

Governments Support Businesses through Equity Investments

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Original post [here](#).

In response to the economic shutdown caused by COVID-19, many countries have announced plans to take equity stakes in private businesses. Germany and Poland have announced large-scale programs focused on relatively large companies that the government determines are systemically important. Other countries, like the U.S., have announced equity programs that target critical industries, which we cover in a separate survey. Several countries -- including the U.K., France, and Germany -- have also announced much smaller programs dedicating small sums to startups or small and medium-sized enterprises, as part of broader efforts to support small businesses.

In this post we outline some of the key design features of equity-support programs.

- Purpose of the Program
- Capital Characteristics
- Eligibility
- Use of Private Investors
- Existing Program or New
- Size
- Funding
- Individual Participation Limits
- Other Considerations

Purpose of the Program

All of the programs evaluated are designed to support companies facing difficulties due to the COVID-19 pandemic, though different programs target different types of companies. In Germany, the government can recapitalize large nonfinancial companies that are considered critical to the economy through the Economic Stabilization Fund. The government modelled the fund on the Financial Market Stabilization Fund that Germany created in 2008 to support financial companies during the global financial crisis of 2007-09 (see the YPFS case study [here](#)). The [Polish Financial Shield](#) includes measures to recapitalize or lend directly to large companies, while [smaller companies](#) are eligible for forgivable loans.

Other programs are designed to support smaller companies, specifically startups or innovative firms. The UK and France have such programs, and Germany also has a EUR 2 billion program to support startups.

Capital Characteristics

The type of capital provided through an equity program varies across countries. The UK, Belgium, and France provide support through convertible loans. The [UK's Future Fund](#) scheme issues convertible loans with a value between GBP 125,000 and 5 million. The loans automatically convert to equity at a minimum conversion discount of 20% to the price of the next qualifying funding round, which is the discount rate. To qualify, the amount of equity capital raised must be at least the size of the convertible loan. [At maturity](#), the loans must either be repaid or convert into equity at a discount of at least 20% to the price in the most recent funding round. In the case of a sale or initial public offering (IPO), the loan either converts to equity at the discount rate or is repaid at a premium of 100% of the principal. Only the principal will convert at the discount rate, while the accrued interest will convert without the discount rate. Loans convert into the most senior class of shares in the company.

In Germany, the [Economic Stabilization Fund](#) can acquire subordinated debt, hybrid bonds, profit participation rights, silent participations, or convertible bonds. Poland's [Capital Shield for Large Companies](#) allows the Polish Fund for the Development of Capital Instruments to provide support [through](#) shares, subscription warrants, bonds, or convertible loans.

In Mauritius, the State Investment Corporation launched the [Equity Participation Scheme](#), which provides financing through redeemable preference shares. Redeemable preference shares receive a fixed dividend distribution and the repayment period is predetermined.

The EU's ESCALAR Program provides investments into venture capital funds, thus providing funding for equity indirectly, as the investment does not go directly to companies. New Zealand relaxed its rules to allow companies to raise more new capital without shareholder approval, thus enabling companies to more easily access financing.

Eligibility

In order to channel the funding to the targeted companies or sectors, governments establish eligibility criteria, often based on size, revenue, or previous capital raises.

In the UK, the Future Fund scheme is available to unlisted, registered UK companies that have previously raised at least GBP 250,000 in equity (USD 310,000). In Poland, the equity program is available to companies with at least 250 employees and PLN 50 million in turnover or at least 150 employees and PLN 100 million in turnover. Companies could not be in arrears as of December 31, 2019 and must have had a 25% decline in business due to COVID-19.

In [Germany](#), recapitalization under the Economic Stabilization Fund is available to companies that meet at least two of the following size requirements:

- At least EUR 43 million in total assets
- At least EUR 50 million in turnover
- More than 249 employees on average

Germany allows exceptions for smaller companies if they are determined to be critical infrastructure or essential to economic or national security. In addition, companies with a valuation of at least EUR 50 million since January 1, 2017, can be recapitalized through the Economic Stabilization Fund. Germany also has a EUR 2 billion package to support smaller startup companies through equity investments.

In [Mauritius](#), the State Investment Corporation's program is available to companies with annual turnover of at least Rs 250 million (USD 6.3 million). A separate Equity Financing Program through the SME Equity Fund is available to companies with annual turnover of less than Rs 250 million.

Use of Private Investors

How the government partners with private investors is another consideration. Some programs do not require private financing; in other programs, the government will provide up to a certain percent of the support.

In Germany, support through the Economic Stabilization Fund is available to companies that cannot access other financing; thus, there is no required private investor match. However, support to startups through the EUR 2 billion package allows public venture capital funds to provide up to 70% of the financing while private investors take at least 30%. In both the UK and France, the government will match investments from third-party investors one-to-one.

Existing Program or New

In many cases, government equity programs utilize existing programs or infrastructure. In Germany, public venture capital firms and the investment arm of the national development bank, KfW Capital, can provide financing through the support package for startups. Other countries, including Angola, Denmark, Mauritius, France, and Belgium, utilize existing public investment companies or funds. The EU's ESCALAR program, a new program in its pilot phase, partners with existing funds and new funds that focus on financing startups. In the UK, the newly established Future Fund will be delivered in partnership with the British Business Bank, the state-owned development bank.

Size

In most countries, the equity-support programs represent a very small portion of the government's economic support to businesses.

In Germany, the government allocated EUR 600 billion in funding for the Economic Stabilization Fund, of which EUR 100 billion is earmarked for recapitalization purposes. The

government also allocated [EUR 2 billion](#) in funding for startups. Other countries have allocated much less to equity programs. The UK's Future Fund has GBP 250 million in funding, less than 0.1% of the more than [GBP 330 billion](#) the government provided in credit guarantees and other support. France has made EUR 80 million in funding for equity available through the public investment bank, Bpifrance, out of more than [EUR 110 billion](#).

Funding

Most governments we reviewed did not specify a unique funding source for these equity programs, but rather structured the programs to pull from the general fiscal budget. However, the Solomon Islands [issued](#) a special COVID-19 Domestic Development Bond for SBD 120 million (USD 14.5 million), from which the funds for its equity program were to be pulled.

Individual Participation Limits

In the [UK](#), the government has defined the limits of the equity investments at between GBP 125,000 and GBP 5 million. Similarly, [France](#) set the limits at between EUR 100,000 and EUR 5 million. In both of these countries the actual size of the government's investment is determined by the amount of funds invested from private investors. In [Mauritius](#), the government will invest an amount that will keep the government's ownership at 49% or below the business's total equity capital.

Other Considerations

Details from the [UK's](#) Future Fund program provide insight into two additional design features of equity-support programs.

Restrictions on use of funds

Businesses that receive equity investments under the Futures Fund cannot use the money to “pay off previous debts or make dividends or bonus payments to staff, management, shareholders, or consultants.” The funds cannot be used to repay existing debt.

Government voting rights

The government indicated that it would have “limited corporate governance rights during the term of the loan and as a shareholder after conversion.”