Background Note: The European Investment Fund (February 2003)

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The European Investment Fund

The EIF, in which the Bank is lead shareholder (60%) alongside the Commission (30%) and a cluster of banks and financial institutions, specialises in venture capital financing and in guarantees for banks' SME activity. It is required to serve the objectives of the European Union and, at the same time, generate profitability.

1. The EIF is the "venture capital arm" of the EIB:

Since 2000, the EIF has been responsible for all the Group's investment in specialist funds backing the creation of technology-oriented businesses with early-stage capital. The EIF also manages budgetary resources previously mobilised by the Commission for seed capital in this sector.

The EIF's total portfolio amounted to nearly EUR 2.5 billion at the end of 2002, invested in 185 funds throughout the Union and the Accession Countries. The EIF is Europe's leading operator in this technology-oriented venture capital market, support for which forms a key element of the Lisbon strategy of closing the Union's competitiveness gap.

One of the EIF's functions is to play a **catalytic role** in setting up funds, which it supports from the start-up stage. Its participation brings in other investors and gives the funds the critical mass they need to launch their investment activity under optimum auspices. Since 2000, the EIF has focused primarily on high technology (biotechnology, convergence, new materials, telecommunications, software and media/audiovisual industry content), regional funds targeting Southern Europe and pan-European funds helping to shape a single European venture capital market that are comparable in financial muscle to their big US counterparts.

Despite a market environment beset by investor wariness, the EIF's investments in 2002 reached EUR 471 million, spread over 36 operations. This activity represents a significant part (some 15-20%) of total resources mobilised in Europe in this market segment – one which is hobbled by the economic outlook, by high risk and by retrenchment or withdrawal from the market by its traditional investors. With the new stock markets struggling and the severe dearth of business development capital, the difficult conditions likewise affect decisions on exiting from investments.

For a fund of funds such as the EIF, the present situation may result in a possible fall in the value of the investment portfolio. But while hardly favourable for exiting, it is nevertheless considered good for making investments, since in a context of scarce resources equity participations may be made at a more favourable price.

These difficult conditions reinforce the role of the EIF. Operating on a **long-term basis** under the Lisbon strategy, the EIF plans in fact to expand its activity in the present environment.

Its investment policy will therefore focus on funds dealing with **development capital** operations, promoted in close partnership with other strategic investors. Such funds will be in a position to place emphasis on backing technology businesses no longer able to secure stock market financing. The situation is particularly acute for biotechnology firms.

At the other end of the venture capital market, much further upstream, the EIF is exploring with **DG Research** and certain universities and research centres how to forge a comprehensive, pan-European approach to financing the link between research and its commercialisation.

Finally, the **Accession Countries** clearly constitute an essential objective of the EIF's future investment policy (to date, 6 funds have been backed in this region).

The EIF can count on the support of the EIB, its principal shareholder, with which it coordinates its activity (Innovation 2000 Initiative). Over 80% of the resources handled and invested by the EIF in venture capital consists of funds which it manages under mandate from the Bank. This EIB involvement, which dates from 1997, will continue in the coming years and arrangements have already been made to equip the EIF with sufficient financial resources to carry on and expand its activity.

2. The second branch of the EIF's activity is the guaranteeing of SME portfolios of banks and financial institutions. Under this heading, the EIF works with over 100 financial intermediaries:

This activity is based mainly on the financial resources of the **Multiannual Programme for Enterprise**, set up by the Commission (DG Enterprise) and managed by the EIF. Covering the period 2001/2005, this programme includes a "SME Guarantee Facility" with four windows (guarantees for high-growth SMEs, equity participations, ICT investment and micro-credit). In 2002, over EUR 700 million was committed under this heading, with 18 financial intermediaries.

These budgetary funds exert a powerful leverage effect, and it is estimated that aggregate lending operations which they have helped to guarantee throughout the Union exceed EUR 30 billion. In total, the Facility has made it possible to cover more than **110 000 businesses** since its creation in 1998.

In 2002, the EIF actively expanded the **micro-credit** component of the Facility (in France, Belgium, Germany and Spain). This window provides guarantees for loans of under EUR 25 000, a niche often shunned by the commercial banks on account of the associated high handling costs and risks. Operations concluded by the EIF in this segment have at times been backed up by support measures for monitoring and managing the beneficiary micro-enterprises. These micro-credit guarantee lines are delegated to specialised associations (Prince's Trust in the United Kingdom, ADIE in France) which are very active in combating social exclusion, and enable the EIF to play an important role in advancing the Community's objective of "economic and social cohesion". They have considerable growth potential, notably in the Accession Countries.

From its own resources (around EUR 450 million committed in 2002), the EIF has contributed to the growth of the European banking sector's lending activity by guaranteeing the "junior" tranches of SME debts via securitisation operations. Enjoying the EIF's guarantee, bonds issued under this technique have enabled the financial intermediaries concerned to reach more SMEs and grant them enhanced credit terms while minimising the risk entailed. This type of guarantee, used in 2002 in Germany ("Promise" Programme), Austria, Italy and Spain, is proving increasingly successful and will be further expanded in the coming years.

3. In response to growing demand, the EIF has just launched an advisory service for structuring guarantee and venture capital funds.

This initiative is being pursued separately from the EIF's guarantee and investment activity under an agreement with DG REGIO. Though directed more particularly towards the regional development agencies situated in Objective 1 or 2 areas, it is set to extend to other regions of Europe, notably the Accession Countries or countries close to the Union's borders. Two operations have already been concluded, with the Andalusian Development Institute and the Walloon Ministry of Economic Affairs.

While remaining a lean organisation, the EIF deploys a wide range of highly specialised financial instruments which are well suited to nurturing European businesses and which perfectly complement those of the EIB. Its activity is destined to grow, because it is a nimble financial agency responsive to market needs. Its role promises to become even more important with the prospective accession of new Member States, which offer vast scope for deploying its services and products. This expanding activity will have the total support of the Bank, through the renewal and development of the existing mandates as well as through the provision of additional capital resources. This proactive approach is fully shared by the European Commission.

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