Mutual Learning Seminar
Session 3: HGIEs

Brussels, 21 March 2013

Finance for high-growth innovative enterprises: What policy makers can do

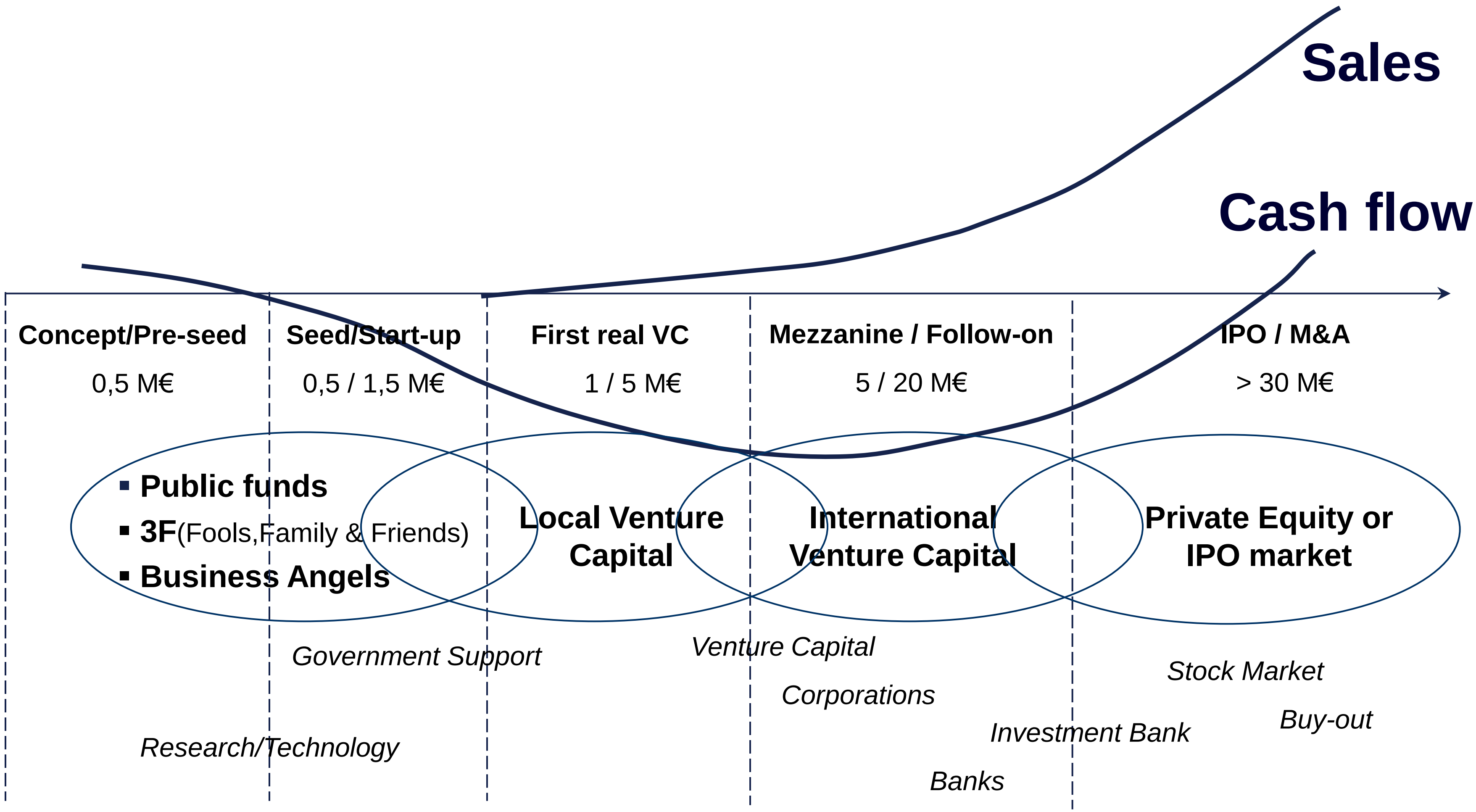
Jean-Marc Soustre

An event of the European Commission

European Commission
RESEARCH & INNOVATION

humaneye
STRATEGY PERFORMANCE GROWTH

What are we talking about?



Innovation, Financing & Venture Capital

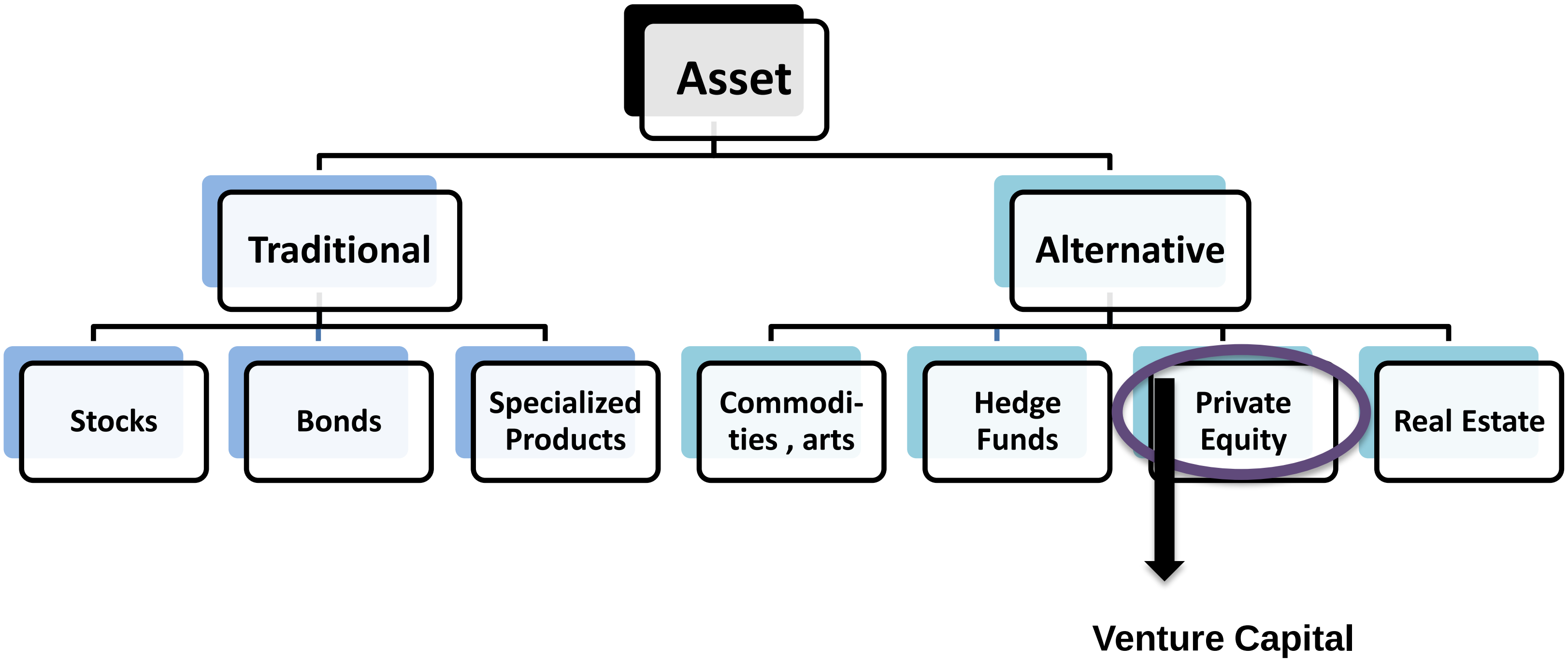
Who develops and finances innovation in EU?

- **Large corporates** retreated from R&D and focus on incremental innovation
  - cost reduction
  - failed to exploit breakthrough (Xerox PARC, Bell Labs)
  - preserve current lines of business > start-ups are innovating (spin offs)

- **Public & governmental** did outfit focus on innovation support
  - direct financing not yet the rule (regulations, cash strapped, past record of failures)
  - indirect financing framework still in process (« European SBA », patchy national regulations …)
  - tax breaks (FCPI, VCTs, wealth tax break) are expensive and unproven

- **Venture Capital** appeared as the solution
  - focus on start-ups and backed disruptive innovations
  - strong alignment of interests between entrepreneurs and financers
  - value creators (academic and operational data)…

Private Equity



Venturing is NOT Silicon Valley VC model

- **½ debunked myth: Silicon Valley venture capital model to finance innovation**

  Generally disappointing results, with cyclical constraints
  Barely finances company creation and spin-offs (European specificities)
  “broken model”: the modern assumed template of venture capital (Silicon Valley) is in crisis since Europe started to adopt the US model in 2001 at the wrong time and without assessment of the applicability of the model to the European background

- **Silicon Valley venture has 2 bias**
  - towards disruptive innovation, with a high risk/return profile and a limited holding period

    against fundamental research, unusual risk/return profiles and uncertain holding periods
  - Monofocus (individual) in the 3 dimensional play
    Individual / Support (soft money …) / Research (labs, team)

- **Venture capital reinforces links with industry**

  Corporate play a new active role, non cyclical

A couple of good news (1/2)

- VC-backed pre-and post-IPO performance now matches or exceeds that of US counterparts - Best European VC funds demonstrate top US quartile performance

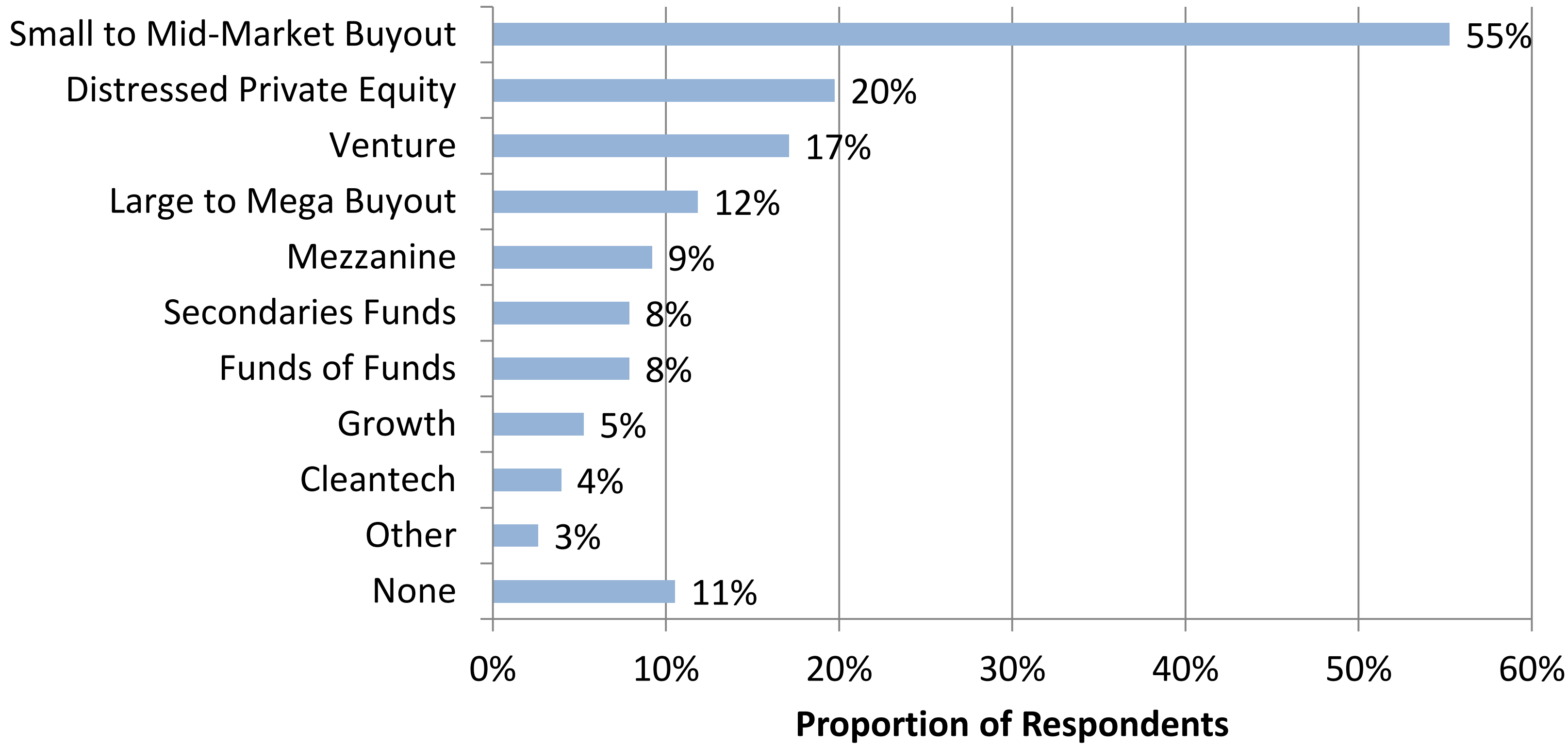
- Europe has seen some $15 billion in venture-backed liquidity events during the past 2 years: 50% of US, yet occurring with only one fifth of the venture funding

- Capital efficiency improvements
    - Proportionally, Europe VC is now producing higher exit multiples than U.S. VC, as well as higher capital efficiency
    - Capital efficiency, lower entry valuations, high-quality dealflow, buyer's market in Europe

- € 8,2B invested in EU in 2011 (close to 2001 level): +55% in 1 year

A couple of good news (2/2)

- LPs (Limited Partners) see the opportunity



Venture Capital Trends

- **Less demand for independent Venture Capital**
  - technologies have made it cheaper to build product and get customers
  - alternative sources of financing are available (corporate VC, Angels, crowdfunding …)
- **Venture Return are lower**
  - Overwhelming peaks in valuation
  - Inefficient capital allocation
- **These trends are not sustainable on the long-term**
  - Growing use of technology in how the investments are made
  - Emergence of ‘branded guilds’ as leading communities attracting deals and talents
  - Independent VC firms are big or smaller, adaptive and tend to hire operational personnel
  - Corporate VCs are growing (>90 new corporate VC funds in 2011)
  - Search for new opportunities that do not fit into the traditional VC investment criteria

VC is part of solution, but not the only one

Potential ways for a European VC model

- **Structural change for the VC market (with impact on exits and fund duration) to stimulate investors**
  - Facilitate longer term for funds (difficult to negotiate with investors – IRR)
  - Facilitate VC market consolidation and syndication by industry
  - Pan-European passport
  - Create a VC second-market (yet to emerge for non ICT)
  - Disintermediation (information gap)
  - Extension of tax-breaks (cost for VCTs are high): cost/impact unclear

Aside of

- A reinforced ‘oriented’ research in universities to achieve international competitive edge
- Conditions to achieve tech transfer from universities to market
- Tech parks and incubators close to labs
- Support to entrepreneurship and investment readiness (training, coaching, seedfunding, competition, soft money)

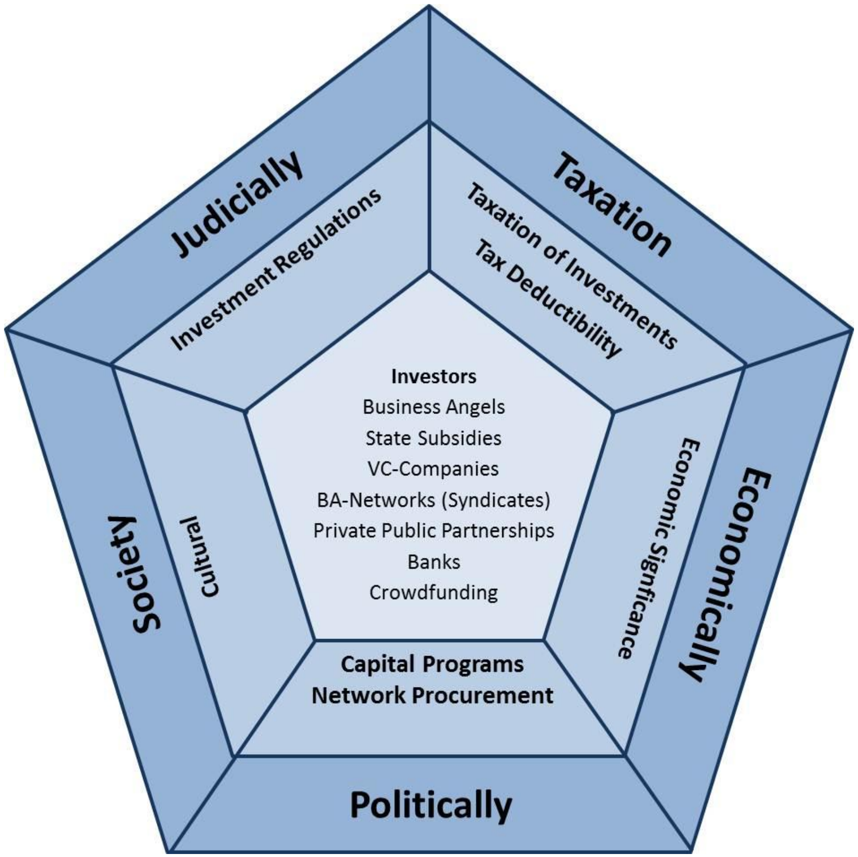
To attract the best entrepreneurs, increase the critical mass and consolidate the role of Innovation Support structures

A simple Process

* Push or pull model

** Linked to strategic options

5 dimensions for Strategic Options



Most options are closely interlinked - not to be used as punctual but rather as an impactful combination depending on the chosen strategy

Qualify typical financial measures

Proposed Measure	Type	Model	Investment Strategy
Subordinated kicker loan	Debt	Direct flexible loan to the startup with subordination - Not convertible Additional kicker (extra % or fixed fee)	Step 1: < 100 K€ - standalone Step 2: 300 K€ in conjuntion with other financing mechanism
Collateral	Debt	Guarantee the bank loan via ... for pre-commercial startup phase	Step 1: < 100 K€ - standalone Step 2: 300-500 K€ in conjuntion with capital inforcement
Public seed fund	Equity	Equity stake in startup <500k CHF	Startups w/ fast international expansion - Investments from 3-5 years - <50% holding
Fund-of-fund investment	Equity	Conditional investment in seed funds - No direct investments	Seed funds only in new sectors will high IP level
Public matching on Private investment	Equity	Top-up at max 50% on private investment	Startups w/ fast international expansion - Investments from 3-5 years - No share holding
Guarantee on investors	Guarantee	Guarantee BA/VC investments	yearly commitment 50-70% guarantee - StopLoss mechanism
Convertible Grant Scheme	Accomp. Measure	Expand current grant scheme to pre-commercialization with grants that will be bought by private investors < 5years	HGEV only (fast growth startups) - Limited to sales development
Attraction of int'l talents	Accomp. Measure	University partnering w/ existing international program	
Tax breaks on individual investors	Accomp. Measure	Exoneration after 2 years - perspective wealth	

Qualify: benefits, weakenesses, Startup type, risk, vehicle, combination, impact, implementation timeframe, effect, cost etc

Some tips... (whatever the model)

- YES
  - Incentivize VC syndication and collaboration including with Corporates
  - Accelerate international exposure to Venture Capital
  - Encourage local funding vehicles (crowdfunding, business angels) and help structuring first round lead investors
  - Privilege Continuity
  - Control exit market
  - Incentivize external cross-pollination across EU

- NO
- Do not limit corporate venturing to Tier Ones only
- Do not invest before you have qualified your own model!
- Output tax incentive is easier but does not favor 'local' R&D

HumanEye

- **Focus on 'Innovation Execution' in technology**
  Strategy/Performance/Financing

- **Missions**
- Expert for public bodies – investors – growth companies
  Lead advisor, Financing Solutions for the Swiss Federal government
  Former NED/Board of Irish NDRC (National Digital Research Center)
  DG Connect - DG R&I, Grand Lyon, Grenoble etc…

- High-level tech investment events in Europe:Biovision IC, Venture4i…

- Founder of the CleanTech Investment Rating Agency

Former CEO of European Techtour

Former executive management in tech groups (>100M€ budget)

Thank you for your attention

jm@humaneye.fr

+33 6 65 02 79 56
+41 78 953 68 60