Seed and Early Stage Finance and the Role of Policy

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The guest speakers Thomas Hellman and Anne Glover overviewed the main hurdles affecting the capacity of young innovative firms to access finance and to grow, along with their interaction with investors. In addition, clear policy recommendations were proposed.

Thomas Hellman explored important insights regarding investors' heterogeneity and the relations between them. He showed that while angel investors represent the highest share of total investments, most of them typically write only one check and invest only in one firm. In contrast, venture capital (VC) investors write several checks to the same firm and finance several ones. He also presented evidence that these two types tend to be substitutes rather than complements, that is, a prior angel investment decreases the probability of a future VC investment, and vice-versa. This understanding is critical because VC investments present higher rates of successful exits than angel investments.

Anne Glover claimed that the current policies in Europe are over protecting investors, making them more risk-averse. As a result, institutional capital has been disappearing from venture funds. Indeed, young innovative firms do not find support to grow within the European investment community, and typically end up having to move abroad (e.g. to NASDAQ). Furthermore, another consequence of the lack of private capital is that venture funds have to rely increasingly on government sources. This is a main concern as there is empirical evidence suggesting that funds financed in total or in majority by governments tend to underperform in the market.

Neither speaker was indifferent about the current excitement regarding crowdfunding platforms. They share the idea that these will benefit young firms by allowing them to reach capital beyond their networks. However, the crowdfunding platforms with models that disintermediate the investment process will attract inexperienced investors and will fail in pursuing the necessary due diligence. Therefore, one is likely to see some failures until the market selects the right models. What is more, both speakers agree that even after reaching a steady state, crowdfunding is not the solution to the main issues affecting young firms, who find it more difficult to scale-up their activities, than to start-up.

Key Policy Recommendations:

- <u>More focus on businesses than on investors</u>;
- <u>Ease corporate tax:</u> effective in attracting capital, but politically controversial and nationalistic;
- <u>Ease capital gain tax for young firms</u>: benefit all investors and is performance based;
- <u>Inheritance tax free investments</u>: incentive long-term capital formation;
- <u>Attract private sector players</u>: after the crisis these funds stopped contributing to VC funds due to low performance, so they need to be incentivized to return, as they have the marketing power to attract large sums of capital worldwide;
- <u>Foster VC at European level</u>: mainstream VC investment philosophy changed from being regionally generalist (acting locally in several industries) to globally specialist (acting worldwide in specific industries). National public funds are a hindrance for this transformation as they require local investments. Hence, European authorities may contribute by fostering European wide policies rather than nationalistic ones.

Notes by Diogo Machado