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German Federal Government Start-Up Financing Program

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The German Federal Government has launched a series of assistance packages of measures for business against the consequences of the COVID-19 pandemic. In particular, the Government is of the opinion that start-ups and young technology companies are particularly important for the German economy.

They create jobs and will, in the future, strengthen Germany's competitiveness. The loan schemes of Kreditanstalt für Wiederaufbau (KfW) provide access to liquidity for sound and healthy companies, which might, however, be in financial difficulties due to the COVID-19 crisis. Under the KfW start-up loan, KfW will assumes 90% of the credit default risk, provided that the company has been active for three years. Further, the German Ministry of Finance has announced the KfW "immediate loan" scheme. It applies to companies with more than 10 employees that have been active in the market since 1 January 2019. The eligibility criteria are similar to the ones for the KfW start-up loan. In addition, the immediate loan scheme requires that the company has reported a profit on average over the last three years (or a shorter period if it has not yet been on the market for three years). Under the immediate loan scheme, the bank receives a 100% risk assumption from the KfW, secured by a guarantee from the Federal Government. The loan is approved without further credit risk assessment by the bank or KfW and can, therefore, be approved quickly. The amount of each loan is limited to up to three months' turnover in 2019 (max. €500,000/€800,000, depending on the size of the company).

However, many start-ups and young technology companies do not have a banking relationship and, therefore, cannot access the COVID-19 credit programs of the KfW. Therefore, the Federal Ministry of Finance, the Federal Ministry of Economics and Energy (BMWi), KFW and its subsidiary, KFW Capital, have worked out the implementation of the €2 billion start-up program. The package of the aid measures shall address the majority of the German start-ups. Initially, there will be two pillars with parallel processing of applications and financing procedures, which are applied as far as possible to the existing structures. Start-ups often do not have access to debt capital and, therefore, often finance themselves via private venture capitalists. Pillar 1 is based on this financing channel. In addition, there are also start-ups and small and medium-sized enterprises that do not or do not yet have access to private venture capital financiers, but are financed through public programs from federal or local authorities, or do not have access to Pillar 1 for other reasons. These are the targets of Pillar 2.

Ultimately, for the start-ups financing program, the German Federal Government should carry out a completely different risk assessment than for the other aid programs, as the Government will indirectly participate in these companies.

Pillar 1.

For start-ups that are already financed by private VC funds or are new to be financed by private VC funds: the Corona Matching Facility (CMF):

- The CMF will provide venture capital funds with additional public funds to ensure that they remain in a position to accompany financing rounds of start-ups with sufficient funds.
- The funds shall be able to be supplement by the public funds in a ratio of up to 70% to 30%, as long as other private investors do not participate in the respective financing round. This means that the public sector will contribute 70% of the investment amount, while the fund itself must contribute 30%. The public funds are invested on the same terms as the private funds.
- In order to ensure that start-ups with a high proportion of investors with access to CMF do not benefit disproportionately from the funding, a maximum of 50% of the total financing round can be funded from CMF resources. It will be handled by two funds in cooperation between KfW Capital and the European Investment Fund (EIF), both of which have good links to a large number of VC funds active in Germany.
- If a private fund decides to use the CMF, it must opt for a fixed matching ratio (up to a maximum of 50% public funding with increase up to 70% public funding, until the 50% CMF funding is reached in one round), which then applies equally to all its investments in the portfolio. In doing so, the private fund needs to offer all its other investments in the portfolio the matching by 31 December 2020 (obligation to tender).
- In addition, a private fund may also decide to sell its new investments o the CMF. Here too, it is important that the matching ratio is observed, which then applies to all new investments up to 31 December 2020. The private fund is also obliged to tender all new investments to the CMF. The matching ratio for new investments can be determined by the private fund independently from its matching ratio in the inventory. The fund can, therefore, use two different matching ratios.

- With the so-called pari-passu logic, the program moves within the framework. At the same time – in the interest of the federal budget – this ensures that the public funds are invested on the same terms as private funds.
- Eligible to apply for the program are not only the start-ups, but also the private funds. This can be both type of funds: funds in which KfW Capital and EIF are already invested and funds that do not yet have either of these two capital providers in their circle of investors. The prerequisite for the use of the CMF is the successful completion of a due diligence. The aim is to achieve a quality oriented, selective access to the programmer.
- The program conditions are now being finalized so that the funds can be made available.

Pillar 2.

For start-ups that do not have access to Pillar 1:

- For start-ups and small SMEs that do not have access to the CMF, further ways will be opened up to provide the financing. The exact form of this is still unclear. Consideration is being given, for example, to making federal funds available to the state funding agencies so that they can then pass on the funds to start-ups and small SMEs via their network. Given the good integration of the state funding agencies into relevant networks, for example with regional investment companies and public funds or fintechs, this could be an approach that would have an accelerating effect.
- The Federal Government intends to share the risk with the respective national company involved and any private investors.
- The state aid framework that the EU Commission has opened up until 31 December 2020 would allow for an entry of up to €800,000 per funding.

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