Report of the Chairman of the expert group on the cross border matching of innovative firms with suitable investors

About this report

This report is based on the work of the expert group on the cross border matching of innovative firms with suitable investors under the auspice of its Chairman, Mr. Anthony Clarke.

The expert group was convened by the Directorate-General for Enterprise and Industry of the European Commission.

This report contains only the main points and arguments that were presented in the three meetings of the expert group and the conclusions reached by the group.

The role of the Commission staff in the group was to take note of the recommendations made by the experts. Consequently the report provided by the Chairman of the expert group should not be constructed as reflecting the position of the Commission and its services. Neither the Commission nor any person acting on behalf of the Commission is responsible for the use, which might be made of the information contained therein.

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1. EXECUTIVE SUMMARY

The current European economic position is that of negative or very low growth in the GDP of Member States. To create jobs and growth in Europe innovation is key. But innovative firms in Europe face significant problems in accessing the funding they need to start, grow and compete in global markets. Especially the cross-border matching of innovative firms and investors posses significant challenges, even though research has identified cross-border funding as key to supporting a company's international growth.

This report sets out the conclusions of a European expert group which was charged with identifying current trends and best practices in the area of matching innovative firms with investors on a cross-border basis and with formulating policy recommendations.

<u>Address the strong reduction of available venture capital in Europe and support funds with real potential for success</u>

Innovative firms, especially in the seed and early-stage when a business is not in a position to generate cash-flows which would allow servicing debt, have almost no other option but to turn to equity investors such as business angels and venture capital firms to obtain the financing they need.

However, the near term climate for new supplies of angel and VC money investing into Europe’s early stage SMEs looks bleak given the backdrop of the current economic crisis. In particular VC fundraising has become increasingly difficult and dropped significantly between 2007 and 2011. Institutional investors like banks, insurance companies and pension funds have materially reduced their exposure to this asset class and many existing venture funds and business angels remain focused on supporting their portfolio companies with few meaningful exits being announced.

In addition, European venture funds tend to be about half the size of US venture funds which creates inefficiencies (no economy of scale) and therefore negatively impacts on returns. It also hinders funds in making follow-up investments into their portfolio companies to support growth.

The expert group therefore recommends that the European Commission financially supports European VC funds and fund-of-funds structures with a clear European angle that back funds which invest cross-border into SMEs at all stages of their development. In order to produce adequate returns and attract private investors back into the asset class, funds and fund-of-funds should be managed by experienced fund managers and should be of sufficient size to support a company to an exit.

Support the emergence of Business Angels to close the early-stage financing gap and professionalize them

As venture capital funds tend to invest on average about € 350,000 - € 400,000 at the seed stage and €1m at the start up stage entrepreneurs are faced with a significant financing gap for investment amounts below these sums.

Business Angels are a growing part of the investor spectrum that is partially filling this financing gap. They are private individuals who either solely invest their own cash or alternatively invest in syndicates where typically one angel in the syndicate takes a lead role. Private high net worth investors are now taking more interest in angel investing particularly given the low or negative returns on other alternative investments. This non institutional equity finance which is still relatively untapped in Europe compared to the US where the angel market is five times larger could become an essential driver to build more high growth SMEs.

The expert group considered that Member States should attempt to raise awareness of Angel investing as an alternative investment class possibly by introducing tax breaks to incentivise Business Angels to invest in high risk seed and start up businesses as has been the case in the UK for some twenty years and more recently in France, Portugal and Sweden.

The need to increase the capacity of Business Angels to invest and professionalise is recognised as an essential component of building a sustainable angel community in Europe. The need to encourage more women to become angel investors is also considered to be a priority given that EBAN[1] estimates that women currently represent only circa 10% of Europe's angel investors.

There is also a role for the EU to play in stimulating and encouraging cross border early stage investing by the business angel community. The use of material developed under previous Commission programmes, such as assessment lists, toolkits and methodologies for cross border angel investing should be further developed and cover markets which have not previously been addressed.

The expert group recommends that the European Commission starts supporting Business Angel investments through a new European Business Angel facility that has an order of magnitude of at least €250 million. The facility should co-invest with suitably experienced angel syndicates and groups whereby only the best deals should be supported (demand-driven, no country quotas). The aim of the facility should be to support the professionalization of the angel community

[1] The European Trade Association for Business Angels, Seed funds and other Early Stage Market Players

and the transfer of best practices. This facility should be administered by an entity or entities with specific business angel market and preferably cross border experience.

Monitor the emergence of new sources of funding that employ social media (crowdfunding)

In response to the changing markets, alternative sources of funding for entrepreneurs, such as crowdfunding, are now emerging in Europe, the US and other parts of the world. Even though they are still at an embryonic stage, the potential risks of such funding and the fragmented European regulatory environment along national lines for cross border platforms are among the emerging challenges which pose issues for entrepreneurs, platform providers and investors alike.

The expert group acknowledged that crowdfunding using social media techniques may have the potential to become an important new source of SME funding at the seed stage for equity capital. It should be encouraged in Europe without over-regulation, however, some investor and entrepreneur protection may be needed.

The expert group therefore recommends that the European Commission sets up a specialist expert group to review the subject of crowdfunding, drawing on existing experiences in Member States and elsewhere internationally.

Support a better training of Europe's innovative entrepreneurs and enhance their access to information

While there are significant shortcomings to be observed on the supply side of capital, obstacles also exist on the demand side for capital.

Often the demand side failure is simply that many innovative SMEs in Europe fail to attract either Business Angel or venture capital finance due to the information asymmetry between entrepreneurs and investors. But many times, the entrepreneurs are also not well equipped to deal with all the challenges that building a business entails.

The expert group believes that the knowledge and skills gap is addressable through publicly supported programmes delivered by experienced private sector experts to assist SMEs in becoming investment ready, particularly where SMEs have ambitions to both raise funding and trade cross border. Targeted support to SME investment readiness and accelerator programmes is seen as an essential component to solving these demand side issues.

Address shortcomings in converting EU research projects into innovation

The expert group discussed the current level and categories of expenditure in the European Commission’s significant annual research and development budget. It concluded that too little attention is paid to supporting research which ultimately can lead to creating viable SMEs that can help to stimulate economic growth in Europe.

EU research projects can be a great value proposition to investors when these projects are investment ready and investor's views are considered throughout the commercialisation lifecycle.

The expert group recommends that a reasonable allocation of the EC's future Research and Development (R&D) budget be set aside for prototype funding, market validity testing and activities related to the building of the management team.

Applicants for research funding should be obliged to demonstrate in their application that there is a clear ambition to take the research further and to try to commercialise the results. Technology Transfer Offices and/or other exploitation specialists, in as far as is possible, should be included in the teams applying for research grants.

Importantly, when it comes to selection of projects to be funded, the selection committee should include some representation from the investment and business community to be able to assess the commercial exploitation potential of the project.

Applicants should in most cases have to raise a reasonable proportion of private funding from market participants prior to draw-down of the research grant. Educational measures and information are needed for both investors and researchers in order to raise more awareness of the opportunities which research projects can provide for innovation.

Utilise the strength of the Enterprise Europe Network (EEN) to deliver information to innovative companies

The expert group believes that due to the breadth of the EEN and its possibility to reach out to SMEs on a local basis, the EEN is well placed to provide SMEs with information about European programmes, rules and regulations and to provide innovation support services.

Given the diversity of the EEN and the wide range of different levels of expertise among the Network members in relation to access to finance, the expert group recommends that the EEN should focus on a sign-posting task to direct SMEs to finance specialists in the regions, e.g. for providing advice on improving investment readiness and financial knowledge. Specialists are hereby considered to be experienced entrepreneurs and persons from the private sector which are connected to the early stage investment community.

Finally the expert group felt that EEN should consider the feasibility of providing 'vouchers' which would then enable SMEs to purchase services from specialists when needed.

2. INTRODUCTION

Europe 2020 is the EU's growth strategy for the coming decade; it is focused on the EU becoming a smart, sustainable and inclusive economy. These three mutually reinforcing priorities should help the EU and the Member States deliver high levels of employment, productivity and social cohesion.

The overall Europe 2020 strategy is supported by seven flagship initiatives[2], one of them being the Innovation Union initiative. In the Innovation Union Communication[3] the Commission has set out the activities and initiatives it will pursue and encourage ensuring smart growth which is driven by research and innovation.

Enhancing access to finance for innovative firms has been identified as one of the main cornerstones to ensure European economic growth. In this context, the following commitment (N° 12) has been made in the Innovation Union: The Commission will strengthen cross-border matching of innovative firms with suitable investors. It will appoint a leading figure to lead the process."

2.1. Expert group and its Chairman

Mr. Anthony Clarke, Chairman of the British Business Angel Association, was appointed[4] in September 2011 as leading figure to Chair a Commission expert group[5] comprising representatives from 12 European organisation appointed by DG Enterprise and Industry (as listed in Annex 1). To nominate experts the Commission sent invitations to the following categories of European-wide stakeholder organisations and networks:

- Demand side for innovative projects and ideas
- Supply side of innovative ideas and projects
- Intermediaries organising the matching of supply and demand

All organisations and networks had to have expertise and understanding of a common interest in the field of financing innovation. Furthermore, the networks and organisations had to represent a broad group of relevant stakeholders. The Chair of the

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2 http://ec.europa.eu/europe2020/tools/flagship-initiatives/index_en.htm

3 Europe 2020 Flagship Initiative Innovation Union SEC (2010) 1161.

4 Appointment occurred following the applicable public procurement procedure

5 http://ec.europa.eu/transparency/regexpert/detailGroup.cfm?groupID=2695

expert group also invited independent experts to each meeting to present their specialist subjects. The expert group met three times between November 2011 and March 2012 and staff from interested European Commission services took part in the expert group as observers.

The aim of the expert group was to identify current activities and best practices which help to identify innovative ideas and businesses on a cross border basis as well as discussing what can be done to support entrepreneurs in attracting the right sources of risk capital. The outcome of the debates that took place and the resulting policy recommendations are presented in this report prepared by the Chairman of the expert group.

In line with the Commission's Communication from the President to the Commission on the Framework for Commission Expert Groups[6], the Commission remain fully independent regarding the way they take into account the recommendations made.

2.2. COSME and Horizon 2020

The expert group is working against the background of COSME and Horizon 2020 which are both programmes that were proposed by the European Commission on the 30th of November 2011 for the period 2014 – 2020[7]. The expert group recommendations point towards possible ways of implementing the financial instruments under both programmes and horizontal measures planned under Horizon 2020.

2.3. The challenges related to financing innovation

The inefficiencies in the capital market for innovative firms in Europe have been characterised as a 'thin market' where limited numbers of investors and innovative growth firms have difficulties finding and contracting with each other at reasonable costs.

An efficient ecosystem of venture capital requires the presence of informed institutional investors, a strong deal flow of attractive firms, large and professional venture capital funds, support and advice for entrepreneurs, and efficient exit markets. A strengthened cross border focus of the venture capital industry will support a stronger deal flow of attractive firms and allow for a better diversification of risk. Improved risk diversification will lead to better returns and make the asset class more attractive to institutional investors, thereby increasing the availability of early stage capital in Europe.

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6 http://ec.europa.eu/transparency/regexpert/PDF/C_2010_EN.pdf

7 COSME proposal: http://ec.europa.eu/cip/cosme/index_en.htm; Horizon 2020 proposal: http://ec.europa.eu/research/horizon2020/index_en.cfm?pg=h2020-documents

2.3.1. Supply Side Market Failures

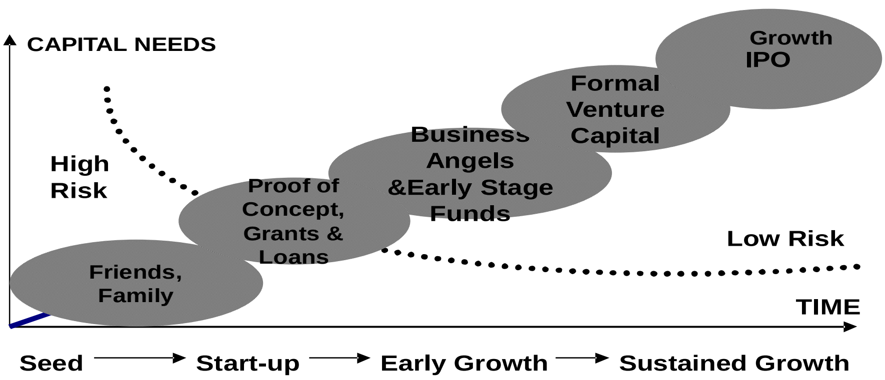
On the supply side of finance which is the provision of equity finance by Business Angels and venture capital funds, innovative projects require expert knowledge from financiers because adverse selection problems are common as entrepreneurs are reluctant to disclose information for fear of imitators. Such information asymmetries are the core of the competitive advantage of innovative firms, and as such desirable and inevitable.

SMEs seeking small amounts of seed investment will typically initially approach seed venture capital funds or business angels in their local regions. As the capital needs of the business increase then the sources of early stage equity finance are more likely to be sought nationally. SMEs that are seeking to raise sums for European or even more international expansion may seek investors outside their own countries so that they have investment partners who have experience of successfully operating and growing companies on a cross border basis.

Access to finance for Europe's innovative SMEs is one of the main cornerstones to ensure economic growth albeit Europe's early stage equity gap at levels up to €2m is often described as the 'Valley of Death' where SMEs seeking equity finance from either Business Angels or venture capital funds are playing in an imperfect market with inadequate supply of capital to meet demand.

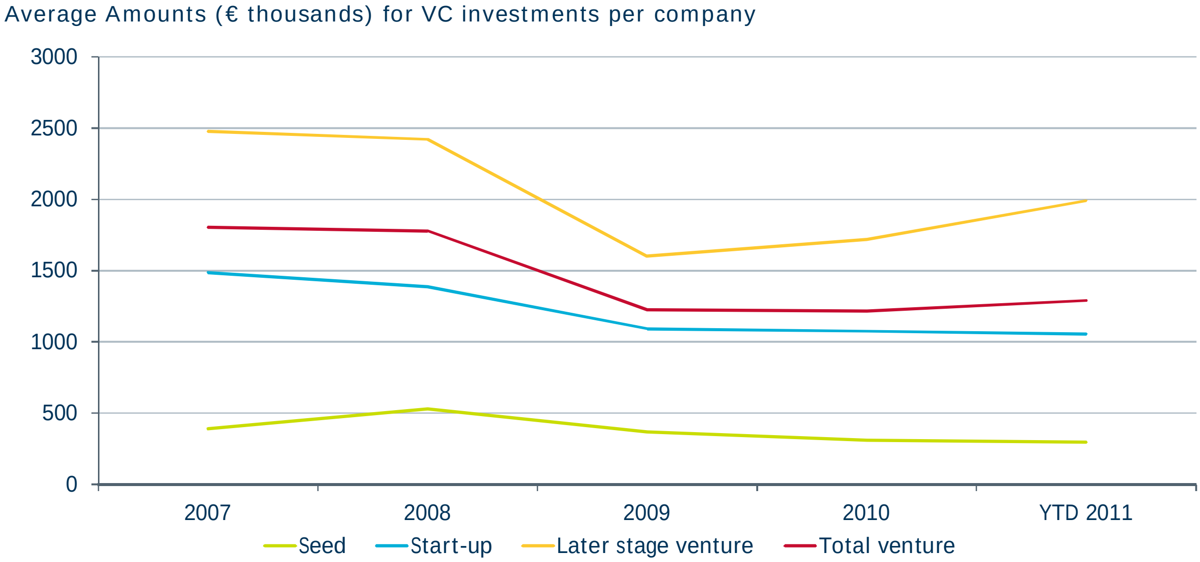
An example of the 'Valley of Death' being the gap between friends and family finance and formal venture capital as illustrated below is where the Business Angel and early stage funds are positioned.

The Funding Ladder and ecosystem:



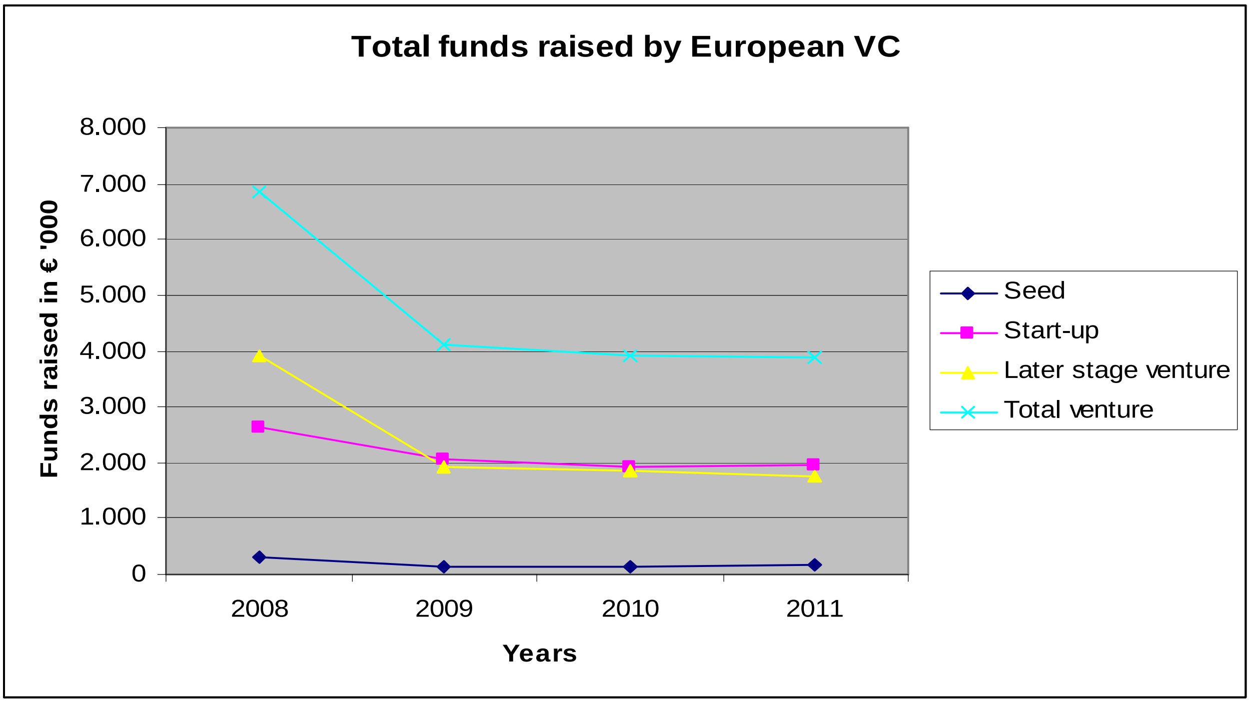
Note: Loans at the start up stage in the funding ladder above refer to 'soft loans' from public sector bodies and not commercial bank loans

As indicated below, European venture funds tend to invest on average about € 300,000 in the seed stage and around € 1 million at the start-up stage.



Source: EVCA\PEREP_Analytics

However, the following graph demonstrates that seed investments by VC funds are very rare and account for only 3-4% of all VC investments in Europe. In addition, overall VC fund raising has declined by 45% following the financial crisis, thereby exacerbating the equity gap for early stage investments.



Source: EVCA\PEREP_Analytics

In Europe Business Angel investment is currently only € 3-4 bn compared to nearly € 20 bn Euro in the US[8], yet the GDP of Europe is currently some US $ 2.5 m trillion greater than that of the US.

Research from the British Business Angel Association (BBAA) on angel investor returns in the UK published in 2009[9] shows that 56% of investments made failed to return the investor's stake money. This high failure rate was comparable to the failure rates in the US[10]. Despite this high failure, overall, returns by angel investors in both studies were positive with internal rates of returns exceeding 20% per annum (based on an overall portfolio approach).

2.3.2. Competitive funding process

Due to the high risks of the investment process described in the previous section, experienced investors seek SMEs that have the potential to generate a very high return and often adopt a portfolio approach to offset their potential gains with some inevitable significant losses.

To determine the potential for high growth, Business Angels and early stage venture capital funds will often adopt the following criteria when screening applications from entrepreneurs for equity funding:

- Sectoral focus: firms considered for investment tend to have a focus on disruptive technology (web/mobile/software, med tech, clean tech) and consumer goods/services

- Attractive market: the product or service must have the potential for a significant and growing addressable market, and preferably for an international expansion strategy

- High growth business: the company must have an innovative and scalable business model

- Potential for explosive growth: the company should have the potential to become a key market leader

- Sustainable competitive advantage: the company must have a clear competitive advantage, scalability and high barriers to entry, for example through intellectual property protection or exclusive commercial arrangements

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8 Based on data provided by the Angel Capital Association (ACA) and the European Business Angel Network (EBAN)

9 http://www.bbaa.org.uk/node/106

10 www.kauffman.org/pdf/angel_groups_111207.pdf

- **Strong management team**: the company must have some persons in the management team with relevant operational/sector experience (the team could be strengthened with some new key hires post completion of funding)

- **Validation within the market place**: some evidence of initial market traction must be presented, e.g. possibly through a trial customer or even some early sales

- **No requirement for significant further product/service development**: the products and/or services should be past the initial concept stage or for hi-tech investments beyond initial 'Proof of Concept'

- **Seeking an exit in the medium term**: there must be a clear vision how in the medium term (3 – 7 years) the investment can be exited, possibly via acquisition, trade sale or stock market flotation, generating a significant return for both company directors and investors

Obtaining equity finance is therefore a very competitive process for entrepreneurs and not all start-up SMEs seeking finance to grow their business will meet these types of criteria. Many companies will therefore need to seek alternative finance sources to fund their businesses using either retained earnings or bank finance which may include debtor, leasing or other asset finance.

However, the VICO research project[11] has shown that VC investments made by experienced, independent VC managers can add significant value to portfolio companies in terms of growth and crisis resistance. Portfolio companies researched by the VICO team indicated that independent[12] VC investors are adding value to their business through changing the management team; finding (international) board members and by having an exit orientation.

Moreover, it was demonstrated that in the crisis (2008) the VC backed firms outperformed the non-VC backed firms significantly in terms of sales and employment.

The VICO project also showed the significant value which can be created through cross border investments. Portfolio companies which have a mixed investor base (domestic and cross border investors) continuously outperform portfolio companies that are only financed by domestic investor or only by non-domestic investors making a cross

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11 ww.vicoproject.org

12 The research project distinguished between independent VC investors, corporate VC funds, bank-controlled VC funds and public sector controlling at least 50% of the fund.

border investment (throughout years 1 – 7 after the initial VC investment).

One of the main barriers to cross border investing is the need for local cultural and market knowledge, as well as the difficulty of monitoring investments. These appear to be greater barriers to cross border investments than the potential tax and regulatory obstacles. Cross border business angel and venture capital activities can help reduce the equity gap albeit raising funds across borders is where the barriers often exist rather than investing across borders.

2.3.3. Demand Side Market Failures

On the demand side which is the part where SMEs seek access to equity finance, European entrepreneurs or inventors are too often unaware of, or insensitive to investor concerns. This prevents them from presenting their projects to potential investors in a convincing way and acquiring investment. At the same time, innovative firms often need hands-on business experience from seasoned managers to overcome the hurdles of starting operations and early growth, and to increase the confidence of investors. In order to survive and flourish, entrepreneurs need to be commercially credible. They must be able to demonstrate both a compelling business idea and the necessary managerial and financial competence. For this they may need investment readiness support and advice.

3. VENTURE CAPITAL

3.1. Market development and trends

The VC fundraising statistics in section 2.3.1 have already indicated the widening equity gap for early-stage investments.

The key market failure faced by SMEs seeking equity finance in Europe is linked to the existence of an “equity gap “at the very early stage of an SMEs development which is particularly acute in the range of €250k to €2m, but below and above this range problems with accessing finance are also now being identified, particularly the “growth capital gap” of investment between €2m and €10m. The gap here is considered to be primarily due to asymmetric information between the VC investor and the business on the likely viability and profitability of the business.

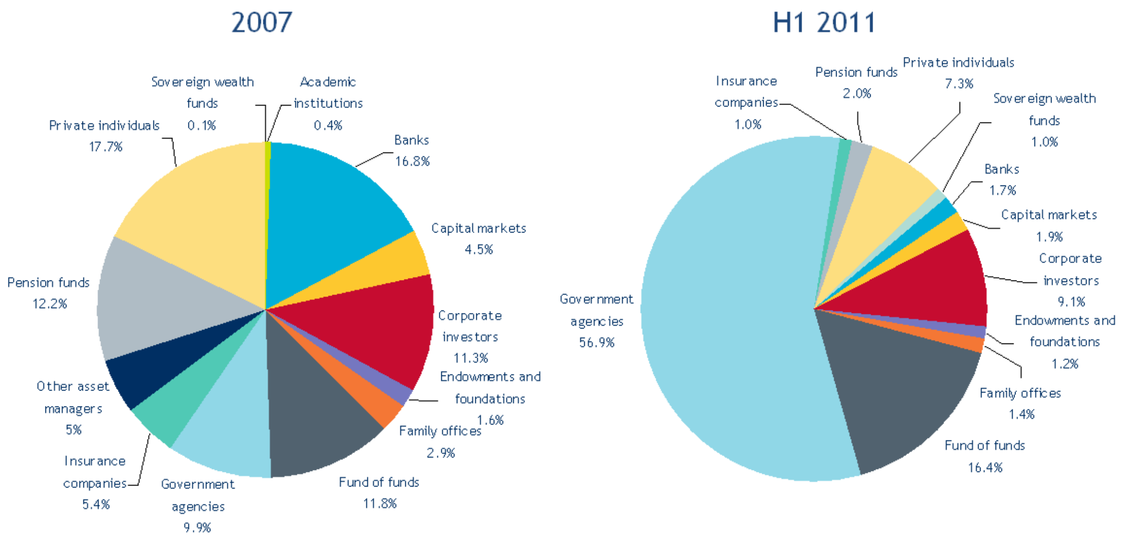
There are now few VC funds in Europe willing to consider investing below € 1 m in their first round of investment in seed, start-up or early stage. Fund managers experience difficulties in assessing the quality of SME proposals and associated likely returns leading to transaction costs which do not vary for the size of investment, such as due diligence costs.

The result is a structural gap in the market where investors and risk capital fund managers focus on fewer, larger investments in more established (lower risk) businesses, leaving viable businesses with growth potential not being able to obtain equity finance.

While the overall strong decline in fund raising negatively impacts on the funding available for innovative businesses, a close look also needs to be taken at the type of investors which currently remain in the market.

The reliance on the public sector for VC funding has increased and it is recognised that the European Investment Fund (EIF), who receives funding for venture capital investments through mandates from public sources, is now the largest VC investor in Europe.

The graph below illustrates this point. In 2007 Government agencies accounted for less than 10% of investment in European venture capital; by the first half of 2011 this had grown to over 55%.



Source: EVCA

The relatively poor historic returns obtained by European VC funds for their investors over the last ten years have blighted the market for new institutional money. As show in the graph above pension funds, banks and insurance companies have significantly reduced their exposure to this asset class.

EVCA commented on this aspect in one of their position papers as follows:

“Venture capital in Europe is now characterised by a reliance on public sector institutions such as the European Investment Fund ("EIF"). It is essential that programmes managed by the EIF and other institutions at a national level are continued. It is also crucial they are built upon and complemented. The investor base must be expanded and diversified if in the long-term the European venture capital industry is to become self sustaining”

3.2. Seed, start-up, early-stage funds, examples of public/private sector collaboration

Public intervention to stimulate the chronic shortage of supply of capital into new seed, start up and early stage VC funds has been channelled through public/private co-investment VC funds managed by private sector fund managers.

The aim of these funds is to increase the availability of capital for innovative SMEs affected by the ‘equity gap’. The fund structure is designed to encourage an increased flow of private capital into the equity gap, by adjusting the risk-reward profile for private investors making such investment; and by lowering the barriers to entry for entrepreneurial risk capital managers by reducing the amount of private capital needed to establish a viable venture fund.

In recognition of the supply side market failure and consequent equity gap in Europe, the European Commission has allocated resources to the European Investment Fund (EIF) under the Competitiveness and Innovation Framework Programme (CIP) to the High Growth and Innovative SMEs facility (GIF). Under this facility, the EIF invests in venture capital funds which cover early and growth stage investments with a view to improve access to finance for SMEs. Between 2007 and end of 2011 the EIF has invested under this facility about € 350 million thereby enabling early and growth stage VC funds to raise € 1.9 billion.

Another example of the public/private funding model is in the UK where the government has since 2006 set up eleven public/private Enterprise Capital Funds modelled on the USA's SBIC programme. These funds are overseen by the UK Government's SME Finance body 'Capital for Enterprise Limited' (CfEL) being the UK Government's Fund of Funds manager. These Funds known as Enterprise Capital Funds are now operating as new UK VC funds being designed to stimulate the development of new early stage investment funds. It is an asymmetric model (which was approved by the European Commission under State Aid Rules) which enhances the upside (return) for private investors but does not provide any downside (risk) protection. The funds are focused on national investments and typically have a size of €30-40m. Public funding is provided for up to 2/3rd of the fund size with private non-institutional investors investing at least 1/3rd. Private investors are often business angels, family offices and small corporate investors.

A further example is in Germany with the introduction of the High-Tech Grunderfonds[13] which has been financing young technology companies domiciled in Germany and not older than 3 years since 2005 with nearly €300m of private/public funding. Within the first 5 years approx. 250 companies from the high-tech sector have been supported. The Gründerfonds II started on 27th October 2011 with an investment volume of €288.5 m.

These public/private initiatives have helped to partially offset the shortage of supply of new national VC funds operating in the early stage equity gap coinciding with a period when new institutional VC funds operating at seed/start up and early stage has been significantly declining.

3.3. Expert group's views and deliberations

The prevailing view of the expert group was that the equity gap changes by region and sector which is confirmed by data published by

13 http://www.en.high-tech-gruenderfonds.de/

EVCA (EVCA publishes statistics on fundraising per country and per stage of investment)[14].

The expert group agreed that the shortage of venture capital in Europe is economically unsustainable with this problem being exacerbated by the current economic crisis. Because of the fragmented markets along national lines, VC supply is less competitive and smaller than it would be with less fragmented markets.

The expert group was concerned about the shortage of venture capital in Europe and therefore indicated the need to attract more private capital into the VC market.

The expert group agreed that there is an urgent need for public money to support VC funds at national level and that funds should be large enough to be able to finance investments through different stages. It was recognised that if funds supported by public money invest only at the very early stage, then these funds will see a dilution of their investments through later rounds in which they cannot participate, but these are normally the rounds where the returns come through. The expert group supported the view that in order to maximise returns and to be able to produce attractive returns for private investors, national VC fund models should operate with fund managers who have national coverage and not a regional limitation.

The expert group's view taking account of the outcomes of the Vico project was that there are likely to be significantly more challenges for SMEs seeking equity finance from investors who are based outside their own country (which can often lead to a more elongated fundraising process) albeit cross border deals can bring higher returns to investors when investees have access to a larger market and can also decrease investment risk with investees operating with a more flexible and 'shiftable' client base.

The expert group believes that it is essential to address this VC funding gap and that policies should be developed that lead to a boost in the supply of funds particularly for European cross border early stage VC investing.

The expert group reviewed possible fund-of-funds structures where also non pari-passu investments between private and public investors could take place (subject to State Aid Rules). The objective was to consider how private investors can be attracted back to this asset class along with institutional investors.

[14] http://www.evca.eu/knowledgecenter/statisticsdetail.aspx?id=6392

3.4. Expert group recommendations related to venture capital

Recommendations for the EU level:

The European Commission should consider supporting European VC funds and fund-of-funds structures with a clear European angle that invest cross border into SMEs at all stages.

Funds which receive financial support should be of sufficient size to support a company to an exit.

VC funds and fund-of-funds structures that are supported by EU public funding should be managed by experienced fund or fund-of-fund managers.

In this context the European Commission should consider the EIF's specialised role and experience with EU programmes.

Recommendations for Member States:

Member States should consider supporting models for national VC funds (possibly based on asymmetric risk sharing) that invest into businesses at the early stage and are of a sufficient size to support a company to an exit.

National VC funds supported by Member States should also be encouraged to make cross border investments.

Member State funds that are supported by the public sector should preferably be managed by experienced fund managers with relevant investment experience.

4. BUSINESS ANGEL FUNDING

4.1. Market development and trends

Business Angels are private (mostly high net worth) individuals who either solely invest their own cash into SMEs or alternatively invest in syndicates where typically one angel in the syndicate takes a lead role. Angels will normally have no previous family connection with the business and will be making their own investment decision rather than through an independent manager.

The lead angel of the syndicate or the angel investing alone will typically follow the investment after it is made by either observing or sitting on the Board of Directors and provide his/her knowledge, experience and support to the investee company by way of mentoring assistance. Good angel investors can provide "smart and patient capital."

Business Angels investment activity and performance is very difficult to monitor unless they are tracked by being members of a recognised Business Angel Network. EBAN reported in 2010 that there are about 350 organised angel networks and groups in Europe compared to around 50 in 1999. EBAN concludes that this statistic is "only the tip of the iceberg" due to the lack of visibility of the unstructured angel market in Europe. These 350 organisations gather some 20,000 Angels and receive 40,000 business plans on average each year. EBAN also confirmed in a 'White Paper Policy' document published in 2011 that there is now "a clear interest from Business Angels, traditionally local investors, to look at collaboration (including investment) opportunities in different countries throughout Europe and beyond."

EBAN's published annual statistics[15] typically indicate that Business Angels, working together in syndicates, invest on average € 200 k per deal in Europe (often with 2 -10+ angels involved). The amount invested can vary greatly depending on the country and region, with individual angel investments ranging from €15k to € 400 k and Angel syndicates sometimes investing in excess of € 1 mio.

EBAN estimates that the total sum invested by Business Angels annually into Europe's SMEs is ca. € 3-4 bn with over a third of this activity being carried out in the UK where attractive (30% - 50%) up front tax rebates are available for individual Angel investors but only for investments made in businesses that are headquartered in the UK.

By contrast, the Angel Capital Association (ACA[16]), the US trade body for Angel investing, estimates that Angel investment in the US is

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15 (www.eban.org/resource-center/publications/eban-publications)

16 www.angelcapitalassociation.org/

ca. $ 20- 25 bn per annum (€ 16-19 billion), being some five times greater than that currently in Europe. ACA estimates there are some 250,000 Business Angels in USA compared to EBAN's estimate of 40,000 – 50,000 Business Angels in Europe (which is more than double the number of Business Angels which are traceable through Europe's networks).

4.2. Examples of private and public intervention

4.2.1. Tax incentive schemes

A number of Member States provide tax incentive schemes to individuals to encourage them to invest in early stage companies. EBAN has compiled a comprehensive study about fiscal incentives in 2009[17]. These schemes tend to provide tax breaks for the amounts invested in early stage companies.

4.2.2. Awareness raising schemes and professionalization of the industry

EBAN and many Member States such as France and the UK have recently launched "Awareness Programmes" to attract new Business Angel investors into the market. Also, efforts are under way to professionalize the Business Angels sector. For example, EBAN is considering the implementation of professional standards for their Business Angel Networks members

4.2.3. European Commission project on cross border Angel investing

The issue of whether Business Angels are prepared to only invest nationally/locally rather than investing cross border was tested in an European Commission funded project titled 'Early Stage Investors Action for Growth of Innovating Businesses (EASY)'[18].

The project's objective was to stimulate cross-border investing by early stage venture capital market actors, to professionalise the process and to create tools.

It included 17 partners from 11 Member States and let to 7 cross border investment events (organised mostly stand-alone). It attracted 1,000 investors and 140 companies resulting in (in as far as was traceable) 14 investment rounds for over € 16 million. It also produced cross border guidelines, tool kits and templates for a limited number of Member States. The EASY project clearly identified the appetite of Business Angels to travel and invest cross border and to attend pitching events albeit this activity only took place as part of an organised EU subsidised pan European programme.

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[17] www.eban.org/resource-center/publications/eban-publications

[18] September 2006-September 2008, www.proinno-europe.eu/project/easy

4.2.4. Support for co-investments with Business Angels

The VICO project highlighted that a combination of public and private investments does become a challenge if the objectives of the different types of investors are not aligned (who gets to make the investment decisions, who does the due diligence)? The same principles can be applied to any publicly funded intervention in the Business Angel market in Europe. Below examples of two different models are illustrated which are currently under implementation with a view to combining public with private Business Angel funding.

For Germany, the EIF has established a pilot project funded through a mandate from the German ministry, which aims to co-invest with Business Angels in Germany. The co-investment facility has been set up in collaboration with the Business Angel Network Deutschland (BAND).

Under this pilot scheme the EIF selects eligible Business Angels and and Family Offices and then co-invests in all deals with the selected Business Angel based on framework agreements.

There is no exclusivity, which means that Business Angels may still invest alongside networks or benefit from public Business Angel support schemes. There is no investment committee involved, investment and divestment decisions are taken by the Business Angel autonomously. Business Angels do not receive a fee from the EIF, incentives are only the carry.

The co-investment amounts are between € 250,000 and € 5 million for investments undertaken over the investment period. The facility does not own a share in the company but it is the Business Angel or the Family Office which holds the equity on behalf of the EIF. The investor has to report to the EIF on a half-yearly basis, costs are shared on a pro-rata basis (e.g. legal fees).

In the UK, another type of co-investment scheme has been set up to support early stage investments alongside Business Angels. It is aimed at encouraging the development and professionalization of investment syndicates.

The Angel CoFund is supported by a commitment from the UK Government's Regional Growth Fund. The Fund has £50m available to invest alongside Business Angel networks or syndicates into eligible SMEs. The Fund operates by investing alongside and on the same terms as syndicates (it is not open to direct approaches from individual businesses).

It is a pari passu scheme based on the market investor principle. The CoFund acts as a private investor within 'partner' networks and syndicates. Generally the CoFund is open to all proposals as long as the syndicate is a new investor to the company (no financing of follow-up deals for avoidance of conflict of interest, pricing, investment time horizon, etc.). The CoFund will always invest less than the total from network partners.

The CoFund has been created by a consortium of private and public bodies with expertise in business angel investment. The CoFund does not have an investment manager but instead an investment Committee which allows the CoFund to have wide application, as new angel syndicate partners are selected by initially putting forward an investment proposal that is subsequently invested into by CoFund. The Investment Committee which decides on each and every investment proposal for CoFund has 10 members who are experienced Business Angel investors but because it needs to meet frequently it is quorate with three people and will normally have five invited for each meeting. This allows for anybody with a conflict of interest to step aside. The CoFund has an administrator who screens whether the criteria of the CoFund have been met. An investment proposal can be rejected but there is a strong feedback process build into the system. Follow-on investments are possible in principle.

Based on the first five completed transactions by the CoFund, the public money has been leveraged by more than 5 times through private money.

4.3. Expert group's views and deliberations

The expert group echoed the view recently expressed by OECD on the importance of angel investors in playing a crucial role in the economy in countries around the world[19].

The expert group recognised that rather than the traditional venture capitalists it is now the Business Angels who are becoming the key investors providing seed, start up and early stage funding as Business Angels are prepared to risk personal investment into SMEs at the very early stage of their evolution and frequently at the seed stage.

But as companies require funding for growth the public sector and other private sector players could provide further funding through venture capital funds possibly alongside further investment from Business Angels.

4.3.1. Angel Investor Capacity Building and cross border investing

The expert group considered that there was a need to professionalise Europe’s Business Angel community. Evidence from EBAN suggests

[19] Report “Financing High Growth Firms: The Role of Angel Investors", OECD December 2011(www.oecd.org/sti/angelinvestors)

(based on estimations) that whilst there are circa 40,000- 50,000 Business Angels in Europe only a limited number can be considered 'super angels' or experienced business angels capable of leading an angel syndicate. These more capable Business Angels should be supported and strengthened further to create a virtuous cycle. Adequate models of cooperation between the public sector and the Business Angels are needed. It was also recognised that EBAN reports that approximately only one in 10 of Europe’s current pool of Business Angels are women.

The expert group acknowledged that it is challenging to encourage Business Angels, who traditionally tend to invest more locally or nationally to go cross border and the expert group considered that benchmarking of cross border Business Angel investments should be undertaken to help investors to better understand the market.

It was recognised by the expert group that Business Angels often need to be accompanied to go cross border as they need to build relationships with investors in other countries (develop trust) with whom they are willing to invest; this collaborative environment needs to be facilitated possibly through vertical networks focused on specific industries.

4.3.2. Tax incentives for Business Angels

The expert group considered different tax schemes in some Member States which incentivise individuals to make much higher risk business angel investments rather than more secure alternative forms of investment. However, they cautioned against the creation of short term 'bubbles'. A high flow of short term 'dumb' money can lead to inflating company valuations with too much money chasing too little suitable investment opportunities.

The expert group concluded that such schemes need to be carefully designed to ensure that investment is targeted at the most acute equity gaps whilst also encouraging more cross border investing. The expert group expressed a concern that cross border investments by Business Angels are for example not encouraged in the UK as the specific tax incentive scheme is restricting Business Angels to only make national investments (as qualifying investments must be headquartered in the UK). This is, however, contrary to the French tax scheme, where for example Business Angels are permitted to structure qualifying cross border investments across the EU and not exclusively to companies that are headquartered in France.

4.3.3. Data and toolkit development for cross border investments

In order to attract significantly more private individuals to consider becoming angel investors, the expert group concluded that more pan European data and information is needed and such data should be made widely available. Especially data on likely returns, on exits and on what can angel investors do to influence a more positive outcome of the investment (similar to Nesta research[20]).

The expert group supported the view that, as demonstrated by the EASY project, Business Angels will invest cross border if the correct framework conditions exist.

Cross border investing requires trust among Business Angels. They will only invest in a cross border deal if in the country of the target portfolio company a trusted local lead investor exists.

The expert group lamented that the reference documents and toolkits that were produced through the EASY project only exists for a limited number of Member States and concluded that an extension of these to more countries would be very useful.

4.3.4. Business Angels and Venture Capitalists

The expert group's view was that there is currently a lack of structural co-operation between the investors at the different stages and sometimes a “disconnect” in the market between Business Angels and Venture Capitalists. The co-operation seems to work much better in the US which creates efficiencies and professionalises the industry. The current shifting environment in Europe was seen as an opportunity to create new models of co-operation between Business Angels and VC funds. Both investor types have a different approach to investing which makes the co-operation difficult. The professionalization of Europe's Business Angel Networks will help to raise the impact and standards of angel investing which will act as a catalyst for further engagement and connectivity with venture capital funds who are typically the later stage investors.

In this context it was recognised that Business Angels in general tend to invest in a much broader variety of companies than venture capitalists as the latter tend to focus on a small number of more established potentially high growth companies (with the most promising return potential) while not all Business Angels are only driven by return motivations (e.g. impact investors who also focus on achieving social or environmental objectives). It was acknowledged, however, that companies which are not focusing on profit maximisation could be better served through a finance mix (equity and debt).

The expert group considered that synergies could be created with more pitching events in Europe which have a dual focus; on the one hand they provide entrepreneurs with the opportunity to display their business ideas to investors, on the other hand 'would be' investors should be attracted to such events to learn how the industry works. Such events could also be used to bring Business Angels and VC investors together.

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[20] www.nesta.org.uk/publications/reports/assets/features/siding_with_the_angels/

4.4. Expert group recommendations related to Business Angels

Recommendations for the EU level:

The European Commission should consider supporting a European Business Angel facility that has an order of magnitude of at least € 250 million whereby the following elements should be taken into consideration for the structuring of the support:

- The facility should support investments by suitably experienced angel syndicates and groups (whether organised within or outside networks) and individual business angels investing locally and cross border;

- The facility should be designed to raise awareness of angel investing in Europe and help growing the eco system and the overall size of the European angel market; it should encourage the creation and development of multi country European BANs;

- The facility should support professionalization and transfer of best practices in Business Angel investing The facility should strive to support some form of standardisation across countries amongst others through the use of Business Angel co-investment schemes or platforms to enhance visibility on deal flow;

- The facility should be demand driven without any country quotas, only the best deals should be supported, the overall objective should be to build companies with international growth potential;

- This facility should be administered by an entity or entities that have specific business angel market and preferably cross border experience.

The European Commission should, based on the experiences of the EASY project, support further pan European projects which focus on cross border investing by Business Angels. The project should build upon the material already developed, develop it further and cover markets which have not been addressed so far.

The European Commission should further consider financially supporting the creation and development of cross-border angel networks.

In addition, the Commission should consider commissioning more research on the European Angel market and in particular on cross border angel investments and their characteristics.

In order to nurture and further develop the European innovation ecosystem, a dedicated budget for capacity building for innovation actors (ranging from entrepreneurs, business angels, venture capitalists to policy makers) should be provided in order to support them to encourage networking with other international innovation actors and increases the possibility of cross border investments.

Recommendations for Member States:

Member States should consider national policies for the financing of new angel networks and growing existing angel networks as established angel networks do not exist in all countries and many struggle to finance their core activities.

Nationally funded investor capacity building programmes should be encouraged.

Member States should also consider schemes raising awareness of Angel investing as an alternative investment class possibly by introducing tax breaks.

5. NEW EMERGING SUPPLY SIDE EQUITY GAP TRENDS / SOCIAL MEDIA AND CROWDFUNDING

5.1. Market development and trends

Crowdfunding (sometimes called crowd financing, crowd sourced capital), describes the collective cooperation, attention and trust by people who network and pool their money and other resources together, usually via the internet, to support efforts initiated by other people or organizations with the aim of supporting a common goal or project to which (in most of the cases) the individual feels emotionally attached.

The financial support can be in the form of donations, loans or equity or a combination thereof. Crowdfunding is emerging as a source of equity funding for seed, start up and early stage SMEs.

Crowdfunding is on the verge of also becoming a substitute seed financing source for entrepreneurial ventures that have difficulties raising capital from traditional sources like bank loans, angel capital, VC and others.

A recent study of the Fraunhofer Institute[21] concludes that:

"If carefully designed, crowd funding could become a serious alternative to or could at least complement the classical forms of early stage start-up financing and for this reason it deserves close monitoring. The difficulty, however, is that this phenomenon is so new that, so far, little empirical data exists and the number of scientific papers is still limited. On the other hand, thousands of web-based articles and blog comments have been posted and the print media have also begun to take up this subject in popular articles, but these do not provide sufficient information to obtain a clear picture of what crowd funding really is".

Massolution[22] forecasts that in 2012 $ 2.8 bn will be raised, up from $ 1.5 bn in 2011 and $ 854 mio in 2010 through all different forms of crowdfunding (donation-based, peer-to-peer lending and equity), which indicates a tremendous potential for this young industry. It reported that out of the 1.2 million campaigns that took place in 2011 654,000 occurred in Europe and 532,000 in North America.

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21 http://publica.fraunhofer.de/eprints/urn:nbn:de:0011-n-1859318.pdf

22 www.marketingcharts.com/direct/crowdfunding-platforms-raised-almost-15b-in-11-up-72-y-o-y-22049/massolution-crowdfunding-volume-growth-2009-2012-may2012jpg/

An example of a platform which offers raising start-up capital is Crowdfunder[23]. While a multitude of business models seem to exist, it appears that mostly entrepreneurs can register their proposals without charge. Investors can invest small amounts of equity in seed investments via the internet and the hosting site typically takes a 5% success fee. There are often no due diligence and 'checks and balances' for investors. The same issues can arise for online Business Angel Networks where the hosting site may not be undertaking any background checks and due diligence on the investee company before it is registered and promoted to investors.

5.2. Examples of public intervention

The expert group considered the regulatory issues and possible investor protections and reviewed the new US crowdfunding initiative. The House of Representatives has voted in March 2012 in favour of a Bill[24] that would allow companies to raise funds from private investors of up to $1million. There are a number of conditions attached (e.g. a single investor may not invest more than $10,000 or more than 10% of annual income into a company).

The Senate[25] voted in favour of a Bill that loosens SEC regulations in order to permit small businesses easier access to capital, thereby creating jobs. This Bill passed despite an impassioned plea by Majority Whip Dick Durbin to extend debate and hold hearings on small business legislation. The Bill now goes back to the House before being signed into law. Dick Durbin warned in March 2012.

“We will rue the day we ran this thing through the House and Senate without the appropriate oversight.” He argued that the only jobs being created by the act are those of “the new charlatans who are offering these types of investments.”

The Angel Capital Association (ACA) which is the North America USA trade association of angel groups and private investors that invest in high growth, early-stage ventures has highlighted its support for the concept of crowdfunding, currently addressed in the House of Representatives by stating that crowd funding legislation is needed.

5.3. Expert group’s views and deliberations

The expert group concluded that crowd funding, despite its rather recent appearance, is an area to be watched and not to be underestimated. It demonstrates the potential to become an important factor for financing activities for which almost no other alternative sources of funding are available (e.g. prototype funding). If used

[23] http://www.crowdfunder.co.uk/

[24] http://thomas.loc.gov/cgi-bin/bdquery/z?d112:H.R.2930

[25] http://thomas.loc.gov/cgi-bin/bdquery/z?d112:S.2190

correctly, it could also be seen as a positive signalling effect to future investors as it demonstrates that the business idea is attractive to the market.

However, experts also did see a potential for fraudulent behaviour by crowdfunding platforms that could put investors and entrepreneurs at risk. It was also pointed out that platforms in Europe that would be dealing with projects and investors on a cross border basis, very quickly had to deal with a regulatory environment which is currently divided along national boundaries.

5.4. Expert group recommendations for crowd funding

Recommendations for the EU level:

Crowd funding should be encouraged in Europe as it could become an important source of equity funding at the seed stage but it should not be over-regulated. However, some investor and entrepreneur protection may be needed.

The European Commission should consider setting up a specialised expert group to investigate crowdfunding, drawing on existing experiences in Member States and elsewhere internationally.

6. INVESTMENT READINESS AND ACCELERATOR PROGRAMMES

6.1. Market development and trends

Many SMEs in Europe fail to attract either Business Angel or venture capital finance due to the information asymmetry between entrepreneurs and investors.

Generally, entrepreneurs and providers of finance do not always speak the same language and have different perspectives. While this challenge already persists within national boundaries, the problem becomes even more severe on a cross border basis (different languages, different legal environments, and cultural differences to approaching finance).

Entrepreneurs often fail to access finance for their company for the following reasons:

- Poor and unrealistic business plans
- Lack of knowledge of the diversity of financial sources and those suitable for their business
- Lack of knowledge on how to successfully approach and professionally present business cases to potential investors with a proper understanding of the needs of investors

Investment readiness of entrepreneurs is an area on which a number of Members States have already focused. In addition, public and private incubator and accelerators are increasingly emerging to focus on commercialisation of Research & Development (R&D) as well as serve as a catalyst or hub in the entrepreneurial ecosystem.

The facilitation of networks, across sectors and geographies (local, national and international) are also important with the lack of an entrepreneurial culture in many countries being seen as a critical barrier to entrepreneurship. Without entrepreneurs, there will not be any start-ups. Changing culture is difficult and requires a long-term effort. Initiatives to raise awareness about entrepreneurship, such as Global Entrepreneurship Week, the growing number of 'Start-up (country)[26]' and other Initiatives are playing a key role. In addition, entrepreneurship is increasingly being introduced into curricula in some or all education levels in a growing number of European countries.

A healthy entrepreneurial ecosystem is critical for successful risk capital investing. Entrepreneurship can only flourish in a healthy entrepreneurial ecosystem in which a range of stakeholders play a

[26] For Britain: www.startupbritain.org/; for the US: www.s.co/

role, including entrepreneurs, investors, large companies, universities, governments, services providers, etc.

6.1.1. Investment Readiness

The provision of “investment readiness” training can improve the entrepreneur's understanding of how to access finance successfully by helping entrepreneurs to strengthen their business plan, understand the needs and requirements of different types of investors and to understand the strengths and weaknesses of their business including aspects linked to the management team.

Meeting angel investors and venture capital firms is often an integral part of an investment readiness programme. There are challenges, however, in the delivery of these programmes as key actors involved in training innovative SMEs must clearly understand and have personal experience of the angel/VC investment market in order to successfully bring investable SMEs to this highly specialised funding market. There are also cost issues as the provision of effective training which often includes 1:1 mentoring can be very costly and start-up entrepreneurs are unlikely to be able to meet the full cost of these programmes prior to receiving a round of equity investment.

6.1.2. Accelerator and Incubator Programmes

More recently there has been the emergence of accelerator and incubator programmes in Europe which allow very early stage innovative SMEs to work with organisations that have specialist sector in-house entrepreneurial expertise and funding. The goal being to work very closely with SMEs in order to develop and seed fund their business models. These programmes are often closely linked to the countries angel networks and VC’s.

6.2. Examples of publicly supported accelerator programmes

The Finnish VIGO[27] Programme is an example of an accelerator programme which was launched by the Finish Ministry in 2009.

Vigo is a new type of acceleration programme. It aims to bridge the gap between early stage technology firms and international venture funding. The backbone of the programme is formed by the VIGO Accelerators, being selected independent companies mainly run by internationally proven entrepreneurs and executives.

[27] http://www.vigo.fi/frontpage

Key elements of the programme are the following:

- The government (TEKES = Finnish Funding Agency for Technology) selected a private consultant to develop and manage the programme with the help of a supervisory committee consisting of private sector experts nominated by the ministry.

- It is the task of the committee to select teams of internationally proven entrepreneurs and executives which will form an accelerator (at this stage there is no funding for the accelerator involved), the teams have to demonstrate that they have the capabilities to help entrepreneurs build an international company; the accelerators are not consultants, they are co-entrepreneurs who must invest in the companies they work with.

- Through TEKES grants can be issued for up to € 1 mio to a company supported by an accelerator team; the accelerator team is allowed to charge during a period of 18-24 months a monthly fee of up to € 9,000 from the portfolio company.

- The Finnvera (Finnish Regional Finance Agency) seed fund can invest up to € 2 mio in a company selected by an accelerator team. Half of Finnvera's shares in a company can be bought later by the accelerator team at a fixed interest rate.

Results of the project after 24 months: 6 accelerator (Vigo) teams have been selected all accelerators have a specific focus (e.g. Cleantech, food processing innovations, web and mobile, etc.). Twenty full time managers work in the selected VIGO teams, managing over 40 portfolio companies with over € 70 mio invested (60% by the private sector, out of the 60% 2/3 is foreign investment).

6.3. Expert group's views and deliberations

The expert group acknowledged that there are a number of policy measures which have recently been developed across Europe focused on demand side actions which may help to increase the capabilities of entrepreneurs to present themselves and their projects to potential investors.

Developing human capability, whether on the investor or the entrepreneur side, was seen as critical by the expert. They agreed on their necessity and usefulness of supporting entrepreneurs who have growth orientated scalable business propositions through publicly supported investment readiness programmes especially in European countries where risk capital from either Business Angels or venture capital funds is scarce or markets are still developing/emerging, entrepreneurs lack understanding (e.g. Eastern Europe). Given that entrepreneurs in those countries would thus need to find financing outside their home country, cross border aspects are essential. The expert group cautioned, however, against the excessive use of consultants for the delivery of investment readiness training, In their view, this training support is best delivered by seasoned professionals 'who have been there' and who can provide powerful insights to entrepreneurs through real world examples and by sharing own experiences.

The expert group acknowledged the importance of the delivery of investment readiness and accelerator and incubator programmes in order to bring forward more “investable businesses” into Europe’s early stage investment market.

6.4. Expert group recommendations

Recommendations for the EU level:

The EU should consider supporting accelerators and incubators accelerators that support entrepreneurs not only financially but also in terms of management and business development and facilitate commercial connections (networks), provided that the companies are seeking cross border investment and international expansion.

The EU should consider only supporting accelerators and incubators which are run by seasoned professionals.

Recommendations for Member States:

Member States should consider supporting accelerators and incubators that support entrepreneurs not only financially but also in terms of management and business development and facilitate commercial connections (networks).

When setting up accelerators and incubators Member States should ensure that these are run by seasoned professionals as these will be able to attract private financing and leverage the public investment.

7. R&D AND INNOVATION

7.1. Market development and trends

Boosting innovation is often equated with boosting R&D spending. Significant sums of research funding are currently dedicated to the R&D phase across Europe but there are often no built in mechanisms which would ensure that once the R&D stage is completed additional funding can be accessed for prototyping.

There is a clear divide in Europe between the research sector and the start-up sector. One of the issues is related to Intellectual Property (IP) rights which are often unclear and researchers may not specifically consider a priority. For the creation of a start-up and raising seed investment it is indispensible to have clear ownership structures for the IP.

Technology based SMEs at the seed stage often spend their first 1-2 years developing their IP whilst producing a prototype. The funding at this stage is typically in short supply as the business is likely to be too small for conventional VC funds; angel investors and local seed funds may be the only means of capital supply.

7.2. Experiences from research projects

Access ICT[28] is an on-going European research project that aims to facilitate financing of attractive ICT SMEs, which have participated in the 6th and/or 7th Research Framework Programs and are seeking sources of equity capital to commercialize the results of their R&D activities.

The objective of this project is to review, consider and address the overall lack of external financing for many of the projects within the EC Research Framework Programme dedicated to ICT.

The project has two key partners with wide networks which are linked to angel and venture capital funding in Europe.

The project has raised awareness regarding access to finance issues. 2000 projects which have obtained research grants through the 6th or 7th Research Framework Programme were screened. For 300+ identified companies investment readiness coaching has been provided and 100+ have been introduced to relevant investors. First indications are that only a very small number of research funded project result in the creation of SMEs.

[28] www.access-ict.com

Some of the key reasons identified are the following:

- 90% of business angels surveyed at the beginning of the project did not know what 'FP7' was.
- Projects applying for research funding have mostly insufficient interest in commercialising the research results and to access debt and/or equity finance; after completion of the project researchers frequently apply for new research funding for different projects.
- There is a need for educational measures and information. Overall, the Research Framework Programmes seems to provide good opportunities for very early deal flow even though this is barely visible to early stage investors.

And these are some of the key lessons learned:

- There is a need to train researchers and SMEs involved in the research projects as early as possible about the potential for commercialisation of their activities and to address investment readiness issues.
- While one-on-one coaching was tried, one-to-many events are deemed more efficient and valued by the teams/entrepreneurs.
- Rather than hosting central events (e.g. in Brussels) it has proven to be more efficient to de-centralise activities and to use local partners (close to the researchers/SMEs) and to have them participate in local investment events.
- EU research projects can be a great value proposition to investors if they are investment ready; investors have to play a role throughout the commercialisation lifecycle.

7.3. Expert group's views and deliberations

The expert group believes that public R&D funding is too frequently focused on pure research and not directed at would be entrepreneurs who are looking to develop and grow a business and to commercially exploit their innovation both nationally and internationally.

The expert group expressed concerns that only a limited amount of public financing support is going into spin-offs from research institutes and universities. They felt that a part of the research budget should be earmarked for prototype funding which would more likely lead to new IP based SMEs being created across Europe.

Furthermore the expert group considered that when it comes to the selection of the research projects to be funded, the commercial exploitation potential should be taken into consideration with prototype funding not being limited to SMEs only, but that it should also be open to tech transfer offices and to research centres.

The expert group was of the opinion that at the seed stage private investors can be a solution to providing prototype equity funding for SMEs with supportive public (grant) money matching private investment and “not the other way around” (first private money and then to be matched with public money).

The importance of the private investor taking the lead in making investment decisions was highlighted as investors cannot be “pushed” into investing into an SME. The provision of partial grant funding would help to mitigate the very high risk for the private investor.

It was also emphasized that besides providing equity finance, the private investors bring critical commercial mentoring support at the prototype development phase. Researchers often had no ability to either identify or to discuss commercialisation with potential customers, a gap that could be bridged by the investors.

The expert group considered that researchers should be brought into closer contacts with a business environment (including sales and marketing). The business environment should not only be seen as providing funding for the next steps but also the necessary contacts to establish the validity of the research for commercialisation.

7.4. Expert group recommendations for R&D and prototype funding

Recommendations for the EU level:

The European Commission should consider setting aside a reasonable allocation of the EC's future R&D budget for grants going towards prototype funding and/or market validity testing and/or activities related to the building of the management team.

The European Commission should give priority in the allocation of these grants to applicants who demonstrate (before approval is granted) that there is a clear ambition to take the research further and to try to commercialise the results.

In order to ensure that there is a potential for commercialisation, applicants should in most cases have to raise a reasonable proportion of private funding from market participants prior to draw-down of the grant.

Evaluation committees evaluating the applications should include some representation from the investment and business community so that the commercial exploitation potential is adequately taken into consideration.

The European Commission should encourage applicants, in as far as is possible, to include Technology Transfer Offices and/or other exploitation specialists in the teams that apply for grants.

The European Commission should consider showcasing completed EU research projects for investment in local markets with events being organised at European level when next rounds of financing are required (taking them back to the European level).

As regards future research projects, educational measures and information should be foreseen for researchers and investors alike to inform those about the opportunities which research provides.

As part of the application for research grants, researchers should be encouraged to submit exploitation and dissemination plans.

Recommendations for Member States:

Spin out companies from research projects should be encouraged to make use of local partners such as angel networks in order to make initial connections with their early stage investment community.

8. ENTERPRISE EUROPE NETWORK (EEN)

8.1. Background

The Enterprise Europe Network[29] (EEN) has about 600 local organisations with about 3,000 experts serving 27 EU and 21 countries outside Europe including chambers of commerce and industry, technology centres, promotional banks, universities and development agencies. The EEN maintains direct contacts to about 2 million SMEs and organised about 12,000 events. They have close relationship with SMEs and provide them extensive services related to internationalisation, innovation and participation in EU programmes. Some network members also provide SMEs services in the area of access to finance and have good contacts with the local investment community.

Due to the breath of the network and its possibility to reach out to SMEs on a local basis the EEN is well placed to provide SMEs with information about European programmes, rules and regulations and to provide innovation support services.

As regards access to finance, services provided by certain EEN members have been limited so far. Any further involvement of Network partners on access to finance will need to consider the very diverse background of its Network members (only few members are banks, most of them are chambers of commerce or similar organisations) with limited expertise in finance as well as existing national infrastructures in the area of access to finance.

8.2. Expert group's views and deliberations

The expert group considered the diversity of the EEN and the wide range of different levels of expertise among the Network members. In view of this diversity experts expressed concern at allowing EEN members to provide advice on improving investment readiness and financial knowledge advice or training. In the view of the experts, this kind of service are best provided by real experts in the field, with the EEN providing a sign-posting task to direct SMEs to specialists in their region.

The expert group concluded that more financial specialists be encouraged to apply to become Network partners in the future. Some banks are already members of the Enterprise Europe Network and could provide services on access to finance to SMEs. The application procedure could be further simplified in order to reduce the administrative burden and increase interest for membership.

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29 www.enterprise-europe-network.ec.europa.eu/index_en.htm

The experts considered that the provision of 'vouchers' which would then enable SMEs to purchase the services from specialists when needed could be introduced.

Furthermore, EEN members could organise brokerage events in which they bring SMEs in contact with investors (which is an activity which is already undertaken by some Network members today).

8.3. Expert group recommendations related to the EEN

Recommendations for the EU level:

The Commission should ensure adequate quality of the services provided given the diversity of the EEN and the wide range of different levels of expertise among the Network members. EEN should focus on a sign-posting task to direct SMEs to specialists in the regions.

The Commission could encourage that EEN members with the necessary expertise in finance provide more detailed information on access to finance for SMEs.

The Commission could encourage EEN members which are experienced in transnational technology transfer and research projects to facilitate matching events with investors.

Recommendations for the Member States:

Member Sates should consider the feasibility of providing 'vouchers' which would enable SMEs to purchase services from specialists when needed for investment readiness programmes.

ANNEX 1: Expert group attendees, presenters and observers

	Participant	Nominated by
EXPERTS		
1	Anthony Clarke	Chairman (nominated by the Commission)
2	BAUMANN Brigitte	European Business Angel Association (EBAN)
3	BURNHAM James	European Private Equity and Venture Capital Association (EVCA)
4	HENTZSCHEL Ingrid	Enterprise Europe Network
5	HOLLE Oliver	European Association of European Chambers of Commerce and Industry (Eurochambers)
6	LAINE Petri	Network of European Financial Institutions for SMEs (NEFI)
7	MORANT Michel	European Knowledge Transfer Association (ProTon)
8	ROMANO José	European Investment Fund (EIF)
9	MORGAN-WILLIAMS Hugh	Business Europe
10	TAILLANDIER-THOMAS Marie-Claude	European Association of national innovation agencies (TAFTIE)
11	VANRIE Philippe	European Business & Innovation Centre Network (EBN)
12	DI ANSELMO Andrea	European Association of Technology Transfer and Innovation Support Professionals (TII)
13	GANOOTE Michel	European Cluster Alliance

Experts invited to present to the Expert Group[30]

- Dusan Stojanovic: Founder of True Global Ventures
- Colombo Massimo: Project Manager VICO Project
- Ken Cooper: Capital for Enterprise limited (CfEl) – UK
- Yesim Kose: Mandate Manager, EIF
- Pertti Valtonen: Counsellor of the Finnish Ministry of Employment and the Economy
- Frank Gielen: Director of Incubation and Venturing at IBBT (Belgium)
- Claire Munck: Ex CEO of EBAN

European Commission Staff participating as observers

- Deputy Head of Unit DG Enterprise and Industry, Unit E3
- Policy Officers, DG Enterprise and Industry, Unit E3
- Deputy Head of Unit, DG Research and Innovation Unit C3
- Policy Officer, DG Research and Innovation Unit C3
- Research Programme Officer, DG Information Society and Media Unit 2
- Policy Officer, DG Competition, Unit A3
- Policy Officer DG Markt, Unit G4
- Policy Officer, DG Regio, Unit D3
- Policy Officer, DG, ECFIN, Unit L2

[30] These experts only attended the meeting during which they presented