Figure 21: Availability of funding (net balance) – by VC investment stage focus

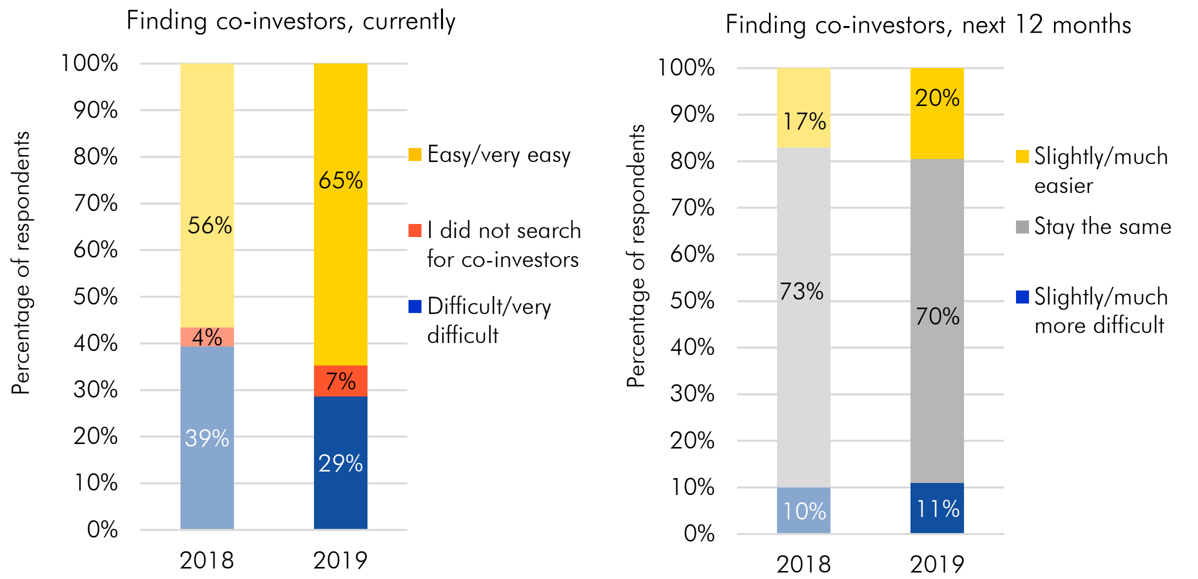


Note: "Net availability of funding" reflects the percentage of respondents rating the availability of funding as "good" or "very good" minus the percentage of respondents rating the availability of funding as "bad" or "very bad".

Compared to 2018, this year's survey findings show an improvement in the easiness in finding co-investors (see Figure 22): a significant majority of VC managers (65%; up from 56% in 2018) found relatively easily co-investors to syndicate, while no significant changes are expected in the coming 12 months. At the same time though, the responses suggest that almost one third of the GPs did report difficulties in finding co-investors.

Figure 22: Finding co-investors to syndicate, currently and over the next 12 months

Finding co-investors to syndicate is perceived easier; stable outlook for the next 12 months



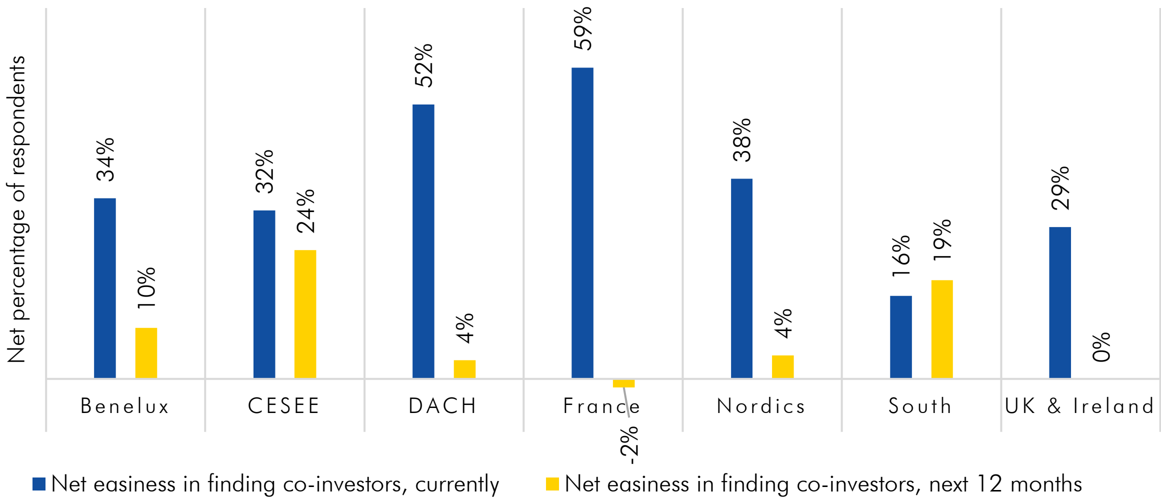
Q. How easy/difficult is it currently to find co-investors to syndicate?
Q. Over the next 12 months, how do you expect finding co-investors to syndicate to become?

A more detailed analysis of the responses reveals however significant variations across regions and industries. As seen in Figure 23, VC managers in France (59%, on balance) and DACH (52%, on balance) currently report greater easiness in finding co-investors to syndicate, as opposed to VCs in the UK & Ireland (29%, on balance) and the South (16%, on balance). At the same time though, GPs in France are the only ones who expect, on balance, finding co-investors to become more difficult in the future; while the easiness in finding co-investors is expected to improve the most in CESEE.

Furthermore, for VC managers investing mainly in Manufacturing and in CleanTech (see Figure 24), finding co-investors to syndicate is currently rather difficult, as opposed to VCs investing mainly in ICT and in Life Sciences. Nonetheless, CleanTech investors exhibit the most optimistic outlook.

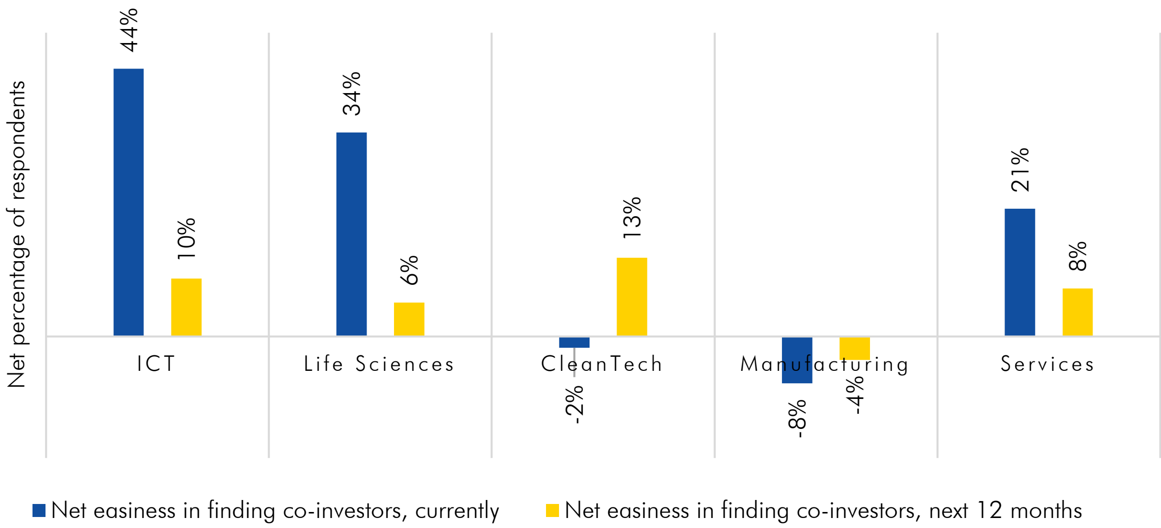
As regards the investment stage focus (see Figure 25), GPs investing mainly in later/growth-stage companies report a relatively lower easiness in finding co-investors, with no change expected in this respect for the 12 months ahead.

Figure 23: Easiness in finding co-investors (net balance) – by VC firm headquarter



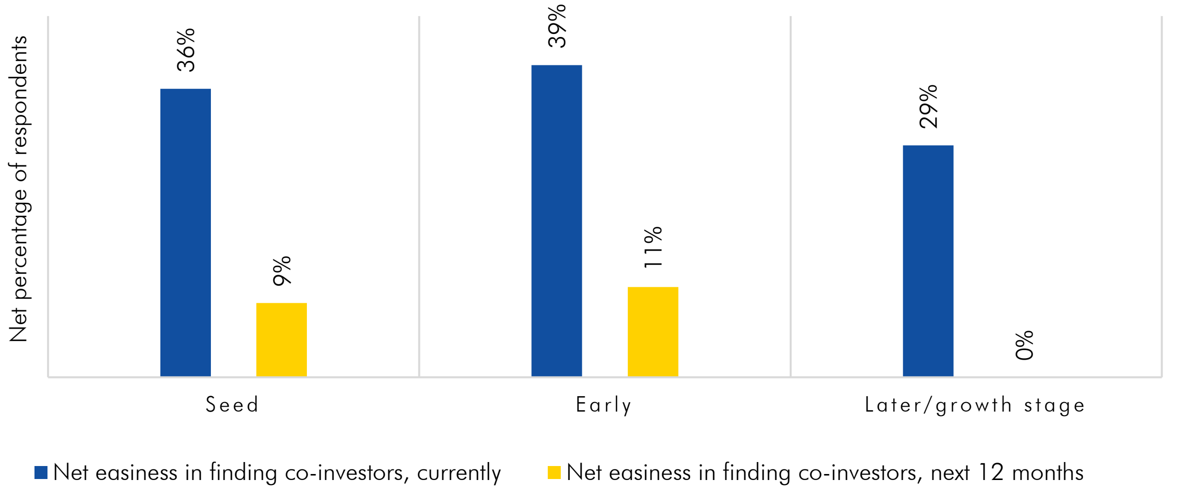
Note: "Net easiness in finding co-investors, currently" reflects the percentage of respondents who perceive finding co-investors as "easy" or "very easy" minus the percentage of respondents who perceive finding co-investors as "difficult" or "very difficult". "Net easiness in finding co-investors, next 12 months" reflects the percentage of respondents who expect finding co-investors to become "slightly" or "much easier" minus the percentage of respondents who expect finding co-investors to become "slightly" or "much more difficult" (a negative net value suggests an increase in difficulty).

Figure 24: Easiness in finding co-investors (net balance) – by VC main target industry



Note: "Net easiness in finding co-investors, currently" reflects the percentage of respondents who perceive finding co-investors as "easy" or "very easy" minus the percentage of respondents who perceive finding co-investors as "difficult" or "very difficult". "Net easiness in finding co-investors, next 12 months" reflects the percentage of respondents who expect finding co-investors to become "slightly" or "much easier" minus the percentage of respondents who expect finding co-investors to become "slightly" or "much more difficult" (a negative net value suggests an increase in difficulty).

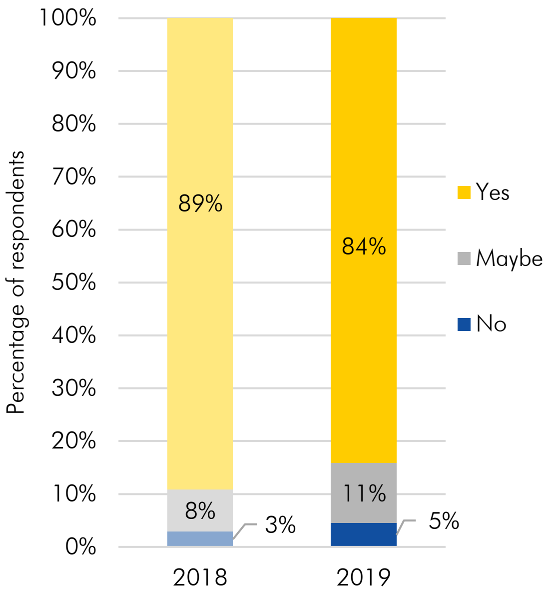
Figure 25: Easiness in finding co-investors (net balance) – by VC investment stage focus



Note: "Net easiness in finding co-investors, currently" reflects the percentage of respondents who perceive finding co-investors as "easy" or "very easy" minus the percentage of respondents who perceive finding co-investors as "difficult" or "very difficult". "Net easiness in finding co-investors, next 12 months" reflects the percentage of respondents who expect finding co-investors to become "slightly" or "much easier" minus the percentage of respondents who expect finding co-investors to become "slightly" or "much more difficult" (a negative net value suggests an increase in difficulty).

Finally, the overwhelming majority of VC managers (84%; slightly below the 89% reported in 2018) state that they intend to raise another fund to make VC investments within the next five years – see Figure 26 (with broadly similar percentages noted across regions, industries and investment stages).

Figure 26: Intention to raise another fund within the next 5 years

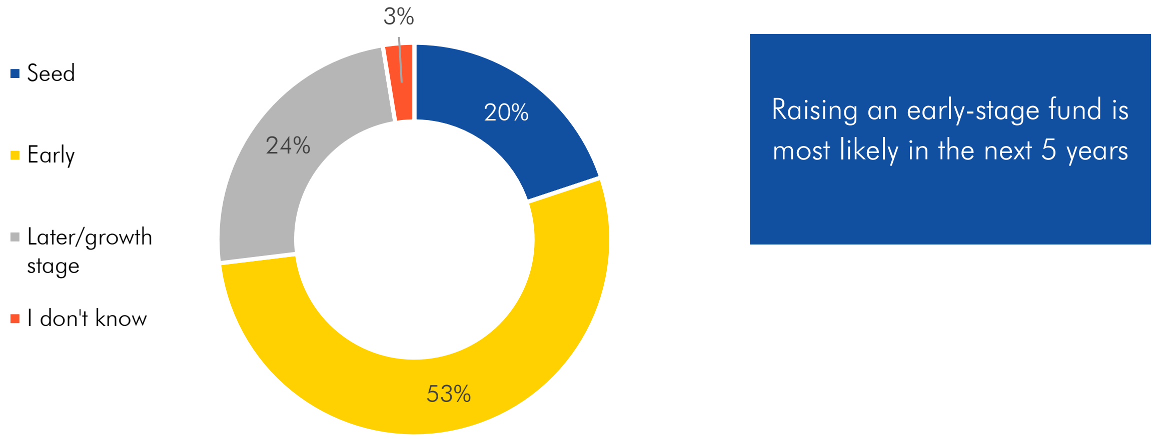


Most VCs intend to raise another fund within the next 5 years

Q. Do you intend to raise another fund to make venture capital investments within the next five years?

Among those who stated that they would indeed raise or at least consider raising another fund within the next five years, 53% of the respondents indicated that early stage would be the most likely stage focus of such a fund (see Figure 27).

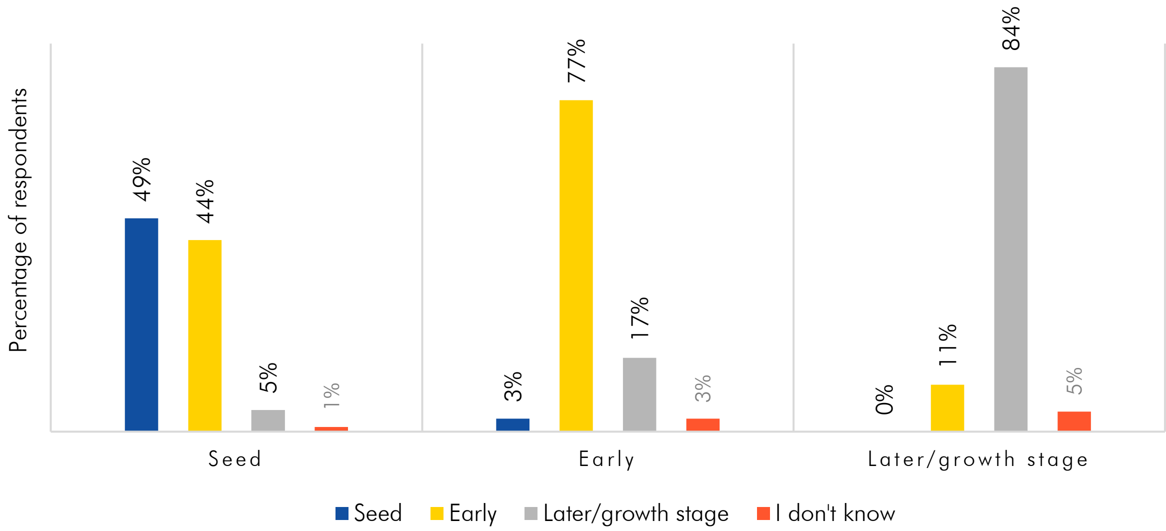
Figure 27: Most likely stage focus of next fund within 5 years



Q. What will be the most likely stage focus of your next fund?

However, the likely stage focus of the next fund is largely influenced by the current investment stage focus of the GPs (see Figure 28). It is only in the case of current seed-stage investors that a more balanced prospect with respect to future funds is documented.

Figure 28: Most likely stage focus of next fund within 5 years – by current VC investment stage focus



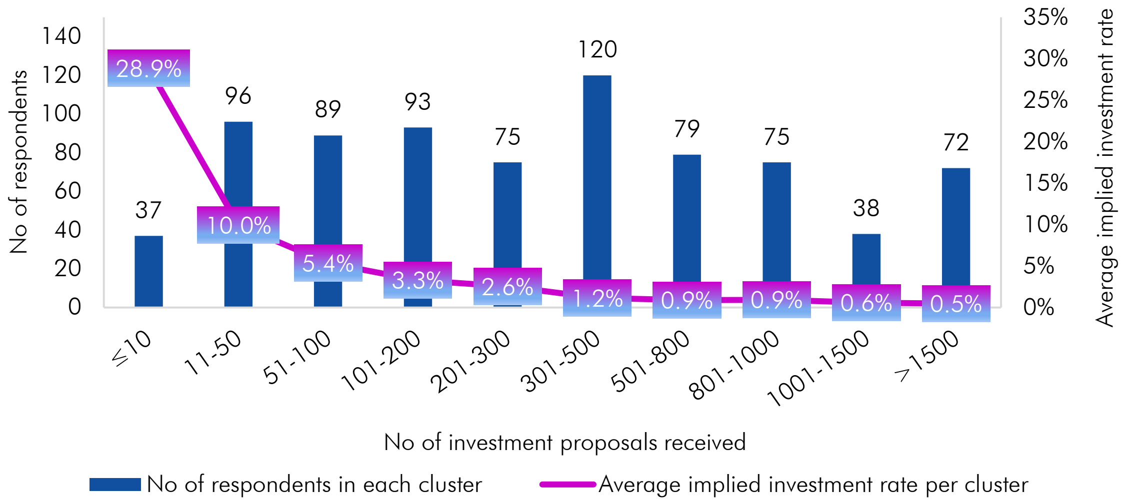
With the availability of funding to finance portfolio companies' prospects being comparatively lower at the seed stage than at other investment stages, the relatively large share of seed-stage fund managers that are likely to move away from their current stage focus might further decrease the availability of finance for seed-stage enterprises through VC funds. Therefore, other ways of seed-stage financing (e.g., in the form of BA financing or accelerators) might become more important, and policymakers should consider broadening public support measures accordingly.

3.3 Investments and portfolio development

Based on the responses of the VC managers that participated in the survey, the average (median) number of qualified venture investment proposals received over the last 12 months is 628 (300), with almost one third of the GPs however (222 out of total 774) receiving not more than 100 proposals (see Figure 29).

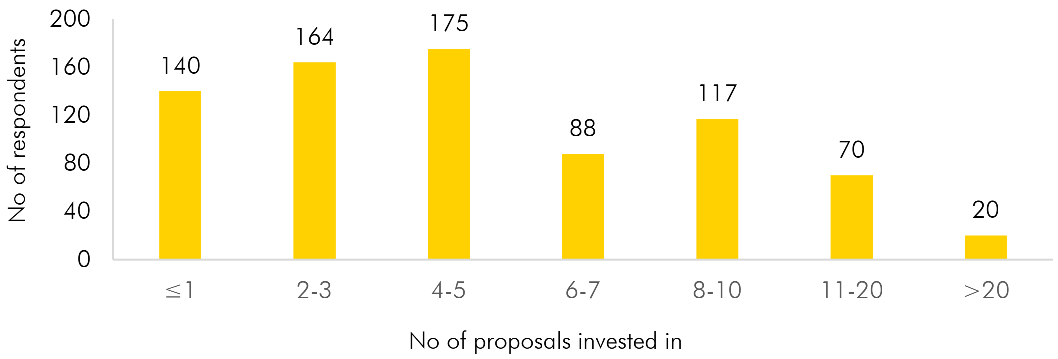
Almost two thirds of the surveyed VC managers do not invest in more than 5 of these investment proposals (see Figure 30). The implied average investment rate (Number of proposals invested in/Number of qualified venture investment proposals received) for the entire sample is 4%; it does vary, however, across firms. For example, for VC firms not receiving more than 10 qualified venture investment proposals, the implied average investment rate reaches almost 30%, significantly decreasing thereafter the more proposals a firm receives.

Figure 29: Number of investment proposals received and implied investment rate



Q. Approximately, how many qualified venture investment proposals did your firm receive over the last 12 months?
Q. In how many ventures did your firm invest over the last 12 months?

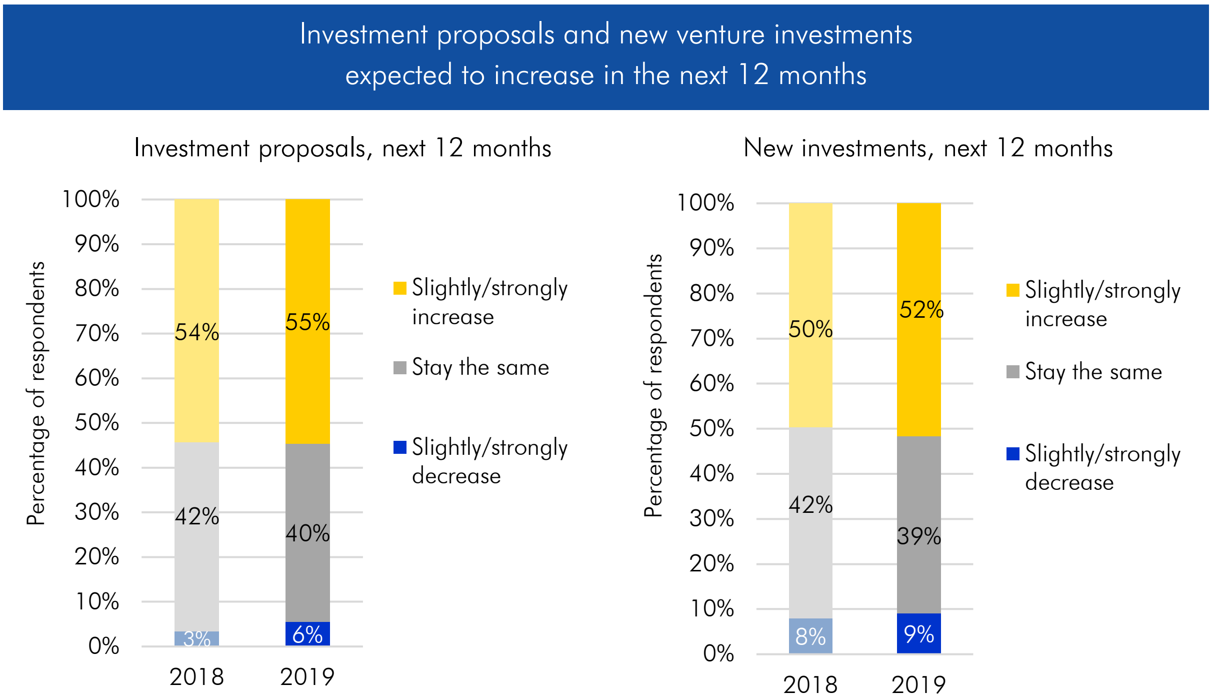
Figure 30: Number of proposals invested in



Q. In how many ventures did your firm invest over the last 12 months?

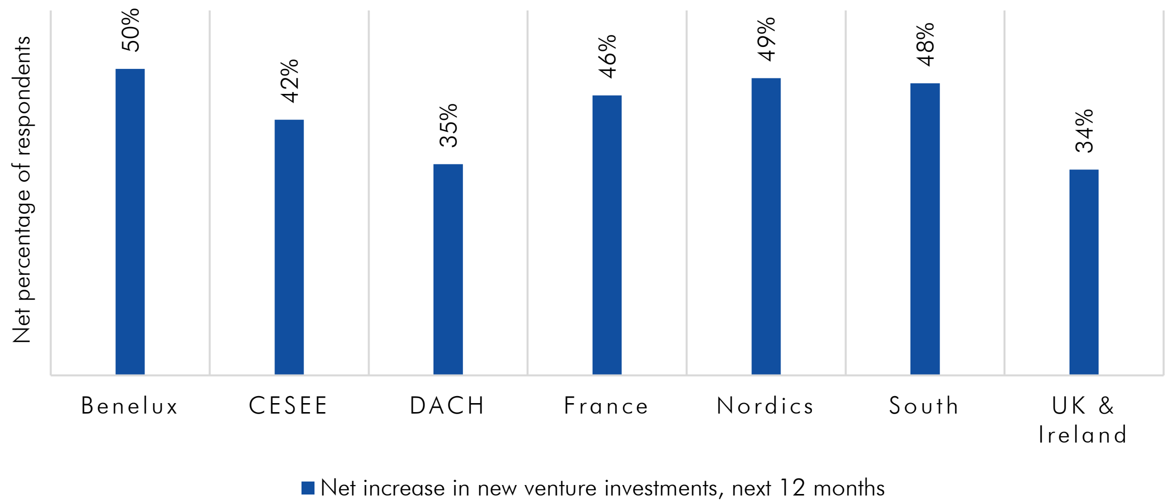
Over the next 12 months, VC managers expect, on average, an increase both in the investment proposals they will receive as well as in the number of new venture investments they will undertake (see Figure 31).

Figure 31: Investment proposals and new venture investments, next 12 months



Q. How do you expect the number of qualified venture investment proposals to your firm to develop over the next 12 months?
Q. How do you expect the number of your new venture investments to develop over the next 12 months?

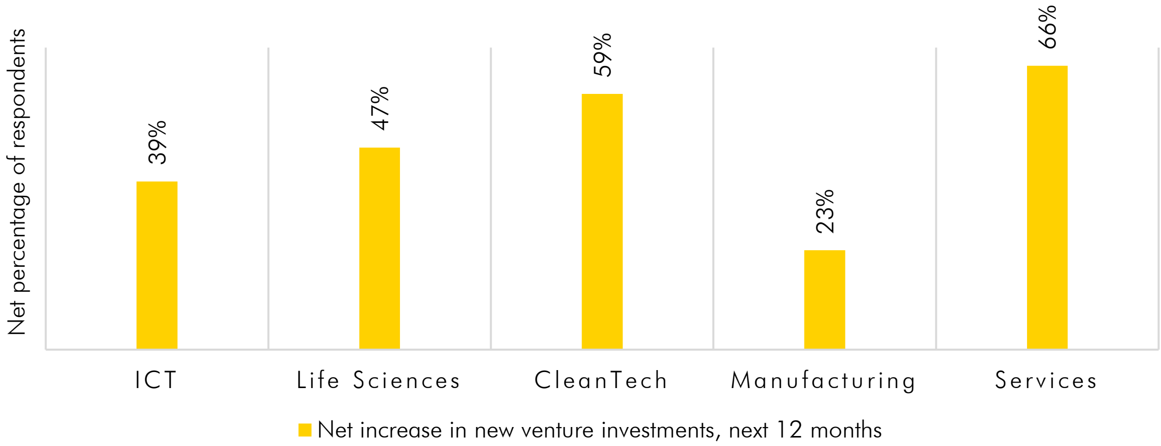
Figure 32: New venture investments (net balance), next 12 months – by VC firm headquarter



Note: "Net increase in new venture investments, next 12 months" reflects the percentage of respondents expecting their new venture investments to "slightly" or "strongly increase" over the next 12 months minus the percentage of respondents expecting their new venture investments to "slightly" or "strongly decrease" over the next 12 months.

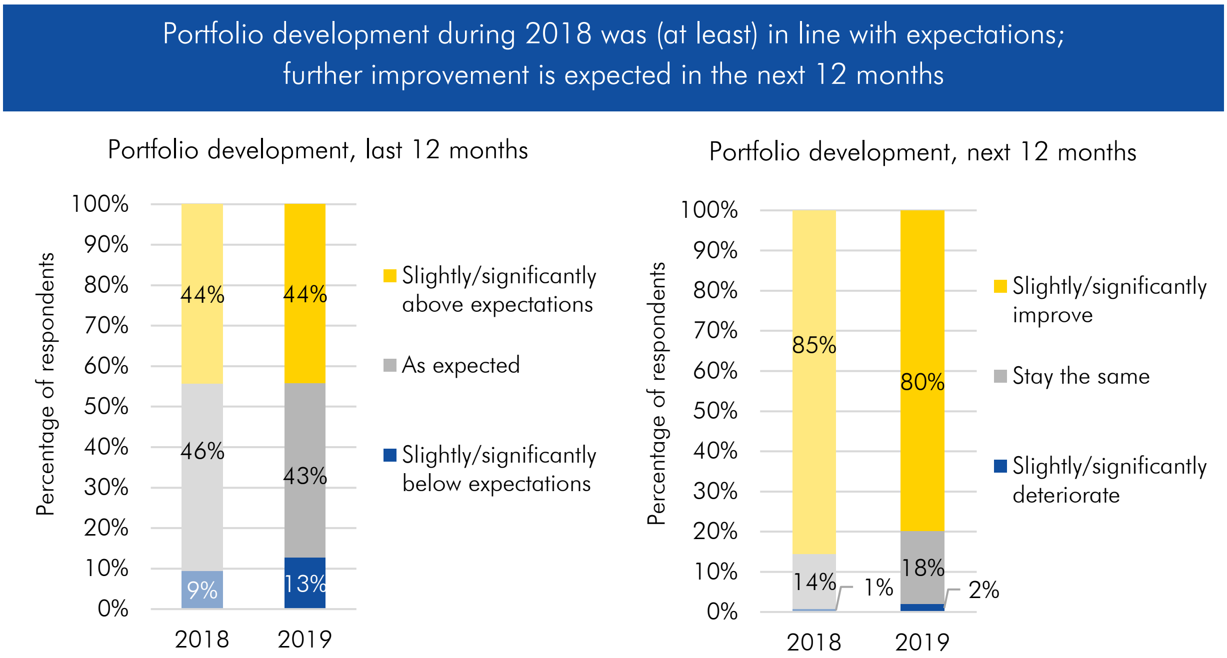
Having said this, it is worth mentioning some interesting variations based on the regional (see Figure 32) and sectoral (see Figure 33) distribution of respondents. In particular, new venture investments are expected to increase the most in Benelux, Nordics and the South, while GPs in the UK & Ireland appear more reserved regarding their future investments. Similarly, new venture investments are expected to increase the most in the Services and CleanTech sectors, and the least in the Manufacturing sector.

Figure 33: New venture investments (net balance), next 12 months – by VC main target industry



Note: "Net increase in new venture investments, next 12 months" reflects the percentage of respondents expecting their new venture investments to "slightly" or "strongly increase" over the next 12 months minus the percentage of respondents expecting their new venture investments to "slightly" or "strongly decrease" over the next 12 months.

Figure 34: Portfolio development, past and next 12 months



Q. How did your venture portfolio companies develop over the last 12 months?
Q. Over the next 12 months, how do you expect your overall venture portfolio to develop?

When asked about the actual development of their portfolio over the last year (see Figure 34), almost 9 in 10 VC managers (same as in 2018) state that investee company performance was in line with expectations (43%) or that it even exceeded expectations (44%). VC managers are even more optimistic when it comes to future portfolio development, as 8 in 10 expect further improvement in the year ahead.

However, 26% of the GPs investing mainly in CleanTech (see Figure 35) as well as 21% of the GPs investing mainly in later/growth-stage companies (see Figure 36) did report that the development of their portfolio companies in the course of 2018 was below expectations. Both groups are nonetheless much more optimistic regarding their portfolio development in the next 12 months (results not presented here for the sake of brevity).

Figure 35: Portfolio development, last 12 months – by VC main target industry

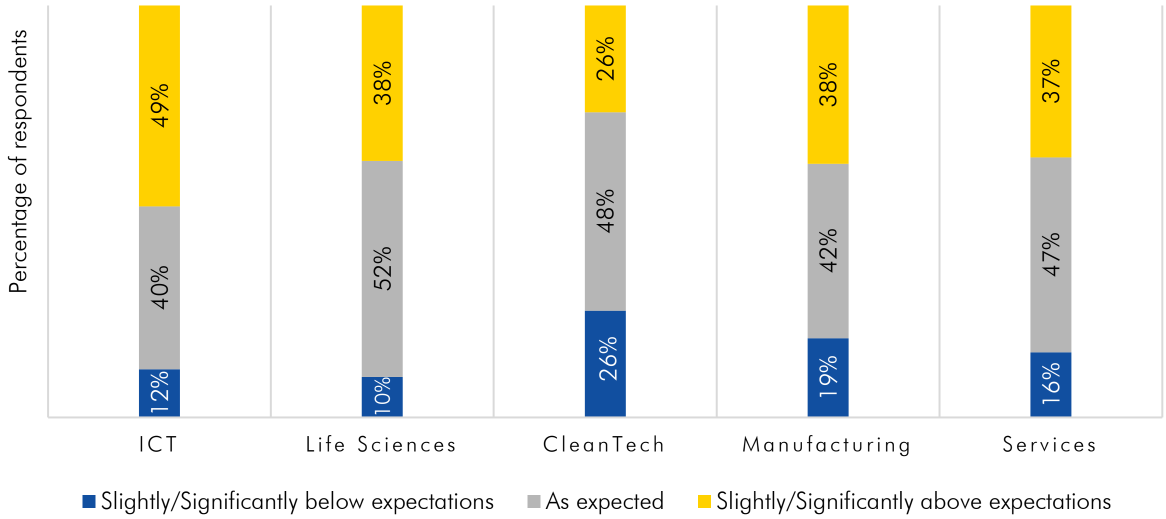
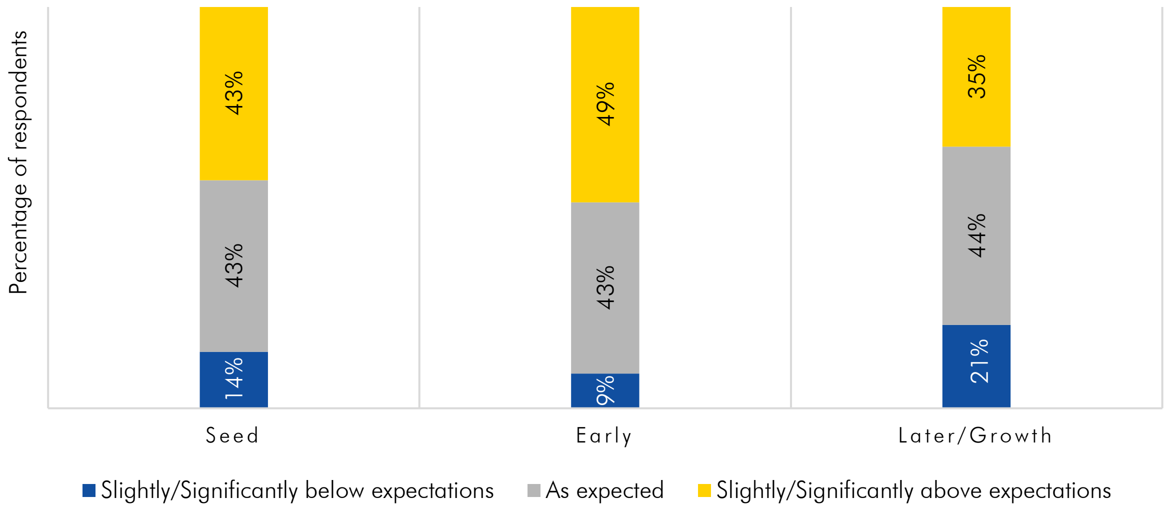
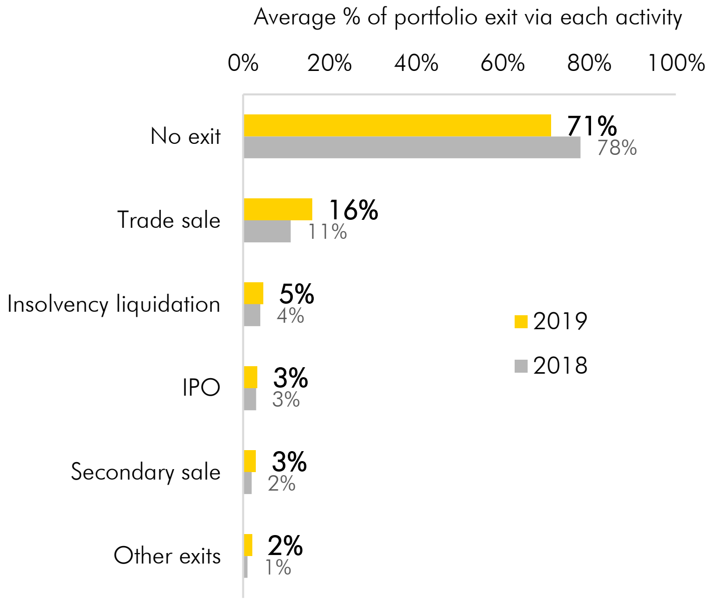


Figure 36: Portfolio development, last 12 months – by VC investment stage focus



As will be seen in subsequent questions too, the exit environment continues to be a major consideration. VC managers reported no exit activities (see Figure 37) over the last 12 months for the vast majority (71%, on average; 2018: 78%) of their portfolio companies.

Figure 37: Exit activities of portfolio companies over the past 12 months



Trade sales continue to dominate the exit activity

Q. Assess the exit activities in your overall venture portfolio over the last 12 months.

As far as the specific types of exit are concerned, the pattern documented for the overall sample is generally consistent across regions, industries and investment stages. The only significant differentiation comes about in the case of France (see Figure 38) which documented the highest percentage of exits via IPO (8%; almost three times the sample average) and in the Life Sciences sector (see Figure 39) for the exact same reason.

Figure 38: Exit activities of portfolio companies over the past 12 months – by VC firm headquarter

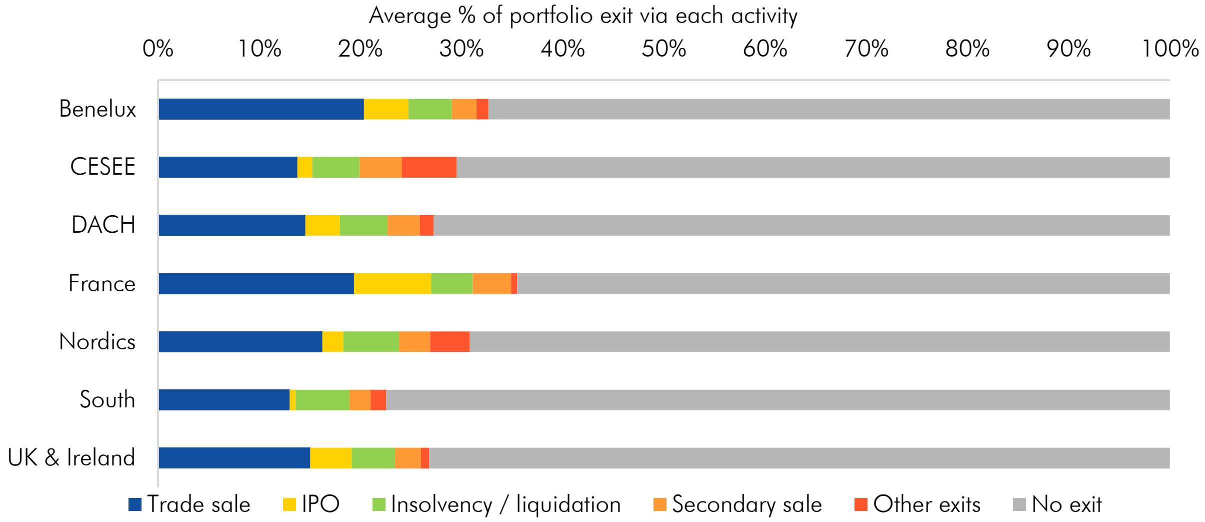
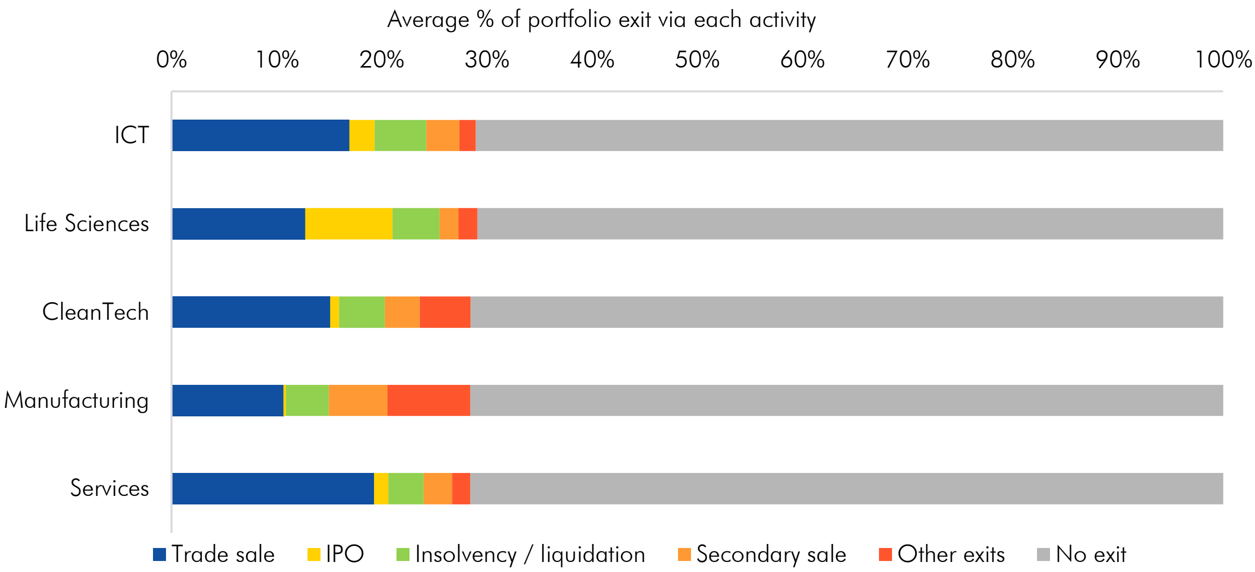
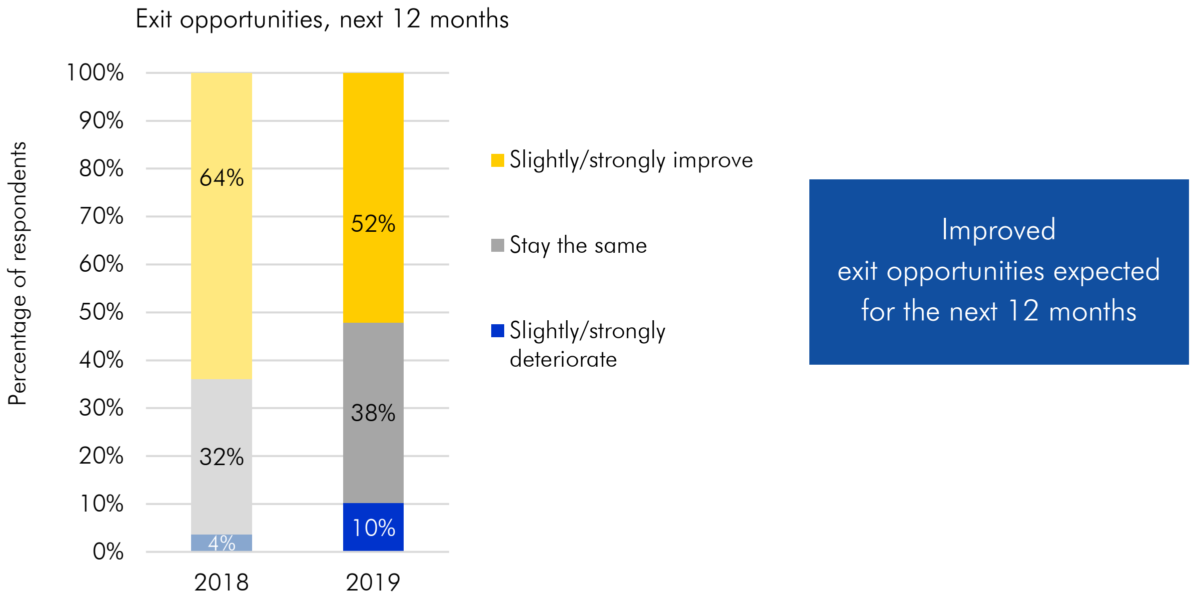


Figure 39: Exit activities of portfolio companies over the past 12 months – by VC main target industry



The exit prospects for the next 12 months continue to be perceived positive (see Figure 40), even if to a lesser extent with regard to a year ago: 52% of the VC managers expect an improvement in the exit opportunity of their investee companies in the year ahead, compared to 64% who shared this optimism in 2018.

Figure 40: Exit opportunities for portfolio companies over the next 12 months



Q. Over the next 12 months, how do you expect the exit opportunities of your venture portfolio companies to develop?

It is important to note that almost 1 in 5 VC managers in the UK & Ireland (see Figure 41) and 1 in 3 VC mangers investing mainly in Manufacturing (see Figure 42) expect in fact a deterioration in the exit potential of their portfolio companies.

Figure 41: Exit opportunities for portfolio companies over the next 12 months – by VC firm headquarter

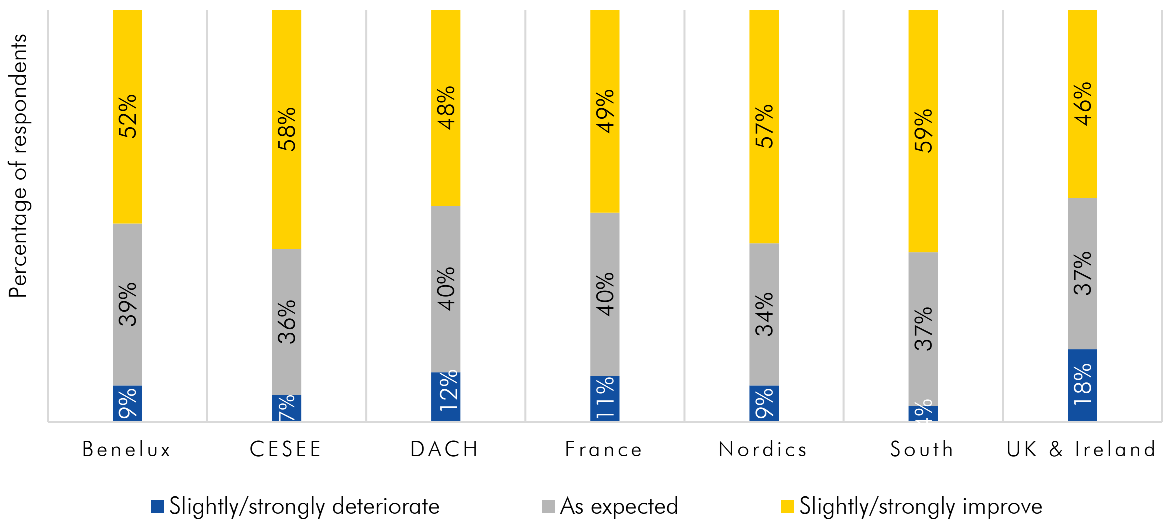
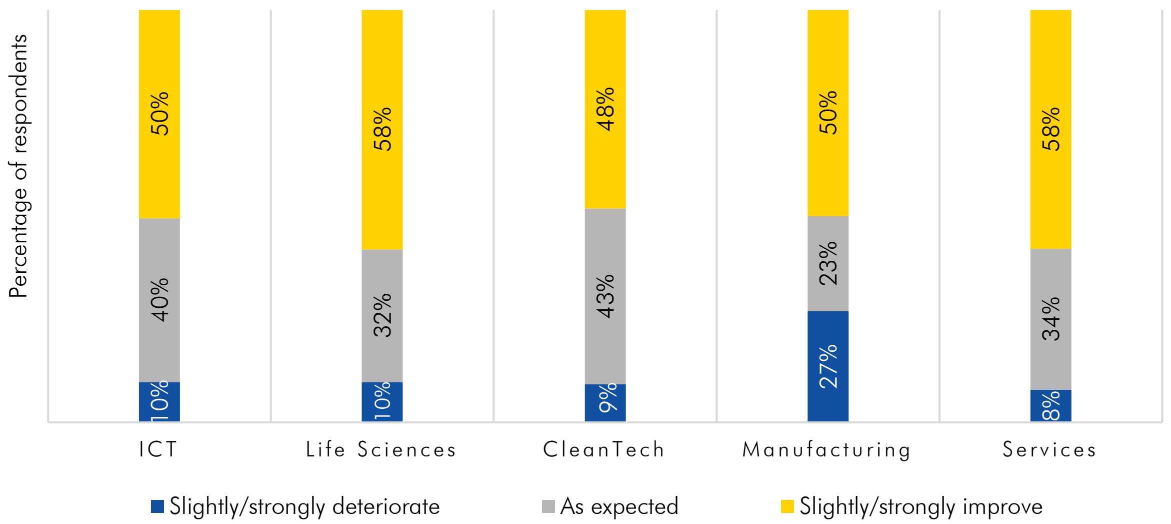


Figure 42: Exit opportunities for portfolio companies over the next 12 months – by VC main target industry

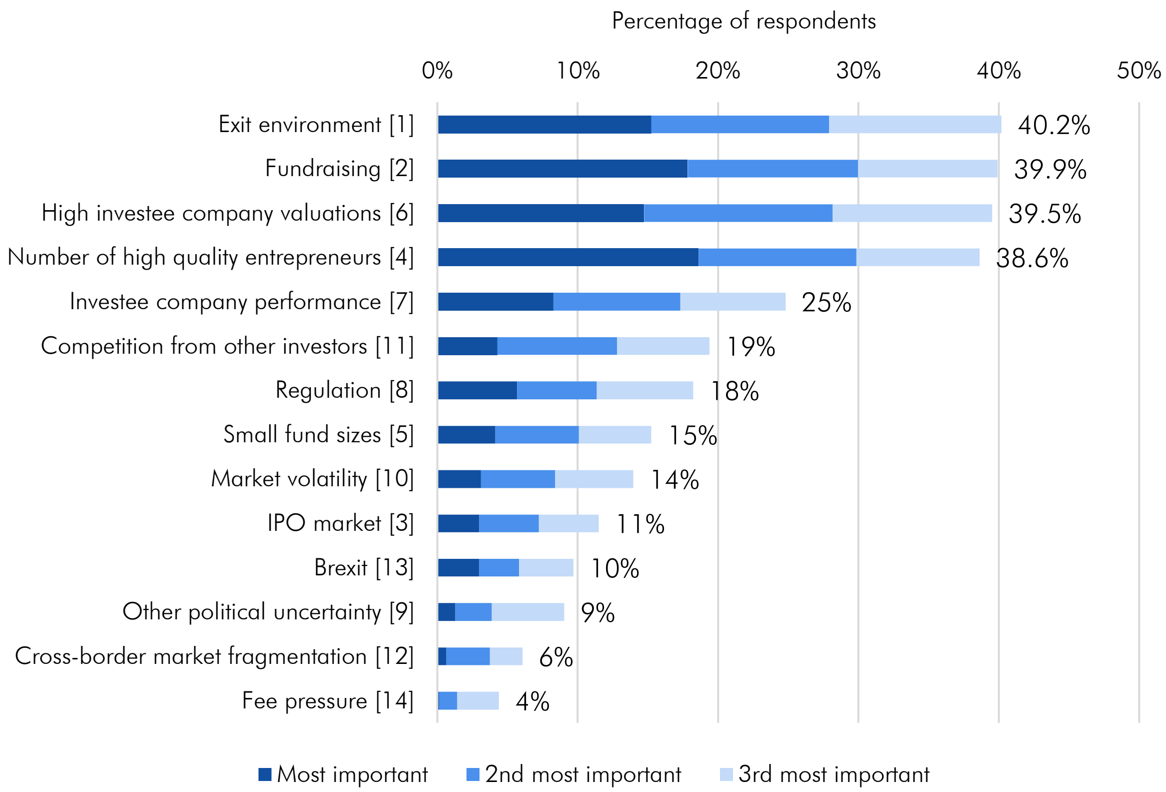


3.4 Important challenges in the European VC business

The exit environment and fundraising continue to be perceived as the biggest challenges in VC business (see Figure 43), with approximately 40% of European GPs ranking them as such. High investee company valuations (ranked 6th in 2018) completes the list of the top three challenges in 2019. This latter finding together with the fact that competition from other investors also gained significantly in importance (currently ranked 6th, up five places compared to 2018) point to an increasingly competitive environment in the European VC market. This is particularly the case for GPs mainly investing in ICT, CleanTech and Services (see Figure 44) as well as for later/growth-stage investors (see Figure 45). It will therefore be very interesting to monitor the evolution of this trend in subsequent survey waves.

Figure 43: Biggest challenges in VC business

Exit environment and fundraising
continue to be perceived as the biggest challenges in VC business



Note: The number in brackets [ ] corresponds to the ranking of the respective challenge in the EIF VC Survey 2018.

Q. Select up to three of the biggest challenges you currently see in venture capital business.

Figure 44: Most important challenge in VC business – by VC main target industry

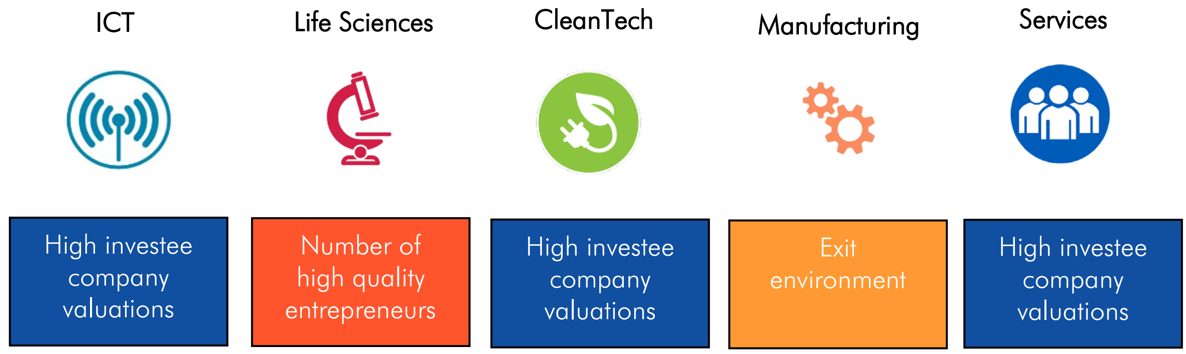
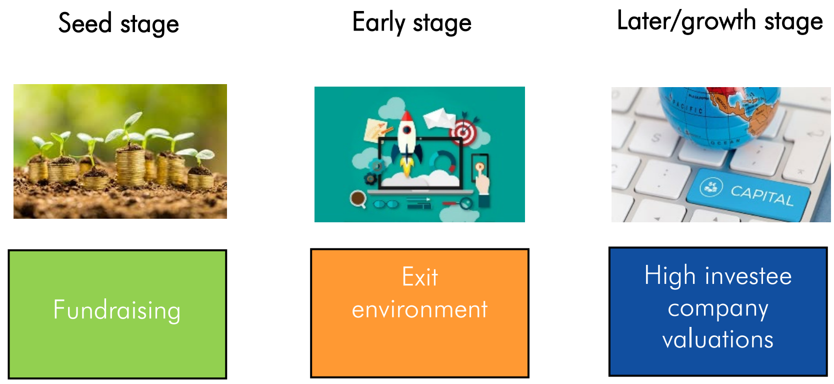


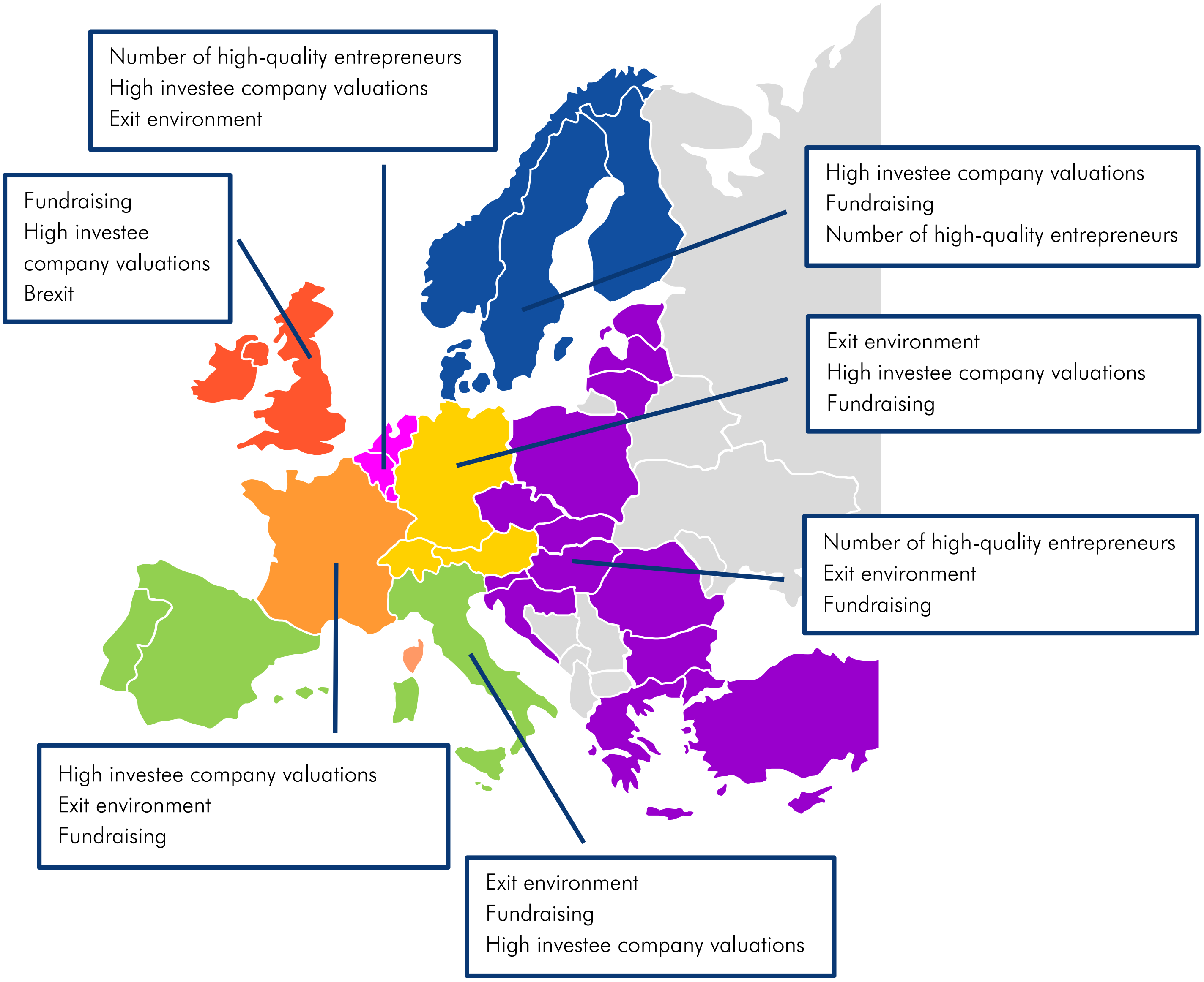
Figure 45: Most important challenge in VC business – by VC investment stage focus



A certain degree of variation regarding the relative ranking of the challenges also exists across regions (see Figure 46). Compared to 2018, the top three challenges have largely remained the same in each region.[10] Same as last year, while Brexit is ranked very low in the list of challenges for the overall sample of surveyed GPs, it is still perceived as an important challenge for VC firms headquartered in the UK & Ireland (but no longer *the* most significant challenge as was the case a year ago).

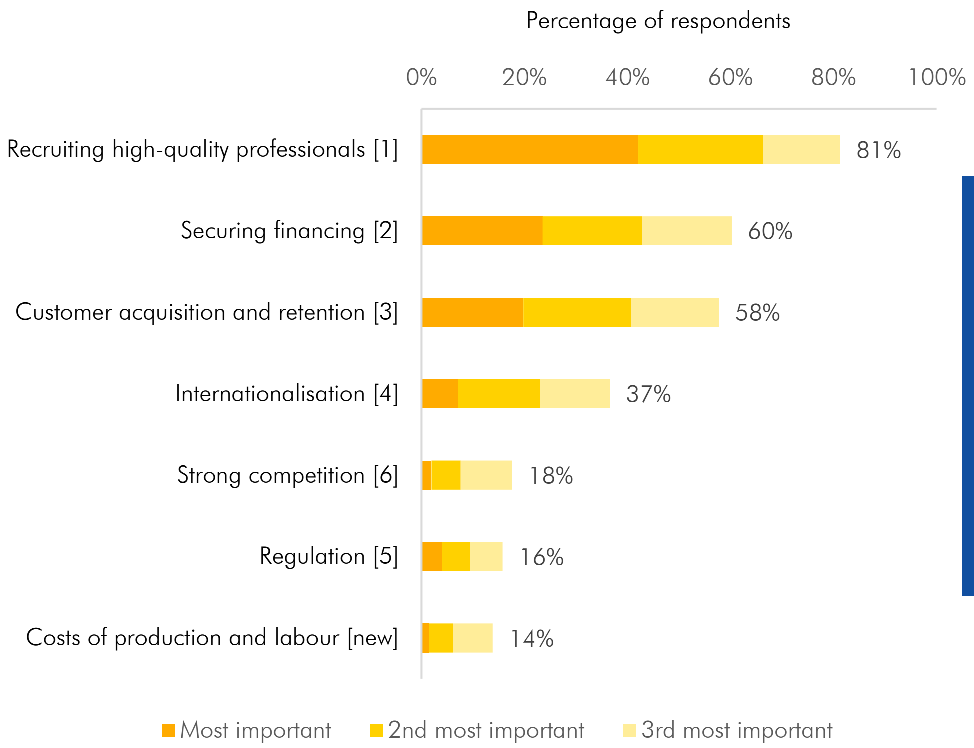
[10] The most significant changes are documented in DACH (where "high investee company valuations" and "fundraising" have replaced the "IPO market" and "regulation" in the list of the top three challenges) and in the South (where "small fund sizes" no longer appears in the top three challenges and has instead been replaced by "high investee company valuations").

Figure 46: Top 3 challenges in VC business – by VC firm headquarter



At the individual portfolio level, for the second year in a row, recruiting high-quality professionals is perceived as the number one challenge faced by investee companies (see Figure 47). The same holds true for all regions, industries and investment stages (results not presented here for the sake of brevity). Securing financing is the second most important challenge for investee companies.

Figure 47: Biggest challenges faced by portfolio companies



Recruiting high-quality professionals and securing financing continue to be perceived as the biggest challenges for investee companies

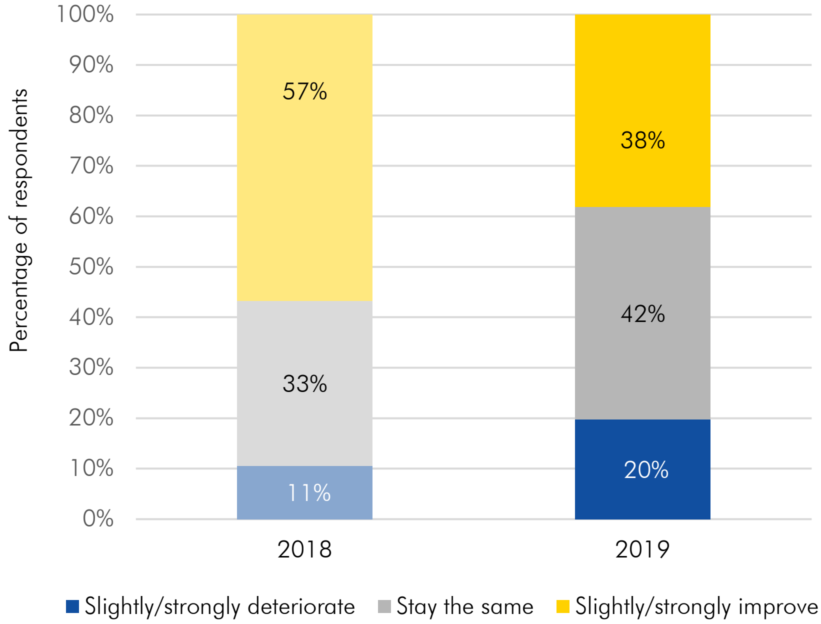
Note: The number in brackets [ ] corresponds to the ranking of the respective challenge in the EIF VC Survey 2018.

Q. What are the largest current challenges faced by your portfolio companies?

3.5 Overall prospects of the European VC market, promising countries and industries

Compared to a year ago, VC managers are relatively less optimistic regarding the prospects of the VC market in Europe. In 2019, 38% of the GPs expect that investment activities in the European VC market will improve over the next 12 months, compared to 57% in 2018 (see Figure 48). Furthermore, the percentage of GPs who expect investment activities to deteriorate has doubled (1 in 5 GPs in 2019, compared to 1 in 10 in 2018).

Figure 48: Investment activities in the European VC market over the next 12 months



Investment activities expected, on balance, to improve in the next 12 months, but the share of pessimistic VCs has increased since 2018

Q. Over the next 12 months, what do you expect to happen to investment activities in the European venture capital market?

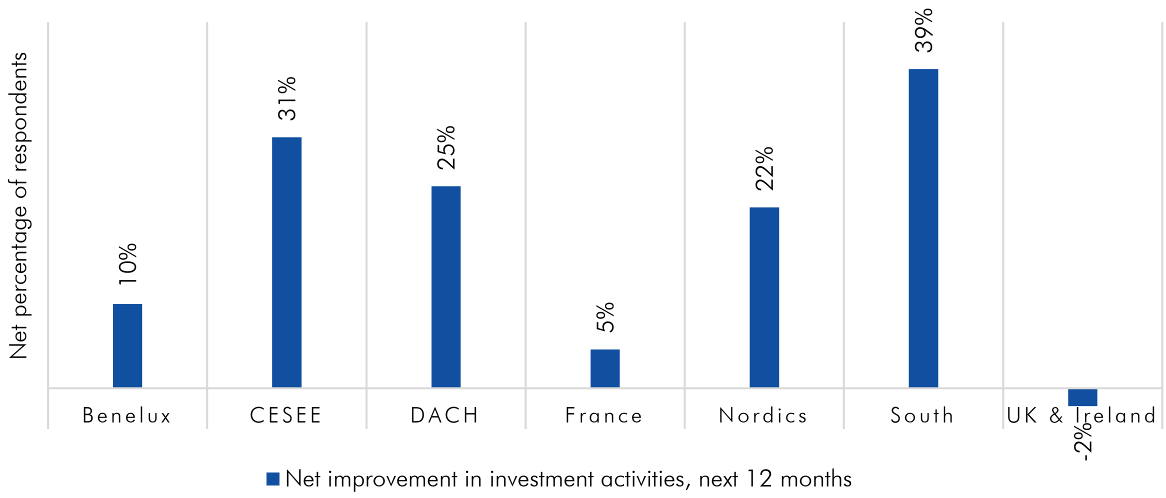
In this respect, the regional, sectoral and investment-stage variations are noteworthy and they echo to a significant extent the results reported earlier regarding the GPs' future state of business (see Figure 11 to Figure 13).

Indeed, according to Figure 49, VC managers in the South (39%, on balance) and CESEE (31%, on balance) appear to be the most optimistic regarding future investment prospects, as opposed to VCs in France (only 5%, on balance) and in the UK & Ireland (who actually expect a deterioration of investment activities in the European VC market).

When industry focus is taken into consideration (see Figure 50), VC managers investing mainly in Life Sciences (22%, on balance) and ICT (20%, on balance) expect an improvement of the VC investment activities in Europe, while, at the other end of the spectrum, VCs investing mainly in Manufacturing expect, on balance, a deterioration.

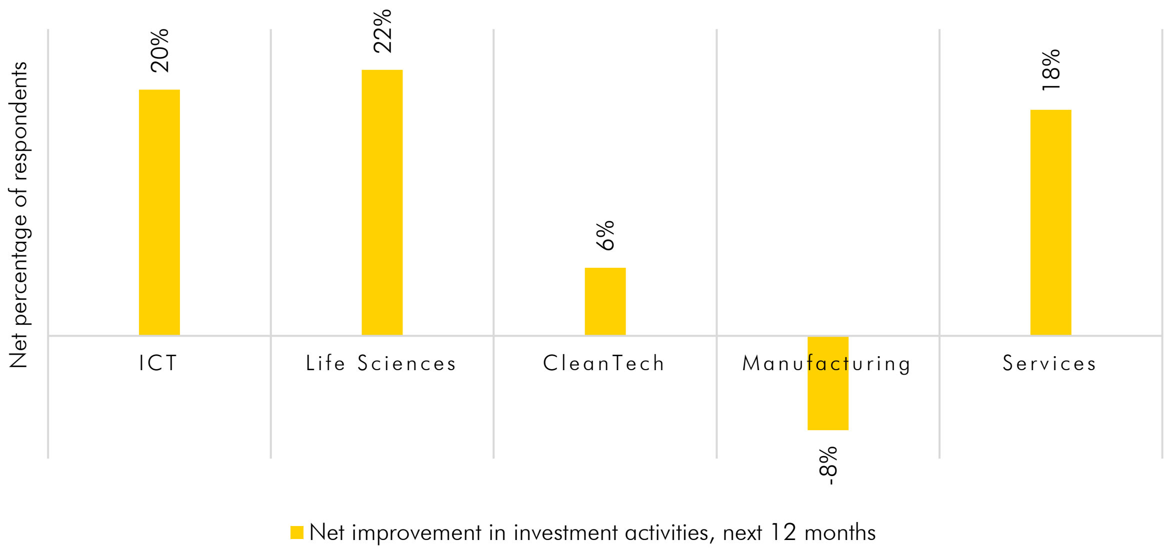
Finally, later/growth-stage GPs (see Figure 51) also appear more conservative in their expectations, as opposed to GPs focusing on other investment stages.

Figure 49: Investment activities in the European VC market (net balance), next 12 months – by VC firm headquarter



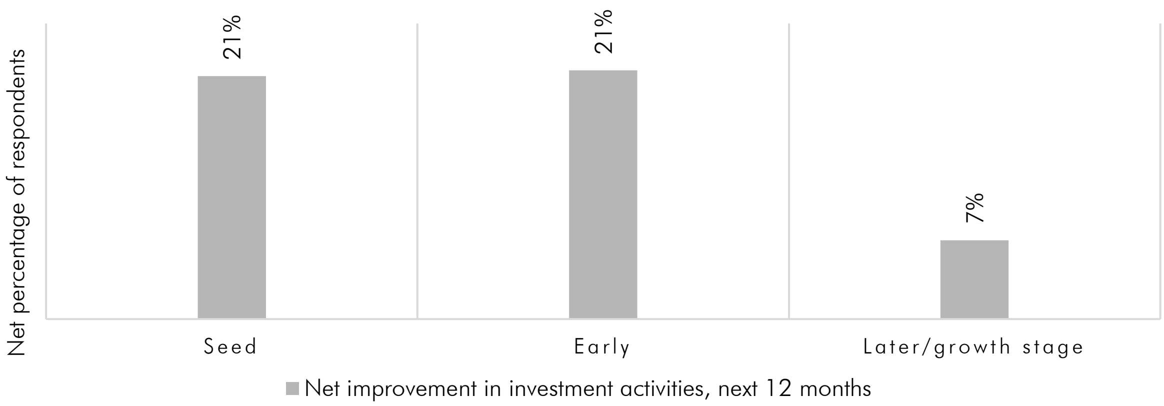
Note: "Net improvement in investment activities, next 12 months" reflects the percentage of respondents expecting investment activities in the European VC market to "slightly" or "strongly improve" over the next 12 months minus the percentage of respondents expecting investment activities in the European VC market to "slightly" or "strongly deteriorate" over the next 12 months (a negative net value suggests a deterioration).

Figure 50: Investment activities in the European VC market (net balance), next 12 months – by VC main target industry



Note: "Net improvement in investment activities, next 12 months" reflects the percentage of respondents expecting investment activities in the European VC market to "slightly" or "strongly improve" over the next 12 months minus the percentage of respondents expecting investment activities in the European VC market to "slightly" or "strongly deteriorate" over the next 12 months (a negative net value suggests a deterioration).

Figure 51: Investment activities in the European VC market (net balance), next 12 months – by VC investment stage focus



Note: "Net improvement in investment activities, next 12 months" reflects the percentage of respondents expecting investment activities in the European VC market to "slightly" or "strongly improve" over the next 12 months minus the percentage of respondents expecting investment activities in the European VC market to "slightly" or "strongly deteriorate" over the next 12 months (a negative net value suggests a deterioration).

GPs who participated in the survey were further asked to indicate on a scale of 1 to 10 their level of confidence in the long-term growth prospects of the VC industry in their market and in Europe altogether (see Figure 52). As far as confidence in the long-term growth prospects of the European VC industry is concerned, VC managers continue to be relatively optimistic – mean value of 7.47 out of 10 (2018: 7.53/10); and even more so about the long-term growth prospects of the VC industry in their own market – mean value of 7.71 out of 10 (2018: 7.82/10).

This pattern (i.e. GPs being more confident about the long-term growth prospects of their own market rather than about Europe altogether) generally holds true across regions, sectors and investment stages, with the exception of GPs in the South (see Figure 53) and those mainly investing in Manufacturing (see Figure 54).

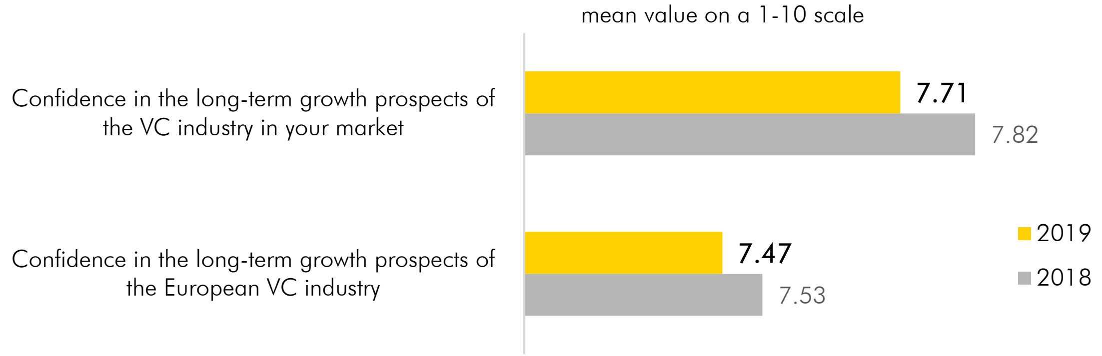
When we analyse the GPs' own market in terms of the headquarter location of their VC firm (see Figure 53), we note that it is GPs in the DACH (8.0/10), Benelux and the Nordics (both at 7.9/10) who exhibit, on average, the highest levels of confidence in the long-term growth prospects of their market, as opposed to GPs in the UK & Ireland (7.3/10) and France (7.2/10).

When the sectoral focus is taken into account (see Figure 54), VCs investing mainly in ICT (CleanTech) are the most (least) confident about future prospects in their respective markets.

Finally, later/growth-stage fund managers (see Figure 55) are once again relatively more conservative (7.3/10) in their perceptions.

Figure 52: Confidence in the long-term growth prospects of the VC industry in your market and in the European VC industry

GPs more confident about the long-term growth prospects of the VC industry in their own market rather than Europe altogether



Q. On a scale of 1 to 10, how confident are you in the long-term growth prospects of the venture capital industry in your market? (1 = Not confident at all; 10 = Very confident)
Q. On a scale of 1 to 10, how confident are you in the long-term growth prospects of the European venture capital industry? (1 = Not confident at all; 10 = Very confident)

Figure 53: Confidence in the long-term growth prospects – by VC firm headquarter

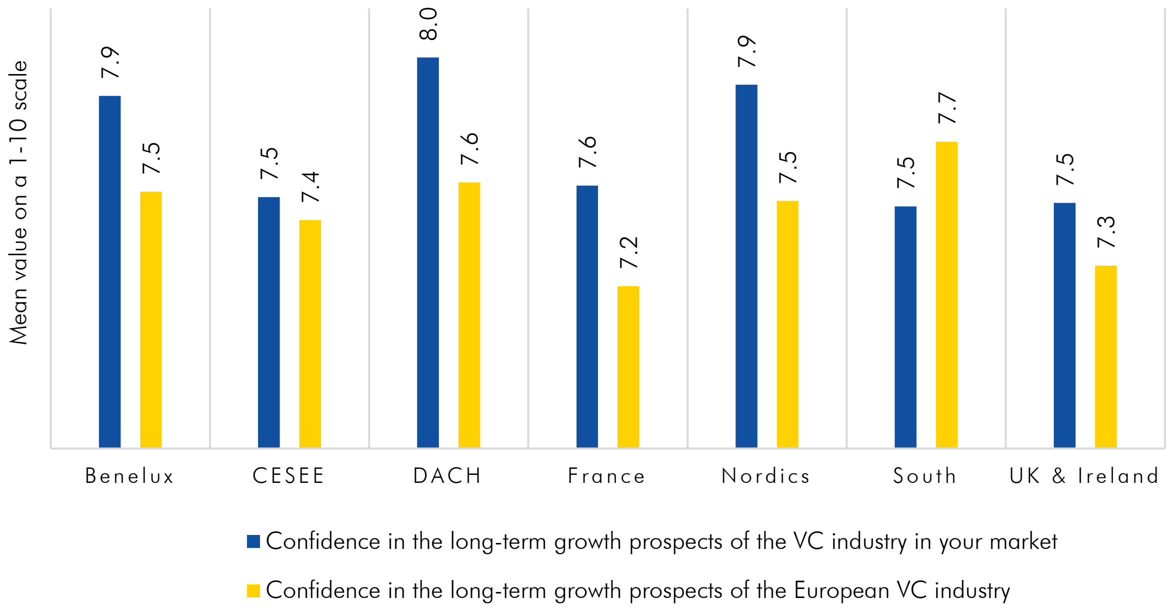


Figure 54: Confidence in the long-term growth prospects – by VC main target industry

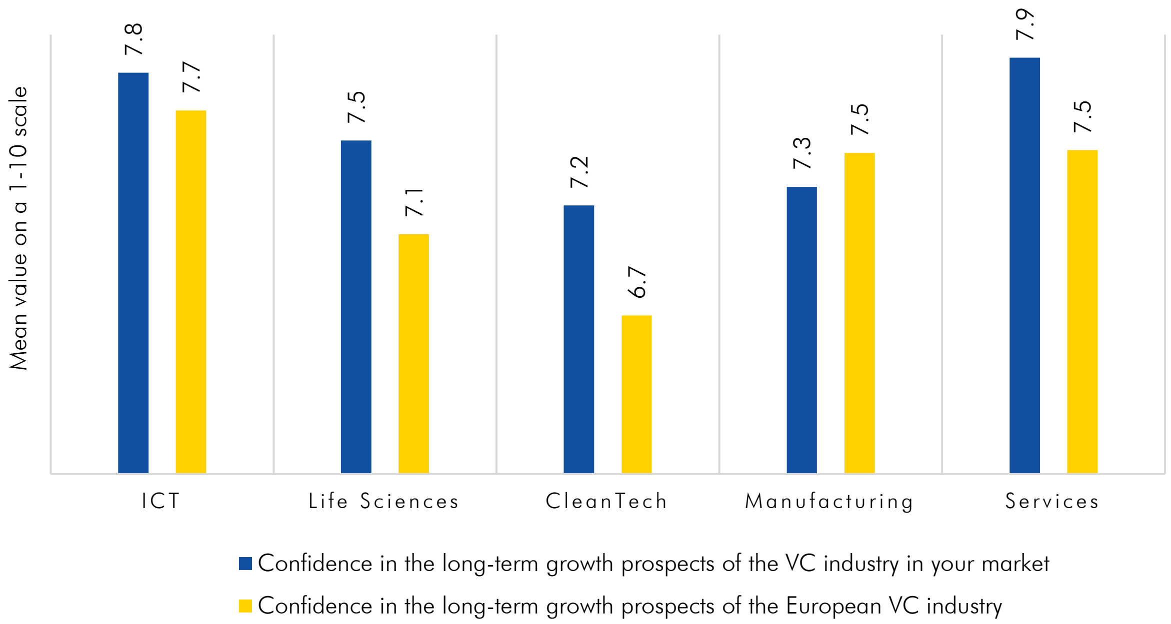
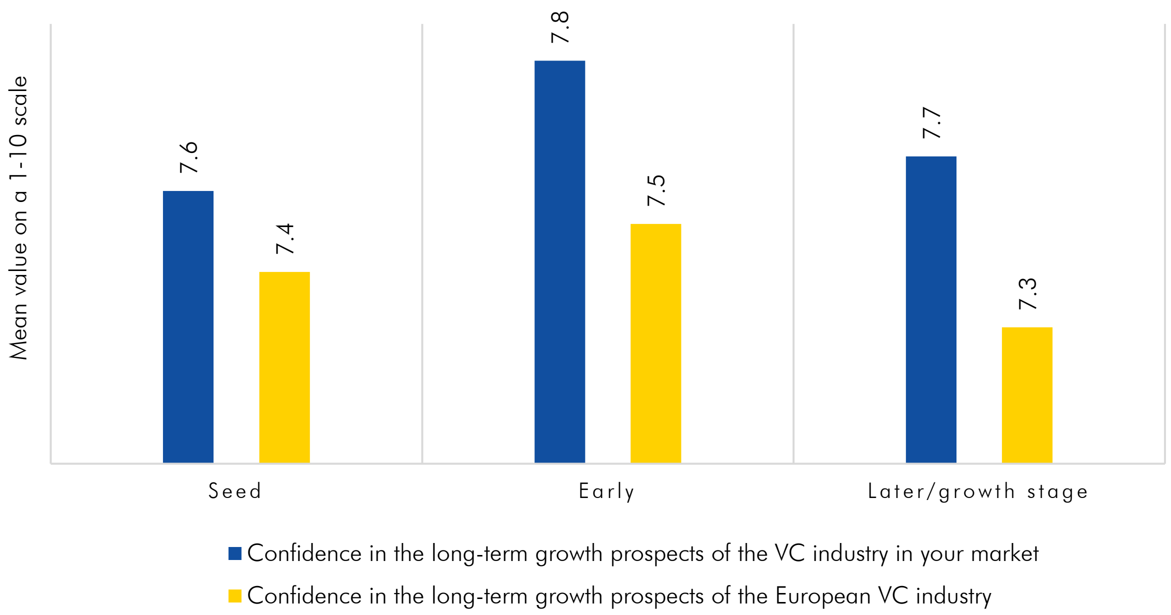
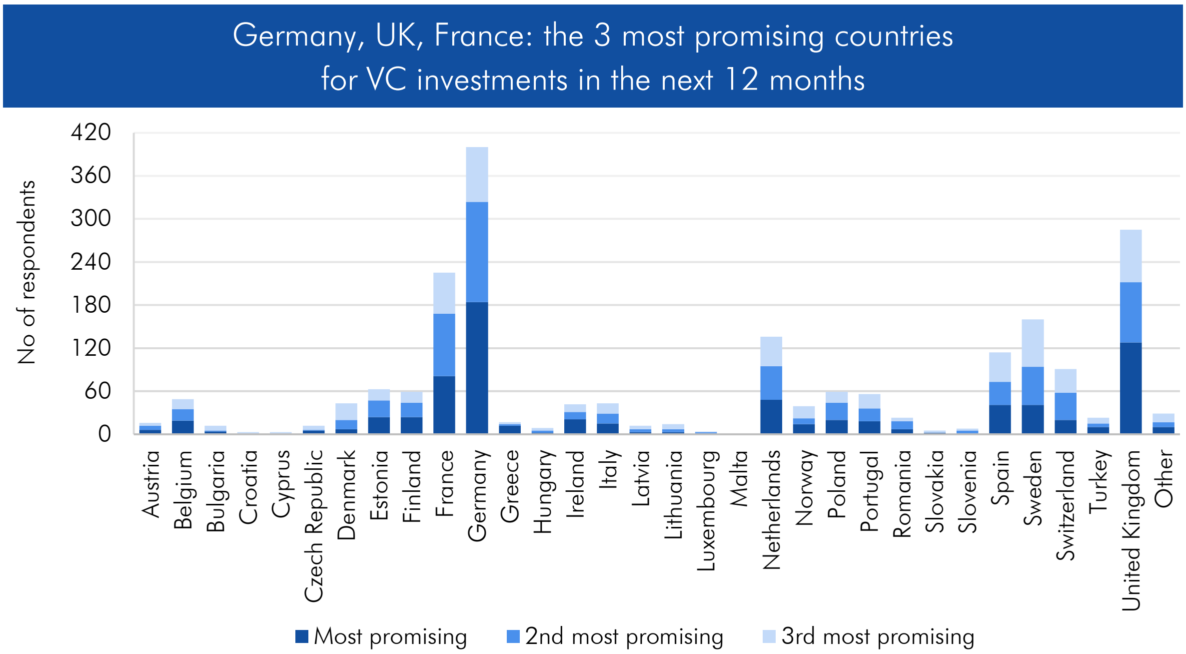


Figure 55: Confidence in the long-term growth prospects – by VC investment stage focus



In the context of the overall prospects, VC managers were also asked to indicate the countries that they would consider most promising for future VC investments. For the second year in a row, Germany topped the list of most promising countries (see Figure 56). Indeed, Germany was flagged as a promising country for VC investments over the next 12 months by 1 in 2 surveyed VC managers (with 1 in 4 indicating Germany as *the* number one most promising country), followed by the UK and France.

Figure 56: Most promising countries for VC investments over the next 12 months

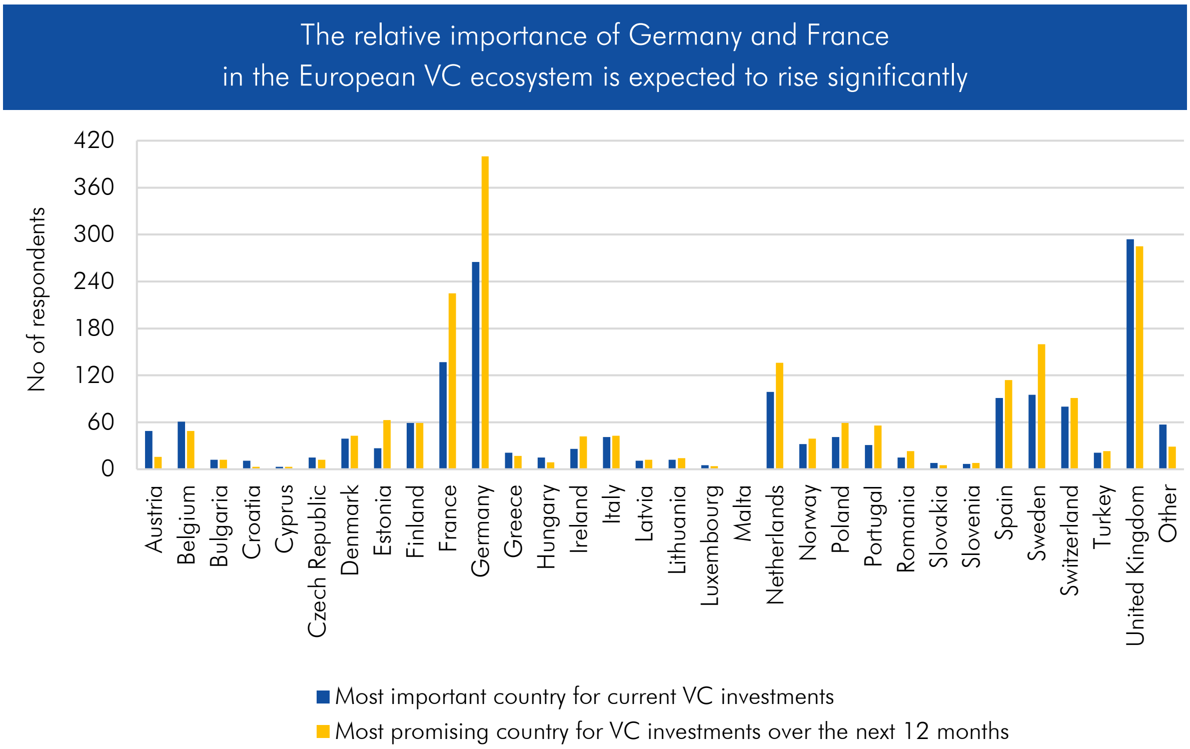


Q. According to your expectation, select up to three European countries that will be the most promising for venture capital investments over the next 12 months.

Comparing the most important countries in which VC managers currently invest with those expected to be most promising for future VC investments enables us to reflect on the extent to which a change in country focus might take place (see Figure 57). Indeed, while the UK, Germany and France are currently the most important countries for VC investments in Europe and are still expected to be the most promising countries for future VC investments, their relative importance might change. The relative significance of Germany, in particular, in the European VC ecosystem is expected to rise strongly, and so is that of France.

In a follow-up, free-text question, VCs were asked to specify their rationale for choosing the most promising country for future VC investments. In the case of Germany, in particular, GPs commented upon its large and mature VC market as well as upon its quality start-up ecosystem, with a good number of experienced entrepreneurs and potential investee companies available. GPs also referred to the possibility of increased opportunities as a result of the Brexit uncertainty. These reasons help explain why Germany's leading position as a promising country for future VC investments goes well beyond a so-called "home bias", meaning that many more GPs consider Germany as a promising country compared to those who already target Germany for their current VC investments.

Figure 57: Most important countries for VC investments – current vs. future portfolio



Q. Select up to three of the most important countries in which your firm invests in venture, in order of importance.
Q. According to your expectation, select up to three European countries that will be the most promising for venture capital investments over the next 12 months.

Taking into consideration the headquarter location of the respondents' VC firm, we can also identify more regional VC hubs such as the Netherlands for GPs in Benelux (see Figure 58), Sweden for GPs in the Nordics (see Figure 59), Poland and Estonia for GPs in CESEE (see Figure 60) and Spain for GPs in the South (see Figure 61).

We finally take into account the industry focus of the VC managers and present accordingly the countries perceived most promising for future VC investments by VCs investing mainly in ICT and in Life Sciences (the two sectors that together make up 85% of the sample). The pattern observed for the entire sample (where Germany, the UK and France are identified as the three most promising countries) holds for the ICT sector too (see Figure 62). For Life Sciences, alongside these latter markets, two more countries also emerge as important and promising, namely the Netherlands and Switzerland (see Figure 63).

Figure 58: Most promising countries for VC investments over the next 12 months – responses from GPs in Benelux

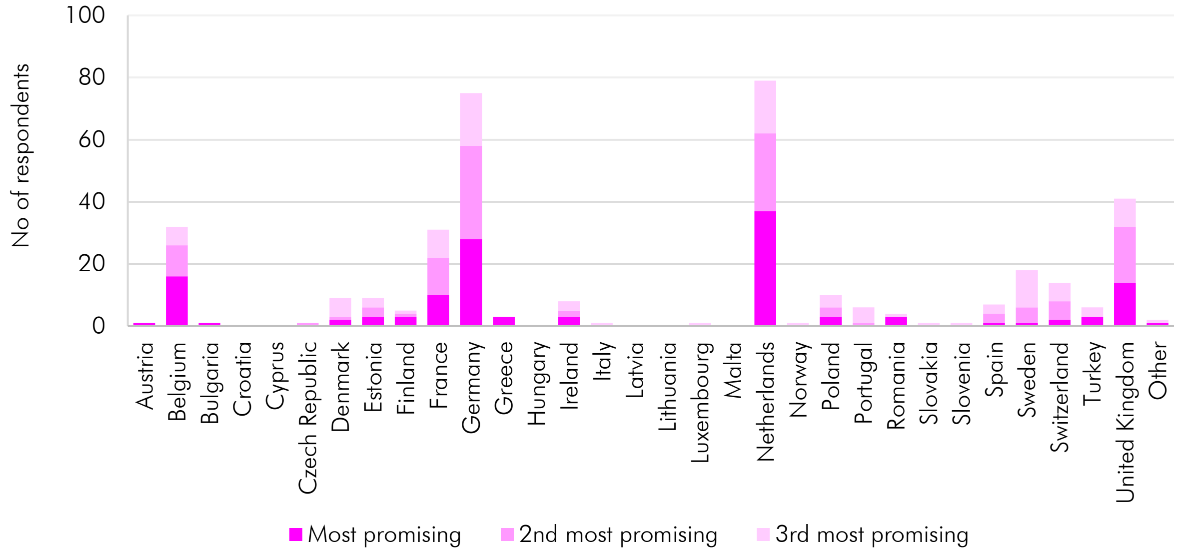


Figure 59: Most promising countries for VC investments over the next 12 months – responses from GPs in the Nordics

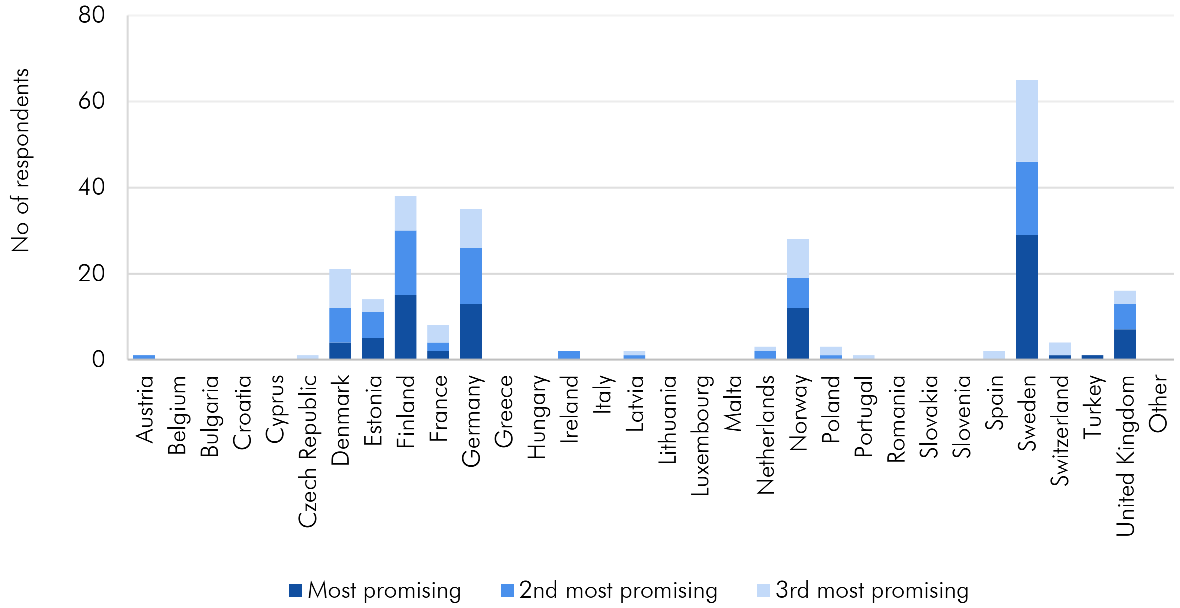


Figure 60: Most promising countries for VC investments over the next 12 months – responses from GPs in CESEE

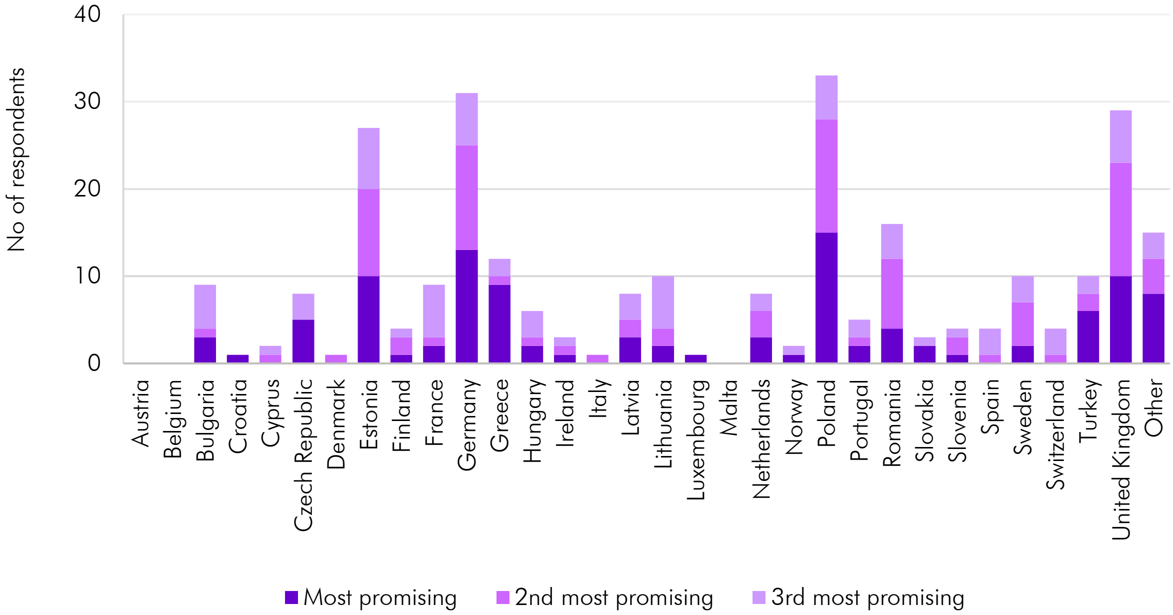


Figure 61: Most promising countries for VC investments over the next 12 months – responses from GPs in the South

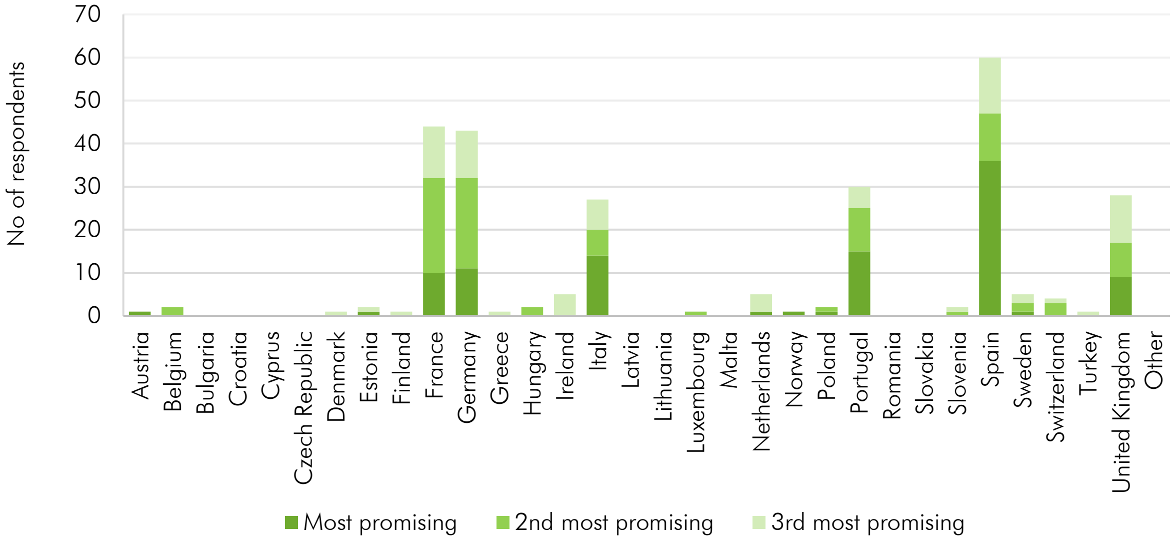


Figure 62: Most promising countries for VC investments in ICT, next 12 months

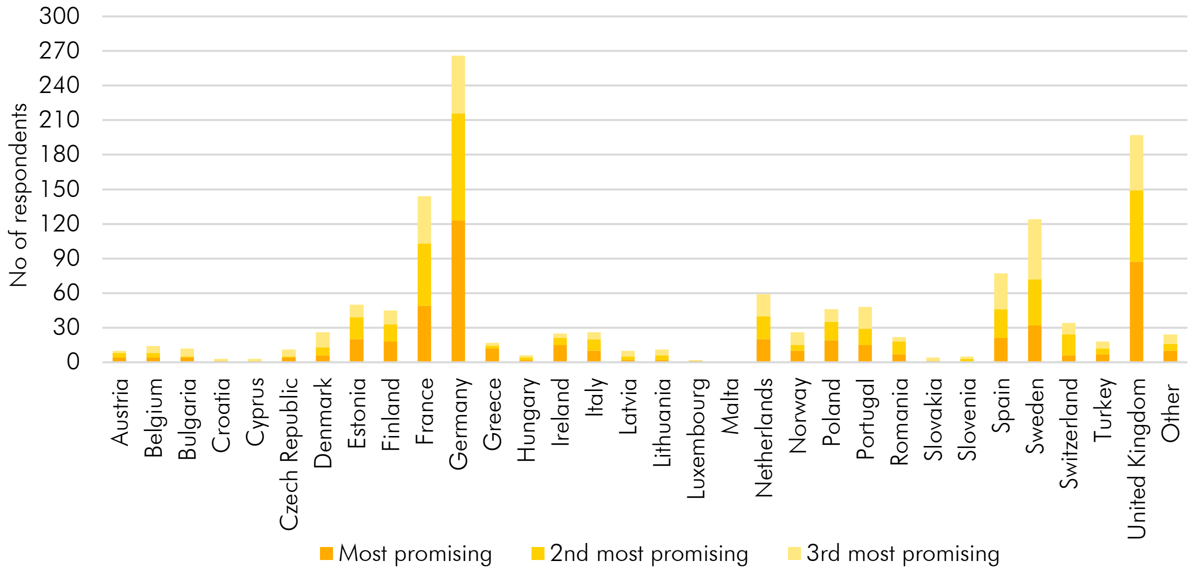
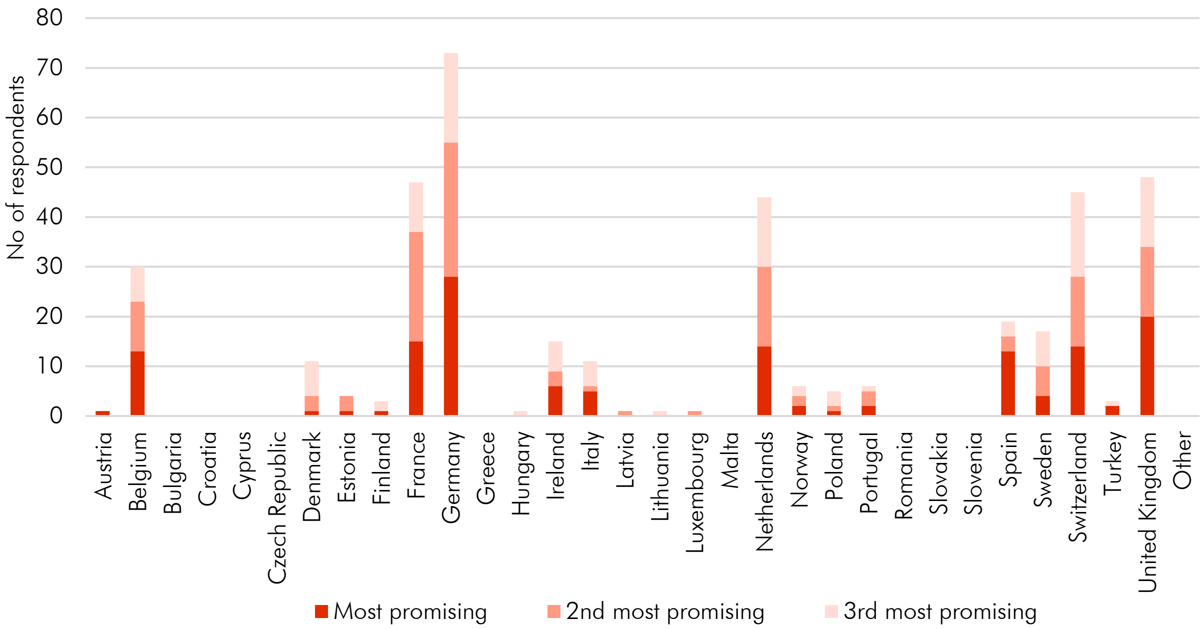
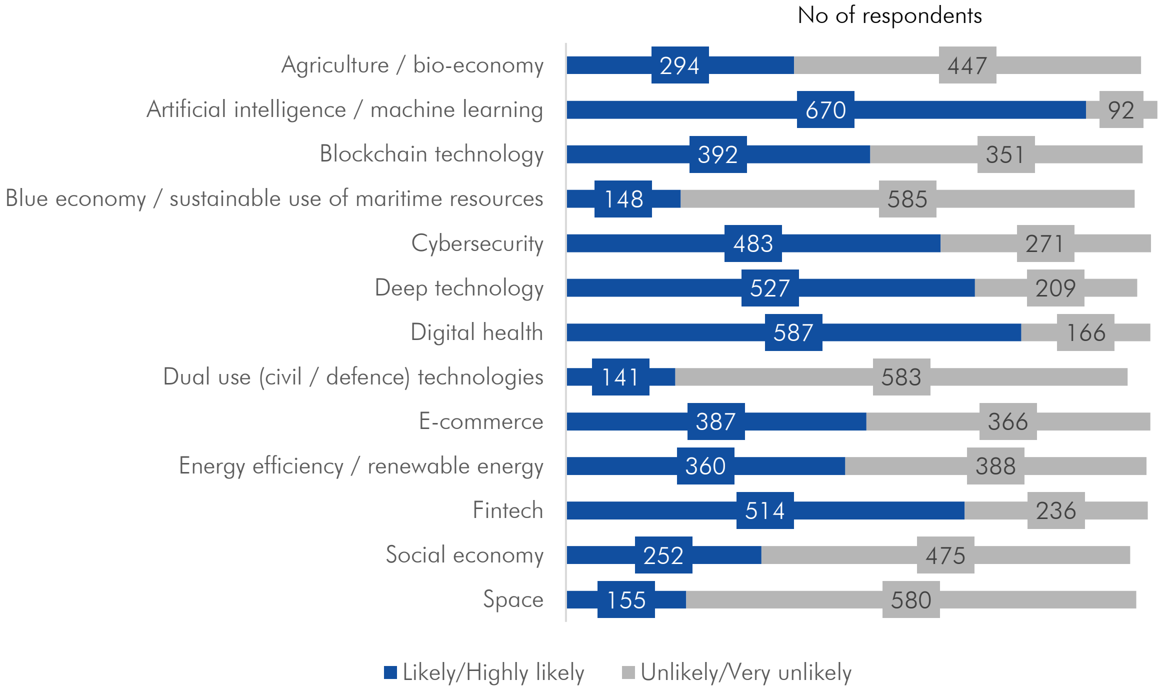


Figure 63: Most promising countries for VC investments in Life Sciences, next 12 months



Apart from the already established VC target industries, VC managers were asked to comment on a series of some more specific areas of investment. More specifically, fund managers indicated how likely they consider it that their final portfolio will include an investee in these areas (see Figure 64). Based on the responses, it is more likely that future VC investments will involve portfolio companies in the areas of Artificial Intelligence, Digital Health, Deep Technology and Fintech.

Figure 64: Likelihood for future portfolio to include an investee in specific industries



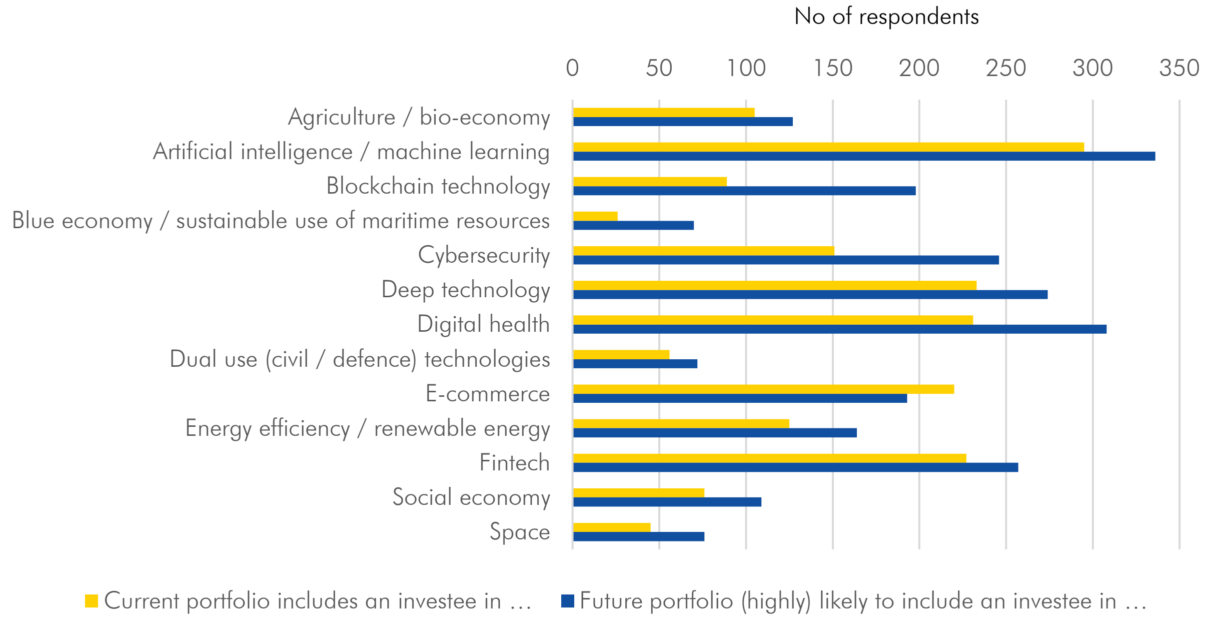
Q. How likely do you consider it that your final portfolio will include an investee in the area of …

Not surprisingly, the aforementioned trend is influenced by the GPs' current industry focus – with ICT being the dominant sector in the sample. Results not presented here for the sake of brevity show that the final portfolio of VC managers investing mainly in Life Sciences is more likely to include investee companies in Digital Health, while VCs currently focusing on Clean Technologies are more likely to include investee companies in the areas of Energy Efficiency and Renewable Energy in their future portfolios.

Taking everything into consideration, by comparing the number of respondents who state that their current portfolio includes an investee in a particular area to the number of those who consider it (highly) likely that their future portfolio will include an investee in that same area, we note that while a significant number of investees already are and will continue to be in Artificial Intelligence, Digital Health, Deep Technology and Fintech, in the future an increasing number of investees (compared to the current situation) in Blockchain and Cybersecurity can be expected (see Figure 65).

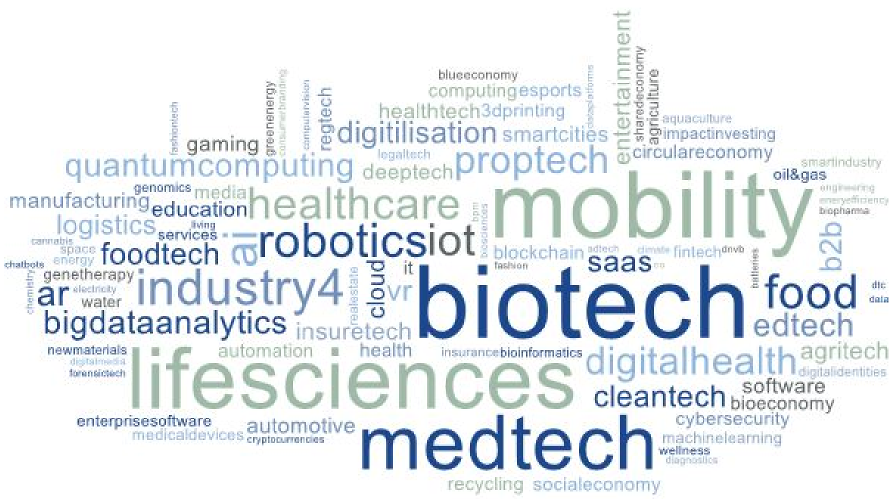
VC managers were finally given the opportunity to provide their free-text response regarding other areas that they would consider promising for VC investments in the near future. In this case too, technology-related areas, in particular in the context of Life Sciences (BioTech, MedTech, etc.) feature prominently (see Figure 66).

Figure 65: Likelihood for portfolio to include an investee in specific industries – current vs. final portfolio



Q. Does your current investment portfolio include an investee in the area of …
Q. How likely do you consider it that your final portfolio will include an investee in the area of …

Figure 66: Other promising areas for future VC investments[11]



More technology-related areas in the context of Life Sciences also promising in the near future

Note:
AI: Artificial Intelligence; AR: Augmented Reality; B2B: Business-to-Business; IoT: Internet of Things; SaaS: Software as a Service; VR: Virtual Reality.

Q. What other area do you consider promising in the near future?

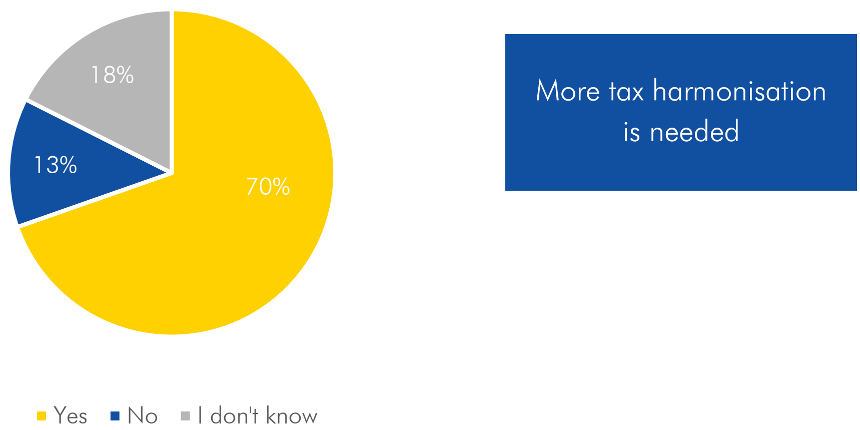
[11] The Figure was generated using Wordcloud whereby the bigger the font size the more frequently the respective answer was mentioned in the free-text field.

4 Role of the public sector: Tax and regulatory interventions in European VC

The *EIF VC Survey 2018* covered extensively the topic of the role of the public sector in the European VC market and provided fund managers with the opportunity to express their views on the existing public interventions. A key message that emerged from this analysis is that while VC managers do share general optimism about the European VC market, they still perceive it as underdeveloped and not dynamic enough. They therefore argued that public support could play a role in stimulating the VC ecosystem in Europe by providing more public resources and by offering tax incentives and ensuring simplified and harmonised regulatory systems. For example, in the context of last year's survey wave, when fund managers were asked to indicate which elements of the ecosystems helpful for venture capital are particularly underdeveloped in Europe, "supporting tax systems" featured in the top two. A similar pattern, i.e. a call for increased harmonisation across the EU28 countries with respect to legal frameworks and tax systems, was also documented when fund managers were asked to comment about which governmental support activities are missing in the European market.

Taking into consideration the aforementioned feedback from fund managers, the *EIF VC Survey 2019* aimed at deriving concrete policy recommendations as to how this harmonisation could be achieved. In the following, we present the results of the related *EIF VC Survey* questions. These reflect the responses of the surveyed fund managers and are not necessarily endorsed by the EIF. To begin with, this year's findings confirm the earlier evidence that in the field of tax regulation, harmonisation is very important, given that 70% of the respondents are indeed in favour of more tax harmonisation across the EU (see Figure 67).

Figure 67: More tax harmonisation across the EU



Q. Do you think that tax regulation should be more harmonised throughout the EU?

In follow-up open-ended questions, fund managers were given the opportunity to provide their free-text responses about which parts of tax regulation are in need of more EU-wide harmonisation and about the kind of tax incentives that are necessary to make VC a more attractive asset class. The fund managers' responses can be classified into three categories, namely suggestions at the investor level, at the GP level and finally at the portfolio company level (see Box 1).

Box 1: Tax-related interventions and tax incentives that are needed to make VC a more attractive asset class. Free-text responses: main patterns[12]

Investor level:

- Tax harmonisation for capital gains
- Tax reliefs for seed/early-stage investments
- Possibility to offset losses against income tax on other sources (or to be carried over)

GP level:

- Taxation of carried interest as a capital gain
- Removal of VAT on management fees

Portfolio company level:

- Reduce/harmonise corporate income taxation
- Employee stock option plans

Q. For which part of tax regulation would you consider more EU-wide harmonisation most important? Please provide concrete examples or recommendations.
Q. What kind of tax incentives would be needed to make VC a more attractive asset class? Please provide concrete examples or recommendations.

Perhaps not surprisingly, a common theme across all three categories is a call to reduce taxation. At the investor level, for example, fund managers suggest that the provision of tax reliefs, particularly in the case of seed and early-stage investments, could help attract more LPs. In this respect, many fund managers refer to the UK's EIS (Enterprise Investment Scheme) or SEIS (Seed Enterprise Investment Scheme) as good practice examples.

At the GP level, taxation of carried interest as a capital gain (and not as a salary/bonus component) is also in the direction of tax reduction – and has indeed been recently implemented in certain regions of the EU.[13]

Finally, at the portfolio company level, many fund managers highlighted the discrepancy in the tax treatment of Employee Stock Option Plans (ESOPs) between Europe (where stock options are taxed at the award date) and the US (where this is done at the exercise of the option, when the money is actually received – usually when the portfolio company goes public or gets acquired). The main benefit of changing the tax treatment of ESOPs in Europe would be an increase in the capacity to attract and retain best talents in start-ups. A change in the time at which ESOPs are taxed would also

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[12] The reported suggestions reflect the views of the surveyed fund managers and are not necessarily endorsed by the EIF. See European Commission (2017), Effectiveness of tax incentives for venture capital and business angels to foster the investment of SMEs and start-ups, doi: 10.2778/51300, for a general overview of best practices in specific VC-related tax policies. AFME (2017), The Shortage of Risk Capital for Europe's High Growth Businesses, summarises existing tax incentive systems for VC in Europe and provides policy recommendations to facilitate investments in European VC.

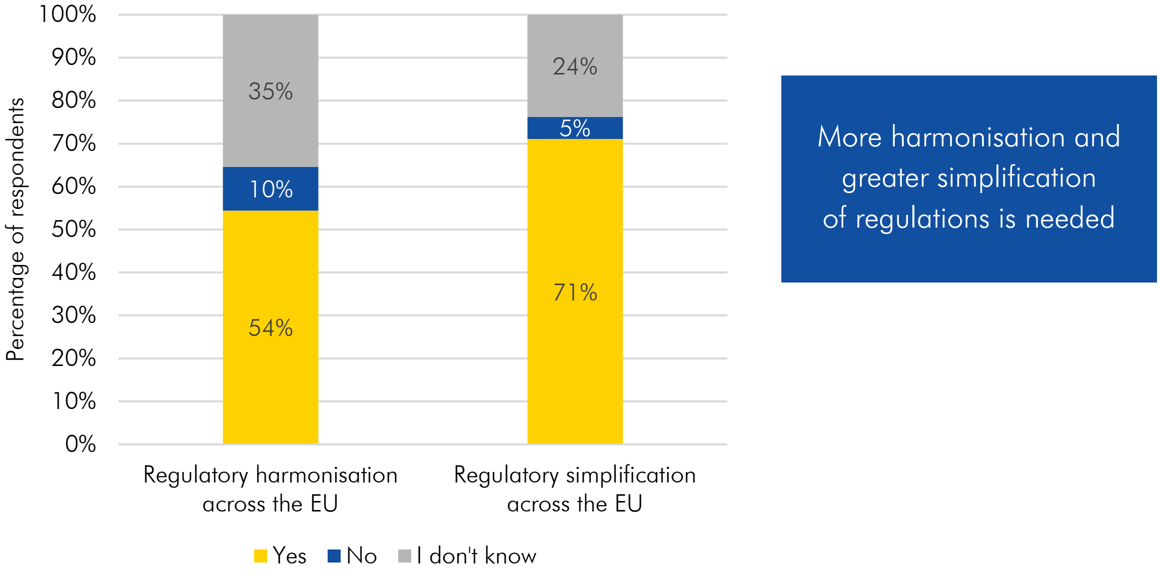
[13] The carried interest, which is a share of a fund's profits at the time of sale that is kept by the GP, helps align GPs' and LPs' incentive structures (Gabison, G.A., Venture Capital Principles in the European ICT Ecosystem, JRC Science for Policy Report, 2015). High carried interest taxation can distort such incentive structures and induce the creation of complex investment structures. Moreover, high taxation reduces a GP's income available for start-up investments. In the US, carried interest is generally taxed at reduced long-term capital gains rates (as opposed to ordinary income rates) if certain requirements are met (Invest Europe, Tax Benchmark Study 2018, Edition June 2018).

increase the funds that start-ups have available for investing.[14] Moreover, it could lead to less concentrated wealth distribution among a company's employees in the event of an exit.

When it comes to other regulations, GPs are also in favour both of more harmonisation as well as of greater simplification across the EU (see Figure 68). In the case of regulation, however, it seems that simplification is relatively more important than harmonisation, given that a greater percentage of respondents agree that regulatory simplification is indeed needed (71%) compared to the percentage of respondents who support regulatory harmonisation (54%).

Among the key areas identified by the respondents (see Box 2) are easing the requirements to establish new VC firms and reducing the regulatory burden associated with reporting to the authorities (particularly for smaller VC firms). Stringent regulations regarding fundraising and marketing of the fund are also frequently mentioned. For example, some fund managers state that AIFMD (Alternative Investment Fund Managers Directive) rules are often interpreted differently in different jurisdictions. Finally, fund managers call for measures to overcome the cross-border market fragmentation of the European VC market, such as facilitating cross-border investments and ensuring greater flexibility in the labour law when it comes to hiring and firing.

Figure 68: More regulatory harmonisation and simplification across the EU



Q. Do you think that other regulations should be more harmonised throughout the EU?
Q. Do you think that other regulations should be simplified?

[14] Taxation of ESOPs at the award date can imply liquidity problems and even enforce the taxpayer to take up a loan in order to be able to pay the taxes on theoretical income that might actually never be realised in reality. See European Commission, Employee Stock Options: The legal and administrative environment for Employee Stock Options in the EU, Final Report of the Expert Group, June 2003, for an elaborated discussion.

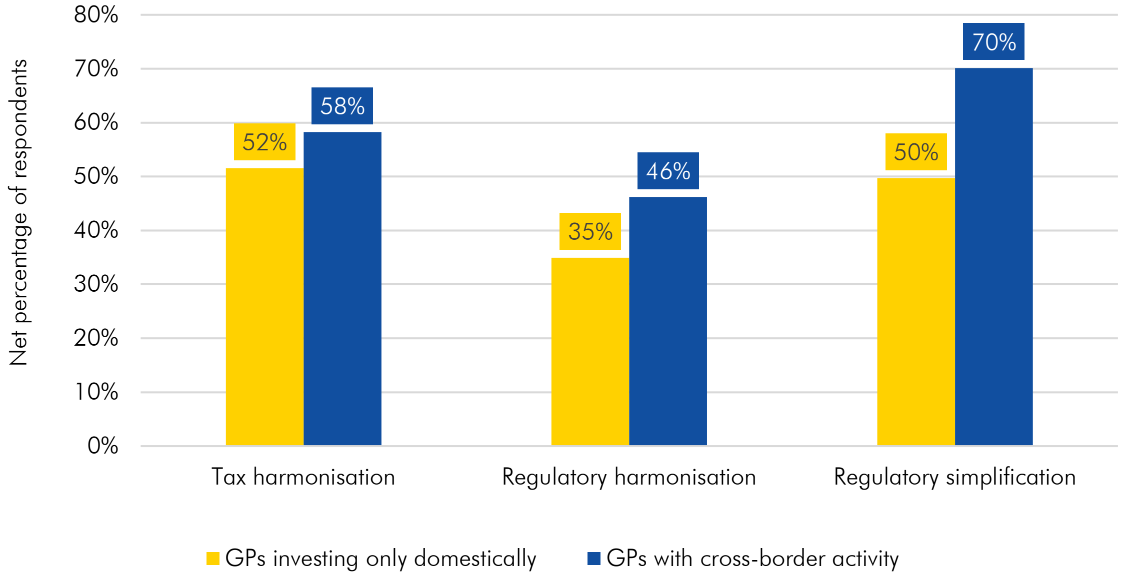
Box 2: Key areas for regulatory harmonisation and simplification. Free-text responses: main patters

- Less strict requirements to establish new VC firms
- Fundraising and marketing of the fund
- Reporting to authorities – particularly for small VC firms
- Investing across countries
- Labour law (applied to start-ups)

Q. Please provide concrete examples or recommendations regarding which regulations could be more harmonised throughout the EU and in what way.
Q. Please provide concrete examples or recommendations regarding which regulations could be simplified and in what way.

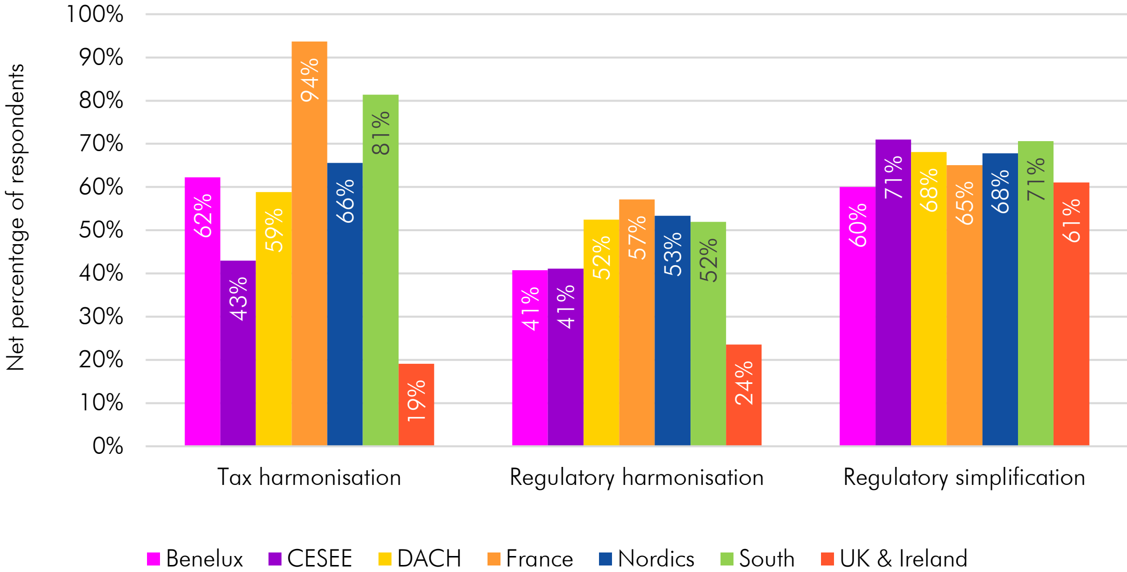
It is worth mentioning that GPs who undertake cross-border investments are more in favour of harmonisation and simplification in taxation and other regulations (see Figure 69) compared to GPs who only invest domestically. Furthermore, when the headquarter location of the VC firm is taken into account (see Figure 70), while there is general consensus across regions that regulations should be simplified, there is greater variation in the responses concerning the element of harmonisation. In particular, GPs in France are most in favour of harmonisation (in both tax and other regulations) contrary to GPs in the UK & Ireland.

Figure 69: Policy recommendations – Impact of the nature of the GPs' investment activity



Note: The reported percentages reflect the net percentage of respondents in each category, i.e. the percentage of respondents who agree that more tax harmonisation/regulatory harmonisation/regulatory simplification is needed minus the percentage of respondents who disagree. "GPs investing only domestically" refers to GPs that only invest in the country of their VC firm's headquarter location; "GPs with cross-border activity" refers to GPs that also invest in countries outside the country of their VC firm's headquarter location.

Figure 70: Policy recommendations – Impact of the GPs' VC firm headquarter location



Note: The reported percentages reflect the net percentage of respondents in each category, i.e. the percentage of respondents who agree that more tax harmonisation/regulatory harmonisation/regulatory simplification is needed minus the percentage of respondents who disagree.

5 Concluding remarks

Following the launch of the first *EIF VC Survey* in 2018, the *EIF VC Survey 2019* was designed to provide further insights into the European VC market, its state of business and market activity. The survey's aim was to identify the current challenges faced by fund managers and VC-supported companies, including their barriers to access finance. Moreover, the project intended to communicate concrete policy recommendations regarding regulatory and tax-related issues in the VC business.

Despite the different sample size and underlying population of the respondents between the current and the previous survey wave, this year's results are generally in line (both qualitatively and quantitatively) with last year's findings and confirm that, on average, VC managers are rather optimistic in their perception of the current market situation as well as of future outlook. The current and future state of business are evaluated positively, portfolio companies have been developing in line with expectations, most VCs intend to raise another fund in the near future and new investments are expected to increase in the next 12 months. Moreover, fund managers are rather confident about the long-term growth prospects of the VC industry in their market and in Europe altogether. However, it should be noted that there are sometimes substantial differences in the responses by country, sector and investment stage focus.

At the same time though, challenges persist, in particular relating to fundraising and exit opportunities. Indeed, only half of the fund managers evaluate positively the current fundraising environment, while the expectations for improvement in the next 12 months appear relatively limited. Even at the portfolio level, securing financing remains the second most important challenge faced by investee companies (after recruiting high-quality professionals). The issue of available funding is more acute for VCs investing mainly in seed-stage companies. Moreover, a relatively large share of seed-stage fund managers are likely to move away from their current stage focus over the next five years, which might further decrease the availability of finance for seed-stage enterprises through VC funds. Therefore, other ways of seed-stage financing (e.g., in the form of BA financing or accelerators) might become more important, and policymakers should consider broadening public support measures accordingly. A third very important challenge that emerged from this year's survey is the high investee company valuations. This issue coupled with the fact that competition from other investors also gained significantly in importance potentially points to an increasingly competitive environment in the European VC market – a trend which remains to be confirmed by future survey waves.

The findings echo the evidence first documented in the previous survey wave that tax and regulatory incentives should be given to crowd-in LPs. Fund managers provide concrete recommendations regarding the type of such incentives and offer suggestions regarding how tax systems and legal frameworks could be further simplified and harmonised across Europe. These suggestions relate to investors, GPs and portfolio companies alike. Perhaps not surprisingly, a common theme across all three categories is a call to reduce taxation. When it comes to other regulations, it seems that simplification is relatively more important than harmonisation. At the same time, fund managers call for measures to overcome the cross-border market fragmentation of the European VC market.

Venture capital is an essential source for start-up and young companies to achieve growth and create value through innovation. The relevance of venture capital financing, not only for young and innovative companies but also for the economy as a whole, is very high. In order to improve the availability of information about this important market segment in Europe, it is envisaged to repeat this survey (at least) on an annual basis. Moreover, based on this survey, a venture capital market sentiment index (barometer) is in development and will provide the possibility to track the VC market sentiment over time. As such, this project contributes to establishing a sustainable venture capital ecosystem in Europe – a key objective of the EIF.

ANNEX

List of acronyms

- AIFMD: Alternative Investment Fund Managers Directive
- AUM : Assets Under Management
- bn: billion
- Benelux (countries): (countries of) Belgium, Netherlands and Luxembourg
- CFO: Chief Financial Officer
- CEO: Chief Executive Officer
- CESEE (countries): (countries in) Central, Eastern and South-Eastern Europe
- COO: Chief Operations Officer
- DACH (countries): (countries of) Germany, Austria and Switzerland
- EIB: European Investment Bank
- EIF: European Investment Fund
- ESG: Environmental, Social, Governance
- ESOP: Employee Stock Option Plan
- EU28: the 28 EU Member States
- EUR: Euro
- GP: General Partner
- ICT: Information and Communications Technologies
- IPO: Initial Public Offering
- LP: Limited Partner
- m: million
- Nordics: Denmark, Finland, Norway, Sweden
- PE: Private Equity
- RMA: Research & Market Analysis
- SME: Small and Medium-sized Enterprise
- South: (here) Italy, Portugal, Spain
- UK: United Kingdom
- VAT: Value Added Tax
- VC: Venture Capital

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