Best Practice Policies for Small & Medium-Sized Enterprises

THE ESTORIL DECLARATION

PORTUGAL 2007
The Enterprise Challenge: Financing the Innovation Value Chain

The present Enterprise Challenge within the European Union is to resolve the still imperfect nature of the local, national and international financial markets available to Small and Medium-sized Enterprises (SMEs) by reinforcing the availability of a range of appropriate financing solutions to promote enterprise growth in sales, employment and innovative capabilities; and to create a holistic financial system for Small and medium sized Enterprises (SMEs) spanning the equity-debt spectrum from both formal and informal risk capital markets to the bank intermediation process. This goal requires the effective integration of four pillars of policy - from Ideas to Markets; Investment Readiness; the Right Environment; and Finance for Growth - in order to support high potential enterprises throughout their development life-cycle or value chain. Its realisation will require the active participation of the entire entrepreneurial infrastructure including the owners and managers of target businesses, the financial services industry, government policy makers, academia and the media. The details of this enterprise challenge are summarised in The Estoril Declaration.
THE ESTORIL DECLARATION

RECOGNISING that the European Union needs to continue to develop a world-class environment nurturing growing numbers of innovative and high growth Small and Medium-sized Enterprises (SMEs) and in which competitive markets work efficiently both within and across borders to allocate a range of appropriate forms of finance and related services from professional and well informed providers to similarly competent entrepreneurs and their businesses at all stages of the enterprise life-cycle, IT IS RECOMMENDED THAT:

re New Ideas to New Markets

Successful entrepreneurial economies have a ‘can do’ attitude to transforming interesting and novel ideas and discoveries into new products and services to both existing and new customers. The full commercial realisation of Europe’s innovative resources and their delivery to world markets requires the ‘catalyst’ of a strongly entrepreneurial culture to be supported and celebrated at all levels of society

- Promotion of an entrepreneurial culture, and the espousing of new business formation as an attractive and feasible career choice, must be widely fostered amongst politicians, business persons, academics, students, and those teaching and advising current and future generations of European citizens;
Spin-out activity commercialising intellectual property from universities and the research community is encouraged via academic-private funding arrangements that recognise the demanding requirements of professionally run and commercially attractive fund structures. Effective structures are likely to require cross-institutional collaboration and co-financing;

Europe’s financial services community should support the identification and industry adoption of practicable means by which intangible assets, such as intellectual property, can be pragmatically valued in order to attract additional debt finance and other resources, especially for innovative and technology-based start-ups;

Effective enterprise support infrastructures must recognise the often peculiar demands of young and growing SMEs for specialist and expert services and the considerable scale and scope benefits stemming from the active concentration of new enterprise activity into dense and mutually supportive local and regional clusters;

A life-cycle perspective requires the availability and collaboration of a full spectrum of SME financial and support services, from ‘seed stage’ incubators/accelerators through business angels and corporate venturing to formal venture capital funds, to be available to attractive growth enterprises;

**re Investment Readiness**
New and growing enterprises have no absolute right of access to commercial resources allocated by a free and competitive market. They have to earn investors’ interest and commitment by the greater attractiveness of their businesses compared to other available opportunities

- A competitive and free market puts the unavoidable onus on the enterprise seeking external resources to be attractive to commercial providers. This attraction to customers, suppliers and investors requires the development and reinforcement of the enterprise’s internal capabilities particularly the recruitment of professional management.

- Entrepreneurs and SME managers must comprehend and be responsible for the provision of sufficient, timely and accurate information to commercial providers in order for appropriate financial and other services to be readily supplied. Particularly, entrepreneurs, their commercial partners and their advisers will need to recognise that Basel II legislative requirements for transparency will impose a greater onus on all parties to reduce information barriers and other constraints affecting access to, or the competitive pricing of, finance;

- In order to meet and to communicate investment readiness criteria to professional investors or bankers, many young enterprises will require professional mentoring and other advisory support services designed to meet the circumstances of attractive but often inexperienced young businesses seeking external resources;
Similarly, as enterprises assume the responsibility of adopting appropriately rigorous standards of governance and disclosure, the commercial infrastructure needs to provide the full spectrum of finance and support relevant to businesses adopting the disciplines of investment readiness. Services enabling the risk and debt financing of early growth, development and the transfer or buy-out of established businesses need to be in place;

re the Right Environment

Nascent and growing enterprises remain highly vulnerable to both scarce internal resources and to external competitive threats. An important role of national government is to ensure that the environments in which young firms are created and trade are not unwittingly hostile to entrepreneurs because of inappropriate, ill-designed or excessively costly demands via the tax, legislative or regulatory systems. Rather, policy makers should actively strive to remove existing barriers and to incentivise strongly new business formation and the growth of existing SMEs. Government has a critical role in supporting enterprise but should seek to ensure that its involvement does not undermine or frustrate free market activity

- Legal, fiscal and administrative policy frameworks that directly incentivise commercial risk taking by informal investors should be put in place given the importance of business angels as providers of early-stage risk capital;

- National legal and fiscal domains require further harmonisation in order to encourage growing levels of cross-
border investment with the goal of creating a single European market in venture capital;

- Legal and fiscal measures supportive of the efficient and cost effective transfer of businesses to new ownership/management are needed in order to ensure the continuation and growth of existing viable enterprises. Such transfer systems also expedite the rapid removal of unsuccessful business ventures from the market thereby assisting the efficient reallocation of existing resources;

- Government has a major supportive role in ensuring entrepreneurial activity. However, public interventions in an imperfect market should always be subordinate and complementary to private and commercial activity wherever possible;

- Public partnerships and collaborations with private interests to encourage the greater provision of entrepreneurial resources should be designed in concert with commercial partners, should be temporary in duration, should not require public servants to assume operational responsibility, and should not confuse market signals of risk or reward that might impair the private partners’ responsibility for or incentive to make commercially optimal decisions;

**Finance for Growth**

*A mature and sophisticated market for entrepreneurial finance engenders the provision of several different types of financial instrument. The finance services industry is recognised for both its entrepreneurial and*
innovative talents. This spectrum of financial services allows firms at various stages of their life-cycle and commercial circumstances to select appropriate products at acceptable costs. It also allows a community of equity investors and debt providers to make available a diversity of new and established financial products which reflect the individual yield and risk preferences of buyers and sellers.

- The predominant importance of bank intermediation is recognised given that overdraft and term debt are the single largest categories of external finance to SMEs.

- The valuable innovative role of banks as both co-designers and providers of Loan Guarantee Schemes and related initiatives to securitise and sell SME debt is further exploited in collaboration with public agencies supporting young enterprises.

- Risk capital sources for entrepreneurial growth firms are encouraged as a direct complement to debt based finance. Particularly, special importance is given to encouraging greater supplies of speculative sources of early-stage risk capital available to innovative pre-seed (‘proof of concept’), seed and start-up enterprises in Europe;

- Later stage venture capital, including Private Equity funds, are encouraged to complement early stage investor commitments and thereby facilitate continued enterprise growth as well as opportunities for early stage investor exits;

- Priority is given to recognising and exploiting the critical role of business angels/informal investors as the largest potential
source of patient, early-stage, informal risk capital to young enterprises;

- Support for the professionalisation of business angel networks is accelerated thereby also strengthening syndicated investment opportunities between business angel groups and venture capital firms;

- The seminal important of an active and liquid, public stock market trading in growing and high potential companies and acting as an exit channel for later stage investors is recognised in national and European entrepreneurial policy;

- the identification, public recognition and support of single European stock market of sufficient economic scale, liquidity, technical expertise and specialism in high growth/high potential, new knowledge based firms is encouraged across the member states.

- the growing market for alternative and novel financing instruments, including micro-finance, mezzanine and stock options, focused specifically on the growth needs of young innovative SMEs is encouraged and widely communicated to both entrepreneurs and their advisers;

Estoril, 9th of October 2007