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Meeting of Experts on Financing for Innovative Development

Geneva, 3-4 May 2007

REPORT OF THE MEETING OF EXPERTS ON FINANCING FOR INNOVATIVE DEVELOPMENT

Summary

The Meeting of Experts on Financing for Innovative Development elected Ms. Aliki Pappa as Chairperson, and Mr. Yuriy Buynov as Vice-Chairperson (para 6); discussed the challenges innovative enterprises face raising finance and how to address them, including the role of business angels and early support programmes (para 9-11), venture capital financing (para 12-14), non-equity forms of financing (para 15-18), the contribution of national and regional development finance institutions to foster innovation (para 19-21) and the directions for future work in this thematic area (para 22-23).

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I. ATTENDANCE

1. The Meeting of Experts on Financing for Innovative Development took place on 3 and 4 May 2007. This Meeting was organized in cooperation with the UN Department of Economic and Social Affairs (UN DESA) and is part of the Programme of Work of the UNECE Committee on Economic Cooperation and Integration (CECI). Experts representing government agencies, the private sector and academic institutions from twenty-eight UNECE member States participated in the meeting. The meeting was also attended by representatives of inter-governmental organizations with activities relevant in the area of financing for innovative development (OECD, WIPO, UNIDO), multilateral financial institutions (EIB, EBRD) as well as the European Commission.

II. OPENING OF THE MEETING

2. Mr. Marek Belka, Executive Secretary of UNECE, opened the meeting and welcomed participants from governments, the private sector, academia and inter-governmental organizations. He noted with appreciation the good and balanced representation of all UNECE subregions and country groupings in this meeting, which creates a fertile ground for the exchange of the experiences.

3. The Executive Secretary underlined that the meeting was organised in cooperation with UN DESA, which had provided substantive and financial support in the preparation of the event. He expressed his hope that this joint effort would herald new opportunities for further cooperation.

4. The Executive Secretary expressed his satisfaction with the presence of many business associations and other representatives of the business community in the meeting, underlining that a meaningful discussion on financing of innovation could not take place without the active participation of the private sector.

5. The Executive Secretary noted the presence of many participants from countries with economies in transition, which face special difficulties in addressing the challenges of financing innovative enterprises. He expressed the hope that the meeting would be particularly beneficial to these countries in helping them to devise the necessary policies to overcome these challenges.

III. ELECTION OF OFFICERS (Agenda item 1)

6. The Meeting of Experts elected Ms. Aliki Pappa (Greece) as its Chairperson and Mr. Yuriy Buynov (Russian Federation) as itsVice-Chairperson.

7. The Chairperson, who is also a member of the Bureau of the UNECE Team of Specialists of Innovation and Competitiveness Policies, welcomed the participants, briefly introduced the Programme of Work of the CECI and invited participants to share their views on the substantive agenda items.

IV. ADOPTION OF THE AGENDA (Agenda item 2)

8. The Meeting of Experts adopted its agenda dated 13 March 2006.

V. SUBSTANTIVE SEGMENT:"FINANCING FOR INNOVATIVE DEVELOPMENT" (Agenda item 3)

9. The discussion under this item was organised in four sessions, with a number of formal presentations[1] by participating experts and discussions led by different moderators.

10. The first session focussed on the role of business angels and early support public programmes. Participants discussed:

(a) The characteristics of business angels and business angels networks in different countries;
(b) The crucial role of business angels financing in the seed and start-up phase of the life of a company, when formal venture capital may be unavailable;
(c) The importance of good communication and improved links between informal and formal venture capital and the relationships between business angels and venture capitalists;
(d) The different tax treatment of business angels in various countries and the overall impact of the tax regime on risk-taking activities;
(e) The role of business angel networks and syndication practices in increasing the reach and effectiveness of this form of financing;
(f) The specific challenges that business angel financing faces in transition economies;
(g) The role of the public sector in facilitating access to finance by innovative enterprises, including that of co-investor, and the constraints posed by EU rules on national policies;
(h) The pitfalls that need to be avoided in public-private partnerships to enhance early stage financing, including crowding out of private investment and adverse selection of projects;
(i) The potential contribution of diasporas as a source of financing for early stage investments;
(j) The effect of the elimination of obstacles on the creation of cross-border markets for lending and venture capital;
(k) The desirability of a strong equity base and equity culture to increase access to finance;
(l) The use of hybrid instruments, such as convertible loans, in early stage financing;
(m) The existence of a quality deal flow as a pre-requisite for a vibrant venture capital industry;
(n) The need to support enterprises to become "investment ready" in order to enable them to attract external finance; and
(o) The role of strong intellectual property rights in raising external financing.

[1] All presentations and submissions by participants are available at the UNECE website.

11. There was a general agreement that start-up companies can eventually have a great impact on output and employment and therefore they deserve to be encouraged. However, it is clear that only a few companies will survive. Failure must be accepted but recognised early. Public support is required to overcome market failures that constrain access to finance for these innovative enterprises. Tax breaks and incentives can play a legitimate role but should not be abused. The creation of networks and the removal of obstacles to cross-border investment can have a positive impact on the access to finance.

12. The second session covered the role of formal venture capital as an engine for innovation. Presentations emphasised the different importance of venture capital in various countries. They echoed interventions made in the previous session that drew attention to the limited weight of early stage investments (seed and start-up) in formal venture capital. This is particularly the case in emerging markets. Size considerations are important in explaining the concentration of formal venture capital in the expansion and later stages.

13. In this second session, participants discussed also:

(a) The links between venture capital, entrepreneurial activity, R&D expenditures and economic growth;
(b) Global and sectoral trends in the development of the venture capital industry;
(c) The benchmarking of tax and legal environments for private equity and venture capital in European countries;
(d) The potential of European emerging markets regarding the development of a formal venture capital industry and existing limitations;
(e) The critical role of public authorities in nurturing the venture capital industry, filling market gaps, providing training and creating an appropriate tax, financial and regulatory environment;
(f) The creation of specific investment instruments with the support of public funds to promote venture capital financing, including funds-of-funds designed on the basis of public-private partnerships;
(g) The impact of multilateral financial institutions, such as the EBRD, in fostering private equity and venture capital investments in emerging markets;
(h) The importance of awareness campaigns, including among institutional investors and entrepreneurs, to promote the development of this industry;
(i) The creation of accepted standards (reporting, valuation, accounting) to facilitate communication and understanding between the various actors;
(j) As in the first session, the potential of regional and pan-European cooperation to overcome the constraints of national markets;
(k) The role of industry associations, at the European and national levels, to promote a better environment for venture capital, provide training, improve communication and facilitate networking; and
(l) The nature of venture capital as long-term investment and the impact of exit possibilities in the development of the industry.

14. The delegate from WIPO emphasised the importance of intellectual property to raise external finance by innovative companies. While participants generally agreed that the prospects

for the venture capital industry in Europe are generally good, there were divergent views over the possible role that banking institutions could play in venture capital financing.

15. The third session of the meeting addressed more generally the issue of access to finance for innovative small and medium enterprises (SMEs), going beyond equity financing and public sector grants to consider other options, including debt instruments, which remain the main source of external financing for SMEs.

16. The participants considered:

(a) The existence of a funding gap for innovative enterprises;
(b) EU policies and instruments facilitating the access to finance for innovative enterprises, including the provision of indirect financing through the EIB;
(c) The role of debt finance and the implications of Basel II requirements;
(d) The impact and limitations of securitisation as a way to increase lending capacity;
(e) The fragmentation of the EU market for cross-border venture capital investments and proposals to address these barriers;
(f) The problems of conflicting definitions and absence of reliable data in order to make cross-country comparisons, identify best practices and design carry out evidence-based policies;
(g) The role of public policies to improve the functioning of the risk capital market, both on the demand and the supply side;
(h) The importance of intellectual property assets in facilitating access to finance by high growth SMEs;
(i) Different programmes of support to the commercialization of new knowledge into products and services by small innovative companies in the Russian Federation, with particular emphasis on intellectual property management;
(j) Microfinance, as a source of entrepreneurial finance and a contributor to increased competitiveness;
(k) Regulatory constraints that impair the development of microfinance, which includes not only microlending but also other financial instruments, such as risk capital and leasing that can support the financing of innovation; and
(l) The role of exports in fostering innovation and, consequently, the contribution of trade finance insurance to the development of innovative activities.

17. Some of the participants stressed that lending capacity in the banking system was not generally an issue and that the problem was the extreme risk sensitivity of banking institutions. Cost of financing rather than availability was the key concern. Different views were expressed regarding the role of banks in financing high-growth innovative enterprises. Some delegates were of the opinion that banks could not be relied upon as providers of risk capital. However, others considered that banks could be a source of entrepreneurial finance; policy efforts should address the problem of collateral for lending, exploring the scope for the use of intellectual property assets. The delegate from UNIDO underlined the role that international organizations can play as builders of trust between those who provide finance and those who receive it in specific projects.

18. The Chairperson noted that a new EU instrument, the High-Risk Sharing Facility, is being finalised, in the context of the Seventh Framework Programme (FP7). In response to a statement from a participant from the Russian Federation regarding the participation of his country in the EU Competitiveness and Innovation Programme, she suggested that this issue could be raised with the EC.

19. The fourth and concluding session of the meeting discussed how to enhance the role of national and regional development finance institutions to foster innovation.

20. The participants considered:

(a) The role of public banks in addressing market failures;
(b) The need to avoid competing with the private sector;
(c) The changing environment, both operational and economic, for the work of these institutions;
(d) The priorities and mandate of the EIB both inside and outside the EU;
(e) The importance of multilateral development banks (MDB) not only as a source of finance but also as catalysts for private financing and providers of technical and policy advice;
(f) The influence of MDBs in helping to create suitable framework conditions for private investment;
(g) The need for more cooperation between multilateral banks;
(h) The assistance provided by the EC to multilateral banks operating in transition countries;
(i) The multistakeholder consultations led by UN DESA on the role of national and regional development banks, seeking to develop policy recommendations to enhance their role in promoting economic and social development;
(j) The role of national development banks as sources of long-term counter-cyclical financing;
(k) The experience of some national development banks in the provision of finance for innovation;
(l) The scope for partnerships between private financial institutions and development banks;
(m) The focus of activity of development banks, including infrastructure, microcredit, SMEs financing and lending to the non-sovereign public sector; and its related impact on supporting innovative development; and
(n) The role of private companies as intermediaries between international capital markets and microfinance providers.

21. The debate on this session stressed the role of national development banks as partners in public-private partnership projects. It was emphasised that risk sharing is the main advantage of these partnerships, rather than outright lower financing costs. The stability and predictability of long-term financing provided by development institutions was underlined as one of its key benefits.

22. After this final session, a number of delegates took the floor to make concluding statements. A representative from the Republic of Belarus presented briefly some ongoing policy

initiatives in the field of innovation and competitiveness and expressed hopes for further collaboration with this group of experts. His remarks were echoed by a participant from the Russian Federation regarding the direction of future work in this area and the need to reflect on how to share the experiences discussed during this meeting.

23. The Secretariat stressed that the outcomes of this meeting will serve as key input for a cross- country comparative review of practices in the area of financing for innovative development, leading to policy recommendations, as mandated in the Programme of Work of the CECI. One of the members of the Bureau of the CECI and delegate from the Republic of Belarus supported this statement and underlined the importance of the CECI virtual exchange platform to carry out this work.

24. The Secretariat noted with appreciation the active participation of the experts involved in this meeting and expressed special gratitude to UN DESA for its substantive and financial contribution to the success of the event.

VI. ADOPTION OF THE REPORT OF THE MEETING (Agenda item 4)

25. Participants agreed that the Secretariat should prepare the meeting’s report no later than 10 days following the meeting and that it be reviewed and adopted by the Chairperson and Vice-Chairperson on behalf of the Meeting of Experts.

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