Introduction to the upcoming fi-compass model FI combining grants and equity for innovation

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Strategic context and cohesion policy objectives

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The innovation financing gap

[ERDF Equity financial instruments (fi-compass.eu)]

- Start-ups are crucial to achieve the goals of the EU Green Deal, MS’ RDI agendas, and digital transition
- They are important in any innovation ecosystem aiming to deliver breakthroughs to the market.
- They are key contributors to jobs creation and sustainable European prosperity
- Despite many innovative and promising start-ups in EU Member States, very often innovative companies remain small or, after, relocate elsewhere, even outside Europe, to seek investors
- This is typically due to a lack of suitable funding tailored to support companies through the different stages of a start-up’ life-cycle.
  - compared to the US for example, the amount of venture capital financing for the early stage of innovative projects is relatively limited due to the actual or perceived level of risks and the risk appetite of the market financiers or lack of developed regional/national ecosystem
  - As a company grows, its need for investment increases meaning access to equity, quasi-equity products such as Venture Debt and lending is key to sustain and support the enterprise

→ **need for more dedicated forms of finance**

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Cohesion supports innovation: 2021-27 Cohesion policy objective 1

The combined equity FI is proposed within the framework of the European Regional Development Fund (ERDF) policy objective 1, ‘*a more competitive and smarter Europe by promoting innovative and smart economic transformation and regional ICT connectivity*’.

Financial instruments envisaged in the programmes and designed and set-up under specific objectives

- 1.1 ‘*developing and enhancing research and innovation capacities and the uptake of advanced technologies*’ and
- 1.4 ‘*developing skills for smart specialisation, industrial transition and entrepreneurship*’

need to be in line with the relevant smart specialisation strategy.

- 'Smart specialisation strategy' means the national or regional innovation strategies which set priorities in order to build competitive advantage by developing and matching research and innovation own strengths to business needs in order to address emerging opportunities and market developments in a coherent manner, while avoiding duplication and fragmentation of efforts; a smart specialisation strategy may take the form of, or be included in, a national or regional research and innovation (R&I) strategic policy framework.

Regulation (EU) N° 1303/2013 of the European Parliament and of the Council:

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Cohesion supports investments through Equity

To ensure long term sustainable growth in regions

To help developing/reinforcing the ecosystem

To support high risk high growth starts-ups that are outside banking radar

To support twin transition with long term funding

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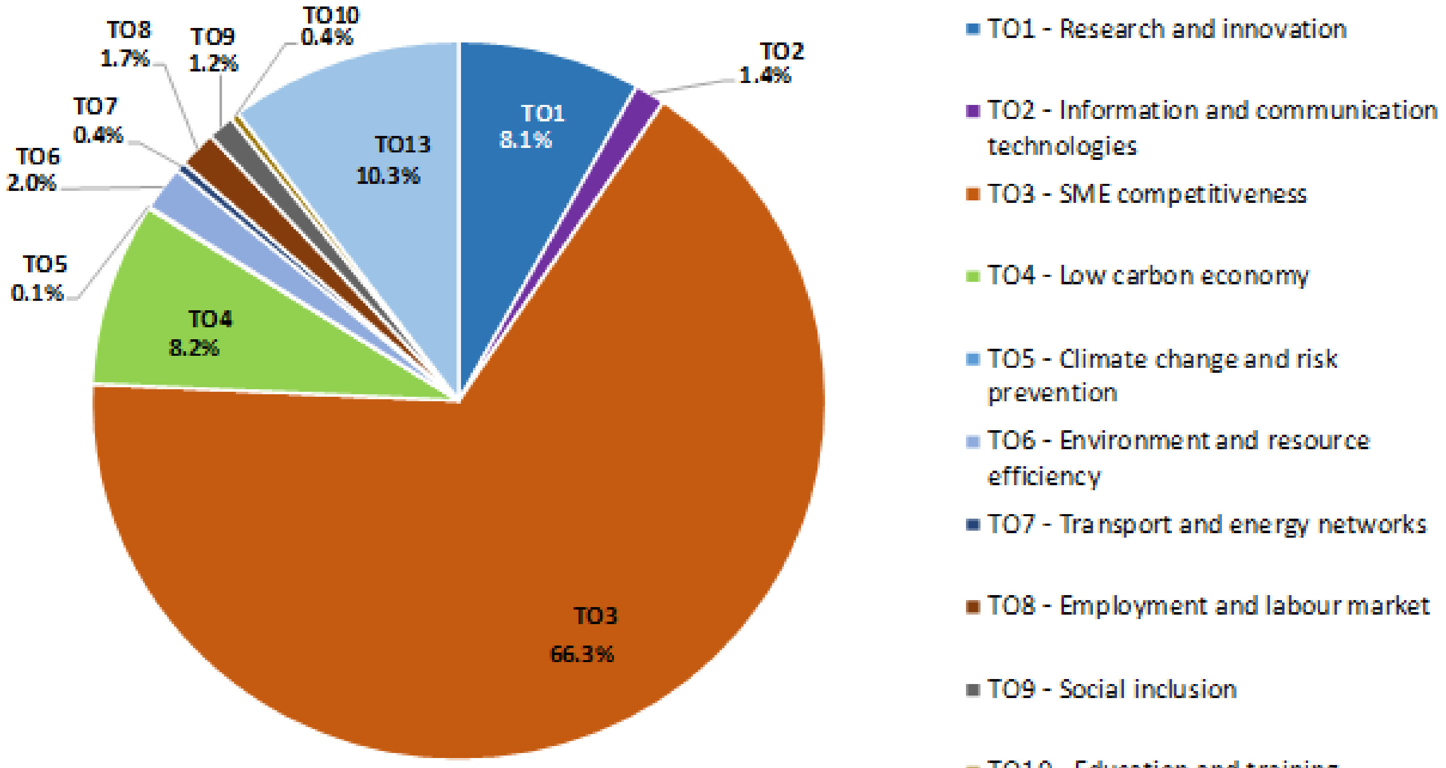
Financial Instruments for Innovation – 2014-20

Shared management funds – Data as of 31 Dec. 2022

Figure 2 Commitments to FIs in the funding agreements as percentage of total commitment by thematic objective (TO) at the end of 2022 (all ESIF)



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Equity Financial Instruments 2014-20 - stable around 15-20% of the total FIs

2007-2013: Equity was used mainly to support enterprises, but also urban development and energy efficiency

Limited policy objectives

17% of total resources paid to final recipients was through Equity

Total value of equity investments EUR 2,694 millions and **4,481 SMEs supported** (out of 221,810)

Leverage up to 18 (calculated on equity for which the MA reported additional contributions mobilised outside the Structural Funds)

2014-2020: Equity mainly to support enterprises, but also innovation, energy efficiency and urban development

Possible for all policy objectives

15.2% of total resources paid to final recipients was through Equity. During COVID, despite the Equity market remaining stable, Equity instruments were slightly replaced by state guarantee.

Total value of EUR 3,348 million and 6,650 SMEs supported (out of 665,000) *

2021-2027: Equity mainly to support innovation and SMEs

Possible for all policy objectives

Estimated **allocations to Equity EUR 2,651** million

Mainly Poland, France, Germany, Bulgaria and Greece (in aggregate counting for 61%), the rest well spread among other Members states

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* Data ERDF and Cohesion Fund December 2022, published in November 2023 - summary_data_fi_1420_2022.pdf (europa.eu)

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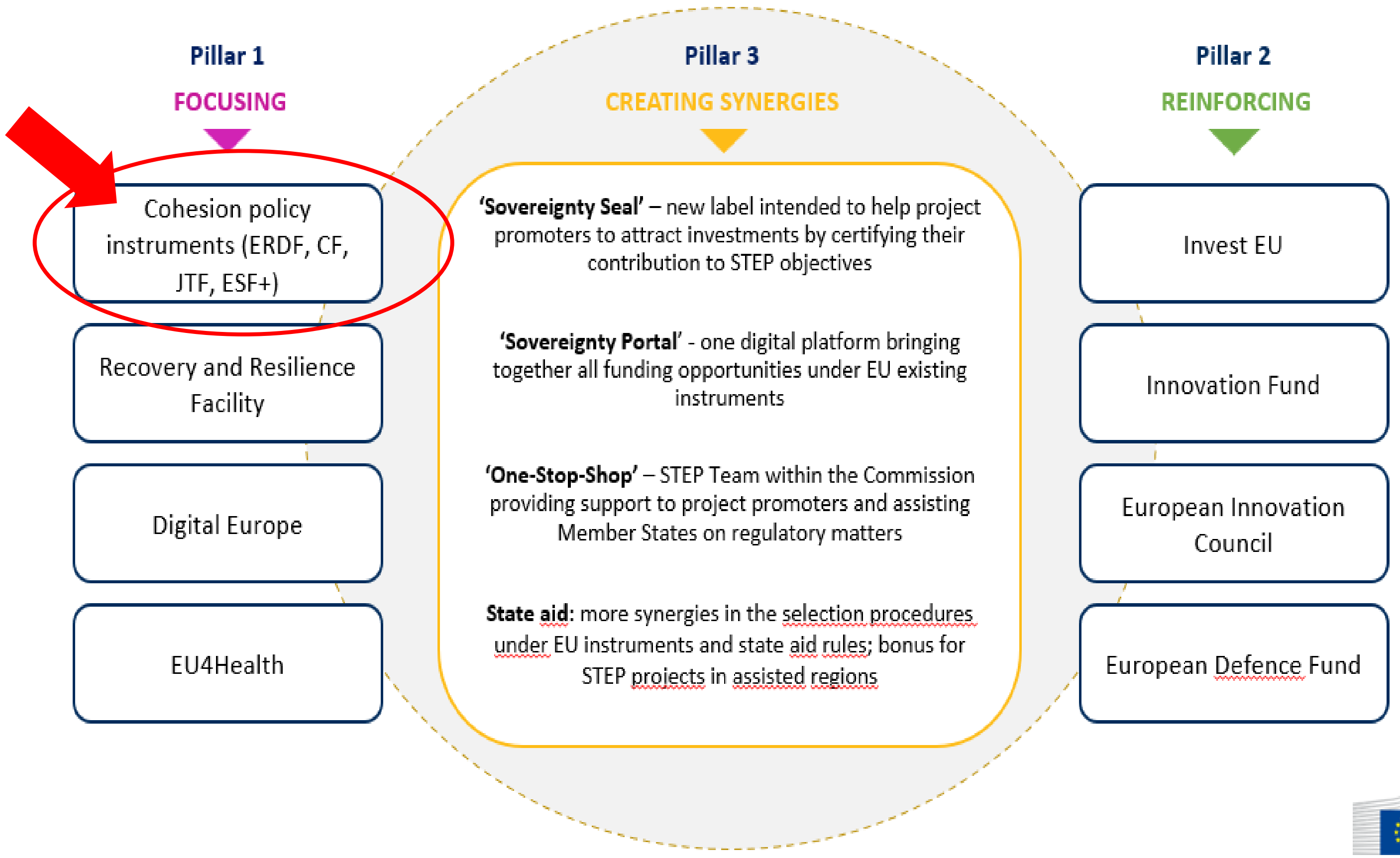
Strategic Technologies for European Platform (STEP)

- New specific objective under the ERDF/CF, under Policy Objective 1 (more competitive and smarter Europe) and Policy Objective 2 (green).
- The latter may open the ERDF/CF for large companies in all transition and less developed regions. In developed regions of those Member States whose GDP/capita is below EU average – to preserve the level playing field in the Single Market.



New regulatory framework for combined FI

Grant is directly linked & necessary to the FI

The programme support in the form of grants does not exceed the investments supported by the FI product

Grant is part of the funding agreement (Annex IX) & is provided by the body implementing the FI (HF/Fint.)

FI rules apply to grants when combined in one FI operation

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Why an Equity & Grant model?

To help the national authorities to:

- Design support for innovation in a sustainable way by developing / creating their equity markets: support the market demand pipeline and the investments
- Reflect on the potential of equity models for STEP objectives
- Reply to their questions about how a grant may work with an equity investment logic
- Make best use of cohesion funds which can offer funded financial instruments, appropriate to support equity

Two FI models for innovation under development

- Model combined loan FI for innovation
- Model combined equity FI

Two FI models already published

  - Model for a combined FI for energy efficiency | fi-compass
  - The fi-compass quasi-equity model financial instrument for SMEs | fi-compass

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Proposed structure of the combined equity Financial Instrument

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Combined Equity FI objectives

- Help cover the **equity financing gap** of innovative companies
- Provide **additional funding** to support strategic/innovation investments (e.g. Sovereignty seal)
- Use new regulatory combination options with grants to **develop tailored financial instruments** to tackle specific local and sectoral challenges during the innovation lifecycle
- Support the development of **equity ecosystems** in underserved areas

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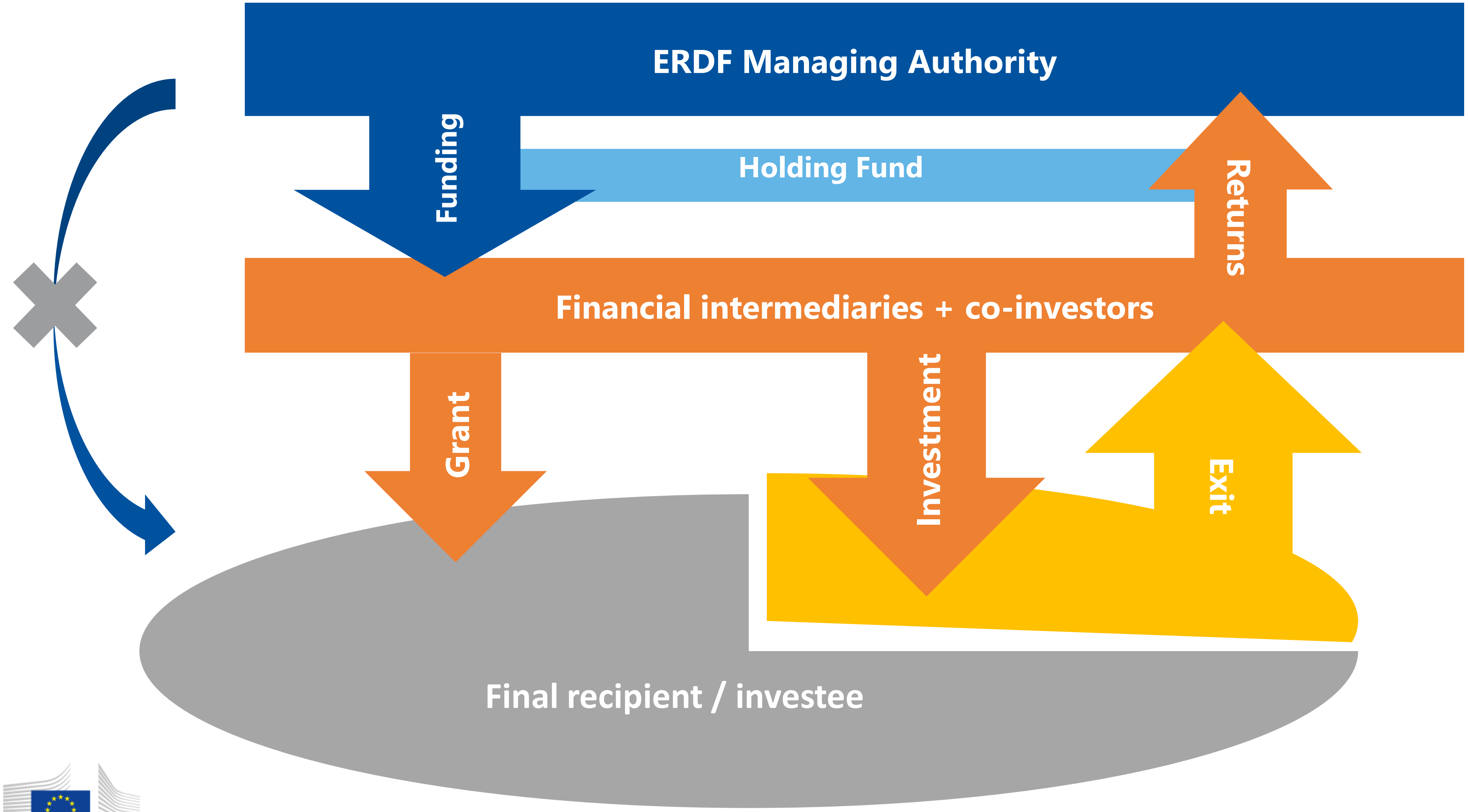
Structure



ERDF Managing Authority
Funding
Holding Fund
Returns
Financial intermediaries + co-investors
Grant
Investment
Exit
Final recipient / investee

Final recipients

- **SMEs, Mid-Caps or larger enterprises,** which comply with all the relevant eligibility criteria
- Final recipients may use the programme resources to invest in **producing, developing or implementing new or substantially improve**:
  - ✓ **products, processes or services**;
  - ✓ **production or delivery methods**; or
  - ✓ **organisational or process innovation** including innovative business models where there is a risk of technological, industrial or business failure as evidenced by an evaluation carried out by an external expert.
- Marketing, branding, activities related to protection and exploitation of intellectual property.
- Employee training, software development or database-related activities (including data analysis) and the purchase (or lease) of tangible assets.

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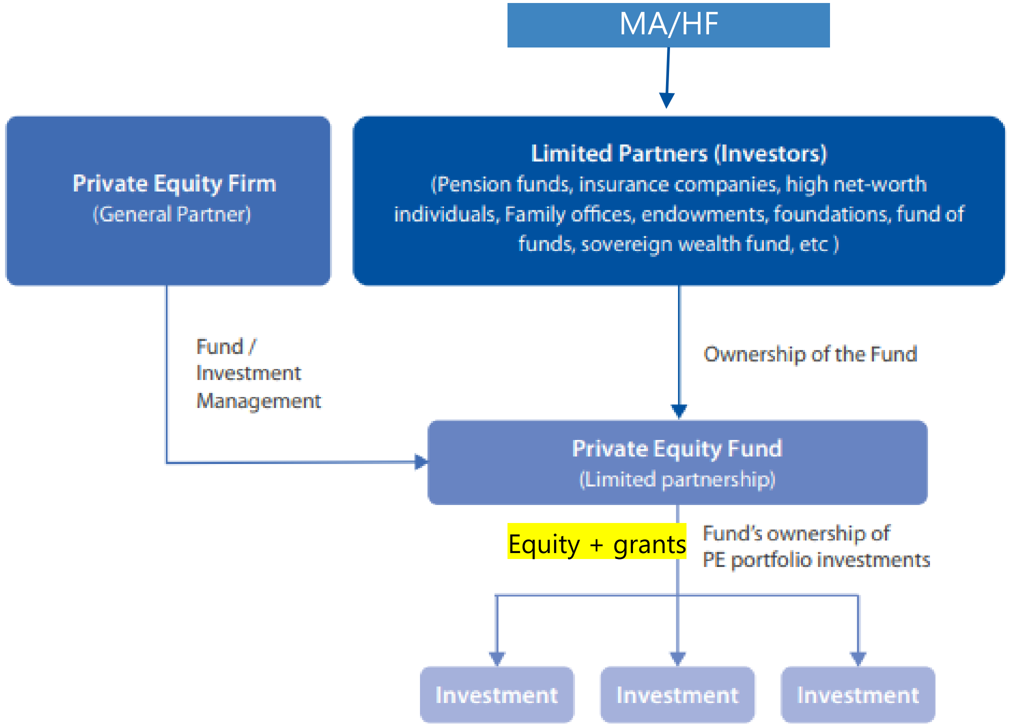
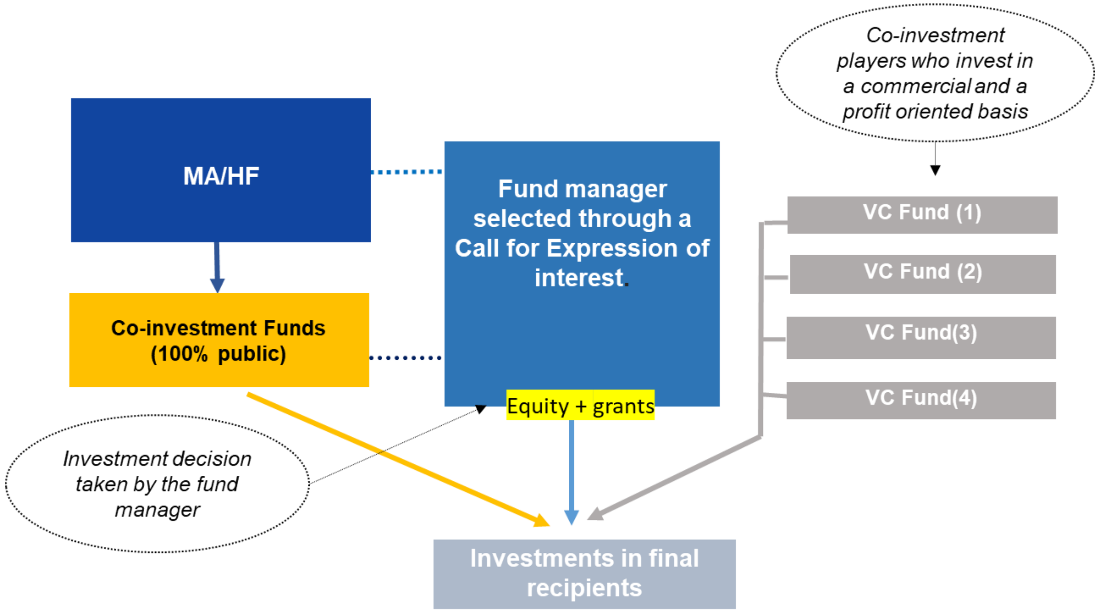
Types of Funds

Pooled Fund



Co-investment model



Source: fi-compass

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Role of the financial intermediary/fund manager

- The MA/HF selects a professional Fund manager, whose role will primarily be to:

Identify co-investors at Fund and/or project level

Performance of due diligence on the investment opportunities

Monitor and report on transactions' performance, reporting to the HF or the MA

Marketing of the FI products and identification of a pipeline of companies to invest in

Investment decision (profit-driven), grant provision, negotiation of the legal documentation

Definition and execution of an exit from the investment

Provision of strategic advice to investees

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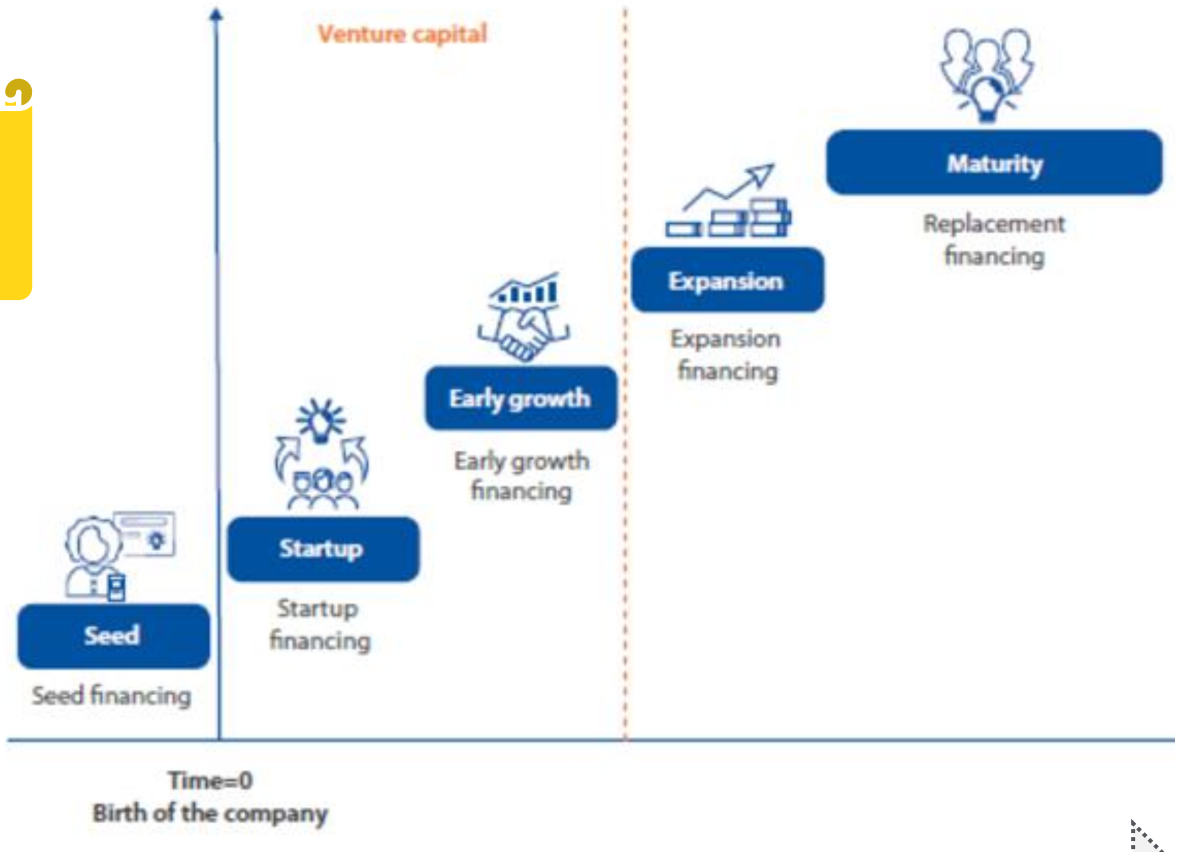
Combination of Equity FI and grant(s)

Single Financial Package under FI rules



Equity

Quasi-equity, VC debt

Technical support subsidy

Accelerating grant

Risk mitigation grant

Reward grant

Grant types - proposals

Technical support subsidy

paid to or on behalf of entrepreneurs for services **supporting the preparation of the investment** e.g. business coaching, advisory, support networks, one-stop-shop or to ensure alignment with Smart Specialisation Strategy (S3).

Grant as an 'accelerator':

paid to the early stage company to help them **reach the proof-of-concept** stage this grant may cover part or the totality of the various investment **costs to demonstrate the feasibility and viability** of the concept under development.

Other(s)?

Grant as a 'risk mitigant'

paid to companies to incentivise the launch the projects by **mitigating technological and financial risks**. The grant may **cover part of the investment costs**, thus increasing viability and helping attract investors (lower risk, higher IRR…)..

Grant as a 'reward'

paid to innovative companies investing in **priority technologies, specifically targeted sectors or underserved areas**. Bonus paid in case the innovation project develops according to targeted milestones.

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Remuneration of the Fund Manager

- Management costs and fees are aimed at **covering the/fund manager's operating costs** and shall not be primarily used to remunerate the performance of the investments made .
- The **remuneration of the financial intermediary shall reflect the current market remuneration** in comparable situations, if any; 20% threshold in case of if direct award, other outcome of the competitive tender.
- The financial intermediary/**fund manager is expected to invest own resources into the fund,** usually about 1% of the fund size.
- The **waterfall of the distribution of gains from investment** exits at the end of the fund's lifecycle or investment period **shall incentivise fund managers performance** thanks to the potential use of catch up and carried interest mechanisms.

Reporting

	FUND MANAGER			MA			MA		
Equity investment + capital grant + technical support subsidy	FI accounts			Declared to EC under FI in payment claims			Reported to EC in Annex on FIs (cumulative)		
	Y1	Y2	Y3	Y1	Y2	Y3	Y1	Y2	Y3
Equity investment			80						80
Capital grant		20		5	20	80		20	20
Technical support subsidy	5						5	5	5

Key questions for discussion

- Which grants are needed at which innovation stage?
- What is the appetite of fund managers for managing/providing grants?
- Does the provision of grants entail potential conflicts or interests?
- Which State aid regime for the combined FI?
- Other type of grant to be combined (‘equity rebate’)?

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Thank you!

www.fi-compass.eu

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