

EUROPEAN RESEARCH AREA BOARD

ERAB Recommendations on Venture Capital (VC)

ERAB has issued two recommendations¹ on the role of Venture Capital in R&I. In its current recommendation ERAB addresses the role of VC in the early investment stages of innovative entrepreneurs. The key question is how to support private innovative technology/ knowledge based business activities to come out of universities or public research institutions and how to make them grow into SMEs. Looking at the US experience, it seems to ERAB that the critical issue is to bring technology and knowledge out of the public research domain and to transform them into business activities.

For this purpose, also the assessment of markets for IP and the support of funds merit public policy attention. Furthermore, private VC expertise should be used by public financial institutions in assessing technology.

ERAB reminds the different *types of VC*: independent VC, Corporate VC, bank-controlled VC, university VC and governmental VC. Each of them shows different investment patterns and behaviours in coaching the activity into which they have invested. Particular attention should be paid to:

- The strength and specialisation of Governmental VC in investing in small, young firms, albeit with limited mentoring activities.
- Independent VC's specialisation in expansion investments in relatively older and larger firms, with a heavy impact on the management of the target firm.
- Corporate VC and their seed finance departments observing new technological innovations in SMEs aiding the renewal of their technological base and fostering their innovative technological growth.

ERAB highlights, based on the US experience, that VC finance of research and innovation based firms require an *eco-system of financial and non-financial activities*:

- The *financial activities* require large scale and continuing support.
- The *non-financial activities* of skill development of investors are of high importance.

ERAB recommends:

- Concentrate on public support activities on the *early phase* of technology firms by fostering the "ecology" and developing the environment of "institutions" by supporting a mixture of capable financial and non-financial institutions.

¹ ERAB views on the role of Venture Capital for the R&I strategy, Brussels April 2010,

http://ec.europa.eu/research/erab/pdf/erab-view-on-venture-capital_en.pdf

Realising the New Renaissance, policy proposals for developing a world-class research and innovation space in Europe 2030. Second report of the European Research Area Board, P. 14 and 15, Brussels 2010:

http://ec.europa.eu/research/erab/pdf/erab-2nd-final-report_en.pdf

- Support the *growth phase* of enterprises through increasing public demand: as VC behaviour is much geared to that demand, public policies supporting Grand Societal Challenges and public procurement² are essential to the success of European VC.
- A well functioning VC market requires a *long-term systemic approach* to build up the VC ecology. Even compared to the US, Europe has plenty of new firms entering the market place, but they fail to grow. Therefore, public policy should particularly focus on enabling growth, and not only on removing entry barriers. A stepwise approach should be taken as follows:
 - Step 1: Improve capacities of investors and entrepreneurs
 - Step 2: Strongly align policy with rewards for success
 - Step 3: Government should focus on long-term indirect benefits (learning, spillovers, and increased tax revenue) rather than direct returns.
- EU policy should not be pushing development of a “VC sector” in each region and Member State. However, transnational capability development in VC firms and early stage investors should be supported.
- At national/regional level ERAB recommends:
 - Increase focus of investment readiness of high-potential individuals/firms;
 - Foster business angel networking and its professionalization;
- At European level ERAB recommends:
 - Provide catalytic, substantial commitments to a few major Funds-of-Funds under private management,;
 - Offer such commitments as public co-financing in an incentivized structure so as to boost returns and attract private sector institutional investors back into VC;
 - Refrain from imposing geographical or thematic constraints or political objectives on such Funds-of-Funds;
 - Create a viable cross-border VC market without double taxation instead of promoting sub-critical ‘regional’ VC funds via the Structural Funds;
 - Reward success rather than subsidising failure (“backing winners”);
 - Enable start-ups to grow and move up a ‘funding escalator’;
 - Foster European level VC funds with sufficient flexibility to adapt to longer-term investment trends.

² ERAB views on the role of Public Procurement for the R&I strategy, Brussels April 2010, http://ec.europa.eu/research/erab/pdf/erab-view-on-procurement_en.pdf, see also: Realising the New Renaissance, p. 9 and 10.