Financing IHGEs – developing an investor ecosystem in the SPECA countries

17 February 2022

The overall framework for the trainings

Preparatory work

- Interviews and background research for the policy handbook (November-December 2021)
- Webinar on IHGEs in Central Asia (23 December 2021)
- Drafting of handbook (January-February 2022)

Training 1 - 15/2/22

- Topic : Scaling-up: the role of accelerators in supporting growth of innovative enterprises
- Invited speaker : Jerry Tran, Deputy Director, Scale-up, Enterprise Singapore

Training 2 - 17/2/22

- Topic : Financing IHGEs - developing an investor ecosystem
- Invited speaker: Adil Nurgozhin, Venture Partner, I2BF Global Ventures

A policy tool-kit for innovation high growth enterprises

Pro-growth business environment

- Regulatory framework for innovation and growth
- Taxation - incentivising R&D and innovation and investors
- Demand side measures - Government as a first mover.

Tailored services for IHGEs

- High growth programmes - client management approach
- Developing ecosystems and peer-to-peer networks
- Access to innovation services and infrastructure

Finance adapted to each growth stage

- Grant and loan instruments
- Crowdfunding, business angel investors & accelerators
- Venture capital : co-investment and fund of funds models.

Reinforcing firms' internal capabilities to grow

- Leadership skills
- Availability of employees with technical and creative skills
- Talent attraction and retention

Internationalisation & business networks that support scaling

- Advice on market trends and entry
- International networks - structuring diaspora links.

A toolkit of potential financial instruments

Direct financial support : grants, innovation vouchers, etc.

Tax credits (indirect financial support): for R&D, digitalisation, etc.

Debt financing : lending to SMEs including SME loan guarantees

Demand side – Innovative Public Procurement

Equity finance with public policy instruments for private investors

Debt financing – tailored to IHGEs needs

Debt finance: essentially involves borrowing money that has to be paid back, along with the interest.

- Different forms: Loans and overdrafts are offered by banks and other lending institutions, as well as peer-to-peer business or startup loans.
- Overdrafts tend to be well-suited for financing working capital and to meet short-term requirements, whereas loans are more often used to finance larger and longer-term purchases.

To encourage financial institutions to to invest in riskier, more innovative firms, governments can :

- provide targeted loan guarantee facilities to commercial banks – e.g. focused on specific types of firms (start-up loans) or different stages of growth (expansion stage).
- Provide convertible and subordinated loan type instruments

KredEX (Estonia) example two main instruments:

- Start-up loan of up to EUR 100,000 – helps companies with insufficient collateral or operating history
- Capital loan – a subordinated loan of up to €2m – for companies that have proven business model

Direct financial support – grants to IHGEs

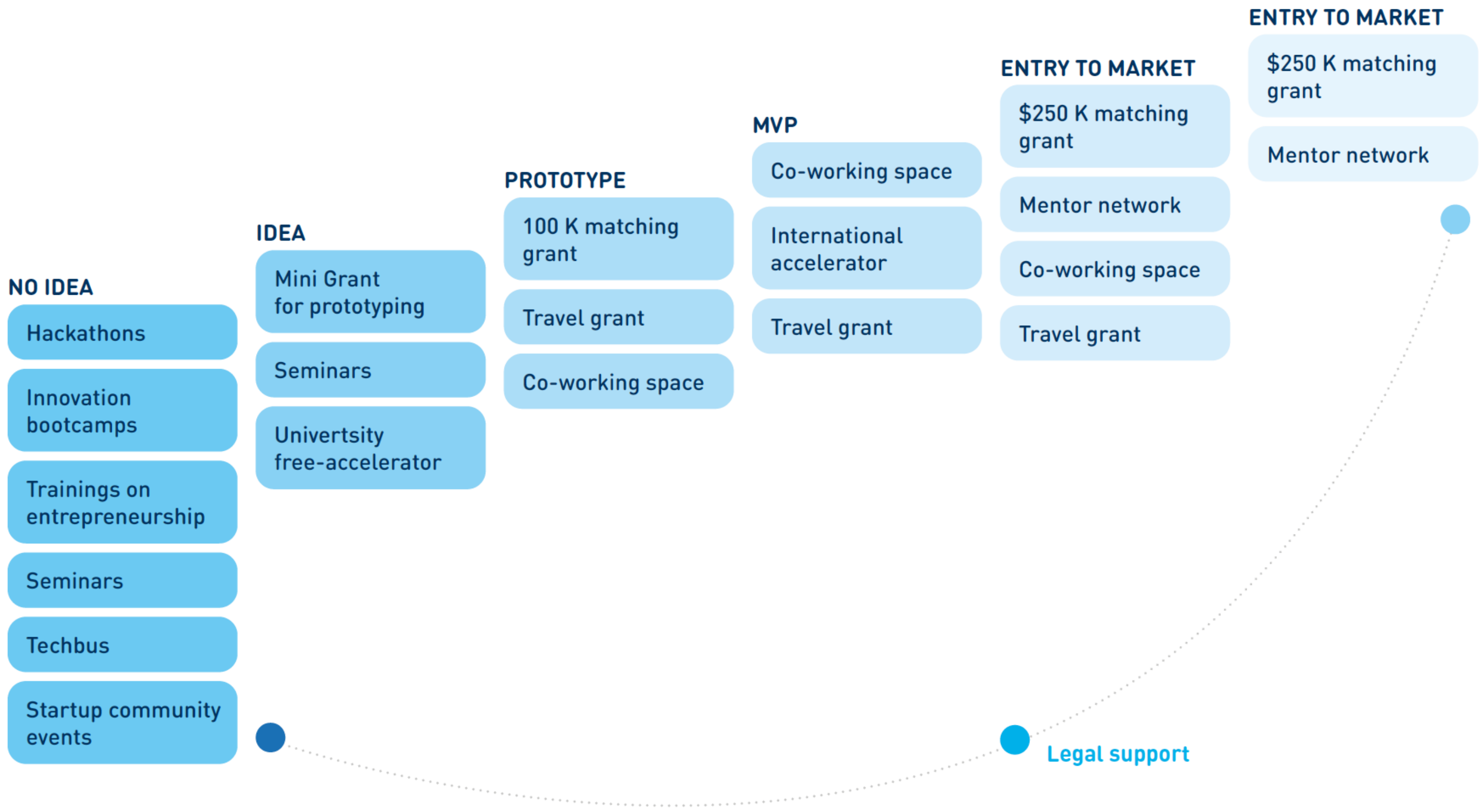
Main instruments:

- Innovation vouchers (small grants enabling to test ideas before further development)
- Feasibility/proof of concept grants – to take idea to higher 'technology readiness level'
- R&D / product development grants – to develop prototypes and test with users, etc.

Share of public funding should decrease as idea moves 'closer to market'.

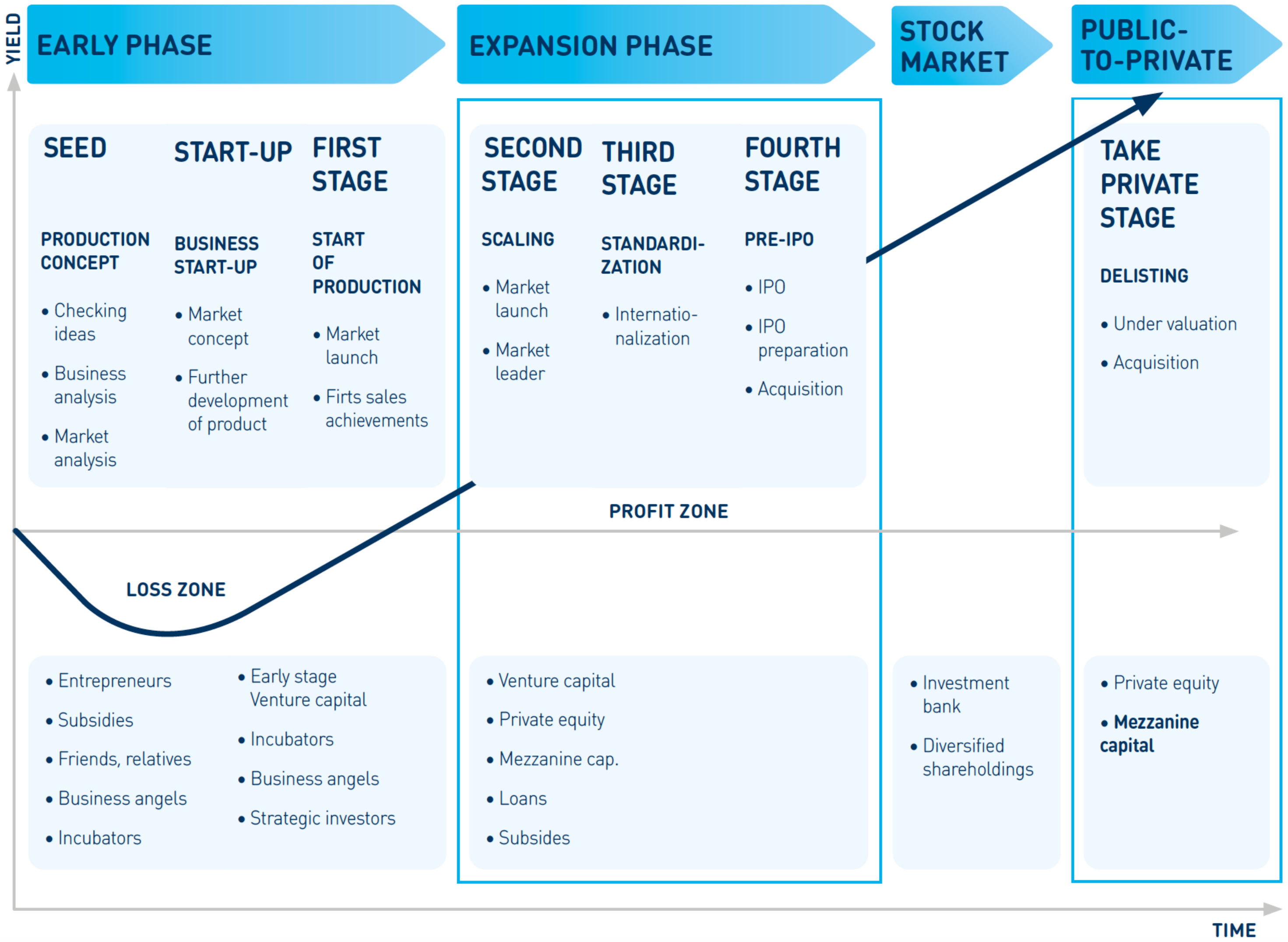
Apart from grants, governments may offer other subsidies for IHGEs, such as tax breaks.

Georgia: support for innovative start-ups – from idea to growth stage



Source: UNECE, adapted from https://gita.gov.ge/

Finance stages for IHGE



Source: UNECE, adapted from (Wilson, 2015).

Why is equity finance important ?

- Firms with equity finance tend to outperform those reliant on debt and own resources.
- IHGE require access to external equity capital to support their product development, operations and expansion phases into international markets;
- Equity finance matches the risk profile of an IHGE with potential payoff. By receiving equity stakes in exchange for their capital, investors have claims on the future value of the enterprise, sharing upside potential but also downfalls.

For IHGEs seeking to scale, equity finance should provide

Deep pockets: ability to support additional rounds of investments

Smart money: industry and domain expertise

Networks : providing access to markets and other investors/funders

Patient capital : supports entrepreneurs to bring disruptive innovation in products, processes and business models to market.

Main forms of equity finance for IHGEs

Equity crowdfunding

- Emerging form of finance – a step beyond ‘family, friends and fools’
- Pre-seed/start-up but also market launch/early scaling stages
- Requires robust regulatory framework

Angel investors

- High net worth individuals who invest own time and money. Angel investment is always a minority investment (usually 10–30%), and is directed at the pre-seed, early or second growth stage.
- Business angels often work in groups or syndicates to pool investments and help create a balanced portfolio of investment.

Venture capital

- Mainly make later stage minority or expansion investments
- Potential for venture funding heavily dependent on sufficient deal flow, investment readiness, institutional (e.g. pension) funds & regulatory framework that favour equity investment

Public-private mechanisms for leveraging equity capital

Main public-private equity financing mechanisms for IHGEs :

- The “co-investment” model with two types of governmental support:
  - a privately managed government-backed venture capital fund that invests on a non-exclusive basis in innovative companies; and
  - public investment as a co-limited partner in a privately managed venture capital fund;
- the “fund-of-funds” model requiring the establishment of a public fund that takes minority equity stakes into existing or new privately managed venture capital funds

Pros and cons of public-private equity instruments

Co-investment fund

- Limit risks of market distortion and have proven to be effective in a range of countries – notably for early stage
- Require existing presence of active investors

Fund of funds

- Widely used to leverage venture capital investments without direct public sector investment in firms.
- Minimal deal flow required – often multi-country (Baltic, Western Balkans, etc.)

Public policy tool kit for improving investment ecosystems

Supply - generating more investors	Demand - quality deal flow	Market Impact and sustainability
Investment friendly tax environment	Investment readiness (incl. regional training and support)	Support for sustainable and professional BANs
Co-investment funds	Financial literacy at schools	Data collection
Investor readiness training sessions	Entrepreneurial mind-set development (incl. links with local businesses)	Local BA/VC forums
Media campaigns	Incubators and other facilitators to educate and prepare entrepreneurs	Light regulation for early-stage investment market

Source: UNECE, based on (European Commission, 2015).

Key principles for financing innovative high-growth enterprises

1. Get the rules of the game right - ensure transparency of legislative and regulatory frameworks, and balanced investor protection.
2. Support the development of a pipeline of investable firms (high-growth programmes - portfolio approach).
3. Ensure IHGEs have access to a 'blend' of financing (grants, loans, equity) that support innovation and scaling of operations
4. Support the development of investor communities through education, promotion and targeted support for angel networks, accelerators, etc.
5. Avoid direct investments by public sector agencies in firms – favour support through co-investment – so that public funding matches rather than displaces angel or VC investors

Case study session – improving access to finance for IHGEs

During this session, the participants will be split into groups supported by a moderator and will work in two steps.

Each group will be assigned one of two proposed business cases (see opposite).

Discuss :

- the types of funding required to help grow the company, with a focus on equity finance: crowdfunding, angel investors, venture capital (co-investment).
- Identify 2-3 priority actions to take to enhance and reinforce the investor ecosystem in the SPECA countries.

Case 1 – an established (10 years old) food manufacturing firm with its registered HQ and an existing production facility in a Central Asian country.
The company has +/-100 employees and has in-house a small lab for testing and quality control staffed by three qualified food technicians. The company has existing export sales (roughly 50% of turnover) notably to the countries of the SPECA region.
Trigger point: change of management
Ambition : first mover in new plant based proteins products in SPECA
Challenge: to secure investment and expertise for new product development and export markets

Case 2 : a start-up launched by two young (under 35) founders in 2019 developing Internet of Things (IoT) devices for improving water and wastewater management and monitoring.
The +/-10 staff (including software engineers and an R&D manager) are based in one of the Central Asian capital cities. The company has received several rounds of seed-stage investment (up to €1.5m) from a mix of local and international equity investors.
Trigger point: Global growth trends for smart water management market.
Ambition : capture a strategic position in the smart water management market in Asia and potentially the middle-East
Challenge: Raise Series A investment and secure expertise on regulatory issues related to water industries in target markets

Brainstorming session – How, Now, Wow

Identify priority actions that should be taken to enable EESC countries business support ecosystem to provide more targeted advice to IHGEs.

Now – what can be done in the short term in my country to improve access to finance for IHGEs.

Wow – ideas sparked by the training that are new or innovative to my country which would really change the investment climate for IHGEs.

How – actions that require more time and investment to prepare but that we need to do in a medium-term perspective to develop an investment ecosystem.