

THE LUCK OF THE IRISH OR JUST PLAIN OLD TAX AND REGULATORY PLANNING? THE SUCCESS OF VENTURE CAPITALISM IN IRELAND.

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This paper considers the growth of venture capital activity in the Irish economy in the last fifteen years from 1990-2006. Significant growth has occurred both in relation to the operation of the funds industry and in relation to venture capital investment in small and medium enterprises. The paper identifies significant factors which

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¹ Thanks to my research assistant Kieran Walsh BCL who helped with ideas and research material in relation to the Irish funds industry generally and the question of “why Ireland?” Particular thanks to Donnacha O’Connor and Andrew Bates of Dillon Eustace, Solicitors, Dublin, for information on the venture capital funds industry and to Professor Brian Carroll, Faculty and Department of Law at University College Cork for his insights, in particular as to the crucial role of tax planning in relation to venture capital. Finally, thanks to the Moritz College of Law at The Ohio State University for inviting me to participate at their symposium. I am grateful to Professor Dale Oesterle of the Moritz College of Law for his comments and to other participants in the symposium for their comments. Errors and omissions are, of course, the author’s.

¹ The phrase “Celtic Tiger” was first coined by Irish economist David McWilliams in the context of considerable debate regarding the growth of the Asian Tiger economies in the late 1980s. It is a phrase which has entered common parlance in Ireland and Europe describing a period of phenomenal economic growth in Ireland from the early 1990s onwards.

have contributed to this success story, which has occurred in the context of substantial growth in the Irish economy. Many of the factors which have contributed to economic growth overall have also contributed to increases in venture capital activity. Other important influences include a responsive and flexible regulatory environment and finally, advantages which Ireland as a member state in the European Union enjoys ('the Delaware effect') comparatively to its fellow member states.

I. INTRODUCTION

This paper will consider the growth of venture capital activity as a contributor to economic growth in Ireland. It will consider Ireland's experience both as a location for venture capital investment indigenously and as a location for the operation of capital venture funds, but with particular emphasis on the contribution of venture capital to innovation, development of R & D, and growth of small and medium sized firms indigenously. The first part will briefly describe what is generally meant by venture capital and discuss why the use of this kind of corporate financing is considered positively. The second part will describe Ireland's economic performance in the decade and a half since 1990 to identify factors which have contributed to what is described generally as the growth of the Celtic Tiger.² This part will also consider Ireland as a country within the European Union, outlining ways in which Ireland's economic performance has differed from other economies in Europe in this period and why. Against this backdrop, the third part will consider a benchmarking of Ireland against other European countries as a location for venture capital activity and will consider the factors which have created an environment which is friendly to venture capital investment and to venture capital funds industry activity. Finally, the paper will consider the implications of the research findings from a comparative perspective extracting what factors can and might be replicated.

II. WHAT IS AND WHY VENTURE CAPITAL?

Venture capital funds are generally used to provide financing to companies which are not quoted on any recognized stock exchange or other kind of market where shares are publicly traded. Venture capitalism, at its most basic definition, can therefore be distinguished from any kind of traditional equity investment on a publicly traded market but, more particularly, must be distinguished from traditional forms of debt financing. In addition, we can identify and distinguish venture capital funding as a

subset of private equity funding which usually occurs at the early stages of corporate development to facilitate launch, in particular where there may be substantial R & D outlays required,³ or which will facilitate second-stage development of a business or the expansion of a business after a successful initial phase. The essential idea is to actively invest in and support businesses which have been identified as having high-growth potential (not always easy or accurate to predict as we will see) and to provide medium to long-term investment thereby providing value, but also advice and support through what is usually a negotiated relationship.⁴ Initiating entrepreneurial firms in addition to sustaining development of small and medium-sized firms is considered to be a significant factor in modern patterns of economic growth. The role of venture capital in achieving these corporate growth goals is clear, so the question remains as to how best to facilitate venture capital investment.

In the European context, the potential which has been identified for venture capital to contribute to economic growth feeds into significant planning goals which have been adopted by the European Union. Now comprising twenty-five member states, the European Union has embraced an aggressive competitiveness policy. The stated goal of the European Union is to become “the world’s most competitive and dynamic knowledge-based economy” and to do this by 2010.⁵ The framework supporting the attainment of this goal is known as the Lisbon Agenda, which is designed to link progressive and dynamic economic policies with the pursuit of equally progressive employment and social policies, the former necessary to sustain growth and the latter considered to be an integral part of the European vision.⁶ Last year a mid-term review of the

³See Giancarlo Giudici & Stefano Paleari, *R & D Financing and Stock Markets*, in CORPORATE GOVERNANCE, MARKET STRUCTURE AND INNOVATION 217, 218-19 (Mario Calderini, Paola Garonne & Maurizio Sobrero eds., 2003) (discussing the implications for R & D policy development).

⁴ANN-KRISTIN ACHLEITNER & OLIVER KLOCKNER, EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL ASS’N, EMPLOYMENT CONTRIBUTION OF PRIVATE EQUITY AND VENTURE CAPITAL IN EUROPE 9 (2005), http://www.evca.com/images/attachments/tmpl_9_art_129_att_953.pdf [hereinafter EVCA].

⁵WIM KOK, EUROPEAN COMMISSION, JOBS, JOBS, JOBS: CREATING MORE EMPLOYMENT IN EUROPE 8 (2003), http://ec.europa.eu/employment_social/publications/2004/ke5703265_en.pdf; *Commission of the European Communities, Green Paper on European Social Policy, Options for the Union*, COM (1993) 551 final (Nov. 17, 1993); *Commission of the European Communities, White Paper on European Social Policy, A Way Forward for the Union*, COM (1994) 333 final (July 27, 1994); *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, Social Policy Agenda*, COM (2000) 379 final (June 28, 2000).

⁶Europa, *Overviews of the European Union Activities*, http://www.europa.eu/pol/socio/overview_en.htm (last visited Aug. 24, 2006).

Lisbon Agenda gave rise to considerable debate at the European institutional level.⁷ A number of difficulties have been identified but these will not be the focus of this paper. Nevertheless the need to create significant numbers of jobs⁸ to restore Europe to full employment has been identified and steps have been taken to give support to measures which will help to achieve this goal.

In order to attain the Lisbon growth and jobs objectives, Europe needs a greater number of active workers, who are also more productive. This will underpin long-term economic growth, combat unemployment and regional disparities and promote social cohesion. Europe therefore needs to address both the quantity and quality of jobs and the productivity of work. It also needs to consider how to tackle the question of economic migration.

As part of the mid-term review of the Lisbon strategy, the Commission has proposed a revamped cycle comprising new guidelines and linking up with the rationalization [sic] of economic policy coordination cycles at European level. The four priorities proposed by the Kok Task Force on employment in 2003 . . . will be at the heart of this cycle in order to increase the adaptability of workers and enterprises⁹

Venture capital has been identified as a positive contributing factor to these goals.

In addition, the development of a “knowledge-based” economy requires considerable investment in R & D. Thus, investment in start-up and early stage companies, which facilitate continued research and

⁷Commission of the European Communities, *Communication to the Spring European Council: Working Together For Growth and Jobs*, at 6, COM (2005) 24 final (Feb. 2, 2005), available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0024en01.pdf; *Communication from the Commission to the Council and the European Parliament: The 2005 Review of the EU Sustainable Development Strategy: Initial Stocktaking and Future Orientations*, COM (2005) 37 final (Feb. 9, 2005), available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0037en01.pdf. See also Irene Lynch-Fannon, *The European Social Model of Corporate Governance: Prospects for Success in an Enlarged Europe*, in INTERNATIONAL CORPORATE GOVERNANCE AFTER SARBANES-OXLEY 423 (Paul U. Ali & Greg N. Gregoriou eds., 2006).

⁸The figure is 20 million jobs required to restore Europe to full employment where many European countries have unemployment figures ranging from a low 4% in Ireland to 9% and 12% in countries such as France, Germany and Italy. European Commission, *Growth and Jobs*, http://ec.europa.eu/growthandjobs/areas/fiche08_en.htm (last visited Aug. 24, 2006).

⁹Commission of the European Communities, *Communication from the Commission on the Social Agenda*, at 6, COM (2005) 33 final (Feb. 9, 2005), available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0037en010033en01.pdf. See also KOK, *supra* note 5.

development of products, processes and intellectual property has been identified as another key contribution to the Lisbon Agenda which can be made by venture capital investment. However, studies have shown mixed results in this regard and, without pre-empting later parts of this paper, it is not entirely clear that the demands of venture capitalists as investors are, in all cases, positive contributors to sustained research where the requirements in relation to research might be significantly different in a broader context.¹⁰

The more complex question of the support which venture capital might give to R & D will be returned to as the question of what sort of research is hoped to be developed is also more complex; but for the moment, the paper will consider the impact of venture capital funding on job creation and employment growth. A report commissioned by the European Venture Capital Association identified the following key facts:¹¹

- 1 million new jobs created by European private equity and venture capital financed companies between 2000 and 2004. Note that this figure is a round figure which covers both jobs created in companies which were the subject of buyouts and companies which received venture backing. However, the figures are further broken down into 420,000 jobs created by buyout financing and, more encouragingly, 630,000 jobs created by venture-backed companies in Europe.¹²
- Employment in this sector grew by an average rate of 5.4%¹³ annually which is eight times the annual growth rate of total employment in the EU 25 which was .7%¹⁴ for the same period, 2000-2004.

¹⁰ For an interesting discussion of this see Mario Calderini, Paola Garrone & Maurizio Sobrero, *Conclusions and Policy Implications*, in CORPORATE GOVERNANCE, MARKET STRUCTURE AND INNOVATION 243 (Mario Calderini, Paola Garrone & Maurizio Sobrero eds., 2003).

¹¹ EVCA, *supra* note 4, at 6.

¹² Note that the figure covers the period 2000-2004 and includes all countries within the European Union in addition to Switzerland and Norway who are not members of the European Union. For the sake of accuracy, it should also be noted that membership of the European Union increased from fifteen to twenty-five on May 1, 2004. The addition of the new accession states does not seem to be either significant or insignificant for the time being when we consider the performance of Ireland in that period.

¹³ The study notes that the growth rate refers to “[the] Compound Annual Growth Rates (CAGR) . . . a method that determines growth over time taking the starting and the ending value, and calculates an average growth rate per year for the period in-between, assuming that growth has happened at a constant rate.” EVCA, *supra* note 4, at 6.

¹⁴ This figure is provided by *Eurostat*, the official website providing statistics about many aspects and activities of the European Union. See <http://epp.eurostat.ec.europa.eu>.

- Private equity and venture-backed companies employed approximately 6 million people in Europe in 2004 which represents 3% of the 200 million economically active people in Europe.¹⁵
- Venture-backed companies employ 17% of the total employment in the countries included in the survey.¹⁶

III. IRELAND'S ECONOMIC BOOM AND CONTINUED GROWTH: THE CELTIC TIGER YEARS.

Although the purpose of this paper is to discuss Ireland as a successful venture capital location, the general economic background in which such activity takes place is significant and will of course affect corporate performance and overall competitiveness. Ireland's overall economic success is mirrored by the growth of a successful venture capital economy both in relation to supply-side investment and the development of a venture capital funds industry. Therefore, factors that are significant to Ireland's success as an economy are also relevant to the types of factors which have supported venture capital activity. Accordingly, Table A shows figures for growth in Ireland's GDP in the preceding decade from 1996 into 2006 compared with four major European economies in addition to the United States and Japan. The average growth rate for 1996 to 2000 was about 9% year on year with the year 2000 showing a decline in the figures but still showing an average growth figure of around 4% from 2000 to 2005.

Table A: Real GDP Growth in Major Industrial Countries and Ireland, 1996 to 2005.

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
U.K.	2.6	3.5	2.7	0.8	1.5	2.4	1.9	2.1	2.7	1.8
Germany	1.32	2.2	2.5	2.2	2.5	1.2	0.2	-0.1	1.6	1.1
France	1.6	3.0	3.1	2.4	2.6	2.6	1.2	0.2	1.9	1.4
Italy	2.6	3.5	2.7	0.8	1.5	1.5	0.4	0.5	1.6	0.0
Ireland	8.1	11.1	8.6	11.3	10.1	6.2	6.9	1.2	3.8	4.8
Total EU	1.8	2.7	2.8	2.2	2.5	4.1	3.6	3.1	4.0	1.3*
U.S.	3.4	3.9	3.5	1.5	2.2	2.2	2.4	3.1	4.0	3.5
Japan	3.9	0.8	-2.6	0.2	0.7	0.7	0.2	2.3	2.3	2.8
Total OECD	2.0	2.5	2.5	1.7	2.3	2.0	1.7	2.2	3.0	

Sources: OECD Review and Outlook, Central Bank and ESRI Quarterly. (*This figure is for the Euro area only.)¹⁷

¹⁵ EVCA, *supra* note 4, at 12.

¹⁶ *Id.* at 6.

¹⁷ "The Quarterly National Accounts for the third quarter of 2005 show GNP to have increased by 7 per cent [sic] in volume terms since the same period in the previous year. The corresponding figure for GDP is 4.8 per cent [sic]. As the figures in earlier quarters had suggested a slower pace of economic growth, the Q3 figures point to an economy

In addition to these strong economic indicators, another figure which is significant in European terms is the exceedingly low unemployment figures. During the 1980s Ireland's unemployment figures hovered around 18% with relatively severe regional variations.¹⁸ Now the figure is 4% and still declining.¹⁹ In countries such as France, Italy and Germany the unemployment figures are and have been in double digits for all of the period under consideration, i.e., 1990 to the present.

As commentators have reflected on the growth and development of the Celtic Tiger, over time a number of points have emerged which have led to a less euphoric view of these figures than at the outset:

- One of the factors that is generally accepted as having contributed to economic growth has been the level of foreign direct investment (FDI) into Ireland. As a result, the figures for growth in GDP do not bear an exact correlation to GNP figures which are usually closely aligned. In Ireland, however because of the significant repatriation of foreign profits the differential is estimated at between 20-25%.²⁰
- The period of apparently spectacular economic growth was preceded by periods of stagnation that on balance commentators are now agreed should not have occurred. For example, during the

that is (a) performing well and (b) performing better than some had previously thought. We believe that this strong performance persisted for the remainder of 2005 and that it will continue into 2006. For 2005, we think GNP will have grown by 5.0 per cent [sic] and that GDP will have grown by 4.8 per cent [sic]. For 2006, we forecast growth in GNP of 4.8 per cent [sic] and 4.7 per cent [sic] for GDP." Alan Barrett et al., *Summary*, THE ECONOMIC AND SOCIAL RESEARCH INSTITUTE QUARTERLY ECONOMIC COMMENTARY, Winter 2005, at 1, available at http://www.esri.ie/pdf/QEC2005Win_ES.pdf. See also Organisation for Economic Co-operation and Development, *OECD Economic Surveys: Ireland*, OECD 19-21 (2006) [hereinafter OECD 2006].

¹⁸ See CENTRAL STATISTICS OFFICE, LABOUR FORCE SURVEY 1988 TO 1997, <http://www.cso.ie/px/pxeirestat/database/eirestat/Labour%20Force%20Survey%201988%20to%201997/Labour%20Force%20Survey%201988%20to%201997.asp> (last visited Nov. 9, 2006); *The Luck of the Irish*, THE ECONOMIST, Oct. 14, 2004, available at http://www.economist.com/surveys/displaystory.cfm?story_id=3261071.

¹⁹ Eurostat, Unemployment Rate – Total, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em071 (last visited Aug. 10, 2006).

²⁰ "The presence of a substantial foreign owned industry sector generates a substantial repatriation abroad of profits and dividends, which must be deducted in the calculation of GNP. As a consequence, on average, Ireland's GDP measure exceeds GNP by a factor of between 20-25%, which is a crude measure of the overstatement of income, or living standards for Ireland, that is inherent in use of the international standard GDP measure." ENTERPRISE IRELAND: IRELAND ECONOMIC PROFILE 2 (2005), <http://www.enterprise-ireland.com/NR/rdonlyres/2FC1B0E8-3641-495E-A541-362FB8E841A0/0/EconomicProfileOctober20.pdf>. See also OECD 2006, *supra* note 17, at 41.

period 1977 to 1984 the government pursued fiscal and economic policies which had a damaging effect on overall economic performance.²¹ In addition, Ireland's relatively poor economic performance in the 1950s and particularly in the 1960s²² has meant that some part of this growth involves an element of catch-up with its European neighbours, although commentators are divided as to the significance of this catch-up point.

- Finally, comparisons are made with countries that display significantly different general characteristics to Ireland in terms of population, GDP per capita, infrastructure, industrial base, and so forth. It is difficult therefore to extrapolate propositions in a comparative context which would equally apply to other economies which are not comparable in other ways. Two points can be made. Firstly, comparisons between Ireland and economies such as the United States in its entirety, or Japan are in many ways meaningless because of difference in size, regulatory structures and so forth. This point is equally relevant to comparisons between Ireland and other European countries. Secondly, a converse point is also relevant that what has worked for Ireland may not work for others.

According to various reports,²³ the short-term trajectory for this economic growth is to continue.

In relation to factors which have fed into this growth, as government agencies tell us, there is now 'general agreement' around the factors which have contributed to economic success. Clearly not all of them are relevant to our discussion, and it is also clear that even if they were relevant they could not be replicated. Nevertheless, for the sake of clarity the factors will be repeated here, relying on information available from government agencies notably the Irish Economic and Social Research Institute, Enterprise Ireland, and the Industrial Development Authority (the latter two agencies having a remit to support business growth and investment generally in Ireland) with a view to extracting factors which are relevant to venture capital as a means of investment and support for entrepreneurial start-up and small and medium sized firms.²⁴

²¹ BRIAN NOLAN ET AL., *BUST TO BOOM?: THE IRISH EXPERIENCE OF GROWTH AND INEQUALITY* (Institute of Public Administration 2000); KIERAN A. KENNEDY ET AL., *THE ECONOMIC DEVELOPMENT OF IRELAND IN THE TWENTIETH CENTURY 87-90* (Derek Aldcroft ed., Routledge 1988).

²² JOSEPH LEE, *IRELAND, 1912-1985: POLITICS AND SOCIETY* (Cambridge University Press 1989).

²³ See The Economic and Social Research Institute, <http://www.esri.ie> (last visited Aug. 12, 2006); ENTERPRISE IRELAND, *supra* note 20, at 3; INDUSTRIAL DEVELOPMENT AUTHORITY IRELAND, *IRELAND VITAL STATISTICS 4-5 (2006)*, available at http://www.idaireland.com/uploads/documents/IDA_Publications/Vital_Statistics_April_2006_FINAL_1.pdf [hereinafter IDA IRELAND].

²⁴ See generally ENTERPRISE IRELAND, *supra* note 20; IDA IRELAND, *supra* note 23.

A. *Economic Success Factors*

The following contributed to Ireland's economic achievements in the 1990's. This paper lists these factors not in the order of importance which is attributed to them in the context of economic growth overall but in relation to their potential relevance to venture capitalism:

- Pursuit of pragmatic and innovative government policies;
- An emphasis on education and technological innovation;
- A youthful population and rapidly expanding labour supply;
- An openness to international trade in goods and services, and to new ideas;
- Substantial inward investment inflows;
- The strategic deployment of EU Structural and Cohesion Funds; and
- A Social Partnership approach to economic development.

Of these factors in relation to creating and sustaining a successful venture capitalist sector, perhaps the pursuit of pragmatic and innovative government policies might be the most relevant and the most easily replicated. In the next section, this paper will consider why Ireland is considered to have a favorable venture capital environment, much more so than many of its European counterparts. In particular, these factors are the most easily replicated in the United States or in Ohio, in particular.

An emphasis on education and technological innovation can also be replicated. Technological innovation is separated from education for the purposes of this paper because the relationship between venture capitalism and support for research and innovation is an important issue.

After that, the presence of a labor supply is important. Ireland is almost unique in relation to established European countries because of its demographic profile which continues to boast a youthful population relative to other countries where birth rates continue to decline.²⁵ It seems to be the case that the particular demographic profile that Ireland experienced during the years of significant economic growth contributed or added value to growth overall. The fact that demographic patterns differed from other European economies in comparable positions at the start of the growth period is considered to be significant and can certainly be described as serendipitous.²⁶ It is also the case that this demographic pattern seems to be

²⁵ EUROPEAN COMMISSION, REPORT OF THE HIGH LEVEL GROUP ON THE FUTURE OF SOCIAL POLICY IN AN ENLARGED EUROPEAN UNION 15-16 (European Communities 2004), available at http://ec.europa.eu/employment_social/publications/2005/ke6104202_en.pdf.

²⁶ See Garret FitzGerald, *Most Policies for Economic Growth a Success*, IRISH TIMES, Mar. 4, 2006, at 14 ("The remarkable economic success of our State in recent times owes something to what might be described as demographic good luck. More than half of the extraordinary improvement in Irish output per head in the 1990s was due to the

continuing despite earlier predictions to the contrary. Increasing birthrates have been noted for the last two years, which may be primarily due to increased immigration,²⁷ but that is not of any particular concern. The fact is growth has occurred. Ireland as an economy is considered to be one of the most open economies in the world with very little barriers to outward or inward flows of capital.²⁸

Openness to investment and outward trade is also similarly important in the overall macroeconomic context but it is not clear how this can be replicated in a particular geographic or regional area. The last two factors are clearly not relevant but it might be worth considering if or whether there are funds available for investment in strategic development and how they would be invested.

Membership of the European Union does not guarantee that a country will enjoy strong economic growth, but it does provide opportunities, as Ireland has shown. Five of the existing member states (to May 2004) were poor when they joined, Italy, a founding member, Ireland, Spain, Portugal and Greece. All, except Greece, have enjoyed substantial catching-up with the average. It is mistakenly claimed that EU funds have been the principle reason for the convergence, but in Ireland's case, it took two decades from joining in 1973, for growth to accelerate.²⁹

happy chance that exactly at the moment 12 years ago when strong external demand suddenly emerged for Irish labour in Ireland, all our sources of labour supply were simultaneously approaching a peak," writes Garret FitzGerald. "No European country had ever previously experienced such a remarkable coincidence of labour demand and supply.")

²⁷ CENTRAL STATISTICS OFFICE, VITAL STATISTICS THIRD QUARTER 2005 4 (Stationery Office 2006), available at http://www.cso.ie/releasespublications/documents/vitalstats/2005/vstats_q32005.pdf ("There were 16,170 births registered in quarter 3 of 2005, 8,337 males and 7,833 females, an increase of 565 on the quarter 3 figure of 2004. The quarter 3 2005 total is 24% higher than in 1996 when 13,015 babies were registered. This represents an annual birth rate of 15.7 per 1,000 of the population, 0.3 above quarter 3 of 2004. This rate is 1.3 per 1,000 population higher than in 1996."). See also Elaine Edwards, *Irish Birth Rate Boosted by Immigrants Having Children*, IRISH TIMES, May 5, 2001, at 5.

²⁸ PAUL SWEENEY, THE CELTIC TIGER: IRELAND'S CONTINUING ECONOMIC MIRACLE 131 (Oak Tree Press 2d ed. 1999); PAUL SWEENEY, THE CELTIC TIGER: IRELAND'S CONTINUING ECONOMIC MIRACLE EXPLAINED (Oak Tree Press 1998); Organisation for Economic Co-operation and Development, *OECD Economic Surveys: Ireland*, OECD 11-14 (1999) [hereinafter OECD 1999]; OECD 2006, *supra* note 17, at 8; *The Luck of the Irish: A Survey of Ireland*, THE ECONOMIST (U.S. ed.), Oct. 16, 2004.

²⁹ JOHN BRADLEY ET AL., THE ROLE OF STRUCTURAL FUNDS: ANALYSIS OF THE CONSEQUENCES FOR IRELAND IN THE CONTEXT OF 1992 (The Economic and Social Research Institute 1992).

Finally, the concept of social partnership is a particularly European idea and has been replicated in Ireland with considerable success. In the context of the United States it is not clear how the same kinds of structures could be put in place to achieve what is described as social partnership or indeed whether this would be acceptable,³⁰ but nevertheless the outcomes can be replicated. The significance of sustained social partnership is the delivery of both a stable wage environment and a stable industrial relations environment which offers a robust background in which rapid economic growth can take place without destabilization of the labor market or individual employment relationships.³¹

In conclusion of this part, some of the factors considered above are mirrored when one considers the success of venture capital activity, in particular innovative legislative and tax policies, support for technological innovation and education, a well educated labor force and so forth. In addition the synergistic interrelationship between an already successful and growing economy and venture capital growth cannot be underestimated.

IV. IRELAND AS A VENTURE CAPITAL ECONOMY: IRELAND IN THE EUROPEAN UNION.

In studies conducted by the European Venture Capital Association, covering over fifteen different European economies, Ireland, along with the U.K. and Luxembourg, scores the highest “composite score” as a location

³⁰ For a consideration of social partnership, see Paul Sweeney, *The Irish Experience of Economic Lift Off With a focus on the Contribution of Social Partnership and the Potential Contribution of Life-Long Learning*, CANADIAN COLLOQUIUM, May 27, 2004, available at http://www.ictu.ie/html/news/briefcase/celtic_tiger.pdf. For a consideration of the legislative and structural issues in a US-EU comparative context, see IRENE LYNCH-FANNON, *WORKING WITHIN TWO KINDS OF CAPITALISM: A COMPARISON OF THE POSITION OF EMPLOYEES WITHIN THE E.U. AND U.S.* (John Parkinson ed., Hart Publishing 2003).

³¹ The following social partnership agreements were agreed between the Government, the trade union movement and other social partners including employers' organizations and organizations representing the unemployed and other disadvantaged groups: *Programme for National Recovery 1987-1990* (1987), Dublin: Stationery Office; *Programme for Economic and Social Progress 1991-1994* (1991), Dublin: Stationery Office; *Programme for Competitiveness and Work* (1994), Dublin: Stationery Office; *Partnership 2000 for Inclusion, Employment and Competitiveness* (1996), Dublin: Stationery Office; *Programme for Prosperity and Fairness 2000-2002* (2002), Dublin: Stationery Office; *Social Partnership Agreement: Sustaining Progress 2003-2005* (2005), Dublin: Stationery Office. See <http://www.taoiseach.gov.ie/eng/index.asp?locID=179&docID=-1>.

which, like the other two, is “most favorable to the development of private equity and venture capital industry.”³² Interestingly, countries with low comparative scores, i.e., scores which are at least below the average composite score include Germany, France, Sweden, Spain, and Belgium. What is interesting about this ranking is that these countries display different indicators for overall economic performance. For example, Sweden displays strong economic indicators as does Belgium during the relevant period. Most recently, the German economy has displayed some signs of recovery in the last year. This might lead us to pause and consider the bigger question of the contribution which venture capitalism and entrepreneurial behavior can make to different kinds of economies. In some economies, for example, it may not be as important to support and encourage venture capital, start-up businesses or entrepreneurial firms, but these are issues which are assumed as moot in the context of this paper. Results for both years of the survey conducted in the successive years 2003-2004 rank Ireland, Luxembourg, and the U.K. in the top three. In considering Ireland’s environment in detail, a number of factors were highlighted by the survey as being significant. These factors pertain primarily to the regulatory framework and address both the supply side in terms of support for investment in companies and demand side support for venture capital funds and include the following:³³

- The availability of the Limited Partnership as a vehicle to organise and manage funds. Limited partnerships are restricted to twenty limited partners.³⁴
- No legal restrictions on the investment by insurance companies in private equity and venture capital.
- Similarly, no restrictions on investments in private equity by pension funds.
- Low corporate tax rates of 12.5% on trading income and 25% on other income. For small or medium enterprises (“SMEs” there is a

³²EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL ASSOCIATION BENCHMARKING EUROPEAN TAX AND LEGAL ENVIRONMENTS: INDICATORS OF TAX & LEGAL ENVIRONMENTS FAVOURING THE DEVELOPMENT OF PRIVATE EQUITY AND VENTURE CAPITAL AND ENTREPRENEURSHIP IN EUROPE (May 2004), available at http://www.evca.com/images/attachments/tmpl_9_art_90_att_587.pdf [hereinafter EVCA BENCHMARK].

³³ Please note that this list replicates the factors which are listed as important by the EVCA. However, references to relevant legislation and explanations are added where appropriate. *Id.* at 29-30.

³⁴ Limited Partnerships Act, 1907, 9 Edw. 7, § 4 (Eng.). See also Investment Limited Partnerships Act, 1994 (Act No. 24/1994) (Ir.), available at http://www.bailii.org/ie/legis/num_act/1994/zza24y1994.1.html (providing a structure for the investment in property).

12.5% tax rate across the board with a 25% tax rate for non-trading companies.³⁵

- Compared to other European countries, the individual tax rate, which is at its highest rate of 42%, is considered to be a favorable element in the venture capital industry, although this is higher perhaps than overall income tax rates in the U.S. Bear in mind however, that there are no significant taxes at the local level such as property taxes and so forth.
- The capital gains tax rate for individuals is 20% which is considered to be attractive.³⁶
- Very significantly, Ireland also provides tax incentives for individual investors in private equity and venture capital funds through various tax schemes, for example the Business Expansion Scheme (“BES”) and the Seed Capital Scheme³⁷ and other tax incentives for investing in particular kinds of sectors, most notably in recent years, property development. These schemes effectively encourage investment by individuals in start up and medium sized enterprises by providing income tax relief to the value of the investment. In some cases, even income which is not related to the investment was covered.

³⁵ Taxes Consolidation Act, 1997 (Act No. 39/1997) (Ir.), *available at* http://www.bailii.org/ie/legis/num_act/1997/zza39y1997.1.html. Note that these significantly lower than average tax rates on corporations are sustained somewhat controversially, both nationally and internationally with pressure from the European Commission on Ireland to raise rates to a more “European level.” Accordingly, tax on manufacturing and other companies was originally 10% which is still available to certain manufacturing companies but will be phased out by 2010. These are also somewhat controversial domestically when compared with the tax rates on individual income which is much higher at 42% (at the highest rate), although this is again lower than the European average of 45.3%.

³⁶ See Irish Revenue, Guide to Capital Gains Tax, <http://www.revenue.ie/leaflets/cgt1.pdf> (last visited Aug. 30, 2006).

³⁷ See Taxes Consolidation Act, *supra* note 35, at Part 16; Finance Act, 2004 (Act No. 8/2004) (Ir.) at Section 18, *amended by* Finance Act, 2005 (Act No. 5/2005) (Ir.) at Section 27. See generally Enterprise Ireland, Business Expansion Scheme, http://www.enterprise-ireland.com/Grow/Finance/Business_Expansion_Scheme.htm (last visited March 9, 2006) (providing details on the Seed Capital Scheme). Both the Business Expansion Scheme and the Seed Capital Schemes have been approved by the European Commission. The BES will run until 2006. Similarly, the current Seed Capital Scheme which allows founding shareholders of “relevant trading operations,” as defined in the legislation to reclaim income tax paid in the previous five years on any amounts invested by the individual in a “qualifying company” where the taxpayer is a full time employee or Director of the company. The scheme is currently described in Sections 488-508 of the Taxes Consolidation Act 1997 and the current scheme is due to expire in December 2006. *Id.* See further <http://www.enterprise-ireland.com> (last visited June 21, 2006).

- Under the heading “bankruptcy and insolvency” it is noted that a statutory corporate rescue scheme (the examinership process)³⁸ provides a pre-bankruptcy system which facilitates company turnaround. Furthermore, the average period between declaration of bankruptcy and closure of proceedings is seventy business days. It also notes that “[m]anagers and directors of a bankrupt company will not face any limitations in getting involved in the management of another company” although this is not quite accurate as, in recent years, there has been a considerable enhancement of penalties which directors and others involved in bankrupt companies may face.³⁹
- Finally, the report is positive about the administrative aspects of setting up entrepreneurial firms in Ireland. For the private limited company, the typical set up time is noted to be 7.5 business days, below the average of the countries surveyed of 23.5 business days. Costs for the establishment of a private limited company are €1,500 compared with the average €1,638. (This is the only thing that is relatively cheaper in Ireland!!) Finally, there is no minimum capital requirement unlike many countries in continental Europe which require significant minimum capital. In relation to a PLC, the set up time is 10 days compared with an average of 25.7 days, minimum capital requirement is €38,100 compared with an average €64,484. These final differences lead us to something which has emerged as a very significant development in the European Union, the development of the possibility of competition for site of incorporation, in other words what is usually described as the Delaware Effect.⁴⁰

Unfavorable factors include the following which are listed in the order of what might seem most significant in the context of entrepreneurial and start-up companies:

- Stock options are taxed when they are granted.⁴¹
- A lack of fiscal incentives for R & D development and R & D collaboration.⁴²

³⁸ Companies (Amendment) Act 1990. *See generally* LYNCH, MARSHALL & O’FERRALL, CORPORATE RESCUE AND INSOLVENCY 261-318 (1996).

³⁹ *See* Companies Act, 1990 (Act No. 33/1990) (Ir.), *available at* http://www.bailii.org/ie/legis/num_act/1990/zza33y1990.1.html; Company Law Enforcement Act, 2001 (Act No. 28/2001) (Ir.), *available at* http://www.bailii.org/ie/legis/num_act/2001/en.act.2001.0028.1.html. *See also* OFFICE OF THE DIRECTOR OF CORPORATE ENFORCEMENT, AN INTRODUCTION (2001), *available at* www.odce.ie/_fileupload/publications/odce_intro.pdf (describing its activities, in particular, in relation to the restriction and disqualification of directors of insolvent companies).

⁴⁰ *Infra* note 47.

⁴¹ Taxes Consolidation Act 1997, *supra* note 35.

Two further factors are listed in the report as being unfavorable to a private equity or venture capital environment, but both of these factors relate to a larger company context rather than to a start up or medium enterprise environment. They are:

- The requirement that all mergers which fall under statutory merger regulation thresholds must be reported to the Irish Competition Authority and the deal will be suspended pending a decision.
- Secondly, the administrative costs for setting up a publicly listed company (“PLC”), a publicly quoted company, are higher than the average cost of €2,301 at around €5,000.

Both of these factors highlight a significant issue in relation to the provision of private equity or venture capital and that is the potential for exit which is available to the investor. Typically this may occur through buyout or merger, or through an IPO on either a full stock exchange or a smaller company’s market of some kind and so both of these factors affect the alacrity with which the investor may exit after a number of years of investment. This is identified as a particular issue for the venture capitalist.⁴³ This problem of exit can however be addressed by providing for a particular type of security or class of security, and in Ireland in the 1990s this issue was addressed by amending the corporate legislation to provide for redeemable shares, which are sometimes referred to in the United States as “treasury shares.” This phrase does not encapsulate the full extent of the possibilities presented in the Irish legislation.⁴⁴ These kinds of securities have limitations most significantly in terms of availability of capital for redemption at particular times when exit might seem most attractive to the venture capitalist. What seems more significant in practice, however, is the availability of a less formal securities market which mimics that of a fully developed stock exchange but which provides access to capital without imposing the rigorous compliance requirements of a full stock exchange listing. The London-based Alternative Investments Market (“AIM”) provides such a model and there are proposals to develop this model at the European level. This kind of market will and does, at present, provide an “effective natural exit route for venture capital and private equity, bridging the gap between early stage debt or private equity financing and public equity and debt.”⁴⁵ AIM has now been in operation

⁴² However the report notes that changes were made to this structure under the Finance Act 2004. The requirements to encourage R & D will be considered later in this paper. EVCA BENCHMARK, *supra* note 32, at 30.

⁴³ See EVCA BENCHMARK, *supra* note 32; Giudici & Paleari, *supra* note 3.

⁴⁴ See Companies Act, 1990, *supra* note 39, at Part XI (amended by the Financial Intermediaries, Companies, Miscellaneous Provisions Act 2005).

⁴⁵ Chris Gibson-Smith, Chairman, London Stock Exch., Address at the Risk Capital Summit: AIM for Europe (Oct. 4, 2005), *transcript available at* <http://www.londonstockexchange.com/en-gb/about/Newsroom/Media+Resources/Speeches/aimforeurope.htm>. See also Chris

for over ten years and as of the end of 2005 included thirty-seven non-U.K. EU companies. Irish companies have access to this market providing opportunities for continued investment or exit for venture capital investment. In putting forward proposals for developing a pan-European model based on the AIM, the proponents clearly recognize the benefits of venture capitalism to an economy generally and the potential added value to venture capital activity provided by such an exit option. These benefits include the availability of cheaper capital for smaller companies with a consequent improved potential for growth for smaller enterprises, in turn resulting in job and wealth creation together with added choice for investors. In addition, the incentive provided for investors due to the attractive exit option which some kind of flotation provides will, in turn, lead to wealth creation in the supply side. Finally, the impetus to create an attractive pan-European market which supports effective competition with U.S. capital markets is also clearly part of the agenda.⁴⁶

It might be useful to benchmark Ireland against a European country which displays similar characteristics in terms of population, industrial base and so forth and so Denmark is chosen as a comparator. The problems presented by the comparative imperative are considered in the conclusion. In the context of the surveys conducted, it is interesting to note that a country like Denmark, which is also a member of the European Union and which displays a similar but not identical regulatory framework to Ireland, is ranked almost at the bottom for creating an environment which is considered to be conducive to a robust venture capital economy. This would indicate that the factors which effect success or otherwise are detailed in their nature and that many other factors which might be considered significant are not. For example, labor market regulation, social security issues, flexibility in product markets, consumer regulation, etc. are not immediately significant. The hostile factors outlined by the reports of the European Venture Capital Association include the following, but the order in which they appear has been rearranged in order of significance to the points made in this paper:

- Corporate tax rate of 30% above the overall European average of 28.8%, with no special tax rate applicable to SMEs unlike Ireland.
- Income tax rate for individuals of 59% (which include municipal tax rates, which are insignificant in Ireland), the overall European average is 45.3%.
- A high capital gains tax rate, with a maximum rate of 43% above the overall average of 16.3%.

Gibson-Smith, Chairman, London Stock Exch., Address at the FESE Convention: Why Europe's Equity Markets Matter (May 27, 2005), *transcript available at* <http://www.londonstockexchange.com/en-gb/about/Newsroom/Media+Resources/Speeches/euroequity.htm>).

⁴⁶ See Gibson-Smith, AIM for Europe, *supra* note 45.

- No tax incentives for individuals to invest in private equity and venture capital funds.
- There is the possibility for both pension funds and insurance companies to invest in private equity and venture capital, but there are quantitative restrictions.
- The cost of establishing a private limited company is significant with costs estimated at €6,715 well above the European average of €1,600. Similarly, the cost of establishing PLC is estimated at the same and this is above the European average of €2,301. Most notably, however, unlike both Ireland and the U.K., a private limited company must be capitalized to the tune of about € 16,500 which is above the overall average of €13,900. Of course, in Ireland and the U.K. there is no minimum capital requirement for private limited companies.⁴⁷ The figures for capitalization of PLCs are similar.
- Finally, there are no significant investment incentives for R & D capital expenditure or support for collaborative ventures, although there are some fiscal supports for R & D expenses.

Favourable factors which are specifically mentioned include administrative efficiencies in actually establishing and registering companies, the fiscal incentives relating to R & D incentives mentioned above, an efficient insolvency (bankruptcy) system, and a supportive taxation system for stock options when underlying stock are sold.⁴⁸

A. Significant Factors which Distinguish Ireland from Other European Countries: The Delaware Effect in Europe?

A consideration of these factors leads us to an important development in the context of the European Union, Ireland's place in the overall regulatory landscape and how this has been deliberately developed to take advantage of certain features of the structure of regulation in the European Union.

Briefly for the uninitiated, the European Union, now comprising twenty-five member states, is broadly similar to the U.S. Federal structure. The European Commission and Council are the primary drivers of European wide legislation which is passed as either Directives or as Regulations. The European Parliament also has a role which has developed over time from being largely consultative to being more influential in the development of legislative policy. The body of European legislation is often referred to as the *aquis communautaire* and imposes direct obligations on member states where the legislation is in the form of Regulation or

⁴⁷ The issue of capitalization is significant in the European context and will be considered in the next section.

⁴⁸ See also ECVA BENCHMARK, *supra* note 32.

imposes a more indirect obligation on member states where the legislative instrument is a Directive. The process of harmonization of company law, where it has taken place at all, is usually achieved through the passing of directives.⁴⁹ The essential point is that there are considerable gaps in the harmonization of company law at the European level, perhaps arising from significant disagreements about the direction of corporate law⁵⁰ and about issues concerning flexibility, or lack of it, which are in the forefront of much of the discussion on regulation,⁵¹ particularly as it effects economic activity at present within the European Union. In effect, however, the failure to harmonize European corporate legislation has given rise to opportunities for those states which seem to represent themselves as a more

⁴⁹ See generally PAUL CRAIG & GRAINNE DE BURCA, *EU LAW: TEXT, CASES, AND MATERIALS* (Oxford University Press 3d ed. 2003); ADRIAAN DORRESTEIJN ET AL., *EUROPEAN CORPORATE LAW* (Kluwer 1994).

⁵⁰ See *European Commission, A Modern Regulatory Framework For Company Law In Europe: A Consultive Document of the High Level Group of Company Law Experts* (2002), available at

http://ec.europa.eu/internal_market/company/docs/modern/consult_en.pdf. See also *European Commission, Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*, COM (2003) 284 final (May 21, 2003), available at http://www.europa.eu/eur-lex/en/com/cnc/2003/com2003_0284en01.pdf; Directorate General for Internal Market and Services, European Commission, *Consultation on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union* (2006), available at http://ec.europa.eu/internal_market/company/docs/consultation/consultation_en.pdf; Internal Market Directorate General, European Commission, *Fostering an Appropriate Regime for Shareholders' Rights* (2005), available at http://ec.europa.eu/internal_market/company/docs/shareholders/consultation2_en.pdf.

⁵¹ See further EurActiv.com, *Opinion and Governance: Better Regulation* (Aug. 14, 2006), <http://www.euractiv.com/en/governance/better-regulation/article-117503> (“Simplifying EU legislation has been defined as a key aspect of the Barroso Commission's efforts to restore economic growth and create more jobs in Europe. Dubbed ‘better regulation’, the initiative started off with a screening process of legislation currently in the EU decision-making pipeline. Those believed to run counter to competitiveness and growth objectives will either be scrapped or rewritten. Moreover, every new legislative proposal will from now on undergo a thorough impact assessment analysis to ensure consistency with the growth and jobs objective. Finally, the Commission has embarked on an ambitious plan to simplify and scale down the entire body of Community legislation adopted since 1957.”); European Commission, Enterprise and Industry, *Better Regulation* (June 21, 2006), http://ec.europa.eu/enterprise/regulation/better_regulation/index_en.htm (“The regulatory framework in which businesses operate is a key factor of their competitiveness, growth and employment performance. Therefore, a key objective of the European Union's Enterprise policy is to ensure that the regulatory environment is simple and of high quality. This is why ‘better regulation’ is a centrepiece of the European Commission's ‘Partnership for Growth and Jobs’ - the renewed ‘Lisbon Strategy’ launched in spring 2005.”).

attractive location for incorporation. The possibilities of this competition for corporate business were finally brought into immediate focus in the significant decisions of the European Court of Justice in the *Centros*,⁵² *Uberseering*⁵³ and *Inspire Art*⁵⁴ (cases where the court held that no *prima facie* restrictions could be placed on the ability of individuals who were nationals of member states of the European Union to incorporate companies in other jurisdictions in the Union). There are a number of different aspects to the establishment of freedom to incorporate throughout the EU,⁵⁵ but the dismantling of barriers relate primarily to the sidelining of the “real seat” theory which had prevailed in a number of EU jurisdictions and to the dismantling of additional restrictions placed on foreign registered companies before being permitted to operate in a particular jurisdiction.⁵⁶ The “real seat” theory, which is certainly alien to the common law countries of Ireland and the U.K., prevents the incorporation of a company in the relevant jurisdiction (e.g., France) where its main activities are to take place outside France and also provides that where a French company moves its main operations outside of France it will be wound up or liquidated.⁵⁷ (Interestingly *Centros* concerned a Danish couple wishing to avoid the minimum capital requirements imposed in Denmark described above by incorporating in the U.K. and setting up a branch of the company in Denmark whilst never engaging in any trading activity in the U.K.). These decisions have given rise to considerable debate about the desirability of the “Delaware effect.” Whilst the debate has raged, particular states, notably the U.K., Ireland, and it would seem the Netherlands have continued to benefit from this phenomenon.⁵⁸ In our context it is clear that where there are more favorable environments for venture capitalist activity in Ireland

⁵² Case C-212/97, *Centros Ltd. v Erhvervs-0g Selskabstyrelsen*, 1999 E.C.R. 1459.

⁵³ Case C-208/00, *Uberseering BV v Nordic Construction Company Baumanagement GmbH*, 2002 E.C.R. 9919.

⁵⁴ Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.*, 2003 E.C.R. 10155. See also Anne Looijestijn-Clearie, *Have the Dikes Collapsed? Inspire Art a Further Breakthrough in the Freedom of Establishment of Companies?*, 5 EUR. BUS. ORG. L. REV. 389 (2004).

⁵⁵ William H. Roth, *From Centros to Uberseering, Free Movement of Companies, Private International Law and Community Law*, 52 INT’L & COMP. L. Q. 177 (2003); Thomas Bachner, *Freedom of Establishment of Companies: A Great Leap Forward*, 62 CAMBRIDGE L. J. 47 (2003).

⁵⁶ *Inspire Art* concerned the imposition under Dutch law of additional restrictions on foreign companies whose activity took place primarily in the Netherlands.

⁵⁷ The “real seat” theory is used in Austria, Belgium, France, Germany, Italy, and Luxembourg. See also L.S. SEALY, *CASES AND MATERIALS IN COMPANY LAW* 9-11, 82 (Butterworths 7th ed. 2001).

⁵⁸ Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUD. 247 (2005); Catherine Holst, *European Company Law after Centros: Is the EU on the Road to Delaware?*, 8 COLUM. J. EUR. L. 323 (2002); T. Koller, *The English Limited Company-Ready to Invade Germany*, 15 INT’L COMP. L. REV. 334 (2004).

compared with other states in Europe the effect of these decisions from the European Court of Justice coupled with the failure of political will or otherwise to impose similar corporate law requirements across Europe will mean that Ireland, in addition to other flexible regulatory regimes, will prevail as a location for incorporation in Europe. Thus Ireland, almost uniquely, apart from the U.K., was particularly well placed to benefit from the opportunities presented by the “real seat” issue. Furthermore, compared with the U.K., Ireland was even better placed to build upon this advantage because of its small size and the opportunities this presented for a definitive, targeted policy approach to the creation of a regulatory and tax friendly environment which facilitated venture capital investment and a venture capitalist fund industry. In other words, the relatively small demographic base of Ireland, compared with the U.K., allows for a very efficient and responsive relationship between those involved in the industry and the regulators and legislature. (This characteristic no doubt has its disadvantages if one takes a more general perspective, but nevertheless is a significant feature and is unapologetically presented as an advantage by those involved in the sector.)⁵⁹

B. Supply and Demand . . . Venture Capital Industry and Venture Capital Investment, Domestic and International Markets.

In considering the regulatory framework, and the distinction made in the introduction between the domestic supply of venture capital to indigenous start-ups and entrepreneurial firms and the operation of venture capital funds, it seems that Ireland is an attractive location in relation to both types of activity. In other words, the regulatory framework supports private equity investment or venture capital investment as a corporate finance strategy but also supports private equity investment and the operation of venture capital funds as one element in Ireland’s ever-expanding funds industry.⁶⁰ This success has similarly been achieved in a very targeted and structured way. There are a number of innovative investment vehicles which have been created by statute to facilitate the creation of collective investment funds which attract private investor funds

⁵⁹ See DFIA, *infra* note 65.

⁶⁰ See further information available from the Dublin Funds Industry Association which is a representative body for the various stakeholders and organizations operating out of the Dublin Financial Services Centre. Dublin Funds Industry Association, Industry Briefing Seminar (Jan. 27, 2006), *available at* http://www.dfia.ie/public/files/1138621100_presentationlondon27.01.06.pdf (providing statistics on the growth of the funds industry in Ireland); Dublin Funds Industry Association, Industry Briefing Seminar (Sept. 30, 2005), *available at* http://www.dfia.ie/public/files/1128640246_finalpresentationboston30.09.05.ppt (providing further information on the operation of venture capital funds).

and qualifying investors with a minimum of 250,000 to invest. Briefly these vehicles include the following:⁶¹

- The Variable Capital Investment Company⁶² which provides a tax exempt vehicle for collective investment. Generally, such funds provide for a close-ended investment commitment for a period of five to ten years with no redemption for the specified period.
- Unit trusts which are common and which were developed originally in the U.K.
- Common contractual funds created under the Investment Funds, Companies and Miscellaneous Provisions Act, 2005.⁶³ These will provide a vehicle for investors to participate as co-owners of the assets of the funds because this is not a separate legal entity providing transparency for Irish legal and tax purposes, facilitating use of double taxation treaties from which Ireland benefits significantly.

In this scenario there is one last question: what competitive advantage does Ireland have to offer over the U.K., its nearest and most competitive neighbour in Europe? It seems that in this context, similar factors which were pertinent to Ireland's economic success in recent years may be pertinent to a discussion of the success of venture capitalism both in its domestic and international context, namely a youthful and well educated workforce, a culture of innovation and adaptability and other factors, which seem somewhat intangible and perhaps illusory, such as quality of life indicators and so forth in terms of presenting Ireland as an attractive place to live and work!⁶⁴ What seems to be significant however, in terms of an advantage which Ireland as a relatively small economy might enjoy as compared with the U.K., is exactly that, its size. In this regard, Ireland is much more similar to Delaware than the latter is to the U.K. and it enjoys one feature which is also considered to be beneficial to Delaware and that is the recognized importance of attracting corporate and funds business to the

⁶¹ The author is very grateful to Donnacha O'Connor and Andrew Bates of Dillon Eustace, Solicitors, Dublin, for their time and information in relation to the operation of venture capital funds in Ireland.

⁶² Companies Act, 1990, *supra* note 39, at § 253.

⁶³ Note stated importance of this development in speech from Michael Ahern, Minister for Trade and Commerce, in relation to the Act and the importance of the funds industry in contributing to the Irish Financial Services Centre and the significance of the financial services industry to the Irish economy. "The Government values the important role the financial services industry plays in the [Irish] economy. It is a [very] significant employer, with more than 51,000 working in the sector, of whom more than 17,000 are engaged in providing wholesale or international services." 602 DÁIL DEB. Col. 1217 (May 18, 2005).

⁶⁴ "It's not because the pubs are great, the golf is great and the climate is, well . . . The fact is, it's tax. Tony O'Reilly tells the Financial Times that Ireland's economic miracle can be attributed to the corporate tax rate of 12.5 per cent [sic]." *This Week They Said*, THE IRISH TIMES, June 17, 2006, at 18.

state economy. Thus, in Ireland, operators in the funds sector (whether indigenous operators or international fund managers) enjoy a relatively close relationship to the regulators and policy makers, and consequently, to a responsive legislature. This seems to be a significant factor in the ability to create a friendly environment for the operation of a venture capital industry. It also seems to be a significant factor in the creation or adoption of policies which are supportive of venture capital and private equity investment indigenously. In relation to the former, it is very clear from statements made from the Dublin Funds Industry Association (“DFIA”), which represents the Irish funds industry, that its relationship with the regulator and its ability to lobby and obtain results from the regulator is marketed as an advantage enjoyed by the funds industry in Ireland.⁶⁵ In relation to the latter, it is also clear that unlike other European countries there seems to be significant political support for the maintenance of a friendly environment; for example, maintenance of particularly low corporate tax levels which would not be acceptable in other countries in Europe where other vested interests representing labor and so forth would have a stronger voice. In other words there are no competing interests who wish to derail the strategic interest in the creation of a venture capital friendly environment. There is no countervailing voice. Lastly, Ireland shares almost by chance a second characteristic with Delaware,⁶⁶ which is considered to be part of the success of the latter, and that is a sophisticated legal environment. Unlike Delaware, however, Ireland did not develop its sophisticated legal environment on its own but inherited a sophisticated legal regime because of its historical connections to England and the U.K. The respectability and advantages of a sophisticated English-speaking common law system are not only inherited and enjoyed but are also maintained because of the continued practice of adopting both legislation and common law developments which have sometimes been developed in the U.K., but in addition, adopting flexible and innovative legislative devices developed indigenously.

⁶⁵ See generally Dublin Funds Industry Association, Industry Briefing Seminar (Jan. 27, 2006), available at http://www.dfia.ie/public/files/1138621100_presentationlondon27.01.06.pdf (discussing general information regarding the International Funds Industry in Ireland and the DFIA).

⁶⁶ For a view of the competitive advantages of Delaware, see ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 37-44 (The AEI Press 1993); Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 563-83 (2002); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 841-47 (1995); Ralph K. Winter, Jr., *The “Race for the Top” Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526, 1526-29 (1989); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 254-62 (1977).

C. The Relationship between Venture Capital and Innovation.

Prior to the conclusion, some observations must be made on the critical relationship between entrepreneurialism, R & D, and venture capitalism or private equity investment. As we have seen, the development of a dynamic *knowledge-based economy* is central to the European Lisbon Agenda. Knowledge and the development of an indigenous R & D culture are therefore of primary importance. At the same time, however, commercialization of R & D is very important and thus the facilitation of commercial investment is important to this second stage of the *knowledge economy*. However, studies have shown that there are some tensions between the venture capitalist imperative and the sustained development of R & D as distinct from the speedy commercialisation of early stage research. A distinction can be made between “pressure-resistant” capital venture investors, mainly institutional investors and “pressure-sensitive” investors, namely retail shareholders.⁶⁷ These latter kinds of investors tend to “expect to capitalize significant gains in the short run,”⁶⁸ even though they also seem ready to take on quite risky investments. The significance of this point is that venture capital investment, particularly of the retail or supply side, may not be conducive to a sustained research and development culture; there is a reduction in “the incentive to engage in in-house private R & D.”⁶⁹ This may be of no immediate concern, but it does present problems in relation to sustainable corporate development if no new innovation occurs. It is also problematic at a macro level in relation to sustained support for R & D generally. This resonates with the macro European level policy to ensure that Europe becomes the “most competitive, dynamic, knowledge-based economy.”⁷⁰ The question of where R & D takes place and how it should be funded becomes of interest to policy makers on the broader level. That question can be answered in a number of different ways. For example, state or regional policies and funds can be directed at supplementing the decrease in research investment but clearly that raises the question as to why public funds should subsidize corporate activities. Alternatively or additionally, policies can be adopted which redirect corporate incentives towards sustained R & D rather than the optimising of immediate returns. Finally, questions are raised as to the role of research institutes and universities in relation to the funding of sustained basic research and/or the incentivization of speedy commercialization of research.⁷¹ The Irish government has reflected the European Agenda and

⁶⁷ See Giudici & Paleari, *supra* note 3, at 238.

⁶⁸ *Id.*

⁶⁹ *Id.* at 248.

⁷⁰ Presidency Conclusions, Lisbon European Council (March 23-24, 2000).

⁷¹ See generally Giancarlo Giudici & Stefano Paleari, CORPORATE GOVERNANCE, MARKET STRUCTURE AND INNOVATION 217 (Mario Calerini, Paola Garrone & Maurizio Sobrero eds., 2003). See in particular Giancarlo Giudici & Stefano Paleari, *Conclusions*

has even recently pledged further funds towards growth of entrepreneurial firms, particularly those engaging in R & D. Further support is offered to foster closer links between universities and industry in developing R & D strengths.⁷² These issues are complex and will not receive prolonged

and Policy Implications, in CORPORATE GOVERNANCE, MARKET STRUCTURE AND INNOVATION 243, 248-50 (Mario Calerini, Paola Garrone & Maurizio Sobrero eds., 2003).

⁷² On May 22, the Irish government announced the planned investment of €175m seed and venture capital funds. Making the announcement, the relevant Minister for Enterprise stated that:

Lack of early stage finance consistently emerges as a key gap in the market for innovative start-up firms. The investment . . . announced today will be a vital contributor to the development of a more robust, commercially viable and sustainable Seed and Venture Capital industry in Ireland. The new Seed and Venture Capital funds will commit the largest investment by the State to Venture Capital, which will in turn leverage the largest matching investment from the private sector. This will greatly improve access to finance for SMEs. It will encourage and leverage private sector investment in sectors that are difficult to finance, and will leverage private sector and institutional investment into VC investment in Ireland.

The existence of a vibrant and sustainable Venture Capital Industry in Ireland is vital for the commercialisation of research. The level of High Potential Start-up companies securing VC investment is an important indicator of future growth . . . A vibrant venture capital market is therefore an essential component in strengthening the indigenous enterprise base.

Press Release, Department of Enterprise, Trade and Employment, Martin announces Enterprise Island to inject €175m into Venture Capital Market (May 22, 2006), available at <http://www.entemp.ie/press/2006/20060522.htm>.

On June 18, 2006 the Irish government launched its New Strategy for Science, Technology and Innovation to 2013, with a pledge of €2.7 billion in the period up to 2008. Again the links described in the main text above are emphasized: We are aiming to ensure more effective commercialisation of the ideas and know how being generated by our Universities and public research institutions and to forge new partnerships between these institutions and enterprise. We also aim to devote significant resources to supporting enterprise R&D, in both the indigenous and multinational sectors to help companies more than double their spend on research in the period up to 2013. The Strategy also sets out a framework for public sector research, which will enhance enterprise performance and deliver benefits for society as a whole, in agriculture and food, forestry, marine, health, energy and the environment. These actions underline the Government's commitment to ensuring that Ireland's manufacturing and international services industries continue to grow their competitive advantage and employment potential, remaining strong players on the global stage.

consideration here, but nevertheless ought to be considered as part of a venture capital policy. However, for the moment it is sufficient to note that not all venture capital activity will yield sustained investment in R & D and that will become an issue to local economies over time.

V. CONCLUSION. THE COMPARATIVE IMPERATIVE.

In conclusion, comparative research must be approached with some caution. What will work in one location may not work in another. Factors which have one set of effects in one setting may yield unexpected results in another.

It is clear that in Ireland, both in relation to supply side venture capitalism and the development of a venture capital funds industry, there are significant tax advantages available to support both kinds of activity. In relation to indigenous venture capital investment, in addition to attractive corporate and capital gains tax rates, there are also particular tax schemes which incentivize and encourage investors into private equity investment. At the funds level, particular vehicles attract significant tax advantages for the overseas investor, together with the presence of multiple double taxation treaties, which are not always as readily available in other locations.

Finally, the regulatory framework is flexible and efficient both in terms of corporate law and in the creation of flexible, innovative and investor-friendly investment vehicles. Some of the detail of the framework has been discussed in this paper, but the more abstract point is clear: Ireland has, through the tax and regulatory framework, created a distinctly advantageous position from an emerging Delaware effect in a European market. The fact that the regulatory framework has also been developed on a strong English speaking common law base is significant, particularly in terms of international success. This has also been supported by the presence of a number of contemporaneous and serendipitous complimentary factors such as a young and well educated workforce and the development of significant expertise in the area against the backdrop of strong economic growth which is forecast to continue in the medium term.

