Venture capital characteristics in France. An international comparison
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1. Introduction

This first chapter gives a general presentation of the area I am working on, in order to give a general background to the reader. The aim is to generate the research question. Moreover, it defines the objectives and limitations of the study.

1.1 Problem Background

When the young innovative firms are in the first stage of an innovative project, sometimes before the commercialisation of their product, it comes the problem of financing. The firm can be financed either by equity or by debt capital. However, the access to capital for the new firms is often a problem because of the limited operating history and the inability to raise funds through a debt issue. There is a problem of asymmetry of information with the fund providers, who do not have financial data from the past, and the characteristics of the innovative project often involve risk.

Start up may then have an alternative source of financing: venture capital, which is a type of private equity capital typically provided by professional, outside investors to new, growth businesses. Venture capital companies act as an intermediary between the investors (which are often wealthy families, banks, pension and insurance funds…) and the small companies with high potential growth. The investors not only provide the funds for growing companies, but also monitor the company in its development and give advice for the recruitment, commercialization, customer or supplier relationship. It allows the venture capitalist to select the projects before the investment and then to have a look on its development (Kaplan and Strömberg, 2001). Venture capital is a narrower sense of Private Equity which includes all the stages of the development of a company. It comes only in the first stages of the creation: early stage and expansion.

It has been showed that Venture Capital benefits to the economy and creates employment. The growth of Small and Medium size companies has been recognized as an important factor for Economic growth and power. It has a key role in the economy today and it helps the young and growing firms, it contributes to the creation of firms, growth and promotes innovation and new technologies, and creates employment: in 2004, portfolio companies held by European private equity and venture capital funds employed close to 6 million people and 630,000 new jobs created by venture-backed companies between 2000 and 2004 (EVCA, 2005).

Dirk Engel (2002), in his study “The Impact of Venture Capital on Firm Growth” evaluates the impact of venture capitalists on employment growth of new founded firms and find that surviving venture-backed firms realize higher growth rates compared to surviving non-venture-backed firms. Moreover, firms run by venture capitalists are more able to grow faster with higher employment than other. Although the importance of venture capital to entrepreneurial firms and these firms’ subsequent contributions to economic development has been well documented, most research on venture capital has treated the industry as
homogeneous (Fried and Hisrich 1988). However, as Bygrave and Timmons (1992) point out, there is significant heterogeneity in the industry. Some research, e.g., Robinson (1987), Florida and Kenney (1988a, 1988b), Sapienza and Timmons (1989), has begun to examine these differences.

European Venture capital market is very active: in 2006, €17.3 billion were invested in Venture Capital in 5590 firms. €112bn were raised in 2006 compared to €12bn in 1997(EVCA). If the UK is in the first place in the money invested in UK companies with 33%, France comes in second with 15.2% and Sweden is 6th with 6%; but when measuring private equity investments as a percentage of total GDP, Sweden is the first largest investor with 1.437% of GDP(EVCA 2006). Could we then see any similarities between the 2nd biggest actor in Europe with the first in term of GDP?

In France, VC has mainly been developed by the government and the banking sector plays an important role in the fundraising process.

As the venture capital industry has grown and become ever more significant it has attracted an increasing amount of attention among scholars. The literature on how the industry works is nowadays wide and deep. A lot of factual evidences on the economic impact of VC have been showed by specialized institutions, especially for the US economy. According to a study carried out by DRI-WEFA on US VC-funded companies over the period 1970-2000, “venture capital-backed companies had approximately twice the sales, paid almost three times the federal taxes, generated almost twice the exports, and invested almost three times as much in R&D as the average non-venture capital-backed public company, per each $1,000 of assets” (NVCA, 2002). The same study also shows that VC fosters local and regional economic growth in the USA. The European Venture Capital Association (EVCA, 1996 and 2001) argues that venture-backed companies stimulate the economy through the creation of jobs, their exceptional growth rate, their heavy investments and their international expansion. Venture Capital is considered as a factor decreasing the required time to introduce an innovation on the market.

Many studies have been conducted about the (US particularly) Venture Capital Industry (Isaksson, 2006, Sandler, 2004), ignoring the experiences in other countries such as France. The fact that venture capital has its origin in the USA (around 1945) can be explained by continuous scientific achievements, technological inventions and improvements, but also by the supporting environment for the combination of free entrepreneurship, technology-oriented know-how and capital (Kortum and Lerner, 1998). It is worth noting that many of the most successful high-technology companies in the United States, such as Amazon, Apple Computers, Cisco, Genentech, Intel or Yahoo have all been financed with Venture Capital. Inspired by this development, many countries all around the world have tried to create a positive and efficient environment for risk capital. This environment has been in some cases an important catalyst for the emergence of venture capital. In Europe, the venture capital industry emerged in the 70’s and the European Venture Capital Association (EVCA) was created in 1983 in order to support collaboration between national VC companies. There is no formal evaluation of the impact of VC on aggregate economic growth, and very few investigations in other industrialized countries. Differences in economic and social structure and legal and fiscal environments may create a different industry from the US and between 2 European countries such as France and Sweden; both countries belong to Europe but have different frameworks, government policies which could influence the venture capital industry. Cumming and MacIntosh (2002) demonstrated that differences in legal and institutional factors between the US and Canada created differences between the venture capital industries in the two countries. Black and Gilson (1998) showed how the capital market laws affect the
development of venture capital industry. Differences in the institutional, legal and cultural environment and in dominant corporate governance systems (Hofstede, 1984; Hampden-Turner and Trompenaars, 1993) may significantly influence the conduct of business. On the other hand, Ooghe et al (1991) investigated the similarities and differences that exist among European countries and conclude that there is strong evidence to assert that European Venture capital industry is not homogenous and every country has some unique characteristic. If we want to compare 2 countries, one should take into account these characteristic before generalizing.

Preliminary Industry Background:

Venture capital has its roots in the US in around 1945 and knew a growth in the 1950’s with the development of electronic industry and its new products. In 1958, the Small Business Investment Act was implemented to regulate the Venture Capital industry and establish the Small Business Investment Companies. But it is from 1978 that Venture Capital really took off with liberal fiscal laws such as the reduction of the plus value tax. From 1979 to 1983, the funds invested in Venture Capital were multiplied by 6 to more than US$2bn.

Development in Europe:

Although venture capital comes from the US, it is hard to compare European to American Venture Capital. Indeed, the characteristics of the American innovation model cannot be found in Europe, where the innovation system is hardly favorable to the emergence of new and growing firms (Dubocage, 2002). Another difficulty for European market is to exploit scientific discoveries commercially. This is particularly true for France, where the education system and public research favor basic discoveries, but which have difficulties in finding applications. The largest part of fundamental research is organized and funded by CNRS, a special institution which is State-funded and separate from the higher education sectors. The innovation gap which can be defined as the gap between basic research and commercial innovation is therefore bigger in Europe than in the US.

The equity gap can be defined as a lack of equity for the innovative firms from venture capital rationing. During the second half of the 90’s, investors provided funds more in larger projects that promised rapid returns on investment (Dubocage, 2002). The equity gap was then bigger for the small firms seeking low volume of capital.

During the 80’s, public policies sustaining venture capital were developed in order to remain competitive in the field of high technology. An interventionist policy was necessary due to the European system of innovation, which differ from that of the US where the large firms and universities show more interest in innovative firms. This policy is to support new actors and practices rather than subsidize existing firms or industries.

The involvement of the governments in Europe was made through a combination of three sets of measures (Avnimelech and Teubal, 2003): 1) Direct government investments; 2) Tax and other incentives to private sector investments in VC (capital gain taxes…); 3) regulatory changes principally affecting Pension and Insurance funds.

In Europe, the venture capital industry was unattractive until the mid 1990’s because the links between the universities and the start-up were weak, which express the difficulties of applying basic discoveries, making the selection of a project riskier and therefore increasing related costs (Dubocage, 2002).
French venture capital industry as well as European one is quiet new but according to the current statistics, it is performing quiet well. France is well known for its efficient public services and a strong presence of the state for public expenses or work regulation. The economy is mainly made of a few big companies (which some of them are state owned such as Gaz de France or SNCF) that existed 30 years ago and there is a lack of young innovative companies that succeed such as Microsoft or Google in the US. According to Landier and Thesmar (2007), the retirement system (people working now pay for retired now) would lead the French to avoid to invest in companies, more profitable but more risky. French people are not confident in the payment of their retirement so they invest in safe placements. Some big banks and insurance companies (such as BNP Paribas, Société Générale or Axa) are important actors of the French economy and traditionally, the country does not have a culture of risk. Even if Sweden has an export oriented economy with high technology features, the economy seems to be similar with the French one with a few big companies (such as AstraZeneca, Ericsson, ABB) and a welfare state. Therefore, it is interesting to wonder if Venture capital knew the same development and follows the same paths.

Only a few studies on the European venture capital industry on a macro level exist. Besides the surveys of the EVCA, the main studies are those of Tyebjee and Vickery (1988) and Roure et al (1990). Tyebjee and Vickery tried to explain the major differences (that they thought important) among the venture capital industries in the different European countries in the early 1980. Roure et al asked 34 major European venture capital firms what were their views and what their strategy would be in the future, the European “environment” and the expected level of competition. They also examine the differences in environmental factors between Europe and the United States and among European countries: the “entrepreneurial climate” could be thought to be higher in the US because the superiority of a market based system versus a bank-based system (such as in Europe) but in fact is not so much when comparing the annual rate of business start per capita; it was showed (Dubocage and Rivaud, 2002) that the UK (market based system) is less preferent than Germany in innovative, high risky segments; they also conclude that the countries where the secondary market is active are with the biggest venture capital industries.

But does the globalization convergence of different financial systems not make consideration of the national characteristics? On this point, Dubocage and Rivaud (2002) conclude that globalization does not signify that the national dimension no longer plays any role and venture capital is at the same time both an international and a local activity. The government incentive may also have an impact on the climate of venture capital industry. Ooghe et al (1991) also compared Europe to the United States and find that the European industry overtook the American one in 1988 in terms of the investments and had almost the same pool of available funds in 1989.

If some comparisons have been made between the US and Europe as a whole, very few cross country comparisons have been done so far, except the cross-country study of investment analysts covering the UK and Germany by Pike et al. (1993).

Some studies on the venture capital industry exist, such as the yearbooks of the national or European Venture Capital Association (EVCA). Although these studies give very clear picture of local venture capital industry, they are never compared with those of other countries. The purpose of this study is to identify the general patents of French venture capital industry and to try to compare it with Sweden and the US. This could not only be useful for
academics, but also for entrepreneurs looking for capital by understanding what the VC’s are looking for and how they behave after an investment.

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1.2 Research question:

What are the main characteristics of the French venture capital industry? Can we compare it with Swedish and US venture capital industry?

1.3 Purpose of the study:

The purpose of this study is to analyze the venture capital industry in France at a macro level. This is made by analyzing historical data and through interviews with french experts and to compare with Sweden and the US. Since the main interest lies with venture capital industry, the US will be used as an example given the specialization that prevails there.

1.4 Limitations of the study:

The study intends to analyse the venture capital markets at a macro level, trying to identify the main characteristics. Then the firm-level will not be analyzed. The thesis is focused on venture capital and does not analyse the private equity market. The other category of investments included in private equity, in addition to Venture capital, is buyouts. Buyouts are usually applied to more mature industry. In a LBO, debt is used to acquire a company and reduce its equity base. MBO are LBO where current management takes control of its company. The primary interest of this study focuses on venture capital, and will then exclude these stages of investments.
1.5 Thesis outline:

The first part of the thesis deals with the methodological choices and data collection process.

The beginning of the second part explains the process of Venture capital to give the reader a better understanding of what venture capital. Then it analyses the historical data and tries to find general patents and drivers of the French VC industry.

The next part presents the findings from the interviews.

The fourth part will analyse the data.

The last part will conclude.

Figure 1 sums up the process of the thesis.

Figure 1: the thesis process
2. Methodology.

This section covers a number of important issues relating to the methods and the analytical processes used in the study. It includes the reasons for choosing this topic and the author preconceptions and motivates the choice of the method of collecting and analyzing the data. It also allows the reader to review and understand the relative suitability of the methodological choices that the authors have made along the way.

2.1 Choice of the subject

To find a subject is not an easy task. It requires a lot of readings and the topic has to be researchable to induce a suitable research question. As I am an exchange student in the master in Finance, I wanted to write my thesis in the finance area. I decided to narrow my research in that domain, and particularly on Venture Capital. I liked the course of corporate finance given during the master program at Umeå School of Business and Economics, and I wanted to extend my knowledge in Venture Capital. I also read the thesis of my supervisor on venture capital, which interested me and gave me the motivation to study that topic. As I worked last summer in the French bank BNP Paribas as an intern in the entrepreneur department and I could see that the SME market plays an important role in the economy today, at least in France. The bank had problems to grant loans to the SME companies. There are many opportunities but the banks are often reluctant to loan these grants. That was another good reason to study about the SME market and the possibilities of financing. A cross country comparison is still interesting to do for a thesis and I took the advantage to be a French student in Sweden to compare French and Swedish venture capital markets.

2.2 Preconceptions

To make this study valid, it was of primary importance to get rid of any preconception. The study is based on a comparison between two countries and it leads to conclusion, I have a background in finance and my knowledge come from the different courses that I took during my studies. But apart the course of corporate finance taken this year during which we saw very quickly the venture capital process, I did not know very much about that concept. In fact, the market is not very developed in France and few people (outside financial world) have heard about it. This made the study easier because my preconception did not have an influence of the conduct of the study and it could be more objective. However, conclusions may be wrong if we engage in speculations that are far from the data. As the study was done at a macro level, the market as a whole was analyzed and the conclusions were easier to draw.
2.3 Perspective of the study

The aim of this study is to draw conclusions by analyzing past data and interviewing different experts of French Venture capital industry. It tries to compare it with the Swedish and US ones. The perspective is to contribute to the academic and theoretical view of the French venture capital market. The data were collected from database in order to perform a comparison and see some characteristics that lead to conclusion. The perspective is then academic and institutional.

2.4 Research approach

Inductive and deductive are the two main approaches when conducting a research work. In the inductive process, the researcher infers the implications of the findings for the theory that prompted the research. The observations or findings should lead to the theory. makes a number of observations which are then sorted into a concept or generalization; the individual does not have prior knowledge of the abstraction but only arrives at it after observing and analyzing the observations. Induction is often associated with qualitative research design. On the contrary, the starting point in the deductive approach is the theory or concept which guides the process of data collection. Deduction is often associated with quantitative research design. A third process, Abduction is a mix of inductive and deductive processes. Abduction, or inference to the best explanation, is a method of reasoning in which one chooses the hypothesis that would, if true, best explain the relevant evidence. Abductive reasoning starts from a set of accepted facts and infers their most likely, or best, explanations.

In order to answer the research question, I first took the data for France and Sweden mainly from the EVCA reports, and then I tried to draw conclusions and made the interviews. The approach of this study is therefore abductive with the goal to explain the conclusions made previously.

This study is based on a comparative design and a cross-national research. Hantrais (1996) has suggested that such research occurs when individuals or teams set out to examine particular issues or phenomena in two or more countries with the express intention of comparing their manifestations in different socio-cultural setting (institutions, customs, traditions, value systems…)(Bryman, 2007).

Epistemological consideration: an epistemological issue concerns the question of what is regarded as acceptable knowledge in a discipline (Bryman, 2007). It refers to what reality is. The two epistemological orientations are positivism and interpretivism. Positivism is a position that advocates the application of the methods of the natural sciences to the study of social reality and beyond (Bryman, 2007). The opposite concept is Interpretivism which requires the researcher to analyse the subjective meaning of social action. The subjective meaning of social action is what is important. My starting point was the data collected, so the epistemological orientation is interpretivism. The reality comes from the mind of the researcher.

Ontological consideration: it refers to the question of weather social entities can be considered objective entities that have an external reality. The two orientations are
objectivism and constructionism. Under Objectivism, social reality exists outside of the researchers’ mind. It is external to the researcher. On the contrary, with constructionism, the reality in the social world is constructed, and not wholly existing out there. Social phenomena and their meanings are continually being accomplished by social actors. The conclusions drawn will come from the researcher’s mind, so we can assume a constructionism approach.

2.5 Data collection

This part explains how the data were chosen. The secondary data came mainly from the EVCA reports and research papers, while the primary data were based on interviews.

2.5.1 Secondary data:

Academic research papers:
The use of academic publications was mainly to acquire knowledge and to identify existing theory applicable for the research. The research papers have been used as the main source as they supply different perspectives to the subject and they often are making cross references and extending each other. It not only helps to understand the phenomenon of venture capital better, but it also contributes to draw conclusions and hypotheses about the venture capital industry in France and Sweden. These hypotheses will serve as a guide for the interviews.

Books:
A lot of books have been written about venture capital, particularly about the process. These books helped me to understand the venture capital process.

Websites
The main websites used were those of the AFIC for France, SVCA for Sweden and EVCA for Europe. They all provide accurate and up to date data for the venture capital industry. The data published on the AFIC website come from answers from members of the association collected on the website www.afic-data.com. These websites helped me to understand the particularities of the venture capital industry in each country and provided some data that were used to draw graphs and have an outlook of the venture capital industry in detail. These graphs are added in the first part to compare different characteristics of the venture capital industry. They were used to draw a questionnaire to do the interviews. Each year, the EVCA publishes a yearbook which provides an overview of the European venture capital industry with reliable data.

2.5.2 Primary data

Interviews:
A common way to categorize the structure of interviews is: Structured-, unstructured- and semi-structured interviews (Saunders et al. 2003, page 246). Structured interviews follow a
The semi-structured interviews seemed to be the most appropriated in order to answer the research question. It could use the theory as a starting point, and also bring new insights and informations for the research.

The aim of the interviews was to try to find the main trends of French and Swedish venture capital. At the beginning I wanted to ask both French and Swedish venture capitalists experts, but as I was in France during the final part of my thesis, I thought it would be better to focus on the French market. The initial goal was to answer 6 to 8 venture capitalists experts who could have a general view of the trends. I decided to answer people from the French private equity association (AFIC) along with experienced venture capitalists and people from the French government, in order to fulfill the criteria of reliability. 3 experienced venture capitalists and one person from the AFIC were interviewed (only 6 interviews were translated due to a technical problem), along with one from the state owned company CDC and one from the french association of asset management. The panel was then quiet complete, even if there could have someone from the ministry of economy.

The interviews were all conducted by phone (most of the people interviewed are based in Paris and I live 500km south). The interviews were all recorded and the persons were warned for that. All were in French and then translated in English.

Selection of respondents:

The topic of venture capital is so interesting and so wide that a lot of questions may be asked and I could ask many people in the field. However, as the research question focuses on the general trend, I thought that it was better to ask experts of venture capital, instead of venture capitalists for example. I choosed to ask experienced venture capitalists and people from the French venture capital association. 5 venture capitalists and one person from the french private equity association were interviewed.wer and the respondents to go in-depth with certain questions and extend both question and answer, bring more insight into the field (Saunders et al. 2003, page 246)

2.5.3. Questionnaire design:

The interviews were divided into sections: I started to ask question about the definition, then I ask about the general trends and the drivers in the industry; after I asked for the role of the government and the venture capital industry in France.

The first part of the questionnaire was about the definition of venture capital in Europe. As I found during my theoretical part, it is not so clear in France (and Europe) as it is in the US. It was quiet difficult to find information about French venture capital when I wrote the theoretical part because the term venture capital is often replaced by private equity. I wanted people to explain the reasons for that.

Then the questions were about the general trends of the venture capital industry. First, it was about the current trend of the French venture capital industry. Then, I asked about the impact of the financial system on venture capital development. The questions were deducted from the
theoretical part 3.5 (bank versus market oriented). This question was vague for some of the respondents and I had to explain my findings from the theory before they could give their opinion.

The following section focused on the role of the government in the development of the VC industry. One of the main question was how much should the public authorities be involved in the financing of SME? The answers were different depending on the respondents. This section was quiet important because most of the respondents spoke about governmental action before I asked question about it.

The last section was about French venture capital industry trying to find reasons why the early stage are not so developed than in other countries such as in the US or even Sweden. The questions were based on data that I collected from the AFIC and EVCA with figures that showed that the industry was more developed in later stage

The order of the different sections of the questionnaire could move from an interview to another and depending on the answers of the respondents, I changed the order of the questions and sometimes the formulation. But in general, all the same questions were asked to the respondents.

An interview guide can be found in appendix.

2.6 Critics and limitation of data collection

For the primary data, as the interviews were conducted in French, it is sometimes difficult to translate or to explain in English. Some venture capitalists may also not have a sufficient global view of the trend.

Moreover, we could expect the answers of the respondents to be different depending on who they are and who they represent. Indeed, we could not expect the same answers from a private VC firm and a state owned company. We can not expect a VC firm to defend the government. That’s why I interviewed someone from a state owned company (CDC), to have different views. The diversity of people may smooth the respondent answers.

For the secondary data: the frontier between venture capital and private equity is not very clear in Europe, particularly in France. The definition often includes the LBO in venture capital, which makes a larger definition, contrarily as in the US. Sometimes, the figures taken may correspond to private equity instead of venture capital.

The sample taken by the AFIC to establish their data comes only from the members of the association. One could argue that it’s not a random sample, but there is quite many companies in it.

The data for Sweden came from the svca website, on which most of the information is in Swedish. Even if it is translated in English, it makes the access of information limited.

Moreover, it was hard to measure VC market at an industry level, due to the lack of reliable data for immature markets such as Swedish and French ones. The statistics from the European Venture Capital Association are not so reliable because the industry is discrete and reticent. The market is also changing very fast, and another reason is the fact that counting venture capital firms and capital is hard and subjective. Some articles from the literature review were quiet old and things may have changes since that time. The persons interviewed gave an insight of the last years, whereas the literature is not very big on this period of time.
2.7 Validity.

Validity is concerned with the integrity of the conclusions that are generated from a piece of research (Bryman A & Bell E, 2007). It is concerned with whether the findings are really about what they appear to be about.

Internal validity:
The research is using general theories which are supported by few interviews. These interviews might be affected by external factors due to the small number of interviews.

External validity:
External validity is concerned with the findings being applicable in other contexts. The interviews are all conducted in one country, with few but qualified and reliable sources. These sources are believed to be highly representative of the French VC market and the panel was quiet wide to have a general view.

2.8 Reliability

Reliability is concerned with the consistency of a measure of a concept. It is important that a study generates trustworthy and reliable results (Bryman & Bell 2007). There are some questions that one can use to assess reliability:
- Will the measures yield the same results on other occasions?
- Will similar observations be reached by other observers?
- Is there transparency in how sense was made from the data?

The theories used in the theoretical part were carefully choosed and are the reference on the venture capital publications. The secondary data were taken from official papers or from the websites of the venture capital associations.
3. Definitions and trends of the venture capital market.

The first part of this chapter will mainly help the reader to better understand what venture capital is and how does it work. The second part will analyze the historical data based on the EVCA statistics and draw some trends of the French and Swedish Venture Capital market. main drivers found in the literature in the venture capital industry and the main problems related to the industry.

3.1 Definition of Venture Capital:

3.1.1 Venture capital and private equity:

According to the European Venture Capital Association (EVCA) the private equity industry provides equity capital to enterprises not quoted on a stock market. Private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a firm’s balance sheet. It can also be used to resolve ownership and management issues in connection to successions in family owned firms or in connection to buyouts (EVCA, 2005). Venture capital is a subset of private equity and refers to equity investments made for the launch, early development, or expansion of a business.

3.1.2 The venture capital mechanism:

The European Venture Capital Association (EVCA) defines venture capital as “Professional equity co-invested with the entrepreneur to fund an early stage (seed and start-up) or expansion venture. Offsetting the high risk the investor takes is the expectation of higher than average return on investment” (EVCA, 2006).

Venture capital is part of private equity. The investments in equity investments are in seed, start-up- or expansion phases. The Buyouts are the investments in more mature development phases. The venture capitalists not only provide capital, but also competencies. The skills involved are not only general management skills, but also industry and technology specific competence including the ability to connect the firm to a larger network of actors (Jacobsson, 1999).

According to Sahlman (1990) we can divide the financing process into stages:
1. Seed investments
2. Startup
3. First stage- early development.
4. Second stage- expansion.
5. Third stage- profitable but cash poor.
6. Fourth stage- rapid growth toward liquidity point.
7. Bridge stage- mezzanine investment.
8. Liquidity stage- cash out or exit.

Venture capital covers the seed, start-up and expansion stage which were defined by the European Venture Capital Association as:

- Seed stage: financing provided to research, assess and develop an initial concept before a business has reached a start-up phase.
- Start up stage: financing provided to firms for product development and initial marketing. Firms may be in the process of being set up or may have been in business for a short time, but have not sold their product commercially.
- Expansion stage: financing provided for the growth and expansion of a firm, which may or may not break even or trade profitably. Capital may be used to: finance increased production capacity, market or product development, provide additional working capital.

Seed and start up stages often referred to early stage.

Venture capitalists generally:

- Finance new and rapidly growing companies;
- Purchase equity securities;
- Assist in the development of new products or services;
- Add value to the company through active participation;
- Take higher risks with the expectation of higher rewards;
- Have a long-term orientation (nvca, 2008).

Venture capital is often defined as “private equity”, particularly in Europe, including the buyouts. But in the US, private equity is clearly divided into venture capital and buyout capital. This thesis focuses on venture capital as defined in the US, that is to say firms who have received equity investments for the launch, early development, or expansion of the business and on the venture capital firms who perform these investments, be they seed, start-up, or expansion stage investments.
Figure 3: Overview of the types of financing for a firm.

Venture capital is characterized by a double obstacle (Dubocage, 2002): the high level of fixed costs relating to the selection and monitoring of firms combined with low economies of scale and the economic risk concerning the viability and results of the firm.

The exit mechanisms:
According to Cumming and MacIntosh (2002), there are five exit mechanisms: an IPO, an acquisition, a secondary sale, a buy-back and a liquidation, reconstruction or bankruptcy.

An exit may be full or partial. A full IPO exit is defined as one where the venture capitalist sells all her holdings within one year of the IPO. A partial IPO exit implies that the venture capitalist has sold only part of her holdings during the same time period (Cumming and MacIntosh, 2003). A full trade sale exit involves the sale of the entire firm for cash. In a partial trade sale exit, the venture capitalist receives - often illiquid - shares in the acquirer company instead of cash (Cumming and MacIntosh, 2003). A partial trade sale typically arises when a private company buys the portfolio firm using its own shares (Cumming and MacIntosh, 2003). In this case the shares are necessarily very illiquid due to the absence of a ready market in which to sell the shares and because private companies typically have constitutional or contractual restrictions on the ability of any shareholder to resell her shares, such as requirements for board and/or shareholder approval of a share transfer (Cumming and MacIntosh, 2003).
In the case of partial exits, at least part of the ownership remains in the hands of the portfolio firm owners. Furthermore, their interests in the firm’s assets are less substantial than the direct interest they formerly held (Cumming and MacIntosh, 2003).

3.2. The Venture Capital process:

3.2.1 Overview of the process:

We can identify 3 main types of actors involved in venture capital: investors (who provide funds to VC firms), VC companies and innovative firms:

![Figure 4: the venture capital process](image)

3.2.2 The steps:

VC’s investment activity is a process that can be described by 5 steps (Tyebjee and Bruno, 1984) which can be sum up as followed:
Figure 5: Decision process model of venture capital investment activity.

The first step is **deal origination**, during which venture capitalists become aware of investment activities. Deals may be referred to the VCs through their parent organizations, trade partners, industry associations, friends… In an environment with increasing competition for deals there appears to be a move toward more proactive approach (Wright and Robbie, 1998).

The second step is a **screening** process, during which venture capital firms focus on possible deals, regarding their own knowledge: they limit their investments in familiar areas, particularly in terms of the technology, product and market scope of the venture. The size of investment, geographical location and stage of financing could also be used as the broad screening criteria. According to Fried and Hirisch, 3 criteria characterize this step:
- integrity, track record and leadership skill of management
- reliability and novelty of the project
- possibility for high return and an exit.

The **evaluation** step assesses the potential risk and return. This is generally a subjective assessment due to the lack of past financial data to analyze, and is based on the business plan presented by the venture’s management.
The investment valuation process is aimed at ascertaining an acceptable price for the deal. The valuation process goes through the following steps (Damodaran, 2002):

- Evaluate future revenue and profitability
- Forecast likely future value of the firm based on experienced market capitalization or expected acquisition proceeds depending upon the anticipated exit from the investment.
- Target an ownership position in the investee firm to achieve desired appreciation on the proposed investment. The appreciation desired should yield a hurdle rate of return on a Discounted Cash Flow basis.
- Negotiating the valuation.

The main methods for evaluating a firm include:

- the Discounted Cash Flow method that use a discount rate to calculate the present value of future cash flows. The main problems with this method are to estimate the future cash flows of the firm and to apply an appropriate discount rate that reflects the risk of investing in the firm (Isaksson, Fredriksen, 2002).
- the Capitalized maintainable earnings: a simplified method of DCF valuation
- the venture capital method

Some other methods include: Adjusted Net Assets, Excess Earnings.

If the outcome of the evaluation process is positive, then the venture capitalist and the potential investee negotiate about the amount, form and the price of investment. They establish the deal price (the equity share the investee will give in exchange of capital) and protective covenants that will limit capital expenditure and management salaries, and in which extent the VC’s can take control of the board, force a change in management or liquidate the investment by forcing a merger, acquisition or public offering.

When the deal is concluded, the venture capitalist is involved in the management of the firm. This involvement varies from one to another, but it is recognized that they should not have too much control by the day to day operations of the firm (Tyebjee and Bruno, 1984).

In France: the venture capital companies have 4 main sources of prospection (Tabourin, 1996):

- the relations with the major shareholders, that is the banks in general
- Institutional, which are public organisms (such as the ANVAR, the CCI).
- Proposition from the entrepreneur interested
- Other sources.

The first 2 sources represent 50% of the propositions with a large presence of the banks. In comparison, the banks count for only 6% in the US (Tabourin, 1996).

Most of the propositions are inspected by the banks, which obviously favor the development projects. There is a lack of active prospection and a lack of informations of the entrepreneurs, who are sometimes lost with the complexity of the information (Tabourin, 1996).
3.3 The alternatives to venture capital financing:

The use of venture capital is preferable to debt in numerous cases: Wright and Robbie (1998) argue that this kind of financing is preferable for firms with non-redeployable or highly specialized assets, or when there is uncertainty of cash flows in early stages new technology business in particular. However, there are some alternatives to venture capital that we will present in this section.

Wright and Robbie (1998) see three competing founders for venture capital: informal venture capitalists, LBO Associations and banks:

**Informal Venture capitalists:** or business angels (see later section). They are typically individuals who provide capital to start-up firms and give his knowledge, competencies and experience to develop the company. Since informal venture capitalists are involved in monitoring their investments and have relationships in the business, it is assumed that there is probably less information asymetry (Landstrom, 1992).

**LBO Associations:** the main difference comes from the nature of the relationship between investor and investee.

**The banks:** they prefer to invest in well-established and stable activities because they are looking for the payment of the debt. For these companies, the information must be reliable and robust in order to be able to evaluate the future value of the company (Wright and Robbie, 1998).

Large companies could also play a role in the financing of start-ups. However, Hardymon et al (1983) find that legal difficulties often arise over whether the corporation has access to ventures’ proprietary information and corporate venture capital groups within large organizations may not be able to operate autonomously. Moreover, Sahlman (1991) notes that the entrepreneur is not enough motivated due to the absence of equity participation and the negative repercussion of failure.

3.4 The types of Venture Capital:

We can divide venture capital into 3 subgroups, depending on the nature of the investors (Allala, 2001): formal venture capital (investments made by professional firms. Public institutions focus mainly on early stages); informal venture capital or Business Angels (private individuals investing their own funds (Sörheim and Landström, 2002): such as alumni of Business School, CEO associations…). Business angels are only a few compared to the thousands in the US; and Corporate Venture Capital (later stage investments made by the big companies). Business angels tend to invest in the earlier stages and are more involved in the day to day monitoring of the firm (Landström, 1993). They invest their money and competencies in potential growing projects instead of in consumer goods and therefore are value creating (Isaksson, 2006).
We have explained what is venture capital and how does it work, referring to the US framework. Now as it should be more clear for the reader on the definition and process, I will continue by giving an insight of the French and Swedish Venture Capital industry.

3.5. Overview of the venture capital industry.

3.5.1 History of the Swedish venture capital market:

Swedish venture capital started in the 70’s and can be divided into 2 major cycles: the first which lasted from the early 80’s to around 88-89 and the second from around 1993 with a peak around 2000-2001 (Isaksson, 2006).
The first cycle:

During the late 70’s, the economic situation was not very good and the tax system was not encouraging capital investments. With the creation of the OTC Market in 1983, a more liquid market appeared with a better economic climate which contributed to the beginning of the venture capital industry. The early 80’s were also marked by involvement of the Swedish government by setting up regional development funds that supported small firms with soft loans and advice (Herzog, 1987).

In the late 80’s, the stock market went down and the investors saw the VC market to make high profitability with short term investment horizon (Isaksson, 2006), which decreased the growth of VC industry. There was also a problem of inexperienced management, they adopted inadapted style for small firms.

The second cycle:

It started around 1995/96 and knew a big growth. The following reasons may explain this growth: first, the stock market was increasing fast, and domestic private savings and allocations of capital from pension funds for private equity also increased. Vast capital inflows from foreign investors, both European and non-European became active players in the Swedish market (Baygan, 2003). Some government incentives may also explain this growth. Moreover, the demand increased together with the increase in high technology ideas and a strong involvement of Sweden in research and development.

After that, the market seemed to slow down in the late 90’s and in 1999, Swedish venture capitalists were investing more in seed and start-ups than in any other European country (SVCA, 2000). The market collapse was followed by the disappearing of small firms created during the boom. In 2002, the number of venture capital investments was estimated to decline by 25% and the amount of investments by 50% from 2001. The most severe decrease has been in investments in early-stage firms in the seed and start-up phases. Then, the years after were characterized by a reluctant and risk avoiding market (Isaksson, 2006).

3.5.2. The role of the Swedish government:

The Swedish government had both a direct (by creating entities) and indirect (by creating a favorable environment through tax incentives) role in sustaining VC industry.

Sweden had traditionally a strong banking sector regulated until the mid 80’s. In the early 90’s, a financial crisis happened due to a financial deregulation which led to rapid lending growth, and although the banking sector was restructured at that time, it counted for only 10-12% of total inflows for venture capital.

In 1996, the Sixth Swedish National Pension Fund was created to provide risk capital for small and medium-sized businesses. The fund could invest in Swedish private equities without limitation. From the beginning, the fund’s capital has increased from SEK 10.4 billion to SEK 16.7 billion. Currently, the fund is one of the largest domestic investor and has participation in around 350 Swedish businesses, of which 64 are direct investments and the others are via private equity funds and investment firms (Sixth Swedish National Pension Fund, 2002).
In 1999, some rules governing public pension funds were also regulated.

Tax incentive: Sweden is a country with one of the heaviest tax burden. Sweden has limited fiscal incentives to venture investments (OECD, 2002a). The basic capital gains tax rate in Sweden is 30% for individuals and 28% for corporations. The tax system remains a hurdle for venture capital companies, because the tax level is high for investments in unlisted companies. A first tax reform was introduced in 1982, based on the suggestion of the “Growth Capital”. The second and more extensive tax reform was established in 1990–91 and the maximum personal income tax was reduced to 55–58% from as high as 85% while the corporate tax rate was lowered to 28% in 1994 (OECD, 1998). Today, the tax system still remain unattractive for VC industry, with high taxation of the income.

The first venture capital fund, Företagskapital was created in 1973 by the government together with merchant banks. Regional development funds and corporations were also launched during this time but after a period of rapid growth in the 1980s, most of these funds were dissolved during the financial crises of the early 1990s (due to the small size, inexperienced management teams as well as unfavorable fiscal provisions). From 1982 to 1984, 20 private VC funds were established but it decreased from 1985.

In the 1990’s, a change occurred in the VC industry. As the limited partnership became dominant, the industry was able to attract talented and experienced managers to become venture capitalists (Jacobsson, 1999). In the 1980’s, the lack of experience of the investment managers was a handicap for VC industry. In the 1990’s, 2 investments funds were created by the government, Atle and Bure. The majority of capital was invested in larger, later-stage firms, and the government sold its share in 1993.

The year 2000 was, in numbers, a record year for the Swedish Venture Capital industry with 19.4 billion SEK invested in 569 companies. Buyouts doubled to 14.7 billion SEK.

According to a study lead by the Parliamentary auditor in 1996, the government did not have a positive impact on VC industry in the 80’s. The creation of governmental bodies that invest venture capital (Industrifonden, Swedish National Pension funds) is probably the policy that had the biggest impact on development of VC market during the 2nd cycle.

<table>
<thead>
<tr>
<th>area</th>
<th>Recent/planned action</th>
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<tbody>
<tr>
<td>Investment regulations</td>
<td>Regulations on public pension funds and individual retirement savings modified to expand allowable investments in venture capital.</td>
</tr>
<tr>
<td>Tax incentives</td>
<td>Government is considering proposal to exempt companies investing venture capital in other companies from capital gains taxes.</td>
</tr>
<tr>
<td>Equity programmes</td>
<td><em>Industrifonden</em> in co-operation with <em>NUTEK</em> (Swedish Business Development Agency) runs a small seed funding programme.</td>
</tr>
</tbody>
</table>
Business angel networks
SwedBan, CapTec and the Nordic Venture Network all working to link business angels with investment opportunities.

Second-tier stock markets
Nordic OTC created to provide common Nordic platform for unlisted companies.

Figure 7: Progress on Swedish VC policies (source: STI WORKING PAPER 2003/11).

3.5.3 The current trends of the market:

As we can see on figure 8, the market grew in the 90’s until the bubble in 2000, followed by a period of recession in the years after. 2002 seems to be the lowest peak in the industry and now we can observe an increasing trend.

Figure 8: Venture capital investments between 1996 and 2006 in SWEDEN (in €billion).

In terms of venture capital investments, Sweden ranks third in the world after the US and the UK. Figure confirms the trend of the growing market.

Investments by source: In 2006, only 18% of all private equity funds came from Sweden. We can then think that the country is able to attract investors from all around the world.

The main source of funds was the pension funds (EVCA, 2006) and in terms of amount invested, the early stages represented less than 5% of the total private equity investment.
Investment by type of activity: in 2006, Biotech, medical technology and IT were in the top for venture capital investors in numbers

3.5.4. Overview of the French venture capital market:

3.5.4.1 The Structure of French venture capital markets

The arrival of venture capital in France is generally dated to the end of the 1970’s but the industry really took off in the second half of the 1990’s (Dubocage, 2002). A new period started in 1996: Venture capitalists decided to focus on high technology and in 1999 a new phase began. The year 2000 was characterized by a peak: according to AFIC, €4.6 bn were invested and €5 bn of funds were raised.

![Venture Capital investments between 1996 and 2006 in France (in M€).](source: Afic/Pwc)

As we could expect in figure 7, the year 2000 knew a peak followed by a downturn in the industry. This graph looks like the previous one for the Swedish industry and confirm that there are some common points between the two. However, the downturn after the crisis in 2000 seems to be limited compared to Sweden. The increasing trend seems to be also smoother.

In 2007, venture capital investments represented 4% (or 416 investments) of the amount invested in private equity against 78% (or 462 investments) for the LBO.

29
The term of venture capital is wide in the case of France: it covers in general the capitals in search for risky investments with potential high returns (F Tabourin, 1992). The AFIC breaks down venture capital in three stages:

- Seed stage (Amorçage): finances the research before the creation of the company.
- Creation: finances the creation of the firm and the beginning of the activity.
- Post creation: finances the manufacturing and the commercialization of a product. It intervenes when the company has achieved the development of its product.

The most commonly used structures for private equity funds in France are: the Fonds Communs de Placement à Risque (FCPR), the Fonds Communs de Placement dans l’Innovation (FCPI) and the Fonds d’Investissements de Proximité (FIP), and the Sociétés de Capital Risque (SCR).

The FCPR:
The FCPR was created in 1983 and is defined in the law as a joint ownership of securities (copropriétés d’instruments financiers et de dépots). It is not a separate legal entity and does not have the legal capacity to contract. Any contracts must be concluded by the management company on behalf of the FCPR’s. An FCPR is formed by 2 founders, the Management company (Société de gestion de portefeuille) and the Custodian (dépositaire). The custodian, generally a bank, is chosen by the Management Company from a list established by the French Finance ministry.
The minimal capital required to form an FCPR is 400,000€. Each fund has its own characteristic concerning the field of activity.
The funds have to invest at least 40% of their asset in non-listed companies and it can not have more than 10% of shares of a company.
In 2007, most of the funds (75%) was raised through FCPR (AFIC, 2007).

The FCPI:
They are a type of FCPR which have to invest a minimum in innovative firms.
Since their creation in 1997, 143 fcpi funds have been created. Between 1997 and 2004, FCPI’s have raised almost €2.6bn.

The SCR:
The SCR was defined by the article 1 of the law of July 11th, 1985: their accounting clear-cut situation must be represented in a constant way to competition of at least 50% of parts, shares, convertible bonds or non-voting shares of French companies the shares of which are not listed. The object is exclusively portfolio management of non listed real estate companies, the shareholders are the providers of funds.

The FIP:
They are funds which are dedicated to regional investments. It is an FCPR where at least 60% of the assets have to be invested in non listed SME in a same geographical area.

The SCR and FIP invest mainly involved in the creation stage. (apce website).
FCPI, FCPR and FIP are limited partnership, not SCR. We can compare the FCPI with FIP as the figure
<table>
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<th>FPCI</th>
<th>FIP</th>
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<tr>
<td>Created in 1997</td>
<td>Created in 2003</td>
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<tr>
<td>Innovative companies</td>
<td>Regional companies</td>
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<tr>
<td>Oseo Innovation Qualification or R&amp;D expenses</td>
<td>No field limitation.</td>
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<td>No geographical constraints</td>
<td>3 neighbourings regions</td>
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<tr>
<td>All the stages</td>
<td>All the stages</td>
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<tr>
<td>No limits for the turnover</td>
<td>turnover &lt; 50 M€</td>
</tr>
<tr>
<td>Employ less than 2000 people</td>
<td>Employ less than 250 people</td>
</tr>
<tr>
<td>No quota for « young » firms</td>
<td>10% at least have to be young firms</td>
</tr>
</tbody>
</table>

**Figure 8: comparison between the FCPI and the FIP**

As we can notice, the FIP are more for the small and young companies than the FCPI; they are also limited to a region.

We can add two other vehicles for the fundraising in France: the SFI and the IRP.

**The SFI:**
The SFI (Sociétés financières pour l’innovation) were created in 1972 in order to: “facilitate the industrial development of technologic research and to promote and exploit inventions about a product, a proceed or a technique which have not been yet exploited or susceptible of entirely new applications”. The oldest is SOFINNOVA (created by the credit national). The SFI have to fulfill some requirements:
- they have to invest at least 80% of their capital in innovative companies with a

**The IRP:**
The Instituts Régionaux de Participation (IRP) are regional institutions, they generally operate in companies with more than 100 employees and a sale of. They can’t have more than 35% of the capital of a company. They mainly are involved in development rather than in seed stage.

The main advantages of these funds come from the limited partnership, the fiscal advantages and potentially high gains for the investors.
Some public companies such as the ANVAR or ADEME have been created by the government to reduce the gap between research and its application.
In France, the banks can obtain a guarantee by the financial institution OSEO for the financing of young and growing firm.

### 3.5.4.2 Funds raised by source:

When it comes to analyze the source of the funds, we can see from figure that in France, the funds are equally provided by insurance companies, banks, private individuals and funds of funds. However, this graph presents the source for the private equity as the AFIC did not provide data for venture capital.
According to the last data (AFIC), the main providers of funds in 2007 were the insurance companies (21%), the physical persons/families (18%) before fund of funds and banks (17%). It confirms the superiority of the insurance companies in the financing process, and the funds of funds are more and more important.
4. Theoretical Framework

This chapter is based on a literature review and it tries to explain what could explain the current trends (seen in the previous chapter). It presents the main theories existing on the topic: the different financial systems, their potential impact on Venture Capital, and the drivers identified by the researchers.

4.1. The financial systems: Banks-based vs market-based.

We can define two financial systems: a bank-based system, which is representative of countries such as Germany and Japan, and a stock market-based system, representative of the US.

There is wide agreement that the market-based financial system is more conducive to the development of venture capital than the bank-based system (Dubocage, 2002). Economists argue that certain financial characteristics would favor innovation in the new technologies. But the fact that a market-based system would be more favorable than a bank-based system for the development of VC is based on a simplified binary opposition.

The reasons for which a bank-system would not favor innovation are: given the contractuals, fixed nature of the salaries and the importance of guarantees provided by tangible asset, bankers prefer to invest in low-risky projects. Moreover, the few big banks that dominate the banking industry are more likely to lend to companies with which they have close relationship (Jeng and Wells, 1998). On the contrary, a market-based system would be more favorable to innovation because the capital market is capable of controlling managers of firms effectively (Dubocage, 2002).

Black and Gilson (1998) find argument for the superiority of a market-based system over a bank-based system for the development of VC industry. The US economy based on a market-system allowed the development of venture capital, and would explain why the investments would be more in early stages than in Europe. This would also explain why the UK, which has a more developed financial system, is more performant than the rest of Europe in the venture capital industry.

Black & Gilson (1997) develop a theory that a stock market based system is a condition for the development of a VC industry. They prove this by showing that the VC market in the US (stock market system) is much more developed than in Germany (bank-centered system), both in size and substance. In Germany, banks are the main providers of funds to VC organizations. Contrary to the US, the main investments are not done in early stage in high-technology industries.

One reason to explain the superiority of a stock market system is the form of exit. In both systems, the VC process ends with an exit of the company but in Germany, the exit is mainly through the company’s repurchase of the venture fund’s stake (Black & Gilson, 1997), and by IPO in the US. Indeed, an exit through an IPO allows VC providers to enter implicit contracts with entrepreneurs and this kind of exit is only available in stock-market centered system.

However, when it comes to compare the UK (most similar to the US system) with Germany, Dubocage and Rivaud (2002) find that the UK is not superior to Germany in the early stages and that the UK is less oriented towards innovative, higher-risk segments.
They explain this result because pension funds encouraged a low-risk behavior on the part of fund managers (Dubocage E., 2001) and no coherent voluntary policy was pursued during the 1990’s. Moreover, Germany overcame the obstacle by developing public policies.

French venture capital industry has historically been linked to the state: the first venture capital industry was Sofinnova (now the biggest in France) created in 1972, Banexi and Iris capital which are major players were linked to the french bank BNP and the state owned association CDC. Venture capital was developed thanks government programs and the creation of some state owned venture capital companies such as CDC or OSEO Innovation. The venture capital company CDC Innovation was created in 1996 and is a subsidiary of the state own company CDC. The company OSEO Innovation(result of a merger between the BDPME and ANVAR) has partnerships with the banks and favour loans to young and growing companies. It then stimulates the creation of companies in France.

A lot of venture capital companies were created with the beginning of the FCPI in 1996, mainly the subsidiaries of the banks such as BNP PE (Private Equity), Société Générale (SGAM AI PE), Caisses d’Epargne (Viveris Management), Natixis Banque Populaire… A lot of independent companies were also created (Truffle capital or OTC AM) and are supported by private banks (such as Tocqueville finance).

4.2. The drivers of VC industry:

The purpose of this study is to analyse the global patterns of the venture capital industry. We can ask if there are some drivers that would lead the development of the industry. Some papers have been published about it, and particularly Gompers and Lerner were interested in this question. The results that emerged from these studies are presented.

The macroeconomic factors: Gompers and Lerner (1998) analysed the determinants of fundraising for the venture capital industry. They developed an economic model of supply/demand, where supply is defined by the willingness of investors to provide funds and demand is the quantity of firms seeking VC funds. Supply is a function of expected return on investment and as demand decreases, the expected return increases.

IPO: the literature shows that the most attractive option for an exit mechanism is by IPO. The importance of an effective exit mechanism is also emphasized by Jeng and Wells (2000); it gives the possibility for the entrepreneur an incentive by acquiring control. On the demand side, the existence of an exit mechanism gives entrepreneurs an incentive to start a firm. On the supply side, investors are more willing to supply funds to venture capital firms if they feel that they can later recoup their investment.

Labour market rigidity: Sahlman (1990) shows how the labour market rigidities are a barrier for venture capital in countries such as Germany and Japan. Labour market rigidity impacts the demand for VC funds negatively (the higher labour market rigidity, the less demand for venture capital funds).

An economic factor that could affect the supply was regulatory changes in the pension fund policy in the US. Before 1979, the principle of prudence stated that the pension managers had to invest with the care of a “prudent man”. The ERISA (Employment retirement Income
Security Act) rule in 1979 incited more pension managers to invest in pension funds. The contribution of pension funds for venture capital then increased from that time. The supply side could also be affected by some macroeconomic factors, such as the level of interest rates. If interest rates increase, it makes the bonds more attractive for the investors.

Gompers and Lerner (1998) also find that demand plays an important role. The increase in demand will lead to an increase in the quantity of venture capital activity. Higher GDP and increases in R&D spending lead to greater venture capital activity. Another important economic factor is the capital gain tax rate: a reduction in capital gain tax might be an incentive for the investors. As shown in several studies in the US, one of the main reasons for the growth of the VC industry has been the reduction of the maximum capital gains tax rate from 49.5% to 28% in 1978, and to 20% in 1981 (Bygrave and Timmons 1992; Fenn et al. 1995). There must also be appropriate governance forms – for example, limited partnership – which provides incentives to staff in the VC industry (Jacobsson, 1999). Poterba (1989) also argues that reductions in the capital gain taxes rate has an effect on the demand for venture capital, because more people are induced to become entrepreneurs and better projects are bought on the market. This is probably why the main change in the venture capital industry in the past 20 years in the US was the development of Limited partnership. This organization is attractive because taxes are not paid by the limited partnership, but only by the investors. The venture capitalist act as general partner and the outside investors as limited partners. However, an increase in capital gain tax rate might affect more the US VC industry than the European one, because the effect is significant for contributions by pension funds, which are dominant in the US.

4.3. The relation between external investor and venture capitalists:

When designing the contracts between investors and venture capitalists, three main problems may arise: the agency problem, the operating cost problem, and the sorting problem.

3.7.1 The agency problem:

Venture capitalists act as agents for the limited partnership, who choose to invest in entrepreneurial ventures through an intermediary rather than directly. In such situations, conflicts of interest between the agent (shareholders) and principal (manager), which must be address in the contracts and other mechanisms that govern their relationship (Sahlman, 1990).

An agency problem may arise in the valuation of investments because it venture capitalists as agents who are responsible for such valuations and on which their performance will be judged (Wright and Robbie, 1998). As Sahlman (1990), the agency problem is particularly difficult in venture capital industry. There is a high degree of information asymmetry between the venture capitalists, who play an active role in the portfolio companies, and the limited partners, who cannot monitor the prospects of each investment as closely. But contracts are designed with several key provisions to protect the limited partners from the possibility that the venture capitalists will make decisions against their interest (Sahlman, 1990). Some of these are the limited life time of the fund, the right to withdraw from funding the partnership. Another reason is the
compensation system that is designed to give the venture capitalists the appropriate incentives. (the fund managers typically receive 20% of the profits generated by the fund. Finally, Sahlman (1990) find that the contract addresses obvious areas of conflict between the venture capitalist and the limited partner. (the venture capitalist is often prohibited from self-dealing or is required to commit a certain percentage of his effort to the activity of the fund.

3.7.2 The operating cost problem

According to Sahlman (1990), two operating costs may arise: taxes and continuing operating costs. For the taxes, partnership gains are not subject to taxation and the limited and general partner report the gains and losses on their individual tax returns. The other operating costs according to the author are scale economies (when the unit cost of production and distribution of a product declines as the volume increases), scope economies and learning curve effect.

3.7.3 The sorting problem:

The problems concerns in which venture capital companies the limited partnership will put their money. Distinguishing the “good” from the “bad” venture capitalist is an important issue. First, the investors spend resources on due diligence, by reading the offering memoranda proposed by the venture capitalist, and checking the venture capitalists’ credentials (Sahlman, 1990).

A basic idea to pick the “right” venture capital company is that they are more likely to accept a finite life of the partnership and the compensation system will depend heavily on investment returns. For example, they can accept a continual review of their performance every few years.

4.4. Conclusions from the theory:

The financial system has an impact on the development of venture capital industry. The bank-based system does not seem to favor innovation and high technology projects. On the contrary, a stock market based system such as in the US allows the development of venture capital industry by the financing of young and risky projects. However, some substitutes have been developed in the bank-based system to develop the industry, such as government involvement through incentives.

Moreover, an efficient exit mechanism is important for the development of venture capital companies, and a strong financial market will be the most appropriate to this issue.

The development of high technology industry in the late 90’s had an impact on venture capital industry as a whole, both in France and Sweden, where VC market knew a big growth. The bubble had also an impact on both countries and the industry had a peak during this period and sharply decreased after.

One can also notice the impact of the improvements in the stock market during the 1990’s, making access to capital easier and then contributing to the development of venture capital industry. Exit possibilities have also improved with the development of new stock listings and interest from larger foreign corporations acquiring Swedish technology companies in areas like IT, telecom, the internet, pharmaceuticals and biotechnology (Tom Berggren, 2001).
The venture capital investments represent only a small part (5% in 2007) of the amount invested in private equity and the LBO market is much more developed. The industry of venture capital in France is very far from the US model and may generally be defined as shareholders equity investments in non listed companies. The relations between entrepreneurs and venture capitalists are sometimes not contributing to venture capital development. In a French autocratic tradition, entrepreneurs like to keep the power and therefore are looking more for “sleeping partners” (F Tabourin, 2006). French venture capital market has still too much passive investor. The government has strongly been involved for developing the industry by the creation of numerous investments vehicles. The industry is also strongly linked to the banks, which makes the investments in seed and start-ups more than in expansion phase.

The venture capital market observed a growth in the second half of the 1990’s in both countries (after a crash in 1989) followed by a peak of activity in 2000 and a downturn after the bubble. The investments seem to be made in the same sector for both countries, where the investments involve risk.
5. Empirical findings.

Based on the previous conclusions, an interview guide could be written. The questions were opened in order to have detailed explanations and point of views of the interviewee. The interviews were semi-structured and depending on the answers of the interviewees, Therefore, I changed the formulation or the order of the questions mentioned in the appendix.

The results are presented by section and are transcripted from the record.

5.1 Interview with Sigma Partners:

This interview was the first made. The questions were asked in order of the initial questionnaire.

Sigma Partners is an experienced Venture Capital firm. It was created in 1993 and is based in Paris. The company manages 4 funds and the investors are french. The investments are mainly made in companies from north east part of France.

The interviewee was Mr Emmanuel Simonneau who is president of the board of Sigma Partners. He joined the company in 1998 and is president since 2000.

About the definition:

Mr Simonneau agrees to say that the distinction between Venture Capital and private equity is not so clear in France as in the US for example. The reason may come from the lack of knowledge of the Venture capital industry and its products in France and the industry is quiet new. But for him, venture capital is included in private equity and he divides private equity into 3 stages: venture capital, development and transmission.

General trend:

He first reminds that he is only an actor of venture capital and would give his personal view. He said that the venture capital industry suffered from the 2000 bubble. The number of projects and the money allocated strongly decreased. But since a few months, it seems that the venture capital industry is growing again in terms of numbers of projects and amount invested. The industry is still growing with ups and downs but the maturity phase is not yet reached.

About the industry, he does not agree to say that the banks are major actors of venture capital, but institutional investors are more important.

The drivers:

Mr Simonneau thinks that the investments funds and the business angels are more important than the banks in the french venture capital. He even thinks that the banks are not really involved in the industry.

The TEPA law could be a driver. This law was established in 2007 and allows some investors (with big heritage) to deduct money invested in non listed SME from the income tax.
The role of the government:

Mr Simonneau thinks that the government should not be involved in the venture capital industry because it’s not its role and the state should not invest directly in the SME. However, he agrees with the fiscal incentive (through reduction of income tax) for the investors and he thinks it can contribute to the development of the industry. Laws such as the TEPA law could be efficient and have a real impact: after the law, €500 million were raised. But it could also have a negative effect because the investor who can deduct 75% (according to the TEPA law) of the amount invested does not pay so much attention on the investment (and the evaluation of the company could be wrong). He thinks that it could create a bubble in the long term.

The French Venture Capital industry:

Mr Simonneau believes that Internet could be an attractive sector in the future through a second wave. He explained the small amount invested in the early stage by the risk aversion.

The future:

Venture capital is clearly still in development and we can expect a growth in the coming years. He noticed that the new president of the French private equity association (AFIC) comes from the venture capital industry, whereas the formers came from later stage industry. We could see it as a sign of encouragement in earlier stage projects.

Conclusion about the interview:

Mr Simonneau sees the French venture capital industry in expansion phase and has a bright future. He does not agree to say that the banks have a major role in France and the venture capital firms along with the business angels are the main actors.

After this first interview, I changed a little the formulation of some questions (particularly concerning the role of the banks) and eliminated one which I thought irrelevant.

5.2 Interview with Equitis:

Equitis, founded at the beginning of 2000, is a service company dedicated to the private equity investors. It offers directly or through its Equitis Entreprise subsidiary a full line of services:
- portfolio management (for primary and secondary funds)
- special operations management (turn around)
- liquidative management and other services (valuation, audit, secondary operation)
- acquisition of investments, portfolios or portfolio management companies

Equitis is a venture capital firm which was created in 2000. I spoke with Guillaume Pellery who is a venture partner at Equitis.
About the definition:

He explained that the venture capital industry in Europe is not so mature as in the US. The number and amount invested in venture capital are small compared to those in LBO or later stages and it may be not enough developed to create a segment.

The investment funds are small in France compared to the US ones. In the US, they represent 500M$ to 1 bn$, whereas in France they are generally from 30 to 150M€ with less money invested in Venture capital.

General trend:

In 2000, venture capital was 0.22% of the french GDP and 0.17% for the LBO. In 2005, venture capital counted for 0.11% of GDP and 0.31% for the LBO. There was also a down in 2003 for venture capital with 0.08% of GDP.

About the financial system, the banks are not an obstacle to the development of venture capital. They invest generally really small amount of money compared to their total capital.

The French Venture Capital industry:

He thinks that we can not compare France with the US in terms of amount invested in early stages because of the size of the country.

Proportionally, the amount invested are still lower, because the returns on investment are on average negative compared to the LBO. Then the investor prefers the LBO with a higher return. They earn more money with less risk

In the US, the early stage are more developed because the industry is older and there is a culture: people not only invest for money, but also because they like the company.

The role of the government:

He thinks that the government plays an important role in the development of french venture capital industry and the french government is a major source for venture capital, compared to the other countries in Europe. He cited the “crédit impôt recherche” (loan for research tax income). The “venture loans” are more and more used in France (loans for the companies that are not eligible for the traditional bank loans).

However, the problem to develop venture capital comes more from the fiscal tax that the entrepreneur has to pay in the young companies.

Conclusion about the interview:

Venture capital industry changed a lot since 10 years ago but it seems to be on a good way. Mr Simonneau noticed that the industry becomes more and more professional, particularly in the due dilligence process with contracts, documents, pacts… He thinks that it will continue in the future in the same way with more transparency in the management.and in informations to give confidence to the investors to make decisions.
5.3 Interview with Cap Decisif:

Cap Decisif is a venture capital company based in Paris. It manages a fund of €17M which invests in high technology companies mainly in Biotechnology, telecommunication technology. I spoke to Jérôme Snollaerts who is president of the board of directors and is financial manager and lawyer.

About the definition:

Mr Snollaert thinks that there is no ambiguity about the definition of venture capital in Europe. For him, venture capital is clearly a subset of private equity.

General trend:

For him, it is hard to find general trends in the industry. But he thinks that the industry of private equity is growing for 3 years. He said that the LBO increased a lot until last year and the early stages are coming back. About Europe, he said that Swedish venture capital has a tradition in venture capital

The drivers:

He said that the drivers of venture capital are money and entrepreneurs who are ready to take risk. The incentive for the entrepreneurs may help to start the business. He explained that the whole process should work, from the fund raisers to the exit process.

The French Venture Capital industry:

He thinks that french people are more risk averse compared to the americans and invest mainly in later stage which are less risky. According to him, life science is performing well and has a bright future. He also thinks that the softwares (in computer and consumer electronics) and the communications sectors are attractive for the French investor. The cleantech energy are also emerging.

The role of the government:

The government should not invest directly because it’s not its role but it should invest indirectly through (public or private) funds. The French public authorities clearly contributed to the development of the venture capital industry through the creation of CDC and ANVAR (funds allocated for venture capital) and he thinks that the incentives (such as fiscal advantage and incentive to create company) are really efficient: fiscal incentives made for 8 years ago have now good results. The important steps for the development of the industry were the creation of FCPI, the TEPA law.

The future:

He worries about some sectors such as the biotechnology because there is not enough creation of biotechnology companies in France and there are not enough incentives. However, the LBO activity decreased a little which could be better for venture capital. Moreover, the government made effort to develop venture capital industry.
5.4. Interview with CDC:

CDC is one of the main institutional investor in french venture capital. They invest either in funds or directly in companies. It is a subsidiary of the “Caisse des Dépôts et Consignations” which is a state-owned company and has public interest actions. The interviewee was Vanessa Giraud, who is investment director.

This interview was an important one as it gives a view of a state institution. CDC is not a private firm, and it could help to understand why the government should invest in VC firms.

For this interview, we could expect the person to defend its interests and the government. But it was not so obvious and the interview was quiet constructive.

About the definition:

She thinks that the definition is clear but the actors do not always agree. She said that 1 or 2 years ago, the EVCA decided to split clearly private equity into LBO and venture capital. But for her venture capital is only focused on early stage. Venture capital is not so known because 80% of the private equity investments come from the LBO.

General trend:

She thinks that venture capital is in good health. She spoke about technological venture capital, such as information technology, medical technology or sustainable environment. There had been a big crash in 2000 in the US, followed in Europe which affected venture capital. The off-peak was in 2003, and since that time venture capital is growing again but today the venture capital firms have difficulties to raise money in order to invest in companies. The crisis had a positive effect because some companies had too much money to manage and only the good companies survived the crisis.

The drivers:

The mentality in France is different from the US one. The main difference comes from the investor and entrepreneurs mind. In the US, people are more interested in business and if they feel that there is an opportunity, they will try to do business.

The French Venture Capital industry:

It is also logical to put a little money at the beginning of the process and invest more and more when the company becomes bigger.

In France, there is only one fund which could invest a lot in early stage and it is the biggest french fund: Sofinnova.

She reminds that in Europe, new do not have the success stories such as google in the US. We only had the bubble in 2000.

The US have a common language, a common culture and in Europe, we only have the euro.

The role of the government:
She thinks that the government should be involved in the financing of SME. CDC invests with the state in all the stage of the development of SME to support innovation and the creation of employment. The main role of CDC is a catalyst that help to invest at the beginning and to lead other to investment. The role is to influence private sector and to make them confident to invest in funds that CDC finances. They try to have a leverage effect of at least 5: when they put one euro in a project, they attract 4 euro from private sector. She strongly thinks that political action is needed in order to develop innovation. The big (private) companies should allocate sufficient money in R&D and public authorities should give money in projects and in companies that will be financed by the CDC. And even if CDC is linked to the government, it invests in the market conditions. The involvement of the state comes from historical development but it has played an important role in the development of venture capital in France. She said that France tried to be inspired by the US model and the Small Business Act with the SBIC: the US administrations have to give 20% of their order to SME and not to big companies. For Venture capital, the effort are maid in R&D with the merger of different research organizations.

**The future:**

She thinks that the venture capital industry has a good future. The industry suffered a crisis but it is now more stable. If we do not create new bubbles such as for the environment field, we have good teams and technologies. Venture capital is needed for technology and for the creation of companies. It is in part a question of fiscal policy. It is difficult to have a long term perspective and that is what CDC is trying to do. They are present in off-peaks and they slow down when there are bubbles. The problem with markets is that they are made by people who act on very short term for their own-interest which are often contradictory or create bubbles, so it is quiet subjective. Long term actions are needed and institutional investors who act on long term and are not sensitive on short term fluctuations.

**Conclusion about the interview:**

France has a potential with universities and research that could be better but there is a lack in the mentality. Moreover, there is still the fact that in Europe, the returns are not high enough. We could expect that CDC strongly support actions made by the government. But it is needed to push private investors to invest.

**5.5. Interview with AFG:**

AFG is the french Asset Management association (Association française de la gestion financière) representing investment funds and individual portfolio management. AFG assists its members and stimulates discussions on key issues (legal and tax issues, management techniques, conduct of business rules, corporate governance, retirement savings…). As a member of the European Funds and Asset Management Association (EFAMA), AFG is active in the drafting of the European regulatory framework and organizes the self-regulation of the funds and asset management industry. The three keys to France's asset management industry professional association: promoting,
representing and assistance. (www.afg.asso.fr).
Through its working groups and committees, it mobilizes its members and keeps them up to
date. One of the committee is venture capital.
Contrary to the AFIC, the association includes not only private equity but all the companies.
I choosed to interview the afg because it's not a venture capital firm and it a could have a
different view.
I spoke to Mr Ephraim Marquer who is president of the association.

About the definition:

He said that since 4 or 5 years, the term private equity (capital investissement) replaced
venture capital. There are less actions in venture capital than in private equity.

General trend:

In France, private equity is doing quiet well and in some extent venture capital as well
(because 80% of the amount of private equity market is represented by LBO). He also thinks
that the last law (TEPA law with fiscal incentive) will boost the market
He agrees that the financial systems are different between Europe and the US through
involvment of the banks and the state. The system in the US is based on pension funds and on
the retirement in France. The lack of pension funds pushed venture capitalists to find other
financing sources. The US market based on an efficient financial market may give more
importance for the capitals.

The drivers:

The french venture capital was mainly developed through FCPI (created in 1996), which
could be an important driver.
There are few organized business angels networks in France so the development comes
mainly from big organizations from the state.

The French Venture Capital industry:

There is maybe a problem of culture in France: according to a study, 70% of french people
aged under 25 want to be civil servant.
There is also a problem in the education programs, particularly in economics in secondary
school, which give not incentive for young people to invest and become entrepreneur.
Then, the low returns may come from the lack of investors
He thinks that the attractive sectors depend on the time. Today, it seems to be renewable
energy

The role of the government:

In France there is a big involvment of public authorities. But French state has a big debt and
has not money.
He reminds that without fiscal incentives from the public authorities, ventire capital would
probably have disappeareed after the bubble in 2000. Therefore, an involvment of the state in
venture capital is needed. But will the state be able to maintain these fiscal incentives? The
answer lies in the benefits of those incentives.
The state played an important role in the development of venture capital through reductions of
income taxes. The venture capitalists and target firms are (obviously) for these incentives that they thinks efficient. There is a clivage between those who say that venture capital would not exist without these incentives and that these incentives are too costly.

**The future:**

On the short term, he is confident that venture capital will exist, particularly thanks to the fiscal incentives.

**Conclusion about the interview:**

Some similarities with the previous interviews could be found. According to him, French venture capital seems to exist through fiscal helps from the state but the true question is will France become more globalized? The problem comes more from the culture in a country where 70% of the people under 25 want to be civil servant. Venture capital in France can not be the one in the US due to historical reasons.

### 5.6. Interview with Gregory Sabah from the AFIC:

**About the definition:**

Mr Sabah agrees to say that Venture Capital has not exactly the same definition as in the US. In the US, venture capital is clearly different from Private Equity, whereas in Europe, Venture capital is included in Private equity. In France, Venture capital is early stage and seed stage.

**The Global trends:**

He thinks that venture capital is doing well in France (according to the statistics and his opinion). In 2000, the valorisations were higher in France than in the US because the French were carefull. That may explain why in 2000 the losses were limited in France compared to other countries. Moreover, the past performance are not so important in the US as it is for France.

Some tools were important for the development of Venture capital in France: First, the creation of the FCFI in 1997 contributed to smooth the crisis linked to the new economy and it had a positive effect. Moreover, the commitment of the insurance companies in 2003 was important. Finally, the creation of “France Investissement” in 2006 contributes to increase the number and amount of funds raised. France Investissement is a result of a partnership between public and private funds. 2 M€ invested are public funds and 1M€ are private funds invested in innovative SME.

The TEPA law also had an impact on the industry.
On the other side, we could say that the French environment is more and more structured with OSEO Innovation (association that labells the companies that are risky), the Credit impôt recherche (loan for research) and the engines of growth and employment. The creation of Alternext in 2004 also contributed to develop venture capital.

About the drivers: Mr Sabah does not really has an idea of some drivers that could lead the industry. He neither thinks that the french (and European) financial system is an obstacle to the development of venture capital because the banks are not important actors in the financing of risky companies. On the contrary, he thinks that France is one of the leader in Europe.

**The Role of the government:**

The French public authorities were strongly involved in the last years in the financing of venture capital and it is even a source of inspiration for some other countries. The important laws were the creation of the FCPI (in 1997), the TEPA law and the creation of France Investissement.

The French industry:

The amount invested in early stage may be due to the model highly competitive with a lot of players.
6. Analysis of the results

6.1 Synthesis of the answers

The following table summarizes the answers of the respondents during the interviews. The results of the answers are presented by general section in order to have a better synthesis.
## Synthesis of the answers of the respondents.

<table>
<thead>
<tr>
<th>Definition of VC</th>
<th>Sigma Partners</th>
<th>Equitis</th>
<th>Cap Decisif</th>
<th>CDC Entreprises</th>
<th>AFG</th>
<th>AFIC</th>
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<tbody>
<tr>
<td>VC is a subset of Private Equity. VC is quiet new in France.</td>
<td>VC is a subset of Private Equity. The sense is the same as in Europe.</td>
<td>VC is a subset of Private Equity. The sense is the same as in Europe.</td>
<td>The VC definition is new in Europe. It’s difficult to translate in French. But VC defines the creation and the first steps of a company. The proportion of LBO in Private Equity (80%) is higher in France than in the US.</td>
<td>The term Private Equity replaced the word venture capital 4 years ago. There is less available information about VC.</td>
<td>VC means only seed and start up stages. VC is more separated from Private Equity in the US.</td>
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<td>Sigma Partners</td>
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<tr>
<td><strong>General trend</strong></td>
<td>VC industry is in a new wave after the bubble. The private equity companies are more important than the banks. Fiscal incentives may be drivers.</td>
<td>The volume of private equity funds has increased a lot for the last 3 years. The LBO market is very dynamic and the early stage (particularly seed stage) are more and more important. The drivers are money, entrepreneurs and investors. The bubble in 2000 stoped the VC activity. It was followed by a decline with an off-peak in 2003. The subprime crisis in 2007 did not change the investments choices. The investors still prefer to invest in LBO. In biotechnolog y, the IPO exits are predominant. The difference with the US is more in investors way of thinking. Funds invested in VC industry are increasing. There is a lack of successful companies in France.</td>
<td>VC as well as Private equity is doing well. New laws and measures (fiscal incentives) have been implemented to encourage VC. The main drivers were fiscal incentives (TEPA law) and the creation of FCPI. An alternative to the US model may be found with an involvement of the state. But it can change in the future with the change of the pension system.</td>
<td>French VC industry suffered less from the bubble than the US. But the new start after was longer. The drivers are the development of new tools (FCPI, FIP), the creation of alternext, the commitment of insurance companies, the creation of France Investisseme nt, the Crédit Impôt Recherche, the engines of growth and employment.</td>
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<td>Role of the state</td>
<td>Sigma Partners</td>
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<td>The TEPA law in 2007 has an impact on VC industry (fiscal incentives). The government should only be involved in VC through fiscal incentives but not directly. Too much fiscal incentive may have a side effect on the valorisation of the companies.</td>
<td>The state should not invest directly in VC. However, it’s good that it invests undirectly in VC funds. It thanks to the government programs that VC has been developed through the creation of funds (FCPI...). The TEPA law had an impact on VC industry.</td>
<td>The state should be involved in the financing of VC. It helps to reduce the risk for the investors by creating fiscal incentives. The state regulates the uncertainty of the financial systems and the decision of investors. The seed funds were created by the state in 1998. The role is to attract private investors. Fiscal incentives for the start ups that invest in R&amp;D develops the VC industry and the TEPA law are drivers.</td>
<td>The state is needed but should not been involved directly. The creation of FCPI and fiscal incentives developed the French VC industry. The involvement depends on the returns on these measures.</td>
<td>The state observed a big involvment of the state in VC in the last years. Its action is needed and it was efficient until 2006. The role is to attract the investors. The main laws are the creation of FCPI (1997), the creation of France Investissement and the TEPA law (2007).</td>
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<tr>
<td><strong>French VC industry.</strong></td>
<td>A second wave on internet is coming. Investors are more risk averse in France than in the US.</td>
<td>The returns in LBO are higher and less risky than those of venture capital. It may explain why the amount invested in early stage are so low. The French market can not be compared to the US one because the private equity market is older than in France.</td>
<td>The amount invested in early stage are low because the french are risk averse. Medical device, telecommunication, and cleantech are the main attractive sectors for the french investors. The biotechnology is not very attractive.</td>
<td>The French industry has the technological potential for VC. It’s logical to invest less in early stage: the funds are smaller than in the US and the investments are risky. Only Sofinnova in France is able to invest €20M.</td>
<td>French are more risk averse. There is a lack of entrepreneurship mind. The culture of entrepreneurship is not as developed as in the US. The high tech green is an attractive sector.</td>
<td>The french VC is structured with a lot of actors.</td>
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<td>The main attractive sectors are the telecommunications, the biotechnologies and computer sciences. But the cleantech may be predominant in the future.</td>
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</table>
6.2. Conclusions.

About the definition:

The definition seems to be not so clear in Europe as it is in the US just because of the lack of knowledge and because venture capital is still growing. In the US, venture capital exists since a long time and is more developed than in Europe. The amount invested are bigger.

But the venture capital defines the same stages in Europe as in the US. In the US, it seems to be a real segment because it is more developed.

We can conclude that there is no difference between the US and the French definition. The theory was clear on it and there may be a lack of information because it’s quite new.

The drivers:

Some actions made by the government could be drivers of venture capital: the creation of the FCP and the FIP in France is one of them with fiscal advantages to invest in venture capital. The argument developed by Black and Gilson (1998) in favour of a superiority of a stock market system over a bank centered system does not really apply for French venture capital market because the banks are not the main providers of money in French VC. Indeed, most of the interviewees said that the French banks are not the main actors.

Almost all of the respondents agreed to say that the French (and in general bank centered systems) financial system is not a problem for the development of the venture capital industry. This obstacle linked to the financial system can be overcome and the role of public policy may replace the lack of an efficient stock market, as it was developed by Dubocage and Danset (2002).

According to the respondents, the main difference between the US and France comes from the culture. The French seem to be more risk averse and have less an entrepreneurship mind. For the general trends, the bubble had a positive effect on VC industry because it was better structured with solid actors.

The future:

According to most of the respondents, venture capital has a bright future but the trend of the industry depends mainly on fiscal incentive.

It seems that the cleantech sector with renewable energy and sustainable environment are more and more attractive for the investors.

The role of the government:

In France, the state played and still plays an important role in the development of venture capital industry. The creation of the FCP and the FIP were really important for the development of venture capital. They are now the main actors of the French venture capital industry.
The fiscal incentives are also important to push people to invest. The important laws cited by the respondents were the creation of FCPI, the creation of “France Investissement” and the TEPA law (in general fiscal incentives). The state is needed and the right word to sum up the action of the government is that it acts as a starter to attract investors.

**The French Venture Capital industry:**

Even if the industry is said to be in good health, there is still some points to be improved. First, the french industry is characterized by an aversion to risk, that may have an impact on the creation of companies. This is in part a result of historical development and culture. The vision of entrepreneurship is different in France from in the US. French people are generally reluctant to risk and prefer safe placement.

**In general:**

In France, funds are raised mainly through organised structure such as FCPI, FCPR and FIP (€530M in 2007). France suffers from a lack of entrepreneurial mind. Some actions from the government could improve the situation for example by giving more will to people to create companies (even at school).

After the bubble in 2000 and a decrease of the industry, venture capital was re-structured on a solid basis and seems to be stronger and more organized (for example with OSEO Innovation, the Credit Impôt Recherche or the engines of growth and employment). The investments in venture capital decreased until 2003, were stable in 2004 and a new wave started in 2005 and 2006. The industry in France (and Europe) becomes more and more professional and organized.

The problem linked to the financial system can be overcome with fiscal incentive or various helps from the state without a total involvement. The financial system mainly centred in Banks is not really a problem and it can be overcome. Even if the European financial system is not as competitive as the US one, the companies can still have access to capital. The obstacle linked to the financial system and the argument that a market oriented system would favour venture capital is not really one because the banks are generally not involved in venture capital. As Sweden shows, a strong presence of the state does not prevent a development of high technology and venture capital industry. The main role of the state is to act as a starter and to lead people to invest. According to almost all the persons interviewed, the presence of the state is important and almost necessary. Some of the drivers cited were tools created by the government. It seems also that in Sweden, a right combination of public and private partnership is profitable. The persons interviewed were quiet confident concerning the future of the venture capital industry in Europe and thinks that the fiscal system will influence the investments.

The early stage investments are more developed in Sweden than in France but it is growing in both countries. This dynamism of Swedish venture capital could be explained by a tradition in high tech industry with more risk. Sweden is also a country which exports a lot and there might be more opportunities for foreign investors.
The problem relies more on the partnership between the R&D and the industry. In Sweden, there is a right combination of public and private partnership

6.2.1 Contributions

The goal of this thesis was to have an insight on the french venture capital industry by making interviews of people involved in the industry such as experienced venture capitalists or people from the french VC association. A comparison was made with Swedish VC by analysing the data from the EVCA website.

6.2.2. Suggestions for future research

The study of a market can be made at a time but as things are changing, it will be different in the future.

The purpose of this study was to analyse the trends in the french venture capital market through interviews of french experts and to compare with Sweden and the US. To make the study even more complete, experts from Sweden could have been asked.

It could be interesting to see if the good (or not) start of a company can have an impact on the development of the company.

One of the conclusion was that the involvement of the state through fiscal incentives could have an impact on the development of venture capital in the future. We could then compare the fiscal system of 2 countries such as France and Sweden and see if the differences may have an impact on the venture capital industry. It could be done by analyzing the 2 fiscal systems in details.
7. GLOSSARY OF TERMS:

**AFIC:** association francaise des investisseurs en capital (french association of capital investors).

**EVCA:** European venture capital association.

**SVCA:** Swedish venture capital association.

**NVCA:** national venture capital association.

**FCPI:** (Fonds communs de placement pour l’innovation): mutual investment funds for innovation).

**PME (petites et moyennes entreprises):** Small and Middle Size companies = SME.

**FCPR:** (Fonds communs de placement à risque): venture capital mutual investment funds.

**SCR:** (Societe de capital risque): venture capital company.

**SFI:** (Sociétés financières d’innovation): financial company for innovation.

**CDC:** (Caisse des dépôts et consignations): French Public Organization.

**FPCR:** (Fonds publics pour le capital risque): public funds for Venture capital.

**FIP** (fonds d’investissement de proximité): type of FCPR which has to invest in non listed SME situated in a same geographical area.

**CCI:** (Chambres de commerce et d’industrie): regional organisms in business and industry areas).

**LBO** (Leverage Buyout): occurs, when a financial sponsor acquires a controlling interest in a company’s equity and where a significant percentage of the purchase price is financed through debt.

**IPO** (Initial Public Offering): when a company issues common stock or shares to the public for the first time.

**Business Angels:** an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.
8. Bibliography.

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Books:


Websites:

www.evca.com
www.afic.fr
www.svca.se
www.nvca.com
Appendix

Appendix1: interview guide:

Definition of venture capital:
Why the definition of venture capital in Europe is not so clear as in the US? (why venture capital is often seen as private equity?).

The general trend:
How do you evaluate the current health of the venture capital industry?
Can you see any trends in the industry?
What are the main drivers of the french venture capital?
Given that France is more bank-oriented, do you think that the banks may have an impact on the development of the french venture capital industry?
The financial system can have an effect on the industry?

The role of the government:
Do you think that the government should be involved in the financing of the SME?
What are the main important laws for the development of the french venture capital industry?
What was the importance of the government in the development of the french venture capital industry?
Are these incentives given by the government really efficient?

The french venture capital industry:
What are the most attractive sectors for the investors?
Why the amount invested in early stage are so little?

**Last question:**

How do you see the future of the french venture capital industry?