II

(Acts adopted under the EC Treaty/Euratom Treaty whose publication is not obligatory)

DECISIONS

COMMISSION

COMMISSION DECISION

of 20 December 2006

on the aid to 'Investbx' C 36/2005 which the United Kingdom is planning to implement

(notified under document number C(2006) 5808)

(Only the English version is authentic)

(Text with EEA relevance)

(2008/126/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above [1] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By letter dated 26 July 2005, registered at the Commission on 28 July 2005, the United Kingdom notified the Commission of the aid measure mentioned above, pursuant to Article 88(3) of the EC Treaty.

(2) The Commission asked for further information on 19 August 2005, following which a meeting between representatives of the United Kingdom and the Commission was held on 8 September 2005. During this meeting, additional information was provided by the UK representatives.

(3) On 26 September 2005, the Commission received a complaint from the undertaking PLUS Markets Group plc (formerly Ofex Holdings plc) (hereinafter 'Ofex').

(4) By letter dated 20 October 2005, the Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the measure.

(5) By letter dated 11 November 2005, the Commission sent its Decision to initiate the procedure laid down in Article 88(2) of the EC Treaty to the interested party Ofex.

(6) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* [2]. The Commission called on interested parties to submit their comments.

(7) By letter dated 21 November 2005, registered at the Commission on the same date, the United Kingdom submitted a response to the Commission's Decision to initiate the procedure.

(8) The Commission received observations from 20 interested parties:

(a) from The Share Centre by letter dated 10 November 2005, registered at the Commission on 23 November 2005;

[1] OJ C 288, 19.11.2005, p. 13.

[2] See footnote 1.

(b) from Ofex by letters dated 25 November 2005, registered at the Commission on the same date and 15 December 2005, registered at the Commission on the following day;

(c) from Mazars by letter dated 24 November 2005, registered at the Commission on 5 December 2005;

(d) from Sir Albert Bore by letter dated 30 November 2005, registered at the Commission on 6 December 2005;

(e) from Quoted Companies Alliance by letter dated 16 December 2005, registered at the Commission on the same day;

(f) from Hembury Associates Ltd, dated 16 December 2005, registered at the Commission on 19 December 2005;

(g) from Hamilton Pratt, dated 13 December 2005, registered at the Commission on 19 December 2005;

(h) from Regione Emilia-Romagna, dated 15 December 2005, registered at the Commission on 20 December 2005;

(i) from JP Jenkins, dated 13 December 2005, registered at the Commission on 20 December 2005;

(j) from Aston Science Park, dated 14 December 2005, registered at the Commission on 22 December 2005;

(k) from Robert Huggins Associates, dated 13 December 2005, registered at the Commission on 22 December 2005;

(l) from Catapult Venture Managers, dated 12 December 2005, registered at the Commission on 22 December 2005;

(m) from EEF West Midlands, dated 14 December 2005, registered at the Commission on 23 December 2005;

(n) from Ofex, dated 19 December 2005, registered at the Commission on 23 December 2005;

(o) from CEBRE, dated 16 December 2005, registered at the Commission on 23 December 2005;

(p) from West Midlands Business Council, dated 22 December 2005, registered at the Commission on 3 January 2006;

(q) from Birmingham Forward, dated 19 December 2005, registered at the Commission on 3 January 2006;

(r) from Confederation of West Midlands Chambers of Commerce, dated 20 December 2005, registered at the Commission on 3 January 2006;

(s) from Advantage Growth Fund, dated 5 January 2006, registered at the Commission on 10 January 2006;

(t) from the University of Warwick, dated 16 December 2005, registered at the Commission on 16 January 2006;

(9) The representatives of Ofex explained their position at a meeting with the Commission on 16 December 2005.

(10) By letters dated 22 December 2005, 13 January 2006 and 19 January 2006, the Commission forwarded the observations from interested parties to the United Kingdom in order to give the United Kingdom the opportunity to react.

(11) At the meeting between the UK authorities and the Commission on 30 January 2006 the UK authorities provided explanations. The Commission asked for further information.

(12) This information as well as the opinion from the United Kingdom in response to the comments of third parties was received by letters dated 3 February 2006, registered at the Commission on the same date, and 7 February, registered at the Commission on 10 February 2006.

(13) The Commission requested further information from the United Kingdom by letters dated 15 February 2006 and 6 April 2006. The United Kingdom provided this information by letters dated 2 March 2006, registered at the Commission on the following day, and 7 April 2006, registered at the Commission 12 April 2006.

(14) The United Kingdom provided further information by letter dated 3 May 2006, registered at the Commission on 11 May 2006.

(15) By e-mail and letter dated 25 May 2006, containing the same information and registered at the Commission on respectively 29 and 30 May 2006, Ofex claimed that Advantage West Midlands (hereinafter 'AWM') was taking preparatory steps in relation with Investbx and requested the Commission to postpone the adoption of the Decision until Ofex would be able to supply further information. By e-mail dated 31 May 2006 and registered on the same date, Ofex requested to be informed before the Decision would be adopted and to receive the Decision before it would be published. By e-mail dated 9 June 2006, registered on the same date, and by letter dated 9 June 2006, registered at the Commission on 13 June 2006, Ofex repeated its request to postpone the adoption of the Decision.

(16) By two e-mails dated 4 July 2006, registered at the Commission on 6 July 2006, the United Kingdom submitted further information to the Commission.

(17) By e-mail dated 12 May 2006, registered at the Commission on 13 May 2006, Ofex informed the Commission that an internet site of Investbx was publicly accessible.

(18) By letter dated 26 July 2006, registered at the Commission on 1 August 2006, Angelbourse claimed that it is a trading facility for smaller companies and Investbx constitutes unfair competition. This letter was received more than seven months after the deadline for comments of third parties and its allegations were not substantiated, therefore the Commission has not taken it into account.

(19) By e-mails dated 3 August 2006, registered at the Commission on the same date, Ofex informed the Commission of the existence and activities of Angelbourse.

(20) By letter dated 7 August 2006, the Commission requested further information from the United Kingdom.

(21) By e-mails dated 23 October 2005, registered at the Commission on the same date, the United Kingdom submitted a response to the request of the Commission.

2. DETAILED DESCRIPTION OF THE MEASURE

(22) Based on the information provided by the United Kingdom, the Commission summarises the description of the notified measure as follows.

2.1. Objective of Investbx

(23) The primary objective of the measure is to create a means for small and medium-sized enterprises ([3]) in expansion stage ([4]) (hereinafter 'SMEs') in the West Midlands region of the United Kingdom to raise equity gap finance ([5]). It will bring together SMEs, service providers and investors to make it easier for companies to raise money by creating a practical forum for issuing and exchanging new shares. Investbx will also provide and facilitate the provision of services at market rates to SMEs to enhance their ability to raise funds.

(24) The measure intends to overcome the market failure for provision of equity financing between GBP 0,5 million and GBP 2.0 million for SMEs in the West Midlands. The UK authorities declared that the ceiling for fundraising will be GBP 2 million per annum during the initial five-year stage in order to focus the measure tightly on combating the market failure in SME fund raising. They are concerned, however, that the market failure is changing over time as private equity is increasingly drawn to bigger scale projects. The CBI report ([6]) estimates the market failure between GBP 0,25 million and GBP 3 million. A GBP 2 million ceiling might therefore, according to the UK authorities, create real barriers to the success over time of the Investbx project, excluding certain SMEs which may require a higher level of investment. If this proves to be the case, AWM will gather the evidence and notify an amendment to the Commission asking for the ceiling to be raised.

(25) Investbx aims at providing a bridge between private investors, including *business angels* and venture capitalists, to whom it will provide an additional exit opportunity, and more senior established markets. Investbx will prepare investees for the listing on the more senior established markets, namely the Alternative Investment Market (hereinafter 'the AIM') and the London Stock Exchange (hereinafter 'the LSE').

2.2. Legal basis of the measure

(26) The legal basis of the measure is the regional Development Agencies Act 1998 ([7]), Section 5.

2.3. Budget and duration

(27) A government body, the West Midlands Regional Development Agency, ('AWM'), will grant Investbx funding of up to GBP 3 million for a period of at most five years. The amount may be lower and/or the period may be shorter if the project becomes self-sustainable. Investbx will use this grant to cover its investment and other start-up costs that may not be covered by the revenues of its activity. Investbx will use the grant according to a financial plan, which projects an increasing number of SMEs to be served by Investbx over the initial five-year period (totalling 47 by the end of the five-year period), and foresees an increasing revenue generation and lowering use of the grant for loss compensation until, in five years at the latest, Investbx breaks even.

([3]) The definition complies with Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36).

([4]) SMEs in expansion stage are SMEs as defined in point 2.2 (h) of the Risk Capital Guidelines (Community Guidelines on State Aid to Promote Risk Capital Investments in Small and Medium-Sized Enterprises, OJ C 194, 18.8.2006, p. 2).

([5]) Equity gap finance refers to the investments in the equity gap range of GBP 0,5 to 2 million.

([6]) Confederation of British Industry: '*Improving access to finance — Enabling the enterprise revolution*' (July 2006).

([7]) http://www.opsi.gov.uk/acts/acts1998/19980045.htm.

(28) The projections foresee a part of the grant to serve as a reserve. After this period, Investbx will repay the remaining unused funds to AWM and AWM will either sell shares of Investbx on the market through an open and non-discriminatory public tender or close it down.

2.4. **Beneficiary of the measure**

(29) The direct beneficiary of the measure is Investbx. Investbx will receive up to GBP 3 million by way of grant of AWM. Any surpluses from Investbx will be reinvested back into Investbx to benefit the regional economy, which corresponds to AWM's mission. AWM will retain a strong influence on Investbx.

(30) Investbx will be a *company limited by shares*. The company status will allow Investbx to enter into contracts in its own right. Being a separate legal entity from AWM will facilitate a possible transfer of the company in the future. If Investbx is successful, it will be sold and become a private sector company. At that time any outstanding funds from the original grant will revert to AWM.

(31) Investbx will have an executive team of 6 to 8 persons responsible for the delivery of the business plan. A non-executive board will comprise West Midlands professionals specifically appointed for their knowledge and experience of working with SMEs and target investors.

2.5. **The current market in the United Kingdom**

(32) According to the United Kingdom, the traditional market for buying and selling shares in the United Kingdom is dominated by the LSE, which is primarily engaged in hosting large stock trades in a global marketplace. SMEs are increasingly shut out as blue-chip stocks of larger companies are preferred.

(33) According to the United Kingdom, the LSE sought to cater for this situation by the introduction of its AIM in 1995. This operates as a second-tier market targeting new and smaller companies. Membership requires no minimum trading record, no minimum assets or profit levels, no minimum capitalisation and no minimum free float of shares.

(34) According to the United Kingdom, outside the realms of the LSE and the AIM is the trading facility Ofex which is regulated by the United Kingdom's Financial Service Authority (hereinafter 'FSA'). It aims to provide a more cost effective and less regulated alternative to the AIM.

(35) There are a number of service providers in the United Kingdom that trade non-listed shares or raise equity, like The Share Centre (Fast Track Service), Univits, JP Jenkins, or Investor Champions.

(36) Despite the above developments, the United Kingdom claims that there is still a long-term market failure for equity investment in SMEs located in regions outside the South-East such as the West Midlands. Among the lowest level of listed companies and total market capitalisation can be found in the West Midlands. AWM asked Ofex whether they could address the market failure in the West Midlands region, in which case AWM would abandon its Investbx project. However, Ofex did not react.

2.6. **Activities and pricing of Investbx**

(37) According to the UK authorities, Investbx is a completely novel measure, for which there is no precedent. While traditional venture capital funds aim at increasing the supply of equity capital, Investbx envisages instead improving the efficiency with which information on investee companies can circulate. Investbx will kick-start the creation of an effective local equity market, by connecting companies to investors, offering them a viable, simple, cost effective solution to raising equity, trading their shares and showcasing their activities. This trading facility will be different to traditional stock markets (namely the LSE with its AIM), as well as Ofex, because it will operate through a visible online electronic auction market, matching buyers and sellers at a single price with investment via an online execution-only platform. Unlike at mainstream markets, such online auctions will only be carried out a few times per month. At the same time Investbx will encourage a longer term view of investing, emphasising the main objective of raising money for SMEs in the community rather than the ability to frequently trade shares as provided by the existing London based markets. Accordingly, Investbx will have three distinct roles: fund raising or primary funding, bundling of support services for SMEs and providing a secondary auction based trading platform for shares once they are admitted for trading.

(38) Companies wishing to raise equity gap finance will be assisted by locally based financial and legal advisers and by the Investbx West Midlands-based team.

(39) The trading platform will be at the online Investbx portal (www.investbx.com), which will also contain a range of integrated services, open online 24/7, specifically designed to meet the needs of SMEs, either quoted or unquoted.

(40) Investbx will not provide funding to the SMEs. Neither will Investbx provide directly funds or guarantees to the investors or the investees. All equity finance will be provided from market investors to private target investees. The function of Investbx is merely to facilitate transactions among private market players.

2.6.1. *Fund raising*

(41) Investbx will assist the fundraising of SMEs. It will be marketing suitable SME's in the region to advisers in search of SMEs to invest in. Fund raising, also called primary funding, will consist of selling shares which have been newly issued by the target SMEs, under the assistance of Investbx, directly to interested investors. The UK authorities have declared that the ceiling for fundraising will be GBP 2 million per annum and SME during the initial five years stage.

(42) According to the professional advisors, who assist SMEs at fund raising and who have been consulted during the whole process of designing the Investbx project, there is a potential in the West Midlands to finance more than 10 SMEs per year on the basis envisaged for Investbx. According to its financial plan, during the first five years of its existence, it should raise at least GBP 70 million for at least 47 companies.

(43) The SMEs will be charged a commission of 6 % of the funds raised. This fee was determined from the financial model in a way that should enable Investbx to break even within the five-year term of the grant funding agreement. Furthermore, it was evaluated by benchmarking the fees against existing case studies for fund raising. This showed that 6 % is more than what is required by some other operators. However, the UK authorities also note that such a benchmarking exercise has limited value given that there are no adequate comparators for Investbx following its unique nature. Investbx will be different to any one of the existing providers of fund raising services in the West Midlands. Therefore it is considered that Investbx will be able to charge a 6 % commission, i.e. at least the rate charged by existing corporate advisors.

2.6.2. *Bundling of support services for SMEs*

(44) According to the UK authorities, Investbx will bring together various service providers that will assist the SMEs in the process of fund raising as well as during the period when their shares will be traded. Investbx will provide a *transaction coordinator* to each SME that decides to raise funds through Investbx. A secure document sharing facility on the Investbx website will contain all the template documents that an SME will need during the process of capital raising and joining the trading platform. These templates have been developed with the local professional community and are simplified in order to be appropriate and cost effective for SMEs.

(45) Any SME seeking to raise funds at Investbx will be assessed by Investbx. This will include assessments of its potential to attract investors for primary funding and of whether the due diligence brought to light any facts that would speak against admission. After a favourable assessment, the Investbx team will contact investors and syndicate partners ([8]), who may have a number of their own investors that wish to participate in the new issue.

(46) During the fund raising process Investbx will provide research and marketing services at market costs, which it will outsource. Investbx will maintain a list of independent financial advisers, legal advisers, reporting accountants, financial public relations advisers and independent research providers who have the appropriate experience and regulatory approvals and from which the SMEs may choose any services they need for fund raising.

(47) All SMEs joining Investbx will have independent research published. Investbx will make available on its website to all potential investors or financial advisors a presentation of each SME containing summary information from the full admission document, the admission document and independent research. The independently carried out research will contain both quantitative and qualitative detailed and in-depth information about that company. This type of research is rarely available to anyone other than institutional fund managers. Such data is usually prepared only for larger stocks of shares and available only to institutional investors. The research will also provide a detailed commentary about each area of the business.

(48) SMEs will pay any advisers' professional fees for assisting them to join Investbx. The individual professional fees will be at market prices charged by private market operators that do not receive any financial benefits from Investbx.

2.6.3. *Secondary trading*

(49) Investbx will also provide an online order driven auction-based secondary market trading platform. The purpose of this platform is to provide some liquidity in shares of the companies subsequent to raising capital in the primary market and being admitted to trading on Investbx.

([8]) A syndicate partner is a group of investors that act together when investing into a company.

(50) An *order driven market* relies on owners of shares in an SME registering that they would like to sell some of their shareholding and disclosing the price that they would be prepared to accept for them. Interested buyers of shares in the SME will also register their interest together with the price that they are willing to pay for the shares.

(51) Both buyers and sellers are able to see all bids and offers for shares in the SME on the Investbx website 24/7 and can change their orders up to an hour before the auction takes place. Auctions take place at a frequency set by the company based on the amount of interest that is shown in trading its shares, possibly weekly or monthly. This, according to the UK authorities, encourages a longer term view of investing in SMEs as it is not possible to buy and sell shares immediately.

(52) In the *auction based system* shares are sold directly between individual investors, by matching buyers and sellers at a single price. It will thus eliminate the market-maker margin, which is the difference between the bid and the offer prices in the usual market-maker quote driven system (the LSE, the AIM and Ofex are established market-maker based markets as explained below, hereinafter called 'established markets'). This difference is typically higher for shares that are traded less often and in smaller amounts. According to the UK authorities, at Ofex the highest spread was up to 75 % and the average share price spread of the six West Midlands based companies traded on Ofex over the preceding 12 months before September 2006 was 16 %.

(53) Investbx will outsource the costly and complex functions involved in regulation and trading to an FSA authorised firm. Such a firm, The Share Centre, has been appointed as preferred bidder for this role following a non-discriminatory selection process published in the *Official Journal of the European Union*. The Share Centre's role will include: FSA authorisation and associated compliance; providing the online stock-broking product; receiving agent services (collecting money from the investors subscribing for new issue shares), employee share scheme administration, provision of the trading facility and running of the periodic auctions.

(54) The UK authorities confirmed that the fees charged by Investbx to the investee SMEs as well as to the investors on services connected to the secondary trading will be equal to the market rates charged by The Share Centre to individual companies. Investbx will profit from a discount from The Share Centre.

2.7. **Indirect beneficiaries**

(55) All primary and secondary trading at Investbx will take place among private market players, the investors and investees, who may only indirectly benefit from the measure.

2.7.1. *Investors*

(56) Taking into account the tendency of institutional investors to invest into larger deals, the UK authorities believe that these investors will not be interested in using Investbx. Investbx expects therefore to raise funds mainly from individual private investors, including high net worth individuals. Investbx will target mainly but not exclusively investors from the West Midlands region, as the UK authorities believe that these are more likely to invest into the West Midlands based target SMEs.

(57) The investors may be approached directly by Investbx or through intermediaries or syndicate partners. In any case, no investors, independently from where they are or if they are institutional or individual private investors, will be excluded from or disadvantaged by using Investbx.

(58) Individual private investors will be able to participate in the primary funding during the fund-raising process and gain access to presentation and independent research on the investees. These opportunities are, according to the UK authorities, usually obtained only by institutional investors. All investors will be able to apply for new issue shares directly online or via financial intermediaries.

2.7.2. *Investee SMEs*

(59) Only SMEs from the West Midlands with viable business plans and at least two years trading records seeking 'expansion capital' ([9]) are eligible for using Investbx. Investbx may exceptionally consider SMEs that do not have a two-year trading record if the SME has received investment from a venture capitalist whilst developing its products or services. The UK authorities have confirmed that SMEs will not raise more than GBP 2 million per year and they will not be beyond the stage of expansion capital, as defined in point 2.2(h) of the Community Guidelines on State Aid to Promote Risk Capital Investments in Small and Medium-Sized Enterprises (hereinafter referred to as 'Risk Capital Guidelines') ([10]).

([9]) As defined in Community Guidelines on State Aid to Promote Risk Capital Investments in Small and Medium Sized Firms, OJ C 194, 18.8.2006, p. 2.

([10]) OJ C 194, 18.8.2006, p. 2.

(60) In order to provide protection for investors, companies joining Investbx must meet a set of regulatory and disclosure requirements in accordance with the FSA regulation.

2.8. **The selection procedure for the service provider of the measure**

(61) The main service provider to Investbx, The Share Centre, has been selected by a competitive and non-discriminatory selection process published in the *Official Journal of the European Union* ([11]). Three undertakings submitted formal offers: Ofex, Univits and The Share Centre. A panel of three independent expert advisers and three internal AWM assessors reviewed the selection based on 18 selection evaluation criteria. Based on these criteria, the Univits proposal scored lowest. The best bidder, The Share Centre, and the second best bidder Ofex were invited to an interview. The Share Centre scored significantly better than Ofex in the assessment and, according to the UK authorities, it was therefore selected as the preferred bidder.

(62) Due to the technical complexity of the project and the importance of the market operator role to the success of the business, an additional independent evaluation of both finalists was commissioned, which also resulted in The Share Centre being the preferred bidder.

(63) According to the UK authorities, all parties were advised of the decision in February 2004. Ofex sought information as to why it had not been selected and this was duly provided. No formal complaint or legal challenge followed this.

2.9. **Comparison Investbx vs. Ofex**

(64) Based on the information provided from the UK authorities, which was not contradicted by the submissions of interested parties, Investbx and Ofex can be distinguished as follows:

INVESTBX	OFEX
Geographical area of operation	
SMEs from West Midlands only	National and International
Dedicated West Midlands based team of 6-8 people	1 business development manager, based in London covering all 9 UK regions
Target market	
SMEs in expansion stage only	Any size of company
Up to GBP 2 million per annum	No limit
Services provided	
Primary objective is raising primary capital for SMEs	Primary and secondary trading market. Broker dealers raise money
Provision of independent research is pre-requisite for joining	No such requirement
Order driven trading platform, periodic auctions matching buyers and sellers at a single price	Quote driven market; real time trading with one price at which to buy and another price at which to sell which generates the share price spread
Regulatory landscape	
Investbx will be an Appointed Representative of The Share Centre which operates an Alternative Trading System	Ofex is currently an Alternative Trading System directly authorised by FSA

3. **GROUNDS FOR INITIATING THE PROCEDURE**

(65) In its Decision to initiate the procedure the Commission identifies aid to Investbx. Moreover, it announces further scrutiny of possible aid to investors and SMEs.

(66) In that Decision the Commission states that, although the measure aims at bridging the equity gap for SMEs, it does not fall within the scope of the risk capital communication ([12]). Since Investbx does not provide any venture capital to SMEs, it cannot be regarded as a venture capital fund. The measure aims at setting up the infrastructure for an exchange facility for investors and SMEs. The grant to Investbx does not qualify as aid under the regional aid guidelines. Also no other State aid regulations, frameworks or guidelines are applicable. Therefore in the Decision to initiate the procedure the Commission states that the assessment of the aid to Investbx could be based directly on Article 87(3)(c) of the EC Treaty. Accordingly, a well-defined market failure has to exist, the aid instrument has to target that market failure and the distortion of competition and the effect on trade must be on balance outweighed by the common interest.

([11]) OJ S 206, 25.10.2003, No 186003.

([12]) OJ C 235, 21.8.2001, p. 3.

(67) In the Decision to initiate the procedure the Commission expresses its doubts about the compatibility of the measure, specifically about whether the market failure in the area of GBP 0,5 million to GBP 2 million, which was identified in the Commission Decision on the *Enterprise Capital Funds* ([13]), is still valid in the United Kingdom and particularly in the West Midlands region.

(68) Finally, the Commission wishes to further investigate differences between Investbx and the traditional markets, in particular Ofex. It announces an examination of any competition with the LSE, the AIM and Ofex, as well as with debt finance providers. The purpose is to verify whether the distortions of competition and the effect on trade are limited to ensure that the aid measure is not, on balance, against the common interest.

(69) Only after consideration of third party comments could the Commission decide whether the measure proposed by the United Kingdom targets a well defined market failure and whether it affects competition and trading conditions to an extent contrary to the common interest.

4. COMMENTS FROM INTERESTED PARTIES

(70) The Commission received comments from 20 interested parties, pursuant to Article 20(2) of Council Regulation (EC) No 659/1999 ([14]). 17 of these 20 interested parties were supporting the Investbx measure. Support was received from West Midlands businesses, professional community and venture capitalists, West Midlands business organisations, West Midlands universities and academic experts, West Midlands stockbrokers as well as a European region. Apart from Ofex, also JP Jenkins Stockbrokers and the Quoted Companies Alliance gave critical comments on the Investbx measure.

4.1. Supporting comments

(71) The majority of the 17 positive comments confirmed the existence of market failure in the provision of equity in the range between GBP 0,5 and 2 million, with one party claiming the market failure to be up to GBP 3 million. The market failure is claimed to be on the demand as well as on the supply side and not to be resolved either by business angels, who provide lower amounts, or by private venture capital funds, which concentrate on larger deals, or by established markets such as the AIM or Ofex, which are claimed to be concentrated on the London and the South-East regions while not being interested in developing a local West Midlands market. The SMEs using the existing platforms suffer from low interest by investors because of the relatively small amounts of transactions and a consequently lower coverage by research on the SMEs. According to several parties Investbx is useful and needed to overcome the market failure, to serve as a bridge towards more senior established markets. By providing an exit possibility, it will thus stimulate interest by business angel investors.

(72) Several parties reaffirm the need for a local market that will concentrate on the market failure left by larger operators and that will profit from local knowledge, expertise and personal networks. Some parties mention that the State aid is necessary as pure private sector provision of equity fails at local level. A case study forwarded by the University of Warwick highlights an SME in one case that had to look to the Australian market to raise equity for growth in light of funding gap in the West Midlands and high cost of entering the present markets. It is argued that since it is not economically viable for investors to visit regularly other regions for deal finding and monitoring, Investbx will improve the situation by raising capital mainly from local investors, in particular from high net worth individuals. Investbx is praised as an innovative, cost effective design, which has the potential to assist the competitiveness of SMEs and to improve the situation in the West Midlands after a series of economic shocks, one of them being the collapse of MG Rover.

(73) Parties from other Member States express their support to Investbx and believe that it will serve as a pilot project from which lessons and good practices may be learned for other European Communities regions.

4.2. Critical comments

(74) The Quoted Companies Alliance (hereinafter 'QCA') claims that a local exchange would dilute the liquidity from other markets and that they *'just don't see how a small local exchange could meet these [extensive regulations] without enormous taxpayers' subsidies'*.

(75) JP Jenkins, an independent execution-only stockbroker that specialises in matching trades in shares, claims that Investbx will be its direct competitor and that the state aid will distort competition and prejudice JP Jenkins' position.

(76) Jamie Whitehorn, General Counsel of Ofex considers the identification by the United Kingdom of the reasons for, and existence of an alleged market failure in the range of

([13]) Commission Decision C(2005)1144, OJ L 91, 29.3.2006, p. 16.

([14]) Council Regulation (EC) nº 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ, 27.3.1999, L 83, p. 1.

GBP 0,5 million to GBP 2 million both incorrect and unproven. As to the imperfect information on both the demand and supply sides, he considers that there is no evidence on, firstly, lack of information for SMEs on how to access equity funding, secondly, failure of the West Midlands companies with viable business plans to raise equity at Ofex or the AIM, and thirdly, that investors lack '*appropriate and reliable information about potential investees*'.

(77) According to Ofex and QCA, at present services to SMEs seeking to raise equity finance are offered by Ofex, the AIM, JP Jenkins Limited, broker networks and investor mailing lists. Furthermore, equity could be raised using the register of '*qualified investors*' maintained by the Financial Services Authority.

(78) Ofex expressed its concerns that some of the information on which the Commission's preliminary assessment is based is incomplete, outdated and/or inconsistent with the way UK equity markets work in practice.

(79) Ofex considers that the studies put forward by the United Kingdom in the context of the *Enterprise Capital Funds* to which the Commission refers are out of date in so far as the service provided by Ofex is concerned. Over the last two years, the Ofex market has been radically improved. This has been reflected in the increased number of admissions of SMEs on Ofex in 2005 compared to 2004, with all of the fund raisings in the sub GBP 2 million range.

(80) Even assuming the existence of market failure, Ofex claims that Investbx would not resolve the underlying problems. Investbx is not in the position to remedy information deficit as due to regulatory constraints it could not provide more information than what is currently available at Ofex or the AIM. Transaction costs, that is professional fees and due diligence costs are equal at all markets and Ofex and the AIM fees only represent a small proportion in the overall costs of raising equity.

(81) Furthermore, Ofex believes that the measure is not an appropriate instrument, because, if closed down within five years the trading platform would disappear and the contact between the SME and its shareholders would be lost. Consequently, the investors could be locked in, which would lead to uncertainty towards the end of the five-year period.

(82) Moreover, Ofex claims that there are limitations of an auction-based system that make it less suitable for trading as compared to market-maker based systems. Firstly, a double coincidence between the seller and buyer at a specific time would be required for realisation of sale. Secondly, such a system will not generate sufficient depth of orders that could reliably inform the investors about the share price. In the market-maker system, however, deals can be done at any time.

(83) Ofex claims that the escalator function is fully covered by Ofex, the AIM and the LSE. According to Ofex the announced objective of bridging the perceived market failure for SMEs would either not be achieved or/and there already exists a number of competitive alternatives in the market that offer comparable means for raising equity.

(84) Furthermore, Ofex argues the proposed state aid targets the operating costs of Investbx rather than the enterprise costs of SMEs. Also the aid proposed is neither for the benefit of potential investors in SME companies nor for the SME companies seeking to raise capital but for the vehicle, Investbx, through which the measures operate. Ofex considers it significant that the proposed instrument allegedly does not operate through a mechanism acknowledged by the Risk Capital Communication.

(85) Ofex submits that the proposed aid will not have the alleged incentive effect. If companies wish to seek capital and believe this could be best achieved through a share trading facility for their shares, there are existing markets already available. Companies in the Midlands have already taken the advantage of these facilities.

(86) Furthermore, referring to the HM Treasury Report *'Bridging the Finance Gap'* (December 2003), Ofex claims investors are not influenced by geographical location but by the business proposition itself.

(87) Ofex claims that on its platform retail investors do have access to, and subscribe for, new issues of shares by SMEs. Given the proportion of companies that raise capital amounts below GBP 2 million at Ofex, Investbx will directly compete with it, rather than complement it. Ofex is further concerned that Investbx would risk 'crowding out' other providers as a result of the provision of state aid to Investbx, namely discouraging other potential investors from providing additional capital to other existing or potential share trading markets. They argue this is because the grant of state aid would excuse Investbx from the need to make profit, thereby allowing it to adopt a revenue model intended simply to meet any surplus costs not covered by the state aid. In contrast, its competitors (such as Ofex) are funded by private sector investors who expect a financial return, and such competitors would therefore need to achieve a sufficient margin to generate profits. It is claimed that in this context Investbx may actually restrain innovation in financial markets. A platform supported by state aid which is not profit driven will not, it is suggested, have the same commercial imperatives to improve its services or introduce new services for the benefit of customers.

(88) In summary, Ofex claims the proposed aid measure cannot be considered to be in the common interest.

5. COMMENTS FROM THE UNITED KINGDOM

5.1. Comments to the Decision to initiate the procedure

(89) In their comments to the Decision to initiate the procedure, the UK authorities argue that the whole premise of Investbx is based on the existence of a well-acknowledged market failure in the provision of equity finance between GBP 0,5 million and 2 million in the West Midlands. Despite the establishment of a number of publicly-backed venture capital funds, there allegedly remains a shortage of funding for SMEs. The UK authorities note that all the available evidence points to the conclusion that the market failure will not be addressed by the private sector, thus the only way to resolve this problem is to stimulate the market by public intervention.

(90) In order to address the market failure, Investbx is intended to be a regional catalyst for the bringing together of SMEs and investors via an online share trading exchange, coupled with a bundle of complementary services focusing on raising funds for SMEs. To the UK authorities' best knowledge, nothing like Investbx currently exists anywhere in the Community. It is an innovative and unique pilot project and offers potential benefits to all regions across the Community by allowing them to observe its progress in rectifying the market failure and to explore whether online regional stock exchanges of this nature are sustainable and helpful to regional economies.

(91) The UK authorities submit that AWM publicly selected The Share Centre, using a selection procedure via the Official Journal of the European Union, for the market operation of Investbx. It is further stated that Ofex supported the project both before and immediately after it was unsuccessful in winning the contract for the running of Investbx. It was further submitted that the selection procedure was conducted in an objective manner and at no stage has the fairness of the procedure been called into question.

(92) The UK authorities believe that Investbx will attract a new kind of investor and as such Investbx will not be competing with Ofex for funds. Investbx will operate as a stepping stone to the more senior markets rather than act as a competitor.

(93) The UK authorities state that the improved services for investors as mentioned in the Decision to initiate the procedure are not currently available. As a result, there would be no possible distortion of competition. The UK authorities say that Investbx will make new issue shares available to the public, which is in contrast to the practice of more senior markets where new issue shares are traditionally made available to a few institutions.

(94) The UK authorities confirm that Investbx will have a dual role (by acting as a forum for inclusive discussion and by trading activities), neither of which is currently fulfilled by Ofex or any other organisation. The structure of Investbx was chosen because it safeguards the effective control of Investbx by AWM, and it ensures that no benefit from funds will be leaked to third parties and any benefits realised from the sale of Investbx will ultimately revert to AWM if the venture proves successful.

(95) The Investbx business plan forecasts primary fund raising for a minimum of 47 SMEs in the West Midlands over a period of five years, raising a minimum of GBP 70 million. In comparison with Ofex, the following was concluded by the UK authorities in their letter of 21 November 2005:

UK level

— Within five years since 2000 at Ofex only GBP 43,3 million primary funding was raised within the GBP 0,5 million to 2 million range for 39 companies based all over the United Kingdom.

— When removing secondary funding from the total funds raised, Ofex companies only raise modest amounts via primary issues.

West Midlands

— The 10 West Midlands based companies listed on Ofex represent only 7 % of the total number of companies at Ofex (November, 2005).

— When only West Midlands based companies are considered, at Ofex a total of GBP 12 million (primary and secondary) has been raised over a five-year period between 2001 and 2005, representing only 4,1 % of the total raised UK-wide by Ofex. Over 50 % of the funding raised by Ofex for West Midlands based companies was in favour of one company.

— Only GBP 3,5 million of primary funding for 5 companies based in the West Midlands has been

raised at Ofex over a five-year period since year 2000. Of the 20 new admissions to Ofex in 2004 only one company was based in the West Midlands.

(96) In their letter of 21 November 2005 the UK authorities state that Ofex's fund raising activity is UK-wide, in contrast to Investbx which is very definitely targeted at one region, the West Midlands. Of over 300 000 SMEs in the West Midlands it is claimed that only 57 are traded on the AIM, 10 on Ofex and between 5 and 10 are helped each year by each major venture capitalist. The UK authorities are not convinced that Ofex or any other provider has the resources or specific plans to address the market failure in the West Midlands, or is willing and interested to do so. Indeed, at two separate meetings Ofex executives were invited to present their plans for addressing the market failure in the West Midlands, but Ofex did not do so. From the available evidence the UK authorities conclude that Ofex did not fulfil at all the role envisaged by Investbx in the past, and either could not or would not do so in the future. The UK authorities conclude that establishing Investbx will not disadvantage Ofex in any way. A principle aim of Investbx is to act as a sort of feeder exchange where companies would become 'accustomed' to the requirements of being a floated company and prepare them for eventual transition to established markets.

(97) According to the UK authorities, there will be no transfer of aid to SMEs or investors. SMEs will engage advisers directly and will pay market rates for the services provided by the advisers.

(98) The UK authorities agree that Investbx is a beneficiary of aid. In order that the aid could be considered compatible, a well-defined market failure has to exist. The most severe equity finance gap for small businesses is considered to be in the region of GBP 0,5 million to GBP 2 million. The UK authorities state that it is supported by a wealth of independent research, by the Commission in previous cases and also by the Risk Capital Guidelines themselves. They have found no evidence that the assessment of the market failure which was re-confirmed in the Enterprise Capital Funds Decision ([15]) has changed in the meantime. The UK authorities quote a number of statements by senior players in the broad professional community in the West Midlands, supporting the need for Investbx. A regionally based Venture Capitalist suggested that of the 500 to 750 propositions received by them in a year, less than 1 % receives funding. Most of the companies which are rejected have viable business plans and while not suitable for VC investment, they may qualify for Investbx. To emphasise that there remains an unequivocal gap in the market, the UK authorities refer to further documents (such as the HM Treasury budget consultation document *'Bridging the Finance Gap'*, the UK Presidency Discussion Paper published in advance of the Risk Capital Summit and the Confederation of British Industry SME Trends Survey).

([15]) Case No 2006/250/EC — United Kingdom — 'Enterprise Capital Funds', OJ L 91, 29.3.2006, p. 16.

(99) Although the UK authorities initially did not exclude transactions of up to GBP 5 million according to a market failure acknowledged by them up till this level, at a further stage of the proceedings, they confirmed that transactions at Investbx during the initial five years would be limited up to GBP 2 million per annum and any transactions above GBP 2 million would be notified to the Commission.

(100) In the opinion of the UK authorities, the aid instrument notified does target the market failure, and goes beyond the traditional means in the way it addresses this difficulty. Investbx is designed to be complementary to other funding providers and to attract and utilise for the benefit of SMEs a further source of funding. The UK authorities find the incentive effect of the project clear in the sense that without public intervention, Investbx would not be created.

(101) The UK authorities consider that the creation and initial funding of Investbx will not distort competition, and rather will help to rectify a market failure which is not currently being addressed. Even if the measure could be argued to be potentially distortive, the limited amount of funding over a maximum of five years, combined with the fact that Investbx's impact will be confined to only one region of the United Kingdom, means that any such distortion is more than compensated by the potential benefits to all regions across the Community. At the end of the five-year period Investbx must be self-sustaining, and when the business is hopefully sold, any returns made will revert to AWM.

(102) The UK authorities consider that Investbx will have a limited possible effect on competition and no discernable effect on trade, as it seeks to work only in one of the nine English regions. It will act as a regional player, so by definition it cannot distort any economic activity outside the West Midlands. In addition, if Investbx proves successful, similar projects in other parts of the Community would induce private sector interest and would not require public intervention.

(103) If the project is a success and the market failure alleviated, then this will have been an excellent way of achieving it with minimal public spending or distortion of competition. If the project fails then similarly competition will not have been distorted, but it will be known that either the Investbx model was not a viable means of tackling the

market failure, or the way in which AWM sought to implement the model was not the appropriate way to do it and that an alternative approach should be considered.

5.2. Observations by the United Kingdom on the critical third parties' comments

(104) Concerning comments from JP Jenkins, the UK authorities strongly differentiate between Investbx and this company. They state that JP Jenkins Stockbrokers operate an entirely different business model to that of Investbx. JP Jenkins Stockbrokers is an execution-only stockbroker and market maker, matching trades in unlisted and unquoted securities off-exchange. There is no regulatory obligation for this market. The primary objective of Investbx is to raise funds for SMEs; JP Jenkins Stockbrokers do not perform this function.

(105) The UK authorities responded to the comments from the QCA and Ofex as follows.

(106) A comprehensive and factual account of the market failure is featured in the UK authorities' state aid notification of 26 July 2005. In addition they quote studies demonstrating the continuing market failure, such as: the HM Treasury, *Pre-Budget Report on 5 December 2005*; DTI Small Business Service, *A Mapping study of Venture Capital Provision*; CBI, *Enabling the Enterprise evolution*. There are over 300 000 SMEs in the West Midlands and on average only one West Midlands based company per annum has joined Ofex over the last five years. Similarly, whilst a network of private investors already exists, comments from third parties suggest that SMEs need an incremental funding instrument to provide the missing step on the finance escalator, as the step to join an established market is evidenced to be too onerous for their stage of development.

(107) The UK authorities accept that it is the overall aggregate costs of the transaction which often prevent the SME from raising funds on the established markets. Third-party comments highlight the cost of floatation to be judged to represent too high a proportion of the funds raised. The UK authorities' intervention has facilitated local competing professional firms to work together on a compliant process of trading on an Alternative Trading System and on preparation of standard templates, which lower the cost of raising funds. The aggregate cost should not be a barrier to joining Investbx.

(108) According to the UK authorities research information is available for stocks on senior markets which attract institutional investment. It is prepared on stocks that institutional investors will be interested in, which will be further used by stockbrokers' sales teams in order to attract institutional interest in the stock and generate trade. Such research information is not however available to individual investors. What is more, financial institutions are not interested in smaller company stocks, as there is insufficient volume of shares available for them to hold a significant position. On the contrary, Investbx will provide data on SME stocks, but in addition independent research will be commissioned by the SMEs at market rates in order to furnish the investor with detailed information about the company in support of their investment decision.

(109) In reply to the argument that Investbx would dilute liquidity, the UK authorities state that, whilst '*the market technology 25 years ago was unable to support geographically diverse markets, as quoting the same share on different markets was understood to fragment market liquidity. However, the advent of the internet delivers the opportunity to reverse the situation and channel regional investors' money into local companies to benefit the region*.' A West Midlands exchange would not fragment liquidity, instead it would encourage ongoing pooling of liquidity through the movement of a larger amount of shares at a single trade price on a weekly or monthly basis.

(110) In reply to the comment about the investor protection, the UK authorities set out the investor protection measures in place in the United Kingdom and applicable to investors investing at Investbx. Companies joining Investbx must meet a set of regulatory and disclosure requirements appropriate for an Alternative Trading System. As noted above, Investbx will comply with FSA Investor Protection obligations with an experienced compliance facility, outsourced to The Share Centre, monitoring all aspects of the Investbx operation in this respect. The FSA regulated firm, The Share Centre, will police the Investbx operation and will ensure Investbx operates the appropriate best practices as set out in the FSA's *Code of Business Practice*. In addition to the statutory information Investbx will give investors far more information about SMEs than is usually possible. This falls outside of the regulatory regime and is indicative of Investbx's innovative approach.

(111) Auction-based systems are an acknowledged alternative to quote driven systems, and better suited to trading in smaller stocks, as evidenced in the '*Regional Stock exchanges in the UK*' paper by Dr Robert Huggins. The target investor for Investbx listed SMEs is interested in the medium to

long-term opportunities and that is why the provision of enhanced information about the prospects of the company is important. This profile of investor does not require the same ability to continuously trade as would an institutional trader. However, data relating to the next auction can be viewed or orders changed 24/7 at any point up to the auction.

(112) The shareholder structure of Ofex is primarily stockbrokers and financial institutions which both use and benefit significantly from the quote-driven market-maker system. As evidenced by the data provided on Ofex, in order to maintain the ability to trade at any time on a quote driven market, large spreads of up to 75 % can be experienced. In contrast, the Investbx model will match buyers and sellers at a single price, benefiting both the SMEs, who will be able to trade small amounts of shares, and the investors, who will not suffer from the spread between the bid and offer price.

(113) The UK authorities suggest that Ofex is becoming a more senior market. In recent press statements Ofex acknowledged that it raised equity to finance the changes to its trading platform in order to facilitate trading stocks in direct competition to the AIM and the LSE. The new platform gives Ofex the capacity to trade substantially higher volumes of certain listed and unlisted securities with existing quotations elsewhere in London.

(114) The UK authorities argue that investors would not be locked in if Investbx had to be closed. Exit from the Investbx project is defined by the funding agreement. In case Investbx had to be shut down, the SMEs could continue to be traded on the platform of The Share Centre at the same conditions.

(115) The authorities consider that the aid to Investbx is the minimum necessary to address a market failure in access to equity finance for SMEs in the West Midlands. Investbx will not grant funds directly; it will not discriminate selection of SMEs based on their subsequent performance and their valuation on the Investbx trading platform. Investbx does not receive any remuneration based on the future valuation of an SME as would a venture capitalist. Without the aid the project will not happen. It is too risky a venture to be attempted with purely private backing, as there is no precedent for this *business model*.

(116) The UK authorities disagree with the susceptibility of the not-for-profit business model to restrain innovation in financial markets. The UK authorities would like to see Investbx establish and build a new profitable business, but submit that in its early stages it will not be profitable and that is why the funding is needed. However it still needs to make profit in order to be self-financing and viable in the long-term once AWM's limited funding expires. The difference is that the profits will be reinvested rather than being taken out by shareholders. Investbx will be measured by the UK authorities on its ability to succeed and to make new services commercially available for West Midlands based SMEs.

6. **ASSESSMENT OF THE MEASURE**

(117) The Commission has examined the measure in light of Article 87 of the EC Treaty and in particular on the basis of the Risk Capital Guidelines. The results of this assessment are set out below.

6.1. **Legality**

(118) The UK authorities notified the measure. They declared that Investbx has not been incorporated, did not start its operations and did not receive any grant or funds.

(119) The UK authorities further stated that AWM recruited a person for the future role of Chief Executive of Investbx, however presently this person works as a staff member of AWM on a variety of projects, one of which is the preparatory work for Investbx. The preparatory work for development of the future Investbx website portal has been commenced. Due to a technical problem, this site, which is clearly labelled as under development, was accessible. This problem was resolved and the site cannot be publicly viewed.

(120) Investbx has not been established yet as an undertaking and has not received any financing. Consequently, no aid has been granted yet.

(121) The UK authorities committed themselves not to grant the aid before the Commission's approval. Therefore, they have complied thereby with their obligations under Article 88(3) of the EC Treaty.

6.2. **Existence of State aid**

(122) Following the Decision to initiate the procedure, the presence of aid was verified at three levels: at the level of

— Investbx as marketplace,

— the investors, and

— the SMEs to be invested in.

This assessment shall be done according to the Risk Capital Guidelines.

6.2.1. *Aid at the level of Investbx*

(123) The investment as well as current expenditure will be financed through state resources through the State-owned development agency AWM. According to the United Kingdom authorities, no private investor was interested in investing into Investbx. Under normal market conditions the initial capital received in the form of a grant would not have been raised under the same favourable terms. This is why the provision of funding does not correspond to the behaviour of a private market investor. Investbx thus receives funding that it would otherwise not be able to seek from private sector sources at market rates. Accordingly, the undertaking Investbx receives an advantage from state resources. As the measure may have effects on other financial service providers, particularly on Ofex, as discussed below, the measure has the potential to distort competition. In general capital and related services may be provided across borders. This is evidenced by the example put forward by the University of Warwick citing an SME from the West Midlands that received financing on the Australian market as well as by the efforts of Ofex to offer its services abroad. Although there is a low probability that West Midlands SMEs seeking equity financing of up to GBP 2 million would seek and receive services from abroad, this cannot be excluded. Thus the measure has a potential of affecting intra-Community trade. The measure therefore encompasses aid to Investbx within the meaning of Article 87(1) EC.

6.2.2. *Aid at the level of investors*

(124) Investbx offers an online auction system that gives the possibility to invest into SMEs to all investors, institutional as well as individual private persons. Investors could possibly benefit from the provision of information and services by Investbx, which they would otherwise not receive. Any investor interested, unless excluded by the legislation on investors' protection, will be able to use Investbx under the same conditions. There is no minimum threshold for investment by a single investor. Therefore, independently of whether the measure accords an advantage to the investors, it is not selective at this level and thus for investors it does not constitute aid in the sense of Article 87(1) of the EC Treaty.

6.2.3. *Aid at the level of SMEs*

(125) SMEs will benefit from the measure insofar as they will be able to raise private equity capital under conditions that otherwise would not be present on the market. The bundle of services provided by Investbx is currently not provided together by any market provider. The fact that private investors are not willing to develop an undertaking equivalent to Investbx shows that the project is risky. This activity implies important overhead costs, which can only be covered if Investbx can reach a given volume of activity; however, it is uncertain that this volume will be achieved. Normally the price to be paid by the investees should reflect this high risk. Although the majority of the services that Investbx offers are outsourced to market providers and Investbx receives a profit margin on them, the price that Investbx charges the investees for the bundle of services provided is too low to ensure that it will cover its overhead costs during the initial period of up to five years, or until a critical mass of companies is using its services. This proposition was not accepted by any market investor. Consequently, the measure may confer an advantage to the SMEs that use Investbx for financing, as due to Investbx's pricing structure, SMEs arguably receive services at more advantageous terms than as if they were offered by existing market players individually. The United Kingdom has shown that services related to the use of a trading platform, employee share scheme, share account, independent research and marketing services will be outsourced to private providers at market conditions. The advantage stems from the bundling of these services as well as from raising funds from investors interested in SMEs in the West Midlands. This advantage is granted from state resources as it is the state financed setting up and maintaining of Investbx that only enables the creation of Investbx that provides the services, which otherwise would not be provided at the same terms by the market. As the investees are likely to be active in markets that are open to competition at Community level, the measure has the potential to distort competition and affect intra-Community trade. In conclusion, SMEs to be invested into will receive aid in the sense of Article 87(1) of the EC Treaty.

6.3. **Compatibility of the measure**

(126) In so far as the measure constitutes state aid within the meaning of Article 87(1) of the Treaty, its compatibility must be assessed in the light of the exceptions provided for in Article 87(2) and (3) of the Treaty. The exceptions provided for in Article 87(2) of the Treaty, which concern aid of a social character granted to individual consumers, aid to make good the damage caused by natural disasters or exceptional occurrences and aid granted to certain areas of the Federal Republic of Germany, do not apply in this case. Neither does the measure qualify for the exception allowed by Article 87(3)(a) of the Treaty for aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment. In the same way, the measure cannot be considered to be an important project of common European interest or to remedy a serious disturbance in the economy of the United Kingdom, as provided for by Article 87(3)(b) of the Treaty; nor does it have as its objective the promotion of culture and heritage conservation as provided for by Article 87(3)(d) of the Treaty.

(127) Article 87(3)(c) of the Treaty provides for the authorisation of aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent that is contrary to the common interest. The Commission notes that the measure at stake aims at setting up a market place and granting aid for five years to the online exchange facility for investors and SMEs. Thereby the measure aims at establishing an investment vehicle that may facilitate the matching between investors and target SMEs, for which it may therefore improve access to risk capital

(128) Article 87(3)(c) of the Treaty in the field of risk capital is applied according to the Risk Capital Guidelines. These guidelines apply to all notified risk capital measures in respect of which the Commission must take a decision after the guidelines are published in the *Official Journal of the European Union*, even where the measures, such as the present one, were notified prior to the publication of the guidelines. ([16]) Investbx facilitates the matching of investors and target SMEs for which it may therefore improve the access to risk capital. Consequently, it is an investment vehicle in the sense of point 5.1(f) of the Risk Capital Guidelines. According to that point a measure constituting aid to an investment vehicle is subject to a more detailed assessment under section 5 of the guidelines. When assessing the compatibility of the measure under section 5 of the Risk Capital Guidelines, the Commission is following the approach announced in the State Aid Action Plan ([17]) which was further specified and concretised in the subsections 5.2, 5.3 and 5.4 of the Risk Capital Guidelines. It will assess whether the aid measure is aimed at a well-defined objective of common interest, in particular at the alleviation of market failure, whether the aid is appropriate to deliver the identified objective of common interest, whether it is necessary and has an incentive effect, whether it is proportional and whether the distortions of competition and the effect on trade are limited to ensure that the aid measure is not, on balance, contrary to the common interest. The Commission will thereby look at a number of positive and negative elements. According to point 5 second paragraph of the Risk Capital Guidelines, no single element is determinant, nor can any set of elements be regarded as sufficient on its own to ensure compatibility. In some cases their applicability, and the weight attached to them, may depend on the form of the measure.

(129) None of the other existing State aid regulations, frameworks or guidelines are applicable. It is true that parts of the West Midlands do qualify for the derogation in Article 87(3)(c) of the EC Treaty ([18]), and the Commission also notes that this region has suffered from the Rover crisis. However, the grant to Investbx is not an application of aid for regional development.

6.3.1. *Is the aid measure aimed at a well-defined objective of common interest?*

(130) According to point 5.2.1 of the Risk Capital Guidelines the Commission assesses whether the aid measure is aimed at a well-defined market failure. For measures specifically involving an investment vehicle, the Commission requires additional evidence of the market failure. Such evidence must be based on a study showing the level of the market failure and the evidence must concern the supply of risk capital and significance of the venture capital industry.

(131) As stated in point 1.3.2 of the Risk Capital Guidelines, the Commission considers that the main source of market failure in risk capital markets relates to information asymmetries. Regarding the access to capital of small and young enterprises, the main difficulties of equity financing are the high transaction and agency costs as well as the risk aversion of investors related to risk capital investments. In general, market failure arises when, due to the inefficient matching of supply and demand of risk capital, the level of risk capital becomes too restricted and enterprises do not obtain funding despite having a valuable business model and growth prospects.

(132) The objective of the present aid measure is to address a market failure in the equity financing of SMEs in the range of GBP 0,5 million and GBP 2 million in the West Midlands region.

(133) In order to demonstrate that the level of risk capital in this range is limited, despite the demand for equity financing by viable businesses, point 5.2.1 of the Risk Capital Guidelines lists an indicative set of elements. In the following assessment on market failure, the Commission takes into consideration in particular the profitability of private equity investments, the development of private equity investment in the United Kingdom over the past years and the distribution of investment by categories of amount of investment linked to the stated range of market failure. The Commission also examines data relating to the West Midlands region, in particular the regional apportionment

([16]) Risk Capital Guidelines, point 7.2 third paragraph.

([17]) Commission Communication COM(2005) 107 final, from 7 June 2005.

([18]) Commission decision of 26 July 2000 on State aid N 265/2000 — United Kingdom concerning the UK regional aid map for 2000 — 2006 (OJ C 272, 23.9.2000, p. 43).

of private equity investment, the demand for equity funding and the extent to which this demand is met at established capital markets. For this purpose the Commission analyses studies submitted by the UK authorities.

(134) It is noted additionally that the aid measure will also support a region undergoing structural changes by setting up an online regional equity market place for SMEs.

6.3.1.1. ***Evidence of the market failure to be targeted by the measure***

(135) Investbx targets equity funding in the West Midlands region in the area of GBP 0,5 million to GBP 2 million. This is the range where the market failure is perceived to be the most severe by the market players according to the United Kingdom and many third-party comments. They consider that this range of investment size is too high for most informal investors such as *business angels* who have access to limited financial resources ([19]), and too low for most formal venture capital investors who find the cost of evaluating potential investments prohibitive when a business is seeking only a modest amount of equity finance ([20]). In line with the financial projection of Investbx, as presented by the UK authorities, the average size of funding is expected to be at GBP 1,66 million by the fifth year of operation.

(136) In its Decision on the Enterprise Capital Funds scheme ([21]), the Commission concluded the existence of a market failure in the GBP 250 000 (EUR 357 000) to GBP 2 million (EUR 2,9 million) range in the United Kingdom, upon the data provided by the *Performance Measurement Survey 2003* ([22]); *Report on Investment Activity 2003* ([23]), upon information provided by the United Kingdom and upon third party comments that confirmed the existence of the market failure.

(137) According to the UK authorities the market failure exists in the United Kingdom and particularly in the West Midlands, and this assessment is supported by the following factors, as stated in a report conducted by ECOTEC ([24]):

— private equity finance companies cannot achieve the level of returns they require on investments below GBP 2 million;

— the market failure in the range GBP 250,000 to GBP 2 million is real and was created post 1999/2000 as venture capital moved on to larger deals;

— very few private equity investments are being made in the region in the range GBP 250,000 to GBP 2 million;

— there is significant demand for funding from SMEs in this market failure range.

6.3.1.1.1. *Returns for investors in private equity and venture capital investments in the United Kingdom*

(138) The profitability of private equity and venture capital investments in different investment categories is an indicator for the analysis of the market failure, as low profitability of investments in the market failure range will make investors switch to more profitable large investments. According to the latest data from the British Venture Capital Association (hereinafter 'BVCA') ([25]), returns on private equity and venture capital investments in the United Kingdom have developed in 2004 as follows. Similarly to 2003, mid-sized management buy-outs (hereinafter 'MBOs') (with GBP 10 million to GBP 100 million of equity invested) and large MBOs (with more than GBP 100 million of equity invested) have shown far higher returns on investment over the short and medium term than early-stage and development-stage investments. (E.g. in 2004 the three-year returns were - 13,2 % in early-stage investments, - 5,3 % in development stage investments, while they reached 13,7 % in mid-sized MBOs and 16,1 % in large MBOs.) As a result, among private equity investments, it is more attractive for investors to invest in MBOs above GBP 10 million of equity invested than in early or development-stage investments.

([19]) Business angels generally invest between GBP 10,000 and GBP 250,000 in start-up or early-stage businesses with growth potential. CBI: *Improving Access to Finance: Enabling the Enterprise Revolution* (July 2006).

([20]) HM Treasury: *Bridging the Finance Gap: next steps in improving access to growth capital for small businesses* (December 2003).

([21]) State aid case C 17/2004, OJ L 91, 29.3.2006, p. 16.

([22]) PricewaterhouseCoopers: '*BVCA Private Equity and Venture Capital — Performance Measurement Survey 2003*' (2004).

([23]) PricewaterhouseCoopers: '*BVCA Report on Investment Activity 2003*' (2004).

([24]) ECOTEC Research and Consulting Limited: '*Advantage Enterprise & Innovation Fund: Analysis of Market Demand*' (2004).

([25]) PricewaterhouseCoopers: '*BVCA Private Equity and Venture Capital Performance Measurement Survey 2004*' (2005) and '*BVCA Private Equity and Venture Capital Performance Measurement Survey 2005*' (2006).

(139) Although in the 2005 report from BVCA on returns on private equity and venture capital investments in the United Kingdom the methodology changed ([26]), in the early and venture-stages returns in the medium term continued to be negative. Development-stage and small MBOs medium-term returns have been far below the medium-term returns of mid and large MBOs.

6.3.1.1.2. *Private equity investment activity in the United Kingdom*

(140) According to the BVCA study on the private equity investment activity in the United Kingdom ([27]), the average size of investment in the United Kingdom has grown in 2005, to a level of GBP 5,2 million, (compared to GBP 4,1 million in 2004, GBP 3,2 million in 2003, GBP 3,7 million in 2002 and GBP 3,6 million in 2001).

(141) According to the above mentioned BVCA study, the amount of private equity received by UK companies increased substantially over the previous years (GBP 6 813 million in 2005, GBP 5 336 million in 2004, GBP 4 074 million in 2003). However, the amount invested in the GBP 0,5 million and GBP 2 million range did not show such an increase but instead declined in 2005 (GBP 313 million in 2005, GBP 330 million in 2004 and GBP 286 million in 2003). In 2005, 2 % of the total amount of private equity received by UK companies was made in investments under GBP 0,5 million, 5 % was invested in the GBP 0,5 and 2 million range and the remaining 94 % was made in investments with a size above GBP 2 million. The proportion of the amount invested in the GBP 0,5 and 2 million range compared to total investments was lower in 2005 than in previous years (5 % in 2005, 6 % in 2004, 7 % in 2003, 10 % in 2002 and 2001).

(142) In terms of the number of companies invested in, their proportion in the GBP 0,5 and 2 million range compared to the total number of companies invested in also shows a decreasing trend in the United Kingdom (23 % in 2005, 25 % in 2004, 25 % in 2003, 30 % in 2002 and 31 % in 2001) according to the BVCA study. In absolute terms, in 2005 the number of companies invested in the GBP 0,5 and 2 million range was at its lowest of the past five years (302 in 2005, 321 in 2004, 317 in 2003, 361 in 2002 and 399 in 2001).

(143) The UK authorities referred to several papers and surveys indicating the existence of the market failure in the United Kingdom, such as:

— the HM Treasury budget consultation document '*Bridging the Finance Gap*' ([28]) confirmed the gap in the area of GBP 0,25 million to GBP 2 million. The report was based on surveys, BVCA data and with reference to academic studies ([29]). As regards surveys, 97 % of the respondents to the '*Bridging the finance gap*' consultation agreed that SMEs continue to face a significant market failure, and many of them argued that the severity of the gap varies according to the size, sector and stage of development of the business. '*The consultation responses to Bridging the finance gap made it clear that there remains a key group of small and medium-sized enterprises (SMEs) which are not suited to debt finance, and which are currently not able to access the equity capital that they need to thrive. Businesses seeking modest sums of investment to modernise or diversify their activities are also affected.*' The report argues that some SMEs are 'not suited to debt finance', and when an enterprise is not yet generating sufficient revenues to repay interest on debt, and/or the business is developing new technologies or products with a substantial growth potential but also with significant risk, raising equity capital may be a more appropriate form of financing. As stated by the report, equity investors can face significant costs in identifying suitable investment opportunities, in particular with regard to the search, due diligence and monitoring costs of investments in smaller and younger firms. '*In comparison to large companies that are quoted on public stock markets, the flow of information about small,*

([26]) In the 2005 Report, statistics were split into funds that first closed before and after 1996. Funds that first closed after 1996 were reclassified to categories of venture (including seed, start-up and early stages of development), small MBO (MBOs/MBIs below GBP 10 million and expansion stage investments), mid MBO (MBOs/MBIs for GBP 10-100 million) and large MBO (MBOs/MBIs above GBP 100 million).

([27]) PricewaterhouseCoopers: '*BVCA Report on Investment Activity 2004*' (2005) and '*BVCA Report on Investment Activity 2005*' (2006).

([28]) HM Treasury: *Bridging the Finance Gap: next steps in improving access to growth capital for small businesses* (December 2003).

([29]) Harding, R. Cowling, M. and Murray, G.: '*Assessing the Scale of the Equity Gap: Report to H.M. Treasury and Small Business Service*' (November 2003) and ECOTEC: '*Advantage Enterprise and Innovation Fund: Analysis of Market Demand, a final report to Advantage West Midlands*' (2004).

unquoted companies seeking investment is limited.' The report argues that due to information asymmetry, potential investors may not perceive correctly the profit-risk profile of businesses and may become reluctant to invest in risk capital. The report concludes that high transaction costs and the proportionally higher costs of obtaining information about smaller firms make investors shift their focus on larger investments. The structural constraint on the provision of funds and venture capital expertise to smaller and riskier companies suggests that venture capital investors will shift their focus further towards larger, later-stage deals.

— Research undertaken by ECOTEC ([30]) restated the existence of a market failure between GBP 0,5 million to GBP 5 million, with the most severe constraints being businesses seeking up to GBP 2 million of growth capital.

— Recent reports by the Confederation of British Industry ('CBI') concluded that there continues to be a clear gap for access to finance. '*There are still market failures and anomalies in the system that need to be addressed.*'… '*Over the past few years, evidence indicates that there is a growing market failure in the GBP 500,000 to GBP 3 million range. Recent data by the BVCA provides no indication that the gap is diminishing, with the average amount of equity investment continuing to increase*.' ([31])

Some studies argue that there is a market failure even below GBP 0,5 million and above GBP 2 million. However, no study disputes the existence of the market failure between GBP 0,5 and 2 million, which is the range of equity financing targeted by Investbx. This is perceived to be the range with the most severe constraints.

(144) The UK authorities also quoted a number of studies and surveys regarding different aspects of the disadvantage that small companies face when they want to get listed at a stock exchange:

— In a research article by Brian Zivicky ([32]) reference is made to the fact that in the United Kingdom few smaller quoted companies are followed by analysts as there is insufficient volume of trading to justify the cost of the research being produced.

— A report carried out by Jaffe Associates on behalf of the Quoted Company Alliance ([33]) states that smaller quoted companies are competing for a small and decreasing proportion of institutional equity investment in the United Kingdom. The ability to deal in large volumes is a key driver in investment decisions, which automatically penalises smaller companies.

— A survey conducted by SWR worldwide ([34]) established that there was a clear awareness among issuers and investors that current mechanisms for providing financial services to SMEs could be improved, particularly with respect to bringing issuers and investors together. As a result of the survey, the most important factor when making investment decisions proved to be the quality and quantity of information. A majority of fund managers, high-net worth investors and venture capitalists surveyed said that current stock exchanges do not do a good enough job providing access to SMEs or providing liquidity for securities offered by SMEs.

— A paper written by Tim Mocroft ([35]) describes that '*…listing and regulatory requirements of traditional exchanges are expensive but given the size of companies involved and the sums of money being raised, costs can usually be accommodated. Both factors, however, impose a floor on the size of company that can effectively access the main markets that serve in the United Kingdom — namely the official list of the London Stock Exchange and the AIM*

([30]) ECOTEC: '*Advantage Enterprise & Innovation Fund: Analysis of Market Demand*' (2004).

([31]) CBI: '*Improving Access to Finance: Enabling the Enterprise Revolution*' (July 2006).

([32]) Newex Research, Brian Zivicky (2000).

([33]) Jaffe Associates on behalf of Quoted Companies Alliance: '*Institutional investment and trading in UK smaller quoted companies*' (2002).

([34]) SWR Worldwide: '*Views of Issuers and Investors across Great Britain on Investment Issues*' (2001).

([35]) Tim Mocroft: '*Bridging the equity gap: a new proposal for virtual local equity markets*' (2001).

[…] Typically an IPO on either market will cost in the region of GBP 500,000; with such costs, it is uneconomic to raise relatively small sums of capital.'

— The Deloitte report *'Improving Access to Finance for Small and Medium Sized Enterprises'* ([36]), found from stakeholder interviews that the general knowledge and awareness of finance options by SMEs is poor. The interviews revealed that poor investment readiness was the main barrier to accessing finance across the West Midlands region. Investment readiness encompasses business attitude to finance, the quality of business documents and the general investability of a project. This has both demand and supply implications: it may deter businesses from applying for finance due to the expectation of being turned down, and may restrict supply as a potential investor faces an increased level of risk if it considers an insufficient level of investment readiness.

6.3.1.2. ***The market failure in the West Midlands***

(145) While the information presented above regards a UK-level analysis, the subject of the Commission assessment is whether there is a market failure in the target region of Investbx — the West Midlands. In this context, in addition to the above elements, further aspects of the supply and demand of investment at regional level were taken into account.

(146) Most of the third-party comments supported the existence of the market failure in the West Midlands region. Moreover, in their reply to the third party comments, the UK authorities submitted evidence, based on an estimate made by regionally based venture capitalists supporting the existence of the market failure between GBP 0,5 and 2 million and claiming that of the 500 to 750 propositions received by them a year, less than 1 % receives funding, even though most of the companies rejected have viable business plans and could receive funding if there were a mechanism like the one proposed by Investbx.

6.3.1.2.1. *Regional apportionment of investment*

(147) According to the data published in the BVCA Report on investment activity in 2005, the total amount of private equity investments in the West Midlands region was 4 % of the total UK level, while the South East and London regions together had 44 % of total UK investments. As regards early-stage investments, the proportion of the West Midlands was 1 % of the total UK amount invested at early stage, while in the South East and London regions it amounted to 49 %. In terms of expansion stage, investment in the West Midlands represented 2 %, in South East and London 42 % of the total UK expansion investments. These data have to be seen in the context of the GDP contribution by the different regions to the total UK level, about which the latest available data from Eurostat is from 2003, which shows that the West Midlands contributed with 8 %, while the South East and London together with 34 % to the UK GDP in 2003. This shows that in the West Midlands the provision of equity in early and expansion-stage investments relative to economic activity is much lower than in the South East and London area.

(148) According to an analysis ([37]) of the total market capitalisation of firms listed on the LSE and the AIM across regions, some of the lowest levels of total market capitalisation exist in the Midlands. In 2003 the regional market capitalisation as a proportion of GDP reached in the London area as high as 621 %, in the South East 139 %, for the total UK 153 %, while only 25 % in the Midlands region. Relative to its economic performance, the Midlands region has a low level of market capitalisation among the UK regions.

6.3.1.2.2. *Demand for equity funding from SMEs in the West Midlands*

(149) It is difficult to verify from statistical data whether unsatisfied demand of companies with viable business plans for finance exists. In order to overcome this problem, surveys proved to be the best possible means of research on the demand of companies with viable business plans for equity finance.

(150) The UK authorities have carried out a number of consultations, workshops and surveys about the demand for equity capital among the West Midlands SMEs. In April 2003 a survey took place, where out of the 41 respondents from the regional business community 73 % felt that access to capital markets was a significant problem for SMEs and 88 % felt that established capital markets did not meet the funding needs of SMEs. Moreover, 68 % of respondents felt that Ofex was a little used source of capital for SMEs and 73 % of them were interested in being involved with the Investbx project.

(151) In November 2003 a meeting about Investbx took place in Birmingham which 81 representatives of the business community attended. A subsequent meeting took place in London at the Centre for Study of Financial Innovation

([36]) Deloitte & Touche: *'Improving Access to Finance for Small and Medium Sized Enterprises'* (2002).

([37]) Robert Huggins, Robert Huggins Associates: *'Regional Stock Exchanges — A Viable Option for Wales and Other UK Regions?'* (2003).

(CSFI) at which 27 representatives of the business community were invited to attend. Feedback from the CSFI was almost unanimous support for the project. In May 2004, 21 firms of professional advisers were approached in order to obtain their detailed input into developing the Investbx proposition and gauge how many of their clients may be suitable for joining Investbx. 13 firms indicated that they would expect to propose between 1 and 6 clients from their portfolio to join Investbx per year. Given that only a small proportion of firms were involved in the workshops, the UK authorities consider that equity financing for 10 SMEs per annum in the Investbx financial projections is a conservative estimate of demand. Since professional advisers are paid only if companies successfully raise capital, it is in their best interest to propose only companies with viable business plans in order that only those companies seek to join Investbx that they believe will be attractive to investors.

(152) As regards raising equity finance for SMEs in the West Midlands in the area of between GBP 0,5 and 2 million — which is the primary objective of Investbx — the existing market places which offer equity financing to SMEs do not sufficiently meet the demand according to the UK authorities and thus do not resolve the market failure. Although they mediated equity investment into a number of SMEs in the West-Midlands, they do not provide a sufficient coverage in the West-Midlands region, and none of them has a regional focus on SMEs. The UK authorities consider that all available evidence points to a conclusion that the market failure will not be addressed by the private sector. At two separate meetings, initiated by AWM, Ofex executives were invited to share their plans for addressing the market failure in the West Midlands, but according to the UK authorities, Ofex were either unable or not interested to do so.

(153) At Ofex 7 enterprises from the West Midlands are presently listed and only 5 out of them are traded ([38]). The United Kingdom does not consider that Ofex has resolved the market failure, nor does it consider that Ofex covers the presently estimated demand in the region of at least 10 companies per year. At Ofex the number of newly-listed SMEs from the West Midlands was only one in 2005 and one in 2004, while Investbx is expected to list 5-12 new West Midlands companies per year.

Conclusion on market failure

(154) The Commission considers that in line with 5.2.1 of the Risk Capital Guidelines, sufficient evidence based on several studies has been provided to conclude that there exists a market failure in the West Midlands region in the range of GBP 0,5 million and GBP 2 million.

6.3.2. *Is the aid instrument appropriate to deliver the objective of the common interest?*

(155) According to point 5.2.2 of the Risk Capital Guidelines the Commission assesses whether the measure is capable of alleviating the established market failure. Furthermore, the Commission takes account of any impact assessment and examines the possibility to achieve the same objectives with other means.

6.3.2.1. ***Targeting the market failure***

(156) Considering the aid at the level of Investbx, the proposed aid addresses the market failure described above by setting up an online regional electronic trading platform that will enable the SMEs to present themselves, to raise capital and to trade their shares. At the same time it will enable the investors to view directly detailed and independently certified information on the SMEs. Thereby Investbx will increase information efficiency and will enable a better perception of risk-reward relationship in SMEs by investors and will decrease the transaction costs of getting information about SMEs for investors by making research documents on all SMEs publicly available.

(157) Investbx aims at raising equity specifically for SMEs in the West Midlands region. The Investbx business plan forecasts primary fund raising for a minimum of 47 SMEs in the West Midlands over a period of five years, raising a minimum of GBP 70 million. In comparison with Ofex, which argues that it is also present in the West Midlands and its transaction size is similar, the following was concluded by the UK authorities in their comments to the Decision to initiate the procedure:

— In five years since year 2000, at Ofex only GBP 43,3 million of primary funding was raised within the GBP 0,5 million to 2 million range for 39 companies in the entire United Kingdom.

— When removing secondary funding from the total funds raised, Ofex companies only raise modest amounts via primary issues (E.g. GBP 0,8 million UK-wide in 2004)

— When only West Midlands based companies are considered, at Ofex a total of GBP 12 million (primary and secondary) have been raised over a five year period, between 2001 and 2005.

([38]) http://www.plusmarketsgroup.com/region.shtml? region = West Mids, on 6 November 2006.

— Only GBP 3,5 million of primary funding for 5 companies based in the West Midlands was raised at Ofex since 2000.

(158) Investbx offers a regional focus with a local network of service providers and investors, which is particularly important for the equity investment into expansion SMEs. Such investment often requires a close follow-up and direct relationship between the investor and the investee SME. According to theoretical and empirical studies it must be noted that the investor's proximity to the financed company is a relevant variable in investing choice. ([39]) It may even be argued that, conceivably, a local investor may be encouraged to invest into a local firm not only for a plausible informational advantage, but also as they will be able to provide to the investees a particular advantage by connecting them to their local networking, as well as to take advantage of externalities on other businesses or even because of regional patriotism. The regional focus is shown by the fact that Investbx serves SMEs from the West Midlands only, has a West Midlands based team of 6-8 people, as well as a non-executive board comprising West Midlands professionals experienced in working with SMEs.

(159) Investbx will offer to the SMEs integrated services, including fund raising, marketing and independent research, as well as a connection to a network of local professionals that shall support SMEs to enter successfully the equity trade platform. To join Investbx, unlike for the established market places, SMEs must provide an independent and standardised research report, which will facilitate the collection of information on SMEs relevant for investors. This bundle of services together with the independent report always available to the investors will improve the chances of SMEs to effectively raise capital at Investbx.

(160) Furthermore, Investbx brings an innovative concept of secondary trading, which differs from established equity market places in many respects. While the LSE, the AIM and Ofex use classical market-making mechanisms through a quote-driven system, with bid and offer pricing, Investbx has no market makers, which would generate revenues based on the margin between bid and offer prices either by selling large volumes of shares or by selling at high spread. The match-making of investors and SMEs will be achieved through the online electronic auction market at a single price, which enables the exclusion of transaction costs that would otherwise be generated by the margins between bid and offer prices. Moreover, as compared to *Recognised Investment Exchanges* (RIE) such as the AIM and the LSE, Investbx, being an appointed representative of an Alternative Trading System (The Share Centre), is subject to a lighter regulation by the FSA. This status requires lighter statutory compliance and allows easier and, in proportion to the amounts raised up to GBP 2 million, less costly access for SMEs to a trading platform.

(161) The overall costs of raising small quantities of equity will be lower than in case of more senior established marketplaces. The United Kingdom illustrates this fact by giving an example that for raising GBP 2,5 million, the total costs of the equity received are about 10 % at Investbx, while 24 % at the AIM. The UK authorities further state that the kind of services received for this price varies, e.g. commissioning independent research subsequently made available to private investors does not take place on any of the established markets. Whilst it is important to keep costs to an affordable level, costs are not likely to be the sole or even the main driver behind SMEs choosing to join Investbx. The choice for many West Midlands SMEs will be Investbx or nothing. The availability of research to investors is qualitative improvement of Investbx that is expected to increase the chances of SMEs to receive funding. Nevertheless, Investbx will in several aspects be more cost efficient than Ofex. This will be in particular due to lower research and marketing costs, linked to the standardised templates and adjustment of the services to the SMEs needs in the primary funding stage and to the elimination of bid and offer spread in the secondary stage.

(162) Investbx will make available admission documents and detailed independent research on all SMEs to all potential investors or financial advisors. This information will be on Investbx's website. Such information is usually prepared only for larger stocks of shares and available only to institutional investors. This non-discriminatory provision of detailed information and in particular of the independent research to all investors is, according to the UK authorities, one of the key factors for the expected success of the measure.

(163) In improving the information and transaction efficiency Investbx addresses a cause of the market failure rather than its consequences.

([39]) This factor is analyzed both by Harald Hau, who shows how traders investing in closely located firms tend to achieve higher trading profits compared to other traders located further, and by Degryse and Ongena, who analysed bank loan contracts and discovered that banks offer better loan conditions to clients located more closely. Harald Hau: *Location Matters: An Examination of Trading Profits*, The Journal of Finance, (2001) Vol. 56, No. 5, pp. 1959-1983; Hans Degryse, Steve Ongena: *'Distance, Lending Relationship, and Competition'*, EFA 2003 Annual Conference Paper No. 260 (2002).

(164) Investbx furthermore aims at providing a bridge between the first sources of finance and the more senior established markets, whereby it has a so called 'escalator function'. This function would be beneficial not only for the investees, but also for the investors in adjacent markets by providing exit routes for their investments. The available evidence does not show that Ofex acts as an escalator towards more senior markets in the West Midlands region. On the Ofex website it is stated that 54 companies moved from Ofex to the AIM, between 2001 and 2004. However, between 2003 and 2005 only one company from the West Midlands region left from Ofex to the AIM.

(165) Its capacity to increasing information transparency for investors and reducing certain costs of fundraising and trading of shares compared to more senior markets demonstrates the suitability of Investbx to alleviate the market failure.

(166) Considering the aid at the level of SMEs, the measure will facilitate the provision of SMEs with equity capital, which — due to the market failure — is difficult for them to obtain despite having viable business plans.

6.3.2.2. ***Impact assessment and use of alternative means***

(167) According to the financial plan of Investbx, during the first five years of its existence, it shall raise at least GBP 70 million for at least 47 companies. SMEs having raised equity capital will be admitted to the trading on the Investbx trading platform.

(168) According to the United Kingdom, once unsatisfied demand was established by surveys, prior to setting up the measure the UK authorities sought to alleviate the market failure with the help of the existing market structure. Ofex representatives were invited to meet AWM on 12 July 2005 at which point they were asked to demonstrate that they could address the market failure occurring in the West Midlands. In that event AWM would stand aside. Ofex decided not to provide the information and AWM therefore concluded that either Ofex had no specific plans to address the market failure, or that they did not have sufficient resources to address it, or a combination of both. In the absence of private interest to tackle the failure, a state intervention appears to be necessary.

(169) The Commission regards positively that in line with point 5.2.2 of the Risk Capital Guidelines the measure is capable of alleviating the established market failure. Furthermore, the Commission takes into consideration that other means have been considered but failed to provide the desired results, and notes that the measure is expected to have a positive impact on the alleviation of market failure.

6.3.3. *Incentive effect and necessity of the aid*

(170) According to point 5.2.3 of the Risk Capital Guidelines the Commission assesses the incentive effect and the necessity of the aid. The measure has an incentive effect if it induces a change of behaviour in favour of the overall increase of risk capital. In the Risk Capital Guidelines the Commission announces that it will also take into account the profit-driven character of the investment decision, in particular the commercial management (point 5.2.3.1 Risk Capital Guidelines), the presence of an investment committee (point 5.2.3.2 Risk Capital Guidelines), the size of the measure (point 5.2.3.3 Risk Capital Guidelines) and the involvement of business angels at the seed stage (point 5.2.3.4 Risk Capital Guidelines).

(171) The present case concerns an investment vehicle that facilitates the matching between private investors and target SMEs. The investment decision is made entirely by private investors and the SMEs will only receive private equity. The investment decisions related to SME fund-raising will be entirely profit-driven.

(172) Being an equity marketplace, the functioning of Investbx is different from that of risk capital funds. In the case of risk capital funds, the management plays an important role in investment decisions. Investbx itself does not provide any funding to SMEs neither does it make investment decisions. Therefore, these criteria are of less relevance.

(173) Concerning the commercial management (point 5.2.3.1 Risk Capital Guidelines) on the one hand, since the management of Investbx will not make investment decisions as regards SME fundraising, this aspect is not relevant here. On the other hand, the United Kingdom assured that the management of Investbx will consist of professionals who have proven experience and track record in capital market investments, which is to be regarded positively.

(174) Concerning the presence of an investment committee (point 5.2.3.2 Risk Capital Guidelines), it comes from the nature of Investbx that no investment committee will be involved in the decision-making on SME investments. At the same time, the Commission regards positively that the Investbx project was developed with the involvement of experts from the West Midlands professional community.

(175) Concerning the size of the measure (point 5.2.3.3 Risk Capital Guidelines), the Commission notes that Investbx will not provide funds to SMEs from its own budget. For fund raising it will reach to the market. According to the financial plan, the aid amount is expected to be sufficient to enable Investbx to reach, within five years, the critical size to use the economies of scale, and to become profitable. This is regarded positively.

(176) Concerning the involvement of business angels at the seed stage (point 5.2.3.4 Risk Capital Guidelines), on the one hand, the present measure does not involve seed-stage investments, and therefore this criterion does not apply. On the other hand, potential business angels as any other investors may use Investbx for investing into SMEs.

(177) Concerning the necessity of the measure, the Commission first takes note that no private market operator was willing to start the Investbx initiative without the granting of state aid. This may follow from the fact that setting up a regional online marketplace for SMEs involves substantial risks at the initial period until economies of scale are achieved. Consequently, in order to target the market failure by setting up Investbx and by supporting it to break-even within the initial five years of operation, state aid is considered necessary.

(178) In the following, the Commission further assesses the incentive effect.

(179) According to the estimates based on surveys conducted by the UK authorities, every year at least 10 SMEs from the West Midlands with viable business plans seek equity but do not receive it. Investbx plans to obtain equity for at least 47 such enterprises during the first five years of its activity. Furthermore, the provision of equity capital in the range of between GBP 0,5 and 2 million is likely to have positive effects on adjacent financial markets. Business angels and other informal investors, who usually provide financing below GBP 0,5 million will be able to use Investbx as a new exit option for their investment, whereby more senior established markets and investors involved in larger deals, such as the AIM and venture capital funds, may benefit from the firms that will grow with the help of Investbx and will require larger financial tranches than GBP 2 million through listing on a stock exchange. The measure concerns a pilot project which, if successful, may lead to further such projects in other regions.

(180) The incentive effect of the aid on Investbx is apparent from the fact that it would not exist without state aid as claimed by the United Kingdom and Ofex. Moreover, a clear end date of the aid is an incentive for Investbx to become profitable and commercially viable. The measure intends to change the behaviour of investors as well as SMEs by improving their information exchange on their potential matches.

(181) The Investbx measure does not provide aid at the level of investors; therefore it does not distort their incentive mechanism to choose the most profitable investments. In contrast to other state aid measures, i.e. direct aid to investing in SMEs, the incentives for investors remain undistorted.

(182) According to the UK authorities' estimates, at least 47 companies are expected to receive equity financing under the conditions offered by Investbx during the initial five years. The majority of them may otherwise be discouraged by the conditions currently present on the market, in particular by lack of information, complicated procedures and the prevailing prices. Thanks to the establishment of the new channel for raising equity finance, the bundling of all related services and a possibility to trade their shares subsequently, SMEs are expected to raise more equity financing for their expansion. This is the incentive effect of the measure.

(183) The Commission considers that in line with 5.2.3 of the Risk Capital Guidelines, the measure is necessary and provides an incentive effect.

6.3.4. *Proportionality of the aid*

(184) According to point 5.2.4 of the Risk Capital Guidelines the Commission assesses proportionality of the aid. The Commission examines whether the aid does not go beyond what is needed to induce more risk capital provision, and in particular whether investors are not overcompensated and the risk of losses are not borne entirely by the public sector while the benefits flow to the other investors. Furthermore, the Commission may consider that an open tender or public invitation to investors will positively influence the assessment.

(185) There will be a public invitation to investors to use Investbx, and the information about Investbx will be publicly available to all investors on the Investbx website. The measure will not be closed, but remains open to any investors.

(186) Compared to risk capital schemes that are commonly used by the Member States to reduce the market failure, the amount of public funding used is very limited. Regional risk capital schemes covering regions similar in size to the West Midlands normally involve far higher amounts of aid than foreseen for this measure ([40]). Furthermore, Investbx does not by itself provide capital to SMEs. The measure only introduces a new type of marketplace for investments in SMEs, which facilitates transactions between private parties at market conditions. In this sense Investbx appears particularly efficient in addressing the market failure.

([40]) Take as example State aid case No C 17/2004 — United Kingdom ('Enterprise Capital Funds'), OJ L 91, 29.3.2006, p. 16, and State aid case No C 72/2003 — United Kingdom ('Invest Northern Ireland Venture 2003'), OJ L 236, 13.9.2005, p. 14.

(187) The size of the aid is calculated in a way to enable Investbx to achieve economies of scale and get a sufficient size to be able to break-even after five years. There is a maximum limit of the aid of GBP 3 million. This will cover only the difference between the prospected revenues from the Investbx activity and the costs incurred by Investbx in the first five years. The actual aid will be limited to what is necessary to cover potential losses. If Investbx performs so well that it covers its administrative costs before the entire amount of aid is spent, it will return the remaining part of grant to AWM.

(188) The Commission notes positively that the measure is limited to five years. After this period, the regional authority, AWM, will either close down Investbx or sell its shares through an open and non-discriminatory tender available to any market participant, including Ofex. AWM would then receive back at least a part of its entire grant and potentially even more in the form of the sale price of Investbx.

(189) The Commission considers that the aid is limited to the minimum necessary and is therefore proportional.

6.3.5. *Distortions of competition and the effect on trade should be limited to ensure that the aid measure is not, on balance, contrary to the common interest*

(190) According to point 5.3 of the Risk Capital Guidelines, the Commission will assess the negative effects of the measure in order to balance them with the positive effects. In the following the possible crowding-out effect on potential competitors and other negative effects will be discussed.

6.3.5.1. ***Potential competitors and the extent to which they may be affected by crowding out***

(191) The principle service provided by Investbx is to obtain equity capital in the range of GBP 0,5 to 2 million for SMEs. Associated services provided by Investbx are auxiliary and with the primary purpose of channelling equity to SMEs. Although there are some advantages to invest into SMEs locally, the geographic market for these equity tranches is at least the entire United Kingdom, as those SMEs that already received such financing received it from sources based in other parts of the United Kingdom, such as London. Although an example of receiving financing abroad has been reported ([41]), the equity capital market for tranches between GBP 0,5 and 2 million generally tends to be national.

([41]) The Warwick University submission reported of a case study, in which a West Midlands SME received equity financing from Australia.

(192) In the following the likely effects of the aid on competitors shall be discussed. The competitors that provide or facilitate the provision of equity financing in the range of GBP 0,5 to 2 million could include business angels, venture capitalists, brokers, Alternative Trading Systems as well as the mainstream stock exchanges the AIM and the LSE.

(193) In comparison with business angels financing, Investbx, on the one hand, facilitates the provision of larger amounts of equity, and on the other hand, requires greater level of disclosure and independent studies than business angels. Although some business angel networks or syndications may provide the same amounts of equity capital, their competition with Investbx in this case may be rather limited because such business angels would offer equity at lower costs than Investbx, as they do not require the same level of research and disclosure. Moreover, business angels could even benefit from the measure by investing through Investbx. The Commission only received positive comments from the business-angel community.

(194) Private venture capital funds, as demonstrated above, concentrate mainly on larger deals. Investbx will facilitate the growth of SMEs that could be further taken over by venture capital funds or investors at more senior established markets. A degree of competition with those funds that provide a small amount of equity cannot be excluded. From the representatives of the venture capital industry, namely the Catapult Venture Managers Ltd. and the Advantage Growth Fund, the Commission only received positive comments. Since the main characteristic of Investbx is to raise capital for SMEs from investors and to act as a trading platform, it does not itself provide funding to the companies traded. Therefore, it is only to a very limited extent in competition with venture capital funds.

(195) From the brokers' community, the Commission received critical comments from JP Jenkins, claiming that Investbx will become a direct competitor benefiting from a competitive advantage by the state aid provided, which would lead to a distortion of competition prejudicing JP Jenkins' position. In this respect, the Commission notes the statement of the UK authorities that JP Jenkins operates a different business model to that of Investbx. JP Jenkins is an execution-only stockbroker and market maker, matching trades in unlisted and unquoted securities off-exchange. Furthermore, there is no regulatory obligation for this market. Consequently, the United Kingdom states that JP Jenkins does not perform the function of raising funds for SMEs, which is the primary objective of Investbx. The same arguments are valid for the activity of other execution-only

brokers. As for the allegations of JP Jenkins, in any event, in June 2006, before removing the possibility to search by regions on its website, JP Jenkins traded 157 companies out of which only four companies were from the West Midlands. Therefore, the Commission considers a potential effect of Investbx on JP Jenkins at least to be very limited.

(196) Investbx is intended to enter the market of trading platforms for equity financing of companies which cannot get quoted on the main stock exchange in the United Kingdom. The LSE is not considered to be a potential competitor of Investbx, since the companies traded at the two markets would be different in terms of their size and other features required by the LSE. In particular, in order to get listed on the LSE, companies have to fulfil certain criteria, such as 25 % of shares being held in public hands, 3 years' trading experience, and working capital for at least the next 12 months, or a minimum market capitalisation. Moreover, the AIM is less suitable for raising amounts under GBP 2 million, as the direct cost of raising such an amount can represent on average 20 — 26 % of the equity raised. It does not provide the same services to SMEs as Investbx. Consequently, SMEs raising GBP 2 million are discouraged from using the AIM.

(197) Present Alternative Trading Systems, such as Ofex and The Share Centre may also provide primary or secondary trading to SMEs. Concerning the competitive situation on the market as a whole, the effects of Investbx will be limited to only one region of United Kingdom. Moreover, in this region the provision and intermediation of equity is less developed than in the United Kingdom as a whole. Concerning possible competition with Ofex in particular, the Commission recalls that presently only 5 % of companies traded on Ofex are based in the West Midlands. From the region, between 2000 and 2005 altogether 10 companies were admitted to Ofex. From the presently listed companies only 2 were admitted since 2003. Ofex is acting nation-wide and aims at international trade and it cannot be excluded that it will use its upgraded platform to trade more significant volumes as well as large companies' shares that may be quoted elsewhere. Moreover, as stated by the UK authorities, during the six years 2000 to 2005, Ofex has raised only GBP 3,5 million of primary funding for 5 companies based in the West Midlands. At the same time, Ofex raised overall GBP 43,3 million of primary funding within the GBP 0,5 million to 2 million range for 39 companies in the United Kingdom. Consequently, the distortion of competition in terms of volume of primary funding and of the number of SMEs potentially switching from Ofex to Investbx in the West Midlands is very limited.

(198) The Commission considers that there would be no distortion of competition at all if Investbx were not at all successful and did not raise any capital and/or would not trade any SMEs. In such a case the measure would be merely ineffective, but not distortive.

(199) At the level of SMEs invested in through Investbx, the distortion of competition is also limited. Their advantage is limited to the West Midlands region and to improved access to financial services in the way of bundling of services otherwise provided at market conditions and raising funds from locally interested investors, for which in any case they have to pay 6 % of the funds raised. Moreover, the access to Investbx is open to SMEs from the West Midlands that fulfil the prescribed disclosure rules and provide an independent research study. It is the private investors who will at the end decide which SME has the most suitable business plan to invest into.

6.3.5.2. *Other distortions of competition*

(200) Concerning other distortions of competition as set out in point 5.3.2 of the Risk Capital Guidelines, the Commission examines whether the measure will lead to the creation of significant market power of the target SMEs, whether it will have the effect of keeping inefficient firms or sectors afloat, the effect of over-supply of risk capital funding and whether the aid may build up an inefficient allocation of production factors between regions.

(201) As stated in the assessment of the existence of aid at the level of SMEs, the target SMEs will receive risk capital from private investors without any aid element. The only advantage they will get consists in receiving services that are otherwise not available on the market. It comes from the nature of the advantage that it cannot alone lead to development of market power. Similarly, the private nature of investment decisions will ensure that the measure will not have the effect of keeping inefficient firms or sectors afloat or to modify the allocation of production factors between regions.

6.3.5.3. *Other factors limiting the distortive effect on competition*

(202) The Commission considers that the GBP 3 million of aid to Investbx may distort competition, however there are several aspects that limit the detriment that may be caused to competitors. The measure is limited in the aid amount provided, geographically and in time.

(203) Firstly, the aid to Investbx will be strictly limited to the maximum of GBP 3 million. This aid amount will not be increased and is limited to what is necessary to cover potential losses in the start-up phase of Investbx.

(204) Secondly, it offers its services to SMEs located only in the West Midlands region, while other marketplaces, such as Ofex, offer their services to the whole UK as well as abroad. Therefore, any potential distortive effects would be limited to a small part of established operators markets.

(205) Thirdly, the aid is also limited in time, to five years. After this period, AWM will either sell its shares of Investbx through a non-discriminatory and open tender procedure to private investors, or close Investbx down and thus the possible distortion will be eliminated. In case of a sale, any outstanding funds from the original grant will be paid back to AWM. Although Investbx does not only cover an initial investment, but also start-up costs for five years, the Commission considers this amount necessary. Since the yearly expected number of new SMEs entering the Investbx marketplace is limited, it is reasonable to assume that the economies of scale will only be effective and Investbx will only be able to break-even when the number of SMEs traded achieves a certain level after several years.

(206) In its additional comments, Ofex raised its concern that after the five-year period there is a risk that no purchaser could be found for Investbx, thus companies admitted to its platform would lose their trading facility and their shareholders would lose the ability to sell their shares and be 'locked-in'. The UK authorities confirmed that in case of a potential closure of Investbx, The Share Centre is obliged to maintain its platform, which Investbx uses, and SMEs will have the possibility to continue to use it at the same conditions as they have at Investbx. Shareholders, contrary to the allegations of Ofex, would have the possibility to continue trading their shares and would not be locked-in.

(207) Fourthly, the measure concerns exclusively SMEs in expansion phase. The aim of the measure is to attract more SMEs to the equity market that previously did not participate and thus to create new investment opportunities. Moreover, the UK authorities have undertaken to limit the transaction size to a maximum of GBP 2 million per year, while at established market platforms this formal upper limit does not exist.

(208) Finally, the distortion of competition was limited by choosing in a non-discriminatory procedure the main provider of services. Only three bids were submitted, among them also one from Ofex. The choice for the Investbx service provider was done on the basis of criteria equal for all bidders. The offer of The Share Centre was superior according to the qualitative criteria as well as to the price.

(209) The 'escalator function' of Investbx for investees that will grow to qualify for more senior established markets at a later stage of their development will be advantageous for the AIM. The restriction of the transaction size to GBP 2 million will reinforce this escalator function.

(210) The project has already attracted broad interest as it may be used in the future to resolve potential local market failures in other regions of the European Communities, as witnessed by the comments of CEBRE and Regione Emilia-Romagna. It may become an interesting and cost effective option for stimulating the risk capital market and supporting SMEs.

(211) At the level of investors into the target SMEs, the Commission considers that private investment is not crowded out as a result of the aid measure, on the contrary, Investbx will give more opportunities for private investors by improving their access to information on SMEs. Furthermore, it aims at targeting the general public rather than institutional investors.

(212) Nevertheless, it cannot be excluded that Investbx will attract at least a part of the companies that would otherwise seek investment through other marketplaces. However, this effect would be confined to a limited time period of maximum five years, and to the region of the West Midlands, where an unresolved market failure demonstrates that the present potential of the region is insufficiently served by other marketplaces.

(213) The Commission considers that overall the negative effects of the aid according to point 5.3 of the Risk Capital Guidelines are limited.

6.3.6. *Commission reaction to the critical comments of third parties*

(214) In the following the Commission resumes its arguments that counter the critical comments made by third parties.

(215) Concerning fragmentation of liquidity, Investbx limits its services to SMEs from the West Midlands that seek raising equity between GBP 0,5 and 2 million. In this particular segment it may attract only a very small part of investees that use other market places. As for investors, it will attract only those who are interested in investing in the West Midlands. Consequently, a possible danger of fragmentation of liquidity that is present at the existing market places is very limited. On the other hand, Investbx will contribute to pooling liquidity through the concentration at the organised auctions of the several securities and transactions, the majority of them would otherwise only be traded separately over the counter.

(216) Investbx will comply with the regulatory and disclosure requirements appropriate for an Alternative Trading System. It will be monitored by The Share Centre, an FSA regulated firm as explained in the description.

(217) Concerning the alleged distortion of competition causing disadvantage to JP Jenkins, the Commission notes that JP Jenkins has a different business model. JP Jenkins trades unlisted companies or those that have been de-listed from Ofex, the AIM or the LSE. It is an execution-only stockbroker and market maker. According to the United Kingdom, whilst a two-way price may be shown against each company it features, JP Jenkins may not necessarily have shares available to buy or sell, but endeavours to match buyers and sellers. In any event, according to its web-pages, JP Jenkins traded in June 2006 only 4 companies from the West Midlands out of its 157 companies traded. Therefore, the Commission considers a potential effect of Investbx on JP Jenkins to be very limited.

(218) As regards the claim of Ofex that the Commission bases its preliminary assessment on information that is incomplete, outdated and inconsistent with the reality of the United Kingdom equity market, the Commission notes that it bases its assessment on the latest available data and studies, in particular the BVCA *Reports on Investment Activity* 2003, 2004 and 2005, the BVCA *Private Equity and Venture Capital Performance Measurement Surveys* of 2003, 2004 and 2005, the HM Treasury reports and other sources referred to throughout the Decision. Neither Ofex nor other interested parties provided any contradictory or more recent studies or data.

(219) Ofex claims that there is no evidence on lack of information for SMEs on how to access equity funding, on failure of West Midlands companies with viable business plans to raise equity and on investors lacking information on investees. Firstly, the Deloitte report 'Improving *Access to Finance for Small and Medium Sized Enterprises*' ([42]), based on stakeholder interviews states that the general knowledge and awareness of finance options by SMEs is poor. The interviews revealed that poor investment readiness was the main barrier to accessing finance across the West Midlands region. Investment readiness encompasses business attitude to finance, the quality of business documents and the general investability of a project. Secondly, the UK authorities conducted a survey that indicates that at least 10 West Midlands SMEs could be brought yearly to Investbx. Moreover, they provided statements of a venture capitalist that many SMEs with viable business plans are rejected by venture capital funds that could be suitable for Investbx. Thirdly, the provided studies cite lack of reliable information for investors as one of the reasons for the existence of market failure. ([43])

([42]) Deloitte & Touche: '*Improving Access to Finance for Small and Medium Sized Enterprises*' (2002).

([43]) Deloitte & Touche: *Access to Finance: Opportunities and Constraints for Business Development and Growth in the West Midlands*; (2002), p. 36 and 39; ECOTEC: *Advantage Enterprise & Innovation Fund: Analysis of Market Demand* (2004), p. 16-18.

(220) As to the doubts on the commercial need for Investbx, the Commission notes that the United Kingdom presented the results of a survey they carried out in 2003 among 21 firms of professional advisers asking them how many companies per year they would expect to introduce on Investbx. As a result, 13 of 20 firms indicated that they would expect to introduce between one and six companies per year. Taking into account that not all professionals active in the West Midlands were contacted, the Commission agrees that an estimation of between five and twelve companies joining Investbx per year can be considered to be conservative. Moreover, in another survey, conducted in 2003 among representatives from the regional business community, 88 % out of 41 respondents felt that established capital markets did not meet the funding needs of SMEs. In the same survey 68 % felt that Ofex was little used as a source of capital for SMEs. Although Ofex claims that since 2003 it has restructured and introduced a regional manager, in 2004 and 2005 only one company from the West Midlands was newly listed on Ofex. The discrepancy between the potential demand and the extent to which it is satisfied by Ofex or any other established market places indicates that there is a need for Investbx.

(221) Ofex claims that Investbx is prevented by regulation from providing more information on the business prospects of the investees than what is available at Ofex and the AIM. Nevertheless, according to the UK authorities, Investbx is allowed and will make available to all investors independent research on the SMEs, which is presently not a prerequisite for joining established market places. As regards investor protection, the UK authorities stated that as an appointed representative of an FSA regulated firm, The Share Centre, Investbx will be subject to the requirements of the Financial Services and Markets Act 2000, and The Share Centre will ensure that Investbx operates the appropriate best practices as set out in the FSA's Code of Business Practice.

(222) Regarding transaction costs, the UK authorities claim that Investbx will ensure the provision of research and showcasing services, on average at a significantly lower cost level, while in addition it will eliminate the market-maker margin between the bid and offer price.

(223) If after five years Investbx is not viable economically, and it cannot be sold, it will be closed. However, the companies listed at that time at Investbx may choose to be taken over by The Share Centre, which will guarantee to the investors and investees a secure continuity of trading at the platform subject to the same fees and other conditions as were offered in the selection procedure for providing services to

Investbx. This arrangement was introduced in order to prevent fear of being locked in the investment towards the end of the five-year period of support.

(224) Concerning the argument that an auction-based system is less suitable for trading SMEs' shares, the Commission notes that both systems offer different advantages. While the market-maker system offers the possibility to trade at any time, the auction-based system eliminates the price spread. Moreover, the UK authorities declared that Investbx will aim at attracting investors with long term perspectives who would attribute less importance to the capacity to trade their shares on a daily basis. In any case it is not for the Commission to establish which system is more suitable. The Commission merely notes that Investbx can contribute to the mitigation of the market failure.

(225) According to Ofex, the escalator function is fully covered by Ofex, the AIM and the Official List. The Commission notes that Investbx aims at contributing to bridging the first step on this scale towards the AIM for West Midlands based SMEs. From the list provided by Ofex of companies that went from Ofex to the AIM during past three years, only one company was from the West Midlands. Taking into account that the AIM is a fast growing market, the Commission assumes that there would, in any event, be space for Investbx to complement the efforts of Ofex to bring new companies to the AIM.

(226) Nevertheless, the Commission recognises that indeed there is a risk that the objectives of Investbx, be it capital raising for SMEs or serving as a step to more senior capital markets, may not be achieved. Such a risk is inherent in the nature of a pilot project. It is the reason why private investors were not willing to invest into this project and why the incentive of state aid is used.

(227) Ofex is right that the aid is predominantly not directed to cover enterprise costs of SMEs to be financed, but the start-up costs of Investbx. Investees will receive equity financing from private investors at market conditions. The aid is directed merely at a market place that will help to increase efficiency in channelling the funds.

(228) Concerning the incentive effect, the aid enables a regional alternative trading system place with additional services to be founded, and which also provides for a new channel for transmitting investment relevant information between investors and investee SMEs. Thus the aid provides an incentive for Investbx to come into existence and to target market failure.

(229) […] (*).

(*) Business secret.

(230) As to the concern of Ofex that Investbx would crowd out private investment to existing or potential trading markets, the Commission does not exclude this possibility to a limited extent but recalls that the activity of Investbx is limited to SMEs in the West Midlands that aim at raising equity of up to GBP 2 million. In this segment the other market places known to the Commission are active to a very limited extent. In particular Ofex lists only 7 companies from the West Midlands out of its 180 quoted companies. If Investbx is not successful, it means that its turnover will be too small to realise profits, and it will be unlikely to influence in any way the position of its competitors. On the other hand, if Investbx is successful, AWM will sell it after five years to private investors through an open tender and thus would attract more private investment into the market for this type of financial services. In any case, it will be for the private investors to assess which type of market place offers better services, is more innovative and offers higher return possibilities for their investment. On the one hand, it is true that during the first five years Investbx will not have to pay any dividends to the public investor. Investbx will for the first five years charge prices for its services such that it aims at breaking even in five years. Nevertheless, in view of its sale, its ultimate aim is to develop into a profitable enterprise, which will have to generate profits once it will be sold. Ofex claims that Investbx may restrain innovation in the financial market. However, by the way how Investbx will operate, it represents by itself a major innovation. Indeed, it is a combination of several innovative elements.

6.4. **Balancing and Conclusion**

(231) The Commission acknowledges that the creation of Investbx is a measure aimed at eliminating a market failure and it will have an incentive effect to raise equity capital for SMEs.

(232) The Commission considers that the GBP 3 million of aid to Investbx is proportional. There are several aspects that limit the detriment that may be caused to competitors. The measure is limited geographically, in time and in terms of targeted investees.

(233) Based on the above considerations, the Commission has come to the conclusion that the aid contributes to overcoming a market failure and makes possible the development of a regional equity trading platform that will facilitate equity financing of SMEs, while it does not adversely affect trading conditions to an extent that is contrary to the common interest. Consequently, the aid to Investbx is compatible with the common market under the Risk Capital Guidelines.

6.5. **Cumulation**

(234) The UK authorities have given the undertaking that the grant to Investbx will not be cumulated with any other state aid at the level of Investbx. As regards aid to the target SMEs, the advantage they may receive from this measure is the access to Investbx services, which they would otherwise either not have, or not at the same terms. They will receive equity not containing any element of aid from purely private resources. The aid element is not in the equity investment, therefore the rules of Section 6 Risk Capital Guidelines, which prevent the cumulation of aided risk capital with other aid measures, do not apply to the SMEs using Investbx.

7. **MONITORING**

(235) Taking into account the innovative nature, the complexity and the potential of the measure to be applied in other regions of the European Communities in order to contribute to resolving the market failure at regional level, the Commission wishes to monitor the effects and the success of the Investbx measure. The UK authorities shall submit in a yearly report concerning this measure the number of SMEs for which capital was raised, and the volume of capital raised for each SME so that the Commission may assess whether the measure indeed appropriately tackles the market failure below GBP 2 million. In order to be able to evaluate the effects on the supply side, the UK authorities shall equally submit the volume of investment capital raised per type of investor. In order to measure the profitability of the measure and to monitor the use of the state resources, the UK authorities shall submit yearly financial accounts of Investbx. At the end of the fifth year after setting up Investbx the UK shall inform the Commission whether Investbx was sold successfully to private investors through a public tender process or whether it was closed down.

HAS ADOPTED THIS DECISION:

Article 1

The aid which the United Kingdom is planning to implement in the form of a grant of GBP 3 million in favour of Investbx is compatible with the common market within the meaning of Article 87(3)(c) of the Treaty.

Implementation of the aid is accordingly authorised.

Article 2

The United Kingdom shall submit an annual report on the implementation of the aid, which will include the following elements:

— the number of SMEs for which capital was raised,

— the volume of capital raised for each SME,

— the volume of investment capital raised per type of investor, and

— financial accounts.

At the end of the fifth year after setting up Investbx the United Kingdom shall inform the Commission whether Investbx was sold successfully to private investors through a public open and non-discriminatory tender process or whether it was closed down.

Article 3

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 20 December 2006.

For the Commission

Neelie KROES

Member of the Commission