



Innova-FI

Interreg Europe



European Union
European Regional
Development Fund

REPORT EXCHANGE OF EXPERIENCE 02

2019, Lisbon



EXCHANGE OF EXPERIENCE

Within Innova-FI project, each participating partner is responsible for the preparation and implementation of one Exchange of Experience – intraregional learning. As partners are not directly managing the policy instruments for internationalisation, the aim of the exchange of experience meetings is to:

- a) Analyse the situation in the hosting region, i.e. investigate the state-of-play in the territory, strengths and weaknesses;
- b) Deepen the knowledge of the project partners and stakeholders on a concrete topic and get inspired and aware of possibilities for policy change in other domains;
- c) Find synergies with other processes (programs and projects) that are part of the organisational work-load and are linked to financial instruments;

Report Elaboration

The aim of this report is to describe and reflect the exchange of experiences and to gain the insight into the intraregional learning process. The corresponding project partner should elaborate the report after each exchange of experience event and send it to the National Innovation Agency (Lead Partner) and Startup Europe Regions Network (advisor partner). The news should be prepared – by SERN - for the Innova-FI website accordingly.

1. Introduction

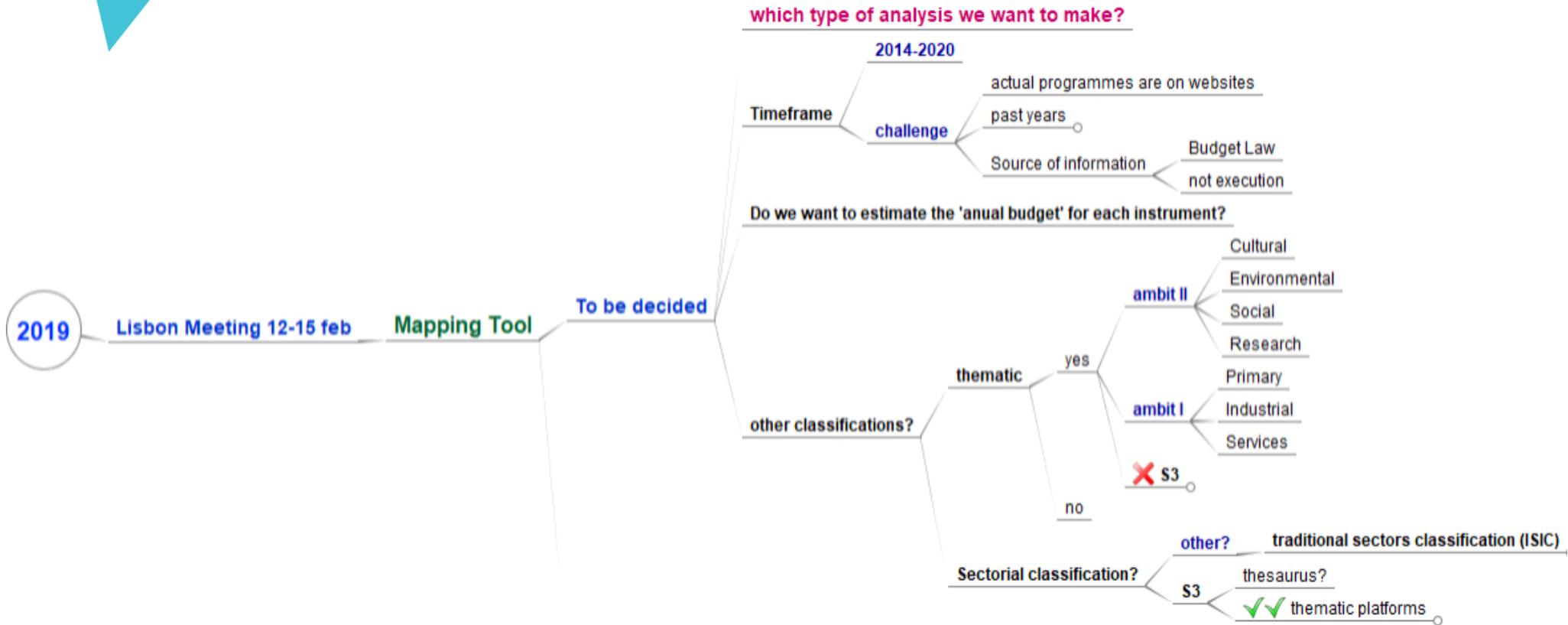
The Interreg Europe 'Financial Instruments for Innovation' (Innova-FI) project aims to improve the design and implementation of Financial Instruments as a delivery mode of Structural Funds, so that they best meet and serve the financing needs of innovative and RTDI-driven businesses in all the stages of their start-up and growth. The second Exchange of Experience (EoE) of Innova-FI was hosted by National Innovation Agency (ANI), the coordinator of the project in Lisbon (Portugal) from 12 to 15 February 2019.

The meeting focused on 'Equity Equity-type Instruments' presented the state-of-play of Financial Instruments put in place in Portugal, targeting highly-innovative enterprises. The thematic workshop/study visits focused mainly in organisations putting in place and working with equity-type instruments, focusing on venture capital and/or business angels for very early stages (e.g.: Banco de Portugal, StartupLisboa and Portugal Ventures)

Also, on this Exchange of Experience the beta version of the mapping tool 'Financing Innovation' was introduced. The partners were invited once again to provide comments, suggestions and feedback on its relevant taxonomies and thematic classifications to make sure this tool is a practical guide to apply in each partner region. Although, the Innova-FI mapping tool will help map existing financial instruments, it is not intended to substitute the Ex-ante analysis that each region has in order to define their OP funds distribution. All this considered, the partners agreed with the following description:

- It is a tool to map existing financial instruments, allowing comparison within the different instruments and the same time among different Regions;
- It should help to inspire decision makers at regional, national and EU level to improve the portfolio of existing instruments, as well as to create new ones well adapted to the SMEs needs and demands;
- It can be a good tool to help all stakeholders in the region to list and describe all existing instruments.

Figure 1 - Innova-FI Tool Analysis



2. More information About the Session

The main purpose of this intraregional meeting was to understand the operationalisation of financing solutions that address market failures in Portuguese SME access to finance, and thus contribute to economic development and to the creation of wealth and employment. The secondary objective was to test the beta version of the tool 'Financing innovation', having the partnership decided on the definitive sectorial classifications and relevant taxonomies. According to the indicative calendar defined by the partner in charge of the design, the tool will be fine-tuned until 28 February 2019 and be ready to go public and map Financial Instruments on 15 March 2019.

Ensuing the agenda, the second Exchange of Experience (EoE) of Innova-FI began with a welcoming speech from Mrs. Mafalda Dourado (International Promotion Director at ANI / National NCP Coordinator). Her speech was followed by a visit to the Agency for Competitiveness and Innovation (IAPMEI) - public Institute, aimed at supporting micro, small and medium enterprises.

Working under the supervision of the Ministry of Economy, IAPMEI's mission is to promote the competitiveness and business growth of the Portuguese enterprises throughout a supply of a range of services committed to the strengthening of innovation, entrepreneurship and business investment. To explain the set of instruments developed to enhance the capacity of companies regarding innovation and competitiveness to the entourage were present Mrs Vanda Narciso (Head of Department for Collective Efficiency, Innovation and Competitiveness) and Mrs Sandra Alvim (Head of Department for Entrepreneurship and Finance). Mrs Vanda presentation highlighted the four priority activity areas of IAPMEI:

- 1) Entrepreneurial assistance, through direct customized assistance to business owners and managers of SMEs, supporting them in shaping and developing strategies for growth and internationalization;
- 2) Induction of qualified business investment, through the management of incentives to companies within the NSRF, targeted business strategies based on innovation, skilled employment, and internationalization;

- 3) Facilitating business financing through the promotion of financial solutions tailored to business needs (e.g.: venture capital and mutual guarantees).
- 4) Promoting entrepreneurship, innovation, and collective efficiency action by encouraging: (a) the creation of new business with innovative potential, (b) the economic enhancement of knowledge, and (c) the promotion of mechanisms to facilitate innovation and development strategies based on a collective approach.

The highlights of the second day of the Exchange of Experience (EoE) include the keynote speech of Mr Antonio Bob Santos (Managing Director of ANI), the Learning Workshops, the study Visit to Banco de Portugal¹ and the session on the Tool 'Financing Innovation'. On the first Learning Workshop 'Review of measures for Financial Instruments' two of the stakeholders of *Government Office for Development and European Cohesion Policy* (GODC, Slovenian partner) presented:

- a) the current Financial Instruments in the country (e.g.: the Slovenian fund of funds with **253 Mio EUR of ERDF funds + financial leverage = 400 Mio EUR of favourable resources for final beneficiaries**);
- b) the financial perspective of FI's for the period of 2021-2027 and their internationalisation aspect.

The third stakeholder of GODC, representing the Business Angels of Slovenia, introduced to the partnership one of the most active VC networks in Slovenia, emphasizing the cooperation with Slovene Enterprise Fund and FIs for SMEs.

To facilitate and stimulate the exchange of new considerations and ideas, ANI used an interactive approach and organized different types of study visits (the third day of the EoE) to encourage the learning concerning public financial resources:

- a) **Banco de Portugal**: the central bank of the Portuguese Republic is a public-law legal person, with administrative and financial autonomy. It has two core missions,

¹ More information about the study visit session can be found on the next page

the first to maintain price stability and the second to promote the stability of the financial system. The idea behind this visit was to comprehend the spectrum of available instruments preferentially leveraged by private co-financing, and in particular Financial Instruments (FI) of Equity / Quasi-Equity so that “viable” SME may increase their equity capital and finance their investments, while developing their activity in industries concerning tradable goods or services, in the start-up stage. In practice, Banco de Portugal shared with the delegation the reality of the Portuguese financial system and how it responds to the needs of companies throughout their life cycle, i.e. the available instruments (capital and debt), the ease and costs of access and the gaps / lack of density in some of these instruments (e.g.: capital and risk).

- b) **StartupLisboa:** A private non-profit association, founded in 2012, that supports the creation of companies and their first years of activity. It provides entrepreneurs with office space, as well as, a support structure (mentoring, strategic partnerships and perks - such as access to investment, networking activities and a community based on knowledge and sharing). With two models of incubation (physical and virtual) their support structure includes mentoring, linking to strategic partnerships, and access to investment/funding. To foster the local ecosystem Startup Lisboa is the organizer of Launch in Lisbon - a soft landing program to help foreign entrepreneurs and investors to set up their business in Lisbon -, and the manager of Hub Criativo do Beato, a new innovation hub. For entrepreneurs arriving in Lisbon to participate in an accelerator or becoming members of an incubator in the city, they offer the possibility to stay at Casa Startup Lisboa, their residence for entrepreneurs. Startup Lisboa is also running two acceleration programs: WPP Booster, for startups that aim to innovate the communication and media industry; and From Start-To-Table, a program supported by Turismo de Portugal, to reshaping the ecosystem of restaurants. To sum up, Startup Lisboa is a unique and important reference for the entrepreneurial ecosystem that, in addition to continuing to support it, has the mission of helping Lisbon to be better prepared to receive ideas and entrepreneurs willing to build value.

- a) **Portugal Ventures:** A venture capital firm that invests in seed rounds of Portuguese startups in tech, life sciences and tourism. It manages around 213 million assets through 19 venture capital funds. Their investment (tickets from 100K€ up to 1,250K€) is always in equity, with a counterparty holding a minority position in the company, improving financial ratios and thus facilitating access to various incentive programs. Currently, Portugal Ventures has two open calls, the first for the tourism sector and the second for innovative projects encompassing technologies, products or services to create an MVP to the global market. The idea behind these open calls is to entice and grow tailor-made companies that can fill a specific gap/need in the Portuguese market. In 2017, CB Insights considered Portugal Ventures the most active venture capital in Portugal

To conclude this Exchange of Experience, the Innova-FI Steering Group meeting took place with all the partners in order to collect their feedback on the event, discuss changes in the EoE methodology, discuss the policy booklet on 'Equity Type Instruments' to be produced in this semester and organise the next steps.

3. Recommendations and Next Steps

Stimulating a more knowledge-driven economy and a faster pace of innovation must be underpinned by the adequate architecture of financial engineering instruments to reduce potential market failures. In the case of a transforming economy like the Portuguese and in a context of structuring innovation system, market failures are expected to be more significant and demand a stronger public intervention.

In accordance, Portugal has created the Instituição Financeira de Desenvolvimento (IFD) which object is to perform operations to mitigate market failures in financing to small and medium enterprises (SME). The underlying analysis of the potential financial solutions and instruments that better serve companies has dictated for Portugal the selection of the following products in terms of Equity or Quasi-Equity Financing:

Equity or Quasi-Equity Financing	Underwriting of funds of funds, co-investing with private agents in SME	Acquisition of Equity Stakes	Venture Capital
		Mezzanine, Subordinate Convertible	Seed Capital Start-up Capital
		Shareholder Loans	Private Equity
Financing to special purpose vehicles owned by Business Angels in co-investment on operations or vehicles destined to innovative companies, in their early life cycle stages			

- **Underwriting of Venture Capital Funds:**
 - Targeting solutions to the various business development stages of the target SME, through the promotion of different vehicles such as Seed Capital, Start-Up and Development Capital Funds and, if possible, transfer of ownership.

- **Underwriting of Co-investment Funds with Business Angels:**
 - In order to increase the investment by Business Angels in SME, new co-investment programs will be developed, namely through funds or collective investment vehicles, with industry specialisation, if necessary, to support projects and companies (especially innovative companies) in the early stages of their activity.

It is also worth stressing, despite being two different solutions, private equity is sometimes confused with venture capital because they both refer to firms that invest in companies and exit through selling their investments in equity financing, for instance, initial public offerings (IPOs)². However, there are major differences in the way firms involved in the two types of funding do things, more specifically they buy different types and sizes of companies, they invest different amounts of money and they claim different percentages of equity in the companies in which they invest. In a nutshell, private equity invests in an existing reality that can be further developed for growth and value creation and venture capital invests in a promising opportunity that can create significant value in the future. Ultimately, to cope with the difficulties, to foster innovation and build a knowledge-based economy, partners and stakeholders agree it is important to:

- Focus resources to achieve critical mass and to ensure the right combination between FI's and other measures;
- Transform cultural mind sets, and to encourage all those who do not get it right the first time (widening the motto to “try over and over again”);
- Public role should not be to crowd out private participation, but rather drive its active and successful participation, to embrace all in what must be a national enterprise.
- Persistence to execute policies and programmes that need many years to bear fruits;

² The sale or distribution of a company's shares to the public for the first time by listing the company on the stock exchange

4. Conclusion

Financing innovation is tricky. Not only there is an issue of imperfect appropriability of the knowledge produced by the private investor (which implies a social rate of return higher than the private return rate), but there is also the increased risk level that makes it harder for highly innovative investments to obtain adequate funding mixes.

According to one of the EIB working papers, external finance represents less than 40% of firms' investment finance, with bank debt and leasing prevailing. Companies believe they can invest and grow without diluting their ownership through external equity financing (Brutscher & Hols, 2018). However, bank debt is not suited to finance intangible investment and innovation (since they rely on collaterals and they are not keen to provide debt financing for the acquisition of the intangible assets that are so important to innovation). Innovation is also about taking risks, which is why equity finance is so important.

So, what can be done at European level? First, European regulators should level the playing field for equity financing. Interest rates on debt financing are usually tax deductible. Profits are taxed, and so are dividends on equity. Second, moving forward with the Capital Markets Union to create a true single market and a cross-border European market. For this case, there is a special need to prioritise private equity and venture capital investment. Extensive bank financing is currently crowding out equity financing – and in the process, crowding out companies that would benefit from more equity financing.

Sustaining fundamental macroeconomic equilibria requires a stable macroeconomic framework and long-term commitments which help anchor agents' incentives.

Equity Type Instruments in Portugal

Portugal has allocated a significant amount of its national (COMPETE 2020) and regional Operational Programmes to the promotion of financial instruments aiming to reduce the market failure observed.

I.e., several measures were launched to reduce the indebtedness and strengthen the capital of SMEs and startups through investments of equity and quasi-equity, in co-investment with private entities.

Nevertheless, there is room for improvements in the governance model as well as in the operational management, which appears sometimes detached from strategic priorities and not biased to the most relevant market failures

Overall, we can say there is still a need to rethink incentives - with the goal of strengthening economic resilience and fostering innovation – that can be part of a broader strategy to support.

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