

Tax-advantaged funds let startup cash flow in France

“A Very Successful Scheme.”

To support local start-up companies, the French government instigated the FCPI system more than a decade ago. FCPIs are tax-advantaged funds that enable private individuals to enter the venture capital market. Mary Lisbeth D’Amico spoke with Jean-Sébastien Cleiftie, investment manager at private equity management company Innoven Partenaires, about the pros and cons of this particular French funding system.

For over a decade, French early stage companies have reaped the benefits of a financial tool that has made start-up capital somewhat easier to come by. In 1997, the French government introduced *Fonds Communs de Placement dans l’Innovation* – dedicated tax-advantaged funds sold by banks, insurers and other financial institutions – that enable private individuals to take part in the venture capital market. Those who invest in an FCPI receive a tax break on 25 per cent of their investment of up to €12,000 per person or €24,000 per household. They also get a capital gain exemption if they hold the shares for five years. And since January 2008, the funds have allowed investors to get a 40 per cent reduction in wealth tax on shares invested in a FCPI.

VC market goes individual

The result was a definite increase in investment in startup companies, both in France and in other EU countries, where FCPIs are allowed to invest. Although there are no exact comparisons of the size of the French market before and after the creation of FCPIs, according to the French Capital Investment Association (AFIC), FCPIs raised €4.4 billion between 1997 and 2007, €2.2 billion of which has been invested in startups.

Market participants definitely notice the effect on early stage companies. “FCPIs have been instrumental in improving access to capital for biotech companies,” says Jean-Pierre Hermet, CEO of Ingen Biosciences in Chilly-Mazarin, France (see box on page 47). “We have access to double or triple the capital we would have had without them.”

Performance not that great

That is not to say that the performance of these funds has always been stellar. According to Roux Capital, a secondary market player, as many as 40 percent of all FCPI portfolios have been write-offs,



Jean-Sébastien
Cleiftie

40 percent show no increase in value, and only about 20 percent can be considered a success. Indeed, criticisms have been voiced that individual investors do not understand the risks inherent in venture capital. But the advocates of this model note that FCPIs are strictly regulated by the government and that the market should have the ability to regulate itself.

Lab Times spoke with Jean-Sébastien Cleiftie, principal, biotech investments, at Innoven Partenaires, one of the oldest players in the FCPI market, about the pros and cons of this financial vehicle.

What was the impetus for the creation of FCPIs?

Jean-Sébastien Cleiftie: This came about as a government initiative in the late 1990’s to create an incentive for consumer savings to be directed away from mutual funds and stocks towards innovation-driven start-up companies in France

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(later expanded to countries of the European Economic Area). They created a tax-advantaged scheme through a closed-end retail fund. Over time, the FCPI scheme has become a significant source of financing for mostly French young SMEs (small and midsize enterprises). A recent report by the French Capital Investment Association (AFIC) confirmed that over ten years, 35 management companies including Innoven raised a total of €4.4 billion through 216 FCPI funds. Of this amount raised, €2.2 billion were invested in 800 companies, which employ a total of 33,000 people and generate over €7 billion in revenues. By such metrics, it is fair to say that the scheme has been very successful.

Innoven characterises itself as “one of the oldest and most experienced FCPI managers”. How does the job differ in running an FCPI versus a typical venture capital fund?

Cleiftie: The most important difference lies in capital sourcing. Typical VC funds backed by a limited number of institutional investors (pension funds, insurance companies, etc.) raise large funds every four to five years and deploy these funds over a similar time period. The fundraising process can be quite long, and is mostly driven by the track-record of the investment team as well as the stability of the team over the years. In the FCPI market, fund raising dynamics are different. Through a financial products

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distribution network made up of financial advisors and banks, FCPI managers typically raise new funds every year (because the FCPI scheme provides a yearly tax advantage) with tens of thousands of retail investors. Fundraising is fundamentally driven by the tax advantage, and differentiation

between FCPI managers, while resting on the track-record of the investment team, very much lies in the “brand” and market presence that the management company, through its commercial and marketing activities, has been able to establish. On the investment side, there are differences in the management of the FCPI fund vs. VC fund due to specific rules, regulations, and processes, but basically the investment activities are similar on a day-to-day basis.

Some FCPIs have not performed up to par and critics say retail investors do not understand how risky these investments are. Do you think there needs to be more disclosure to investors about such risks?

Cleiftie: FCPI management companies must clearly indicate the risks associated with this product (this communication is regulated by the French SEC [AMF; an agency which holds responsibility for enforcing the federal securities laws and regulating the securities industry]. So in that sense, I would say there isn't a need for more formal warnings from FCPI managers. Furthermore, as the scheme has been in existence for more than a decade and communication channels have multiplied (investor chat rooms, blogs, etc.), the level of awareness – at the retail investor level – of the risky nature of FCPIs has increased. It is fair to say that the general public is more often than not aware that FCPI investment carries risks. All in all, I would say that there is self-regulation by the market.

Say I'm a small biotech company seeking funds. What advantages do FCPIs offer me? What disadvantages?

Cleiftie: Apart from minor differences, FCPI capital is fairly similar to typical VC capital. Time horizons from fundraising to liquidation are usually the same, and FCPI funds can be invested outside of France, in all EEA countries. Indeed, Innoven has invested significantly outside of France in Germany, the Netherlands and Scandinavia for example. One important advantage of FCPIs is that because of the regularity in fundraising, FCPI managers can raise new funds every year or even several times a year. This enables managers to maintain some ‘dry powder’ for their investments.

One possible disadvantage is that FCPI funds have to invest in companies that must demonstrate their “innovativeness”. A dossier has to be submitted to a French agency that is able to make that assessment and deliver a “stamp” that certifies that the company

Parisian Ingen grows with FCPIs

Profitable after 8 years

Ingen Biosciences benefitted from FCPI funding

Ingen Biosciences from Chilly-Mazarin (near Paris), is a good example of a biotech company that has benefited from FCPI funding. Capital provided by its two main investors, SGAM and Innoven, enabled the company to rapidly grow from a startup in 2001 to a profitable company with annual revenues of €19 million today, a staff of 60 and a 2,000 square meter facility in Chilly-Mazarin, south of Paris. The company started as AbAg, a company specialized in blood tests for diagnosing bacterial infection. Its focus is on diagnosis, prosthetic joints, respiratory and reproductive tract infections. After receiving investment of €8 million from investors SGAM & Innoven, in 2006 the company was able to acquire InGen, a distributor of *in vitro* diagnostics. Jean-Pierre Hermet, CEO of Ingen Biosciences, says that further acquisitions are also planned. To be internationally competitive, however, Hermet needs to jazz up his company's French website and provide an English version...

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is innovative. This process, which takes a few weeks, can be considered a disadvantage, but it is in reality quite straightforward. Most French start-ups know about this process, but sometimes for non-French companies this can be a bit difficult to grasp. As mentioned before, though, it is a pretty simple process.

Do you think there is a model here for others to copy? Could this be applied in Germany for example?

Cleiftie: Many countries could introduce this scheme, but it takes the will at the political level.

In the UK, the V.C.T. market has been quite successful. Germany certainly has the right environment for such a scheme to be applied. There is world-class scientific and engineering research, highly qualified managers and developers, large pools of entrepreneurs, and strong local support of high-tech start-ups. In fact, Innoven has actively invested in Germany. We invested in gate5 (sold to Nokia in 2006), Paion (IPO on FSE in 2005), and 20/10 Perfect Vision (established a joint-venture with Bausch & Lomb last year).

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