INDUSTRIAL LEADERSHIP - Access to risk finance

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Specific objective

The specific objective is to help address market deficiencies in accessing risk finance for research and innovation.
The investment situation in the R&I domain is dire, particularly for innovative SMEs and mid-caps with a high potential for growth. There are several major market gaps in the provision of finance, as the innovations required to achieve policy goals are proving too risky, typically, for the market to bear and therefore the wider benefits to society are not fully captured.
A facility for debt ('Debt facility') and a facility for equity ('Equity facility') will help overcome such problems by improving the financing and risk profiles of the R&I activities concerned. This, in turn, will ease access by firms and other beneficiaries to loans, guarantees and other forms of risk finance; promote early-stage investment and the development of existing and new venture capital funds; improve knowledge transfer and the market in intellectual property; attract funds to the venture capital market; and, overall, help catalyse the passage from the conception, development and demonstration of new products and services to their commercialisation.
The overall effect will be to increase the willingness of the private sector to invest in R&I and hence contribute to reaching a key Europe 2020 target: 3 % of Union GDP invested in R&D by the end of the decade with two-thirds contributed by the private sector. The use of financial instruments will also help achieve the R&I objectives of all sectors and policy areas crucial for tackling the societal challenges, for enhancing competitiveness, and for supporting sustainable, inclusive growth and the provision of environmental and other public goods.

Rationale and Union added value

A Union-level Debt facility for R&I is needed to increase the likelihood that loans and guarantees are made and R&I policy objectives achieved. The current gap in the market between the demand for and supply of loans and guarantees for risky R&I investments, addressed by the current Risk-Sharing Finance Facility (RSFF), is likely to persist, with commercial banks remaining largely absent from higher-risk lending. Demand for RSFF loan finance has been high since the launch of the facility in mid-2007: in its first phase (2007-2010), its take-up exceeded initial expectations by more than 50 % in terms of active loan approvals (EUR 7,6 billion versus a forecast EUR 5 billion).

Furthermore, banks typically lack the ability to value knowledge assets, such as intellectual property, and therefore are often unwilling to invest in knowledge-based companies. The consequence is that many established innovative companies – both large and small – cannot obtain loans for higher-risk R&I activities. In the design and implementation of its facilit(y)(ies), which will be carried out in partnership with one or several entrusted entities in compliance with Regulation (EU, Euratom) No 966/2012, the Commission will ensure that appropriate levels and forms of technological and financial risks will be taken into account, in order to meet the identified needs.

These market gaps stem, at root, from uncertainties, information asymmetries and the high costs of attempting to address these issues: recently established firms have too short a track record to satisfy potential lenders, even established firms often cannot provide enough information, and at the start of an R&I investment it is not at all certain whether the efforts undertaken will actually result in a successful innovation.

Additionally, enterprises at the concept development stage or working in emerging areas typically lack sufficient collateral. Another disincentive is that even if R&I activities give rise to a commercial product or process, it is not at all certain that the company that has made the effort will be able to exclusively appropriate the benefits deriving from it.

In terms of Union added value, the Debt facility will help remedy market deficiencies that prevent the private sector from investing in R&I at an optimum level. Its implementation will enable the pooling of a critical mass of resources from the Union budget and, on a risk-sharing basis, from the financial institution(s) entrusted with its implementation. It will stimulate firms to invest more of their own money in R&I than they would otherwise have done. In addition, the Debt facility will help organisations, both public and private, to reduce the risks of undertaking the pre-commercial procurement or procurement of innovative products and services.

A Union-level Equity facility for R&I is needed to help improve the availability of equity finance for early and growth-stage investments and to boost the development of the Union venture capital market. During the technology transfer and start-up phase, new companies face a 'valley of death' where public research grants stop and it is not possible to attract private finance. Public support aiming to leverage private seed and start-up funds to fill this gap is currently too fragmented and intermittent, or its management lacks the necessary expertise. Furthermore, most venture capital funds in Europe are too small to support the continued growth of innovative companies and do not have the critical mass to specialise and operate transnationally.

The consequences are serious. Before the financial crisis, the amount invested in SMEs by European venture capital funds was about EUR 7 billion a year, while figures for 2009 and 2010 were within the EUR 3-4 billion range. Reduced funding for venture capital has affected the number of start-ups targeted by venture capital funds: in 2007, some 3 000 SMEs received venture capital funding, compared to only around 2 500 in 2010.

In terms of Union added value, the Equity facility for R&I will complement national and regional schemes that cannot cater for cross-border investments in R&I. The early-stage deals will also have a demonstration effect that can benefit public and private investors across Europe. For the growth phase, only at European level is it possible to achieve the necessary scale and the strong participation of private investors that are essential to the functioning of a self-sustaining venture capital market.

The Debt and Equity facilities, supported by a set of accompanying measures, will support the achievement of Horizon 2020 policy objectives. To this end, they will be dedicated to consolidating and raising the quality of Europe's science base; promoting research and innovation with a business-driven agenda; and addressing societal challenges, with a focus on activities such as piloting, demonstration, test-beds and market uptake. Specific support actions such as information and coaching activities for SMEs should be provided. Regional authorities, SMEs associations, chambers of commerce and relevant financial intermediaries may be consulted, where appropriate, in relation to the programming and implementation of these activities.

In addition, they will help tackle the R&I objectives of other programmes and policy areas, such as the Common Agricultural Policy, climate action (transition to a low-carbon economy and adaptation to climate change), and the Common Fisheries Policy. Complementarities with national and regional financial instruments will be developed in the context of the Common Strategic Framework for Cohesion Policy 2014-2020, where an increased role for financial instruments is foreseen.

The design of the Debt and Equity facilities takes account of the need to address the specific market deficiencies, and the characteristics (such as degree of dynamism and rate of company creation) and financing requirements of these and other areas without creating market distortions. The use of financial instruments must have a clear European added value and should provide leverage and function as a complement to national instruments. Budgetary allocations between the instruments may be adapted during the course of Horizon 2020 in response to changing economic conditions.

The Equity facility and the SME window of the Debt facility will be implemented as part of two Union financial instruments that provide equity and debt to support SMEs' R&I and growth, in conjunction with the equity and debt facilities under COSME. Complementarity between Horizon 2020 and COSME will be ensured.

Broad lines of the activities

(a) The Debt facility providing debt finance for R&I: 'Union loan and guarantee service for research and innovation'

The goal is to improve access to debt financing – loans, guarantees, counter-guarantees and other forms of debt and risk finance – for public and private entities and public-private partnerships engaged in research and innovation activities requiring risky investments in order to come to fruition. The focus shall be on supporting research and innovation with a high potential for excellence.

Given that one of the objectives of Horizon 2020 is to contribute to narrowing the gap between R&D and innovation, helping to bring new or improved products and services to the market, and taking into account the critical role that the proof-of-concept stage plays in the knowledge transfer process, mechanisms may be introduced enabling financing for the proof-of-concept stages that are necessary in order to validate the importance, relevance and future innovatory impact of the research results or invention involved in the transfer.

The target final beneficiaries shall potentially be legal entities of all sizes that can borrow and repay money and, in particular, SMEs with the potential to carry out innovation and grow rapidly; mid-caps and large firms; universities and research institutions; research infrastructures and innovation infrastructures; public-private partnerships; and special-purpose vehicles or projects.
The funding of the Debt facility shall have two main components:
(1) Demand-driven, providing loans and guarantees on a first-come, first-served basis, with specific support for beneficiaries such as SMEs and mid-caps. This component shall respond to the steady and continuing growth seen in the volume of RSFF lending, which is demand-led. Under the SME window, activities shall be supported that aim to improve access to finance for SMEs and other entities that are R&D- and/or innovation-driven. This could include support at phase 3 of the SME instrument, subject to the level of demand.
(2) Targeted, focusing on policies and key sectors crucial for tackling societal challenges, enhancing industrial leadership and competitiveness, supporting sustainable, low-carbon, inclusive growth, and providing environmental and other public goods. This component shall help the Union address research and innovation aspects of sectoral policy objectives.

(b) The Equity facility providing equity finance for R&I: 'Union equity instruments for research and innovation'

The goal is to contribute to overcoming the deficiencies of the European venture capital market and provide equity and quasi-equity to cover the development and financing needs of innovating enterprises from the seed stage through to growth and expansion. The focus shall be on supporting the objectives of Horizon 2020 and related policies.
The target final beneficiaries shall be potentially enterprises of all sizes undertaking or embarking on innovation activities, with a particular focus on innovative SMEs and mid-caps.
The Equity facility will focus on early-stage venture capital funds and funds-of-funds providing venture capital and quasi-equity (including mezzanine capital) to individual portfolio enterprises. The facility will also have the possibility to make expansion and growth-stage investments in conjunction with the Equity Facility for Growth under COSME, to ensure a continuum of support during the start-up and development of companies.
The Equity facility, which will be primarily demand-driven, shall use a portfolio approach, where venture capital funds and other comparable intermediaries select the firms to be invested in.
Earmarking may be applied to help achieve particular policy goals, building on the positive experience in the Competitiveness and Innovation Framework Programme (2007 to 2013) with earmarking for eco-innovation, for example for achieving goals related to the identified societal challenges.
The start-up window, supporting the seed and early stages, shall enable equity investments in, amongst others, knowledge-transfer organisations and similar bodies through support to technology transfer (including the transfer of research results and inventions stemming from the sphere of public research to the productive sector, for example through proof-of-concept), seed capital funds, cross-border seed and early-stage funds, business angel co-investment vehicles, intellectual property assets, platforms for the exchange and trading of intellectual property rights, and early-stage venture capital funds and funds-of-funds operating across borders and investing in venture capital funds. This could include support at phase 3 of the SME instrument, subject to the level of demand.

The growth window shall make expansion and growth-stage investments in conjunction with the Equity Facility for Growth under COSME, including investments in private and public sector funds-of-funds operating across borders and investing in venture capital funds, most of which will have a thematic focus that supports the goals of the Europe 2020 strategy.

Context

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