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European Investment Fund

Introduction to EIF: innovation and SME finance

The European Investment Fund (EIF) is the EU financial institution within the EIB Group specialising in SMEs. It operates in close partnership with the European Commission and financial institutions. EIF acts as a fund of funds in the **venture capital** market, offers **SME credit guarantees** and provides financial engineering services. EIF financing is made available through financial intermediaries, using its own resources as well as funds mandated to EIF by its shareholders or third parties.

EIF operations are driven by a twofold objective: **servicing EU policies** and **generating appropriate financial returns**. EIF enjoys a AAA rating and multilateral development bank (MDB) status. The ownership structure of EIF comprises EIB as lead shareholder (some 62%) alongside the European Commission (30%) representing the European Union and some two dozen banks and financial institutions.

Selected highlights of 2005 *

EUR	2005	2004	Total commitments (at year end 2005)
Venture Capital (commitments)	468m	358m	3.2bn
Guarantees (own funds)	472m	697m	2.98bn
MAP Guarantees	1213m	750m	6.33bn
Subscribed capital	2 000m	2 000m	
Own funds (before appropriation of dividend)	619m	587m	
Treasury and debt securities	551m	545m	
Net income for the year	42.9m	27.2m	
ROE	7.44%	4.86%	

* Unaudited

EIF venture capital commitments

In 2005, venture capital commitments ran to **EUR 468m**, of which EUR 368m signed, invested in some 24 (21 signed) venture capital funds covering a broad range of operations. This compares to operations worth EUR 358m (committed) in 2004.

The total VC commitments amounted to **EUR 3.2bn at end-2005**. With investments in some 217 funds, EIF is a leading player in European venture capital, due not only to the **scale and scope of its investments**, especially in high-tech and early-stage segments, but also to its catalytic role in attracting private sector funding. EIF has established itself as a key institution in promoting innovative financial instruments for SMEs developing best practice and corporate governance.

The **stability of EIF's presence** underlines the added value of public funding in times of market difficulties. Nevertheless, EIF acts as a fully commercially minded investor and thus does not distort market dynamics. Moreover, with substantial disbursement flows, EIF has confirmed its position as a steady and major player in the VC industry.

EIF has continued to diversify its investment activities beyond early-stage funds, adding mid- and later-stage funds. Some 56% of EIF's investments are tech-related, primarily ICT and life sciences.

EIF was closely associated with one of *the* most famous 2005 venture backed success stories being on investor in Skype (voice over internet) through its investment in the first fund managed by Luxembourg-based Mangrove. Having supported Mangrove twice since its inception, this also confirms EIF's competence in identifying successful first time fund management teams.

EIF's expertise and breadth of portfolio enables it to specifically target niche strategies in European venture funding, as demonstrated by its investment in Nordic Biotech. Nordic Biotech is a special situation investor in life science companies aiming at assembling late-stage assets in newly established firms to achieve critical mass in their market position.

The ERP-EIF Dachfonds - the fund EIF is managing on behalf of the German Federal Ministry of Economics and Technology (BMWFi) and ERP - is exceeding expectations. A further EUR 115m was committed in four funds, which in turn helped raise another EUR 554m from private investors, highlighting EIF's leveraging effect on the market.

2005 witnessed the setting-up of a investment mandate, managed by EIF, notably with CDTI, the innovative technologies development centre of the Spanish Ministry of Industry, for investments in Spanish SMEs fostering innovation and research and development jointly with a range of private sector corporate investors (signature is pending).

In a still gloomy macro-economic environment, the private equity and venture capital industry is actively contributing to job creation in the EU's 25 countries, as highlighted by a recent study published by EVCA¹. In that context, EIF's commitment has substantially impacted the creation of jobs in Europe.

SME guarantees

SME Guarantees were issued for **EUR 1.7bn in 2005** bringing the total portfolio to **EUR 9.3bn at year end-2005**. EIF's guarantee activity is conducted with EIF's own resources and under mandates from the European Commission.

EIF offers two main product lines for its SME guarantee activity: credit enhancement for securitisation and credit insurance/re-insurance (including for micro-credit loans). Under EIF's own resource activity, some **EUR 457m** worth of credit enhancement operations were signed and one credit insurance deal for EUR 15m was completed.

The main role of EIF in securitisations is to enhance SMEs' access to debt finance by facilitating credit risk transfer from the originating banks to the capital markets. This is achieved by guaranteeing certain tranche of risk. EIF's credit rating and MDB status make possible reduced regulatory capital allocation on assets guaranteed by EIF and thereby enable financial institutions to expand their lending capacity. When opportunities arise, this activity is conducted in cooperation with banks, especially shareholders, EIF often taking mezzanine tranches. This was the case for instance in the Douro SME Series 1 securitisation transaction in Portugal (originated by BPI – Banco Português do Investimento) in early 2005, where EIF was advisor and guarantor alongside EIB and KfW as investors.

In 2005, EIF signed 24 guarantee operations amounting to **EUR 1.2bn** under the guarantee window of the current EU programme of DG Enterprise (MAP – multi-annual programme for SMEs 2001-2006). Over 260 000 SMEs have benefited from this programme (and its predecessor), including some 25 000 entrepreneurs benefiting from micro-loans.

The guarantees that have been issued by EIF since its inception have helped mobilise at least 15 times the actual EU budgetary commitment; this leverage effect has been key to the financing of SMEs in Europe.

Included in this window is the micro-credit guarantee facility, which supports entrepreneurs and micro-enterprises with up to 10 employees, guaranteeing micro-loans of up to EUR 25 000. It is aimed at entrepreneurs who are starting a business and face particular difficulties in gaining access to financing due to the relatively higher risk they represent and the insufficient security they can provide to lenders. Guarantee commitments have reached roughly EUR 180m, a substantial amount considering that the size of the micro-loans is on average just below EUR 10 000.

¹ Undertaken for EVCA by the Center for Entrepreneurial and Fiscal Studies (CEFS) at Munich Technical University, and published in November 2005, the study examines both the current levels of employment by private equity and venture capital financed companies as well as the new jobs created by the industry in recent years.

For the first time in Europe, EIF has structured and co-arranged the securitisation of loans to micro-finance institutions (MFIs). This is a very significant transaction involving several countries, mostly in the Western Balkans. Through this asset-backed funding deal, MFIs will secure long-term funding to support continued growth in their micro-lending. Despite the small size of the micro-loans (a few thousand euros on average), there is high potential in terms of business productivity gains and job creation supported by this important niche lending activity. It is estimated that this transaction will result in the direct financing of at least some 20 000 new micro-loans.

EIF as an actor in the Lisbon agenda

The core policy underpinning EIF's activities remains the **Lisbon strategy for European competitiveness**. A further key driver will be the European Research Area programme whose objective is to improve conditions for the **commercialisation of European research and development**.

The EUR 3.2bn that the Fund and its financial backers have injected since 1994 into venture capital investments targeting high-growth SMEs has helped mobilise around EUR 15bn. This leverage effect has been key to the financing of European innovation.

Another example of support for research and innovation is the "Technology Transfer Accelerator" (TTA) project. The strategic value of this EIF initiative, supported by the European Commission and mounted in cooperation with EIB, was recognised by the 2005 EU Council Spring Summit. It offers new types of risk capital vehicles linking leading research centres as well as financing mechanisms to intervene upstream from VC, which could be instrumental in addressing the clear market failure in this area.

Seeking to capitalise on the results of its Technology Transfer Accelerator study, EIF is participating in two consortia both selected by DG Research of the European Commission for Sixth Framework Programme funding:

- AFIBIO ("Access to Finance in the Biotechnology Sector") generally aims to analyse the biotechnology and healthcare sectors' needs in terms of funding and R&D commercialisation;
- EUCIST ("European Coaching Innovation Standard", since renamed ACHIEVE) focuses on financing solutions aimed at university spin-offs in the information and communications technology area.

The proposed European Commission "Competitiveness and Innovation Framework Programme" – CIP (successor of MAP) of DG Enterprise and under EIF management will further develop the positive experience gained through the MAP in 2001/2006. Covering the period from 2007 to 2013, the CIP will offer a range of facilities in the field of early-stage financing and guarantees. In recent years, the efficient implementation of MAP by EIF (in terms of geographical coverage and number of operations) has led to repeated budget increases decided by the European Parliament and the Council, the last one being in the 2006 budget procedure.

Technical assistance and development of financial engineering / "JEREMIE"

EIF has developed its role in technical assistance in the SME sector, notably with national and regional authorities implementing early-stage VC schemes. Examples include the assessment of venture capital funds and schemes in Andalusia and Flanders.

The JEREMIE (Joint European Resources for Micro to Medium Enterprises) initiative was launched in late 2005 by the Commission's DG REGIO and EIF to enhance SME access to finance in regional development areas. Member States and regional authorities can outsource to EIF the management of structural funds for financial engineering/SME finance programmes, thus transforming parts of the ERDF (structural funds) grants into a range of financial products for SMEs. These products will include equity, venture capital, guarantees and technical assistance, and will allow a multiplier effect on the budget. Special emphasis may be given to micro-finance.

In 2006-2007, EIF's implementation team and the national or regional programme authorities will assess the gaps between supply and demand for SME access to finance in cooperation with national institutions and agree on operational action plans. Following this phase, EIF will help implement the financing schemes in close cooperation with lending institutions such as EIB, other international financial institutions and national or local banks, including several EIF shareholders.

Contribution to EIB Group strategy

EIF is a significant contributor to three of the five key operational priorities of the new EIB Group strategy as approved by the Board of Governors in June 2005:

- **Support for SMEs:**
This remains at the core of EIF activities. Support for SMEs was added in 2005 to the EIB's operational priorities. This enhances the pivotal role played by EIF and the EIB, working together to identify the most suitable products to improve SMEs' access to finance. In addition to its own resources, the Fund not only benefits from the full back-up of the EIB and its financing capacities, but also acts as a sophisticated manager and deployer of other sources of finance, ranging from international, national or local financial institutions to investment funds, micro-credit agencies, etc. In so doing, EIF addresses market failures and weaknesses in SME financing.
- **Innovation:**
EIF complements the EIB's activities in support of i2i by providing equity funding as well as loan guarantees to innovative companies. Mainly backed by EIB venture capital resources (the "Risk Capital Mandate"), EIF has become a leading investor on the European VC scene. This has been confirmed by the deployment of new and important joint investment facilities with public partners.
- **Cohesion and regional policy:**
SMEs remain an essential part of the backbone of the European economy, while innovation is crucial to the EU's plans for the future, notably in the context of the Lisbon agenda. Consequently, EIF's support for regional development (through JEREMIE financial instruments and toolkit) will facilitate the deployment of the Lisbon strategy in delivering economic and social cohesion.

For further information on the EIF, visit its website www.eif.org, or contact:

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