

Scoping Paper for
Horizon 2020 work programme 2018-2020
Access to Risk Finance (ARF)

Important Notice: Working Document

This scoping paper will guide the preparation of the work programme itself. It is a working document not formally endorsed by the Commission, and its content does not in any way prejudge the final decision of the Commission on the work programme.

The adoption and the publication of the work programme by the Commission are expected in October 2017. Only the adopted work programme will have legal value.

Scoping Paper for the Horizon 2020 work programme 2018-2020 Access to Risk Finance (ARF)

1. Context

This scoping paper draws on the report¹ of the 'Access to Risk Finance' Advisory Group; discussions at the Latvian, Luxembourg and Dutch 'Innovative Enterprise' Presidency conferences; the conclusions of the Dutch Presidency event on Philanthropic and Social Investments; reports made by the European Investment Bank (EIB) via 'InnovFin Advisory' at the request of the European Commission; the final report of the 'Action 9' Independent Investment Expert Group; the Communication on the Capital Markets Union; the outcome of the call for ideas on a European Innovation Council²; working papers from the European Investment Fund (EIF); reports by the OECD; the OXEPR roundtable on equity crowdfunding; and exchanges in the Horizon 2020 Programme Committee in its configuration 'SMEs and Access to Risk Finance'.

Advisory Group and stakeholder recommendations cover a stronger focus on alternative financing, especially equity crowdfunding; measures to increase cross-border investments; enhanced support for technology transfer offices and operators; greater efforts to increase potential clients' awareness of the funding opportunities offered by the financial instruments, and to simplify their offerings; improving the investment-readiness of SME Instrument clients; fostering the prospects of women entrepreneurs; and supporting VC funds with a lifespan that better matches the funding needs of 'deep tech' sectors such as cleantech and the bio-economy. Many of the recommendations made are embedded in this document, though due to the wide scope of many of them, and budget limitations, not all can be translated into concrete actions at this point.

The overall objective of 'Access to Risk Finance' is to help innovative companies and other bodies of all types and sizes to access debt and equity financing under reasonable terms and conditions.

The current Work Programme, covering 2016-2017, focuses on rolling out a debt instrument providing loans, guarantees, counter-guarantees and other forms of debt finance³, to innovating entities of all forms and sizes, and an equity instrument providing finance for mainly early-stage investments plus some growth-stage. A range of accompanying demand-side measures help firms improve their ability to access suitable sources of finance at each stage of the company life-cycle and during each innovation phase.

For 'bottom-up' debt, 'InnovFin MidCap Growth Finance' provides loans from €7.5mn to €25mn directly from EIB, 'InnovFin MidCap Guarantee' provides guarantees and counter-guarantees on loans from €7.5mn to €50mn supplied by banks and other financial intermediaries, with a portion of their potential losses guaranteed by the EIB.

¹ *Strategic Programme Consultation, Access to Risk Finance Advisory Group, June 2016*

² See <https://ec.europa.eu/research/eic>

³ The EU does not provide direct lending but a guarantee, mainly as a first-loss piece, to the EIB.

while 'InnovFin Large Projects' channels direct loans from €25mn to €300mn. These are demand-led instruments with no sectoral allocations.

For 'thematic' debt, 'InnovFin Energy Demo Projects' makes loans of between €7.5mn and €25mn to first-of-a-kind, commercial-scale industrial demonstration projects in the energy domain, or extends guarantees to financial intermediaries who will make such loans. 'InnovFin Infectious Diseases' makes loans of between €7.5mn and €75mn to SMEs, midcaps, special-project vehicles, research institutions and other entities for corporate or project finance, and to large pharmaceutical companies to finance the development of pre-identified medical products on a risk-sharing basis.

For SMEs and small midcaps, 'InnovFin SME Guarantee', supported by the European Fund for Strategic Investments (EFSI), provides guarantees and counter-guarantees on loans from €25 000 to €7.5mn supplied by banks and other financial intermediaries, with a portion of their potential losses guaranteed by EIF; and 'Uncapped Guarantee for Unsecured Loans to R&I-driven SMEs and Small Midcaps', to be launched in the second half of 2016, provides uncollateralised loans. The 'SME Initiative', which uses funds from COSME, Horizon 2020 and European Structural and Investment Funds (ESIF) combined with resources from EIB and EIF, provides guarantees or securitisation.

On the equity side, 'InnovFin SME Venture Capital', implemented by EIF via risk-capital funds, focuses on early-stage venture capital (VC) and business angel (BA) finance. It is complementary to COSME's Equity Growth Facility, with both instruments investing pro rata in multi-stage funds.

Complementing all of the above, 'InnovFin Advisory' guides clients on how to structure R&I projects to improve their access to finance, and also provides advice on improving investment conditions via sectoral analyses. So far, the latter cover key enabling technologies (KETS), transport, the circular economy, the bioeconomy, agri-food, health, and broadband. InnovFin Advisory also maintains a navigational aid⁴ to help companies find the InnovFin products that suit them best. In addition, actions such as InvestHorizon, the Independent Investment Expert Group and Progress-TT help coach entrepreneurs and innovation intermediaries, build their capacities, and bring them together with investors.

2. Strategic orientations for 2018-2020 and translation into financial instruments and calls

Securing suitable financing on reasonable terms and conditions remains a problem for innovative firms, and especially for SMEs and small midcaps, whose business models are not supported by most traditional financial institutions. The same applies to PROs. The results of a recent European Commission Innobarometer survey⁵ confirm that access to funding is a key obstacle for spurring R&D and the commercialisation of innovative products or services. At the same time, economic research shows that innovation is a crucial driver of long-term productivity and economic growth. At present, when many

⁴ *Six simple steps to loan funding* <http://helpingyouinnovate.eib.org>

⁵ See Innobarometer 2014, European Commission: http://ec.europa.eu/growth/industry/innovation/facts-figures/innobarometer/index_en.htm

companies need to restructure following the protracted recession, there is a particular need to support innovative SMEs and small midcaps in making investments.

For medium and large midcaps and large firms, although capital is available, banks are often unable to offer appropriate terms. Especially for midcaps, most of what the market offers for short-term, highly collateralised financing, usually fee-heavy, that does not match the characteristics of the long-term, flexible debt required by companies seeking to fund investments primarily in intangible assets (such as research staff and acquisitions). The demand exceeds the available supply of suitable offerings.

Turning to equity, potentially viable, profitable SMEs and small midcaps, as well as PROs, are often unable to raise venture capital for R&I, especially at the earliest, most risky technology transfer stages. The same applies at the scale-up or expansion stage. For medium and large midcaps, there is a significant short-fall between the supply and demand of equity-type financing, and a discrepancy between the optimal investment product and what is available.

The new generation of EU financial instruments for R&I, launched in 2014-2015 under Horizon 2020, was designed to help address this situation, and the prime demand from stakeholders for 2018-2020, as for 2016-2017, is for their continued implementation. Stakeholders also want to see the piloting of new facilities in response to developments in the risk finance landscape and the wider economic environment. A holistic approach to improving access to finance — complementing the provision of finance itself with other initiatives that improve framework conditions — will continue to guide the development of Horizon 2020's financial instruments.

The main challenge for 2018-2020, as for 2016-2017 and 2014-2015 before, is to ensure a sustainable pipeline of financial instrument operations with a good geographical spread, and the involvement, for intermediated products, of a broad, diverse range of types of financial intermediary. To achieve this will require further measures to inform and engage intermediaries, investors, corporations and final beneficiaries.

In addition, 2018-2020 will feature the launch and roll-out of a pan-European VC fund-of-funds funded by Horizon 2020's 'Access to Risk Finance', EFSI, and the EIB Group (support from COSME is also foreseen). This product will be part of the new, overall risk-sharing equity instrument, developed in 2016, backed by Horizon 2020's InnovFin, EFSI and EIF as risk-sharing partners. This InnovFin/EFSI equity instrument — forming the early-stage part of the Equity Investment Platform of the SME Window of EFSI — embeds, as well as the fund-of-funds, the products InnovFin SME VC, Piloting Co-Investments by Business Angels (launching in 2017), and the InnovFin Technology Transfer Financing Facility (launching in 2016). Generally, further and stronger interactions between InnovFin and EFSI will typify this period.

In the light of the above, the main objective for 2018-2020, as in 2016-2017, is to keep improving access to sources of debt and equity financing, and its take-up and absorption, by innovative companies of all sizes and by research centres and universities, public-private partnerships, R&I infrastructures, special-purpose vehicles or projects, innovation procurement projects, and joint ventures.

On the debt side, the anticipated impacts of Horizon 2020's financial instruments in 2018-2020 are more direct loans to larger firms and other entities in terms of the number of operations and the volume of funding mobilised; and more intermediated loans to SMEs, small midcaps and other midcaps in terms of the number of agreements reached with financial intermediaries and the volume of funding mobilised).

Anticipated impacts on the equity side for innovative SMEs and small midcaps are a higher volume of 'formal' early-stage equity financing available in terms of the number of agreements reached with venture capital and other risk-capital funds and the volume of funding mobilised; a higher volume of 'less formal' early-stage equity financing available in terms of the number of agreements reached with business angel groups and other less institutionalised groups and the volume of funding mobilised); and greater technology transfer financing in terms of the number of agreements reached with technology transfer funds and vehicles and the volume of funding provided.

There are links to several other parts of the Horizon 2020 work programme:

- Enabling SMEs emerging from phases 1 or 2 of the SME Instrument to access risk finance (phase 3) [Leadership in Enabling and Industrial Technologies and all Societal Challenges].
- Improving the potential of SMEs to undertake innovation [Innovation in SMEs].
- Improving access to risk finance by R&I infrastructures [European Research Infrastructures (including e-Infrastructures)].

'Continuity' will be an important principle in the next work programme, with the financial instruments and accompanying measures launched in 2014-2015, and continued or launched in 2016-2017, sustained in 2018-2020. Above all, though, increased interaction with EFSI is likely to characterise this period, given the Commission's intention to call for an extension of EFSI beyond 2018⁶. On this basis, cooperation between InnovFin and EFSI will intensify, and will come to cover, as a priority, the whole range of SME-focused debt and equity facilities, including the VC fund-of-funds. Also, EFSI, with InnovFin, will reinforce the current thematic products, InnovFin Energy Demo Projects and InnovFin Infectious Diseases, which are in much demand. And to ensure stronger support for R&I by the European Investment Advisory Hub, InnovFin Advisory will receive more resources.

The financial instruments to be continued are InnovFin Large Projects, InnovFin MidCap Growth Finance, InnovFin MidCap Guarantee, InnovFin Energy Demo Projects, InnovFin Infectious Diseases (*Loans Service for R&I in the Work Programme 2016-2017*); InnovFin SME Guarantee (*SMEs & Small Midcap R&I Loans Service*), SME Initiative Uncapped Guarantee Instrument (*Joint Guarantee Instruments for R&I-intensive SMEs and Small Midcaps*), and 'Uncapped Guarantee for Unsecured Loans to R&I-driven SMEs and Small Midcaps' (launching in 2016); and InnovFin SME Venture Capital, Pan-European VC Fund-of-Funds, Piloting Co-Investments by Business Angels

⁶ See section 5 of *Europe investing again: Taking stock of the Investment Plan for Europe and next steps* COM(2016) 359, 1.1.2016

(launched in 2017), and the InnovFin Technology Transfer Financing Facility (launched in 2016) (*Equity Facility for R&I*).

The possibility of topping-up existing products with ring-fenced budgetary contributions and of developing new thematic finance instruments will continue to be explored, with a particular focus on, as examples, the circular economy (potentially involving an investment platform), bioeconomy and key enabling technologies (KETs).

The main accompanying measures to be continued⁷ are InnovFin Advisory (*Technical and Financial Advisory Service for Risk Finance in R&I*), the EBRD-provided *Technical Assistance for Financial Intermediaries and Small, Innovative Firms* (to be launched in 2017) and the Coordination and Support Actions *Capacity-Building in Technology Transfer* and *Boosting the Investment-Readiness of SMEs and Small Midcaps*. In addition, the *Six simple steps* application will be updated to cover new financial instruments and intermediaries.

Potential pilot financial instrument facilities (or new features integrated into current instruments) may feature the wider use of blended finance (grants with loans and/or equity), convertible loans, and varieties of claw-back or royalty-based grants⁸; co-investments with equity crowdfunding platforms; support for venture philanthropy and impact investors; loans based on or including intellectual assets, including patents and other intellectual property rights as collateral; and R&I bonds/mini-bonds and dividend-based investments.

There may be calls for proposals covering capacity-building for philanthropic funding and impact investors, and further calls covering studies on risk-finance matchmaking platforms, credit-scoring registries, the application of fintech to improving access to risk finance, the European alternative finance market⁹ (including R&I bonds/mini-bonds), corporate venturing, support for incubators and accelerators, and on patent markets and technology transfer. An expert group may address the development of a charter for socially responsible investment.

Two calls for expressions of interest launched in 2014-2015 will continue to be open, addressing banks and other financial intermediaries for the products InnovFin SME Guarantee (via EIF) and InnovFin MidCap Guarantee (via EIB). The call for expression of interest for intermediaries for the 'Uncapped Guarantee for Unsecured Loans to R&I-driven SMEs and Small Midcaps' instrument (launched in 2016) will also remain open.

Subject to discussion with the incoming Presidencies concerned, conferences on access to risk finance will be held in each of 2018, 2019 and 2020.

⁷ With a potential shift from calls for proposals to calls for tenders.

⁸ Based on the outcomes, due in early 2017, of a study sponsored by the RISE High-Level Advisory Group.

⁹ Building on the findings of the 2016 DG RTD-commissioned study *Assessing the potential for crowdfunding and other forms of alternative finance to support research and innovation*.