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# *EFTA SURVEILLANCE AUTHORITY*

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## EFTA SURVEILLANCE AUTHORITY DECISION

OF 5 AUGUST 1994

ON THE VENTURE CAPITAL GUARANTEE SCHEME OF THE FINNISH GUARANTEE BOARD  
(FINLAND)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area<sup>1</sup>, in particular to Protocol 26 and to Articles 61 to 63 of the Agreement,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice<sup>2</sup>, in particular to Article 24 and Article 1 of Protocol 3 thereof,

WHEREAS:

### I. FACTS

#### 1. The notification

By letter dated 17 May 1994, received by the EFTA Surveillance Authority on the same day (ref. 94-7451A), the Finnish Government notified, in accordance with Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, a proposal to alter the act on State guarantees for risk capital, notified to the Authority as an existing aid scheme by letter dated 18 February 1994 (ref. 94-3057A). The EFTA Surveillance Authority, by letter dated 6 June 1994 (ref. 94-8301D), requested additional information from the Finnish Government.

The notification was amended by letter dated 27 June 1994, received by the EFTA Surveillance Authority on the same day (ref. 94-9545A).

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<sup>1</sup> Hereinafter referred to as the EEA Agreement.

<sup>2</sup> Hereinafter referred to as the Surveillance and Court Agreement.

The existing venture capital guarantee scheme, based on the existing act on State guarantees for risk capital, need not be formally reviewed by the EFTA Surveillance Authority under Article 1(1) of Protocol 3 to the Surveillance and Court Agreement once this decision has been taken as both the existing law and the alteration thereto shall be assessed here.

## **2. The aim and contents of the proposed law**

The act on State guarantees for risk capital aims at improving the availability of risk capital for small and medium-sized enterprises (SMEs). The Finnish SMEs are considered to be undercapitalised which reduces their ability to withstand business difficulties and may inhibit their growth.

The objective of the scheme is to promote SMEs with good growth prospects that are engaged in the early stages of innovation activities and in particular SMEs that utilize new production technology or develop internationally competitive products. Thus, the scheme aims at improving the production of new risk-bearing products that are vital for enterprises' long-term international competitiveness.

According to the law bill, State guarantees may be granted against risks of loss associated with investments made by Finnish or foreign credit institutions, other corporations and funds and individuals. The guarantee may cover all investments that are long-term investment in capital, i.e. share capital, convertible bonds, bonds with warrants, loans with profit share and debt security instruments.

The Finnish Guarantee Board, which administers the scheme, may offer a guarantee covering up to 50% of the losses actually suffered on the capital invested in SMEs. A partial loss is considered to have arisen, when realizing the investment, the investor relinquishes his investment for a price lower than that of the invested capital.

According to the act on the Finnish Guarantee Board<sup>3</sup>, the operations of the Board have to be self-supporting in the long run. When concluding a guarantee contract, the Guarantee Board charges a single fee constituting 0,75% of the guarantee up to FIM 10,000,000 and in addition 0,2% of the amount exceeding that. Premiums are charged annually which vary between 0,5-3,0% during the period of validity of the guarantee.<sup>4</sup>

In addition to the fees on guarantees for risk capital issued by the Board, the law bill stipulates that a compensation for any increase in value of the guaranteed investment may be collected for the guarantee. The compensation is at most 30% of the profit yielded by the guaranteed proportion of the investment.

The law bill covers State guarantees granted in 1992-1996. The total amount of outstanding guarantees granted may not exceed FIM 500 million at any one time. It is estimated that the average guarantee amount will be FIM 3-5 million.

<sup>3</sup> Act on the Finnish Guarantee Board (*Laki Valtiontakuuksuksesta (111/89)*).

<sup>4</sup> Decision of the Ministry of Trade and Industry (*Kauppa- ja teollisuusministeriön päätös valtion riskipääomatakuista perittävien maksujen perusteista, 16.12.1992*).

Guarantees may be granted only for investments made in SMEs operating in the following sectors: industry, workshops, tourism, fur farming, fish farming, market gardening and peat production<sup>5</sup>. In the law bill a small and medium-sized enterprise is defined as an enterprise which has no more than 250 employees and has either an annual turnover not exceeding FIM 120 million or a balance sheet total not exceeding FIM 60 million. Moreover, the enterprise cannot be more than 25 % owned by one or more companies not falling within this definition.

## II. APPRECIATION

The guarantee offered to investors provides SMEs with capital which the investors would normally not provide or would provide only at a higher cost of capital. By offering the guarantee under the proposed scheme the Finnish authorities, in particular due to the economic difficulties now prevailing in Finland, create economic activities that would otherwise not be undertaken or which would be undertaken under different commercial terms. As the guarantee is of direct benefit to the investors and the scheme confers a competitive advantage to SMEs which indirectly benefit from the guarantee, the aid threatens to distort competition and affect trade within the EEA, particularly since the products of the favoured undertakings may be in competition with that of undertakings in other States participating in the EEA. Therefore, the foreseen guarantee scheme constitutes aid in the meaning of Article 61(1) of the EEA Agreement.

Consequently, the EFTA Surveillance Authority is obliged to assess whether any of the exemption clauses under Article 61(2) and (3) are applicable in order to exempt the aid measure from the general prohibition of aid under Article 61(1).

The Surveillance Authority notes that the guarantees to be granted could be used for investments made in SMEs operating in a number of different sectors. In some of these sectors the Authority is not competent to assess the aid. However, this fact does not prevent the Authority from assessing the compatibility of the proposed aid as regards those sectors which fall within its competence in accordance with Article 24 of the Surveillance and Court Agreement.

The scheme has clear horizontal objectives in improving the availability of risk capital for small and medium-sized enterprises which normally have greater difficulty in raising finance. The definition of SMEs stated in the law bill is compatible with the EEA provisions on State aid, as stated in chapter 10 of the Procedural and Substantive Rules in the Field of State Aid, adopted by the EFTA Surveillance Authority on 19 January 1994<sup>6</sup>. Due to the importance of SMEs in job creation and job maintenance, the Finnish authorities aim to promote SMEs through the venture capital guarantee scheme which is seen to have an active role in changing the financial structure of these enterprises.

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<sup>5</sup> Act on State guarantees for certain branches of trade and industry (*Laki eräiden elinkeinoalojen valtiontakauksista* (375/63)).

<sup>6</sup> Hereinafter referred to as State Aid Guidelines.

The availability of risk capital is to be directed above all to SMEs engaged in application of new production technology and development of products or product enhancement with international competitiveness. The scheme, therefore, encourages innovation and R&D activities which normally involve risks but when successful promote the dissemination of new technology and the emergence of new products and, thus, improve competitiveness and contribute to economic growth. The scheme would not be intended to keep unprofitable enterprises in business but to compensate for the particularly high risks involved in the investments. Moreover, as innovative SMEs with good growth potential would be promoted, the investments could be realised more rapidly and the risk of failure of these companies would be smaller.

The guarantee is used to indemnify the investor for a loss that the investor has incurred owing to the guaranteed investment. The loss is indemnifiable insofar as it is covered by the guarantee. Such a loss is considered to have arisen when the enterprise in which the investment was made is declared bankrupt or enters into liquidation. As hardly any guarantees have been granted under the existing law due to the tight conditions of the scheme, the law bill includes the possibility of claim also in partial loss whereby the price of the relinquished investment is lower than that of the invested capital.

When the investor relinquishes his investment without compensation or against a compensation that is clearly disproportionate to the value of the investment, as a prerequisite for paying the indemnity it may be required that no payment is made unless the investment in capital that constitute the object of investment be transferred, on corresponding terms, to the Guarantee Board. The Board may then assign these rights thus transferred in the manner which it considers to be appropriate.

The mobilisation of the guarantee is, therefore, contractually linked to specific conditions such as the declaration of bankruptcy of the benefiting enterprise or any similar procedure in the case of total loss. Specific conditions apply also for partial loss as the price of the invested capital must be clearly higher than that of the value received once the investment is relinquished. The scheme is, thus, compatible with the EEA provisions on State aid, as laid down in chapter 17 of the State Aid Guidelines dealing with State guarantees.

While the guarantee cannot cover any profit yielded from the investment but only that of total or partial loss, the amount of risk of loss associated with the investment guaranteed may not exceed 50%. The aid intensity, which is difficult to be quantified for guarantees, is limited also by the fact that premiums and other charges, including a compensation for an increase in value of the investment, are collected by the Guarantee Board which should cover the losses of the scheme. Moreover, the Guarantee Board must by law be self-supporting in the long run. As regards the venture capital guarantee scheme, the requirement for self-supporting operations is to be strengthened by a balanced portfolio by granting guarantees to enterprises whose activities are oriented towards technology and R&D and to companies that have the prerequisites for profitable operations.

The benefit of the scheme to SMEs is indirect as the guarantee is offered to the investors. Guarantees may, however, not be granted to venture capital investors that receive the main bulk of funding for their investments from the State. In promoting the activities of SMEs, the distortions of trade are being outweighed by the positive effects of aid as SMEs may strengthen their financial structure and, thus, contribute to improvement of employment and economic growth. Moreover, a guarantee scheme is likely to distort trade less than is the case when direct grants are given for investment projects carried out by these enterprises.

The scheme may be cumulated with other aid schemes. The Finnish Guarantee Board will, however, in the application of the scheme ensure that the guarantee together with other aid granted to investments or investors may not exceed half of the total capital invested.

As the nature of the scheme is an experimental one, it is approved for a limited period of time covering State guarantees granted in 1992-1996. The application of the scheme shall be monitored closely through the annual reports that the Finnish authorities shall be requested to submit to the Authority.

The scheme may be applied to various sectors, including all sectors of industry. However, in the application of the scheme, the specific notification obligations with regard to certain sensitive sectors (currently synthetic fibres, motor vehicles and steel), as laid down in Part V of the State Aid Guidelines and in the Act referred to in point 1 a of Annex XV to the EEA Agreement establishing Community rules for aid to the steel industry (Commission Decision No. 3855/91/ECSC) have to be observed.

The scheme is in line with the EEA provisions on State aid as regards the granting of State guarantees. Furthermore, when adopting the State Aid Guidelines, the EFTA Surveillance Authority expressed a general presumption in favour of the compatibility of aid to SMEs, innovation and R&D. Therefore, it is concluded that the act on State guarantees for risk capital qualifies for exemption under Article 61(3)(c) of the EEA Agreement by facilitating the development of certain economic activities.

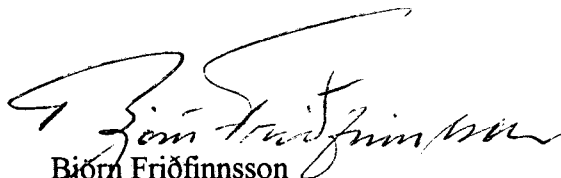
#### **HAS ADOPTED THIS DECISION:**

1. The EFTA Surveillance Authority has decided not to raise objections to the act on State guarantees for risk capital, as notified by letters dated 17 May and 27 June 1994.
2. The Finnish Government is obliged to submit a detailed annual report (according to chapter 30 of and Annex III to the State Aid Guidelines) on the application of the scheme to the EFTA Surveillance Authority.
3. The Finnish Government is reminded of the obligation in the application of the scheme to ensure the cumulation control and to observe the rules on notification obligations for certain specific sectors of industry, as laid down in Part V of the State Aid Guidelines and in the Act referred to in point 1 a of Annex XV to the EEA


Agreement establishing Community rules for aid to the steel industry (Commission Decision No. 3855/91/ECSC).

Done at Brussels, 5 August 1994

For the EFTA Surveillance Authority



Björn Friðfinnsson  
College Member



Pia Övelius  
Acting Executive Secretary