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Review: Portugal

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VENTURE CAPITAL POLICY REVIEW: PORTUGAL**Ricardo Tejada**

Abstract

The small Portuguese venture capital market is characterised by expansion-stage investments in manufacturing industries, primarily consumer goods. Government equity programmes, which have tended to be investment vehicles for European structural funds, have crowded out potential private investors. Recent initiatives, including a new venture capital law and a scheme aimed at leveraging private venture funding, should help stimulate venture activity. Measures are also needed to foster the emergence of more entrepreneurs, create a less risk-averse investment culture, and take fuller advantage of international venture capital flows. This paper analyses trends in Portuguese venture capital markets and makes policy recommendations which have been developed through an OECD peer review process.

EXAMENS DES POLITIQUES DE CAPITAL-RISQUE : PORTUGAL**Ricardo Tejada**

Résumé

Le marché portugais du capital-risque, de petite dimension, se caractérise surtout par des investissements au stade du développement dans les industries manufacturières, en particulier celles qui produisent des biens de consommation. Les programmes de capital-investissement qui ont été mis en place par le gouvernement et qui ont eu tendance à servir de support d'investissement pour les fonds structurels européens ont évincé les investisseurs privés potentiels. Plusieurs mesures récentes, dont une nouvelle loi sur le capital-risque et un dispositif destiné à exercer un effet de levier sur les financements privés, devraient contribuer à stimuler l'activité dans le secteur du capital-risque. Il faudrait aussi faire en sorte que les entrepreneurs soient plus nombreux, instaurer une culture de l'investissement empreinte d'une moindre aversion au risque et tirer davantage parti des flux internationaux de capital-risque. Cet article analyse les tendances des marchés de capital-risque au Portugal et présente les recommandations formulées à l'issue d'un examen par les pairs réalisé dans le cadre de l'OCDE.

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ASSESSMENTS AND RECOMMENDATIONS

The Portuguese venture capital sector, relative to the size of the economy, is one of the smallest in the OECD. It originated in generous tax incentives for venture investing, but is now dominated by banks and public venture capital companies. Government programmes have traditionally been used as investment vehicles for European structural funds, particularly in the early 1990s, rather than as catalysts to stimulate the development of an equity market. This has tended to crowd out potential private investors, both domestic and foreign. However, the government continues to make efforts to further develop the private venture capital industry. The traditional structure of the Portuguese economy and the marginal position of high-technology sectors are reflected in the predominance of expansion-stage investments in manufacturing industries, primarily consumer goods.

In 2002, Portugal launched a broad initiative to stimulate growth and productivity, the *Programa para a Produtividade e Crescimento da Economia (PPCE)*, which included various venture capital measures. A new venture capital law, the *Decreto Lei No. 319/2002*, aims to simplify rules and regulations for the venture capital sector and introduced tax incentives and lower capital requirements for venture funds and companies. An attempt has been made through the *Fundo de Sindicação de Capital de Risco (FSCR)* to strengthen the role of government equity programmes in stimulating private venture activity based on co-financing and risk-sharing. In particular, a new venture capital programme, *Novas Empresas de Suporte Tecnológico (NEST)*, is designed to encourage seed-stage investment by the private sector. However, many of the rigidities imposed by previous venture capital legislation, such as the exclusive provision of incentives to registered companies and funds, remain.

Legal, institutional and cultural constraints need to be removed to allow the private equity market to thrive in Portugal. Further changes to the fiscal and regulatory environments could increase participation by private players and foreign investors in the venture market. There is a need to diversify the sources of capital to include institutions (*e.g.* pension funds and insurance companies), corporations, and individuals (business angels), which depends partly on developing a less risk-averse investment culture. The Portuguese government should continue to reduce its direct participation in venture markets and focus on ways of leveraging greater private sector involvement, including taking fuller advantage of international venture capital flows. On the demand side, importantly, further measures are needed to create a more entrepreneurial environment and to stimulate the emergence of start-ups and entrepreneurs. A summary of progress and recommendations concerning Portuguese venture capital policies is given in **Table 1**.

Table 1. Progress and recommendations on Portuguese venture capital policies

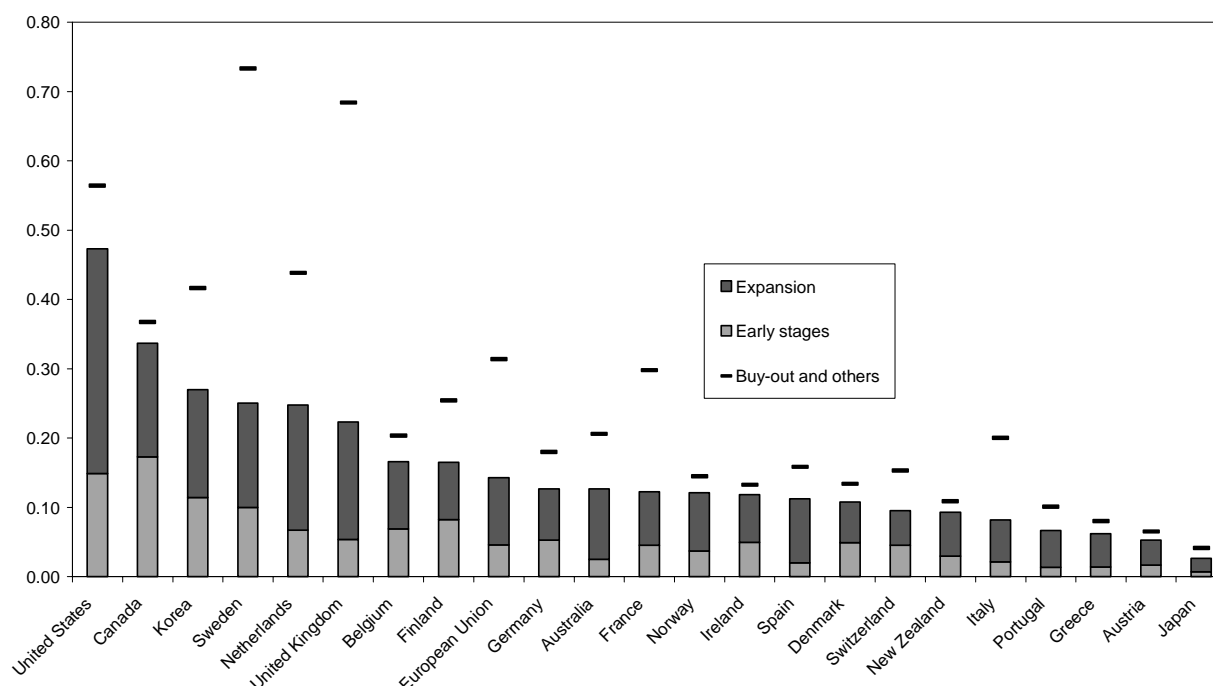
Area	Recent/planned action	Recommendations
Investment regulations	<i>Decreto Lei No. 319/2002</i> simplified venture capital rules, although investment restricted to registered SCRs and FCRs. Quantitative restrictions on institutional investors being relaxed.	Monitor effects of new legislation and enhance venture investment expertise among institutional managers. Consider expanding range of legalised venture investors and removing quantitative limits on institutions.
Tax incentives	Special tax incentives for SCRs and FCRs and low capital gains tax rate for individuals.	Harmonise tax rates on different sources of capital to reduce confusion and extend benefits to a wider range of venture investors.
Equity programmes	Large array of schemes investing EU structural funds; under FSCR, a new NEST programme aims to leverage private venture capital for start-ups.	Simplify and reduce number of government programmes and focus on leveraging private venture investments, following NEST example.
Business angel networks	No existing business angel networks, but creation of national network in early planning stages.	Promote creation of a national-level business angel network and link to emerging private funds.
Second-tier stock markets	No second-tier stock market.	Encourage creation of single second-tier stock market though joining with Spain and other European partners.

TRENDS IN VENTURE CAPITAL MARKETS

Overview

Portugal's nascent venture capital market is one of the smallest in the OECD. In 1999-2002, total venture investment as a share of GDP averaged 0.09%, well below the OECD average of 0.29% (**Figure 1**). In the mid-1980s, generous tax incentives for private sector investing and an expanding economy fuelled a period of growth in venture capital markets that lasted through the early 1990s. The withdrawal of fiscal incentives in 1994 coincided with a slowdown in the Portuguese economy and a period of stagnation in equity investing ensued. During the mid-1990s, public and private venture capital entities, funded by a combination of European structural funds and public money, were used to boost domestic industrial activity and speed economic development. Growth picked up for a brief period beginning in 1999, parallel to the surge in general capital and technology markets. As has been the case in most OECD economies, activity in the Portuguese venture capital sector has since tapered off.

Figure 1. OECD venture capital investment by stages as a share of GDP, 1999-2002



Note: 1998-2001 for Australia, Japan, Korea and New Zealand. The definition of private equity/venture capital tends to vary by country.

Source: OECD venture capital database, 2003.

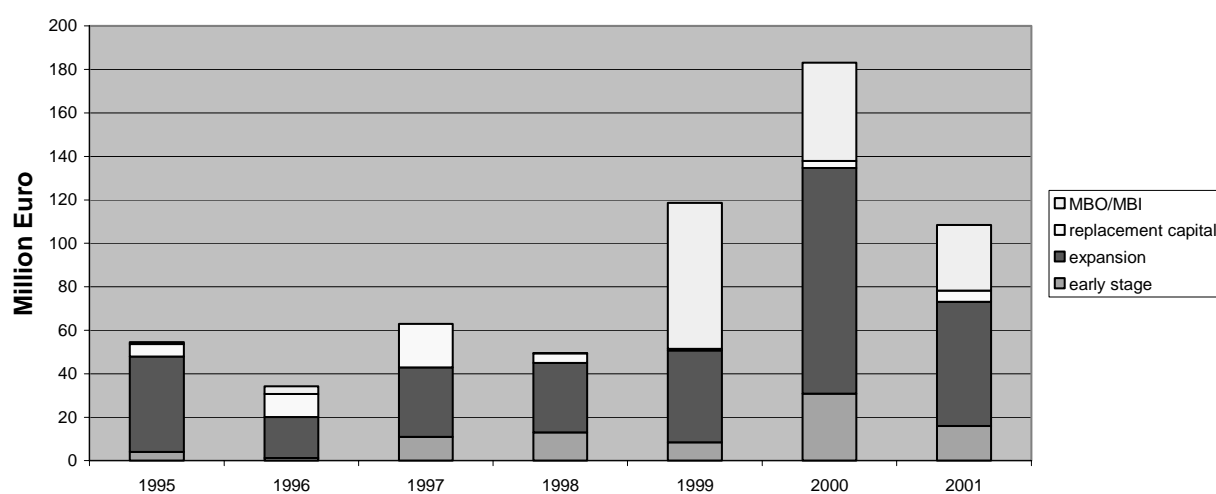
Portugal continues to benefit from sizeable structural transfers from the European Union, on a scale equivalent to more than 3% of GDP per year since 1994 and continuing at least through 2006. In the context of successive Community Support Frameworks (CSF), venture capital in Portugal has been directed to promoting more balanced growth across regions and, more recently, to developing an information and communications technology (ICT) sector. Although recent years have seen the entry of new private equity firms, the number of private investments remains low, with the four main private firms responsible for half of the 150 investment deals in 2002.

Investment by stage and deal size

Venture capital investments in Portugal have consistently favoured expansion-stage projects which have, on average, accounted for at least half of total investments (**Figure 2**). Since 1997, early-stage firms have begun to receive more funding reaching upwards of 15% of total venture capital investment in 2000. But as in Spain and much of Europe, Portugal has had difficulties channelling venture capital investment to early-stage companies. Returns from companies in these stages are generally perceived as too low relative to their more mature counterparts, particularly given their risky and illiquid nature. Average deal size in Portugal, at just over EUR 1.2 million in 2001, is also relatively small (**Figure 3**). In addition to a risk-averse investment culture, a scarcity of viable projects and an underdeveloped entrepreneurial sector are underlying reasons for the current investment profile.

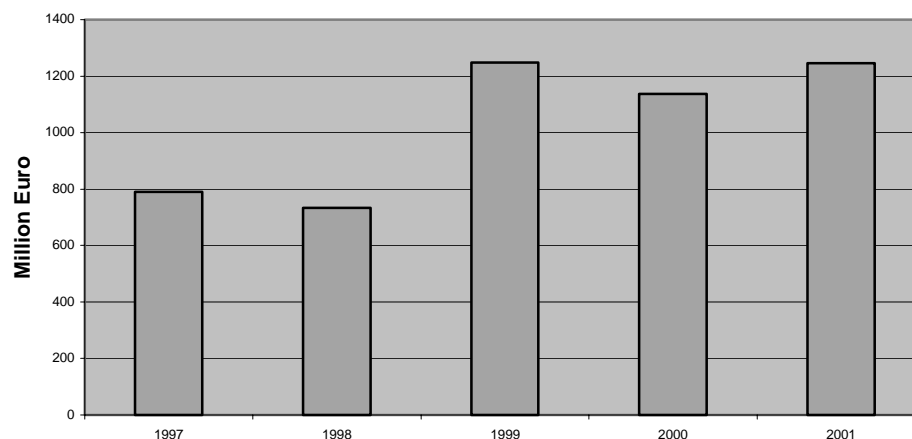
Prior to 1999, later-stage deals – primarily management buy-ins and buy-outs (MBIs/MBOs) - accounted for an insignificant share of private equity investment. This was largely due to a lack of larger complex conglomerates in the Portuguese economy and the predominance of state-owned firms. Portugal began an ambitious privatisation programme in the late 1990s, with more than 100 enterprises sold in recent years. However, privatisation efforts slowed after 1999 and state ownership remains extensive in several sectors, including communications (radio, television) and finance. This may be limiting competition in certain markets and hindering efforts to increase the overall level of start-ups and entrepreneurs.

Figure 2. Portuguese venture capital investment by financing stage



Source: APCRI, 2002.

Figure 3. Portuguese venture capital investment by average deal size

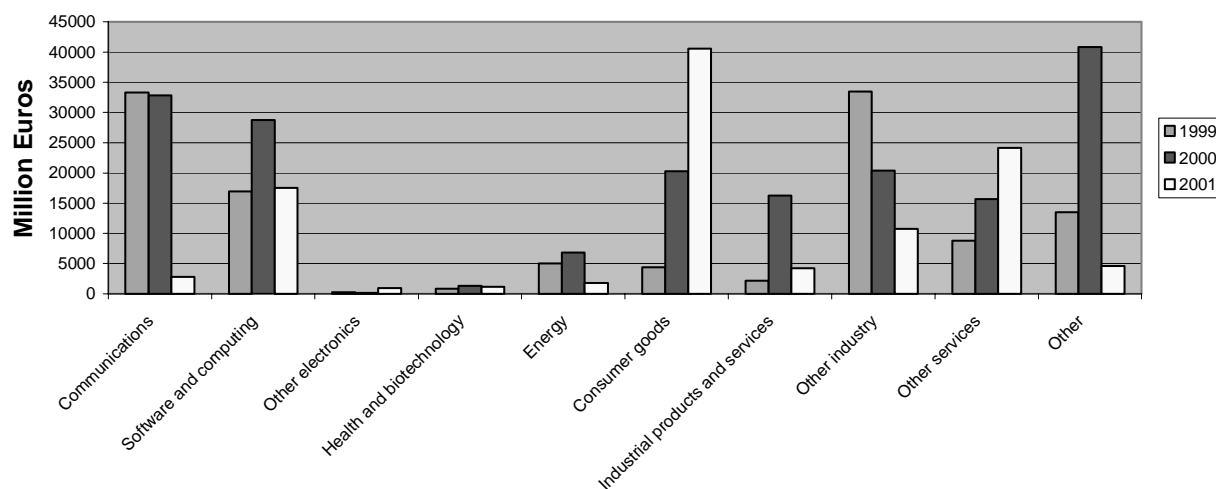


Source: APCRI, 2002.

Investment by sector

The Portuguese venture capital market is focused primarily on traditional manufacturing sectors such as consumer goods, primarily textiles and footwear (**Figure 4**). These sectors were defined as “strategic” by the government, which earmarked them for venture investments under the EU structural funds programme. Overall, venture investments are concentrated in manufacturing (40%), services (18%) and retail trade (9%). Investments in the ICT sector, including computer software, account for about 15% of the total. There are pockets of investment in advanced sectors such as health and biotechnology (2%).

Within the ICT sector, computer hardware and communications figured prominently in recent years in terms of number of investments and total volume of investment. Portugal’s high-technology sector remains small relative to the size of its economy, and gross investment in the ICT sector as a percentage of GDP (11% in 2001) is low by OECD standards. Despite a high degree of Internet usage in regional comparisons, there is little electronic commerce activity in the country. However, certain ICT sub-sectors, such as communications equipment, have grown considerably. Following partial privatisation of *Portugal Telecom*, new entrants increased competition in the mobile phone market and in fixed-line long-distance services. However, venture activity fell in the communications sector with the slowdown in privatisation efforts and downturn in markets. To expand the role of the ICT sector, Portugal in 2000 launched programmes such as the *New National Electronic Trade Initiative* and *Internet Initiative*, which could help increase demand for venture capital by ICT-based start-ups.

Figure 4. Portuguese venture capital investment by sector

Source: APCRI, 2002.

Investment by region

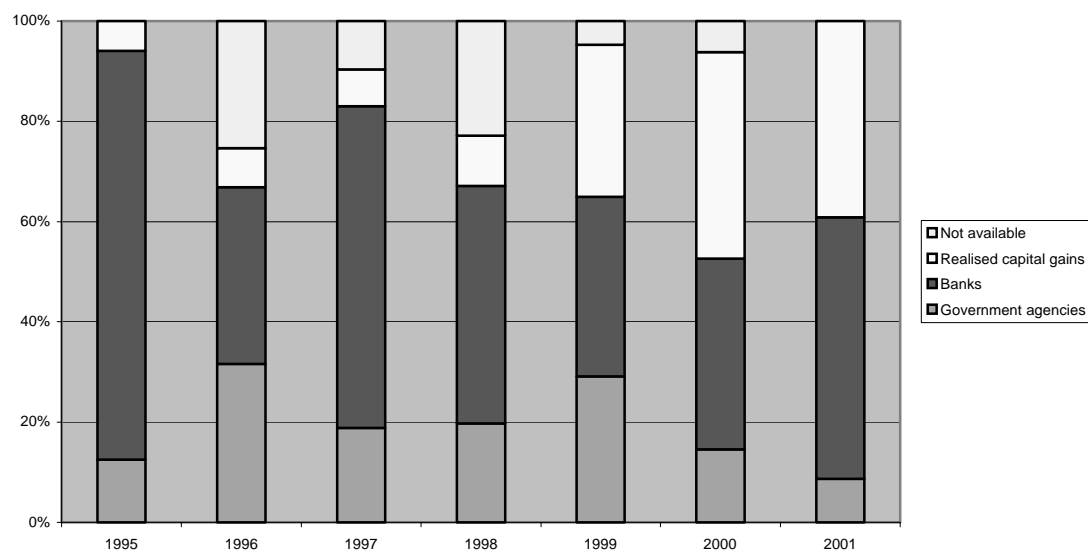
As in most OECD countries, venture capital investment coincides with regional industrial activity, with most activity in the larger coastal cities of Lisbon and Porto, and to a lesser extent, in Braga and Coimbra. In 2001-2002, about 50% of investments were in companies located in the Lisbon area, 16% around Porto (Portugal's second largest city) and 23% in the rest of the country. Only 10% of investments covered pan-European companies. This pattern largely reflects the availability of investment-ready projects and firms, but also the regional development component of public venture capital funds and programmes.

Funds raised by source

Venture capital in Portugal is almost exclusively raised from domestic banks and public sources, including contributions from the EU (**Figure 5**). Government-owned banks and venture capital entities account for 44% of the Portuguese private equity market, and most private players are heavily dependent on public funding. It is estimated that the share of EU funds in the Portuguese equity market likely exceeds 50%. Realised capital gains from these public investments, which are channelled back into venture funds, are the only other significant source of capital in the Portuguese private equity market.

In Portugal, venture capital is still a relatively obscure form of investment and little has been done to promote the sector among potential participants other than larger banks. Unlike in OECD countries with more developed venture capital sectors, institutional investors such as pension funds and insurance companies do not participate in the venture market. There is also little input from corporations or individuals (business angels). International participation in the Portuguese private equity market has been negligible, largely due to the small size of the market as well as bureaucratic barriers.

Figure 5. Portuguese funds raised by source



Source: APCRI, 2002.

VENTURE CAPITAL POLICIES AND PROGRAMMES

Overview

The venture capital market in Portugal has been characterised by government initiatives to channel European structural funds to venture capital companies and other investment vehicles, with a view to aiding Portuguese firms. Despite some contribution by private banks and emerging private funds, the government remains the key player in the Portuguese venture market. In the past, public support to firms in the form of both investments and grants acted to stifle potential private investment. In addition, on the demand side, Portugal suffers from the small size of the domestic market and a dearth of dynamic start-ups and entrepreneurs, reinforced by a generally risk-averse culture. On the supply side, a bank-dominated economy and a family-dominated corporate world have not fostered a venture investment environment. These factors have combined to suppress venture capital activity in Portugal.

As part of the *Programa para a Produtividade e Crescimento da Economia (PPCE)*, the Portuguese government is now focusing on developing a more entrepreneurial culture and creating an attractive legal and fiscal environment for venture investing. The *Programa Operacional da Economia (POE)* (2000-2006) (POE), launched in the context of CSF III, aims at providing financial and technical support for small firms and reducing the complexity of the legal and administrative framework for start-ups as well as supporting investment projects in ICT sectors. A new venture capital law, enacted in 2002, introduced a number of changes to the venture investment framework. Public equity programmes under the *Fundo de Sindicacção de Capital de Risco (FSCR)* are now focusing more on leveraging private sources of capital. However, the public role is still dominant, and the government needs to use the regulatory and fiscal tools at its disposal to further stimulate private sector venture activity.

Investment regulations

Since October 2002, the Portuguese venture capital sector has been subject to specific legislation under the *Decreto Lei No. 319/2002*, intended to clarify and simplify regulations governing the venture industry (**Box 1**). Prior to this, venture capital legislation consisted of a confusing number of laws enacted and updated between 1986 and 1998. Regulatory and supervisory responsibility was shared by the Bank of Portugal, the stock market regulator *Comissão do Mercado de Valores Mobiliários (CMVM)*, and the Ministry of Finance. Entities wishing to undertake venture capital activity in Portugal were required to register with and report to all three organisations. The sector was also subject to high capital requirements (EUR 3 million for venture capital companies and funds) and unfavourable tax treatment relative to other types of investment vehicles.

Decreto Lei No. 319/2002 is based on the Spanish and, to a lesser extent, French and British legal frameworks. The law eliminated the *Fundos de Reestruturação Empresarial (FRIE)*, which were dedicated to companies in distress, and created two equity investment vehicles – the *Sociedades de Capital de Risco (SCRs)* and the *Fundos de Capital de Risco (FCRs)*. As in Spain, these vehicles are subject to strict regulations and report to the stock market supervisor, the *Comissão do Mercado de Valores Mobiliários (CMVM)*.

Box 1. Decreto Lei 319/2002

The legal framework governing the Portuguese venture capital sector, *Decreto Lei 319/2002*, was signed into law on 16 October 2002. Its objective is to clarify and simplify the legal status of different venture capital entities by bringing them under one law. It also seeks to lessen the financial and bureaucratic burden borne by venture capital investment vehicles, foreign and domestic, operating in Portugal. The most important changes brought about by the law include:

Definition of investment vehicles – The new law defines one type of venture capital company (SCR) and two types of funds (FCR):

Sociedades de Capital de Risco (SCR) – are venture capital companies, with legal identity, that raise and manage their own funds.

Fundos de Capital de Risco (FCR) – are funds without legal identity, intended for temporary investment in companies with a high growth potential. Two types are defined by the law:

Fundos para Investidores Qualificados (FIQ) – are funds open only to sophisticated or “qualified” investors such as banks, pension funds, insurance companies, government entities, etc.

Fundos Comercializáveis junto do público (FCP) – are funds open to both qualified investors and the general public which are subject to stricter reporting standards than FIQs.

Capital requirements – were previously EUR 3 million for all venture capital entities. Requirements have been reduced to EUR 750 000 for SCRs and EUR 1 million for FCRs.

Regulatory supervision – SCRs and FCRs are now supervised by one entity, the stock market supervisory body *Comissão do Mercado de Valores Mobiliários* (CMVM).

Although it is too early to accurately assess their impact, a number of important changes enacted by the law are likely to have a positive effect on the venture market. Lower capital requirements should allow a greater and more varied number of players to enter the sector and make it easier for smaller venture firms to participate in the market. The lighter bureaucratic burden brought about by consolidating supervisory powers under one regulator should attract players who found the earlier registration and reporting process cumbersome. While the new law serves to simplify the regulatory environment, however, it may still prove too rigid and bureaucratic for many investors, particularly those from abroad. Its effects on venture investing should be evaluated after a few years’ time and consideration given to relaxing requirements for investor registration and oversight by the CMVM.

As is the case in many European countries, pension funds and insurance companies are regulated by a series of quantitative restrictions designed to limit the risk profile of their investment portfolios. Until December 2002, pension funds were prohibited from investing more than 3% of their portfolios in unquoted companies. This was changed by the *Norma do ISP 21/2002-R*, which now permits pension funds to invest up to 15% of their assets in venture type investments. Insurance companies still face the 3% ceiling, though this limit is currently under revision and will most likely increase to 15% in the future. The combination of a conservative investment culture and restrictive investment regulations is limiting the sources of venture funds for Portuguese firms. Removing current limits and adopting a more flexible prudent man-type rule could possibly send a stimulus to venture investment by institutions. However, institutional investors in Portugal remain unfamiliar with the venture capital sector and are unlikely to change their risk-averse stance in the absence of programmes to develop better venture investment expertise among institutional managers and other potential investors.

Tax incentives

Portugal has generous tax incentives for venture investments by FCRs and SCRs as well as low capital gains tax rates for individuals. While there is a 32% tax on short-term and long-term capital gains realised by corporations, capital gains on investments held by individuals for a period longer than 12 months are not taxed, while those held for less than one year are taxed at 10%. Portugal has a lower corporate tax rate of 20% for small and medium-sized enterprises (compared to 30% for larger firms). In addition to a new investment tax credit, there are attempts to spur private R&D spending through one of the most generous tax provisions in the OECD. Firms can deduct 20% of eligible R&D expenditures from their taxable income and an additional 50% on incremental expenditures above the average of the previous two years.

Decreto Lei 319/2002 introduced tax incentives specific to the venture capital sector for the first time since previous measures were eliminated in 1994. These provisions are designed to bring benefits in line with those granted to other, less risky investment vehicles and to attract foreign participation in the private equity sector. Capital gains on investments made by SCRs registered with the CMVM are tax-free provided divestment takes place between one and ten years, while dividend income remains taxed at 32% unless rolled over into venture capital equity. Investors participating in SCRs are also exempt from capital gains taxes. FCRs are exempt from taxes on both capital gains and dividend income, while investors participating in FCRs are granted a tax exemption on 50% of short-term capital gains realised.

Different tax rates for participants in the Portuguese venture capital market tend to be confusing and can introduce unwanted distortions. In general, increasing neutrality in the tax system and making it less complicated in distinguishing between different sources of capital could increase investment flows. In addition, extending targeted tax benefits beyond SCRs and FCRs could increase flexibility and draw in other potential participants such as corporations. As in many OECD countries, corporate interest payments – as opposed to distributed profits – are deductible from the corporate tax base which penalises new equity finance. The government should harmonise overall tax rates on capital income and make the fiscal system more neutral towards savings and investment decisions.

Equity programmes

The government has played a dominant role in the Portuguese venture capital market. The first public venture capital programmes were put in place in 1986 as a segment of the *Programa Específico de Desenvolvimento de Indústria Portuguesa 1* (PEDIP 1). Through this programme, funds were distributed via the Portuguese Institute for Support of Small and Medium Enterprises (*Instituto de Apoio às Pequenas e Médias Empresas*) (IAPMEI) to two government venture capital firms, *Norpedip* and *Sulpedip* (known as *PME Capital* and *PME Investimentos* since 1999).

In the beginning, *Norpedip* and *Sulpedip* had identical structures and were responsible for making venture-type investments in industrial sectors and firms deemed strategic by the Portuguese government. However, investment decisions were aimed more at maintaining faltering companies than promoting businesses with growth potential. The venture capital entities did not play a relevant managerial or advisory role in the investee companies. At that point, *Norpedip* and *Sulpedip* became regarded as “company hospitals” rather than venture capital firms. Their strategic and operational reorientation as *PME Capital* and *PME Investimentos* allowed them to play a more relevant role in equity markets.

PEDIP 1 was followed by PEDIP 2 from 1994 to 2000. During PEDIP 2, in order to stimulate private venture activity, government programmes placed European Union (EU) structural funds in seven venture capital funds and one private venture capital company, based on principles of hybrid public/private funding and risk-sharing.

Since 2000, most initiatives dedicated to Portuguese economic development, including venture capital activities, are managed by the successor to PEDIP 2, the *Programa Operacional da Economia* (POE) (**Box 2**). POE, which also channels EU structural funds, is supposed to prioritise support based on venture capital, seed capital or development capital and to reward high value-added projects and foster public/private partnerships. Venture capital programmes, which are provided for under the Financial Innovation sub-programme 3.4, have a wider focus than those under PEDIP 1 and PEDIP 2. The emphasis is no longer on manufacturing industry alone but on all sectors outside agriculture and fisheries, including services such as finance and ICT. Also, as a response to a low number of investment-ready projects, the POE sub-programme attempts to address the demand-side through government-sponsored training programmes and seminars aimed at potential and active entrepreneurs.

Box 2. Government venture capital programmes in Portugal

The following are venture capital activities under the *Programa Operacional da Economia* (POE) (2000-2006). The firms and programmes listed below are venture capital vehicles investing in small and medium enterprises not yet quoted on the stock exchange. However, most of them can also make investments in other types of vehicles.

PME Capital – (originally *Norpedip*). Created by PEDIP1, this is a venture capital company with EUR 79 million in assets managing the following funds:

FRIE/PME Capital – General venture investment fund aimed at financing firms with high-growth potential in all sectors.

Retex – This fund is limited to smaller firms in textile-producing regions in need of corporate revitalisation or looking to expand internationally.

Global – This fund targets investments in start-up businesses, company incubators and early-stage projects with business potential.

Inter-Regional – A fund which finances start-ups and small and medium enterprises in the north of Portugal or operating in the Galicia region of Spain.

PME Investimentos – (originally *Sulpedip*). Created by PEDIP1, this is a venture capital company with EUR 76 million in assets managing the following funds:

FRIE/PME Investimentos – General venture investment fund aimed at financing firms with high-growth potential in all sectors.

Retex – This fund is limited to smaller firms in textile-producing regions in need of corporate revitalisation or looking to expand internationally.

Tiec – This fund targets investments in the information and communications technology (ICT), electronics and culture sectors.

Global – This fund focuses on start-up financing, buy-outs, and refinancing and revitalisation of small firms with high growth potential.

Novas Empresas de Suporte Tecnológico (NEST) – This programme will make seed-stage investments in R&D projects that offer new innovative products, services or means of production. Entrepreneurs must cover a minimum of 5% of a project's budget, while NEST investments must be matched by outside funding and are limited to EUR 375 000 or 15% of total capital. The remaining funding, which must come from other SCRs or FCRs, is guaranteed by NEST in the event of capital loss.

Instituto de Financiamento e Apoio ao Turismo (IFT) – A venture capital firm dedicated exclusively to investments in the tourism sector and the only public capital vehicle to receive financing directly from the government as opposed to IAMPEI. The institute provides soft loans, grants and subsidies, and makes investments, which range in size from EUR 10 000 to EUR 15 million.

Under POE, *PME Capital* and *PME Investimentos* remain the primary public vehicles for venture capital investment of IAPMEI funds. However, in 2001, as part of an effort to increase their efficiency as well as to ease confusion, the investment focus of each was clarified. *PME Capital* now concentrates on early-stage projects, while *PME Investimentos* takes on later-stage activities, including the MBO/MBI segment of the private equity market. The two SCRs continue to manage a set of similar funds, including *Retex* which focuses on firms in textile-producing regions.

The government also reorganised several public funds under the *Fundo de Sindicacção de Capital de Risco* (FSCR) in the attempt to focus more on leveraging private venture capital. In particular, the *Novas Empresas de Suporte Tecnológico* (NEST), approved in late 2002, is directed to helping seed-stage projects obtain financing from public and private SCRs and FCRs. NEST focuses on technology-based firms deemed to have high-growth potential. Equity guarantees offered to private venture investors are intended to attract funding to early-phase firms. Follow-on funding for successful firms may then be obtained from other public sources such as *PME Capital*, giving the programme an important degree of continuity should private funding prove elusive.

In the past, government funding programmes served to crowd out private investment as business owners preferred direct subsidies rather than forgo partial ownership to potential investors. Furthermore, public investments and subsidies that targeted ailing firms and regions kept uncompetitive businesses in the market, hindering the rise of new firms and entrepreneurs. Starting with the FSCR and NEST programmes, public venture schemes should focus on leveraging private funds and promoting a private equity culture and environment. Diverse government venture capital programmes should also be rationalised and simplified to reduce confusion and overlaps in providing finance to the small firm sector.

Business angel networks

According to the *European Business Angels Network* (EBAN), business angel activity in Portugal is largely informal and limited in scope. Although there are no specific fiscal incentives for individual investments in small firms, business angels could benefit from the zero tax on long-term capital gains and from tax breaks given to investors in FCRs and SCRs. There are at present no public or private networks to link business angels with entrepreneurs and investment opportunities. The Portuguese Venture Capital Association (*Associação Portuguesa de Capital de Risco*) (APCRI), established in 2000, is building its membership and organising some networking events. Interest has been expressed in establishing regional business angel networks in the Porto region and in Viana do Castelo by the *Camara Municipal Viana do Castelo*. The Portuguese government has announced that it is in the early planning stages of creating a business angel network under the venture capital segment of the *Programa Operacional da Economia* (POE). Steps should be taken to create a national-level business angel network once regional programmes are up and running and to link these to existing investment programmes and funds.

Second-tier markets

The main Portuguese stock market is *Euronext Lisbon*, which emerged in 2002 following a merger in 1999 between the *Bolsa de Valores de Lisboa* and the *Bolsa de Derivados de Porto* or BVLP. It is relatively small and illiquid and there is currently no secondary market for smaller firms. (Table 2). Although the creation of a second-tier market was considered in the late 1990s, the idea was abandoned following the sharp downturn in world capital markets. Informal talk of creating an over-the-counter market for shares in unquoted companies continues, but this remains unlikely in the foreseeable future.

The Portuguese economy lacks a critical mass of technology-based small firms to support either a secondary market or initial public offerings (IPOs). The lack of options for exit is an additional barrier to the development of the venture capital sector in Portugal. Currently, trade sales are the only viable means

of exit open to investors. Small specialty exchanges in countries such as Portugal tend to lack liquidity and may not be financially viable in the long-run. Portugal should seek to attract venture capital from abroad as fuller integration with international financial markets and stock exchanges would support development of domestic start-ups and venture activity. The government should also explore participating in a consolidated European secondary market or combining with the *Nuevo Mercado* in Spain in order to achieve economies of scale in small firm listings and IPOs.

Table 2. Second-tier stock markets in OECD countries

Country (stock market)	Year of creation	Number of initial public offers (IPOs)				Number of quoted companies				Market capitalisation (% GDP)			
		1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
Sweden (O-List)	1988	..	..	24	9	150	228	240	235	28.3	24.0	23.3	18.5
United States (NASDAQ)	1971	485	397	63	40 ⁽¹⁾	4 829	4 734	4 109	3 725 ⁽¹⁾	56.5	36.9	28.9	16.5
Canada (Canadian Venture Exchange) ⁽²⁾	1999	2 425	403	330	122	2 358	2 598	2 688	2 504	1.7	10.2	12.7	9.7
Korea (KOSDAQ)	1996	160	250	181	176	453	604	721	843	22.0	5.6	9.5	5.0
Norway (SMB List)	1992	3	7	7	3	78	77	79	79	4.2	1.8	1.5	1.2
United Kingdom (AIM)	1995	67	203	109	78	347	524	629	704	1.5	1.6	1.2	1.0
Ireland (ITEQ)	2000	---	..	..	..	---	7	8	8	---	3.6	1.7	0.7
Italy (Nuovo Mercato)	1999	6	32	5	0	6	40	45	45	0.6	2.2	1.2	0.6
Germany (Neuer Markt) ⁽³⁾	1997	132	132	11	1	201	338	326	240	5.7	6.0	2.4	0.5
France (Nouveau marché)	1996	32	52	9	2	111	158	164	154	1.1	1.7	1.0	0.5
Switzerland (SWX New Market)	1999	6	11	1	0	6	17	15	9	..	3.0	0.9	0.2
Finland (NM List)	1999	..	..	..	..	..	17	16	15	..	0.7	0.3	0.2
Denmark (Dansk AMP)	2000	3	0	1	3	3	3	4	7	0.1	0.1	0.1	0.1
Spain (Nuevo Mercado)	2000	---	..	..	..	---	12	..	14	---	3.4	..	..
Japan (Mothers in Tokyo)	1999	2	27	7	8	2	29	..	..	0.2	0.1	..	..
Japan (Hercules in Osaka)	2000	---	..	43	..	---	..	32	..	..	..	0.3	..
Netherlands (EURO.NM Amsterdam)	1997	1	2	---	---	13	15	---	---	0.3	0.2	---	---
Belgium (EURO.NM Belgium)	1997	6	3	---	---	13	16	---	---	0.2	0.2	---	---
Europe (EASDAQ)	1996	..	..	---	---	56	62	---	---	---	---	---	---
NASDAQ Europe ⁽⁵⁾	2001	---	---	..	..	---	---	49	43	---	---	---	---
Austria (Austrian Growth Market) ⁽⁶⁾	1999	..	..	---	---	2	2	---	---	0.01	0.01	---	---

Notes:

⁽¹⁾ End of October.

⁽²⁾ Data includes both high-growth firms' shares and shares of investment funds.

⁽³⁾ The Neuer Markt segment will be discontinued, after a transition period, at the end of 2003.

⁽⁴⁾ Previously NASDAQ Japan.

⁽⁵⁾ In 2001, NASDAQ Europe acquired majority ownership in Easdaq.

⁽⁶⁾ On April 2001, the two stocks in the AGM segment were transferred to the Specialist Segment of Wiener Börse.

Source: Compiled by OECD Secretariat from national sources.

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