FINANCIAL INSTRUMENTS TO ENCOURAGE INNOVATIVE VENTURES

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Chairman OECD Working Party on SME and Entrepreneurship
Research and innovation are two of the most challenging activities for enterprises

• Large companies can leverage their access to resources to invest in R&I.

• Small firms have instead to overcome two main barriers:
  1) Lack of financial resources;
  2) Difficulties in hiring skilled labour.
Young innovative firms as drivers of job creation

• Any government is well advised to support innovative SMEs and their ventures.

• Questions:
  1) is government the sole supporter?
  2) what kind of support?
## Differences in funding sources among innovative SMEs

(Source: OECD Innovation Policy Platform 2014)

<table>
<thead>
<tr>
<th>Phase</th>
<th>Suppliers of Funds</th>
<th>Preconditions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SEED</strong></td>
<td>Personal assets&lt;br&gt;Family &amp; friends&lt;br&gt;“Type ii” individual investors&lt;br&gt;Academic &amp; professional colleagues&lt;br&gt;Government &amp; university grants&lt;br&gt;Endowments and foundations&lt;br&gt;Seed funds</td>
<td>Framework for entrepreneurship&lt;br&gt;Business/government/research links&lt;br&gt;Government &amp; university support for applied research</td>
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<tr>
<td><strong>START UP</strong></td>
<td>Family &amp; friends&lt;br&gt;“Type ii” individual investors&lt;br&gt;Academic &amp; professional colleagues&lt;br&gt;Government &amp; university grants&lt;br&gt;Business angels&lt;br&gt;Venture capital&lt;br&gt;Endowments and foundations</td>
<td>Robust legal system&lt;br&gt;Enforceability of contracts&lt;br&gt;Efficient bankruptcy regime&lt;br&gt;Support facilities&lt;br&gt;Science parks/incubators&lt;br&gt;Favourable tax environment&lt;br&gt;Business angel networks</td>
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<td><strong>EXPANSION</strong></td>
<td>Business angels&lt;br&gt;Venture capital/private equity/mezzanine finance</td>
<td>Institutional savings&lt;br&gt;Sufficient volume&lt;br&gt;Flexible regulation&lt;br&gt;Legal framework&lt;br&gt;Tax transparency</td>
</tr>
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<td><strong>IPO</strong></td>
<td>Pension funds&lt;br&gt;Endowments and foundations&lt;br&gt;Corporate venturing&lt;br&gt;Government&lt;br&gt;Foreign venture capital</td>
<td>“Growth” exchanges&lt;br&gt;Environment for M&amp;A</td>
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<tr>
<td><strong>EXIT</strong></td>
<td>Institutional investors&lt;br&gt;Retail investors</td>
<td>Legal and regulatory framework for investment</td>
</tr>
<tr>
<td><strong>PUBLIC LISTING</strong></td>
<td>Institutional investors&lt;br&gt;Retail investors</td>
<td></td>
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</table>
Figure 2  Life-cycle of a firm and stages of financing

Early phase
- Seed
  - Production concept
  - Checking ideas
  - Business analysis
  - Market analysis
- Start-up
  - Business start-up
  - Market concept
  - Further development of products
- First stage
  - Start of production
  - Market launch
  - First sales achievements

Expansion phase
- Second stage
  - Scaling
  - Market launch
  - Market leader
- Third stage
  - Standardization
  - Internationalization
- Fourth stage
  - Pre-IPO
    - IPO preparation
    - Acquisition

Stock market
- Take private stage
  - Delist
    - Under valuation
    - Acquisition

Public-to-Private
- Venture capital
- Private equity
- Mezzanine capital
- Loans
- Subsidies
- Investment bank
- Diversified shareholdings
- Private equity
- Mezzanine capital

Source: Natusch (2003); OECD (2013d).
Funding tools for Early-phase innovative SMEs

• Support to firms
  – Market-based instruments
    • Apart from FFF investment in equity and loan,
    • Bank loans
    • Seed money, angel investor, venture capital, crowdfunding,
    • Peer-to-peer lending
  – Public-based support
    • Seed money
    • Grants
    • Direct and indirect lending
    • Subsidized loans
    • Credit guarantees
    • Fund-of-funds
    • Co-investment, co-financing
    • Tutoring, mentoring and labor training
    • Regulatory and administrative barriers easing
    • Intellectual property protection
    • Incubators and accelerators
    • Tax benefits (especially to innovation chains)

• Support to investors
  – Public support
  – Front-end and back-end tax benefits
  – Information and training
  – Regulatory constraints easing for institutional investors (pension funds and insurance companies)
Funding tools for Expansion-phase innovative SMEs

Support to firms or ventures

*Market-based instruments*

- Bank loans
- *Business angel, venture capital, crowdfunding*
- Subordinated loans
- Mezzanine finance
- Profit participation rights
- Bonds, convertible bonds, SME network bonds
- Loan securitization
- Trade sales (M&A), IPO

*Public-based support*

- Grants
- Direct and indirect lending
- Subsidized loans
- Credit guarantees
- Fund-of-funds
- Co-investment, co-financing (including asymmetric funding)
- Tutoring, mentoring and labor training
- Regulatory and administrative barriers easing
- Intellectual property protection
- Tax benefits (especially to innovation chains)
- Easing Initial Public Offer rules and stock market listing
- Develop ecosystem for innovation

Support to investors

- Front-end and back-end tax benefits
- Information and training
- Regulatory constraints easing for institutional investors (pension funds and insurance companies)
- Development of efficient and liquid capital market infrastructures for small cap and tech stocks, including secondary markets
# Governments’ policy response

(Source: OECD)

<table>
<thead>
<tr>
<th>Policy response</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government loan guarantees</td>
<td>Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Finland, France, Greece, Hungary, Ireland, Israel, Italy, Korea, Mexico, the Netherlands, Norway, Portugal, Russian Federation, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Thailand, Turkey, United Kingdom, United States,</td>
</tr>
<tr>
<td>Special guarantees and loans for start ups</td>
<td>Canada, Denmark, Mexico, the Netherlands, New Zealand, Serbia, United Kingdom</td>
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<tr>
<td>Government export guarantees, trade credit</td>
<td>Austria, Belgium, Canada, Colombia, Czech Republic, Denmark, Finland, Hungary, Korea, the Netherlands, New Zealand, Spain, Sweden,</td>
</tr>
<tr>
<td>Direct lending to SMEs</td>
<td>Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Finland, France, Greece, Hungary, Ireland, Israel, Korea, Norway, Portugal, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Turkey, United Kingdom</td>
</tr>
<tr>
<td>Subsidized interest rates</td>
<td>Hungary, Portugal, Russian Federation, Spain, Turkey, United Kingdom</td>
</tr>
<tr>
<td>Venture capital, equity funding, business angel support</td>
<td>Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Finland, France, Greece, Hungary, Ireland, Israel, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Turkey, United Kingdom</td>
</tr>
<tr>
<td>SME banks</td>
<td>Czech Republic, France, Portugal, Russian Federation, United Kingdom</td>
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<tr>
<td>Business advice, consultancy</td>
<td>Colombia, Denmark, Finland, the Netherlands, New Zealand, Sweden</td>
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<td>Tax exemptions, deferments</td>
<td>Belgium, Finland, Italy, New Zealand, Norway, Spain, Sweden, Turkey</td>
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<tr>
<td>Credit mediation/review/code of conduct</td>
<td>Belgium, France, Ireland, New Zealand, Spain</td>
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<tr>
<td>Bank targets for SME lending, negative interest rates for deposits at central bank</td>
<td>Ireland, Denmark</td>
</tr>
<tr>
<td>Central Bank funding to banks dependent on net lending rate</td>
<td>United Kingdom</td>
</tr>
</tbody>
</table>

Source: National Scoreboards.