Meeting with Members of the European Round Table of Industrialists (ERT)

Berlaymont

12 September 2016

17:00 – 18:00

Main contact person:

Person responsible: 

Cabinet Member:

RTD colleague at meeting: Name, , RTD-unit, office

Back up (in case of absence): Name, , RTD-unit, office
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**KEY MESSAGES**

- The Commission, the Council - as expressed at its last Competitiveness Council\(^1\) - and the Parliament\(^2\) agreed that Digital Revolution has opened up new opportunities and on the necessity that an adequate regulation. ERT is a very good proof of how cooperation among private actors is an essential key enabler for such development and represents a tremendous influence on potential growth and job creation.

- Europe must increase its efforts for a clear and coherent legal framework able to break down digital barriers to facilitate start-ups to grow fast and to remain in Europe.

- Strengthening our European dynamic ecosystem for entrepreneurs is my driving force of my mandate, as I have made open innovation, open science and open to the world the three priorities, so that more start-ups can succeed from Europe and in Europe.

- Many instruments, under Horizon 2020, are influential factors to soften start-ups' systemic problems, thought incentives and grants.

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\(^1\) See Council of the European Union, Competitiveness Meeting, 26 and 27 May 2016.

\(^2\) See relevant supporting analyses prepared by Parliament’s policy departments for the committees on Internal Market and Consumer Protection, Foreign Affairs, Employment and Social Affairs, Economic and Monetary Affairs, Industry, Research and Energy, and Culture and Education.

1. STEERING BRIEF

1.2 Objectives

- To re-affirm the key role of start-ups within the Research and Innovation Policy
- To explain how the RTD instruments support start-ups within Digital Economy, by focusing on three key aspects:
  - Facilitating access to research and innovation grants
  - Making start-ups ecosystems more dynamic by responding to structural gap (resources and knowledge) as well as ecosystem deficiency (access to finance when high-risk projects)
  - Bridging gap between feasibility of high-risk projects and market constraints
- Asking ERT members their concrete proposals in better supporting European start-ups in their particular challenges in facing their bottlenecks.

1.3 Line to take

- Europe has many examples of start-ups in all parts of Europe and we need to celebrate them more.
- Our future prosperity requires more start-ups to 'scale up' into world class businesses.
- The Commission fully understands the need for policy changes as evidenced for example by the initiatives on the Digital Single Market and Capital Markets Union.
2. SPEAKING POINTS

- High-growth young firms play a critical role contributing substantially to intra-industry labour productivity growth. An increasing number of so-called 'unicorns' (start-ups valued at over $1 billion) are home-grown in Europe. Cooperation between industry and academia has intensified. Digital technologies have been instrumental in the growth of start-ups.

- Their leverage effect on net job creation is very important. For example, in Sweden and Spain, the Start-ups ratios on net job creation are, where in any given year, for every existing 100 jobs, start-ups will add between 5 to 7 new jobs. That means that young SMEs are primary source of job creation.

- These two elements combine lead to the conclusion that Europe shall work for better regulation, which helps unleash the full innovative potential of our start-ups and people. Moreover, Europe's ability to attract inward investment requires pro-innovation regulatory context.

- The Commission has confirmed the importance of innovation through its different instruments to better face their systemic barriers and to avoid that innovation in Europe remains marginal by providing a high-quality and cost-effective regulatory framework to fast growing firms.

- Start-ups are very much dependent on bank lending and equity. In the Euro Zone, loan rejection rates as well as interest rates remain in the Eurozone, ecosystemic barriers for start-ups. Start-ups particularly cannot tap capital markets due to their size, scant credit information and regulatory obligations. Alternative financing mechanisms like venture capital, private equity and other non-bank channels play a very limited role especially for

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EU start-ups and SMEs. Private funding for start-ups in the EU is very limited.

- Stronger efforts are put in place by the European Union to provide better conditions for financing of start-ups. In the context of the Investment Plan and the Capital Markets Union, the European Union aims at improving their access to finance.

- The European Innovation strategy implemented through Horizon 2020 is responding to this by also distinguishing more clearly the respective roles of company size and sector orientation.

- Under Horizon 2020 Programme, many instruments already provide a tailored-made support to start-ups, either through collaborative projects, the SME instrument, and finally the different financial instruments. This overall combination of instruments provides better structural conditions to start-ups to drive their high-risk projects into the market.

- Start-ups are a volatile group of enterprises: on average 40% of start-ups exit within the first three years of activity. The challenge Europe faces is an insufficient amount of venture capital available for high-growth scale-ups. European venture capital funds are financing too many start-ups with too little money. And dedicated growth venture capital funds are too few in Europe.

- As a consequence, companies at the scale-up stage cannot call on deep and sophisticated capital markets to raise the capital they need. The main problem is the high fragmentation of the EU venture-capital industry along national borders.

\[\text{(COM}(2015)\ 468\ \text{final})\]
A. Opportunities for start-ups under the assess to finance tools

- Financial instruments have the objective to ease and strengthen access to finance (debt and equity) for innovative SMEs and small midcaps with the objective:
  - To leverage between 2014 and 2020:
    - Up to €9 billion of loans;
    - Up to €1.8 billion of early stage investments;
  - To make concrete synergies with the European Structural and Investment Funds (ESIF) in order to offer joint portfolio guarantees or joint securitisation operations for the benefit of R&I-intensive SMEs and small midcaps in the context of the SME Initiative.

- Key results achieved up to now (as of end of February 2016) are very positive:
  - With the InnovFin SME Guarantee product, launched with the EIF in June 2014:
    - 41% of the target to leverage €9 billion of loans for innovative SMEs and small midcaps has already been achieved by the end of December 2015 (i.e. €3.96 billion of expected maximum portfolio of loans) [15 Member States covered; 31 agreements with intermediaries];
    - 62% of the target has been achieved by February 2016 (i.e. €5.57 billion of expected maximum portfolio of loans);
    - In the fall of 2016 at the latest, the full objectives will already be reached [with an almost full geographical spread (33 Member States or Associated Countries) and around 80 Agreements]
With the InnovFin SME Venture Capital product, launched with the EIF in June 2015:

- 13% of the target to leverage €1.8 billion of early stage investments for innovative SMEs and small midcaps has already been achieved (i.e. €237 million of expected investments out of which €52.7 million of EU investments) [4 operations signed – out of which 3 multi-countries; out of which 3 VC Funds and 1 Business Angels Fund];
- 52% of the target are expected to be achieved by the end of 2016 already according to EIF pipeline (i.e. €937 million of expected investments out of which €219 million of EU investments). [10 additional operations under appraisal, out of which 8 VC and 2 BA Funds]

Under the Uncapped Guarantee product of the SME Initiative launched with COSME, the EIF and the EIB on January 2015:

- 3 agreements have been signed with Spain, Malta and Bulgaria, all have chosen Horizon 2020 InnovFin SME Guarantee as a financing partner.

According to 'European Startup Monitor' a, 21.2% of European start-ups are in the start-up stage and have succeeded in generating revenue. The following Instrument is for them in particular to consolidate their growing phase:

B. Opportunities for start-ups under the SME Instrument

- In Phase 1, the highest number of evaluated projects is in ICT (ODI), with 4172 projects representing 29% of all evaluated proposals. In Phase 2, ICT (ODI) yields a number of evaluated projects with 1340 projects out of 4738 –

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representing 28%. So, demand is there and it is up to Europe to succeed even better.

- Analysis provided by Venture Radar on companies selected for funding under SME Instrument presents the following results: out of 1.640 selected SMEs, 8% raised €692 million of private investment in total. This represents an average of € 5,2 million per company. Phase 1 companies gathered € 214 million and Phase 2 SMEs, €478 million (69%).

C. Optimisation of result by complementarity with national schemes

- According to "The 2016 Startup nation Scoreboard 2016" published by the European Digital Forum, in terms of dedicated policy frameworks for start-ups, 18 EU member states have a national strategy in support of start-ups. This normally falls within broad policy actions such as a digital strategy (Belgium, Germany, Ireland and Luxembourg), SMEs and entrepreneurship (Croatia, Malta, Portugal and Spain) or the broader reform agenda (Czech Republic).

- 69% of European start-ups do not achieve unbroken revenue growth between years two and three of their existence, according to a World Economic Forum report. Exit strategy shall be enhanced at policy level.

- The European Union is increasing investment alongside EU member states in large public-private venture capital funds of funds.

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7 All following data is provided by EASME, June 2016.
8 Data was collected and provided by Venture radar in March 2016 [www.ventureradar.com](http://www.ventureradar.com)
3. DEFENSIVE POINTS

A) SME Instrument

1) Are start-ups really targeted within the SME-Instrument?

Only SMEs are eligible to such instrument and may apply, as a single for-profit SME or as a consortium of for-profit SMEs. All applicants need to be legally established in the EU-28 or in a country associated to Horizon 2020. Other partners, such as research providers or larger companies, can be involved as third parties, usually in a subcontracting relationship, and do not need to be established necessarily in the EU or countries associated to Horizon 2020.

B) Financial instruments

2) There are no support for exit strategy in Europe?

Because of the diversity of rules in EU member states, venture-capital managers bear high costs in raising funds across Europe. The result is EU venture capital funds are relatively small, and thus have less capital to support growing businesses. That is a reality that we cannot deny. However, the instruments put in place under Horizon 2020 are building up an opposite trend. Also, the European venture-capital sector has become increasingly reliant on public-sector institutions for the past decade. That should also change. Increasing of involvement of private investors is essential, and ERT actions and involvement is a good proof of it.
5. BACKGROUND INFORMATION

Innovation Support Schemes: some characteristics

<table>
<thead>
<tr>
<th>WHY</th>
<th>1. Market failure type</th>
<th>asymmetric info</th>
<th>asymmetric info</th>
<th>asymmetric info</th>
<th>asymmetric info</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Policy goals in addition</td>
<td>strengthen European startup ecosystem</td>
<td>crowd-in private €, tackle Soc. Challenges</td>
<td>crowd-in private €, structure VC industry</td>
<td>encourage lenders to support R&amp;I</td>
<td></td>
</tr>
<tr>
<td>3. Innovation is more likely to happen if you</td>
<td>support start-ups and connect them to support systems &amp; networks</td>
<td>support single firms through early stages of innovation cycle</td>
<td>force-feed small, fast fish, &amp; help them grow</td>
<td>help minnows expand</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>WHO</th>
<th>4. Entity type / stage supported</th>
<th>start-ups</th>
<th>SMEs (single-firm focus)</th>
<th>SMEs pre-seed, seed, start-up; some growth; singletons</th>
<th>SMEs post-start-up: single firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. Quality of team / promoter / beneficiary is assessed face-to-face</td>
<td>no</td>
<td>no</td>
<td>yes: by EIF re fund, &amp; by fund re firm</td>
<td>yes by EIF re bank, &amp; by bank re firm</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>WHAT</th>
<th>6. Funding type</th>
<th>none</th>
<th>grant €50k phase 1 €0.5-2.5m phase 2</th>
<th>VC ~ €2.2 early, €7m growth -1st round</th>
<th>loan €25k to €7.5m</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. Innovation stage</td>
<td>early</td>
<td>early to close to market</td>
<td>early</td>
<td>early to growth</td>
<td></td>
</tr>
<tr>
<td>7a) TRL</td>
<td>not specified</td>
<td>at least 6 for phase 2</td>
<td>not specified</td>
<td>not specified</td>
<td></td>
</tr>
<tr>
<td>8. Innovation type</td>
<td>tech (ICT) /services (Web)</td>
<td>business-driven</td>
<td>technological</td>
<td>all types</td>
<td></td>
</tr>
<tr>
<td>9. Innovation degree</td>
<td>high novelty [sic]; foundational [sic]</td>
<td>from incremental to disruptive (sector variance)</td>
<td>towards the disruptive pole</td>
<td>from incremental to disruptive</td>
<td></td>
</tr>
<tr>
<td>10. Interplay with private capital</td>
<td>attract networked capital</td>
<td>strong so far</td>
<td>strong</td>
<td>strong</td>
<td></td>
</tr>
<tr>
<td>11. 'Smart' funding available</td>
<td>network &amp; support actions</td>
<td>coaching, investment-readiness training …</td>
<td>mentoring</td>
<td>some banks mentor</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>HOW</th>
<th>12. Geog. implementation</th>
<th>EU + ACs</th>
<th>EU +ACs</th>
<th>EU+ACs: KPIs to avoid over-concentration on NW Europe: see Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>13. Intermediation levels</td>
<td>in cooperation with NGO</td>
<td>1 - EASME</td>
<td>2 - EIF, then fund</td>
<td>2 - EIF, then bank</td>
</tr>
<tr>
<td>14. Redirection possible</td>
<td>n/a</td>
<td>yes (phase 1=&gt;2)</td>
<td>yes (not untypical)</td>
<td>unlikely</td>
</tr>
<tr>
<td>15. Investment write-off possible</td>
<td>n/a</td>
<td>yes (grant)</td>
<td>yes (not untypical)</td>
<td>yes (guarantee)</td>
</tr>
<tr>
<td>16. Connects to networks</td>
<td>very strong emphasis</td>
<td>yes (phase 3)</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>17. Short-/long-term balance</td>
<td>short</td>
<td>short</td>
<td>medium</td>
<td>can be long</td>
</tr>
<tr>
<td>18. Supply matches demand</td>
<td>yes</td>
<td>no</td>
<td>yes so far</td>
<td>just (with EFSI help)</td>
</tr>
<tr>
<td>19. Competitive level</td>
<td>n/a</td>
<td>very high</td>
<td>funds, first-serve, first-served</td>
<td>banks, first-serve, first-served (see note F.19)</td>
</tr>
<tr>
<td>20. Bottom-up vs. top-down</td>
<td>bottom-up within ICT &amp; Web focus</td>
<td>mixed</td>
<td>bottom-up, within hi-tech focus</td>
<td>bottom-up</td>
</tr>
<tr>
<td>21. Alignment of interest</td>
<td>evaluators: no</td>
<td>evaluators: no</td>
<td>fund managers: yes</td>
<td>loan officers: yes</td>
</tr>
<tr>
<td>22. Speed of tangible outcome</td>
<td>fast</td>
<td>fast (time to grant)</td>
<td>slowish</td>
<td>fast</td>
</tr>
</tbody>
</table>
Overview of Financial instruments for SMEs and Start-ups

In 2014, the European Commission, together with the European Investment Bank and European Investment Fund launched "InnovFin – EU Finance for Innovators", a series of Horizon 2020 complementary financing tools (covering both debt and equity financing) and advisory services supporting R&I promoters, such as universities, research centres, and companies - from the early stage to growth stage, all throughout the innovation lifecycle.

- The EU financial contribution to InnovFin, coming from the Horizon 2020 Access to Risk Finance Programme is expected to reach almost EUR 3 billion for the period 2014-2020. It is projected to leverage around EUR 25 billion of financial support corresponding to an expected total investment of around EUR 50 billion.

- **InnovFin SME Guarantee** targets R&I-driven SMEs and small midcaps requiring loans of between EUR 25,000 and EUR 7.5 million. A loan of more than EUR 7.5 million can be considered on a case-by-case basis. The European Investment Fund (EIF) implements this facility by providing direct guarantees to financial intermediaries (such as banks and non-bank lenders), who extend the actual loans to final beneficiaries. The guarantee covers up to 50% of intermediaries' potential losses (up to 80% in the case of the SME Initiative additional participation mechanism described below). EIF also offers counter-guarantees to financial intermediaries (such as guarantee institutions) providing risk protection to banks or other entities extending loans to R&I-driven SMEs and small midcaps.

- **InnovFin SME Venture Capital** improves access to risk finance by early-stage R&I-driven SMEs and small midcaps through supporting early-stage risk capital funds that invest, on a predominantly cross-border basis, in individual enterprises. SMEs and small midcaps located in Member States or in Associated
Countries are eligible as final beneficiaries. The European Investment Fund (EIF) makes and manages equity investments into risk-capital funds. EIF is able to invest in a wide range of financial intermediaries, including those cooperating with business angels. The funds concerned make VC and quasi-equity (including mezzanine capital) early-stage investments in enterprises, which are mainly SMEs. In the case of multistage funds (i.e., covering both early- and growth-stage investments), funding can be provided pro rata from this facility and COSME's growth-stage equity facility, EFG. A pilot sub-facility focuses on co-investments with business angels in the ICT domain.

The SME Initiative uses funds from COSME, Horizon 2020 and European Structural and Investment Funds (ESIF) combined with resources from EIB and EIF. The initiative enables Member States and regions to channel significant amounts of ESIF through InnovFin SME loan Guarantee. Member States and regions may choose to deliver part of their operational programmes by allocating national or regional programme contributions in this way, with disbursements geographically linked to contributions. The initiative can take the form of joint portfolio guarantees or joint securitisation operations for the benefit of R&I-intensive SMEs and small midcaps.

SME Instrument

- Horizon 2020 provides financial support covering the entire innovation cycle, from conceptualisation-to-market. The European Commission launched an unseen portfolio of new opportunities for SMEs; which definition encompasses start-ups.
- Horizon 2020 promotes start-ups participation across the board, but in particular in the industrial leadership and societal challenges pillars. 20% of the total combined budget for all societal challenges (SC) and the enabling and
industrial technologies (LEITs) will be allocated exclusively to SMEs. In addition, the new SME-Instrument innovation activity is receiving 7% of the combined budget SCs & LEITs.

- In the SME Instrument, half of SMEs participating in Phase1 have less than 10 employees. A majority are start-ups, in particular in domain of short-term innovation cycle (such as ICT).
- In Phase 1, the grant size is fixed to €50,000 for all selected projects – while in Phase 2, the average amount in 2014-2015 period was €1.7 million.
7. SOCIAL MEDIA

Hashtags

#H2020

#Competitiveness

#Innovation

#investors

#ScaleUps

#StartUps

#InvestEU

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