

# Korea Development Institute Conference

FINANCING INNOVATION-ORIENTED  
BUSINESSES TO PROMOTE ENTREPRENEURSHIP

Seoul, Korea. April 26, 2007

*Efforts to Develop Risk Capital Markets in  
Europe*

John K. Thompson, Senior Fellow

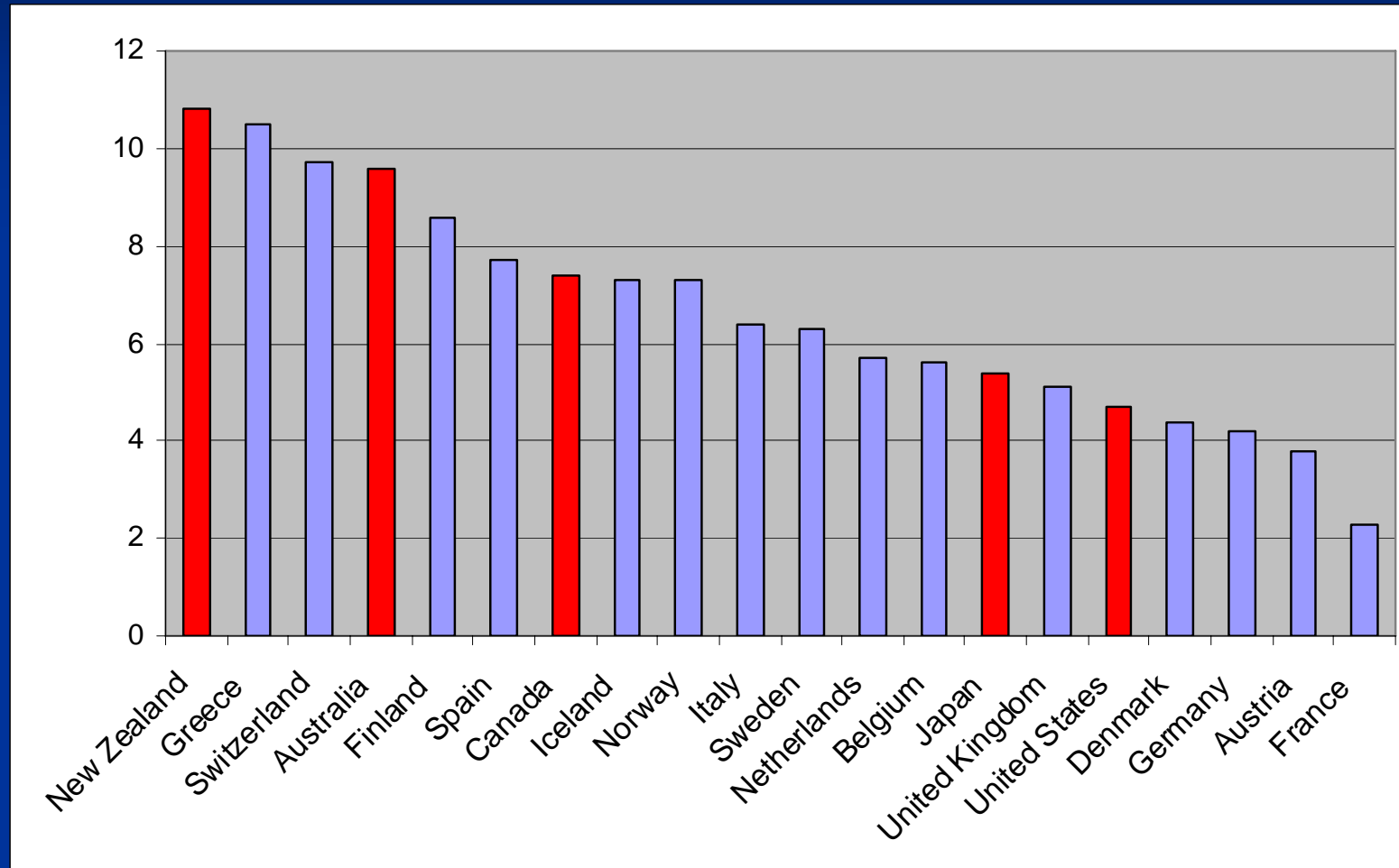
Boston Institute for Developing Economies

# CHARACTERISTICS OF SME SECTOR IN EUROPE

- Well Established
- Large Share of Income and Employment
- Often Family-Owned Companies
- Adequate Financing (mainly bank centered)

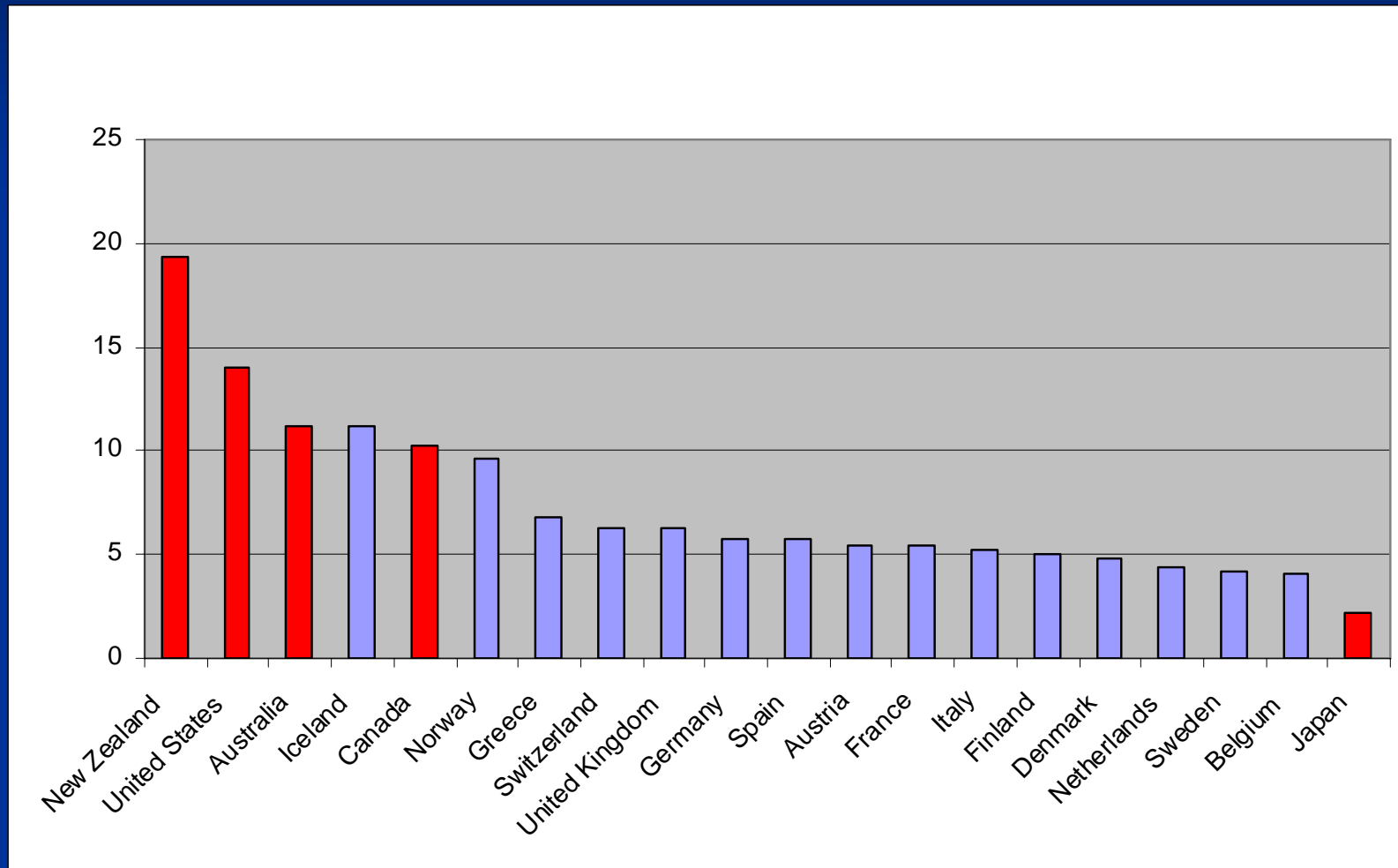
# Established entrepreneurs

*% of non-agricultural labor force*

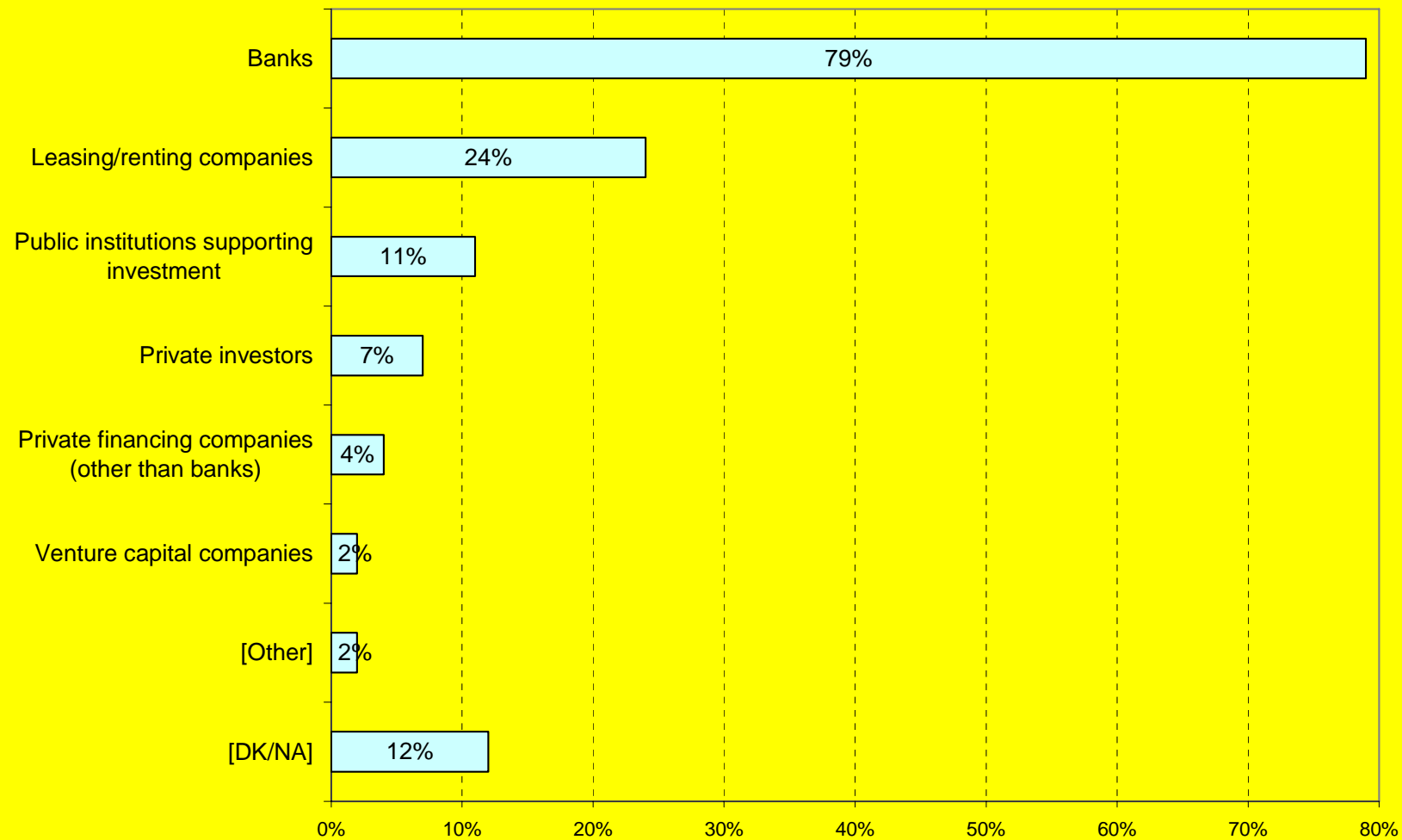


# Early stage Entrepreneurs

*% of non-agricultural labor force*



# SOURCES OF FINANCING FOR EU-BASED SMES



## SURVEY RESULTS in EU COUNTRIES

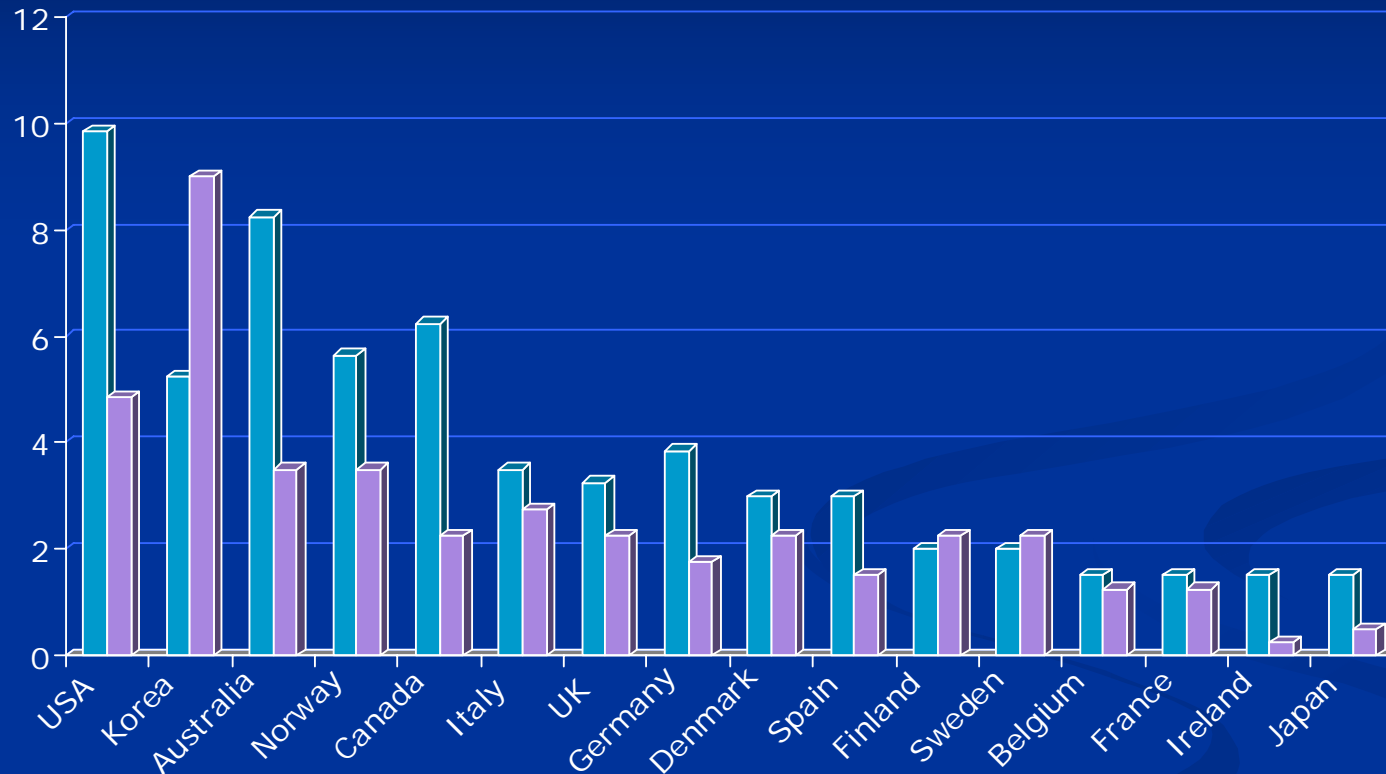
*“Is the company’s current financing sufficient to see project through?”*



# WEAK SPOTS IN EUROPEAN SME SECTOR

- Low Levels of New Company Formation
- Lack of Dynamism in ISMEs, Especially in Hi Tech Sectors
- Lack of Non-Bank Finance

# Entrepreneurial Activity in Selected Countries.



- Start up activity: Percentage of adults engaged in the process of creating a business in the past 12 months
- New Firm Activity: Percentage of adults owning (solely or partly) and managing an operating business that is less than 42 months old

# Environment for Entrepreneurship

- Cultural values
- Education and training system
- Corporate and bankruptcy law
- Financial markets
- Taxation policy
- Social protection
- Science/industry linkages
- *Paradoxes: Sweden, Korea and the United States have the strongest venture capital sectors*
- *Some countries are very entrepreneurial but have weak venture capital*

# Criteria for the Development of a Successful “Technology Hotbed”

- ✓ **Capital Sources**
  - ✓ Business Angels, Venture Capital and Private Equity
- ✓ **Intellectual Capital**
  - ✓ Universities, Research Institutions, “Pillar” companies
- ✓ **Social Dynamic**
  - ✓ Entrepreneurial Climate, New Business Creation
- ✓ **Tax Legal Regulatory Environment**
  - ✓ Property Rights (including IP rights), Tax Incentives
- ✓ **Infrastructure**
  - ✓ Legal, Accounting, Finance, Transportation and Communications
- ✓ **Market**
  - ✓ Market for Technology Products
- ✓ **Environment**
  - ✓ Pleasant Environment, Role Models, Success Stories, Political Stability

***In Europe Nordic Countries Score Best***

## NON-BANK FINANCING

### *WHERE DO EUROPEAN COUNTRIES FALL SHORT OF MORE DYNAMIC REGIONS?*

1. Informal Equity, or “Business Angels”
2. Venture Capital
3. “Growth” Stock Exchanges

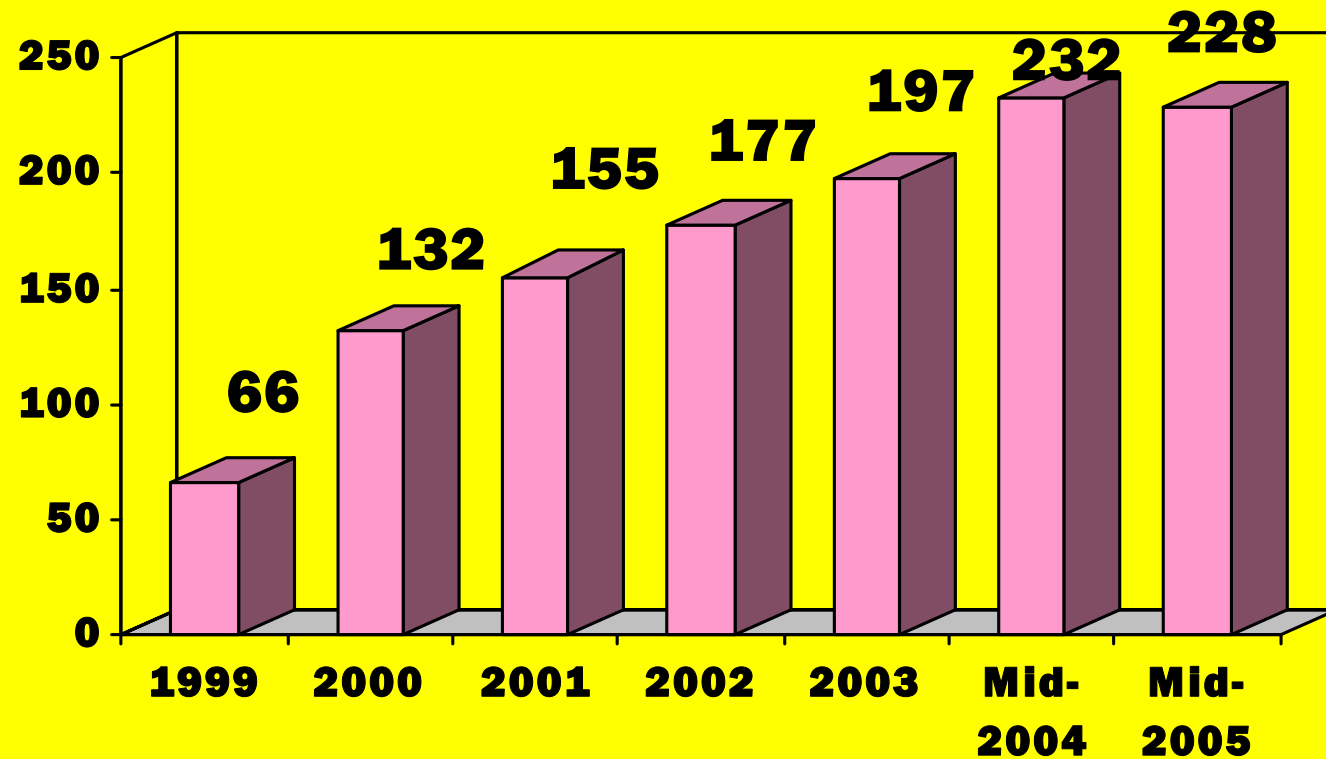
# INFORMAL EQUITY INVESTMENT

- Former Entrepreneurs with Capital and Business Skills
- “Hands On” Participation, “Coaching”
- Locally Oriented
- Both Venture Capital Candidates and Traditional SMEs
- Business Angel Networks
- Often “Gateway” to Formal Venture Capital
- IN USA \$30 billion Invested per Year, Equal to Formal VC, mostly in Early Stage Investments
- Larger Number of Small Deals

# EUROPEAN BUSINESS ANGELS

- European BAs investment estimated at € 2-3 billion, about 10% of US market; Growing since mid-1990s
- Biggest Markets UK, Germany & France
- Investment Range € 25 000-€250 000, Syndication to € 2 Million
- Co-Investment with Public Sector
- Industry Priorities
  - Official Infrastructure Support
  - Co-Financing
  - Tax Preferences
  - Increased Professionalism
    - Education for Entrepreneurs: Investment Readiness Programs
    - Education for Angels: Business Angel Academies

# BUSINESS ANGEL NETWORKS IN EUROPE

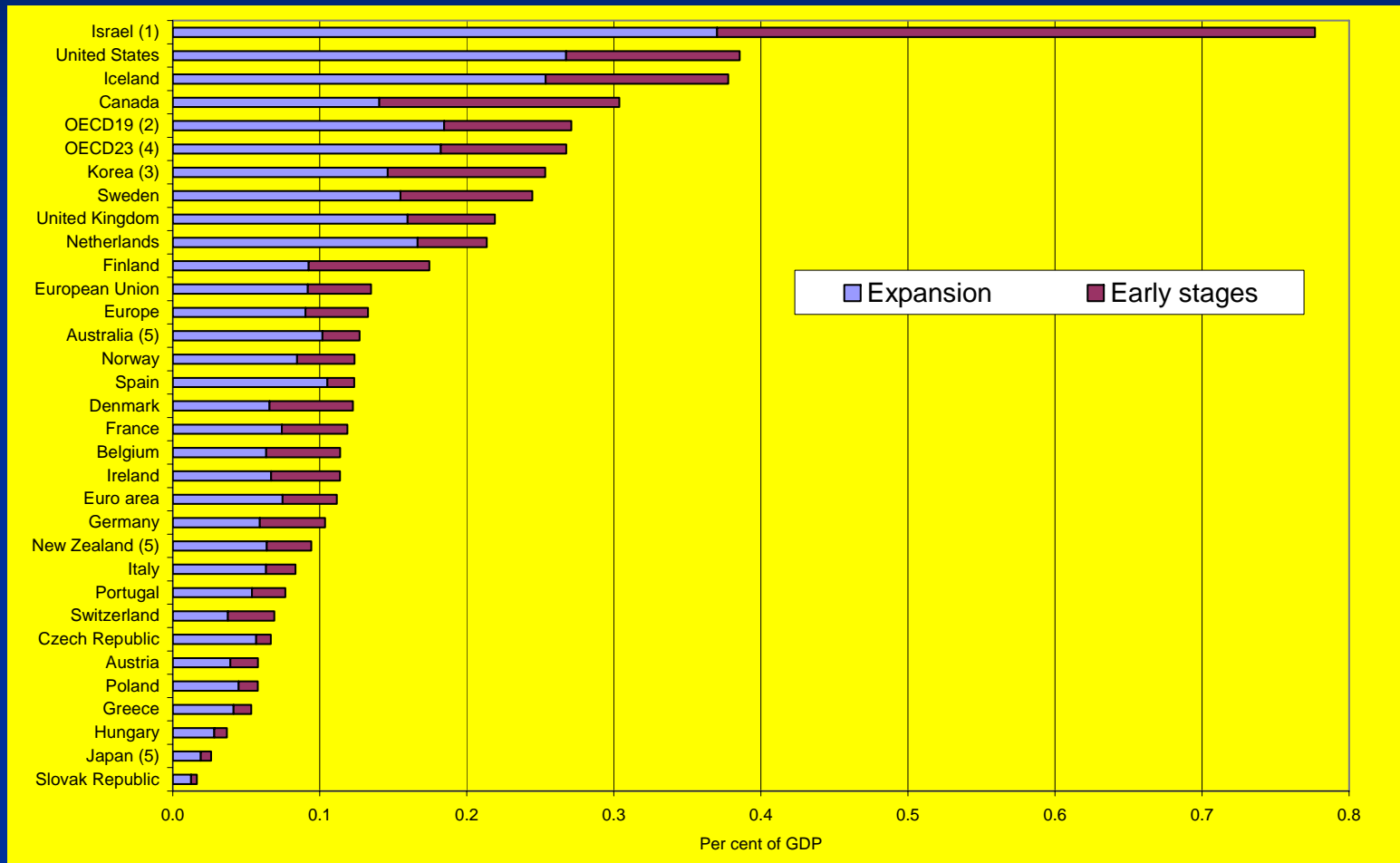


Source EBAN 2005

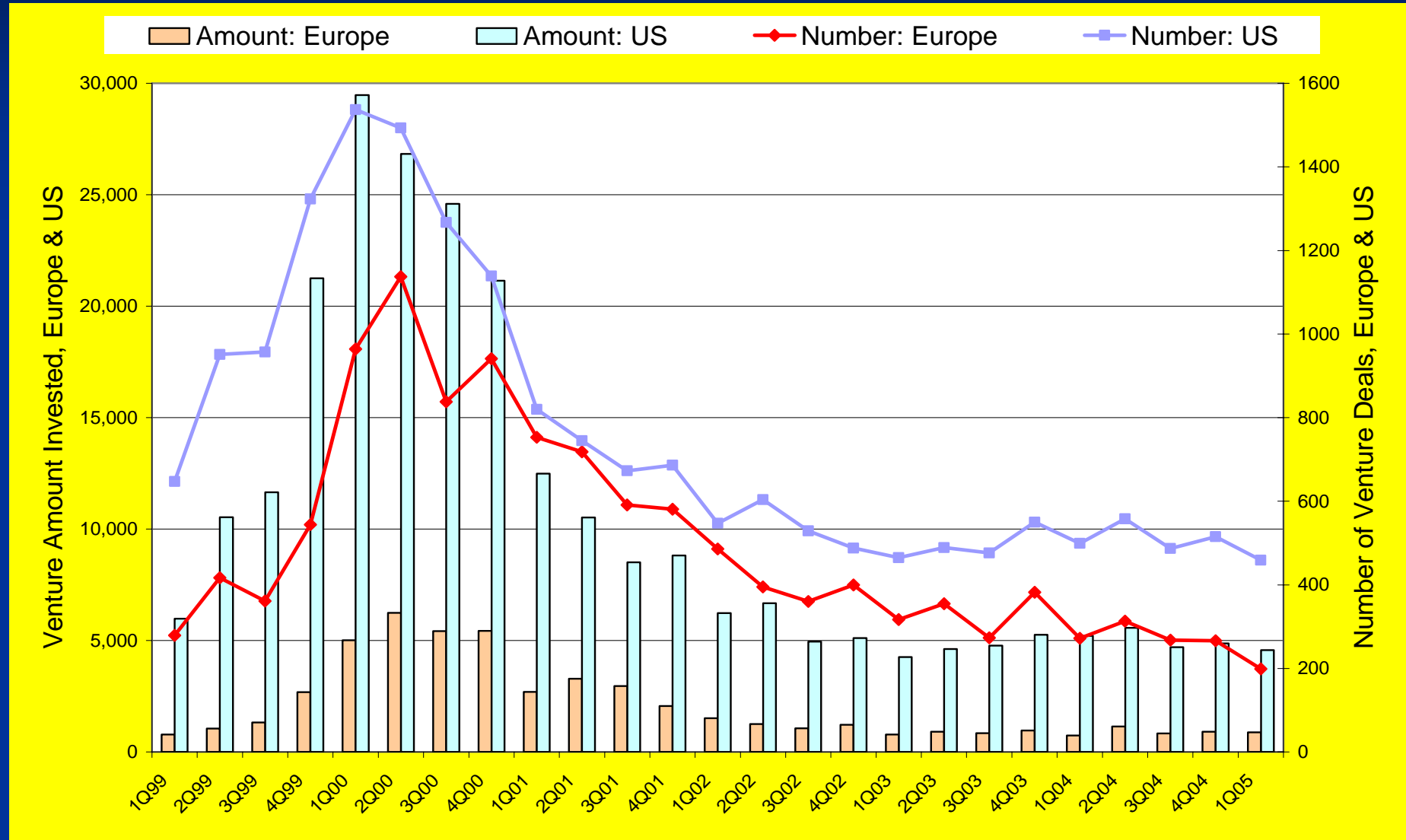
# VENTURE CAPITAL IN EUROPE

- Estimated 1/3 Size of U.S. Market
- Weak in Technology Sectors
- Dominated by Banks/Low Investment by Pension Funds
- Low Returns on Investment in “True” VC
- Since 2000-- Buy-outs Strong but VC Sluggish

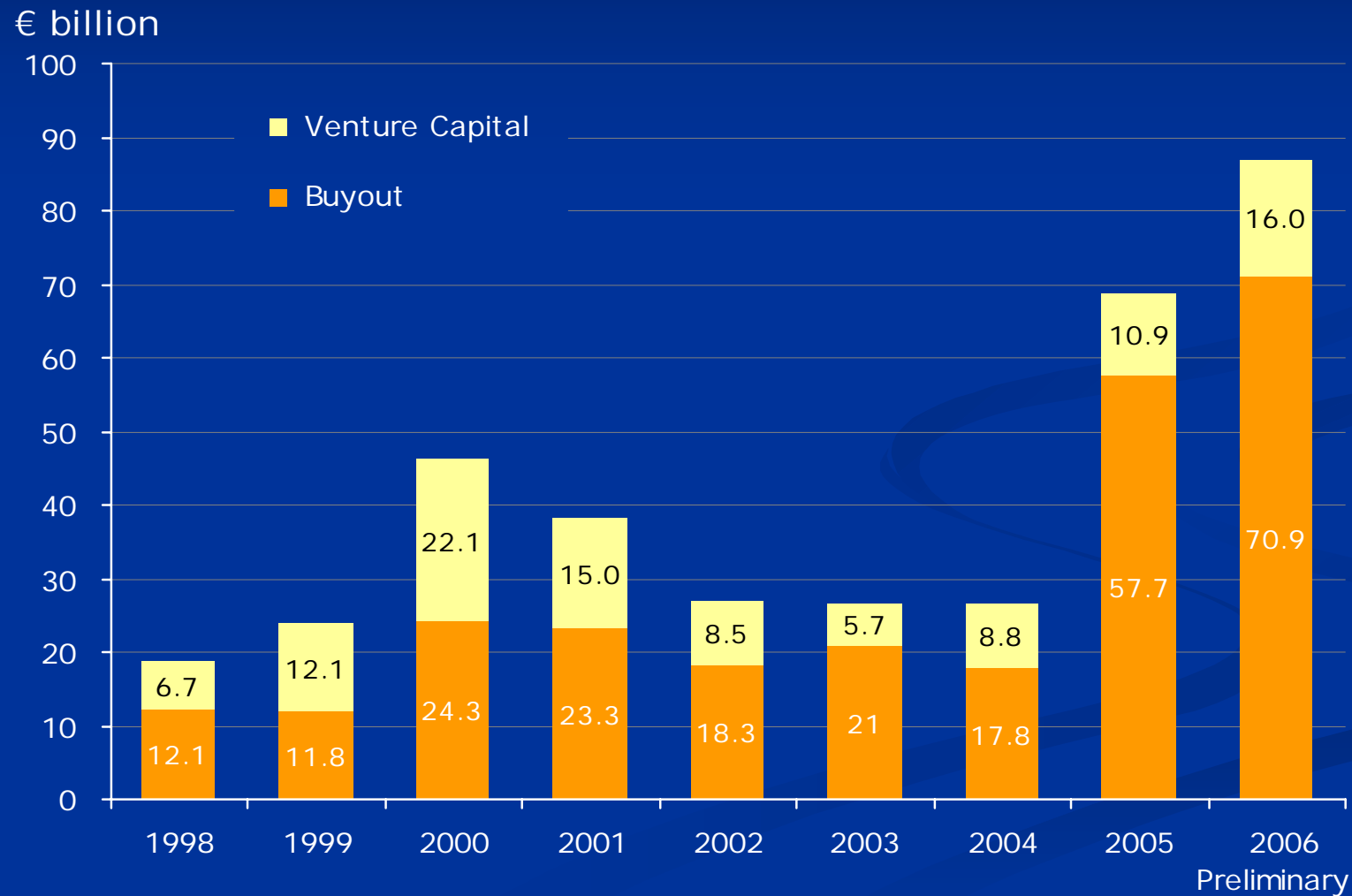
# Venture Capital Investment ( averages 2000-2003)



# Venture Capital: United States vs. Europe



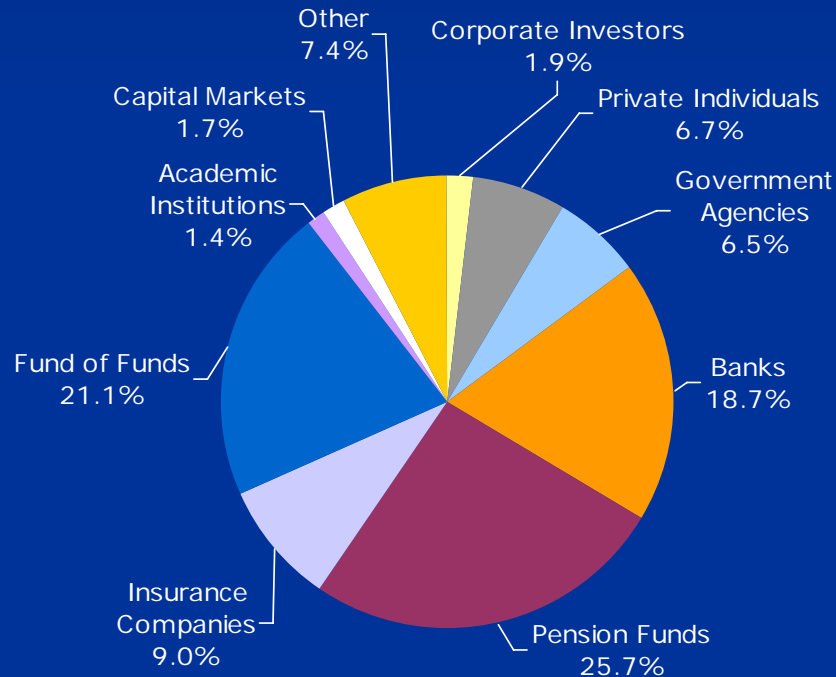
# Record Funds Raised in Europe



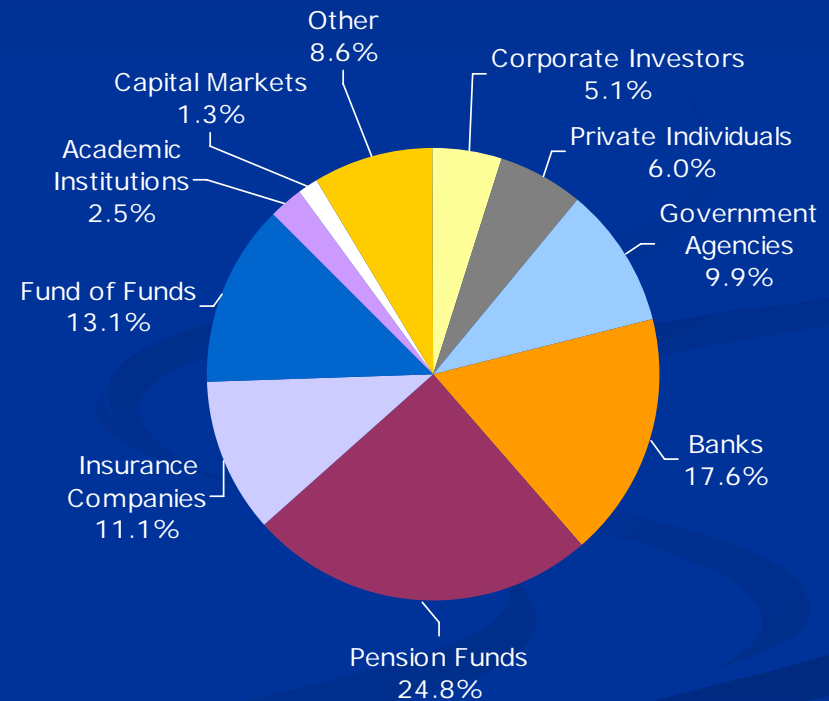
# Sources of New Funds Raised

Strong increase in Fund of Funds' allocation to PE

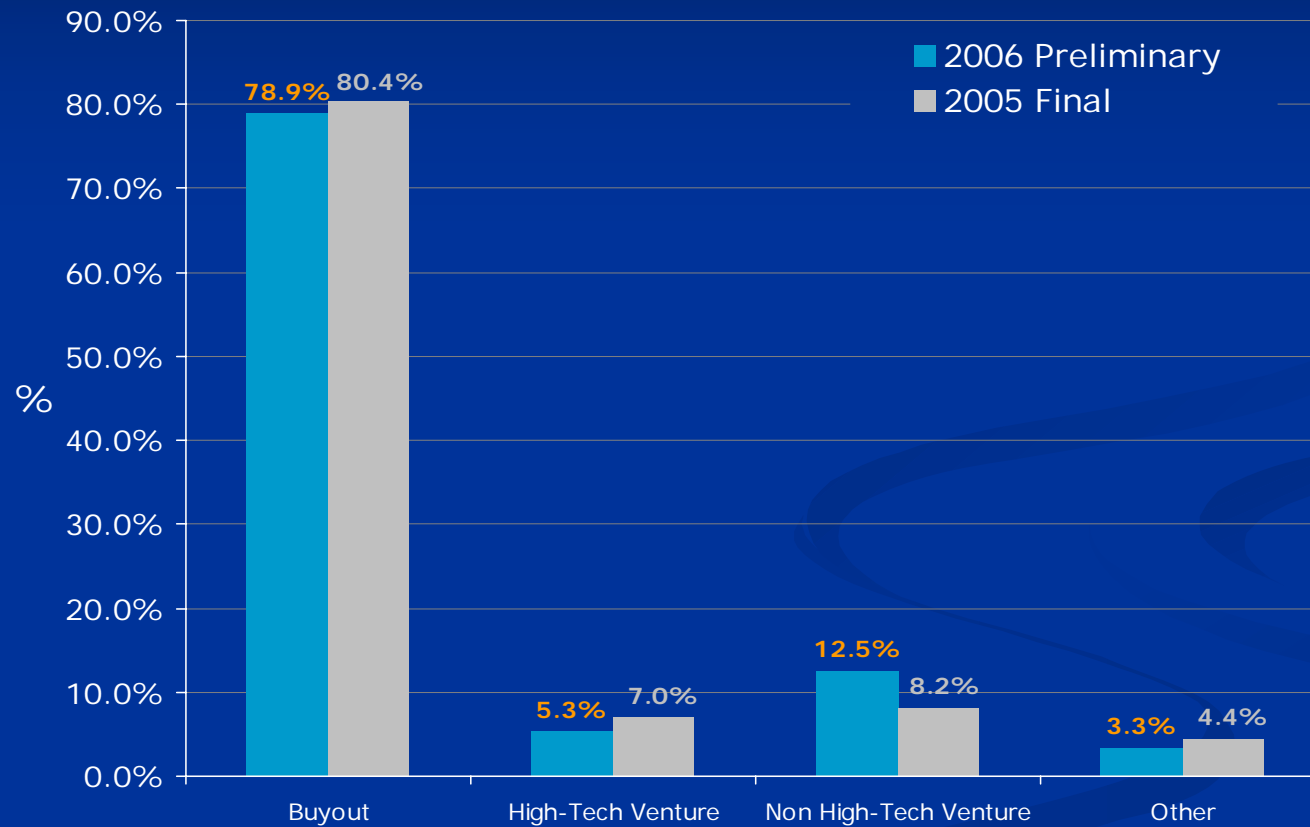
2006 Preliminary



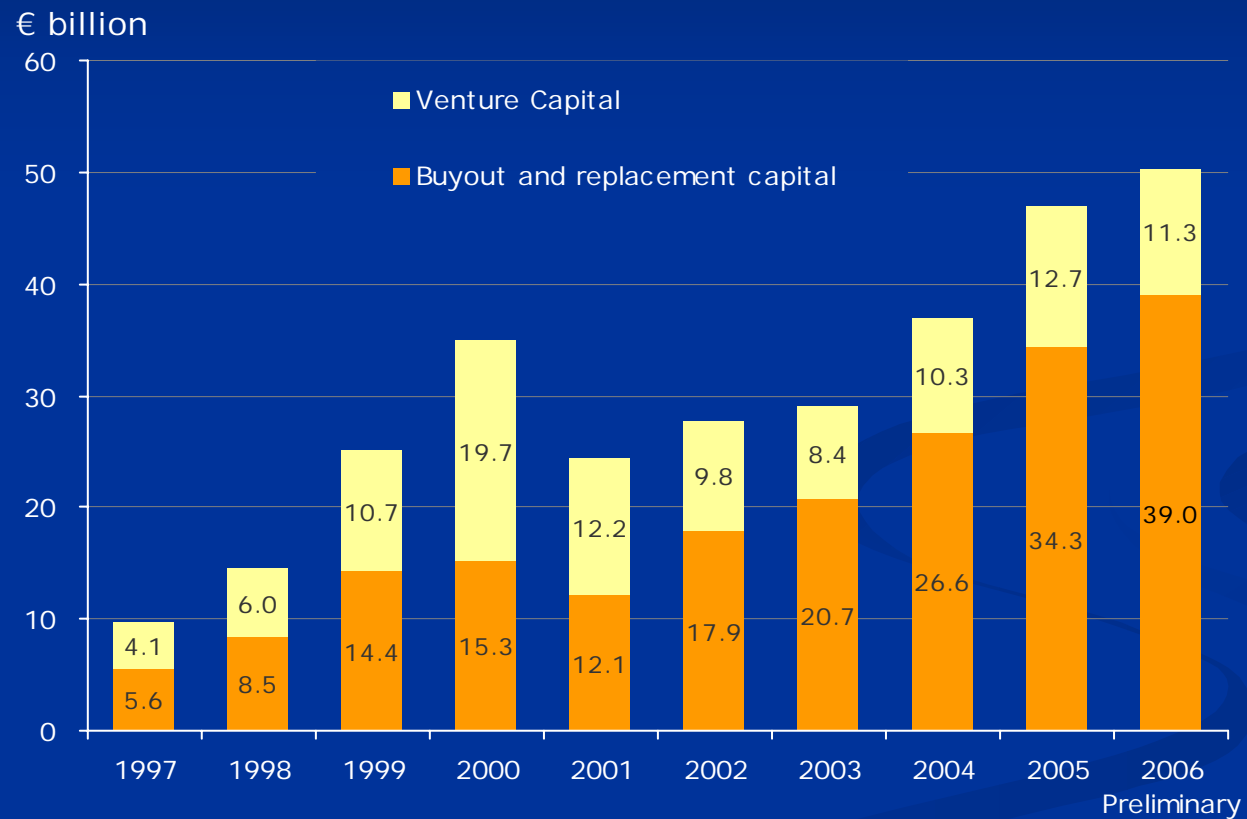
2005



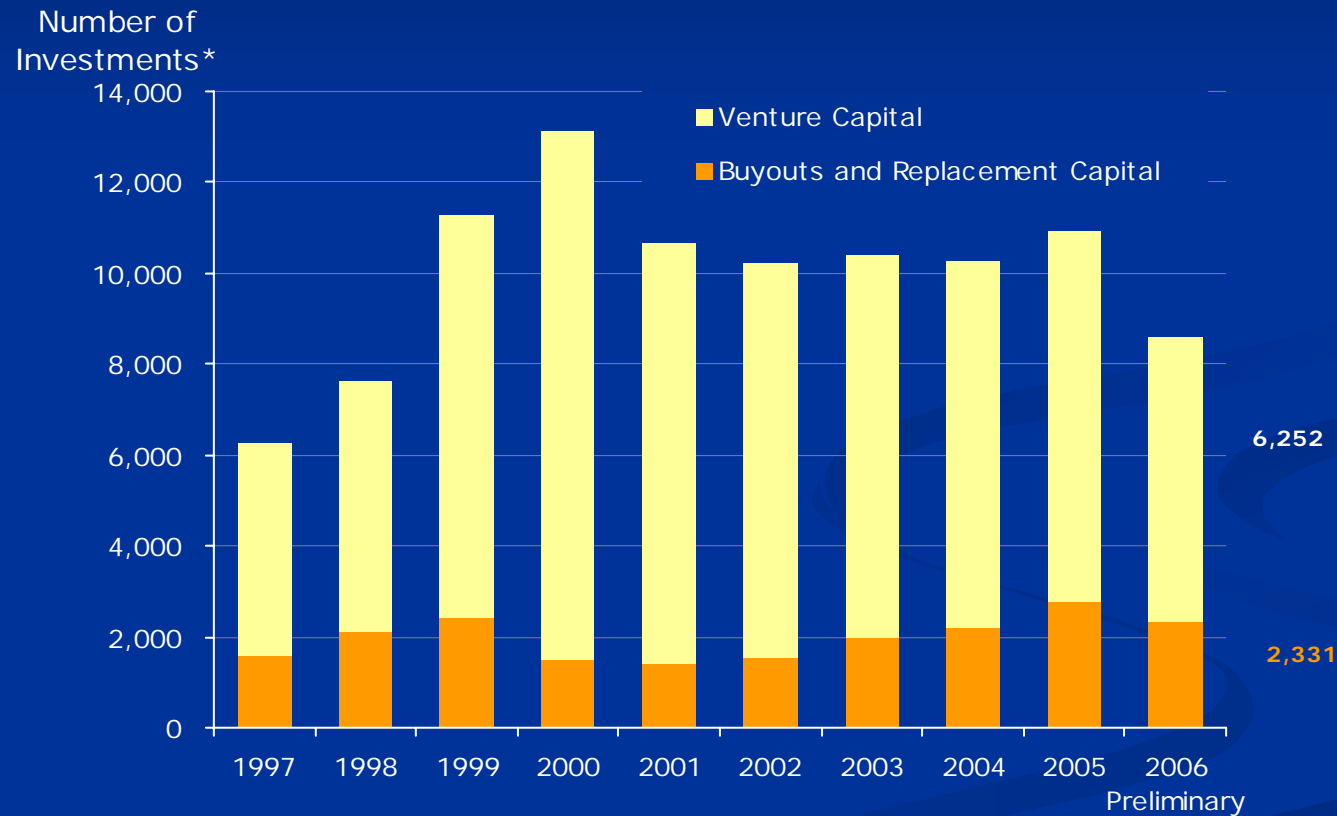
# EXPECTED ALLOCATION OF FUNDS RAISED



# FUNDS INVESTED



# Investments by Number of Deals

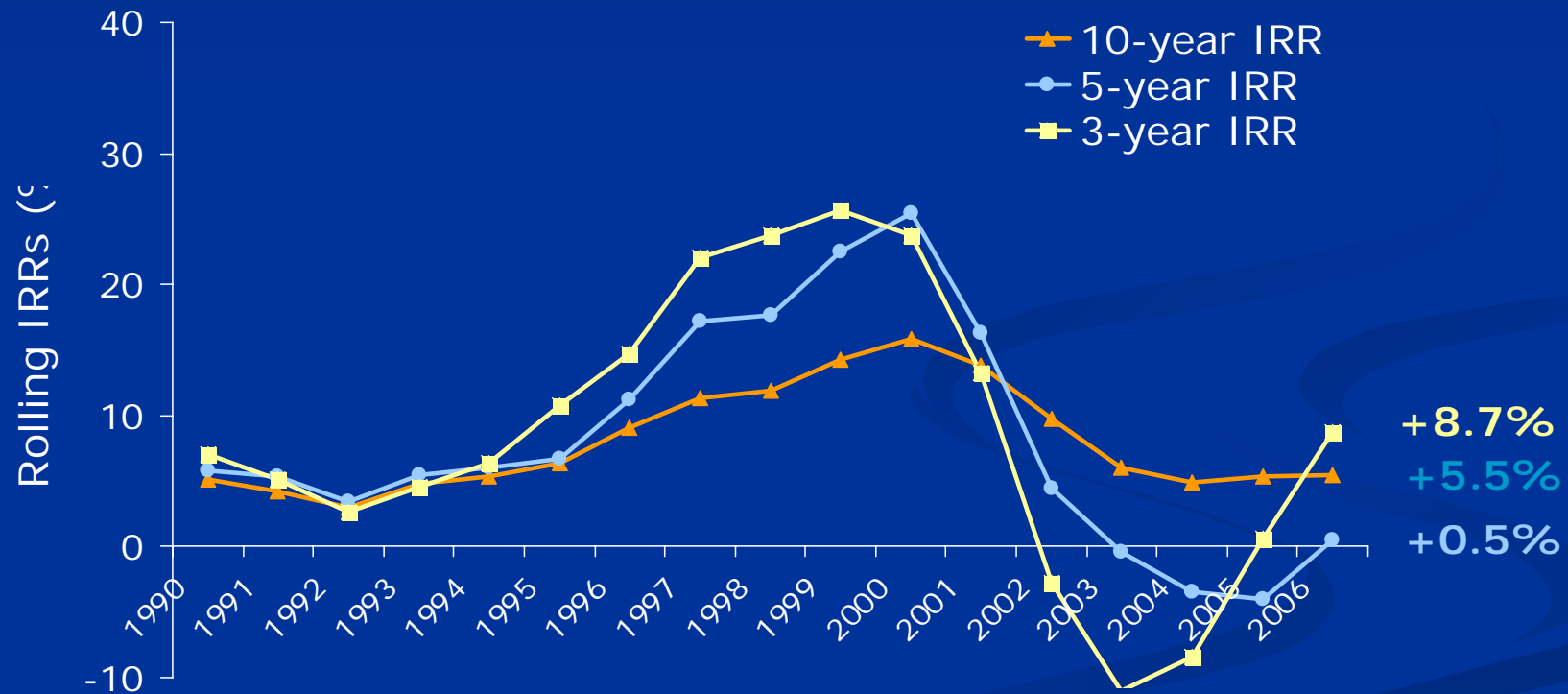


**EUROPEAN PRIVATE EQUITY FUNDS**  
**FORMED 1980-2006, NET IRRS TO INVESTORS**  
**Investment Horizon Returns as of 31 Dec 2006**

STAGE	1 year	3 years	5 years	10 years	20 years
Early Stage	1.1	2.1	-4.8	-1.2	-0.1
Development	0.4	7.2	1.2	7.2	8.6
Balanced	-9.4	15.9	5.1	11.1	10.0
All Venture	-0.7	8.7	0.5	5.5	6.6
Buyouts	26.9	13.2	7.2	13.6	13.8
All Private Equity	21.3	11.0	4.3	10.3	10.5

# 3-year venture IRR moves into positive territory

European Venture  
3-,5-,10-Year Rolling IRRs



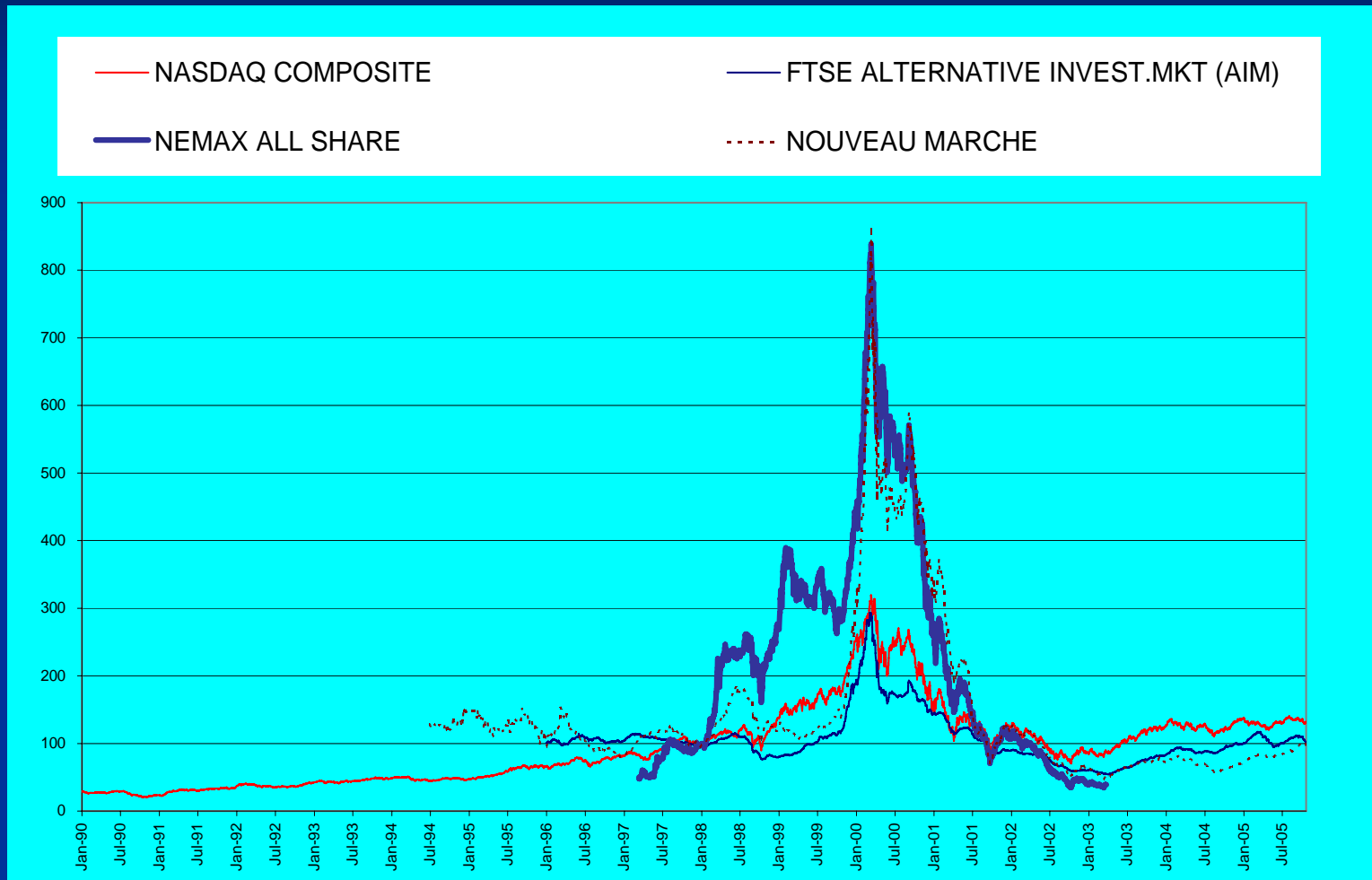
Source: Thomson Financial / EVCA

# GROWTH EQUITY EXCHANGES IN EUROPE

- Europeans Seek Exit Vehicle for Venture-Funded Companies
- Model is NASDAQ
- Unsuccessful Attempts to Develop Markets for SMEs in 1980s
- Many “Growth Exchanges” formed during tech Boom 1995-2000 (More than 20 in 2000)
- Most Growth Markets Close after Tech Bubble Bursts in 2000

# Performance of Growth Stock Exchanges

Indices, 02/01/1998 =100



Source: Thomson Financial DataStream.

# THE FUTURE OF GROWTH EXCHANGES IN EUROPE

- Recovery in IPOs after 2003 Renews Interest in “Growth Markets”
- Single European Platform or National Exchanges?
- Candidates
  - AIM London
  - Alternext (Euronext)  
Deutsche Börse
  - EASDAQ
- List on NASDAQ
- Questions
  - What Configuration for Global Growth Exchanges?
  - What is the Impact of Sarbanes-Oxley?