

The EUREKA Venture Capital Expert Group

REPORT



EUREKA

EUREKA-CSE : EAN01-VECA

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Venture capital sub-Group

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1. Executive summary	3
2. Initial caveats	5
2.1 The private funding issue in former EUREKA evaluation reports	5
2.2 The reasons of non-action: external funding and the shortcomings of EUREKA diversity	6
3. Three action lines	7
3.1 Promotional activities	8
3.2 The “EUREKA Diamond Label” for promising SMEs	9
3.3 EUREKA and Venture Capital schemes	11
4. Conclusions: about implementation	12
Annex 1: Short Curriculum Vitae	13
Annex 2: Acronyms	14

Composition of the EAN2001-VECA Group *

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* Short CVs are provided in Annex 1

1 Executive Summary

EUREKA is a European-wide initiative aimed at fostering European competitiveness through co-operation among firms and research institutions in the field of advanced technologies. The initiative has a bottom up approach – it is up to the participating companies and institutions to propose their projects in any domain of research and development. It has a decentralised support scheme: once a project has been EUREKA-labeled each participant may be funded by national authorities according to national rules and programmes.

One of the bottlenecks of EUREKA lies in the shortage of funding and the deficient synchronisation of funding among partners. The involvement of private funding (external to the company) is almost non-existent. This is especially true in the case of small firms in early stages of their development.



The issue of private funding in EUREKA has been repeatedly raised in all Evaluation Reports since the early nineties. Despite this, very little has been done in order to implement experts' recommendations. Why is this?

Three main answers may explain the reasons for non-action:

- a) unbalanced political commitment among EUREKA member countries;
- b) diversity of National Innovation Systems (NIS) within EUREKA, especially in the field of financial and innovation policy institutions;
- c) lack of adequate organization for implementing actions.

These issues remain unsolved and any recommendation is deemed to fail unless proper actions are pursued. Nevertheless, whilst changes in NIS require sustained and long-term initiatives, there are decisions which can be taken in the short term regarding political support and adequate resources and organization.

With these caveats in mind, the EUREKA Venture Capital Expert Group (the Group) has explored the paths to bridge the gap between small firms and private investors. The basic assumption underlying our work is that young, innovative and professionally managed EUREKA firms with expectations of high growth and returns may be attractive

in principle to private investors. EUREKA could therefore become a qualified source of deal flow to the venture capital industry in Europe.

Three action lines emerged from the discussions:

- 1) promotional activities aimed at the venture capital industry;
- 2) the EUREKA Diamond Label and
- 3) EUREKA and venture capital schemes.

The recommendations include concrete actions along these three lines:

- As far as the promotional activities are concerned, the Group recommend dedicating resources to create and maintain the awareness of the EUREKA brand in the financial community and to use all specialised vehicles already available such as venture capital conferences, investment fora, etc.

- The Group then propose to launch a EUREKA Diamond Label to praise EUREKA firms with expectations of high growth who are looking for external funding.

- In the third area, the Group advise using the venture capital schemes already existing in several countries and approaching EIF and EBRD with the aim of building up suitable schemes for equity funding for EUREKA participants in the medium term.

However, most of these recommendations are not truly original. From the Group's point of view, the diagnosis is very well known and it is time for the therapy to work. It is therefore time for decisions and decisions must inevitably be accompanied by suitable resources. The two last recommendations are aiming at implementation:

1. EUREKA should set up a specialised unit at the Secretariat to pursue these objectives. EUREKA needs a champion in the network – *an intrapreneur* – who strongly believes in the Initiative and who will be dedicated 100% to implement actions. This champion must work according to the principles of *empowerment* and *accountability*.

2. EUREKA should set up a Task Force of selected and voluntary NPCs committed to push the actions aiming at bridging the gap between innovators and investors in EUREKA. Co-ordinated by the *champion*, this task force should formalise their work and would constitute the seed for EUREKA-wide activities in this field.

2 Initial Caveats

2.1 The private funding issue in former EUREKA evaluation reports

EUREKA is probably the European R&D programme which has been most frequently evaluated over time. Evaluation reports are produced regularly and they provide rich information on the impacts of the Initiative as well as sensible and balanced recommendations for its improvement and development. However, being one of the best “informed” R&D programmes, it is also one in which few recommendations have ever produced tangible results. This is especially true in the case of external funding, “a recurring theme in EUREKA” in the words of the Annual Impact Report 2000 (AIR 2000). Every single evaluation report since the early nineties has somehow highlighted the issue:

Annual Impact Report, 2000 (Bobe Report): “EUREKA [should] consider taking action to facilitate private funding especially for SMEs”.

Annual Impact Report, 1999 (Bobe Report): recommendation “to analyse the current situation of EUREKA and Venture Capital businesses in order to improve information flows between the two areas and make a suitable approach from the EUREKA side”.



Stevens consulting Report (IPS, 1997) stated “The greatest need for external capital can be expected from smaller, independent, innovative or fast-growing firms” and identified “significant potential for action by EUREKA to stimulate private investment”.

The *EUREKA medium term plan 1996-2000* dedicated a whole chapter to the issue of external funding, insisting on the need of securing adequate and timely level of public funding and of improving better access to sources of private funds (pages 7-8).

Sixth and eighth recommendations of the Davignon report, 1996: “6) To reconfirm the commitment of the Members of EUREKA and for this to be effective, a common approach to public funding must be established, in terms of procedures, increased budgets and funding agencies, both national and European; 8) Means to improve the access to, and the provision of, private funding for projects involving innovation must be found”.

Evaluation Report, 1995 (Airaghi Report): “We recommend that a new supportive measure is considered which allows firms, on a voluntary basis, to request an international review of the technical feasibility of their outputs which may be used in evidence in the capital market or as an aid to marketing”.

Evaluation of EUREKA industrial an economic effects in 1993 (Ormala report) : “There is a need to explore what new supportive measures should be developed, in particular to support SME participation, and how the existing mechanisms could be made more effective”.

Then, why is this? The lack of political will has often been mentioned as the main reason for the failure to implement actions in this field. As stated by the Strategic Review of EUREKA, 1999 (Georghiou report) as regard to the Autumn scenario : “The essence of this scenario is that there is no change, either because some members do not perceive a problem or because of an inability to take decisions”.

Although the unbalanced political support for EUREKA remains probably as the most important obstacle to the implementation of recommendations, it is however the Group’s belief there is nevertheless space for constructive actions. These ideas will be discussed in the next chapter.

2.2 The reasons of non-action: external fundin and the shortcomings of EUREKA diversity

An exercise has been worked out classifying seven EUREKA countries according to three criteria:

- 1) political support to EUREKA;
- 2) public measures fostering private venture capital investments into early stage technology businesses;
- 3) links between venture capital industry and innovation communities (including technology policy agencies and innovative firms).

According to these criteria, several profiles of EUREKA member states have been identified:

- Small and Medium Sized Member countries such as Finland or the Netherlands which rank high in all three criteria.

- Large countries with high scores in factors 2 and 3 but with less political commitment in EUREKA (Germany and the United Kingdom might belong to this group).

- Large countries with less favorable scores in factors 2 and 3 but stronger political support for EUREKA (e.g. France, Spain and Italy).

- Any other EUREKA country could be classified according to these criteria, thus creating a rather complex picture.

The first obvious result of this exercise is the confirmation of the anticipated diversity. It means, for the scope of this report, that it would be very difficult to promote a solution with universal value, applicable to all participants in the

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Many interviews with representatives from the finance sector and public institutions reflected great ignorance about what EUREKA really is. If the term EUREKA was known at all it was very often unspecifically interpreted as “something in the EU context”. This impression was supported by some NPCs who have also encountered a disturbing lack of public awareness about EUREKA and its specialities in comparison with national or European Union research programmes.

Given this situation, it should not surprise that the venture capital (VC) community has not taken notice of EUREKA as an initiative that could be a source of qualified deal flow for them.

There follows immediately the question why this situation could emerge after so many years of successful EUREKA projects, several thousands of participants (1985-95) and to dedicate funding resources to the Initiative as a reason for that situation. However poor or insufficient public relations efforts cannot be disregarded

With these caveats in mind, the Group organised the work interviews with European key players (EUREKA NPC, venture capital business angels associations, European and national financial institutions, corporate finance advisors, etc.), plus extensive communications and four group meetings between February and May 2001.

3. Positive References and Role Stories

Whatever PR activity is chosen it must be "content-based" referring to success cases portfolio. The

VC industry demands good stories about companies and their contribution to the projects. PR must be selected among those who produced extraordinary results in terms of product or process development, new

1. Goals and Target Groups for Promotion

Promotional activities not only cover those directed towards the VC industry collaborative R&D, even at national level.

2. EUREKA Branding Campaign

Given the poor penetration of the brand, a professional campaign should be started to pr

brand name in Europe. The Group consider

experienced communication

amount to generate the desired effect and to

maintain the brand at an appropriate level. The

aware that such campaigns require sizeable

nevertheless EUREKA should try to make a

en the effect of such a strong new approach

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5. Workshops

Sometimes the investment fora are incorporated into larger conferences or events. It is suggested that at events dealing with related subjects – of which there are very many taking place in Europe, for instance European Venture Capital Association (EVCA) early stage conferences – EUREKA could organise workshops both as an investment forum and an information and PR platform. Some representatives of the EUREKA network would introduce the EUREKA Initiative and highlight a small number of good EUREKA projects. If possible, one of the positive role stories mentioned earlier should be presented with the entrepreneurs and investors present on the floor. Then one or two EUREKA companies seeking venture funding should introduce themselves to the investors. At the end there should be enough space and time for private talks. This suggestion implies limited resources for the preparation of the workshop but it would benefit from the infrastructure provided. Being an add-on with relevant content, the organisers, particularly public institutions, should welcome such workshops.

6. Printed Material and Press Articles

EUREKA must continue producing brochures informing about concrete and commercially relevant results of EUREKA projects. This could also be done by a regular column in the EUREKA Newsletter. Care must be taken of the proper selection of issues presented, according to the target group – not too many scientific or technical descriptions! –. The distribution channels must include the Press, media and the entire VC industry and banks (address lists available at national VC associations). Regular collaboration with the media should be reinforced benefiting from events where EUREKA may raise public awareness.

7. Internet as public relations Channel

In our view Internet is not the best medium to convey PR information on EUREKA to the VC industry because this channel is not targeted enough. The websites most probably are visited by Web users who know EUREKA and are deliberately looking for some specific information. Venture capitalists would not consult the sites, unless they expect a positive value added. Most probably they would need data on successful projects in general and about an individual project itself, the roles and contributions of the consortium partners, history and track record of the partners, CVs of the entrepreneurs, commercial data, technological results, intellectual property rights (IPR), product descriptions, data on market potential and competition and the like.

The Group does not recommend using the web as a marketplace to match companies seeking equity and investors looking for good investment opportunities, at least until other measures have made EUREKA better known in the VC industry. Similar experiments have proven to be low acceptance in the financial community: venture capitalists would hardly trust investment opportunities which are easily available through the Internet.

3.2 The “EUREKA Diamond Label” for promising SMEs

Within the strategy of increasing the visibility of the EUREKA brand, it is recommended to launch a EUREKA Diamond Label aimed at distinguishing those EUREKA firms which are supposed to positively accomplish EUREKA R&D projects having an appealing commercial potential and looking for additional funding.

In fact, financial investors, already fed through their own networks and generally flooded by proposals of all kinds, have no interest in adding other generic projects to their pipeline.

The goal is, therefore, to establish EUREKA as an acknowledged brand of “technical validity” – as proposed in 3.1 – as a means to build up a qualified deal flow of investment opportunities for venture capital operators focused on seed and early stages.



It is therefore mandatory, that any small, technology-based firm, participating in EUREKA projects with high growth potential and looking for funding, be prepared to appropriately present both itself and the project in order to attract the interest and consideration of skilled investors. The positive accomplishment of such a process – which requires significant efforts in terms of company and project analysis and presentation – will be acknowledged by the award of the **EUREKA Diamond Label**.

Since the label should be a sign of quality for the participant company rather than the project itself, companies willing to achieve it must undergo an analysis of the status of development of each project and the quality of information related to it. Such an activity should be performed by an external Advisor with extensive experience in companies and project evaluations and present in most European countries. The Advisor will act as a service provider, supporting the EUREKA structure (both central and local) and will be in charge of:

1. Defining the sets of *requirements* needed for a firm to be suitable for presentation to financial investors (detailed business plan and business assumptions, management team and skills, market and competitors analysis, technology strategy, etc.).
2. Proposing a tailored methodology to attribute scores to each firm/project and to weigh up the different criteria.
3. Delivering to EUREKA Secretariat for each firm a final audit report with an overall qualitative evaluation on its suitability to be awarded the EUREKA Diamond Label.

The Advisor will not be asked to perform any due diligence nor express an opinion on the achievement of the technological goals set in the project and their further possible market exploitation. However, the report must include the Advisor’s judgement about the feasibility of the approach chosen by the firm and its market relevance.

The EUREKA Secretariat has the responsibility to periodically (e.g. each year) appoint the Advisor who will be required to provide the service detailed above at the same cost throughout Europe – through a call for proposals.

As a result of the interviews made by the Group to consultancy firms/consortia aimed at defining the profile of the Advisor (whether specialized in technology evaluation or in company appraisals), it emerged that a major Corporate Finance Advisor looks the most appropriate choice, being in the position of:

- a) fulfilling the tasks set about at points 1, 2 and 3;
- b) assuring complete European coverage through its network;
- c) supporting the Diamond-labelled firms to raise funds thanks to their established business contacts with business angels, venture capitalists and, in general, financial investors.

As a second choice, local consultants might become EUREKA auditors under proven and common appraisal methods licensed by the EUREKA Secretariat.

From a procedural point of view, any EUREKA firm – in an advanced stage of research & development or close to its successful completion and looking for additional funding – could formally apply for the EUREKA Diamond Label to the local NPC who would forward the relevant information to the Advisor for evaluation. The final report would be delivered to the EUREKA Secretariat which will formally communicate to the firm the result (positive or negative) of the evaluation and, eventually, the award of the EUREKA Diamond Label.

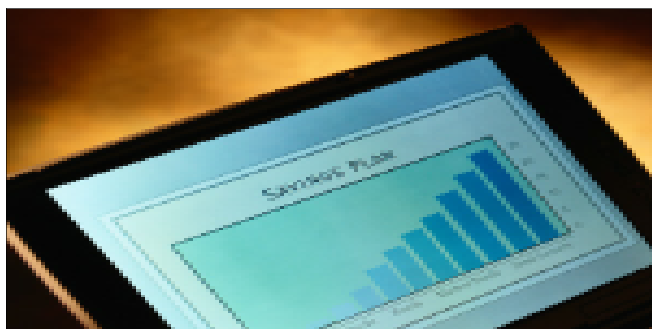
It is suggested that Advisors' costs be shared by the firm, local NPC and the budget of the EUREKA Secretariat. The price would be the same in all EUREKA countries although the degree of subsidization could be different – it would depend upon national decisions.

Any additional costs related to further involvement of the Advisor in raising funds on behalf of the EUREKA company would be directly incurred by the company itself.

3.3 EUREKA and Venture Capital schemes

In addition to other measures to strengthen links between EUREKA projects and the market, it would be recommendable to further develop mechanisms that would be designated to attract venture capital to companies that participate in EUREKA projects. EUREKA could be an experimental field to implement some strategies of the European Union Risk Capital Action Plan.

In some EUREKA countries there are properly working schemes that make it possible to provide participants in successful EUREKA projects with sufficient venture capital financing – for instance, BTU in Germany, Fonds pour la Promotion du Capital Risque (FPCR) in France, Sitra in Finland, etc. Unfortunately this does not apply to all member countries. The positive examples prove, however, that their mechanisms do work. There is a variety of different models in which there are public, semi-public and private players and different financing vehicles involved. It is advised that these schemes be used more frequently in all countries. In order to succeed this requires more communication and coordinated actions among NPCs, EUREKA participants and the venture capital industry in each country.



As a result of different circumstances in different countries, it is not feasible to suggest a new uniform venture capital financing model for the whole EUREKA network.

However, it would be possible to take some measures in order to improve the present situation. It would be natural for an international network like EUREKA to try to create schemes that would cover more than just one single country at a time. It would strengthen the role and image of EUREKA to be able to offer if not one standard scheme applicable in all countries at least some coordinated schemes that would be available in more than one country. An ultimate goal in the future could be to have a set of uniform financing tools for EUREKA participants in all European (and other) EUREKA countries.

One important requirement for all schemes is that they should be lean and efficient. No extra bureaucracy must be allowed. This is necessary due to the fact that the number and size of EUREKA participants eligible for venture capital is rather limited.

In order to achieve a sufficient geographical coverage, it would also be advisable to have international institutions involved. In this context this means particularly the European Investment Fund (EIF) and/or European Bank for Reconstruction and Development (EBRD). The EIF covers the most of the area of EUREKA while the EBRD limits its operations to the former East Block countries. In both cases financing of technology based European companies would fit in well with the scope and objectives of the institutions mentioned.

Participation of the EIF and/or EBRD would make it easier to apply common terms, structures and rules for operations in different countries. At this stage it is not possible to give any detailed proposals for structures. The mechanisms could include the participation of both national and international investors.

As to the tools and vehicles applicable, it is only possible to mention different options. These could include direct investments, indirect investment through funds, co-investment arrangements and guarantee systems. It would also be possible to use already existing funds and other schemes in which EIF and EBRD are involved.

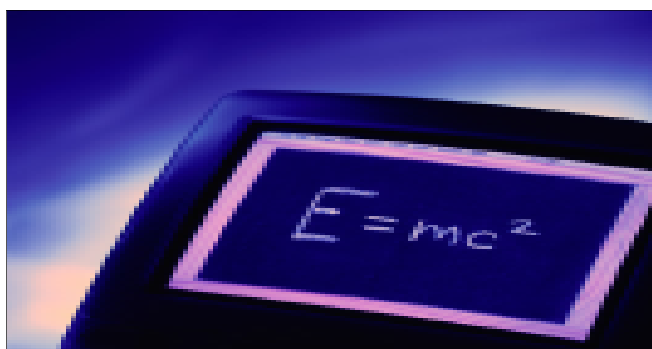
One possible way to organise this could be to have investment commitments from EIF and/or EBRD in EUREKA countries. These investments would be matched by national venture capital investors both public and private. One of the national investors would be in charge of the management with a hands-on approach. EIF/EBRD would also be welcome as refinancing and guarantee partners for private and public investors.

One important thing worth mentioning is participation of private funding. Private funds and private sector investors look for high returns on their investments. This is the best guarantee for a sound investment policy and efficient operations. It is also preferable that investments be managed by people who have a chance to earn money when an investment is successful. This requires proper incentive systems that are offered to the manager of the investment. Despite this the role of public financiers is also important in view of their statutory mission. An interest in participating in a EUREKA venture capital scheme has already been expressed by some major public operators from Finland, France, Germany, Italy and Spain.

4 Conclusions: About Implementation

Chapter 3 has provided a wide range of recommendations and examples of actions that could be implemented in the EUREKA network. Most of them depend entirely on the national commitment and therefore it is not envisaged that all countries will share the same degree of interest in these actions.

However, most of these recommendations are not truly original. From our point of view, the diagnosis is very well known and it is time for the therapy to work. It is therefore time for decisions and decisions must inevitably be accompanied by suitable resources. The two last recommendations aim at implementation:



1. EUREKA should set up a specialised unit at the Secretariat to pursue these objectives. EUREKA needs a *champion* in the network – an *intrapreneur* – who strongly believes in the Initiative and who will be dedicated 100% to implement actions. This champion must work according to the principles of *empowerment* – he/she will be officially appointed to this mission and endowed with appropriate resources to accomplish it – and accountability – he or she will have to report periodically on progress and achievements.

2. EUREKA should set up a Task Force of selected and voluntary NPCs committed to promote the actions aiming at bridging the gap between innovators and investors in EUREKA. Co-ordinated by the champion, this Task Force should formalise their work and this would constitute the seed for EUREKA-wide activities in this field.

Annex 1:

Short Curriculum Vitae

Bernard BOBE (56) is professor of Economics and Management of Innovation; he is currently CEO of the Polytechnicum de Marne la Vallée (France). As a consultant he chaired the Annual Impact Report for the EUREKA Secretariat in 1999 and 2000. He was a member of the Airaghi Evaluation expert group (1995) and of the European Union research programme evaluation expert groups during the beginning of the nineties.

Alessandro DE DOMINICIS. Degree in Chemical Engineering at Rome University. CEO of Iritech (Venture Capital company of Finmeccanica Group, focused on early stages) since 1991. Past business experiences at ENI, Rockwell International and Finsider. He is past member of the Board of AIFI (Italian Venture Capital Association) and of the High Tech Committee at EVCA (European Venture Capital Association) and present member of the High Tech Committee at AIFI.

Jean-Michel ETARIAN (49) is graduated in Civil Engineering and Marine Civil Engineering (M. Eng. ENSTA, Applied School of Polytechnique). Preparations for E.N.A. (Ecole Nationale d'Administration), Major in Economy. Training periods in research laboratories in the industrial domain. He established and directed a services company – 35 engineers and marine officers. Involved in public policy as Office manager within the French Ministry of Transportation, he was at the origin of a major reshaping of the French shipbuilding industry. Within the French Ministry of Economy, Finance and Industry, he was the representative of this Ministry in charge of EUREKA and the Framework programme. Since beginning of 2000, Director, Deputy Head of the Eureka Secretariat.

Joachim HEMER, born 1946, studied Diplom-Wirtschaftsingenieurwesen (Economics/Machine and Electrical Engineering). Since 1980 he is scientist with the Fraunhofer Institute Systems and Innovation Research (FhG-ISI), part of the Fraunhofer Society (FhG) doing applied research. His research fields are, among others, technology transfer, innovation financing of SME/NTBF (incl. VC), foundation processes, spin-offs, incubation, technology and market appraisal of innovation projects.

Olli LINDBLAD, born 1952 in Helsinki. Education: Master of Science (Econ.) Helsinki School of Economics and Business Administration in year 1977, Master of Laws University of Helsinki year 1977. Present position: Vice President of Sitra, Finnish National Fund for Research and Development since 1999, responsible for venture capital operations. Before that Finance Director at Sitra 1995-1999. 1983-1994 various positions at Skop Finance Ltd. including managing director 1992-1994 and deputy managing director 1989-92. In 1979-82 head of administration Independent Leasing Oy.

Javier URZAY (38) studied Economics at Universidad Autónoma de Madrid and undertook postgraduate studies at Istituto Adriano Olivetti (ISTAO) at Ancona (Italy). He worked as business analyst and consultant at the Databank Group and in 1992 joined the Centre for the Development of Industrial Technology (CDTI), the Spanish Agency for R&D funding, where he was Deputy Director General. He has been recently recruited by Farmaindustria (National Association of the Pharmaceutical Industry) as Director of Customer Service. He has wide experience in innovation policy, programme evaluation and innovation financing and he lectures regularly in several Spanish Universities on these issues.

Annex 2:

Acronyms - commonly used in this report

AIR:	Annual Impact Report (EUREKA)
BTU:	Beteiligungskapital für kleine Technologieunternehmen (D) <i>[Business Investment Capital for Young Technology Based Firms]</i>
EBRD:	European Bank for Reconstruction and Development
EIF:	European Investment Fund
EVCA:	European Venture Capital Association
FPCR:	Fonds pour la Promotion du Capital Risque (F)
IPR:	Intellectual Property Rights
NIS:	National Innovation Systems
NPC:	National Project Coordinator (EUREKA)
PR:	Public Relations
SME:	Small & Medium-sized Enterprises
VC:	Venture Capital