HUNGARIAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

INDUSTRY POSITION PAPER

The European venture capital sector has gained momentum in the last few years and Hungary has been at the forefront of such progress. The European Union (EU) and individual member states recognize that this form of financing can significantly contribute to the growth of the overall EU and domestic economies, the development of undertakings and the improvement of macro-economic competitiveness. This realization spurred the channeling of state funds into the industry. The most well-known example being the venture capital program segment within the *Joint European Resources for Micro and Medium Enterprises* (JEREMIE) program of the EU, which was launched in Hungary under the name of New Hungary Venture Capital Programs (*in Hungarian: Új Magyarország Kockázati Tőkeprogramok*).

The first JEREMIE tender (JEREMIE I) occurred at the end of 2008. The intermediation agreement was concluded with the eight winners by Magyar Vállalkozásfinanszírozási Zrt. These JEREMIE I funds commenced during the summer of 2010, and based on placements implemented so far, the program is considered highly successful. At the end of the first quarter of 2013, 93 investments were funded with a total of HUF 32 billion. The first successful exit, namely the sale of the investor's stake, took place in September, 2012.

Due to the success of JEREMIE I, the National Development Agency invited the second, third and fourth JEREMIE venture capital tenders under the name of New Széchenyi Venture Capital Programs in the following years. This established seed funds and growth funds which simultaneously created a way for small nascent businesses and large established companies to participate.

The appearance of venture capital funds set the private sector in motion: startups began to compete; incubators and accelerators were launched followed by professional blogs; conferences and consultants provide assistance with education and the opportunity to establish contacts among investors and entrepreneurs.

In the past few years, members of the Hungarian Venture Capital and Private Equity Association ("Association") actively contributed to the promotion of venture capital as a generally known, accepted and efficient financing solution for Hungarian enterprises. We consider the establishment of a competitive regulatory environment to be in the best interests of the national and overall economy so our efforts include submitting proposals to legislators. We firmly believe that a coherent and market-friendly regulatory framework would bring realistic economic advantages to Hungary allowing it to become the regional center for startup businesses and venture capital thereby creating numerous jobs and sustainable economic growth.

One Association effort toward achieving the above objectives is its second industry paper, prepared by the Legal Committee with the assistance of the following attorneys and consultants:

Dr. Ákos Bajorfi (Noerr and partners Law Office)
Dr. Judit Budai (Szecskay Law Office)
Heléna Csizmadia (Mazars)
Dr. Márton Eörsi (Allen & Overy LLP)
Zsombor Imre (InVendor)
András Reich (EY)
Dr. Balázs Sahin-Tóth (Allen & Overy LLP)
Balázs Szabó (InVendor)
Balázs Tüske (EY)
Dr. Péter Zalai (PwC Legal)

CURRENT REGULATION

Venture capital and private equity investments have three levels/steps. Investment funds (Fund) raise capital from private individuals or corporate investors (Investors). The capital is then invested by Fund Managers into the shares and equity interests of portfolio companies (Portfolio Companies). Provided that the activity occurs in Hungary, taxation of these levels is as follows:

- Investor level:
  - Economic organization: The yield received from investment units and similar income from financial investments, is to be shown under the interest on financial transactions and it shall be subject to a corporate taxation rate of 10-19%.[1] Even if the Fund's income is received from the dividend of the Portfolio Companies, the yield shall not be tax exempt at the Investor level, in contrast to holding structures.
  - Private individual investor: The yield received from investment units is subject to taxation as foreign exchange gain (16% personal income tax + 14% healthcare contribution, up to a maximum annual amount of HUF 450 thousand). There is no possibility of tax equalization.
- Venture capital fund: No corporate tax obligation.
- Portfolio companies: Tax and tax based concessions are available primarily in relation to research and development activities, otherwise the general rules apply.

Hungary has favorable regulations with respect to international transactions. Payments to foreign economic organizations are not subject to withholding tax. Hungary also has an extensive network of treaties.

PROPOSAL

- **Investor level/economic organization: notified shareholding**

  With domestic economic organizations, foreign exchange gain that is received with respect to notified shareholdings, a share of at least 30% held in a domestic legal entity with a holding period of at least one year, is tax exempt. Theoretically, the above rule can also be applied to the investment units of Funds, like shareholdings.[2] In practice however, no shareholding in excess of 30% exists with collective investment funds, particularly venture capital funds due to risk reduction. Nevertheless, a tax exemption for the foreign exchange gain in this particular industry would facilitate the funds obtained by companies who invest private equity into higher risk companies.

[1] Section 84(3)b) of the Accounting Act

[2] The fund is a legal entity; there is no specific definition for equity security. However, according to Section (5) 1a of the Personal Income Tax Act (Sztv.), investment units and venture capital notes constitute equity securities.

Similar to our proposal last year, we propose that the minimum shareholding threshold be reduced to 10%. Also, if necessary, the item modifying the tax base[3] should be supplemented with the yield received from investment units, with special care that, in the case of incubators and seed type investments, the shareholding of investors is typically around 10-15%. The tax legislation package for the next year already includes the reduction of the threshold, and we welcome such amendment. Moreover, we propose the extension of the definition of notified shareholding, without the stipulation of any ownership limitation with respect to the acquisition of "*venture capital fund units.*" To provide an international comparison from another EU member state, Ireland applies a similarly favorable regulation.

- **Investor level/private individual investor**

  The long term investment of private individuals is encouraged, in terms of taxation, through long-term investment accounts that receive a 10% tax rate after a holding period of one year, and a 0% tax rate after five years. As of January 1, 2013, the term "*privately issued security*" was removed from the definition of controlled capital markets transactions set forth under the Personal Income Tax Act, and also referenced by the rules applicable to long-term investment agreements (TBSZ). As a result, the units of special investor funds can no longer be placed on such accounts.[4] We consider the exclusion of venture capital and private equity investments to be senseless because, in terms of content, venture capital and private equity investments are also long term capital investments. Therefore, they are similar to the investments of the currently favored investor groups.

  Presumably the inconsistent treatment of long-term capital investments was unintentional. Therefore, we propose extending the group of investments that are eligible for a TBSZ account. This could be done simply by adding a provision that the foregoing can be applied also in the case of "*venture capital fund units*", regardless of whether such unit is a privately or publicly issued security. Regarding the tax exemption of the "venture capital" investment of private individuals, similar examples can be found in Great Britain[5], the U.S. and Australia[6], where tax exemption is available for the investor level subject to specific conditions. Moreover, in Great Britain tax concessions are available in based on the amount of the investment. The regulation is aimed at facilitating the financing of small and medium sized enterprises.

- **Portfolio companies/administration and tax concessions**

  Excessively high taxes and other administrative obligations burdening enterprises are a matter of common concern, which present even greater challenges for startup enterprises, due to the limited availability of employees and resources, and in several cases render their operation impossible, especially because they are to face the same amount of administration as large enterprises ready for market entry.

[3] Section 7(1) dz) of the Act on Corporate Tax and Dividend Tax (Tao).
[4] Sections 67/A(3) and 67/B(3) a) of the Personal Income Tax Act (Szja tv.)
[5] Venture Capital Trust
[6] ESVCLP – Early Stage Venture Capital Limited Partnership

The significant reduction of the burdens above would facilitate the launching of these enterprises and making Hungary a more attractive location for them.

In the EU, enterprises younger than six years that assign at least 15% of their sales revenue to research and development activities qualify as innovative enterprises. The Hungarian legal system has not introduced any special regulations for such enterprises, although tax concessions related to research and development activity are currently available.[7] We propose a more simplified manner for the utilizing tax concessions and the extension of the scope of such concessions:

- Introduction of local tax concessions during the first five years of the operation of young innovative enterprises. We propose that young, innovative enterprises be granted an exemption from local tax during the first three years of their operation. Furthermore, we propose the reduction of their local tax base by 50% during the 4th and 5th year of their operation.[8]
- Young, innovative enterprises typically qualify as micro and small enterprises and they frequently encounter cash-flow problems. In order to accelerate the growth of these enterprises, we propose that a tax concession, similar to that applicable for the employment of researchers, be introduced in relation to the health contribution payable after the salary, or at least a part of the salary of employees.

- **Portfolio companies/ Tax deferral for owners**

Income can be generated for private individuals at the time that the in-kind contribution is provided. When utilizing venture capital, the asset transferred is delivered to the portfolio company, while the income (dividend) realized is expected to be received from the company only several years later. Commencement of such companies would become significantly easier if it was possible to defer (e.g. exit) the tax payable until after the income generated as a result of the transfer of certain assets provided as in-kind contribution (e.g. know-how) is incorporated into the relevant legal regulation since the income is realized only on such later date. The reduction of the income tax of private individual owners is also considered for the purpose of providing an incentive for investments in certain cases involving registered venture capital investors and following a holding period of adequate length (5-10 years).

- **Fund managers/tax concessions for "*carried interest*"**

Countries placing special emphasis on attracting capital investments and venture capital funds typically apply tax concessions with respect to the success fee of fund managers in order to keep the activity of not only the fund, but also the fund manager within the country. Such regulations are in place in the UK and the U.S. We propose the incorporation of similar concessions into the Hungarian regulations. For example, application of the taxation rules for foreign exchange gains to the success fee of venture capital fund managers.

[7] Section 7(1) t), (17), (18) of the Act on Corporate Tax and Dividend Tax (Tao.)

[8] The proposal concerns a simple tax reduction, which will not result in a significant administrative burden for the taxpayer. The municipalities concerned would be compensated for the reduction by the creation of new jobs at their territory.

PROPOSALS FOR IMPROVING THE LEGAL FRAMEWORK FOR CAPITAL MARKETS

CURRENT REGULATION

Although the capital markets legal regulations applicable to venture capital are currently set forth under the Capital Markets Act (Tpt.), a new Act is expected to enter into force as of January 1, 2014. This is to provide so-called alternative investment funds and their managers with a uniform regulatory framework. Consequently, similar rules shall apply to the venture capital and the "traditional" investment sectors.

The introduction of a common regulatory framework is necessitated by the Directive 2011/61/EU (AIFM Directive), which aims to provide a uniform regulatory framework for alternative investment fund managers operating in the EU (AIFM). However, within the framework specified by the Directive, national legislators, thus Hungarian legislators, may develop the solutions they consider the most efficient and competitive from the perspective of the given country.

It is to be noted that in 2013 Community legislators also issued regulations with respect to the venture capital sector, which are to be directly applied in the member states. From these regulations we specifically refer to Regulation 345/2013/EU (EuVECA Regulation), which established the legal institution of the European venture capital fund.

PROPOSAL

- **Cancel the license obligation of fund managers below the "*de minimis*" value limit.** The AIFM Directive releases fund managers managing funds with a total asset value of less than EUR 100 or 500 million from numerous obligations. This solution was adopted by Germany, Luxemburg and Austria. For the purpose of ensuring the competitiveness of the sector, we propose the formulation of a regulatory environment no more stringent than the provisions of the Directive.

- **Introduce funds operating in corporate form.** In Western Europe it is becoming infrequent for funds to appear as pools of assets, instead they operate in some corporate form such as investment companies limited by shares or limited partnerships. This trend can already be observed in our region since the implementation of the AIFM Directive created an opportunity in the Czech Republic also for the establishment of funds operating in a corporate form. Corporate forms offer are far more flexible solutions in terms of the relationship between the fund and its manager, e.g. the fund itself selects, or when applicable, dismisses its manager. Moreover, considering the more detailed regulation of corporate law, the introduction of operations in corporate form would resolve several issues that were raised earlier (e.g. temporary investment units).

- **Introduce self-managed funds.** The AIFM Directive also regulates the operation of so-called self-managed funds where the fund and its manager are not separate persons, but constitute a single legal entity. With view to the fact that in Western Europe it is an

accepted solution, we propose creating the Hungarian regulatory background for this form.

- **Cancel the obligation to engage a dealer for marketing.** Venture capital funds typically market their capital fund units to a few (2-5) professional investors. Therefore, engaging a dealer results in extra costs. Since investment fund managers have been entitled to privately market the securities of their funds for several years, maintaining this obligation to engage a dealer for venture capital funds is unreasonable.

- **Permit employees to purchase fund securities as quasi professional investors.** To provide incentives to the employees of fund managers, they should be allowed to purchase securities from the fund, even if they do not qualify as professional investors under the MiFID as private individuals. Qualifying employees of fund managers as quasi professional investors is a solution used in Germany with the category of "semiprofessioneller Anleger".

- **Reduce minimum amount required for large investors to qualify as quasi professional investors.** Another category of "semiprofessioneller Anleger" are investors who implement investments of at least EUR 200,000. The experience and expertise of such investors is examined by the fund manager who decides whether the foregoing experience is sufficient for investment. Being cognizant of the Hungarian financial conditions, we propose that the amount referenced above be set at EUR 100,000, as specified under the EuVECA Regulation.

- **Cancel the deadline for the payment of registered capital.** Since venture capital funds implement capital placements only upon the delivery of the decisions on such placements, it is unreasonable that the payment of the fund's registered capital is required to take place within a set deadline. We propose that, similar to practice in Western Europe, the regulation be amended so that the proportionate payment of the registered capital takes place only upon delivery of the investment decisions.

- **Notification of management rules.** Presently, fund management rules, including amendments, should be approved by the Hungarian National Bank. Since the securities of venture capital funds are available only to professional investors, the requirement of such approval is unreasonable. A requirement to notify the management rules would be sufficient.

- **Relax the investment restrictions applicable to temporary current assets.** Current regulations require that assets which have already been drawn down from investors but have not yet been invested, may only be held in specific financial instruments. This restriction is unreasonable since such temporary current assets are owned by professional investors. Also, as a result of the above restriction, significant capital is removed from the capital markets. We propose abolishing this restriction because it puts Hungarian venture capital funds at an unreasonable competitive disadvantage compared with other European funds.

- **Create a public register of venture capital funds.** To ensure the availability of information on venture capital funds, and the security of transactions, we propose that the Hungarian National Bank create a public register. The register would serve as a trustworthy source for the public of the most significant data regarding venture capital funds.

- **Clarify the rules applicable to the termination of funds.** Presently, the Capital Markets Act stipulates contradictory provisions with respect to the deadline for the preparation of the termination report. We propose the clarification of the rules applicable to the termination of funds.

- **Allow use of English Language for registers, policies and minutes.** In the procedures conducted by the Financial Supervisory Authority it is possible to use the English language. Therefore, the requirement to use the Hungarian language for the documents requested by the Financial Supervisory Authority is unreasonable. Therefore,

- **Introduction of temporary units to fund investors.** We propose that regulations be adopted allowing the issuance of temporary units to fund investors operating as pools of assets. This would operate similar to the temporary shares of companies limited by shares. These temporary units would entitle investors to exercise their voting rights in proportion to their contributions until the total registered capital of the fund is paid in full.

CURRENT REGULATION

The new Civil Code will bring favorable corporate law changes. Industry players consider the adoption of the new Civil Code to be a positive development. We especially welcome the provision that, as a principal rule, the parties may deviate from the rules applicable to business associations, and the end of the five-year restriction on options. However, in our view, the principal rule stipulated by the new Civil Code may prove overly restrictive in judicial practice and result in uncertainties.

PROPOSAL

- **Limitation of the liability of executive officials.** In business life the most significant problem will be the rule applicable to the liability of executive officials. According to Chapter 6, Section 541 of the new Civil Code, if the executive official of a legal entity causes damage to a third party in his capacity as an executive official, such executive official and the legal entity shall have joint and several liability to the aggrieved third party. This provision is contrary to the principle applied to legal entities that acts of executive officials are attributable to the legal entity, and the legal entity shall be held liable for such acts. Under the effective Hungarian regulations if a legal entity becomes insolvent the court may establish the liability of executive officials with respect to unsatisfied creditor claims. However, such a court decision requires that additional facts be established. The new Civil Code places the liability of executive officials on a level with the liability of the legal entity. Limited liability is intended to promote entrepreneurship by ensuring that in the case of the failure of the enterprise, the owners will lose only the assets provided to the company. However, under the new Civil Code the foregoing provision no longer applies to executive officials and they have full personal liability for damages caused by the company. The above provision shall apply, even if the executive officials are employees and have no share in the profits of the company. This rule will cause the most experienced professionals to refrain from accepting official executive positions, and making business decisions that may involve any risk. Therefore, we consider the foregoing provision extremely harmful from the perspective of business innovation. It is customary for the industry that successful entrepreneurs with proven expertise undertake an advisory position in the board of promising early stage enterprises. Following the entry into force of the new Civil Code an employee will undertake such activity by using a straw man. As another possible consequence is that experienced managers will conduct activity through foreign enterprises. We believe that sanctioning abuse is appropriate. However, abuse should to be differentiated from the failures of businesses operating in good faith.

- **Clarification of the possibility of deviation from the provisions of corporate law.** Pursuant to Chapter 3, Section 4(3) of the new Civil Code, the parties may not deviate from the law, if such deviation is prohibited by the new Civil Code, or "the deviation clearly infringes upon the rights of the creditors, employees or a minority of the members of the legal entity, or prevents supervision over the lawful operation of legal

entities". Naturally, the first half of the above sentence causes no interpretation problem, unlike the general reference to the rights of creditors, employees and members. With creditors, the legislature presumably had in mind the objective of breaking through the limited liability of the legal entity, the liability of members and executive officials towards creditors and the set of rules ensuring the preservation of the company's assets. With employees, the provision possibly refers to the rules of participation of employees. It is reasonable that no deviation from these rules should be allowed, since neither creditors, nor employees are parties to the company's instrument of constitution. However, it would have been a more precise solution, if the new Civil Code had made this interpretation evident from the wording of the provision.

- **Deviation from the rules in the case of minority rights.** Minority members are parties to the instrument of constitution. When decisions are adopted by the majority, minority members are required to consent to the restriction of their rights (see Section 102(3) of Chapter 3). Therefore, the fact that the law strives to protect minority members despite their own will is unreasonable and alien to corporate law. It raises a further issue that as a result of the above referenced rule, the lawfulness of long-established legal institutions is rendered questionable. For example, it cannot be estimated whether the institution of the so-called "drag-along right" will be considered lawful in judicial practice. Uncertainty may prompt entrepreneurs to establish their businesses abroad and conduct their activity in Hungary through such foreign companies.

- **Restriction on lock-up arrangements in relation to limited liability companies.** Although a limited liability company shares certain features of the partnership and the company limited by shares, lock-up arrangements remain prohibited in respect of share transfers for cash consideration. There is no such restriction in relation to companies limited by shares where the shares ought to be more freely transferable. The identity of the founding owners is essential for the venture capital industry, as investor decisions are made primarily in light of the capabilities of founders. Therefore, it is critical to ensure that the founding owners may not exit from the venture in the middle of the investment period by transferring their shareholdings. This provision in the new Civil Code forces the industry to structure all portfolio companies as companies limited by shares which is a significantly costlier corporate form for early stage enterprises.

- **Transfer restrictions for companies limited by shares.** Furthermore, we do support the provision that only the articles of association of private limited companies may contain valid restrictions with respect to the transfer of shares. There is no suitable reason for the legislature to prohibit two shareholders from concluding an agreement with binding force, according to which that they will not transfer, or transfer only subject to certain conditions, the shares of the private limited company. If the majority required for the amendment does not grant approval the two parties are not allowed to agree on the foregoing themselves pursuant to the new Civil Code. If the Articles of Association does not contain transfer restrictions, the legal result will be that the restriction will not be applicable to any third party acquiring the shares in good faith and against consideration.

- **Removal of the restriction on the number of preference shares.** The restriction that the total face value of issued ordinary shares is to, at all times, exceed half of the share capital of the company limited by shares continues in effect for companies limited by shares. At first glance this restriction does not seem to be unrealistic. However, it is completely unreasonable if, for example, there is a two member company where the parties also wish to be entitled to preference dividends, preferential voting rights and mutual preemption rights. In such cases both shareholders are to be provided with preference shares.

PROPOSALS RELATED TO STATE AID

ANTECEDENTS

According to the preliminary government communications, during the 2014-2020 programming period more than half of the development aids will be allocated within the framework of enterprise development programs. The programming period is still in the planning phase and the final priorities have not been determined yet. However, it is already known[9] that the development of the competitiveness and growth potential of small and middle sized enterprises, and the development of financial instruments and services, particularly the improvement of the availability of external financing for SMEs by way of financial instruments, will be given special priority in the operative programs.

Professional circles recognize the success and economic recovery effects of the JEREMIE programs. Nevertheless, additional capital injections and aid provided to enterprises in other forms do not always entail the simultaneous sharing of know-how, as in the case of venture capital investments. Therefore, the utilization of such aids frequently fails to reach the optimal or expected level of efficiency.

It presents a further problem that venture capital cannot reach young startups without difficulty and subject to conditions (e.g. stipulation of the investor's majority ownership) which render the second or further phases of raising capital impossible.

PROPOSAL

- **Continue venture capital programs.** We propose the continuation of venture capital programs, and the support of the SME sector through the involvement of venture capital funds. We particularly recommend that prior to launching further programs, the authority that is providing the aid conduct consultations at investor and entrepreneur forums or other public events. At these events, investors and entrepreneurs can exchange experiences, particularly to that new programs can be harmonized with market circumstances to the maximum extent possible, including tender invitations and the terms of intermediation contracts.
- **Launch entrepreneurship education programs.** We propose launching an aid program during the 2014-2020 programming period aimed at promoting a culture of entrepreneurship, strengthening entrepreneurial awareness, while simultaneously providing experience-based, practical entrepreneurship knowledge and comprehensive financial, tax and legal information to SMEs with a potential for growth. We propose that fund managers with investment experience, Hungarian business angels and consultants experienced in terms of the Hungarian legal and investment environment be involved in the development of the professional methodology of the program.

[9] http://www.nfu.hu/2014_2020_skv_partnersege

PROPOSALS RELATED TO INCUBATION ENVIRONMENT

CURRENT SITUATION

Startup financing significantly improved in Hungary as a result of the programs aimed at activating capital markets (JEREMIE I and JEREMIE II). The JEREMIE II seed funds strive to bridge the gap startup financing with moderate investment needs at a stage that is too early for participation in the JEREMIE I program. However, the greatest difficulty is still presented by the initial financing of the implementation of the enterprise/business idea, which remains the highest risk phase of startup investments. The growth of startup culture and thereby the increase in the number of potential investments may improve the position of venture capital market players. The state deserves credit for its participation as a catalyst during the financing phase involving the highest risks, which gave a start to the business incubation process. This participation provided market players with significant boost by supporting the establishment of Accredited Technology Incubators. A significant portion of the Business Incubator Program proposals contained in the previous position paper of HVCA was incorporated into the tender invitation titled "Accredited Technology Incubator" issued under the professional supervision of the National Innovation Office. HVCA and InVendor Kft. completed a survey among the bidders/persons showing an interest prior to and following the announcement of the tender results. Our analysis is a representative sample since we sent the relevant questionnaire to more than 50% of the bidders.

Based on the market responses to the questions, the general opinion was that the Accredited Technology Incubator (ATI) program was favorable primarily to venture capital funds participating in the JEREMIE program, and market players expected winners from bidders without adequate professional experience too. According to our questionnaire completed following the announcement of the tender results, the market was positive that the evaluation criteria of the ATI tender included assessment of bidders regarding the extent of their foreign connections and their international professional expertise. When selecting technology incubators, ATI gave priority to bidders with actual entrepreneurial and company building experience, instead of further supporting venture capital market players, which provides grounds for confidence regarding the future of early stage enterprises.

CHALLENGES OF THE FINANCING OF EARLY STAGE ENTERPRISES

- A comprehensive startup strategy is required, specifying the successive steps of government participation and harmonizing the activities of those concerned (entrepreneurs, investors, educational institutions). Entrepreneurs, investors, professionals and the parties concerned should be involved in the development of the foregoing.
- Risk avoidance is a cultural characteristic which is further strengthened by the educational system. This attitude needs to be changed so that the failure of an enterprise is considered an opportunity to gain experience and an investment resulting in future success.
- The lack of market transparency and the insufficiency of information (background of founders and managers of startups, business angels, and institutional investors) may

result in more complicated, laborious, expensive and suboptimal investment decisions.

- In current programs, the support of the establishment in Hungary of regional startups is not sufficiently pronounced. One of the strengths of the Finnish model actually lies in the fact that the local ecosystem is enlivened by talented international entrepreneurs and teams.
- There is hardly any entrepreneurial training in secondary education, appearing only sporadically, and with little emphasis in higher education. Meetups, hackathons, programmer/design competitions could help to ensure the training of future entrepreneurs by promoting the entrepreneurial attitude, thereby providing a remedy for the insufficiency of education. Nevertheless, in the long term it will be essential to supplement business education with entrepreneurial elements.
- Hungarian entrepreneurs' lack of knowledge about international markets, language skills and experience is a significant problem to be solved, as it hinders the success of startups.
- In international comparisons, startup events play a significant role in the creation of the "startup country image" and the improvement of international competitiveness. From the foreign models, the one that proved most efficient was market-based but also state supported event, combining domestic events raising the interest of the investor ecosystem with satellite events in the neighboring countries, and a large scale domestic startup event.
- There are few market players with genuine entrepreneurial experience capable enough, and willing, to invest as business angels and create significant value through their knowledge and network relations, which can assist enterprises to overcome initial difficulties.
- The development of the ecosystem is also hindered by the lack of knowledge and application of up-to-date, internationally recognizable investment conditions and structures.

PROPOSAL

- **Separate the concepts of incubator and accelerator. I**n accordance with international best practices in programs aimed at the promotion of innovation management, the concepts and the application of these concepts should be separated since they were frequently confused in the ATI tender.
- **Separation of sub-programs.** At a later stage of the incubation tender it would be advisable to separate the sub-programs aimed at the support of the establishment of incubators, their entry into the international markets and the protection of industrial property rights. It is also advised to conduct a prompt decision making process in a non-bureaucratic manner that is delegated to the level of market players.
- **Provide an incentive for the settlement of foreign startups in Hungary.** Focusing on the Central and Eastern European region may provide a solution for the dealflow issues of the Hungarian venture capital industry.
- **Reconsideration of the forms of support to startups.** Introducing other forms of support like vouchers, or innovation card based, similar to the health fund system,

which are swifter than the current tender process and would be available for the accredited services necessary for the development of the company.

- **Support investment platforms increasing market transparency.**
- Organization, through cooperation between the government and market players, a series of events including satellite events abroad and a large scale domestic event.
- Support provided to programs and events promoting and encouraging the culture of entrepreneurship and the generation and implementation of creative ideas is essential, as the startup sector faces significant cultural and educational challenges.
- Support provided through normative rules and tax concessions may foster the development of the entrepreneurial ecosystem.
- Provide future entrepreneurs with useful and clearly understandable **educational materials and publications.**
- Professionally recognized incubators are to provide assistance, as broadly as possible, to innovators with implementing ideas and exploring market opportunities as early as the business idea phase.

PROPOSALS RELATED TO PUBLIC FUND RAISING

ANTECEDENTS

Public share offering can be an efficient method for fund raising. However, this method is typically used by companies at a more mature stage of operation since. In addition to the numerous advantages, public offerings carry significant difficulties and costs for issuers and startup stage companies are frequently not sufficiently prepared and lack the necessary funds.

We may observe a tendency in capital markets to provide attractive opportunities for entry into capital markets and public offerings to innovative young companies through specifying lighter and more flexible conditions. As an example we refer to the "*Jumpstart Our Business Startups Act*" (JOBS Act) adopted in the U.S. in 2012, which provided emerging growth companies with an opportunity to implement an initial public offering under lighter conditions. The platform of the Warsaw Stock Exchange (WSE) named New Connect also provides an opportunity to innovative, emerging growth companies for public offering. In many respects, Hungarian legal regulations and the Regulations of the Budapest Stock Exchange for Listing and Continued Trading also take into consideration the above referenced changes (e.g. transformation of share categories: Premium, Standard, T category).

Capital markets compete for emerging growth companies. It is therefore particularly important that the Hungarian legal environment also be suitable for offering favorable and competitive conditions to startup companies considering public offering.

PROPOSAL

- **Creation of an alternative trading platform.** It would be necessary to create a trading platform specifically providing emerging growth, young companies with adequate conditions for public offering, in a cost-effective manner and with minimum administrative burden.

- **Reduction of costs resulting from the publication obligation related to public offering.** It should sufficient for documents prepared in relation the public offering (prospectus) to be published only electronically.

- **Reduction of the administrative burden.** The scope of the information and publication obligation applicable in the case of a public listing should be significantly reduced with respect to startup companies implementing public offerings, at least during the first few years following the commencement of their operation. It is essential to preserve the flexible operation of the companies by the reducing administrative burdens.

- **Shortening the deadlines for licensing procedures.** Efforts should be taken to significantly shorten the public offering procedure, compared to average procedures, by shortening procedural deadlines.

SUMMARY

The foregoing clearly demonstrates that in recent years Hungary has made great strides in promoting venture capital and private equity financing as well as innovative small and medium sized enterprises. However, the potential for venture capital and private equity financing has by no means been exhausted.

Therefore, in addition to this position paper and proposals, the Association endeavors to continuously monitor the Hungarian and international legal framework for the industry. If the government is willing to cooperate, the Association is, at all times, ready to provide assistance to the Hungarian legislature through its experience and advice.

We trust that our proposals will meet understanding, whereby we may contribute to the development of an efficient capital market that is also competitive internationally.

Budapest, December 23, 2013

Nikolaus Bethlen
Chairman
Hungarian Venture Capital and Private Equity Association